

LEVERAGING QARDH AL-HASAN WITHIN ISLAMIC FINANCE: A CONCEPTUAL FRAMEWORK FOR ADVANCING SUSTAINABLE DEVELOPMENT AMONG EARLY-STAGE ENTERPRISES

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Abstract. *Early-stage enterprises significantly contribute to economic development through innovation, job creation, and productivity enhancement. However, these enterprises face substantial financial challenges, particularly in securing capital that adheres to ethical and Sharia-compliant principles. This paper investigates the use of Qardh al-Hasan, an altruistic loan concept in Islamic finance, as a strategic tool for supporting sustainable development initiatives within early-stage enterprises. By leveraging Qardh al-Hasan, which embodies social solidarity and economic justice in Islam, the study proposes a conceptual framework to enhance entrepreneurial resilience and sustainable business practices among nascent businesses. Employing a descriptive analysis and a framework-based review, the research explores strategies to optimize Qardh al-Hasan in financing early-stage enterprises, positioning it as an effective mechanism for addressing sustainability challenges. Key findings reveal Qardh al-Hasan's potential in fostering sustainable development, while highlighting practical challenges such as default risk, management issues, and liquidity requirements. The analysis indicates a deviation of many Islamic financial institutions from the social objectives of Islamic finance, prioritizing economic growth over holistic development. The theoretical implications enhance the understanding of Qardh al-Hasan's role in achieving economic and social justice, while practical implications advocate for its integration into modern financial systems to support entrepreneurship and reduce social inequality, emphasizing the need for adequate management and supranational support. This paper's novelty lies in its innovative approach to repositioning Qardh al-Hasan within contemporary Islamic finance, proposing a comprehensive model that addresses both theoretical and practical challenges, thus advancing the sustainable development objectives of Islamic finance by integrating underprivileged segments into the formal economy.*

Keywords: *Sustainable development, Qardh al-Hasan, Islamic finance, early-stage enterprises.*

Abstrak. *Perusahaan rintisan (early-stage enterprises) secara signifikan berkontribusi pada pengembangan ekonomi melalui inovasi, penciptaan lapangan kerja, dan peningkatan produktivitas. Namun, perusahaan-perusahaan ini menghadapi tantangan finansial yang substansial, terutama dalam memperoleh modal yang sesuai dengan prinsip-prinsip etis dan syariah. Penelitian ini mempelajari penggunaan Qardh al-Hasan sebagai alat strategis untuk mendukung inisiatif pembangunan berkelanjutan bagi perusahaan rintisan. Dengan memanfaatkan Qardh al-Hasan, yang mewujudkan solidaritas sosial dan keadilan ekonomi dalam Islam, studi ini mengusulkan kerangka kerja konseptual untuk meningkatkan ketahanan*

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kewirausahaan dan praktik bisnis berkelanjutan di kalangan pelaku usaha yang baru tumbuh. Menggunakan analisis deskriptif dan review-based framework, penelitian ini mengeksplorasi strategi untuk mengoptimalkan Qardh al-Hasan dalam pembiayaan perusahaan tahap awal, menempatkannya sebagai mekanisme yang efektif untuk mengatasi tantangan keberlanjutan. Temuan utama mengungkapkan potensi Qardh al-Hasan dalam mendorong pembangunan berkelanjutan, sambil menyoroti tantangan praktis seperti risiko default, masalah manajemen, dan persyaratan likuiditas. Analisis menunjukkan penyimpangan banyak lembaga keuangan Islam dari tujuan sosial keuangan Islam, lebih memprioritaskan pertumbuhan ekonomi daripada pengembangan holistik. Implikasi teoritis meningkatkan pemahaman tentang peran Qardh al-Hasan dalam mencapai keadilan ekonomi dan sosial, sementara implikasi praktis menganjurkan integrasinya ke dalam sistem keuangan modern untuk mendukung kewirausahaan dan mengurangi ketidaksetaraan sosial, dengan menekankan perlunya manajemen yang memadai dan dukungan organisasi supranasional. Kebaruan penelitian ini terletak pada pendekatan inovatifnya untuk memposisikan ulang Qardh al-Hasan dalam keuangan Islam kontemporer, dengan mengusulkan model komprehensif yang mengatasi tantangan teoretis dan praktis, sehingga memajukan tujuan pembangunan berkelanjutan keuangan Islam dengan mengintegrasikan segmen-segmen yang kurang beruntung ke dalam ekonomi formal.

Kata Kunci : *Pembangunan berkelanjutan, Qardh al-Hasan, keuangan syariah, Perusahaan rintisan.*

Introduction

Early-stage enterprises, often synonymous with startups or nascent businesses, are crucial for economic dynamism through innovation, job creation, and productivity enhancement (Shane, 2008). These ventures face significant challenges such as limited financial resources, market uncertainties, and managerial deficiencies (Rasmussen & Sørheim, 2006). Effective opportunity identification and strategic resource allocation are essential for fostering resilience and success in startups (DeTienne & Chandler, 2004). The discourse surrounding early-stage enterprises has become increasingly pertinent to the Sustainable Development Goals (SDGs) agenda. Sustainable development integrates economic growth, social inclusivity, and environmental stewardship, providing a holistic approach to the challenges faced by early-stage enterprises (UNESCO, 2005). The transition from MDGs to SDGs emphasizes global collaboration and innovative financial arrangements like blended finance. This approach, which includes the participation of the 'third sector', strategically mobilizes private investments to support inclusive development projects (UNDP, 2015).

In Muslim societies, the active role of the 'third sector' is deeply rooted in the institutional heritage of Islam, persisting into the modern era. During the COVID-19 pandemic, institutions such as *Infaq*, *Sadaqa*, *Zakah*, and *Waqf* have functioned as natural societal safety nets, supporting communities and complementing state safety nets globally. Additionally, instruments like *Qardh al-Hasan* have provided crucial support during difficult times, addressing urgent individual needs. In recent years, third sector entities in the Muslim world have evolved, playing increasingly active roles in supporting productive economic sectors through programs such as productive *Zakah*, *Waqf*, and *Qardh al-Hasan*, thereby addressing sustainability challenges faced by the Muslim community. However, among these instruments, only productive *Zakah* programs have been notably successful in delivering tangible results and impacts, particularly for lower-income groups. Challenges persist in effectively deploying productive *Waqf* and *Qardh al-Hasan* to meet sustainability goals.

While productivity is a fundamental characteristic of *Waqf*, *Qardh al-Hasan* is primarily associated with social purposes. Its essential nature resembles a conditional debt forgiveness clause. However, current practices have pushed *Qardh al-Hasan* towards *Tamwil* activities, where it is viewed as a key solution for financing early-stage businesses or projects. This shift raises two significant concerns: the issue of non-conditional repayment forgiveness, which can lead to moral hazards and improper conduct, and the financial sustainability of *Qardh al-Hasan* as it becomes a hybrid between commercial (*tijari*) and social (*taawun*) contracts, with limited financial viability. Accordingly, this paper will explore these issues by assessing the current state of *Qardh al-Hasan* and proposing alternative approaches to positioning it to address sustainability challenges effectively.

An increasing number of work has cited closed association between the concept of sustainability and altruism in the case of economic development. In contrast, Leys and Shaw (1996) to previous discourse that placed religious as a scapegoat to underdevelopment in Moslem world, this new line of work suggest that religion, as a growing force in world affairs and a guide for living a good life, has the potential to play a decisive role in the development process (Barrett, 2000; Ter Haar & Ellis, 2006; Tyndale, 2003). Chapra (2008) argued that in the Islamic literature, Islam has a vision of social and economic development based on *Maqasid al-Shariah* (the objectives of Islamic law). According to Chapra (2008), the primary indicator of development is not simply an increase in income and wealth, but also the satisfaction of justice and human brotherhood, which emphasise both the spiritual and non-material components of well-being.

Several studies explore the role of Islamic economy in sustainable development by delving into the fundamentals of the Islamic development framework. Chapra (2001, 2008) argued that in order to obtain a comprehensive picture of the relationship between Islamic economy and development, additional variables such as socioeconomic factors (i.e., social interest, morally oriented behaviour, *Zakat*), the state's role (i.e., moral obligations, Islamic

values, business ethics), physical capital (i.e., infrastructure), social capital (i.e., the degree to which an individual is literate and educated), social security (i.e., assisting the unemployed, the needy, the orphans, the widows, the aged, the disabled, and so on).

Furthermore, Ahmed et al. (2015) suggested that, theoretically, Islamic economic and finance could contribute to sustainable development by incorporating broader goals of Islamic law into its operations. Given Islamic finance's principles, which promote social inclusion and development, the Islamic financial sector through its financial institutions, capital markets, and social sector, has the potential to promote resilience, increase social sustainability (financial inclusion and vulnerability reduction), achieve environmental and social goals, and facilitate sustainable infrastructure development.

The current practice of sustainable economy in the Moslem world, explore the potential of integrating Islamic social finance into market and infrastructure development in order to support inclusive development. Fundamentally, Islamic finance has offered options for social security financing that include crucial elements of social sustainability such as *Zakat*, *Waqf*, *Takaful*, and *Qardh al-Hasan*. Nevertheless, among the four Islamic social finance instrument, the exploration in *Zakat* and *Waqf* are the only initiatives that have successfully mobilised new, untapped resources for fighting poverty. On the other hand, only *Qardh al-Hasan* which potential has not been unlocked to plays particular role in supporting sustainable development.

Although *Qardh al-Hasan* is regarded as an essential element of Islamic finance, its role has not been well positioned in the sustainable development architecture. As an example, *Qardh al-Hasan* in Indonesia is limited explored by the Islamic finance institution, which it mostly provided as a side business of Indonesian Islamic microfinance institutions (i.e. BMTs). Instead of defines the ideal state, *Qardh al-Hasan* is forced to performed outside its potential. Therefore, this paper aims to explore and position *Qardh al-Hasan* beyond its current state so it can better perform as a strategic financial instrument to

support sustainable development initiatives within early-stage enterprises. By aligning financial support with principles of social responsibility and economic justice in Islam, this study proposes a conceptual framework aimed at fostering resilience and promoting sustainable business practices among early-stage enterprises.

Literature Review (Book Antiqua 13)

The Concept of *Qardh al-Hasan* and Its Root in Islamic Tradition

Qardh al-Hasan, etymologically derived from 'Qard' and 'Hasan', denotes a benevolent loan. 'Qard' means "cutting off a portion," signifying the lender's transfer of property to the borrower, also known as 'Salaf', implying an advance to be repaid later (Zuhaili, 2003). 'Hasan' reflects compassion or beauty, derived from 'Ihsan' (Ismail & Possumah, 2010; Ariffin & Adnan, 2012; Yussof et al., 2015), creating the concept of a 'lovely loan' or 'benevolent loan.'

Legally, Hanafi scholars define *Qardh al-Hasan* as the transfer of a fungible asset with the borrower obligated to repay an equal amount, differing from a gift or sale, encompassing various types of assets (Zuhaili, 2003). Technically, *Qardh al-Hasan* mandates repayment of the principal in kind and within an agreed timeframe, without any additional amount (Selim, 2019; Ariffin & Adnan, 2012; Selim & Hassan, 2020). It rejects the notion of time value of money, aligning with Islamic principles by offering interest-free assistance to those in need (Farooq, 2011).

Islamic law prohibits *Riba* (interest), underscoring *Qardh al-Hasan*'s role as a *Shari'ah*-compliant financial option, favored for its flexibility and ethical nature (Abidin et al., 2011). It involves a straightforward process, accommodating both borrowers and lenders locally (Iqbal & Shafiq, 2015), with provisions for leniency based on the borrower's circumstances (Aderemi & Ishak, 2020). The Qur'an and Hadith commend *Qardh al-Hasan*, promising abundant rewards for lenders in this life and the hereafter (57:11, 18; 64:17; 2:245) (Sadr, 2014; Selim, 2019). It serves as a voluntary form of financial

support, distinct from obligatory acts like *Zakat* and *Khums*, aligning with Islamic ethical principles (Abdullah, 2015).

Overall, *Qardh al-Hasan* promotes financial inclusion and sustainable development by integrating marginalized groups into the formal economy, contributing to economic and social justice (Iqbal & Shafiq, 2015; Hasan et al., 2021). Despite its benefits, challenges such as default risk and financial mismanagement should be considered (Khidher, 2014).

***Qardh al-Hasan* and Sustainable Development**

Sustainability is at the center of on-going discourse in economic development, including in the Islamic economics sphere. The terms 'sustainability' and 'sustainable development' are frequently used interchangeably in various publications and are not strictly distinguished (Bettencourt & Kaur, 2011; Deng, 2015; Zhu & Hua, 2017). As discussed by Olawumi & Chan (2018) and Sartori, et al. (2014), the interchangeability is due to the association of both concepts to the main agenda of global economic development. The two terms are frequently used interchangeably, even in academic and scientific fields, as evidenced by the literature.

The concept of sustainable development originated in the early 1970s, when numerous works warned against the need to impose limits on the Western development model (Mebratu, 1998; Mitlin, 1992). The accumulating evidence of the negative environmental consequences of the green revolution in agriculture (Carson, 1962) industrial pollution such as the Minamata disease (Harada, 1995) and the Seveso disaster (Bertazzi, 1991) and the Western way of life and urbanisation (Meadows et al., 1972), as well as the risks inherent in sustaining the economic growth rationale as the strategy for development (Meadows et al., 1972).

The theory of sustainable development, which gained prominence through the Brundtland Commission's 1987 report 'Our Common Future,' emphasizes the balance of economic growth, social equity, and environmental protection. This theory posits that development must meet the needs of the

present without compromising the ability of future generations to meet their own needs (WCED, 1987). Afterwards, the majority of the international community accepted the statement as the new development paradigm (Alvarado-Herrera et al., 2017; Gore, 2015).

In the realm of Islamic finance, *Qardh al-Hasan* embody these principles by providing interest-free financial support aimed at fostering social justice, economic empowerment, and environmental sustainability. Leveraging *Qardh al-Hasan* for early-stage enterprises aligns with sustainable development theory by addressing critical financial barriers and promoting inclusive economic growth.

Numerous studies indicate that when the term 'sustainable development' is used, there are only two benchmarks associated with the framework for integrating three pillars of sustainability (social development, economic development, and environmental protection), namely the MDGs and SDGs. Although, Horner (2017) and Horner and Hulme (2019) suggest that the MDGs continue to be conceptualised in terms of the 'international development' paradigm, which is mainly focused on developing countries. On the other hand, the SDGs shifted into a paradigm of 'global development,' as that perspective views all countries, developing and developed, as sharing a 'common goal' of sustainability, and thus as sharing responsibility.

Table 1. List of SDGs

Sector	SDG No.	Goals
Social	SDG 1	End poverty in all its forms everywhere.
Social	SDG 2	End hunger, achieve food security, improved nutrition and promote sustainable agriculture.
Social	SDG 3	Ensure healthy lives and promote well-being for all at all ages.
Social	SDG 4	Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all.

Sector	SDG No.	Goals
Social	SDG 5	Achieve gender equality and empower all women and girls.
Environment	SDG 6	Ensure availability and sustainable management of water and sanitation for all.
Environment	SDG 7	Ensure access to affordable, reliable, sustainable and modern energy for all.
Economic	SDG 8	Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all.
Economic	SDG 9	Build resilient infrastructure, promote inclusive and sustainable industrialisation and foster innovation.
Social	SDG 10	Reduce inequality within and among countries.
Social	SDG 11	Make cities and human settlements inclusive, safe, resilient and sustainable.
Economic	SDG 12	Ensure sustainable consumption and production patterns.
	SDG 13	Take urgent action to combat climate change and its impacts.
Environment	SDG 14	Conserve and sustainably use the oceans, seas and marine resources for sustainable development.
Environment	SDG 15	Protect, restore and promote sustainable use of terrestrial ecosystems, sustainably manage forests, combat desertification, and halt and reverse land degradation and halt biodiversity loss.
Governance	SDG 16	Promote peaceful and inclusive societies for sustainable development, provide access to justice for all and build effective, accountable and inclusive institutions at all levels.

Sector	SDG No.	Goals
Governance	SDG 17	Strengthen the means of implementation and revitalise the global partnership for sustainable development.

Source: SDGs Report, UNDP (2015).

The United Nations' Sustainable Development Goals (SDGs), established in 2015, provide a comprehensive framework for global development efforts, encompassing 17 goals that target a wide range of issues, including poverty, inequality, climate change, and economic growth. *Qardh al-Hasan* can significantly contribute to several SDGs, particularly those related to decent work and economic growth (Goal 8), reduced inequalities (Goal 10), and responsible consumption and production (Goal 12). By facilitating access to capital for entrepreneurs who are often excluded from traditional financial systems, *Qardh al-Hasan* supports the creation and growth of early-stage enterprises, which are vital for economic dynamism and innovation. This financial inclusion fosters economic resilience and diversified growth, essential for sustainable development (United Nations, 2015).

In the sense of Islamic economy, the above sustainable development agenda is relevance to the objective of Islamic economy. Ensuring a growth and sustain development of someone's economy is in line with Islam's definition on development, which Zaman & Asutay (2009) remind that in the process of achieving human life goals have always consider moral, spiritual, and universal uplift, explaining the futuristic dimension of development. We can see that developmental uplift is being one of key aspect of developmental goals in Islam. On top of that, Hidayat et al. (2021) also remind of what some Islamic economist defining the Islamic Moral Economy framework on development, which the provision of essential human needs as well as creation of goodness and welfare of all human being are the true meaning of what development is. In this context, it can be seen that sustainable development in Islam is in the essentialisation of *Maslahah* term and context, that it can be interchangeable one to another.

Economic sustainability, a core component of sustainable development theory, is advanced through the provision of interest-free loans under *Qardh al-Hasan*. This financing model alleviates the financial burden on early-stage enterprises, allowing them to allocate more resources toward productive investments rather than debt servicing. Such financial support can catalyze business growth, enhance productivity, and facilitate the creation of job opportunities, thereby contributing to sustainable economic development (Ahmed, 2002). The infusion of capital through *Qardh al-Hasan* helps build a robust entrepreneurial ecosystem where businesses can thrive, innovate, and contribute to broader economic stability and growth.

Social equity, another critical pillar of sustainable development, is inherently supported by *Qardh al-Hasan*. The ethical principles of Islamic finance ensure that these benevolent loans are directed toward underserved and marginalized populations, thus promoting social inclusion and reducing economic disparities (Dusuki, 2008). By empowering individuals and communities who lack access to conventional financial services, *Qardh al-Hasan* helps bridge socio-economic gaps and fosters social cohesion. Additionally, this financing model can be tailored to support enterprises that prioritize environmental sustainability, aligning with SDGs related to climate action (Goal 13) and life on land (Goal 15). By promoting environmentally responsible business practices, *Qardh al-Hasan* ensures that economic advancements do not come at the expense of ecological health.

***Qardh al-Hasan* and Social Enterprise**

Social enterprise theory, which emphasizes the dual objectives of social impact and financial sustainability, offers valuable insights for the application of *Qardh al-Hasan* in Islamic finance to support sustainable development in early-stage enterprises. Social enterprises operate as hybrid organizations that balance social missions with commercial activities, aligning closely with the ethical and social principles of Islamic finance. According to Dees (1998), social entrepreneurship involves creating social value through innovative solutions, distinguishing these ventures from traditional non-profits and purely

commercial enterprises. Theoretical frameworks such as resource dependence theory (Pfeffer & Salancik, 1978) and institutional theory (DiMaggio & Powell, 1983) have been instrumental in understanding how social enterprises navigate complex stakeholder environments and institutional pressures while maintaining their dual missions.

Empirical studies on social enterprises have highlighted key areas such as impact measurement, scaling strategies, and financial sustainability, which are pertinent to the application of *Qardh al-Hasan*. For instance, tools like Social Return on Investment (SROI) have been developed to quantify and communicate the social value created by these organizations (Nicholls, 2009). Research by Bloom and Chatterji (2009) on scaling social impact has identified effective strategies like social franchising and partnerships that can be adapted to leverage *Qardh al-Hasan* for broader social benefits. Additionally, studies on the financial sustainability of social enterprises, such as those by Smith, Gonin, and Besharov (2013), emphasize the importance of diverse revenue models and funding sources, which can inform the structuring of *Qardh al-Hasan* to ensure the viability and growth of early-stage enterprises.

The integration of social enterprise theory with *Qardh al-Hasan* offers a promising framework for promoting sustainable development in early-stage enterprises within Islamic finance. *Qardh al-Hasan*, a benevolent loan that is free of interest, aligns with the social objectives of social enterprises by providing financial support to those in need without the burden of debt. This mechanism can be particularly effective in fostering entrepreneurship and economic development in underserved communities. However, challenges such as ensuring mission alignment and avoiding mission drift (Ebrahim, Battilana, & Mair, 2014) must be addressed. Future research should explore how the principles of social enterprise theory can be applied to enhance the effectiveness of *Qardh al-Hasan*, thereby contributing to the broader goals of sustainable development and social welfare in Islamic finance.

Methodology

This study utilizes a descriptive analysis approach in conjunction with a framework-based review to explore strategies aimed at optimizing the application of *Qardh al-Hasan* in financing early-stage enterprises. Moreover, this methodology investigates *Qardh al-Hasan* as a feasible alternative for effectively addressing sustainability challenges. The research methodology employed adopts a comprehensive approach to examine both the theoretical underpinnings and practical implications of *Qardh al-Hasan* within Islamic finance. This includes an exploration of classical Islamic jurisprudence texts and contemporary scholarly literature on *Qardh al-Hasan*, encompassing its definitions, historical applications, and relevance in contemporary financial systems. The study employs qualitative analyses to achieve a holistic understanding of the subject matter, underpinned by a thorough literature review that establishes a theoretical framework, particularly in relation to sustainable development and social enterprise.

Results and Discussion

In the pursuit of sustainable development within emerging markets, it is imperative to devise financial mechanisms that not only promote economic growth but also adhere to ethical principles. This paper introduces a conceptual framework that leverages *Qardh al-Hasan* specifically designed for early-stage businesses, addressing the critical need for inclusive markets. Early-stage enterprises in low-income economies often face significant barriers to accessing traditional financial services due to stringent requirements and high costs, which inhibit their growth and contribution to the broader economy. By integrating *Qardh al-Hasan* into the financial ecosystem, we can provide equitable access to capital for nascent enterprises, thereby promoting socio-economic development and fostering entrepreneurial innovation. This proposed framework underscores the importance of market inclusivity as a driver of sustainable growth, ensuring that financial support reaches the most marginalized segments of society. The subsequent discussion will elaborate on

the mechanisms and impact of this framework, highlighting its potential to transform emerging markets through ethical and inclusive financial practices.

Implementing *Qardh al-Hasan* within the Framework of the Capability Approach

Capability approach as conceived by Sen (1985) is a framework for evaluating and enhancing human well-being that focuses on the real opportunities people have to achieve their goals or in fulfilling the potentials. It emphasizes the importance of freedom and agency while recognizing that individuals have different values, goals, and aspirations (Sen, 1999). The approach is based on the recognition that capabilities are interdependent and that well-being depends on a range of factors, including social and economic conditions, political freedoms, and environmental sustainability (Alkire and Deneulin, 2009).

One of the strengths of the capability approach is its ability to capture the complexity and multidimensionality of well-being (Robeyns, 2005). By focusing on capabilities, rather than just income or material possessions, the approach provides a more comprehensive understanding of what constitutes a good life. The approach is also flexible and adaptable and can be applied to a wide range of contexts and issues.

However, the capability approach has also been subject to critiques. One critique is that it is too individualistic and does not adequately account for the role of social structures and institutions in shaping capabilities (Nussbaum, 2003). Another critique is that it is too abstract and does not provide clear guidance on how to measure or enhance capabilities in practice.

Despite these critiques, the capability approach remains a valuable framework for evaluating and enhancing human well-being. It emphasizes the importance of valuing human diversity and recognizing the unique capabilities of each individual. The approach has been influential in a range of fields, including development economics, social policy, and ethics (Alkire and Deneulin, 2009). Expanding choices is at the core of the capability approach.

The capability approach has been used to build a number of conceptual and normative frameworks within philosophy, most notably within development ethics, political philosophy, public health ethics, environmental ethics and climate justice, and the philosophy of education. Based on this concept, various indices such as the Human Development Index, the Gender-related Development Index, and the Human Poverty Index (HPI) arose.

In this paper's context, the raised capability issue is the incapability of people on below the poverty line (*mustahiq*) to access financing in order to pass through the line and scale-up their life independently. In the sense of morality and sustainable development, it is unjustified to maintain someone to always being *mustahiq* and unproductive, where there should be another effort to move it to a better and productive stage and financially sustainable. In this case, we finally come to the existence of *Qardh al-Hasan*, which is a financial instrument utilised to finance an early-stage enterprises (start-ups). *Qardh al-Hasan* is also recognised as a social instrument since it is an interest-free loans or a pure loans without any additional charge like interest or margin (Elgari, 2004). Thus, the *Qardh al-Hasan* contract typically used to scale up the *mustahiq* which already assisted by *zakah* to start become productive by promoting him to be entrepreneur.

Leveraging *Qardh al-Hasan* within Islamic finance presents a robust framework for promoting sustainable development in early-stage enterprises, grounded in the principles of the capability approach theory. This framework begins with the identification and targeting of early-stage enterprises that lack access to conventional financial resources due to stringent lending criteria and high-interest rates. *Qardh al-Hasan*, by providing interest-free loans, addresses these financial barriers, thereby enabling entrepreneurs to invest in their ventures, expand their operational capacities, and enhance their productive capabilities. This directly aligns with Sen's (1999) emphasis on expanding economic capabilities as a critical component of human development. By facilitating access to financial resources, *Qardh al-Hasan* empowers

entrepreneurs to pursue their business goals, achieve economic self-sufficiency, and contribute to broader economic growth.

Furthermore, the framework incorporates a holistic assessment of the socio-environmental impacts of funded enterprises, ensuring that the support provided not only fosters economic growth but also promotes social inclusion and environmental sustainability. *Qardh al-Hasan* loans can be strategically allocated to businesses that prioritize eco-friendly practices, sustainable production processes, and community-oriented initiatives. This aligns with Nussbaum's (2011) extension of the capability approach, which includes social and environmental dimensions of well-being. By supporting enterprises that adhere to sustainable practices, *Qardh al-Hasan* ensures that economic advancements are achieved without compromising environmental health and social equity. Additionally, the framework includes continuous monitoring and evaluation mechanisms to assess the impact of *Qardh al-Hasan* loans on the capabilities of entrepreneurs and the sustainability of their businesses, thus providing valuable insights for future improvements and scalability of the model. This comprehensive approach ensures that *Qardh al-Hasan* not only addresses immediate financial needs but also contributes to long-term sustainable development in alignment with the principles of the capability approach.

***Qardh al-Hasan* for Early-stage Enterprises**

It is agreed that Islamic finance must be distinct to conventional practices. The moral value that leads to the embeddedness of social objectives in the Islamic finance model is one of the distinct features of Islamic finance, as well as its imperative role to be always connected to real economic activities. That is why one of the goals of Islamic finance should be the creation of new entrepreneurship, and facilitating the development and growth of it, so it can contribute to the nationwide economy.

Figure 1 delineates various financial, operational, and strategic hurdles encountered by early-stage enterprises. Addressing financial concerns,

implementing effective management practices, fostering adaptability, and cultivating robust team dynamics are crucial for mitigating these risks and enhancing prospects for success. According to the survey conducted among early-stage enterprises proprietors, the primary factor contributing to their business failures was insufficient financing, cited by nearly half of the startups. Additionally, the COVID-19 pandemic influenced the demise of one-third of these businesses. Bankruptcy seldom results from a single cause but rather from a confluence of factors, as evidenced by the diverse reasons provided by the respondents.

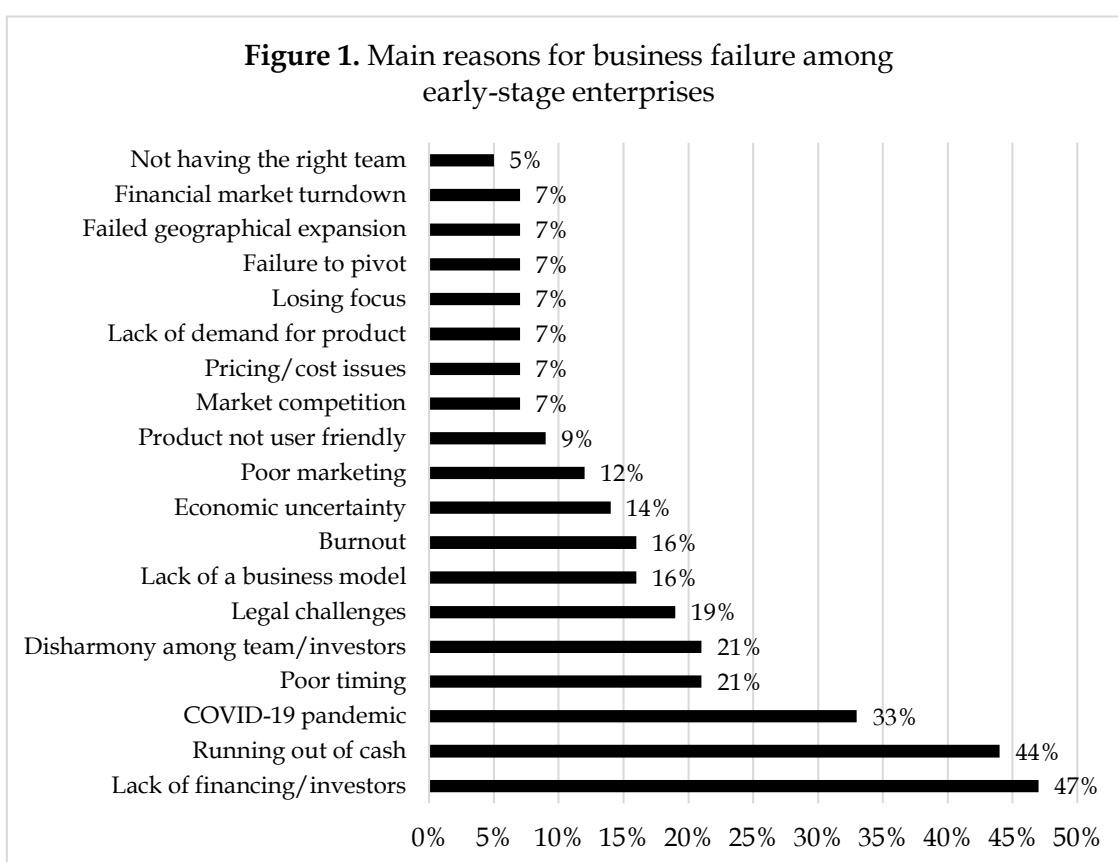


Figure 1. Main reasons for business failure among early-stage enterprises

Source: Skynova; CB Insights (2023). Number of respondents: 500 early-stage enterprises owners

In practice, many Islamic financial institutions have been deemed incompatible with the social goals of the Islamic economy. Accordingly, critics toward Islamic financial institutions emerged, indicating that Islamic finance practises have abandoned their original purpose of enhancing social function

and community development (Ahmed, 2011). Additionally, Islamic financial institutions are attempting to mimic conventional products, market-oriented, and focusing exclusively on economic growth rather than encouraging a more comprehensive development (Asutay, 2012). These circumstances are almost certainly a reference to what several scholars have identified as deviant Islamic finance practises, such as a simple substitution of conventional banking terminology (Khan, 2010; Nomani, 2006), the *Murabahah* syndrome (Miah and Suzuki, 2020), and even a camouflage of *riba*-based financing activities (Minhat and Dzolkarnaini, 2016). As a result, Islamic finance, which is intended to boost economic growth and holistic development (Iqbal et al., 2006), appears to have become disconnected from the objectives for sustainable development (Iqbal and Mirakhor, 2013).

In this case, our understanding is that market in Islamic finance ecosystem must be inclusive, for instance is by promoting staged entrepreneurial development, where it has inclusion and financing roles for different segments, from the underempowered (poorest of the poor) to the advanced and sustained entrepreneurship. Indeed, Islamic finance already has the financing tools to accommodate all those segments, from the *Tabarru'* contracts to *Tijari* contracts.

According to Shari'ah, *Qardh al-Hasan* is neither a social (*tabarru*) nor a commercial (*tijari*), but is situated between the two, since it possesses qualities of both *tabarru* and *tijari*. In Islam, *Qardh al-Hasan* is primarily positioned as a financing tool for the needy in order to confirm wealth distribution, perform a charitable act, encourage the disadvantaged to create new fields of work, new businesses, and ultimately assist in eradicating social and economic inequality in the community (Khan et al., 2021; Saqib et al., 2015).

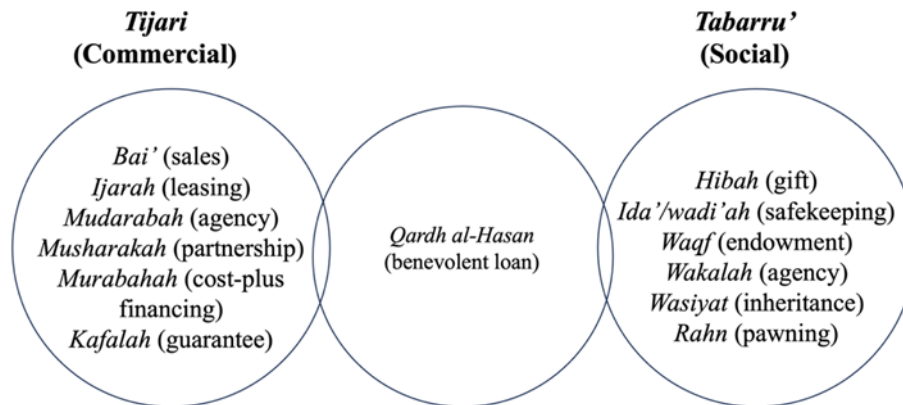


Figure 2. Types of contracts (*'aqd*) according to Islamic tenets

Source: Author

Moreover, it is noted that *Qardh al-Hasan* is not the sole enterprise-supporting instrument. Islamic microfinance uses Islamic financial principles to provide financial services to low-income people for pre-commercial and commercial enterprises in which profit is not actively generated. Moreover, Islamic microfinance focuses largely on the welfare of the community and stresses the financial inclusion of the economically disadvantaged part of the community. In addition to Islamic microfinance, Islamic rural banks may play a significant role in assisting the commercial businesses stage, especially in rural regions of certain nations, such as Indonesia, to support agribusinesses. The greatest level of enterprise maturity, sustainable, is often the most appealing stage for commercial banks, including Islamic banks, because at this point, the firm is already well-established, generating exceptional profits, able to manage lesser risk, and capable of supporting finance for sustainability initiatives that adhere to ESG guidelines.

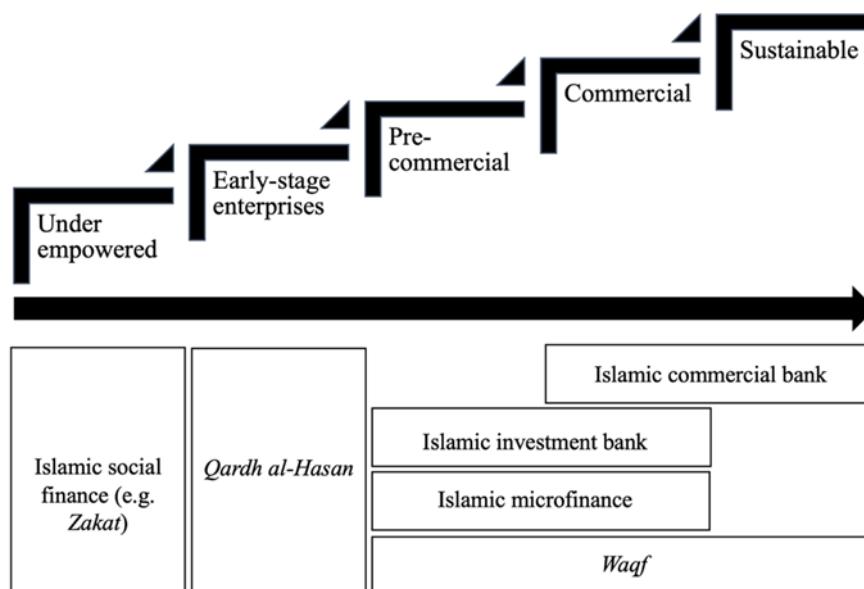


Figure 3. Stages of enterprises

Source: Author

It could be argued that the direction of Islamic banks towards financing sustainable and mature businesses is influenced by market logic, given that the expansion of the Islamic finance and investment industry creates an environment in which religion and market logic compete for influence over screening practises (Fathallah et al. 2020; Alotaibi et al, 2022).

Yet, this simile overlooks the early function of Islamic financial institutions in promoting socio economic growth in the society. Mit Ghamr Saving Bank, for instance, developed as a pioneering trial microfinance organisation and was founded in Egypt in 1963, and was traditionally formed to promote socio-economic development among the Muslim community (Asutay, 2012; Orhan, 2018; Tuncay, 2018).

By employing the capability approach theory discussed by Sen (1999) and Nussbaum (2002), it is determined that the inability of early-stage enterprises to access capital is caused by a lack of power to access capital, as Islamic commercial banks tend to avoid this stage of enterprises because early-stage enterprises are deemed unsustainable. So, early-stage enterprises do not have the option to acquire additional capabilities or to take advantage of new possibilities to employ those capabilities. Although it is expected that

additional skills and prospects will result in more expansion options for startups, this is not the case.

As noted by Chapra (2008), this situation implies that Islamic banks, as a representation of Islamic economic institutions, face major obstacles in achieving *Maslaha* aims. In a broader sense, the *Maslaha* concept is founded on the notion that Islamic law is not merely a set of rules, but rather a moral and ethical framework that promotes the well-being and welfare of individuals and society (Al-Bouti, 2006) and tends to be regarded as a framework of a people-centered model of development.

Within the context of *Maslahah*, *Qardh al-Hasan* is classified as *Maslahah Mu'tabarah* because it is specifically referenced in Islamic law sources, namely the Qur'an and Hadith. The *Qardh al-Hasan* framework would be of considerable assistance to startups in gaining access to affordable finance services. Due to its singularity as a non-business-oriented instrument, this framework will give micro-enterprises with initial money and access to capital (Aderemi and Ishak, 2023). As a result, *Qardh al-Hasan* is more linked with a social purpose due to the similarity between its main character and a conditional debt forgiveness provision. Nevertheless, present norms and development have forced *Qardh al-Hasan* into *tamwil* (financing) endeavours, where the plan is considered as the primary answer to supporting and financing early-stage enterprises.

In contrast to other Islamic financial instruments, *Qardh al-Hasan* is perceived to be risky. Accordingly, *Qardh al-Hasan's* promotion as a financing scheme raises two main concerns: the first is that the scheme's non-conditional repayment forgiveness factor will make financing vulnerable to moral hazard and other improper acts; the second is that the scheme's financial sustainability will suffer as a result, as *Qardh al-Hasan* will essentially become a hybrid contract between a *tijari* contract and a *ta'awun* contract, with poor financial feasibility.

In addition to the possibility of default risk, *Qardh al-Hasan* carries other dangers such a low revenue risk, an uncertain future, and the possibility of

inflation (Khidher, 2014). However, with the help of certain fintech processes for conducting due diligence, monitoring the project, and guaranteeing the repayment in instalments, these risks may be controlled and avoided. Awareness and practise of *Qardh al-Hasan* and the *amanah* (trustworthiness) ideology would help greatly in mitigating these dangers (Aderemi and Ishak, 2023).

Implementing *Qardh Al-Hasan* as a Tool for Inclusive Market

The capability approach perspective is insufficient to address the current state, as market exclusion prevents early-stage businesses from gaining access to necessary market infrastructure. The formation of market exclusion is generally as a result of social disparities that prohibit some social groups from building the capabilities or connections necessary for full engagement in the market (Mair et al., 2012, 2016; Qureshi et al., 2018; Sutter et al., 2022).

As highlighted by Bhatt et al. (2022), the emergence of successful intermediaries may alter the social backdrop and develop capabilities as they aim to construct more inclusive markets. Furthermore, intermediaries play an active role in negotiating a more conducive social setting for market involvement (Dutt et al., 2016; Kistruck et al., 2013; Mair et al., 2012; Sutter et al., 2022). Certain supranational institutions (e.g., the Islamic Development Bank) may facilitate inclusive market and infrastructure in the context of *Qardh al-Hasan* by developing capabilities and negotiating the social context, establishing new connections within the social context, and attempting to alter the institutionalised power dynamics between groups, communities, and countries. As intermediaries construct inclusive markets, they participate in two key activities: competence building and social context altering (Dutt et al., 2016; McDermott et al., 2009).

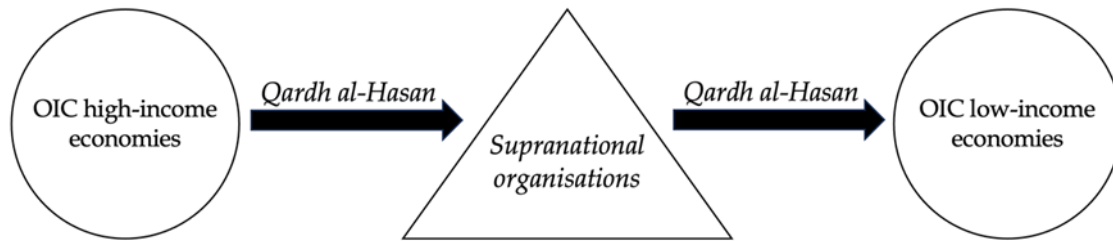


Figure 4. Mechanism of inclusive market and infrastructure

Source: Author

Instead of promoting financial inclusion, it is better to develop the inclusive market as it can be designed and worked in ecosystem manner, which *Qardh al-Hasan* will be positioned as the main tool of it. It is notable that there is another sustainability issue regarding to assignment of *Qardh al-Hasan*, which it requires capabilities on liquidity (source of fund). Considering to that issue, supranational organisations must take a revolutionary step. By applying Islamic social funding instruments (e.g., *Zakat*), it is possible to collect funds from OIC high-income economies (e.g., GCC) and manage their distribution to OIC member states with low incomes.

Table 2. GNI percapita of OIC member countries (2024)²

No	Country	GNI (USD)	Income category	No	Country	GNI (USD)	Income category
1	Qatar	65,862.76	High	30	Bangladesh	2,578.86	Lower-middle
2	UAE	43,216.89	High	31	Cote d'Ivoire	2,462.04	Lower-middle
3	Kuwait	36,453.46	High	32	Mauritania	2,143.82	Lower-middle
4	Brunei	31,650.24	High	33	Uzbekistan	2,023.39	Lower-middle

² The classifications are based on the GNI per capita published by the World Bank with the following classifications: High income (>USD13,205), Upper-middle income (USD4,256-13,205), Lower-middle income (USD1,086-4,255), and Low income (<USD1,085)

No	Country	GNI (USD)	Income category	No	Country	GNI (USD)	Income category
5	Lebanon	30,997.49	High	34	Nigeria	1,868.36	Lower-middle
6	Bahrain	24,990.36	High	35	Cameroon	1,636.16	Lower-middle
7	Saudi Arabia	23,641.69	High	36	Comoros	1,620.49	Lower-middle
8	Oman	18,183.82	High	37	Senegal	1,602.30	Lower-middle
9	Iran	17,426.69	High	38	Pakistan	1,583.79	Lower-middle
10	Malaysia	10,768.89	Upper-middle	39	Benin	1,346.70	Lower-middle
11	Guyana	9,784.65	Upper-middle	40	Kyrgyz	1,294.42	Lower-middle
12	Turkey	9,518.64	Upper-middle	41	Tajikistan	1,047.50	Low
13	Maldives	9,390.55	Upper-middle	42	Guinea	1,046.00	Low
14	Kazakhstan	9,167.86	Upper-middle	43	Syria	996.54	Low
15	Turkmenistan	8,070.02	Upper-middle	44	Togo	946.45	Low
16	Gabon	7,357.95	Upper-middle	45	Chad	922.83	Low
17	Albania	6,290.02	Upper-middle	46	Uganda	914.87	Low
18	Libya	5,838.91	Upper-middle	47	Burkina Faso	864.86	Low

No	Country	GNI (USD)	Income category	No	Country	GNI (USD)	Income category
19	Azerbaijan	5,262.93	Upper-middle	48	Mali	848.62	Low
20	Iraq	4,645.49	Upper-middle	49	Guinea-Bissau	759.62	Low
21	Suriname	4,588.03	Upper-middle	50	Gambia	753.06	Low
22	Indonesia	4,217.18	Lower-middle	51	Niger	585.17	Low
23	Palestine	4,175.52	Lower-middle	52	Sierra Leone	498.83	Low
24	Jordan	4,037.52	Lower-middle	53	Mozambique	481.24	Low
25	Morocco	3,800.84	Lower-middle	54	Somalia	444.48	Low
26	Egypt	3,778.43	Lower-middle	55	Sudan	429.76	Low
27	Tunisia	3,678.77	Lower-middle	56	Afghanistan	376.93	Low
28	Algeria	3,618.27	Lower-middle	57	Yemen	301.06	Low
29	Djibouti	3,253.51	Lower-middle				

Source: World Bank (2024)

The implementation of *Qardh al-Hasan* within Islamic finance offers a compelling framework for fostering inclusive markets, extending beyond mere financial inclusion to create broader economic opportunities across the OIC countries. This framework proposes a structured mechanism wherein high-income OIC countries extend *Qardh al-Hasan* loans to early-stage enterprises in low-income OIC countries. By doing so, the financial resources are not only directed towards empowering individual entrepreneurs but also towards

building resilient and inclusive markets that drive sustainable development. This approach leverages the ethical principles of Islamic finance to ensure that economic growth is equitable, inclusive, and sustainable.

The proposed framework begins with the establishment of a centralized *Qardh al-Hasan* fund, contributed by high-income OIC countries, aimed explicitly at supporting early-stage enterprises in low-income member states. This fund would be administered by a coalition of Islamic financial institutions and development agencies to ensure transparency and accountability. The focus would be on identifying and financing businesses that have the potential to generate significant socio-economic impact, particularly those engaged in sectors such as agriculture, renewable energy, and technology. By channeling resources to these critical areas, *Qardh al-Hasan* can help bridge economic disparities between OIC countries, fostering an inclusive market environment where entrepreneurs from low-income countries can compete effectively on a global scale (El-Komi & Croson, 2013; Wilson, 2012).

Moreover, this framework incorporates capacity-building initiatives, wherein recipients of *Qardh al-Hasan* loans are provided with technical assistance, mentorship, and market access support. These complementary services are crucial for enhancing the capabilities of entrepreneurs, enabling them to leverage the financial support effectively and scale their businesses sustainably. Additionally, continuous monitoring and evaluation mechanisms would be established to assess the impact of the loans on market inclusivity and enterprise development. This holistic approach ensures that *Qardh al-Hasan* is not merely a financial tool but a catalyst for creating inclusive markets that promote economic integration and shared prosperity among OIC countries. By fostering such inclusive markets, the framework aligns with the broader objectives of sustainable development and the capability approach, ultimately contributing to a more equitable global economic landscape (Dusuki, 2008; Chapra, 2008).

Conclusion

The aim of this study has been to delve into the issue of sustainability and sustainable development, particularly in relation to its socio-economic objectives, by reviewing and examining the current stage and offering alternative methods for positioning *Qardh al-Hasan* to meet sustainable challenges. Moreover, within the frameworks of capability approach and the inclusive market perspective, we proposed that early-stage enterprises could be supported by *Qardh al-Hasan* in order to not only be able to access sufficient capital, but also obtain the necessary market infrastructure for being more inclusive. Furthermore, supranational organisations of OIC member countries may function as intermediaries to modify their activities, which they employ to affect the social backdrop and develop capabilities as they strive to construct more inclusive market.

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