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An Islamic Finance Model for The Small and Medium-Sized Enterprises in France

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Abstract. The dominant effect of the global financial shockwaves ravaging the whole of Europe is becoming proverbial in the history of world economic crises. This has been largely due to untoward economic policies that have negatively impacted most economies in Europe. The recent European sovereign debt crisis experienced more in Greece, Italy, Spain and Portugal, and the most recent downgrade of France's credit rating by Standard and Poor's call for a rethinking of the existing economic policies. The need to foster innovation in Small and Medium-sized Enterprises (SMEs) and sustainably support the existing ones has remained a major challenge in France. With over 2.5 million SMEs in France, the recent report of the Institut Nationale de la Statistiqueet des Etudes Economiques [INSEE] reveals that one in every two new business fails in the long run. This paper examines the need to find credible alternatives for French SMEs to the collateral-based debt financing. Built on ethical business models, the Islamic SMEs and microfinance models are expected to foster innovation and sustainability to smaller economic players. Although, loans remain SMEs' main source of financing, banks require more collateral from entrepreneurs, and now provide lower financing compared to the period before the financial crisis. In this context of financial difficulties for SMEs, considering alternative models of financing such as Islamic financial products based on the profit and loss sharing has increased the interest of many European countries. While focusing on the econo-legal issues underlying any of such proposals, the paper considers the feasibility of Islamic venture capital as a credible alternative to bank's loans for SMEs within the existing French legal and regulatory framework.

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1. Introduction

With over $1.6 trillion Sharī‘ah-compliant assets globally, the Islamic finance industry has gradually established its resilient nature even during the global financial crisis that brought giant corporations to their knees (Oseni & Hassan 2010).The issuance of banking licence by the Federal Financial Services Authority (BaFin) of Germany to Kuveyt Turk Participation Bank – an Islamic bank – is a milestone in the history of Islamic finance in continental Europe. Even though it is a limited licence, it shows the eventual entry of Islamic financial products into the European Union [EU].France, as the second largest economy in the EU, has the largest population of Muslims in the EU.With a negligible 7% population of Europe being Muslims, countries like France have between 8 – 10% of total population as Muslims (United States Department of State 2010)(1). Though over the years, there have been certain strands of Islamic finance thought with the inflow of a number of Arab banks in France and the proclivity of the former Finance Minister to reposition the French economy to reflect on-going global practices, Islamic finance with particular reference to small and medium-sized enterprises (SMEs) modelled after certain Islamic financial products remains elusive in the French economy.

Many across the world have welcomed the recent legal and regulatory reforms carried out in France to accommodate Islamic finance. The literature on Islamic finance in France is increasingly gaining prominence generally but much has not been done on the aspect of SMEs built on the Islamic finance models. In other words, though scholarship on Islamic finance across the word, including Europe, has mushroomed over the years, yet, there is a gap in the literature with respect to SMEs patterned after Islamic financial products in France (Siddiqi 1999). This important aspect is a tacit, albeit potent, drive of the economy of any country, which is often neglected while discussing the general framework of the economy.

The *INNO-Policy Trend Chart –Innovation Policy Progress Report* of 2009 on France identified three major challenges faced by French SMEs. These are: “(a) the need to increase business R&D [Research and

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(1) United States Department of State, *2010 Report on International Religious Freedom - France*, 17 November 2010, available at:
http://www.unhcr.org/refworld/docid/4cf2d09b2d.html [accessed 25 November 2011]

Development] investment; (b) the need to improve transfer from public research to innovation; (c) the need to foster innovative small and medium-sized enterprises (SMEs) growth through better funding" (European Commission 2009). This paper takes on the third challenges, which is biting more into the fabric of the French economy particularly in the recent wave of financial turmoil in Europe generally. With a unique focus on the French economy and the need to find innovative structure which could overcome conventional loans, this paper examines the current challenges as well as the potentiality of the Islamic finance models in engendering sustainability for SMEs. One key SME model is venture capital, which is at the core of Islamic financial services (Vogel & Hayes 1998). The financial instruments underlying the Islamic venture capital models include the popular Islamic financial products such as *mushārakah*, *muḍārabah* and *murābaḥah.*

Against the above background, this paper is organized into five major sections. After this introduction, section two briefly reviews the definition and classification of SMEs according to the European Commission which sets the tone for further analysis. Section three examines the current challenges facing existing SMEs in France and the need to develop alternative to conventional loans. Section four discusses the opportunity to develop specific products for SMEs in France with particular reference to Islamic finance. Two major models examined in this section are the Islamic venture capital and Islamic microenterprise. Section five gives the conclusion, findings, recommendations and implications for further research.

With over 2.5 million SMEs in France, the recent report of the *Institut Nationale de la Statistiqueet des Etudes Economiques* [INSEE] reveals that one in every two new business fails in the long run (My Business 2000). The most recent downgrade of the credit rating of France would negatively impact the SMEs industry (Charlton & Kondo, 2012; Wiesmann, Spiegel, & Wigglesworth, 2012).This seems to be the most appropriate time to introduce meaningful reforms and attract investors from all over the world particularly from the Gulf Cooperation Council (GCC) countries who are predisposed towards Sharīʿah-compliant products.

2. Definition of SMEs According to the European Commission

For legal and regulatory purposes, the European Commission recommendation 2003/361/EC gives the definition of different categories of SMEs (see Table 1 below)(2). Article 2 of the recommendation provides for three distinct categories of SMEs. These categories are reproduced below as a guide for the understanding of what constitute SMEs.

1. The category of micro, small and medium-sized enterprises (SMEs) is made up of enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding EUR50 million, and/or an annual balance sheet total not exceeding EUR43 million.

2. Within the SME category, a small enterprise is defined as an enterprise which employs fewer than 50 persons and whose annual turnover and/or annual balance sheet total does not exceed EUR10 million.

3. Within the SME category, a microenterprise is defined as an enterprise which employs fewer than 10 persons and whose annual turnover and/or annual balance sheet total does not exceed EUR2 million.

Any enterprise that is larger in size and annual turnover or balance sheet than the categories described in Table 1 does not necessarily qualify to be referred to as an SME (OECD, 2004: 11).

Table (1) Definition and Classification of SMEs by the European Commission

SME Definition				
Enterprise category	Ceilings			
	Staff Headcount (number of persons expressed in annual work units)	Turnover	Or	Balance sheet total
Medium-sized	<250	≤ € 50 million		≤ € 43 million
Small	<50	≤ € 10 million		≤ € 10 million
Micro	<10	≤ € 2 million		≤ € 2 million

Source: (European Commission 2009)

(2) Commission Recommendation 2003/361/EC of 6 May 2003.

France did not adopt the legal and regulatory definitions but uses the statistical methods introduced by the EU. That is, France uses the number of people employed and the annual turnover as the criteria for defining SMEs. Enterprises that employ fewer than 250 people with an annual turnover of not more than EUR50 million or a balance sheet not exceeding EUR43 million are classified as SMEs(3). It is pertinent to note that SMEs cannot be discussed in isolation because the sources of necessary funding are also significant. So, the role of banks and Islamic financial institutions in financing SMEs with special reference to Islamic banks will also appear in the analysis that follows.

According to Fisher (2010), SMEs are “a source of vitality and innovation; a pool of skilled and semi-skilled workers; a driver for job creation; promotion of economic stability as a complement to large corporations; a broadening and diversification of the basis of competition within the economy” (Fisher, 2010: 95).

3. Islamic Finance and SMEs in France: Challenges and Opportunities

SMEs are a major pillar of the market economy and an essential building block of economic development in Europe (Ardic, Mylenko & Saltane 2011). A recent research report confirms this assertion where it observes that: “both in the European Union and the Gulf region, small and medium-sized enterprises are the main drivers of job creation, growth and economic diversifications” (European Agency for Safety and Health at Work 2010).

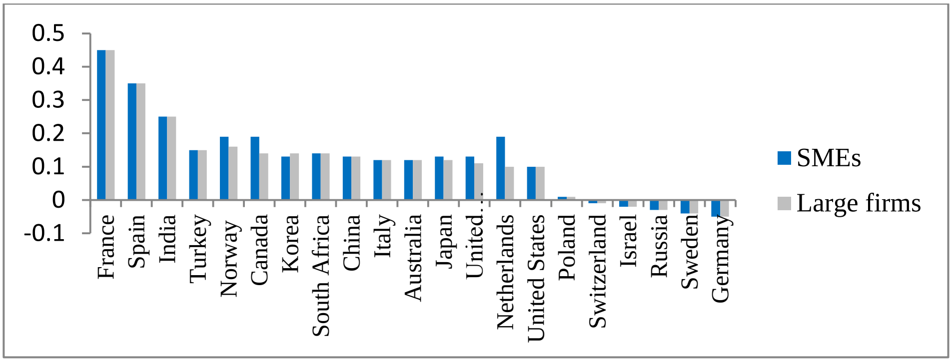
Since the SMEs are considered the mainstay of most economies across the world, particularly in developing countries, a consideration of a number of challenges currently facing the SME market is essential to structuring alternative models. Understanding the current challenges would assist in proposing an alternative model that is expected to be sustainable economically in the long run. One of the most striking challenges faced by Islamic finance since its re-emergence in the modern world relates to the regulatory and legal frameworks (Zaher & Hassan 2001).This prompted Malaysia, one of the leading and most progressive Islamic finance jurisdiction in the world, to enact the Islamic Banking

(3) See Application Decree (No. 2008-1354) of Article 51 of the Law on Modernization of the Economy.

Act of 1983.This legal regime was meant to complement the existing regulatory framework under the Central Bank. Such dedicated legislation, in addition to other reforms introduced, places the practice of Islamic finance in Malaysia on a good footing, which is now becoming the cynosure of all eyes in the wider Islamic finance industry (Oseni & Hassan, 2011). In France, entrepreneurship through SMEs is a major economic phenomenon. According to the 2012 panorama of the SMEs sector in France (CGPME & KPMG), SMEs account for 63% of employment, more than 53% of total added-value and 34% of real investment. Although, this market is a very strategic segment for the French economy, SMEs are facing several challenges which constrain their development. Patel (2012) has summarized these challenges into three. First, French SMEs are affected by a lack of equity; second, they have less access to financial markets for their financing needs; and third, they suffer from a risk rating system. While it may not be necessary to probe into the details of these unique economic challenges, it suffices to observe that a survey from Ecorys in 2012 showed that SMEs represent virtually all (99.8%) of the economy in EU-27 in terms of the numbers of enterprise, but account for only 58% of the value added. It should be recalled that the third challenge, which is considered as the most important among the three challenges facing the French economy according to *INNO-Policy Trend Chart –Innovation Policy Progress Report* of 2009 on France is “the need to foster innovative SMEs growth through better funding” (European Commission 2009). Better funding can be accessed when there is a sound regulatory framework, financial inclusion through integration of other alternative frameworks, and proper models for SMEs. When there is funding, Research and Development (R&D) would be enhanced maximally. For instance, there is tax incentive in France for SMEs and other large firms who engage in R&D, which is an important component of the country’s economy (Mairesse & Mulkay 2004).Figure 1 below gives the breakdown of a 2008 analysis of 21 OECD countries that gave tax credits to SMEs and other large firms for R&D. From the figure, it is clear that France provided the largest subsidies out of 21 countries even though for this purpose, it did not make any distinction between the SMEs and the large companies in the country (Warda 2009). In reality, France shows a deficit in R&D expenditures for medium-sized companies.

R&D subsidies are only concentrated in a few sectors (such as the Automobile sector). Islamic finance could play a role in complementing existing frameworks by targeting scores of productive Muslims entrepreneurs. For instance Muslim entrepreneurs are flourishing due to their expertise in the French *ḥalāl* food market which represents more than EUR5Bn. (Patel 2012). Such productive individuals who can introduce meaningful R&D must be integrated into the mainstream economy through benevolent reward for innovation (Mitchell 2010).

Figure 1: Tax Subsidy rate for USD 1 of R&D, large firms and SMEs, 2008



Source:(Warda 2009).

While the problem of funding lingers on in relation to the funding of SMEs in France, we propose new frameworks that can legally be adopted by the relevant stakeholders and issued as supplementary instructions to increase more access to credit facilities and enhance the growth of SMEs in the country.The banks cannot be left out of the continuum because entrepreneurs rely heavily on them for funding. As such, there is an opportunity for the establishment of Islamic banks that are ready to enter into productive partnership with the entrepreneurs (Aggarwal & Yousef, 2000; Zaher & Hassan, 2001).

4. Islamic Finance and the Existing Legal Framework for SMEs in France

As part of its efforts to domesticate the EU recommendation, France has adopted the definition or categorisation of SMEs given by the recommendation. This categorisation fits into the Islamic finance framework for Islamic microenterprise because there is no generally acceptable definition for SMEs in Islamic commercial law. But there is much flexibility in the principles of Islamic jurisprudence that allows the adaptation of any paradigm that does not fundamentally contradict the basic principles of Sharī'ah. Such adaptation must be targeted at achieving public benefit (*maṣlaḥah*).Therefore, from the lexical meaning of microenterprises, they are usually small enterprises.

When one considers the principles of Islamic finance and the existing legal framework for SMEs in France, there seems to be room for interdependence and accommodation to produce economic development. With the growing number of Muslim population in France and the recent global shockwaves in the regional financial sector, Islamic financial products are becoming attractive in France. Though the rate of acceptability is still marred with scepticism, it is believed the Islamic finance market could penetrate the fabric of the French economy as it is being experienced in the United Kingdom and United States(4). Though there are some fundamental differences between the Islamic legal principles regulating financial transactions and the principles of French law, it appears that there are areas of convergence, which do not necessarily imply common foundational principles. Table 2 gives an illustration of the analogous tradition between the Islamic legal principles and the principles of French law as prepared by Marc (2008).

(4) One of the key arguments in favor of the existence of a strong demand for Islamic financial products is the size of the Muslim population in France. According to a report made by the French Senate in 2008: "France has the first Muslim community in Europe with about 5.5 million people." (Rapport d'information du Sénat 2008:10). For those who support the existence of a significant demand for Islamic retail market, there is no doubt that the large share of the French Muslim population would be willing to consume Sharī'ah-compliant products. However, an analysis of the demand side, make us realize that potential entrant's optimism is excessive when it comes to the strong demand for Islamic financial products in France. Indeed, even if France has the largest Muslim community in Europe, there is no obvious reason that these people would all be religious. Several experts like a representative from the French Banking Federation, Jean-François Pons, said that "for retail there is no significant demand for Islamic financial services". In 2010, a survey conducted by Equinox consulting concluded that demand for Islamic financial products in France would be small because only one quarter of the Muslims living in the country would be practicing. On the other hand a survey made by the IFOP institute in 2008 gave positive conclusions about the perspective of a retail market in France. The survey claimed that "more than 500,000 potential customers would be attracted by Islamic financial products." and that "more than 55% of French Muslim people would be interested in a banking supply compliant with their religious or ethical beliefs."

Table (2) Analogous Traditions in Islamic Law and French Law

Sharīʻah Principles	**Principles of French Law**
Prohibition of *ribā* Islamic finance does not authorize remuneration based on the mere passing of time	Prohibition of usury (French Commercial Code, art. L.313-3 and CMF, art. L.313-5; applicable to professionals and legal entities until 2003/2005) Prohibition of remuneration of deposit accounts until the decree of 8 March 2005
Prohibition of *garhar*, of *maysir* Islamic finance does not authorize speculation or situations of uncertainty	Regulations on gambling (French Civil Code, art.1965) Recent opening of future markets (cf. laws on deferred markets dated 28 March 1885 and 31 December 1987) Requirement to have a determined or determinable purpose (French Civil Code, art.1129)
Prohibition of *ḥarām* Islamic finance does not authorize investment in certain sectors (arms, alcohol, pornography...)	Protection of the public order and good behavior (French Civil Code, art.6)
Share of profits and losses	Obligation to share profits and losses under corporate law (French Civil Code, art.1844-1) Regime applicable to participating loans (French Monetary and Financial Code, art.L313-13 s) Regime applicable to participating instruments (French Commercial Code, art. L.228-97)
Asset-backing Islamic finance implies financing backed to a tangible asset	FCC units representing a joint ownership over the underlying assets

Source: Saint Marc (2008).

Even if French law has some connections with Islamic law in matters relating to business transactions, their underlying philosophy and justifications may differ. Nevertheless, France remains a secular country –an argument the French government has consistently adopted in relation to Islamic finance. While it may not be necessary to probe into the underlying philosophy or justifications of each legal regime, it is essential to make a *prima facie* case for the areas of convergence in order to highlight a somewhat receptive legal framework for Islamic finance in France. Table 2 above shows the general principles underlying Islamic finance transactions are not alien to the French legal regime.

5. Islamic Finance for SMEs: Legal Reforms, Challenges and Opportunities

Since 2008, French authorities have driven some initiatives to facilitate the implementation of Islamic finance in France. For instance, in 2007 and 2008, the Financial Market Authority has issued notes on Islamic mutual funds and *ṣukūk* . In 2008, an Islamic finance commission in Europlace was established in order to make some proposals for the adaptation of legal framework. (Cekici & Weil 2011).Subsequent reforms introduced in 2009 and 2010 relating to legal and tax reforms seem to provide a "soft landing" for Islamic finance particularly in the areas of developing and enhancing the SME market. Meanwhile, there was also need to amend the tax laws to avoid double taxation of underlying assets of Islamic financial products. As experienced in the UK before tax reforms, one of the major challenges for the implementation of Islamic finance in Europe is double stamp duty for Islamic mortgages; both on the purchase of the property by the bank and on the transfer of the property by the bank to the customer at the end of the mortgage. Tax law has been identified as the major obstacle to the introduction of Islamic financing structures in France. For instance, *murābaḥah* is considered as a sale contract according to which a seller sells an asset to an Islamic financier who resells it to the investor in exchange for a price (which includes a mark-up covering, notably, the financial cost for the financial intermediary, which is paid later). This tax scheme does not exempt this operation from double taxation, which is based on the sale of the asset and the mark-up.

In order to solve these problems and to promote the introduction of this new industry in France, the former Finance Minister announced during a conference in Paris on 3 November 2009, that tax instructions would be published for eliminating all tax obstacles for operations based on *ijārah*, *istiṣnā'*, and *mushārakah*. This announcement was subsequently implemented by the publication of tax instructions on 25 February 2010 and on 23 July 2010 in order to clarify *murābaḥah*, *tawarruq*, *istiṣnā '*, *ijārah* and *ṣukūk* legal and tax framework in France. Subsequently, all business operations, including SMEs backed by *murābaḥah* and *ṣukūk* currently benefit from tax neutrality. For the purpose of tax administration, *ṣukūk* are now considered as debt instruments, which benefit from tax-deductible interests and *murābaḥah* operations are exempt from taxation on the mark-up.

With these instructions, the French legal system is gradually undergoing some sort of financial revolution, which, for the first time, addresses the needs, and aspirations of a growing Muslim population. Despite the decision of the Constitutional Council in October 2009, Islamic finance benefited from the legal arrangements made by the French authorities, which permit easily the implementation of this new industry in France. The demand for Islamic financial products in France has prompted the on-going reforms to reposition and strengthen the French economy in its rightful place within the ailing European economy (Visser 2009). In fact, it demonstrates the willingness of France to welcome Islamic financial institutions in its country.

In France, banking operations are defined by articles L 311-1 and L 311-2 of the Monetary and Financial Code. They are: deposit operations, credit operations, operations of management of means of payment, connected banking operations (exchange, consulting etc.). If we focus on credit operations, we will notice that the French legal framework can accommodate Islamic credit operations without the need for any change in the law. According to Articles 1874 and following Civil Code, the loan is free in principle (Cekici & Weill 2011). Article 1905 permits the stipulation of interest, but only as an exception. As a result, interest is not an element defining credit in French law. Moreover, article L 313-1 of the Monetary and Financial Code acknowledges that credit is costly but does not explicitly require the stipulation of interest. Doctrine and case law admitted that participating earnings are acceptable as long as parties freely assent (Stoufflet 2007).

Against the above backdrop, it thus follows that to a great extent, the French law offers a suitable legal vehicle to offer Islamic financial products. For instance, *murābaḥah* transaction can be structured through forward sale; *ijārah* through leasing (credit bail regime of art. L 313-7 Monetary financial Code); *muḍārabah* through participative loans (art.L313-13 MFC); and *ṣukūk* through subordinated bonds (art.L 228-97 French Commercial Code) and fiducie (art. 2011 Civil Code). (Affaki 2009)

Since 2009, French officials have fretted about the ill-informed sloth in France in exploring Islamic financial products. There have been concerns about Paris missing out on its share in Islamic finance, particularly to London, whose multicultural approach gives an open-arms welcome to Islamic investors. For Christine Lagarde, a former French Finance Minister and the incumbent Chief of the International Monetary Fund, who has pushed to open France up to Islamic finance, "to make Paris a greater centre for Islamic finance" (Kayed, Mahlknecht, & Hassan, 2011: 380).

One would have expected a smooth sailing for any form of legal and statutory reforms for Islamic finance since there are some connections between the French law and Islamic law in matters that relate to business transactions. As explained above in Table 2, the French law seems to have some similarities with Islamic Law in matters that relate to trade and financing (Marc, 2008)[(5)]. Such areas include: the prohibition of usury (article L 313-5 of the Monetary and Financial Code), the share of profits and losses (article L 313-13 of the Monetary and Financial Code), the protection of public order and morality (articles 6 and 1133 of the Civil Code) and the supervision of gambling (article 1965 of the Civil Code).Nevertheless, a legislative reform for the implementation of Sharī'ah-compliant products in France has been stopped by the Constitutional Council in 2009. A brief overview of the facts of the case may be necessary to determine the position of SMEs that are based on Islamic finance models as well as the subsequent legal reforms introduced in France.

Islamic Finance, SMEs and the 2009 Decision of the French Constitutional Court

In a dramatic event, the French Constitutional Court on Wednesday, 14 October 2009, declared two articles in the Small and Medium-sized Enterprise (SME) Access to Credit Law unconstitutional. The two articles introduced in the amendment of the law before the French Senate would have granted access to certain credit facilities based on Islamic financial products such as *murābaḥah*, *ijārah* and *istiṣnā'*.The SMEs in France would have been able to access these Islamic financial products. The articles would have also allowed for the legalization of Sharī'ah-

(5) In French law, the joint venture defined in article 1832 of the Civil Code can be used to structure *muḍārabah* operations, partnerships for *mushārakah*, forward sale for *murābaḥah* and leasing for *ijārah*. Affaki, G. (2009) L'accueil de la finance islamique en droit français: essai sur un transfert d'un système normatif, in La Finance Islamique à la française, Un moteur pour l'économie, Une alternative éthique, sous la direction de Jean Paul Laramée, Préface d'Ahmad Jachi, de Hervé de Charrette et Avant-propos de Dominique de Courcelles, Secure Finance.

compliant *ṣukūk*. Despite the fact that the Islamic financial products in question have equivalents in the conventional finance though with some variations in contractual relationship and obligations between the parties apart from the prohibition of interest, the court ruled that the procedure through which the articles were inserted into the law was unconstitutional (Marinero, 2009).

A brief overview of the facts of the case may be necessary to determine the position of SMEs that are based on Islamic financial models as well as the subsequent legal and regulatory reforms introduced in France. On 18 September 2009, the Socialist Party members of the French National Assembly petitioned the Constitutional Court to review Articles 14 and 16 of the SME Access to Credit Law respectively.[(6)] The purpose of the law was to promote access to credit for SMEs and improve the functioning of financial markets. The amendment to the law was to allow for Sharī'ah-complaint transactions in France, which would have given a wider scope in benefiting from Islamic financial products as being experienced in the United Kingdom. This was part of the plan of the policy makers to align the French economy to best practices in global finance, which now includes Islamic finance practices. To this end, the new amendments included the insertion of article 14 amending the Monetary and Financial Code and article 16 which alters the Civil Code to allow for what may tacitly and subtly allow for Sharī'ah-compliant products within the SME market. But the members of the National Assembly from the ruling Socialist Party brought the petition before the Constitutional Court to declare the amendments unconstitutional (Marinero, 2009).

The argument of the petitioners was that the new articles inserted in the bill compromised secular law and the French legal culture, and would negatively impact the French economy in the long run. On the other hand, the proponents of the amended bill argued that allowing for such financial inclusion would allow France to tap into the global Islamic finance capital and attract foreign investors that prefer only Sharī'ah-compliant business. The court held that "Articles 14 and 16 of the Bill to promote access to credit for small businesses and improve the

(6) Decision No. 2009-589 DC of 14 October 2009, available in French at http://www.conseil-constitutionnel.fr/conseil-constitutionnel/francais/les-decisions/2009/decisions-par-date/2009/2009-589-dc/decision-n-2009-589-dc-du-14-octobre-2009.45861.html

functioning of financial markets are declared unconstitutional".[(7)] Many see this move as a betrayal of the often-declared promise of the ruling party to promote financial inclusion in the country (Parker, 2011). Given the secular nature of the French constitution, faith-based issues such as finance and face veil have remained controversial over the years. Though Islamic finance has a huge market in France greater than what is obtainable in the United Kingdom, the secular aspect, which the Constitutional Court is more inclined to invoke at any point in time, remains a major stumbling block.

Despite the decision of the Constitutional Council in October 2009, Islamic finance benefited from the legal arrangements in France, where there is much room for manoeuvre to implement Sharīʻah-compliant transactions in France. In fact the on-going reforms demonstrate the willingness of France to welcome Islamic financial institutions in its country. But a major hurdle that Sharīʻah-compliant products will have to sail through is the regulations of the French banking regulators. Before a full-fledged Islamic financial institution can be established, it needs the approval of the banking regulators.

The Autorité de contrôleprudentiel (ACP) is the French authority which issues licenses for banking business, including any potential Islamic bank. Prior to 2010, the Comité des établissements de créditet des enterprises d'investissement (CECEI) was in charge of issuing such banking license. It thus appears that since 2010, the ACP became more familiar with the specific characteristics of Islamic financial institution. However there is no official position of the authority that would give the criteria for this particular type of banks. In essence, Islamic banks are subjected to the same procedures as other institutions. There is no doubt that ACP will require Islamic banks to comply with the French law, especially the Monetary and Financial Code by stressing an internal control. Accordingly, Islamic banks should establish Sharīʻah-compliant services conforming to the French law in order to propose the best products to their customers. Islamic financial institutions will also have to respect the French prudential rules just like other conventional banks. As for the Sharīʻah Board, the ACP will follow the position of CECEI which decided in 2008 that: "the existence of the Sharīʻah Board in charge of supervising the compliance of financial products with Islamic

(7) ibid.

principles comes under the internal free decision of the institution, following the example of institutions which propose products of socially responsible investment. However its role will have to be limited to the task of supervising and certifying Islamic products. It cannot be extended further and cannot interfere with general governance of the bank and its terms for internal functioning." In spite of these positive signs from the French authorities to accommodate players of Islamic finance, there is still no Islamic bank in the country. Since 2011, the Chaabi Bank, (a Moroccan subsidiary of the French Bank: Banque Populaire) has opened offices in Paris and tried to propose Islamic financial products to its customers but all to no avail because it could not receive the approval from the regulators to market financial products as an Islamic bank.

Developing Specific Products for SMEs in France

Having examined the French regulatory and legal framework and the need to act at the appropriate time, it is pertinent to propose specific products for SMEs in France based on the Islamic finance models that have been specifically proposed for SMEs by experts. For the purpose of this paper, we specifically select two related and intertwined models – Islamic venture capital and the Islamic microfinance models –for SMEs financing. These two models, which are variously structured based on different forms of Sharīʻah-based contracts, are directly related to financing different categories of SMEs in France. Apart from the usual retail and commercial banking, one unique area Islamic finance should target is the SMEs market, as this is considered as the main driver of economic progression (Beck, Demirgüç-Kunt & Levine 2005).One has to really study the economic atmosphere in France to identify the most appropriate model. However, for this preliminary research, it suffices to propose general models for financing SMEs, which neither pose more burdens on the entrepreneurs nor exposes them to excessive risk that may ultimately jeopardise their businesses.

Considering the Option of Islamic Venture Capital

The funding problem of SMEs could be improved through medium-term equity investments through Sharīʻah-based partnership contracts (Khan & Al-Rifai 2002).The significance of venture capital in an economy cannot be overemphasised as it develops human capital, provides the required funding and encourages innovation in the SMEs market (Hasan, Mikail & Arifin 2011).Tracking the history of venture capital in Islamic law, one may unravel certain trade practices that were prevalent during the pre-Islamic period which were later modified and adapted into Islamic law as fair and just commercial transactions for SMEs (Choudhury 2001).Most of the business enterprises existing during the advent of Islam, including the partnership between Prophet Muhammad (pbuh)[(8)] and his first wife, Khadijah, were SME models. The modern conglomerate businesses were not known at that time in the world history (Watt 1961). Entrepreneurs during the 5thcentury Arabia were reported to have owned a number of caravans with some employees to manage their businesses, which suitably satisfy the requirements of modern-day SMEs (Crone 2007).

Islamic legal paradigm for the regulation and supervision of commercial transactions, which were mostly carried out through SMEs, came as an alternative model to the then prevailing pre-Islamic legal jumble. Streamlining the rules guiding business enterprise, including the injection of business ethics to the process, reengineered the Arabian economy and for once people knew the true meaning of mutual gains as opposed to the usurious exploitative tendencies that characterised the pre-Islamic era (Muhammad, et al, 2008).

It is pertinent to observe that Islamic commercial principles are inclusive provided the alien practice conforms to the general philosophy underlying Islamic commercial law (Mohammad Hussin & Mohammad Hussin 2011).Therefore, any mode of financing, which is based on equity financing through the promotion of economic growth and partnership in business, generally falls within the ambit of Sharīʻah-compliant financing provided it invests in permissible sectors and products (Smolo and Hassan;2011; Siddiqi 1985; Chapra;1992; Kia;2001; Durrani & Boocock; 2006).Table 3 below juxtaposes the major principles underlying the conventional venture capital practice with the Islamic paradigm.

(8) An abbreviation for "May peace be upon him", which is required, according to Islamic beliefs, of Muslims when they mention, or hear the mentioning of, the name of the Prophet.

Table (3) Sharīʻah view of Some Key Practices in Venture Capital Financing

Conventional Venture Capital Practice	Islamic View
Limited partnership structure	Acceptable
Long terms contracts	Acceptable
Contracts can be nullified	Acceptable
Restrictions placed on the activities of fund managers	Acceptable
Equity ratchets to entrepreneurs	Acceptable
Investments in equity, fully convertible bonds (zero coupon)	Acceptable
Preferred stocks, preference shares or convertible debt	Not Acceptable
Greater control rights through restrictive covenants	Acceptable
Board seat	Acceptable
Staged financing	Acceptable
Replacement of management (CEO)	Acceptable
Liquidation rights	Acceptable
Provision of non-financial services (strategic advice etc.)	Acceptable
Application of discount rate for valuation	Acceptable

Source: (Durrani & Boocock, 2006: 166)

The similarities in the two models of venture capital financing outweigh the differences. Generally, "venture capital financing is praised for its role in promoting growth while maintaining financial stability" (Al-Suwailem, 1998: 3).According to Nik Ramlah Nik Mahmood, former Managing Director, Securities Commission Malaysia, "Venture capital brings profound impact to the economy. It bridges the financing gap where direct bank lending or financing through the debt or equity market is difficult to obtain" (Nik Mahmood, 2008).This far-reaching impact of venture capital makes it appealing for France to try out the Islamic finance model of venture capital to enhance the productivity of the SMEs. Nisar (2010, 12) identifies the following three key advantages of venture capital in economic transformation:

1. "Venture capital is most attractive for new companies with limited operating history that are too small to raise capital in the public markets and have not reached the point where they are able to avail financing from banks;

2. Technology advancement;

3. Increase in job creation and innovation in an economy. We have examples of highly successful companies originated by venture capitalists such as Google, Amazon, Apple Computer, Intel, FedEx and Microsoft".

Though we may not need to restate the principles of major Islamic financial products utilized in the venture capital structure, suffices to observe that the *mushārakah* and *muḍārabah* models are primarily two notable venture capital models (Durrani & Boocock; 2006; Al-Suwailem, 1998).Streamlining them to meet the needs of modern SMEs require proper product development. The business ethics paradigm of Islam will go a long way in structuring the products to boost the French SMEs even though some may likely consider this as an interference of religion in the state particularly in such a secular society (Choudhury & Hoque, 2004).Ethical investment is not all about prohibiting gambling, pornography and alcohol alone; it also extends to compliance with contractual terms, deceptive advertising and misrepresentation, accurate measurements and weights, hoarding and destruction of surplus produce, fair recruitment practices, corporate governance, environmental protection, etc. (Durrani & Boocock 2006; Warren 2011).

Though venture capital financing is used for capital project development in some cases (Choudhury 2001), there is an opportunity to specifically structure the Islamic venture capital model to primarily serve the SME market in France. Bringing to bear the salient Islamic commercial law principles, such as profit and loss sharing, prohibition of interest-bearing loans and transactions, avoidance of speculative transactions, and promotion of socially responsible investments, will encourage equity financing as opposed to debt-based financing (Hj. Nawawi 2009).

For proper regulation of venture capital financing for SMEs, there is need for regulations to guide the market. The *Guidelines and Best Practices on Islamic Venture Capital* of the Securities Commission Malaysia issued in May 2008 would serve as a good model (Securities Commission Malaysia 2008).The three main Sharī'ah principles and concepts identified in the Guidelines are *muḍārabah*, *mushārakah*, and *wakālah* (agency contract).These Guidelines are meant to be read and interpreted with the *Guidelines for the Registration of Venture Capital*

Corporations and Venture Capital Management Corporations issued by the Securities Commission (Securities Commission Malaysia 2002).This is a good model of the harmonization of the venture capital financing in both the conventional practice and Islamic finance.

Micro-enterprises: The Islamic Microfinance Models for SMEs

Another model introduced specifically for SMEs is Islamic microfinance, which is also premised on a number of Islamic modes of financing depending on the way they are structured (Dhumale & Sapcanin, 1999).Apart from the need to alleviate poverty through microfinance models, empowering the poor through micro-lending and micro-enterprises is also paramount (Rahman 1999).Rather than just giving a man a fish, taking sustainable steps to teach the same man how to fish will empower such a person and boost the overall economy of the country. This is the role of microfinance in the society. It is important to clarify the need to use the term “Islamic microfinance” rather than just “microfinance.”Table 4 below gives a summary of the major differences between the Islamic microfinance model and the conventional microfinance framework.

Table (4) Differences between Islamic and Conventional Microfinance Institutions (MFIs)

	Islamic MFI	**Conventional MFI**
Liabilities (Source of Funds)	External Funds, Savings of clients	External funds, Savings of clients, Islamic Charitable Sources
Assets (Mode of financing)	Interest-based	Islamic Financial Instruments
Funds transfer	Cash given	Good transferred
Deductions at inception of contract	Part of the funds deducted at inception	No deductions at inception
Target group	Women	Family
Objective of targeting Women	Empowerment of women	Ease of availability
Liability of the loan (when given to women)	Recipient	Recipient and spouse
Work incentive of employees	Monetary	Monetary and religious
Dealing with Default	Group/center pressure and threats	Group/center/spouse guarantee, and Islamic ethics
Social Development Program	Secular (or un-Islamic) behavioral, ethical, and social development.	Religious (includes behavior, ethics, and social)

Source: (Ahmed, 2002: 41)

There is no doubt that there are different models of conventional practice of microfinance but any form or model that complies with the basic norms of Islamic finance through profit and loss sharing principles, benevolent loan (*Qarḍ ḥasan*) model, charitable endowment (*waqf*), *zakāh* and *ṣadaqah* (obligatory and voluntary alms), and investment in permissible class of products, targeted at the poor who are financially excluded from conventional financing, may be regarded as Islamic microfinance (Oseni and Hassan, 2012; Ahmad & Al-Mubarak 2011).

Though most existing Islamic banks across the world do not engage in micro-financing – a common practice that is antithetical to the very basis of Islamic finance – it is important to emphasise that in order to fulfil the objectives of Islamic law (*maqāṣid al-Sharī'ah*) in their banking businesses, microfinance should be part and parcel of their businesses (Shahinpoor 2009).Even though some scholars have proposed specialised financial institutions for microfinance, the Islamic banks should not only finance macro business ventures or serve the rich (Ahmed 2002).They should also finance microenterprises and SMEs. The Islamic banks and financial institutions can reasonably serve as institutional providers of credit facilities for SMEs through partnership contracts such as *muḍārabah* and *mushārakah* models (Dusuki 2008). Specifically, Islamic microfinance models that may be utilised by Islamic banks and financial institutions in supporting SMEs include participatory-based Islamic financial products such as *mushārakah* and *muḍārabah*; exchange-based models such as *murābaḥah*, *salam* (Forward sale), *istiṣnā'* (manufacturing contract), and *ijārah* (lease contract); voluntary charitable contracts such as *rahn* (mortgage contract), *Qarḍ ḥasan* (benevolent loan); and hybrid contracts such as *mushārakah mutanāqiṣah* (diminishing partnership), and *ijārahthumma al-bay* (hire purchase contract) (Dusuki 2008).

For example, in a *muḍārabah* model of Islamic microfinance targeted at SMEs or micro-entrepreneurs, the micro-entrepreneur does not just get the credit facilities from the microfinance institution or bank (Shubber 2011). They become partners in the clearly defined partnership of trust financing. That is, the microfinance institution or Islamic bank and the micro-entrepreneur become business partners in the contract where, in most cases, the microfinance institution is the capital provider (*rabb al-māl*) while the micro-entrepreneur is the entrepreneur (*muḍārib*).In some situations this contractual relationship is structured in a way that would allow each party to contribute both financial and managerial resources to the venture. This may be termed a *mushārakah* contract. The underlying contract must clearly specify the profit sharing ratio as well as the rights and liabilities of the parties (Abdul Rahman, 2010).

Apart from the simple *muḍārabah* microfinance model which involves just two parties on a bilateral contractual arrangement as explained above, an alternative model is to have a two-tier *muḍārabah* model popularly known as re-*muḍārabah* where the arrangement involves three parties –capital provider, intermediate *muḍārib* and the final *muḍārib* (Abdul Rahman 2007).In this arrangement, the capital provider may be the government, *zakāh* or *waqf* foundation, or an Islamic bank. The intermediate *muḍārib* is a dedicated microfinance institution that practically manages the funds disbursed by the capital provider and may provide technical assistance to the final *muḍārib*. The final *muḍārib* is the micro-entrepreneur who practically manages the business only or in conjunction with the intermediate *muḍārib* (Abdul Rahman, 2007; Abdul Rahman 2010).Though these strings of contracts are linked, they are to be concluded as independent contracts. The Islamic microfinance paradigm will be useful for self-entrepreneurs. It will also help in cushioning the effects of austerity measures through the provision of credit facilities which are not merely meant to further impoverish the poor, but to empower them through partnership business models in the SME market.

On a final note, one may propose another Sharīʻah-compliant model that is specifically regulated by the existing legal and regulatory framework in France. On 17th July 2007, Autorité des marchés financiers (AMF) otherwise known as the Financial Market Authority issued a note that allows Islamic mutual funds to trade their products in France. According to a report, this is "the first mutual fund created by BNP Paribā s Asset Management: Easy ETF DJ Islamic Market Titans 100 which aims at replicating the performance of the Dow Jones Islamic Markets Titans 100 index. This index being composed of 100 stocks of the world's largest world companies respecting Sharīʻah principles" (Rapport d'information du Sénat2008: 47).

According to the directive, the AMF requires Islamic mutual funds to comply with the following requirements:

1. The management company is supposed to preserve its independence from the Sharīʻah Board. This means the company is in

charge of the selection of securities whereas the Sharīʻah Board only gives its opinion.

2. All the selection criteria must be compliant with legal requirements.

3. Discriminatory criteria based on religion are forbidden in the selection of managers of the company issuing the securities.

4. Shares of revenues considered as impure/*ḥarām* can be redistributed to charitable organizations provided that the prospectus mentions the beneficiary which has to be a non-profit organization.

The Undertakings for Collective Investments in Transferable Securities (UCITS) are investment vehicles that can be marketed across the EU. Since 2007, the AMF has allowed the marketing of Islamic UCITS which are as a matter of fact compliant with Sharīʻah principles (Riassetto2011).Such companies who adopt the Sharīʻah-compliant UCITS take into account extra-financial criteria in their investment decisions. For instance, such funds cannot invest in SMEs which trade in alcohol, pork, arms, etc. Therefore, the Islamic venture capital model may be structured under these existing legal and regulatory frameworks. Undoubtedly, the modern economies are increasingly yearning for alternative modes of financing to boost their Gross Domestic Product (GDP).

Conclusion

With the recent downgrade of the credit rating of France by Standard and Poor's, France must re-strategize and reengineer its economy through sustainable economic policies (Charlton & Kondo, 2012; Wiesmann, Spiegel, & Wigglesworth 2012).Apart from the economic gains, the fact that there is a considerably large market for Islamic financial products in the country, it is a good incentive for the integration of Islamic finance in French financial framework. Islamic finance is more than just a faith-based alternative, which does not necessarily have anything to do with fundamentals of acts of worship in Islam. So, any SME product or commercial banking alternative proffered by Islamic finance should be embraced without any spectre of scepticism. From the tremendous growth recorded in the last decade in the global Islamic finance industry and its widespread across all nooks and corners of the world, it seems it has become an invaluable force to be reckoned with in most countries despite some occasional political tantrums being experienced from some quarters.

While exploring alternative business models such as the Judeo-Christian and Islamic ethical business models, there should be emphasis on ethical financing (Warren 2011).This is an inherent feature of Islamic financial products. This paper therefore examined the adaptability of key Islamic financial products in France –the second largest economy in Europe. In continental Europe, Germany – the largest and strongest economy in Europe – has taken the lead in integrating Islamic financial products in its economy. France should not be an exception in this difficult time in the history of the continent.

In these difficult times of financial crisis, Islamic finance should be geared towards developing the SMEs as niche market for the time being. Experience shows that focusing on a niche market such as the SMEs has yielded more beneficial results than a full-scale introduction of an alternative financial system at a time (Salavou & Avlonitis 2008).Gradualism is encouraged in the process of introducing new financing schemes in a secular society to avoid swift opposition as earlier witnessed in France.

There is a need to scale-up SME programs and SME access to cushion the effect of the biting financial crisis on common people; particularly in the face of the series of austerity measures introduced in some countries in Europe. More importantly, stakeholders in the global Islamic finance industry should come up with standard benchmarks for the pricing of Islamic financial products to avoid the unwarranted criticisms being hurled at the Islamic finance industry as a result of excessive profit rates in some products that have cheaper conventional counterparts. Transparency, accountability and fairness should be the guiding principles in Islamic financial engineering especially when that involves the financing of SMEs based on unique structures such as *muḍārabah* or *mushārakah*. The underlying principles of the proposed Islamic financial products for SMEs are also present in the relevant French law and its legal heritage. Undoubtedly, this is the time to explore and integrate viable alternatives that are within the realm of possibility.

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نموذج تمويل إسلامي للمؤسسات الصغيرة والمتوسطة في فرنسا

عمر أوسيني وكبير حسن ودرساف متري

المستخلص. أثرت أزمة الديون السيادية بشكل كبير على أداء اقتصاديات دول الاتحاد الأوربي خاصة اليونان، وإيطاليا، وإسبانيا، والبرتغال. وها هي تلك الآثار تمتد إلى دول لها وزنها في هذا التكتل الاقتصادي؛ كفرنسا، وذلك لما أحدثته السياسات الاقتصادية المنتهجة من آثار سلبية على أداء هذه الاقتصاديات. فقد خفضت وكالة التصنيف الائتماني ستناندراردز آند بورز درجة التصنيف الائتماني للحكومة الفرنسية. هذه الوضعية التي عليها حال اقتصاديات الدول الأوربية تستدعي إعادة النظر في السياسات المنتهجة لاحتواء آثار هذه الأزمة. إن الحاجة لاحتضان مؤسسات إبداعية صغيرة ومتوسطة الحجم مع الحفاظ على نمو المؤسسات القائمة يشكل تحديًا كبيرًا للاقتصاد الفرنسي؛ حيث يشير التقرير الأخير الذي أصدره المعهد الوطني للإحصاء والدراسات الاقتصادية أن عدد هذه المؤسسات يقدر بما يزيد عن ٢,٥ مليون، وأن حوالي نصف المؤسسات الجديدة تتعرض للفشل على المدى الطويل. تستعرض هذه الورقة حاجة هذا الصنف من المؤسسات إلى تمويلات بديلة عن التمويل التقليدي القائم على الفائدة والضمان. وبما أن التمويل الإسلامي قائم على نموذج تمويل أخلاقي فيُتوقع منه أن يساهم في دعم الابتكار والاستمرارية في المؤسسات المتناهية الصغر، والمؤسسات الصغيرة والمتوسطة. إن الاقتراض القائم على الفائدة مع تقديم الضمانات المطلوبة للمصارف لا يزال يمثل المصدر الرئيس لتمويلات هذا النوع من المؤسسات على المستوى الأوربي، إلا أن المعطيات تشير إلى انخفاض مستويات التمويلات عما كانت عليه قبل اندلاع الأزمة. في ظل هذه الأوضاع المالية الصعبة فإن البحث عن البديل يصبح أمرًا ضروريًا ومهمًا. من البدائل التي تناقشها الورقة؛ منتجات البديل الإسلامي القائم على المشاركة في المغانم والمغارم. لقد اصبح هذا البديل محل عناية واهتمام على المستوى الأوربي. تقدم هذه الورقة مقترحات تمويلية بديلة للمؤسسات الصغيرة والمتوسطة، ومن ذلك رأس المال الإسلامي المخاطر في ضوء الأطر الإشرافية والقانونية الفرنسية.