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## Article

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# Determinants of the decision to adopt Islamic finance: evidence from Oman

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## Abstract

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

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

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

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

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

**Keywords** Islamic financial decisions, SMEs, Oman, Owner-manager's Islamic financial knowledge, Firm's characteristics

**Paper type** Research paper



## Introduction

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

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

Only a limited number of the studies on capital structure have, however, been conducted on SMEs, and this deficiency is particularly evident when investigating what influences funding decisions around Islamic finance. In light of the rising importance and potential of Islamic finance, it is, therefore, essential to understand what factors influence the adoption of this new financing option. This paper attempts to contribute to the process of filling this gap.

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

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

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

## Islamic finance and SMEs in Oman

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

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

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

## Literature review and hypotheses

Myers (1984) characterises capital structure decision-making as a puzzle. Both theoretical and empirical studies of capital structure generate many viewpoints to explain the capital structure enigma; however, neither theory nor empirical research has been able to suggest a comprehensive justification of precisely what factors affect financing decisions (Myers, 1984; Matthews *et al.*, 1994). Attempts to theorise SMEs' financial behaviour have revealed a number of different financing patterns followed by SMEs. For example, the financial growth paradigm proposed by Berger and Udell (1998) suggests that financial need and the financing options which are available for SMEs alter during the various phases of a firm's life cycle; thus, a number of empirical studies have used the life-cycle model to understand the financial behaviour of SMEs (Barton and Gordon, 1987; La Rocca *et al.*, 2011). However, this model has been criticised by many researchers for its failure to offer a complete picture of SMEs' financial decisions and behaviour (Abdulsaleh and Worthington, 2013).

Further, SMEs' financing patterns, as explained by Berger and Udell (1998), contrast with the hypothesis behind Myers' (1984) pecking order theory (POT). POT suggests that the capital structure decision of a firm is a function of the firm's age, and that a firm prioritises internal sources of funding rather than external sources. In other words, when seeking funds, firms adhere to a hierarchy of financing preferences: internal equity to external debt, short-term debt to long-term debt and external debt to external equity. Many studies have applied POT to explain the financial structure of SMEs, even though the theory was developed for large corporations (Zoppa and McMahon, 2002; López-Gracia and Sogorb-Mira, 2008), and have proved that the financial choices of SMEs clearly fit the POT. On the other hand, Holmes and Kent (1991) argue that application of the POT to SMEs is

constrained; first, because SMEs are usually not in a position to issue equity to the public, and second, because their owner-managers tend to be deeply opposed to anything that weakens their ownership interest and control.

A number of other theories are relevant to the financial behaviour of SMEs. These include: trade-off theory, agency theory, market timing theory, signalling theory and information asymmetry. Different theories suggest different approaches. Commenting on the extent to which existing financing theories can explain the financial structure of businesses, [Pettit and Singer \(1985, p. 54\)](#) state:

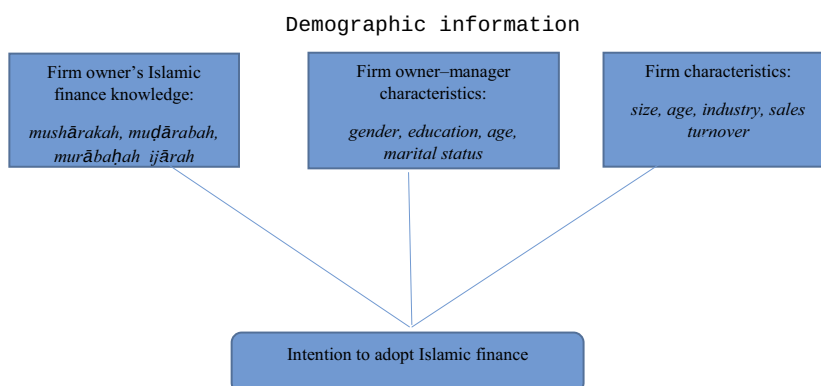
Business firms of all sizes select their financial structure in view of the cost, nature, and availability of financial alternatives. For a number of reasons, our understanding of this decision for large and small firms is deficient.

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

As it is generally agreed that the characteristics of both the firm and the firm’s owner affect the financing methods chosen and employed by SMEs ([Abdulsaleh and Worthington, 2013](#)), this study details how those characteristics and the firm owner-manager’s Islamic financial knowledge impacts the capital structure decisions *vis-à-vis* Islamic finance in small firms. Thus, this is one of the few studies that investigates Islamic financing decisions among SME owner-managers. [Figure 1](#) delineates the relationship between the demographic variables and SME owner-managers’ intentions to adopting Islamic finance within their capital structuring decisions.

#### *Factors influencing the adoption of Islamic finance*

As [Sayani and Miniaoui \(2013\)](#) show, customer preferences vary not only according to geographical location but also from segment to segment, for example, in Muslim-majority versus Muslim-minority countries. In their investigation into the factors that motivate



**Source:** Authors’ own

**Figure 1.**  
Relationship between  
demographic  
variables and  
intentions

consumers to adopt Islamic banking, [Erol and El-Bdour \(1989\)](#) find that, while peer group influence, awareness about profit/loss and economic and social development are the main factors that influence the adoption of Islamic banking, religious motivation does not appear to be the main justification when selecting Islamic financing.

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

- (1) *Malaysia*: Using the theory of planned behaviour (TPB) model, [Ibrahim et al. \(2017\)](#) find that there is a significant relationship between attitude, subjective norm, perceived behavioural control, level of knowledge or awareness and religiosity and a customer's intention to select Islamic home financing. According to [Ibrahim et al. \(2017\)](#), religiosity is the most influential factor in selecting Islamic financing. In another Malaysian study, [Selvanathan et al. \(2018\)](#) identify religion, bank reputation and cost–benefit factors as factors that influence Malaysian customers' selection of Islamic banking products and services, while convenience is not seen to be a significant factor.
- (2) *Pakistan*: Using the theory of reasoned action (TRA) model, [Ali et al. \(2017\)](#) investigate factors affecting intentions to select Islamic credit cards and find that attitude and subjective norms are positive and significant factors in choosing an Islamic credit card, while perceived financial cost has a negative effect. In addition, [Akhtar et al. \(2016\)](#) find that religion, awareness regarding Islam's teachings on finance, awareness of Islamic banking products and services, advertising and networking are the most important factors which affect customer perception regarding Islamic banking.
- (3) *Indonesia*: [Usman et al. \(2017\)](#) state that religious norms play an important role in the relationship between religiosity and choosing of Islamic banks. More specifically, they show that religiosity does not always play a critical role in selecting Islamic banks, as only people with a higher degree of religiosity tend to prefer Islamic banks. According to the authors, their results aligned with previous studies they examined which showed inconclusive findings on the relationship between religiosity and the selection of Islamic banks. For customers of conventional banks, their results found that religiosity is not a determinant for choosing an Islamic bank.
- (4) *Turkey*: [Genç et al. \(2016\)](#) find that household and corporate customers adopt Islamic banking because of staff friendliness; the other factors that motivate them to use Islamic banking include the availability of interest-free financial institutions, efficient service and financial counselling offered by staff.
- (5) *Qatar*: [AlBaker \(2017\)](#) finds that Shari'ah-compliance and family/friends are the most influential factors that attract customers to adopt Islamic banks, while factors such as quality of services and corporate social responsibility activities have less influence on customers.
- (6) *Kuwait*: [AlHunnayan and AlMutairi \(2016\)](#) find that quality of service and low service charges offered by Islamic banks are the most important factors that motivate customers to deal with them, while banks' mass media advertising is the least important factor.



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- (7) *The United Arab Emirates*: Shome *et al.* (2018), targeting university students, find that students' Arabic language skills and their expectations in terms of the conformity of a bank's operations with Islamic principles are the main factors that affect their decision to open an account with an Islamic bank. On the other hand, factors such as students' nationality, gender, education and familiarity with Islamic banking are not seen to have any effect on the decision to open an account with an Islamic bank.
  - (8) *Bahrain*: AlHadrami *et al.* (2017) identify the criteria that customers consider to be important when selecting Islamic banks; they find that religion is the major factor, followed by service quality.
  - (9) *Saudi Arabia*: Alanazi and Lone (2016) show that people in Saudi Arabia prefer to invest in Islamic banks rather than conventional banks and that they are satisfied with Islamic banking operations. This study emphasises that Islamic values are more important for Saudis than anything else. Similarly, Lone *et al.* (2017) conclude that Saudi Arabian customers are satisfied with Islamic banking and that customer satisfaction is the key element contributing to the success (or failure) of Islamic banking institutions.

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

#### *Firm owners' Islamic finance knowledge*

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

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

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

- H1. There is a significant difference between SMEs' awareness level of Islamic finance types and their intention to adopt Islamic finance.
- H1a. There is a significant difference between SMEs' awareness level of *mushārah* and their intention to adopt Islamic finance.
- H1b. There is a significant difference between SMEs' awareness level of *muḍārah* and their intention to adopt Islamic finance.
- H1c. There is a significant difference between SMEs' awareness level of *murābahah* and their intention to adopt Islamic finance.
- H1d. There is a significant difference between SMEs awareness level of *ijārah* and their intention to adopt Islamic finance.

#### *Firm owners' characteristics*

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

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

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

- H2. There is a significant difference between male and female individuals in adopting Islamic finance.

*Education.* There is a general assumption that those who are better educated are better able to weigh risk and return than their less well-educated counterparts. Researchers have shown a positive correlation between educational attainment and financial behaviour; indeed, Cole



*et al.* (2014) provide evidence showing that a person with higher education will engage in smarter financial decision-making.

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

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

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

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

Both younger and older decision-makers make mistakes; however, they do so for different reasons. In terms of financial decision-making specifically, *Bangma et al.* (2017) find no significant effect of age on financial decisions. As financial decision-making is the main factor for business success, especially for SMEs' development and expansion, in this study, the differences between younger and older SME owner-managers in their financing decision to adopt Islamic finance are investigated. Accordingly, the fourth hypothesis relates to:

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

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

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

*Firm characteristics*

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

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

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

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

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

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

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

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

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

## Research methods and sample characteristics

### *Data collection method*

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

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

A total of 385 firms were then randomly selected, since "The random sample is the best because it's most representative of the entire population. It's least likely to result in bias" (Alreck and Settle, 2004, p. 71). To ensure that 385 represented a sufficient sample size, the following assumptions were used (Waters, 1994):

- proportion ( $\pi$ ) equals to 0.5, as this is the safest possible assumption;
- a confidence level of 95 per cent, which corresponds to a Z-value of 1.96; and
- an error or precision (E) of 0.05.

Given the above assumptions, the sample size N is estimated by:

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

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

Items	Factor loadings
<i>IFIA 1</i> . I intend to adopt Islamic banking services in the future	0.926
<i>IFIA 2</i> . I predict that I will frequently use Islamic banking services in the future	0.942
<i>IFIA 3</i> . I will strongly recommend others to use Islamic banking services	0.901
Eigenvalue	2.555
Variance explained	85.179
KMO measure of sampling adequacy	0.742
Bartlett's test of sphericity	Chi-square = 818.563 (df, 3; $p = 0.000$ )
Cronbach's alpha ( $\alpha$ )	0.919

**Note:** *IFIA* = Islamic Financial Instrument Adoption

**Table I.**  
Factor loading  
(dependent variable)

*Characteristics of the sample*  
**Table II** details the descriptive statistics of the SME firm owners and their firms' characteristics.

*Statistical analysis*  
Non-parametric model Kruskal–Wallis one-way ANOVA was conducted to test the hypotheses (Noulas, 2001; Urionabarrenetxea and Rodríguez Castellanos, 2009; Uyar and Guzelyurt, 2015). Because of the nature of the data obtained from the survey, the results are

Description	(%)
<i>Gender</i>	
Male	68.8
Female	31.2
<i>Educational level</i>	
Primary	0.8
Secondary	36.9
Higher diploma	28.0
Bachelor's	31.7
Master's	2.6
<i>Age in years</i>	
Under 20	1.0
20-30	40.8
31-40	46.2
41-50	11.0
Over 50	1.0
<i>Marital status</i>	
Single	39.7
Married	57.1
Other	3.2
<i>Number of employees</i>	
1-5	59.7
6-25	37.4
26-99	2.9
<i>*Sales turnover in Omani Rials (OMR)</i>	
Less than 100,000	76.4
Between 100,000 and less than 500,000	22.3
<i>Firm age in years</i>	
0-1	13.2
2-3	47.8
4-5	23.2
Over 5	15.8
<i>Nature of business</i>	
Manufacturing	19.7
Services	35.1
Trade	45.2

**Table II.** Respondents' profile  
**Note:** \*Turnover does not add up to 100 per cent because a few participants were reluctant to provide this information

not required to comply with the assumptions of normality or homoscedasticity that variance analysis requires (Urionabarrenetxea and Rodríguez Castellanos, 2009).

Decision to  
adopt Islamic  
finance

## Results and discussion

### *Firm owners' Islamic finance knowledge*

Table III shows the influence of firm owners' Islamic finance knowledge on their intention to adopt Islamic finance. There is support for *H1a*, *H1b* and *H1c*, indicating that SME owner-managers' knowledge of PLS such as *mushārah* and *muḍārah* and non-PLS such as *murābahah* influences their intention to adopt Islamic finance. For example, SMEs' intention to adopt Islamic finance shows a statistically significant difference in the mean scores between SMEs' awareness level of *mushārah*, *muḍārah* and *murābahah* at  $p < 0.01$ ,  $p < 0.01$  and  $p < 0.05$ , respectively. It is clear from Table III that SMEs with full awareness of Islamic finance are more likely to adopt Islamic financing compared to those that are not aware. This finding is not surprising, as SMEs with higher knowledge of Islamic financial products understand the advantages of these financial instruments, and, thus, it is easier for them to make an informed and confident decision; in addition, they are ready to accept this newly available financing option in the Omani banking industry.

This finding suggests that awareness of financial knowledge can help in improving SMEs' Islamic financial decision-making. While this finding is consistent with Khattak's (2010) and Jaffar and Musa's (2013) previous research findings, there is a lack of support for *H1d*, i.e. SME owner-managers' intention to adopt Islamic finance does not vary with their awareness level towards *ijārah*.

### *Firm owners' characteristics*

*Gender.* Table IV shows the influence of gender on the adoption of Islamic finance. A statistically significant difference in the mean scores between male and female SME owner-managers on their intention towards adopting Islamic finance ( $p < 0.01$ ) offers support for

IFIs	Mean rank	Kruskal–Wallis $\chi^2$	Hypotheses
<i>Awareness of mushārah</i>			
Fully aware	208.03	8.252*	Supported
Somewhat aware	194.80		
Not aware	158.93		
<i>Awareness of muḍārah</i>			
Fully aware	207.11	8.044*	Supported
Somewhat aware	195.90		
Not aware	159.93		
<i>Awareness of murābahah</i>			
Fully aware	209.77	9.603**	Supported
Somewhat aware	195.06		
Not aware	158.08		
<i>Awareness of ijārah</i>			
Fully aware	204.34	1.787	Not supported
Somewhat aware	190.92		
Not aware	183.34		

**Note:** \* and \*\* are significant at 0.05 and 0.01 levels, respectively

**Table III.**  
Kruskal–Wallis  
results for SME  
owner-managers'  
knowledge about  
IFIs

**Table IV.**  
Kruskal–Wallis  
results for firm  
owners'  
characteristics

Personal characteristics	Mean rank	Kruskal–Wallis $\chi^2$	Hypotheses
<i>Gender</i>			
Female	171.38	6.936**	Supported
Male	202.79		
<i>Education</i>			
Primary	91.50	17.699*	Supported
Secondary	208.82		
Higher diploma	202.34		
Bachelor's	164.24		
Master's	248.90		
<i>Age in years</i>			
Under 20	203.50	6.303	Not supported
20-30	192.14		
31-40	185.45		
41-50	218.04		
Above 50	289.25		
<i>Marital status</i>			
Single	197.06	2.901	Not supported
Married	192.97		
Other	141.71		
<b>Note:</b> * and ** are significant at the 0.05 and 0.01 levels, respectively			

*H2.* As is clear from [Table IV](#), male owner-managers have a higher mean score (202.79) for adopting new financing options that are available in Omani banking compared with a score of 171.38 for their female counterparts. This finding suggests that female individuals are more cautious and less confident in their abilities to make financial decisions involving the adoption of the Islamic financing options that are available in the country's banking sector.

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

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

*Education.* [Table IV](#) also shows support for *H3*, in that intention to adopt Islamic finance varies with the SME owner-managers' education level. Intention to adopt Islamic finance among SMEs is significantly different at  $p < 0.05$ , with mean scores being higher for those



with master's-level education (248.90). This finding suggests that SME owner-managers with higher education are more likely to adopt Islamic finance than those with lower levels of education such as only primary education (91.50). This result may indicate that educated SME owner-managers are more confident because of their knowledge and understanding of the benefits of Islamic finance as a method of financing their businesses. Furthermore, this result indicates that education has important effects on financing decisions among SMEs. This finding confirms the results of [Cole et al. \(2014\)](#), who find that a wide range of financial outcomes are causally impacted by education.

In fact, because awareness about Islamic banking in Oman was the main challenge when Islamic banking was first introduced, the country's policymakers later introduced a number of measures to increase people's awareness. For example, some universities have begun to introduce courses such as Islamic finance and Islamic insurance into their academic curricula. According to [Thomson Reuters \(2014\)](#), Oman ranks 15th for Islamic finance education in terms of the Islamic Finance Development Indicator (IFDI) education sub-indicator, which indicates that knowledge has spread within the country. Similarly, this study finds that SME owner-managers with higher education are more likely to adopt Islamic finance.

On the other hand, there is a lack of support for *H4* and *H5* – the *age and marital status* of SME owner-managers. Thus, it is to be concluded that age and marital status are not associated with SMEs' financing decisions. This finding is consistent with those of [Grable and Joo \(1997\)](#) and [Bangma et al. \(2017\)](#).

*Firm characteristics.* [Table V](#) shows that in terms of the firms' characteristics, there are no substantial differences in adopting Islamic finance (indicating a lack of support for *H6*, *H7*, *H8* and *H9*) when the following variables are considered:

- *Firm size:* This is consistent with market efficiency hypotheses that the firm's size does not affect the capital structure, as per [Modigliani and Miller's \(1958\)](#) theory.
- *Firm age:* The growth cycle paradigm does not fit all SMEs ([Berger and Udell, 1998](#));

Firm characteristics	Mean rank	Kruskal–Wallis $\chi^2$	Hypotheses
<i>Firm size: number of employees</i>			Not supported
Micro	193.79	1.243	
Small	194.48		
Medium	157.14		
<i>Firm age in years</i>			Not supported
0-1	192.49	0.036	
2-3	193.29		
4-5	194.16		
Above 5	190.88		
<i>Sales turnover in Omani Rials (OMR)</i>			Not supported
Less than 100,000	191.34	0.081	
Between 100,000 and less than 500,000	187.62		
<i>Nature of business</i>			Not supported
Manufacturing	211.77	3.567	
Services	194.36		
Trade	183.75		

**Note:** \* and \*\* are significant at the 0.05 and 0.01 levels, respectively

**Table V.**  
Kruskal–Wallis  
results for firm  
characteristics

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

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

### Summary and conclusion

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

The authors adopted a questionnaire survey methodology for this research. A questionnaire was administered via face-to-face interviews between December 2016 and February 2017 to 385 SME owner-managers operating in Muscat, Oman's capital city. The Kruskal–Wallis one-way ANOVA non-parametric test was used to analyse the questionnaire survey data. The findings reveal that Omani SME owner-managers' intentions to adopt Islamic finance are strongly influenced by:

- the firm owner's knowledge of Islamic finance, specifically knowledge of PLS such as *mushārah* and *muḍārah* and non-PLS such as *murābahah*; and
- by the firm owner's personal characteristics.

While knowledge of *ijārah* does not influence their Islamic financial decisions, factors such as gender and education do affect SME owner-managers' Islamic financial decisions. Age and marital status are not associated with SMEs' financing decisions and neither do firm characteristics such as firm size, firm age, industry and sales turnover show any significant effect on SMEs' intention to adopt Islamic finance as a financing option.

The study contributes to the literature on corporate finance in several ways. First, it emphasises the growing importance of Islamic finance not only as an effective financial tool around the globe but also of its key instruments, PLS and non-PLS. Moreover, the study's findings clarify whether an understanding of key instruments of Islamic finance affects

SME owner-managers' financing decisions. Second, this study focuses on Omani SME owner-managers' Islamic finance knowledge, their own characteristics and factors within their firms' characteristics that are important for decision-making regarding capital structure. Lastly, the focus of prior studies has been on large listed firms; SMEs, however, significantly differ from them in terms of their financial decisions and behaviour (Abdulsaleh and Worthington, 2013). Consequently, determinants of SMEs' capital structure are not well understood, especially as regards Islamic finance decisions.

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

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

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

This study has some limitations which need to be considered. The research's first limitation relates to its geographical location, as the study focused on SME owner-managers in Muscat only. Second, the study's findings cannot be generalised to large and public firms, as the sample includes only SME owner-managers. Future studies could survey a wider sample of SME owner-managers in locations beyond Oman's capital city, Muscat. Finally, the findings are limited to SME owner-managers' knowledge of Islamic finance, their own characteristics and their firms' characteristics only. Consequently, more research should be carried out to determine what other factors affect the intention of Omani SME owner-managers to adopt Islamic finance.

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