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THE ROLE OF ISLAMIC FINANCE IN PROMOTING ENTREPRENEURSHIP AND ECONOMIC GROWTH

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ABSTRACT
This study uses the endogenous growth model to analyze how Islamic finance can spur economic expansion and entrepreneurship. It draws attention to the historical forces behind global economic expansion highlighting the shift from established forces to emerging markets especially the emergence of the BRICS economies. The endogenous growth model is examined as a theoretical underpinning because of its emphasis on internal elements like innovation investment and human capital. In order to show how mechanisms like risk-sharing ethical investing and financial inclusivity support sustainable development the paper incorporates Islamic financial principles into this model. Particularly in the economies of the Middle East and Southeast Asia empirical research shows that Islamic finance has a positive effect on capital accumulation and entrepreneurship. While tackling issues of inequality and financial exclusion tools like equity-based financing and Sukuk (Islamic bonds) encourage moral and sustainable growth. The conversation emphasizes how Islamic teachings which support just wealth distribution moral behavior and social solidarity are consistent with international economic goals. Policy suggestions to improve the incorporation of Islamic finance into international economic systems are included in the papers conclusion. These include investing in human capital establishing public-private partnerships bolstering regulatory frameworks advancing financial inclusion fostering innovation and integrating Islamic finance into national development plans. Islamic finance can significantly contribute to the promotion of equitable moral and sustainable economic growth by implementing these policies.
***Key words:** Quran Islam, human development, economic growth.*

INTRODUCTION

For economic growth and development entrepreneurship is essential because it stimulates innovation generates employment and raises living standards. Since they concentrate on seeing opportunities and making choices that affect how resources are distributed entrepreneurs are frequently viewed as important change agents in any economy (Stevenson & Gumpert 1985; Hebert & Link, 1989). With their efforts directly influencing the creation of wealth and jobs they play a crucial role in promoting economic development (Audretsch & Fritsch 2003; Decker et al., 2014). In addition to creating jobs entrepreneurship also produces the financial resources necessary for economic expansion (Audretsch & Keilbach, 2004; Carree & Thurik, 2010; Van Praag & Versloot, 2007). Numerous empirical studies demonstrate the significance of different elements that affect the success of entrepreneurs. For example, it has been demonstrated that entrepreneurship benefits from higher education (Arshed, 2019) and possess excellent managerial abilities. Additionally, one important factor that influences entrepreneurship is the availability of financial resources. Particularly wealth is important for starting and expanding new businesses and elements like inflation FDI and credit availability are all critical for encouraging entrepreneurship (Rusu & Roman, 2017).

Additionally, financial markets are essential to entrepreneurship. Businesses must develop financial services such as debt and equity financing in order to survive and expand. Business profitability is greatly impacted by the availability of suitable financial tools and entrepreneurs can secure funding through their own resources debt or equity. Because it is asset-backed and ethical Islamic finance in particular has special advantages over traditional financing methods (Azmat et al., 2015). The religious tenets that govern financial transactions are intricately linked to entrepreneurship in the context of Islamic finance. Under Shari'ah (Islamic law) which forbids actions involving undue interest (Riba) and uncertainty (Gharar) Islam promotes entrepreneurship. Islamic finance models like equity-based transactions and profit-sharing (Mudarabah) are intended to encourage moral and environmentally friendly business operations. Following the Maqasid al-Shari'ah guarantees that Muslim business owners uphold the values of justice and fairness while ensuring that their enterprises benefit society (Hassan & Hippler, 2014). Accordingly, Islamic finance guarantees that entrepreneurship stays in line with larger social and moral values while also facilitating it (Abdullah & Azam, 2020).

Objectives of The Study

This study examines how Islamic finance promotes entrepreneurship by looking at how institutional frameworks financial resources and ethical considerations affect the establishment and expansion of businesses in economies with a majority of Muslims. This study emphasizes how Islamic financing can offer sustainable growth prospects by integrating Islamic principles into entrepreneurial finance particularly in areas where access to traditional financial services may be restricted.

Literature Review

Creating an Islamic financial system is one of the first steps in aligning all economic institutions with the principles of Islamic economics. The benefits of financial markets include greater portfolio diversification the possibility of fluctuations in risk levels and the movement of money from savers to investors all of which open up new investment opportunities and raise the level of economic development (Anwar & Tahir, 1995). According to Bacha and Mirakhor (2015) the financial sector and capital markets are crucial for economic development and growth in Muslim countries. They argue that conventional capital markets which are heavily skewed toward debt and debt-based instruments are inherently unstable in light of the current global financial crisis. Therefore, they propose a risk-sharing structure that restores stability and lowers if not completely eliminates debt.

Finding funding is one of the difficulties faced by business owners (Fowowe, 2017; Ullah, 2020). Empirical studies show that SMEs struggle to get timely and affordable debt financing from commercial banks (Jagoda & Herath, 2010). In order to lower high risk commercial banks usually require collateral as a safety net (Nawai & Shariff, 2011). Additionally, the collateral requirement makes it difficult for SMEs to get loans from commercial lenders (Ramlee & Berma, 2013). One study claims that traditional funding is unable to provide startups with the necessary liquidity (Mensi et al., 2020). According to Rose (2012) only 0–2% of US startups rely on venture capital funding rather than bank financing. The role that Islamic debt financing plays. dot. The rise in domestic credit to the private sector demonstrates how simple it is to obtain credit which encourages entrepreneurship (Vidal-Suñé & López-Panisello, 2013; GEM, 2021). According to some theories funding and investment are essential components of launching or growing a business (Nkwabi & Mboya 2019). The impact of funding on entrepreneurship was the subject of several theories put forth by Laplume and Yeganegi (2019). According to Arshed and Kalim (2021) these theories include Pecking Order Theory Real Options Theory (Bowman & Hurry, 1993) Signaling Theory of Entrepreneurship (Bhattacharya, 1979) Stewardship Theory and Information Asymmetry Theory. These theories claim that entrepreneurship and financial development are related which calls for measuring the effects. Bank loans and other private debt sources are essential for funding business owners (Shareef et al., 2017).

Additionally, it is evident that bank debt is a significant source of outside funding for SMEs (Robb & Robinson, 2014). According to Berger et al. (1998), moral hazard issues and systemic irregularities make obtaining bank debt a significant obstacle for many new businesses. There are numerous resources and institutions where SMEs can obtain credit (Altaf et al., 2019). Further, crucial are the sources of funding available to SMEs. Islamic banking targets SMEs as one of its target sectors. Since SMEs are among the most prosperous sectors in the nation Islamic banks also provide financing for them. It is forbidden in Islam to charge interest on any kind of product but it is allowed to make an investment profit and sale based profit are allowed in Islam (Muhamad et al., 2020). Both Islamic and commercial banks offer debt financing however the primary distinction is that Islamic banks alter the market profit rate whereas commercial banks charge the time value of money (Khan, 2000).

The risk of misusing clients' money is the primary factor that makes Islamic banking superior to traditional banking. Islamic banking typically ensures robust economic activity by purchasing goods or assets. The assets fundamental participation in each transaction guarantees that the money lent through any Islamic banking product is used for the intended purpose. Thus it is believed that Islamic banking eliminates the possibility of clients or business owners misusing their money. Injustice is therefore not included in the fund cost. One of the debt financing options offered by Islamic banks is Ijarah or leasing which refers to the rent of a service or asset for a predetermined amount of time in exchange for the payment of rental installments. At the conclusion of the lease period the leased asset may be transferred to the lessee. Because the asset ownership tax and rents are only assessed upon use this debt-based product is accessible to entrepreneurs. Because of this banks in Islamic banking will not charge rent if the leased assets user is unable to use it. Not a single conventional system has this facility (Patterson & Mujtaba 2013; Lateef et al., 2017). Islamic law serves as the foundation for the entire Islamic banking system. Because of this it operates in accordance with Shariah principles (Nasiru & Mansur 2015). Islamic banking helps businesses and SMEs by offering contract-based financing that takes risk factors into account and is managed through various agreements such as Ijarah and Murabaha (Hameed et al., in 2020).

A number of metrics that measure entrepreneurship in an economy were covered by Martins (2007). Among the many variables he proposed were the employment rate in services the survival rates of new businesses social economy businesses newly established businesses and existing businesses among many others. Various studies examined the connection between entrepreneurship and economic growth (Yusuf et al., 2021). Various studies have differing views on the significance of financial development and how it contributes to the expansion of an economy. The impact of domestic credit and saving mobilization on private entrepreneurship was demonstrated by Wujung and Fonchamnyo (2016). They also demonstrated how expanding access to financing will boost the economys entrepreneurship growth. Economic growth and financial development are closely associated (Ujunwa & Salami, 2010). The relationship between the development of the Islamic financial system and economic growth in the United Arab Emirates was examined by Tabash and Dhankar (2014). From 1990 to 2010 they discovered that financing from Islamic banks had a long-term positive impact on UAE investment. Although the financial sector influences economic growth it is also thought that an immature financial sector will have a detrimental impact on the economy (Ductor & Grechyna, 2017).

According to a framework put forth by Muhammad and Rahim (2020) SMEs can benefit more from Islamic financing products when it comes to financing applications. Arshed et al. (2020) examined the connection between Islamic banking and economic expansion. They have discovered a positive correlation between the growth of the economy and the expansion of Islamic banking. Meierrieks and Dutta (2021) talked about entrepreneurship and financial development. They contend that a stable financial sector will enable entrepreneurs to access affordable credit and effectively expand their enterprises. In his research Hidiroglu (2017) sought to determine whether entrepreneurship and financial development were related. Four measures of financial development—access to loans affordability bank soundness and venture capital—were used in the study. According to the study's findings there is a significant correlation between entrepreneurship and access to loans and venture capital but not between affordability and bank soundness.

According to some studies there is a negligible and negative correlation between economic growth and the financial market. Mauro (1995) demonstrated in his paper that corruption is a factor that impacts economic growth and financial development in the context of entrepreneurship. Demirguc-Kunt and Detragiache (2005) demonstrated that political instability and corruption are the two main elements influencing an economy financial development. Aggarwal and Goodell (2009) added that corruption has an impact on the economy and causes issues with financial development. Research such as Arshed et al. (2020) have investigated how the economy human capital or educational attainment affects the quantity of newly registered enterprises. They contend that education improves a person's capacity to withstand the risks involved in launching a new company.

Analysis

Historical Drivers of Global Economic Growth

Major nations like the United States the former Soviet Union Japan and Germany have been at the forefront of the world economys unprecedented expansion since World War II. These nations made substantial contributions to global growth despite having different post-war situations. A change occurred in the late 20th century with the rise of the BRICS nations—Brazil Russia India China and South Africa—which showed remarkable expansion particularly prior to the financial crisis of 2007–2008. The way economic dynamics change over time—from established drivers to emerging markets that reshape global growth patterns—is highlighted by this era.

Endogenous Growth Theory and Its Foundations

Based on the writings of classical economists such as Adam Smith David Ricardo and Thomas Malthus contemporary growth theory saw significant advancement in the middle of the 20th century. Contrary to the neoclassical approach the endogenous growth model highlights that internal factors like innovation investment rates and human capital determine long-term growth. The theoretical foundation established by academics such as Stiglitz and Uzawa emphasizes the ways in which real-world developments in these fields impact economic performance. This model is still essential for comprehending the processes underlying long-term economic expansion.

The Role of Islamic Finance in Economic Growth

A significant exogenous factor impacting growth in the framework of endogenous growth is Islamic finance. Islamic financial systems encourage investment and capital stock accumulation especially in Middle Eastern economies (Tabash & Anagreh 2017). Islamic finances influence in Southeast Asia has been further cemented by instruments like Sukuk (Islamic bonds) which have fueled economic growth. Islamic finance enhances access to capital and promotes moral investment practices which enhances conventional banking systems and promotes economic growth worldwide.

Entrepreneurship and Innovation in Growth Models

In the framework of endogenous growth finance is crucial for promoting innovation and entrepreneurship two key forces behind economic expansion. Financial mechanisms assess entrepreneurial potential and direct resources toward high-yield endeavors as demonstrated by King and Levines (1993) model. This dynamic stimulates economic performance increases productivity and fosters innovation. The focus placed by Islamic finance on equity-based financing is consistent with these ideals offering a morally sound and long-lasting framework for assisting business endeavors especially in developing nations.

Theoretical and Empirical Alignment

The connection between finance and economic growth is consistent with Schumpeters supply-leading hypothesis which holds that innovation and productivity are fueled by the growth of the financial sector. This theory is supported empirically by McKinnon and Shaws (1973) findings which demonstrate how financial development stimulates growth by promoting investments and savings. This theory is furthered by Islamic finance which provides substitute systems that encourage capital accumulation and entrepreneurship while also abiding by moral standards.

Regional aspects

The regional and global economies are significantly impacted by the expansion of Islamic finance. The economies of the Middle East and Southeast Asia where Islamic finance is widely practiced have grown significantly. Policies supporting Islamic financial products like Sukuk have improved capital flows and encouraged entrepreneurship. These advancements demonstrate how strengthening growth trajectories particularly in economies looking to diversify their financial systems can be achieved by incorporating Islamic finance into more comprehensive economic policies.

Discussion

The integration of Islamic principles with economic growth and entrepreneurship presents a unique perspective on achieving sustainable development. This section discusses the historical evolution of economic growth, the theoretical underpinnings of the endogenous growth model, and the role of Islamic finance in fostering economic prosperity.

Global Economic Growth: Historical and Contemporary Context

The world economy has grown at an unprecedented rate since World War II. At first the main forces behind growth were the US and the former USSR as well as Japan and Germany. The emergence of the BRICS countries—Brazil Russia India China and South Africa—followed this momentum and their remarkable rise until the financial crisis of 2007–2008 signaled a change in the balance of power in the world economy. The historical development demonstrates how development of human capital policy changes and technological breakthroughs have propelled economic growth in various locales and eras (Jovanovic, 2000).

Endogenous Growth Model and Its Relevance

The internal elements that propel long-term economic growth such as investment rates human capital and innovation are highlighted by Romer (2012) endogenous growth model. This model emphasizes the role of factors within the economy itself in contrast to neoclassical models that attribute growth to external factors like technological advancement. For instance, Jhingan (2011) emphasized how crucial human and capital are to attaining sustainable growth. The relationship between financial development and growth was further demonstrated by King and Levines (1993) studies which showed how financial systems direct resources toward the most creative and successful industries encouraging entrepreneurship and economic growth.

Islamic Finance as a Growth Catalyst

Islamic finance has become an important driver of economic expansion especially in areas with sizable Muslim populations. With mechanisms like risk-sharing ethical investing and financial inclusivity it influences growth as an exogenous factor in the endogenous growth model. The beneficial effects of Islamic finance on investment levels and economic performance in Middle Eastern economies have been validated by Tabash and Anagreh (2017). Furthermore, Ledhem (2020) illustrated how financial instruments such as Sukuk (Islamic bonds) have stimulated economic growth in Southeast Asia by accumulating funds for profitable ventures.

Entrepreneurship and Financial Systems

Financial systems play an important role in encouraging entrepreneurship according to King and Levines (1993) theoretical framework. Financial institutions boost economic dynamism and productivity by assessing entrepreneurial potential and allocating savings to the most creative projects. By abiding by Shariah laws which forbid exploitative practices like interest-based lending Islamic finance supports this procedure. Rather by encouraging equity-based funding and profit-sharing plans it synchronizes economic activity with moral and socially conscious objectives.

Islamic Principles and Economic Justice

Islamic principles provide a comprehensive foundation for social and economic justice. The Quran promotes social solidarity moral earning and spending and the equitable distribution of wealth. These ideas naturally fit with the objectives of inclusive growth and sustainable development. Islamic finances focus on lowering inequality and promoting shared prosperity is consistent with the notion that financial development leads to economic growth which is supported by McKinnon and Shaws (1973) financial repression theory.

The findings suggest that integrating Islamic financial principles into global economic systems can address contemporary challenges such as wealth inequality, financial exclusion, and unsustainable practices. Policymakers can leverage the ethical foundations of Islamic finance to create systems that promote innovation, reduce corruption, and enhance social equity. Moreover, Islamic finance has the potential to play a transformative role in emerging markets by fostering entrepreneurship and creating opportunities for marginalized communities.

Conclusion and Policy Recommendations

Within the context of the endogenous growth model this study emphasizes the critical role that Islamic finance plays in promoting entrepreneurship and economic growth. By encouraging moral investing financial inclusion and innovation Islamic finance acts as a development accelerator. In contrast to traditional financial systems it follows Shariah principles placing a strong emphasis on social justice equity and risk-sharing—all of which support inclusive and sustainable growth. A holistic strategy for tackling global issues like poverty inequality and financial exclusion is provided by the fusion of Islamic principles with commercial principles. Islamic finance promotes economic dynamism while upholding moral principles by fostering entrepreneurial endeavors and developing human capital. The study confirms that Islamic financial concepts are compatible with contemporary economic theories especially endogenous growth models which place a strong emphasis on internal variables like innovation and investment. Previous studies have shown that Islamic finance raises capital stock while also encouraging productivity and innovation in the entrepreneurial sector which eventually boosts global economic growth.

Policy Implications

- **Promoting Financial Inclusion**

The availability of Islamic financial instruments should be increased by policymakers especially in underserved areas. Providing profit-sharing microfinance options can strengthen underserved communities and promote equitable economic development.

- **Strengthening Regulatory Frameworks**

It is essential to create strong regulatory frameworks for Islamic finance to guarantee accountability transparency and adherence to Shariah. Global capital will be drawn to Islamic financial markets as a result boosting investor confidence.

- **Encouraging Innovation in Islamic Financial Products**

Governments and financial institutions should spend money on research and development to produce cutting-edge Islamic financial products like social impact bonds or green Sukuk to address new issues like social inequality and climate change.

- **Enhancing Human Capital Development**

For Islamic financial institutions to become experts in Shariah-compliant financial practices they must fund educational and training initiatives. This will guarantee a workforce with the necessary skills to meet the industry's expanding demands.

- **Fostering Public-Private Partnerships (PPPs)**

Government cooperation with private Islamic banks can spur the growth of infrastructure entrepreneurship and employment. PPPs have the ability to raise funds for significant projects that support sustainable development objectives.

- **Integrating Islamic Finance into National Development Plans**

Islamic finance should be incorporated by policymakers into national economic development plans. Using its tenets to advance social justice lessen income inequality and aid in long-term growth goals is part of this.

- **Expanding the Role of Islamic Finance in Global Markets**

The influence of Islamic finance on sustainable development can be increased by expanding its global reach through cross-border investments and international collaborations. Promoting collaboration between Islamic finance centers in Africa the Middle East and Southeast Asia can result in synergy for global expansion. To achieve sustainable and equitable economic development governments and financial institutions can fully utilize Islamic finance by putting these policy measures into place. Incorporating moral values into the global financial system guarantees social cohesion and environmental sustainability in addition to fostering economic prosperity.

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