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Venture Capital Strategies as Mediating Effects in Managing the *Musharakah* Contract for Islamic Banking: Malaysian Demand-side Perspectives

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Abstract

The users (demand-side) of Malaysian Islamic banking uphold their behavioural intention toward their awareness of the need to comply with Riba-free banking, especially for entrepreneurs demanding venture capital strategies. Because of high risks, *Musharakah* contracts are deemed less preferred in Islamic banking. This study needs to examine the factors influencing the intention to apply venture capital strategies in the *Musharakah* contract. The data were collected through a survey of 286 respondents and were analyzed using the Structural Equation Modelling (SEM) AMOS. The results showed that subjective norms positively affect venture capital strategies and mediate intention via subjective norms. While the other factors are not significant, the findings contribute to the literature on venture capital strategies by demonstrating the drivers of behavioural intention and testing the mediating role of venture capital strategies and the integrated Theory of Reasoned Action (TRA) in the context of Islamic banking by introducing venture capital strategies as a potential driver of intention and as a mediator effect. Islamic banks in Malaysia have great potential to offer the *Musharakah* contract and mitigate risk by adopting venture capital strategies. The results of this study are vital in proposing the channelling of Islamic Corporate Social Responsibility (i-CSR) funds for the *Musharakah* contract as an initial step in applying venture capital strategies. Also, regulatory bodies and Islamic banks may benefit from the outcome, which provides insight into the factors they should consider to promote venture capital strategies in the *Musharakah* contract.

Keywords: Management, Musharakah Contract, Structural Equation Modelling (SEM), Theory of Reasoned Action (TRA), Venture Capital Strategies

Introduction

Muslims are not allowed to participate in operationalizing the conventional banking system, which is largely founded on *Riba's* activities. The establishment of the Islamic banking industry in Malaysia has enlightened the people, thereby raising their understanding of the importance

of adhering to *Riba*-free banking. They have realized that Islamic banking offers unique financial activities, and investment and financing are the activities that are particularly inclined toward equity-based such as *Musharakah*, which is consistent with the spirit of *Shariah*. However, this type of contract is deemed less favourable in the Islamic banking industry (Shaikh, 2017; Mohamad & Basah, 2022).

The *Musharakah* contract has lower involvement than other contracts because of the higher risk involved. *Tawarruq*, *Murabahah*, *Bai-bithaman Ajil*, and *Ijarah* are contracts that are frequently employed in Malaysia's Islamic banks' most popular products since they are highly profit-driven and less likely to offer risky schemes like *Musharakah* (Danlami et al., 2022). With proper and discreet monitoring, Islamic banks may provide a *Musharakah* contract because it increases value for the institutions. The goal of *Maqasid Shariah* can be achieved given the presence of the *Musharakah* contract in Islamic banking, particularly in asset acquisition by channelling Islamic Corporate Social Responsibility (*i*-CSR) funds of this contract as an initial step in applying venture capital strategies. Furthermore, Isa and Abdul Rashid (2018) stated that implementing venture capital strategies and sharing the risks will lighten the load on each side by carrying out the Islamic economy's objective to support socioeconomic development, as needed in Sustainable Development Goals (SDGs).

***Musharakah* Contract & Venture Capital Strategies**

The concept of *Musharakah* is similar to the concept of venture capital but diverges in basic principles. It can be liquidated through an initial public offering (IPO); however, *Musharakah* is not (Abdul Rahman et al., 2020). Thus, this study focuses on the *Musharakah* contract, which practices the business concept of profit and loss sharing and is widely implemented in Malaysia.

In principle, business capital fund activities represent equity-based practices, which emphasize risk and profit and loss sharing between investors and entrepreneurs (Isa & Abdul Rashid, 2018; An et al., 2022). It is so-called partnership activity as it brings advantages to both parties. Entrepreneurs do not have to bear the burden of debt that requires scheduled repayments, whereas investors will gain the advantages of technological know-how due to the partnership. Additionally, investors can mentor their partners by assisting in developing the business's corporate strategy and improving performance through new network financing and markets.

Similarly, a venture capital investor is a professional financial intermediary who combines cash to finance new or current projects. Funding or investing through venture capital company activity has been conducted in Malaysia since the 1990s and has contributed to the country's economic progress. Malaysia's total committed funds for private equity and venture capital increased 26.75 per cent to RM 14.83 billion in 2021 from RM 11.70 billion in 2020, according to the Securities Commission's annual report. According to the press citation on budget 2023, the venture capital industry has continued to grow as an innovative source of economic financing since the nation's economic growth momentum is expected to remain steady in the third quarter of 2023, supported by robust economic and social business activities.

The venture capital success in Malaysia is the foundation for the government's requirements and incentives and the venture capital industry's plan to minimize risks. However, using

venture capital through a *Musharakah* contract has some challenges and difficulties. Risks, collateral, the selection procedure, market demand, and the assurance of capital security are all included. The prevalence of the *Musharakah* contract has drawn more academic attention (Ajmi et al., 2019; Ahroum et al., 2020; Abdul Rahman et al., 2020; Nik Abdul Ghani et al., 2021). As such, there needs to be more empirical research quantitatively on the *Musharakah* contract in terms of the application of venture capital strategies in the literature. Instead, earlier studies, such as Abdul Rahman et al (2020) have concentrated on exploratory challenges and strategies only based on qualitatively that are fundamentally unrelated to investigating the demand-side perspective (users). Therefore, research on the investigation of behavioural intention via the application of venture capital strategies as a mediator effect in the *Musharakah* contract is needed, which is the focus of the current study.

To understand users of Malaysian Islamic banks' desire to employ the *Musharakah* contract via the application of venture capital strategies, this study uses the Theory of Reasoned Action (TRA). There is mounting evidence that venture capital strategies have a mediation effect in determining behavioural intentions in Islamic banking. Thus, to improve the capacity to comprehend the desire to employ the *Musharakah* contract, the current study attempts to extend the TRA by integrating venture capital strategies as a predictive variable.

As such, to enhance the participation of venture capital via the *Musharakah* contract, there are five strategies included, which need to be closely monitored by Islamic banks especially, resulting from the findings of (Abdul Rahman et al., 2020). It includes of right selection of the company to enter into a *Musharakah* contract in terms of background and capability to ensure the triumph of an investment for a determined period. Then, funds disbursement is also needed to ensure effective venture capital strategies via the *Musharakah* contract; for example, preliminary measures must be undertaken to disburse funds (via disbursement schedule) to the venture company to prevent the mishandling of funds. Also, continuous monitoring should be done after the disbursement of funds to prevent mismanagement and mishandling of the disbursed funds. In addition, skill training is important as non-capital assistance to ensure the investment's success and reduce the risk of failure of venture capital companies. Lastly, the investment period is needed as it is categorized as a long-term investment lasting five years before the term ends.

Given the issues, strategies, and gap of study, this study aims to examine the determining factors of behavioural intention toward the application of venture capital strategies in the *Musharakah* contract via investigating the user's Malaysian Islamic banking perspectives and providing empirical evidence on the reliability and validity of applying venture capital in *Musharakah* contract.

The results of this study add to the body of literature in three ways. First, by examining the factors influencing the behavioural intention toward applying venture capital strategies among users of Malaysian Islamic banking, the findings add to the knowledge of the *Musharakah* contract. Second, the study expands the TRA by including venture capital strategies as one of the variables towards the intention to utilize the *Musharakah* contract. Thirdly, by examining the mediating role of venture capital strategies, the study adds to the body of literature. The study's findings could aid the government, bank managers, and marketers in promoting various Islamic financial contracts such as *Musharakah*.

Literature Reviews & Hypotheses Development

The structure of the empirical investigations is influenced by studies on venture capital, behavioural intention, and the *Musharakah* contract (Albalushi et al., 2019; Abdul Rahman et al., 2020; Bananuka et al., 2020; Yi et al., 2023; Jin et al., 2021). Existing research has demonstrated that this contract may be developed in the future due to its many benefits and the application of venture capital techniques. The goal of maximizing the project's profit, which will be divided between partners by a predetermined ratio, may be jeopardized even though the application of venture capital raises many issues, such as investment risk, moral hazard, and asymmetric information from agency theory. These issues emphasize the self-interests of the behavioural intention of the entrepreneur (Parker et al., 2018).

In Islamic banking, the idea of *Musharakah* is an equitable profit-sharing model that considers two rates of joint-venture profit between the capital provider and the entrepreneur; in return, both parties share in the risks of profit and loss (Hassan et al., 2020). By agency theory, it is a so-called equitable-based contract because it takes collaboration into account. Additionally, this agreement aids in funding business owners' fixed assets and working capital, which motivates them to invest and pay the first cash to demonstrate their commitment based on the criteria rules set by Bank Negara Malaysia (BNM).

Likewise, the *Musharakah* criteria rules for Islamic banking institutions cover capital, management, profit-and-loss sharing, and joint ventures (released on September 15, 2007). All of the criteria allow the market, especially small and medium-sized businesses (SMEs), to identify, understand, utilize, and recognize the contract from other contracts that are frequently accessible in the sector. However, Abdul Rahman et al (2020) claimed that due to liquidity concerns while providing medium- to long-term investments, implementing the *Musharakah* contract is hazardous and not optimal for Islamic banks. According to Aslam and Haron (2021), operational risks exist under this contract due to the requirement for additional monitoring costs, the lack of market transparency, and depositors' aversion to taking risks. Challenges with clarity, thorough recordkeeping, and information on entrepreneurial skills further exacerbate the information asymmetry in the *Musharakah* contract processes. Likewise, Mohamad et al (2018) stated that one of the low-level participation under this contract is credit risk which is related to capital impairment risk, which means that the capital provided by the financier may not be recovered, especially during a financial bankruptcy.

The *Musharakah* contract has much promise since it might boost the nation's economic growth and decent work, as described in the SDG, and reduce risks, even though it differs from V.C. only in its principles, execution, and operational features. Anwer et al (2019) asserted that corporate venture capital companies are more advanced, even though they are newer, riskier, and less profitable than independent venture capital companies. Approximately two-thirds of V.C. firms need more skill; thus, they entail high investment risks, but such a feature is not an obstacle for investors in the V.C. industry. However, some studies, such as Abdul Rahman et al (2020); Saeed et al (2020), stated that V.C. is a high-risk and high-return investment.

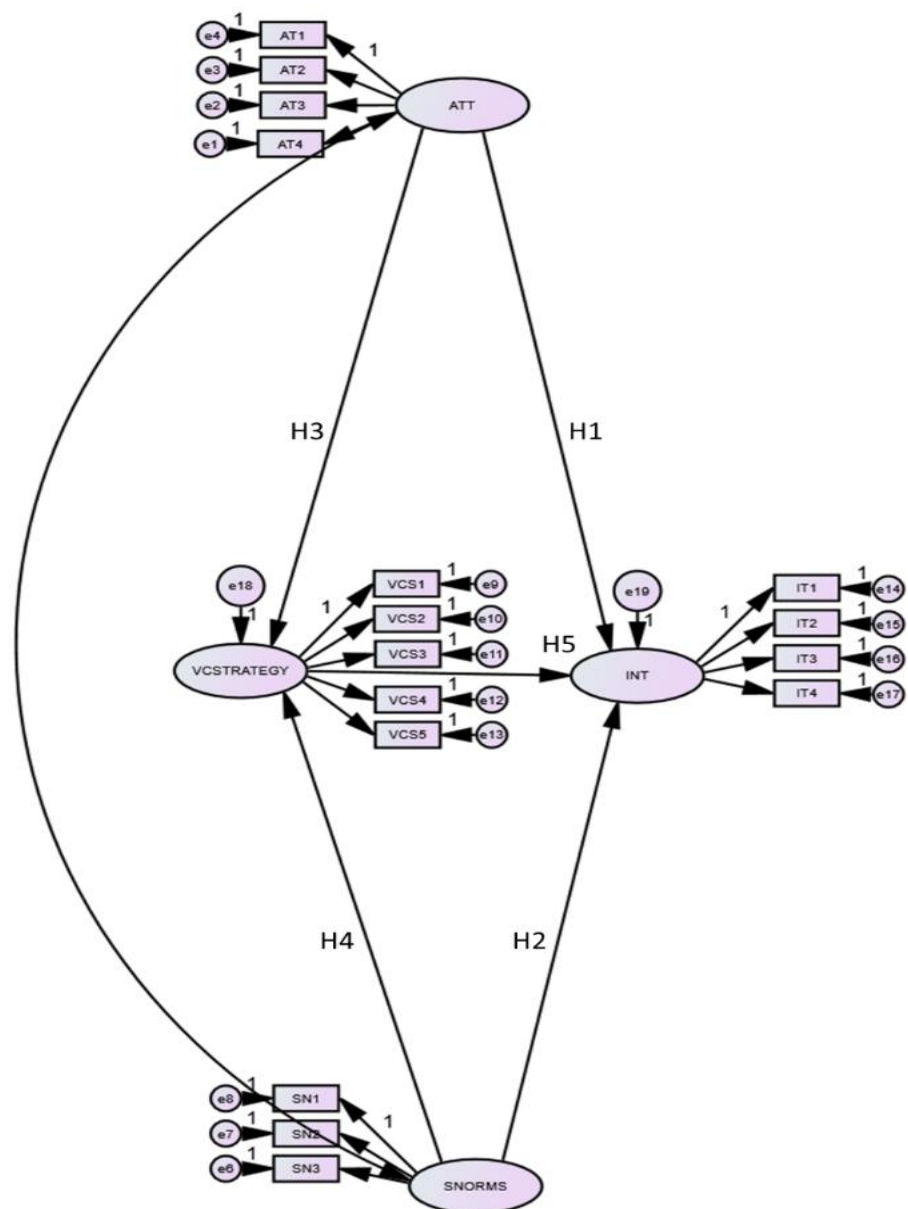
The *Musharakah* contract can be applied to various venture capital strategies. One of them is the proper company selection. These fund disbursements include proactive steps to prevent improper handling of funds, ongoing oversight to prevent improper management of the disbursed funds, skill development, and investment duration. By examining the user's Malaysian Islamic banking perspectives and presenting empirical data on the reliability and validity of applying venture capital in a *Musharakah* contract, this study seeks to examine the determining factors of behavioural intention toward applying venture capital strategies.

However, venture capital is high risk and has the potential to be developed further since it might produce attractive income, according to a conclusion based on prior studies. Researchers did acknowledge that the V.C. business faces a few challenges that need to be resolved. The problems investors and entrepreneurs face include issues of moral hazard, business management, and asymmetric information.

For this reason, the intention should be measured based on specific dimensions. These differences differ from nation to national venture capital strategies via *Musharakah* contract in bank industry players such as Islamic banks, policymakers, central banks, and merchants have to measure intention to adopt venture capital strategies via *Musharakah* contract using a unique measurement according to the present context.

Although research examined factors influencing the intention to adopt the *Musharakah* contract, the studies needed to be more comprehensively applied strategies. Among the aspects investigated include perspectives on the public, customers, or clients and their intention in selecting several types of financing only. However, the above-mentioned studies needed to be more comprehensive to cover the whole aspect of the financing product, user's context, and insufficiency focusing on venture capital strategies as mediator effect.

Because of the lack of relevant literature, the researcher has to source factors that drive the intention to use from other contextual settings as a basis for developing a behavioural intention model on the *Musharakah* contract by putting venture capital strategies as the mediator effect. This ensures that the measurement developed is established from a sound theoretical and conceptual lens (Ye et al., 2022). The theoretical approach is based on the TRA model created by Fishbein and Ajzen. This study's model has been modified to describe better the purpose of utilizing the *Musharakah* contract. TRA has enough capacity to explain consumer behaviour in the context of financial facilities (Rafien et al., 2022).



Notes: Attitudes represent ATT, subjective norms represent SNORMS, venture capital strategies represent VCSTRATEGY, and intention represents INT

Figure 1. Conceptual Model Development with Hypotheses

In this study, the TRA model is expanded by including another variable, venture capital strategies (see figure 1), all of which have been proven to be relevant in multiple previous studies connected to patronizing financial facilities in Islamic banking. Venture capital strategies were also regarded as a possible mediator. Hypotheses were developed as follows:

H1: Attitudes have a positive effect on the users' venture capital strategies in the *Musharakah* contract

H2: Subjective norms have a positive effect on the user's behavioural intention in the *Musharakah* contract

H3: Venture capital strategies mediate the relationship between attitudes and users' behavioural intention in the *Musharakah* contract

H4: Venture capital strategies mediate the relationship between subjective norms and users' behavioural intention in the *Musharakah* contract

H5: Venture capital strategies have a positive effect on the user's behavioural intention in the *Musharakah* contract

Methodology

A quantitative research design is adopted to quantify behaviours, opinions, attitudes, and other variables and make generalizations from a larger population (Leavy, 2022). This type of design uses quantifiable data to articulate facts and reveal patterns in research. A deductive strategy is used to collect data to develop hypotheses based on existing theory and then design a research strategy to test the hypotheses of venture capital strategies to be applied to the *Musharakah* contract. The deductive approach is suitable for theory development confirmation because if examples are true, the developed conclusion will always be true. The quantitative technique is judged appropriate for this study because it allows for the formation of hypotheses that allow for an in-depth assessment of the subject and focuses on a particular business, such as Islamic banking and venture capital.

This study gathers the primary data from a semi-structured questionnaire process. The process begins by surveying the users of Malaysian Islamic banking to investigate their behavioural intention and the mediating role of venture capital strategies in the *Musharakah* contract using Structural Equation Modeling (SEM) AMOS. The study was conducted on users of Islamic banking institutions in Malaysia that are directly involved in various financial contracts.

All data and information gathered were obtained from questionnaires with 286 respondents engaged in the financial activities of Malaysian Islamic banks. 250 of the 286 targeted surveys sent out and returned had answers. The profile of the responders is shown in Table 1 below:-

Table 1

Respondents' Profile (N=250)

Characteristics		Frequency	%
Gender	Male	100	52.6
	Female	150	47.4
Marital Status	Single	90	37.9
	Married	160	62.1
Age	18-25 Years Old	30	16.6
	26-35 Years Old	50	25.6
	36-45 Years Old	100	19.0
	46-55 Years Old	62	19.0
	56 Years Old and Above	8	20.0
Education	High School	0	9.5
	Diploma	2	16.6
	Bachelor Degree	80	53.6
	Masters' Degree	18	11.8
	Ph. D	150	8.5
Occupation	Government Sector	150	71.1
	Private Sector	50	18.0
	Self-Employed	50	9.0
	Student	0	1.0
	Unemployed	0	1.0

Dual survey methods (online and offline) were made to conduct the surveys with users of Malaysian Islamic banking. Survey sessions lasted between 10 to 15 min. In the preliminary study, a pilot test was conducted to test a proposed research study before a full-scale performance. It also uses subjects from a population different from those recruited for the main study.

Also, this study analyzed the effects of attitudes, subjective norms, and venture capital strategies on the intention to utilize the *Musharakah* contract as well as the mediating effect of venture capital strategies using the SEM approach.

A two-step procedure was adopted by Byrne (2016) to assess the suggested conceptual framework. The constructs' reliability and validity were assessed in the first stage, and the importance of the links between them was assessed in the second.

Moreover, the SEM technique of contrasting various models to judge relative model fit makes it a more robust method because regression is especially sensitive to erroneous interpretations by misspecification. To calculate the goodness of fit indices and assess how well the data matched the model in this investigation, then the SPSS AMOS 24 was utilized.

Table 2

Model Fit and Level of Acceptance

Name of category	Name of index	Level of acceptance
Absolute fit	Chi-Square	P-value > 0.05 (not applicable for large sample sizes of more than 200)
	RMSEA	RMSEA < 0.08
	Gof FI	GFI > 0.90
Incremental fit	AGFI	AGFI > 0.90
	CFI	CFI > 0.90
	TLI	TLI > 0.90
	NFI	NFI > 0.90
Parsimonious fit	Chisq/df	Chi-Square/ df < 3.0

Notes: ***The indexes in bold are recommended since they are frequently reported in the literature.

The fitness indices show how well the items are suited to measure each latent component. Table 2 above lists the Fitness Indexes, the categories they fall under, and their level of approval (Whittaker & Schumacker, 2022).

Findings**Reliability Analysis**

Cronbach's Alpha was used to test the reliability of the instruments. Whittaker & Schumacker (2022) noted that Cronbach's Alpha value should be greater than the minimum standard of 0.7.

Table 3

Reliability Analysis

Latent Variables	No. of Observed Variables	Cronbach's Alpha
Intention	4	0.727
Attitudes	4	0.708
Subjective Norms	4	0.728
Venture Capital Strategies	5	0.701

Table 3 shows the reliability result for each latent variable tested in this study. The result indicates good internal consistency reliability estimates as the values range between 0.728 and 0.701.

Confirmatory Factor Analysis

The first and final measurement models from the confirmatory factor analysis (CFA) are used in this inquiry (Byrne, 2016). Adding the scale items as "measured variables" and the item groups as "latent variables" was the first step in creating two CFA models. If the fit is satisfactory, the second model is built, where the item groups are the "measured variables" and the sub-scales are the "latent variables." Examining the factorial validity of the suggested measurement model is important before evaluating the structural model. Figure 2 displays the initial measurement model, whereas Figure 3 displays the final model.

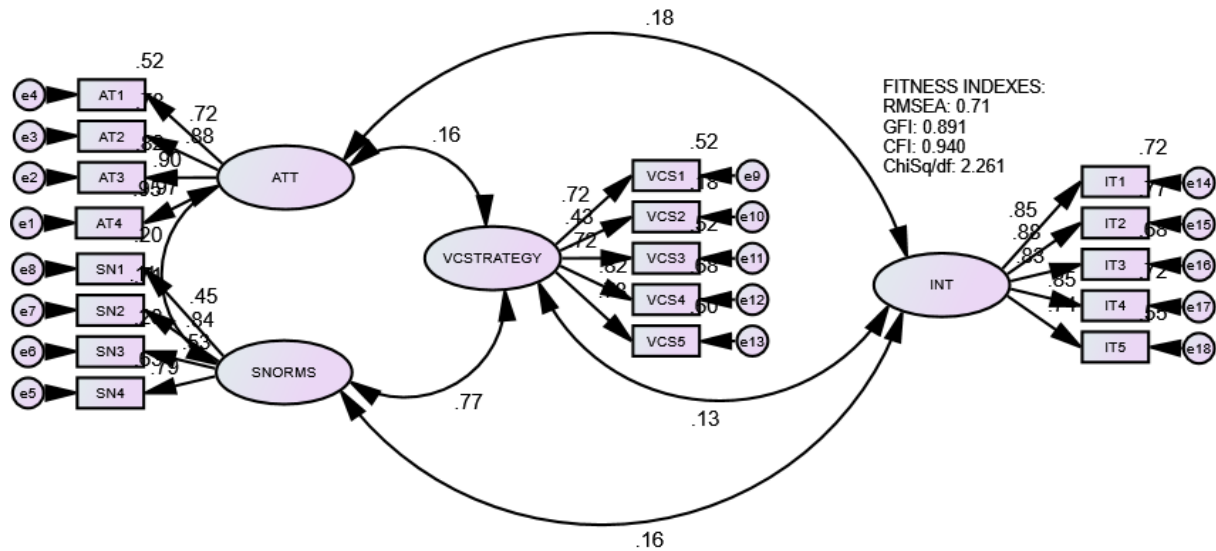


Figure 2. Confirmatory Factor Analysis (Model 1)

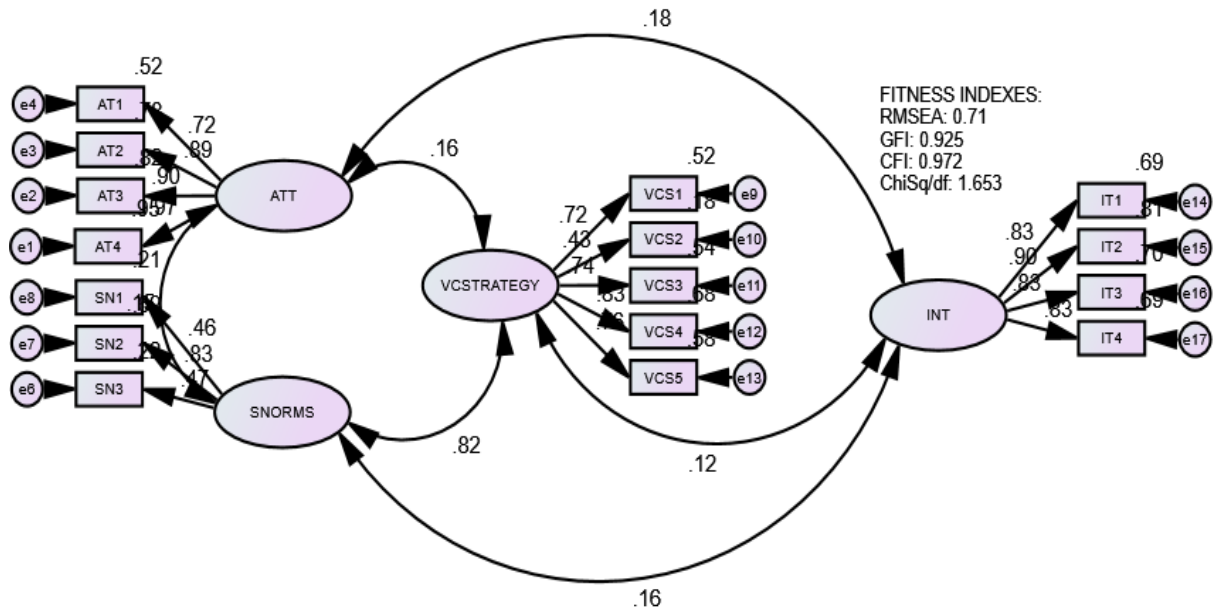


Figure 3. Confirmatory Factor Analysis (Model 2)

According to the rule of thumb, the root mean square error approximation (RMSEA) should be less than 0.08, the goodness of fit index (GFI) and comparative fit index (CFI) should be greater than 0.9, and the chi-square/ degrees of freedom (Chisq/df) should be less than 3.0.

Then, convergent validity is evaluated, a measurement of the convergence or share of the proportion of variation in common among a construct's indicators. A CR value of 0.7 or higher is deemed acceptable, as is an AVE value of 0.50 or higher. The C.R. and AVE result also shows that the most recent variables evaluated in this study are met, as shown in Table 4.

Table 4
 Reliability & Validity Tests

Latent Variables	Convergent Validity	
	CR (> 0.70)	AVE (>0.50)
Attitudes	0.78	0.59
Subjective Norms	0.71	0.52
Venture Capital Strategies	0.81	0.63
Intention	0.73	0.57

Structural Model

The hypothesized relationship between the dependent and independent variables is measured using path coefficients. It is possible to quantify the proposed relationship between the dependent and independent variables using path coefficients. The structural model output created and the route coefficient findings for every tested connection are listed in Tables 5 and 6, respectively. Figure 4 depicts the structural model's result and the path coefficients. Each path coefficient is significant in its own right.

Table 5
 Path Analysis Results (Direct Effects)

Hypotheses	Path	Estimate	S.E.	C.R.	P
H1	INT <-- ATT	.22	.090	2.41	.02
H2	INT <-- SNORMS	.58	.56	1.03	.30
H5	INT <-- VCSTRATEGY	-.19	.58	-.34	.74

Table 6
 Path Analysis Results (Indirect Effects)

Hypotheses	Path	Estimate	S.E.	C.R.	P
H3	INT <-- ATT*VCSTRATEGY	.015	.02	.70	.49
H4	INT <-- SNORMS*VCSTRATEGY	.75	.13	5.94	***

Hypothesis 1 shows that attitudes have no significant and direct effects on intention. The type of mediation here is called “no mediation effect” since the direct effect of attitudes on intention is not significant after venture capital strategies entered the model (Hypothesis 3). Thus, attitudes have no indirect effect on intention through the mediator variable venture capital strategies.

Hypothesis 2 shows that subjective norms have no significant and direct effects on intention. The type of mediation here is called the "complete mediation effect" since the direct effect of subjective norms on intention is not significant after venture capital strategies entered the model. Instead, the indirect effect is significant (Hypothesis 4). Thus, subjective norms indirectly affect intention through the mediator variable venture capital strategies.

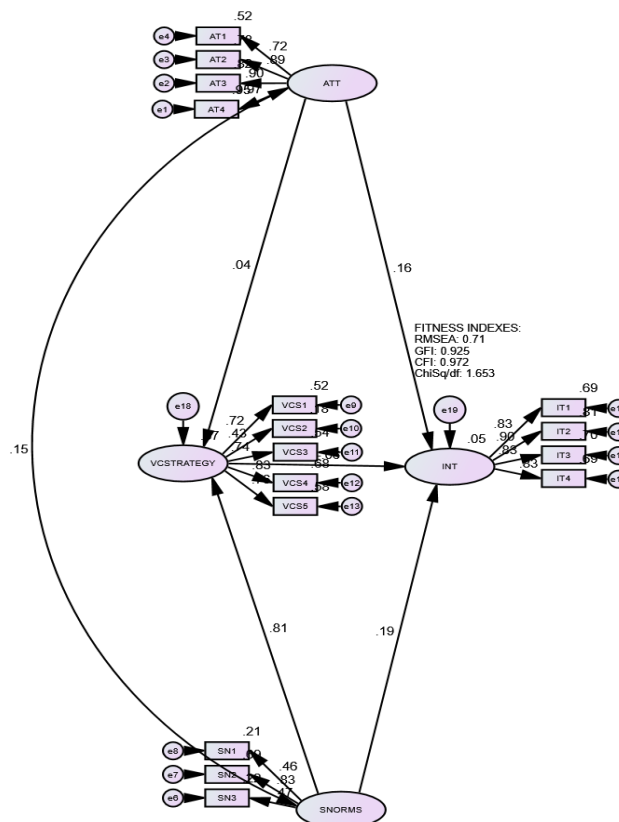


Figure 4. Structural Model

As a result, these path data revealed that only the direct effect of subjective norms toward venture capital strategies investigated in the study was accomplished. Based on these findings, it is inferred that subjective norms have a significant role in persuading users of Islamic banking towards the application of venture capital strategies, particularly those needing business financial assistance.

Hence, these path results confirmed that the hypotheses examined in the study are analyzed. It is found that venture capital strategies are an important factor influencing the behavioural intention toward applying venture capital strategies in the *Musharakah* contract in Malaysian Islamic banking. It has their mediation effect neither complete nor outside the path model investigated.

Conclusions

The findings of this study examined the factors influenced by the application of *Musharakah* via venture capital strategies in Malaysian Islamic banking. With data collected from 286 respondents, it is shown that subjective norms positively affect venture capital strategies and mediate intention via subjective norms. While the other factors are not significant, the findings contribute to the literature on venture capital strategies by demonstrating the drivers of behavioural intention and testing the mediating role of venture capital strategies and the integrated Theory of Reasoned Action (TRA) in the context of Islamic banking by introducing venture capital strategies as a potential driver of intention and as a mediator effect.

Based on the empirical studies, it is also believed that the four main challenges faced by Islamic banks in providing *Musharakah* contracts such as high risks, entrepreneur selection, market demand, and capital guarantee must be managed wisely to minimize the possibility of defaults. Even though the significant factor for this study is not consistent with the findings of past studies, it is well presented based on the mediation effect. Likewise, the study's results imply that if attitudes and subjective norms are significant, they will positively affect users' behavioural intentions.

The V.C. industry, which is largely successful in joint venture businesses, should be considered a close example of Islamic banking to offer *Musharakah* products on a wider scale. The approach used in the V.C. strategies must be fully understood to ensure that the V.C. elements compliant with the *Shariah* requirements could be applied to the *Musharakah* contract. Islamic banking institutions could learn and apply the strategies for reducing the risk of losses and business failures by the V.C. industry in providing *Musharakah* contracts.

The V.C. strategies that could be used include the selection criteria, disbursement of funds, monitoring, non-capital assistance, and investment period, as discussed earlier. Application of the V.C. strategies could facilitate the widespread provision of equity-based contracts such as *Musharakah* and *Mudharabah* by Islamic banking in the future. These strategies will benefit all parties, especially users and the Islamic community, once Islamic banking overcomes its phobia of offering an equity-based contract.

This study could also facilitate a Sustainable Development Goals (SDGs) potential in deploying financing using Islamic banking to promote inclusive growth, reduce inequality and accelerate poverty reduction. It is good for Bank Negara Malaysia (BNM) to continue to support by

strengthening the legal, regulatory and institutional foundations of CSR in Islamic banking to gear it towards playing an expanded role in global development. Initiatives are also underway to foster equity-based instruments/contracts addressing specific parties such as SME Muslimpreneurs and large Muslimpreneurs who lack capital for their business development via venture capital strategies. Hence, the findings of this study can add value to Islamic banking and fulfil the *Maqasid Shariah* by not solely focusing on profit, enhancing the community standard of living, thus, simultaneously upgrading the Islamic economies worldwide via channelling of Islamic Corporate Social Responsibility (*i*-CSR) funds for the *Musharakah* contract as an initial step in applying venture capital strategies.

The development of the Structural Equation Model (SEM) for this study also presents the significant role of venture capital strategies as a mediator within users' behavioural intention factors in the *Musharakah* contract. This model can give added value not only for Islamic banking institutions but for investors and other dynamic Islamic entrepreneurs as a source of financing and acts as another innovative instrument for the *Musharakah* contract. For that purpose, applying venture capital strategies as a mediation effect within subjective norms and intention is a step outside Islamic bankers' comfort zones by offering business financing and investment financial activities based on *Musharakah* and becoming involved in the business as active partners.

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