BUKTI REVIEWER

ARTIKEL JURNAL INTERNASIONAL BEREPUTASI

Judul artikel : An alternative model for Islamic venture capital firms

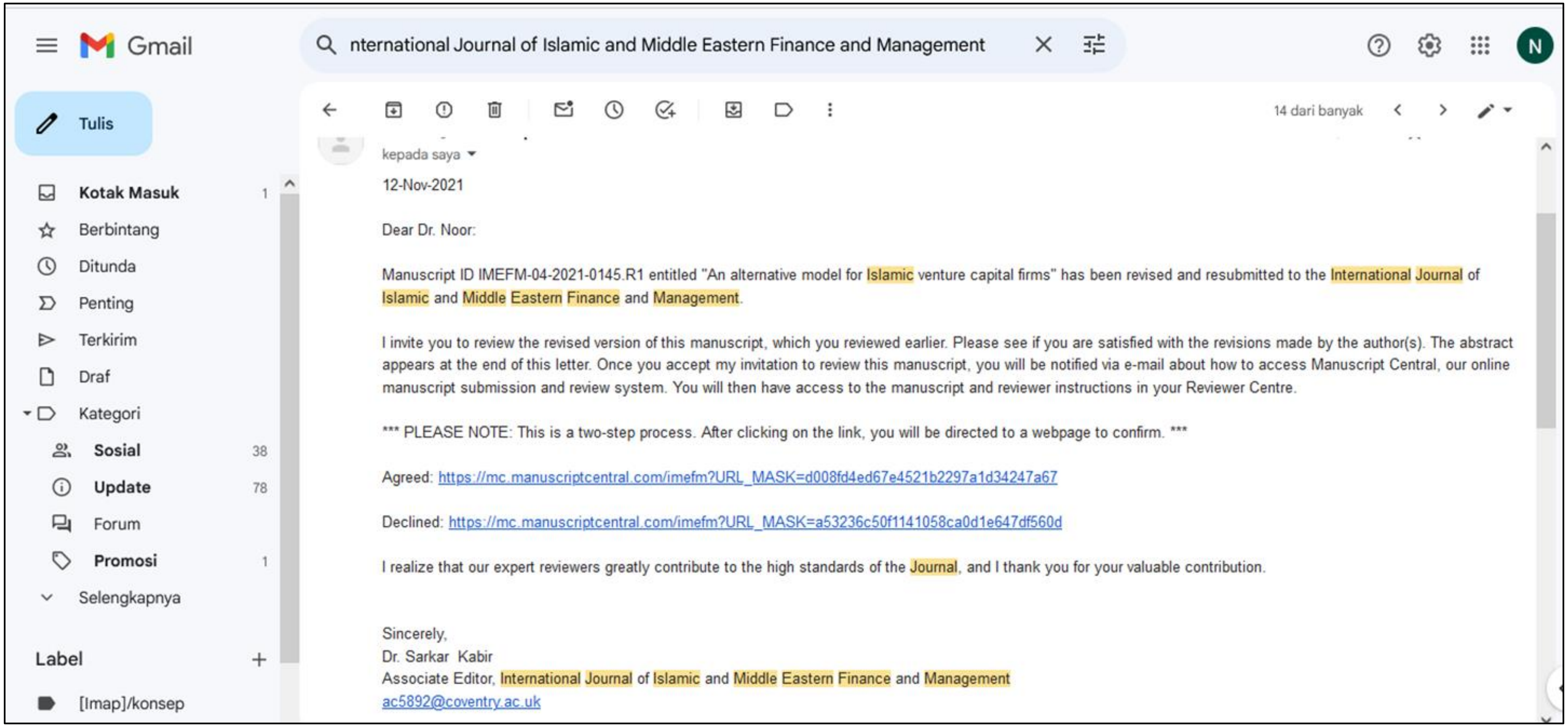
Jurnal : International Journal of Islamic and Middle Eastern Finance and Management

Penerbit : Emerald Group Publishing Ltd.

Indeks : Scopus, Q2, Sjr: 0,49

No	Perihal	Tanggal
1	Bukti Undangan Sebagai Reviewer	12 Novemeber 2021
2	Bukti Mereview	19 November 2021
3	Bukti Persetujuan	29 Desember 2021
4	Bukti Artikel Terbit	22 Januari 2022

Bukti Undangan Sebagai Reviewer



kepada saya

12-Nov-2021

Dear Dr. Noor:

Manuscript ID IMEFM-04-2021-0145.R1 entitled "An alternative model for Islamic venture capital firms" has been revised and resubmitted to the International Journal of Islamic and Middle Eastern Finance and Management.

I invite you to review the revised version of this manuscript, which you reviewed earlier. Please see if you are satisfied with the revisions made by the author(s). The abstract appears at the end of this letter. Once you accept my invitation to review this manuscript, you will be notified via e-mail about how to access Manuscript Central, our online manuscript submission and review system. You will then have access to the manuscript and reviewer instructions in your Reviewer Centre.

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I realize that our expert reviewers greatly contribute to the high standards of the Journal, and I thank you for your valuable contribution.

Sincerely,
Dr. Sarkar Kabir
Associate Editor, International Journal of Islamic and Middle Eastern Finance and Management
ac5892@coventry.ac.uk

nternational Journal of Islamic and Middle Eastern Finance and Management

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17-Nov-2021

Dear Dr. Noor:

Thank you for agreeing to review Manuscript ID IMEFM-04-2021-0145.R1 entitled "An alternative model for Islamic venture capital firms" for the International Journal of Islamic and Middle Eastern Finance and Management. Ideally, we would like to receive a report within six weeks' time.

In your review, please answer all questions. On the review page, there is a space for "Comments to Editor" and a space for "Comments to the Author." Please be sure to put your comments to the author in the appropriate space.

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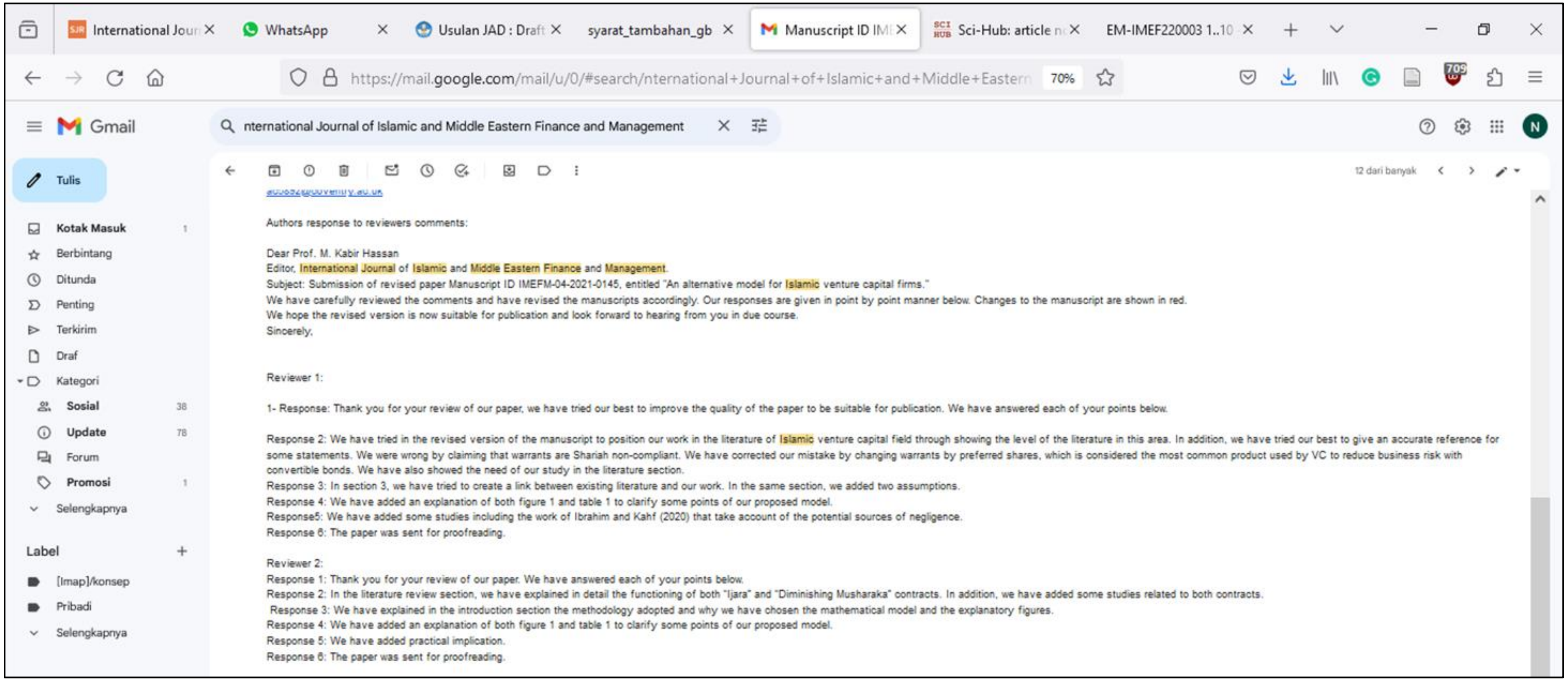
All communications regarding this manuscript are privileged. Any conflict of interest, suspicion of duplicate publication, fabrication of data or copying must immediately be reported to me.

Thank you for evaluating this manuscript.

Sincerely,
Dr. Sarkar Kabir
Associate Editor, International Journal of Islamic and Middle Eastern Finance and Management
ac5892@coventry.ac.uk

Bukti Mereview



Authors response to reviewers comments:

Dear Prof. M. Kabir Hassan
Editor, International Journal of Islamic and Middle Eastern Finance and Management.
Subject: Submission of revised paper Manuscript ID IMEFM-04-2021-0145, entitled "An alternative model for Islamic venture capital firms."
We have carefully reviewed the comments and have revised the manuscripts accordingly. Our responses are given in point by point manner below. Changes to the manuscript are shown in red.
We hope the revised version is now suitable for publication and look forward to hearing from you in due course.
Sincerely,

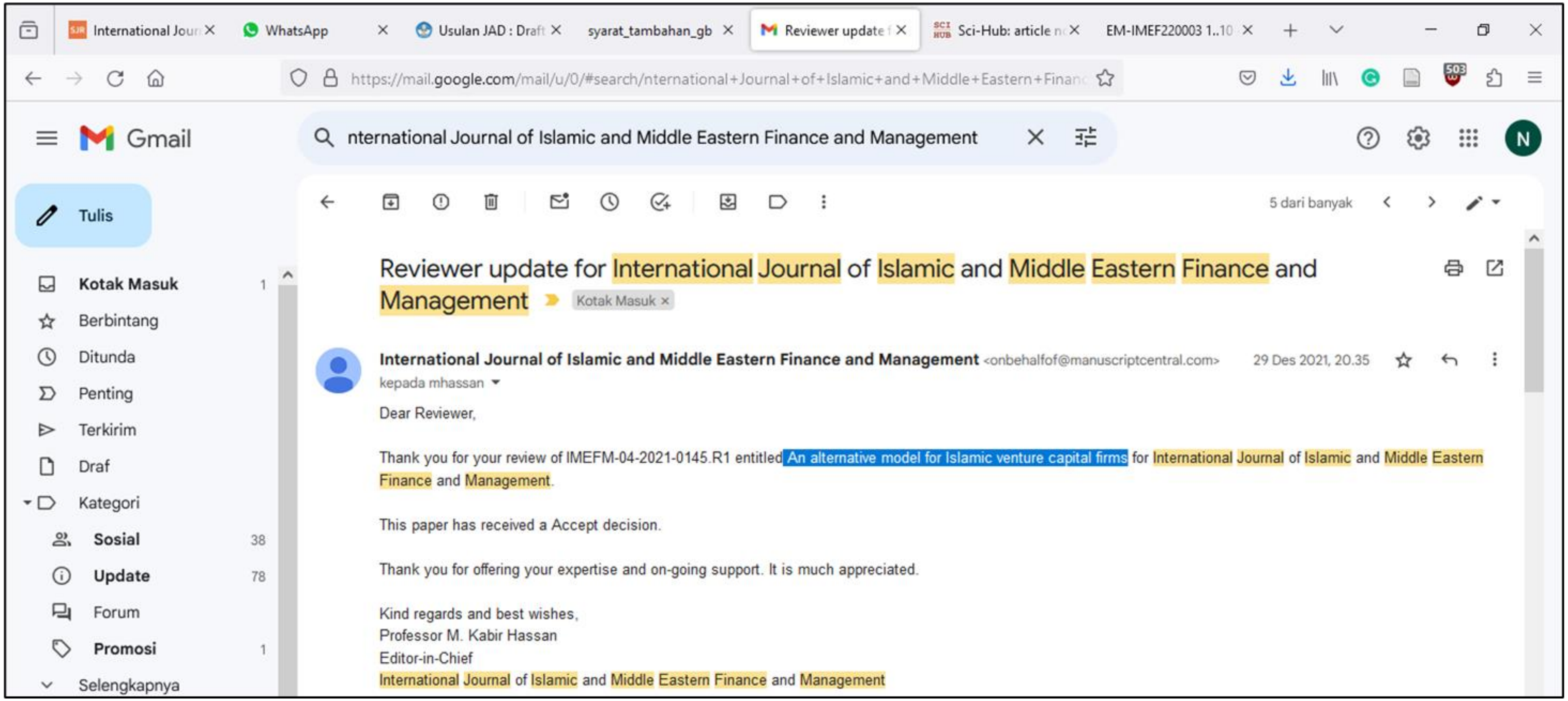
Reviewer 1:

1- Response: Thank you for your review of our paper, we have tried our best to improve the quality of the paper to be suitable for publication. We have answered each of your points below.

Response 2: We have tried in the revised version of the manuscript to position our work in the literature of Islamic venture capital field through showing the level of the literature in this area. In addition, we have tried our best to give an accurate reference for some statements. We were wrong by claiming that warrants are Shariah non-compliant. We have corrected our mistake by changing warrants by preferred shares, which is considered the most common product used by VC to reduce business risk with convertible bonds. We have also showed the need of our study in the literature section.
Response 3: In section 3, we have tried to create a link between existing literature and our work. In the same section, we added two assumptions.
Response 4: We have added an explanation of both figure 1 and table 1 to clarify some points of our proposed model.
Response5: We have added some studies including the work of Ibrahim and Kahf (2020) that take account of the potential sources of negligence.
Response 6: The paper was sent for proofreading.

Reviewer 2:
Response 1: Thank you for your review of our paper. We have answered each of your points below.
Response 2: In the literature review section, we have explained in detail the functioning of both "Ijara" and "Diminishing Musharaka" contracts. In addition, we have added some studies related to both contracts.
Response 3: We have explained in the introduction section the methodology adopted and why we have chosen the mathematical model and the explanatory figures.
Response 4: We have added an explanation of both figure 1 and table 1 to clarify some points of our proposed model.
Response 5: We have added practical implication.
Response 6: The paper was sent for proofreading.

Bukti Pesetujuan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Dear Reviewer,

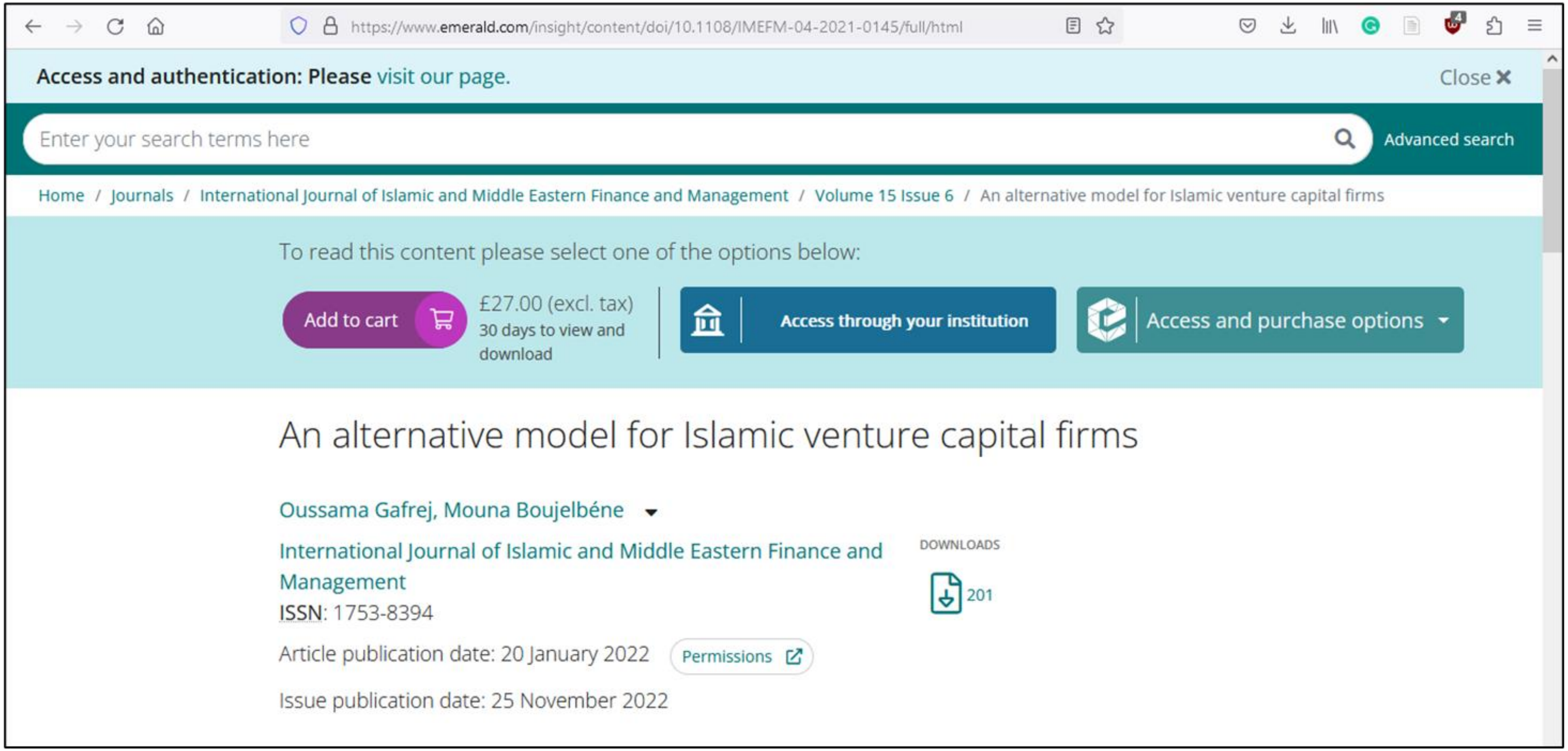
Thank you for your review of IMEFM-04-2021-0145.R1 entitled An alternative model for Islamic venture capital firms for International Journal of Islamic and Middle Eastern Finance and Management.

This paper has received a Accept decision.

Thank you for offering your expertise and on-going support. It is much appreciated.

Kind regards and best wishes,
Professor M. Kabir Hassan
Editor-in-Chief
International Journal of Islamic and Middle Eastern Finance and Management

Bukti Artikel Terbit



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An alternative model for Islamic venture capital firms

Oussama Gafrej, Mouna Boujelbéne

International Journal of Islamic and Middle Eastern Finance and Management

ISSN: 1753-8394

Article publication date: 20 January 2022

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Issue publication date: 25 November 2022

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An alternative model for Islamic venture capital firms

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Received 7 April 2021
Revised 8 October 2021
Accepted 29 December 2021

Abstract

Purpose – The purpose of this paper is to propose a financial instrument by combining two main contracts in Islamic finance with the aim to minimize risks involved in Islamic venture capital (IVC) activities.

Design/methodology/approach – A mathematical model and explanatory figures are provided to see how IVC firms can benefit from the combination of "*Ijara*" contract and "Diminishing Musharaka" contract to provide financing for start-up and high-tech companies.

Findings – The proposed instrument could be considered as an alternative solution for IVC firms. It represents a low level of risk with a stable income in the beginning of the project. In addition, it allows benefiting from the possible development of start-up and high-tech companies with a smooth exit from the capital of the financed company without the intervention of another investor. It is also considered as a motivational instrument for the entrepreneurs, because it allows benefiting from a grace period on the one hand and from a lower cost of financing compared to other type of funding on the other hand.

Practical implications – Some studies have concentrated on identifying and understanding the concept, the operation and the challenges of IVC industry. The study is considered among few studies that provide a practical model for IVC firms, which takes account of the different stages of venture capital process. The instrument can promote the development of IVC firms and give alternative financing opportunities to Muslim entrepreneurs.

Originality/value – The current model provides a truly revolutionary solution for young Muslim entrepreneurs who do not accept to be financed by the proposed instruments of venture capital (VC) firms such as convertible bonds and warrants. On the other side, it provides an alternative solution for IVC firms to the already offered products such as "*Musharaka*", "*Mudharaba*" and "Wakalah" contracts. An expert in "Fiqh Al-Muamalat" (Islamic law of transaction) assessed the Sharia compliance of the model.

Keywords Islamic venture capital, Financial risks, "Ijara" contract, "Musharaka" contract

Paper type Research paper

1. Introduction

Venture capital (VC) represents an interested funding source to firms that have a technological aspect and a high development potential (Yang *et al.*, 2016). It provides a financing source dedicated to the stages of creation and post-creation (Rédis, 2009). According to Sincerre *et al.* (2019), VC is addressed to companies that have placed or nearly places its product or service on the market. In addition, it represents an alternative to bank financing that requires guarantees, which are often lacking for young entrepreneurs (Fathonih *et al.*, 2019). The extant literature shows a significant link between VC industry, economic growth and innovation (Samila and Sorenson, 2011; Kolmakov *et al.*, 2015). The principal role of venture capital firms consists of receiving from their own shareholders (pension funds, banks, insurance companies, industrial groups, independents and sovereign wealth funds) and then reinvesting these funds by taking participations in the capital of companies. The main goal of such financing is to maximize the value of the selected companies to realize additional capital gains for each exit. Similar to any other financial institution, VC firms have been established to fulfill the Islamic finance principles.

International Journal of Islamic and Middle Eastern Finance and Management

1753-8394
DOI 10.1108/IMEFM-04-2021-0145

Islamic venture capital (IVC) emerged for two reasons: First, venture capital firms may invest their funds in illicit activities, which led the Islamic financial investors not to invest in such financing. Second, the financial instruments that have been used by VC firms to minimize the risk associated with their investments are considered non-compliant with Islamic finance principles such as preferred shares and convertible bonds. The main objective of this paper is to contribute to the sustainability of the IVC industry through proposing an alternative model of financing by combining "*Ijara*" and "Diminishing Musharaka" characteristics. A mathematical model and explanatory figures will be developed to understand the stages of implementing the proposed model and to explain its functioning. This methodology will be accompanied by a numerical example to show its benefits for IVC firms and entrepreneurs.

This study is arranged in four sections including the introduction in the first section. Section 2 outlines the literature review of IVC-related studies. A mathematical model explained through practical example and figures to show the benefits of the instrument for both entrepreneurs and IVC firms as well as to investigate its feasibility is developed in Section 3. The findings of the numerical example are summarized in a table in this section as well. Finally, a conclusion is formed in Section 4 to provide a quickly synthesize this work.

2. Literature review

The current state of literature regarding IVC industry is limited in number compared to its potential contribution to economic growth, innovation and employment in Muslim countries. Omran (2015) shows that IVC industry represents a great opportunity to fill the gap between the financial need of educated young people in Arab countries and investors who seek Sharia-compliant investments. Bint Hasan *et al.* (2011) have diagnosed the state of IVC in Islamic countries and its stages of development. They have also cited the contracts used by IVC firms, which are "Musharaka", "Mudharaba" and "Wakalah" and the Islamic legal maxims relating to those contracts. Ibrahim and Kahf (2020) tried to provide a detailed explanation of Shariah-compliant instruments that can be used in IVC industry including the clauses relating to negligence and supermajority. The study is based on the analysis of the VC process (from fundraising to post exit), proposed by Wright Robbie's (1998). They proposed a variety of instruments that accompanying the IVC team to protect the investments of their limited partners during the investment-holding period. The instruments include "Perpetual Mudharaba", "Diminishing Musharaka", "Musharaka with Qard" and "Musharaka with Murabaha". Alwi *et al.* (2020) conducted a study in the form of face-to-face interviews with the two managers of the only two parts, covering the operation and the challenges of IVC firms in Malaysia, respectively. According to the study, the most common contract provided by both firms to the target companies is "Musharaka" with a "Wakalah" contract signed between the IVC firm and the investor (limited partner) to act as a fund manager. However, IVC firms in Malaysia have to increase awareness about the presence of such firms and minimize the risk related to the rate of return of "Musharaka" contract.

Anwer *et al.* (2019) discussed in detail the investments models of IVC. They divided these models into three categories. The first model consists to acquire the majority of shares of a target company and then replace the current management by the fund managers to perform better business strategy. The second model consists to reduce IVC risks by investing in a variety of sectors. This form needs a strong governance to properly assess each business segment. Third, the IVC investment can be made by investing in crowdfunding platforms, which complies with the Islamic finance principles. The authors suggested also that IVC firms should include additional conditions in "Musharaka" and "Mudharaba" contracts such as a compensation to be paid in the case of the breach of the contract. In addition, Athief (2019) proposes to combine both IVC and crowdfunding. The idea lies in having additional income, which comes from the service provided by the IVC firm through publishing the selected company on its website in the form of equity crowdfunding campaign on the one hand. On the other hand, it aims to share risks between different investors. The study proposes also an internal market as an exit strategy for crowdfunding investors. Abdul Rahman and Mohd Nor (2018) tried to investigate the possibility to adopting the strategy of VC firms by Islamic banks through *Musharaka* financing. The study begins by understanding the main reasons for the non-use of "*Musharaka*" financing by Islamic banks and ends with asking venture capitalists about the mechanism used to reduce business risk. The reasons are the high degree of risk, the difficulty to select the business partner and the guarantee of capital security. Concerning the strategies adopted by VC companies, the authors highlight four points that could be adopted for "*Musharaka*" financing, which are, the selection process, the funds disbursement schedule, the continuous monitoring and the skills training. Fathonih *et al.* (2019) proposed some recommendations for future research in this field, including investigating the benefits of IVC as a type of financing to small business owners and finding other financing alternatives to reduce business failure risk.

According to Rédis (2009), the risks involved in VC industry are classified into three categories: Business risk, which is related to the type of the project. It is composed of three strands. First, the commercial side that involves the inability to commercialize the product, the competitive intensity and the target market complexity. Second, the technological aspects that depend on the stage and the nature of the project and the nature. Third, when referring to the entrepreneurs' management, in particular, the ability of the entrepreneur to manage properly the project development. Financial risks or, in other words, the difficulty to know at the beginning the exact long-term value of the company and the exit modes from the investments. Managerial risk, which is related essentially to the asymmetric information. The latter concept could be explained by two factors the risk of adverse selection and the moral hazard. The adverse selection also called "hidden information" appears essentially when certain precise information about the situation of the entrepreneur and the development of the company are not known with certainty by the VC firm. This type of asymmetric information leads to an inefficient allocation of funds. The adverse selection occurs when the investor is unable to observe the entrepreneur's actions. Varian (1990) defined the moral hazard as follows: *Situations where one side of the market can't observe the actions of the other [and] is sometimes [referred to as] a hidden action problem*.

The current literature in the IVC industry have tried to show the main challenges. In addition, some authors investigate how to find a suitable model that can handle with different stages of venture financing that can help to ensure the evolution of IVC firms over time. In this context, we try to solve this problem by proposing a model that takes into account the different stages of the financing process through a combination of "Diminishing Musharaka" and "Ijara" contracts.

Our proposed model is based mainly on two different contracts. First, the "*Ijara*" contract in which one person rents an asset to another against rental payments to usufruct the asset (Guéranger, 2009). According to Obaidullah (2020), the functioning of "*Ijara*" contract with the bank is presented as follows: the client chooses an asset and approaches the bank for proposing an "*Ijara*" contract with a promise to lease the asset. After that, the bank acquires the asset from the vendor and leases it to the client. Then, the latter pays the hire of the asset and at the end of the contract, the asset goes back to the bank. Second, the "Diminishing Musharaka" contract which represents an interesting product for Islamic banks. According to Hussain (2010) in "Diminishing Musharaka", one of the partners (typically the bank) agrees to sell progressively its shares to its partner (the client). The bank's proportion will be reduced ant the client's shares will be increased at the same time. This type of contract is usually used in house financing (Meera and Razak, 2009).

In the next section, the model will be demonstrated with a numeric example to show its potential implications for IVC industry.

3. The model

The research demonstrated below uses the mechanism of diminishing partnership and the model of house-financing proposed respectively by Smolo and Hasan (2011) and Selim (2020).

In conducting this work, two assumptions were made:

(1) The combination of "Ijara" and "Diminishing Musharaka" characteristics in IVC industry will provide appropriate protection of investors through maintaining a stable source of revenue as well as a smooth exit strategy.

(2) The proposed model will ensure for the entrepreneur a lower cost of financing with a full ownership of the company.

After approving the project by venture capital firm, the representative of the latter discuss with the entrepreneur the initial cost of starting a business. They will evaluate the amount of money that the entrepreneur need for the period between the expenses and the first cash inflows. To calculate this amount, it is necessary to quantify the financial requirements during the first few months following the commencement of the company's activity. This gap in the treasury counts a minor part compared to the total of capital needed to launch a project. The entrepreneur himself should finance this amount in our proposal or it may recourse to love money (provided by family or friends). However, the two parties sign an "Ijara" contract. The IVC firm is designed to be the owner of the asset required for the business' activity. The assets will be available for the entrepreneur as a lessee to profit therefrom. In return of the enjoyment of the assets the entrepreneur pays a compensation called "rent". The IVC has to acquire only the assets that are necessary for the business' activity. The other assets will be acquired progressively on a six-monthly or an annual basis as a sequential financing in the light of the achievement of the business objectives. In addition, the IVC firm provides to the entrepreneur a grace period, which depends essentially on the business sector of the target company. The duration of the proposed "Ijara" contract is equal to three years from the date of receipt of the necessary assets. It could be varied on the basis of the period that has already estimated to begin the sales process. At the same time, the entrepreneur makes a partnership promise to the IVC firm (the usefulness of this promise will be understood below).

The entrepreneur pays the monthly rent based on the following three steps:

First, we calculate the accumulated amortization value by the following formula:

$$A = (P \times i \times y) \tag{1}$$

where: P is the original price, i is the amortization rate and y is the number of years, which corresponds to three years in our case.

Second, we calculate the earned value of the accumulated amortization based on a margin rate. We can get the following formula:

$$E = \Sigma \ A \ (1 + r)^{3-m} \tag{2}$$

where E is the earned value of the accumulated amortization, A is the accumulated amortization, r is the margin rate and m is the number of years, which corresponds to the date of asset acquisition.

Third, we calculate the monthly rent, which later will be adjusted progressively according to the successive acquisitions of the additional assets, by the following formula:

At the end of the grace period:

$$R = \frac{E1}{n-d} \tag{3}$$

At the beginning of the second year, assuming that the VC firm will acquire other asset at that date:

$$R = \frac{E1}{n-d} + \frac{E2}{n-n2} \tag{4}$$

where R is the monthly rent, n, d and $n2$ represent respectively the number of months of *Ijara* contract, the grace period and the period, which corresponds to the difference between the acquisition date and the end of *Ijara* contract.

Suppose an IVC firm plans to finance a project. The total funds required for the project are equal to \$100,000. This includes \$15,000 as a working capital, \$70,000 as necessary assets with an average depreciation rate on a straight-line basis of 10% and \$15,000 as additional assets (\$7,500 per year) with the same depreciation rate. The term of "*Ijara*" contract will be three years with a margin rate of 20%.

From equation (1), the accumulated amortization of the necessary assets and the additional assets can be calculated as follows:

$$A1 = (70\ 000\$ \times 10\% \times 3) = 21\ 000\$ \tag{5}$$

$$A2 = (7\ 500\$ \times 10\% \times 2) = 1\ 500\ \$ \tag{6}$$

$$A3 = (7\ 500\$ \times 10\% \ \times 1) = 750\ \$ \tag{7}$$

The earned value can be calculated from equation (2) as follows:

$$E = 21\ 000\$.\ (1.2)^3 + 1\ 500\$.\ (1.2)^2 + 750\$.\ (1.2) = 39\ 348\$ \tag{8}$$

The monthly rent can be calculated from equations (3) and (4) as follows:

At the end of the grace period:

$$R = \frac{21\ 000\$.\ (1.2)^3}{36-6} = 1\ 210\ \$ \tag{9}$$

At the beginning of the second year:

$$R = 1\ 210\$ + \frac{1\ 500\$.\ (1.2)^2}{36-12} = 1\ 300\ \$ \tag{10}$$

At the beginning of the third year:

$$R = 1\ 300\$ + \frac{750\$.\ (1.2)}{36 - 24} = 1\ 375\ \$ \tag{11}$$

At the end of the contract, the IVC firm ensures that the depreciation value of the assets is covered with a margin that corresponds to the difference between the earned value and the accumulated amortization. It also receives a monthly rent greater than the amount received in the case of "*Ijara*" contract in its classical form if we take into consideration the duration of the contract following the termination of this contract. Through this contract, the IVC firm observes the managerial behavior of the entrepreneur and it has the right to sign a separate contract "Diminishing Musharaka" according to the partnership promise given by the entrepreneur at the beginning of "*Ijara*" contract. In addition, it will ensure that the assets could be sold, as the duration of the contract can regarded as reasonable to achieve gains on disposal of asset sales.

On the other side, the entrepreneur benefits from a grace period and a reduced cost compared to classical financing modes. In addition, the monthly rent is considered as operating expense deducted from the corporate tax. This contract could motivate the entrepreneur to benefit from the additional assets and to convince the IVC firm to sign the "Diminishing Musharaka" contract.

The terms of the contract are as follows:

- The object of the lease must be known and agreed by both parties.
- The rental period, the term of payment, the lease amount and the periodicity must be determined and known at the time of the contract's conclusion.
- The IVC firm must designate someone to do a periodic inspection of the current state of the assets and maintenance required.
- The duration of the contract is three years.
- The grace period shall not exceed six months.
- The supplementary investments could be acquired yearly or half-yearly.

The following figure explains the functioning of the "*Ijara*" contract.

Figure 1 shows that the entrepreneur should provide a minor part of the amount of the investment, which corresponds to the amount needed to enable the commencement of the company activity. After that, a contract of "*Ijara*" will be signed between both parties with a grace period. The IVC firm at the first time acquire only the essential assets for the business activity against the payment of monthly rents. The additional assets will be acquired on a six-monthly basis as a sequential financing from different vendors. At the same time, the monthly rents will be adjusted to take account of the successive acquisitions of the additional assets.

The IVC firm is facing two choices. First, it could recover its assets and sell them on the market after noticing an element of mismanagement. Second, it could sign with the entrepreneur a "Diminishing Musharaka" contract. In the latter case, an external expert using different methods of valuation determines the enterprise value (EV). The value that represents the proportion of the IVC firm is the market value of the assets at the end of the "*Ijara*" contract. This proportion is calculated as follows:

$$IVCp = \frac{\Sigma\ MV}{EV} \times 100 \tag{12}$$

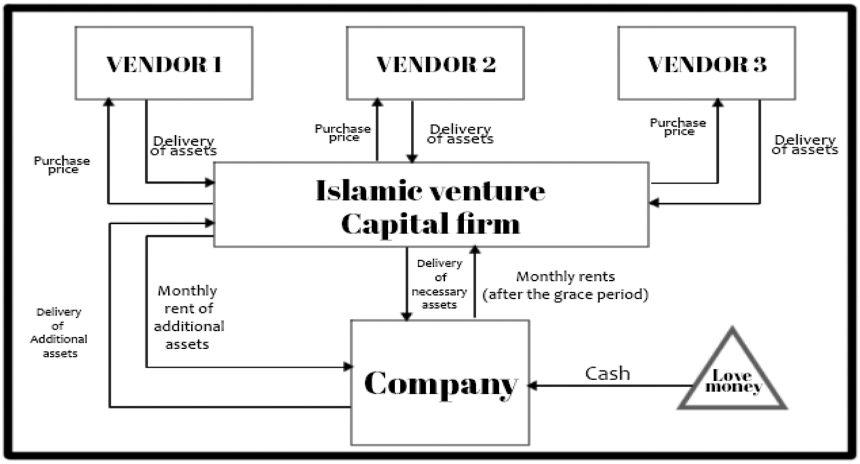

Figure 1. Overview of the functioning of the proposed "Ijara" contract

On the other hand, the part of the entrepreneur in the capital will be equal to the residue after deducting the investor's part.

$$Ep = 100 - IVCp \tag{13}$$

where: $IVCp$ and Ep are the IVC firm and the entrepreneur value part. respectively, MV and EV are the market value and enterprise value, respectively.

Suppose that the market value of the assets and the enterprise value are equal to \$60,000 and \$200,000 respectively.

From equations (13) and (14), the proportion of both the IVC firm and the entrepreneur can be calculated as follows:

$$IVCp = \frac{60\ 000}{200\ 000} \times 100 = 30\% \tag{14}$$

$$Ep = 100 - 30\% = 70\% \tag{15}$$

Then, the both parties sign a "Diminishing Musharaka" in which the IVC firm will withdraw progressively from the enterprise's capital by selling its shares to the entrepreneur. Consequently, the entrepreneur becomes the sole owner of the company. The pricing is determined at the end of each semester (at the moment of the progressive sale). Profits are distributed between both parties throughout the duration of the contract, according to the proportion of each part. The functioning of this contract is carried out in the following manner: the IVC firm sells 5 or 10% of the shares to the entrepreneur half-yearly and yearly, respectively. At the same time, the profits are distributed according to 70/30 ratio. At the end of the first year, the entrepreneur purchases other shares and consequently reducing the proportion of the profits and the shares of the IVC firm in the company's capital. The process continues in a consistent manner until the end of the contract in which the entrepreneur purchases all the VC firm's shares and he became the sole owner of the company (100 %). The following diagram explains the approach to be followed in this contract (Figure 2).

Now suppose that the enterprise value will increase by 10% per semester and the amount to be received at the end of the first semester is equal to $6,000, and it will grow with the same growth rate. IVC's share in the capital, IVC's share in the profit, the amounts to be received by the IVC firm on disposal of shares and related issues are displayed in the following table.

Table 1 shows that IVC firm maintains a stable profit margin throughout the duration of the contract. The reduction in the amount to be received through profit sharing is covered by the amount to be received on the disposal of shares thanks to the growth of the financed company. On the other side, the percentages presented in Table 1 demonstrate how the entrepreneur will become the sole owner of the company in a gradual manner.

This mode of financing is advantageous to an IVC firm. It represents a steady source of income. Also, it provides a progressive exit method. Based on the above method, the IVC firm eliminates the risk of not finding a buyer at the maturity date of the contract. It allows achieving a high performance by investing in startup and high-tech companies.

On the side of the entrepreneur, the cost is based on the achieved outcomes. The financial expenses are paid only if the company makes a profit. In addition, it permits to regain the capital share of the company without the intervention of any other investors.

The conditions and clauses associated with this contract are the following:

- The distribution of profits should be clearly defined.
- The valuation of the company is made on a mid-year basis.
- Both parties shall define clauses dealing with the control of the firm and the monitoring of the investments.

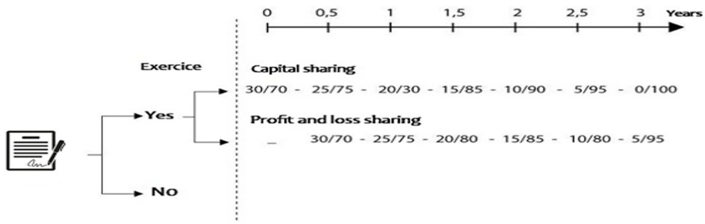

Figure 2. Overview of the functioning of the proposed "Diminishing Musharaka" contract

Table 1. Payment schedule and the progressive exit of the proposed "diminishing musharaka" contract

End of semester	IVC's share in the capital (%)	IVC's share in the profit (%)	The amount to be received on disposal of shares	The amount to be received through profit sharing
1	25	30	$200\ 000\$ \ .\ (1.1).\ 5\% = 11\ 000\$$	6000$
2	20	25	$200\ 000\$ \ .\ (1.1)^2.\ 5\% = 12\ 100\$$	$\frac{6\ 000\$ \ .\ (1.1).\ 25\%}{30\%} = 5\ 500\$$
3	15	20	$200\ 000\$ \ .\ (1.1)^3.\ 5\% = 13\ 310\$$	$\frac{6\ 000\$ \ .\ (1.1)^2.\ 20\%}{30\%} = 4\ 840\$$
4	10	15	$200\ 000\$ \ .\ (1.1)^4.\ 5\% = 14\ 641\$$	$\frac{6\ 000\$ \ .\ (1.1)^3.\ 15\%}{30\%} = 3\ 993\$$
5	5	10	$200\ 000\$ \ .\ (1.1)^5.\ 5\% = 16\ 105\$$	$\frac{6\ 000\$ \ .\ (1.1)^4.\ 10\%}{30\%} = 2\ 927\$$
6	0	5	$200\ 000\$ \ .\ (1.1)^6.\ 5\% = 17\ 716\$$	$\frac{6\ 000\$ \ .\ (1.1)^5.\ 5\%}{30\%} = 1\ 610\$$

- The entrepreneur should seek the agreement before any important decision is made such as launching a new product, new investments.
- The entrepreneur should organize a specific reporting to the investors through presenting budgets, programs and financial statements on a fixed period basis.

4. Conclusion

The development of venture capital activity could be guided directly to economic growth, since it has a significant impact on job creation through financing firms in their start-up stages that have a high potential for growth. This development could be hampered in Muslim countries by the failure to comply with Islamic finance principles. The reasons for which the IVC industry has been established are: The investors often shy away from investing their funds in unlawful activities and the young entrepreneurs do not accept to be financed by the proposed instruments of VC firms such as convertible bonds and warrants. The offered products by IVC firms such as "*Musharaka*", "*Mudharaba*" and "*Wakalah*" contracts could not minimize effectively the risks involved in IVC activities. The main objective of this paper is to propose a financial instrument by combining two main contracts in Islamic finance, which are "Ijara" and "Diminishing Musharaka" contracts.

The demonstration of how the model works and the numerical example fully supports the practical feasibility of the model. It allows the IVC firm to benefit from attractive profits, while minimizing the potential risks of IVC industry. It allows a smooth exit from the capital of the financed company, while avoiding a major problem relating to venture capital industry. In addition, our proposed model provides to the IVC firm a stable income with the high possibility to benefit from accelerated growth in start-up value. Furthermore, our model presents several advantages to the entrepreneur. It benefits from a grace period at the beginning of the project. The monthly rent is less costly compared to classical modes of finance. The entrepreneur will become the sole owner of the company at the end of the project. This paper elaborates a possible model of financing that IVC firms might use to minimize the risks of their operations. The present paper contributes to widening the choice of financing methods that can be adopted to specific projects. The IVC firm has to strengthen its position in the negotiation of "Dimininshing Musharaka" contract, as the entrepreneur might not fulfil his partnership promise. In addition, certain changes could be made to our proposed model to be used by other financial institutions such as Islamic banks and Islamic micro finance firms.

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