Small and Medium Enterprises' (SMEs) Access to Islamic Banking Finance in Pakistan

Saba Ishaq

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Aston University

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Thesis Summary

This study investigates Small and Medium Enterprises' (SMEs) access to Islamic banking finance in Pakistan. Despite the significance of SMEs in the economic development of Pakistan, this sector is not shielded from the unavailability of adequate financing facilities. Banks are considered the primary source of financing SMEs all over the globe. However, banks in Pakistan lend to SMEs selectively and, at times, reluctantly. Islamic banks in Pakistan represent only 13% of the whole banking industry lending out of which just 3.7% is attributed to SMEs. It reflects Islamic banks' unexhausted capabilities to meet a significant part of SMEs' funding needs in Pakistan.

Strong structuration theory was drawn upon through every stage of the research. This study adopts a theoretically informed circular design which consists of the following interlinking parts: a clear objective to investigate the specific research problem, prior theory, theoretically informed research questions, interview questions based on theoretically specific data requirements and thematic data analysis which link the findings to the prior theory (Makrygiannakis and Jack, 2018). The empirical evidence was collected from thirty-five semi-structured interviews with SME owners/managers, Islamic bank managers and a Sharia board member.

The findings indicate that significant independent influences are exerted on the activities of SMEs by the external structures. These include Islamic banks, the government of Pakistan, the Federal Board of Revenue (FBR), academic institutions, the State Bank of Pakistan (SBP), Sharia boards and media. SMEs' internal structures also play a vital role in shaping their practices while accessing Islamic banking finance. These include SME owner/manager's characteristics, views on Sharia compliance of Islamic banks, preference for different sources of financing, knowledge of Islamic financial products, knowledge of accounting and financial reporting and motives to use Islamic banking finance. These internal and external structures of SMEs seeking to acquire Islamic banking finance interact with each other. As a result of active agency, the on-going patterns of structuration led to the outcomes that incorporate structural reproductions or structural transformations.

Keywords/Phrases: *strong structuration theory; Islamic financial system; qualitative inquiry; Sharia complaint financial products*

Dedication

To my late mother

I cannot thank her enough for her unconditional love, unwavering support, and innumerable sacrifices she made for her children. This success would be more meaningful if she were around.

And

To my lovely father

Who has never been to school but made sure his kids leave for school every morning.

Their never-ending nurture, love and support have taken me this far and will continue to take me further.

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List of Abbreviations

AAOIFI: Accounting and Auditing Organization for Islamic Financial Institutions
CLA: Corporate Law Authority
FBR: Federal Board of Revenue
GDP: Gross Domestic Product
IFSB: Islamic Financial Services Board
IIFM: International Islamic Financial Market
IMF: International Monetary Fund
MFIs: Micro Finance Institutions
OIC: Organization of Islamic Cooperation
PBC: Pakistan Banking Council
SBP: State Bank of Pakistan
SECP: Securities and Exchange Commission of Pakistan
SMEDA: Small and Medium Enterprises Development Authority
SMEs: Small and Medium Enterprises

Chapter One: Introduction

1.1 Introduction

Small and Medium Enterprises (SMEs) are significant contributors to the development and achievement of economic goals in developing and developed countries. Being the dominant part of any industrial structure, SMEs are considered an engine of economic growth and make a vital commitment to economic development (Asad and Henderson, 2010). They are a vital part of the economic agendas of many countries because of their significant role in promoting entrepreneurship (Carsamer, 2012), contributing to GDP (Beck et al., 2005), alleviating poverty (Asikhia, 2010), reducing unemployment (Cant and Wiid, 2013), developing skilled labour force (Mahmood, 2008), promoting social cohesion (Clarke et al., 2016) and introducing innovative products and techniques to the market (Rudjito, 2003). However, despite their significance, SMEs have limited choice of financing sources as compared to large enterprises. For instance, unlike large enterprises, capital markets are not an available platform for SMEs to raise capital (Nassr and Wehinger, 2016). SMEs' limited access to finance has long been a significant area of discussion and research for both academics and practitioners worldwide.

Pakistan's economy is also SME driven. Nine out of every ten businesses in Pakistan are classified as SMEs (SMEDA, 2019). This sector contributes 40% to the total GDP, 35% in value addition and over 40% in export earnings of Pakistan (Shah, 2018). At present, there are more than 3.8 million registered SMEs in Pakistan, employing more than 78% of the non-agricultural labour workforce (Baig, 2019). However, despite the significance and potential of SMEs to contribute to economic development, this sector in Pakistan suffers from a variety of constraints, including limited access to financial resources, which restrict their capacity to take full advantage of rapidly expanding global markets. Although various policy efforts are directed at improving SMEs' access to formal sources of finance, access to finance remains the biggest obstacle to the growth of SMEs in Pakistan (Chaudhry, 2000; Bari and Cheema, 2005; Niethammer et al. 2007; Hassan, 2008; Saeed and Sameer 2015; Hyder and Lussier, 2016; Dar et al., 2017; Ullah, 2018). On the other hand, as of 30 June 2019, Islamic banks in Pakistan represent only 13% of the whole banking industry lending out of which just 3.7% is attributed to SMEs (SBP, 2019a). It reflects Islamic banks' unexhausted capabilities to meet a significant part of SMEs' funding needs in Pakistan.

This study, therefore, seeks to investigate SMEs' access to Islamic banking finance in Pakistan. It represents an attempt to explore how SMEs think of the Islamic finance context in Pakistan. What do SMEs perceive to be the constraining and enabling conditions of accessing Islamic banking finance? What are their perceived benefits of accessing Islamic banking finance? How do they perceive their relationships with Islamic banks? After this introduction, the research background is presented in the following section. The research problem is then highlighted in section 1.3. Section 1.4 specifies the aims and objectives of this study along with the research questions. Section 1.5 provides the description of the motivations and contributions of this study. The structure of the thesis is provided in section 1.6. Finally, section 1.7 concludes the introductory chapter.

1.2 Research Background

The significant contribution made by SMEs in developing and achieving economic goals is well recognised in developed and developing countries. They are an engine of economic growth and, therefore, be a vital part of the economic agendas of many countries. SMEs also play a significant part in the political economy by means of promoting and strengthening reforms (Smallbone and Welter, 2001). Economically, they have an inherent interest in promoting policies that accelerate economic growth. In contrast, politically, a prospering SME sector engages and grows a strong middle class, which in turn seeks reforms for sound economic governance (Dixit and Kumar, 2011). Governments, therefore, emphasise and encourage the establishment and support of SMEs to decrease unemployment and achieve other economic goals (Beck and Demirgüç-Kunt, 2004; Cravo et al., 2012; Gherghina et al., 2020).

SMEs are the focal part of any industrial structure (Umar et al., 2018). They are the paramount segment of any economy and make a vital commitment to economic development (Asad Sadi and Henderson, 2010). SMEs play a significant role in promoting entrepreneurship (Carsamer, 2012), contributing to GDP (Beck et al., 2005), alleviating poverty (Asikhia, 2010), reducing unemployment (Cant and Wiid, 2013), developing skilled labour force (Mahmood, 2008), promoting social cohesion (Clarke et al., 2016) and introducing innovative products and techniques to the market (Rudjito, 2003). In addition to directly contributing to GDP, the existence of SMEs also increases governments' revenue from taxation, empowering them to spend more on the wellbeing of the society such as education and healthcare (Jamali et al., 2017). Moreover, SMEs also promote industrialisation in rural areas, encouraging regional dispersion of economic activities (North et al., 2001).

Globally, SMEs account for 90 to 95 % of the total businesses (Zafar and Mustafa, 2017). Their significance is not only exhibited by their numbers, but also by the strong support they offer to create employment opportunities. In most the countries, between 60% and 70% of total job opportunities are generated by SMEs (Zafar and Mustafa, 2017). SMEs have been noted to contribute 55% to 70% of a country's total GDP (Ramadan and Ahmad, 2018). According to Koh and Simpson (2005), SMEs have more flexible organisational structures and cultures than their large counterparts. They are more flexible than large enterprises in manufacturing, marketing and services since they observe the market closely, have strong relations with their employees and understand customers' requirements better (Stefanović, et al., 2009). Because of their flat management structure, SMEs can quickly adapt to meet their business requirements in response to changing circumstances. It empowers SMEs to make and implement rapid decisions in response to any change (Matlay et al., 2006). Lavia López and Hiebl (2014) also highlight SMEs' flexibility and quick responses to changes, particularly changes in the customers' demands. According to Wong and Aspinwall (2005), SMEs' flat structures enable ease of communication and information sharing among all workers, resulting in a strong learning environment where employees are part of idea generation and creative thinking. This positively impacts employees' motivation and thus improves their productivity (Keskin, 2006).

SMEs' role in creating employment opportunities, generating income and alleviating poverty is well recognised in the literature (Audretsch et al., 2002). They also promote the development of entrepreneurial skills and link geographically and/or economically diverse sections of an economy (Kubíčková et al., 2017). In this way, SMEs help to make an increasingly prosperous country and improve the well-being of society. Therefore, in the last few decades, SMEs' crucial role in economic development has been identified by many countries and they have become an important part of their policies (Blackburn, 2016). According to Beck (2007), SMEs make a major part of the private sector in both developed and developing economies. Though SMEs' role is crucial in both developing and developed economies, they are particularly recognised by the governments in transition economies as an engine of economic growth (Ratten, 2014).

To accomplish their potential in economic development, SMEs need access to sources of finance. However, it is commonly recognised that banks and other lending institutions are reluctant to provide finance to SMEs (McMahon, 1998; Abouzeedan, 2003; Ul Hassan, 2008; Chowdhury et al., 2015). This difficulty in obtaining finance is linked to many factors such as the nature and size of their businesses (North et al., 2001), the age of firms (Serrasqueiro and Nunes, 2012), marketing difficulties and low innovation capabilities (Irjayanti and Azis, 2012). Carrolla and McCannb (2017) assert that banks consider SMEs a risky proposition and require large collateral and relatively high-interest rates to cover higher default risk. This high cost of capital further widens the funding gaps for SMEs. Islamic finance can, therefore, play a central role in funding SMEs since it prohibits interest and works on profit and loss sharing principles (Mirakhor and Zaidi, 2007).

Contemporary Islamic economics developed from the Islamic revival and the belief that Islam must have a framework that provides a comprehensive alternative to the conventional economic system (Choudhury, 1999). Islamic finance, which is a subset of an Islamic economic system, prohibits interest and promotes the profit and loss sharing principle intending to promote justice and equitable treatment for the financially vulnerable members of the society (Usmani, 1999). Economic and social development is the basic pillar of Islamic economics' philosophy. One of the important aspects of such development is financial inclusion by servicing the underprivileged sectors of society. In terms of access to finance, SMEs are at a disadvantage as compared to large corporations. Here, Islamic banks can address financial inclusion by promoting Islamic financial products as an alternative to conventional financing. According to Pearce (2011), Islamic banks can address the issue of financial inclusion to build a healthy and vibrant economy from two directions. First, through their risk-sharing features that are well-suited for SMEs and second by using instruments of redistribution of wealth such as Zakat (Pearce, 2011). Islamic banks can, therefore, play a vital part in bridging the funding gap of the SME sector (Joint, 2015).

1.3 Research Problem

Organisation for Economic Co-operation and Development (OECD) (2013) and the World Bank (Hallberg, 2000) identify SMEs as a tool for making a vital commitment to economic advancements in OECD countries. Pakistan's economy is also SME driven since it heavily depends on SMEs for reducing unemployment, increasing industrial productivity boosting export earnings and thus creating a progressive economy (Kongolo, 2010). More than 3.8 million registered SMEs in Pakistan employ more than 78% of the non-agricultural labour workforce (Baig, 2019). This sector contributes 40% to the total GDP, 35% in value addition and over 40% in export earnings of Pakistan (Shah, 2018). Furthermore, this sector is also significant due to its role to engage women, youth and minorities and empower them to be a part of economic activities.

To achieve the smooth functioning of Pakistan's economy, SMEs need to be promoted. However, despite their significance and potential to contribute to economic development, SMEs in Pakistan face various constraints, limiting their capacity to take full advantage of rapidly expanding global markets. These include lack of technological innovations, inefficient management, poor infrastructure, a law-and-order situation, a dearth of entrepreneurial education and lack of access to finance (Ul Hassan, 2008; Dar et al., 2017). Among all these constraints, access to finance remains the biggest obstacle to the growth of SMEs in Pakistan (Chaudhry, 2000; Bari and Cheema, 2005; Niethammer et al., 2007; Saeed and Sameer, 2015; Hyder and Lussier, 2016; Ullah, 2018). Cosh and Hughes (2003) identify banks as the major source of formal financing of SMEs all over the globe. However, banks in Pakistan lend to SMEs selectively and, at times, reluctantly since lending to SMEs is perceived riskier than lending to large corporations (Aazim, 2019). The major reasons for SMEs being perceived as riskier ventures by Pakistani banks are lack of their capacity to bear high financing costs, inability to provide collaterals and known cash flows, and poor governance and documentation practices (Rabbani and Moossa, 2014).

In the context of the Islamic financial system in Pakistan, the first attempt towards developing an Islamic banking system was made in the late 1950s, with the establishment of interest-free savings and loans societies (Wilson, 1983). The bank did not charge any interest or penalty for late repayment except for a small processing fee to meet the bank expenses (Najaf and Najaf, 2016). Next, in 1979, three institutions; Mutual Funds Investment Corporation of Pakistan, National Investment Trust and the House Building Corporation, were directed to abolish interest from their operations and work on a profit and loss sharing basis (Kennedy, 1990). The Government of Pakistan took significant initiatives, for example, establishing Mudarabah companies and introducing Participatory Term Certificates (PTC), to launch interest-free products in the market, particularly in the banking sector. By 1981, all the state-owned banks were required to establish interest-free counters for their clients (Zaidi, 1987). Efforts to abolish the interest-based financial system continued and in 2002, Meezan Bank started its operations as the first full-fledged Islamic bank of Pakistan (Ahmad et al., 2010). Since then, the Islamic banking network in Pakistan is gradually expanded. Currently, there are five full-fledged Islamic banks with 1,437 branches, 1,457 Islamic banking branches of conventional banks, and 1,348 Islamic windows within the branches of conventional banks operating in Pakistan (State Bank of Pakistan [SBP], 2019a).

Given the size of the Muslim population in Pakistan (95 - 97%)[1], a greater use of Islamic financial products is expected in general and for financing SMEs. This, however, is not the case. According to the International Finance Corporation (IFC, 2017a), the un-served and under-served SMEs in Pakistan are assessed to need an additional USD 3.8 billion investment. SMEs in Pakistan hold only 6% of the total banking credit portfolio (Sajjad, 2018). As of 30 June 2019, Islamic banks in Pakistan represent only 13% of the banking industry lending, out of which just 3.7% is attributed to SMEs (SBP, 2019a). It reflects Islamic banks' unexhausted capabilities to meet a significant part of SMEs funding needs in Pakistan.

In the light of this background discussion, it is evident that the growth of the SME sector in Pakistan needs to be promoted by making adequate financing facilities available to them and Islamic banks have the potential to bridge the funding gaps of SMEs. Although the research focusing on SMEs' access to Islamic banking finance is limited, few attempts have been made to explore SMEs' access to Islamic banking finance in the context of Pakistan. For instance, Ellahi et al. (2010) investigate the role of Islamic modes of financing for the growth of SMEs. However, their sample comprises SMEs located in one city (Islamabad) only while excluding SMEs from other parts of the country. Gillani et al. (2016) investigate the determinants of the promotion of SMEs in Pakistan through Islamic financial institutions. However, they only focus on SMEs in the halal food business (trading sector) and exclude SMEs in other sectors. The above-mentioned studies are limited in scope as they either focus on SMEs in a particular geographical area, sector or are conducted without an overarching theoretical framework. Moreover, these studies mainly concentrate on SMEs' normative practices shaped by the economic perspective of the agency while ignoring the interactions between SMEs' context and agency to understand the micro-processes of Pakistani SMEs' access to Islamic banking finance. This study, therefore, aims to investigate SMEs access to Islamic banking finance in Pakistan by exploring the interactions between the context and agency of SME owners/managers.

[1] Pakistan Bureau of Statistics, Government of Pakistan: http://www.pbs.gov.pk/sites/default/files//tables/POPULATION%20BY%20RELIGION.pdf

1.4 Research Aims, Objectives and Questions

The principal aim of this study is to explore SMEs' access to Islamic banking finance in Pakistan. In particular, this study investigates how the social world and the arrangements embedded therein impact Pakistani SMEs' access to Islamic banking finance.

Other objectives to be served by this study include:

- To critically review relevant literature to analyse the SMEs and Islamic banking sectors in Pakistan.
- To analyse how Islamic banks currently meet the needs of SMEs in Pakistan.
- To explore the demand for Islamic banking finance for SME financing through the perceptions and opinions of SMEs in Pakistan.
- To ascertain whether SMEs have sufficient knowledge of Islamic banking finance.
- To investigate the experience of Islamic banks' managers in servicing SME financing.
- To explore the main factors influencing the level of SMEs' access to Islamic banking finance.
- To identify the challenges and limitations faced by Islamic banks' in providing finance to SMEs.
- To make recommendations, based on analysis of the data, on how SMEs can seek and acquire support from Islamic banks in Pakistan.
- To inform current policies and practices of SME financing in Pakistan.

The main research question is "How the interactions between social structures and agency implicated in Pakistani SMEs access to Islamic banking finance?"

The strategy employed in this investigation aimed to enhance understanding of how the social world impacts SMEs and how do social structures and agency interact and influence SMEs seeking to acquire Islamic banking finance. To address the main research question, the following sub-questions have been framed:

- How the practices of SMEs seeking to acquire Islamic banking finance are influenced by, and in turn, how do they influence the significant agents-in-context (position-practice relations network)?

- How do the internal structures of the SMEs reconcile with their contextual field when seeking to acquire Islamic banking finance?
- How do social structures and agency interact and influence SMEs' access to Islamic banking finance in Pakistan?
- How can the access of SMEs to Islamic banking finance be developed further to meet the needs of SMEs?

1.5 Research Motivations and Significance

This study seeks to investigate SMEs' access to Islamic banking finance in Pakistan. The prime motive for this study stems from the fact that there is limited literature that draws on Islamic finance for SMEs (Oseni, 2013; Ali, 2014; Elasrag, 2016). Given their significance, there is a wealth of literature exploring SMEs and their access to finance. For instance, Irwin (2010) explores barriers faced by SMEs in raising bank finance; Fatoki and Asah (2011) study the impact of firm and entrepreneurial characteristics on access to finance by SMEs; Lee et al. (2015) investigate access to finance for innovative SMEs since the financial crisis. In the context of Pakistan, SMEs are one of the most significant research concerns. For instance, Chaudhry (2000) studies the significance of SMEs in Pakistan in creating employment opportunities; Niethammer et al. (2007) investigate the problems faced by women entrepreneurs while accessing finance in Pakistan; Khalique et al. (2011) explores challenges for Pakistani SMEs in a knowledge-based economy; Dar et al., (2017) examine the financing gaps faced by SMEs in Pakistan.

Islamic finance, on the other hand, is also one of the significant areas of research. For instance, Dusuki and Abdullah (2007) explore the factors that motivate customers to deal with Islamic banks in a dual banking environment of Malaysia; Aggarwal and Yousef (2000) examine the financial instruments used by Islamic banks. Similarly, in the context of Pakistan, many studies are focusing on the Islamic banking sector. For instance, Hassan (2003) studies the efficiency of Islamic banks; Jaffar and Manarvi (2011) compare the performance of Islamic and conventional banks in Pakistan; Rashid and Jabeen (2016) explore performance determinants of Islamic banks; Ullah (2019) explains Islamic financial services. However, most of these studies centre on explaining the differences between conventional and Islamic banks.

Some studies also focus on the accessibility of Islamic finance to SMEs. For instance, Huda (2012) offers a framework in which Islamic financing could be used to solve financing problems faced by SMEs; Ali (2014) investigates the challenges of Islamic trade finance in promoting SMEs; Abdesamed and Wahab (2015) explore SME owner/managers' preference towards Islamic banking; Shaban et al. (2016) develop a two-stage competition model to investigate the growth in SME lending by Islamic banks. Some authors also attempt to explore SME lending by Islamic banks in Pakistan. For instance, Ellahi et al. (2010) investigate the role of Islamic modes of financing for the growth of SMEs in Islamabad, the capital of Pakistan; Gillani et al. (2016) investigate the determinants of the promotion of SMEs in Pakistan halal food industry through Islamic financial institutions; Rasheed et al. (2018) explore the influence of awareness on SMES' intention towards adoption of Islamic finance in Pakistan. However, the above-mentioned studies are limited in scope as they either focus on SMEs in a particular geographical region, sector or are conducted without an overarching theoretical framework. Therefore, this study aims to address the gap in the literature by exploring the perceptions and current practices of SMEs in accessing Islamic finance in Pakistan. This thesis differs from the existing studies in at least four aspects; scope of the study, theoretical framework, philosophical approach and incorporating opinions of other stakeholders.

This thesis addresses the limitation of previous studies focusing on SMEs' access to Islamic banking finance in Pakistan. For instance, Ellahi et al. (2010) investigate the role of Islamic modes of financing for the growth of SMEs. However, their sample comprises SMEs located in one city (Islamabad) only while excluding SMEs from other parts of Pakistan. Gillani et al. (2016) investigate the determinants of the promotion of SMEs in Pakistan through Islamic financial institutions. However, they focus on SMEs in the halal food business (trading sector) and exclude SMEs in other sectors. This research attempts to overcome these limitations by including SMEs operating in different sectors and cities of Pakistan. Moreover, most of the previous investigations adopted a quantitative approach to building a picture and understanding of SMEs' access to Islamic banking finance in Pakistan. This study is developed on the body of existing literature by employing a qualitative methodology with a particular reference to interviews to understand how SMEs seek to acquire Islamic banking finance in Pakistan.

In addition to contributing to the existing literature, the use of strong structuration theory as a theoretical framework is another main contribution of the thesis. Academics previously explored SMEs' access to Islamic finance and put forward various opinions and results. Previous studies uncover some significant findings. However, most of these investigations have been carried out without a proper theoretical framework. Furthermore, these studies mainly employed objective philosophy while overlooking the contextual elements. According to Fillis (2007), the main theoretical limitation of SME research is the use of conventional methodologies, which are insufficient to address the contextual issues and thus fail to provide an insight view on SMEs. These methodologies tend to generalise research findings and are more biased towards the philosophical assumptions of positivism (Jayasinghe, 2003). This study employs a strong structuration perspective as a theoretical tool to guide the research. The focus is on how social structures are involved in SMEs practices to acquire Islamic banking finance and how SMEs (agents) interact with these structures to make a difference in their practices. Therefore, to investigate how SMEs seek to acquire Islamic banking finance in Pakistan, this study mainly draws upon the notion of structuration and minimise the dichotomy between subjective and objective points of view. SMEs practices to seek access to finance are considered from the perspective of duality; SMEs' access to Islamic finance is social interaction, developed and reproduced through the actions of SMEs (agents) that are empowered as well as limited by structural properties.

Another unique aspect of this study is its focus on multiple stakeholders. Most previous studies investigating SMEs' access to Islamic banking finance focus on SMEs only and ignore other stakeholders. With SMEs being an agent-in-focus, this study also aims to investigate the perceptions and experiences of other agents-in-context, such as Islamic bank managers dealing with SMEs and a Sharia board member, while exploring SMEs' access to Islamic banking finance. A combination of voices gathered from SMEs and other stakeholders will improve understanding of how access to Islamic banking finance is perceived and experienced by SMEs.

The study also makes recommendations to assist those involved in providing Islamic banking finance to SMEs in Pakistan on the obstacles faced by SMEs in accessing Islamic banking finance and how to increase SMEs' access to Islamic banks by evacuating the difficulties associated with it. It may serve as a material reference in the area of policy formulation and administration for the different tiers of government, SMEs and Islamic banks' management.

1.6 Structure of the Thesis

This thesis consists of ten chapters. This chapter has identified the research problem and set the key aim and objectives of this study. It also developed the research question followed by the motivation and significance of this research. A brief description of each of the remaining chapters is as follows:

Chapter two and chapter three provide a comprehensive review of the background literature on SMEs and Islamic finance. Chapter two discusses SMEs and issues associated with SMEs' access to finance. It discusses the varied definitions of SMEs in various countries and highlights the characteristics and significance of SMEs. It also covers the sources of finance available to SMEs, followed by examining evidence of the financing gap in various countries. The constraints which SMEs face while accessing finance are also highlighted in this chapter. Next, in chapter three, an overview of the Islamic financial system is provided. This chapter covers issues such as the Islamic economic system, including its development, characteristics and concept of entrepreneurship in Islam, and the historical evolution of Islamic finance. It also includes a brief account of the institutional aspects of Islamic financial institutions, criticism and challenges faced by them and differences between conventional and Islamic financing. Islamic financial products as well as the relevance of Islamic modes of financing for SMEs are also discussed in the chapter.

Chapter four provides the context in which the empirical investigation takes place. Given that this study aims to explore SMEs' access to Islamic banking finance in Pakistan, the research context is reviewed from different perspectives. For instance, this chapter provides an overview of Pakistan's economy, characteristics and significance of the SMEs sector in Pakistan and the state of SME financing in Pakistan. It also highlights the historical development, current state, and regulatory environment for Islamic banks in Pakistan. Moreover, it also reviews the initiatives taken to support SMEs in Pakistan through Islamic banks.

Chapter five concentrates on bringing insights into the theoretical framework and the interpretive lenses employed in this thesis. The chapter provides a brief account of the origin of structuration theory followed by an explanation of the theory, its key concepts and criticism. The chapter then discusses the development of strong structuration theory, which is the fundamental theoretical framework employed in this study, and how it differs from the structuration theory. The use of strong structuration theory in the context of SMEs and the motivation for using it in this inquiry are also explained in chapter five.

Chapter six introduces and rationalises the selection of research methodology and methods employed to meet the overall aim and objectives. It describes the research philosophy, including assumptions about the world's nature, the different philosophical paradigms identified by Burrell and Morgan (1979), and the philosophical assumptions underpinning this study. It also highlights the circular research design followed by the data collection and analysis techniques adopted in this study.

Chapter seven analyses the context of Pakistani SMEs seeking to acquire Islamic banking finance. The chapter presents a comprehensive mapping of the position-practice relations of Pakistani SMEs seeking to acquire Islamic banking finance. After identifying the significant clusters of agents-in-context, the chapter analysed the significant external structures, where notable themes arose under each cluster. It helped to identify how these structures enabled or constrained SMEs' actions and their access to Islamic banking finance.

Chapter eight focuses on the conducted analysis of Pakistani SMEs seeking to acquire Islamic banking finance. The chapter begins by outlining the concept of conduct analysis. It then presents the empirical evidence on general-dispositional and conjuncturally-specific internal structures of those SMEs.

Chapter nine explores the major aspects of active agency and outcomes to complete the structuration analysis of SMEs' access to Islamic banking finance in Pakistan.

Chapter ten concludes the thesis by presenting the main conclusions and contributions drawn from this study within the context of the specified aims and research questions. It then draws upon insights obtained from this research to identify implications for policy and practice. Finally, the limitations of this study are acknowledged and suggestions for future research are addressed.

1.7 Conclusion

This chapter introduced the major aspects of the study. It provided the research background and exploratory lines of inquiry for this thesis, which includes the aim, objectives and research questions. It also discussed the motives behind the current study as well as its potential contributions. It then outlined the structure of the thesis. The next chapter provides an overview of SMEs and Islamic finance in Pakistan to contextualise this research.

Chapter Two: Small and Medium Enterprises (SMEs)

2.1 Introduction

SMEs have become an important area of research due to their economic significance (Bazza et al., 2014). Like any other corporation, access to finance is one of the key factors that ensures SMEs' growth. However, as compared to their large counterparts, SMEs face hindrance in accessing finance from formal sources. This study aims to investigate SMEs' access to Islamic banking finance in Pakistan. To achieve the aim of the study, this chapter undertakes a review of existing literature on the financing of SMEs, setting the foundation of the study. The remainder of the chapter is structured as follows. Section 2.2 discusses the varied definitions of SMEs in different countries. Section 2.3 highlights the characteristics of SMEs. Section 2.4 reviews the role and significance of SMEs. Sources of finance available to SMEs are then discussed in section 2.5. Next, SMEs' financing gap is highlighted in section 2.6. The review of literature on the constraints SMEs face while accessing finance are covered in section 2.7. Finally, section 2.8 concludes the chapter.

2.2 Definition of SMEs

There is no global consensus on a single standardised definition of an SME (Al-Hyari 2009; Robu, 2013; Waweru, 2017). Jenkins (2004) identifies contextual problems as the major obstacle in developing a universal definition. A business can be classified into a small, medium, or large enterprise using several parameters, including the number of employees, annual turnover, and total assets (Cunningham and Rowley, 2008). However, the number of employees is the most commonly used parameter (Lukács, 2005; Abor and Quartey, 2010). Cordeiro and Vieira (2012) argue that the lack of coherence in the definition of SMEs are likely to make the cross country and, in fact, the cross-industry comparisons difficult.

One of the earliest explanations of SMEs can be traced in the Bolton Committee's report on Small Firms (1971) which identifies SMEs using qualitative parameters. It classifies SMEs based on relatively small market share, managed personally by the owner and independent from outside control (Beaver and Jennings, 2000). The World Bank SME department defines small firms as a business with up to 50 employees, total assets of up to USD 3 million and total sales of up to USD 3 million, and medium firms as a business with up to 300 employees, total assets of up to USD 15 million, and total annual sales of up to USD 15 million (World Bank, 2012).

SMEs' definitions differ widely from country to country due to the differences in prevailing economic, cultural, social and industrial conditions (Matlay et al., 2006). For instance, in France, a business can be characterised as an SME if it has less than 500 employees, whereas, in Germany number of employees must be less than 100. Furthermore, in many cases, multiple definitions of SMEs are used even within the same country based on the vision and objectives of national or international stakeholders (Mohamed et al., 2013) or the sectors they are operating in (Zeitouni, 2012). For example, in Japan, SMEs in manufacturing, mining, transportation and construction sectors must have less than 300 employees and assets worth less than Yen 100 million. Whereas, in the retail sector, SMEs must have up to 50 employees and up to Yen 10 million assets. Table 2.1 summarises different parameters used in different countries to define SMEs. In Pakistan SMEs are defined by the central bank[2] as "a business entity, ideally which is not being a public limited company, and having employees not more than 250 in case of manufacturing concern and 50 in case of trade/services concern, and also fulfils one of the following criteria: (i) Total assets at cost excluding land and buildings up to PKR 50 Million in trade/service concern; (ii) Total assets at cost excluding land and building up to PKR 100 Million in manufacturing concern; (iii) Net sales not exceeding PKR 400 Million as per latest financial statements in any case" (SBP, 2017a p.12).

Table 2.1: Parameters Used in Different Countries to Define SMEs.

Country	Measuring Parameter(s)	Criteria
Belgium	Number of employees	Up to 100
	Annual turnover	Up to Euro 50 million
Canada	Number of employees • Manufacturing • Service industry	 • UP to 500 • Up to 50
	Gross revenue • Manufacturing • Service industry	 • Up to CAD 50 • Up to CAD 50
Germany	Number of employees	Up to 255
	Annual turnover	Up to Euro 50 million
Hong Honk	Number of employees • Manufacturing • Retail	 • Up to 100 • Up to 50

[2] Different institutions in Pakistan, use different parameters to define SMEs. Definitions of SMEs by other institutions in Pakistan are presented in chapter 4.

Japan	Number of employees • Wholesale • Service • Retail • Manufacturing and others	 • Up to 100 • Up to 100 • UP to 50 • Up to 300
	Total assets • Wholesale • Service • Retail • Manufacturing and others	 • Up to JPY 100 million • Up to JPY 50 million • Up to JPY 50 million • Up to JPY 300 million
Malaysia	Number of employees • Manufacturing • Service	 • Less than 150 • Less than 50
	Total assets • Manufacturing • Service	 • Up to MYR 25 • Up to MYR 5 million
Nigeria	Number of employees	From 10 to 300
	Total Capital	Between NGN 1.5 million and NGN 200 million (excluding cost of land)
Pakistan	Number of employees • Manufacturing • Trading/Service	 • Up to 250 • Up to 50
	Total assets • Manufacturing • Trading/Service	 • Up to PKR 100 million • Up to PKR 100 million
	Annual turnover • Manufacturing • Trading/Service	 • Up to PKR 400 million • Up to PKR 400 million
Philippines	Number of employees	Up to 200
	Total assets	Up to PHP 60 million
USA	Number of employees • Manufacturing and non-exporting services firms • Exporting services firms • Farms	 • Up to 500 • Up to 500 • Up to 500
	Revenue • Manufacturing and non-exporting services firms • Exporting services firms • Farms	 • Not applicable • Up to USD 25 million • Up to USD 0.25 million

Source: Author's compilation

2.3 Characteristics of SMEs

SMEs are enterprises that maintain a number of employees, assets and annual turnover below a certain threshold. While SMEs and large enterprises both may work in a similar market, they have significant characteristics that affect their business operations. SMEs exhibit a distinct set of characteristics that set them apart from their larger counterparts. These include the following:

- **The extent of the owner/manager's engagement**: One of the significant differences between large enterprises and small and medium sized businesses is the separation between ownership and management. In large industries, the business is run by managers who usually do not have any direct contacts with the owners (Solomon, 2007). Whereas, in small businesses, the owner himself administers the business's daily operations (Daily and Dollinger, 1993). Similarly, the owner is the primary figure in medium sized businesses and tall management structures are absent (Wijewardena et al., 2008). These differences between the management of SMEs and large businesses imply that the incentives and strategies of governance of SMEs differ from those of big enterprises.

- **Restrictions on size of capital:** SMEs are confronted with high restrictions on the capital available to establish or expand a business venture (Mateev et al., 2013). This is due to the limited availability of savings of the owner and difficulties in raising capital from external sources. SMEs generally begin with restricted tangible (land and equipment, etc.) and intangible (knowledge, training, goodwill, etc.). These restrictions on resources limits the SMEs ability to offer multiple products in the markets. According to Kraus et al. (2007), SMEs' focus is on using market penetration strategies rather than development strategies.

- **Smaller teams of employees:** One of the commonly used parameters of defining SMEs is the number of workers employed. Similar to financial capital, SMEs usually employ limited human capital as compared to their large counterparts (Van Gils, 2005). The number of employees can range from a single owner managing the whole business to a few hundred employees.

- **The job generation process:** Though SMEs employ fewer workers, the cost of job creation is considerably low as compared to large industries. In most countries, SMEs absorb a larger portion of the workforce since they are considerably more in number than large businesses.

North and Smallbone (1995) assert that SMEs generate more jobs and at a lower cost per job generated than the larger firms.

- **Flexibility:** Due to their simple management structures, SMEs enjoy greater flexibility and the ability to proliferate than large organisations (Bartz and Winkler, 2015). Flexibility can be both internal and external. Internal flexibility includes the capacity to respond to internal conditions, such as addressing workers' concerns (Mihail, 2004). Whereas external flexibility reflects the capacity to address changes in the outside environment, for example, customers' concerns. According to Levy et al. (2001) SMEs characteristics to quickly acclimatise to different circumstances enables them to adapt to the changing market conditions.

- **Marketing difficulties:** One of the features that distinguish the SME sector from other sectors is the high level of marketing difficulties they face. Given the high cost associated with marketing, SMEs find it difficult to bear these expenses (Bocconcelli et al., 2018). Such expenses will reduce their profits and, therefore, have limited budgets for promoting their products and services.

2.4 Significance of SMEs

SMEs receive significant consideration because of their critical role in economic growth and development (Beck and Demirguc-Kunt, 2006; Ortiz-Molina and Penas, 2008). Umar et al. (2018) identify SMEs as the focal part of any industrial structure. They are the paramount segment of any economy and make a vital commitment to economic development (Asad and Henderson, 2010). SMEs play a significant role in promoting entrepreneurship (Carsamer, 2012), contributing to GDP (Beck et al., 2005), alleviating poverty (Asikhia, 2010), reducing unemployment (Can't and Wiid, 2013), developing skilled labour force (Mahmood, 2008), promoting social cohesion (Clarke et al., 2016) and introducing innovative products and techniques to the market (Rudjito, 2003). In addition to directly contributing to GDP, the existence of SMEs also increases governments' revenue from taxation, empowering them to spend more on wellbeing of the society such as education and healthcare (Jamali et al., 2017). Moreover, SMEs also promote industrialisation in rural areas, encouraging regional dispersion of economic activities (North et al., 2001).

Globally, SMEs dominate in terms of the number of businesses, representing 90 to 95% of the businesses and employ 60 to 70% of the total work force (Kheng and Minai, 2016). Having identified their importance, many countries have directed their policies to support the growth and success of SMEs (Kraus, 2007; Emine, 2012). To stimulate economic growth and employment rates, supporting SMEs is one of the core strategies of The World Bank (World Bank, 2016). In addition to their role in economic growth, The World Bank's doing business reports demonstrate that a healthy SME sector also helps in reducing "black market" activities (World Business Council for Sustainable Development, 2007). They are, therefore, regarded as a vital indicator of a healthy and growing economy. Though SMEs' role is crucial in both developing and developed economies, they are particularly recognised by the governments in transition economies as an engine of economic growth (Ratten, 2014).

Compared with their large counterparts, SMEs can be more progressive due to their flexible organisational structures and culture (Koh and Simpson, 2005). They are considered to be more flexible than large enterprises in manufacturing, marketing and services since they observe the market closely, have strong relations with their employees and understand customers' requirements better (Stefanović, et al., 2009). Because of their flat management structure, SMEs can quickly adapt to meet their business requirements in response to changing circumstance. It empowers SMEs to make rapid decisions and implement them in response to any change (Matlay et al., 2006; Lavia and Hiebl, 2014). According to Wong and Aspinwall (2005), the flat structure of SMEs also promotes ease of communication and information sharing among all workers, which in turn creates a good learning environment where employees are part of idea generation and creative thinking. This positively impacts employees' motivation and thus improves their productivity (Keskin, 2006). In terms of building relationships with clients, the less formal structure of SMEs gives them an edge over large industries in maintaining more personal contact with their customers (Rauyruen and Miller, 2007).

SMEs hold a major share of private sectors in developed and developing economies (Beck, 2007). For instance, among the developed countries, the UK has approximately 4 million SMEs that account for around 46% of private-sector employment (Cowling et al., 2012). USA has nearly 30 million SMEs that account for two-thirds of private-sector jobs (United States Trade Representative, 2019). In Canada, there are 1.2 million SMEs, which employ 69.7% of private-sector workers (Robichaud et al., 2017). In the Eurozone, approximately 20 million SMEs employ 86.8 million workers, representing 65.5% of jobs (Hassan and Mohamed, 2014). In developing economies, the number of SMEs in India is estimated to be 42.5 million (95% of the total industrial units), which employ about 40% of the total workforce (Evoma, 2019). In Indonesia, SMEs represent 99% of enterprises and employ approximately 97.16% of the total workforce in 2012 (Imronudin, 2015). In Malaysia, SMEs represent about 90% of enterprise and generate 56% of total employment (Auzzir et al., 2018). Similarly, Pakistan’s economy is also SME driven (Kongolo, 2010). More than 3.8 million registered SMEs in Pakistan employ more than 78% of the non-agricultural labour workforce (Baig, 2019). This sector contributes 40% to the total GDP, 35% in value addition and over 40% in export earnings of Pakistan (Shah, 2018). Furthermore, this sector is also significant due to its role to engage women, youth and minorities and empower them to be a part of economic activities.

2.5 Sources of Finance for SMEs

Access to the sources of finance is one of the most important requirements for the growth and survival of both the new and existing SMEs. An SME owner might have a feasible business plan, but its execution will depend on sufficient financial resources. SMEs have limited choice of financing sources as compared to large enterprises. For instance, unlike large enterprises, capital markets are not an available platform for SMEs to raise capital (Nassr and Wehinger, 2016). SMEs' potential sources of finance can be broadly classified into two categories: internal sources and external sources. SMEs consider some important factors while deciding as to what source of finance will be more appropriate for them. These include the cost of borrowing, reason of borrowing, period of borrowing and their ability to pay back (Burns and Dewhurst, 2016).

2.5.1 Internal Sources

According to OECD (2006), SMEs face substantial difficulties in securing funds from formal financial institutions as they are perceived as risky investments by such institutions. Therefore, instead of raising finance from financial institutions, SMEs first rely on internal sources to finance their operations. According to Osei-Assibey (2013), SMEs use external sources of finance only when funding from internal sources are insufficient. The use of internal sources of finance saves SMEs from being accountable to the outside parties. However, relying only on internal sources of finance can constraint the growth of SMEs by limiting their ability to expand their operations. Internal sources of finance include personal savings and loans from friends or family.

2.5.1.1 Personal Savings

The use of personal savings is the most common and quickest way of funding SMEs, particularly small businesses (Shinozaki, 2012). Hitachi Capital Finance (2017), a leading financial services company, surveyed 500 SMEs in UK to understand their attitudes towards sources of finance. The study concluded that 72% of SMEs are running on owner(s) personal savings. The survey also revealed SMEs' aversion to borrowing money from external sources as only 17% of SMEs depicted indifferences to the use of external sources of finance. Similarly, according to U.S Small Business Administration (SBA) (2016), SMEs rely more on private investment capital to finance their business than any other source. Sherazi et al. (2013) assert that SME owner(s) first tap their savings before obtaining finance from banks and other specialised institutions in Pakistan. In addition to the difficulties associated with obtaining external finance, another reason SMEs give preference to personal savings over external sources is their fear of not being able to pay back the interest on the loan (Irwin and Scott, 2010). Furthermore, relying on personal savings maximises owner(s) control over the business (Mason, 2006).

2.5.1.2 Loans from Friends or Family

Friends or family are the second most common source of SMEs financing, particularly the young businesses (Bilal et al., 2016). SMEs that find it difficult to secure loans from formal means can benefit from borrowing from friends or family. SMEs' owners believe that obtaining loans from friends or family provides fast and convenient access to cash. One of the advantages of private lending from friends or family over formal sources is the absence of dealing with the application process and the flexibility of repayment schedules. Furthermore, SMEs can negotiate on financing cost which is usually lower than formal sources. In some cases, such loans can be interest-free as the lender's motivation is to help a friend (Logenecker et al., 2008).

Lin and Sun (2006) suggest that the most frequent source of debt financing for SMEs is not commercial lending institutions but family or friends. Daskalakis et al. (2013) also state that SMEs are believed to utilise their savings then loans from friends or family and use external sources of financing as a last resort only. This reluctance on the part of SMEs to use external finance can be observed in many countries. For instance, SMEs in Greece rely on private funds and do not prefer to raise additional capital from sources outside the family (Daskalakis et al., 2013). Sources of SMEs capital in China is dominated by personal savings, loans from friends or family, or disposal of fixed assets (Gudov, 2013). Similarly, in Pakistan 61% of SMEs financing comes from friends or family members (Ul Hasan, 2008).

2.5.2 External Sources

SMEs generally rely on owner(s) personal savings and loans from friends or family at the earliest development stages. With the growth in their business, SMEs soon outgrow internal sources of finance. SMEs consider external sources of finance as a last resort and obtain external finance only after internal sources of finance are fully exhausted. The external sources of SMEs financing include the following:

2.5.2.1 Commercial Banks

Moro et al., (2012) highlight that banks are viewed as the most common external source of financial assistance to SMEs. Banks can provide financing to SMEs through different instruments such as loans and mortgages, overdrafts, credit card finance, etc. Abdesamed and Wahab (2014) assert that SMEs financing through banks is more likely to be short-term in nature than medium and long-term. SMEs often encounter many difficulties when trying to access finance from banks such as unavailability of suitable financial products, regulatory rigidities or lack of information on both the bank and the SME. All these factors make bank loans unaffordable for SMEs since banks demand high interest to compensate for the high level of risk associated with financing SMEs (Fredriksson and Moro, 2014).

2.5.2.2 Specialised Credit Institutions and Government Assistance

Since the commercial banks are reluctant to provide long-term financing facilities to SMEs, the government in many countries have established specialised credit institutions to address SMEs' long-term financing needs. The most common examples of such institutions include Micro Finance Institutions (MFIs). MFIs are characterised as a sector of formal or informal financial institutions that are directed to address the financial requirements of microeconomic units (Gutierrez-Nieto et al., 2007). These are agents and organisations engaged in serving those who lack access to commercial banking finance including SMEs and lower-income households (Belwal et al., 2012). Other such institutions include SME Bank; directly providing business loans, and Credit Guarantee Corporation; providing guarantees for loans from commercial banks. Such institutions are expected to improve the flow of credit to SMEs by enhancing diversity and widening participation in the financial system.

To improve SMEs' access to finance, one of the important sources of external finance is government assistance which usually takes the form of grants or loans at subsidised interest rates

(Doh and Kim, 2014). Most governments recognise the significance of SMEs and the difficulties they encounter while accessing finance, which their large counterparts do not face due to their structural differences. Therefore, support structures in the form of government organizations or SMEs development centres have been established in many countries around the globe to promote the growth of healthy SME sector (Xiang and Worthington, 2013).

2.5.2.3 Trade Credit

Trade credit serves as another important external financial resource for SMEs. Pasadilla (2010) states that suppliers' credit is the principal type of trade credit used by SMEs whereas, some SMEs also rely on advances from their customers. During the financial crunch in 2008, SMEs that were less liquid heavily relied on trade finance (Vasilescu, 2014). Also, financially stable SMEs extended trade credit to financially weak SMEs after the financial crisis (McGuinness and Hogan, 2016). Trade credit is significant for SMEs since it brings down their expenses compared with the costs of obtaining finance from other external sources of funding. This is because the interest cost remains a significant challenge for SMEs while accessing finance (Fatoki and Odeyemi, 2010).

2.6 Financing Gap of SMEs

Since the Macmillan Report (1931) on finance and industry, the financing gap of SMEs has become a significant topic of discussion and research. Although in many countries, SMEs are the vital segment of the private sector, SMEs' growth faces many obstacles that limit their progress and hence their contribution to economic development. Access to finance is identified as one of the major challenges to the growth and survival of SMEs (Ping-fei, 2002; Abereijo and Fayomi, 2005; Duan et al., 2009; Gbandi and Amissah, 2014; Zhao et al., 2019) and this financial constraint is even more critical in case of developing countries where the financial systems are weak and under-developed (Beck, 2007). For instance, Fal (2013) estimates that up to 84% of SMEs in Africa are either un-served or underserved, representing an additional financing requirement of approximately USD 140 - 170 billion. Claessens (2006) classifies SMEs' access to finance into three dimensions; availability of financial services, cost of obtaining finance and flexibility of financial products (are those products tailored to SMEs needs?). Contributing to the debate on the SMEs financing gap, Domeher et al., (2014) argue that inaccessibility of external sources of finance impedes SMEs growth.

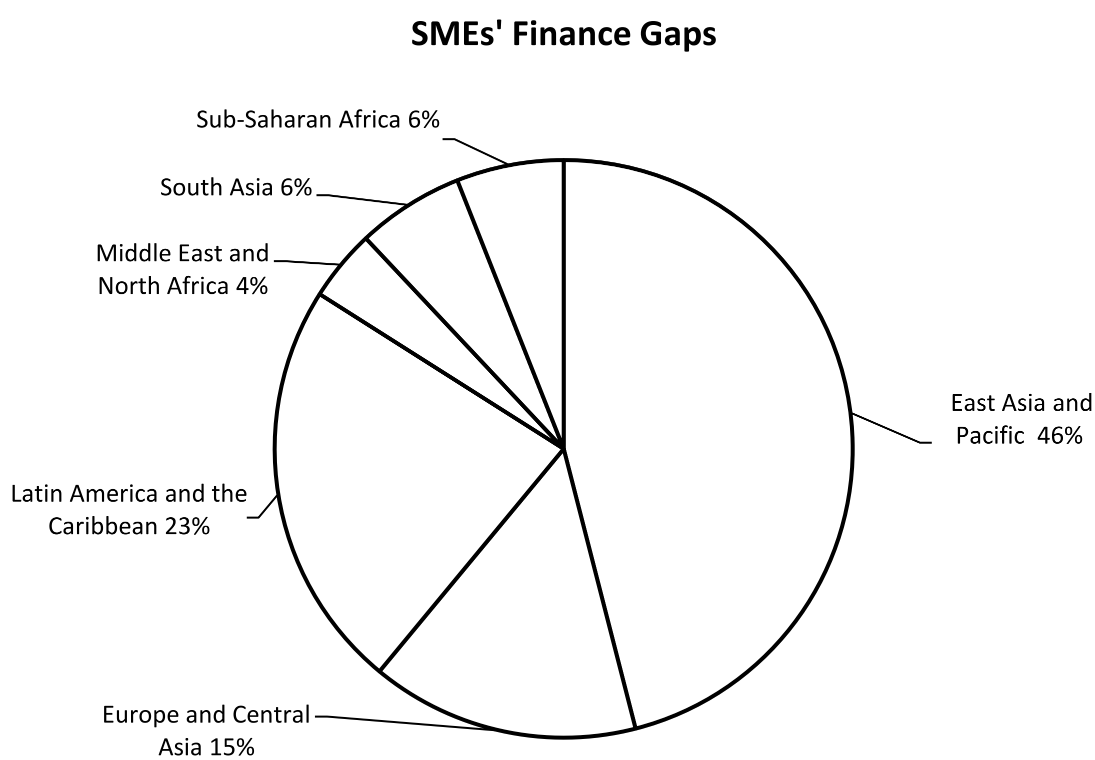
Beck et al. (2014) find that SMEs appear to be severely underfunded, particularly small enterprises. SMEs face various obstructions in securing external finance because of their small size and weaker financial structures (Ayadi and Gadi, 2013; Rabbani and Moossa, 2014). This situation often forces SMEs to depend on short-term or medium-term finance, which is more expensive than long-term finance and does not appropriately address SMEs financing requirements for expanding their operations (Irjayanti and Azis, 2012). The IFC with McKinsey and Company in 2010, attempted to appraise the size of the SMEs financing gap in developing economies (Stein et al., 2010). The study concluded that 60% of formal SMEs are either unserved or underserved and need an additional USD 2.6 trillion. Another attempt to quantify SMEs' financing gap in its Eastern Partnership Program Countries was made by the European Investment Bank (EIB) in a series of studies conducted in 2013. Their synthesis report depicts that although financial institutions are willing to provide finance to SMEs, there are significant financing gaps for SMEs in the agricultural sector and in rural areas. This gap is mainly due to the lack of collateral and SME owner's low literacy levels (Kraemer-Eis and Lang, 2014). SMEs that face severe financing constraints either go out of business resulting in a potential loss to the economy or find incentives to abandon the formal system and operate in the informal economy (Williams and Gurtoo 2016). This involves evading taxes and regulations and, therefore, limiting those SMEs' contribution to the economic growth.

Machmud and Huda (2011) investigate SMEs' access to finance in Indonesia. They surveyed 161 firms to collect data about SMEs' characteristics, their sources of finance, and the obstacles they face in accessing finance. The findings reveal that 45% of SMEs failed to obtain finance from external sources mainly due to a lack of collateral. They rather have to rely on finance from a social network of family, friends and relatives. It was also found that most SMEs commonly use trade credit from suppliers and micro-credit from MFIs (Machmud and Huda, 2011).

Quaye et al. (2014) explore the role of MFIs in reducing the financing gap faced by SMEs in Ghana. The study identified a wide financing gap of SMEs in the country since most of the SMEs are not granted access to finance by banks and other financial institutions. They concluded that MFIs have the potential to address the financing needs of SMEs as they offer loans at a subsidised interest rate. However, MFIs demand collateral in the form of land or credit history or well-maintained financial statements. The study recommends that to increase SMEs' access to finance, MFIs being a potential financing source for SMEs, should consider providing other support services to SMEs, such as training them in credit management.

In the study conducted to analyse the SMEs' finance gap by IFC (2017b), it is identified that 59% of SMEs' demand for long term financing is unmet in developing countries. The financing gap of the SMEs sector in developing countries is estimated to be USD 5.2 trillion, equivalent to 19% of these countries' cumulative GDP (IFC, 2017b). Regional analysis exhibits that the finance gap of SMEs is the largest in the East Asia and Pacific region; mainly driven by the large demand in China (IFC, 2017b). Latin America and the Caribbean have the second highest share in SMEs' financing unmet demand, mainly driven by Brazil (IFC, 2017b). Figure 2.1 illustrates the regional distribution of SMEs' finance gap. The study suggests that these financing gaps can considerably be narrowed down, if governments create a favourable environment for businesses and if the financial institutions in the private sector adopt the advance approaches to meet SMEs needs in the constantly changing macroeconomic environments (IFC, 2017b).

Figure 2.1: Regional Distribution of SMEs' Finance Gap



Source: SMEs finance gap (IFC, 2017)

In their study about the availability of finance for SMEs in Brazil, Veiga and McCahery (2019) identify the substantial funding gaps faced by SMEs. According to their findings, the SMEs financing gap in Brazil grew from 54.29% in 2014 to 87.5% in 2016. They argue that this increase in SMEs financing gap is due to several reasons, including inadequacy of appropriate financial products and services to address the needs of SMEs, low competition in the financial sector to finance SMEs and SMEs' inability to provide sufficient collaterals (Veiga and McCahery, 2019). In light of the findings of their study, they suggested that availability of finance to SMEs can be improved by enhancing competition in the supply of loans, designing new products that facilitate SMEs' requirements, providing guarantees for loans from commercial banks and promoting non-bank financing channel to provide finance to SMEs (Veiga and McCahery, 2019).

In Pakistan, access to formal sources of finance is identified as one of the major obstacles to the growth of SMEs (Chaudhry, 2000; Bari and Cheema, 2005; Niethammer et al., 2007; Saeed and Sameer, 2015; Hyder and Lussier, 2016; Ullah, 2018). Most of the Pakistani SMEs, rely on personal savings and informal sources of finance (Ul Hassan, 2008; Naveed, 2012; Khan, 2015) and in 2007, approximately 90% of small businesses obtained finance from the informal sector (Ul Hassan, 2008). This is because most SMEs appear deficient in accounting and financial information that hamper their access to formal sources of financing (Dar et al., 2017). According to the IFC (2017a) the un-served and under-served SMEs in Pakistan are assessed to require an additional USD 3.8 billion investment.

2.7 Challenges and Obstacles in Financing SMEs

2.7.1 Challenges and Obstacles Faced by Banks

Banks perceive SMEs as a risky proposition and therefore, are reluctant to provide finance for SMEs unless they can protect their interest. Fredriksson and Moro (2014) highlight that banks operate in a context characterised by limited competition to finance SMEs. Since the banking sector dominates the financial system and is considered the major source of external finance for SMEs, it is, therefore, important to understand the obstacles that prevent banks from providing finance to SMEs.

2.7.1.1 Information Asymmetry

One of the major reasons for the funding gap of SMEs is the information asymmetry between the lender and the SMEs (Lean and Tucker, 2001; Brewer III, 2007; Steijvers et al., 2010). Information asymmetry refers to a situation where SMEs have more information about their business and the risks they face than the lenders, affecting the lender's decisions (Agarwal and Hauswald, 2006). In perfect market conditions, where the perfect and free of cost information is accessible to both the lender and the borrower and there is no risk or uncertainty attached to future market conditions, the lender's decisions are not affected by the information asymmetry. In the real world, however, information is neither perfect nor free. Furthermore, finance markets, particularly the SMEs' finance markets, are vulnerable to risk or uncertainty regarding future conditions (Lean and Tucker, 2001).

When processing a loan request, banks gather relevant information about the applicant which costs the banks in terms of time and effort (Stein, 2002). Huang et al. (2014) argue that information asymmetry is more acute in the case of SMEs, since due to the relatively small size of SMEs, banks do not find it viable to invest time and resources in gaining a deeper understanding of every business project, which eventually results in a lack of information to precisely measure the degree of risk associated with financing SMEs. To mitigate the risk arising from information asymmetry, banks impose strict covenants (Lemmon and Zender, 2019) or demand collateral (Menkhoff et al., 2006) or charge higher interest rate (Cassar et al., 2015). All these measures by banks make SMEs' access to finance even more difficult.

2.7.1.2 Adverse Selection

One of the consequences of asymmetric information is adverse selection. Adverse selection is the problem related to identifying and selecting the healthy investment over the riskier investment (Hyytinen and Väänänen, 2006). Given the limited resources, banks cannot facilitate all the loan applications and must make a selection among them. The bank has to rely on forecasted results rather than the actual results (Lin and Sun, 2006). Consequently, when financing SMEs, there is a possibility that the bank might reject a good investment project. In addition to the possibility of a good investment project being rejected, there is also a possibility of poor investment project being accepted by the bank (Huda, 2012). These type of lending errors would contribute significantly to the financing gap of SMEs. To address the problem of adverse selection and to minimise the risk of loan default, banks can monitor the activities of SMEs where they employed those funds during the life of the credit (Huang et al., 2014). However, monitoring such activities will increase banks' costs, making it uneconomical for them to invest in small or even medium-sized projects.

Furthermore, to recoup these additional costs banks may respond by demanding a high collateral or by increasing the interest rates in excess of what the inherent risks would require (Huang et al., 2014). The bank may also limit lending, commonly known as credit rationing[3], even when SMEs are willing to pay higher interest costs. As a result of higher interest rate and credit rationing, many SMEs lack access to external finance and are ultimately eliminated from the market.

2.7.1.3 Moral Hazard

Moral hazard is another by-product of asymmetric information. Once funding is granted, the SMEs may have incentives to take higher risks than they otherwise would, resulting in a bad debt for the lending bank (Lean and Tucker, 2001). This is because the SME advantages completely from any additional returns but does not suffer proportionately in case of a loss. As banks cannot actively monitor and control the use of finance by the borrowers, there is a likelihood of borrowers engaging in unnecessarily excessive risk and violating the original commitment they made. Dowd (2009) argues that moral hazard emerges when the borrowers' action affects the probability distribution of the outcome. He further adds that the borrower's inclination for risk corresponds to the interest rate i.e., it increases with the higher interest rate and decreases with the lower interest rate (Dowd, 2009). To maximise their expected earnings, SMEs have an incentive to take higher risks, and this motivation will become progressively stronger if their trading position falls below the break-even point (Lean and Tucker, 2001).

Furthermore, SMEs that had performed badly in the past have an incentive to hide information from the lender (information asymmetry). This is compounded by banks' inability to effectively monitor SMEs' projects due to the high costs involved (Binks and Ennew, 1996). Although Moral hazard occurs when the SME has already acquired the loan, banks demand higher collateral and higher interest rates from SMEs to protect themselves against the moral hazard problems (Niinimäki, 2009), which would further exacerbate the financing difficulties of SMEs.

[3] Credit rationing is a result of market imperfection where price mechanism fails to bring about the equilibrium in the demand and supply of finance. Therefore, the lenders limit the supply of additional credit to borrowers even if they are willing to pay higher interest rates.

2.7.1.4 High Transaction costs

Lenders are risk averse and to constrain their risk, they practice protective measures. Jensen and Meckling (1976) argue that these measures have cost implications (agency cost) such as monitoring costs. From the banks' point of view, lending to SMEs involves high transaction costs, which serves as a barrier for banks offering finance for SMEs (Jiang et al., 2014). This high transaction cost is a result of a comparatively small amount of loans, involving complicated administrative procedures, large amount of time and resources to comprehend SMEs' needs, creditworthiness, and financial performance (Jiang et al., 2014). SMEs' relatively small size makes it less economical for banks to put time and resources into building up a comprehensive understanding of their business. Banks are, therefore, reluctant to provide finance to SMEs as, in addition to being a riskier investment, financing SMEs' results in high costs for banks, the smaller the loan, the bigger the unit transaction cost.

2.7.2 Challenges and Obstacles Faced by SMEs

The challenges and obstacles commonly faced by SMEs while accessing external finance include the followings:

2.7.2.1 Lack of Collateral

Collateral is a pledge of property or asset made by the borrower to the lender as a security in the lending agreements (Garrett, 1995; O'sullivan and Sheffrin, 2003). It serves as a lender's assurance against a borrower's default and thus, can be utilised to offset the loan in case the borrower fails to pay the loan and interest in accordance with the terms of agreement (Canesi et al., 2016). The interest rate on unsecured loans is higher than the loans secured by the collateral due to the high risk attached. This reduction in interest rate can vary depending on the type and value of the collateral. In the context of financing SMEs, banks are in a relatively disadvantaged position due to asymmetric information. Collaterals act as a signaling device for the borrower's quality and enable the bank to mitigate adverse selection arising from asymmetric information (Chaudhary and Ishfaq, 2003). They also reduce the risk of borrowers' shifting behaviour after the finance has been granted, thus solving the problem of moral hazard and aligning the borrower's interest with the interest of the lender (Blazy and Weill, 2013).

Bădulescu (2010) claims that inability to provide sufficient collateral is the most asserted reason for SMEs' challenges in obtaining external finance. Menkhoff et al. (2006) also highlight that due to their small size and limited resources, SMEs, particularly those in less developed countries, have a lower level of collateralisable assets that can provide security for their finance thus resulting in high probability of credit rationing for SMEs. In addition to being perceived as a riskier proposition, lack of competition among the lenders also influences collateral requirements of SMEs. For instance, when the good borrowers are more in number and several lenders are competing for the same borrowers, it lowers the collateral prerequisites for the borrowers (Voordeckers and Steijvers, 2006). Furthermore, borrowers are at a strong bargaining position and can obtain loans at a lower interest rate as there are many opportunities to borrow from different banks. However, SMEs finance markets are characterised by low competition, and banks are reluctant to finance SMEs (Chong et al., 2013). They, therefore, demand large collaterals, which most of the SMEs are constrained to offer. Consequently, the SMEs' financing gap keeps on expanding.

2.7.2.2 High Cost of Finance

Another obstacle that SMEs face while accessing the formal sources of finance is a high financing cost. Banks' main focus is on creating value for them under a controlled risk. Therefore, when banks assess finance requests, their main concern is the risk involved and strategies to mitigate them. One of these risk mitigation strategies is to charge a risk-adjusted interest rate based on the probability of whether the borrower can make timely payment of the principal and interest on it (Fredriksson and Moro, 2014). This implies that the higher risk borrowers will be charged with a higher interest rate than the lower risk borrowers. It has been established that banks perceive SMEs as risky borrowers and are reluctant to provide them with finance (Gbandi and Amissah, 2014). They use collaterals as a screening device to establish SMEs' creditworthiness; however, usually, SMEs are not financially sophisticated enough to provide collateral (Menkhoff et al., 2006). Consequently, banks only provide finance to SMEs at a risk-adjusted interest rate much higher than the interest rate charged from their large counterparts (Lean and Tucker, 2001).

Furthermore, since the moral hazard issue remains one of the key impediments to SMEs' access to finance, the banks charge higher financing costs to receive their compensation as quickly as possible in case of any payment default in future (Rahman et al., 2017). Higher interest rates result in increased debt burden and reduced profits of SMEs (Chaibi and Ftiti, 2015), and therefore, SMEs are discouraged from obtaining finance from banks. SMEs inability to bear higher financial costs limits their access to formal sources of finance and widens their financing gap.

2.7.2.3 Inadequate Financial Records

Another significant reason SMEs face discrimination from banks is the unavailability of adequate financial records (Tagoe et al., 2005). Berger and Udell (2002) highlight that SMEs are characterised by the lack of audited financial records, making it difficult for them to justify their credit quality. Businesses are required to keep proper books of account and prepare financial statements which give a true and fair perspective of the business's financial affairs. However, SMEs tend to have only limited interest in financial reporting (McMahon, 1998; Stainbank, 2008). A good reporting practice is not only about keeping financial information but how well those records meet the information requirements of internal and external decision-makers (Abdul-Rahamon and Adejare, 2014). Xu et al. (2003) highlight that using a service of qualified accountants can positively impact maintaining the records in such a way that they provide sufficient information required by the decision-makers. However, the high cost associated with obtaining the services of professional accountants has left SME owners with no other option but to compromise on the quality of their financial records (Jayabalan et al., 2009). SMEs view any attempt of improving their reporting practices as an unnecessary increase in cost without conveying clear advantages (Litjens et al., 2012). The development of sound accounting records in SMEs depends on the owners' level of accounting knowledge (Ismail and King, 2005). According to Abdul-Rahamon and Adejare (2014), SME managers/owners lack sound knowledge in accounting practices and, therefore, cannot maintain proper records.

Large enterprises generally can maintain better financial records, which improve their access to banking finance (Berger and Udell, 2002). On the other hand, the lack of adequate financial records makes it difficult for SMEs to access finances from banks (Hilton and Platt, 2008). In the absence of sufficient information banks rely on their methods for credit rating while making lending decisions. Based on their own credit rating methods, banks charge higher interest rates and impose non-price related restrictions while financing SMEs (Hanedar et al., 2014). These restrictions include higher collateral, shorter maturity, and smaller loan size (Farinha and Felix, 2015; Kirschenmann, 2016).

2.7.2.4 Lack of Knowledge and Understanding of Islamic Financial Products

SMEs' knowledge and understanding of Islamic financial products is a critical variable in determining SMEs' access to Islamic finance (Mansor et al., 2012). Al Balushi et al. (2019) assert that SMEs lack knowledge about Islamic banking products which is a significant factor that hinders the adoption of Islamic banking finance (Al Balushi et al., 2019). Dusuki and Abdullah (2007) assert that many Muslim customers, in countries with dual banking systems, are known to bank with both the Islamic and conventional banks. This use of conventional finance in the presence of alternative Sharia-compliant products can be attributed to the poor level of knowledge about the Islamic banking principles and Islamic financing products (Khan et al., 2007; Khattak, 2010).

Naser et al. (2013) explore the level of awareness about institutions offering interest-free financing products in Kuwait. Based on the opinions of 429 Islamic banks customers gathered via questionnaire, they concluded that customers only have a little knowledge about the product(s) they are using and lack knowledge about the other products and services offered by the same institution (Naser et al., 2013). Rammal and Zurbruegg (2016) explore the level of awareness of Islamic financial products among the Muslim population in Australia. Their findings reveal that the low use of Islamic financial instruments is due to the lack of relevant knowledge and understanding of the Islamic banking framework (Rammal and Zurbruegg, 2016).

In a country like Pakistan, where Islamic banking is still in its development phase, knowledge of Islamic financial products may greatly impact financing decisions among small and medium business owners. In their investigation about the determinants of low adoption of Islamic banking in Pakistan, Butt et al. (2018) identify that SMEs are not well-aware of Islamic banking in Pakistan. They also highlighted the need to create awareness about the Islamic banking products and services with the help of print, social and electronic media (Butt et al., 2018).

2.7.2.5 Lack of Advertising of Islamic Financial Products

The primary purpose of advertising is to inform people about a particular product or service and persuade them to adopt it (Arens, 2002). As discussed earlier, lack of knowledge about the available Islamic banking products is identified as a significant factor that hinders SMEs' adoption of Islamic banking finance (Al Balushi et al., 2019). One of the main reasons for little or no knowledge about Islamic banking is the lack of advertising activities (Ackermann and Jacobs, 2008).

Tara et al. (2014), in their investigation about the factors influencing the adoption of Islamic banking in Pakistan, identified a significant positive correlation between advertising and consumers' preference for using Islamic banking services. The positive correlation between advertising and consumers' preference for using Islamic banking services can be attributed to the fact that advertising will increase knowledge and awareness among consumers (Alshannag et al., 2020). SMEs in Pakistan lack sufficient knowledge about Islamic financial products (Butt et al., 2018). This lack of knowledge creates a barrier to SMEs' access to Islamic banking finance (Ali, 2018). Here, Islamic banks have an opportunity to develop SMEs' access to Islamic finance by adopting an effective marketing and advertising strategy aimed at making SMEs aware of the available products and the potential benefits of using those products (Tara, 2014; Imronudin, 2015; Iqbal and Ali, 2020).

2.7.2.6 Other Obstacles

Osano and Languitone (2016) point out that one of the barriers which aggravate SMEs' financing gap is banks' focus on traditional services and sales models, which are not aligned with SMEs needs in today's dynamic environment. As a result of continuously changing macroeconomic conditions, SMEs needs are also evolving fast; loans are not their sole expectation from the bank. They demand innovative and personalised services from banks addressing their business issues. Other significant constraints obstructing SMEs' access to finance include lengthy and complex paperwork involved (Kathuria and Mamta, 2012; Chowdhury et al., 2015), lack of experience on the part of applicant (Zarook et al., 2013; Cant et al., 2014), insufficient loan size and maturity (Duan et al., 2009; Eniola and Entebang, 2015), lack of management skills of applicants (Brink et al., 2003) and inability to generate sufficient cash flows in future (De Maeseneire and Claeys, 2012). All these factors exhibit the probability that SMEs are reluctant to access finance from banks and instead rely on internal sources of financing. As a result, their financing gap grows.

2.8 Conclusion

This chapter reviewed the literature regarding SMEs and their financing. It highlighted that SMEs are the backbone of an economy because of their significant role in promoting entrepreneurship, contributing to GDP, alleviating poverty, reducing unemployment, developing a skilled labor force, fostering social cohesion and introducing innovative products and techniques to the market. However, there is no single international definition of SMEs, and in some countries, the definition varies from sector to sector. This is due to the different parameters used by other stakeholders to classify an SME. It also discussed SMEs' characteristics and the financing sources of SMEs. The literature review presented in this chapter corroborates the existence of a financing gap for SMEs. Lastly, the challenges and obstacles faced in financing SMEs are discussed. The main obstacles faced by banks while financing SMEs are identified as information asymmetry, adverse selection, moral hazard and high transaction costs. On the other hand, lack of collateral, high-interest rate, inadequate financial records and unavailability of suitable financial products are the main factors that inhibit SMEs ability to access finance from external sources. To achieve the aim of this study i.e., to investigate SMEs' access to Islamic finance in Pakistan, the next chapter will provide an overview of the Islamic financial system and what role Islamic banks can play in bridging the funding gap of SMEs.

Chapter Three: Islamic Financial System

3.1 Introduction

Even though Islamic financial framework has been established since the time of Prophet Muhammad (PBUH), it has become an important research topic in the twentieth century. Since then, many researchers have investigated the phenomenon of Islamic finance (Mills and Presley, 1999; Warde, 2000; El-Hawary et al., 2004). This chapter seeks to provide an overview of the Islamic financial system. The remainder of the chapter is structured as follows. Section 3.2 contains an overview of the Islamic economic system, including its development and characteristics. Section 3.3 summarises the historical evolution of Islamic finance. It also shed light on the institutional aspects of Islamic financial institutions, criticism and challenges they face, and the difference between conventional and Islamic financing. Islamic financial products are then discussed in section 3.4. Section 3.5 examines the relevance of Islamic modes of financing for SMEs. Section 3.6 concludes the chapter.

3.2 Islamic Economics

3.2.1 Origin and Development of Islamic Economics

The idea of Islamic Economics originates from the Holy Quran and Sunnah (traditions of the Prophet Muhammad). The Holy Prophet laid the foundation of the Islamic economic system fourteen centuries ago (Kuran, 2004). The primary characteristics of an Islamic economy are often recognised as the behavioural standards and moral foundations prescribed by the Quran and Sunnah, prohibition of interest, and collection of zakat and other Islamic taxes (Kuran, 1992; Karim, 2010). The Quran as the word of God and Sunnah as its practical implication exhibit teachings that span various economic activities. The Qur'an and Sunnah directed the basic principles and emphasised on application of reasoning. Based on these principles, Muslim scholars used reasoning to derive juristic logic, which applies to contemporary issues in the changing historical and economic conditions.

The modern version of Islamic economics was born during the second quarter of the 20th century. In many aspects, the teachings of the Quran and Sunnah are consistent with the western economic theories, yet they contradict some fundamental economic principles. For example, while interest is paid to borrow money, it is strictly prohibited in Islam[4]. Moreover, given his income, a consumer can choose any combination of goods that helps him to maximise his utility. On the other hand, in addition to prohibiting certain goods like alcohol and pork, Islam discourages overconsumption in general (Sandikci and Ger, 2011). Because of these differences, Islamic scholars and economists asserted that the conventional economic paradigm lacks comprehension of Muslim societies' needs (Ahmed, 2000). Therefore, they highlighted the necessity of the Islamic economic system. Contemporary Islamic economics developed from the Islamic revival and the belief that Islam must have a framework that provides a comprehensive alternative to the conventional economic system (Choudhury, 1999). In 1941, Abul A'la Maududi, a renowned Islamic scholar, addressed the economic problems of man and its Islamic solutions which is reckoned as the founding documents of contemporary Islamic economics (Nasr, 1996; Kuran, 2004). Although it emerged in 1940’s (Usmani, 1988), the discipline of Islamic economics attained recognition both on national and international level when the first international conference on Islamic Economics was held in 1976 (El-Ashker, 2006). Since then, a lot of work has been done by Muslim scholars to describe Islamic economic framework.

With regards to Pakistan, the idea of Islamic economics is a fundamental part of the ideology of Pakistan. The Objectives Resolution passed by the Constituent Assembly of Pakistan in 1949 approved developing economic policies based on the fundamental components of Islamic vision of economics (Mehmood 2002). These include judicial changes to eliminate interest and develop a mechanism to collect and use Zakat effectively (Haque and Gardezi, 1991). The first constitution of Pakistan (1956) also directed the state to abolish interest as early as possible (Mehmood 2002). In 1978, the President of Pakistan, General Zia-ul-Haq advanced a programme to align Pakistan’s law with Sharia standards and to create an interest-free economy (Hathaway and Lee, 2004). Despite its initial success, this programme did not meet the targets of commercial interactions with major international banks (Kaushik, 1993). Even after four decades, there is no substantial change in the system, and the interest-free economy plan is still far off implementation.

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[4] Prohibition of interest in mentioned in a number of verses in The Holy Quran. For instance, 2:275; 2:276, 2:278; 3:130; 4:161; 30:39.

3.2.2 Characteristics of an Islamic Economic System

Understanding Islamic economics requires an understanding of certain characteristics which are essential for the Islamic way of life. The Divine revelation sets out several economic principles and these principles have advanced through the development of the Sharia (Islamic law). One of the fundamental characteristics of Islamic economics is that economic activities are not only driven by human desires and experiences but also by the basic directives of the Sharia (Khan, 2013). Islam gives special consideration to economics and many essential economic parameters have been integrated in the Islamic framework. These parameters include allocation of resources, financing instruments, fair trade, consumers' rights, taxation and business relationships (Al-Misri and Keller, 1991).

The Islamic economists do not agree on the standard number of economic principles. Ahmad (2007), for instance, asserts that the philosophical foundation of Islamic economics is tawhid (oneness of God), rububiyya (God's ownership of resources) and the caliphate (governance). While Ayub (2002) argues that the four major features constitute the basic building blocks of an Islamic economic system according to the Sharia. These include profit and loss sharing, prohibition of interest, avoiding speculation and excessive risk and uncertainty, and asset backing (Ayub, 2002). According to Alam Choudhury (2001), the fundamental principles of Islamic economics include tawhid, the principle of work and productivity, and the principle of distributional equity. Although various scholars identified different principles as the building blocks of the Islamic economic system, they all lead to the same estuary of equality, fairness and socio-economic justice (Kuran, 2004). Based on these principles, the principal characteristics of an Islamic economic system can be identified as follows.

3.2.2.1 Ownership of God

The first and the foremost principle of Islamic economics is the ownership of God (Ganjoo, 2004). One of the underpinnings to understand this concept is the verse of the Holy Quran which states that:

> *"God is the sole proprietor of everything in the heavens and on earth."*
>
> (Chapter 2, Verse. 284)

All the natural resources and wealth we have today belongs to Him since He is the one who is the creator of everything. This principle shapes the economic conduct of Muslim individuals as they firmly believe that God is the ultimate owner of all resources and man as His vicegerent is responsible to use them in accordance with His instructions (Mortazavi, 2004). We are only the trustees of all His dominion, and this should be reflected in all our social, financial and economic activities. This characteristic of the Islamic economic system differentiates it from capitalist and socialist economic systems. Though Individual ownership is valued in Islam, it is not absolute, and it must comply with Islamic laws (Ahmad, 2009) as man will be answerable for its use on the Day of Judgment. On the other hand, in capitalism, ownership is absolute, and the owner has the right to use it in any way and in socialism, the authority belongs to the state and the concept of individual ownership is not recognised (Shleifer, 1998).

3.2.2.2 Prohibition of Riba (Interest)

Islam strongly prohibits interest (Khan and Mirakhor, 1986; Saeed, 1996; Kuran, 2004) and considers it an impediment to economic growth and a means of exploitation (Ahmad and Humayoun, 2011). The rationale behind prohibition of interest is that money is only a tool for exchanging goods and services and does not have any value in its own. Money cannot be traded since it will result in the exploitation of the weak and accumulation of wealth in the hands of a few, consequently increasing income inequalities (Pryor, 2007). The prohibition of interest is explicitly directed in various verses of the Quran. For instance, Verse 279 of Chapter 2 says that "O believers, fear God, and give up what is still due to you from interest if you are true believers".

On another occasion, believers are warned about the consequences of interest as "That which you give as an interest to increase people's wealth increases not with God; but that which you give in charity, seeking the goodwill of God, multiplies manifold" (Chapter 30, Verse. 40). To conduct economic transactions in the absence of interest, profit and loss sharing agreements is being suggested as an alternative mode of finance (Ahmad, 1980; Crane and Leatham, 1993; Mirakhor and Zaidi, 2007; Weill, 2019).

3.2.2.3 Prohibition of Gharar (Uncertainty, Deception or Excessive Risk)

The term "Gharar" literally translates to risk, uncertainty, or hazard, resulting in a loss (Uddin, 2015). In the context of economic contracts, Gharar stands for the unnecessary risk and uncertainty emerging from the absence of sufficient knowledge and information about the outcome (Kamali, 1996). Islam strictly prohibits Gharar (Sarker, 1999; El-Gamal, 2001; Usmani, 2002). Short selling of securities and trading in unidentified items are also against Islamic laws (Ayub, 2013). Similarly, the trading of options and futures also have the elements of Gharar and, hence, they are also prohibited (Ayub, 2013). According to Kuran (1989), the rationale behind this prohibition is that such transactions result in an unearned gain for one party at the cost of an undeserved loss for the other. This is against the notion of social justice, which is the prime objective of the Islamic economic system.

3.2.2.4 Zakat and the Concept of Qard al-Hasan (Benevolent Loan)

Another important characteristic of the Islamic economic system is Zakat. It is a religious tax payable by those who meet the necessary criteria of wealth[5] and is used for charitable causes (Al-Qaraḍāwī, 1999). To fulfil their social obligations, Muslims are strongly required to participate in charitable giving, which helps to narrow down the gap between the "haves" and the "have-nots". Zakat is one of such tools where Muslims annually pay 2.5% of their net wealth, which is then distributed among the poor and needy. This built-in mechanism in Islam ensures redistribution and decentralisation of wealth (Hasan, 2005). Zakat develops individuals' sense of responsibility and consciousness of their obligations towards society from the ethical perspective. It results in better socio-economic development by promoting a welfare system that divides the rich and the poor.

The idea of charitable giving in Islam goes beyond Zakat where Muslims are persuaded to assist the poor and needy through Qard al-Hasan. It is another redistributive instrument that provides interest-free loan based on benevolence (Farooq, 2011). Karnani (2007) identifies Qard al-Hasan as an integrated approach in an Islamic economic system towards improving society's overall well-being.

3.2.2.5 Equity and Justice

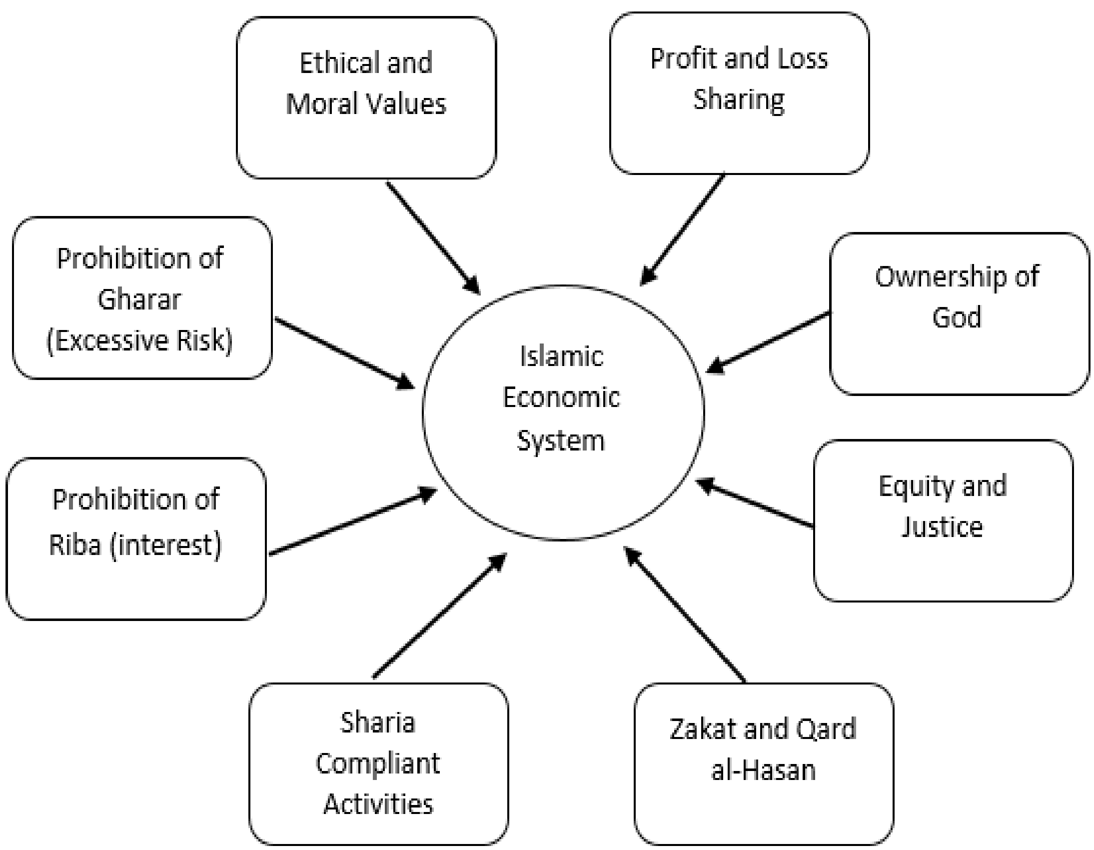
According to Kuran (2004) the idea of social justice is a belief that people in a society should share its benefits and treat each other fairly. Following the teaching of Quran and Sunnah, the principle of equity and justice underpins all laws governing activities in an Islamic economic system. It is not only the state's responsibility to ensure the socio-economic rights of individuals, but the members of society are also required to fulfil their fellow members' rights (Ahmed, 1991). In an Islamic economic system, every individual is entitled to fundamental socio-economic rights

[5] Zakat is payable on 87.48 grams or above of gold or 612.36 grams or above of silver or equivalent amount of savings.

(Jan et al., 2015). These rights include i) economic equity, i.e., access to factors of production, ii) legal equity i.e., the privilege to be heard and redress of unfairness and iii) social equity i.e., fulfilment of basic needs like food, shelter, education etc. (Randeree, 2015). One of the prerequisites of socio-economic justice is the fulfilment of the economic needs of all the segments of the society which requires assisting the individuals who need aid to take part in economic activities. Therefore, in line with achieving financial inclusion, Islamic finance is more suitable for SMEs that are viewed as risky and unfavourable by conventional banks (Ali, 2015).

To summarise the above discussion, primary characteristics of an Islamic economic system are briefly summarised in Figure 3.2.

Figure 3.2: Primary Characteristics of an Islamic Economic System



Source: Author’s compilation

3.3 Islamic Banking and Finance

3.3.1 The Historical Evolution of Islamic Banking and Finance

Islamic banking is a banking system established on the principles of Islamic economics and guided by Islamic laws (Khan, 2014). Ali and Sarkar (1995) highlight that the Islamic banking system is based on two fundamental principles: prohibition of interest and profit and loss sharing. The foundation of the Islamic financial framework was led since the time of Prophet Muhammad. One of the examples of such foundations is the development of Bayt al Mal, which acted as the central bank and played a significant role in supporting poor people, particularly the Muslims (Mohammad et al., 2013). Chachi (2005) records that Muslims built a financial system that did not involve interest and rather work on profit and loss sharing models during this era. An example of one of such models is the contract of Mudarabah between Prophet and His wife Khadijah (Iqbal and Mirakhor, 2011). Also, benevolent loans were very common in those days (Nazirwan, 2010). Later, the boom in trade prompted increased use of other financial tools for example, cheques, bills of exchange, and so forth, to adapt to these business advancements (Shahar et al., 2017). However, Islamic financial practices diminished gradually due to the weakening of the Islamic empire and were replaced by the Western monetary model in the sixteenth century (Mohammad et al., 2013).

In the 20th century, Muslims began to realise that the existing financial system is interest-based and there ought to be an alternate framework that complies with Islamic laws (Syed Ali, 2015). The development in the theory and practice of Islamic banking can be categorised into three phases (Iqbal and Mirakhor, 1999). The first phase can be identified as the period from 1950 to 1975, in which the development of a conceptual framework was the main focus (Iqbal and Mirakhor, 1999). They argued that during this era, the efforts of Muslim scholars were focused on highlighting the issue of interest (Iqbal and Mirakhor, 1999). The second stage was from 1975 to 1990 which is regarded as the experimentation phase, and the third stage of implementation started in 1990 and continues to the present (Iqbal and Mirakhor, 1999).

In the late 1950s, the first attempt was made to develop an Islamic banking system in Pakistan to establish interest-free savings and loans societies (Wilson, 1983). The Muslim landowners deposited their money which was then lent to other proprietors for agriculture development. The bank did not charge any interest or penalty for late repayment except for a small processing fee to meet the bank expenses (Najaf and Najaf, 2016). Among the early practices of Islamic banking was the foundation of a local saving bank named “Mit Ghamr” (on profit and loss sharing basis) in Egypt in 1963 (Visser, 2013). Although the bank was well-received among farmers and rural communities, it was soon merged with state-owned conventional banks for political reasons (Visser, 2013). Later in 1971, Nasser Social Bank was founded in Egypt as an interest-free bank without referring to Sharia-compliant bank in its charter (Kamal et al., 2008). Next, in 1972, a special committee was formed by Islamic nations for establishing an Islamic bank together, and in 1975, Islamic Development Bank (IDB) was founded (Ariff, 1988). At that time, it was the only international Islamic financial institution built to bring the economic and social advancement of Islamic nations while conforming to all Islamic law principles (Ariff, 1988).

Following the initial success of Islamic financial institutions, various Islamic banks were initially established[6] in Islamic countries to provide an alternative to conventional banking frameworks. The need for Islamic financial institutions as an ethical investment and a protection against excessive risk mechanism was soon recognised in non-Muslim countries (Venardos, 2010). In 1980, The International Islamic Bank of Investment and Development was built in Luxembourg. It is recognised as the first Sharia-compliant bank to be founded outside the Muslim world. In 1984, Iran switched to interest-free banking at the national level (Yasseri, 2002).

Murtuza (2000) relates the success of Islamic banking and finance to the desire of Muslims to invest and save their wealth in a way that conforms to their religious beliefs. Additionally, the success of Islamic finance can further be attributed to the availability of Islamic banking services at conventional banks through Islamic windows (Pollard and Samers, 2007). Given the global acceptance and rapid growth of Islamic finance and to obtain uniformity among the practices of Islamic financial institutions, it was important to develop regulatory bodies for such institutions. For instance, Accounting and Auditing for Islamic financial Institutions[7] (AAOIFI) and Islamic Finance Service Board[8] (IFSB). Most countries follow the standards and directives of these

[6] The Islamic Development Bank in Saudi Arabia (1975), The Dubai Islamic Bank (1975), The Faisal Islamic Bank in Egypt (1976), The Faisal Islamic Bank of the Sudan (1977), The Jordan Islamic Bank (1978), The Islamic Development Bank in Saudi Arabia (1975), The Jordan Financial and Investment Bank (1978), The Islamic Investment Company Ltd in The United Arab Emirates (1978) and Kuwait Finance House (1979), Source: (Venardos, 2005, p. 64).
[7] AAOIFI was established in 1990 in Algeria and then registered in the state of Bahrain in 1991. It has issued a total of 100 standards covering the areas Sharia, accounting, auditing, ethics, and governance for Islamic financial institution.
[8] IFSB was established in 2002, in Kuala Lumpur Malaysia. Its main aim is to ensure the soundness and stability of the Islamic financial services industry.

boards (Hassan and Lewis, 2007). Some key moments in the development of Islamic banks around the globe are summarised in table 3.2.

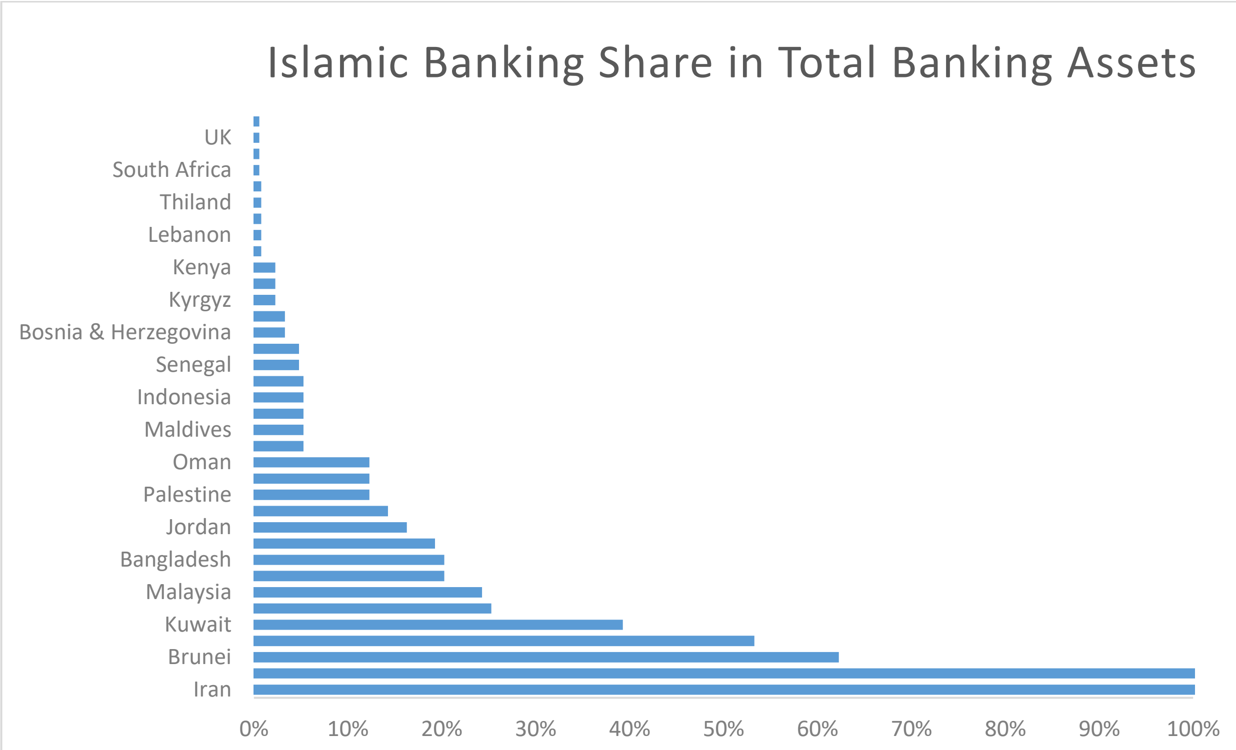
Table 3.2: Key Moments in the Development of Islamic Banks around the Globe

Year	Location	Milestone
1950	Pakistan	Interest-free savings and loans societies were established.
1963	Egypt	A saving bank named “Mit Ghamr” was established that worked on profit and loss sharing basis.
1971	Egypt	Nasser Social Bank was founded as an interest free bank.
1972	-	A special committee was formed by Islamic nations for establishing an Islamic bank together.
1975	Dubai	First commercial Islamic bank, Dubai Islamic Bank was founded.
1975	Saudi Arabia	Islamic Development Bank (IDB) was founded.
1979	Pakistan	Efforts were begun to “Islamize” banking practices at the state level.
1980	Luxembourg	The first Islamic bank, The International Islamic Bank of Investment and Development, was built in a non-Muslim state.
1984	Iran	Iran switched to interest-free banking at national level
1990	Algeria	Accounting and Auditing for Islamic financial Institutions (AAOIFI) was established.
2002	Malaysia	Islamic Finance Service Board (IFSB) was established.

Source: Author’s compilation

Today, Islamic finance is a $2.2 trillion industry spread over more than 70 countries with 505 Islamic banks, including 207 Islamic banking windows (Domat, 2018). Islamic banking has also reached in South America, following a conversation of a conventional bank into a Sharia-compliant bank in Suriname, making Islamic banking products available on all six habitable continents (IFSB, 2019). Over the last decade, the Islamic financial industry in many Jurisdictions has expanded with Iran and Sudan following Sharia law across the entire financial industry (IFSB, 2019). The following bar chart illustrates the share of Islamic banking compared to total banking assets in various countries in the year 2019.

Figure 3.3: Islamic Banking Share in Total Banking Assets



Source: Islamic Financial Industry Stability Report (IFSB, 2019)[9]

3.3.2 Institutional Aspects of Islamic Banks

3.3.2.1 Sharia Supervisory Boards

The distinctive feature of Islamic banks is the presence of Sharia supervisory boards to ensure the credibility of sharia-compliance and a board of directors. The AAOIFI indicates that a sharia board can be characterised as an independent body of specialised jurists in Islamic commercial jurisprudence[10]. According to the AAOIFI standards, there should be at least three members in a Sharia board[11] and Warde (2000) identifies that in most of the cases, their number varies between there to nine. These Sharia boards comprise Sharia advisors who reinforce the entity's credibility in the eyes of its customers by acting as an internal control body. According to Hassan and Chaowdhury (2004) the Sharia board plays a multi-dimensional role between the bank and its

[9] Available at: https://www.ifsb.org/sec03.php#REPORTS

[10] Accounting, Auditing and Governance Standards for Islamic Financial Institutions, (Sharia standard 1424-5H/2003-*4, page. 5*) Available at : https://aaoifi.com/standard/accounting-standards/?lang=en

[11] Accounting, Auditing and Governance Standards for Islamic Financial Institutions, (Sharia standard 1424-5H/2003-*4, page. 6*) Available at : https://aaoifi.com/standard/accounting-standards/?lang=en

customers, depositors, shareholders and management. They are entrusted to examine, analyse and follow up Islamic banks’ operations to ensure compliance with guidelines and standards of Sharia.

Furthermore, they are also responsible for the validity of the implemented transactions and finding a legitimate alternative in case of any inconsistencies (Wardhany and Arshad, 2012). In addition to having a command over sharia law, ideally, the Sharia board members are expected to understand the issues relating to other legal and economic frameworks (Sorour and Ken, 2014). However, the number of advisors with expertise in both sharia law and other related disciplines is still low (Shafii and Hanefah, 2013).

3.3.2.2 Forms of Islamic Banks

According to Kamaruddin et al. (2008) there is no standard method for classifying Islamic banks; however, in terms of services provided, they can be categorised into two general classifications: full-fledged Islamic banks and Islamic windows.

3.3.2.2.1 Full-Fledged Islamic Banks

These are standalone entities that are not under the influence of any conventional banking activities. They have a similar organizational set-up as their conventional counterparts. However, they follow sharia principles and deal only in Islamic products. In terms of ownership structure, fully-fledged Islamic banks can be international banks, joint-venture banks, publicly owned banks or state-owned banks (Mejia et al., 2014). They may offer products and services which are harmonious with other products in the market. However, it is not an obligation. It is argued that there is room for innovation and experimentation of new structures in full-fledged Islamic banks. They can offer new products in the market subject to the approval of Sharia Board (Mejia et al., 2014).

3.3.2.2.2 Islamic Windows

Islamic Window refers to a part of a conventional financial institution that is not a separate legal entity, but a separate Sharia-compliant unit dedicated to Islamic financial services (Al-Ajmi et al., 2009). Oladimeji et al., (2016) regarded Islamic windows as "bank within a bank". Certain conditions must be satisfied while establishing Islamic windows within the conventional banks. For instance, the activities of the Islamic window must be supervised by the sharia supervisory board, and their fund must be segregated entirely i.e., separate accounts, books and computer programs for these services (Jamaldeen, 2012).

3.3.3 Distinctive Features of Islamic Banking

Islamic banks operate like conventional banks and perform all the functions required to run the economy smoothly. They are, however, not just a copy of conventional banks and function on different logics since all their activities must comply with sharia laws. It can be said that Islamic banks are different from conventional banks because they do not charge interest, yet it is only the tip of the iceberg. The fundamental purpose of establishing an Islamic bank is to promote and encourage principles of Islamic economics (Rosly, 2008). The conventional financial framework centres on the economic aspects of transactions and focuses on profit maximization, while the philosophical foundation of the Islamic financial framework goes beyond that. To promote equality and fairness for the benefit of society, Islamic finance gives significant attention to ethical, moral and social aspects as well. Based on these considerations, the distinctive features of Islamic banking can be identified as follows.

3.3.3.1 Money as a Measure of Value Only

Among the major differences between the Islamic and the conventional financial systems is their perception of money. In a conventional financial system, money is more like a commodity of trade and, in that capacity, can be purchased, sold and speculated (Ahmad and Hassan, 2006). On the contrary, according to the Islamic financial system, money cannot directly fulfil human needs as it is considered to have zero intrinsic value. It is a unit of measurement and a store of value but not a commodity (Ahmad and Hassan, 2006). In an Islamic financial system, money cannot be used to make more money on it in the form of fixed interest payment simply by being put in a bank or lent to someone. It must be converted into a real asset to earn a profit on it (Nurrachmi et al., 2012). Islamic scholars reckon money as capital only when it is used to finance a business activity. Furthermore, money induced to a venture in the form of a loan is considered a business debt and not capital since it does not bear any share in the risk associated with that venture (Nurrachmi et al., 2012).

3.3.3.2 Avoiding Interest

Islamic banks are not allowed into any activity that involves interest as they must comply with Islamic laws, and interest in strictly prohibited in Islam. Weber (1975) identifies interest as one of the major contributors to inflation. Interest can be viewed as an unjustified increase in money, which leads to exploitation and is, therefore, against the principles of Islam (Hassan et al., 2013). Interest is assumed to play a negative role in the economy by encouraging speculation, fuelling inflation and squeezing out productive investment. The productive investment is withheld when a business cannot yield a profit that is at least equivalent to the interest rate prevailing in the market (Maududi, 1984). The principal means of Islamic banks are based on trading, and the bank will trade in Sharia-compliant investments with the customers' money while sharing both the profit and risk with them. In other words, Islamic banks use equity participation systems in the absence of interest.

3.3.3.3 Alternative Financial Products

Islamic banks have various products with which to conduct business in the absence of interest. Among these include Mudarabah, Musharakah, Murabaha, Salam, Ijarah and Istisna (Ahmed, 2011). These products are discussed in detail in section 3.4.

3.3.3.4 Entitlement to Profit with Risk and Responsibility

The probability of an unfavourable outcome is an indispensable feature of any business activity. One of the core principles in Islamic financial transactions is sharing the fundamental business risk and responsibility between the providers and users of funds. In the conventional financial frameworks, all the risks are borne by the borrower and the provider of funds is entitled to a predetermined return (interest) (Agha and Sabirzyanov, 2015). The provider of capital is remunerated regardless of whether the borrower made a profit or incurred a loss (Kettell, 2010; Johnes et al., 2014). On the other hand, in Islamic financial contracts, profit is only legitimate if it is earned by bearing proportionate risk and should not be generated from risk-free contracts (Kettell, 2010).

3.3.4 Barriers to the Growth of Islamic Banking

Although Islamic banks have made significant achievements over the previous decades, some prominent issues still require consideration to reinforce their market position comparative with their conventional counterparts.

3.3.4.1 Reliance on Debt-Based Products

Theoretically, the distinguishing feature between Islamic banks and conventional banks is the substitution of interest with profit and loss sharing models (Dar and Presley, 2000). However, in practice, only a small proportion of Islamic banks' activities is based on profit and loss sharing (Nienhaus, 1986; Dar and Presley, 2000). Dusuki and Abozaid (2007) note that activities of Islamic banks which are entirely on profit and loss sharing basis, constitute less than 5% of their operations. Kuran (2004) asserts that over the past few years, use of profit and loss sharing based products such as Musharakah and Mudarabah have diminished, whereas debt-based financing dominates Islamic banks 'operations. According to Iqbal and Mirakhor (2002), Murabahah and Ijarah (debt-based products) constitute 80% of Islamic banks' asset portfolios. Thus, Islamic banks cannot claim superiority over conventional banks (Rosly and Baker, 2003). Nienhaus (1986) attributes this to the mixed nature of most modern economies and the need to survive in the dual banking system. He further adds that Islamic banks face two main problems while applying profit and loss sharing models. Firstly, these models rely on a rough guide of potential income since they do not provide information about the earnings of the institution in advance (Nienhaus, 1986). Secondly, profit and loss sharing products involve high risk since the return is not fixed, unlike debt-based financing (Nienhaus, 1986). In addition to this, some Islamic banks do not use profit and loss sharing techniques due to their insufficiency to recognise 'good' and 'bad' investments (Kuran, 2004).

3.3.4.2 The Regulatory Environment

While the theoretical foundations of Islamic banking appear attainable, its implementation confronts several challenges. One of the most significant challenges is the absence of an agreed regulatory framework for Islamic banking (Zaher and Hasaan, 2001). The absence of administrative foundations creates obstacles in developing uniform standards and policies (Zaher and Hasaan, 2001). Usmani (2002) asserts that Islamic banks have restricted their profit and loss sharing models and instead turned to a camouflaged interest in the absence of standardisation. Furthermore, in the absence of a theoretical paradigm that complies with Sharia law, Islamic banks in non-Islamic countries must embrace Western-orientated models. A few institutions such as AAOIFI, IFSB and IIFM have been established to support Islamic banking. However, the guidelines provided by these institutions are encouraged to follow but are not mandatory (Hassan and Lewis, 2007) except in Bahrain, Qatar, Oman, Sudan and Syria (Al-Sulaiti, 2018). Iqbal and Mirakhor (1999) highlight that for the growth of the Islamic banking sector, there is a strong need for supervisory and regulatory establishments that address standardisation and monitor Islamic banks' worldwide.

3.3.4.3 Inconsistency of Sharia Interpretations

In the absence of standardisation, Islamic banks rely on the advice of their own Sharia Boards (Zaher and Hasaan, 2001). The religious standards applied in Islamic countries lack consistency (Zaher and Hasaan, 2001). Thus, the opinion of Sharia boards about approving products and policies could vary, reflecting the different schools of Islamic thoughts (Iqbal and Mirakhor, 1999). The differences in interpretation may imply that the product or service acknowledged by one board could be rejected by the other. This is because there is no central authority promulgating Sharia law, and the comprehension of what is permissible and what is not differs among Sharia scholars and jurisdictions.

Furthermore, the success of Islamic financial products is subject to the credibility of Sharia scholars (Kahf, 2004), and conventional banks offering Islamic products also attempt to achieve credibility by hiring top-positioning and well-known Sharia advisors (Matthews, 2005). However, the selection and appointment criteria for Sharia board members vary among countries (Wilson, 2010). This could bring further religious inconsistencies in Sharia approved products in different countries.

3.3.4.4 Products Innovation and Development

Islamic banks are required to develop products that accomplish the objectives of Sharia while meeting the economic needs of society simultaneously. Ainley et al. (2007) claim that Islamic banks lack skilled staff that can develop innovative Sharia-compliant products. The Islamic banking sector needs to centralise attention to developing products that promote market integration and attract investors and entrepreneurs to their risk-return attributes instead of focusing only on its Sharia compliance. In addition to providing education and training, this development requires forming a council of Islam and banking scholars with international exposure to harmonies rules and subsequently limiting any confusion and contradiction about new products (Ainley et al., 2007).

3.3.4.5 Accounting and Reporting Practices

The nature and treatment of Islamic financial products differ from those offered by conventional banks. Thus, the accounting procedures followed by conventional banks do not fully address Islamic banks' accounting and reporting requirements (Zaher and Hasaan, 2001). The problem for most Islamic financial products is that their accounting treatment, unlike their conventional counterparts, can often diverge from the actual economic substance of a transaction. This situation calls for the standardisation of accounting and auditing procedures and the development of well-defined reporting frameworks consistent with Sharia laws (Iqbal, 1997).

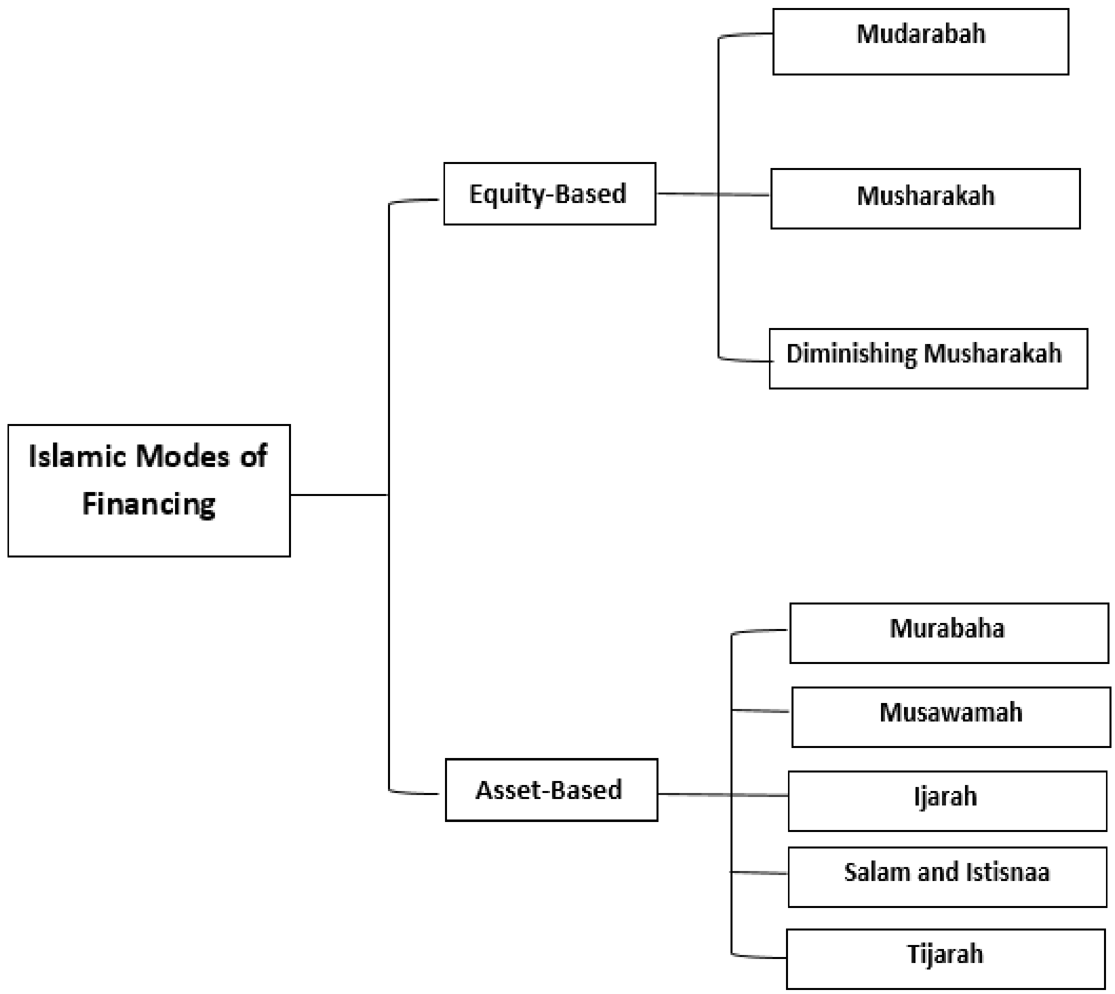
3.3.4.6 Consumers' Level of Knowledge about Islamic Banks

Another factor that hinders the development of Islamic banking includes consumers' knowledge about Islamic financial products and the procedures involved in accessing them (Mariadas and Murthy, 2017). Khalaf (2007) argues that most Muslim customers lack awareness about the products and services offered by Islamic banks. Moreover, the level of knowledge about Islamic banking products is further limited in case of non-Muslim corporate customers (Ahmad and Haron, 2002). The utilisation of Arabic language terminology for Islamic financial products appeared to be hard for non-Arabic customers to comprehend (Bley and Kuehn, 2004). Imparting knowledge about Islamic banking, particularly among non-Muslims, is vital since Islamic banks need to compete with their conventional counterparts that have long and stable existence in the dual banking framework.

3.4 Islamic Financial Products

Fundamental principles of Sharia structure Islamic financial products. These financial products are classified into two groups: equity-based financial products and asset-based financial products. Figure 3.4 illustrates these two Islamic modes of financing. The equity-based financial products work on profit and loss sharing principle whereas, asset-based financial products are based on mark-up (Abdul Aziz and Gintzburger, 2009).

Figure 3.4: Islamic Modes of Financing



Source: The International Shari'ah Research Academy for Islamic Finance.

3.4.1 Equity-Based Financing

Three types of equity-based financing are commonly used for SMEs: Mudarabah, Musharakah and Diminishing Musharakah.

3.4.1.1 Mudarabah

Mudarabah is an old type of financing arrangement commonly practised in the Arabian Peninsula long before the advent of Islam. One of the examples of the use of Mudarabah in the early Muslim era is the contract between Prophet Muhammad and His wife Khadijah (Iqbal and Mirakhor, 2011). Accounting and Auditing Organization for Islamic Financial Institution (2014) defines Mudarabah as an agreement wherein two parties are involved to establish a project; one is the owner of capital (*rab-ul-Maal*) who provides finance to the other and assumes no additional role in the venture, and the other is the entrepreneur (*mudarib*) who contributes knowledge, skills, experience and efforts and acts as a trustee or a business agent. Mudarabah is a silent partnership (Zuḥaylī and Eissa, 2007) where *mudarib* is presumed to employ the capital with prudence to generate optimal profits while adhering to the Sharia principles. Profits from the venture are distributed between both the partners in a pre-decided proportion. In the event of loss, the owner of capital bears all the monetary loss, and the entrepreneur bears fruitless efforts (Shaikh, 2011). However, if the loss is caused by negligence or breach of the contract terms by the entrepreneur, he becomes liable for the amount of capital (Usmani, 2002).

Mudarabah can be restricted, where the provider of capital indicates a specific business in which the capital is to be employed, or unrestricted, where the provider of capital allows the other partner to invest in any business as per his discretion (Iqbal and Mirakhor, 1987). Sabri and Jalil (2007) suggest that restricted Mudarabah is a more appropriate way of financing SMEs since the bank can safeguard their capital in the business by specifying the terms and conditions of using it. However, due to high-risk considerations, Islamic banks around the globe are reluctant to provide Mudarabah financing (Joint, 2015). In Pakistan, Islamic banks are not offering Mudarabah financing for SMEs (SBP 2019a).

3.4.1.2 Musharakah

Musharakah is an Arabic term which means sharing. It is a contract in which two or more parties share capital to undertake a business project and divide profit and loss among them (Nawawi, 2009; Iqbal and Molyneux, 2005). Partners can share profits in any pre-determined ratio, which may not necessarily be symmetric to their capital contributions however, losses must be borne in the proportion of their capital contributions (Al-Harran, 2003). In Musharakah contracts, every partner is entitled to participate in the management of business. However, the partners may, with consensus, agree on managing the business by one of them and the other partner(s) acts only as a sleeping partner (Al-Harran, 2003). In the context of Islamic banking, Musharakah can be characterised as a joint venture between the bank and an individual or organization. Although both Mudarabah and Musharakah are equity-based financial products, they differ from each other. In a Mudarabah contract, losses are solely borne by the provider of the funds (except for those caused by negligence or misconduct of the borrower). The user of the funds is solely responsible for running the business. Whereas, in case of a Musharakah contract, profits and losses are shared by both the provider and the user of funds and they both are entitled to take active part in the management of the business.

Musharakah is a financial tool for promoting justice which is the primary vision of the Islamic economic system (Usmani, 1998). This is because of the two characteristics of Musharakah contracts; profit-sharing instead of fixed interest payment and risk-sharing so that the borrower or the financer does not solely bear risk. Furthermore, it also promotes equitable distribution of financing as such contracts are not confined to the individuals who can provide collateral. Therefore, theoretically Musharakah can be an ideal product for financing SMEs since it allows risk-sharing and is not associated with high interest cost and collateral requirements (Farid and Madehah, 2007; Promwichit et al., 2013; Saad and Razak, 2013) which most of the SMEs are unable to furnish. In Pakistan Musharakah constitutes 20% of Islamic banks' financing portfolio, making it the second most used mode of financing (SBP, 2019a).

3.4.1.3 Diminishing Musharakah

Diminishing Musharakah is a particular type of Musharakah, which is based on decreasing partnership concept. One of the parties undertakes to purchase the other party's shares over the specified period of time (Siswantoro and Qoyyimah, 2007). In case of a Diminishing Musharakah contract, the Islamic bank participates as a financial partner but does not intend to stay in the partnership until the dissolution of the company (Dinc, 2017). It instead withdraws its share from equity every year and earns profit/loss based on its remaining share capital in the project. Eventually, the other party becomes the full owner. In this way bank's share of profit will decrease with the decrease in the bank's share of equity, whereas the borrower's share of profit and share of equity will increase. Dinc (2017) identifies Diminishing Musharakah as an Islamic banks' innovation that differs from the classic model of Musharakah in continuity only. Similar to a Musharakah agreement, profits can be distributed in any pre-agreed ratio whereas, losses must be borne in accordance with the share of capital at that time.

Contemporary researchers reckon Diminishing Musharakah as an effective tool for financing SMEs (Sanusi, 2006; Sadique, 2008). SMEs which do not have adequate resources to meet the strict collateral requirements could benefit from this mode of financing. When compared with the classical model of Musharakah, Diminishing Musharakah has some advantages. For instance, in Musharakah contracts, share of bank in the capital is perpetual and may be taken back all in once at the end of the contract. Whereas, in Diminishing Musharakah, bank's investment is gradually withdrawn until the SME becomes the sole owner of the business therefore, at least a certain part of capital is received back in case of any possible risk (Boualem and Khan, 1996). Moreover, in case of Musharakah the principal amount of bank's investment is fixed until the maturity of the contract which limits the bank's ability to invest in multiple projects at a time. Whereas, in case of Diminishing Msuharakah, bank gradually receives back its share in the equity and can reinvest those funds in other ventures at the same time (Boualem and Khan, 1996). This could help the bank to bring more and more SMEs into its financing network. Among the equity-based modes of financing, Diminishing Msuharakah is the most commonly used product by Islamic banks around the world (Joint, 2015) and in Pakistan 33.6% of Islamic bank financing is through Diminishing Musharakah contracts (SBP, 2019a).

3.4.2 Asset-Based Financing

Due to the agency problem, bank considered asset-based financing as less risky and hence more favourable mode of financing SMEs (Aggarwal and Yousef, 2000). Five types of asset-based financing products are commonly offered by Islamic banks: Murabaha, Musawamah Ijarah, Salam and Istisna and Tijarah.

3.4.2.1 Murabaha

A Murabaha contract is generally used by the entrepreneurs as a mode of trading merchandise. Even though it is an asset-based mode of financing, Murabaha is an extensively used financing product by Islamic banks. This is due to the fact that it is simple to implement, uses same assessment criteria as conventional financing and mimic the revenue and risk elements of conventional credit (Haron, 1995). In Murabaha financing, the bank purchases the asset requested by the client, and then re-sells it to the client at the predetermined price which comprises of the cost of asset plus mark up. This mode of financing is preferred by banks since it bears the risk only until the asset is handed over to the client (Nafar and Amini, 2017). Ali (2011) asserts that in the Middle East and North Africa (MENA) region the proportion of Murabaha to total Islamic financing is about 75% and according to the SBP (2019a) the proportion of Murabaha financing to total Islamic financing in Pakistan is about 13.5%.

From the bank's perspective, Murabaha is considered to be the most appropriate mode of financing SMEs since it is based on collateral-by- contract (ownership of the asset remains with the bank till the end of the contract) and does not bear the risk of adverse selection due to innate information asymmetry in SMEs financing (Shaban et al., 2014). On the other hand, from the SMEs point of view, Murabaha is believed to fill the Sharia consciousness gap but does not make any significant contribution to reducing the funding gaps of SMEs (Joint, 2015).

3.4.2.2 Musawamah

Musawamah, includes a transaction in which the selling price of a product is the result of negotiation between the seller and the buyer, where the buyer is unaware of the actual cost of the good (Usmani, 2002; Kahf, 2013). It is a trading arrangement similar to Murabaha financing. However, it differs from Murabaha in respect of the pricing formula. In a Musawamah contract, the buyer is unaware of the actual cost as the seller is not obliged to reveal the price they paid to make or acquire them (Usmani, 2002). Whereas, in Murabaha financing, the seller is obliged to make the buyer aware of the cost incurred for making or acquiring the item (Usmani, 2002). All other conditions relevant to Murabaha are valid for Musawamah as well. This form of a transaction can only be utilised where the seller is not able to precisely ascertain the costs of commodities that he is offering to sell and not to gain excess profit (Usmani, 2002).

3.4.2.3 Ijarah

The term Ijarah is derived from the Arabic word 'al-Ajr' which signifies compensation or return against the use of an object. In simple words it means "to give something on rent" (Jamaldeen, 2012). Ijarah provides a Sharia-compliant alternative to conventional lease contracts. This agreement incorporates the transfer of the right to use the good to the hirer but does not transfer the ownership of property (Al-Zuhayli, 2002). In the context of Ijarah financing by Islamic banks, the client specifies the asset he needs, the bank then buys the asset and rents it to the client for a specified period (Karim, 2007). In conformity with the Sharia, the bank must own the asset to be leased, transfer the asset to the client, receive periodic rentals and exercise all the rights of ownership (Usmani, 1998). Since the ownership lies with the bank, the bank is responsible for maintaining, insuring and repairing the asset. Risk and rewards of ownership also remain with the bank, which means that the bank should bear any loss to the asset beyond the client's control. At the other end, the lessee acquires the right to use the asset in exchange for periodic rentals and in the event of a failure to pay the lease rental on time, he cannot be charged any late payment penalty. (Usmani, 1998). The lessee may agree to take responsibility for maintenance, insurance and repairs in exchange of a reduction in rent (Usmani, 1998).

Islamic banks broadly use Ijarah to fund SMEs with the purpose of enabling them to obtain production equipment such as plant and machinery (Mohieldin et al., 2012). It is a desirable mode of financing for Islamic banks as assets under Ijarah financing are marketable and maintain their market value fairly above the book value. This provides bank some protection against default risk as, being the owner, it may sell the asset or lease it to another business in case of the failure of the project. It is desirable from the perspective of SMEs as well since it considers their ability to generate cash flows rather than providing collaterals and credit history (Dalimunthe et al., 2019). According to (Joint, 2015) Ijarah is the second most broadly used financing product by Islamic banks around the globe. However, in Pakistan only 6.1% percentage of Islamic banks' financing portfolio is comprised of Ijarah financing (SBP, 2019a).

3.4.2.4 Salam and Istisna

Usmani (1998) defines Salam as a contract of sale whereby the seller agrees to supply a particular commodity to the buyer at a future date and receives full price in advance. It is a type of forward deal contract which is an exemption to the general rule of sale since the seller is permitted to sell on a forward premise, where the subject matter does not exist at the time of the contract (Haron and Ibrahim, 2016). The Holy Prophet permitted farmers to sell their uncultivated crops forward (International Trade Centre, 2009). However, Abdul-Khaliq (2014) conclude that Salam is not a commonly used mode of financing except in Sudan. In Pakistan, only 2.6% of Islamic banks' financing is through Salam (SBP, 2019a).

The word Istisna is derived from the Arabic term Sanaa, which implies making, producing, or developing something (Muhammad and Chong, 2007). Istisna is an agreement between two parties to produce or construct something as indicated by specific criteria for the cost determined in the agreement along with the instalment dates (Karim, 2007). Istisna contracts are employed for long term financing such as a large construction project of property and machinery (Malde, 2013). In Islamic banking, customers request their bank to facilitate an agreement of production for goods they need, and the bank contract with a third party (the producer) to produce and deliver the good according to the given description (Al-Bashir and Al-Amine, 2001).

3.4.2.5 Tijarah

Tijarah is an Islamic mode of providing Sharia-compliant working capital financing solutions. Tijarah would facilitate the customers in both the trading and manufacturing concerns who sell finished goods on a credit basis (Mirakhor, 2010). This financing mode can be used to provide a financing facility where finished goods are ready for sale. It allows the customers to sell the stock of their finished goods and meet their working capital requirements while enjoying the benefits of cash sales (Mirakhor, 2010). For instance, SMEs that generally sell their products on a credit basis have a stock of finished goods. However, during this credit period, they will be short of funds, which will impact their working capital. In such a case, the SME can approach the bank for a financing facility based on Tijarah. The underlying Islamic mode of Tijarah financing is agency and sale (Usmani, 2002). It is like an ordinary sale and purchase transaction where a seller (the customer) sells goods to a buyer (bank) on a cash basis. Under this concept, the bank first purchases goods from the customer on a cash basis and then the customer is appointed as the bank's agent to sell the same goods to a third party in the market on a credit basis.

The summary of Islamic financial products discussed in this section is presented in table 3.3.

Table 3.3: Islamic Financial Products

Type of Product	Name of Product	Definition	Benefits for SMEs
Equity Based	Mudarabah	An agreement wherein two parties establish a project; one contributes the capital (*rab-ul-Maal*) and the other (*mudarib*) contributes knowledge, skills, experience and efforts.	• Capital contribution is not required. • Profit sharing only. • Long-term financing.
	Musharakah	A partnership agreement in which two or more parties share capital to undertake a business project and divide profit and loss among them.	• Risk sharing. • Possibility to receive a percentage of profits higher than their share of capital. • Long-term financing.
	Diminishing Musharakah	A special type of Musharakah, in which one of the parties undertakes to purchase the shares of the other party over the specified period of time.	• Profit and loss sharing. • Not giving up equity for a long-term. • No dilution of power as the founder of the business.
Asset Based	Murabaha	In Murabaha financing, the bank purchases the asset requested by the client, and then re-sells it to the client at the predetermined price which comprises of the cost of asset plus mark up.	• Fixed financing rate during the term. • Knowledge about the actual cost and mark-up. • No collateral requirements.
	Musawamah	In Musawamah financing, the bank purchases the asset requested by the client, and then re-sells it to the client at the negotiated price which comprises of the cost of asset plus mark up. The buyer is not aware of the actual price of the asset.	• Ease of application. • Fixed financing rate during the term. • No collateral requirements.
	Ijarah	A contract between two parties, where the owner transfers the possession of a particular asset to the hirer who has the right to use that asset in exchange of agreed rent for a specific period.	• Ease of application. • No collateral requirements. • Medium and long-term financing.

	Salam and Istisna	These are advance contracts to manufacture and deliver specified goods in future.	• Provide working capital. • Beneficial for agricultural import and export. • Fulfil short-term financing needs.
	Tijarah	The bank first purchases goods from the customer on the cash basis and then the customer is appointed as the bank's agent to sell the same goods to a third party in the market on credit basis.	• Ease of application. • No collateral requirements. • Meets liquidity requirements of the customers.

Source: Author's Compilation

3.5 Relevance of Islamic Banking Finance for SMEs

Access to finance by SMEs is a significant condition to eliminate obstacles to their growth (El-Said, 2013). Alper and Hommes (2013) assert that around 75% of SMEs rely on internal funding sources. About 55% of SMEs do not have access to external financing facilities despite their severe need for it. Banks are expected to be one of the major external sources of financing SMEs (Zhao and Jones-Evans, 2016). However, banks view SMEs as a risky proposition. Therefore, they are reluctant to provide finance to SMEs because of their inability to provide acceptable collateral and bear relatively higher interest cost (Owen et al., 2016). It is therefore, suggested that Islamic banking finance is a viable alternative source to meet the needs of SMEs since it works on profit and loss sharing basis instead of charging fixed interest (Kammer et al., 2015; Elasrag, 2016).

Economic and social development is the basic pillar of Islamic economics' philosophy. One of the important aspects of such development is financial inclusion by serving the underprivileged sectors of society. In terms of access to finance, SMEs are at a disadvantage as compared to large corporations. Here, Islamic banks can address financial inclusion by promoting Islamic financial products as an alternative to conventional financing. According to Pearce (2011), Islamic banks can address financial inclusion to build a healthy and vibrant economy through their risk-sharing features that is well-suited for SMEs. Islamic banks can, therefore, play a vital part in bridging the funding gap of the SMEs sector through their asset-based and equity-based financing contracts (Joint, 2015). The asset-based financing assures ease of access, flexibility and greater affordability by providing indemnity against the financial fluctuations that many SMEs suffer from (Joint, 2015). Equity-based financing practices profit and loss sharing between banks and SMEs, fostering entrepreneurship through risk-sharing (Joint, 2015). The significance of risk-sharing characteristics of Islamic finance for SMEs from the perspective of economic development is well recognised by various policy makers. For instance, the Organization of Islamic Cooperation (OIC) has characterised SMEs as its principle focus to develop appropriate policies to converge Islamic finance and SMEs sector (Rasheed et al., 2019).

Profit and loss sharing based financing is just and fair since risk and rewards are shared between the provider and borrower of funds, unlike interest-based financing where the borrower has a fixed burden regardless of making a profit or bearing loss (Aggrawal and Yousef, 2000). According to

Beck et al. (2006), lack of audited information results in high collateral demanded by banks and SMEs inability to provide sufficient collateral gives rise to a finance gap. Menkhoff et al. (2006) maintain that collateral requirements are crucial for SMEs compared to large corporations because they lack physical assets to pledge. Since Islamic finance works on a profit and loss sharing basis, any collateral demanded by Islamic banks is against possible fraud or repayment-evasion, and not the risk of losses (Awad, 1994). Furthermore, the profit and loss sharing system promote capital allocation efficiency by investing funds in productive projects, unlike interest-based financing, which prioritises the borrower's creditworthiness (Hasan, 2005). Therefore, Islamic modes of financing are more appropriate for meeting the needs of SMEs.

Having identified the potential of Islamic modes of financing in promoting SMEs' access to finance, this area is receiving the utmost attention from researchers. Many studies have been conducted focusing on integrating these two sectors of the economy. Some of the prior studies in this regard are summarised in the table 3.4.

Table 3.4: Prior Studies on Financing SMEs through Islamic Banks

Study	Name of Author(s)	Year	Country	Main Findings
Financing economic development in Islamic economics: Attitude towards Islamic finance in small manufacturing businesses in Saudi Arabia.	John Presley	1996	Saudi Arabia	The perceived benefit of Islamic modes of financing for small firms lies in the non-existence of high borrowing cost which is one of the main features of capital markets in developing economies.
Islamic banks and investment financing.	Rajesh K. Aggarwal and Tarik Yousef	2000	-	Islamic banks do not comply with the principle of profit and loss sharing rather most of the financing is based on debt-based contracts.
Islamic Microfinance: A missing component in Islamic banking.	Abdul Rahman and Abdul Rahim	2007	Malaysia	Although the elements of microfinance are consistent with the objectives of Islamic finance, Islamic microfinance is contended as a missing part in Islamic banking.
Islamic micro-finance practice with a particular reference to financing entrepreneurs through equity participation contracts in Sudanese banks. Islamic finance for micro and medium enterprises.	Gaffar A. Ahmed	2008	Sudan	Using group lending concept in financing Musharakah to SMEs can serve as a security against default and reduce the administrative burden on the bank staff.
Libyan business firm attitudes towards Islamic methods of finance.	Alsadek Gait and Andrew C. Worthington	2009	Libya	Religious motives are the primary drivers for the demand of Islamic finance. However, most of the Libyan firms do not have adequate knowledge about the Islamic financial instruments.
Role of Islamic modes of financing for growth of SMEs a case study of Islamabad city.	Nazima Ellahi, Tayyab A. Bukhari and Mehwish Naeem	2010	Pakistan	SMEs prefer Islamic modes of financing because they are interest free and believe that application of these modes results in increasing their earnings.
Determinants of awareness on Islamic financial institution e-banking among Malaysian SMEs.	Norudin Mansor, Noor Rohaya and Abdul Rahmat Abdul Manap	2012	Malaysia	Promotion, technology and service quality are three main variables that contribute towards the creation of awareness among the SMEs about e-banking services of Islamic financial institutions.

Sharia compliant “possibility for Italian SMEs”.	Paolo P. Biancone and Maha Radwan	2014	Italy	Islamic finance can provide a great opportunity to the SMEs since it promotes poverty alleviation and financing the microfinance activities.
Financing for Small and Medium Enterprises: The Role of Islamic Financial Institutions in Kuwait	Khaled Alhabashi	2015	Kuwait	Islamic financial instruments are more suitable than commercial instruments for financing SMEs, however, collateral is one of the main obstacles in accessing Islamic finance.
An evaluation of SMEs satisfaction toward Jordanian Islamic banks service quality.	Sana N. Maswadeh	2015	Jordan	SMEs are satisfied with Islamic banks’ operations in terms of their compliance, assurance, reliability, tangibility, empathy, and responsiveness.
Enhancing active participation of SMEs and Islamic banks towards economic diversification in Oman.	Jamal A. Majmani and Fuadah B. Johari	2015	Oman	The government is keen to expand cooperation among Islamic financial institutions and SMEs since it is expected to help in achieving diversification of the national economy.
Owner/Managers’ External Financing Used and Preference towards Islamic Banking.	Khalid H. Abdesamed and Kalsom A. Wahab	2015	Libya	SMEs using conventional finance have less inclination for Islamic finance than those using informal finance.
Is small the new big? Islamic banking for SMEs in Turkey.	Ahmet F. Aysan, Mustafa Disli, Adam Ng and Huseyin Ozturk	2016	Turkey	Islamic banks in Turkey are more willing to provide finance to SMEs as compared to conventional banks.
Islamic banking and empowerment of small medium enterprise.	Femei Purnamasari and Arif Darmawan	2017	Indonesia	The number of SMEs using Islamic modes of finance has been increased significantly.
Influence of Awareness on SME’s Intention towards adoption of Islamic Finance in Pakistan.	Rabia Rasheed, Sulaman H. Siddiqui and Maria A. Rahman	2018	Pakistan	Due to the financial illiteracy of SME owner/managers, they find it difficult to identify the appropriate financial product to suit their business financial needs.

Source: Author’s Compilation

3.6 Concluding Remarks

This chapter reviewed the relevant literature on Islamic finance. It introduced the basics of Islamic economic system, the history and evolution of Islamic banking, main differences between Islamic and conventional banks and barriers to the growth of Islamic banks. It also provided a description of Islamic financial products and the relevance of Islamic finance for SMEs.

Given their significance, there is a wealth of literature exploring SMEs and their access to finance. For instance, Chaudhry (2000) discussed the Significance of SMEs in Pakistan in creating employment opportunities; Khalique et al. (2011) studied Challenges for Pakistani SMEs in a knowledge-based economy; Niethammer et al. (2007) explored the problems faced by women entrepreneurs while accessing finance in Pakistan; Dar et al., (2017) examined the financing gaps face by SMEs in Pakistan. Similarly, many studies are focusing on the Islamic banking sector in Pakistan. For instance, Hassan (2003) studied the efficiency of Islamic banks; Jaffar and Manarvi (2011) compared the performance of Islamic and conventional banks in Pakistan; Rashid and Jabeen (2016) explored performance determinants of Islamic banks; Ullah (2019) explained Islamic financial services. However, most of these studies explain differences between conventional and Islamic banks but SMEs' access to Islamic finance has not been extensively explored.

Although the research focusing on SMEs’ access to Islamic banking finance is limited, few attempts have been made to explore SMEs’ access to Islamic banking finance in the context of Pakistan. For instance, Ellahi et al. (2010) investigate the role of Islamic modes of financing for the growth of SMEs. However, their sample comprises SMEs located in one city (Islamabad) only while excluding SMEs from other parts of the country. Gillani et al. (2016) investigate the determinants of the promotion of SMEs in Pakistan through Islamic financial institutions. However, they only focus on SMEs in the halal food business (trading sector) and exclude SMEs in other sectors. The above-mentioned studies are limited in scope as they either focus on SMEs in a particular geographical area, sector or are conducted without an overarching theoretical framework. Moreover, these studies mainly concentrate on SMEs’ normative practices shaped by the economic perspective of the agency while ignoring the interactions between SMEs' context and agency to understand the micro-processes of Pakistani SMEs’ access to Islamic banking finance. This study will contribute to the knowledge in the domain of SMEs’ access to Islamic banking finance by filling this gap of literature.

This investigation aims to address the gap in the literature by exploring the perceptions and current practices of SMEs in accessing Islamic banking finance in Pakistan. The literature review (presented in chapters two and three) identifies several key issues that this study will investigate. Furthermore, based on the findings, it will also make recommendations to the SMEs, governments of Pakistan and Islamic banks management to increase SMEs' access to Islamic banks by evacuating the difficulties associated with it. The review of literature has established a detailed foundation for the empirical analysis.

Chapter Four: Research Context

4.1 Introduction

The main purpose of this chapter is to present the context in which the present research takes place. Given that this study aims to explore SMEs' access to Islamic banking finance in Pakistan, this chapter provides a comprehensive account that articulates the economy of Pakistan, characteristics of SMEs sector in Pakistan and the state of SMEs financing in Pakistan. It also highlights the development and current state and the regulatory environment for Islamic banks in Pakistan. The final section looks at the initiatives taken to support SMEs through Islamic banks.

4.2 Pakistan and its Economy: At a glance

Pakistan formally recognised as 'The Islamic Republic of Pakistan', is a democratic country which came into being in 1947 as an Islamic state. Stephens (1964, p. 30) reckons it as 'something very unusual' and 'an exceptional country' since the country was founded on religious philosophy. The country was established for Muslims to freely practice their religion in a separate state without any discrimination. At present, 97% of Pakistan's population[12] is the follower of Islam, making it the second-largest Muslim majority country (Zaman, 2018). The majority of Pakistani Muslims are the followers of the Hanafi School of Islamic thoughts[13] (Abbas et al., 2020). Muslims in Pakistan take guidance from religion in every matter of life, and Islam tends to have a significant impact in their daily life. The constitution of Pakistan also mirrors the doctrine of Islamic law[14].

The entire area of Pakistan covers 796,095 km^2. Geographically, Pakistan is located in the Southern part of Asia and wedged between Afghanistan, Iran, China, India and the Arabian Sea. Pakistan is a developing economy and has a high potential of being counted among the world's largest economies in the 21st century (Grant, 2011). The growing percentage of the working-age

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[12] According to the last census conducted in 2017, the total population in Pakistan was estimated at 207.7 million (Pakistan Bureau of Statistics, 2017): http://www.pbs.gov.pk/content/provisional-summary-results-6th-population-and-housing-census-2017-0

[13] There are four main school of thoughts in Islam: Hanafi, Maliki, Shafi'I and Hanbali. These four schools recognise each other's validity *and* follow the directions set in Quran and Sunnah.

[14] The constitution of Pakistan of 1973 announces Islam as a state religion. The constitution of Pakistan states: "Wherein the principles of democracy, freedom, equality, tolerance and social justice as enunciated by Islam shall be fully observed. Wherein the Muslims shall be enabled to order their lives in the individual and collective spheres in accordance with the teachings and requirements of Islam as set out in the Holy Quran and the Sunnah".

population[15] provides the country with a potential for substantial economic development. According to the World Bank Group's[16] (2018) flagship report[17], Pakistan's position is improved by 11 points in the ease of doing business index. The country has substantial natural resources, including the cultivated land and untapped market potential for trade. Pakistan's economy stands at 24th largest in terms of purchasing power parity and 42nd largest in terms of nominal Gross Domestic Product (GDP) (International Monetary Fund, 2019)[18]. Agricultural sector represents 22% of the total GDP, engaging almost half of the country's workforce (Ahmad and Ma, 2020). Other significant industries include textile, leather goods, sports goods, cement, fertilizer, steel, sugar and electrical products and handicrafts (Abbas and Waheed, 2017).

4.3 SME Sector in Pakistan

4.3.1 Definition of SMEs

A comprehensive, unified definition of SMEs is lacking in the literature (Ahmed and Chowdhury, 2009; Dar et al., 2017; Durst and Bruns, 2019). Every country has defined SMEs according to their own context and a business can be categorised as a small, medium or large enterprise based on number of employees, annual turnover, and total assets (Cunningham and Rowley, 2008). SMEs in Pakistan are no exception and there is no uniform definition of SMEs (Rana et al., 2003). For instance, Punjab small industries corporation's classification of an SME is based on fixed assets only, Federal Bureau of Statistics considers the number of employees only when defining SMEs. In contrast, Small and Medium Enterprise Development Authority (SMEDA) and the central bank, State Bank of Pakistan (SBP), provides a comprehensive definition of SMEs which encompasses the number of employees, total assets and annual turnover (Dar et al., 2017). Since this study is concerned with the financing of SMEs through Islamic banks, SBP's definition will be followed as the financial institutions fall under the central bank's jurisdiction. In its prudential regulations for SMEs financing, the State bank of Pakistan defines SMEs as "a business entity,

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[15] According to the National Human Development Report (NHDR) (2017), 64% of the total population of Pakistan is below the age of 30. Available at: http://hdr.undp.org/en/content/national-human-development-report-2017-pakistan

[16] The World Bank Group is a family of five international organisations that make leveraged loans to developing countries.

[17] This report is compiled by comparing business regulation for domestic firms in 190 economies. Available at: https://www.doingbusiness.org/content/dam/doingBusiness/media/Annual-Reports/English/DB2018-Full-Report.pdf

[18] Available at: https://www.doingbusiness.org/content/dam/doingBusiness/media/Annual-Reports/English/DB2018-Full-Report.pdf

ideally which is not being a public limited company, and having employees not more than 250 in case of manufacturing concern and 50 in case of trade/services concern, and also fulfils one of the following criteria: (i) Total assets at cost excluding land and buildings up to PKR[19] 50 Million in trade/service concern; (ii) Total assets at cost excluding land and building up to PKR 100 Million in manufacturing concern; (iii) Net sales not exceeding PKR 400 Million as per latest financial statements in any case"[20] (SBP, 2017a p.12). The details of definitions of SMEs by different institutions in Pakistan are presented in table 4.5 below.

Table 4.5: Definition of SMEs by Different Institutions in Pakistan

Institution in Pakistan	**Criteria**	
Federal Bureau of Statistics	Number of Employees	Less than 10
Punjab Small Industries Corporation	Fixed Assets (excluding land and building)	Up to PKR 20 million
Small and Medium Enterprise Development Authority (SMEDA)	Number of Employees	Up to 250
	Total Assets	Up to PKR 25 million
	Annual Turnover	Up to PKR 250 million
State Bank of Pakistan (SBP)	Number of Employees • Manufacturing • Trading/Service	Up to 250 Up to 50
	Total Assets (excluding land and building) • Manufacturing • Trading/Service	Up to PKR 100 million Up to PKR 50 million
	Annual Turnover	Up to PKR 400 million

Source: Author's compilation

4.3.2 The SMEs Landscape of Pakistan

After the creation of Pakistan, the country faced uncertainty in the business environment. Following two wars with India in 1965 and 1971, the fragile Pakistani economy was weakened further (Nishat and Saghir, 1991). Despite their economic significance, the economic policies of Pakistan in the 1950s and 1960s did not pay much attention to the SMEs sector (Haque, 2007). Following the nationalisation of the manufacturing sector, insurance companies, and banks in the late 1970s, the private sector began to receive its due attention. However, the focus was still on

[19] PKR is the official currency of Pakistan and, as on 27th Jan 2020, 1PKR= 0.0049 GBP
[20] Prudential Regulations for Small & Medium Enterprises Financing. Available at: http://www.sbp.org.pk/smefd/2017/SME-PRs-Updtd-Dec-2017.pdf

large-scale corporations. This outlook changed during the 1990s following the recognition of an internationally competitive SMEs division to facilitate the growth and sustainability of the national economy. The development of SMEs is now an integral part of the socio-economic policies of the Government of Pakistan (Shah, 2018). In order to accelerate the challenging task of developing SMEs sector in Pakistan, the government established two specialised institutions: Small and Medium Enterprise Development Authority (SMEDA) in 1998 and SME Bank in 2001. The responsibility for developing policies to create a feasible business context for SMEs lies with SMEDA which works under the Ministry of Industry and Production (Saleem, 2008). In addition to developing SME policies, it also provides business development services to SMEs. It has acknowledged the significance of the role of research in improving the business context and launched a journal of economic research specifically tailored to the dynamics of the SME sector in Pakistan.

In the present era, the notion of “big is beautiful” is no longer relevant (Ullah and Taylor, 2007) since 90% of modern economies are driven by SMEs (Wolff and Pett, 2006). In Pakistan, similar to other countries, SMEs are viewed as the backbone of the state economy. Kongolo (2010) identifies Pakistan’s economy as SME driven since it heavily depends on SMEs for reducing unemployment, increasing industrial productivity and boosting export earnings and thus creating a progressive economy. According to the Small and Medium Enterprise Development Authority (SMEDA, 2019), nine out of every ten businesses in Pakistan are SMEs. This sector contributes 40% to the total GDP, 35% in value addition and over 40% in export earnings of Pakistan (Shah, 2018). At present, there are more than 3.8 million registered SMEs in Pakistan, employing more than 78% of the non-agricultural labor work force (Baig, 2019).

Unemployment has been a critical issue in Pakistan over the last three decades (Daly et al., 2017) and the public sector has limited opportunities for new entrants. Therefore, a substantial number of these people end up joining SME sector. Moreover, SMEs serve as a training ground for the growth of entrepreneurial and managerial skills. SMEs in Pakistan are broadly categorised into three groups by SBP: manufacturing, trading and services. Approximately there are 0.8 million SMEs in the manufacturing sector, 1.8 million in the trading sector and 1.2 million in the service sector (Baig, 2019). Table 4.6 summarises the salient features of the SME sector in Pakistan.

Table 4.6: Salient Features of SME Sector in Pakistan

Number of SMEs - **Manufacturing** - **Trading** - **Services**	 0.8 million 1.8 million 1.2 million
Share in industry	90%
Share in GDP	40%
Share in export earnings	40%
Share in value addition	35%
Share in generating employment opportunities (non-agricultural)	78%

Source: Author's Compilation

4.3.3 SME Financing in Pakistan

Despite the significance and potential of SMEs to contribute to economic development, this sector in Pakistan suffers from various constraints, limiting their capacity to take full advantage of rapidly expanding global markets. These include lack of technological innovations, inefficient management, poor infrastructure, law and order situation and dearth of entrepreneurial education (Hassan, 2008; Dar et al., 2017). Access to finance remains the biggest obstacle to the growth of SMEs in Pakistan (Chaudhry, 2000; Bari and Cheema, 2005; Niethammer et al., 2007; Hassan, 2008; Saeed and Sameer 2015; Hyder and Lussier, 2016; Dar et al., 2017; Ullah, 2018). According to the International Finance Corporation (IFC, 2017a), the un-served and under-served SMEs in Pakistan are assessed to require an additional USD 3.8 billion investment.

Most SMEs, particularly small enterprises, in Pakistan rely on personal savings and informal sources of finance (Hassan, 2008; Naveed, 2012; Khan, 2015). For instance, in 2007, approximately 90% of small businesses in Pakistan obtained credit from the informal sector (Khan, 2015). The informal financing sources include loans from friends or family, moneylenders, informal credit unions and credit clubs. These sources generally provide small and short-term loans and access primarily depends on relationships and social networks. The informal financing sources lack regulation and usually require small or no collateral at all (Qadir, 2005). Another common feature of such sources is the variation in interest rates; interest rates differ from those in formal financial markets and vary from one source to another. For instance, the interest rate could range from 0%, when borrowed from friends and family to a very high and unjust finance cost when acquired from moneylenders (Khan, 2015).

Cosh and Hughes (2003) identify banks as the major source of formal financing of SMEs all over the globe. According to Muriithi-Ollows (2017), while providing finance to SMEs, banks rely on two primary lending methods. The first approach is transaction lending, which relies on quantitative data about the financial status, collateral, credit history, and the other method is relationship lending, which is based on qualitative data gathered throughout SMEs relationship with loan officers (Berger et al., 1999; Muriithi-Ollows, 2017). Banks in Pakistan lend to SMEs selectively and, at times, reluctantly since lending to SMEs is perceived riskier than lending to large corporations (Aazim, 2019). The major reasons for SMEs being perceived as riskier ventures by Pakistani banks is lack of their capacity to bear high financing costs, inability to provide collaterals and known cash flows, and poor governance and documentation practices (Rabbani and Moossa, 2014).

To improve SMEs' access to finance in Pakistan, SBP has introduced 'Credit Guarantee Scheme (CGS) for Small and Rural Enterprises' in March 2010 with the cooperation of UK's Department for International Development (DFID) to provide up to 60% risk coverage to financial institutions on their lending to SMEs (SBP, 2017b). As of 30th June 2019, financing to SMEs via banking institutions stood at PKR 464.86 billion, constituting only 6% of private sector financing (SBP, 2019b). Out of this PKR 464.86 billion, PKR 299.90 billion (64.5%) is invested in fixed assets, PKR 118.90 billion (25.6%) is attributed to the fixed investment and PKR 46.06 (9.9%) is provided for trade finance (SBP, 2019b). Islamic banks share in providing banking finance to SMEs stood at PKR 58.14 billion (13%). The total number of SME borrowers in the banking sector is 183,606, which is only 4.8% of the total 3.8 million SMEs (SBP, 2019b). SMEs in manufacturing, trading and service sectors borrowed PKR 175.13 billion (37.7% of total SME financing), PKR 155.02 billion (33.3% of total SME financing) and PKR 155.02 billion (29% of total SME financing) respectively from the formal banking sources (SBP, 2019b). Currently, 6% of the banking credit portfolio is held by SMEs and one of the targets of the National Financial Inclusion Strategy (NFIS) is to enhance SME sector credit to 17% (SBP, 2019b). To achieve this target, the coordination between banks and SMEs needs to be improved. Aazim (2019) emphasises that banks should come out of their comfort zones, connect with new SMEs and serve the current ones with more dedication to achieve the government's target of revitalising the SME sector. The key figures of SMEs' financing through commercial banks in Pakistan are summarised in table 4.7.

Table 4.7: Key Figures of SME Financing through Commercial Banks in Pakistan

Number of SMEs using banking Finance	183,606 (4.8% of total SMEs)
SMEs financing through commercial banks (including Islamic banks)	PKR 464.86 billion (6% of private sector financing)
Islamic banks' share in financing SMEs	PKR 58.14 billion (13%)
Sector wise breakup of SMEs financing • Manufacturing sector • Trading sector • Service sector	• PKR 175.13 billion (37.7% of total SME financing) • PKR 155.02 billion (33.3% of total SME financing) • PKR 155.02 billion (29% of total SME financing)
Facility-wise Composition of SME Financing • Fixed assets • Fixed investment • Trade Finance	• PKR 299.90 billion (64.5% of total SME financing) • PKR 118.90 billion (25.6% of total SME financing) • PKR 46.06 billion (9.9% of total SME financing)

Source: Compiled from SBP's "SME Financing Data Tables - June 30, 2019" [21]

4.4 Islamic Banking Sector in Pakistan

4.4.1 Historical Development of Islamic Banking in Pakistan

Religious political leaders and scholars have pursued the demand for an interest free economy in Pakistan since its creation as the country was established in the name of Islam (Ziring, 1984). In 1956, the first constitution of Pakistan directed the state to transit to interest-free economy (Ahmad et al., 2010). Under the Constitution of Pakistan, the Council of Islamic Ideology was established in 1962 to create an interest-free economy and particularly eliminate Riba (interest) from the banking system (Masud, 2015). The council invited renowned bankers and economists to make recommendations about the interest-free financial structure. In 1969, directed the state to abolish interest. The Supreme Court of Pakistan instructed the disposal of Riba from the economy (Masud, 2015). Since then, significant efforts have been made to implement interest

[21] Available at: http://www.sbp.org.pk/sme/PDF/DFG/2019/June.pd

free banking and according to Zuberi (1992) Pakistan was the third country that attempts to execute interest free banking[22].

Practically, the first attempt towards developing an Islamic banking system in Pakistan was made in the late 1950s, with the establishment of interest-free savings and loans societies (Wilson, 1983). Muslim owners deposited their money with such societies which was then lent to other proprietors for agriculture development. The bank did not charge any interest or penalty for late repayment except for a small processing fee to meet the bank expenses (Najaf and Najaf, 2016). However, the bank operations were failed due to the management issues and a vast difference between available capital and credit demanded (Najaf and Najaf, 2016). Next, in 1979, three institutions; Mutual Funds Investment Corporation of Pakistan, National Investment Trust and the House Building Corporation were directed to abolish interest from their operations and work on a profit and loss sharing basis (Kennedy, 1990). The Government of Pakistan took significant initiatives, for example, establishing Mudarabah companies and introducing Participatory Term Certificates (PTC), to launch interest-free products in the market, particularly in the banking sector. By 1981, all the state-owned banks were required to establish interest free counters for their clients (Zaidi, 1987). SBP was required to transit interest-based financial institutions into interest-free institutions by 1985[23] . According to SBP's plan, these institutions would function under the existing framework while eliminating the interest-based transactions from their operations (Hassan, 2007). SBP's efforts to abolish interest-based financial system continued and in 2002, Meezan Bank started its operations as the first full-fledged Islamic bank of Pakistan (Ahmad et al., 2010). The timeline of some of the significant developments in the Islamic banking sector of Pakistan is presented in the table 4.8.

[22] Iran and Sudan are the only two countries where the interest-free banking model has been implemented.
[23] All banks were prohibited to accept interest-bearing deposits as from July 1, 1985, with the exception of foreign currency deposits.

Table 4.8: Significant Developments in the Islamic Banking Sector of Pakistan

Year	Event
1950	Interest-free savings and loans societies were established.
1956	The first constitution of Pakistan directed the state to eliminate interest from the economy.
1962	The Council of Islamic Ideology was established to create an interest free economy.
1969	The Council of Islamic Ideology directed the state to abolish interest.
1979	Interest was eliminated from the operations of three specialised financial institutions; Mutual Funds Investment Corporation of Pakistan, National Investment Trust and the House Building Corporation.
1981	Separate Interest-free counters were established in all the state-owned banks.
2002	The first full-fledged Islamic bank; Meezan Bank commenced its operations.

Source: Author's compilation

Despite significant progress, the Islamisation efforts cannot achieve the objective of total elimination of interest (Khan and Bhatti, 2006; Rammal and Parker, 2013). This failure could be attributed to various factors. For instance, the transition process was revolutionary rather than adopting an evolutionary approach (Khan and Bhatti, 2006). Completely eliminating interest from the economic system is an enormous task that could encounter many obvious and hidden obstacles. Initially the aim was to eliminate interest from the banking sector in one go. However, the revised strategy focuses on developing a parallel system to assist banks keener to eliminate interest from their operations and allow the other banks to join the process gradually (SBP, 2007b). Furthermore, the lack of an appropriate institutional mechanism to scrutinise Sharia compliance and lack of interest from the stakeholders[24] also resulted in the failure of the Islamisation process in the field of banking and finance in Pakistan (Khan and Bhatti, 2006).

[24] For instance, government being a significant stakeholder is expected to end its reliance on interest-based borrowing. However, this aspect has not been given due consideration in formulating government budgetary and other policies.

4.4.2 Present State of Islamic Banking Sector in Pakistan

Since the inception of the first Islamic bank in 2002, the Islamic banking network in Pakistan is gradually expanding. Currently, three types of Islamic banks exist in Pakistan; full-fledged Islamic banks, standalone Islamic banking branches of conventional banks and Islamic windows in conventional banks (Israr et al., 2018). The number of full-fledged Islamic banks currently operating in Pakistan is five with a network of 1,437 branches spread all across Pakistan (SBP, 2019a). These banks include Al Baraka Bank (Pakistan) Limited (183 branches), Bank Islami Pakistan Limited (218 branches), Dubai Islamic Bank Pakistan Limited (200 branches), Meezan Bank Limited (678 branches) and Muslim Commercial Islamic Bank Limited (177 branches) (SBP, 2019a). Additionally, another premier conventional bank, Faysal Bank[25], has announced a transformation plan to convert into a full-fledged Islamic banking financial institution over the next few years. In addition to these full-fledged Islamic banks, Islamic financial services are also offered by 17 conventional banks through 1,457 Islamic banking branches and 1,348 Islamic windows of 11 conventional banks (SBP, 2019a).

At the end of June 2019, assets of Islamic banks stood at PKR 2,992 billion, depicting an increase by 7.3% from the last year and accounted for 14.4% of total assets of the banking sector (SBP, 2019a). The deposits of Islamic banks, at the same date, amounted PKR 2,415 billion, showing a 9.8% growth from the last year and accounted for 15.9 % of total deposits of the banking sector (SBP, 2019a). For the fiscal year 2018, Islamic banks' profit before tax was recorded at PKR 32 billion (SBP, 2019a). During the financial year ending on 30th June 2019, Diminishing Musharakah was the most extensively used financial product[26] (33.6%) by Islamic banks in Pakistan followed by Musharakah (20%) and Murabaha (13.5%) (SBP, 2019a). In light of the National Financial Inclusion Strategy (NFIS) Action Plan 2023, Islamic banking share in the banking industry is to be increased to 25% (Ministry of Finance, 2018). In terms of financing SMEs, only 3.7% of the financing portfolio of Islamic banks is held by SMEs, which depicts growth of 0.6% only since the last year (SBP, 2019a). The Islamic financial products offered to SMEs in Pakistan include, Musharakah, Diminishing Musharakah, Ijarah, Murabaha, Salam and Istisna (SBP, 2019a). The position of Islamic banks as of June 30, 2019, is summarised in table 4.9.

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[25] Faysal Bank, a subsidiary of Bahrain-based Islamic retail bank, currently has a branch network of 550 branches with 284 Islamic branches and 1 Islamic window.
[26] These Islamic financial products are explained earlier in chapter three.

Table 4.9: Position of Islamic Banks in Pakistan as on June 30, 2019

Number of Islamic banks • Full- fledged Islamic banks • Islamic banking branches of conventional banks • Islamic windows in conventional banks	• 5 (1,437 branches) • 17 (1,457 branches) • 11 (1,348 branches)
Total Assets	PKR 2,992 billion (14.4% of total assets of banking sector)
Total Deposits	PKR 2,415 billion (15.9 % of total deposits of banking sector)
Profit Before Tax (Financial year 2018)	PKR 32 billion
SMEs Financing Portfolio	3.7%
Products offered to SMEs	Ijarah Murabaha Salam Istisna Musharakah and Diminishing Musharakah
Percentage of Islamic Financial Instruments Used • **Diminishing Musharakah** • **Musharakah** • **Murabaha** • **Ijarah** • **Salam** • **Istisna** • **Others**	 33.6% 20.0% 13.5% 6.1% 2.6% 8.9% 15.3%

Source: Compiled from Islamic Banking Bulletin 2019, Islamic Banking Department, State Bank of Pakistan[27]

4.4.3 Regulatory Environment for Islamic Banks in Pakistan

In Pakistan, banks are the organisations that function under the provisions of the Banking Companies Ordinance (1962)[28]. Section 5(b) of the ordinance defines banking as “banking means accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise and withdraw able by cheques, drafts, and orders or otherwise” (The Banking Companies Ordinance, 1962, p.4). Earlier, the State Bank of Pakistan (SBP), Pakistan Banking Council (PBC) and Corporate Law Authority (CLA) were three regulating

[27] Available at: http://www.sbp.org.pk/ibd/bulletin/2019/Mar.pdf
[28] Available at: http://www.sbp.org.pk/publications/prudential/ordinance_62.pdf

bodies for managing and supervising the financial sector in Pakistan. In 1997, PBC was dissolved, and SBP became the sole authority to supervise and regulate all banks and financial institutions in the country. In 1999, another regulatory body, Securities and Exchange Commission of Pakistan (SECP) was established to govern the capital market, leasing and investment banks.

In 2004, the SBP established an Islamic banking department to develop the Islamic banking sector. The objective of this department is to facilitate the implementation of the strategic plan formulated for the development of the Islamic banking sector. Since Islamic financial institutions are required to comply with Sharia (Islamic law) provisions, SBP has developed a Sharia compliance framework for them. The SBP founded a Sharia board in the Islamic banking department, consisting of five members, to provide guidelines about Islamic banks' procedures, rules, and regulations and evaluate and approve Islamic financial instruments (SBP, 2007a). The Sharia board at SBP has prescribed eight Sharia-compliant products: Mudarabah, Musharakah, Diminishing Musharakah, Ijarah, Murabaha, Musawamah, Salam, and Istisna. In addition to a national level Sharia board, every Islamic bank or a conventional bank offering Islamic financial services through Islamic branches or Islamic windows must appoint a Sharia advisor to ensure that all products and services conform to Sharia principles. To strengthen the overall Sharia compliance environment, the Islamic banking department of SBP has also issued a comprehensive Sharia governance framework[29] that aims to institutionalise the Sharia compliance function. The framework clearly establishes the roles and responsibilities of board of directors, executive management, Sharia board, Sharia compliance department and internal and external auditors towards ensuring Sharia compliance.

Islamic banks are required to implement the accounting standards of Islamic Financial Services Board (IFSB). Furthermore, based on IFSB*'s* 'Guiding Principles of Risk Management for Institutions offering Islamic Financial Services', the SBP has also developed risk management regulations for Islamic banking institutions[30]. These regulations provide a set of best practices for establishing and implementing effective risk management by specifying principles applicable to the six categories of risk: credit risk, equity investment risk, market risk, liquidity risk, rate of return risk and operational risk. As part of the risk management strategy, Islamic banks are required to have in place a comprehensive reporting process and an appropriate board and senior

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[29] Available at: http://www.sbp.org.pk/ibd/2015/C1-Annex.pdf
[30] Available at: http://www.sbp.org.pk/ibd/2007/Draft-Risk-Management-Guidelines.pdf

management oversight to identify, measure, monitor, report, and control relevant categories of risks (Khalid and Amjad, 2012). The reporting process shall also incorporate appropriate steps to comply with Sharia rules and principles, which further ensure the adequacy of relevant risk reporting (Baydoun and Willett, 1997; Khalid and Amjad, 2012).

The Islamic banking department of SBP has also issued guidelines prescribing prerequisites regarding licensing, capital, liquidity and cash reserve, internal controls and audit of Islamic financial institutions (SBP, 2007). It also specifies the minimum qualifications, experience, and integrity standards for board members and managers (SBP, 2007a). To help improve transparency, the SBP has also issued directions about profit and loss distribution in Islamic banks. The guidelines about profit computation and distribution process are annexed in appendix 1.

4.5 Initiatives to Support SMEs through Islamic Banks

The development of SME sector is of fundamental significance since SMEs play a key role in the progress of any economy. However, banks' financing needs are not sufficiently addressed since it is relatively simple to lend to large enterprises where the economies of scale, published financial information, collateral and credit worthiness parameters are conveniently accessible. Mohieldin et al. (2011) argue that Islamic banks can take the lead in attending the financing needs of this economy sector since economic and social development factor is the foundational philosophy of Islamic finance. Saeed and Sameer (2015) highlight banks in Pakistan are reluctant to extend finance to SMEs due to the lack of data on the SME sector. Sherazi et al. (2013) also assert the unavailability of data as one of the major obstacles to SMEs' access to banking finance in Pakistan. Kouser et al. (2012), in their investigation of banks' lending criteria to SMEs in Pakistan, concluded that the main obstruction of SMEs' access to finance is the inadequacy of financial records due to which banks could not measure the performances of SMEs. Unavailability of data makes it difficult for banks to determine whether the SME can generate sufficient cash flows and repay the loan on time, which has an adverse impact on their lending decisions.

However, despite banks' reluctance to provide finance to the SME sector, Pakistan's government is keen to escalate the growth of SMEs in the country. Under the National Financial Inclusion

Strategy (NFIS) Action Plan 2023[31], SMEs have been distinguished as one of the key priority sectors. To facilitate SMEs' bookkeeping requirements, SMEDA offers a free of cost software-based accounting package specifically developed for SMEs. SMEDA also provides free of cost training sessions at different locations on the usage of this software to maximise its utility for users. In addition, to assist SMEs with their bookkeeping requirements, the SBP has undertaken various other steps to fuel the growth of Islamic finance for SMEs in Pakistan. Guidelines on SME financing primarily emphasise on implementing effective risk management measures and developing human capital. SBP has established a strategic roadmap for the Islamic banking sector to expand the market share of Sharia-compliant assets to 25% (Ministry of Finance, 2018). This strategic plan also focuses on the various issues associated with SMEs, which inhibit their growth by blocking their access to finance. It also suggests measures to reduce the financing gap of SMEs through the involvement of Islamic banks, such as assigning financing targets for Islamic banks to serve the financing needs of SMEs. SBP's strategic plan to support SME financing incorporates improving regulatory framework, introducing SME targets and risk coverage, simplifying procedures for SME financing, enforcing Sharia compliance mechanism, providing non-financial advisory service and creating awareness among bankers and SMEs (SBP, 2017b).

4.6 Conclusion

This chapter has outlined the context of SMEs and Islamic banks in Pakistan. It presented the key features of Pakistan's economy, characteristics of the SMEs sector in Pakistan, the state of SMEs financing in Pakistan. It also provided a description of the Islamic banking sector in Pakistan. Having discussed the context and developed the background to the empirical analysis via discussion of SME literature relevant to the aim and objective of this research, the next chapter explains and justifies the theoretical foundation through which the research problem and research question(s) are evaluated.

[31] Available at: http://www.finance.gov.pk/NFIS.pdf

Chapter Five: Theoretical Foundations: Strong Structuration Theory

5.1 Introduction

The preceding chapters reviewed the relevant literature on SMEs and Islamic finance, keeping in mind the aim of investigating SMEs' access to Islamic banking finance in Pakistan. Every investigation requires a theoretical foundation since it establishes a structure that guides a study (Osano and Languitone, 2016). This chapter provides the theoretical underpinnings and interpretive lenses employed in this thesis. In the context of SMEs' access to finance, agents (SMEs) have power and ultimate concerns about their sources of finance which influence their perceptions of constraints and ways of accessing Islamic finance. Ultimately, these perceptions will shape the ways and practices they will utilise to seek Islamic banking finance. In this study, an important aspect of this context is the relationship of SMEs with Islamic banks. Thus, the main assumption underpinning this study is that their immediate context influences SMEs' access to Islamic banking finance.

The structuration theory is a social theory developed by British sociologist Anthony Giddens to describe the interrelation between social structure and agency (Giddens, 1984). Giddens explains structuration theory in a series of publications (1976, 1979, 1981), leading to the Constitution of Society (1984) where he advances to his previous discussion and analysis of the significant themes of sociological theories (Berends et al., 2003). Giddens (1984) criticises the dualism of structure and agency[32] and emphasises their duality to account for human actions successfully. The underlying premise of the structuration theory includes the identification of the relationship between the individuals and the social forces that act upon them to understand our shared reality. Stones (2005) extends Giddens' original structuration theory to develop a strong structuration theory that focuses on the agent's conduct and context to understand the structuration processes. This study draws mainly on the work of Stones (2005) to investigate SMEs' access to Islamic banking finance in Pakistan. However, some aspects of Giddens' (1984) structuration theory are also incorporated. The remainder of the chapter is structured as follows. Section 5.2 includes a brief account of the structuration theory, its key concepts and criticism. Section 5.3 presents the development of strong structuration theory and how it differs from the structuration theory. Section 5.4 summarises some of the studies employing strong structuration theory. The use of strong

[32] Dualism of structure and agency refers to the strict division between people constituting society and social formations shaping human agents.

structuration theory in the context of SMEs and the motivation for using it in this inquiry is then explained in section 5.5 and section 5.6, respectively. Section 5.7 concludes the chapter.

5.2 Giddens and Structuration Theory

5.2.1 Origin and Premise of Structuration Theory

Notwithstanding a long and recognised history of the development of social theory, there is no consensus on a particular theory that regulates and justifies how society functions. Whether an individual action is the result of voluntarism or dictated by the larger social structure is one of the central questions social researchers in various disciplines must consider. This consideration gives rise to the objectivist-subjectivist dichotomy where the objectivist theorists advocate systematic aspects of the social world, and the subjectivist theorists suggest a voluntarist view (Pérez, 2008). Giddens was a critic of extreme views, and in response to the objectivism-subjectivism debate, he developed a theory of structuration that attempted to bridge the gap between both views (Ferdoush, 2020). He contended that individual practices are neither shaped by free will nor social structure alone; rather individual action and social structure influence each other (Giddens, 1984). Therefore, giving priority to one over the other will result in an asymmetrical analysis of a social action.

The idea of structuration was initiated in 1966, in their publication “The Social Construction of Reality” by two sociologists, Thomas Luckmann and Peter Berger. They contended that the human being is a social product, society results from human action, and society can be explored as an objective reality (Berger and Luckmann, 1966). Persuaded by their idea, Giddens began to address and question the role of agency and structure in his work “New Rules of Social Method and Functionalism” (Ferdoush, 2020). His journey proceeded with the publication of “Central Problems in Social Theory: Action, Structure and Contradiction in Social” (1979) followed by “Profiles and Critiques in Social Theory” (1982). Later in 1984, Giddens unfolded a layout of structuration theory in his publication “Constitution of Society” (Ferdoush, 2020). Other influential scholars advocate structuration school and corroborate Giddens’ (1984) claim that social practices are the product of interdependence of individuals and structures (Ferdoush, 2020). For instance, Bourdieu (1977), in his theory of practice, posits how the structure of social phenomena determines and is itself propagated by action. Bhaskar (1975) emphasises that the primary unit of analysis in social sciences should be relations rather than isolated entities. However, these authors have varying views regarding the mediating elements between practices and structures.

The core mediating element in Giddens approach is the duality of structure and agency that have innate significance to the practice research (Ferdoush, 2020).

Giddens' (1984) idea of structuration differs from other schools of thought such as functionalism[33], structuralism[34], and existential phenomenology[35]. The premise of the structuration theory requires recognition of the connection between people and the social forces that act upon them (Ferdoush, 2020). Giddens (1984) integrates ideas from objectivist and subjectivist social theories, negating objectivism's emphasis on structures in isolation without considering humanist elements and subjectivism's sole focus on people while ignoring structural context. He supports the view that reality can better be understood in terms of interaction between structures (context) that may set rules and regulations for agency (individuals' capacity to make choices) (Baxter and Chua, 2003). This implies that the centre of structuration theory is the reciprocal interaction of human agents and social structures. Agents are both empowered and constrained by the structures, but at the same time, these structures are the outcome of the actions by agents (Giddens, 1984).

The reception of duality in the structuration theory implies that neither structure nor agency is considered to work independently (Giddens, 1979). It takes the view that the fundamentals of social sciences lay the basis that both the structure and agency perform together to frame the social setting and practices (Giddens, 1976, 1981). People's actions frame the institutional properties of social systems, and their future actions are then shaped by these institutional properties (Orlikowski and Robey, 1991). On this account, understanding and interpreting any social phenomenon require the need to capture both the agency and structure in one framework (Giddens, 1984).

5.2.2 Key Elements of Structuration Theory

5.2.2.1 The Duality of Structure and Agency

Giddens (1984) rejects the idea that the agency and constitution of structures have an independent existence. Instead, his approach focuses on overcoming the dichotomies between structures and human agency and regards them as a mutually constitutive duality. The notion of

[33] Functionalism, in social sciences, is a premise that all parts of society serve a purpose and they are vital for the long-term survival of the society.
[34] Structuralism, in social sciences, implies that it is necessary to understand the elements of human culture by way of their relationship to a broader, overarching system or structure.
[35] Existential phenomenology is concerned with the experiences and actions of the individuals.

the duality of structure implies that structure is both medium and outcome of the replication of social practices (Giddens, 1984). That is, structure shapes individuals' practices; however, individuals' practices comprise and recreate structure. Giddens (1984) asserts that structure constitutes the rules and resources produced through people's actions. A duality arises as structure limits people’s actions but, at the same time, these actions maintain or modify structure. This presents a picture of human agency and structure as presupposing one another (Sewell, 1992). According to Schwandt and Szabla (2013), the connection between structure and agency, as depicted in this duality, is both self-replicating as well as indivisible. These structuration processes are ongoing. Thus, structures, at any point, constitute of consistently evolving social exercises surfacing from the duality of structure and agency (Coad and Herbert, 2009). For structuration to occur, individual actors must interact with a given social structure. In this manner, they may decide to completely recreate, partially recreate, or not to recreate that social structure (Giddens, 1984).

5.2.2.2 Human Agency in Structuration Process

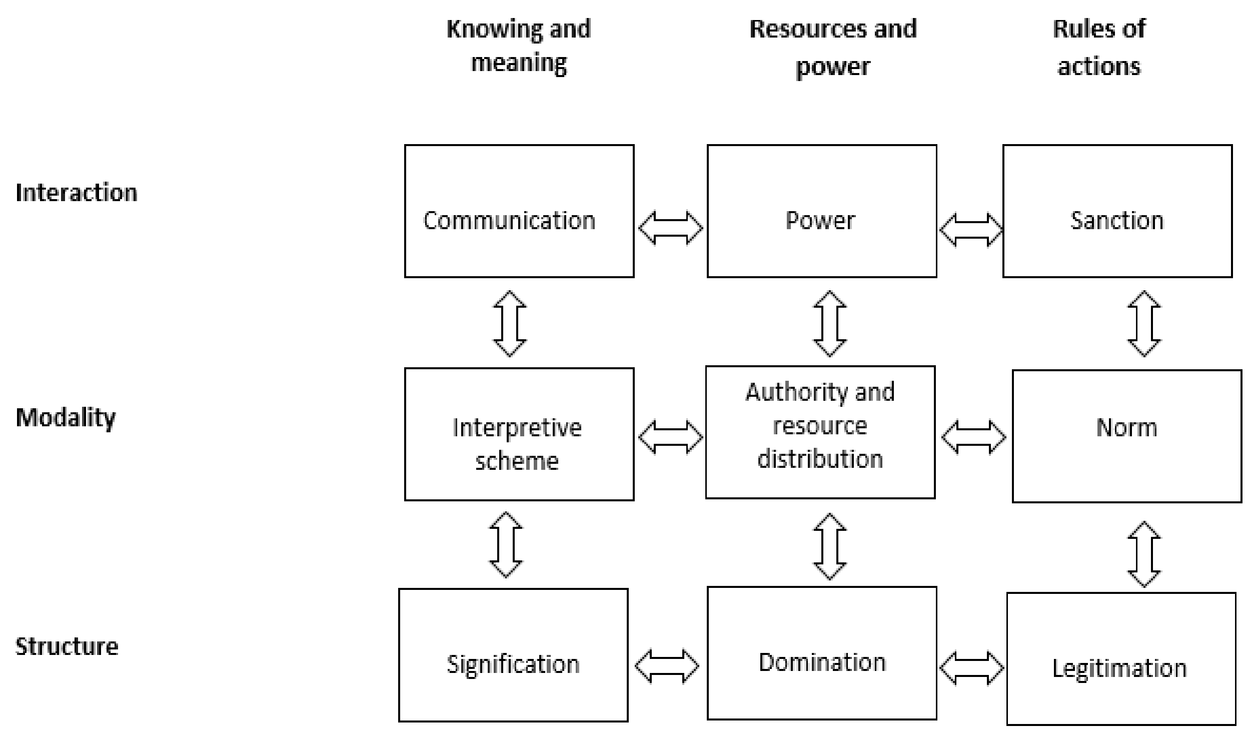
Agency in the structuration theory relates to the idea of intentional and purposive actions. Giddens (1984) describes an agency as the individual’s ability to make a change and interlinks it with the actions where people exercise power through their social practices (Giddens, 1984). Social structures empower or compel the agency’s ability to make or prevent making a difference in their world. Stones (2012) argues that “agents continuously monitor their thoughts and activities as well as their physical and social contexts” (p. 523). Individuals’ ability to make any change is related to their knowledge about their surroundings (Giddens 1984; Naidoo, 2009). Since agency implies an individual’s ability to observe their own experience and then rationalise their action, it is associated with reasoning and knowledge (Tucker, 1998). Ferdoush (2020) maintains that the basic argument of structuration theory is that every individual is a knowledgeable agent who knows a lot about the conditions and outcomes of the everyday activities around them. The knowledge of agents enables them to behave in a reflexive manner (Giddens, 1984). Based on their knowledge of the social structure and framework, agents either replicate, partially replicate, or not replicate the actions that approve the specific social structure or framework (Giddens, 1984).

Giddens (1984) indicates that it is mainly the reflexive form of knowledgeability that is engaged with the recursive structure of social practices. Moreover, Giddens (1984) characterises reflexivity as the monitored character of the progressing stream of social activities. It can, thus, be said that agents in Giddens' theory are purposive actors who are knowledgeable and have explanations of what they practice. However, the concept of purposive actions does not suggest that individuals manage to control all outcomes of their activities; they may face unacknowledged conditions, which may lead to unintended consequences outside the absolute control of the agency's purposive actions (Giddens, 1984).

5.2.2.3 The Structural Dimensions of Signification, Legitimation and Domination

Giddens (1984) claims that structure comprises the rules and resources produced by individuals' actions through practices and routines. To describe the constitution of society, Giddens (1984) summarises key ideas of his theory in three dimensions of structuration: signification, domination and legitimation, with domination referring to resources and legitimation and signification being rules-based. The three different aspects of each of these structural dimensions are presented in figure 5.5.

Figure 5.5: The Dimensions of the Duality of Structure



Source: Giddens (1984, p. 29)

The bottom row represents the particular rule or resource; the modality can be seen as the tools that make interaction possible. The form of interaction is represented in the top line. Structures of signification facilitate meaning in social interactions. In the context of signification, agents make use of available information (interpretive schemes) to create a meaning. Interpretative schemes are the stocks of implicit and explicit knowledge, acquired through experience, enabling agents to comprehend things around them, whether physical or more abstract and conceptual (Giddens, 1984). Walsham (1993) highlights that agents make sense of their own and others' actions based on the cognitive schemes mapped through their experience of the world. To guide the social communication between agents, they share these meanings among them (Giddens, 1979).

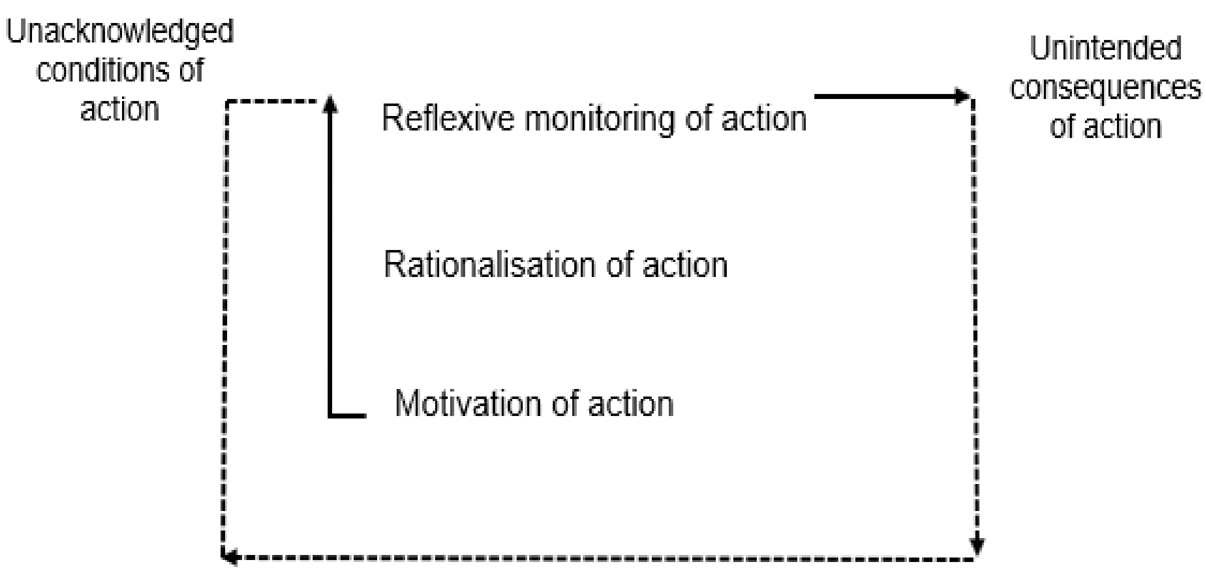
Domination structures are identified with power (for instance, control or influence) over allocative and authoritative resources, which facilitates power over other agents. According to Giddens (1979), power is generally embedded in agency or institutions; however, structures of domination can modify an individual's actions by means of control over resources. Control over resources makes the agents either capable or incapable of utilising their free will while determining their course of action. Giddens (1979) argues that possession of absolute power is never lasting; therefore, it is contended that there is no ultimate control in social frameworks and structures. Legitimation structures provide the evaluative criteria for agents regarding established norms and the limits of acceptable practices. In the context of legitimisation, agency depends on norms that set the criteria, within a particular structure for an action to be legitimate. The norms are established in social structures and are communicated as rights and duties for agency (Giddens, 1984). The rules shape the norms and social practices and give an appropriate direction to an agency to act within their social setting (Giddens, 1979). Hence, legitimate social practices are authorised or inhibited by means of organised social interactions.

All three dimensions play a significant role in any action. For example, when an SME approach an Islamic bank to seek finance, the bank manager would draw upon their stocks of knowledge about legitimation to understand if providing finance is within the norms. Such norms might, for instance, require that the SME seeking finance must have been operating for at least five years or can pledge assets of a certain value. Ignoring such norms would inevitably lead to the potential for sanctions such as a job demotion or financial penalties to reinforce the norms. In terms of domination, the manager will have to consider if they have the authority and resources to complete the action. This might, for example, be the control over the people needed to verify the value of the pledged asset or the power to make the decision. Finally, the manager would draw on their structures of signification to communicate the reasons for providing or not providing the finance to the SME. To successfully comprehend such a complex task, the manager would need sophisticated knowledge about power configurations, meanings and norms within the field.

5.2.2.4 The Stratification Model of Human Action

Giddens (1984) developed a stratification model of human action in which he explained how agents consistently monitor the progression of their actions. The stratification model emphasises the continuous flow of action. Cohen (1989) asserts that the three basic components in the nucleus of the model depict subjective processes sustained by the individual continuously. The first component of Giddens' (1984) stratification model is the motivation of the action which provides the reasons to act in a particular way. Then there is the rationalisation process, where the agent adapts his actions to his understanding of the basis of action. Lastly, the monitoring of action makes individuals aware of and encourages a response to unintended consequences, facilitating future motivations. The stratification model of human action is illustrated in figure 5.6

Figure 5.6: The Stratification Model of the Agent



Source: The constitution of society: Outline of the theory of structuration (Giddens, 1984, p. 5)

Giddens (1984) makes a distinction between reflexive monitoring and rationalisation of action from its motivation. In doing so, he distinguished between reasons (the justification for actions) and motives (the needs which leads to the action). Motivation in Giddens' stratification model is defined as a potential for an action. Even though motivation may appear as an obvious starting point, Giddens reckons it is less implicated in the flow of the human action model than rationalisation or monitoring. However, the motivation is the beginning point of an action and serves as a driving force behind the individuals' actions. Stones (2005, p. 24) recommends that motivations can be "direct, intense and purposeful" or "indirect and much more routined". An individual's motivations may be entirely or partly conscious or unconscious (Bryant and Jary, 2001), and much of our everyday actions are not explicitly motivated at all (Giddens, 1984). However, motives become more directly implicated in action when the action breaks the routine practices (Giddens, 1984).

Giddens (1984) highlights the agent's capacity to distinguish between their actions and the motives for their actions. Rationalisation of their action enables the agent to give reasons for their conduct. To the core of the rationalisation process is Giddens' (1984) notion of knowledgeability of human agents. Being knowledgeable makes the agent to comprehend his undertakings and rationally justify them. Nevertheless, these rationally justifiable actions may have unintended outcomes, identified through the reflexive monitoring of action, which in turn influence unacknowledged conditions of further actions.

5.2.3 Criticisms of Structuration Theory

Several criticisms levelled against structuration theory which limit its full application in different disciplines (Rose 1998; Thompson, 2004; Kort and Gharbi, 2013). For instance, inadequate consideration of external structures (Thrift, 1985; Archer, 1995; Roberts, 2014), the conflation of structure and agency (Rose, 1998; Barnes 2001; Layder, 2005), complexity and the outspread of the theory (Turner, 1986; Craib, 1992, Loyal, 2003) and lack of methodological guidelines (Turner 1986; Joseph, 2006). Among this criticism, the followings are the main factors which restrict the use of structuration theory in achieving the aim of this study i.e., to investigate SMEs' access to Islamic banking finance in Pakistan.

Structuration theory has been criticised for its inadequate consideration of external structures (Sewell, 1992; Archer, 1995; Roberts, 2014). External structures, in this context, are the independent forces that exist outside of the agents' capacity to resist or control (Stones, 2005).

Giddens' conception of structure is limited to virtual existence that guides social conduct and dismisses the existence of structures outside of the agent's mind. Coad et al. (2015) highlight that Giddens also rejects the idea of any hierarchical categories of structures and supports the concept of flat ontology (discussed in section 5.4.1). Archer (1995), however, rejects a flat ontological argument. In response to these critiques, Stones (2005) proposes the quadripartite model of structuration discussed later in section 5.4.2.

Olson and Yahia (2006) criticise structuration theory by arguing that structuration theory tends to combine ontology and epistemology. Ontology relates to the existence of phenomena whereas, epistemology is associated with knowledge. Coad and Herbert (1989) argue that Giddens tends to be a meta-theorist with a little concern for empirical research. Therefore, he positioned the ontological stance of structuration theory at an abstract level. Turner (1986) also points out that structuration theory does not contain any clear propositions, making it difficult to test empirically. However, Giddens did not propose structuration theory as a research programme; it was not developed into a form that was easily translated to an in situ empirical application (Lee et al., 2007). Instead, Giddens' work is rationalised as imparting sensitising devices that are valuable for considering research issues and interpreting results (Turner, 1986). While applying Giddens' structuration theory for an empirical inquiry, there is a need to move from philosophical theorisation to the ontic level which Stones (2005) refers to as a move from 'ontology in general' to 'ontology in situ' (an ontology that relates to specific social practices and events at specific time and places) (Lee et al.,2007).

Archer (1995) builds critique on Giddens' notion of duality of structure and argues that duality conflates agency and structure. Methodological bracketing facilitates a researcher to emphasise on a particular part of the problem by focusing on certain aspects of a phenomenon under study. The researcher may then de-emphasise area in the following phase of bracketing. Giddens (1984) suggested using methodological bracketing in structuration studies, and proposed bracketing likewise to institutional analysis and strategic conduct analysis. However, since Giddens (1984, p.375) viewed institutions as "chronically reproduced rules and resources", this form of bracketing tends to eliminate agency from this part of the analysis. Stones (2005) argues that Giddens' form of institutional analysis brackets out the way that agents perceive and draw upon their structural context. Consequently, it re-introduces the way for the analytical dualism encompassing structures and agency, despite its evasion being key to structuration theory. Stones (2005) dealt with this criticism by fostering an alternative approach to bracketing which maintains a bridge between structure and agency regardless of whether context or conduct is being investigated. Stones (2005) refers to his agent's context analysis as going from the agent to outside into the field and such form of contextual analysis aids in maintaining consideration for the significance of the phenomenology of agents.

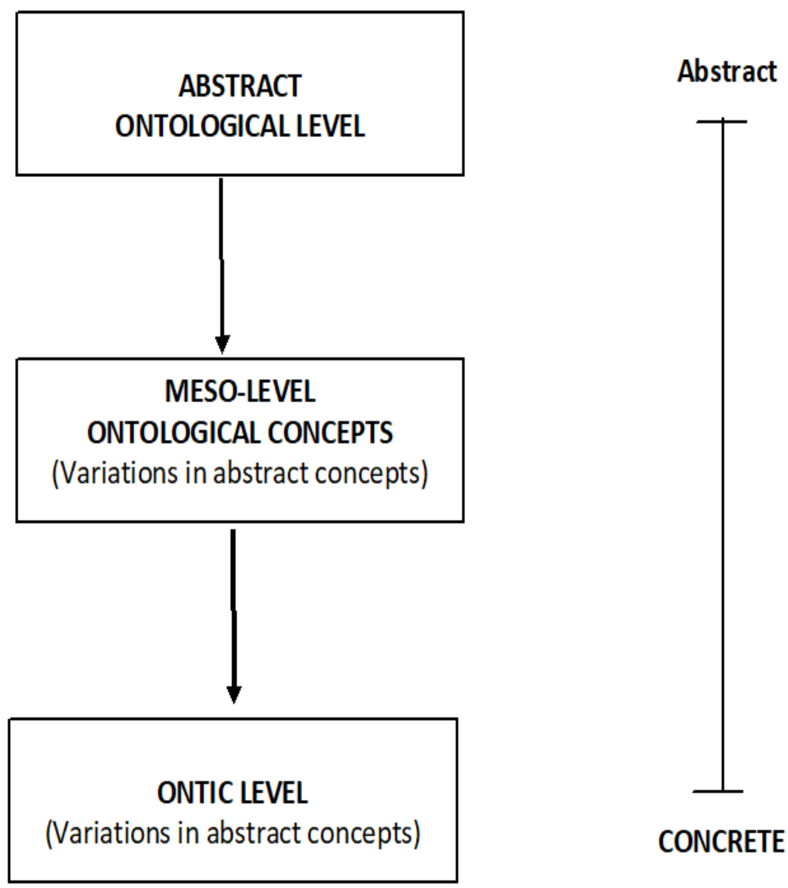
5.3 The Development of Strong Structuration Theory and Its Key Concepts

In response to the shortfalls of structuration theory, strong structuration theory was developed by Rob Stones in 2005. It is not an alternative version of structuration theory but an advancement that incorporates a wide scope of ideas from Giddens and maintains the duality of structure. Stones (2005) emphasises ontology-in-situ (an ontology that relates to specific social processes and events at specific times and places) in contrast with Giddens' (1984) approach of ontology-in-general. Asserted by Parker (2006 p. 122), Stones proceeds from an "all and every" approach to "who did what, where, when, how and why?" The oncological abstraction in structuration theory lacks the necessary detail required to carry out empirical work (Gregson, 1989; Stones, 2005). Strong structuration theory is a significant advancement in structurationism, helping researchers with an upgraded set of tools to link macro and micro-levels. This is accomplished in three ways. First, strong structuration theory sets out logical details of how structuration evolves and develops in repeating cycles, where entire macro structures are considered a foundation of the process (Elbasha and Wright, 2017). Second, it gives the fundamental methodological details by proposing appropriate research questions and incorporating the use of both types of methodological bracketing; context (macro) and conduct (micro) analyses (Elbasha and Wright, 2017). Third, through the development of 'meso-level' ontological concept guides the researcher to analyse action and structure in relative terms (Coad et al., 2015). The main constituents of strong structuration theory employed in this study are discussed in the following sections.

5.3.1 Placing Social Practices Within a Web of Structural Forces

Stones (2005) asserts research as a 'drilling down'' process, which requires a shift from ontological abstraction to ontology in-situ to investigate a given phenomenon in greater detail. He argues that the move from abstract to ontic might weaken the theory's broad concepts and, therefore, develops an ontological scaling concept. Figure 5.7 depicts three levels of ontology developed by Stones (2005). The first level is the most abstract and is harmonious with Giddens' concept of ontology in general. It sets out broad guidance to researchers and sensitises them to the issues that may warrant interrogation in an empirical study. The third level is the ontic level, representing substantive empirical details informed by particular practices in time and space. Stones (2005) attempts to bridge the gap between abstract theorising and ontic level data collection by introducing a middle layer to guide and inform empirical data collection. This meso-level facilitates a systematic and logical progression from abstract concepts to the empirical realities of the given study.

Figure 5.7: Three Levels of Ontology

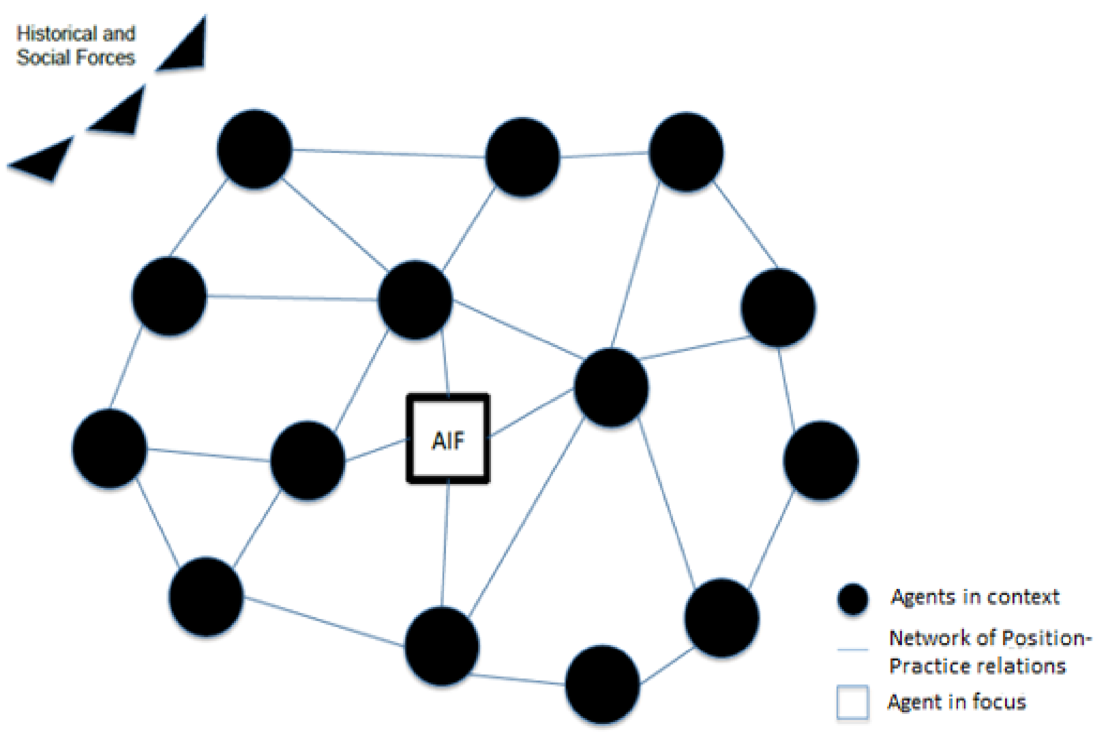


Source: Structuration Theory (Stones, 2005, p. 77)

To conceptualise the meso-level institutional connection between structures and agency, Stones (2005) embraces Cohen's idea of position–practices. Cohen (1989) highlights the complexity of relations existing between position-practices and how they are realised in the actions of individuals. Stones (2012) proceeds to build up on Cohen's idea, claiming that events (and practices) are better comprehended within a progression of position-practices and their networks of relations. In particular, one can develop an appropriate theorised contextual framework of these position-practice relations, relevant to the agent-in-focus, which addresses the specific research questions (Stones and Tangsupvattana, 2012). This is possible because actors within position-practices, for instance, SMEs seeking to acquire Islamic banking finance, are believed to be reflexively knowledgeable with respect to their particular social positions and the network of practices encircling them, how agency is carried out and how structures are reproduced.

The concept of position-practice relations is illustrated in figure 5.8. The position represents the social 'position' held by the focal agent in relation to the different agents in the given context. Whereas 'practices' are identified with the obligations and rights embedded in the role of focal agent (Stones, 2005). The focal agent can be seen as embedded in the network with the clusters of agents-in-context. They have relations and interact to execute their obligations in a given social position. Stones (2005) emphasises that position-practice relations can be particularly used to highlight how different groups of agents battle against each other and how this may affect practices across the network.

Figure 5.8: Network of Position-Practice Relations



Source: Structuration theory (Stones, 2005 p. 94)

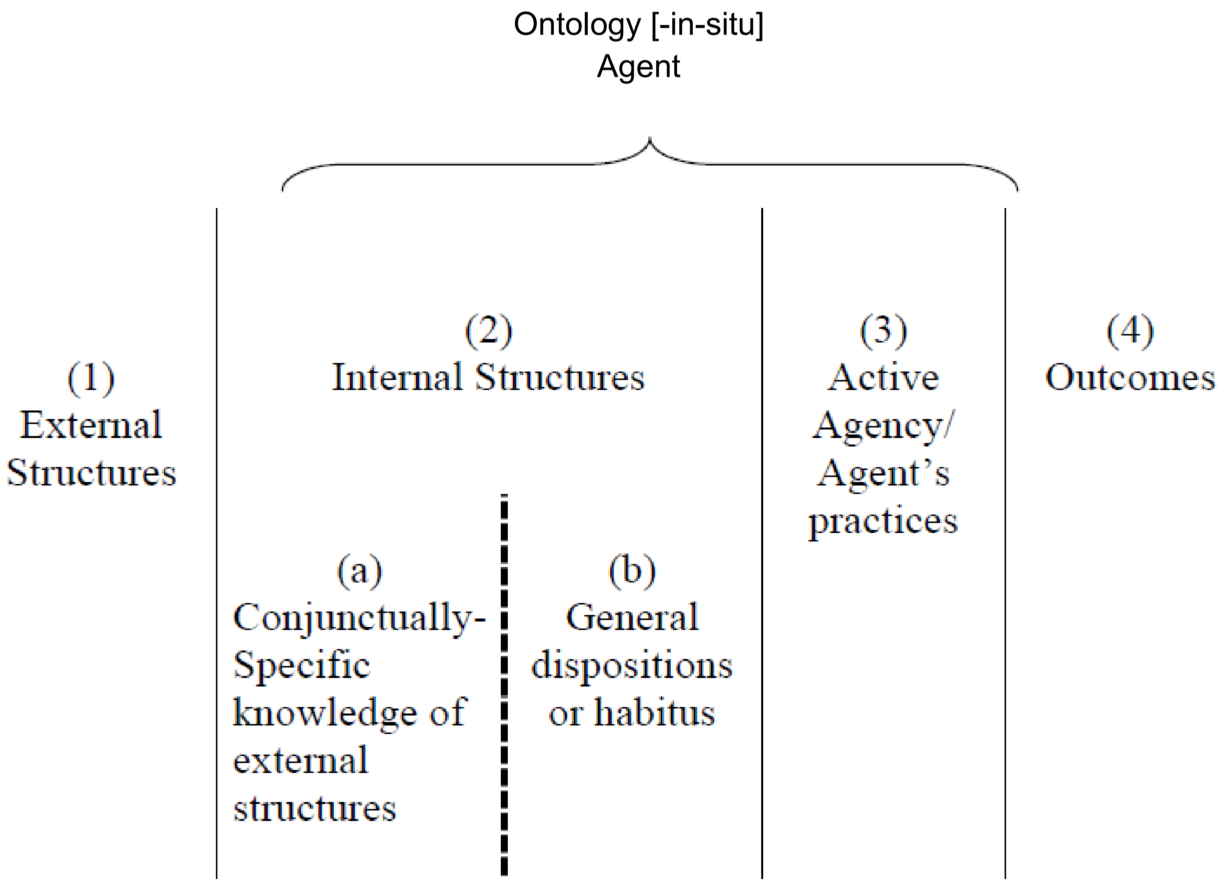
Cohen (1989) highlights the complexity of relations between position-practices and how agents incorporate them in their actions. Following the discussion of position-practice relations above, this concept can be used to contribute to our understanding of how SMEs seek to acquire Islamic banking finance. For instance, an SME has to take the specific and distinctive set of position-practice relations into account while acquiring finance. Each set of position-practices is situated within a complex nexus of position-practice relations. By examining these position-practice relations, a strong structuration approach constructs a contextual framework relevant to the focal agent. It is possible by considering the Giddens' (1984) tenet about the agents within position-practice being reflexively knowledgeable with respect to their particular social positions and the network of practices encompassing them.

Furthermore, to comprehend the development of a specific social position, its historical context needs to be reflected (Cohen, 1989). Along these lines, for instance, previous actions of SMEs seeking to acquire Islamic banking finance have reproduced/transformed that position through the duality of structure and agency. In this manner, SMEs will acquire the heritage of past patterns of structuration that have created or replicated rights, commitments, obligations, norms and power resources concerning their access to finance. These structuration procedures will continue as the in-situ SMEs repeats or changes their legacy.

5.3.2 The Cyclical Process of Structuration

At the core of strong structuration theory, Stones (2005) clarifies the interplay between structure and agency in "quadripartite model of structuration" with four interwoven dimensions: external structures, internal structures, active agency and outcomes. The quadripartite of structuration is illustrated in figure 5.9.

Figure 5.9: The Quadripartite Model of Structuration



Source: Structuration theory (Stones, 2005, p. 85)

5.3.2.1 External Structures

External structures represent contextual forces and pressures, which may constrain or enable agency that are autonomous of the agent. It implies that the external structures are not subject to the agent's control and influence the social conditions irrespective of the agent's wishes. The concept of external structures advances from Sewell (1992) and challenges Giddens' (1984) concept of structure restricted to virtual presence that guides social conduct. Harris et al. (2016) argue that structures are not characterised as external because they are outside of the organisation in which the agent is employed but because they are outside the agent themselves. External structures are best comprehended through the position-practice network by mapping the social terrain that agents-in-focus face and external to the agent.

5.3.2.2 Internal structures

Internal structures refer to the structures within the agent. Coad and Herbert (2009) identify the concept of internal structures as one of the most crucial conceptual elaborations made to Giddens' (1984) structuration theory. Stones (2005) classifies internal structures into two groups: the general-dispositional and the conjuncturally-specific. The general-dispositional internal structures incorporate “generalised worldviews, principles of action, habits of speech and gesture, methodologies for adapting generalised knowledge to a range of particular practices in particular locations in time and space” (Stone, 2005, p. 88). The conjuncturally-specific internal structures, on the other hand, comprise of the knowledgeability around the distinctive aspects of the conjuncture or phenomenon under study. Consequently, these structures incorporate knowledge of Giddens' virtual structures of signification, domination, and legitimation. Along with their role as knowledge stocks within the agent, conjuncturally-explicit structures also bridge the gap between an agent's external and internal structures.

5.3.2.3 Active Agency

Active agency refers to the actions taken by the agent (Feeney and Pierce, 2016). Stones (2005) identifies two types of active agency: the agent consciously making a choice or decision to act and the other is routine and conventional decisions. Stones (2005) sets out five analytically distinguishable aspects of active agency: shifting horizons of action arising from motivated persuasive action; creativity and innovation in agents' action; degrees of critical distance and reflection; conscious and unconscious motivations and the ordering of concerns/sorting of priorities.

5.3.2.4 Outcomes

The on-going patterns of structuration lead to the outcomes, as a result of active agency. Stones (2005) highlights that, as in the Giddens' stratification model, the outcomes may be intended or unintended and structures may be continued or modified. Whichever outcomes develop, they serve as the basis of following structuration cycle (Stones, 2005). The four parts of the quadripartite are interlinked (Stones, 2005); structures are the medium of the action (inner structures) and the results of the actions (both internal and external structures). Whereas active agency is firmly weaved with other components and cannot be isolated from them.

The quadripartite nature of structuration serves as a basis for analysing SMEs' access to Islamic banking finance in Pakistan. The beginning point is to recognise the relevant external structures by mapping the position–practices network of Pakistani SMEs seeking to acquire Islamic banking finance. The following stage is to analyse internal structures of the focal agent (SMEs). The general-dispositional factors are first identified then, the conjuncturally-specific interpretative schemes, norms and allocation of resources of the focal agent are investigated. This is extended to incorporate their perceptions of the external terrain and other agents in the network. It leads to the analysis of SMEs' financing practices as knowledgeable and critically reflective agents and identifies the possibilities and constraints facing them. Finally, the active agency and outcomes are studied to investigate the degree to which these were intended or unintended.

5.3.3 Methodological Bracketing to Analyse both Conduct and Context

To overcome the propensity to concentrate either on the macro or micro level at the expense of others, Stones (2005) addresses the criticism raised on Giddens' structuration theory and developed the methodological detail for conducting empirical research. He proposed two kinds of related methodological bracketing, including agent's context analysis and agents' conduct analysis (Stones, 2005). Agent's context analysis depicts the external process of structuration, investigating the potential outcomes and impediments offered and posed by position practices. It focuses on the social landscape in which agents are embedded, depicted by the position-practice networks of their particular field. The agents' interpretations of their social landscape are affected by their hermeneutic frame of meaning. Therefore, agents' hermeneutic frame of meaning remains of significant concern during the context analysis of the agent-in-focus (Stones, 2005).

On the other hand, the agent's conduct analysis relates to the ontological concept of knowledgeability (Stones, 2005). Giddens (1984) considers knowledgeability as what an agent knows about the circumstances surrounding his and other agents' actions that lead to the production or replication of that action. Stones (2005) develops conduct analysis to incorporate the analysis of an agent's reflexive monitoring. In this regard, the emphasis is on the agent's conjuncturally-specific internal structures when they encounter external structures (Stones, 2005). Stones (2005) asserts that many research questions require using both the agent's conduct and context analysis since the conjuncturally- specific internal structures play a linkage role between external structures and active agency. It implies that, conjuncturally- specific internal structures serve as a hinge between external structures, agents' general-dispositional frames, and practices (Stones, 2005).

Strong structuration theory presents four recurring steps that employ context and conduct methodological bracketing and follow the quadripartite structuration model. The order of these steps in term of priority can be changed and the steps can also be consolidated as required by the nature of the research question(s) (Elbasha and Wright, 2017). Stones (2005 p. 123-125) identifies these four steps as follows:

- the general-dispositional frame through conduct analysis,
- the conjuncturally-specific internal structures,
- relevant external structural clusters, and
- possibilities for action and constraint.

To facilitate a contextually sensitive explanation of the practices of SMEs seeking to acquire Islamic banking finance, this study draws upon both the context and conduct analysis. The analysis of the contextual field will provide affirmation on the external conditions facing the SMEs, and the agent's conduct analysis will investigate the internal structures and agency of SMEs.

5.4 Empirical Studies Using Strong Structuration Theory

Strong structuration theory has been used in many empirical studies in different disciplines addressing a wide range of contexts. Stones and Jack (2016) highlight that the empirical use of strong structuration theory is gaining popularity among researchers, especially in accounting. For instance, Makrygiannakis and Jack (2016) investigate the impact of the 2008 financial crisis on budgeting and control practices of hospitality organisations in Greece in their study "Understanding management accounting change using strong structuration frameworks". Through a case study, Makrygiannakis and Jack (2016) carried out agents' context analysis to explore the changing context and agents' conduct analysis to understand their perceptions of the impact of changes in the economic environment.

In a study of management accounting practices in a privatised utility company, Coad and Herbert (2009) explored the interaction between accountants and engineers. Coad and Glyptis (2014) employed a position-practice network to study a joint venture between a state-owned oil company and a privately-owned oil transport company. Through this case study, the authors discussed the extent to which the strong structuration theory contributes to management accounting research. Coad and Glyptis (2014), in their study "structuration: a position–practice perspective and an illustrative study", focus on the use of position–practice perspective for research in accounting and control. This study was among the first papers to make detailed use of the position-practice framework. Kholeif and Jack (2019) use the analytical framework of strong structuration theory in their study, focusing on resistance in the budgeting literature. They used an illustrative case study, exploring an unsuccessful attempt of implementing performance-based budgeting in the Egyptian Sales Tax Department. Moore and McPhail (2016) also use the position-practices framework to investigate the development of carbon accounting practices. They include an examination of all three levels on the ontological scale in their study to explain the role of internal structures and the exercise of power by participants in creating the frameworks.

Elmassri et al. (2016) draw upon the quadripartite framework to examine how managers in Egypt responded to emerging structures in strategic investment decision-making after the financial crisis/revolution. The paper focuses on both the 'people and process' dimensions of strategic decision making during the extreme uncertainty of the political situation. In another study focusing on strategic investment decision-making, Harris et al. (2016) reanalysed previously published case studies from strong structuration perspective. They propose a new way of theorising strategic investment decision-making based on the key insights gained by reflecting on the agent's knowledgeability and position-practice relations. Daff and Jack (2018) drew upon strong structuration theory and presented a tentative model of accounting communication. They characterised active agency in terms of influence on the conjuncturally-specific knowledge and conduct of others. Daff and Jack (2018) began with mapping the position-practices network of accountants and then explained how accounting communications create and maintain these networks. Adhikari and Jayasinghe (2017) employed strong structuration theory to investigate the central government accounting practices and reforms in Nepal. The study used position-practice relations of Nepalese central government accountant to explore how government accountant' articulated duality and a dialectic relation with the other agents in their contextual field result in the reproduction of routinised accounting practice and the resistance to reforms (Adhikari and Jayasinghe, 2017)

Strong structuration theory is not confined to the accounting discipline only, and research focusing on the health care sector also acknowledges a strong structuration perspective. For instance, Greenhalgh and Stones (2010) combine actor-network theory with strong structuration theory to study the introduction of information technology in health care. The study focuses on a position-practice framework alongside human agents to explore the acceptance of technology.

Greenhalgh and Stones (2010) illustrate the value of moving back and forth between levels of analysis and provide an example of intended and unintended outcomes. Within the health care domain, another study by Creswell et al. (2011) combines actor network theory with strong structuration theory to explore the adoption and implementation of electronic health record systems. Creswell et al. (2011) import the concept of the distinction between internal and external structures from the strong structuration theory to find how internal structures helps in understanding why agents act as they do.

The application of strong structuration theory to the research in the domain of SMEs is increasing. Kabanda and Brown (2017) analyse the adoption of E-Commerce by SMEs by employing strong structuration theory to identify structural practices associated with E-Commerce in Tanzanian SMEs. Their study conceptualises information systems as social systems and defines E-Commerce applications in practice as rule-resource sets that limit or empower SME business interactions. Such practices (structures) are then produced and reproduced by SME social interactions depending on how knowledgeable the SME is about E-Commerce. Kennedy (2018) attempts to explore the internationalisation process of Irish SMEs from a strong structuration perspective. Kennedy (2018) applied a quadripartite model of structuration to explain how and why the internationalisation process occurs within SMEs. SMEs' internationalisation processes are conceptualised as a reciprocal relationship between structure (contextual and environmental factors) and agency (managerial practices).

5.6 Theoretical Framework Employed in Previous Studies on SME Financing

Economists have developed many theories that explain how SMEs differ from their large counterparts in terms of financing practices and the problems they encounter while accessing external finance. These include agency theory (Ross, 1973), information asymmetry theory (Van Caneghem and Van Campenhout, 2012), signalling theory (Morris, 1987), credit rationing theory (Stiglitz and Weiss, 1981), pecking order theory (Donaldson, 1961) and discouraged borrower theory (Kon and Storey, 2003). Previous research, focusing on problems faced by SMEs while accessing external sources of finance, has relied mainly upon agency theory and the information asymmetry theory. Some studies concerning financing practices of SMEs mainly concentrate on their normative practices shaped by the economic perspective of the agency. From the economic perspective, an agency relationship can be characterised as an agreement that enables a person(s) (the agent) to perform some service on behalf of another person(s) (the principal) (Jensen and Meckling, 1976). Binks and Ennew (1996) explores SMEs financing practices from the principal-agent framework and concludes that SMEs, being an agent of the finance provider, are required to produce returns for them. Here, the agency problem arises since the lender does not play an active role in the management of SMEs. Other researchers, such as Lean and Tucker (2001), Steijvers et al. (2010); Han et al. (2012) explore financing obstacles faced by SMEs through the theoretical lens of information asymmetry. The theoretical foundations employed in some previous studies exploring SMEs' access to finance are shown in table 5.10.

Table 5.10: Theoretical Foundations Employed in Previous Studies

Study	Author(s)	Year	Country	Theoretical Foundation
Entrepreneurial finance: financing antecedents and SMEs performance	Maria Rio Rita and Sugeng Wahyudi	2019	Indonesia	Resource based view
A structuration analysis of entrepreneurial financing practices.	Colm O'Gorman and Aileen Kennedy	2018	Ireland	Strong structuration theory
The impact of FNGO services on the performance of micro and small enterprises: Empirical evidence from the Volta Region, Ghana	Victor Yawo Atiase	2018	Ghana	Institutional theory
Influence of Awareness on SME's Intention towards adoption of Islamic Finance in Pakistan.	Rabia Rasheed, Sulaman H. Siddiqui and Maria A. Rahman	2018	Pakistan	Theory of planned behaviour
Factors influencing access to finance by SMEs in Mozambique: case of SMEs in Maputo central business district	Hezron Mogaka Osano and Hilario Languitone	2016	Mozambique	Information asymmetry theory
Financing for Small and Medium Enterprises: The Role of Islamic Financial Institutions in Kuwait	Khaled Alhabashi	2015	Kuwait	Agency theory
Small and Medium Enterprises' Access to Finance: Evidence from Selected Asian Economies	Charles Harvie, Narjoko Dionisius and Sothea OUM	2013	Asia	Information asymmetry theory
SME Access to Finance in Selected East Asian Economies	Charles Harvie	2011	East Asia	Information asymmetry theory
SME Access to Finance in Thailand	Chaiyuth Punyasavatsut	2011	Thailand	Information asymmetry theory
SMEs' Access to Finance: An Indonesia Case Study	Zakir Machmud and Ainul Huda	2011	Indonesia	Transaction cost theory

SMEs' access to bank finance in Scotland: an analysis of bank manager decision making	David Deakins, Geoff Whittam and Janette Wyper	2010	United Kingdom	Information asymmetry theory
Role of Islamic modes of financing for growth of SMEs a case study of Islamabad city.	Nazima Ellahi, Tayyab A. Bukhari and Mehwish Naeem	2010	Pakistan	No theoretical framework
Financing of Small and Medium Sized Enterprises in Nigeria	Danjuma Adamu Dabo	2006	Nigeria	Theory of the principal-agent

Source: Author’s compilation

5.7 Motivation for Using Strong Structuration Theory

This study aims to investigate SMEs' access to Islamic banking finance in Pakistan. In order to achieve this aim, strong structuration theory is employed, whilst retaining the spirit of Giddens' original theory, as the main theoretical paradigm to guide and explain the research findings. Strong structuration theory is an advancement to structuration theory, which demonstrates the duality of the relationship between agency and structure. Blackburn and Kovalainen (2009) assert that issues regarding agency and structure are obvious within the domain of SMEs. However, studies in this area focus upon either agency (micro-level) or structure (macro-level) whereas, research based on their duality are scarce (Perren and Grant, 2000). According to Fillis (2007), the main theoretical limitation of SME research is the use of conventional methodologies, which are insufficient to address the contextual issues and thus fail to provide an insight view on SMEs. These methodologies tend to generalise research findings and are more biased to the philosophical assumptions of positivism (Jayasinghe, 2003). Since such studies assume a functionalist[36] standpoint, their conclusions will only be valid for static environmental conditions (Jayasinghe, 2003). Hofer and Bygrave (1992); Hill and McGowan (1999) also assert that the functionalist approach does not adequately address the nature and characteristics of SMEs and the insights of individuals who manage them since human behaviour varies between times and places.

As mentioned earlier, previous research concerning financing practices of SMEs mainly concentrates on their normative practices shaped by the economic perspective of the agency. However, agency is not limited to the principal-agent relationship only, instead it incorporates a broader perspective since factors outside the principal-agent contract also influence the agent's behaviour. Giddens (1984) describes agency as the individual's ability to make a change within their context. He ascribes this ability to change individuals' knowledge about their context and the motivations behind their behaviour and practices (Giddens, 1984). In other words, one's agency is one's independent capacity to act on one's will. This capacity is influenced by one's cognitive belief structure, which is shaped by his experience, perception, circumstances, and environmental factors. In employing strong structuration theory, this study follows Sarason et al. (2006) who

[36] Functionalists attempt to explain consequences of social structures; however, they do not provide an explanation of causes of behaviour (Burrell and Morgan, 1979).

propound it as an approach to understand SMEs (agents) and their actions (agency) in their social context.

The duality of structure and agency in social practices is the principal focus of structuration theory. This duality implies that agents could be both restrained and empowered by their social context. The focus of this study is not only on how social structures are involved in SMEs' practices to acquire Islamic banking finance but also how SMEs (agents) interact with these structures to make a difference in their practices. Hence, seeking access to finance can be viewed as a social interaction that is contextually embedded. The main assumption underpinning this study is that their immediate context influences SMEs' access to Islamic banking finance. The interactions between SMEs ' context and agency need to be explored to understand the micro processes of SMEs' access to Islamic banking finance. Research concerning SMEs' access to finance is mainly concerned with the impact of structurally set out normative practices. Such approaches view firm practices as distinct from the agents and thus, neither investigate the potential interrelation between social structures and agents, nor fully recognise the role of SMEs' agency in shaping their practices to seek access to finance (O'Gorman and Kennedy, 2018). The approach of this study is to explore SMEs' practices to seek access to finance as a recursive and evolving process that acknowledges the substance of SMEs' interactions within their environment without giving priority to either agency or structure. Thus, within this research, SMEs' practices to seek access to finance are viewed as emergent from the dynamic interaction of structure and agency, in a manner highlighted by the structuration theory.

In light of the above discussion, to investigate how SMEs seek to acquire Islamic banking finance in Pakistan, this study mainly draws upon the notion of structuration and minimise the dichotomy between subjective and objective points of view. SMEs' practices to seek access to finance are considered from the perspective of duality; SMEs' access to Islamic banking finance is a social interaction developed and reproduced through the actions of SMEs (agents) that are empowered and limited by structural properties. The primary ontological assumption of this study affirms the construction of reality through the flow of social practices. This ontological stance challenges the notion of dualism between subject and object and advocates the view of interdependence between them in understanding any particular phenomena (Chabrak, 2005). Therefore, the duality of structure, which is the central tenet of structuration theory, provides an appropriate guide to this research as Giddens (1984) pointed out that structures shape social practices and agents can change or replicate those structures through their social practices. Epistemologically, this study supports the notion of understanding a social phenomenon by identifying how, why and in what manner realities are constructed through social interactions. Hence, reflecting on the objectives of this research, strong structuration theory deems fit for examining how SMEs seek to acquire Islamic banking finance in Pakistan.

5.8 Conclusion

This chapter has outlined the structuration theory and the strong structuration approach used to underpin this study. It also considered the feasibility of employing this particular framework to conduct the study. Strong structuration theory (Stones, 2005) is a significant advancement in Giddens' work and is employed to empirical studies over a wide scope of research issues. The criticism levelled against Giddens' work provides a reinforced version of the ontology that clarifies how empirical work may be carried out. The quadripartite nature of structuration serves as a basis for analysing SMEs' access to Islamic banking finance in Pakistan. This next chapter reviews the research design and methodology employed to conduct this study.

Chapter Six: Research Methodology and Methods

6.1 Introduction

The appropriate research methodology is one of the most significant and challenging aspects of any research (Ahmed et al., 2016). The researcher must design a methodology that helps to answer the research question(s) for the given research problem(s) appropriately. This chapter aims to introduce and rationalise the selection of research methodology and methods employed to meet the overall aim and objectives. The remainder of the chapter is structured as follows. Section 6.2 highlights the different philosophical paradigms. It also discusses and justifies the philosophical stance adopted in this study. Section 6.3 outlines the theoretical foundation and circular research design adopted in this study. Section 6.4 presents different aspects of data collection in this study, including data collection techniques, development of data collection instruments, pilot interviews, sample selection and data collection process. It also addresses ethical considerations. Next, the data analysis methods are discussed in section 6.6. Lastly, section 6.7 concludes the chapter.

6.2 Philosophical Paradigm

Research is a process of knowledge creation. A research philosophy incorporates ways of understanding the reality of the world and how knowledge about the world is created (Thornhill et al., 2009). Lather (1986) asserts that a research paradigm inherently reflects the researcher's beliefs and principles about the world, shaping how a researcher sees, interprets, and acts within that world. In other words, a philosophical paradigm represents a fundamental system of beliefs that guides ontology, epistemology and methodology in conducting any research (Coombs, 1993).

6.2.1 Essential Elements of a Philosophical Paradigm

Lincoln et al. (2011) and Creswell and Poth (2016) identify four elements that underpin a researcher's philosophical stance: ontology, epistemology, axiology and methodology. It is essential to understand these components well since they comprise the fundamental assumptions, beliefs, norms and values that each paradigm holds. Each of these is now discussed in turn.

6.2.1.1 Ontology

Ontology constitutes "the nature of our beliefs about reality" (Richards, 2003, p. 33). It is concerned with 'being' (Cimiano, 2006) and investigates what is possible to know about the world

(Ormston et al., 2014). Mack (2011) asserts that ontology is the branch of philosophy that relates to the nature and structure of the world, indicating the idea of the real world and what can be known about it. Concerning ontology, the fundamental consideration is whether social reality exists autonomously of the human being who is experiencing it (Mack, 2011). It implies that ontology deals with a focal issue of whether social entities should be perceived as objective or subjective. Burrell and Morgan (1979) introduce a sliding scale approach to ontology by differentiating the nominalist view of the social world and the realist view. The nominalist view supports the idea that social reality is relative. It is constructed within people's consciousness (Thornhill et al., 2009) when they attach labels to their experiences to describe and explain them. On the other hand, the realist view sees the world as a substantial external structure autonomous of the human consciousness. It, therefore, supports the scientific explanation or a theoretical description of reality. Ontologically, the researcher holds explicit or implicit assumptions about how reality exists; "A singular, verifiable reality and truth, or socially constructed multiple realities" (Patton, 2002, p. 134), and what can be learned about it. The researcher's ontological stance plays a central role in setting the course of the study since ontological assumptions guide the choice of epistemological approaches, research methodologies, and consequently influence the type of research issues being explored (Leavy, 2011).

6.2.1.2 Epistemology

After addressing the beliefs about the nature of reality, the researcher must consider what is implied by the term 'knowledge' and its sources. This consideration is basically about epistemology, which refers to the nature of knowledge, focusing on the connection between the social world being examined and the researcher (Burrell and Morgan, 1979). Creswell and Poth (2016) assert that knowledge is created distinctly through people's experiences, and therefore, epistemology addresses the issue of how researchers know what they know. Burrell and Morgan (1979) highlight that several epistemologies exist, ranging from objectivism to subjectivism. Objectivism supports the view that reality exists independent of people, whereas subjectivism takes the view that reality is socially constructed through interactions between the phenomenon and the researcher (Burrell and Morgan, 1979). Waizbort (2004) highlights that a researcher's ontological assumptions guide him to certain epistemological position. For instance, if the reality is believed to be singular and verifiable, knowledge about the social world is gathered by being objective and through observations and experiments like in pure sciences (Waizbort, 2004). Conversely, belief in socially constructed multiple realities leads to knowledge about social phenomena by getting involved with the subject and understanding their perceptions and contexts (Collis and Hussey, 2013).

6.2.1.3 Axiology

Axiology is concerned with the values and biases that researchers bring to their research (Creswell and Poth, 2016). The researcher's values do dominate not only the research design of the study but also has an impact on what is chosen to be explored (Killam, 2003). In this context, assumptions about the purpose of research are important. The researcher will carry values to the investigation that direct whether they believe that the research target is inciting change or creating knowledge. The ontological and epistemological assumptions made by a researcher influence his view of axiology. For instance, a positivist objective approach sees research as inherently valuable, suggesting that the researcher's values do not have any impact on the research plan i.e., value-free (Killam, 2003) and their activities are determined by the environment (Burrell and Morgan, 1979). On the other hand, in the case of researchers operating with an interpretive subjective viewpoint, the researcher's values are central to the research approach i.e., value-bound (Killam, 2003) and their activities are free-willed and independent (Burrell and Morgan, 1979).

6.2.1.4 Methodology

Methodology refers to “an articulated, theoretically informed approach to the production of data” (Ellen, 1984, p. 9). The choice of methodology guides the researcher about what type of data is required to explore the reality and what methods are suitable to collect the required data so that the key research objectives are appropriately met (Kothari, 2004). In other words, methodological choices decide how to gain knowledge about the world. Therefore, the researcher’s ontological and epistemological assumptions and views on axiology shape the methodology to investigate a particular phenomenon (Creswell and Poth, 2016). There are two prominent methodological approaches; the idiographic approach and the nomothetic approach (Lindlof, 2008). An idiographic methodological approach relates to subjective investigation and is accomplished through getting inside situations by gathering first-hand information i.e., the qualitative method of inquiry (Lindlof, 2008). Whereas the nomothetic approach relates to the objective inquiry, typical of the natural sciences, and is accomplished through measuring a phenomenon against pre-determined hypotheses, i.e., the quantitative method of inquiry (Lindlof, 2008).

6.2.2 Burrell and Morgan's Framework

Various researchers offer different clarifications of the idea of the research paradigm in social science research. According to Wilson (2008), a paradigm is a set of propositions that clarify how the world is seen from a specific perspective. Bassey (1990) views the research paradigm as the broad system which connects scholars with the common ideas about the nature of the social world. A paradigm helps a researcher identify and explain their presumptions about society's nature, which enables them to justify the choice of a specific approach to investigate a given phenomenon (Burrell and Morgan, 1979). Considering all four assumptions about the nature of social science, i.e., ontology, epistemology, axiology and methodology, Burrell and Morgan (1979) distinguish between objective and subjective dimensions of social science research. The objective view recognises that knowledge exists and is waiting to be discovered and ignores the role of meaning in constructing knowledge (Letherby et al., 2012). Only measurable and quantifiable outcomes can inform the real world; therefore, knowledge can only be generated through measurable and objective data (Crossan, 2003). In contrast, the subjective view recognises that reality is subjective and complex and depends on how individuals interpret the situation they find themselves in (Hammersley and Atkinson, 2007). From a subjective point of view, knowledge is created by understanding the concepts and meanings affecting the behaviour of subjects being researched (Garcia and Quek, 1997). Since the researcher collaborates with the social world to build and (re)develop the meaning of social phenomena, he needs to be reflexive in shaping and presenting the findings (Hammersley and Atkinson, 2007).

In addition to the objective-subjective dimensions, Burrell and Morgan (1979) draws upon the work of Dahrendorf (1959) and categorise assumptions about the nature of the social world from another dimension: the sociology of regulation or the sociology of radical change. The sociology of regulation incorporates the works of the social scholars who are reluctant to change and favour the status quo, emphasising order and stability (Dahrendorf, 1959). On the other hand, the sociology of radical change represents those scholars who criticise the status quo and favour the change (Dahrendorf, 1959). Combining these two dimensions of subjective vs. objective and radical change vs. regulations, Burrell and Morgan (1979) recognised four mutually exclusive paradigms to represent the various perspectives on the social world based on a researcher's assumption about the nature of society. These paradigms are illustrated in figure 6.10.

Figure 6.10: Four Paradigms for the Analysis of Social Theory

Sociology of Radical Change

Subjective	**Radical Humanist**	**Radical Structuralist**	**Objective**
	Interpretive	**Functionalist**	

Sociology of Regulations

Source: Burrell and Morgan (1979, p. 18)

The functionalist paradigm views social science objectively and assumes that society is in a particular order. Researchers employing the functionalist approach believe that social phenomena and their implications have a presence autonomous of social researchers (Bell et al., 2018). Epistemologically, the functionalist paradigm affirms that knowledge can only truly be obtained by using and expanding the existing theories to develop and test appropriate hypotheses (Gill and Johnson, 2002). For creating knowledge, functionalist researchers believe in a nomothetic view of methodology and trust only in the deductive/scientific approach which should be deterministic, mechanistic, independent, empirical and methodical (Donaldson, 1996). Since it draws on structured, systematic and objective methods and focuses on establishing relationships to produce generalisable findings (McAuley et al., 2007), functionalist researchers must develop prior theories before approaching a research phenomenon (Gill and Johnson, 2002). Regarding the regulations, the functionalist paradigm corroborates the interpretive paradigm and favours the status quo at the expense of change. It is also similar to the radical structural paradigm in terms of an objective assumption about the social world.

The interpretive paradigm lies at the subjective dimension in Burrell and Morgan's (1979) framework. It rejects the idea of a single verifiable reality and instead, believes in socially constructed multiple realities. The understanding of reality is not independent of the researcher since it is always mediated by our senses (Leitch et al., 2010). The interpretive approach considers how individuals understand their lives and how they characterise their circumstances in interactions with each other (Leitch et al., 2010). Therefore, the interpretive paradigm promotes an inductive approach to understanding a social phenomenon (Nunes and Al-Mamari, 2008). The interpretive approach aims to understand a social phenomenon through the participants' eyes and not the researcher. Regarding the regulations, the interpretive paradigm corroborates the functionalist paradigm and favours the status quo at the expense of change. It is also similar to the radical humanist paradigm in terms of a subjective assumption of social science.

The radical structuralist and the radical humanist are two paradigms identified by Burrell and Morgan (1979) in the sociology of radical change. The radical structuralist paradigm lies in the objective dimension of the social world with a view that society requires a radical change, sharing similarities with functionalism but with an adherence to a radical change. Studies adopting this paradigm share a focus on radical change, power relationships, emancipation, deprivation and potentiality (Burrell and Morgan, 1979). They view radical change as a part of the structure of every contemporary society, which is generated through political and economic crises (Burrell and Morgan 1979). It means that the radical structuralist paradigm is not only concerned with the structure of organisations and exiting relationships and conflicts but is also directed at achieving a fundamental change in organisations (Saunders et al., 2011). Therefore, studies employing the structuralist paradigm subscribe to a realist positivist, determinist and nomothetic approach (Burrell and Morgan 1979).

The radical humanist adopts sociology of radical change from a subjective view of the social world, sharing similarities with interpretive paradigm but with an adherence to a radical change. Unlike interpretivist researcher, radical humanist criticises the status quo and favours radical change. Patton (2002) highlights that radical humanist researchers aim to understand or explain society and change it. Studies adopting the radical humanist paradigm assume that reality exists. However, it has been shaped by a social framework of cultural, political, ethnic, gender and religious factors (Kreuger and Neuman, 2006). Epistemologically, it assumes the subjective position and takes an axiological stance that no object can be researched independent of the researcher and subscribes to an idiographic assumption about methodology (Kreuger and Neuman, 2006).

6.2.3 Criticism of Burrell and Morgan's (1979) Framework

Despite its popularity and usefulness, Burrell and Morgan's (1979) framework have received several criticisms from various social science researchers such as Hopper and Powell (1985); Chua (1986); Willmott (1990); Laughlin (1995) and Ryan et al. (2002). Hopper and Powell (1985); Chua (1986) and Willmott (1990) criticise Burrell and Morgan (1979) for making a distinction between radical humanists and radical structuralists. The authors contended that this dichotomy is artificial and is not adequately underpinned by the sociology literature (Hopper and Powell 1985; Chua, 1986; Willmott, 1990). Another criticism raised by Chua (1986) is about the mutual exclusivity of the paradigms. Burrell and Morgan (1979) identify the four paradigms as mutually exclusive. They believed that these paradigms offer alternative views to understand the social world (Burrell and Morgan, 1979). Merging these paradigms is not possible since they, in their pure forms, are contradictory, and by accepting the assumptions of one, we reject the assumptions of all the others (Burrell and Morgan, 1979). Chua (1986) challenges the mutual exclusivity of paradigm as it is neither supported by the objectivists nor by the subjectivists. Laughlin (1995) also corroborates Chua (1986) and criticised the strict dichotomy of the objective and subjective ends of the continuum. He suggests a middle-range approach to be more realistic as inherent weaknesses associated with the objective and subjective ends can be improved by embracing the middle position (Laughlin, 1995).

Giddens (1984) recognises dualism as the limitation of paradigms and proposes the duality of structures as a means of overcoming this limitation. He argues that this dualism has to be reconceptualised as a duality (Giddens, 1984). Giddens (1984) in his theory of structuration, which is the fundamental theoretical framework employed in this study, attempted to bridge this dualism with the concept of structuration which conceives the dichotomies as dualities rather than dualisms. Giddens (1984) asserts that structuration theory seeks to address the separation of objective-subjective division and perceived deficiencies of the opposing prevailing schools of sociological thought. According to Jones (1999), structuration theory tends to overcome the weaknesses of both the functionalism that underplays the significance of human activity and the interpretivism that is strong on action but weak on the structure.

6.2.4 Philosophical Assumptions Underpinning This Study

Despite these criticisms, the current study adopts Burrell and Morgan's (1979) framework, as it provides an appropriate foundation for discussion of the research methodology in a deeper and wider context. Nevertheless, further theoretical perspectives must be incorporated in the philosophical considerations to examine SMEs' access to Islamic finance in Pakistan. Weaver and Gioia (1994) contend that, although the reconciliation of individuals and structures dichotomy in investigating a particular phenomenon may not appear to be practical, it is possible to achieve a unified body of knowledge through Giddens' structuration theory. However, Giddens does not provide details regarding his epistemological and methodological approaches. Therefore, in this study, Burrell and Morgan (1979) framework were not adopted eclectically to place the researcher in a particular research paradigm, but as a guide to choosing the appropriate epistemology and methodology to achieve the research aims and objective, keeping in mind Giddens' (1984) claim about the duality of structures.

The philosophical assumptions about the ontology, epistemology, axiology and methodology underpinning this study are discussed in the following sections. Table 6.11 summarises these philosophical assumptions as compared to the philosophical assumptions in Burrell and Morgan's (1979) paradigms.

Table 6.11: Philosophical Assumptions

	Ontology	Epistemology	Axiology	Methodology
This Study	Duality	Anti-Positivist	Value bound	Idiographic
Functionalist	Universal truth	Positivist	Value free	Nomothetic
Interpretive	Multiple realities	Anti-positivist	Value bound	Idiographic
Radical Humanist	Multiple realities	Anti-positivist	Value bound	Idiographic
Radical Structuralist	Imperfect reality	Positivist	Value free	Nomothetic

Source: Adapted from Burrell and Morgan (1979).

6.2.4.1 Ontology

Stones' (2005) strong structuration theory, which is the development of structuration theory, is employed as the overarching theoretical framework in this investigation. Structuration theory offers its own ontology that opposes the strict dichotomy of the objective (structuralism) and subjective (agent orientated) positions and acts as a bridge between them. Along these lines, the duality of human agency and social structure is vital to the ontological position of this study. Such a position implies that the subject (agent) and the object (structure), in social science research, are reciprocally related and thus, the objective of the research is to investigate the link between these various dualities (Greenhaigh and Stone, 2010).

6.2.4.2 Epistemology

The vast majority of SME financing literature is situated within the functionalist paradigm. It is based on the underlying assumption that SMEs operate logically and are controlled by a wider economic structure. Given that the research questions of this study focus on understanding how their social settings influence the practices of SMEs seeking to acquire Islamic banking finance, this study rejects the positivist stance and adopts a non-positivist position. Under this epistemological position in Burrell and Morgan's (1979) framework, the focus is on the subjective experiences of individuals and, therefore, knowledge can only be generated by making the participants reveal their inner thoughts (Hopper and Powell, 1985). Consequently, the anti-positivist epistemology of this research is concerned with making sense of the perceptions and experiences of SMEs and positions human interpretations as central in generating knowledge of the social world (Mack, 2010).

6.2.4.3 Axiology

This study aims to delve into the experiences of Pakistani SMEs seeking to acquire Islamic banking finance and understand the meanings they attach to different aspects of their practices. To achieve this aim, the relevant data is subjective and potentially vague rather than precise, and hence, the research axiology tends to be value bounded and not value-free (Killam, 2013).

6.2.4.4 Methodology

The methodological framework is the product of the ontological, epistemological and axiological assumptions underlying this study. This study intends to comprehend the world of SMEs from their perspectives, and the research questions are aimed at gaining a deeper and social infused understanding of SMEs' financing practices. To achieve this aim, SMEs and other agents-in-context need to be provided with an opportunity to share their experiences and reflect upon their ideas and concerns (Smith and Shinebourne, 2009). Therefore, an idiographic methodological approach is employed in this investigation. The anti-positivist stance of this study requires moving away from large sampling and data modelling to an approach involving engagement with agents in the field. Hence, nomothetic methodologies would be inconsistent with the epistemological and theoretical positions of this investigation.

6.3 Theoretical Foundations and Circular Design

There are substantial discussions about the appropriate time to bring theoretical ideas into an investigation and the scope of integrating a priori theory before, during, and after collecting empirical data (Marginson, 2004). Makrygiannakis and Jack (2018) highlight two approaches of using social theory; as a sensitising device: collecting the data and applying a social theory to analyse it and the other is deploying a social theory to a study since its inception. Using social theory to analyse already collected data relates to Giddens' (1984) ideas. It employs theory as a way to think about interesting research problems, and to interpret the research outcomes. The proponents of this approach argue that applying the theory prematurely may lead to inflexible or closed thinking. Therefore, the theoretical ideas should emerge after collecting the data (Makrygiannakis and Jack, 2018). Fundamentally, effective investigation and understanding of an empirical domain involve being open to alternative theories that would require arriving at a study with no pre-conceptions. However, Marginson (2004) asserts this as an unrealistic approach as the preparatory work for the research will instil the researcher with some prior theoretical perspectives.

On the other hand, the idea of mobilising social theory from the beginning incorporates that "research problem, theory, and data influence each other throughout the research process" (Ahrens and Chapman, 2006). When entering the research site, the researcher has a theory in mind with only tentative expectations of the research problems (Layder, 1993) and gradually narrows down his focus on the specific phenomenon. The research design is loose and adaptable at the initial stages. However, a more specific design is developed after the clarification of the theoretical and empirical problems. This may prompt the reconsideration and refining of the research question(s), levels of analysis, and the modes of analyses suited to the findings.

Stones and Jack (2016) propose an alternative to the use of social theory as a sensitising device in the form of using it as a conceptualising methodology to design the research. It requires the researcher to have a clear objective to study a specific phenomenon before visiting the research site(s). Thus, prior theory can design the research to facilitate the appropriate data collection to investigate that phenomenon (Stones and Jack, 2016). This incorporates a process of abstraction (Sayer, 1998) to build up a conceptual model opposite to the research problem and the area of study.

This study adopts a theoretically informed circular design which consists of the following interlinking parts: a clear objective to investigate the specific research problem, prior theory, theoretically informed research questions, interview questions designed in accordance with the theoretically specific data requirements, thematic data analysis, which links the findings to the prior theory (Makrygiannakis and Jack, 2018). Consistent with the circular design, the study began with a clear research problem at hand, taking theory into consideration which served as a tool for setting research questions and the broad directions for conducting the research. For instance, the introduction of the position-practice relations of the field, which is the core of context analysis in strong structuration theory, directly influenced the design and data collection decisions. In terms of design, it guided the data collection. It led to interviews with the Islamic bank managers dealing with SME financing (agent-in-context) and not only the interviews with SMEs (agent-in-focus).

Furthermore, it guided the specific interview questions, such as who did what, where, when, how and why, to investigate the issues identified by this particular theoretical perspective, such as the concepts of knowledgeability of the agent, agent's motivation of action etc. The next stage of the circular design is a thematic analysis which is discussed in section 6.5.1. Finally, the findings are linked to the prior theory in chapters seven, eight and nine.

6.4 Data Collection

Data collection is one of the most significant stages in leading research. It is the way towards gathering and measuring relevant information on variables under inquiry in a systematic manner to enable the researcher to address the research question(s) (Kabir, 2016). Data collection aims to gather quality evidence that provides the basis for answering the research question(s). Therefore, accurate data collection is vital to establish the credibility of research, irrespective of the field of study or type of data (quantitative or qualitative) required. In this regard, the choice of appropriate data collection instruments together with the clearly outlined directions for their right use increases the likelihood of gathering accurate data.

6.4.1 Semi-Structured Interviews

Bell et al. (2018) highlight that the social world must be explained from the viewpoint of the subjects being studied. In order to achieve the aim and objectives of this study, where the focus is on SMEs' access to Islamic banking finance through the perceptions of SMEs, primary data (which is not available from a database) related to Islamic banks and SMEs' financing needed to be collected. This involved interactions with the participants and interpreting their views that represent the socially constructed realities of funding SMEs through Islamic modes of financing. As the investigation required primary data, semi-structured interviews were conducted to understand the SMEs' owners/managers perceptions of constraints as well as ways of accessing Islamic finance. Thirty-five face-to-face semi-structured interviews were conducted targeting SME owners who have actively sought Islamic banking finance in the past, Islamic bank managers who deal with SME financing and a Sharia board member.

Semi-structured interviews were considered the most suitable for this study because of two significant advantages associated with them. First, they facilitate two-way communication, ensuring that the interview questions are well comprehended (Sekran, 2003). They also help the researcher obtain a more profound knowledge about the issues being considered by providing an opportunity to ascertain and clarify the reasons for any position held through the follow-up questions (Hussey, 1997). Second, semi-structured interviews allow a great degree of flexibility as, although the interview questions are established in advance, the interviewer has the freedom to reorder, modify or insert the questions following the information provided by the interviewee (Berg and Lune, 2007; Bryman, 2016). Thus, the interviewer can guide the interview in a manner to obtain relevant information on the phenomenon under research.

6.4.2 Development of Interview Guides

The interview guides were developed with the research objectives, research questions, issues identified in the literature, previous research studies, and the theoretical framework underpinning this study. Some of the questions were derived from previous studies on SMEs financing[37], however, after an informal discussion with three SME owners who have actively sought Islamic banking finance in the past, interview guides were adjusted according to the context of this study. To ensure the inclusion of all the relevant issues, interview probes and prompts were also developed along with the interview questions to seek further details or explanations.

Given interviews with SMEs' owners/managers, Islamic banks' managers dealing with SMEs and a Sharia board member, separate interview guides were developed for each group. However, the

[37] For instance, Financing for Small and Medium Enterprises: The Role Of Islamic Financial Institutions In Kuwait (Alhabashi, 2015); The feasibility of using profit and loss sharing for financing small and medium sized enterprises in Saudi Arabia (Binzomah, 2008).

fundamental issues addressed in the interview guides were more or less the same for all the groups. The interview guide for the Sharia board member was developed after conducting the preliminary analysis of data gathered from interviews with SME owners/managers and Islamic bank managers. Apart from the variations in the interview questions depending on the targeted group of interviewees, the interview questions were divided into four main phases. The first phase is the introductory part which provides the introduction of the researcher, the aims of the study and the description of the project. The company's and/or interviewee's profile was obtained in the second phase. The third part then addressed the main interview questions which were divided into sub-sections. The final part of the interview guide provides an opportunity for the interviewee to make any additional remark or cover any additional issues they feel relevant.

The interview guide for all three groups of interviewees is provided in Appendix 3. The interview guides were developed in English. Although the native language of Pakistan is Urdu, English is the official language and is widely spoken and understood in Pakistan. The supervisors of this study reviewed the initial drafts of all the interview guides. Their feedback prompted the alterations of the wordings and elimination and addition of some questions.

6.4.3 Pilot Interviews

Interviewing is a task that requires many abilities and skills and therefore, conducting pilot interviews is significant before conducting a full-scale study (Van Teijlingen and Hundley, 2002). Piloting interviews provide an opportunity to check the validity and reliability of the research but also help in building the ability to deal with the interviewees (Mason and Davies, 2011). The researcher conducted three pilot interviews: two with SME owners/managers and one with an Islamic bank manager. The interviews were conducted in September 2020 at their workplaces as chosen by the interviewees. This pre-testing brought various developments to the interview guides regarding the wordings and order of the question and provided an opportunity to learn how to conduct the face-to-face interviews. This experience was very beneficial since it helped enhance the researcher's self-confidence and identified several weaknesses in the way of conducting the interview, which was then avoided in the actual interviews. Based on the pilot interviews, the interview guide was revised by rephrasing some questions and adding one more question to develop a final draft for the full-scale study.

6.4.4 Sample Selection for Interviews

A key element of sampling for qualitative data is its relatively small size. Crouch and McKenzie (2006) argue that a qualitative study is concerned with establishing meanings and not making a generalisation. Therefore, a small sample size facilitates an in-depth exploration of the phenomenon under research. Choosing a suitable sample size in qualitative research is a debatable issue since there is no one size fit all. Strauss and Corbin (1998) assert that to establish validity in qualitative studies based on interviews, the number of interviews conducted in a study should be adequate for reaching theoretical saturation. Theoretical saturation is closely identified with the grounded theory and characterised as a stage where no new theme emerges from the successive data regarding a category under investigation (Glaser and Strauss, 1967). Guest et al. (2006) attempt to identify a sufficient number of interviews in their study "how many interviews are enough? An experiment with data saturation and variability", employing an empirical approach, based on a set of sixty interviews and reach the saturation with twelve interviews with no major theme emerging after six interviews. They highlight that homogeneity of the given sample is an important factor affecting the number of interviews required and conclude that for most of the studies, twelve interviews should suffice to understand the perceptions and experiences of relatively homogeneous individuals (Guest et al., 2006). However, the point of saturation may vary for any given study. For instance, Francis et al. (2010) report saturation after 17 interviews, whereas Wright et al. (2011) reached saturation after a much larger sample of 63.

For this study, the guiding principle of the 'saturation' was used to determine the sample size. A total of thirty-five participants were selected; of which twelve were Islamic bank managers dealing with SME financing, twenty-two were owners/managers of SMEs operating in different sectors (manufacturing and trade/services) and one was a Sharia board member. After these interviews, it was evident that although individual experiences will never completely overlap and align, there was significant saturation since data began to repeat and no additional issues or insights related to this study were identified. The relationship established with the first interviewee facilitated access to other interviewees by means of their recommendations. There was a level of purposiveness while selecting the interview sample, which implies that not all individuals have an equal chance of being included in the sample (Jennings 2010). Purposeful sampling is a sampling method employed in qualitative research to identify and select information-rich cases (Patton, 2002), i.e., identifying and selecting individuals especially knowledgeable about or experienced with the phenomenon under research (Cresswell and Clark, 2011). Bernard (2002) adds that in addition to being knowledgeable and experienced, availability and willingness to participate and the ability to communicate in a reflective manner are also considered as significant factors.

After the introductory phase, the next section of the interview guide was targeted to obtain the participants' profiles. Some of the key details regarding the participants are summarised in the Table 6.12 on the next page.

Table 6.12: Participants' Profile

No.	Participant's Code	Gender	Participant's Age	Highest Level of Education	Experience (No of years)	Firm's Age
1	Bank Manager 1	F	29	Master's Degree	8	-
2	Bank Manager 2	M	37	Master's Degree	14	-
3	Bank Manager 3	M	46	Cost and Management Accountant	20	-
4	Bank Manager 4	F	35	Master's Degree	15	-
5	Bank Manager 5	M	33	Master's Degree	13	-
6	Bank Manager 6	M	30	Master's Degree	8	-
7	Bank Manager 7	M	28	Master's Degree	7	-
8	Bank Manager 8	M	45	Master of Philosophy	19	-
9	Bank Manager 9	M	39	Master's Degree	17	-
10	Bank Manager 10	M	26	Master's Degree	4	-
11	Bank Manager 11	F	28	Bachelor's Degree	6	-
12	Bank Manager 12	F	31	Master's Degree	9	-
13	SME Manager 1	M	27	Master's Degree	7	31
14	SME Owner 2	F	23	Bachelor's Degree	8	8
15	SME Owner 3	M	31	Diploma of Business Administration	10	10
16	SME Owner 4	M	29	Master's Degree	6	39
17	SME Owner 5	M	50	High School	23	23
18	SME Owner 6	F	34	Master's in architecture	7	20
19	SME Manager 7	M	25	Master's Degree	4	37
20	SME Owner 8	F	51	Bachelor's Degree	23	24
21	SME Owner 9	F	38	Diploma of Business Administration	13	13
22	SME Owner 10	M	47	High School	12	42
23	SME Manager 11	M	30	Master's degree	8	21
24	SME Owner 12	M	46	High School	28	30
25	SME Owner 13	F	55	Diploma of Associate Engineering	35	35
26	SME Owner 14	M	36	High School	17	33
27	SME Owner 15	F	45	Bachelor's Degree	15	15
28	SME Owner 16	M	27	Master's Degree	7	50

29	SME Owner 17	M	30	Master’s Degree	6	6
30	SME Owner 18	M	28	Bachelor’s Degree	7	24
31	SME Manager 19	M	29	Master’s Degree	6	26
32	SME Owner 20	M	33	Master’s Degree	11	11
33	SME Owner 21	M	37	High School	15	18
34	SME Owner 22	F	49	Middle School	27	53
35	Sharia board Member	M	45	Doctor of Philosophy	23	-

Over 2/3rd of the participants was male (11 females and 24 males), reflecting the socio-cultural factors and traditional values in Pakistan where women predominantly manage the household affairs and men are the breadwinners (Hussain and Mahmood, 2012; Yunis et al., 2019). However, the findings of this study are not skewed by this gender imbalance since the sample fits in well with the business landscape in Pakistan [38]. The age of participants varies between 26 and 55 years. Whereas the age of SMEs who participated in this study varies between 6 and 53 years. The table also highlights that participants' experience in their respective fields varies from 4 to 35 years. All the bank managers who participated in this study held a masters or a higher level of qualification except for those who held a bachelor's degree. In the case of SME owners/managers, 9 of them had master's degree level, 8 had a bachelor's or an equivalent degree level, 4 had high school level and 1 had middle school level education. The Sharia board member holds a doctorate.

6.4.5 Conducting the Interviews

Thirty-five participants were interviewed, with each interview lasting between 50 to 60 minutes. The interviews were conducted in two phases. In the first phase, thirty-four interviews were completed with SME owners/managers and Islamic bank managers over three months from September 2020 to November 2020. In the second phase, a Sharia board member was interviewed in July 2021 after conducting the preliminary analysis of interviews completed in the first phase. This approach was used to reinforce the main findings that emerge from the interviews with SMEs and the bank managers and to ascertain the views of the Sharia Board member on the key findings of the study.

A suitable time and place to conduct the interview were arranged with the participants in advance. Also, they were informed about the estimated time the interview will take. Before starting the actual interview, three key processes were addressed. First, to break the ice and build a friendly and trusting environment, the researcher introduced herself. The fact that the researcher and the participants share the same socio-cultural values made trust-building relatively easy. Next, the participant was reminded about the aim of this study and assurance was given to maintain their

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[38] According to The Women Entrepreneurs Finance Initiative (We-Fi) supports program, percentage of women's entrepreneurship in Pakistan is lowest in the world with only 1% of female entrepreneurs compared to 21% of male. [Available at: https://we-fi.org/enabling-women-entrepreneurs-in-pakistan-through-training-and-legal-reform/]

confidentiality and anonymity. Lastly, their consent was obtained to record the conversation digitally.

All interviews were conducted face-to-face at the participants' workplaces. While conducting the interviews, digital recording was made subject to the participant's consent. In addition to recording the interviews, field notes were also taken. Interview questions were generally asked in the sequences established in the interview guide. However, on a few occasions, the arrangement was changed to match the flow of the conversation. All the interviews were conducted in the English language. The interviews were transcribed, and the transcripts were cross-checked with the recordings and notes to ensure accuracy. The interviewees were provided with the transcripts to follow up and comment upon.

6.4.6 Ethical Considerations

All research, whether using primary data or secondary data, must adhere to ethical standards. However, studies that involve human participation require more attention to ethical principles (Waycott et al., 2016). Analysts need to comprehend ethical measures on voluntary participation, informed consent, confidentiality, and anonymity (Thorpe, 2014). Drake (2014) highlights that adherence to ethical standards ensures that the participants do not encounter any harm or a lack of privacy from involvement in the study. This study is carried out under the ethical approval guidelines of Aston Business School. The confirmation of ethical approval is annexed in appendix 3.

The research participants were given the free will to participate in the study. Their consent was obtained, and they were given the right to exclude themselves from the study. To ensure freely informed consent, the purpose of the study was explained to the participant, and they were informed about their right to refuse to respond to any question or withdraw at any time if they experience any pressure or apprehension during the interview. All information provided by the participants shall be treated with confidentiality and shall be used for an academic endeavour only and not for any financial gain. Further, the participants' anonymity is maintained, and their identity is not revealed in any part of the study. For this purpose, the participants are assigned codes, such as Bank manager 1, SME owner/manager 1 etc. and these codes were used in referring to them in the study. Lastly, accurate referencing and acknowledgement is done for the sources and data used for this study.

6.5 Data Analysis

Krauss (2005) describes data analysis and concluding data as the most perplexing stage of subjective research. Strauss and Corbin (1998) highlight that qualitative data is subject to careful analysis to examine patterns. Data that is analysed in an efficient manner using a systematic approach can be transparently communicated to others (Malterud, 2001). For this study, the subjective information accumulated from the interviews is analysed using thematic analysis to identify key themes that the interviewees consider important in relation to how SMEs seek to acquire Islamic banking finance in Pakistan.

6.5.1 Thematic Analysis

Thematic analysis is one of the widely used tools for analysing qualitative data (Joffe, 2012; Terry et al., 2017). It goes beyond simply counting phrases or words in a text and searches for the explicit and implicit meanings within the data (Guest et al., 2011). Braun and Clark (2006) characterise thematic analysis as a tool for identifying, analysing and reporting themes within the given set of data. Those themes are the patterns across data sets that capture the essence of the phenomenon being investigated (Bruan et al., 2019). O'Donovan (1999) points out that using open-ended semi-structured questions results in an extensive amount of data. To analyse this huge volume of data, major themes should be recognised so that the data can be categorised into those themes. Braun and Clarke (2006) identify six stages of thematic analysis. These include becoming familiar with what the data entails, creating initial codes, combining codes with themes, reviewing themes, naming themes, and producing the final report based on themes that make meaningful contributions to understanding what is going on within the data (Braun and Clarke, 2006). Braun and Clarke (2006) further contend that thematic analysis is not a linear process that runs from moving one stage to the next it instead requires moving back and forth throughout the analysis process.

King (2004) identifies thematic analysis as a flexible approach that can be adapted according to the requirements of the study while providing a detailed account of data. Flexibility in theoretical design and research design means that thematic analysis can be applied to various theoretical and epistemological stances (Braun and Clarke, 2006). Since there are few prescriptions and procedures, thematic analysis can easily be grasped even by relatively unfamiliar with qualitative methods (Boyatzis, 1998). King (2004) affirms that thematic analysis is a valuable tool for exploring different research subjects' perspectives, enabling the researcher to compare participants' points of view and generate uncovered insights in the data set. It is also useful for summarising key features of larger data sets, as it enables the researcher to adopt a well-structured approach to handle the data (King, 2004).

6.5.2 NVivo Template

Collecting and analysing unstructured or semi-structured information using manual tools alone can be a complex and time-consuming process, particularly when the researcher has extensive data (Flick, 2018). Identifying themes and extracting meanings from data can be challenging if it needs to be done using manual techniques only (Basit, 2003). Roberts et al. (2013) assert that qualitative research is increasingly being conducted using computer-assisted methods to analyse data. Such methods permit more efficient and effective work processes since they require less time than the manual methods and help gain deeper insights into the data that might have been missed otherwise (Hilal and Alabri, 2013). This study utilised NVivo, a computer-aided qualitative data analysis software to analyse the data.

NVivo assists the analyst in managing, shaping and making sense of qualitative data (Edhlund and McDougall, 2019) by providing ways to thematically analyse textual data (King and Brooks, 2017). It requires building up a coding template that summarises various themes identified by the researcher through the data review and then creates meaningful relationships from those themes (King and Brooks, 2017). Welsh (2002) asserts that computer-aided analysis ensures a high degree of accuracy and greater transparency. NVivo provides more comprehensive techniques for examining and organising the data through coding, making nodes, setting up attributes, finding links, developing conceptual maps and so on (DeNardo and Levers, 2002). In addition, NVivo also makes retrieval easier as a researcher can also search for words and phrases very quickly (Edhlund and McDougall, 2019) whereas, manual coding, retrieving may require a researcher to spend a longer period.

6.5.3 Data Preparation

As identified by Creswell (2009), the initial step of analysing data was to organise and prepare data for analysis by transcribing interviews, optically scanning material, corroborating with field notes and digital recordings, and sorting and arranging the data. Next, all the transcripts were reviewed to understand the information from the organised data and reflect upon its overall meaning. Finally, the textual data were imported into NVivo for coding.

6.5.4 Defining Themes (Nodes) and Coding on NVivo

NVivo template analysis generally begins with initiating some ‘a priori’ nodes that indicate themes regarded as relevant to the analysis (King and Brooks, 2018). After defining ‘a priori’ nodes, the next step is to read through the data and find segments relevant to the research question(s) and where such segments correspond to ‘a priori’ nodes, they are coded under each theme (King and Books, 2017). NVivo assigns significance to some themes over others based on how frequently each theme occurs in the data being analysed. Consequently, nodes can be adjusted or omitted if they are not significant to the actual data examined. New themes can also be defined to encompass the relevant materials from the data (Sinkovics, 2018). As a result, an initial template is being created. King and Brooks (2017) highlight that an initial template can usually be generated after reading and coding the first few transcripts. It can be applied to the whole data set and is open to any modification required after reading each transcript. Once a final template is established after coding all the transcripts, it is used as a guide to interpret the data set and extract the findings to answer the research question(s) (Skinkovics, 2018).

In line with the above-mentioned template style of thematic analysis, the interview transcripts were reviewed to identify and list the themes relevant to the research questions. Then the various ‘a priori’ nodes were created to incorporate all the relevant themes and sub-themes. These nodes were based on the theoretical lens of strong structuration theory and incorporate four elements of the quadripartite model of the structuration cycle: external structures, internal structures, active agency and outcomes. After defining themes, the transcripts were read and re-read through the lens of these nodes, where various sub-themes were identified and coded using each component as codes (these themes are presented in the following chapters). Edhlund and McDougall (2019) identify coding as the most crucial stage of Nvivo analysis. Coding refers to the process of recognising one or more units of texts that demonstrate some theoretical ideas (Edhlund and McDougall, 2019).

6.5.5 Drawing and Verifying Conclusions

Conclusions were built during the data collection and analysis phases, with verification being a continuing exercise ranging from reviewing field notes to reading through the interview transcripts. A basic framework emerged from the primary areas addressed in the interviews, such as the context of SME managers/owners, which was used to group the various ideas embedded in the responses. Data were then coded, based on the themes identified during the literature review and from the data set itself, to dig out the deeper meaning in the data. The concluding stages focused on substantial going back and forth to the data to filter critical themes until the refinement was obtained and the story was told. The relevant literature and the theory were entwined into the analysis throughout this process. The detailed data analysis is presented in the following chapters.

6.7 Conclusion

This chapter provided an overview of the research methods and methodology employed in this study, keeping in mind the study's overall aim and theoretical underpinnings. This study does not subscribe to a particular research paradigm. It is based on the ontology of structuration theory which opposes the strict dichotomy of the objective (structuralism) and subjective (agent orientated) positions and instead acts as a bridge between them. Epistemologically, knowledge about the social phenomenon of SMEs' access to Islamic banking finance was gathered through the experiences of SMEs' owners/managers and Islamic bank managers dealing with SMEs. The inductive research approach is applied since the research seeks to derive the general patterns from the data collected during the research, rather than asserting the consistency of data with prior assumptions. An idiographic research methodology is utilised, with semi-structured interviews being used as a data collection instrument. Thirty-five face-to-face semi-structured interviews were conducted targeting three groups; SME owners/managers (22 interviews) who have actively sought Islamic finance in the past, Islamic bank managers who deal with SMEs' financing (12 interviews) and a Sharia board member). The chapter also explained thematic analysis to analyse the data gathered through the interviews using NVivo. Having discussed the, literature review, research context, theoretical framework and the methodological framework in the current and previous chapters, the next chapter presents the findings of interviews.

Chapter Seven: Findings I: Agent's Context Analysis

7.1 Introduction

The preceding chapter sets out the approach to data collection and analysis, keeping in mind the aim to investigate SMEs' access to Islamic banking finance in Pakistan. A total of thirty-five semi-structured interviews were undertaken with the owner/manager of SMEs seeking to acquire Islamic banking finance, Islamic bank/branch managers dealing with SME financing, and a Sharia board member. Chapters 7, 8 and 9 explore the findings emerging from the empirical evidence collected during the fieldwork. This chapter reflects on agent's context analysis; one of the two building blocks intrinsic to methodological bracketing proposed by Stones (2005) in strong structuration theory. The remainder of this chapter is organised as follows: Section 7.2 outlines the concept of agent's context analysis. Section 7.3 maps the position-practice network of the significant clusters of agents-in-context as identified by the agent-in-focus, SMEs. Section 7.4 identifies the external structures impacting practices of SMEs seeking to acquire Islamic banking finance. Section 7.5 concludes the chapter.

7.2 Revisiting the Concept of Agent's Context Analysis

One of the distinguishing features of strong structuration theory is its emphasis on different ontological levels and the employment of methodological bracketing including agents' context and conduct analysis. Giddens (1979) asserts that society is built and transformed through social experiences which produce and reproduce it afresh. This ontological position makes it inherent to applying structuration theory to comprehend the context of social interaction, including its inevitable features of constraint and enablement. As explained in chapter five, Stones (2005) suggests the bracket of agent's context analysis for this purpose. He asserts that strong structuration theory simply cannot be "operationalised adequately" without analysing the agent's context (Stones, 2005, p.123). Analysing an agent's context provides an opportunity to understand their perspective on looking out at the opportunities and limitations, power relations, norms and possible positive and negative outcomes (Stones, 2015). It shifts the focus from the agent towards the social landscape in which they are embedded. To understand the practices of SMEs seeking to acquire Islamic banking finance, the investigation must go beyond the surface-level analysis of SMEs and examine the significant characteristics of the social environment in which SMEs operate.

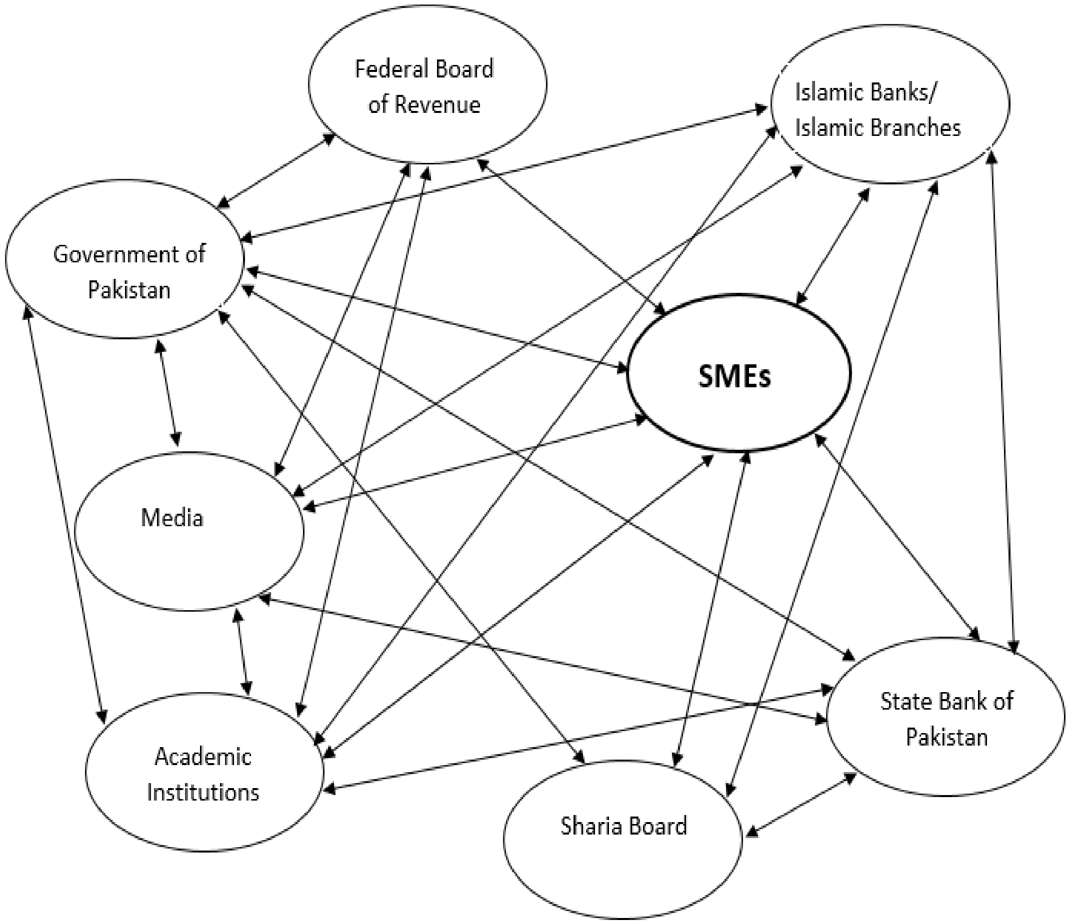
7.3 Position-Practices Network of SMEs Seeking to Acquire Islamic Banking Finance

Agent’s context analysis depicts the external process of structuration, investigating the potential outcomes and impediments offered and posed by the position-practice network. It focuses on the social landscape in which agents are embedded, represented by the position-practice relations of the field. To conceptualise the meso-level institutional connection between structures and agency, Stones (2005) embraces Cohen’s (1989) idea of position–practices, highlighting the complexity of relations between position-practices and how they are realised in the actions of individuals. Stones (2012) proceeds to build upon Cohen’s idea, claiming that events (and practices) are better comprehended within a progression of position-practices and their networks of relations. One can develop an appropriate theorised contextual framework of these position-practice relations, relevant to the agent-in-focus, which addresses the specific research questions (Stones and Tangsupvattana, 2012). This is possible on Giddens’ (1984) tenet that actors within position-practices are believed to be reflexively knowledgeable with respect to their particular social positions and the network of practices encircling them, how the agency is carried out and how structures are reproduced.

Understanding the agent’s contextual field requires gathering evidence on various factors, including the primary actors embedded within the field (Stones, 2005). The position represents the social ‘position’ held by the focal agent in relation to the different agents in the given context. Whereas ‘practices' are identified with the obligations and rights embedded in the role of focal agent (Stones, 2005). The focal agent can be seen as embedded in the network with the clusters of agents-in-context. They have relations and interact to execute their obligations in each social position.

Before proceeding to the significance of different agents-in-context and the principal themes of external structures, the mapping of SMEs’ position-practice network, as perceived by SMEs, provides a useful analytical point. SMEs’ position-practice relation network is illustrated in figure 7.11.

Figure 7.111: Network of Position-Practice Relations of SMEs



Consistent with Cohen (1989), the empirical evidence collected demonstrate that all the clusters of agents illustrated in figure 7.11 are important. However, they should not be considered as of uniform significance. The supremacy could be derived from, for example, the frequency with which a particular cluster interacts with the SME or the perceived impact of a specific cluster on the actions of SMEs. For instance, only a small number of participants mentioned academic institutions as an important agent-in-context, but this cluster's perceived influence was significantly high. On the other hand, although, participants attached relatively high importance to media, the empirical evidence reveals relatively fewer interactions between SMEs and this cluster of agents. The relatively high importance attached to the Federal Board of Revenue (FBR) may be surprising. The interview guide initially did not contain any specific question(s) regarding the FBR. However, when all participants repeatedly mentioned it during the pilot interviews, the interview guide was adjusted to incorporate this significant agent-in-context. All thirty-five participants mentioned FBR. However, they view it as a structure that constrains SMEs' access to Islamic banking finance (as discussed in section 7.4.3).

Stones (2005) clarifies the interplay between structure and agency in the "quadripartite model of structuration" with four interwoven dimensions: external structures, internal structures, active agency and outcomes. To investigate SMEs' access to Islamic banking finance through the lens of strong structuration theory, it is necessary to build an understanding of the contextual field of the agent-in-focus. The contextual field of the agent is depicted through position–practices network and is significant to analyse external structures since the external structures are mainly mediated through position–practices (Stones, 2005). This section mapped the significant clusters of agents' in-context that influence actions of Pakistani SMEs seeking to acquire Islamic banking finance. The consideration of the external structures of knowledgeable agents; the first element of the quadripartite model of structuration, is presented in the next section.

7.4 Empirical Evidence of Impact of External Structures on SMEs' Access to Islamic Banking Finance

The principal aim of this study is to investigate SMEs' access to Islamic banking finance in Pakistan. To achieve this aim, it is necessary to identify the external structures that provide the conditions for the actions of SMEs since these actions do not occur in isolation and considering only the moment of active agency is likely to give an incomplete or a misleading picture. External structures, which involve position–practices and their networked relations, represent contextual forces and pressures that provide the necessary (un)acknowledgeable conditions that either constrain or enable agency (Stones, 2005). They are entirely autonomous of the agent-in-focus and influence social conditions irrespective of the agent's own wishes (Stones, 2005).

The evidence of the impact of external structures on practices of SMEs seeking to acquire Islamic banking finance, gathered from the semi-structured interviews, can be summarised into the following themes:

7.4.1 Islamic Banks-SMEs Relations Are the Most Significant Component of SMEs' Network

One of the basic pillars of the philosophy of Islamic finance is the economic and social development of society (Hasan, 2005). The most significant aspect of such development is financial inclusion and equal distribution of wealth by serving the underprivileged sectors of society. The SME sector is at a disadvantage compared to large corporations and, hence, is a disadvantaged sector in terms of access to financial resources. Pearce (2011) asserts that the profit and risk-sharing features of Islamic financial products make them suitable for SMEs and can act as an important tool for redistributing wealth in society. This assertion is supported by the following view of one of the participants:

> *"One of the major principles of Islamic finance is the redistribution of wealth and if you are not catering the 90% of the economy, this will result in the concentration of wealth with the remaining 10%. It will hamper economic development. So, funding SMEs is a way to comply with the basic principles of an Islamic financial system."*
>
> (Bank manager, 6)

Given that financial inclusion is one of the fundamental aspects of an Islamic financial system, some of the prior studies attempted to investigate the role of Islamic finance in financial inclusion. For instance, Abdu et al. (2018) explore the impact of Islamic banking finance on financial inclusion in the member countries of the Organization of Islamic Cooperation (OIC) in Sub-Saharan Africa (SSA). The study suggested a strong link between the introduction of Islamic banking finance and financial inclusion (Abdu et al., 2018). In their investigation of the role of Islamic financial institutions in financial inclusion in Bangladesh and Pakistan, Nawaz (2018) finds that Islamic financial institutions promote social and economic fairness in society by engaging in financial inclusion. Another study of financial inclusion, conducted by Mustafa et al. (2018), identifies a significant positive impact of Islamic finance on economic growth in Nigeria by means of financial inclusion.

Being an important player in an Islamic financial system, Islamic banks can play a significant role in addressing financial inclusion by promoting the use of Islamic financial products, as an alternative to conventional financing, for the underprivileged SME sector. Tagoe et al. (2005) assert that one of the significant reasons SMEs face discriminations from banks in accessing finance is the unavailability of adequate financial records. Businesses are required to keep proper books of account and prepare financial statements that give a true and fair perspective of the business's financial affairs. However, SMEs tend to have only limited interest in financial reporting (McMahon, 1998; Stainbank, 2008). A good reporting practice involves keeping all the financial records and how well those records meet the information requirements of internal and external decision-makers (Abdul-Rahamon and Adejare, 2014). Xu et al. (2003) highlight that using services of qualified accountants can positively impact maintaining the records in such a way that they provide sufficient information required by the decision-makers. However, the high cost associated with obtaining the services of professional accountants has left SMEs owners with no other option but to compromise on the quality of their financial records (Jayabalan et al., 2009). Incomplete accounting records are one of the most significant barriers to SMEs' access to finance in Pakistan (Dar et al., 2017; Thaker et al., 2020). Since SMEs lack detailed financial information, a prerequisite for obtaining finance from the formal banking channel, they prefer obtaining finance from informal sources (Noumigue, 2015). Hence, SMEs' access to Islamic banking finance can be developed by improving SMEs' recordkeeping practices (Dar et al., 2017; Thaker et al., 2020).

During the fieldwork, bank managers highlighted inadequate financial records of SMEs as one of the major reasons which limit their ability to provide them access to finance. For instance:

> *"In the case of SMEs, it is a big challenge for us to identify the good investments as SMEs are not maintaining proper records. It is difficult to work with SMEs as compared to the large corporations because large enterprises are listed and require maintaining proper documents by SECP."*
>
> (Bank manager, 13)

> *"SME sector is an unorganised sector; they are not maintaining proper financial records. The procedures for providing finance to SMEs becomes difficult because SMEs do not maintain financial records and other documents in the prescribed manner. I had to turn down many applications on the grounds that their documents did not support the information they have provided us, and they were not willing to rectify their records."*
>
> (Bank manager, 6)

In the above-mentioned situation, the structural dimensions of signification, domination and legitimation are interlinked and play an important role in shaping SMEs' action. For instance, the bank managers have a power (domination) over the resources, which facilitates power over the actions of SMEs seeking to acquire Islamic banking finance. When an SME with inadequate financial and other documents approach the bank to seek finance, the bank manager will draw upon their stocks of knowledge about legitimation to understand that providing finance to such SMEs is not within the norms. The bank manager can refuse to facilitate SMEs' financing requests (sanction) to legitimise their actions. Finally, the manager would draw on their structures of signification to communicate the reasons for not providing the finance to that SME. This will form the basis for future actions of the SME, which may not be the replication of their current recordkeeping practices.

Fieldwork evidence suggests that a significant independent influence is exerted by Islamic banks on the activities of SMEs (knowledgeable agents) regarding access to Islamic banking finance. They provide the conditions that either enable or constraint SMEs' actions. For instance, bank managers assist SMEs in preparing the required documents. It is observed from the interviews that SMEs perceived this assistance provided by Islamic banks as one of the enabling features which helps them to gain access to Islamic banking finance. The extent of this enablement is illustrated in the following extracts:

> *"The bank manager did not only provide me with the list of required documents but also guided me on how I can get them prepared. They introduced me to the accounting software, which I am currently using, and it really helped me to get my financial records maintained in an appropriate way."*
>
> (SME owner, 12)

> *"The bank manager guided me on every step of the application process. I was short of some documents, and he guided me about how to prepare those documents. He even helped me in filing my previous tax returns."*
>
> (SME owner, 17)

The guidance provided by Islamic banks to SMEs in preparing the required documents serves as an example of the enabling feature of the banks' resources that allows SMEs to modify their actions. This evidence is in line with Giddens' (1984) notion of "reflexive monitoring of action". The idea of reflexive monitoring of actions is associated with agents' knowledge and the ability to comprehend what they do (Giddens, 1984). Agents consistently monitor the progression of their actions as well as the contexts in which they move. The monitoring of actions makes individuals aware of and encourages a response to unintended consequences, facilitating future motivations (Giddens, 1984). This reflexive monitoring of actions and their consequences allows agents to either replicate, partially replicate, or not replicate their previous actions (Walsham, 2002). Here it is evident that the SMEs reflected upon unintended consequences, and acted, reacted and interacted in new ways. For instance, SMEs' reflexively monitor the unintended consequences of their recordkeeping practices, which form the basis for the agents' subsequent actions (changes in their recordkeeping practices) that are not the repetitions of what they have done before.

Islamic banks do not only provide enabling conditions for SMEs seeking to acquire Islamic finance, but they also impose a degree of constraints on their actions. For instance, responses from the interviewees suggest that SMEs perceive that Islamic banks' preferences for short-term financing have become an increasing source of constraint on their access to Islamic banking finance. One of the SME owners identified banks' preference for short-term financing products as a reason for not using Islamic finance and stated that:

> *"It has never been difficult for me to obtain short term loans for my business from a friend or a family member. With Islamic banks less willing to enter into a partnership or long-term financing to small businesses, I do not see any incentive in obtaining short-term finance from them. For a short period of time, I can borrow from a friend or a family member without fulfilling a long list of requirements and it will not even cost me anything."*
>
> (SME owner, 22)

Alhabashi (2015) asserts that Islamic banks prefer short-term financing products for SMEs because of the quick profits attached with these products. The banks' preference for short-term Islamic financing to facilitate SMEs can be attributed to the issues of business continuity and the higher risk involved in lending to this sector (Makhlouf, 2017). As Islamic banks are risk-averse, they usually offer short-term asset-backed products to SMEs in an attempt to mitigate the risk involved in financing this sector (Makhlouf, 2017). These short-term products are generally used to meet SMEs' working capital and trade financing requirements (Zin et al., 2019). According to Makhlouf (2017), equity-backed long-term Islamic financing is generally used to cater for the financing needs of well-established large enterprises with a sound financial and business viability.

On the other hand, most SMEs face difficulties in accessing finance for long-term projects, which restricts their ability to expand their business (Makhlouf, 2017). Islamic banks in Pakistan offer several Islamic financial products to the SME sector. However, most of the products are short-term, and this does not correspond with the needs of SMEs (Rasheed et al., 2019). One of the participants, who was looking to set up a manufacturing plant to produce textile dyes locally instead of importing them, shared his thoughts in this regard and stated that:

> *"I want to start manufacturing textile dyes locally. It is a capital-intensive project and cannot be self-funded. But the bank is reluctant to contribute a share in the equity. Currently, I am importing these products and then distributing them but if I will start manufacturing them, this will generate new employment opportunities. I feel that Islamic banks claim to comply with Sharia but are not truly serving the objectives of Sharia. Islamic finance should be focused on long term and sustainable growth of the economy, but Islamic bank seems to be less interested in backing long term projects."*
>
> (SME owner, 13)

Another example of a constraint imposed by Islamic banks is their time to process an SME's financing request. From the early stages of data collection and analysis, it became apparent that time taken by Islamic banks while dealing with SMEs' financing requests, acts as a significant impediment to SMEs' access to Islamic banking finance. These findings corroborate the study conducted by Zairani and Zaimah (2013), who identify access to Islamic financial products as more time consuming than conventional instruments. Participants of this study expressed their concern about the processing time taken by Islamic banks and shared their experiences:

> *"I used their Murabaha facility twice, but I am not using it anymore because they take a lot of time to process my application. I import the raw material on credit basis and then my finished products are also sold on credit and when I receive money from the buyers, I pay my creditors. I cannot wait for 14/15 weeks to get my financing approved so if I need finance, I usually borrow from my friends for a short period."*
>
> (SME owner, 8)

> *"I think they should consider reviewing their process flows and try to make it as simple as possible. A small or a medium sized business in Pakistan usually rely on self-financing and if they are approaching a bank to obtain finance, they are not in a position to wait for weeks and weeks before they get the financing. This issue needs to be addressed and efforts should be made to make these processes as fast as possible. Time is a discouraging factor for many SMEs and because of that they do not approach Islamic banks for financing."*
>
> (SME owner, 3)

The perceived service quality is an important element of a bank's selection criteria and significantly influences customers' decision to select one bank over others (Kheng et al., 2010; Sharma, 2015; Fida et al., 2020). Customers consider fast services as the provision of high-quality services by a bank and expect the quick completion of the transactions (Ringim and Mohd Yussof, 2014). Generally, the time taken by Islamic banks in Pakistan to process financing requests is longer than that of conventional banks (Qureshi and Herani, 2011). However, this longer processing time can be attributed to the unique nature of Islamic financial contracts and does not necessarily depict inefficiency on the part of the bank (Sufian and Noor, 2009). Salih et al. (2019) assert that Islamic banking finance is based on customised contracts rather than standardised processes and the customised nature of these contracts make them time-consuming.

From the above discussion, it is evident that Islamic banks' preference for short-term financing products for SMEs and the longer time taken by Islamic banks to process SMEs financing applications are perceived as constraining factors by SMEs which impose breaks on their actions and make them choose otherwise i.e., not to use Islamic banking finance. However, these constraining conditions of Islamic banks (external structures) are shaped by SMEs' practices.

> *"The most difficult part is assessing the true picture of SME's business. They are not recording the actual figures and the true and fair picture of their business is not presented. This problem becomes severe because SMEs, particularly small businesses, usually deal in cash transactions. Since most of the transactions are not through the banking channel, it is easy for them to manipulate the figures. That is why banks are reluctant to enter into equity-based long-term financing agreements with SMEs."*
>
> (Bank manager, 12)

This presents a picture of human agency and structure as presupposing, which is the central tenet of structuration theory. Structure shapes individuals' practices: however, individuals' practices comprise and recreate the structure. For instance, bank managers relate Islamic banks' preference for asset-based short-term financing to SMEs' practices of under-reporting true profits (SMEs' motives for under-reporting their profits are discussed in section 7.4.3). Similarly, the time taken by Islamic banks to process SMEs' financing can be attributed to the inadequate recordkeeping practices of SMEs (SMEs' recordkeeping practices are discussed in section 8.4.3).

> *"It is true that obtaining Islamic finance has some additional steps involved because it must comply with the requirements of trade established in Sharia. But that is not what makes the process lengthy. Most of the time the delay is caused by the issues on part of SMEs. For example, they do not have their audited accounts ready or lacking other important documentations."*
>
> (Bank manager, 5)

> *"Yes, I agree it takes SMEs, I repeat it takes "SMEs" more time to get finance from Islamic banks as compared to the conventional banks. The big corporate companies do not face such problem. This is because Islamic banks need to perform additional checks for SMEs in the absence of adequate records. Secondly, although Sharia-compliant banking is available in Pakistan for 20 years, it has flourished in last 7 or 8 years only, so it is still a new phenomenon and that's why it takes time to establish a relationship with our SME clients. Once the relationship is established the process becomes smooth and speedy."*
>
> (Sharia Board Member)

7.4.2 Government's Influence on SMEs' Access to Islamic Banking Finance.

The significance of SMEs as a vital source of economic development, income generation, job creation and alleviating poverty in an economy is well established in the literature (North et al., 2001; Audretsch et al., 2002; Asad Sadi and Henderson, 2010; Cant and Wiid, 2013; Kubíčková et al., 2017). They are, therefore, the focus of governments' economic policies (Ganbold, 2008; Peter et al., 2018). Governments are keen to support SMEs and thus, provide financial supports to SMEs in different forms. Jasra et al. (2011) assert that government policies are among the key factors influencing SMEs' success and growth. The Government of Pakistan is keen to create a favourable business environment for SMEs in Pakistan by improving their access to finance and eliminating obstacles that obstruct their development (Shah and Syed, 2018). The evidence suggests that the government of Pakistan mainly influences SMEs' access to Islamic finance through credit guarantee schemes and by prioritising the growth of SMEs in a particular sector. Through its credit guarantee schemes and prioritising SMEs in a particular sector, government enables Islamic banks to finance SMEs by underwriting all or part of their credit risk. Hence, through its policies, the government is acting as a significant external structure that impacts SMEs' access to Islamic banking finance.

Governments' credit guarantee schemes have gained popularity as a tool that attempts to enhance financially constrained SMEs' access to finance (Gozzi and Schmukler, 2016). These schemes are mechanisms in which the government acts as the guarantor and undertakes to repay the lender whole or part of the amount financed in case of the borrower's default (Green, 2003). Hakeem (2019) asserts that the government's support to SMEs through credit guarantee schemes can be much more effective than providing direct financing or subsidies to the SME sector. The bank managers who participated in this study were asked about the external conditions, particularly the government policies, that influence their decision to provide finance to SMEs. Ten out of twelve managers identified government credit guarantee schemes as a significant factor that positively influences their decision to finance SMEs and thus, enhances SMEs' access to Islamic banking finance. In this regard, one of the participants stated that:

> *"Nobody wants to have a high ratio of non-performing loans under the portfolio they are managing. Whenever government introduces any credit guarantee scheme for SMEs it gives us the opportunity to cater more and more SMEs' financing application. Well, it does not mean that we get engaged in aggressive financing. We still perform necessary checks for the SMEs but as we are insured against the default, we are able to provide them with some relaxations."*
>
> (Bank manager, 1)

Although SME financing represents a considerable proportion of a bank's credit portfolio, lending to SMEs involves a high degree of credit risk (Liang, 2017). While financing SMEs, banks are exposed to the problems of adverse selection and moral hazard, and thus, they are reluctant to provide finance to SMEs (Hyytinen and Väänänen, 2006; Niinimäki, 2009; Huda, 2012). Therefore, lending under the credit guarantee scheme has become a key approach by banks to finance SMEs in many countries, including Japan, Germany, UK and USA (Liang, 2017). Under the umbrella of the credit guarantee program, SME financing would cover the credit risk for banks and thus, make the process of obtaining finance easier for SMEs. Given the significance of government credit guarantee schemes in promoting SMEs' access to formal sources of finance, the government of Pakistan has also launched credit guarantee schemes for SMEs. The SME owners/managers who participated in this study shared their opinions about the government's guarantee schemes. They expressed that such schemes enabled them to obtain finance from Islamic banks/ branches, which they would otherwise find difficult because of the lack of adequate collaterals. For instance, an SME owner who secured financing through the Youth Entrepreneurship Scheme[39] stated that:

> *"Currently, I am trading in one city only but for the past few years I really wanted to expand my business to other cities. My business was completely self-funded, but the expansion required additional funding. The business premises are on rent so I could not obtain finance from the bank against the property. I applied for financing under the Prime minister's Youth Entrepreneurship Scheme and my financing has been approved on clean financing basis[40]. The best part is Islamic banks are offering Diminishing Musharakah contracts under this program otherwise they are very reluctant to provide equity finance. It is really a great imitative for the economic empowerment of youth and I believe government should keep introducing such schemes."*
>
> (SME owner, 18)

Craig et al. (2008) assert that the primary purpose of a credit guarantee scheme is to bring down the expected loss for the lenders that may arise from non-performing loans. Through the credit guarantee scheme, the government provides insurance against the risk of default and thus reduces the bank's expected losses from financing riskier borrowers (Olaitan, 2006). Consequently, these credit guarantee schemes effectively provide a substitute for collaterals. This

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[39] In 2019, the Government of Pakistan launched Youth Entrepreneurship Scheme to provide subsidised financing to small and medium sized businesses through both the conventional and Islamic banks under the guidance and supervision of the State Bank of Pakistan.

[40] A clean financing facility enables the borrowers to obtain finance without collaterals. It also spares the lender from this risk since it is secured by third party guarantors.

is because the government's assurance to repay the whole or part of the amount financed in case of SMEs' default brings down the amount of collateral that SMEs are required to provide to obtain finance. It implies that the credit guarantee can allow the riskier borrowers to secure financing and obtain better lending conditions for a given amount of collateral since the guarantee lowers the risk banks face (Olaitan, 2006). A study by Green (2003) concludes that the credit guarantee schemes effectively improve SMEs' access to finance by addressing the problem of relatively high risk faced by banks in the absence of adequate collaterals.

In addition to the credit guarantee schemes, the government also influences SMEs' access to Islamic banking finance by prioritising and emphasising SMEs in a particular sector. For instance, in its SMEs Policy 2020, the government focuses on SMEs in the construction sector. To promote SMEs in the construction sector, the government is keen to bring down construction costs by reducing the sales tax, excising duties levied on construction material, and improving access to financial resources (Haq and Bukhari, 2020).

Two of the participants of this study own construction businesses and expressed the following views regarding their access to Islamic banking finance in light of the government's policy to promote SMEs in the construction sector:

> *"It is good to see that the present government is determined to support SMEs in the construction sector. I received a call from my bank explaining the relief package announced for us and they were offering an immediate financing facility within only 2 weeks of application. Previously, I relied on financing from family members and was never interested to obtain banking finance. But during the pandemic it is becoming really difficult to make things work with informal financing. It is really a good opportunity, and I am definitely going to avail it."*
>
> (SME owner, 6)

> *"I once used Murabaha financing but that was some seven years ago. I never utilised Islamic finance after that because their processes and documentation requirements are just too much for me. My strong belief in the prohibition of interest never let me go for conventional financing so, I was totally dependent on informal sources. But now when the banks are providing relaxation to the construction business, I am planning to use Murabaha again."*
>
> (SME owner, 20)

The government of Pakistan attempts to bridge the funding gaps of SMEs by designing programs for SMEs operating in a particular sector to stimulate regional economic development (Shah and

Syed, 2018). Such programs include identifying priority sectors, investigating the challenges and demands of SMEs in those sectors, and making the required support available for them (Yamori, 2015). Generally, these priority sector(s) are the sector(s) which has the increased potential to access growing markets because of some significant changes including change in the government policies (Tambunan, 2005). For instance, the government has announced a relief package for SMEs in the construction industry in Pakistan. Among other initiatives to promote SMEs in the construction sector, improving their access to finance is at the top of the list (Sajjad, 2020). The increased focus on the construction sector is due to the growth in demand for their services due to the government's flagship project, "Naya Pakistan Housing Programme", to build five million housing units for financially underserved populations.

The above discussion, supported by some of the extracts from the fieldwork data, illustrates that the government through the credit guarantee schemes and prioritising SMEs operating in a particular sector; currently in the construction sector, creates enabling environment for Islamic banks to develop their capacities for SME financing and thus improving SMEs' access to Islamic banking finance. The Sharia board member also acknowledged the government's role in improving SMEs' access to Islamic banking finance and highlighted the need to create further enabling conditions for SMEs' access to Islamic finance by providing business consultancy services through Islamic banks.

> *"Islamic bank should increase the scope of SME financing from the traditional lending to providing consultancy as well. They should provide guidance regarding their business model, their recordkeeping and how they can improve it etc. But as Islamic banks are not non-profit organisations, it will result in increased expenditure and therefore, banks are not very keen to provide such services. Government should launch such consultancy programs in collaboration with Islamic banks where the government is bearing at least some part of the additional costs."*
>
> (Sharia Board Member)

7.4.3 SMEs Perceive Federal Board of Revenue (FBR) As a Constraining Actor.

Tax is the most reliable and significant source of revenue for governments (Abiola and Asiweh, 2012). Therefore, tax compliance by SMEs is an area of keen concern for the revenue and tax collection authority in any country (Zivanai et al., 2016). Baurer (2005) asserts that SMEs, especially those in developing countries, face difficulties dealing with the tax administration. These difficulties with the tax authorities can mainly be associated with poorly conceived tax policies and incentives to evade whole or part of their tax liability (Baurer, 2005). Alhaimer (2019) asserts that SMEs, particularly small enterprises, would attempt to recover their investments as quickly as possible. The increased tax liability will reduce their return and disposable income and thus, provides an incentive to underreport their income by means of improper recordkeeping (Anyaduba and Modugu, 2013). In addition to the incentives to evade their tax liability, some other major factors behind the SMEs being out of the tax system include complex tax system and filing procedures (Atawodi and Ojeka, 2012), low service quality in return for taxes (Al-Ttaffi and Abdul-Jabbar, 2016), lack of tax knowledge (Saad, 2014) and perception of a high level of irregularities and corruption in tax and other public institutions (Kirchler, 2007). In Pakistan, most SMEs are not registered with the FBR, and a good number of SMEs get away with not paying their taxes (Gul, 2019). SMEs are generally family-run businesses or owned by sole proprietors who prefer to avoid inclusion in the tax net (Malik and Younus, 2020).

Moreover, tax rules and related processes are complicated, and SMEs may require a tax specialist to comprehend and implement them (Sherazi et al., 2013). However, SMEs with limited financial resources find it difficult to hire a tax specialist and may end up either underpaying tax or avoiding it altogether (Eragbhe and Modugu, 2014). Therefore, there is a need to ease the tax system through reforms and introduce separate rules and regulations for the SME sector to bring more and more SMEs into the tax net (Malik and Younus, 2020).

External structures are not always seen as the conditions that enable actions, but also act as determinants that influence actions and are seen to be constraining factors. From the participants' views, FBR is identified as a significant external structure that influences SMEs’ practices in such a way that restricts SMEs’ access to Islamic banking finance. The review of literature presented in previous chapters identified insufficient documentation practices of SMEs as one of the main obstacles in SMEs’ access to finance. These practices are not produced or reproduced in isolation but are influenced by external forces. Participants of this investigation highlighted FBR as one of the significant external structures that exerts a major influence on SMEs’ recordkeeping practices.

> *“The issue of inadequate documentation and financial records is very common in SMEs. But why they are not maintaining proper records? One of the major reasons is they are not comfortable with the tax system and are unhappy with the behaviour of staff at the tax departments.”*
>
> (Bank manager, 9)

> *"It is difficult to evaluate SMEs' financial position because* systematic accountin*g is rare in this sector and their financial records are not properly maintained. Even, they are not willing to share information with us and are reluctant to provide any information regarding their business. I think the main reason is to conceal income from FBR."*
>
> (Bank manager, 7)

The above-mentioned statements of bank managers are supported by the fact that SMEs contribute 40% of the total GDP of Pakistan. In contrast, their share in total tax revenues is even less than 10% (Gul, 2019). Most SMEs are not even registered with FBR. Abbasi (2019) highlights that there are 3.1 million industrial and commercial electricity consumers in Pakistan who should be registered with FBR. However, the total number of industrial and commercial power consumers in the sales tax net is less than half a million (Abbasi, 2019). This non-compliance of tax is reflected mainly in the inadequate documentation and recordkeeping practices of SMEs. Gul (2019) asserts that documentation practices, access to finance and the taxation system of the SMEs are all interrelated. Speaking at the Pakistan innovative forum, the chairman of FBR also linked the inadequate documentation of SMEs with the perceived obstructions created by the taxation system (Abbasi, 2019). These obstructions discourage SMEs from tax compliance and consequently restrict their access to formal sources of finance (Abbasi, 2019).

Previous literature in the domain of SME financing highlights the link between SMEs' tax compliance and their documentation practices, which influences their access to formal sources of financing. For instance, Evans et al. (2005) analyse the relationship between SMEs' recordkeeping practices and tax compliance in Australia. The study concluded that SMEs perceive a strong link between their recordkeeping practices and tax compliance costs (Evans et al., 2005). Ravselj and Aristovnik (2020) explore the link between SMEs' perceptions of tax compliance-related administrative barriers and their financial reporting practices. Their empirical results showed significant differences in the financial reporting practices of SMEs that perceive these barriers to be high and those that perceive them to be low (Ravselj and Aristovnik, 2020). To investigate SMEs' accounting and financial reporting practices in Bangladesh, Asaduzzaman (2016) identifies that 56% of participant SMEs do not keep proper accounting records because they perceive that it will compel them to pay more taxes. Ezejiofor and Olise (2014) assert that accounting records provide a basis for tax computation. It is challenging to assess SMEs' actual income in the absence of complete and accurate accounting records.

Consequently, SMEs perceive that maintaining adequate financial records will expose their financial position to outside parties, including the tax authorities (Kahsay and Zeleke, 2019). De la Torre et al. (2008) highlight that the lack of tax compliance is one of the significant factors that make SMEs more informal in their financial recordkeeping. However, this insufficient recordkeeping acts as one of the major barriers to SMEs' access to formal sources of financing (Tagoe et al., 2005; Kouser et al., 2012; Dar et al., 2017). Hence, SMEs' noncompliance with the tax system negatively correlates with their financial inclusion (Fouejieu et al., 2020).

The government of Pakistan has also acknowledged the influence of FBR on SMEs' access to finance and tax reforms are one of the major objectives of the government's policy for promoting SME Finance[41]. In the context of improving SMEs' recordkeeping practices to develop SMEs' access to Islamic banking finance, one of the participants emphasised introducing tax reforms and stated that:

> *"Tax reforms are required to improve SMEs' documentation practices. The taxation system should encourage SMEs to come into the tax network, but this is not the case in Pakistan. This cannot be done overnight; a long-term plan is required to change the practices of this undocumented sector of the economy. Unless SMEs' perceptions about tax system are not changed and their experience with them is not improved, SMEs documentation issues will never be resolved and their access to Islamic financial products will not be improved."*
>
> (Bank manager, 3)

7.4.4 State Bank of Pakistan (SBP) as a Constraining as well as Enabling External Structure.

Support and guidance from the central bank are essential for the growth of Islamic banking finance for SMEs, since it is a key player in developing a country's economic policies and is responsible for the supervision of the monetary system (Ezeh and Nkamnebe, 2018). In a developing country, the role of the central bank goes well beyond the regulatory duties of managing the monetary policy. Also, it includes the promotion of the fuller utilisation of a country's resources by means of financial inclusion (Sayeed and Abbasi, 2015). In this regard, the development of the SME sector is of fundamental significance for the central bank since SMEs play a key role in achieving the overall macroeconomic objectives thus leading to the progress of any economy.

[41] Available at: http://www.sbp.org.pk/smefd/PolicyPromotionSME-Finance.pdf

In many countries, including Pakistan, the central bank controls and monitors the banking system (Sayeed and Abbasi, 2015). In 2004, the SBP established an Islamic banking department to develop the Islamic banking sector in Pakistan. Since then, the bank has undertaken various steps to fuel the growth of Islamic finance for SMEs in Pakistan. SBP has been voted as the best central bank in promoting Islamic finance by a poll conducted by Islamic Finance News in 2021 (Islamic Finance News, 2021). In 2020, SBP was declared the best central bank by Global Islamic Finance Awards (Global Islamic Finance Awards, 2020). As a policymaker and regulator, the SBP is a significant external structure that influences SMEs' access to Islamic banking finance. The participants' opinions showed that SBP, through interactions with Islamic banks, provides constraining and enabling conditions for SMEs' access to Islamic banking finance in Pakistan. For instance, the participants of this study assert that the requirements of SBP for SMEs to obtain finance impose a degree of constraint on SMEs' access to Islamic banking finance.

> *"State bank of Pakistan has more or less the same rules and regulations for obtaining finance for corporate as well as SMEs sector. It very difficult for small businesses to comply with those requirements and this actually blocks their access to Islamic financial products."*
>
> (Bank manager, 9)

In the context of SBP's requirements for SMEs to obtain finance, the participants identified collaterals as one of the main hindrances that obstruct SMEs' access to Islamic banking finance. Karamat et al. (2016) highlight that SMEs must mortgage their factory, assets, and/or machinery as security for obtaining financing from banks, including Islamic banks. However, most small-scale factories are on a rent basis and cannot be mortgaged since the business does not have ownership rights (Karamat et al., 2016). This creates a hurdle in SMEs' access to Islamic banking finance. The participants expressed the following views in this regard:

> *"SBP should keep in mind that SMEs really struggle to meet the collateral requirements. There is no doubt that collaterals are important to keep the client disciplined in their repayments, but it is difficult for SMEs to provide high collaterals and that is what discouraged them from approaching Islamic banks for financing. They should provide some relaxation in the collateral requirements."*
>
> (Bank manager, 4)

> *"Islamic finance is supposed to be collateral free, but it is not true. They have same collateral requirements for SMEs which conventional banks have. I had to collateralise my house, in which I am currently residing, to obtain Ijarah facility. Now, I want to obtain*

> *Murabaha in addition to my current financing arrangement, but I don't have any other property to offer as collateral. My business is very stable and profitable, I have repayment capacity, but the bank is still asking for collateral as it is required by the State bank."*
>
> (SME owner, 16)

In addition to the collateral requirements, participants of this study also highlighted the documentation requirements of SBP as a significant hurdle in SMEs' access to Islamic banking finance.

> *"The documentation requirements from SBP are also very complicated. It is almost the same as for the large corporations. I believe SBP should consider this matter and simplify the requirements for SMEs. When we receive a financing request from an SME, and we forward it to our credit department, they send us the same number of queries as they send for large corporations. They should limit these queries for SMEs."*
>
> (Bank manager, 9)

> *"Their documentation requirement was too long for the amount I applied for. They have a long, long, long list of requirements which I had to comply with before getting finance. It was a lengthy process and if I remember correctly, they gave me a 6-page long check list along with the financing application. It was such a nuisance. At that time, I was in immediate need of finance, so I obtained a loan from a friend. I think they should go a little easy with SMEs. We are a small business, how they can expect us to have the time and expertise to get involved in complicated documentation processes? They must review the documentation requirements they have set for us."*
>
> (SME owner, 20)

These findings corroborate the assertions made by several previous studies. For instance, Machmud and Huda (2011) identify that 45% of SMEs failed to obtain finance from external sources mainly due to a lack of collateral. Veiga and McCahery (2019) argue that this increase in SMEs' financing gap is due to several reasons, including inadequate financial products and services to address the needs of SMEs, low competition in the financial sector to finance SMEs and SMEs' inability to provide sufficient collaterals. In their investigation of banks' lending criteria to SMEs in Pakistan, Kouser et al. (2012) conclude that the main obstruction of SMEs' access to finance is the inadequacy of documentation, including financial records. Banks could not measure the performances of SMEs. Rabbani and Moossa (2014) also highlight that the major reasons SMEs are perceived as riskier ventures by Pakistani banks are their inability to provide collaterals and known cash flows and poor governance and documentation practices.

It is identified that SMEs' practices shape these constraining conditions of high collaterals and complex documentation requirements. SBP's collateral requirements and complex documentation processes influence SMEs' actions and impose a constraint on their access to Islamic banking finance. However, these requirements are the results of SMEs' inadequate recordkeeping practices. It is an example of Giddens' (1984) idea of presupposing nature of human agency and structure. This can be reflected in the following extract from one of the interviews.

> *"I do agree that SMEs are required to provide high collaterals and there is a lot of paperwork involved in financing SMEs. But this is because of SMEs' inadequate record keeping practices. We do not have sufficient information available to ascertain the true and fair picture of SME's financial position. In this situation we have no option but to ask for collaterals and incorporate additional steps to the contract in order to mitigate our risk. If we have more accurate information and a true and fair picture of SMEs' financial position, we will not depend on complex contracts and high collaterals."*
>
> (Bank manager, 3)

Here, the structural dimensions of signification, domination, and legitimation interacted and played an important role in shaping SMEs' actions. For instance, the state bank has domination over the Islamic banks/branches as the regulator and supervisor of the banking system, which facilitates the power to set the requirements for SMEs seeking to acquire Islamic finance. Banks would draw on their structures of signification to communicate these requirements to SMEs. In case of non-compliance of these requirements by SMEs, the bank will then exercise the structures of legitimation to sanction the SMEs in the form of high collateral and complex documentation requirements. These sanctions will impact SMEs seeking to acquire Islamic banking finance and will form the basis for future actions of these SMEs that may not be a replication of their current practices.

SBP has dual enabling and constraining features in efforts directed at expanding Islamic finance for SMEs and the explicit collateral and documentation requirements. SBP has established a strategic roadmap for the Islamic banking sector to expand the market share of Sharia-compliant assets to 25% (Ministry of Finance, 2018). SBP's strategic plan to support SME financing incorporates improving regulatory framework, introducing SMEs targets and risk coverage, simplifying procedures for SMEs financing, enforcing Sharia compliance mechanism, providing non-financial advisory service and creating awareness among bankers and SMEs (SBP, 2017b). In addition to these steps, SBP also attempts to improve SMEs' access to Islamic banking finance by assigning financing targets for banks to serve the financing needs of SMEs. For instance, one of the National Financial Inclusion Strategy (NFIS) is to enhance SME sector credit to 17%, which is currently 6% of the total banking credit portfolio (SBP, 2019b). To include more and more SMEs in the formal financing network, SBP also aims to increase the number of SME borrowers from existing 174,000 to 500,000 (SBP, 2019b). The participants of this study regarded SBP's target for SME financing as a significant factor that influences SMEs' access to Islamic banking finance. For instance:

> *"We have some targets from the State bank, and we need to report the bank about these targets. For instance, we are required to direct a certain percentage of our SMEs financing portfolio to women entrepreneurs. Sometimes government's schemes also influence our financing decisions, for example, last year government launched a plan to provide financing to SMEs which are owned by young entrepreneurs (between 25 to 35 years of age). But it's not that government can directly influence us they give targets to state bank, and we are directed by SBP on how to work on those targets."*
>
> (Bank manager, 8)

> *"I must highlight that SMEs' access to banking finance is improving because of the efforts from both SMEs and banks sides. SMEs are becoming more organised in terms of maintaining records and banks are more willing to expand SME financing because of the push from the State Bank."*
>
> (Sharia Board Member)

7.4.5 Positive Influence of Sharia Board Members on SMEs' Preferences for Islamic Finance.

One of the distinctive features of Islamic financial products is the approval of the Sharia board to ensure they are developed and executed in compliance with the principles of Sharia. These Sharia boards are comprised of Sharia advisors (Islamic scholars) who reinforce the entity's credibility in the eyes of its customers by acting as an internal control body (Grassa, 2016). According to Hassan and Chaowdhury (2004) the Sharia board plays a multi-dimensional role between the bank and its customers, depositors, shareholders and management. They are entrusted to examine, analyse and follow up Islamic banks' operations to ensure compliance with standards and guidelines of Sharia. Furthermore, they are also responsible for the validity of the implemented transactions and finding a legitimate alternative in case of any inconsistencies (Wardhany and Arshad, 2012). In this way, the Sharia board act as a significant external influence on SMEs' access to Islamic banking finance. Kahf (2004) asserts that the success of Islamic financial products is subject to the credibility of Sharia scholars. Therefore, banks offering Islamic financial products attempt to achieve credibility by hiring top-positioning and well-known Sharia advisors (Matthews, 2005). This is reflected in the following extract:

"Religious compliance is one of the main reasons of client's preference for interest free products over the conventional finance. They are concerned about who the members of Sharia board are and whether the religious beliefs of board members confirm their own beliefs."

(Bank manager, 11)

In Islamic banking, trust and confidence are important determinants of consumer choice (Tabrani et al., 2018). This choice goes beyond financial decision making but is rather influenced by trust and confidence in the bank's compliance and adherence to Sharia principles (Hoq et al., 2010; Grassa, 2013; Azmi et al., 2020). The crucial responsibility of ensuring compliance with Sharia principles mainly lies with the Sharia boards (Wardhany and Arshad, 2012; Laldin and Furqani, 2016; Supriyatni, 2020). During the fieldwork, SMEs highlighted the credibility and reputation of Sharia board members as one of the main factors when asked about the reasons for choosing a particular Islamic bank/ Islamic branch.

"I had my account with a conventional bank for 10 years. It was a current account, and I was not using any interest-based facility. Although they have Islamic branches as well, when I decided to obtain finance from the bank, I switched to this bank because I know one of their Sharia board members. He is a renowned scholar."

(SME owner, 18)

Various previous studies, attempting to explore the determinants of customers' choice to adopt Islamic financing options in a dual banking environment, identify their Sharia compliance as the most significant factor that influences a customer's decision (Butt and Aftab, 2013; Jaffar and Musa, 2014; Ullah and Lee, 2016; Lajuni et al., 2017; Butt et al., 2018; Bananuka et al., 2019). Islamic financial products possess unique characteristics (Damirchi and Shafai, 2011). Therefore, it is difficult for most customers to establish how these products are developed in accordance with the Sharia principles (Al-Salem, 2009). Consistent with the findings of Jaffar and Musa (2014); Awang et al. (2020), Pakistani SMEs expressed their limited knowledge and ability to understand the underlying mechanisms of Islamic financial products (SMEs' knowledge of Islamic financial products is discussed in section 8.4.1). Hence, in order to establish the conformity of their preferred Islamic financial product to the Sharia principles, SMEs rely on the approval of Sharia board members. Therefore, Sharia boards can improve SMEs' access to Islamic banking finance by means of SMEs' trust and confidence in them. This is in line with the findings of Ltifi et al. (2016), who establish a positive relationship between the adoption of Islamic finance and the credibility of Sharia board members.

There is a debate in the literature whether the Islamic banks differ from traditional conventional banks and the extent to which they are truly Sharia-compliant. Some previous studies suggest that customers view Islamic banks as mimicking traditional banks and the only difference is in terms of the terminology they use (Khan, 2010; Butt et al., 2011; Majeed and Zainab, 2017). During the fieldwork, SMEs expressed their doubts about Islamic banks being truly Islamic, nevertheless, those doubts were dismissed and ignored because they trust Sharia board members.

> *"I have some doubts if the Islamic banks in Pakistan are actually doing what they say to us. To be honest, I don't understand how their products are interest free when I am paying fixed amount for availing those products. Maybe I am confused if it is Sharia-compliant or not, because I don't have sufficient religious knowledge. But they have famous scholars on their board. If they have approved the transaction as being interest free, then I am sure they are right, and it must be interest free."*
>
> (SME owner, 9)

The role of Sharia boards in facilitating SMEs' access to Islamic banking finance by promoting the Sharia-compliant image of Islamic banks is of crucial importance. One of the fundamental driving forces behind the customers' adoption of Islamic finance is their religious motives and values (Demirguc-Kunt et al., 2013; Jaffar and Musa, 2014; Ullah and Lee, 2016). These religiously motivated customers ought to be ensured that all the activities of the Islamic financial institution are fully in accordance with the principles of Sharia (Gambetta, 2000). Ltifi et al. (2016) assert that, apart from the supervision of Sharia boards, customers do not have any other means to be sure that Islamic banks are complying with the Sharia laws. In their investigation of the role of Sharia boards in Islamic banks of Pakistan, Ahmed et al. (2017) inquire the participants about the impact of Sharia boards on their perceptions of Sharia compliance of the bank. All the participants unanimously agreed that the Sharia board members positively influence their perceptions of Islamic banks' Sharia compliance (Ahmed et al., 2017). This is reflected in the above-mentioned extract from one of the interviews, where an SME owner finds it difficult to comprehend the working of Islamic financial products. However, he still believes them to be Sharia-compliant and adopts them because they are developed and approved by the Islamic scholars in Sharia boards who he trusts to have a command over the Sharia laws.

The above discussion illustrates the extent to which Sharia board members provide enabling conditions for SMEs' access to Islamic banking finance and affect their actions. SMEs have some reservations about the extent to which Islamic banks are truly Islamic. However still, they want to continue dealing with them because they have renowned Islamic scholars on their Sharia board. This implies a strong level of trust they have in Sharia boards, which provides enabling conditions for their actions.

7.4.6 Academic Institutions Represent a Significant but Neglected Agent Cluster.

The next cluster of agents-in-context to be considered is academic institutions. The review of literature presented in chapter 2 identified access to finance as one of the key factors that ensure SMEs' growth. However, as compared to their large counterparts, SMEs face hindrance in accessing finance from formal sources. This is due to high-interest rates, inadequate financial records, collateral constraints, and the lack of market research (Maro, 2020). Research is a channel for businesses to develop and grow. However, it can be costly and time consuming with no assurance of success. Cohen and Klepper (1996) argue that larger firms have an advantage in research and development due to their large output. Whereas, for SMEs with limited resources, investment in research processes can be considered a risky activity with a high cost (Ortega-Argilés et al., 2009).

From the empirical evidence gathered during the fieldwork, it has been observed that the respondents accentuated their inability to involve in research activities. They also view the lack of market research as a constraining factor that hampers SMEs’ access to finance. One of the SME owners, who sought Islamic banking finance, but his financing application was rejected by the bank, expressed that:

> *“I am running a small trading business for 35 years; I import threads and textile dyes and then distribute them in different cities. For the past few years, I have been planning to start manufacturing them locally. It is a huge investment, so I approached the bank with my business model for financing through the Diminishing Musharakah contract. But my financing request was turned down as, according to them, this project was not backed by proper market research. How can they expect a small business with limited resources to invest so much time and cost in a research process? Where I am not even sure that I will even get the finance after investing in this research.”*
>
> (SME owner, 13)

Osano and Languitone (2016) point out that one of the barriers which aggravate SMEs’ financing gap is banks’ focus on traditional services and sales models, which are not aligned with SMEs needs in today’s dynamic environment. As a result of continuously changing macroeconomic conditions, SMEs needs are also evolving fast; loans are not their sole expectation from the bank. They demand innovative and personalised services from banks addressing their business issues (Osano and Languitone, 2016). However, this can only be accomplished through intensive market research by identifying SMEs' current positions and requirements in different sectors. Here, academic institutions can play a key role. In support of this view, a bank manager stated that:

> *“Universities can pay a vital role in addressing the financing issues of SMEs. I would suggest that universities offering business and finance degrees should make their students do group research projects on SMEs. Based on their interest, they can choose different sectors and study how SMEs in that sector work? What is their business model? How are they running their business operations? What are their bookkeeping practices? In this way it will be possible to understand the real business process flows, the specific requirements of a particular sector and the areas that need to be improved. It will not only identify the issues on part of SMEs but also the problems that they face due to the policies of regulators. Then the government can use that research to devise their policies or to align the existing policies and regulations. This whole process will take time and efforts, but the end results will be beneficial for SMEs and the economy as a whole.”*
>
> (Bank manager, 3)

The literature well supports this need for collaborative research projects by universities and SMEs. Dalmarco et al. (2018) assert that in recent years, the focus of universities has been extended from the traditional mission of teaching and performing research to what is referred to in the literature as the “third mission”. This third mission addresses the socio-economic mission of the universities and their commitment and contribution to society (Laredo, 2007). Therefore, the focus of the third mission is on generating, imparting and applying knowledge in collaboration with the external stakeholders and society in general (Secundo et al., 2017). Pecas and Henriques (2006) highlight the significance of SME-university networking to conduct collaborative research to gain a better understanding of the dynamic processes of the growth of local industrial regions. However, the involvement of SMEs with academia is usually based on short-term agreements and fewer resources since it is more focused on results that can be used in the immediate future (Pecas and Henriques, 2006). There is, therefore, a need to focus on establishing strong and long-term collaborative research relationships between the universities and SMEs that adapts to the intrinsic attributes of the SME sector involved in the process.

There is no shortage of literature in the domain of SMEs and the challenges they face, including their financing gap. However, the collaborative research between universities and SMEs, identifying and addressing the specific problems faced by SMEs in their sector, is scarce (Moradi and Noori, 2020). SMEs operating in different sectors differ from each other depending on the nature of their business and the conditions within which they operate (Baregheh, 2012). One of the participants highlighted that this difference could also be evident in the financing requirements of SMEs.

> *"The type of products which SMEs demand depends on the nature of their business and their individual needs and circumstances. In fact, within the same line of business, their demand can vary from a company to company."*
>
> (Bank manager, 9)

These differences in circumstances and operating conditions of different sectors can also have an impact on SMEs' access to finance. The following extract provides an example of how SMEs' operating conditions in the steel sector adversely impact banks' decision to finance them.

> *"We are currently not offering any financial product to SMEs in the steel industry on the ground that they are not doing very well these days and are considered to be risky clients. It is one of the most prominent industries in Pakistan and was a very profitable business. We find this industry risky so we are not financing them but what are the economic, social or political conditions which make them a risky investment for now? We cannot figure out the answer alone. To explore this issue joint research projects are required between the key stakeholders including government, SMEs in the steel industry, research institutions and both Islamic and conventional banks."*
>
> (Bank manager, 9)

The significance of developing university and industry cooperation to conduct collaborative research by involving the key stakeholders is emphasised in the above extract. Such collaboration involves performing systematic activities by integrating the respective facilities of the university and industry to carry out tasks that each of them cannot perform alone (Mrva and Stachová, 2014; Moradi and Noori, 2020). Generally, the goal of such cooperation includes expanding knowledge, improving access to technology, bringing innovation, and enhancing access to available financial resources (Lin, 2017). In the context of improving access to finance, such collaboration will help to understand better the actual business model of SMEs in a particular sector, their specific requirements, their practices and the external conditions that inhibit their access to formal sources of finance. It will also help to identify how their access to finance can be improved by evacuating the difficulties attached to it. The findings of such collaborative research can help the regulators devise new policies or align the existing policies concerning SMEs' access to finance, considering SMEs' experiences and operating conditions.

The above discussion concludes that there is a lack of collaborative research that impacts SMEs' access to Islamic banking finance. Academic institutions can fill this research gap by taking effective actions to encourage collaborative research with SMEs. They are not merely a subject to be researched but also involved in each research stage. These collaborative projects must focus on problematic areas in the sector to identify the existing problems by exploring the real situations that SMEs are operating in that sector face. Based on their findings, such projects can also propose new and efficient solutions which are derived from the concerned SMEs' recommendations. Since SMEs alone cannot finance research costs and efforts, a nexus should be built up among research institutions, universities, SMEs, and Islamic banks. In this way, academic institutions can provide informational resources that will create enabling conditions for SMEs seeking to acquire Islamic banking finance.

7.4.7 Lack of Advertising and Marketing of Islamic Financial Products

Islamic financial products possess unique characteristics, whether they are developed from the existing conventional products by eliminating prohibited elements to make them Sharia-compliant or through innovations consistent with Sharia principles (El Qorchi, 2005; Damirchi and Shafai, 2011). Given that these products have unique characteristics, previous studies assert that SMEs knowledge and understanding of the workings of Islamic financial products is not very strong (Jaffar and Musa, 2014; Awang et al., 2020). Shareef et al. (2019) highlight advertising and marketing among the most significant ways of promoting a product by imparting knowledge and awareness about it. The use of media for promoting Islamic financial products makes customers aware of the specifications and the potential benefits of using those products and reminds them of their needs (Al-Sharif et al., 2017).

Participants of this study identified lack of advertising and marketing as one of the reasons that inhibit the coordination between SMEs and Islamic banks and thus, act as an obstacle to SMEs' access to Islamic banking finance.

> *"There is a potential for Islamic finance to grow in the SME sector but not much effort has been expended on the marketing of Islamic products for them."*
>
> (Bank manager, 5)

> *"The promotion policy of Islamic banks through advertising is still immature due to the absence of clear strategies targeting SMEs. You will see very few advertisements of Islamic financial products on media, particularly the electronic media. Even those ads are mainly targeting individual consumers. I can't recall any ad which was made specifically*

for SME financing. How will you convey SMEs the benefits of using Islamic banking products?"

(Bank manager, 8)

"Islamic banks are not doing much to advertise their products which is one of the reasons that Islamic banks' share in SME lending is low as compared to conventional banks[42]."

(Sharia Board Member)

The issue of inadequate advertising and marketing practices of Islamic banks is well identified in the existing literature. For instance, Rammal and Zurbruegg (2007) highlight the absence of an effective marketing and advertisement plan to make people aware of the working of Islamic banking products in Australia. Schmidt (2019) advocates the potential of the growth of Islamic finance in the United States. However, he is of the view that not much consideration has been given to the marketing of Islamic financial products. In an investigation of the perceptions on the accessibility of Islamic banking in the United Kingdom, Riaz et al. (2017a) point out the lack of engagement with the Islamic banking industry due to Islamic banks not promoting their services through advertisement. Naeem (2019) concludes that Islamic banks in India lag the conventional banking systems in adopting the contemporary technologies of exchanging information for marketing their products and services. Moreover, the use of traditional marketing tools for promoting Islamic banking products in India is also very limited as compared to conventional financing products (Naeem, 2019).

The inadequate advertising and marketing practices for Islamic financial products are observed in non-Muslim majority countries but are also very much evident in the context of Muslim majority countries. For example, Marimuthu *et al.* (2010) report the absence of sufficient mass media advertising for Islamic banks in Malaysia. Rashid and Hassan (2009), in their study of customers' demographics affecting bank selection criteria, highlight the lack of marketing of domestic Islamic banks in Bangladesh. A study of the determinants affecting the preference of Islamic banking services in Tunisia, conducted by Chenguel (2019), concludes that the current marketing level is insufficient to impact individuals' preference for Islamic banking services significantly. The study also suggested that Islamic banks increase their advertising campaigns to attract more customers (Chenguel, 2019). In the context of Egypt, Abou-Youssef (2012) identifies limited marketing

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[42] As on 30 June 2019, Islamic banks share in providing banking finance to SMEs is 13% only.

activities of Islamic banks as the major reason behind the lack of customers' awareness about the presence of Islamic banks and the fundamental differences between the Islamic and the conventional banks.

In addition to acknowledging the absence of sufficient advertising and marketing of Islamic financial services, various previous studies also established a positive link between effective marketing and the adoption of Islamic finance. For instance, Ismail et al. (2014) identify that media advertisement influences customers' selection criteria for the mode of financing. Alshannag et al. (2020) analyse the impact of marketing and advertising on the consumers' acceptance of Islamic banking in Jordan. The study concluded that marketing and advertising strongly impact consumers' decision to adopt Islamic banking (Alshannag et al., 2020). While investigating the attitudes of Libyan customers towards the Islamic modes of financing, Gait and Worthington (2015) conclude that it is possible to strengthen the positive attitude towards Islamic finance by advertising their products and the community service role of Islamic banks. Abdulmajid (2018) establishes a positive relationship between advertising and the profitability of Islamic banks in Kenya by having a significant positive influence on the targeted audience.

Several studies have been conducted in Pakistan to explore the consumers' perceptions, awareness, preferences and attitudes towards Islamic finance by using advertisement and marketing practices of Islamic banks as a moderating variable. In this regard, Riaz et al. (2017b) assert that Islamic banks should focus more on developing better marketing strategies to enhance the awareness and understanding of Islamic finance. They also suggested ways to increase the presence of Islamic banks through mosque visits and conferences (Riaz et al., 2017b). Awan and Azhar (2014), in an attempt to explore consumer behaviour towards Islamic banking in Pakistan, conclude that advertisement plays a vital role in the adoption of Islamic finance by creating awareness and knowledge about Islamic financial products and services. Tara et al. (2014) investigate the factors influencing Islamic banking adoption in Pakistan and establish a significant positive correlation between advertising and consumers' preference for using Islamic banking services.

During the fieldwork, SMEs have also shown that Islamic banks are very weak in their advertisement and, therefore, failed to reach a wider audience. They believe that Islamic banks do not seek to engage with the wider public through an advertisement and rather wait for religiously motivated individuals to approach them. In this way, they are losing many prospective clients as only those approaching them are already convinced to use their products and services. This can be echoed from the following statements of the participants.

> *"I recently switched to Islamic banking on the recommendation of one of my suppliers who is already using their Murabaha facility. I always knew interest is against our religious beliefs and I was strongly against it. I had no option but to use interest-based facilitates as, although, I was aware of the existences of Islamic banks but was not sure how they work. It was only after the discussion with my supplier that I went to an Islamic bank, got to know how they work and decided to switch to the Islamic mode of financing. They are not marketing their products properly."*
>
> (SME owner, 12)

> *"Islamic banks need to educate people about the benefit of their products and the service quality they are offering in order to attract more clients. Religious motives are no doubt the biggest attraction for customers to use Islamic financial products and they know that Islamic banks are offering Sharia-compliant products but what about those who do not mind using interest-based products? How will bank convince them to use Islamic financial products? This can only be done by adequate and effective marketing about the quality of services provided by Islamic banks*."
>
> (Sharia Board Member)

Along with highlighting the lack of advertising and marketing of Islamic banking products for SMEs, the findings of this study also predict a strong positive impact of marketing of Islamic banking products on their adoption. The participants emphasised the need for Islamic banks to promote their products by engaging with the mass public through advertisement. The advertising of Islamic financial products will help to develop a positive mindset and reduce misconceptions among SMEs. The participants reflected on their own experience of being introduced to Islamic banking finance and suggested that banks advertise their products to attract clients who are willing to switch to interest-free financing facilities but are not aware of how they work and the potential benefits of using Islamic financial products. The participants, in this regard, stated that:

> *"I know in a Muslim country people are expected to be generally inclined towards Islamic banks, but this does not mean they should just sit and wait for a client, who knows about the working of Islamic banks, to come and use their products. They need to advertise their products to educate their potential clients about them and the benefits they will get by using those products. Before using Islamic finance, I was not aware of the fact that they do not charge compound interest or late payment penalties if I miss any repayment for genuine reasons. I only got to know about it when I started using Islamic finance. I faced disruption in my business activities due to torrential rain last year and was not able to pay two instalments on time, but they did not charge me anything. Being a small business owner, I can understand this is such a big favour for small businesses. Just imagine if they*

> *use power of media to communicate only this benefit to the mass public how many SMEs would switch to Islamic banking."*
>
> (SME owner, 17)

> *"If I had known about their products earlier, I would have switched to Islamic banking long ago."*
>
> (SME owner, 12)

From the above discussion, it is clear that the participants of this study perceived the lack of advertising and marketing of Islamic financial products as a significant factor that imposes a degree of constraint on the actions of SMEs. Hakim et al. (2011) assert that in addition to informing individuals about a certain product, idea, or service, another important function of advertisement is to persuade them to adopt that product, idea, or service. Islamic banks are required to inform SMEs about the features of available products since the mere existence of products, without SMEs knowing about them, will not persuade SMEs to use those products. The participants also believed that Islamic banks' improved marketing and advertisement policies, aimed at educating SMEs about the Islamic financial products and how using those products will benefit them, is highly likely to influence SMEs to patronise Islamic banks that now chose to do otherwise.

7.5 Conclusion

The premise of this chapter is to analyse the context of Pakistani SMEs seeking to acquire Islamic banking finance. It is inherent to applying structuration theory to comprehend the context in which social interaction occurs, including its inevitable features of constraint and enablement. Fieldwork evidence identified the position-practice network relations of the field that SMEs are embedded in, and how these relations are implicated in SMEs practices. The use of the position-practice relations model facilitated an in-depth description and explanation regarding the critical agents-in-context and their positional attributes. The mapping of the SMEs' position-practice network, as perceived by SMEs, identified seven critical clusters of agents-in-context. These include Islamic banks, the government of Pakistan, the Federal Board of Revenue, the State Bank of Pakistan, Sharia boards, academic institutions and media. After identifying the critical clusters of agents-in-context, the context analysis aimed at analysing external structures, mediated by position-practice relations of the field, was carried out where notable themes arose under each of these clusters. It helped to identify how these structures enabled or constrained SMEs' actions and their access to Islamic banking finance.

To complete the methodological bracketing process, the analysis moves from the external environment towards the structures within the focal agent. In this regard, agents' internal structures are addressed in the next chapter through the bracket of agent's conduct analysis. This involves assessing the internal structures of Pakistani SMEs seeking to acquire Islamic banking finance and exploring how such structures interact with the external conditions resulting in their actions.

Chapter Eight: Findings II: Agent’s Conduct Analysis

8.1 Introduction

The previous chapter reflects on the principal findings of the agent's context analysis. It depicts the external process of structuration by investigating the potential outcomes and impediments offered and posed by the position-practice network. To complete the methodological bracketing process, this chapter shifts the focus from the external environment towards the structures within the focal agent. Stones (2005) asserts that the agent's internal structures have an influence on how they experience external structures and position-practice relations. Therefore, there are significant links between the context analysis undertaken in the preceding chapter and the conduct analysis presented in this chapter. The remainder of this chapter is organised as follows: Section 8.2 outlines the concept of agent's conduct analysis. Section 8.3 provides empirical evidence on general-dispositional internal structures of Pakistani SMEs seeking to acquire Islamic banking finance. Next, the empirical evidence on conjuncturally-specific internal structures of Pakistani SMEs seeking to acquire Islamic banking finance is discussed in section 8.4. Finally, Section 8.5 concludes the chapter.

8.2 Revisiting the Concept of Agent's Conduct Analysis

As discussed earlier, the conduct analysis turns the focal point to the internal structures of the agent-in-focus. Internal structures refer to the structures within the agent. Stones (2005) classifies internal structures into two groups: the general-dispositional and the conjuncturally-specific. The general-dispositional internal structures incorporate "generalised worldviews, principles of action, habits of speech and gesture, methodologies for adapting generalised knowledge to a range of particular practices in particular locations in time and space" (Stone, 2005, p. 88). The conjuncturally-specific internal structures, on the other hand, comprise of the knowledgeability around the distinctive aspects of the conjuncture or phenomenon under study. Consequently, these structures incorporate knowledge of Giddens' virtual structures of signification, domination, and legitimation. Along with their role as stocks of knowledge within the agent, conjuncturally-explicit structures also bridge the gap between an agent's external structures and internal structures.

The conduct analysis of agent-in-focus involves assessing the internal structures of agents in the field and exploring how such structures interface with the external conditions. There were significant links evident between the agent's context and the agent's conduct during the field work. This is an illustration of the interwoven nature of the elements of the quadripartite model of structuration. The agent's conduct analysis relates to the ontological concept of knowledgeability (Stones, 2005). Giddens (1984) considered knowledgeability as what agents know about the circumstances surrounding their and other agents' actions that lead to the production or replication of that action.

Stones (2005) develops conduct analysis to incorporate the analysis of an agent's reflexive monitoring. In this regard, the emphasis is on the agent's conjuncturally-specific internal structures when they encounter external structures (Stones, 2005). Stones (2005) asserts that many research questions require making use of both the agent's conduct and context analysis since the conjuncturally-specific internal structures play a linkage role between external structures and active agency. It implies that conjuncturally-specific internal structures serve as a hinge between external structures, agents' general-dispositional frames, and practices (Stones, 2005).

The next sections expand the agent's conduct analysis and present empirical evidence on the two forms of internal structures: general-dispositional and conjuncturally-specific internal structures.

8.3 Empirical Evidence of General-Dispositional Internal Structures

The general-dispositional internal structures, what Bourdieu (1977) called ''habitus'', comprise socially established habits, skills, dispositions, generalised knowledge, and methodologies for adapting that knowledge to a range of practices (Stone, 2005). Stones (2005) expands on the work of Bourdieu (1977) and his idea of habitus, who conceptualised habitus as a set of durable dispositions, propensities and perceptions which influence the production of social practices (Mouzelis, 2008). To achieve the aim of investigating SMEs' access to Islamic banking finance in Pakistan, due attention was given to the general-dispositional internal structures of an agent-in-focus to discern if they are implicated in the practices of SMEs. Following themes have been identified in this regard.

8.3.1 SME Owner/Manager's Characteristics: Gender, Motivation, Age and Education Level

There is an extensive amount of research devoted to identifying the link between characteristics of an SME owner/manager and the financing preferences of the firm (Woldie et al., 2008; Blackburn et al., 2013; Zabri et al., 2015; Rasheed and Siddiqui, 2019; Baker et al., 2020). However, no definite set of characteristics influences SMEs' decision-making process (Woldie et al., 2008). Different studies use a different set of characteristics to measure their impact on the financing decisions of SMEs. For instance, Woldie et al. (2008) used age, gender, education and motivation; Zabri et al. (2015) used ownership status, education and level of experience; Baker et al. (2020) used a set of traits consisting of gender, age, education and experience. In the context of Pakistan, Rasheed and Siddiqui (2019) investigated the influence of SME owner/managers' motivation, awareness and risk aversion on their decisions regarding sources of finance.

During the fieldwork for this study, gender, motivation, age and education level of SME owner/managers were identified as the significant general-dispositional internal structures that tend to influence SMEs' financing preferences and their practices in this regard.

Women are under-represented among entrepreneurs in most of the countries around the globe (Sauer and Wiesemeyer, 2018). The literature concerning gender differences in access to finance suggests that women business owners experience more financial constraints than their male counterparts (Rahman et al., 2018; Chaudhuri et al., 2020). Morris et al. (2006) argue that among the financial obstacles for women entrepreneurs include using commercial loans, attracting investors and securing finance form banks. These obstacles are due to lack of networking and managerial experience in a specific field (Brush, 1992) and a lack capital investment which restrict the growth of a business venture (Marlow and Carter, 2004). Featherstone (2017) attributes the difficulties in obtaining finance by women entrepreneur to the fact that the vast investment opportunities from the formal sources are hold by men limiting the funding opportunity available for women entrepreneurs. Consequently, they rely on personal savings and informal sources of finance (Ozar, 2007). However, gender differences in access to finance may arise from differences in characteristics and preferences for credit use by the male and female entrepreneurs (Baye, 2013; Aristei and Gallo, 2016; Wellalage and Locke,2017). Aterido et al. (2013) assert that women entrepreneurs are more likely to get finance and at a lower interest rate in comparison with their male counterparts. They further argue that the gender discrimination in the lending markets is the result of different firms' characteristics rather than pure gender bias (Aterido et al., 2013).

Banks' financing decisions are not supposed to be influenced by gender discrimination, however, because of women being under-represented among entrepreneurs, they are typically gender biased in favour of male entrepreneurs (Bellucci et al., 2010). The participants of this study are also of the opinion that as the country's financial system is dominated by men therefore, the barriers to accessing financial services are perceived to be higher for women.

> *"I failed to secure finance from bank when my business was new. Women do face gender discrimination when it comes to financing and growth opportunities. They find it more difficult to establish and run a business specially for the initial few years. The financers and even the suppliers assume that women are becoming entrepreneurs just as a hobby and are not very keen to establish a long-term venture."*
>
> (SME owner, 8)

Motivation is a driving force that influences individuals' decisions to start a business as well as their business processes and decisions (Shane et al., 2003). SME owner/managers' motivations are largely influenced by their family traditions (Basu and Altinay, 2002). The participants of this study identified two main reasons that make them run an SME; to continue the family business or experience independence and self-achievement. The data shows that those running family businesses to fulfil the family traditions tend to be more inclined to use internal financing sources. On the other hand, those with independence as their main motivation to run their own business are more ready to obtain banking finance. The following extracts depict the participants view in this regard:

> *"My father run this business for 30 years and it was entirely self-funded before my brother and I took the charge 12 years ago. Even we never used banking finance until recently. We are expanding our production capacity and for that we just got the Diminishing Musharakah facility approved. We got the facility for nine years only and if things go as planned then we are going to keep a very little percentage of profit during that period and we have agreed to pay a large share of bank's equity back. It is a family business and I feel that this financing is a liability on me which I need to pay back as early as possible. My father gave this business to us with no loan from anyone and I want to do the same for my children."*
>
> (SME owner, 10)

"A nine to five slavery is not for me. It was like a prison so, I left it and became my own boss. Self- achievement and the intrinsic rewards are the main things that pushed me to start my business. I sold my property to start my business because banks were not willing to finance a new venture but now after 8 years, I am expanding my business with financing from bank."

(SME owner, 2)

The relationship between the age of the entrepreneur and their activities and business success has been inconclusive in literature (Zhang and Acs, 2018). For instance, in their investigation of factors affecting business success among SMEs, Indarti and Langenberg (2004) concluded that there is no significant relationship evident between the age of the owner(s) of SMEs and their business activities. Whereas Reynolds et al. (2003) assert that business owners aged 25-44 years were the most entrepreneurially active. Sinha (1996) investigated the role of human factors in entrepreneurship effectiveness and concluded that young entrepreneurs are relatively more successful. Kristiansen (2002), on the other hand, finds a significant direct correlation between the age of the entrepreneur and business success.

The data collected for this study reveals that age was an important characteristic of SME owners/managers that influences their business practices and preferences. The participants of this study belong to different age groups ranging from 24 to 63 years. The aim of this study was not to measure business success; therefore, the relationship between the age of SME owner/manager and business success was not analysed. Keeping in mind the primary aim of investigating Pakistani SMEs' access to Islamic banking finance, it is evident from the data that young owners/managers are more willing to approach formal sources, particularly banks when they need finance. Moreover, they are more likely to adopt formal bookkeeping practices and maintain their records better, which facilitates their access to formal sources of finance. Whereas the age of the owner/manager is positively related to their preference for internal sources of finance. The following statement of a bank manager, dealing with SME financing for 21 years, espouses that:

"Surprisingly, young entrepreneurs are more disciplined in term of their recordkeeping practices. Some 10/12 years ago the scenarios were different, SMEs were not maintaining proper records, and their financial statements were not in an organised way. Most of them were not even filling their tax returns but now the situation is getting better. SMEs, especially those run by younger generation, now practice better bookkeeping and most of my clients had their financial statements and other documents ready when they approach us. If I compare (new) SMEs' current bookkeeping practices with what was there ten years ago, there is a huge, huge, huge difference."

(Bank manager, 2)

Various previous studies that attempted to assess the factors that are affecting the performance of SMEs found the education level of the owner/manager as a critical factor that affects their business activities and decision making (Yusuf 1995; Alfaadhel, 2010; Abebe, 2011; Lema, 2013; Karadag, 2017). Lange and Topel (2006) identify education as a significant element of human capital. Education is a source to gain knowledge and skills and has an impact on a person's discipline, motivation, and self-confidence (Cooper et al., 1994). All the participants of this study, regardless of their educational level, acknowledged the importance of education in running their business successfully. In this regard, the participants stated that:

> *"I have a master's degree in business administration, and I believe that it is the key to success in my business."*
>
> (SME owner, 4)

> *"Educational background of SME owner is an important element. Most of our client SMEs are family run businesses and usually people join their family businesses from a very young age. They are not professionally qualified, and they prefer experience over education. Experience is no doubt an important factor, but the world is changing now and experience without education is not every effective. I have observed that those clients who started their own business or joined their family business after completing a relevant degree are more competent. They are aware of the changing environment and are well-equipped with the skills to deal with such changes in a better way."*
>
> (Bank manager, 9)

However, some participants believed that even if they do not have an appropriate level of education, it is still possible to acquire and develop necessary business skills through relevant training. They also acknowledged their inability to organise or attend frequent training sessions due to its cost. Most of them are not aware of the free training sessions provided to SMEs by SMEDA (discussed in section 8.3.3).

> *"I do not have a formal degree. I joined my father's business right after finishing my A Levels. But I do not think that it has any negative impact on my activities as a businessman. I learnt a lot under my father's supervision and gained experience over the time."*
>
> (SME owner, 10)

8.3.2 Diverse Views on the Extent of Sharia Compliance of Islamic Banks in Pakistan

Naser and Moutinho (1997) assert that Islamic banks do not operate in an environment of isolation and compete with each other and conventional banks in a dual banking system to make and retain customers. Ennew et al. (2011) highlight the importance of consumers' trust and confidence in the financial stability and reputation of the institution while choosing financial and banking services. In the case of Islamic banks, consumers' trust and confidence is not limited to the bank as a provider of financial services but also includes their perceptions about whether the bank adheres to the guidelines and principles of Sharia (Omer, 1992; Amin and Isa, 2008; Hoq et al., 2010; Yahya et al. 2012). Theoretically, Islamic banks function in accordance with the rules of Sharia (Usmani, 2002; El-Hawary et al., 2007; Al-Salem, 2009). However, some previous studies also questioned the extent to which the Islamic banks are functioning in accordance with the principles of Sharia and regarded their practices as ambiguous in much of their translation of Sharia (DiVanna, et al., 2009; Warde, 2010; Khan, 2010; Hayat et al., 2013).

During the fieldwork, the Pakistani SMEs which are currently using Islamic financial products or have used Islamic financial products in the past have expressed varied views on the Sharia compliance of Islamic banks in the country. The diverse views of participants of this study on Sharia compliance of Islamic banks are highlighted from the following three extracts, which illustrate negative, moderate and positive perspectives on Islamic banks' adherence to Sharia principles.

> *"I do not think they are working according to the teachings of the Quran. Interest is explicitly prohibited in Quran, but it is involved in their transactions. Ok, they do not call it interest but calling it profit does not change the fact that they are charging a fixed amount for financing. I used their product once and I do not find any difference between them and conventional banks."*
>
> (SME owner, 5)

> *"I am not sure if the bank is following all the principles of Islamic laws. But I am sure some of their operations are according to the principles of Islam like they do not charge you any penalty if you miss a repayment or two for some genuine reasons. That is why I use Islamic finance rather than the conventional one because it has at least some Islamic touch. Something is better than nothing at all."*
>
> (SME owner, 11)

> *"Of course, they are fully Sharia-compliant. This is the main reason that we are using their products. They are avoiding interest-based transactions and all of their operations are approved by not only one Islamic scholar but a group of scholars."*
>
> (SME manager, 4)

A bank manager who participated in this study corroborates these diverse views of SMEs on Sharia compliance of Islamic banks.

> *"It is very common that a new customer coming to us is not fully convinced that we are complying with Islamic principles. They usually ask us about how transactions are interest free when they appear similar to conventional banks with the same end results. While some customers are already convinced on Islamic banks being truly Islamic."*
>
> (Bank manager, 1)

The analysis of the contextual field of SMEs seeking to acquire Islamic banking finance, presented in the previous chapter, reflects on the position-practice networks of SMEs, which link their internal structures with the external structures. The contextual analysis of SMEs identifies insufficient marketing and advertising of Islamic financial products as one of the major impediments to SMEs' access to Islamic banking finance (discussed in section 7.4.7). The lack of marketing and advertising of Islamic financial products contributes to inadequate knowledge about those products (as discussed in section 8.4.1), resulting in the customers questioning the extent of Sharia compliance of Islamic banks in Pakistan. This interaction of internal and external structures of Pakistani SMEs seeking to acquire Islamic banking finance is reflected in the following statement of a Sharia board member:

> *"Being a member of sharia board, I am confident that Islamic banking in Pakistan is fully Sharia-compliant. People have doubts about it mainly because of the lack of knowledge about Islamic finance. They do not understand how Islamic financial products differ from conventional products. However, the responsibility to address these concerns and clear their doubts lies largely on Islamic banks and sharia board members. It can be done by highlighting the distinguishing features of Islamic banks and Islamic financial products through advertisement. The Sharia board members can record video messages about different products and use social media to make those messages reach a wider audience."*
>
> (Sharia Board Member)

The general-dispositional view about the extent of Sharia compliance of Islamic banks flowed into the way Pakistani SMEs perceive the benefits of using Islamic finance. However, the fact that the participants of this study expressed a diverse opinion on the Sharia compliance of Islamic banks but most of them are still using Islamic financial products, even if they are not fully convinced with the validity of a transaction, depicts their trust and confidence in Sharia board members as discussed in section 7.4.5. This is another example of interaction between SMEs' internal and external structures.

8.3.3 Stock of Knowledge on Organisations Providing Non-Financial Support

The significance of access to sufficient financial resources as a critical element for the growth and success of SMEs is well established in the literature (Ping-fei, 2002; Abereijo and Fayomi, 2005; Duan et al., 2009; Gbandi and Amissah, 2014; Zhao et al., 2019). However, this is not the only factor, and the growth of SMEs rather occurs as a result of many interlinked elements, including the non-financial factors (Perren, 1999). Non-financial support services are the capacity-building inputs with the focus on enhancing a business's performance (Owusu-Ansah et al., 2017). These services seek to enhance SMEs' knowledge and skills and can take general information and advice, training, assistance in preparing financial statements and thus, act as a tool to boost SMEs' productivity (Anwar and Li, 2020).

To accelerate the challenging task of developing the SME sector in Pakistan, the government has established a specialised institution, Small and Medium Enterprise Development Authority (SMEDA), in 1998, which provides non-financial support to SMEs. The responsibility for developing policies to create a feasible business context for SMEs lies with SMEDA which works under the Ministry of Industry and Production (Saleem, 2008). In addition to developing SME policies, it also provides business development services to SMEs. It has acknowledged the significance of the role of research in improving the business context and launched a journal of economic research specifically tailored to the dynamics of the SME sector in Pakistan. For the capacity building of SMEs, SMEDA organises many need-based training programs through seminars, workshops, and conferences across the country. These programs cover many areas including, finance, technical competencies, compliance with the regulatory and legal framework, managerial and administrative skills, and marketing (SMEDA, 2021). Such programs help to improve key performance indicators, including productivity, quality, competitiveness, and sustainability (SMEDA, 2021). Furthermore, SMEDA offers a free of cost software-based accounting package developed explicitly for SMEs to facilitate SMEs' bookkeeping requirements. SMEDA also provides free of cost training sessions at different locations on the usage of this software to maximise its utility for users.

In today's dynamic environment, the survival and success of businesses depend largely on their managerial and administrative capabilities; however, SMEs, particularly small enterprises, lack managerial and administrative skills (Pansiri and Temtime, 2008). Bryson and Forth (2016) identify that managerial skill training for SMEs results in significantly increased turnover and a lower rate of business failures. According to OECD's (2018) policy note on monitoring and evaluation of SME and entrepreneurship programmes, although SME owners/managers can acquire desired skills through informal on-the-job training by other experienced staff, off-the-job training tends to be more effective in improving businesses' productivity and survival ratio. Khan and Ghouri (2011) assert that the lack of managerial skills and training is one of the major factors that hinder SMEs growth in Pakistan. The Government of Pakistan has also identified the need for training to develop managerial skills in SMEs to promote the SME sector. In the government's policy for promoting SMEs, particular focus is being given to SMEs' managerial and other skill development (SBP, 2017b). The government, in this regard, is organising free of cost training programs in collaboration with SMEDA (SBP, 2017b).

The participants of this study also exhibited awareness about the importance of managerial skills for the growth and survival of their business. SMEs acknowledged their inability to organise or attend such training due to their cost; on the other hand, SMEDA is offering such training for free. It shows a lack of knowledge on the part of SMEs about a supporting organisation. One of the participants stated that:

> *"I am really surprised to know that there is an institute that is arranging free training sessions for SMEs. Honestly, I still doubt if they are actually free but if it is so, that is really a very good thing. It is difficult for SMEs to bear the cost of frequent in-house training. I have myself seen many businesses failing because of little or no basic business management skills."*
>
> (SME manager, 1)

The fieldwork evidence suggests that SMEs in Pakistan are not aware of the support and assistance available from SMEDA to maintain and produce their financial records. For instance, SMEs' inadequate financial recordkeeping practices are identified as one of the major obstacles to their finance access. In this regard, SMEDA offers free of cost accounting software that assists SMEs in maintaining their financial statements. However, most SMEs are not aware of this service available to them. When asked if they are aware of SMEDA and the free of cost software-based accounting package offered by them, an SME owner stated the following:

> *"What is small and medium enterprise development authority? I never heard about it. Do they really provide free software? In that case I can save the additional cost I am paying an accountant to prepare my income statement and balance sheet. I know that making proper accounts is necessary when we need financing but if you do not know how to do yourself you need to hire an accountant and it is an additional expenditure. Free software is really a good initiative for us."*
>
> (SME owner, 19)

SMEs' lack of knowledge about SMEDA is implicated in the production of their practices and, thus, influences SMEs' access to Islamic banking finance. For instance, the availability of adequate financial records is one of the major obstacles to SMEs' access to Islamic banking finance. On the other hand, SMEDA provides free of cost accounting software to help them manage their accounting records and produce financial statements. The lack of knowledge about the assistance provided to SMEs' for preparing financial statements is reflected in their deficient recordkeeping practices.

8.4 Empirical Evidence of Conjuncturally-Specific Internal Structures

The conjuncturally-specific internal structures comprise knowledgeability around the distinctive aspects of the conjuncture or phenomenon under study. Consequently, these structures incorporate knowledge of Giddens' virtual structures of signification, domination, and legitimation. Along with their role as stocks of knowledge within the agent, conjuncturally-explicit structures also serve as the meeting point between the two forms of bracketing; the context and the conduct, and in this way bridge the gap between internal and external structures. Stones (2005) considers a comprehension of conjuncturally-specific structures as integral to understanding agents' in-situ practices.

In this section, four themes from the fieldwork related to SMEs conjuncturally-specific knowledge are presented. These include stock of knowledge on Islamic financial products; high value placed on internal sources of financing, SMEs' accounting and financial reporting knowledge and practices and SMEs' motivation to use Islamic financial products.

8.4.1 Stock of Knowledge on Islamic Financial Products

Knowledge is a significant determinant of a customer's intention to adopt a particular product or service (Rasheed et al., 2019). The depth of knowledge that SMEs possess on Islamic financial products fundamentally impacts their access to Islamic banking finance. It informs SMEs of the essential matters such as the existence of different types of Islamic financial products available, the difference between various types of Islamic financial products as well as the difference between Islamic and conventional financial products, how these products are free from the element of interest and the profit and loss sharing mechanism. This knowledge drives SMEs' course of action and thus influences their access to Islamic banking finance. However, most Muslim customers lack awareness about the products and services offered by Islamic banks (Khalaf, 2007). Moreover, the level of knowledge about Islamic banking products is further limited in the case of non-Muslim customers (Ahmad and Haron, 2002).

The use of Islamic financial products, in general, and for SME financing, is expected to be higher in Pakistan since the majority of the population is Muslim[43]. However, this is not the case, and according to the SME financing data provided by SBP (2019b), conventional banking still dominates SME financing. The greater use of conventional finance in the presence of alternative Sharia-compliant products can be due to the lack of knowledge and understanding about the Islamic banking principles and Islamic financing products (Khattak, 2010; Rasheed et al., 2019). The fieldwork provided evidence that SMEs and the agents-in-context view SMEs' knowledge as an important element that influences SMEs' access to Islamic banking finance. However, based on the evidence gathered from the participants, it is identified that sufficient knowledge about Islamic financial products was lacking. Some of the responses of the participants, when inquired about SMEs' knowledge of Islamic financial products, are as follows:

> *"I am currently using Murabaha and Ijarah and I know they offer partnership contracts as well. I don't know if they have any other products available. Actually, when I approached the bank, they asked me all my requirements and then offered these products, so I did not even inquire if they have any other product available."*
>
> (SME owner, 5)

> *"My bank manager told me about some of their products. The only thing I remember about those products is that their names were very difficult to pronounce."*
>
> (SME owner, 11)

[43] 97% of Pakistan's total Population is Muslim as per the last census conducted in 2017, by the Pakistan Bureau of Statistics. : http://www.pbs.gov.pk/content/provisional-summary-results-6th-population-and-housing-census-2017-0

The above extracts validate the findings of Rasheed et al. (2019), who assert that generally, SMEs in Pakistan do not have sufficient knowledge about Islamic financial products. SMEs' knowledge and understanding of Islamic financial products are critical in determining their access to Islamic finance (Mansor et al., 2012). Al Balushi et al. (2019) assert that SMEs do not have adequate knowledge about the available Islamic banking products, which inhibits their access to Islamic finance. Pakistan has a dual banking system, and, as of 31st December 2020, Islamic banks share in SME financing stands only at 8.34% of the total SMEs lending portfolio (SBP, 2020). The use of conventional finance in the presence of alternative Sharia-compliant products can be attributed to the poor level of knowledge about the Islamic banking principles and Islamic financing products (Dusuki and Abdullah 2007; Khan et al., 2007; Khattak, 2010). In a country like Pakistan, where Islamic banking is still in the development phase, knowledge of Islamic financial products may greatly impact SME owners' financing decisions. In their investigation about the determinants of low adoption of Islamic banking in Pakistan, Butt et al. (2018) identify that SMEs are not well-aware of Islamic Banking in Pakistan. They also highlighted the need to create awareness about Islamic banking products and services with the help of print, social and electronic media (Butt et al., 2018). One of the respondents also linked SMEs' limited use of Islamic financial products to the lack of knowledge about them and stated that:

> *"One of the reasons that SMEs are not using Islamic finance is lack of knowledge. Most of them are not aware of how many Islamic financial products are available. How do they work? How they differ from conventional products? How they are interest free? What are the benefits of using Islamic finance?"*
>
> (Bank manager, 1)

Inadequacy of sufficient knowledge about Islamic financial products is highlighted in various studies. For instance, Naser et al. (2013) investigated the level of awareness about institutions offering interest-free financing products in Kuwait. They concluded that customers only have a little knowledge about the product(s) they are using and lack knowledge about the other products and services offered by the same institution (Naser et al., 2013). Bley and Kuehn (2004) investigate the level of students' knowledge and perception of conventional versus Islamic finance in the United Arab Emirates. The results suggest that conventional banking knowledge was higher than Islamic banking among the participants (Bley and Kuehn, 2004). Rammal and Zurbruegg (2016) explore the level of awareness of Islamic financial products among the Muslim population in Australia. Their findings reveal that the low use of Islamic financial instruments is due to the lack of relevant knowledge and understanding of the Islamic banking framework (Rammal and

Zurbruegg, 2016). In their investigation of Libyan business firms' attitudes towards Islamic methods of finance, Gait and Worthington (2009) conclude that most of the respondents are aware of the existence of Islamic banking in the country, however, they have no or very little knowledge about Islamic modes of financing. In South Africa, Cheteni (2014) asserts that the awareness of Islamic banking products and services has been very low despite the presence of the Islamic banking system in the country since 1989. Rasheed and Rahman (2018) argue that lack of awareness among SMEs is a major concern for the Islamic banking industry in Pakistan. Yet, insufficient research work is done to enhance SMEs' awareness level in the context of Islamic banking (Rasheed and Rahman, 2018).

The unavailability of adequate knowledge about Islamic financial products among Pakistani SMEs is one of the major challenges while accessing Islamic banking finance. Giddens' (1984) highlights that structures of signification facilitate meaning in social interactions, which means that agents use available information to create meaning. Interpretative schemes are the stocks of knowledge that enable agents to comprehend things around them, whether physical or more abstract and conceptual (Giddens, 1984). As suggested by the fieldwork evidence, SMEs do not have sufficient knowledge of Islamic financial products. Therefore, this is a challenge for SMEs to learn how to draw efficiently on internal structures of signification. There is a need to enhance SMEs' knowledge and understanding of Islamic financial products to utilise them to draw on sophisticated signification structures effectively.

The reflections on SMEs' stock of knowledge about the Islamic financial products also consider how the significant agents-in-context are influenced by SMEs knowledge and also how they, in turn, influence SMEs' access to Islamic banking finance. For instance, the analysis of SMEs' contextual field identifies Sharia boards as an important cluster of agents in the context which influences SMEs' access to Islamic banking finance (discussed in section 7.4.5). Despite lacking sufficient knowledge about those products and their reservation about the extent to which Islamic banks are truly Islamic, SMEs still prefer to use Islamic financial products. It is because of the fact that they trust and rely on the Sharia boards, as reflected from the following opinion of one of the participants:

> *"Most of their products do look similar to conventional financing but I still believe they are interest-free. I do not have sufficient religious knowledge to understand the underlying mechanisms that make those products Sharia complaint. They have muftis (Islamic scholars) with a sound knowledge of Sharia principles who assess the products from all*

the aspects and then validate it. And it is not a one member, if a group of highly qualified muftis agree on a product being in accordance with Islamic principles, they cannot be wrong."

(SME owner, 22)

In the contextual analysis of agent-in-focus presented in the previous chapter, it was identified that the power of advertising and marketing to impart knowledge about Islamic financial products and the benefits of using those products is not adequately utilised (discussed in section 7.4.7). This inhibits the development of coordination between SMEs and Islamic banks and thus, acts as an obstacle to SMEs' access to Islamic banking finance. Islamic financial products possess unique characteristics (Damirchi and Shafai, 2011) and SMEs' knowledge and understanding of these unique characteristics are not very strong (Jaffar and Musa, 2014; Awang et al., 2020). Advertising and marketing Islamic financial products through mass media are one of the most significant ways of imparting knowledge and awareness about them and thus, promoting these products (Shareef et al., 2019). The link between SMEs' insufficient understanding of Islamic financial products and lack of advertising and marketing of those products is evident from the following extract:

"Conventional products have simple processes involved and SMEs have knowledge and understanding of them as they are dealing with them for a long time. Still, you will see lot of advertisement about them on billboards, newspapers and even on television. Islamic banking is relatively new but still they are not paying attention to advertise their products. This is one the major reasons that most of our customers do not have strong knowledge of Islamic financial products."

(Bank manager, 11)

The above discussion highlights that SMEs' knowledge of Islamic financial products is a significant conjuncturally-specific internal structure that can facilitate SMEs' access to Islamic banking finance. The external structures influence SMEs knowledge about Islamic financial products in their contextual field, such as inadequate advertising and marketing. In turn, they can influence SMEs' actions by shaping their perceptions and attitudes towards Islamic banking finance. The Sharia board member also accentuated SMEs' lack of knowledge about Islamic financial products and highlighted the need for Islamic banks, a significant agent in the contextual field of SMEs, to play a role in imparting knowledge about Islamic finance. He stated that:

"People generally lack knowledge about Islamic financial products, particularly those who are not using them or recently switched to Islamic banking. In my opinion, knowledge of Islamic financial products is one of those concerns which needs a lot of attention. I would

suggest Islamic banks play a significant role in educating SMEs about Islamic financial products. For the starting point, the branches located in industrial zones can arrange free seminars and workshops for SMEs through the trade unions."

(Sharia Board Member)

8.4.2 High Value Placed on Internal Sources of Financing

Literature on SME financing practices highlights that SMEs depend much on internal sources of financing (Shinozaki, 2012; Jiang et al., 2014; Abbasi et al., 2017). Abdulsaleh and Worthington (2013) assert that when seeking funds, internal sources of finance take precedence over external sources and SMEs utilise external sources only when the internal sources are fully exhausted. In addition to prioritising internal sources over external sources, SMEs generally prefer external debt over external equity and short-term debt over long-term debt (Abdulsaleh and Worthington, 2013). Hence, the pattern of an SME's preferences for the financing sources follows financing through internal sources, obtaining external debt and issuing equity (Kumar and Rao, 2016). Daskalakis et al. (2013) investigated the financing practices and preferences for micro and small firms. The study participants were asked to evaluate preferred sources for financing their business if they do not face any obstructions in accessing any source of finance. The study concluded that small businesses heavily rely on their funds and are reluctant to finance their business from sources outside the family (Daskalakis et al., 2013).

It was identified from the literature review that most of the SMEs in Pakistan, particularly the small enterprises, rely on personal savings and informal sources of finance (Hassan, 2008; Naveed, 2012; Khan, 2015). For instance, in 2007, approximately 90% of small businesses in Pakistan obtained credit from the informal sector (Khan, 2015). The informal financing sources include loans from friends or family, moneylenders, informal credit unions and credit clubs. These sources generally provide small, and short-term loans, and their access primarily depends on relationships and social networks. The informal financing sources lack regulation and usually require small or no collateral (Qadir, 2005). Dar et al. (2017) assert that one of the reasons that SMEs in Pakistan are more inclined towards personal and informal sources of financing is their inadequate accounting and other recordkeeping practices.

The fieldwork evidence confirmed that SMEs generally place a high value on the use of personal savings and informal sources of finance. The use of personal savings is the most common and quickest way of funding SMEs, particularly small businesses (Shinozaki, 2012). Irwin and Scott (2010) assert that, in addition to the difficulties associated with obtaining external finance, SMEs give preference to personal savings over external sources is their fear of not being able to pay back the loan and the interest on the loan. SME owner(s) in Pakistan first tap their savings before obtaining finance from banks and other specialised institutions (Sherazi et al., 2013). Almost 75 to 80% of the financing of 22 SMEs interviewed for this study comprised their personal savings. Most of them cited "no dilution of power over the business" as one of the most common reasons to finance their business through personal savings. The importance of financing their business by using personal savings is evident in the following extracts:

> *"For the 15 years I run my business entirely as a self-funded project. I am using Murabaha for the past 8 months due to some unexpected personal circumstances, but I hope situation will get better soon and I will not have to use external finance. I think the best option to fund your business is investing your own money. Self-financing your business gives you much more control as you know precisely how much money is available to maintain your business."*
>
> (SME owner, 21)

> *"I wish if my business was still self-funded, and I did not have to rely on outside lenders. If you retain full ownership of the business, it gives you much more flexibility as you do not have to fulfil the requirements of the lender. Also, all the profits are yours, you don't need to pay anyone anything back. You do not need to worry what if you will not be able to pay the lender on time"*
>
> (SME owner, 10)

These findings are in line with the findings of Du and Dai (2005), who argue that SMEs prefer to use personal savings over external equity to finance their business to avoid diluting their controlling position. Mishra and McConaughy (1999) also agree that due to their control risk aversion, small firms are less willing to dilute their control over the business. The utility of controlling their business decisions makes SME owners resistant to diluting their stake in it (Berggren et al., 2000). The absolute control over the business enables the owner to make quick decisions since they do not need to wait for the approval of external equity holder(s) (Kirsch et al., 2009). The willingness to avoid dilution of control over the business is further stronger in family-owned firms (Gómez-Mejía et al. 2007; Kotha and George, 2012). The introduction of external equity expands control risk, increasing the probability of loss of family control and, hence, deterring the business from issuing external equity (Abor, 2007).

Participants of this study also revealed that, once they have tapped their personal savings, they prefer borrowing from internal sources such as loans from friends or family to finance their business. SMEs consider these informal financing sources as quick, cheap, flexible and easier to access. The importance of these features of informal sources of finance for SMEs is evidenced in the following extracts:

> *"Loans from relatives or friends are very easy to get. I do not have to fill a pile of forms; I do not need to provide my business records and I can literally get the cash within few minutes. They do not charge me anything and if for some reasons I am unable to pay on time, they are flexible with it."*
>
> (SME owner, 6)

> *"Borrowing from friends gives me quick access to cash and I do not have to spend lot of time trying to fulfil lots of requirements."*
>
> (SME owner, 16)

These findings resonate with Lin and Sun (2006), who assert that the most frequently used source of debt financing for SMEs is not the commercial lending institutions but family or friends. Daskalakis et al. (2013) also state that SMEs rely on their personal savings and then loans from friends or family before using external sources of financing as a last resort. SMEs mostly rely on informal sources of finance to avoid the borrowing costs, collateral and lengthy documentation involved in obtaining finance from the formal sources (Khan, 2015). In Pakistan, obtaining a small business loan from a formal source involves an average of 27 steps and 9 client meetings (Nenova and Niang, 2009). On the other hand, informal borrowing usually occurs within the social networks where the lender and borrower know each other (Forkuoh et al., 2015). Therefore, SMEs can obtain finance from informal sources at a low or no cost, with little or no documentation requirements, fewer steps, and a short period of time compared to the formal sources (Yaldiz et al., 2011).

On the other hand, formal sources of finance are difficult for SMEs to access due to the inherent information asymmetries between financiers and firms (Agarwal and Hauswald, 2008). This uneven distribution of information between the formal sources and SMEs reduces the level of trust between them. To mitigate the risk arising from information asymmetry, banks impose strict covenants (Lemmon and Zender, 2019) or demand collateral (Menkhoff et al., 2006) or charge higher interest rates (Cassar et al., 2015) from SMEs that eventually result in increased reliance on informal sources.

In light of the above discussion, it is evident that a major constraint on the range of external financing sources available to SMEs is imposed by the greater value placed on internal sources of financing. SME owners are not willing to dilute their control over the business by injecting external equity. They are more inclined towards internal sources of finance and use external finance only as a last resort. This high reliance on internal sources affects SMEs' perceptions and attitudes towards formal sources of finance, including Islamic banking finance. It hence plays a significant role in shaping SMEs' practices while accessing Islamic banking finance. For instance, since SMEs use their records for internal purposes only, most SMEs do not maintain audited accounting records. Audited accounting records, however, is one of the requirements to obtain finance from external sources and their unavailability limits SMEs' access to Islamic banking finance. SMEs' financial recordkeeping practices and their impact on access to Islamic banking finance are discussed in detail in the following section.

8.4.3 SMEs' Accounting and Financial Reporting Knowledge and Practices

Accounting information is one of the significant types of data required for decision making both inside the organisation as well as for the outsider (Collier, 2015). Most of the SMEs are not registered as corporate bodies but are incorporated as sole proprietorships (Abbasi, 2017). Thus, SMEs' accounting practices primarily differ from that of large enterprises (McMahon, 2001). In contrast with large corporations, many SMEs, particularly small enterprises, randomly record their transactions without adherence to any established accounting and reporting frameworks (Zotorvie, 2017). Hence, it is difficult to keep track of their cash flows and other significant financial information (Hilton and Platt, 2008). Producing and maintaining adequate financial records have been identified among the major challenges for SMEs (Akerele, 2004; Sian and Roberts, 2009; Ezejiofor and Olise, 2014). Abdul-Rahamon and Adejare (2014) assert that a good reporting practice is about keeping financial information and how well those records meet the information requirements of internal and external decision-makers. However, the financial reporting practices of SMEs generally fail to meet the standards suggested by various external users of their financial information (Ahmad, 2012; Sava et al., 2013). Inadequate accounting and financial information are some of the main factors that hamper SMEs' access to formal sources of financing (Dar et al., 2017).

Kouser et al. (2012) highlight that, in the context of Pakistan, the main obstruction in SMEs' access to banking finance is the inadequacy of their financial records. Banks could not measure the performances of SMEs. In the absence of adequate financial data, it is difficult for banks to determine whether the SME has the probability of generating sufficient cash flows and repaying the loan on time (Kouser et al., 2012). The fieldwork data collected for this study also indicates that SMEs' deficient financial records were the major obstacle in their access to Islamic banking finance. During the interviews, SMEs were asked questions about the difficulties they faced while accessing Islamic finance. This enabled them to reflect on various circumstances that they experienced during obtaining Islamic finance, explain what they did in those circumstances, and provide reasons for their actions accordingly. The respondents highlighted inadequate financial records as a major challenge they face while accessing/providing Islamic banking finance. Some of the responses in this regard are presented below:

> *"I was maintaining all the necessary financial records, but they were not in a proper format. I was able to understand them even the bank manager was able to understand them, but they were not sufficient as per the bank's requirements. Then, I had to take services of a part qualified accountant to get them sorted and prepare my financial statements in a proper way."*
>
> (SME owner, 18)

> *"The biggest difficulty in financing SMEs is the unavailability of required documents and adequate financial records. Even if they are properly maintaining their records, they are not getting them audited because it involves incurring additional expense and secondly, they also feel that it is not of any benefit for them. They usually rely on internal sources of financing, and they do not need audited accounts for that. They only get them audited when they want to obtain finance from the formal sources."*
>
> (Bank manager, 5)

Ismail and King (2005) assert that developing a sound accounting recordkeeping system in SMEs depends on the owner/manager's level of accounting knowledge. However, SME managers/owners lack sound knowledge of accounting practices and, therefore, cannot maintain proper records (Abdul-Rahamon and Adejare, 2014). While reflecting on the difficulties they faced in obtaining Islamic banking finance because of their inadequate financial records, the participants of this study also described and explained how their knowledge of accounting and financial recordkeeping influenced their actions. They identified that their limited accounting knowledge and accounting records solely for internal purposes resulted in inadequate recordkeeping practices. They believed that although neither they were recording all the transactions nor following any prescribed manner, their accounting records, as per their understanding of accounting and financial reporting, were still sufficient for use.

> *"I was recording everything that was necessary to keep track of my business activities. My records were more than enough to assess the profitability and stability of business. But*

bank manager needed audited financial statements. It seemed that they want to know about my business even more than what I know."

(SME owner, 15)

Establishing and efficiently handling an accounting recordkeeping system is always a major challenge for SMEs (Cant and Wiid, 2013). In addition to their limited knowledge of accounting and reporting procedures, SMEs' recordkeeping practices are also influenced by the cost attached to maintaining accounting records appropriately. Barbera and Hasso (2013) suggest that to ensure adequate financial records, SMEs need to hire the staff with the proper skills and knowledge for maintaining the records. Using services of qualified accountants can positively impact maintaining the records in such a way that they provide sufficient information required by the decision-makers (Xu et al., 2003). However, the high cost associated with obtaining the services of professional accountants has left SME owners with no other option but to compromise on the quality of their financial records (Jayabalan et al., 2009). Furthermore, SMEs view any attempt of improving their reporting practices as time-consuming and an unnecessary increase in cost without bringing any clear advantages for them (Litjens et al., 2012). A respondent shared his view in this regard:

"I have hired an accountant to maintain my records and prepare financial statements only since I started using banking finance. I do not think that I would be doing it if my business was still fully self-funded. It's not free, why should I pay when I can keep the records of my business which are enough for my understanding."

(SME owner, 15)

To encourage SMEs to maintain proper accounting records with no or minimal additional cost, SMEDA offers a free of cost software-based accounting package specifically developed for SMEs. However, SMEs are not utilising the support and assistance available from SMEDA to maintain and produce their financial records because of their lack of knowledge (discussed in section 8.3.3). In this regard, the Sharia board member expressed his views and highlighted that:

"Islamic banks need to play a role in improving SMEs' recordkeeping practices not only to gain clients but because it is the basic principle of Islamic ethics to provide help and support to others. This is my suggestion for State bank of Pakistan to introduce free of cost and user-friendly accounting software to SMEs through Islamic banks. I am aware that SMEDA is already providing such software, but it is reached by a very limited number of SMEs. If SMEs are introduced to such software at the time of opening account with the Islamic bank, it will help to improve their recordkeeping practices."

(Sharia Board Member)

Giddens' (1984) introduced the 'reflexive monitoring of action' to the notion of human agency. The concept of reflexivity is critical for understanding how agents make their actions meaningful to themselves and others (Blaikie, 2010). Reflexive monitoring of action is associated with agents' knowledge and the ability to comprehend what they do. Agents consistently monitor the progression of their actions as well as the contexts in which they move. The monitoring of actions makes individuals aware of and encourages a response to unintended consequences, facilitating future motivations. This reflexive monitoring of actions and their consequences allows agents to either replicate, partially replicate or not replicate their previous actions (Walsham, 2002). It is evident from the data that SMEs reflected upon unintended consequences and reacted and interacted in new ways. For instance, SMEs were asked questions about how they overcame difficulties they faced due to their inadequate records. This enabled them to explain how being knowledgeable about providing audited financial statements for obtaining Islamic finance changed their recordkeeping practices.

> *"The bank manager guided me about the requirements of audited financial statements. I am now using services of an accountant to maintain my records, prepare financial statements and get them audited."*
>
> (SME owner, 15)

It corroborates Giddens' (1984) claim that Individuals' ability to make any change is related to their knowledge about their surroundings. Tucker (1998) asserts that since agency implies an individual's ability to observe his/her own experience and then rationalise their action, it is therefore associated with reasoning and knowledge. Hence, it can be argued that the knowledge obtained by SMEs about the required financial records for accessing Islamic banking finance enabled them to rationalise their current practices and modify their actions.

Abrie and Doussy (2006) assert that SMEs are generally reluctant to produce adequate financial reports that outsider can access due to the requirements of the regulatory authorities. The analysis of SMEs' contextual field presented in chapter 7, identified the Federal Board of Revenue (FBR) as a significant agent in the context that exerts a major influence on SMEs' recordkeeping practices. Shlafman et al. (2019) highlight that proper recordkeeping will expose the firm's financial position, which has an impact on the business's tax liability. Thus, their reluctance to pay more tax incentivises them not to record all the transactions (Shlafman et al., 2019). However, the unavailability of sufficient financial data makes it difficult for banks to determine whether the

SME can generate favourable cash flows and repay the loan on time, which has an adverse impact on their lending decisions (as discussed in section 7.4.1).

8.4.4 SMEs' Motives to Use Islamic Financial Products

Given the rising importance and potential of Islamic finance, various previous studies attempted to understand and explain the motivation of customers to adopt Islamic financing options in a dual banking environment (Butt and Aftab, 2013; Jaffar and Musa, 2014; Ullah and Lee, 2016; Lajuni et al., 2017; Butt et al., 2018; Bananuka et al., 2019). Most of these studies identified their religious values as the major factor influencing a customer's decision to use Islamic banking finance. Demirguc-Kunt et al. (2013) assert that conformity of Islamic finance to the Sharia principles, values and goals represents significant motives for Muslim customers to adopt these products. The other factors include quality of services (Ahmad et al., 2010), low cost of services (Marimuthu et al., 2010), efficient and friendly bank staff (Hasan et al., 2012), awareness about Islamic finance (Unegbu and Onuoha, 2013) and recommendations of friends or family members (Jaffar and Musa, 2016).

The participants of this study identified their religious motives as the primary determinant that has influenced their decision to adopt Islamic finance. Although most SMEs are not aware of all of the features of Islamic financial products, being free from the element of interest is a sufficient reason for them to use these products.

> *"I want to avoid dealing in interest-based transactions as much as I can. Interest is not only forbidden in Islam but also considered as one of the most heinous sins. In Holy Quran Allah has declared war on those who partakes in Interest. Is there any armour that can defend you in the war against Allah? By engaging in interest-based transaction, you are not only committing a major sin but trust me it will not help the growth of your business as well."*
>
> (SME manager, 18)

> *"Before I joined this company almost six years ago, they were using both Islamic and conventional banking services. I convinced the directors to completely switch to interest free banking. Interest is a curse. It will not bring you any benefits, neither in this world nor hereafter. If you are deliberately involved in something which God has clearly and repeatedly forbidden you from, how will you stand in front of Him on the Day of Resurrection?"*
>
> (SME manager*, 4)*

Various previous studies support these findings. For instance, Kontot et al. (2016) conclude that the participants of their study are more inclined towards the use of Islamic finance on religious grounds; Kamiyama and Kashiwagi (2019) identify avoidance of interest as the foremost motivating factor for adopting Islamic finance in Jordan; Akhtar and Abbasi (2019) assert sharia abidance as the dominant factor that motivates customers to avail Islamic finance in Pakistan; Herliansyah et al. (2020) highlight that micro, small and medium entrepreneurs' intention to become a customer of Islamic banks is collectively determined by their religiosity and the services and location of Islamic banks.

From a legitimation viewpoint, any financial transaction involving *Riba* (interest) is forbidden since it is considered unlawful in Islam. According to Giddens (1984), rules of legitimation define and govern norms and these norms reflect the shared values and standards for conduct in a given society. When the agents' conduct falls outside the norms, they are followed by sanctions (Giddens, 1984). The threat of sanction then becomes implicated in the practices of agents. In accessing finance for their business, religiously motivated SMEs want to abide by the rules of legitimation for a transaction as prescribed in the Sharia principles. They are, therefore, motivated to use Islamic financial products since the validity of such products as being Sharia complaints is established by the Islamic scholars present in the bank's Sharia board. As reflected from the above-mentioned extracts, the threat of sanction by going against the orders of God determines SMEs' attitudes towards Islamic finance and thus, becomes implicated in the practices of SMEs.

Islamic banking is not a simple phenomenon and requires detailed knowledge and skills to understand it (Sorour and Ken, 2014). It requires an understanding of the issues relating to banking, economic and legal frameworks and an understanding of sharia laws (Sorour and Ken, 2014). As discussed in section 8.4.1, the study participants expressed their limited ability to understand the underlying mechanisms that make Islamic financial products Sharia-compliant. Some of them find it difficult to comprehend how it is interest-free. They believed that it is due to the lack of required religious knowledge on their part. However, even if they do not understand the underlying framework of Islamic financial products, they still believe them to be Sharia-compliant. This is because every product and its related transactions are approved by the qualified Islamic scholars in the Sharia boards. Thus, their religious motives behind the use of Islamic finance (internal structure) are addressed by the presence of Sharia board members (external structure).

"It is not possible for me to have a complete understanding of how these products work. Islamic finance is not a basic religious education which every Muslims have. Yes, we all know interest is prohibited, we should not exploit others, we should follow ethical principles but dealing in Islamic products involve more than that. They are developed to be interest free but at the same time they should make a lawful profit for banks without exploiting their users financially. They have qualified and credible Muftis (Islamic Scholars) who take care of these matters and they are specialists in their field. "

(SME owner, 2)

In addition to religious motives, SMEs also identified Islamic banks' handling of delayed repayments as another significant reason to adopt or continue using Islamic financial products. Wan and OU (2005) assert that commercial banks are reluctant to provide finance to SMEs because they are not confident in their repayment capability. The inherent risk of SMEs' failure to timely repay the financial obligations is not uncommon in Islamic financing. The fact that Islamic modes of financing are based on profit and loss sharing mechanisms does not shield Islamic banks against delay or even default in repayments (Yaakub et al., 2014). However, Islamic banks' handling of delays in repayment differs from that of conventional banks. In case of a failure to repay on time, Islamic bank's share of profit will not be increased, unlike the interest-based-lending where any such failure will result in increased interest cost (Mirakhor and Zaidi, 2007), which leads to the borrower's exploitation and is, therefore, against the philosophy of Islamic economic system. However, the actual cost of debt collection can be imposed on the client (Yaakub et al., 2014). Consistent with the Sharia principles, Islamic banks in Pakistan are not allowed to charge any penalty from their customers, including SMEs, for late payment due to unforeseen circumstances. However, if the customer is at default and the delay is caused by his negligence, the bank forces the customer to make a charitable contribution[44]. Pakistani SMEs identified this unique feature of Islamic financing as beneficial for them when their businesses face unforeseen situations. In this context, the opinions of some of the participants of this study are stated on the next page.

"Their policy of not charging any additional amount on delayed payment is really good for SMEs. We also want to be prompt in repayments and do not get financing with the intention of not paying it back. We also want to continue are business and maintain our market reputations. Still, sometimes it happens that circumstances are not in our control; like delay in production due to a delay or default on part of supplier or our sea cargo did

[44] According to the State Bank of Pakistan's guidelines for Islamic banks, clients who delay repayments without any genuine reason should be made to contribute to the charity as a penalty. However, this amount cannot be treated as bank's income. (Available at: https://www.sbp.org.pk/ibd/handbook-ibd.pdf)

not reach on time because of some weather issues. In such cases Islamic banks are very facilitating and do not charge us any additional amount."

(SME owner, 12)

"Islamic financing is not only interest free but ethical as well. They do not overburden an already struggling borrower. I faced disruption in my business activities due to torrential rain last year and was not able to pay two instalments on time, but they did not charge me anything. Being a small business owner, I can understand this is such a big favour for small businesses."

(SME owner, 17)

The previous fieldwork confirmed that Pakistani SMEs' motives to use Islamic banking finance are clear, deliberate and conscious. This study concludes religious values as the major motive for SMEs to adopt Islamic banking finance. These findings are consistent with the prior studies of Gait and Worthington (2008); Awan and Bukhari (2011); Hasan et al. (2012); Demirguc-Kunt et al. (2013); Jaffar and Musa (2014); Ullah and Lee (2016); Butt et al. (2018); Bananuka et al. (2019) which identified religion as the primary driver of customers' intention to adopt Islamic finance. In addition to their religious motives, Pakistani SMEs' is also driven to seek Islamic banking finance because of its unique feature of not imposing any penalty in case of a delay in repayment(s) for genuine reasons. Both of these motives influence SMEs' intention to adopt Islamic finance and thus, determine SMEs' practices while accessing Islamic banking finance.

8.5 Conclusion

This chapter presented the empirical evidence of the internal structures of agents-in-focus; Pakistani SMEs seeking to acquire Islamic banking finance. Consistent with the ontology of strong structuration theory, this chapter examines both the transposable habitus and the more specific internal structures drawn upon by Pakistani SMEs seeking to acquire Islamic banking finance within the specific contextual field discussed in chapter seven. The patterns identified in this chapter provide significant insights into SMEs' conduct and suggest that SMEs' practices are not only influenced by their conjuncturally-specific internal structures but also by their general-dispositional internal structures. The chapter first identified general-dispositional internal structures of SMEs' that are implicated in their practices. These include their motivation to run business, age, educational background, preference for different sources of financing, views on the extent of Sharia compliance of Islamic banks and their knowledge about the organisations providing non-financial support to SMEs. The fieldwork evidence suggested that their above-mentioned habitus influences Pakistani SMEs seeking to acquire Islamic banking finance. For instance, it is evident from the data that the varied educational background of SME owners/managers coupled with the agency intrinsic significantly influenced their practices. Since examining habitus alone does not help build a robust understanding of complex practices patterns (Stones, 2005), the analysis was then shifted to SMEs’ conjuncturally-specific internal structures. The conjuncturally-specific internal structures implicated in SMEs' practices seeking to acquire Islamic banking finance include their stock of knowledge on Islamic financial products, a high value placed on internal sources of financing, accounting and financial reporting knowledge, and motivation to use Islamic financial products.

To complete the structuration analysis of SMEs’ access to Islamic banking finance in Pakistan, the next chapter integrates the active agency and outcomes into the analysis. This requires going back and forth through the interwoven dimensions of the quadripartite framework since one element informs another.

Chapter Nine: Active Agency and Outcomes

9.1 Introduction

To achieve the principal aim of investigating SMEs' access to Islamic banking finance in Pakistan, this study mainly drew on the quadripartite structuration framework presented by Stone's (2005) in his strong structuration theory. The preceding chapters reflect on the principal findings of the agent's context analysis; depicting the external process of structuration and agent's conduct analysis; presenting the structures within the focal agent. Given that the quadripartite model of structuration components interrelates with each other, the overall research questions cannot be addressed without integrating active agency and outcomes into the analysis. This chapter, therefore, explores the major aspects of active agency and outcomes to complete the analysis of the cyclic process of structuration. The chapter begins by revisiting the concept of active agency and outcome in section 9.2. Section 9.3 explores active agency in relation to SMEs' access to Islamic banking finance by employing Giddens' (1984) stratification model. Section 9.4 takes on the major aspects of outcomes by entwining the various strands of structuration cycles together. The chapter is concluded in section 9.5.

9.2 Revisiting the Concept of Active Agency and Outcomes

Active agency arises from the interplay of external structures (context) and internal structures (conduct). Stones' (2005) idea of active agency is consistent with Giddens' (1984) stratification model which emphasises the continuous flow of action and explains how agents consistently monitor the progression of their actions. Stones (2005) sets out five analytically distinguishable aspects of active agency: shifting horizons of action arising from motivated persuasive action, creativity and innovation in agents' action, degrees of critical distance and reflection, conscious and unconscious motivations and the rationalisation of action and sorting of priorities. These aspects are harmonious with the elements of Giddens' (1984) stratification model of the agent; some of them directly replicate his classifications while others crosscut them in varying but definite manners (Stones, 2005). To discuss the aspects of active agency in the context of SMEs' access to Islamic banking finance in Pakistan, the following section will draw on Giddens' (1984) stratification model along with two further relevant aspects from Stones (2005); degree of critical distance and reflection and shifting horizons of action.

The ongoing patterns of structuration lead to outcomes as a result of active agency. The outcomes may be intended or unintended and may lead to the structures being continued or modified. Whichever outcomes develop, they serve as the basis of the following structuration cycle since structures are both the medium as well as the results of the actions (Stones, 2005).

9.3 Active Agency and SMEs' Access to Islamic Banking Finance

9.3.1 Motivation of Action

Giddens' (1984) stratification model defines motivation as a potential for action. An actor's motivations can be "direct, intense and purposeful" or "indirect and much more routined" (Stones, 2005, p. 24). Giddens (1984) asserts that much of our everyday actions are not explicitly motivated and motives become more directly implicated when the action moves away from the routine practices. The fieldwork evidence identified that accessing Islamic banking finance for Pakistani SMEs is a deviation from the routine matter. Therefore, their motivation for accessing Islamic finance is clear, deliberate and conscious. However, by conceptualising SMEs as embedded in a continual flow of events, such motivation is likely to be a product of various conscious and unconscious elements. SMEs' motivational grounds to access Islamic banking finance (as discussed in section 8.4.4), combined with their knowledge of their social context and conducts set the course of their actions.

9.3.2 Rationalisation of Action

The rationalisation of action involves the agents' capacity to identify and articulate the reasons behind the action. Cohen (1989) asserts that the agent is expected to believe that a particular course of action would lead to a certain outcome. The agents' belief of a likely outcome is permeated by drawing on their conjuncturally-specific internal structures (Stones, 2005). Thus, the rationalisation of action incorporates degrees of knowledgeability, implications for outcomes and the (re)production of structure(s). SMEs seeking to acquire Islamic banking finance would draw on their stocks of knowledge about their current accounting practices, how those practices are interacting with other significant agents in their contextual fields, for instance, Islamic banks and the Federal Board of Revenue (FBR), and the likely reaction from those agents.

The concept of rationalisation of action is central to the human agency since rationalisation plays a critical role in understanding how agents make their actions meaningful to themselves and others (Blaikie, 2010). Agents' ability to rationalise their actions is linked to knowledge of their surroundings (Giddens, 1984). Since agency requires the agents to rationalise their actions, it is linked with them being knowledgeable and able to articulate the reasons that drive their actions (Tucker, 1998). During the interviews with SMEs, it was evident that while accessing Islamic finance, SMEs' knowledge enabled them to rationalise their current practices and modify some of their actions. For instance, the knowledge obtained by SMEs about the required financial records for accessing Islamic banking finance enabled them to rationalise their current recordkeeping practices and modify their actions.

> *"The bank manager guided me about the required accounting records. I have now hired an accountant who prepares my financial accounts, get them audited and also file my tax returns."*
>
> (SME owner, 12)

9.3.3 Reflexive Monitoring of Action

Agent's reflexive monitoring of their actions is one of the significant aspects to be examined in applying strong structuration theory (Coad et al., 2015). Generally, agents reflexively monitor the conditions and outcomes of their actions in an implicit and taken for granted manner (Giddens, 1984). Stones (2005) develops conduct analysis to incorporate how knowledgeable agents reflexively monitor their actions and change their practices. This is consistent with Goffman's (1978) idea of individuals as skilled actors, who can transform social situations and in doing so, they scrutinise their own behaviour through reflexive monitoring and thus, can comprehend the activities that are connected to their actions. Reflexive monitoring of action integrates agents' knowledge and the capacity to make sense of what they do. A knowledgeable agent continuously monitors the flow of their actions and contexts, which makes them aware of and encourages a response to unintended consequences. This reflexive monitoring of actions and their consequences facilitate agents to either replicate, partially replicate or not replicate their previous actions (Walsham, 2002). Hence reflexivity is innate to the production, reproduction and transformation of structures as well as to comprehend how and why new structures are produced.

It is evident from the data that participants reflected upon unintended consequences and reacted and interacted in new ways. The capability of knowledgeable SMEs to be reflexive gives an example of the foundation for structural change and transformation. Reflexivity assists SMEs to change the structures of their minds and brings about new structures since, being knowledgeable actors, SMEs could monitor their actions and the wider environment within which their activities occur. For instance, SMEs were asked how they overcame difficulties in obtaining Islamic banking finance due to their inadequate records. This enabled them to explain how they monitor their present recordkeeping practices and being knowledgeable about the required financial records for obtaining Islamic finance changed their current practices.

9.3.4 Unacknowledged Conditions and Unintended Consequences

The concepts of unacknowledged conditions and unintended consequences of action are of significant consideration in the ontology of structuration. Unintended consequences are a fundamental component of purposive human actions (Cohen, 1989) since individuals cannot anticipate their conduct's consequences. Stones (2005) asserts that the unacknowledged aspects of external structures create scope for unintended consequences. Therefore, considering the unacknowledged conditions and unintended consequences is related to the relevant agent's knowledgeability (Giddens, 1984). Being knowledgeable makes the agent comprehend his undertakings and rationally justify them. Nevertheless, these rationally justifiable actions may have unintended outcomes, identified and facilitated a reaction through the reflexive monitoring of action, which will form the basis for future motivations, rationalisations and further monitoring.

Interpretive research employing strong structuration theory is focused on understanding the lived experience of the agents. Therefore, what constitutes unintended consequences of an action would depend on the purpose intended by the agents when they performed a particular action (Stones, 2005). There is a need to understand the inner thoughts of agents to determine and explore the unintended consequences of their actions. It is evident during the fieldwork that SMEs were able to articulate their experience about what they perceived as unintended consequences of their actions while accessing Islamic banking finance. For instance, an SME in immediate need of financing would ideally prefer to obtain finance within a short period. Unintended consequences would include a longer time taken by the Islamic bank to provide finance. This unintended consequence will flow into future motivations, rationalisations and further monitoring of SMEs' actions. This is exhibited in the following extract:

> *"I was in the immediate need of financing when I applied for Murabaha, but their processes were so time-consuming, complicated and tiring that it made me reconsider whether to continue with Islamic banks or not. Keeping this long processing time in my mind, now I apply for financing well in advance of time when I need it."*
>
> (SME owner, 14)

9.3.5 Degree of Critical Distance and Reflection

In structuration theory, the idea of agency is concerned with having a sense of power and the ability of agents to act and influence their environment of action and interaction (Makrygiannakis and Jack, 2016). In every action and interaction, the focal agent draws on his structures either unreflectively or critically and acts to reproduce them either in a routine or strategic manner (Stones, 2005). For routine matters, the agent reproduces the structures in an unreflective way. If the situation moves away from the routine, the agent reproduces the structures strategically (consciously trying to change or preserve them), exercising critical distancing from those structures (Stones, 2005). Fook (2015) identifies critical distancing and reflection as ongoing scrutiny of practices to identify the underlying structures. The agents bring varying levels of critical distance and reflection to their internal structures based on the significance of the matter (Mouzelis and Mouzelēs, 2008).

Accessing Islamic banking finance is not a routine matter for Pakistani SMEs. While seeking to acquire Islamic finance, SMEs' critical distance from internal structures and reflection upon their context will widen since they deviate from the routine practices. There would be ongoing scrutiny of their practices by SMEs based on the critical reflection of the structures underlying those practices in such a situation. For instance, as discussed earlier in section 8.4.2, Pakistani SMEs' place a high degree of reliance on internal sources of finance and access formal sources only as a last resort after exhausting all the available internal sources. Therefore, for an SME that relies on internal sources of finance, the decision to avail of Islamic banking finance takes critical distance from their established ways of doing things. Here, SMEs are likely to employ extended reflection and a high degree of critical distance from their internal structures. Stone (2005) highlights that the actions of agents are based on the plurality of structures. Consequently, when the action of the agent moves away from the routine matters, they will strategically draw upon some structures while employing others unreflectively. For instance, while seeking to acquire Islamic finance, Pakistani SMEs act strategically on their knowledge about Islamic financial products and at the same time, they unreflectively draw upon their motivation to use those products.

9.3.6 Shifting Horizons of Action

One of the aspects of agency relates to the "structure of opportunities within the actor's range of action" (Marshall, 2000 p.12). This aspect is also referred to as an individual's horizons for action

(Hodkinson and Sparkes, 1997; McAlpine et al., 2014). While investigating an agent's conduct, it is of central significance to consider their horizons of action in addition to their internal structures (Stones, 2005). It is because the horizon of action ascertains the "context of relevance" and will, therefore, direct the agent to access and draw upon the particular aspects of structure (Stones, 2005 p.101). In the context of SMEs' access to Islamic banking finance in Pakistan, SMEs will consider certain aspects of their terrain as distinctly significant i.e., the contexts of relevance. These specific structures would then be vivified in SMEs' actions. For instance, an SME is seeking Islamic finance under the Governments' credit guarantee scheme; Youth Entrepreneurship Scheme would designate a particular context of relevance around such scheme and its requirements and those agents who are particularly managing such schemes. They would reduce the context of relevance around other structures. On the other hand, an SME switching from conventional finance to Islamic banking finance for religious reasons would designate a particular context of relevance around the Sharia compliance and Sharia boards while reducing the context of relevance around other structures. Hence, the social landscape takes on various shapes and forms subject to the specificities of actions.

9.4 Outcomes and Structuration Cycles

9.4.1 Structural Transformation: Changes in SMEs' Accounting and Financial Recordkeeping Practices

Inadequate accounting and financial records are being identified in the literature as one of the main factors that hamper SMEs' access to formal sources of financing (Berger and Udell, 2002; Tagoe et al., 2005; Jayabalan et al., 2009; Ezejiofor and Olise, 2014; Dar et al., 2017). Many SMEs, particularly small enterprises, lack the knowledge and expertise to document their transactions properly and record their transactions randomly without adherence to any established accounting and reporting frameworks (Zotorvie, 2017). SMEs in Pakistan are no exception to this, and they lack sufficient accounting records, which restrict their access to formal sources of financing (Kouser et al., 2012; Dar et al., 2017). This study also indicates that SMEs' deficient financial records were one of the major obstacles in their access to Islamic banking finance (section 7.4.1 and section 8.4.3).

Drawing upon the evidence obtained during the fieldwork, it is possible to obtain a deeper understanding of this pattern of insufficient recordkeeping practices of SMEs and how such practices restrict SMEs' access to Islamic banking finance. Fieldwork evidence presented above in section 8.4.3 highlighted that SMEs identified that their knowledge of accounting and financial recordkeeping had influenced the development of a sound accounting recordkeeping system. Drawing upon their conjuncturally-specific internal knowledge of accounting and financial recordkeeping, the participants identified that their limited accounting knowledge and solely use of accounting records for internal purposes resulted in inadequate recordkeeping practices. Although they are not recording transactions in any prescribed manner, they believe that their accounting records were still sufficient for use as per their own understanding of accounting and financial reporting requirements.

In addition to SMEs' conjuncturally specific internal structures, their general-dispositional internal structures also drive their recordkeeping practices. During the fieldwork for this study, gender, motivation, age and education level of SME owner/managers were identified as the significant general-dispositional internal structures that tend to influence SMEs financing preferences and their practices in this regard (discussed in section 8.3.1). Even though it is difficult to speak of habitus universally, some common patterns were evident amongst the participants' habitus and their recordkeeping practices. For instance, young owners/managers are more likely to adopt formal bookkeeping practices and maintain their records better, which facilitates their access to formal sources of finance.

SMEs' insufficient recordkeeping practices are not produced in isolation but are influenced by external structures. Fieldwork evidence highlighted FBR as a significant external structure that influences SMEs' recordkeeping practices (discussed in section 7.4.3). One of the major reasons SMEs do not keep proper accounting records is that they perceive it will compel them to pay more taxes. The chairman of the Federal Board of Revenue (FBR) also linked the inadequate documentation of SMEs with the perceived obstructions created by the taxation system.

The outcome of these various aspects of internal and external structures is that SMEs do not have sufficient accounting and financial records, which obstruct their access to Islamic banking finance. At the centre point of the interpretation of SMEs' conduct is the active agency where SMEs consciously chose to do otherwise. The fieldwork evidence identified that accessing Islamic banking finance for Pakistani SMEs is a deviation from the routine matter. Therefore, their motivation for accessing Islamic finance is clear, deliberate and conscious (discussed in section 8.4.4). Participants rationalise their current recordkeeping practices by drawing on their knowledge, how those practices interact with other significant agents in their contextual fields, and the likely reaction from those agents. It is evident from the data that participants reflexively monitor their actions reflected upon unintended consequences of their inadequate recordkeeping practices and reacted and interacted in new ways. Consequently, the final outcome of this set of structuration processes is the change in SMEs' accounting and financial record-keeping practices.

9.4.2 Structural Transformation: Acceptance for External Sources of Finance

SMEs depend much on internal sources of financing. When seeking funds, internal sources of finance take precedence over external sources, and SMEs utilise external sources only when the internal sources are fully exhausted (Abdulsaleh and Worthington, 2013). Similarly, most of the SMEs in Pakistan, particularly the small enterprises, rely on personal savings and informal sources of finance (Hassan, 2008; Naveed, 2012; Khan, 2015). The findings of this study also confirmed that SMEs generally place a high value on the use of personal savings and informal sources of finance (discussed in section 8.4.2). The use of personal savings is perceived as the most common and quickest way of funding SMEs.

The participants identified the most common reason that influences their inclination towards internal sources of finance is to avoid dilution of control over the business. Likely, the habitus of SMEs would also be implicated in decisions regarding the sources of finance (discussed in section 8.3.1). For instance, the fieldwork evidence depicts that SME owners who are running the family business to fulfil the family traditions tend to be more inclined towards using internal sources of financing than those with independence as their main motivation to run their own business. Similarly, it is evident from the data that young owners/managers are more willing to approach external sources than their old counterparts.

When interpreting SMEs’ preference for personal and internal sources of finance, the processing time of Islamic banks can be identified as the key external structure that influences such preferences. Islamic banks form a significant external structure in the position-practice network of SMEs seeking to acquire Islamic banking finance. The time taken by Islamic banks while dealing with SMEs’ financing requests imposes a constraint on their access to Islamic banking finance (discussed in section 7.4.1). The participants explained that usually, SMEs are in immediate need of finance and, therefore, prefer internal sources since these are the quickest way of obtaining finance. Furthermore, SMEs do not prefer to use external sources of financing because they do not want their business information to be accessible by the outsiders such as FBR; which is one of the significant agents in the contextual field of SMEs seeking to acquire Islamic banking finance.

The participant SMEs of this study deviate from their routine reliance on internal sources of finance and consciously chose to do otherwise (agency), i.e., to utilise Islamic banking finance. Participants rationalise that the currently used sources of finance are limited and, therefore, put a constraint on their growth. SMEs reflected upon unintended consequences (growth constraint) and reacted and interacted in new ways. They take a critical distance from their established ways of doing things, i.e., using personal and internal sources of finance, and change their course of action, i.e., availing Islamic banking finance. This cycle of structuration has altered the conjuncturally-specific internal structure of preference for internal sources of finance that SMEs draw on when they need finance and make them adopt Islamic banking finance.

9.4.3 Structural Transformation: Acknowledging the Significance of Academic Institutions in Facilitating SMEs' Access to Islamic Banking Finance

The dearth of research in SMEs' access to Islamic finance has been commented on in the review of literature presented in chapters 2 and 3 of this thesis. Access to finance is one of the key factors which ensures the growth of any business. However, SMEs find it difficult to obtain finance from formal sources (Ping-fei, 2002; Abereijo and Fayomi, 2005; Duan et al., 2009; Gbandi and Amissah, 2014; Zhao et al., 2019). This is due to high financing costs, inadequate financial records, collateral constraints, and the lack of market research (Maro, 2020). The significance of research for the development and growth of any business is indisputable. However, research activities can be costly and time-consuming. Due to their large output, larger firms have an advantage in research and development (Cohen and Klepper, 1996). On the other hand, because of the limited resources, SMEs' investment in research processes can be considered a risky activity with a high cost (Ortega-Argilés et al., 2009). The participants of this study expressed their limited ability to involve in research activities. They also view the lack of market research as a constraining factor that hampers their access to finance.

In this regard, fieldwork evidence has provided support for the significance of academic institutions as an external structure that can play a prominent role in facilitating SMEs' access to Islamic banking finance by means of collaborative research projects with SMEs (discussed in section 7.4.6). The role of this cluster as an important element of SMEs' external terrain has been addressed in the mainstream literature. However, in practice, the significance of coordination between SMEs and academic institutions to conduct collaborative research to understand better the dynamic processes of the growth of local industrial regions is broadly ignored. These collaborative projects must focus on problematic areas in the particular sector to identify the existing problems by exploring the practical situations that SMEs are operating in that sector face. SMEs will draw on their conjuncturally-specific internal structures of past successes or failures in accessing Islamic banking finance with or without support from academic institutions in the form of collaborative research projects. These research projects will inform the SMEs on how to get the support of the academic institutions and, therefore, will modify those structures.

9.4.4 Structural Reproduction: Lack of Knowledge and Understanding of Islamic Financial Products

Consistent with previous studies (Ahmad and Haron, 2002; Khalaf, 2007; Rasheed et al., 2019), the findings of this thesis highlight that SMEs do not have sufficient knowledge and understanding of Islamic financial products. Since knowledge is a key determinant of a customer's intention to adopt a particular product or service. Therefore, SMEs' depth of knowledge on Islamic financial products fundamentally impacts their access to Islamic banking finance (Mansor et al., 2012). As of 31st December 2020, Islamic banks share in SME financing stands only at 8.34% of the total SMEs lending portfolio (SBP, 2020). Khattak (2010) asserts that the extensive use of conventional finance in the presence of alternative Sharia-compliant products can be attributed to the poor level of knowledge about Islamic banking principles and Islamic financing products. The findings of this study acknowledge the impact of participants' limited knowledge of Islamic financial products on their access to those products (section 8.4.1).

Inadequate advertising and marketing of Islamic financial products is a substantial external structure that obstructs SMEs' access to Islamic banking finance (section 7.4.7). The strand of SMEs' conjuncturally-specific internal structures in the fieldwork evidence that identified the lack of knowledge about Islamic financial products within SMEs (section 8.4.1) depicts the need to build robust advertising and marketing strategies for these products. Hence, SMEs seeking to acquire Islamic banking finance is likely to employ a high degree of critical distance from their internal knowledge structures about Islamic financial products. However, SMEs' agency seems to have no discernible impact on these structures. For instance, even SMEs using Islamic modes of financing exhibit very limited knowledge about Islamic financial products, including those that they are currently using or have used in the past.

> *"I did not know about any of their products when I approached the bank. Now, I know the name of few of Islamic banking products, but I do not know what they are for and how they work."*
>
> (SME owner, 4)

9.4.5 Structural Reproduction: Trust in Sharia Boards

One of the distinctive features of Islamic banks is the presence of Sharia boards. Sharia boards form a critical external structure in the contextual field of SMEs seeking to acquire Islamic banking finance. The Sharia boards examine, analyse and follow up Islamic banks' operations in order to ensure compliance with standards and guidelines of Sharia. Furthermore, they are also responsible for establishing the validity of the implemented transactions and finding a legitimate alternative in case of any inconsistencies. Due to the unique presence of Islamic banks in a dual banking system, it is important that trust between SMEs' and Sharia board members remains strong to ensure SMEs of Islamic banks' compliance with the principles of Sharia.

The fieldwork evidence shows that one of the fundamental driving forces behind the customers' adoption of Islamic finance is their religious motives and values (discussed in section 8.4.4). The Sharia boards play a key role in promoting the Sharia-compliant image of Islamic banks. Thus, the credibility and reputation of Sharia board members is of crucial importance for SMEs to make them adopt Islamic banking finance (discussed in section 7.4.5 and section 8.3.2). During the fieldwork, SMEs expressed doubts about their understanding of Islamic banks being truly Sharia-compliant; nevertheless, those doubts were dismissed and ignored because they trusted Sharia board members. Furthermore, the conduct analysis of Pakistani SMEs seeking to acquire Islamic banking finance presented in chapter 8, identified that SMEs do not have sufficient knowledge about Islamic financial products, and the unavailability of adequate knowledge about Islamic financial products among is one of the major challenges faced by SMEs while accessing Islamic banking finance. This is because Islamic financial products possess unique characteristics and SMEs find it difficult to comprehend the working of those products. Despite lacking sufficient knowledge about those products and their reservation about the extent to which Islamic banks are truly Islamic, SMEs still prefer to use Islamic financial products. It is because they trust and rely on the Sharia boards. These structures of trust are continually reproduced through the regularised use of Islamic financing products by SMEs as Sharia-compliant alternatives to conventional finance.

9.5 Conclusion

This chapter has brought the last two elements of the quadripartite structuration framework; active agency and outcomes, into the analysis to produce detailed descriptions of the practices of Pakistani SMEs seeking to acquire Islamic banking finance. The chapter began with a brief review of the concept of active agency and outcomes, followed by a discussion around the active agency of Pakistani SMEs seeking to acquire Islamic banking finance by employing Giddens' (1984) stratification model. The major aspects of outcomes are also presented in this chapter.

Next, the final chapter attempts to summarise the contributions of this study. It also highlights the main limitations of the study and suggests some future research opportunities in this area.

Chapter Ten: Reflections, Implications, Limitations and Conclusions

10.1 Introduction

This chapter brings together the various threads of this study in order to distil its overall contributions. This study aimed to investigate SMEs' access to Islamic finance in Pakistan. The main objectives were to explore SMEs' motivations behind using Islamic finance, SMEs' perceptions of the constraining conditions of accessing Islamic finance, SMEs' perceptions of perceived benefits of accessing Islamic finance, SMEs' perceptions of their relationships with Islamic banks and the experiences of Islamic banks' managers in servicing SMEs' financing. The existing literature focusing on SMEs' access to Islamic finance in Pakistan is scarce, and therefore, it warrants further research. To achieve the principal aim of this study, the empirical evidence was collected from thirty-five semi-structured interviews; twenty-two with SME owners/managers, twelve with Islamic bank managers dealing with SME financing and one with Sharia board member.

Following the introduction, this chapter proceeds: Section 10.2 revisits the research questions framed at the beginning of the research. Section 10.3 summarises the empirical, theoretical, methodological, and policy contributions of this study. Section 10.4 outlines the main limitations of the current study. The chapter, as well as the thesis, conclude with section 10.5, which suggests some future research opportunities in this area.

Before proceeding further, the results of the cyclic process of structuration, incorporating the analysis of four interwoven dimensions of the quadripartite model of structuration; external structures, internal structures, active agency and outcomes, are illustrated in figure 10.12.

Figure 10.12: Structuration Cycles and Outcomes

External Structures (Context Analysis)

- A significant influence on the activities of SMEs is exerted by Islamic banks.
- Government through credit guarantee schemes and prioritising SMEs operating in a particular sector enables SMEs' access to Islamic banking finance.
- Tax non-compliance is reflected in SMEs' recordkeeping practices.
- State Bank of Pakistan (SBP) provides constraining as well as enabling conditions for SMEs' access to Islamic banking finance.
- SMEs have a strong level of trust in Sharia boards.
- There is a lack of collaborative research projects between SMEs and academic institutions.
- Islamic banks are not engaging with the wider public through advertising and marketing their products.

Internal Structures (Conduct Analysis)

General-Dispositional Internal Structures

- SME owners' gender, motivation, age and education level tend to influence their financing preferences and practices in this regard.
- SMEs have a diverse opinion on the Sharia compliance of Islamic banks.
- SMEs lack knowledge about organisations providing non-financial support.

Conjuncturally-specific Internal Structures

- SMEs' lack of accounting and financial reporting knowledge results in insufficient financial records.
- Internal sources of finance take precedence over the external sources.
- Lack of knowledge about Islamic financial products impacts financing decisions of SMEs.
- Religious motives and Islamic banks' handling of delay in repayment are the primary determinants of adoption of Islamic finance.

Active Agency

- SMEs motivation for accessing Islamic finance is clear, deliberate and conscious.
- SMEs are able to identify and communicate the reasons behind their action.
- SMEs reflexively monitor the conditions and outcomes of their actions.
- Unintended consequences play a role in shaping the conditions for future action by SMEs.
- SMEs are likely to employ a high degree of critical distance from their internal structures when seeking to acquire Islamic banking finance.

Outcomes

- Structural transformation: Changes in SMEs' accounting and financial recordkeeping practices.
- Structural transformation: Acceptance for external sources of financing.
- Structural transformation: Acknowledging the significance of academic institutions in facilitating SMEs' access to Islamic banking finance.
- Structural reproduction: Lack of knowledge and understanding of Islamic financial products.
- Structural reproduction: Trust and confidence in Sharia boards

10.2 Revisiting the Research Aim, Objectives and Questions

The principal aim of this study is to explore SMEs' access to Islamic banking finance in Pakistan. In particular, this study investigates how the social world and the arrangements embedded therein impact Pakistani SMEs' access to Islamic banking finance.

Other objectives to be served by this study include:

- To critically review relevant literature to analyse the SMEs and Islamic banking sectors in Pakistan.
- To analyse how Islamic banks currently meet the needs of SMEs in Pakistan.
- To explore the demand for Islamic banking finance for SME financing through the perceptions and opinions of SMEs in Pakistan.
- To ascertain whether SMEs have sufficient knowledge of Islamic banking finance.
- To investigate the experience of Islamic banks' managers in servicing SME financing.
- To explore the main factors influencing the level of SMEs' access to Islamic banking finance.
- To identify the challenges and limitations faced by Islamic banks' in providing finance to SMEs.
- To make recommendations, based on analysis of the data, on how SMEs can seek and acquire support from Islamic banks in Pakistan.
- To inform current policies and practices of SME financing in Pakistan.

The main research question is "How the interactions between social structures and agency implicated in Pakistani SMEs access to Islamic banking finance?"

The strategy employed in this investigation aimed to enhance understanding of how the social world impacts SMEs and how do social structures and agency interact and influence SMEs seeking to acquire Islamic banking finance. To address the main research question, the following sub-questions have been framed:

- How the practices of SMEs seeking to acquire Islamic banking finance are influenced by, and in turn, how do they influence the significant agents-in-context (position-practice relations network)?

- How do the internal structures of the SMEs reconcile with their contextual field when seeking to acquire Islamic banking finance?
- How do social structures and agency interact and influence SMEs' access to Islamic banking finance in Pakistan?
- How can the access of SMEs to Islamic banking finance be developed further to meet the needs of SMEs?

10.3 Research Contributions

10.3.1 Empirical Contributions

The research problem presented in section 1.3 highlights the limited literature exploring SMEs' access to Islamic banking finance in the context of Pakistan. Furthermore, existing studies mainly concentrate on SMEs' normative practices shaped by the economic perspective of the agency while ignoring the interactions between SMEs' context and agency to understand the micro-processes of Pakistani SMEs' access to Islamic banking finance. The focus of this study was to extend the existing literature by adopting a sociological lens on Pakistani SMEs' access to Islamic banking finance. This approach stands in contrast to the mainstream literature, in which the interactions between SMEs' context and agency to understand the micro-processes of Pakistani SMEs' access to Islamic banking finance are not given due attention. This study's contribution to empirical research can be summarised in terms of following:

- **Islamic banks provide enabling as well as the constraining conditions for SMEs' access to Islamic banking finance:** Islamic banks exert a significant independent influence on the activities of SMEs. They provide the conditions that either enable or constraint SMEs' actions. For instance, inadequate financial records of SMEs are identified as one of the major factors which limit their access to formal sources of finance, including Islamic banks. The guidance provided by Islamic banks to SMEs in preparing the required documents serves as an example of the enabling feature of the banks' resources that facilitate SMEs' access to Islamic banking finance. On the other hand, Islamic banks' preference for short-term financing options for SMEs and the longer time it takes to process SMEs' financing requests are perceived as constraining factors by SMEs that impose breaks on their actions and influence their decisions about the sources of finance. However, these constraining conditions of Islamic banks are shaped by SMEs' practices. For instance, Islamic banks' preference for asset-based short-term financing over equity-based long-term financing can relate to SMEs' under-reporting true profits. Similarly, the time taken by Islamic banks to process SMEs' financing can be attributed to the inadequate recordkeeping practices of SMEs. This presents a picture of human agency and structure as presupposing one another, which is the central tenet of structuration theory.

- **Government of Pakistan influences SMEs' access to Islamic banking finance:** The government of Pakistan is keen to create a favourable business environment for SMEs in Pakistan by improving their access to finance and eliminating obstacles that obstruct their development. It mainly influences SMEs' access to Islamic finance through credit guarantee schemes and by prioritising the growth of SMEs in a particular sector. Through its credit guarantee schemes and prioritising SMEs in a particular sector, government enables Islamic banks to finance SMEs by underwriting all or part of their credit risk.

- **Federal Board of Revenue (FBR) is perceived as a constraining actor**: The Federal Board of Revenue (FBR) is identified as a significant external structure that influences SMEs' practices in such a way that restricts SMEs' access to Islamic banking finance. FBR is one of the significant external structures that exerts a major influence on SMEs' recordkeeping practices. SMEs, particularly small enterprises, would attempt to recover their investments as quickly as possible. The increased tax liability will reduce their return and disposable income and thus, provide an incentive to underreport their income using improper recordkeeping. The inadequate recordkeeping practices of SMEs, in turn, limit their access to Islamic banking finance.

- **Interactions between SMEs and State Bank of Pakistan (SBP) have dual constraining and enabling features:** SBP has dual constraining and enabling features in the form of explicit collateral and documentation requirements and the efforts to expand the Islamic banking finance for SMEs. SBP's collateral requirements and complex documentation processes influence SMEs' actions and impose a constraint on their access to Islamic banking finance. To expand Islamic finance for SMEs, SBP has developed a strategic plan to improve SMEs' access to Islamic finance, which incorporates improving regulatory framework, introducing SMEs targets and risk coverage, simplifying procedures for SMEs financing, enforcing Sharia compliance mechanism, providing non-financial advisory service and creating awareness among bankers and SMEs. In addition to these steps, SBP also attempts to improve SMEs’ access to Islamic banking finance by assigning financing targets for banks to serve the financing needs of SMEs. Hence, as a policymaker and regulator of the banking system, the SBP acts as a significant external structure that influences SMEs’ access to Islamic banking finance.

- **SMEs’ trust in Sharia boards has a strong influence on their preferences for Islamic finance**: The success of Islamic financial products is subject to the credibility of Sharia scholars who have developed or approved that product. Pakistani SMEs have limited knowledge and ability to understand the underlying mechanisms of Islamic financial products. Hence, to establish the conformity of their preferred Islamic financial product to the Sharia principles, SMEs rely on the approval of Sharia board members. Furthermore, there is a debate in the literature whether the Islamic banks differ from traditional conventional banks and the extent to which they are truly Sharia-compliant. SMEs expressed their doubts about Islamic banks being truly Islamic. Nevertheless, those doubts were dismissed and ignored because they trust in Sharia board members.

- **Highlighting the role of academic institution as a significant but neglected agent cluster:** Academic institutions represent a significant but neglected agent in the context of SMEs’ external field. It is significant to develop cooperation between academic institutions and industry to conduct collaborative research by involving the key stakeholders. Such cooperation involves performing systematic activities by integrating the respective facilities of academic institutions and industry in order to carry out tasks that each of them cannot perform alone. Generally, the goal of such cooperation includes expanding knowledge, improving access to technology, bringing innovation, and enhancing access to available financial resources. In the context of improving access to finance, such collaboration will help to better understand the actual business model of SMEs in a particular sector, their specific requirements, their practices and the external conditions that inhibit their access to formal sources of finance. It will also help to identify how their access to finance can be improved by evacuating the difficulties attached to it. The findings of such collaborative research can help the regulators devise new policies or align the existing policies concerning SMEs’ access to finance, in light of SMEs' experiences and operating conditions.

- **Acknowledging the role of Media in facilitating SMEs' access to Islamic banking finance:** Advertising and marketing are the most significant ways to promote any product by imparting knowledge and awareness. The use of media for promoting Islamic financial products makes customers aware of the specifications and the potential benefits of using those products and reminds them of their needs. Thus, media is an important external structure that can create favourable conditions for SMEs' access to Islamic banking finance by imparting knowledge about Islamic financial products. However, an effective marketing and advertisement plan to make SMEs aware of the working of Islamic banking products is currently not in place. Consequently, Islamic banks are being very weak in their advertisement and fail to reach a wider audience.

- **Diverse habitus and access to Islamic banking finance:** There is no specific set of characteristics that are required to run an SME. However, Gender, motivation, age and education level of SME owner/manager are significant general-dispositional internal structures that tend to influence Pakistani SMEs' financing preferences their practices in this regard.

- **knowledge of Islamic Financial Products as a main driver of SMEs' course of actions:** The knowledge of Islamic financial products is the main driver of SMEs' course of action and thus influences their access to Islamic banking finance. However, the majority of SMEs lack awareness about the products and services offered by Islamic banks. The unavailability of adequate knowledge about Islamic financial products is one of the major challenges while accessing Islamic banking finance. SMEs knowledge about Islamic financial products is influenced by the external structures in their contextual field, for instance, advertising and marketing, and, in turn, can influence SMEs' actions by shaping their perceptions and attitudes towards Islamic financial products.

- **Reliance on Internal Sources of Financing:** Most of the SMEs in Pakistan, particularly the small enterprises, rely on personal savings and informal sources of finance. A major constraint on the range of external financing sources available to SMEs is imposed by the greater value placed on internal sources of financing. SME owners are not willing to dilute their control over the business by injecting external equity. They are more inclined towards internal sources of finance and use external finance only as a last resort. This high reliance on internal sources affects SMEs' perceptions and attitudes towards formal sources of finance, including Islamic banking finance. It hence plays a significant role in shaping SMEs' practices while accessing Islamic banking finance.

- **SMEs' Inadequate accounting and financial reporting knowledge and practices:** SME managers/owners lack sound knowledge of accounting practices and, therefore, cannot maintain proper records. Because of their limited knowledge of accounting and financial reporting procedures, establishing and efficiently handling accounting recordkeeping systems is a major challenge for SMEs. In addition to their limited knowledge of accounting and reporting procedures, SMEs' recordkeeping practices are also influenced by the cost attached to maintaining accounting records appropriately. Furthermore, SMEs are generally reluctant to produce adequate financial reports which that outsider can access due to the requirements of the regulatory authorities. For instance, SMEs perceive that proper recordkeeping will expose the firm's financial position to FBR, a significant agent in the contextual field of SMEs, which will have an impact on the business's tax liability. However, the unavailability of sufficient financial data makes it difficult for banks to determine whether the SME can generate favourable cash flows and repay the loan on time, which has an adverse impact on their lending decisions.

- **Clear motivation of SMEs' actions:** Access to Islamic banking finance is a deviation from the routine matters of SMEs. Therefore, their motivation for accessing Islamic finance is clear, deliberate and conscious. Religious values are the major motives for SMEs to adopt Islamic banking finance. Since religion is the primary driver of customers' intention to adopt Islamic finance, Sharia boards hold a significant place in the position-practices network of SMEs seeking to use Islamic financial products.

- **SMEs' access to Islamic banking finance is a continuous flow:** SMEs' access to Islamic banking finance cannot be seen in isolation. Instead, it consists of an incessant flow and ongoing process. SMEs motivation for accessing Islamic banking finance is clear, deliberate and conscious. SMEs' motivational grounds to access Islamic banking finance, combined with their knowledge of their social context and conduct, set the course of their actions. The capability of knowledgeable SMEs to be reflexive gives an example of the foundation for structural change and transformation. SMEs could reflexively monitor and rationalise their actions and the wider environment within which their activities occur. Reflexivity assists SMEs to change the structures of their minds and brings about new structures since, being knowledgeable actors, SMEs' actions regarding their access to Islamic banking finance can result in unintended consequences. These unintended consequences will flow into future motivations, rationalisations and further monitoring of SMEs' actions.

10.3.2 Theoretical Contributions

This study is undertaken to broaden the essence and quantity of scholarly understanding in the domain of SMEs' access to Islamic banking finance in Pakistan. The prime motive for this study stems from the fact that there is limited literature that draws on Islamic finance for SMEs (Oseni, 2013; Ali, 2014; Elasrag, 2016). The findings of this study are useful to augment the existing literature on how SMEs think of the Islamic banking finance context in Pakistan. What do SMEs perceive to be the constraining conditions of accessing Islamic banking finance? What are their perceived benefits of accessing Islamic banking finance? How do they perceive their relationships with Islamic banks? The study also incorporates the views of Islamic bank managers dealing with SMEs about SMEs' accessibility of Islamic banking finance.

Some previous studies focus on financing SMEs through Islamic modes of financing. For instance, Huda (2012) offers a framework in which Islamic financing could be used to solve financing problems faced by SMEs; Ali (2014) investigates the challenges of Islamic trade finance in promoting SMEs; Abdesamed and Wahab (2015) explore SME owner/managers' preference towards Islamic banking; Shaban et al. (2016) develop a two-stage competition model to investigate the growth in SMEs lending by Islamic banks. Some authors also attempt to explore SMEs lending by Islamic banks in the context of Pakistan. For instance, Ellahi et al. (2010) investigate the role of Islamic modes of financing for the growth of SMEs. However, their sample comprises SMEs located in one city (Islamabad) only while excluding SMEs from other parts of Pakistan. Gillani et al. (2016) investigate the determinants of the promotion of SMEs in Pakistan through Islamic financial institutions. However, they only focus on SMEs in the halal food business (trading sector) and exclude SMEs in other sectors. The above-mentioned studies are limited in scope as they either focus on SMEs in a particular geographical area, sector or are conducted without an overarching theoretical framework. Therefore, this study addressed the gap in the literature by exploring the perceptions and current practices of SMEs in accessing Islamic banking finance in Pakistan. This research attempted to overcome the limitations of previous studies by including SMEs operating in different sectors and cities of Pakistan. Moreover, most previous research employed a quantitative methodology to develop a picture and understanding of SMEs' access to Islamic banking finance in Pakistan. This study is built on the body of existing literature while adopting a qualitative approach with a particular reference to interviews to develop an understanding of how SMEs seek to acquire Islamic finance in Pakistan.

In addition to contributing to the existing literature, this research also adds to the growing body of empirical studies employing strong structuration theory and thus, contributes to the theory by extending its empirical use in a new research scenario. Academics previously explored SMEs' access to Islamic finance and put forward various opinions and results. Previous studies uncover some useful information. However, most of these studies have been carried out without a proper theoretical framework. Furthermore, these studies mainly employed objective philosophy while overlooking the contextual elements. According to Fillis (2007), the main theoretical limitation of SMEs' research is the use of conventional methodologies, which are insufficient to address the contextual issues and thus, failed to provide an 'insight' view on SMEs. These methodologies tend to generalise research findings and are more biased to the philosophical assumptions of positivism (Jayasinghe, 2003). This study employs strong structuration perspective as a theoretical tool to guide the research. The focus is on how social structures are involved in SMEs practices to acquire Islamic banking finance and how SMEs (agents) interact with these structures to make a difference in their practices. In this way, the study also comprehends the autonomy of external structures and the significance of practices in shaping those structures. In this investigation, the use of empirical analytical tools, such as the ontological scale, position practice networks and cyclic process of structuration, contributes to strengthening strong structuration theory for further empirical studies.

Furthermore, in the application of strong structuration theory, this study extends its scope beyond incorporating the opinions of SMEs (agent-in-focus) and includes the voices of bank managers dealing with SME financing (agent-in-context) and a Sharia board member (agent-in-context) as well. This approach captured a bigger picture and gathered richer evidence since the inclusion of agents-in-context aided in constructing a more compelling narrative.

10.3.2 Methodological Contributions

One of the significant contributions of this study is the adoption of a circular research design to guide the research process. This theoretically informed circular design consists of the following interlinking parts: a clear objective to investigate the specific research problem, prior theory, theoretically informed research questions, interview questions designed in accordance with the theoretically specific data requirements, thematic data analysis, which links the findings to the prior theory (Makrygiannakis and Jack, 2018). Consistent with the circular design, the study began with an apparent research problem at hand, taking theory into consideration which served as a tool for setting research questions and the broad directions for conducting the research. For instance, the introduction of the position-practice relations of the field, which is the core of context analysis in strong structuration theory, directly influenced the design and data collection decisions. In terms of design, it guided the data collection and led interviews with the Islamic bank managers dealing with SMEs financing and a Sharia board member (agents-in-context) and not only the interviews with SMEs (agent-in-focus). Furthermore, it also guided the specific interview questions. The next stage of the circular design was thematic analysis. Finally, the findings were linked to the prior theory.

One of the contributions of this study is the application of the methodological bracketing approach. Stones (2005) suggests a form of bracketing that emphasises epistemology rather than ontology, based on the conduct and context analysis of the focal agent. The methodological bracketing approach directed the data collection and analysis stages of the research. Interview protocols were designed according to the theoretically specific data requirements to ensure that the primary focus remains on the context and conduct of SMEs seeking to acquire Islamic banking finance. By drawing on the methodological bracketing approach, data were analysed in two phases; the first phase explored the specific context and external structures of SMEs seeking to acquire Islamic banking finance. The second phase investigated the conduct of those SMEs. Employment of the bracketing approach to analyse the context and conduct separately helped to explore these structures and their interaction.

In terms of methodology, another distinct aspect of this study is semi-structured interviews as a data collection instrument. Key concepts from strong structuration theory were reflected in specific interview questions, such as who did what, where, when, how and why, to investigate the issues identified by this particular theoretical perspective such as the concepts of knowledgeability of an agent, agent’s motivation of action etc. Interview protocols guided by strong structuration theory helped make the most from limited time with participants to produce the highest quality evidence possible. Moreover, after conducting the preliminary analysis, a Sharia board member was interviewed to ascertain his views on the key findings. This is an established technique in the methodological literature. However, it is not widely used. It resulted in corroborating the preliminary findings as well as some additional contributions arising directly from the interview.

10.3.3 Policy Contributions

10.3.3.1 Assist SMEs

This study has identified that some of the obstructions in securing Islamic banking finance are largely SMEs' internal factors due to their practices, which are under the control of owners/managers. The findings also highlight the difficulties Islamic banks face when financing SMEs, which they can attempt to overcome to circumvent the potential problems they may encounter in securing Islamic banking finance. Thus, the findings of this study will serve to guide SMEs to facilitate their access to Islamic banking finance in the future.

Fieldwork evidence suggests that one of the main obstructions in SMEs' access to banking finance is the inadequacy of financial records. Banks could not measure the performances of SMEs. The main reasons for SMEs' deficient recordkeeping practices are inadequate accounting knowledge and the costs attached to maintaining accounting records appropriately. SMEs should give due consideration to improving the quality of their accounting and financial records. In this regard, SMEs can equip themselves with the skills required to improve their accounting and financial reporting practices by using the free of cost accounting software provided by SMEDA, which is mainly developed for SMEs. Appropriately maintaining financial information will make it easier for banks to assess SMEs' probability of generating sufficient cash flows and put SMEs in a position to secure a better deal with banks.

In today's dynamic environment, the survival and success of businesses depend largely on their managerial and administrative capabilities. However, the findings of this study suggest that SMEs, particularly small enterprises, lack managerial and administrative skills. The presence of skilled owners/managers is an essential factor for an SME's success in obtaining finance from external sources. This is because owner/managers' managerial and administrative skills of owner/managers are significant in dealing with the obstacles they face while accessing external finance. Therefore, training and skills acquisition can enhance SMEs' managerial and administrative capabilities, which in turn, help them to reduce the difficulties they face with external sources of finance. The findings of this study highlight SMEs' inability to organise or attend such training due to the cost attached to them. The Government of Pakistan has also identified the need for training to develop managerial skills in SMEs in order to promote the SME sector. In the government's policy for promoting SMEs, special focus is given to SMEs' managerial and other skill development (SBP, 2017b). The government, in this regard, is organising free of cost training programs in collaboration with SMEDA. For capacity building of SMEs, SMEDA organises much need-based training programs through seminars, workshops and conferences across the country. These programs cover many areas including, finance, technical competencies, compliance with the regulatory and legal framework, managerial and administrative skills and marketing (SMEDA, 2021). Such programs help to improve key performance indicators including productivity, quality, competitiveness and sustainability. These services seek to enhance SMEs' knowledge and skills. They can take the form of general information and advice, training, and assistance in preparing financial statements and, thus, act as a tool to boost SMEs' productivity, making them a favourable investment for the bank. Therefore, SMEs, both the existing ventures and the start-ups, must acquire the required skills through the training sessions provided by SMEDA and other appropriate sources that will facilitate their access to Islamic banking finance.

Another significant finding of this study indicates that SMEs lack adequate knowledge and understanding of Islamic financial products. This lack of knowledge restricts SMEs' access to Islamic banking finance. Therefore, it is expedient for SMEs to acquire greater knowledge of Islamic financial products. It will inform SMEs of the essential matters such as the existence of different types of Islamic financial products available, the difference between various types of Islamic financial products as well as the difference between Islamic and conventional financial products, how these products are free from the element of interest and the profit and loss sharing mechanism. Thus, gaining adequate knowledge about Islamic financial products will help SMEs in developing their access to Islamic banking finance.

10.3.3.2 Assist Islamic Banks

This study has identified that some of the limitations of SMEs' access to Islamic banking finance are caused by the practices of Islamic banks. The findings highlight the difficulties SMEs face when seeking to acquire Islamic banking finance, which Islamic banks can attempt to overcome to facilitate SMEs in securing Islamic banking finance. Thus, the research findings will guide Islamic banks in improving SMEs' access to Islamic banking finance.

The SME sector is at a disadvantage compared to the large corporations and hence, is an underprivileged sector in terms of access to financial resources. The fieldwork evidence illustrates that Islamic banks' high collaterals and complex documentation requirements act as the main hindrances in SMEs’ access to Islamic banking finance. The participants asserted that these requirements for SMEs are more or less the same as for the large corporations, and most SMEs struggle to meet these requirements. Therefore, to promote financial inclusion, which is one of the fundamental principles of Islamic economics, Islamic banks should treat SMEs differently from big corporations, and SME financing should be based on discretionary lending. The banks need to provide some relaxation to SMEs in the collateral and the documentation requirements, which will make it easier for them to acquire Islamic banking finance and, in turn, will encourage more SMEs to avail themselves of Islamic banking finance.

The fieldwork evidence highlights that SMEs lack adequate knowledge and understanding of Islamic financial products, limiting their access to Islamic banking finance. In this regard, Islamic banks also have a responsibility to impart knowledge of Islamic financial products. Advertisement plays a vital role in adopting Islamic finance by creating awareness and understanding about Islamic financial products and services. The findings of this study highlight that Islamic banks in Pakistan are very weak in their advertisement and, therefore, failed to reach a wider audience. To enhance the awareness and understanding of Islamic finance, Islamic banks should focus more on developing better marketing strategies. In this current digital era, the use of digital marketing and traditional marketing techniques will aid to address the critical needs of imparting knowledge about Islamic banking products.

Based on fieldwork evidence, Islamic banks’ preferences for short-term financing is perceived by SMEs as an increasing source of constraint on their access to Islamic banking finance. Islamic banks prefer short-term financing products for SMEs because of the quick profits attached with these products. Equity-backed long-term Islamic financing is generally used to cater to well-established large enterprises' financing needs with a sound financial and business viability. On the other hand, most SMEs face difficulties in accessing finance for long-term projects, which restricts their ability to expand their business. Therefore, in light of the responses from the participants, it is suggested that to improve SMEs’ access to Islamic banking finance, Islamic banks should expand the use of equity-backed long-term financing products for SMEs.

In addition to the Islamic banks' broader utilisation of short-term financing products for SMEs', another barrier to SMEs' access to Islamic banking finance is the long processing time taken by Islamic banks. The participants identified access to Islamic financial products as more time consuming than conventional instruments. The long processing time is discouraging SMEs from using Islamic banking finance. Therefore, Islamic banks should consider making their process flows simple for SMEs which will help to accelerate the processing of SMES' financing requests.

10.3.3.3 Assist Regulators and Policy Makers

SMEs' access to Islamic banking finance has long been of profound interest to regulators and other policymakers. This study led to learning about SMEs' access to Islamic finance in Pakistan by getting involved with SMEs and understanding their perceptions and contexts. In addition to the opinions of SMEs, gathering the opinions of other stakeholders such as Islamic bank managers and Sharia board members helped to provide a comprehensive understanding of SMEs' access to Islamic banking finance in Pakistan. Thus, the more profound understanding of SMEs' access to Islamic banking finance obtained from this study has direct policy relevance for regulators in devising policies to improve SMEs' access to Islamic banking finance.

Based on fieldwork evidence, the most obvious area that requires the attention of regulators and policymakers is the taxation system. In Pakistan, most SMEs are not registered with the FBR, and a good number of SMEs get away with not paying their taxes. The findings suggest that the Federal Board of Revenue (FBR) has a significant influence on SMEs' practices in such a way that restricts SMEs' access to Islamic banking finance. In Pakistan, tax rules and related processes are complicated, and SMEs may require a tax specialist to comprehend and implement them. However, SMEs with limited financial resources find it difficult to hire a tax specialist and may end up either underpaying tax or avoiding it altogether. This non-compliance of tax is largely reflected in SMEs' inadequate documentation and recordkeeping practices and consequently restrict their access to formal sources of finance. Therefore, there is a need to ease the tax system through reforms and introduce separate rules and regulations for the SME sector to bring more and more SMEs into the tax net. The government can also help SMEs understand the tax rules and procedures by arranging training sessions.

The fieldwork evidence indicates that SMEs' documentation practices, access to finance and taxation system are all interrelated. Accounting records provide a basis for tax computation and SMEs perceive that maintaining adequate financial records will expose their financial position to the tax authorities. The tax liability will reduce their return and disposable income, thus providing an incentive to SMEs to underreport their income through improper recordkeeping. However, insufficient documentation practices of SMEs act as one of the main obstacles in their access to finance. In this regard, it will be beneficial to introduce the flat tax rate for SMEs for ten years, and during this period, efforts should be directed at making SMEs adopt standard bookkeeping practices. Once SMEs' documentation issues are resolved, it will improve their access to Islamic banking finance.

The role of the government in creating an enabling environment in which banks can engage in SME financing is of crucial significance. Under the umbrella of credit guarantee programs of the government, SME financing would cover the credit risk for banks and thus, make the process of obtaining finance easier for SMEs. The findings of this study suggest that the government of Pakistan mainly influences SMEs' access to Islamic finance through credit guarantee schemes and by prioritising the growth of SMEs in a particular sector. Through its credit guarantee schemes and prioritising SMEs in a specific sector, government enables Islamic banks to finance SMEs by underwriting all or part of their credit risk. The government can expand its credit guarantee schemes to further facilitate Islamic banks in the efficient delivery of finance to more and more SMEs. These credit guarantee programs can also be used to encourage Islamic banks to provide equity-based long-term financing for SMEs.

Another area that requires the attention of policymakers is educating SMEs about the support provided to them by the Small and Medium Enterprise Development Authority (SMEDA). SMEDA is a specialised institution established by the government of Pakistan in 1998 to accelerate the challenging task of developing the SME sector in Pakistan. It provides business development services to SMEs and organises much need-based training programs across the country through seminars, workshops and conferences. These programs cover many areas including, finance, technical competencies, compliance with the regulatory and legal framework, managerial and administrative skills and marketing. Furthermore, SMEDA offers a free of cost software-based accounting package developed explicitly for SMEs to facilitate SMEs' bookkeeping requirements. SMEDA also provides free of cost training sessions at different locations on the usage of this software to maximise its utility for users. However, the evidence from this study identifies that most SMEs are not aware of SMEDA and, therefore, have never taken advantage of the services they provide. There is, therefore, a need to use various channels to make SMEs aware of the support and assistance available to them from SMEDA. For instance, the government can direct the Securities and Exchange Commission of Pakistan (SECP) and FBR to give information about SMEDA and its services when registering their business with them. Government can also use prime time on television to advertise about services of SMEDA. Furthermore, they can instruct banks to guide SMEs about the services offered by SMEDA at the time of opening their business account.

Another key finding of this study is the significance of collaborative research projects by universities and SMEs in improving SMEs' access to Islamic banking finance in Pakistan. However, the collaborative research identifying and addressing the specific problems different SMEs face in their respective sectors is scarce. The government should develop and promote the coordination between academic institutions and SMEs to conduct collaborative research projects. Such cooperation involves performing systematic activities by integrating the respective facilities of the university and industry to carry out tasks that each of them cannot perform alone. These collaborative research projects will help expand knowledge, improve access to technology, bring innovation, and enhance access to available financial resources. In the context of improving access to finance, such collaboration will help to understand better the actual business model of SMEs in a particular sector, their specific requirements, their practices and the external conditions that inhibit their access to formal sources of finance. It will also help to identify how their access to finance can be improved by evacuating the difficulties attached to it.

10.4 Limitations of Study

The discussions on SMEs' access to Islamic banking finance in Pakistan represent an underexplored area within the SMEs and Islamic finance literature and offers ample scope for future research. Despite the contributions identified in the previous sections, this study's limitations should be noted. While it was maintained that these limitations do not affect the overall validity and reliability of this research, their effects on certain areas of the collection and analysis of the data should be taken into account.

This research adopted a qualitative design and used semi-structured interviews as a data collection tool. Although much care and consideration were given to limit any potential bias, this risk cannot be eliminated using interviews to collect data. For instance, there is always the possibility that the SME owner/manager was telling what they felt the researcher wanted to hear. Gathering the opinions of other stakeholders such as Islamic bank managers and Sharia board members in addition to the opinions of SMEs should have reduced this issue, but the risk of any bias cannot be completely eliminated.

Secondly, the strong structuration theory was utilised throughout the research and served as a tool for setting research questions and the broad directions for conducting the research. This theory emphasises certain concepts such as the duality of structure, context and conduct analysis, position-practices and the agent-in-focus. Such concepts were employed as “the unit of analysis” to facilitate the appropriate data collection to investigate SMEs’ access to Islamic banking finance in Pakistan. Developing the particular research design and examining the empirical evidence through the lens of strong structuration theory steered a course to pursue a specific analytical path. Suppose the study had employed an alternative theoretical framework. In that case, a different research design might have been required to investigate SMEs’ access to Islamic banking finance in Pakistan, which might have led to uncovering additional or even different findings.

Finally, this study is based on the context-specific data collected from SMEs, Islamic bank managers and a Sharia board member in Pakistan. Since different countries define SMEs differently and have different socio-economic contexts, the findings of this study have limitations in terms of generalisability and cannot be applied to SMEs operating in other countries. However, with this study being qualitative, this limitation does not actually impact the overall quality of the study, as it is not the aim of such a study to attain generalisability.

Nevertheless, this study has fulfilled its aims and objectives set at the beginning of the research despite these limitations. It remains one of the first comprehensive investigations of SMEs’ access to Islamic banking finance in Pakistan, where little research has been undertaken.

10.5 Considerations for further research

While this study has contributed significantly to our understanding of SMEs’ access to Islamic banking finance in Pakistan, further work needs to be undertaken to comprehend this phenomenon. Based on the limitations of this research and the points that emerged during the investigation, new opportunities for future research in this domain are therefore presented in this section.

This research adopted a qualitative design and used semi-structured interviews as a data collection tool. The subjective nature of qualitative research using interviews may expose it to a bias (Novick, 2008; Chenail, 2001). As the previous section points out, opinions of other stakeholders in addition to SMEs were incorporated to reduce any such bias. However, further research using participant observation and interviews as complementary methods could also help overcome the inherent limitations of interviews. The findings of this research could be used to help design such a study.

The present study investigated SMEs' access to Islamic finance in Pakistan through the lens of strong structuration theory. This phenomenon can further be investigated from a different theoretical perspective, leading to a different philosophical, epistemological, methodological and/or analytical approach. Therefore, considering the diversity of the available theoretical framework in the accounting discipline, approaching the same phenomena from a different theoretical lens appears to be a fruitful avenue for further research.

Islamic financial products can be utilised by both Muslims and non-Muslims since the values espoused by the Islamic economic system are not for Muslims only. Therefore, future work may also consider exploring SMEs' access to Islamic finance in a non- Muslim country. This aspect could itself be worthy of a doctoral thesis on its own. It will help discover greater insights in this area and provide a basis for comparison among Muslim and non- Muslim countries.

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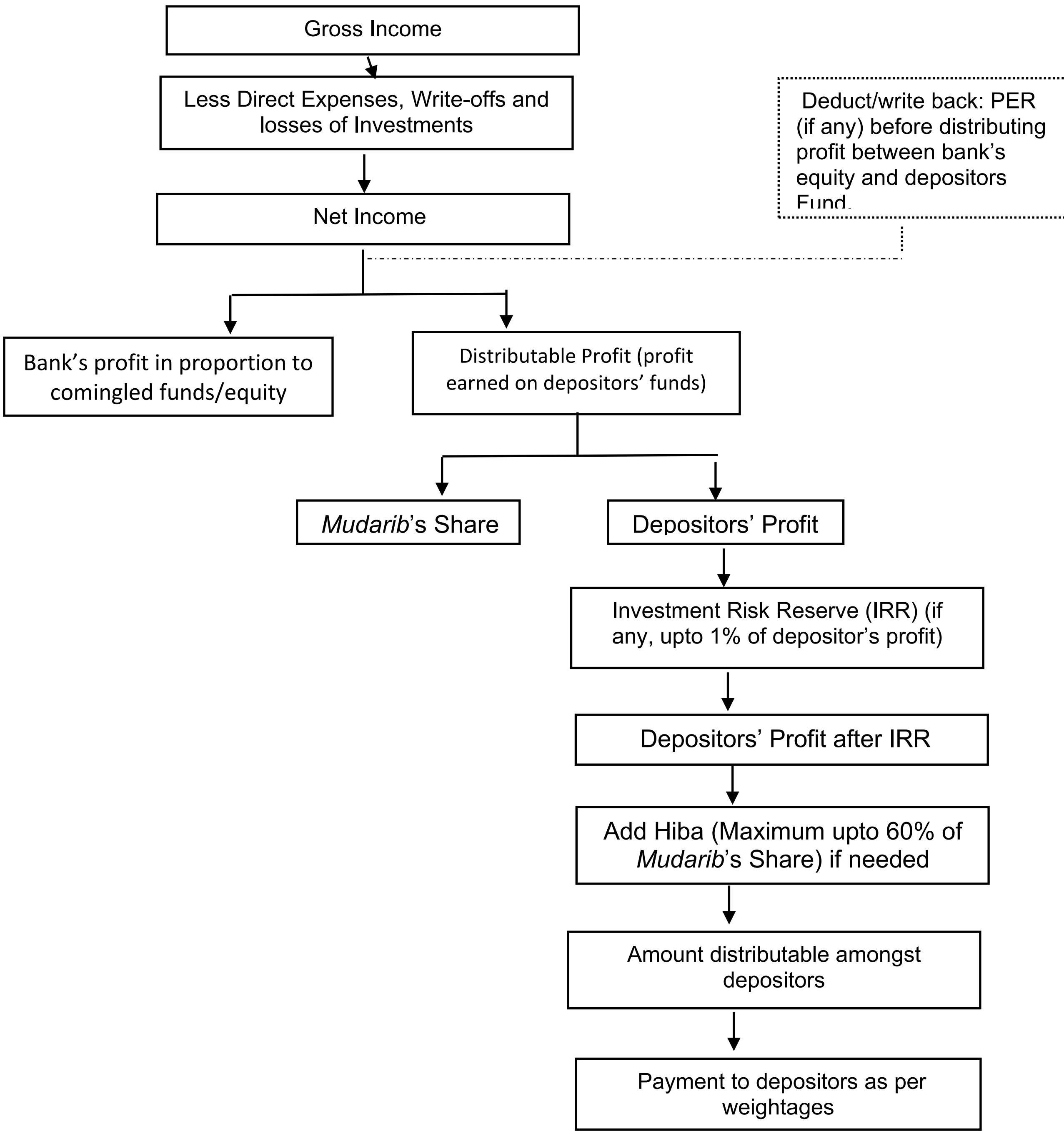
Appendices

Appendix 1: Profit Computation and Distribution Process Flow in Islamic Banks



Source: Instructions for Profit and Loss Distribution for Islamic Banking Institutions (SBP, 2020)

Appendix 2: Interview Guides

Aston University

<u>Draft Interview Protocol for SME Owners/Managers</u>

Title of Project: Small and Medium Enterprises' (SMEs) Access to Islamic Banking Finance in Pakistan

Name of the interviewee: ________________________
Nature of Business: ______________________________
Details of the interview:
Date:
Time:

Stage 1 – Welcome and introduction:

• Thank you for your participation.
• Confidentiality of responses is guaranteed
• Approximate length of interview: 60 minutes
• Purpose of research

<u>Stage 2 – General questions about the participant and business</u>

1. How do you run the business?
- As the project owner
- As a specialised manager

2. Your age: __________ years

3. Highest level of Education: ______________________

4. Experience in running this project and previous experience: __________ Years

5. Age of Business: __________ Years

6. Number of people employed in the business: __________

7. Approximate size of the total assets of business: ___________

8. Estimated average annual turnover: ___________

9. What is the main source of finance for your project?
- Self-financing/ personal savings
- Family and friends

- Private banks
- others (specify)

10. Can you please briefly tell me about your business?

11. What is you motivation to run your own business?

Stage 3 – Discussion about the Core aspects of the study

- **SMEs' Knowledge about Islamic banking**

12. Are you utilising Islamic financial products for financing your business? Or have you tried to access Islamic finance?

13. For how long have you been using Islamic financial products?

14. Are you aware of the types of Islamic financial products offered by Islamic banks to SMEs?

15. How did you get to know about Islamic financial products? What is the role of media in imparting the knowledge about Islamic banking and their products?

- **Motivation to use Islamic financing products**

16. What are your motivations behind using Islamic finance as an alternative to conventional finance?

17. Which Islamic financial instrument would you prefer to use in financing your business? Why?

- **SMEs' opinions and experience with Islamic banking**

18. What type of Islamic bank are you dealing with? Full-fledged Islamic bank, standalone Islamic banking branch of conventional bank or Islamic window? And why?

19. For how many years have you been dealing with your particular bank? Does your relationship with the bank affect the decision making in relation to the provision of the loan? If yes how?

20. Does your bank offer your preferred instrument or do they offer different instrument? If they offer different product, why, in your opinion, they do so?

21. What is your opinion about Islamic banking service? Has Islamic banking service met your expectations?

22. What are the main obstacles you faced while accessing Islamic finance?

23. How did the bank support you to overcome those difficulties?

24. What did you do to overcome these difficulties?

25. In your opinion, what steps could be taken to overcome these difficulties?

26. Do you wish to continue financing your business through Islamic financial instruments? Why or why not?

27. What are your views about the Sharia compliance of Islamic banks in Pakistan? Are they truly Islamic?

28. Are you using or aware of the support available to SMEs through SMEDA?

29. How is your experience with the Federal Board of Revenue (FBR) and what influence does it have on your business or accounting practices?

- **Developing SMEs' access to Islamic finance**

30. What are your suggestions to facilitate the SMEs' access to Islamic banking finance?

Stage 4 - Closure

- Do you have any questions or concerns that you would like me to address?
- Thank you to interviewee.
- Reassure confidentiality

Aston University

Interview Guide for Islamic Bank Managers

Title of Project: Small and Medium Enterprises' (SMEs) Access to Islamic Banking Finance in Pakistan

Name of the interviewee: ___________ Organisation: Islamic bank/ Islamic branch/ Islamic Window Details of the interview: Date: Time:
Stage 1 – Welcome and introduction • Thank you for your participation. • Confidentiality of responses is guaranteed. • Approximate length of interview: 60 minutes • Purpose of research.
Stage 2 – General questions about the participant 1. Participant's age:________ 2. How long have you been working for this organisation? 3. What is your educational background? 4. What are your previous work experience?
Stage 3 – Discussion about the core aspects of the study • **Policy framework of Islamic banks** 5. What types of financing instruments are offered by your institution to SMEs? 6. What types of financing instruments are demanded by SMEs? Are they different from those offered by your institution? If yes, then why? 7. What are the requirements for the SMEs to obtain finance from your institution? • **Experience with SMEs** 8. You have some particular requirements for SMEs to get finance but What are the other (implicit) factors that you consider while providing finance to SMEs? And why these factors are important?

9. What type of conditions influence your decision to provide finance? E.g., government influence to support a particular sector.

10. What type of SMEs usually approach you for financing? Trading, manufacturing etc

11. What are the most common reason for rejecting SMEs' finance application?

12. Do you provide any additional support on the turned down applications so that the SME can develop their plan?

13. What are the most important difficulties facing your institution in financing SMEs?

14. How do you deal with these difficulties?

15. What can be further done to overcome these difficulties?

16. What are the difficulties, if any, that SMEs usually encounter in the case of repayment?

17. How do you deal with the difficulties SMEs usually encounter in the case of repayment?

18. Would you like to share any peculiar experience with an SME?

- **Developing SMEs' access to Islamic finance**

19. In your opinion, how SMEs' access to Islamic finance can be further improved? E.g., changes in government's policies, changes in your organisation's policies etc.

Stage 4 - Closure

- Any other comments you would like to make?
- Thank you to the interviewee.
- Reassure confidentiality.

Aston University

Interview Guide for Sharia Board Member

Title of Project: Small and Medium Enterprises' (SMEs) Access to Islamic Banking Finance in Pakistan

Name of the interviewee: ____________ Organisation: Details of the interview: Date: Time:
Stage 1 – Welcome and introduction • Thank you for your participation. • Confidentiality of responses is guaranteed. • Approximate length of interview: 60 minutes • Purpose of research.
Stage 2 – General questions about the participant 1. Participant's age:_________ 2. How long have you been serving at Sharia board? 3. What is your educational background? 4. What are your previous work experience?
Stage 3 – Discussion about the core aspects of the study • **Policy framework of Islamic banks** 5. Currently, Islamic banks' share is only 13% of total SME financing through commercial banks. What do you think why it is so? How it can be improved? 6. SME owners identified that Islamic banks prefer to finance them through debt-based short-term financing products, whereas they are more willing to enter in equity-based contracts. Why they offer different products? How can this issue be addressed? 7. SMEs have experienced that obtaining finance from Islamic banks take longer than getting a loan from conventional banks. Why it is so? What can be done to reduce their processing time?

8. In todays' dynamic environment, SMEs needs are also evolving fast as a result of continuously changing macroeconomic conditions. They do not only expect finance from the bank but demand innovative and personalised services addressing their business requirements. How can Islamic banks fulfil their expectations?

- Do they have sufficient resources like qualified and trained staff to cater SMEs specific needs?

9. How can government create enabling environment for SMEs' access to Islamic banking finance?

10. Tax noncompliance is one of the major reasons for SMEs' inadequate record keeping practices which in turn, limits their access to Islamic finance. How this undocumented sector of economy can be brought into the tax net?

11. SMEs highlighted collaterals as one of the major issues in securing finance. What do you think of the collateral requirements of Islamic banks? Are there any alternatives?

12. How SMEs' recordkeeping practices can be improved? Can Islamic banks play any role in it?

13. Why marketing of Islamic financial product is very weak and unclear? How Islamic banks can advertise their products?

14. Although SMEs expressed strong trust in Sharia board member, some SMEs expressed their concern about the extent of Sharia compliance of Islamic banks. What is your opinion about their Sharia compliance?

- Are they fully Sharia-compliant? If not what factors influence Sharia compliance?
- What steps can be taken by banks or the Sharia board members to assure their customers, particularly SMEs, about their Sharia compliance?

15. Do you agree that SMEs' lack of knowledge about Islamic financial products is one of the main reasons that hinder their access to Islamic Financial products? What can be done to educate SMEs about Islamic banking and their products?

16. Almost all the participant expressed strong trust in Sharia board members. What role they can play in imparting knowledge for Islamic financial products?

17. What are your suggestions for the policy makers (SBP and/or government) to make Islamic finance more accessible by SMEs?

Stage 4 - Closure

• Any other comments you would like to make?
• Thank you to the interviewee.
• Reassure confidentiality.

Appendix 3: Confirmation of Favourable Ethical Opinion

Aston University
Birmingham B4 7ET
United Kingdom

+44 (0)121 204 3000
www.aston.ac.uk

Aston University
BIRMINGHAM UK

15 September 2020
Dr Umair Riaz, Dr Melina Manochin
Student: Saba Ishaq
College of Business and Social Sciences

Dear Saba,

Study title:	Small and Medium Enterprises' (SMEs) access to Islamic banking finance in Pakistan.
REC REF:	#ABSREC023

Confirmation of Favourable Ethical Opinion

On behalf of the Committee, I am pleased to confirm a favourable opinion for the above research on the basis of the application described in the application form, protocol and supporting documentation listed below.

Approved documents

The final list of documents reviewed and approved by the Committee is as follows.

Document	*Version*	*Date*
Participant Information Sheet: SME owner/manager	1	11/08/2020
Participant Information Sheet: Bank managers	1	11/08/2020
Consent form: SME owner/manager	1	15/09/2020
Consent form: Bank managers	1	15/09/2020
Interview guides: SME owner/manager	1	11/08/2020
Interview guide: Bank managers	1	11/08/2020

Invitation	1	11/08/2020
Project summary	1	11/08/2020

After starting your research, please notify the University Research Ethics Committee of any of the following:

- Amendments. Any amendment should be sent as a Word document, with the amendment highlighted or showing tracked changes. The amendment request must be accompanied by a covering letter along with all amended documents, e.g., protocols, participant information sheets, consent forms etc. Please include a version number and amended date to the file name of any amended documentation (e.g., "Ethics Application #100 Protocol v2 amended 17/02/19.doc").

  Amendment requests should be outlined in a "Notice of Amendment Form" available by emailing research_governance@aston.ac.uk.

- Unforeseen or adverse events e.g., disclosure of personal data, harm to participants.
- New Investigators
- End of the study

Please email all notifications or queries to research_governance@aston.ac.uk and quote your UREC reference number with all correspondence.

Wishing you every success with your research.

Yours sincerely

[signature removed]

Professor James Wolffsohn

Acting Chair, University Research Ethics Committee