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Evaluating the Role of Islamic Banks in Financing Micro, Small, and Medium Enterprises (MSMEs) In Palestine

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Abstract: The study sought to evaluate the role of Islamic banks in financing micro, small, and medium enterprises (MSMEs). To achieve this aim, the study adopted both qualitative and quantitative approaches, as it conducted structured interviews with Islamic bank managers and relied on statistical data through its quantitative analysis. The study concluded that Islamic banks depend to a large extent on the Murabaha financing formula (87.56%), and that the diversity of Islamic financing formulas provided to project owners is at a very low level, as the percentage of participation, Mudaraba, leasing and Istisna' is equivalent to (12.34%) and the percentage of participation alone (0.00%), which is the most important financing tool suitable for MSMEs. In addition, the study showed that Islamic banks do not encourage project owners to use participation-financing formulas except by 50%, which is a very low degree, which negatively affects project owners in terms of the nature of the guarantees required to obtain financing. Moreover, the findings showed that the policies and procedures of Islamic banks in financing MSMEs were sufficient and effective to a moderate degree. The results showed that the contribution of Islamic banks in financing MSMEs out of the total financing in the Palestinian banking system equals (2.59%), which is a low degree, and that the contribution of Islamic banks out of the total financing of Islamic banks themselves (12.61%), which is low and insufficient given that the MSMEs constitute (95%) of the Palestinian economy. The results also revealed a significant explanation for the challenges and obstacles encountering Islamic banks in financing MSMEs, as it was found that the first obstacle is "the inefficiency of owners of MSMEs in managing projects and marketing their products", where it was at a rate of (77%), and the second obstacle is "The failure of project owners to provide appropriate guarantees for Islamic finance " that got a score of (67%). Finally, it was found that there is a moderate level of MSMEs owners' satisfaction about financing formulas provided by Islamic banks. Therefore, the study recommended Islamic banks to diversify the financing provided to project owners and not focusing on Murabaha and activate other financing formulas, raise the percentage of Islamic banks' contribution to financing MSMEs, establish specialized departments to provide advice in the field of preparing feasibility studies, risk management and defaults, raising the awareness of project owners about other financing tools, such as participation and Mudaraba, so that guarantees are mitigated and access to appropriate financing is facilitated to achieve financial sustainability and contribute to the local product and solve the problems of poverty and unemployment in the Palestinian economy.

Keywords: Islamic finance, Traditional Finance, Evaluating, micro, small, and medium enterprises (MSMEs), Participation, Mudaraba, Murabaha.

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1. Introduction

Micro, small, and medium enterprises (MSMEs) have proven their effectiveness in bringing about economic and social development in various countries of the world. Indeed, these projects almost represent the backbone of most countries' economies, and for this reason the interest in these projects for their development and improvement (Abu Shanab, 2015). MSMEs constitute 80% or more of the total establishments in many countries, in addition to employing 60% or more of the workforce, in addition to its role in supporting the market with local products. Thus, it contributes to stimulating local production (Arqoub and Ben Mohammed, 2020). Especially the significance of small and medium enterprises mainly in generating many jobs and their contribution to reducing many problems such as unemployment and poverty that the Arab countries suffer from (Al-Asraj, 2011), and its addition to the Gross Domestic Product (GDP).

However, MSMEs face problems in financing, which hinders their growth and development. Perhaps the most prominent of these obstacles is securing the sources of financing necessary to invest in and develop projects, and the inability of project owners and entrepreneurs to secure the adequate guarantees required by commercial banks in traditional financing based on interest-bearing loans. This represents an additional burden on projects and negatively affects their competitive advantage (Abdul Karim, 2015). Especially since the owners of small projects do not enjoy high financial solvency in the beginning.

Accordingly, small and medium enterprises found themselves in a dilemma that limits growth and sustainability, and for this reason, Islamic banks realized this gap, and developed various methods and Islamic tools that contribute to financing small and medium enterprises (Arqoub and Ben Mohammed, 2020). Islamic finance has given way to multiple and varied options characterized by flexibility and ease of procedures, and has become an alternative to traditional finance (Kalash and Bahloul, 2020).

Despite the recent experience of Islamic finance in the State of Palestine compared to other countries, it was able to establish itself in the Palestinian financial market within a short period of time, as it was able to reach large numbers of people in various areas of the Palestinian National Authority and played a role in solving many of the problems facing small and medium enterprises (Haroun, 2016).

1.1 Statement of problem

The Palestinian Monetary Authority emphasized the importance of micro, small and medium enterprises and their pivotal role in production, employment and income generation, in addition to their role in achieving economic development. The Palestinian economy depends entirely on the activity of MSMEs, as they constitute 95% of the Palestinian economy (The Palestinian Monetary Authority, 2020). Despite the importance of small projects, there is still a problem with the difficulty of financing or the high cost of financing by traditional methods, which requires a lot of guarantees to obtain them, which do not meet the capabilities of the project owner, especially in developing countries. To overcome this problem, attempts to provide support or reduce interest rates are no longer feasible, and therefore the option to solve this problem was Islamic finance, as it provides many tools and formulas appropriate to the nature of these projects, and covers a large number of different types of financing, and corresponds to the financing needs of the investors. However, this role is still very limited (Union of Arab Banks, 2020). Hence the problem of the study lies in answering the following main question: What is the role of Islamic banks in financing micro, small, and medium enterprises (MSMEs) in Palestine?

In order to answer the main study question, the following sub-questions must be addressed:

1.2 Study Questions:

1. What is the extent of the variety of Islamic financing formulas offered to finance micro, small, and medium enterprises (MSMEs)?
2. How effective are the Islamic financing formulas provided for financing micro, small, and medium enterprises (MSMEs)?
3. What are the adequacy of the policies and procedures of Islamic banks towards micro, small, and medium enterprises (MSMEs)?
4. What is the extent of the contribution of Islamic banks in financing small, micro and medium enterprises out of the total financing in the Palestinian banking system?
5. What is the extent of the contribution of Islamic banks in financing micro, small, and medium enterprises (MSMEs) out of the total other finances in Islamic banks?
6. What are the challenges facing Islamic banks in financing micro, small, and medium enterprises (MSMEs)?
7. How satisfied are the owners of micro, small, and medium enterprises (MSMEs) who benefit from Islamic financing formulas?

1.3 Study Hypothesis

1. The Islamic financing formulas offered to finance micro, small, and medium enterprises (MSMEs) varied to a moderate degree.
2. Islamic financing formulas provided by Islamic banks in financing micro, small, and medium enterprises (MSMEs) are considered to be moderately effective.
3. The policies and procedures of Islamic banks in financing micro, small, and medium enterprises (MSMEs) are highly adequate.
4. The contribution of Islamic banks in financing micro, small, and medium enterprises (MSMEs) from the total financing in the Palestinian banking system is low
5. The contribution of Islamic banks in financing small, micro and medium-sized enterprises, out of the total other finances in Islamic banks is low?
6. The most important challenge facing Islamic banks in financing micro, small, and medium enterprises (MSMEs) is the inefficiency of project owners in managing their projects.
7. The level of satisfaction of owners of micro, small, and medium enterprises (MSMEs) with Islamic finance is moderate

1.4 Significance of the study

The significance of this study lies in the importance of micro, small, and medium enterprises (MSMEs) because they play a vital role in employment by providing job opportunities, as reports indicate that these projects constitute 95% of the Palestinian economy, in addition to employing 81% of the workforce (Palestinian News and Information Agency (Wafa), 2021), and therefore providing the necessary funding for them is one of the most important steps that must be taken to support and sustain these projects, and to overcome their financial problems, as funding is one of the most dangerous stages facing projects. It has been evident that the traditional interest-based financing system is very unsuitable for project owners, and sometimes it is considered an obstacle to them, because traditional financing by its nature is provided by one means, which is lending with interest, which means that the contractual relationship between traditional banks and project owners is governed by the loan formula, with its legal provisions, it does not make the traditional banks solidarity with their customers in the event of the project's failure, meaning that the borrowers who own the projects still have great fears of the failure of the project and the failure of payment, which opens the worst options for the borrowers who own the projects by refinancing with compound interest or by resorting to guarantees and liquidating the projects. This is why Islamic finance is considered one of the best methods available to ensure the growth and continuity of projects, because Islamic finance is based on various forms such as Mudaraba, participation, lease-to-own, Istisna', Salam, Murabaha and Tawarruq. Which means that the contractual relationship between Islamic banks and clients who own projects is basically governed by the formula of participation, sales or leasing, including the legal provisions it contains. Most of them are different formulas that make Islamic banks solidarity with their clients and not lending to them, because they are based on participation and not loan. Since Islamic banks are partners of clients, they are keen on the success of projects financed by them to a large extent, and do not ask project owners for guarantees except in the case of infringement and negligence.

Hence the importance of the study in shedding light on the role of Islamic banks, especially in financing micro, small, and medium enterprises (MSMEs), in addition to providing those interested in Islamic banks operating in the State of Palestine (administrators, investors, workers, dealers, researchers) in the field of Islamic banks with information and indicators about the adequacy and effectiveness of the Islamic finance for financing micro, small, and medium enterprises (MSMEs), and the challenges they face. The recommendations of the study will be rich with ideas and solutions aimed at improving the effectiveness and adequacy of project financing in a country living under occupation.

1.5 Previous Studies

Jassim (2020) carried out a study entitled "The Role of Islamic Banks in Financing Small and Medium Enterprises in Iraq". The study used the descriptive analytical method, by administering (100) questionnaires, and conducting a content analysis. The study reported a significant of the legal environment for regulating the work of Islamic banks.

In addition, Faydi and Qasi (2020) conducted a study entitled "The Role of Islamic Banks in Financing Small and Medium Enterprises in Algeria". The study used the questionnaire tool as it relied on (62) online questionnaires distributed to managers and their assistants in Islamic banks. The study concluded that the method of Islamic financing would contribute to the development and support of small and medium enterprises and reduce their financing problems.

Baaziz and Makhloufi (2019) performed a study entitled "The role of Islamic banks in financing micro-enterprises in Algeria". The study adopted the analytical approach, and aimed to clarify the importance of Islamic banks in supporting micro-enterprises. The study concluded that Islamic banks play an important role in financing micro-enterprises through tools and formulas that are compatible with the provisions of Islamic Sharia.

Al-Manan (2017) conducted a study to identify the role of Islamic banks in financing small projects in Sudan. The study adopted the analytical method, and concluded that the financing provided by financial institutions and commercial and specialized banks for small projects is very small when compared to the financing provided to other sectors, which affects the continuity of these projects.

Abu Shanab (2015) carried out a study entitled "The Role of Islamic Finance in Supporting Small and Medium Enterprises in Jordan". The study adopted the descriptive analytical approach, and concluded that a number of Islamic financing formulas provide effective solutions to enhance the economic role of small and medium enterprises.

In another study conducted by Al Jowaifel (2013) entitled "The role of Islamic banks in financing Jordanian small and medium-sized enterprises". The study relied on the descriptive analytical approach, as (150) questionnaires were distributed to workers in Islamic banks. The study concluded that there is a role for Islamic banks in financing small and medium-sized enterprises. In addition to the existence of effective financing formulas used to finance projects.

Zyadat and Alrawashdeh (2021) conducted a study that entitled "Islamic finance and its role in financing small projects in Jordan". The study used the questionnaire to elicit quantitative data. The study found that the benefit of small enterprises from Islamic finance provided by Islamic banks is high.

Thaker et al., (2020) carried out a study entitled "Benefiting from Islamic banking and finance for small businesses". It focused on Malaysia and Indonesia, and the study found that the financier is reluctant to provide financing to small business owners, for the following reasons: entrepreneurs' lack of business experience, lack of additional collateral, high transaction costs, small loan size, bad credit and others.

Moreover, Santoso (2019) investigated the role of micro, small and medium enterprises in achieving sustainable development goals through Islamic financial institutions. The study found that it is difficult to obtain financing from Islamic banks due to the weak guarantees owned by project owners. The study reported that the role of Islamic finance remains weak.

However, Raza et al., (2017) carried out a study entitled "Islamic banking services for small and medium enterprises in Pakistan". The study found that more than 89% of small and medium-sized companies are either deprived or completely neglected by the banking sector in Pakistan, and the reason for the decline in Islamic lending to small and medium-sized enterprises is due to the lack of awareness of Islamic products towards small and medium-sized companies.

In addition, Matarneh, & Mousa (2015) explored the contribution of Islamic banks to financing small and medium enterprises in the Kingdom of Bahrain. The study found that the contribution of Islamic banks to financing small and medium enterprises increased significantly during the period 2010-2012, due to the special features of the growth of Islamic finance, which focuses on risk-sharing mechanisms.

Finally, Huda (2012) investigated the development of the Islamic Finance System for Small and Medium Enterprises in a Developing Country. The study analyzed it, and concluded that the government should work alongside academia as a strategic partner for Islamic banks in reducing the asymmetric information that prevents the bank from lending to small and medium enterprises.

Commenting on the previous study and scientific addition:

Due to the importance of the topic of the study, the studies focused on the period after 2012 to 2021, which reflects their keeping pace with everything new in different environments. Most studies have concluded that there is Islamic financing for small and medium enterprises, but it needs to be further strengthened, and to reduce the challenges facing this type of financing. As it can be noted, the scarcity of Palestinian studies that research in this aspect, as far as the researchers know, this study is the first of its kind in Palestine.

This study differed from previous studies in that it is applied in an exceptional and unstable environment in which Palestinian institutions suffer from a difficult economic and political reality represented by the occupation, the restrictions it imposes, and the difficult economic conditions experienced by the Palestinian National Authority.

This poses a challenge to its management according to the requirements of the special reality, which gives it a comprehensive privacy, in contrast to the Arab studies that were applied in fully sovereign countries characterized by the stability of the surrounding environment. This is what made this study a reason to add a new scientific to this field.

1.6 Theoretical Framework

The Islamic banking system provides Islamic formulas that comply with the principles of Islamic law, which means the provision of Islamic financial services without interest; Because the rules of Islamic Sharia do not allow usury or interest on money lending, and so far at the global level, the spread of Islamic banks is still limited and not as wide as traditional banks (Reille, & Naseem. 2016). In this regard, Islamic banks have taken serious steps and made good leaps in the comprehensiveness of financial tools and the diversity of financing formulas, and according to the results of many studies and literature, Islamic banks have become able to skip the long procedures in the traditional system, especially with regard to small and medium enterprises that are considered a bridge to achieving Economic and social development. This interest comes in accordance with the importance of the effective role of small and medium enterprises in building the emerging economy (Sakhri and Ben Ali, 2021). Below, the study variables appropriate to the environment in which the study is being conducted will be addressed as follows:

Islamic finance concept

It is defined as financial or banking activities that are compatible with the provisions of Islamic Sharia and is governed by two basic principles, namely the sharing of profits and losses, and the prohibition of collecting and paying interest by lenders and investors (Tarver, & khartit. 2021). Islamic finance has also been defined as a part of the Islamic economic system inspired by Islamic law (Franzoni, & Allali. 2018). It aims to deeply support the realization of the objectives of Sharia, which must be reflected in the economy because it allows growth and justice, and ultimately the economic system serves the interest of all humanity (Alasrag. 2011. The basis of these instructions is the ethical Islamic treatment of financial transactions (Khan, et al., 2019). The Islamic Financial Transactions Law aims to protect the rights of all parties involved in commercial transactions and at the same time eliminate the possibility of any party exploiting the other, or the possibility of changing the value of things by depriving them of goods and services, or actual efforts and actual implementation through intermediaries (Rahama). .2017).

The first independent variable: Islamic finance formulas

a) Murabaha: The Murabaha formula is considered one of the most common forms of financing in Islamic banks, as it reached 70% of Islamic transactions through the Murabaha formula all over the world (Bhatti, 2011).

Murabaha is defined as "selling at the original price plus profit". In Murabaha, the bank buys the commodity specified by the customer and owns it according to the required specifications, including consumer goods and production assets. After the bank obtains ownership, it sells these goods to the customers at a price that includes the purchase cost in addition to the profit allocated to the purchase effort and the bank's expenses. Then the goods are delivered to the customer (Reille, & Nassem, 2016). In order for Murabaha to achieve its desired goal of developing small and medium enterprises, the purchase of production units (production lines) or the purchase of raw materials and operating supplies required for making final products must be financed (Islamic Development bank, 2021). On the other hand, the Islamic Bank provides the production requirements for these facilities and pays them for individuals, institutions, and medium and small-sized enterprises that wish to purchase certain products. In addition, it can meet these demands from the production of small and medium enterprises. The risks of this formula are reflected in the production unit who use the raw materials in the end. It represents the process of buying, selling and owning, in addition to fail of making the payment on time (Al-Asraj, 2010).

b) Mudaraba: In this formula, the Islamic bank provides the capital, while the other party (the customer who owns the project) has to provide management, skill, and labor (Jamaldeen, 2021), and accordingly the Islamic bank does not participate in the daily operation of the business, but it remains free In determining the conditions it deems necessary to ensure the optimal use of its money, and at the end of the contract, the Islamic bank recovers the capital, in addition to the profits, but in the event of a loss, the bank bears all the losses (Okte, 2010). Mudaraba opens the way for project owners to innovate, develop and harness their talents in production without financial problems. In this regard, the owner of the project does its utmost with its interest in the success and development of the project, because it is a partner in the profit generated from it (Al-Asraj, 2017).

c) Participation: An investment contract in which two or more parties share money or work and share profits according to the contract (Keton, 2020). As for the losses, they must be based on the ratio of the participating capital, and the Islamic bank applies this formula by entering its money as a partner with a party (the project owner). The Islamic bank participates in the management and follow-up procedures for all parties involved in financing the project (Baaziz and Makhloufi, 2019). Participation can be diminishing so that it ends with ownership, so that the bank sells its share to the customer in a gradual manner and collects it from the profits of the project until the project becomes completely for the customers, thus achieving economic empowerment for the customers and the Islamic bank recovers its capital with profits and returns.

d) Salam: This formula is done by the buyer paying an advance payment, but the delivery of the commodity is in the future, accordingly the buyer is the Islamic bank, and the customer is the owner of the project (Said, et al., 2020). This formula is widely used by farmers, so that Islamic banks provide the farmers with the capital needed to finance the cost of producing the crop in return for the future delivery of the final product, and the Islamic bank is able to promote and market this product to other customers (Islamic Bank Bangladesh limited, 2021). Thus, this formula is suitable for financing agricultural and production projects, while it is not suitable for commercial or service projects (Farhan, 2011).

e) Istisna'a: It means that the bank manufactures what the customer desires at its request from production or real estate units (through manufacturers) and then the customer pays the amounts due to the bank in instalments while achieving profitability, or the construction of residential buildings and so on (Muhammad, & Chong, 2007). The risks of the Istisna' formula do not differ from the Salam sale formula, which can be insured (Abdul Karim, 2015). The Istisna'a formula is suitable for small and medium enterprises through expanding business by increasing existing production lines or establishing real estate units for assembly units (Mo'ti, 2020). This formula enables the bank to recover its capital with a contractual profit margin with project owners.

f) Lease-to-own: A method of direct financing to a person. The banks lease the assets owned or not owned by it at the request of the customer to use them against a specified lease paid in instalments of a specified amount and a specified payment date (Shoon, 2008). The premise is that the customer wants to own the asset at the end of the period, and during the period the customer is responsible for the normal (operating) maintenance costs and expenses that depend on the income of the asset, and there are basic expenses borne by the lessor, which is the Islamic bank. At the end of the contract, if the customer does not pay the prepaid amount for the rent, the portion exceeding the lease itself is returned to the customer (Al-Safa Bank, 2021). The formula of financing through leasing is compatible with the undertaking to own small and medium production facilities that require production lines such as printing presses and packaging factories, as well as projects that require devices and equipment such as medical laboratories (Mohammed, 2017).

These Islamic financing formulas mentioned previously are suitable for MSMEs for all categories of society, especially minorities, marginalized people, people with special needs, women, graduates, the unemployed and entrepreneurs with creative ideas, who do not have the capital and do not have sufficient guarantees for financing because in some formulas the Islamic Bank is a partner in the outcome of project work, guarantees may not be requested except in the case of infringement, negligence and violation of conditions.

The second independent variable: the adequacy of Islamic financing formulas

The role of Islamic banks in achieving the goals of Islamic investment and sustainable development is limited, and the effectiveness of efforts to develop and innovate new mechanisms that depend on the Palestinian people's own capacity is weak, and their ability to restore investors' confidence in the national economy and the work of weak economic development (Al-Jaabari, 2013). This is because it focuses on providing financial services that achieve a fixed return, as is the case in Murabaha (Al-Momani, 2020). As the role of Islamic banks declined in increasing production and ignoring the agricultural sector, because the percentage of financing in this sector reached only (1%), it is known that this sector was distinguished by the allocation of three financing formulas (watering and farming), which indicates its importance in the Islamic economy and therefore there is weakness and the inadequacy of the methods used in Islamic banks to attract capital (Al-Jaabari, 2013). The adequacy will be measured by conducting interviews with employees of Islamic banks, and analyzing the percentage of Islamic banks' contribution to financing small projects.

The third independent variable: the effectiveness of Islamic financing formulas

Palestinian Islamic banks suffer from a shortage of qualified and trained cadres in the field of Islamic banking. In addition to the ineffectiveness of its marketing policies and the awareness of individuals and entrepreneurs about its banking services that are based on Shariah principles (Al-Rjoub, 2011). However, there are other aspects in which the effectiveness of Islamic finance stands out, including: It encourages small and medium business owners to do their best, and at the same time enthusiastic about the success of the project, because they are partners in the profits generated from it, thus ensuring the mechanism for allocating financial resources (Hassan, 2020). In addition to choosing the profit distribution system that suits the situation of the two parties to the relationship, it also provides a variety of options for owners of small and medium enterprises to choose appropriate fields and methods for them, and motivate entrepreneurs to innovate and innovate without financial obstacles, by providing various financing formulas for small and medium enterprises (Al-Asraj, 2011). For example, Murabaha is suitable for financing the purchase of existing assets, or the provision of goods, equipment, or raw materials for trade. As for leasing, it provides equipment for the project and is leased as an operating lease or with ownership, but it does not provide raw materials and working capital. And mudaraba and Participation provide the financing resources needed for the project, whether in the form of fixed capital or working capital (Fasih, 2012). As for Istisna' financing, it provides non-existent assets, buildings and machines that need to be manufactured by paying their value in advance from banks for the benefit of customers. With the emergence of these financing methods, projects have the opportunity to grow and prosper, use the available production capacity, control costs, and achieve stability in production conditions, thus highlighting the effectiveness of financing formulas by their availability in Islamic banks, unlike traditional banks (Hassan, 2020).

The fourth independent variable: the challenges facing Islamic banks

The challenges arise in the absence of modern financing models in Islamic banks, and this can be explained by the following reasons: the absence of laws and legislations regulating this type of financing, as well as the weak links in the state's financial markets. Just as Islamic banks have incomplete experience, and their financing methods are uncommon among market participants (Faydi and Qasi, 2019). In addition, most MSMEs do not have experience in organization and management (Farhan, 2011). It can be explained given that most companies, especially small ones, are family businesses that rely on relatives rather than competence (Faydi and Qasi, 2019). On the other hand, there are challenges in the possibility of entrepreneurs not repaying their debts from financing, in addition to their fear of entering into participations with Islamic banks, the clients' lack of understanding of the Murabaha formula, as well as the lack of feasibility studies for small and medium enterprises to prove the effectiveness of financing, in addition to the failure to choose the project according to experience and full awareness of the potential risks (Abu Rumman, 2018). Islamic finance faces the challenge of inadequate infrastructure, an inadequate local market and needs a fundamental change to achieve development and economic growth, in addition to the fact that the human competencies in Islamic banks are still not qualified or sufficient, as Islamic finance formulas need specialized workers in this field, and on the one others hand, the lack of clear laws and regulations that define the mode of operation of Islamic banks (Al-Asraj, 2011). Islamic banks suffer from the problem of the lack of unified banking foundations among all Islamic banks, and the weakness of coordination and cooperation among them (Al-Maghyoub, 2010). This leads to an inability to bear risks, due to weak production structures and investment opportunities. Therefore, most banks resort to the Murabaha formula as it is the least risky and closest to traditional financing formulas, in addition to weak follow-up with regulatory authorities, lack of transparency, and neglect of development research (Haroun, 2016).

The Dependent variable: Entrepreneurs' satisfaction with Islamic finance

Satisfaction is defined as the entrepreneur's feeling of happiness or disappointment that is generated by comparing performance with the expected expectations (Razak, et al., 2016). Therefore, it is the responsibility of Islamic banks to provide services that meet the needs, requirements and expectations of project owners (Kumasey, & Ghana, 2014). The quality of service significantly affects the satisfaction of entrepreneurs (Maswadeh, 2015). The dimensions of service quality based on legitimacy are represented in two aspects, the first related to the service outcome, which is reliability, and the second refers to service provision, which are the standards of tangibility, response, assurance and empathy (Raza, & Ali, 2015). Thus, providing high-quality services will lead to a high level of customer satisfaction and loyalty (Al-Fuqaha, 2012).

Micro, Small and Medium Enterprises (MSMEs)

There is no unified concept of small and medium enterprises in various countries of the world, and this is what made there are problems in estimating the size of projects according to the number of workers or capital and others, by banks and financial and governmental institutions, which hindered their development (IFC WB Group, 2014). In this regard, the Palestinian Council of Ministers recently decided to develop a unified law for small and medium enterprises, and this would develop and improve the enterprise sector by setting its own policies and plans. The definition was based on two criteria: (number of employees, annual sales), and projects were classified into five categories, as shown. Below (Palestinian Council of Ministers, 2021).

Table 1. Classification of small projects according to the decision of the Palestinian Council of Ministers

Classification	Number of employees	Annual Turnover
Micro	1-4	provided that turnover does not exceed USD 100.000
Very Small	5-9	provided that turnover does not exceed USD 200.000
Small	10-19	provided that turnover does not exceed USD 500.000
Medium	20-49	provided that turnover does not exceed USD 2.000.000
Large	+50	More than USD 2.000.00

2. Methodology

2.1 Study Design

Since the study aims to evaluate the role of Islamic banks in financing MSMEs in Palestine, the necessary sources of information are the primary and secondary sources, and the mixed research strategy between the quantitative and qualitative approach was based on the descriptive analytical method on the basis of conducting organized interviews with a sample of employees in Islamic banks specializing in the department of finance, facilities and small projects, and analysis of statistics and data sent from the Palestinian Monetary Authority. In addition to a convenient sample of MSMEs owners. Based on the foregoing, it was found that this method is the most appropriate and suitable for the nature of this study.

2.2 Study Population

Since the study is related to the evaluation of the role of Islamic banks in financing the owners of MSMEs from Islamic banks, the study population included all three Palestinian Islamic banks, namely the Arab Islamic Bank, the Palestinian Islamic Bank, and Al-Safa Bank. The researchers tried to reach the beneficiaries of MSMEs owners to assess their satisfaction with the Islamic financial services granted to them, but they were unable to do so because Islamic banks are not allowed by law to disclose customer data.Moreover, the population of the quantitative study was represented by all MSMEs owners who were clients for Islamic banks in Palestine.

2.3 Study sample

A sample of the specialized employees in the finance and facilities department (small projects) in the Palestinian Islamic banks, a total of (6) managers were recruited. In addition, to measure the MSMEs owners' satisfaction level, a sample of 115 project owners' individuals was selected through accidental sampling from different socioeconomic and academic backgrounds were recruited to participated in the quantitative part of the study.

2.4 The Study Model

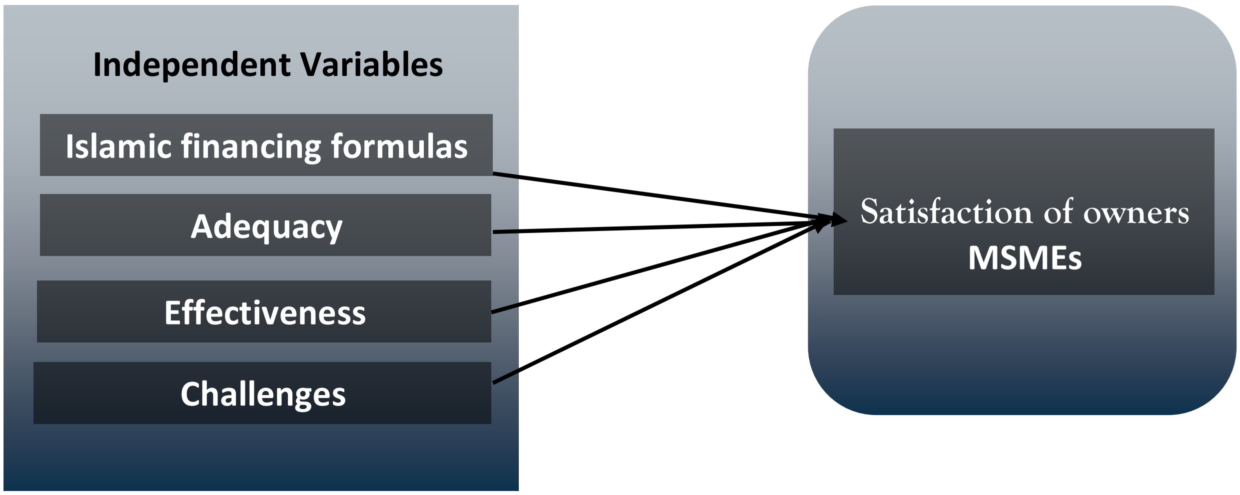

Figure (1): The study model

2.5 Study tools

Since the population and sample of the study are specialized managers in Islamic banks, the study tools also varied to include conducting interviews of (6) to answer questions related to the adequacy and effectiveness of Islamic banks and the challenges they face, and they were analysed quantitatively. In addition, the content analysis tool was used for the analyses of tables and statistics that were sent from the Palestinian Monetary Authority, in order to answer the first study question related to the diversity of financing formulas used, and questions related to the percentage of Islamic banks' contribution to microfinance. The official websites of Islamic banks were reviewed to find out the financing formulas provided. In addition the questionnaire tool was used to explore the level of MSMEs owners' satisfaction of the financing formulas provided by Islamic banks in Palestine,

Description of the study tools

1. Interview: The initial interview protocol was formulated based on previous research and studies, and each interview lasted for an average of an hour. Written notes were taken during the interview in order to support the research with the views of Islamic banks. The interview included (7) closed statements related to the effectiveness domain, and (10)) closed statements and two open questions related to the competency domain, while (7) closed statements and an open question were allocated to the challenges domains. The statements of the closed interviews were gradually categorized as follows: (a very low degree

(1)/ low (2)/ medium (3)/ high (4)/ very high (5)). The scoring key was adopted to classify the answers as in Table (2)

Table 2. Scoring key of the interview responses

Percentage	Degree
Less than 50%	Very low
50% - 59%	Low
60% - 75%	Medium
76% - 89%	High
90% or more	Very high

2. Questionnaire: The study adopted a valid and reliable version of a researcher-developed questionnaire that consisted of 11 items. Each statement in the questionnaire had four choices (To a high degree = 5, high degree = 4, moderate degree = 3, Low degree = 2, very low degree = 1). The scoring of the participants' responses is illustrated in table (3). The reliability of the study questionnaire was calculated using Cronbach's Alpha coefficient (0.90).

Table 3. Scoring key of the participants' responses on the questionnaire items

Degree	Range	Percentage
Weak – very low degree	1 – 1.80	Less than 50%
Accepted – low degree	1.81 – 2.61	50% - 59%
Good – moderate degree	2.62 – 3.42	60% - 75%
Very good – high degree	3.43 – 4.23	76% - 89%
Excellent – very high degree	4.24 – 5	90% or higher

3. **Findings and Discussion**

3.1 Results related to the first question: "What is the extent of the variety of Islamic financing formulas offered to finance micro, small, and medium enterprises (MSMEs)?"

The results presented in Table (4) show the extent of the diversity of Islamic financing methods and formulas provided by Islamic banks to customers. The most prominent of these formulas was Murabaha. The highest percentage was recorded (87.56%) among other forms, and it is the sum of my values (75.96%) Murabaha + (11.60%). Tawarruq, given that Tawarruq is implemented in Islamic banks through the Murabaha formula, and considering the use of Murabaha (87.56%), it is concluded that the diversity in financing formulas exists, but to a low degree, and what confirms this conclusion that the other ratios are very low, especially the participation rate (0.00 %), and this confirms the acceptance of the first hypothesis, which states that "the forms of Islamic financing provided to finance small, micro, and medium projects varied to a low degree in Palestine." Table (3) shows the formulas and percentage.

Table 4. Total Islamic Banks Financing by Nature

Statement	Total	Relative significance
Murabaha for the purchase order	1,554,235,208	75.96%
Istisna'	63,948,083	3.13%
Overdraft with current and on-demand accounts	6,354,488	0.31%
Mudaraba	23,407,603	1.14%
good loan	25,349,143	1.24%
Lease-to-own	135,413,475	6.62%
Tawarruq	237,341,774	11.60%
participation	0	0.00%
Total	2,046,049,774	100.00%

Source: Palestinian Monetary Authority, recent data on 09/14/2021

3.2 Results related to the second question: "How effective are the Islamic financing formulas provided for financing micro, small, and medium enterprises (MSMEs)?"?

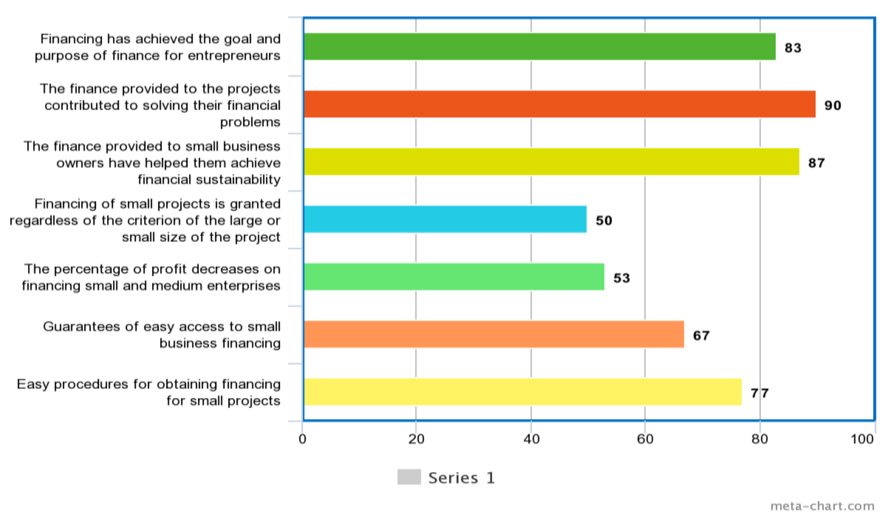

Figure 1. Participants' responses related to the effectiveness of the Islamic financing formulas provided for MSMEs owners

To answer the second study question,

The researchers adopted seven closed-ended statements for evaluation by the respondents with the possibility of giving notes and reasons in addition to examples to support the answer. Accordingly, the answers to seven statements show that the effectiveness of Islamic banks in financing projects was at a moderate degree, with a mean score of (72.4%). This means accepting the hypothesis that the Islamic financing formulas provided by Islamic banks in financing MSMEs are effective to a moderate degree.

The results shown in Figure (1) that the statement stating that "the financing provided to the owners of small projects contributed to solving the financial problems of the projects" achieved the highest degree at a rate of 90%. This is due to the fact that the main objective of the financing is to provide a solution for the development or revitalization of projects, and this role emerged clearly during the COVID-19 pandemic. The statement stating that "Finance for small projects is granted regardless of the criterion of the large or small size of the projects." At the lowest degree, at a rate of 50%, this is due to the failure to deal with small projects as large projects, as funds are given according to the size of the activity practiced. As for the procedures for projects to obtain financing, Islamic banks commented that the procedures are somewhat clear and easy, as there is a conviction that economic development depends on the development of the project sector, and it is unavoidable to say that the problem lies with the owners of the projects themselves, as a result of their inefficiency and lack of information provided. This constitutes an obstacle to their access to financing. In the context of the topic, it is necessary to refer to the issue of guarantees. Guarantees were emphasized that they are unified for all and there are no guarantees for project owners from others, but of course they are a series and commensurate with the volume of activity carried out by the project owner, and it is noteworthy to mention that there are some cases with small-scale funding, which does not require guarantees. In line with that, there is a high degree of flexibility regarding the issue of guarantees for project owners. Islamic banks unanimously said that the rate of profit from projects ranges from moderate to high, and this is due to the nature of MSMEs fraught with high risks, which leads to an increase in the rate of return.

In general, Islamic banks have contributed to achieving sustainability for MSMEs, due to the effective role they play, and we cannot fail to note the effective role of Islamic banks during the period of the Corona pandemic, which was positively reflected on the sustainability of projects and their failure to stumble. It must be emphasized that Islamic banks achieve the goal and purpose of small business owners to a large extent if their needs are related to goods, tools and real assets, but it is inevitable to say that the goal of many projects is to obtain cash financing and this is not commensurate with the principle of the work of Islamic banks and therefore not achieve their goal in this respect.

3.3 Results related to the third question: What are the adequacy of the policies and procedures of Islamic banks towards micro, small, and medium enterprises (MSMEs)?

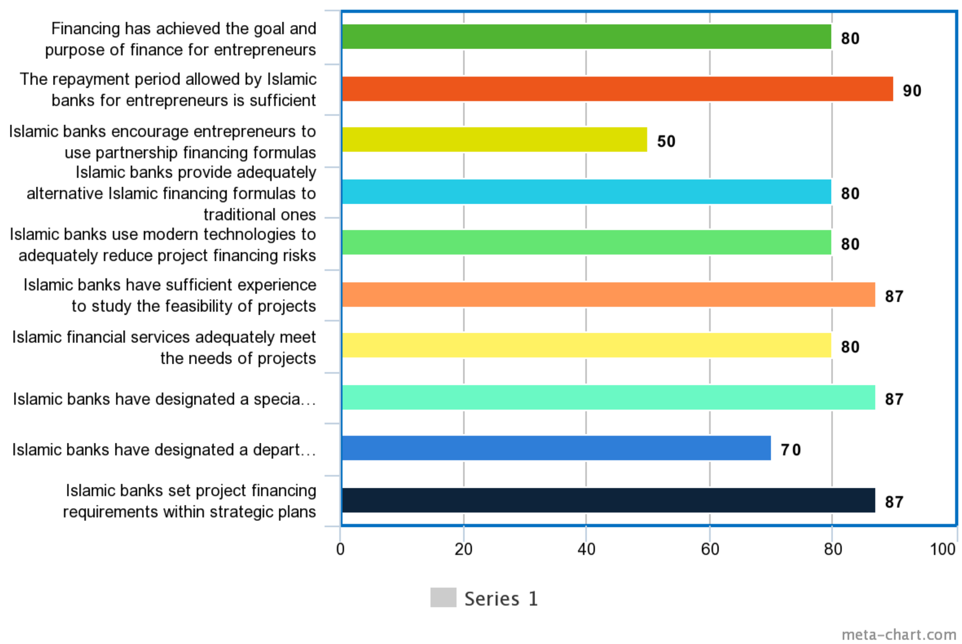

Figure (2).

Participants' responses regarding the adequacy of the policies and procedures of Islamic banks towards MSMEs

To answer the third study question:

The researchers adopted 10 closed-ended statements for evaluation by the respondents with the possibility of giving notes and reasons in addition to examples to support the answer. The adequacy of the policies and procedures of Islamic banks towards projects is high, as the mean score reached (79%). This means accepting the hypothesis which states that the policies and procedures of Islamic banks in financing MSMEs are highly adequate.

As shown in Figure (2), the statement stating that "the repayment period allowed by Islamic banks for project owners is sufficient" obtained the highest degree at a rate of 90%. The reason is that the repayment period is given within the project's operational need, it is sufficient, and this is due to the Islamic banks' view of the project life cycle and the determination of the time related to the nature of the activity, as the activities of industrial projects differ from commercial ones, and thus determining the grace period is based on the study, visit and nature of the activity.

And the statement stating that "Islamic banks encourage project owners to use participation financing formulas" got the lowest degree at a rate of 50%, and the lack of encouragement is due to the following reasons: Islamic banks do not have the capabilities to implement participations with clients in their projects, and the difficulty of providing a full staff to be with projects, in addition to their high risks.

As for the existence of specialized departments for financing project owners, it was found that this department exists in one of the Islamic banks, while in other banks there is no specialized department for project owners, but there are competent employees who have experience in this field and are ready to provide advice and guidance.

Islamic banks reported that 90% of the financing needs are covered by the Murabaha formula, because it is the easiest for both parties and the least dangerous. Although there are no people specialized in conducting a feasibility study for owners of small projects, feasibility studies are conducted when needed, and project owners must complete feasibility studies or by resorting to specialized centers. In the field of using modern technologies and developments, Islamic banks keep pace with financial technology constantly, but the problem lies in the failure of project owners to keep pace with these technologies. Islamic banks offer many solutions in case of default, so that resorting to the courts and the judiciary is the last solution.

As for the open question related to the sufficiency domain, which states, "Are the policies of Islamic banks sufficient to support the enterprise sector?" The answers to this item varied, as some emphasized that the formulas are sufficient and varied and cover all the needs of project owners, while the other part of them opposed that the policies are insufficient as required, as there are some formulas that are not implemented.

Regarding the answer to the second open question, which states: "What are the proposals or recommendations that enhance the level of adequacy of Islamic banking policies to finance the project sector?", It was commented on the need to reduce guarantees, and there must be a willingness to work in full Islamic financing formulas, appointing employees with experience in dealing with financing forms other than Murabaha, and the need to spread awareness about Islamic financing to attract project owners, in addition to the need for institutions to support projects.

It is clear from Table (3) that other financing formulas such as mudaraba, Istisna, lease-to-own and participation, which are more important to the needs of small business owners, are less used than. Therefore, it can be concluded that relying on the financing formula currently used, which is Murabaha, is not sufficient to meet the requirements and needs of owners of MSMEs.

3.4 Results related to the fourth study question: What is the extent of the contribution of Islamic banks in financing small, micro and medium enterprises out of the total financing in the Palestinian banking system?

Table 5. The share of MSMEs provided by Islamic banks in the total financing of the Palestinian banking system

Statement	Total Amount (USD)	The relative importance of financing both conventional and Islamic banks
MSMEs	258,033,353	2.59%

Source: Palestinian Monetary Authority, recent data on 09/14/2021

Table (5) shows that the share of MSMEs provided by Islamic banks in the total financing of the Palestinian banking system (conventional and Islamic) is equal to (2.59%), which is very low. However, if we look at Table (6) in a different insight, we find that the share of MSMEs in the total financing in the Palestinian banking system as a whole is (13.61%), which is very low in view of the foregoing that the activity of MSMEs constitutes what It accounts for 95% of the Palestinian economy (PMA, 2020). Also, if we look at the share of Islamic banks in the net assets of the Palestinian banking sector until the end of 2020, it is equivalent to 18% (Palestine Banks Association, 2021), we may conclude that the contribution of Islamic banks in financing MSMEs from the total financing in the Palestinian banking system is acceptable. In light of its share of net assets, this conclusion is reinforced by the analysis of the fifth study question.

Table 6. The share of MSMEs in the total financing in the Palestinian banking system

Statement	Total Amount (USD)	The relative importance of financing both conventional and Islamic banks
MSMEs	1,355,917,273	**13.61%**

Source: Palestinian Monetary Authority, recent data on 09/14/2021

3.5 The results related to the fifth study question: What is the extent of the contribution of Islamic banks in financing micro, small, and medium enterprises (MSMEs) out of the total other finances in Islamic banks

Table 7. The share of MSMEs provided by Islamic banks in the total financing of Islamic banks themselves

Statement	Total Amount (USD)	The relative importance of financing both conventional and Islamic banks
MSMEs	258,033,353	12.61%

Source: Palestinian Monetary Authority, recent data on 09/14/2021

Table (7) shows that the share of MSMEs provided by Islamic banks in the total financing of Islamic banks themselves is (12.61%), which may be an acceptable percentage in the context of the share of MSMEs provided by conventional and Islamic banks in the banking system as a whole. However, in a different insight, it can be said that it is not acceptable, given the foregoing that the activity of MSMEs constitutes 95% of the Palestinian economy (PMA, 2020). That is, the need for small businesses to finance is an urgent need, and Islamic financing formulas such as participation, mudaraba, Istisna' and lease-to-own are more appropriate than traditional financing formulas based on interest-only lending, and we may explore the reasons in the challenges domain and answer the sixth and final question of the study.

3.6 Results related to the sixth study question: What are the challenges facing Islamic banks in financing micro, small, and medium enterprises (MSMEs)?

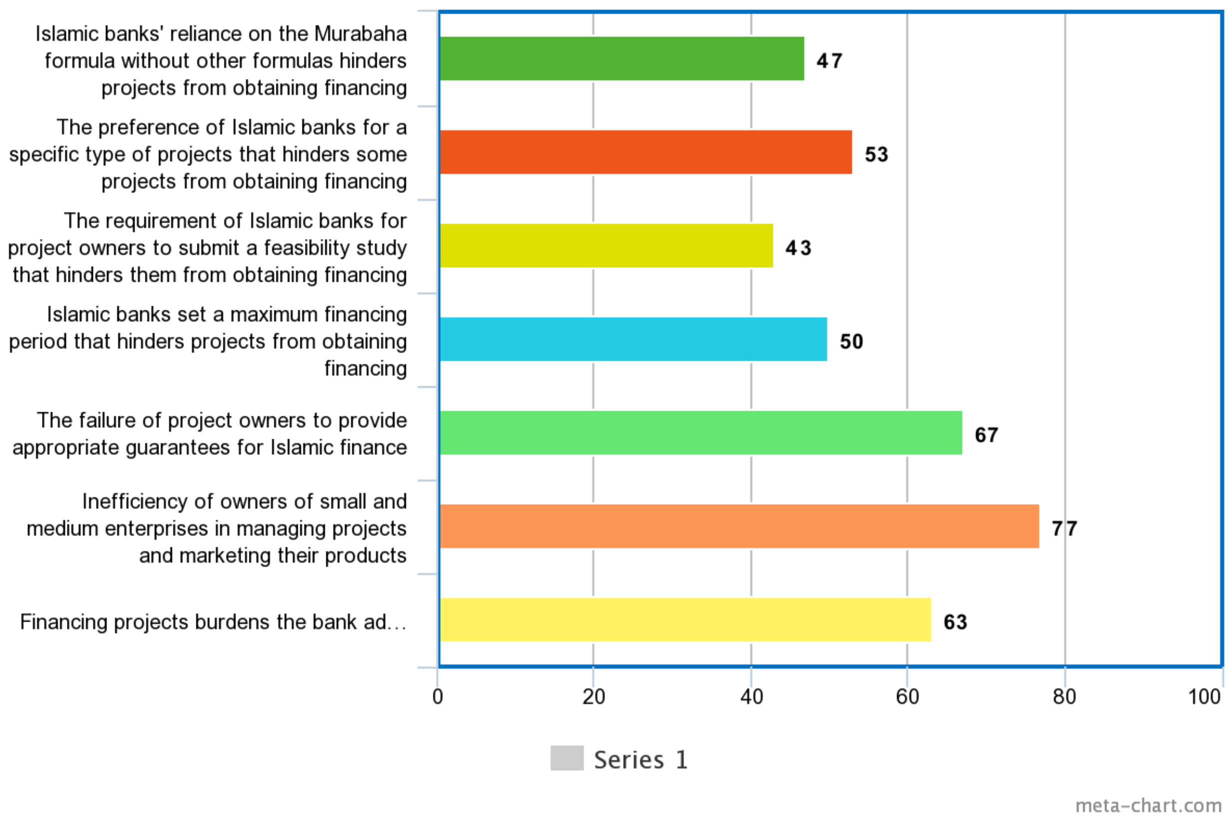

Figure 3. The participants' responses related to the challenges facing Islamic banks in financing

It is clear from Figure (3) that the average challenges that were supported by their presence in Islamic banks in providing financing to project owners at a rate of (57.14%), i.e. a low degree. The results also showed that the challenge "the inefficiency of owners of small and medium enterprises in managing projects and marketing their products" achieved the highest percentage (77%). This, the accepting the hypothesis stating that the most important challenge facing Islamic banks in financing small projects is the inefficiency of project owners in managing their projects. The second challenge, "Project owners' failure to provide appropriate guarantees for Islamic finance" came in second rank, with a percentage of (67%). In conclusion, this first and second challenges are of the most important challenges facing Islamic banks in financing MSMEs. It is a fundamental problem due to the lack of knowledge and experience of project owners in preparing plans and feasibility studies, project management and market and operational risks due to the recentness of their experience and based on personal diligence and the meager capital available with project owners

3.7 Results related to the seventh study question: How satisfied are the owners of micro, small and medium enterprises (MSMEs) who benefit from Islamic financing formulas?

To answer this question, the researchers calculated the percentages, means, and standard deviations for the satisfaction of entrepreneurs at all levels, as follows:

Table 8. Means and standard deviations of the satisfaction of entrepreneurs at all levels

Rank	Statement	M	SD	%	Level
4	I felt the desire and interest of Islamic banks to MSMEs	3.87	.96	77.4%	High
9	I feel that the Islamic financing I received helped me sustain my project	3.86	.83	77.2%	High
2	There is satisfaction with the methods of Islamic banks dealing with owners of MSMEs	3.86	.86	77.2%	High
11	I feel that the funding I received helped me get through the financial problems that were in the project	3.7	.93	74%	Moderate
10	I feel that Islamic banks have given me a unique opportunity to build my own project	3.66	.96	73.2%	Moderate
1	There is satisfaction with the diversity of Islamic financing formulas to suit MSMEs	3.66	.69	73.2%	Moderate
3	There is satisfaction with the installment payment period to match the cash flow of MSMEs	3.55	.87	71%	Moderate
8	There is satisfaction with the grace period allowed before starting to pay the financing installments.	3.52	.95	70.4%	Moderate
7	There is satisfaction with the time period for obtaining financing for the project.	3.35	1.02	67%	Moderate
5	There is satisfaction with the guarantees required from project owners with limited income to complete the financing process	3.33	1.00	66.6%	Moderate
6	There is satisfaction towards the advice provided by Islamic banks for MSMEs upon request	3.11	1.06	62.2%	Moderate
Satisfaction domain for project owners at all levels (total for all Islamic banks)		**3.59**	**.92**	**71.7**	**Moderate**
Satisfaction domain of Entrepreneurs (Palestine Islamic Bank)		**3.72**	**.71**	**74.4%**	**Moderate**
Entrepreneurs Satisfaction Domain (Arab Islamic Bank)		**3.3**	**1.05**	**66%**	**Moderate**
Entrepreneurs' Satisfaction Domain (Al-Safa Bank)		**3.7**	**.82**	**74%**	**Moderate**

It is obvious from the results presented in table (8) that the statement (I felt the desire and interest of Islamic banks to finance MSMEs) had the highest mean score (3.87), while the statement (there is satisfaction towards Consultations provided by Islamic banks to MEMEs upon request) got the lowest mean score (3.11). Hence, it could be explained that the domain of MSMEs owners' satisfaction at all levels, where the general men score of the respondents' responses was (3.59), which is a moderate degree, which means the acceptance of the seventh study hypothesis stating that the level of satisfaction of owners of micro, small, and medium enterprises (MSMEs) with Islamic finance is moderate.

4. Conclusion and Recommendations

The results of the study showed that the diversity of Islamic financing formulas provided to owners of MSMEs is very low, as the percentage of financing provided, such as participation, Mudaraba, leasing-to-own and Istisna', is equivalent to (12.34%) and the greatest reliance on the Murabaha formula is (87.56%). According to the tables and financial data, the participation rate alone was (0.00%), and the lowest statement of 50% showed that Islamic banks encourage project owners to use participation financing formulas to a very low degree, which negatively affects project owners who look forward to the participation of Islamic banks and mitigating guarantees for them more than offering them Murabaha financings that lead to proof of indebtedness need high guarantees. This is consistent with the findings of the study (Santoso, 2019) that it is difficult to obtain financing from Islamic banks due to weak guarantees owned by project owners, and that the role of Islamic financing is still weak.

The results showed that the effectiveness of the finances provided to entrepreneurs in Palestine to a medium degreeaccording to theMSMEs owners and by service providers, that is, it contributed to solving their financial problems and achieving sustainability for them, but to a medium not high degree. The results also showed that the policies and procedures of Islamic banks in financing MSMEs are sufficient, but to a moderate degree, according to theMSMEs owners and open answers reported by service providers. What reinforces its insufficiency is the percentage of Islamic banks' contribution to these financings, as the results showed that the contribution of Islamic banks in financing MSMEs out of the total financing in the Palestinian banking system came at a rate of (2.59%), which is a low degree, but if we look at the share of MSMEs out of the total financing in the Palestinian banking system as a whole, we find it (13.61%), which is very little in view of the foregoing that the activity of MSMEs constitutes 95% of the Palestinian economy (PMA, 2020). But if we consider the share of Islamic banks in the net assets of the Palestinian banking sector until the end of 2020, it is equivalent to 18% (Palestine Banks Association, 2021), meaning that the percentage of Islamic banks' contribution to financing MSMEs must equal their share in the banking market, and it turns out that the ratio It is equivalent to (0.19%) of the total ratio (13.61%), which is consistent with the share of Islamic banks in the net assets of the banking system as a whole.

We may conclude that the contribution of Islamic banks in financing MSMEs from the total financing in the Palestinian banking system is acceptable in light of their share of net assets, but it is not acceptable in relation to their focus on the Murabaha formula first and then what MSMEs constitute in the Palestinian economy (95%).

The previous conclusion reinforces what the results of the study showed that the share of MSMEs provided by Islamic banks in the total financing of the Islamic banks themselves is (12.61%), which is an insufficient proportion given the foregoing that MSMEs constitute (95%) of the

Palestinian economy, and it needs a larger proportion of financing. This is consistent with the study (Al-Manan, 2017) that the financing provided by financial institutions and commercial and specialized banks for small projects is very small when compared to the financing provided to other sectors, which affects the continuity of these projects. The results of the study also revealed an explanation of the challenges and obstacles facing the financing of MSMEs in Palestine, as it was found that the first obstacle is "the inefficiency of owners of small and medium enterprises in managing projects and marketing their products," where it was at a rate of (77%), and the second obstacle was "The failure of project owners to provide appropriate guarantees for Islamic finance", with a percentage of (67%). This is consistent with the results of the study (Thaker, et al., 2020) that the financier is reluctant to provide financing to owners of MSMEs, for the following reasons: the lack of business experience for entrepreneurs, lack of additional guarantee, high transaction costs, small size of loans, poor credit and others.

Accordingly, the study recommended Islamic banks to diversify the finances provided to project owners and to strengthen the participation formula between Islamic banks and project owners in order to reduce the obstacles of the guarantees mentioned in the results, and in return not to be limited to Murabaha to reduce the guarantees required of customers as well. The study recommended Islamic banks to raise the effectiveness of the finances provided to project owners so that their goal is achieved, which is to overcome financial problems, help in operation and expansion of operations, and achieve financial sustainability for projects. In addition, the study recommended reducing the project size criterion in making credit decisions, and reducing the profit rate for small finance more than the profit rate for large projects to create financing opportunities and an incentive system for owners of small projects.

Moreover, the study recommended Islamic banks to follow adequate financing policies and procedures for small business owners, such as allocating specialized departments to finance small business owners, raising the awareness of project owners on all Islamic financial products and services, providing advice in the field of economic feasibility, how to manage risks, and providing the necessary assistance to project owners when they fail to repay. The study also recommended Islamic banks to raise the percentage of their contribution to financing MSMEs because small projects constitute 95% of the Palestinian economy. Further, the study recommended working to reduce the financing challenges and obstacles for owners of MSMEs, especially the inefficiency of project owners in managing their projects, and the failure of project owners to provide appropriate guarantees for Islamic financing, as the study recommended that Islamic banks establish specialized departments for owners of MSMEs and provide the necessary advice in the field of preparing feasibility studies and how to manage risks and failures, raise the awareness of project owners about other financing tools such as participation and Mudaraba, so that the provision of guarantees is reduced and access to appropriate financing for projects is facilitated. Finally, it is recommended that the Islamic banks perform customer satisfaction surveys, targeting all the categories, especially MSMEs owners in order to achieve the highest satisfaction level of MSMEs owners in Palestine.

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