Sharia Compliant “Possibility for Italian SMEs”

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Abstract— Islamic Finance have been a flourishing phenomenon recently with a very high growth rates and countries worldwide are exerting efforts to introduce it as an alternative financial system especially after proving its stability in the last financial crisis. Introducing the Islamic finance in Italy would be very important step with high potential opportunities due to the creation of investment opportunities, increase of liquidity, accessing Arab sovereign funds, and promoting integration policies for immigrants. Understanding the current nature of the Italian companies in particular the Small and Medium Enterprises (SMEs) and by testing their eligibility of being Sharia compliant in this paper; which is a fundamental step for exploring the feasibility of adapting them to the Islamic financial system and therefore the possibility for financing them through Islamic financial instruments; had proved its validity with an optimal results whether on the screening process or the performance and profitability measures.

Keywords: Islamic finance, Sharia Compliant, SMEs, Sharia Indices, Sharia Compliant Screening.

I. RESEARCH PROBLEM AND OBJECTIVES

Small and Medium Enterprises (SMEs) are the basic stones in most of the economies. They contribute heavily to the economic growth worldwide. Most of the countries always try hardly to encourage development of SMEs as it contributes a lot not only to economic growth, capital accumulation but also through the employment opportunities that they create.

This research aims to explore the feasibility of adapting Italian SMEs to the Islamic financial system and verify the possibility of financing them through Islamic financial instruments which requires certain aspects to be fulfilled. Applying this would require that the Italian SMEs to be a Sharia compliant.

Objectives of the research are:

- To test the Italian SMEs for Sharia compliant screening
- To determine the eligibility of Italian SMEs to the Islamic finance
- To evaluate the problematic criteria’s that could prevent the SMEs from being eligible
- Figuring out what are the suitable tools that Islamic finance could offer to SMEs

II. INTRODUCTION AND LITERATURE REVIEW

Islamic finance is, indeed, a growing sector with its diversity in different segments in various parts of the world. Although the Islamic finance industry started to flourish recently, Islamic theories of economics have existed for more than a millennium. However, only in the 20th century Muslim scholars and academics seriously started to revisit these topics; and this had been the beginning for the modern Islamic finance industry to emerge in the 1970s (Iqbal & Mirakhor 2011) [13]. Islamic finance has not taken root solely in Muslim countries but has also spread to non-Muslim countries. It is not serving only religious Muslims in Muslim’s societies and Muslims in Western countries but also it started really to flourish as an ethical non risky attractive financial instrument for Non-Muslim population.

Islamic finance is a system for all financial transactions that are conducted according to Sharia which is the legislative framework that regulates all aspects of life for Muslims; it governs all their public and private life. Sharia is derived directly from four main sources: 1) The Holy Quran; which is the Holy book that contains the words of Allah “God”. 2) Sunna; which refers to Hadith “sayings”, actions, of Prophet Mohamad “Messenger of Allah”. 3) Ijma; which is the consensus of all Muslim scholars on a specific issue. 4) Qiyas; means “Analogy” and this for the issues that were not explicitly mentioned either in Quran or in Sunna and consequently in this case it is declared by qualified scholars who evaluate a measurement through studying rules applied for similar issues.

Islamic finance from an economic point of view refers to a system which identifies and promotes economic and financial orders that are consistent with the principles of Sharia [7]. These principles differentiate Islamic finance from the conventional finance. Specifically, Islamic principles require that Muslims earnings must come from permissible means, and
must also be spent on acceptable categories of expenditure that are Sharia Compliant “adhering completely to Sharia principles”. Consequently, Islam prohibits investing in businesses that are considered unethical or contrary to the Islamic ethical teachings and values.

Islamic economics is mainly concerned about the distribution of wealth as a mean for achieving justice, equality, fairness, and economic equilibrium among the society. Muslims are encouraged to maximize their wealth as long as they do not create a situation that is creating a social distortion or violating the norms of Islamic justice.[4]. As a result the need for financial institutions, products and contracts that is compliant with Sharia and within the constraints of Islamic ethical principles.

Sharia compliant institutions are similar to conventional financial intermediaries in that they are profit maximizing institutions and offer traditional banking services, but differ in some of the principles under which they operate [9]. Research from the International Monetary Fund (IMF) indicates that Islamic banking appears to be a complement to conventional banks, rather than a substitute.

A core concept of finance in Islam is that Allah “God” is the owner of all wealth in the whole world, however at the same time, Muslims have the right to enjoy whatever wealth they acquire and spend it in Sharia compliant ways. The most important principles of Islamic finance include a prohibition for Riba “Usury”, prohibition of Gharar “uncertainty or speculation”, prohibition of Maysir “Gambling” and prohibition on investment in Non–Halal that is equivalent to Haram “unethical” businesses products or services (such as alcohol, tobacco, pork, adult entertainment, and weapons). Sharia compliant products must be backed by or based on an identifiable and tangible underlying asset; it is also important that the investor and investee adhere to the concept of profit and loss sharing which is in other terms sharing the risk of all financial transactions.

Islamic Financial products, while they are derived from Islamic ethical laws, are not limited to Muslims population only but they are available to everybody. It is a technical financial system that is operating on an ethical basis that is very similar to the social responsibility investments that promotes for an ethical finance.

Islamic Finance is considered to be the fastest growing sector of finance in the world. The Islamic finance industry has experienced in recent years (estimated at 10%-20% annual growth) [3]. Industry experts estimate that assets held under Islamic finance management doubled between 2007 and 2010 to each around $1 trillion [10]. A survey of the top 500 Islamic financial institutions shows that Sharia compliant assets in these institutions rose from $822 billion in 2009 to $895 billion in 2010.

III. FUNDAMENTALS AND FINANCIAL INSTRUMENTS OF ISLAMIC FINANCE

Islamic finance institutions operate with reference to principles of Sharia. Those principles have got specific characteristics and prohibitions that regulate it which are different from the traditional conventional financial institutions features.

1. Prohibition of Riba “Usury or Interest”:

From a Sharia prospective, riba “interest” is considered to be usurious and is prohibited. Riba refers to the premium that must be paid by the borrower to the lender along with the principle amount as a condition for taking the loan. Scholars have classified riba into two types that could be seen in;

- Inequality of quantity or weight and dissimilarity of quality exchanged between parties
- The extension of the repayment period of a loan for additional amount of money. It makes no difference whether the loan is for consumption, or business purposes, or whether the return is a fixed or a variable percentage of the principal. It also makes no difference whether an absolute amount to be paid in advance or on maturity, or received in the form of a gift or a service if stipulated as a condition in the loan contract or an extension in its maturity” [2].

2. Prohibition of Gharar “Uncertainty or Speculation”:

Gharar “uncertainty” in Arabic refers to excessive risk, uncertainty and hazard. Gharar can be seen into two types: gharar in the object of the contract and gharar in the terms of the contract. The rationale behind the prohibition of gharar is that to ensure the full consent of all parties in a contract.

3. Prohibition of Maysir “Gambling”:

Maysir in Arabic means gambling which is hazard game of chance and it is considered as an extreme form of gharar. It refers to all transactions that have the element of gambling i.e. based merely on chance. The logic behind the prohibition of maysir is that the unjustified gains and increase of wealth through games of pure chance is a transfer of wealth from one to another and this kind of transfer is done on the expense of the society.

4. Principle of Profit and Loss Sharing (PLS):

The Islamic ethics and Sharia has encouraged the increase of wealth however this increment should be done with reference to a very important principle which is Profit and Loss Sharing (PLS): This principle specifically refers to an equitable sharing of risks and profits between the parties involved in a financial transaction. Earnings of profits or returns from assets are permitted as long as the business risks are shared by the lender and borrower.
5. **Prohibition of Haram “Unethical” Versus Halal “Ethical Investments”:**

Sharia has prohibited Haram “unethical activities”. Haram unethical activities are represented not only in the riba, gharar, maysir but also for specific businesses and industries that are forbidden in socially and ethically manner that do not work in the direction of benefiting the society. These include, for example, pornography, alcohol, weapons, pork based products...etc. It is also not allowed to acquire the shares of the companies providing financial services or business that is not Sharia compliant.

6. **Necessity of Underlying Tangible Asset:**

Sharia defined that each financial transaction must be tied to a “tangible, identifiable underlying asset,” i.e. real estate or commodities, etc. Money is recognized in Islam as a means of exchange, but not as a commodity because it is not capable of fulfilling human needs unless converted into a commodity. Sukuk which are Islamic financial instrument that are similar to those of conventional bonds but a key difference is that they are backed with underlying asset.

7. **Obligation of Zakah “Purification”:**

Zakah is one of the five pillars of Islam and is a religious duty for Muslim as a charitable activity for the needy and poor. Zakah has a strong rationale behind being an obligation as for its great benefit for the society and the reinforcement of the social responsibility towards the poor and needy.

IV. **FINANCING MECHANISM AND ISLAMIC FINANCIAL CONTRACTS**

The previously mentioned fundamental principles in Sharia concerning the financial transactions and operations should be transformed into a set of rules and contracts or financial instruments to be practically used.

A. **Equity-Based Financing Mechanism**

The most widely used contracts in the Equity-based modes are the Musharaka “Joint Venture or Partnership of Equity Participation” and Mudaraba “Partnership”. They are mainly based on the modes of profit and loss sharing, where the profitability of Islamic institutions is directly linked to their physical investments. This constructs the main difference between the Islamic banks and the conventional banks that get the return in the form of interest on the loans provided to the customers regardless the fact that they invested this loan and whether it generated any profit or not [8].

B. **Debt-Based Financing Mechanism**

The debt-based financing is a mechanism that depends on the idea of a fixed return on investment. In order to achieve this concept with a Sharia compliant way without breaking the rule of prohibition of Riba “interest” it must be done in a particular mechanism. This mechanism is done by mark up cost plus concept and this can be used in contracts that are based on sale with a deferred payments or purchase or that are based on leasing. Most well known contracts are Murabaha “cost plus mark up”, Ijara “leasing”, Salam and Istisna.

V. **SHARIA COMPLIANT SCREENING METHODOLOGY**

Investments should always be Sharia compliant, which requires screening for its eligibility for qualitative and quantitative criteria. The qualitative criteria are mainly related to the business activity of the company and it permissibility according to Sharia. Regarding the quantitative criteria they are a set of financial ratios and levels that had to be examined and their results should not exceed specific threshold.

1. **Qualitative Screening Criteria**

Companies must have their activities within the permitted activities which are named Halal and avoid all non permitted activities which are referred as Haram activities. Activities should of course include all of the production and sales of the company’s products. Screening for those activities in the companies is considered a fundamental step and crucial phase. This step represents the classification of the core business of each company. Passing this initial qualitative screening phase means moving towards a quantitative financial screening.

Non permissible activities are those:
- Alcohol
- Pork related products
- Pornography
- Tobacco
- Gambling
- Interest bearing financial services (i.e. conventional banks and insurance companies)
- Weapons and defense
- Biological human and animal genetic engineering (ex: cloning)
- Media and advertising companies with exception to news channels, newspapers, and sports

2. **Quantitative Screening Criteria**

The second phase is the quantitative screening in which the financial ratios of the companies are tested for not exceeding specific threshold that are different among the different global indices.

The three main aspects that should be tested are the leverage level (debt level ratio), interest ratio, and the liquidity ratio (cash and account receivables), and finally the portion of revenue that is generated from non compliant operation.
- **Level of Debt**: Any interest based debt is not permitted according to Sharia principles and this ratio verifies that the interest based debt is not exceeding the specified threshold.

- **Interest Ratio**: The second ratio is the interest one which tests practically the investment in interest bearing securities and assuring that the income generated is not considered riba.

- **Liquidity Ratio**: The third ratio is the liquidity ratio that is mainly focused on testing the liquid assets in the company (i.e. cash and accounts receivables).

- **Non Permissible Income**: There is a final criteria of financial ratio to be verified as well which is the level of non permissible income ratio. There is a minimum level of tolerance to accept some income that is generated from impermissible operations as long as the business sector is Sharia compliant.

### VI. SHARIA COMPLIANT DIFFERENT INDICES

The most famous worldwide Islamic indices are:

1. S&P 500 Sharia Index
2. Dow Jones Islamic Market Indices
3. FTSE
4. MSCI Islamic Index Series
5. Security Exchange Commission (SEC) Shariah Advisory Council of Malaysia (SAC)

The main differences applied among them in the qualitative and quantitative criteria could be seen and summarized in the following two tables:

**TABLE I. QUALITATIVE CRITERIA**

<table>
<thead>
<tr>
<th>Activity</th>
<th>S&amp;P</th>
<th>Dow</th>
<th>FTSE</th>
<th>MSCI</th>
<th>SEC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alcohol</td>
<td>AI</td>
<td>AI</td>
<td>CB</td>
<td>CB</td>
<td>CB</td>
</tr>
<tr>
<td>Tobacco</td>
<td>AI</td>
<td>AI</td>
<td>CB</td>
<td>CB</td>
<td>CB</td>
</tr>
<tr>
<td>Pork</td>
<td>AI</td>
<td>AI</td>
<td>CB</td>
<td>CB</td>
<td>CB</td>
</tr>
<tr>
<td>Pornography</td>
<td>AI</td>
<td>AI</td>
<td>CB</td>
<td>CB</td>
<td>CB</td>
</tr>
<tr>
<td>Gambling</td>
<td>AI</td>
<td>AI</td>
<td>CB</td>
<td>CB</td>
<td>CB</td>
</tr>
<tr>
<td>Media</td>
<td>AI</td>
<td>AI</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Conventional Financial Services</td>
<td>AI</td>
<td>AI</td>
<td>CB</td>
<td>CB</td>
<td>CB</td>
</tr>
<tr>
<td>Conventional Insurance Services</td>
<td>AI</td>
<td>AI</td>
<td>CB</td>
<td>CB</td>
<td>CB</td>
</tr>
<tr>
<td>Weapon / Defense</td>
<td>-</td>
<td>AI</td>
<td>CB</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gold &amp; Silver Hedging</td>
<td>AI</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Entertainment</td>
<td>AI</td>
<td>AI</td>
<td>CB</td>
<td>CB</td>
<td>CB</td>
</tr>
<tr>
<td>Hotels</td>
<td>AI</td>
<td>AI</td>
<td>CB</td>
<td>CB</td>
<td>CB</td>
</tr>
</tbody>
</table>

*AI refers to exclude any involvement  **CB refers to: exclude core business involvement*
The Italian SMEs are the main composer of the Italian enterprises as they represent 99.9% of the total enterprises. Despite of this strong presence but their performance and access to finance are the major problems facing the Italian SMEs. Since 94.6% of the SMEs are of micro enterprises which are the most companies that face difficulty to access finance from banks since they are too small and are considered risky business, moreover they lack international exposure, and business development [5].

The huge share of SMEs in the total of Italian enterprises makes it of great importance to try finding new possible alternative for financing them. This could be found in the Islamic financial system. The Islamic finance has got many available mechanisms for financing enterprises whether equity based financing mechanisms or debt based financing mechanisms.

In order to be able to use Islamic finance for financing Italian SMEs, they should be approved as Sharia compliant and here comes the significance for testing and measuring the Italian SMEs for being Sharia compliant.

VIII. RESEARCH TOOL

This empirical research is conducted based on several assumptions that had been used are covering both the qualitative and quantitative criteria for Sharia compliant screening. The used search database bank for reaching information regarding all Italian SMEs is Aida which is an Italian company information and business intelligence that is a huge databank source that provides full details about Italian companies.

Small and Medium Enterprises (SMEs) are the basic stones in most of the economies. They contribute heavily to the economic growth worldwide. Most of the countries always try hard to encourage development of SMEs as it contributes a lot not only to economic growth, capital accumulation but also through the employment opportunities that they create.

Small and medium enterprises (SMEs) are entrepreneurial organizations with limited number of employees and specific financial threshold. The definition of parameters threshold is different from one country to another. SMEs have problems in accessing finance, and banks are always reluctant in financing them.

The Italian SMEs current parameters definition compared to its existing share in the economy as follows:

<table>
<thead>
<tr>
<th>TABLE II: QUANTITATIVE CRITERIA</th>
<th>TABLE III: ITALIAN SMEs PARAMETERS – ECONOMY SHARE</th>
</tr>
</thead>
<tbody>
<tr>
<td>S&amp;P</td>
<td>Dow Jones</td>
</tr>
<tr>
<td>Level of Debt</td>
<td>Total Debt / Market Capitalization (avg 36 months) &lt; 33%</td>
</tr>
<tr>
<td>Interest Ratio</td>
<td>Cash &amp; Interest bearing Securities / Market Capitalization (avg 36 months) &lt; 33%</td>
</tr>
<tr>
<td>Liquidity Ratio</td>
<td>Accounts Receivables / Market Capitalization (avg 36 months) &lt; 50%</td>
</tr>
<tr>
<td>Non Permissible Income (NPI)</td>
<td>NPI (excluding interest) / Total Revenues &lt; 5%</td>
</tr>
</tbody>
</table>

VIII. EMPIRICAL RESEARCH SHARIA COMPLIANT SCREENING FOR ITALIAN SMEs

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The Italian SMEs current parameters definition compared to its existing share in the economy as follows:

<table>
<thead>
<tr>
<th>Number of Employees</th>
<th>% of Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Micro: 1-9</td>
<td>94.6%</td>
</tr>
<tr>
<td>Small: 10–49</td>
<td>4.8%</td>
</tr>
<tr>
<td>Medium: 50–249</td>
<td>0.5%</td>
</tr>
<tr>
<td>Large &gt; 250</td>
<td>0.1%</td>
</tr>
</tbody>
</table>

The number of employees is measured in the following way:

- Micro: 1-9
- Small: 10–49
- Medium: 50–249
- Large > 250

The Italian SMEs are the main composer of the Italian enterprises as they represent 99.9% of the total enterprises. Despite of this strong presence but their performance and access to finance are the major problems facing the Italian SMEs. Since 94.6% of the SMEs are of micro enterprises which are the most companies that face difficulty to access finance from banks since they are too small and are considered risky business, moreover they lack international exposure, and business development [5].

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In order to be able to use Islamic finance for financing Italian SMEs, they should be approved as Sharia compliant and here comes the significance for testing and measuring the Italian SMEs for being Sharia compliant.

This empirical research is conducted based on several assumptions that had been used are covering both the qualitative and quantitative criteria for Sharia compliant screening. The used search database bank for reaching information regarding all Italian SMEs is Aida which is an Italian company information and business intelligence that is a huge databank source that provides full details about Italian companies. The pool that is to be examined is the Italian companies in specific the unlisted ones that are of them SMEs. This is considered a new assumption that this paper propose, since the test will be applied for the unlisted companies only so for example there is no available market capitalization for them (that was previously mentioned in testing the quantitative criteria).
IX. RESEARCH HYPOTHESIS

- First hypothesis is imposing a criterion that companies should be owned by ultimate user and specifying its characteristics of their ultimate owner to be domestic so this assures that it is Italian and then another filter for the type that is owned by one or more individuals or families. This is to stress on the fact that it is not consolidated to another group.

- Second hypothesis is an additional filter for the stock data and was imposed to select unlisted companies only.

- Third filter is related to the type of industry of the companies and that will be the first step in the quantitative screening as it is set to exclude all Haram (non Halal) activities that are considered not permitted according to Sharia.

The quantitative screening starts with the financial variable index for verifying the liquidity ratio. As it was mentioned before that we are testing a new assumption for the unlisted companies so there is no available market capitalization. As a result the formula was set to measure relatively to the shareholders equity. The idea behind the choice of using the equity shareholders instead of using for example total assets as mentioned in some indices is that the value of shareholders equity is indeed lower in its amount that the total assets, which by dividing the value of debt or interest will give a higher value and this makes this filter much more rigid in its verification. So starting liquidity, the formula used is:

\[
\text{Total Accounts Receivables / Total Shareholders Equity}
\]

“With the imposition of threshold: < 33%”

- The second financial variable index is for verifying the Interest ratio. The filter was set to impose the formula and limit it to the accepted threshold. The formula is:

\[
\text{Cash & Interest Bearing Securities / Total Shareholders Equity}
\]

“With the imposition of threshold: < 33%”

- The third financial variable index is for verifying the debt level ratio. The filter was set to impose the formula and limit it to the accepted threshold. The formula is:

\[
\text{Total Debts / Total Shareholders Equity}
\]

“With the imposition of threshold: < 33%”

- The fourth and last financial variable index is for verifying the non permissible income ratio. This filter was set to impose the formula and limit it to the accepted threshold. The formula is:

\[
\text{Non Permissible Income / Total Revenue}
\]

“With the imposition of threshold: < 5%”

- The exclusion of all inactive companies and to limit the pool to legally active companies.

X. ANALYSIS OF FINDINGS

Important results and findings were seen after applying all the imposed filters and looking to the final outcomes of the research. Those results are extremely important whether on the level of eligibility to Sharia or on the level of those companies profitability.

First focusing on the screening process regarding the type of business and sector when it was imposed the filter for excluding the Non Halal i.e. Haram activities which are prohibited according to Sharia it was only excluded few companies despite of excluding many impermissible activities and despite also that it was excluded some industry as a whole for example the meat industry was excluded as a whole not only pork related products and this was just to ensure that the prohibition is totally covered. The companies that were excluded from the pool in the filter imposing the qualitative criteria were very few. The total companies prior to qualitative criteria were 389,970 and the total number after applying the filter was 371,268 that successfully passed the screening. This means that only 18,702 companies were excluded.

This indeed gives a strong message regarding the business activities of the Italian SMEs that they are not having a problem with the qualitative criteria of Sharia compliance and there is a great pool and a sufficient market share to start with. Moving to the filters of financial data that were imposed for the verification for the financial ratios, important findings were seen. Here it started to fall down with the numbers significantly as the financial and accounting structure of the Italian SMEs is not fitting so much with the Sharia requirements.

After applying the quantitative screening, the results showed that the real problem that would face the Italian SMEs in case of applying for being a Sharia complaint would be in facing difficulty because of their financial structure as first it is based on liquid current assets (accounts receivables) which is not highly appreciated with reference to Sharia that requires tangible fixed assets on the contrary to the conventional system. The second point is related to debt level which gives an idea about the financial risk (total debts/market capitalization) Both Sharia and conventional appreciate low levels. Herein that particular ratio more than half of the total companies that gone through this filter had been excluded. This conveys that the 52% of the Italian SMEs is financed through debt which is
basically done through conventional financial system which is rejected by the filters as mentioned before; moreover it reflects high financial risk.

Reviewing the other two ratios which are the interest ratio and the non permissible income ratio, findings showed that the companies which were excluded because of the interest ratio imposition were not huge as the other two financial ratios. The interest ratio is to look for the cash and interest bearing securities portion in the company but since our pool is SMEs and providing the exclusion of the high level of debt and accounts receivables so the portion of the interest ratio was not so high and had almost met the threshold.

The last ratio was for the non permissible income correlates to the non Sharia compliant income portion in the generated revenue. Since the research was done without totally all non Sharia compliant activities then it was evident that the non Sharia compliant income portion in the financial statements of the remaining companies would be sorted out in the interest of the financial income coming from conventional sources.

The results of the imposed filters could be seen in the following table:

<table>
<thead>
<tr>
<th>Sector</th>
<th>Number of Companies</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accommodation</td>
<td>13</td>
<td>3</td>
</tr>
<tr>
<td>Retail Trade</td>
<td>19</td>
<td>4</td>
</tr>
<tr>
<td>Wholesale Trade</td>
<td>28</td>
<td>6</td>
</tr>
<tr>
<td>Constructions of Building</td>
<td>37</td>
<td>8</td>
</tr>
<tr>
<td>Management &amp; Consultancy</td>
<td>54</td>
<td>12</td>
</tr>
<tr>
<td>Real Estate</td>
<td>161</td>
<td>35</td>
</tr>
</tbody>
</table>

**Companies Classification**

Almost 84% of the resulted eligible companies are Micro size companies that its threshold of employees 1-9 and this is perfectly reflecting the real current Italian SMEs companies’ situation as the majority in general are of Micro size and a perfect example for this type of companies are the Real Estate companies as these companies mainly depend on hiring few number of employees however generates high profit. On the other hand the small size companies had took a share of almost 12% while Medium had a share of only 4.8 %. Micro companies face huge difficulties for getting finance for their business especially in the conventional institutions however in the Islamic financial institutions it is much more likely to have finance for their business. One of the most significant points of Islamic finance that could play a major role for the SMEs is

http://www.ojs.unito.it/index.php/EJIF
that the Islamic finance focuses on the microfinance and one of the main principles in Sharia is poverty alleviation. The following table summarizes the companies according to their size:

<table>
<thead>
<tr>
<th>Category According to Number of Employees</th>
<th>Number of Companies</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Micro (1 - 9)</td>
<td>379</td>
<td>83.5 %</td>
</tr>
<tr>
<td>Small (10 – 49)</td>
<td>53</td>
<td>11.7 %</td>
</tr>
<tr>
<td>Medium (50 – 250)</td>
<td>21</td>
<td>4.8 %</td>
</tr>
<tr>
<td>Large (&gt; 250)</td>
<td>1</td>
<td>-</td>
</tr>
</tbody>
</table>

**Profitability Measures**

One of the most important findings that characterized the 454 Sharia compliant Italian SMEs companies was the high ROE as a measure of profit for those companies in the last three years in comparison to the whole Italian companies (non Sharia complaint). The analysis revealed that 61% of the Sharia complaint SMEs have got positive (ROE > 0%), 36% have got ROE > 5%, 22% have got ROE >10%, and finally 13% have got ROE > 15%. Those results really reflect how much profitable are the Sharia complaint companies are as by adopting the same measures over the last 3 years to whole Italian companies reflected a significant lower ROE in every category: as only 22% has ROE >0%, 11% has ROE > 5%, 7% has ROE > 10%, and finally 5% has ROE > 15%. The following table summarizes the companies according to their ROE:

<table>
<thead>
<tr>
<th>ROE</th>
<th>Italian Sharia Complaint Companies Percent</th>
<th>Total Italian Companies Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROE &gt; 0%</td>
<td>61 %</td>
<td>22 %</td>
</tr>
<tr>
<td>ROE &gt; 5%</td>
<td>36 %</td>
<td>11 %</td>
</tr>
<tr>
<td>ROE &gt; 10%</td>
<td>22 %</td>
<td>7 %</td>
</tr>
<tr>
<td>ROE &gt; 15%</td>
<td>13 %</td>
<td>5 %</td>
</tr>
</tbody>
</table>

**Regional Classification**

About 61% of the resulted eligible companies are located in the north of Italy which is represented in the following regions: (Valle D’Aosta, Piemonte, Liguria, Lombardia, Trentino Alto Adige, Veneto, Friuli, and Emilia - Romagna). The center of Italy represented 20% of the companies and can be seen in the following regions: (Toscana, Marche, Umbria, Lazio, Abruzzo, and Molise). The third part which is correlated to the south of Italy has taken a share of 19% and is representing the following regions: (Sardegna, Campania, Puglia, Basilicata, Calabria, and Sicilia). The following table summarizes the companies according to their regional location:

<table>
<thead>
<tr>
<th>Category According to location</th>
<th>Number of Companies</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>South</td>
<td>88</td>
<td>19 %</td>
</tr>
<tr>
<td>Center</td>
<td>91</td>
<td>20 %</td>
</tr>
<tr>
<td>North</td>
<td>275</td>
<td>61 %</td>
</tr>
</tbody>
</table>

**XI. Conclusion**

The Islamic finance has been growing rapidly in the recent years and it has seen wide expansion not only the Arab or even Muslim countries but also Non Muslim countries. This is due its estimated high growth rate as it is considered the highest growing financial instruments. Its stability in the financial crisis and its ethical principles had been the major reason for the Western countries to get introducing it.

The numerous benefits and opportunities for Italy that could be generated with it like opening up to attract Arab sovereign funds to invest in Italy is a huge opportunity, the liquidity that could be generated is of a great importance more over the creation of employment opportunities that could be created. Moreover, the positive impact on the immigrant’s integration polices through providing them with a Sharia compliant financial system on one hand and benefiting from their funding liquidity on the other hand.

In order to introduce the Islamic finance system it is of a great importance constructing a good base to start from. In order to let the Islamic finance work and generate the aimed opportunities it should have all the structure in which it would work with. As the Islamic investments would not come before Italy has got a Sharia compliant businesses and investments. The Sharia complaint would be needed in several aspects like attracting Arab sovereign funds, Retail banking services for Muslim clients, Sukuk in the stock exchange, and for one important reason which is financing and investing opportunities in SMEs.

The study has also revealed the importance of the SMEs in the economic growth and has seen that the SMEs in Italy compose 99.9% of the Italian enterprises. And one of the most important facts about them is that there 94.6% of those SMEs are micro enterprises which have huge difficulty in accessing finance that problem could be resolved through Islamic finance that gives a particular weight to the microfinance.

In the empirical research it was observed how Italian companies are considered to a great extent eligible for Sharia complaint from a qualitative criteria screening prospective and
this is a very encouraging outcome. This outcome actually is of a great impact and significance because this is the main core and primary stage of screening and without being eligible in the qualitative criteria there is nothing to be done but to change totally the business sector or the industry. After this encouraging outcome the empirical research showed that the real problem facing the Italian SMEs to be a Sharia compliant is the quantitative screening. This conveys the real challenge for the SMEs in which how to have some changes in their financial structure to be compatible with Sharia. Another important finding was the high profitability of those SMEs which is a key element in making them attractive for investors. As they proved to be have higher ROE than the non Sharia compliant Italian companies.

Based on those findings Islamic finance would be of a great opportunity to the Italian SMEs and especially the micro enterprises as Sharia promote poverty alleviation and they promote financing the microfinance activities. This would represent a beneficial step for both the Italian economy and the investors who are using the Islamic financial tools as this will create growth and prosperity to the Italian economy and on the other hand a successful profit maximizing investments.

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