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Influences of Islamic Practices on Small Firm Performance: A Study in North Sumatera, Indonesia

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Abstract
Islam as *ad-din* (way of life) outlined value systems established by al-Quran and al-*hadith* in every aspect of life. The underlying principle of the Islamic values is the well beings of human life and the *'alam* (environment). This study aims to investigate the impact of Islamic practices on small firm performance. Conceptually, practices translate knowledge, ability and experience into action for desired outcomes or performance. Three main theories namely the theory of human capital, organization and strategy are used as the underpinning theories in explaining performance. Ten independent variables delineated from the respective theory are chosen for developing a multivariate performance model. It includes networking, branding, financing, motivation, education, training, business experience, firm's size, ownership and age as independent variables, while performance is conceptualized as sales growth serves as a dependent variable. The ggovernment support towards Islamic practices in small firm is tested for its moderating effects. The study approach is evidence-based positivism and employs quantitative deductive hypotheses testing methods. The sample size (N) is 370 small firms' owner-managers randomly picked from four regions in the Province of North Sumatra, Indonesia. The measurement justifications are based on the Islamic values/perspectives or conventional values that are in compliance with the Islamic principles. It is found that all the Islamic practices captured in the independent variables are positively related to the firms performance, while, the Government supports moderates the relationship between the Islamic practices and the firm performance. This findings might add knowledge to the small firm performance literature, probably help policy makers in their decision making regarding small firm sector, and possibly small firms' owner-managers who want to improve their performance.
Keywords: Islamic practices, government support and firm performance.

1.0 INTRODUCTION

The small firms sector is an important component to economic development in all countries around the world. It makes contributions in improvement of income distribution, poverty reduction, employment creation, export growth, industry growth and rural economic development (Tambunan, 2009). In Indonesia, the small firms had contribution of 43.66% on GDP which also create 91 million employements' opportunities to the industry (Minitsyr of Cooperative and SMEs, 2010), this would give the picture on the essentiality of small firm sector for economic growth and well-beings of the society that justifies continuous government support and encouragement to the sector's efficiency and effectiveness. This also applied in regional basis whereby its contributed about 50% of sales/value added to GDP in Southeast Asia developing countries (Narain, 2003). However, these small firms have to face many constraints in their performance specifically the managerial aspect which needs to besolved by the firms' owner-manager.

Islam is a religion with a comprehensive way of life (*ad-Din*) based on Al-Qur'an and *Sunnah* that rules everything, including commercial activities. It governed the business operational and managerial aspects aimed to achieve better performance and success as God commanded in which all the process of business must be observed strictly to the permissible (*halal*), abstaining from the prohibited (*haram*) and s*hariah* compliance (Rosly, 2006), emphasize on ethical behaviors such as honesty and justice (Yousef, 2001). Most Muslims are aware of the benefits of Islamic concept and practices in their lives, but to what extent those practices influence their performance might not widely explained. Thus, this study expected to answer the question to what extent Islamic practices and behavior encapsulated in human capital theory, business strategy theory and organizational theory explain small firm performance?

The small firm generally refers to companies with a limited number of employees (Hong and Jeong, 2006) or a company whose headcount or turnover falls below a certain limit (Chu, 2004). Burns (2001) stated that small firms

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are not just scaled down versions of large ones but the manner in which small firms go about their business differs from larger organisations. Sandee *et al*. (2002) mentioned that small firm were implemented traditional way of organizing business; family orientation; poor management; and adopted inappropriate method of production. The Ministry of Cooperative and SMEs of Indonesia and the two government agencies such as Ministry of Industry (MoI) and Central Statistical Agency (BPS), defined a small firm as a firm (retail, service, manufacturing and agriculture) that employs fewer than 20 employees with total initial assets of up to US$20,000, not including land and buildings, or with an annual value of sales of a maximum of US$100,000.

The optimal contribution of small firm through maximization output can be gained from better performance and growth. Despite the increased of total enterprises' units in Indonesia in 2006-2010 (9.79% growth), but the total output is fluctuated with low proportionate growth by 2.82% as depicted in Table 1.1. It assumed the small firms' performances have low efficiency and has negative growth.

Table 1.1 Total enterprises by size category in Indonesia, 2006 - 2010

Indicator	MSEs					Proportionate Growth 2006-2010 (%)
	2006	2007	2008	2009	2010	
Units	48,985,040	50,107,518	51,369895	52,723,470	53,781,101	9.79%
Share GDP (%)	42.46%	42.61%	42.24%	33.08%	43,66%	2.82%

Source: Ministry of Cooperative and Small and Medium Enterprises (2010)

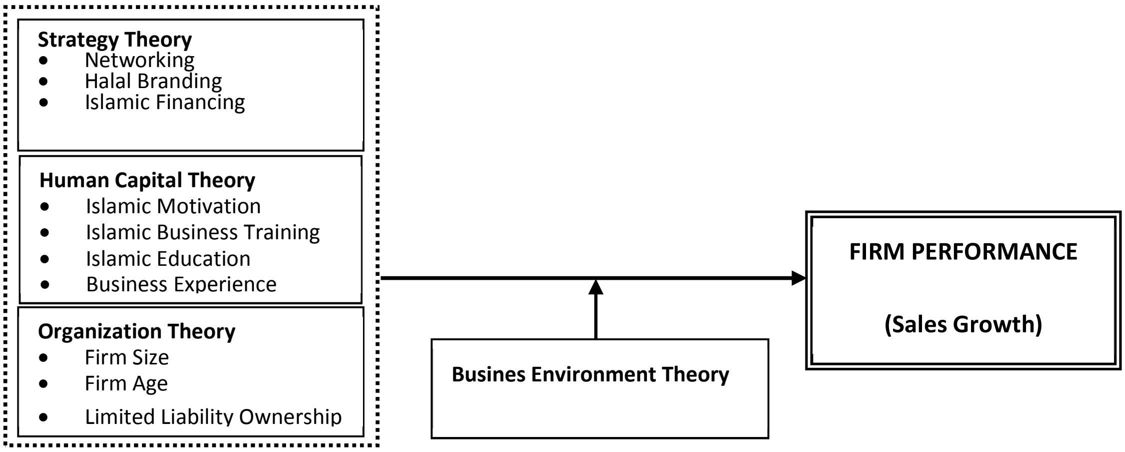
The negative growth may derive from low quality of human capital such as skills and education of firms' owner-managers. Tambunan (2008) found out that 28.81% of labors in Indonesia are educated and skilled labor, and the rest of 71.9% are dominated by low skills labor. Moreover, other possibilities of firms' negative performance, it could be the entrepreneurs, strategy and characteristics of the firms specifically the absent of Islamic practices implementation in their performances, althought, it has positive development of such Islamic banking and finance growth of assets up to 19.71% annually with total financing of USD519 billion in 2011 in Indonesia but whether this Islamic finance strategy could help for better performance is still unanswered. Furthermore, the adoption of *halal* certificate as an authority for *halal* compliance product is still under researched. The process of certification is tedious and may take some time to be authorized besides high costs incurred. Does *halal* certification influence firm performance? This is also a problem faced by the owner-manager of small firms.

Having educated human resource team in an organization has been associated with high performance. Small firms however, have very limited resources to employ graduates especially from high reputable universities who usually demand high pay. An alternative option is to employ employees from Islamic education institutions who usually not so demanding in their pay, though their reputation as pious persons are high. Small firm owner-managers really wanted to know whether religious education impact firm performance. Observing all these problems faced by the small firm owner-managers, this study is trying to investigate whether Islamic practices in small firms' management influence performance. Lastly, as claimed that the government has a concern on the development of small fims with its' program and other assistances, it is need to prove the effects toward the Islamic practices in the relationship with firm performance.

In traditional measurement of performance, the financial ratio variables used as explanatory variables. These include return on investment, return on equity and return on sales (Browne *et. al*., 1997). Neely (1999) posited that traditional measurement has problems such as rarely integrated with each other or aligned with business process and it is less relevant due to rapid changing of business environment (Maskell, 2001). However, some researchers used non-financial variables as dependent variables of business performance such as growth variable (Hall, 1995) and that is the best indicator of performance (Rodriguez and Fratesi, 2004). This study can be viewed to serve as an information for the stakeholders to benchmark the development and ensure quality outcome to increase small firms' productivity. In addition, the Islamic practices could be seen as value added among the Muslim owner/manager in their performance. Lastly, it expected to provide significant contribution for future research of small firms' performance.

1.1 Conceptual Framework

Neely *et al.* (1999) posited that the role of performance measurement as a process of quantifying the efficiency and effectiveness of a company's actions. An organization has to achieve its desired goals with greater efficiency and effectiveness than its competitors to have better performance. Browne *et al.* (1997) asserted that a company must have a process of measurement that measures both the present performance and the performance after any changes have been made in order to have improvement in performance. Storey (1994) proposed that factors influencing performance in small firms derive from three components, (i) the owner-manager (ii) the firm (iii) the strategy employed by the firm. While, Begley *et al*. (2005) stated that business environment as the external factor of moderating factor to the firm performance. However, the Islamic practices which based on these theories and other literatures are not been examnined. Thus, this study will be focus on whether or not the Islamic practices in firms' strategies, owner-manager and organization characteristics, and business environment influence the small firm performance.



Theoretical Framework of the Research

2.0. LITERATURE REVIEW AND HYPOTHESES

2.1 The Islamic and Work Values in Organization

Clarke (1998) posited that values, beliefs, intentions and objectives that people bring to their work are regarded as the work ethics. Islam as a religion which prescribes an extensive set of principles and regulations shaping all the aspects of life, including business ethics such as unity, equilibrium, free will, responsibility and bounty/benevolence (Torlak, *et al*. 2008). Hanafy and Sallam (1995) highlighted the importance of work ethics in Islam based on the Qur'an and Hadith. They specifically relate to six principles of Islamic ethics namely truthfulness, trust, sincerity, brotherhood, knowledge and justice. Other Islamic business guidelines are; mode of transactions that adherence of contracts, accurate measurements and weights, interests and unlawful trade, fair recruitment practices and treatment of employees and protection of environment are crucial to apply in any business operations. Moreover, Islam regards working as *ibadah* (good deeds to God), encourages trading, productivity and puts strong emphasis on the equal distribution of wealth in society (Ocal, 2007).

Islam and Christianity are having different belief systems, work ethic values with comparable characteristics (Weber, 2004). Weber posited that Islam was such a salvaging religion that did not support the economic growth in the world, while Protestant ethic has influenced people to work hard, expand their business, involve in trading, create wealth and then invest their wealth in order to gain more wealth, in which this related to the capitalism approach. However, Naqvi (1981) argued that ethical values in Islam are not oriented to social economics system or welfare state but oriented to an economics system which based on Unity of God or the *tauhid* principle as the moral basis that will create a fair and distributable economic system. Thus, the aim of Islamic economics is to reach the overall good deeds of maslahah (welfare) for everyone including the non-Muslim.

2.1.1 The Small Firm and Entreprenuership

As been discussed in the literature, the terms of small firm and entreprernuership are associated and used interchangeably. In the 17th century, Richard Cantillon developed one of the early theories on entrepreneurship by focusing on the individual. He defined the entrepreneur to be an individual who assumes risk, by buying at a certain price and selling at an uncertain price (Hisrich and Peters, 2002), while, Jean-Baptiste Say in the 19th century described the entreprenuership as a process involving the shifting of economic resources from an area of low productivity to an area of higher productivity and greater yield (Chaston, 2009). Thurik and Wennekers (2004) stated that one of role of small firms is as the backbone of economy and provide essential support to the larger firms which carry the entreprenuership's dimension of innovation. They added that one of the major different of entreprenuerial concept is the initial of ambition to grow, while it is not neccesarily for small business. The small firms served as agents of change in terms of their entrepreneurial activities and it does not necessarily mean that entrepreneurship only present in small firms but it could be present in a large corporation which generally termed as intrapreneurship (Hisrich and Peters, 2002; Deakins and Freel, 2003).

Moreover, the differences of owner-manager and entrepreneur terms still as a debatable issue till the present day. According to the Oxford English Dictionary defintion, an entrepenuer as "a person who sets up a business or businesses, taking on financial risk in the hope of profit". Using this definition, entrprenuers and business owners are synonumous (ICP, 2012). However, Jennings and Beaver (1997) posited that both terms are born and made. They have certain personal character traits that they are born with and are influenced by antecedent factors. For example, during the introductory phase of the firm's life cycle, the owner-manager will be actively involved and adopt a hands-on approach. Then, during this critical phase, the role and personality of the owner-manager greatly impacts on the successful management of the small firm. It would be difficult to separate the management styles and behaviour of personality set, experience and training of the owner-manager in the small firm.

However, Burns (2001) argued that the two terms are related but not synonymous. An assumption is when the entreprenuers start their own business, they have a risk taker character as it is be the owner who own the business. This linkage are not that simple or direct all of the time. An entrepreneur might manage a business belonging to someone else, at least for a time. Similarly, an owner-manager may find himself with a growth business, quite by accident (ICP, 2012). Wennekers and Thurik (1999) stated that the owner or manager could be as an entreprenuers through the components of ability and roles. The entreprenuerial ability refer the skills of an individual or team in creation of new economic opportunities, new organizational schemes as well as introduction of ideas in the market to face the uncertainty and obstacles by determining decision on location, forms and the use of resources and institutions. While, it's roles can play such a risk taker, supplier of financial capital, decision maker, innovator, manager, coordinator of economic resources, employer of factors of production, and owner of an entreprise.

As many authors mentioned that the terms of entreprenuers would be synonumous with small business owner, Vargas-Hernández *et al.* (2010) posited that there are significant differences between the entreprenurial ventures and small business in the statements such as: (i) a successful entrepreneurial venture creates substantial wealth not simply generating an income stream that replaces traditional employment, typically in excess of several million dollars of profit; (ii) a successful small business can generate several million dollars of profit over a lifetime, entrepreneurial wealth creation often is rapid; for example, within 5 years; (iii) the risk of an entrepreneurial venture must be high; otherwise, with the incentive of sure profits many entrepreneurs would be pursuing the idea and the opportunity no longer would exist; (iv) Entrepreneurship often involves substantial innovation beyond what a small business might exhibit. This innovation gives the ventures competitive advantage that results in wealth creation. Then, it may be in the product or service itself, or in the business processes used to deliver it.

2.2 Islamic Practices

In small firms' behavioral theory, the behaviour of the owner-manager (entrepreneurs) and the behavior of the firs are regarded as synonymous (Hall, 1995). In this study, Islamic practices are conceptualized into two dimensions. Firstly, the practices of the Muslimpreneurs religiosity such as performing prayers, give *sodakah* (charity), fasting during *Ramadhan*, join the Muslim *jemaah* (networking) are contributively to the performance of the firm. Secondly, the practices of the firm that is *shaariah* compliance such as, Islamic finance, Halal production, paying *zakat,* Islamic values in the business management functions' are also contributively to the firms' performance. Thus the main hypothesis of the study is, "*Islamic practices are influencing the firms' performance.* All of these practices had cited in Al-Qur'an and Hadith or based on the guideline of *shariah* rules, *muamalah* and ethical values (akhlaq

Islamiyyah). By virtue of the human nature, the person must firstly be a Muslim, then an entrepreneur. He has the responsibility to perform *'ibadah'* and be a *'khalifah'*. Muslim entrepreneur should search for God's blessings above all other factors. Muslim entrepreneurs perform business not solely for profit, but above all, to fulfill the 'fardhu *kifayah'*.
In regard to the implementation of Islamic practices, it has prescription of an extensive set of ways and regulations which based on the 4 (four) servitude principles of devotion to God, a committed heart, truthful words, and rightful deeds (Angha, 2002). It needs to understand the concept of entrepreneurship in Islam which intended for pleasing The Almighty Allah and it has a religious dimension alongside its economic dimension where Muslim entrepreneurs meet their economic needs, serve their communities and fulfil religious duties, they will attain a state of well-being (falah).

2.3 The Growth Models
Growth is a process of overcoming resource deficiencies resulting from the liabilities of newness and smallness (Shelton, 2005) or a differential outcome between (at least) two points in time or measures over a certain number of years or within the time periods of 1-, 3-, or 5- year periods (Penrose, 1959; Delmar, *et al*., 2003). The research of growth has been done by many researchers. Davidsson *et al*., (2006) came out with similar work and suggested two models of growth, there are: (i) stages and transitions; (ii) growth antecedents and determinants. Storey (2000) and Davidsson *et al*. (2006) assumed the stages models measure the growth process of life cycles or stage or transition throughout the life of an organization. The life cycle model refers to start-up, growth, maturity and decline stages. Mostly, it is focus on identifying problems that organization face during growth stage such as transition and managerial role problems (Davidsson *et al*., 2006). However, the limitation is not all the firms begin at the first stage and move to final stage, and eventually, the management roles do not shift at the same time in related stage. Storey (1994) asserted that an organization may have a management styles that is more or less advanced than its stage. Models of growth antecedents and determinants refer to factors or determinants that affect the firm growth. However, Storey (2000) differentiates the models which based on personality or entrepreneurs' perception. The origin of personality-based models may explained in Davidsson's model whereby the determinants are ability, need, opportunity and entrepreneur's perception. Thus, this study is adopting the Storey's growth model.

2.4 Factors Influenced the Small Firm Performance
2.4.1 HUMAN CAPITAL THEORY
Rastogi (2002) posited that human capital is an important input for organizations and employees' continuous improvement mainly on knowledge, skills and abilities. The entrepreneurs' characteristic of human capital constitute a key determinant of business success and give positive impact on firm performance (Hoxha, 2009; Al-Ma'ani and Jaradat, 2010). In Islamic perspective, the human capital is the integration of physical and spiritual. The better person is posses the technical knowledge, skills and good values as taught in Islam religion (Trim, 2009). It aims to produce better workers that obliged and fearful not only to the employer but most importantly to the Al-Mighty.

Business Experience
According to Oxford Dictionary (1996), an experience means a practical contact with and observation of facts or events or an event or occurrence which leaves an impression on someone. Previous experience is another relevant dimension of human capital that may have an impact on firm's growth (Bosma *et. al*., 2004). In this case we argue that work experience gives to the entrepreneur the specific knowledge and managerial capabilities, which can help him/her develop more successful strategies leading to higher growth rates (Lazear, 2004). Nevertheless, empirical evidence on this issue remains unclear. Westhead and Cowling (1995) find that previous labor market experience and growth are negatively correlated, whereas Schutjens and Wever (2000), Friar and Meyer (2003) and Bosma *et al.* (2004) report a positive relationship between entrepreneur's previous work experience as an employee and firm growth. Thus, the hypothesis is:

H1: The owner-maneger with more business experience is related to firm growth.

Islamic Motivation
The management vision in Islam is to achieve success means of everlasting prosperity and blesing in this word and the here after, this known as al-falah (Ahmad, 2006). He added that the al-falah build by the triangle concepts of

tawheed, *shariah* and *akhlaq*. Khalifa (2001) posited the 4 (four) dimensions of *al-falah* such as a dynamic (strive to thrive), a universal (implying the endeavours of one's entire life), an ethical (to be righteous, in intentions and deeds, to be blessed), and a continuity (enjoyed both in worldly life and in the Hereafter). Furthermore, entreprenuership is a mission in Islam. The activities of entreprenuership was done by Prophet Muhammad (PBUH) as a role model to be followed by all Muslim. It is also could shape to be good Muslim who raise the economic prosperity to the society. Even the entry of Islam in our region is through trading and business activities which learned that Islamic business is far from fraud actions or any unethical transaction which harm the individual and its institution (Ahmad, 2009). These explanations are the basis of motivation of Muslim in their life. Motivation refers to a driving force which helps and causes to achieve goals. Griffin and Ebert (2007 defined a motivation is the set of forces that costs people to act in a certain ways. Number of authors asserted that the motivation contribute significantly to firms performance (Benzing and Chu, 2009). Muslim workers find the motivation factor as a very important aspect as stated in the religion taught compared to other religions (Ali, 2009). In a study on the perception of 147 employees towards the Islamic motivation concept from various organizations in Bangladesh, Ather *et al*., (2011) found that the traditional motivation concept is a reflection partially of a total Islamic motivation concept. They insist to have mix expectations of materialistic world and the hereafter which bring permanents happiness. Muslim feels motivated to earn these materialistic gains for rendering the duty of a Muslim to Almighty Allah SWT as well as the duty of a Muslim towards fellow and all other creations of Allah SWT. Thus, the hypothesis is:

H2: The owner/manager with Islamic motivation is related to firm growth.

Islamic Business Training

Training can add the owner's skills, acquire knowledge and network, transfer of technology, develop commercial activities and acquire new and better management techniques (Roomi *et al.* 2009). Training also related to the motivations factors of employees with motivation for growth, encourage and can change their behaviours in their workingplace (Singh and Belwal, 2008) which may affect the earnings and productivity of firms. A study by Kessy and Temu (2010) (n=225) found out that the enterprises who are recipients of business training have higher level of assets and sales revenue. In Islamic perspective, Ali (2009) commented that the Islamic training is all encompassing, beginning from the moral and spiritual development of man and manifested eventually into physical development, althought some of the training methods are rely on Western techniques but it could be integrated with Islamic business model. Training and development also should be conducted to increase faith in God. Al-Marsati (1980) posited that Muslim workers should work with full capacity, eagerness, and sincerity to achieve excellence and success for themselves, as well as for the society, and more importantly for the life in the Hereafter. Training is a way to gain knowledge and as learning process which is compulsory for Muslim. Thus, the hypothesis is:

H3: The owner/manager with Islamic business training is related to firm growth.

Islamic Education Background

The owner-managers need to posses those attributes to look into the opportunities and face the firms' challenges. The firms' owner-manager who has better education level is more efficient in their work and building their character and enhances the skills (Souitaris *et al*., 2007). The formal education may provide entrepreneurs with a greater capacity to learn about new production processes and product designs, offer specific technical knowledge conducive to firm expansion, and increase owners' flexibility. However, the owner-managers are not concern on the impact of education and rely mostly on prior beliefs and past experience (Parker *et. al*., 2003). For example, in Indonesia, only 5.47% of the owner-managers are posses high education level, 82.33% of them has primary and secondary education level and the rest of 12.20% even not completed the primary education level (Ministry of Cooperatives and SMEs, 2010). It is assumed that education has a positive influence on the firm performance.

In Islamic perspective, the education conceptualized as a factor affecting individual and organization characters with the goal of ultimately perfection of the human soul and salvation which consists of ethical and moral consideration along with the formal and logical. This includes the possession of intuition, creativity, and possibility of response to that delightfully given intellectual power. There are many attention and reminder cited in Al-Qur'an and Hadith on obtaining education to be successful. Thus, in this regard, the owner-manager expected to gain competitive advantage with cores values of sincerity, simplicity, individual autonomy, solidarity and self-control (Zuhdi, 2005). Thus, the hypothesis is:

H4: The owner/manager with Islamic education background is related to firm growth

2.4.2 STRATEGY THEORY

Schermerhorn (2002) defined a strategy as a comprehensive actions plan that identifies long-term direction for an organization and guides resource utilization to accomplish goals with sustainable competitive advantage. Porter (1980) mentioned that a strategy is important for the firms to gain competitive advantages and able to outperform their competitors. Beaver (2002) asserted that a strategy is the action takes by an organization to pursue its business objectives. Thus, a new venture success or failure depends almost totally on the strategic initiatives taken by the firm (Roper 1997). Previous research discussed and investigated on the relationship between new venture strategies and firm performance such as quality, low cost and innovativeness (Tsai and Li 2007), new product development (Zott and Amit 2008) and market development and geographic scope (Hsu and Pereira 2008). This study emphasize to the Islamic marketing and financial strategies' implementation in an organization.

2.4.2.1 Marketing Strategy in Relation to Firm Performance

Marketing strategy refers to the best marketing practices used by firms to gain competitive advantage and achiving company goals (Brassington and Pettitt, 2003). Marketing practices in small firms are different with larger firms. Hill (2001) posited that the small firms are more flexible, closer to customers, more capable of adaptation and implementing creative change through exploitation of core competencies and small firms cannot follow formal marketing practices because of the limited resources and different ways of managers' minds (Gilmore *et. al*., 2001). A study by Indrati and Langenberg (2004) on small firms' performances in Indonesia found out that marketing practices are the main factor of firm performance and positively related to the business success in a significant way.

There are five categories of ethical principles in Islamic marketing practices (Hanafy and Salam (1988). These include (i) truthfulness; communication which relate to advertising or personal selling, must be done in a truthful manner, (ii) trust; a marketer must uphold the trust Allah SWT through proper management of resources for the betterment of society and environment, (iii) sincerity; to be sincere in fulfilling consumers' needs and ensuring consumer safety, (iv) brotherhood; having a sense of brotherhood in dealing with business partners and consumers and (v) justice; the justice could ensure all dealings are conducted with fairness to all parties. A study by Abdullah and Ahmad (2010) found that many businessmen do not observe the marketing practices as outlined in the Quran and Sunnah particularly in products' promotion such as giving full disclosure of information, use of exaggerations and vulgar languages and false promises in their attempt to sell the products. Thus, the Islamic marketing practices have superior influence which based on the values that embedded in every element of practices (Arham, 2010). This study focuses on variables of Islamic networking and Halal strategies of small firms.

Islamic Networking

The networking strategy refers as an access to people and their resource of information and knowledge of its relational activities through informal and personal or formal and professional networking (Macpherson and Holt (2007). Burt (2005) added that a networking increased understanding of potential markets, new business locations, innovations, sources of capital and potential investors, and it is positively influence the performance of small firms. Networking is the most useful of marketing practices and as an important sign of growth in small firms (Brown *et al*., 2005; Gilmore *et al*., 2001). A study conducted by Delapierre *et al*. (1997) found that most successful firms in terms of growth belong to dense and convergent networks while the inadequate networking will lead to firm poor performance.

In Islamic perspective, networking relates in having good relationship among the human beings which is compulsory especially seeking for doing goodness. The role of Islamic networking is maintaining the relationship that encourage trust, reciprocity and shape the quality and quantity of the interactions towards providing the inputs and growth (Chapra, 1992) with an application of the Islamic value dimensions such as honesty of communication, appreciation of diversity of human race, justice and fairness (Rice and Al-Mossawi (2002). Thus, the proposed hypothesis is:

H5: A networking strategy in Islamic organizations is related to firm growth.

'Halal' Branding Strategy

The small firms need to encourage the branding experiences to their customers in order to explicitly communicate positive associations and increase customer confidentiality in goodness of products. The branding strategy emphasizes on creation and development of brands as a source of sustainable competitive advantage (Gilmore, 2003) and generates growth (Mowle and Merrilees, 2005). With an increasing competitive market, the small firms are motivated to build brand strategy to enhance sales. In Islamic perspective, the concept of branding strategy associated with halal certification as a way to inform and reassure their target consumers on their products are *shariah* compliant (Wilson and Liu, 2011). The term halal is better known by consumers as a food that is permissible to be consumed. The small firms need to invest and align the standard set by local authorities to obtain *halal* products' certification. A study by Osman and Sahidan (2002) in Malaysia (N=891) indicated that *halal* logo did play a role in their purchase decision. He added that the *halal* concept is an absolute key to consumption and the products which carry halal logo have more meaningful and important than those carrying ISO or similar certification. Thus, the hypothesis is:

H6: A halal branding strategy in Islamic organization is related to firm growth

2.4.2.2 Financial Strategy in Relation to Firm Performance

Financial strategy refers to the practices that a firms adopts to pursue financial objective. With sufficient financial support, new ventures can more effectively utilize their existing resources to continuously improve, upgrade, and develop advanced products and processes. Cassar (2004) asserted that financial capital is an instrumental resource required by new venture and as a factor for growth. Levine (2004) posited that a firm with limited or no access to external capital may face serious constraint in its ability to pursue the firm's growth. For example, In Indonesia, a total of 75,63% of small firms' owners use their own money to finance their businesses and 2.35% borrow money from financial institutions (Tambunan, 2008).

In Islamic perspective, Shanmugam and Zahari, (2009) posited that Islamic finance aims of fulfilling the teachings of the Quran as opposed to earning maximum returns on financial assets. It is based on five main principles, which include the prohibition of interest (riba), excessive uncertainty (gharar), speculation (maysir), risk and return sharing, and the prohibition of investing in 'unethical' industries. However, the small firms in Malaysia does not consider the Islamic financing scheme as the most desirable capital source in operating their daily business transaction due to reason that it is less competitive as compared to their conventional counterparts (Norafifah and Sudin 2002). Meanwhile, in Indonesia, the development of Islamic finance showed positive development by the high demand on its products and services with reached the total assets of USD713 billion, increased of 5,23% compare the previous quarter in 2011 (Bank of Indonesia, 2011). The Islamic micro financing institution (IMFI) provide financing to the small firms to improve the firm performance by increasing their income, profit and assets (Widiyanto and Ismail, 2007). With the concept of profit/loss sharing, it avoid a burden to the borrowers and this shows by the low rate of non-performing loan (NPL) problem with less than 5% or the rate of repayment greater than 95% during years of 2002-2005 in Indoneesia. Moreover, Zaher and Hassan (2001) provide an overview of the returns by 37 Islamic equity funds for the period 1997–1999 and found that ethical investments offer a good return compared to conventional mutual funds. Given these arguments, thus the hypothesis is:

H7: An Islamic financial strategy in Islamic organization is related to firm growth

2.4.3 ORGANIZATION THEORY

The organization factors refer to the characteristics of the firms in terms of age, size and ownership. These factors are the most comprehensive set of small firms' organizational factors in many studies (Wong and Aspinwall, 2004) which influence significantly to the firms' performances and growth (Hunger and Wheelen, 2003).

Firm Age

Storey (1994) stated that young firms are more likely to achieve significant growth than older firms. Older and larger firms tend to exhibit lower growth rates due to having less of a growth imperative and their expansion is more likely to involve mergers and acquisitions (Davidsson *et al*., 2006). Jovanovic (1982) asserted that firms learn about their real efficiency over time which relates to the firm's age, thus, the small firms grow faster than large firms. An IDB study reveals that the major expansion of dynamic enterprises occurs during their third year of operation (Kantis *et al*., 2004). Thus, the firm age is an important factor in determining business growth of small firms and the hypothesis is:

H8: Firm age in Islamic organization is related to the firm growth.

Firm Ownership

Abby and Nicholas (2006) posited that a firm's ownership dictates the sources and amounts of funding available which determine the competitive advantage of firms and associated with more efficient strategies and higher firm performance. (Porter (1990) points out that the ownership structures such as family ownership or professional management has strong influences on organization's goals, innovation activities (Ortega-Argiles *et al*., 2005), firm size, business strategy and internal control systems (Daily and Dollinger, 1992). However, Storey (1994) argued that generally ownership is not specifically taken into account since the firms are independent or even single-plant independent firms. The small firms' forms of ownership are a sole proprietorship, a partnership and limited liability company (Schermerhorn (2002). Partnership is highly valued by professionals because it provides three benefits such as significantly higher compensation, the right to participate in decision-making and high status (Greenwood and Empson, 2003), while, limited liability has more protection than sole proprietorships but more expensive to create. Sometimes the private owned companies may suffer internal conflict and thus, it is difficult to manage (Durand and Vargas, 2003). However, the limited liability ownership companies can achieve or expect more rapid growth compare to other types of ownership (Deakins and Freel, 2003). Further, one could be relate is the ability of limited liability firms with their strong capital source or investment in applying of *Halal* certification which made them differ than sole proprietorships or partnership companies. This also may assume that the limited liability firms are implementing the Islamic business practices than the firms with other types of ownerhsip. Thus, the hypothesis is:

H9: A limited liability of firm ownership in Islamic organization is related to firm growth.

Firm Size

There are arguments from previous studies on the firm size and its relationship with the firm performance. Gibrat's (1931) Law of Proportionate Effect (LPE) point out that firm's growth is independent of its size or irrelevant to growth rates. Number studies found evidence which fully or partially support the LPE (Piergiovanni, *et al.* 2002; Audretsch *et al*., 2002). Goddard *et al*., (2006) argued that the firm growth is just happed, thus, past growth is not a reliable predictor of future firm growth and some empirical studies have rejected the LPE (Hall, 1987; Evans, 1987; Geroski and Gugler, 2004). Moreover, Jovanovic (1982) suggests that differences in firm size would reflect different positions along the critical growth path. The larger firm may enjoy the advantages of having bigger resources that may give the optimum combination for optimum production. However, Liedholm (2002) argued that small firms grow more rapidly than large ones. Menwhile, Storey (1994) found that the firm size was a significant factor to small firm performance and it is the most widely studied factor for its contributions to growth. Thus, the hypothesis is:

H10: Firm size in Islamic organization is related to firm growth.

2.4.4 BUSINESS ENVIRONMENT THEORY

Business environment plays a crucial part for performance in a competitive market. The term 'business environment' connotes external forces, factors and institutions that are beyond the control of the business and they affect the functioning of a business enterprise. These include customers, competitors, suppliers, government, and the social, political,legal and technological factors etc. While some of these factors or forces may have direct influence over the business firm, others may operate indirectly. Begley *et al*. (2005) posited that different business environment conditions may influence the appearance of different types of entrepreneurs. One of the factor may have affected entrepreneurial aspirations includes government policies and support (Krasniqi, 2009) which frequently affected small firms' growth. Lee and Peterson (2000) believed that the entrepreneur must develop closer relations with the business environment because their opportunities and resources emanates from this environment. Rwigema and Venter (2004) state that the entrepreneur must consider the business as a whole and be fully aware of its place within the market it operates in. They added that viewing the business in its totality will provide the entrepreneur with a long-term perspective for future growth and sustainability. Althought scholars tend to agree on the important role of the government in facilitating and providing a condusive environment for the growth of entreprenuers and their enterprises (Gilbert *et al*., 2006; Nolan, 2003), there is less agreement among the scholars on the effective level of government influences (Low, 2006; Papanek, 2006). Nevertheless, the firms' owners and managers are required to know any changes in their external environment, especially how these changes impact upon the organizations' positions.

Government Support in Relation to Firm Performance

The government support contributes to the small firm success. Yusuf (1995) in his study on 220 small business entrepreneurs in the South Pacific region highlighted one of the critical factors that would contribute to the success of small businesses is satisfactory government support. He also added that government assistance was more critical for the success of small indigenous entrepreneurs than the non-indigenous ones. The problem with the small firm in developing countries occur when they rely on the government support which emphasize on financial credits. In some cases, the financial support is failed to achieve the objective in creation values and jobs (Tambunan, 2008). The provision of credit is imbalance without offering the non-monetary support in terms of management education and technical training, consultancy, marketing approaches, market information, common facilities and promotion activities which aim to expose their products and the entreprise itself, even, this relate to the industry growth as a whole (Tambunan, 2009). An evidence by Sarder *et al*. (1997) in a study of 161 small enterprises in Bangladesh found that firms receiving non-monetray support and services either from the public or private agencies experienced a significant increase in sales and productivity.

Moreover, Chaston (1997) posited that small firms has lack of updated information and new product introduction which may facilitated by the government agencies with regard of penetration to the international or domestic trading. This asserted by Verhees and Meulenberg (2004) that small firms need to acquire credible information gathering, market and environmental understanding with the reference of government support. The government support hope could be more proactive in their approach of providing inputs such firms' customer analysis (Rahman, 2001). Field (1997) posited that one of good example by the US Department of Commerce on the assistant to small firm in selling globally and fulfills their export potential through an aggressive program of advocacy and trade promotion till they gain impressive performances in international markets. A study in Iran by Nazemi *et al*. (2007) revealed that small firms who attended national and international trade fairs could promote the image of their products and market standout against competitors. It is further noticed that trade fair participation led to a positive effect on sales and improved customer relationship (Nazemi and Shirazi, 2010). However, some studies found different findings and stated that government assistance was unimportant to small business success. Mambula (2004) in a case study on 3 small manufacturing firms in Nigeria found that those firms receiving credit and other forms of assistance did not perform better than those less privileged firms. Moreover, Kirpalani and Macintosh (1980) studied 34 SMEs in the U.S and Canada and found that internal factors such as involvement of R&D, technology, marketing mix and production function determined the firm success in international marketing but not government assistance. According to them, government assistance is regarded as a hygiene factor in the sense that it is an enabling condition for small firms to compete in global markets, but insufficient for their success.

Thus, this study focus on the government support through facilitating in trading promotion domestically or internationally provided by the Ministry of Cooperative and SMEs of Indonesia for the small firms, whether this kind of support could contribute to the business growth. The more frequent attendance of trade exhibition, probably it has potential to grow. This moderating variable assume has an influence the independent variables in theire relationship to the firm performance. Thus, the hypothesis is:

H11: The government support moderates the relationship between Islamic practices and firm growth.

3.0 METHODOLOGY

The quantitative deductive research approach is chosen in this study. The deductive approach allows the research to establish a hypotheses by using theory Creswell (2002). Trochim (2011) posited that a deductive research is based on the general idea to reach at the specific situation and it is linked with the positivism paradigm. Furthermore, this study is using the cross-sectional correlation survey design which requires using the statistical correlation tests to describe and measure the degree of association/relationship between or among variables or sets of data (Creswell, 2002), in this case to reveal the Islamic practices factors influence small firm performance.

3.1 Population and Sampling Frame

The population chosen for the study is the owner-managers of 10,757 small firms registered in Provincial Department of Cooperative and SMEs and Deprtment of Industry located in the 4 (four) most strategic and potential regions. Refer to the table of determining random sample size by Sekaran (2003), the sample size of 10,757 population is 370 respondents. These questionnaires are draw randomly from sample size.

3.1.1 Research Variables Measures

The measurement of the variables is based on the conceptual and theoretical framework operationalized in the studies. The variables measures are as follows:

1. Islamic Motivation is measured by whether or not the firm has a program of religiosity to drive spiritual factors into business. It is measured as dummy variable (yes: 1; no: 0).
2. Education is measured by whether the owner-manager has attended any Islamic formal education or otherwise. It is measured as dummy variable (yes: 1; no: 0).
3. Training was measured by whether or not the owner had attended formal Islamic business management training. It is measured as dummy variable (yes: 1; no: 0).
4. The business experience measured by the period of years that the owner/ entrepreneur had gone through in businesses (continuous data).
5. Halal Strategy is measured whether or not the firm obtained Halal products' certification. It is measured as dummy variable (yes: 1; no: 0).
6. Islamic Networking Strategy is measured whether or not the firm become an Islamic trading/commerce association. It is measured as dummy variable (yes: 1; no: 0).
7. Financial Strategy is measured whether or not the small firm purchased the Islamic financing. It is measured as dummy variable (yes: 1; no: 0).
8. Firm Age is measured by use the number of years a firm has been incorporated (continuous data).
9. Firm Size is measured by the total number of employees employed by the firms (continuous data).
10. Firm Ownership is measured by whether the firm has limited liability type of ownership. It is measured as dummy variable (yes:1; no: 0).
11. Growth Sales. The growth rate of sales is calculated by the proportionate values of sales growth rate from the given period of five years from 2009 – 2011.
12. Government support is measured whether the owner-manager had ever attended the trade fair offered by the government. It is measured as dummy variable (yes: 1; no: 0).

3.2 Result

3.2.1 Descriptive Statistics and Analaysis

Of the 370 respondents, 206 (55.4%) were male 164 (44.1%) were female. Althought the population rate among the male and female are equal, probably due to the religion influence who encourage male to involve more in business rather than female. Hence, the majority of the owner-manager was predominance by male. Almost half of the firms are in manufacturing business sector with 40.6 percent and followed by the retail sector of 31.5 percent. Additionally, the majority of business' age of 67.0% were incorporated since 3-7 years ago and most of them by 68.7% were in the age of 31 – 44 years old.

3.2.2 Predictive Variables Bivariate Correlation Matrix

Table 3.1 presents rank order correlation matrix with Pearson Correlation Coefficients among the 10 predictive variables of this study. This was a two-tailed test because a relationship was expected but the direction of the relationship was not predicted. Pearson's r ranges from -1.0 to 1.0 measure the strength of linear relationship. The larger the absolute value of r is, the stronger is the linear relationship. Pearson correlation coefficients also indicate normality and linearity (Bryman and Cramer, 2001).

The most highly correlated variables between firm's age and business experience was at 0.87 ($p<0.01$), followed by firms' ownership and business experience was at 0.81 ($p<0.01$), firms' ownership and firms' age was at 0.789 ($p<0.01$) and firms' ownership and finance strategy was at 0.756 ($p<0.01$). It was observed that each variable were significantly correlated with other variables which indicated would contribute significantly in the equation formulation. The lowest correlation was between halal certification strategy and training was at 0.153 percent.

Table 3.1 Pearson Correlation Matrix of the Independent Variables

Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
(1) Experience	1.00									
(2) Motivation	0.598**	1.00								
(3) Training	0.535**	0.439**	1.00							
(4) Education	0.594**	0.450**	0.352**	1.00						
(5) Networking	0.469**	0.406**	0.271**	0.375**	1.00					
(6) Halal	0.453**	0.263**	0.153**	0.412**	0.268**	1.00				
(7) Finance	0.788**	0.592**	0.522**	0.525**	0.423**	0.404**	1.00			
(8) Age	0.871**	0.579**	0.458**	0.556**	0.410**	0.421**	0.741**	1.00		
(9) Limited Liability	0.814**	0.552**	0.567**	0.564**	0.412**	0.390**	0.756**	0.789**	1.00	
(10) Size	0.624**	0.460**	0.398**	0.499**	0.343**	0.370**	0.656**	0.690**	0.676**	1.00
**. Correlation is significant at the 0.01 level (2-tailed).										

3.2.3 Multiple Regression Analysis

The main quantitative analysis method used in this research is the Multiple Regression analysis. The relationship between independent and dependent variables is modeled in the following equation:

$$Yi = a + bXi + e$$

Where Y represents growth rate of sales (GrS) in ith small firms, Xi represents six independent variables such as Business Experience (X1), Islamic Motivation (X2), Islamic Business Training (X3), Islamic Education (X4), Islamic Networking Strategy (X5), Halal Certification (X6), Islamic Financing Strategy (X7), Firms' Age (X8), Limited Liability Ownership (X9) and Firms' Size (X10), and a is intercept, and e is error term. Table 3.2 summarises the regression results of the growth model generated by OLS techniques. The direction of the sign of each variable would be used as the hypothesis testing technique. From Table 3.2, it is depicted that adjusted R^2= .785 indicates that the variables in the model explained 78.5% of the variation of the dependent variable sales growth. The results also explained that all the predictive variables are positively associated with the firms' performance which has had significant *t-test*. The Growth Model is given below:

$$Y = 1631.152 + 79.143X1 + 239.829X2 + 434.326X3 + 338.866X4 + 312.073X5 + 257.021X6 + 460.689X7 + 79.957X8 + 487.853X9 + 87.474X10 + e$$

Table 3.2 Multiple Regression analysis of Islamic Practices and Firm Performance (n = 370)

	Unstandardized Coefficients		Standardized Coefficients			Collinearity Statistics	
Model	B	Std. Error	Beta	t	Sig.	Tolerance	VIF
(Constant)	1631.152	171.828		9.493	.000		
Business Experience (X1)	79.143	29.754	.162	2.660	.008	.161	6.221
Islamic Motivation (X2)	239.829	118.361	.066	2.026	.043	.563	1.777
Islamic BusinessTraining (X3)	434.326	113.165	.119	3.838	.000	.620	1.613
Islamic Education (X4)	338.866	117.708	.093	2.879	.004	.580	1.725
Islamic Networking (X5)	312.073	105.465	.084	2.959	.003	.740	1.351
Halal Certification (X6)	257.021	103.752	.071	2.477	.014	.737	1.357
Islamic Finance (X7)	460.689	166.917	.123	2.760	.006	.301	3.321
Firm Age (X8)	79.957	27.174	.163	2.942	.003	.196	5.108
Limited Liability Ownership (X9)	487.853	190.661	.124	2.559	.011	.253	3.950
Firm Size (X10)	87.474	24.034	.134	3.640	.000	.439	2.278
R Square = 0.785	Adjusted R Square = 0.779		F = 131.100	Durbin-Watson = 1.977		Sig (F) = 000a	

As illustrated in Table 3.2, the F value of 131.100 is significant at the 0.01 level. All the Islamic practices delineated from three theories utilized in this study have significant relationship with sales growth. This model of Islamic practices' variables explained 78.5% of the variance in firm performance (sales growth). Thus, the findings support all the hypotheses H1, H2, H3, H4, H5, H6, H7, H8, H9 and H10.
Further result is the Durbin-Watson test statistic as suggested by Field (2000) to see the correlations between errors whereby a value smaller than 2 indicates a positive correlation. As depicted at Table 3.2 that the test statistic a value of 1.977 indicating that the errors in the model were independent or uncorrelated. While, assessing the assumption of no multicollinearity among the independent variables was based on the collinearity statistic as depicted in Table 3.2 above. Menard (1995) pointed out that a tolerance value of less than 0.1 indicates a serious collinearity problem. Additionally, a VIF value greater than 10 is cause for concern. For this model, the VIF values were all well below 10 and the tolerance statistics all well above 0.1. Therefore, it concludes that there was no collinearity within the data in this study.

3.2.4 Hierarchical Regression Results

This analysis used to test the effect of government support on Islamic practices and firm performance.

Table 3.3 Hierarchical Regression analysis of Islamic practices, government support and firm growth

	Unstandardized Coefficients		Standardized Coefficients			Collinearity Statistics	
Model 2	B	Std. Error	Beta	t	Sig.	Tolerance	VIF
(Constant)	1557.924	157.943		9.864	.000		
Business Experience (X1)	66.635	27.348	.137	2.437	.015	.160	6.240
Islamic Motivation (X2)	272.609	108.698	.075	2.508	.013	.562	1.779
Islamic BusinessTraining (X3)	370.064	104.147	.102	3.553	.000	.617	1.622
Islamic Education (X4)	226.321	108.882	.062	2.079	.038	.571	1.753
Islamic Networking (X5)	336.573	96.835	.091	3.476	.001	.739	1.352
Halal Certification (X6)	299.615	95.358	.082	3.142	.002	.735	1.361
Islamic Finance (X7)	305.376	154.337	.082	1.979	.049	.297	3.372
Firm Age (X8)	71.825	24.958	.146	2.878	.004	.195	5.116
Limited Liability Ownership (X9)	466.934	174.996	.119	2.668	.008	.253	3.951
Firm Size (X10)	83.319	22.063	.128	3.776	.000	.439	2.279
Government support (X11)	779.830	94.404	.213	8.261	.000	.755	1.324
R Square = 0.819	Adjusted R Square = 0.814		F = 147.706	Durbin-Watson = 1.931			Sig (F) = 000b

The Table 3.3 above shows that government support has moderating effect on all dimensions in Islamic practices and firm performance (sales growth) relationship. The R square was increased to 81.9% when the government support included in the analysis. The model is fit when the R square is 0.6 and above. Therefore, hypothesis H11 was supported. In regard the Durbin-Watson test statistic a value of 1.931 indicating that the errors in the model were independent or uncorrelated. For this model, the VIF values were all well below 10 and the tolerance statistics all well above 0.1. Therefore, it concludes that there was no collinearity within these data.

4.0 CONCLUSION

The aim of this study is to investigate the relationship between Islamic practices and firm performance among the small firms in North Sumatera, Indonesia. The government support is included as a moderating factor in this relationship. Dependent variable is proportionate growth of sales. Three dimensions of Islamic practices namely the business experience, Islamic motivation, Islamic business training, Islamic education, Halal strategy, Islamic networking strategy, Islamic financing strategy, firm size, firm age and firm ownership and one dependent variable (growth rate of sales).

The research findings found that all of these variables have positively significant influence to the firm performance and consistent with the previous researches. For example, among other are the studies by Storey (1994); Begley *et al*. (2005); Angha (2002); Yousef (2001); Abeng (1997); Ali (1988) and Ahmad (2006). The highest contribution to the firm performance is limited liability of ownership (β=487.853) and followed by Islamic finance strategy (β=460.689) of small firms. Meanwhile, it is found that the government support moderates the relationship between Islamic practices and firm performance. With the government support, the Islamic practices effort will increase and therefore the performance of the firm also will increase. This explained by the hierarchical regression analysis findings the adjusted variance reaches between 78.5% and 81.9% of the total variation in performance. Thus, this was encouraging result.

This study has implications for the small firms, stakeholders and researchers. The findings suggest that the owners/managers should implement the Islamic 'halal' branding, networking and financing strategies due to the high concern of customer toward the cleanliness of processes and good content of products through halal certification, the importance of building the trust, reciprocity and quality interactions which carry justice and fairness values, and the vital of minimization of burden and increase their profit with the profit/sharing concept. These kind of strategy should be long term and planned specifically. Secondly, it needs to consider toward attending the Islamic motivation program, business training, education as the way to gain more *'ilm* (knowledge), works with ethical emphasis and self-advancement of seeking *ridha* (pleasure) of Allah. Lastly, it is shown that the limited liability firms are implementing Islamic business practices than the firms with sole priopriotership ownership which could influence positively to the firm growth. Further, it also proven by previous researches of positive relationship that the increase of business experience, firm's age and size in an Islamic organizations will increase the sales growth.

This study provides the additional empirical evidence that analysis of small firm growth should be based on a multidimensional framework. Further studies should be implemented with the support of more comprehensive and coherent theoretical background, and should consider many important Islamic factors as variables in the analysis model to reflect actual conditions on researching sample, which are more essential for developing countries. This is a potentially important form of growth that should be considered in the design of future studies.

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