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Sharia venture capital as financing alternative of Muslim entrepreneurs:

Opportunities, challenges and future research directions

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# *Sharia* venture capital as financing alternative of Muslim entrepreneurs

## Opportunities, challenges and future research directions

*Sharia* venture  
capital

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### Abstract

**Purpose** – Muslim entrepreneurs face various obstacles when starting their business, especially in gaining access to financing. Some financing practices have some *Sharia* violations, so this paper tries to explore the opportunities and challenges of one financing alternative for Muslim entrepreneurship development in Indonesia that fully complies with *Sharia* principles. This paper aims to further understand the concept of venture capital and how it relates to Islamic teachings, and the paper ends with the suggestion for future research direction.

**Design/methodology/approach** – This study uses qualitative methods with descriptive and exploratory analysis. A case study approach using semi-structured in-depth interviews with several key informants were conducted to identify the opportunities and challenges for Muslim entrepreneurs in gaining access to Islamic financing. Various literary syntheses are also provided to better understand alternative financing for business development of Muslim entrepreneurs.

**Findings** – Muslim entrepreneurship, depending on their goals and needs in obtaining financing, uses different models in the process of agreements with capital-funding institutions based on *Sharia* principles. *Sharia* venture capital is one alternative financing that gives freedom for Muslim entrepreneurs to develop their business based on the Islamic system, without thinking about the requirements that must be met in obtaining access to the financing. However, it seems that this scheme still has relatively low interest, especially from Muslim entrepreneurs because they do not know the information and procedures of *Sharia* venture capital.

**Practical implications** – Some policy implications include increasing capital from *Sharia* venture capital institutions, the role of the government in providing adequate policy support and incentives and broader socialization and education about the existence and importance of developing *Sharia* venture capital. Practical implications include useful information for Muslim entrepreneurs to address financing issues in their entrepreneurial activities and suggest insights for future research.

**Originality/value** – This study provides the link of financial access for Muslim entrepreneurs to *Sharia* venture capital as a new financing business innovation. Thus, it contributes to the literature on *Sharia* venture capital and Muslim entrepreneurship. The authors also propose some useful recommendations for further research in this field.

**Keywords** Business value, Business development, Muslim entrepreneurs, Financing alternative, *Sharia* venture capital

**Paper type** Research paper



## 1. Introduction

Entrepreneurship has been widely recognized as the acceleration of economic development (Hisrich *et al.*, 2012; Ramadani *et al.*, 2014, 2013). This may have contributed to the development through job creation, income and welfare improvement and linking local economies to the global arena (Henderson, 2002). Even though science and technology, investments and natural resources are factors that have influenced economic development, religion has also been considered an important element in shaping the ethics of community work (Anggadwita *et al.*, 2017). Islam is one of the religions that encourage involvement in business activities as part of worship and obedience to Allah, using Islamic principles that include fair trade and entrepreneurial culture. This implies that Muslim entrepreneurs who are performing their business operations in accordance with Allah's command will gain a reward in their afterlife. The main principle of Islam is justice and honesty.

Indonesia consists of various cultures, regional languages, races, ethnicities, religions and beliefs. The Indonesian society holds strong religious values so that religion cannot be separated in community life, including in economic activity (Dana, 2014). Islam is the religion of the majority of the Indonesian people. Based on the data from the Central Bureau of Statistics, Indonesia (2010), Muslim population of Indonesia amounts to 87.2 per cent of the total population. Islam is a religion that also encourages entrepreneurial activity (Audretsch *et al.*, 2013). Currently, there are no exact data regarding the number of Muslim entrepreneurs in Indonesia. According to Vice President Jusuf Kalla, there is an imbalance between the numbers of Muslim entrepreneurs compared to the Indonesian population (Republika, 2018). Based on the data from the MUI in 2015, the number of Muslim entrepreneurs in Indonesia is only 1 per cent, and the fact that among the 50 richest people in Indonesia is only eight people who are Muslim (MUI DKI Jakarta, 2015). In addition, information related to Muslim entrepreneurial activities was also obtained from the website of the Indonesian Muslim Entrepreneurs Community where registered members numbered more than 32,000 entrepreneurs (<https://kpmi.or.id/>). This shows that the enthusiasm and intention of Muslims to build entrepreneurial participation was still relatively low.

The community is a forum for sharing information and knowledge, discussing various problems and opportunities for welfare, including the entrepreneurial community (Bacq and Janssen, 2011). Communities can mobilize their members to actively engage them in business development, introduce resources and financing alternatives, so they tend to influence community members (Vestrum, 2016). Muslim entrepreneurs in Indonesia face various problems, one of which is related to financing for business development in accordance with Islamic principles. Various communities, including the Muslim entrepreneur community, can be a means of overcoming the problems of its members, including those related to financing alternatives that are in accordance with religious law.

Financial institutions in Indonesia consist of banks and non-banks. In the past two decades, the development of Islamic financial institutions has shown an encouraging trend. Islamic banking is growing rapidly to bring the Islamic financial system in harmony with the principles of *Sharia* to realize greater justice as a solution needed by the society. One of the conditions that must be fulfilled in the Islamic financial system is that investors should be willing to share the risks so that not all risks are imposed by the entrepreneur. *Sharia* is a set of laws and principles that make the Islamic legal system and generally refer to the totality of Islamic way of life. In the context of Islamic finance, it recognizes the conventional principle of profit maximization, but at the same time, establishes the limits governing this principle by ensuring benefits to the wider society. The basic principles of Islamic finance are asset-based financing, a partnership in which the share of profit and loss (SPL) (Imad-ad-Dean Ahmad, 2013).

Venture capital is one form of non-bank financial institution, which is one of the financing alternatives that offer more effective and efficient incentives in the business development of Muslim entrepreneurs. Venture capital is directed at helping individual businesses who are experiencing capital difficulties in potential investment activities. Venture capital has two main dimensions consisting of business dimension and social dimension. The venture capital business dimension aims to provide financial benefits for Venture Capital Company. Meanwhile, venture capital with social dimension is also directed to help small businesses that are experiencing capital difficulties in their business activities and growth process of their business scale (Gompers and Lerner, 2004).

Venture capital companies in Indonesia are increasingly showing an important role in the development and investment of start-up companies. This is supported by the increasing attention and support of various parties toward startup and the digital economy. However, this condition is inseparable from the low amount of funding, limited long-term funding sources, limited human resources who have knowledge in the field of venture capital and lack of attention from stakeholders in encouraging the development of venture capital companies in Indonesia. Thus, business actors interested in venture capital in Indonesia are also still relatively limited. However, *Sharia* venture capital as an alternative financing institution for Muslim entrepreneurs through a community approach can develop and mobilize its members to be able to take advantage of *sharia*-based financing opportunities. Entrepreneurial behavior from some community entrepreneurs can be radical, introducing resources and encouragement from the external environment to change local culture, norms and resources (Vestrum, 2016). This behavior may be related to external networks and entrepreneurs' knowledge of the external environment.

Some financing systems have an impact on religious laws, so it becomes a consideration for customers, especially Muslim entrepreneurs, in choosing the type of financing. This leads to multi-criteria decisions, as several factors must be considered. This study discusses Muslim entrepreneurship in Indonesia and analyzes the factors that might be the opportunities and challenges to the growth of Muslim-owned businesses, especially in gaining access to Islamic-based financing. However, previous studies on Muslim entrepreneurship have been very limited, particularly related to alternative financing in accordance with religious principles. Thus, this study will act as a part of Islamic literature focusing on *Sharia* venture capital. In addition, this paper aims to further understand the concept of venture capital and how it relates to Islamic teachings so as to raise awareness for investors and entrepreneurs about *Sharia* venture capital investment.

## 2. Literature review

### 2.1 Muslim entrepreneurship

Entrepreneurship in an Islamic perspective is one of many aspects of life discussed in the Quran. Allah SWT has stated in the Quran:

And We have certainly established you upon the earth and made for you therein ways of livelihood. Little are you grateful (Al-A'raf: 10).

And out of His mercy He made for you the night and the day that you may rest therein and [by day] seek from His bounty and [that] perhaps you will be grateful (Al-Qasas: 73).

Entrepreneurship in Islamic context is a form of worship in fulfilling the balanced needs of life from the aspects of material and *ukhrawi* or afterlife (Mubarak *et al.*, 2014). Allah SWT says in the Quran:

But seek, with the (wealth) which God has bestowed on thee, the Home of Hereafter, nor forget thy portion in this world but do thou good, as God has been good to thee, and seek not (occasions for) mischief in the land: for God loves not those who do mischief (Al-Qasas: 77).

All verses are evidence or reminder for humans to work hard and seek benefit from all sources provided by Allah SWT in this world. Entrepreneurship is one of the recommended economic activities based on these three verses, so the practice of entrepreneurship is a form of “worship” (religious ritual) to Allah SWT if conducted in accordance with the teachings of Islam (Yaacob and Azmi, 2012).

A Muslim entrepreneur is seen as an individual who has a responsibility in fulfilling the needs of society to get benefit in the world and the hereafter. The concept of Muslim entrepreneurship stresses the integration of the spiritual elements with worldly life because Islam is ideally functioning in every aspect of life (Hamid and Sa’ari, 2011) in fulfilling the duty as the *khalifa* (leader) in the world. A Muslim entrepreneur has a personality that influences his/her actions and the way he/she interacts with issues based on Islamic values (Kamsah and Zakaria, 2008). Islamic values such as “*amar ma’ruf nahi mungkar*” in a Muslim entrepreneur will enable him/her to be very detailed and disciplined in doing his/her job, capable of clearly making business planning, working hard, willing to take risks, generate a sustainable business and be ready for any given responsibility (Yaacob and Azmi, 2012). In the Islamic context, a Muslim’s entrepreneur activities should be focused primarily on worshipping Allah SWT, which includes doing business consistent with moral and ethical standards of Islamic practices, fulfilling one’s religious duties and contributing to the overall goal of Islam to give benefit to the communities. Religion and economic activity are inseparable, and as a result, the set of economic behavior is guided not only by secular, legal and ethical guidelines, but also by religious guidelines. The religious aspect of Islamic entrepreneurship implies that success is measured not only by personal financial success, but also by how well the religious objectives are achieved, which can reward entrepreneurs in the afterlife (Hassan and Hippler, 2014). Some previous literature shows that religious beliefs seem to contribute to sustainable economic development (Barro, 2003; Guiso *et al.*, 2003; McCleary and Barro, 2006). Meanwhile, based on the study of Galbraith and Galbraith (2007), it shows that “intrinsic” religiosity is positively related to entrepreneurial activity, which then impacts on economic growth.

Muslim entrepreneurs have various motivations to do business, including the motivation in getting financing for the development of their business. Based on the literature, Muslim entrepreneurs have a passion not only from a materialistic perspective, but also on a spiritual aspect (Salleh, 1999). The concept of motivation in the view of Islam as a will triggered by the will of God (Khaliq, 2011), inspired by the strength or belief in the help of Allah SWT in every aspect of life, including entrepreneurship. According to Anggadwita *et al.* (2017), the motivation of Muslim entrepreneurs is in doing entrepreneurial activities, such as blessing, worship, personal ambition and profit. Meanwhile, according to Mubarak *et al.* (2014), the motivation of a Muslim entrepreneur is the belief of God’s greatness that good fortune comes from God and keeps relationship with God. Another study was conducted by Masruki *et al.* (2012) that the motivation of Muslim entrepreneurs is passion and interest, money consideration and improving living conditions, independence and freedom.

A Muslim entrepreneur has a responsibility to ensure that business is in compliance with Islamic beliefs as presented in the Quran and *Sharia* law. In Islam, economic transactions are only valuable and permissible if they involve or facilitate the transfer of goods and services that actually meet the needs of communities. *Sharia* laws and practices prohibit Muslims from engaging in practices that involve a large amount of risk, uncertainty and speculation. Consequently, Islamic religious beliefs make them reject economic activities that involve excessive uncertainty and avoid trading of risk assets, such as commodity speculation or other forms (Hassan and Hippler III, 2014). Similarly, in the financing process,

Muslim entrepreneurs must be able to follow the rules set by Islamic principles, where *riba* is prohibited in religion. Osman and Ali (2008) found that Muslim entrepreneurs' understanding of financing was good enough so that the majority of entrepreneurs chose Islamic financing because it was based on Islamic principles. Meanwhile, Savaşan *et al.* (2013) found that conservative entrepreneurs in Turkey had little knowledge and awareness about Islamic finance (Islamic trade law). This is because there is no effective *Sharia* supervision process in the Islamic finance sector and lack of knowledge about *Sharia* in society. Muslim entrepreneurs are aware of Islamic banks, but their use rates are low, because they consider efficiency, lower bank costs, availability of automated teller machines and extensive branch networks as important factors when choosing banks, rather than motivation for religious adherence (Saini *et al.*, 2011). Meanwhile, Aida and Imen (2014) found that the decision to cooperate with Islamic banks was based on costs and religious beliefs. Based on the previous studies, it can be concluded that knowledge of the principles of Islamic finance is an important factor that supports the use of Islamic products.

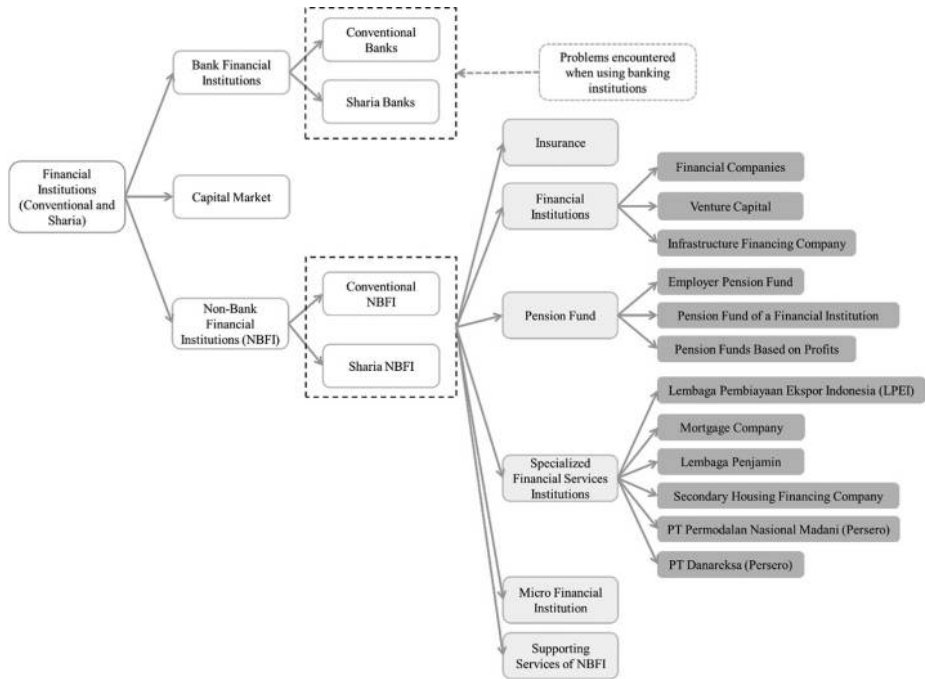
### 2.2 The types of Sharia-based financing alternatives

Entrepreneurs are often faced with the problem of getting financing in the development of their business. This study presents various alternatives financing in accordance with the existing laws and regulations in Indonesia. Based on the data from the Financial Services Authority of Indonesia (OJK, 2018), financial institutions in Indonesia consist of bank financial institutions, capital markets, and non-bank financial institutions. Figure 1 below shows the scheme of various financing alternatives.

Figure 1 shows a variety of alternative financing that can be used by entrepreneurs in Indonesia. Focusing on NBFi as an alternative financing institution that can provide business capital loan, as the banking financial institution is considered difficult in meeting the requirements needed, especially for startups, it becomes an obstacle of entrepreneurs in accessing financing through banks. Start-up companies, in addition to having good business vision and ideas, need to have access to external funding sources to realize their business and further business development. If the business environment provides motivation for creativity, innovation and commercialization, there is a much greater chance for business success (Hisrich *et al.*, 2012). NBFi consists of several institutions, including insurance, financial, pension fund, specialized financial services, micro-financial and supporting services (OJK, 2018).

Currently, financial institutions have different systems in operation, including conventional and *Sharia* systems. The Quran and Hadith are the main sources of *Sharia*. The Islamic financial system supports the creation and distribution of wealth. Islamic finance establishes profit or loss sharing instruments as an alternative to interest-based arrangements used by conventional banking. According to Haryono (2009), financing is a contract that contains the commitment of *Sharia* financial institutions to other parties to provide funds or other equivalent instruments and commitment of the customer to return the fund plus reward (*ijarah*) or profit sharing according to agreed time. Arifin (2005) stated that portfolio financing is the largest part of *Sharia* financial institution assets as the main activities. Meanwhile, according to Kasmir (2008), financing is the provision of money based on approval or agreement between Islamic financial institutions with other parties obligating the party financed to return the money or the bills after a certain period of time plus the reward or profit sharing. One form of NBFi is venture capital where the form of cooperation can be carried out based on profit sharing and without guarantees. Small and medium business owners usually need partners who can share the benefits and risks in their business. In fact, in case of loss, they do not have to pay interest on the loan, which can





**Figure 1.**  
Financial institutions  
in Indonesia

Source: OJK (2018)

worsen their financial difficulties. Thus, venture capital can be an alternative financing for entrepreneurs.

Islamic finance has a difference with conventional financing, including a contract process that is an agreement that binds both parties where, if one or both parties bound to the contract cannot fulfil their obligations, they receive sanctions as agreed in the contract. Meanwhile, in conventional financing, usually using a system *wa'ad* which is only based on one party, that is if the promised party cannot fulfil its promise, then the sanction it receives is more of a moral sanction (Table 1).

### 2.3 Sharia venture capital

This study focusses on *Sharia* venture capital as one method of financing that becomes an alternative for Muslim entrepreneurs with the scale of micro and small enterprises. According to Dignan and McKittrick (2001), venture capital is an investment given to companies in the early stages of development to get high potential returns from the success of new companies. The financing method on *Sharia* venture capital uses a partnership system, unlike the Islamic banking system that uses exchange methods in funding activities, the use of partnership contracts is considered very limited (Yusoff and Wilson, 2005). This is due to the lack of financial institutions that can bear the high risk implicit in the contract. Venture capital has a positive impact on the performance of the investee company because they are active investors that provide not only financing, but additional services required by entrepreneurs, such as technology and commercialization processes

*Sharia* venture capital

Sharia financial institutions	Conventional financial institutions
<i>Contracts and legality</i> Sharia law: Aqad Banking law	Banking law
<i>Organizational structure</i> Sharia Supervisory Board: has a role to oversee the day-to-day operations of financial institutions to keep them in line with <i>Sharia</i> requirements The National <i>Sharia</i> Board: has a national coverage that oversees all Islamic financial institutions and the performance of the <i>Sharia</i> Supervisory Board	Supervisory Board: Bank Indonesia
<i>Operational</i> Profit and loss sharing, for savings or financing products Al Falah orientation or pleasure of Allah, pay attention to <i>halal</i> and <i>haram</i> Relationship with the customer: partnership	Interest, for deposit products and loan products (credit) Profit orientation, not clearly between <i>halal</i> and <i>haram</i> Relationship with the customer: debtor–creditor

**Table I.**  
Differences between *Sharia* and conventional financial institutions in Indonesia

(Keuschnigg, 2005). Venture capital firms often play an active role in helping new business success by providing professional support, managerial advice and referrals to potential customers, alliance partners, management talents and other investors (Fried and Hisrich, 1992; Hellmann and Puri, 2002; Hochberg *et al.*, 2007; Hsu, 2006). Venture capitalists are very familiar with the network of suppliers, customers and other businesses in the field where they invest their capital (Kaplan and Stromberg, 2001). Table II below is the difference between banking and venture capital.

The table above shows the difference between a banking system and venture capital. Although venture capital business has started since a decade ago, the total financing given to the business sector is still relatively small compared to other financial institutions. The slow growth of venture capital business in Indonesia is caused by several factors such as venture capital is a high-risk business and new financing concept so that its function and role has not been widely understood by the business community, investors and businessmen. Venture capital is highly compatible with the basic principles of Islamic finance primarily related to risk-taking and the sharing of profit and loss between business partners. Mutalip and Lutfi (2009) argue that the similarity between conventional venture

No.	Type of difference	Banking	Venture capital
1	Actors	Creditor, bank, debtor	Investors, venture capital companies, investee companies
2	Financing assistance	Loans/credit	Equity participation/financing
3	Management involvement	No	Yes, as a partner
4	Type of risk	Bad credit	Business failed
5	Profit	Credit interest	Capital gain, dividend
6	Time period	Short, medium, long	Medium and long (5-10 years or more)
7	End of contract	Paid off and terminate	Divestment

**Table II.**  
Differences between banking and venture capital

Source: [www.bahanaventura.com/profil/faq](http://www.bahanaventura.com/profil/faq)



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capital and *Sharia* venture capital is reflected in the fact that both are equity investments, risk-sharing and reward partnerships, investing in the long term and providing added value. The only difference is that conventional venture capital applies to all industries, while *Sharia* venture capital applies only in *Sharia*-compliant industries. Al-Suwailem (1998) argues that venture capital, based on equity financing, is within the framework of Islamic finance while investing in permitted and non-interest-based products. The types of financing provided by venture capital companies can be conducted in three ways in accordance with *Sharia* principles: equity participation, quasi equity participation and profit sharing. Thus, Muslim entrepreneurs who actually hold the religious principle can make *Sharia* venture capital as one of the financing alternatives in religious adherence and reduce the economic risks that arise.

*Sharia* venture capital aims to assist new business innovation by engaging in the development and establishment of the company. The methods of financing on *Sharia* venture capital include: *Mudharabah* is a transaction conducted by two parties to cooperate to gain profit. The first party as the owner of capital and the second party as the executor of business; *Musyarakah* is a cooperation transaction between the two parties where the profit sharing is based on an agreement of ratio and loss based on the capital portion; and *Murabahah* is a cooperation transaction based on the original price with additional agreed benefits (Hamid, 2015).

*Mudharabah* is a form of partnership contract that has been practiced since the time of Prophet Muhammad (saw) where the owner of the capital (called *Rab Almal*) handed over the partnership capital to the business actor (called *Mudarib*) to establish a profitable business based on the agreement between the parties to agree on a profit-sharing ratio with losses borne by the provider of capital. However, due to the lack of an appropriate legal system, among other reasons, this type of contract has been practiced minimally in recent years (Elsiefy, 2014). One aspect of compatibility is that venture capitalists are prepared to bear the risk of either a loss or a business failure and are not charged to entrepreneurs at an early stage and are granted without collateral for not returning capital or profits. Most venture capital investments provide real goods and services that have a long-term positive impact on the economy. It has a tremendous impact on companies that are supported by venture capital (especially in job creation) in contributing to the economic growth conditions of developed countries such as the USA and many European countries (Elsiefy, 2014). In addition, it enables capital providers (partners) to ensure compliance of business operations with the principles of *Sharia* financing related to, among others, the prohibition of using interest-based capital or engaging in unauthorized business activities. The convergence of venture capital and private equity with Islamic finance is an attribute of a private equity financing approach that creates the compatibility inherent with Islamic finance principles.

#### 2.4 Theoretical framework of the sharia venture capital process

Venture capital is often invested in small businesses dealing with scientific studies and the application of modern technology, where investment is characterized by high risk (Ramadani, 2014). Venture capital represents financial funds, usually in the form of equity and management know-how, invested by individuals and institutions in small and medium enterprises, which are not listed on the stock market and have high growth potential (Ramadani, 2014). However, not all businesses are attractive to invested by venture capitalists. According to many studies in various countries around the world, venture capitalists analyze 100 to 200 projects before they invest their facilities and finances and invest only in small amounts (Van Osnabrugge and Robinson, 2000).

Based on the results of roundtable at Tech in Asia in 2016, according to Raditya Pramana (Investment Manager, Venture Capital) and Dimitra Taslim (Associate, Monk's Hill Ventures), there are several criteria in getting venture capital financing. Muslim entrepreneurs should consider factors such as Smartass Team; it means the business must have a strong and intelligent team composition and be ready to face all challenges in the business. Kickass Product which means that start-up business must be able to execute disruptive product and acceptable to society. Huge-ass Market is a market that will be entered very large, and Spectrum of Craziiness defined as a crazy idea that could be the most important innovation in history (Tom MC Ifle, 2017).

The concept of entrepreneurship from an Islamic perspective is a highly recommended activity to improve people's welfare. According to Mokhlis (2009), religion is one of the most universal and significant influences on attitudes, values and behaviors on an individual or community level. Ramadanani *et al.* (2017) and Dana (2009, 2010) have underlined that religion is neutral and does not prohibit entrepreneurship, where business ethics can shape entrepreneurs to become better human beings based on morals and norms prevailing in the society. Muslim entrepreneurs are bound by Islamic law and regulation during the execution of entrepreneurial activities, so they must have the ability to run a business with good intentions, transparent and fair acts and avoid prohibited scenarios (Anggadwita *et al.*, 2015). In Islam, the characteristics of entrepreneurship are based on the principles stated in the Quran and Hadith to guide entrepreneurial operations (Oukil, 2013). Thus, the business financing process must also pay attention to the principles of Islam, where prohibited the existence of *riba* or *gharar*. Muslim entrepreneurs must have knowledge related to financing in Islamic principles; it is intended as a guide in carrying out business operations in accordance with the teachings of the religion. Ali bin Abi Thalib said, "Whoever trades but does not understand the knowledge of religion, then he will surely fall into *riba*, then he will fall into it and continue to fall". As in the words of Allah STW in the Quran:

Those who consume interest cannot stand [on the Day of Resurrection] except as one stands who is being beaten by Satan into insanity. That is because they say, "Trade is [just] like interest." But Allah has permitted trade and has forbidden interest. So, whoever has received an admonition from his Lord and desists may have what is past, and his affair rests with Allah. But whoever returns to [dealing in interest or usury] – those are the companions of the Fire; they will abide eternally therein (Al-Baqarah: 275).

Muslim entrepreneurs can apply for financing from venture capital companies by demonstrating business feasibility, including prospective business plan, smart team, products/services position in markets, huge markets and brilliant ideas. The cooperation process can begin with negotiation and equate perceptions of the vision and mission of business development, as well as the agreement of both parties. Then, the venture capital side will conduct an assessment of the business activities of prospective business partners to be financed. The process of appraisal of all aspects of a business is carried out by a venture capital account to determine whether it is feasible or not to be financed. Then, the venture capital committee decides whether a financing request is approved or not.

Contract agreement or in Islam called *aqad* is an agreement between two parties who make sale and purchase transactions in accordance with the *Sharia* principle. Jumhur Ulama defines the contract as "a connection between the consent and the *Kabul* justified by the *syara'* which creates a legal effect on the object" (Anwar, 2007). Similarly, in the process of *Sharia* venture capital agreement, *aqad* is one of the requirements that must be met in conducting transactions in accordance with Islamic *Sharia*. This is emphasized in the words of Allah SWT:

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O you who have believed, fulfill [all] contracts. Lawful for you are the animals of grazing livestock except for that which is recited to you [in this Qur'an] – hunting not being permitted while you are in the state of ihram. Indeed, Allah ordains what He intends (Al-Maidah: 1).

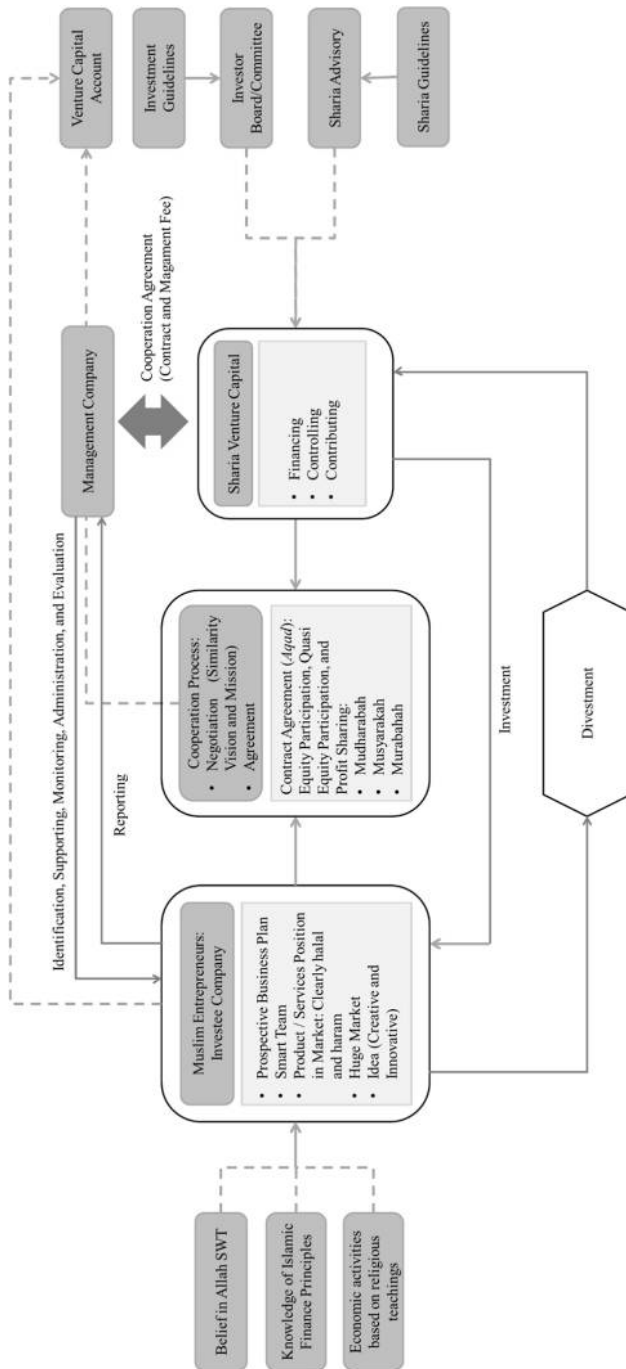
Based on the literature review that contract agreement which can be conducted based on *Sharia* principle consists of: Mudharabah, Musyarakah and Murabahah. In the operation of *Sharia* venture capital, *Sharia* Advisory must be in charge of overseeing the operational process in line with the *Sharia* principles. Investment committee is a capital owner who wants a high profit from its capital. The capital of some of these investors is collected in one place called venture capital funds (Hamid, 2015). In addition, the management process can be done by *Sharia* venture capitalist or professionals who have expertise in managing investment and looking for potent investment types. This professional can take the form of an institution called a management venture capital company (Hamid, 2015), usually an expert in the business field undertaken by an investee, consultant hired and assist investment company (Jalil, 2005) (Figure 2).

### 3. Methodology

This research is based on an entrepreneurship-driven phenomenon to support entrepreneurs in overcoming financing problems in developing their business holistically. Capital is one of the biggest obstacles for entrepreneurs in developing their business. *Sharia* venture capital is one of the financing alternatives as a solution for entrepreneurs in developing their businesses, especially for Muslim entrepreneurs who prioritize the principles of financing in accordance with the Islamic religious law. A holistic research approach is used to understand the phenomenon of the relationship complexity between all factors and actors (Damanpour, 1991; Greenhalgh *et al.*, 2004; Fagerberg, 2006).

#### 3.1 Data collection

This study uses qualitative research methods with descriptive and explorative approaches, where the approach is not just a data collection technique but is a way of approaching the empirical world (Taylor and Bogdan, 1984). In this study, researchers developed the concept and gathered facts, but did not test the hypothesis. According to Sugiyono (2005), exploratory research and often also in descriptive research do not need to formulate hypotheses. In qualitative research, there is no minimum number of participants needed because it depends on the type and nature of the study, where the aim is to analyze more deeply about a phenomenon or event (Yin, 2013). Purposeful sampling allows an in-depth understanding of the topic being investigated, which helps provide rich case study data (Patton, 2002). The data source of this research is primary and secondary data sources. Primary data are obtained by conducting interviews and observations on Muslim entrepreneurs and management of *Sharia* venture capital financial institutions because they are considered the most knowledgeable about the subject of research (Corley and Gioia, 2004). While secondary data are obtained through books, the internet, relevant papers and journals. A total of six respondents consisting of four Muslim entrepreneurs and two *Sharia* venture capital managers were involved as key informants in this study. The preliminary interview was conducted with informants to understand their thoughts about Islamic business financing. An interview instrument was developed and then adjusted based on the preliminary interview. Some key questions were given to informants regarding the opportunities and challenges to gain access to finance, knowledge and understanding of various types of financing alternatives and informants' perceptions of *Sharia* venture capital. The interview method used in this study is a semi-structured interview where the researcher prepares questions first, but in the implementation, it is more flexible and allows



Sharia venture capital

Figure 2. Theoretical framework of Sharia venture capital implementation

for the emergence of new questions that are still relevant to obtain opinions and ideas from informants more broadly. An observation of this study is passive participation, which means that researchers come to the research location, but do not participate in activities (business) carried out by the observed object. In this case, the researcher makes direct observations in the field and records all events related to the Islamic financing process and observes every business process that occurs. Interviews are conducted in Indonesian language through telephone, email and directly. Most interviews lasted at least 20 min and were recorded.

### 3.2 Data analysis

The analysis technique used in this study is descriptive and explorative analysis. The results of the interviews were analyzed using a thematic analysis approach. This enables analysis of outputs and topics that arise from convergence interviews to help understand different points of view. This research uses an interactive approach to take into account data from interviews but also continuous dialogue (Aagard Nielsen and Svensson, 2006). Records are taken during interviews to highlight important points and interesting findings regarding the opportunities and challenges of Muslim entrepreneurs in gaining access to finance.

To maintain the confidentiality of informants, we use codes or initials. Data analysis also compares information with previous interviews in the ongoing process. This allows the amplification process so that new insights are highlighted then clarified for meaning among the participants. A cross-case analysis is used to compare various perspectives related to *Sharia*-based financing. The triangulation process was carried out to clarify and analyze the changes in responses from informants. This allows examination of patterns among informants analyzed (Eisenhardt and Graebner, 2007). In addition, this study uses quality measurements that include internal validity, external validity and reliability (Yin, 2009).

## 4. Finding and discussion

### 4.1 *Sharia* venture capital practices in Indonesia: some insight

Indonesia is a country with a majority of the Muslim population, so it is expected that there are Islamic financial institutions in accordance with the *Sharia* principles about the prohibition of *riba* and *gharar*. The Islamic finance industry in Indonesia has the potential to continue to grow and have great benefits for the economy. The *Sharia* non-bank finance industry (NBF) is a pillar of strength in the Islamic finance industry, whose development is expected to contribute to the *Sharia* economy growth in Indonesia.

The development of venture capital in Indonesia began in 1973 with the establishment of Bahana Pembina Usaha Indonesia Company, which at that time, the institutional status included in non-bank financial institutions whose activities primarily finance business development. Bahana Pembina Usaha Indonesia Company was established based on Government Regulation No. 18 of 1973 which is engaged in equity participation (Hamid, 2015). Since 2011, through Law No. 21 of 2011, the Indonesian Financial Services Authority (OJK) has the function of organizing an integrated regulatory and supervisory system on the overall activities within the financial services sector. According to the OJK, *Sharia* Venture Capital Company is a business entity which has business activities of venture fund management and other business activities with OJK approval which is entirely implemented based on *Sharia* principles. Implementation of *Sharia* capital venture capital business activities must fulfil the principles of justice (*‘adl*), balance (*tawazun*), benefit (*mashlahah*) and universalism (*alamyah*) and not contain *gharar*, *masyir*, *riba*, *zhulm*, *risywah* and *haram* objects.

*Sharia* NBFIs are a field related to activities in the insurance industry, pension funds, financing institutions and other financial services institutions, which in practice do not conflict with the *Sharia* principles. In general, its activities do not have differences with conventional NBFIs. However, there are certain characteristics with products and transaction mechanisms based on *Sharia* principles in accordance with the National *Sharia* Council of Indonesian Council of Ulama include financing: *Mudharabah (Qiradh)*, *Musyarakah*, *Ijarah*, *Wakalah*, *Aqad Mudharabah Musytarakah* and *Aqad Kafalah* (OJK, 2018). The institution that regulates material laws and *Sharia* principles in Indonesia is called BAMUI (Indonesian Arbitration Board of *Muamalah*) which was jointly established by the Attorney General's Office and the Indonesian Council of Ulama. However, in 2013, the MUI changed the name of BAMUI into the National *Sharia* Arbitration Board (BASYARNAS).

Based on the OJK data (2018), there are only seven *Sharia* venture capital companies compared to conventional venture capital firms which reached 62 companies, including: PT Permodalan Nasional Madani Techno Ventura Syariah, PT Persada Ventura Syariah (PT Waqof Ventura Syariah), PT Amanah Ventura Syariah, PT Permodalan BMT Ventura, PT. Vasham Kosa Sejahtera, PT. Celebes Artha Ventura and PT Mitra Bisnis Keluarga. Based on the OJK data (2018), assets owned by *Sharia* venture capital in Indonesia reached RUP1,267tn. Meanwhile, until October 2015, the amount of financing from *Sharia* venture capital amounted to RUP337bn. This shows that the *Sharia* venture capital trends in Indonesia began to grow and utilized by business actors, especially Muslim entrepreneurs.

*Sharia* venture capital has a great opportunity to develop, based on the [Start-up Ranking \(2018\)](#) data (2018), indicating that Indonesia is ranked sixth in the world with 1,595 startups. The first rank is the USA and is followed by India with 45,917 and 5,782 startups respectively. This trend will continue to increase where the growth of e-commerce also reaches 50 per cent from year to year with a value of billions of rupiah. *Sharia* venture capital in Indonesia can take advantage of the potential for rapid growth of the startups.

#### 4.2 Opportunities and challenges of sharia venture capital for Muslim entrepreneurship development in Indonesia

The research data are based on the results of interviews conducted with six informants, consisting of four Muslim entrepreneurs and two *Sharia* venture capital managers in Indonesia. To maintain the confidentiality of respondents, we use codes or initials. [Table III](#) below shows the profile of the research informants.

Based on the table above, it shows that the business sectors of the informants in this study is scale of micro, small and medium enterprises (MSMEs) with the duration of business running around two to five years. In addition, the business scope of the majority of informants is regional, where their business scope is only in their area, and only one

No.	Informants	Business sector	Position	Duration of business/work (in years)	Business scope
1	Informant_1	Small enterprise	Muslim Entrepreneur	3	Regional
2	Informant_2	Medium enterprises	Muslim Entrepreneur	5	National
3	Informant_3	Micro enterprises	Muslim Entrepreneur	2	Regional
4	Informant_4	Micro enterprise	Muslim Entrepreneur	3	Regional
5	Informant_5	Financial institution	SVC Manager	8	National
6	Informant_6	Financial institution	SVC Manager	5	Regional

**Table III.**  
Profile of informants



informant has national market coverage. Meanwhile, two informants came from financial institutions that focused on providing sharia venture capital. Informant\_5 is an SVC manager for a financial institution with a national business scale, which has several business units in several regions in Indonesia.

Furthermore, this study analyzes the opportunities and challenges of Muslim entrepreneurs in gaining access to finance and Sharia venture capital as one of the business financing alternatives for Muslim entrepreneurs. Most of the informants stated that the opportunity to get access to finance was very limited, especially for access to banks, because there were several requirements that could not be met by entrepreneurs, including business feasibility and lack of financial guarantees. In addition, some informants also still consider the religious perspective on *riba*, where *riba* is something that is prohibited in religion. Some of the interviews from informants are as follows:

As far as I know, financial institutions are banking and non-banking. There is also capital assistance from the government but there are many competitors, so I never submitted it. I once applied to the bank but was refused, they said, my proposal could not be processed because it did not meet the requirements, so I opened a business with my own limited capital (Informant\_1).

I use my own capital, don't use a loan. But indeed there were some customers who ordered in large quantities, but our capital is limited, when we offered to fill half of their order, they refused, they wanted all orders to be done in the same place (Informant\_4).

Based on the results of interviews with informants, it was shown that, to maintain and develop their business without financing alternatives, the informants preferred to use a limited amount of self-owned capital, which caused their businesses to not be able to develop quickly because some of them could not meet the amount of consumer demand for production. However, current technological advancements have helped many entrepreneurs to market their products at no major cost. So, Muslim entrepreneurs can also take advantage of technological advances to promote their products, such as using social media to introduce their products. In addition, the existence of Muslim entrepreneur communities such as the Indonesian Muslim entrepreneur community also helps Muslim entrepreneurs in marketing their products, regular meetings held by the community can be a place for Muslim entrepreneurs to strengthen mutual friendship, share experiences and knowledge and promote their products directly to show that goods that are traded are real and clearly the benefits are in accordance with Islamic teachings, and finally, word of mouth is created.

This study also analyzed the knowledge and understanding of the informants regarding Sharia venture capital financing alternatives. However, based on the results of the interview, it was found that not all informants, especially Muslim entrepreneurs, were aware of the existence of Sharia venture capital financing. However, they feel interested if the financing system does not complicate and help the process of developing their business as long as it is based on Islamic principles. This was identified from the results of the interview as follows: TYsdzxbkhgjk./

I only know access to finance through a bank, but I am interested if there are other alternatives that the process is not difficult, as long as the procedure is clear and in accordance with religious teachings (Informant\_2).

If there are other financing alternatives for business capital, I want it as long as it does not conflict with religious principles. I avoid the *riba* financing system, because it not only harms me but also conflicts with religious law. My business is still relatively new, and the risk of failure is still large, so if I have to bear the loan it is also hard for me. I've heard of venture capital, but I don't know how the procedure is, the information is also limited (Informant\_3).

The interview results above show that *Sharia* venture capital has an opportunity as one of the financing alternatives that can be accepted by Muslim entrepreneurs. In addition, the responses from *Sharia* venture capital managers revealed that *Sharia* venture capital provides not only capital but management support for business development. It is also shown based on interviews with managers of *Sharia* venture capital companies:

At present, the trend of *Sharia* venture capital financing has shown an increase, although not yet significant. We acknowledge that this financing model is not yet familiar to some entrepreneurs in Indonesia, but I believe this financing model will develop because it not only offers solutions for entrepreneurs but also we provide managerial, operational, and marketing support to help their product development and commercialization (Informant\_5).

The potential for *Sharia* venture capital financing is increasing because of the religious awareness of Muslims, making them increasingly need more comfortable financing alternatives according to religious guidelines. This condition is an opportunity for *Sharia* venture capital to demonstrate its existence (Informant\_6).

In addition, the challenges of financing *Sharia* venture capital were also identified based on the results of interviews with informants. The following are some excerpts from the interview:

Maybe the information must be clear, because personally I don't know what the procedures of the *Sharia* venture capital financing system are (Informant\_1).

I doubt the payment system, inevitably the end will be the same as other financial institutions, and the interest is large (Informant\_3).

Other challenges are expressed by the *Sharia* venture capital managers as follows:

So far, we are still funding a limited number of start-ups, because the amount of capital is indeed insufficient for a larger scale business. The investors who work with us are also still limited, so the funding that we do is not maximal. Maybe, it's because taxes are quite high also for investors (Informant\_5).

Our business system is indeed still intersecting with conventional financial institutions in general, so the financing scheme is to provide loans/debts to prospective clients. Perhaps, this also makes prospective investees hesitate to cooperate with us (Informant\_6).

Although the existence of venture capital including *Sharia* venture capital has developed since a few years ago, until now, it has not been widely known to the public. The findings reveal that there is a need for socialization of *Sharia* venture capital financing procedures so that the public can know and understand the *Sharia* venture capital financing system. Support from various stakeholders is a way to increase the existence of *Sharia* venture capital because of the increasing number of Muslim entrepreneurs who increasingly understand and realize the importance of financing based on Islamic principles. Another challenge is the limited capital so that the role of the government is needed in overcoming funding constraints, for example, by providing adequate policy support and incentives, such as tax incentives for participation in *Sharia* venture capital (Kelana, 2015). In addition, in practice, the venture capital financing system is not different from the banking system, so there are misperceptions in the community caused by products and financing patterns that tend to be similar to banks and different from the purpose or nature of venture capital financing (Sinamo, 2017).

## 5. Implication and future research direction

One of the most important aspects for Muslim entrepreneurs in obtaining financing is conformity with the principles of Islamic teachings. This is especially necessary for start-up companies that are just starting their business and experiencing problems in acquiring business development capital. In this article, we present various financing alternatives in Indonesia and why *Sharia* venture capital can be an alternative as a financing solution for Muslim entrepreneurs. This will help Muslim entrepreneurs to expand their businesses by sticking to the teachings of their religion.

Several policy implications were also identified in this study, including the low financing of *Sharia* venture capital so that there is an expected increase in the amount of funding for this institution to encourage the development of various business sectors of Muslim entrepreneurs, especially start-up businesses. The government must also play an active role in providing adequate support and policy incentives, for example, low tax incentives. In addition, broader socialization and education to the community, especially Muslim entrepreneurs, about the existence of *Sharia* venture capital as an alternative to *Sharia*-based finance.

This article explains the phases of Muslim entrepreneurs in obtaining Islamic venture capital financing and provisions that must be met by both parties in a cooperation agreement. This article also offers understanding the implementation model of *Sharia* venture capital that can help Muslim entrepreneurs understand how it works and how to use it. In addition, this study presents guidelines that can be used by Muslim entrepreneurs to apply and when to use them as well as possible. One recommendation for further research is to apply a theoretical framework and analyze its impact. Another recommendation is to look at the impact of this conceptual framework in different countries (majority and minority of the Muslim population) so that we can see how the characteristics of each stage differ. In addition, the existence of an entrepreneurial community is also important to facilitate the exchange of information and knowledge, such as learning about Islamic economics and finding solutions to problems faced in business management, particularly related to Islamic finance. And, the community can also be used by Islamic financial institutions to promote *Sharia* venture capital as one of the financing alternatives for Muslim entrepreneurs.

This paper is one of several studies that widely consider *Sharia* venture capital in Indonesia. In addition, we may recommend applying the proposed conceptual frameworks in different sizes of companies so that we can see the difference in the implementation of joint *Sharia* venture capital. The difference will mainly arise in the models of cooperation agreements and the strategies they choose in business development. Another suggestion for further research is to find other financing alternatives that Muslim entrepreneurs can use, whereby the financing can reduce the risk of business failure and help business development. Future research should be problem-oriented whether small business owners have demonstrated readiness to accept the way in which venture capital functions and the types of benefits they see from this type of financing. This is an important point that can be further investigated, as it may be able to contribute to government agencies when formulating policies that encourage *Sharia* venture capital development in Indonesia.

## 6. Conclusion

This paper discusses alternative financing for Muslim entrepreneurs who want financing procedures in accordance with Islamic principles. Some venture capital practices have several violations of *Sharia*, so this research tries to identify the opportunities and challenges of Muslim entrepreneurs in obtaining financial access. This study also tries to develop a conceptual model of venture capital cooperation implementation that fully

complies with *Sharia* principles. This research is an initiative to provide insight to Muslim entrepreneurs in obtaining the widest possible access to alternative financing free of *riba* and *gharar*. It is proposed that Muslim entrepreneurs before searching for financing alternatives need to analyze the available theories or models before ultimately choosing which alternative funding to use. This study is conducted in Indonesia as a developing country, so this combination may be different for other countries. This is why, we propose a theoretical framework of the implementation process of *Sharia* venture capital financing. In this theoretical framework, it is proposed for Muslim entrepreneurs to follow three major steps beginning with belief in Allah SWT, economic activity based on Islamic teachings and knowledge of Islamic financing principles. The process of selecting alternative financing strategies must have a very clear understanding of the terms and conditions in the process of cooperation with financial institutions. Thus, this study proposes the potential of *Sharia* venture capital as an alternative financing, analyzing the theory and model in the implementation of *Sharia* venture capital in accordance with the Islamic principles.

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