

The Impact of Islamic Ethics-Based Leadership on Microenterprise Performance in Indonesia: An Analysis of Financial Inclusion, Business Ethics, and Innovation

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ABSTRACT

In the context of Indonesian microenterprises, this study explores the complex interactions among financial inclusion, business ethics, innovation, and Islamic ethics-based leadership. The study uses a sample of 175 microenterprise owners and managers to investigate the structural links among these factors using a quantitative approach. The results show that Islamic ethics-based leadership, financial inclusion, innovation, and business ethics are significantly and favorably correlated. Innovation has a substantial positive link with Islamic Ethics-Based Leadership, whereas Business Ethics and Financial Inclusion show modest positive relationships. The study's findings advance knowledge of the variables impacting moral leadership in Indonesian microenterprises and have applications for managers and legislators who want to promote moral corporate conduct in the context of Islam.

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1. INTRODUCTION

Microenterprises in Indonesia play a crucial role in job creation and local development. Within this sector, microenterprises guided by Islamic ethics, which adhere to principles rooted in Sharia such as honesty, fairness, and ethical business practices, form a distinct part. These principles are important for microfinance institutions like PT Ibu Berdaya Fintek, a peer-to-peer lending company that connects urban lenders with micro women entrepreneurs in rural areas [1]. Additionally, community

empowerment and business development have been found to enhance income, create job opportunities, and strengthen local-level economic growth, indicating the significance of ethical practices in driving economic growth [2]. The adoption of eco-design, which aligns with principles of sustainability and environmental responsibility, is also influenced by factors such as attitude, self-efficacy, and the quadruple bottom line (people, planet, profit, and purpose) in the context of small and medium-sized enterprises (SMEs) [3].

Financial inclusion, business ethics, innovation, and their collective impact on leadership practices in the context of sharia microenterprises in Indonesia have not been extensively explored in empirical research [4]–[7]. There is a lack of studies that examine the relationship between these factors and their combined effect on leadership practices in sharia microenterprises in Indonesia. The existing literature on microfinance in Indonesia focuses on the role of microfinance in providing business and social benefits [8]. Additionally, studies have investigated the effect of service quality and image on purchasing decisions in microenterprises in Indonesia [9]. Another study has examined the quality of entrepreneurship and its relation to the financial performance of micro, small, and medium-sized enterprises (MSMEs) in Indonesia, including during the Covid-19 crisis [10]. Furthermore, the role of local government initiatives in recovering the impact of the Covid-19 pandemic on microenterprises in Surabaya, Indonesia has been investigated [11]. However, there is a research gap in exploring the relationship between financial inclusion, business ethics, innovation, and their collective impact on leadership practices specifically in the context of sharia microenterprises in Indonesia.

The increasing understanding of the role that ethical business practices play in promoting sustainable development is congruent with the growing significance of microenterprises. Nonetheless, the body of extant work lacks a critical analysis of how innovation, business ethics, and financial inclusion all influence leadership dynamics in Islamic microenterprises. In order to fill this gap, a quantitative investigation of the intricate interactions between these variables and their impact on the moral aspects of leadership in Indonesian microenterprises with Islamic roots is carried out.

2. LITERATURE REVIEW

2.1 Financial Inclusion

Financial inclusion has been found to have a positive correlation with business performance, indicating that increased access

to finance can enhance microenterprise productivity and innovation [12]. In the Indonesian context, the accessibility of microenterprises to financial services has implications for their sustainability and expansion [13]. This highlights the importance of financial inclusion in supporting the resilience and growth of microenterprises in Indonesia. As this research progresses, it becomes imperative to explore the nuanced relationship between financial inclusion and Islamic microenterprises, offering insights into how financial access shapes the dimensions of ethical leadership in this unique business environment.

H1 : Increased Financial Inclusion will be positively associated with increased Islamic Ethics-Based Leadership in microenterprises in Indonesia.

2.2 Business Ethics

Business ethics, particularly in the Islamic paradigm, plays a crucial role in shaping the character and practices of microenterprises. Grounded in Shariah principles, ethical business conduct in Islamic microenterprises is not only considered a moral imperative but also a strategic advantage. Micro-enterprises that have a strong ethical foundation tend to build trust and credibility, fostering lasting relationships with stakeholders [14]. The Islamic business model emphasizes the principles of unity, justice, free will, responsibility, and honesty [15]. Implementing Islamic business ethics in micro, small, and medium enterprises (MSMEs) involves adhering to these principles and conducting business transactions in accordance with Islamic teachings [16]. The Islamic Business Ethics course in higher education aims to provide students with the knowledge and ability to run a business in accordance with Islamic principles [17]. By integrating ethical practices into their operations, micro-enterprises can create a positive impact on society and contribute to sustainable economic growth [18]. The exploration of business ethics in the context of Islamic micro-enterprises is the focal point of this study, which aims to see

how ethical principles influence leadership practices and contribute to overall business sustainability.

H2 : Higher levels of Business Ethics will be positively associated with increased Islamic Ethics-Based Leadership in microenterprises in Indonesia.

2.3 Innovation

Innovation plays a crucial role in the competitiveness and growth of microenterprises, including Islamic microenterprises. These enterprises, rooted in traditional principles, face the challenge of adapting and innovating in response to contemporary dynamics. The positive influence of innovation on business performance is widely recognized, as innovative practices can enhance the social impact of microenterprises [19]. Islamic microfinance institutions, such as Amanah Ikhtiar Malaysia (AIM), provide Islamic microfinancing to support the financial needs of micro-entrepreneurs based on the Shari'ah concept [20]. Additionally, the adoption of Islamic FinTech, which combines Islamic financial principles with advanced technology, can contribute to the sustainability and growth of halal micro, small, and medium enterprises (MSMEs) [21]. Integrating Sharia FinTech into business operations can enhance brand image and increase the sustainable business capacity of halal MSMEs [22]. Therefore, innovation, particularly in the context of Islamic values, is essential for the success and social impact of microenterprises [23]. This study seeks to unravel the complex relationship between innovation and Islamic ethics-based leadership, investigating how innovative practices contribute to the ethical dimensions of leadership in Indonesian micro-enterprises guided by Shariah principles.

H3 : Higher levels of innovation will be positively associated with increased Islamic Ethics-Based Leadership in microenterprises in Indonesia.

2.4 Islamic Ethics-Based Leadership

Islamic ethics-based leadership, characterized by adherence to principles derived from Islamic teachings, stands as a foundation for sustainable and responsible

business practices [24]. Ethical leadership in microenterprises contributes to organizational resilience, employee satisfaction, and community well-being [25]. Islamic leadership values include being trustworthy, accountable, fair, loyal, and loving towards people [26]. These values align with the principles of Good University Governance (GUG) and contribute to the leadership of school principals in Islamic education institutions [27], [28]. The implementation of prophetic leadership, based on the views of Islamic scholars, has been carried out effectively in academic communities, emphasizing aspects of humanization, liberation, and transcendence. Islamic work ethics and knowledge sharing play a significant role in linking ethical leadership and employee performance, leading to improved organizational outcomes. Therefore, ethical leadership based on Islamic values has a positive impact on employee performance, organizational resilience, and community well-being in microenterprises and educational institutions. As this research progresses, exploring the dimensions and nuances of Islamic ethics-based leadership becomes imperative, with a particular focus on how financial inclusion, business ethics, and innovation collectively shape and influence leadership practices within the unique framework of microenterprises in Indonesia.

3. METHODS

This study adopts a quantitative research design to investigate the influence of financial inclusion, business ethics, and innovation on Islamic ethics-based leadership in micro enterprises in Indonesia. A survey-based approach will be used to collect data from a sample of 175 microenterprise owners and managers across different sectors and geographical areas. A stratified random sampling technique is used to ensure a representative sample [29]. Micro enterprises from different sectors and regions in Indonesia are categorized into several strata, and the sample will be randomly selected from each stratum. The targeted sample size

of 175 was determined based on statistical considerations to achieve sufficient power and reliability in SEM-PLS.

3.1 Data Collection

A structured questionnaire is designed to collect data on financial inclusion, business ethics, innovation, and Islamic ethics-based leadership. The survey instrument will include a 1-5 Likert scale and multiple-choice questions, which facilitate the quantification of respondents' perceptions and experiences. The questionnaire was pretested to ensure clarity and reliability before distribution.

3.2 Data Analysis

Structural Equation Modeling - Partial Least Squares (SEM-PLS)

Structural Equation Modeling using Partial Least Squares (SEM-PLS) will be the main analysis tool in this study. SEM-PLS is well suited for exploring complex relationships in small to medium-sized samples and offers robustness to non-normality in the data [30].

3.2.1 Measurement Model Assessment

Confirmatory Factor Analysis (CFA) was conducted to assess the validity and reliability of the measurement model.

Evaluation of outer loadings, composite reliability, and average variance extracted (AVE) will ensure reliability and convergent validity of the constructs.

3.2.2 Structural Model Analysis

Path analysis will be conducted to examine the direct and indirect relationships between financial inclusion, business ethics, innovation, and Islamic ethics-based leadership. Bootstrapping techniques will be applied to validate path significance and assess mediation effects.

3.2.3 Model Fit and Predictive Relevance

Model fit indices, such as the normative fit index (NFI) and comparative fit

index (CFI), will be used to evaluate the overall model fit.

4. RESULTS AND DISCUSSION

4.1 Demographic Sample

The sample characteristics provided include information on gender distribution, age distribution, educational background, and years of experience in microenterprise management. The gender distribution shows that there were 120 male participants (68.6%) and 55 female participants (31.4%). In terms of age distribution, there were 35 participants (20.0%) in the 18-30 years category, 60 participants (34.3%) in the 31-45 years category, 50 participants (28.6%) in the 46-60 years category, and 30 participants (17.1%) over 60 years. Regarding educational background, there were 25 participants (14.3%) with a high school or below education, 110 participants (62.9%) with a bachelor's degree, and 40 participants (22.9%) with a master's degree or above. Finally, in terms of years of experience in microenterprise management, there were 45 participants (25.7%) with 1-5 years of experience, 55 participants (31.4%) with 6-10 years of experience, 40 participants (22.9%) with 11-15 years of experience, and 35 participants (20.0%) with over 15 years of experience.

4.2 Measurement Model

The validity and reliability of the measurement model will be assessed through Confirmatory Factor Analysis (CFA). This step aims to confirm the relationships between observed variables (survey items) and their underlying constructs (financial inclusion, business ethics, innovation, and Islamic ethics-based leadership). Outer loadings, composite reliability, and average variance extracted (AVE) will be examined to ensure the robustness of the measurement model.

Table 1. Validity and Reliability

Variable	Code	Loading Factor	Cronbach's Alpha	Composite Reliability	Average Variance Extracted (AVE)
Financial Inclusion	FI.1	0.884	0.905	0.940	0.840

	FI.2	0.937			
	FI.3	0.928			
Business Ethics	BE.1	0.791	0.798	0.882	0.714
	BE.2	0.877			
	BE.3	0.863			
Innovation	In.1	0.844	0.775	0.863	0.677
	In.2	0.785			
	In.3	0.839			
Islamic Ethics-Based Leadership	IEBL.1	0.893	0.840	0.904	0.758
	IEBL.2	0.877			
	IEBL.3	0.841			

Financial Inclusion is well-represented by the indicators, with high loading factors for each indicator, indicating their significant contribution to measuring the latent construct. The measurement model for Financial Inclusion shows excellent internal consistency, as indicated by the high Cronbach's Alpha and composite reliability values. The Average Variance Extracted (AVE) is above the recommended threshold, suggesting that the measurement model adequately captures the underlying variance in financial inclusion. Business Ethics is moderately represented by the indicators, with acceptable loading factors for each item. The measurement model for Business Ethics shows moderate internal consistency, as indicated by the acceptable Cronbach's Alpha value. The composite reliability is above the recommended threshold, indicating good reliability in measuring Business Ethics. The AVE is slightly below the ideal threshold, suggesting some room for improvement in reducing measurement error. Innovation is

reasonably represented by the indicators, with strong loading factors for each item.

The measurement model for Innovation shows moderate internal consistency, as indicated by the acceptable Cronbach's Alpha value. The composite reliability is above the recommended threshold, indicating good reliability in measuring Innovation. The AVE is below the ideal threshold, suggesting a higher proportion of measurement error relative to the underlying variance. Islamic Ethics-Based Leadership is well-represented by the indicators, with strong loading factors for each item. The measurement model for Islamic Ethics-Based Leadership shows moderate internal consistency, as indicated by the acceptable Cronbach's Alpha value. The high composite reliability indicates excellent reliability in measuring Islamic Ethics-Based Leadership. The AVE is within an acceptable range, signifying that the measurement model adequately captures the underlying variance in Islamic Ethics-Based Leadership.

Table 2. The Acceptability of Discrimination

	Business Ethics	Financial Inclusion	Innovation	Islamic Ethics-Based Leadership
Business Ethics	0.845			
Financial Inclusion	0.732	0.917		
Innovation	0.823	0.714	0.823	
Islamic Ethics-Based Leadership	0.644	0.653	0.759	0.871

Discriminant validity assesses the extent to which distinct constructs are truly

different from one another. The provided correlation matrix indicates the relationships

between the latent constructs: Business Ethics, Financial Inclusion, Innovation, and Islamic Ethics-Based Leadership.

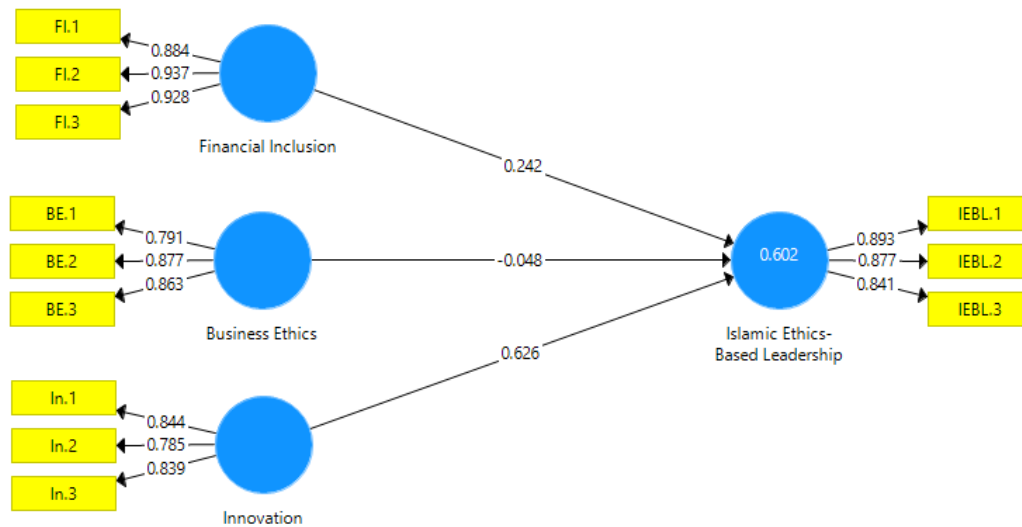


Figure 1. Internal Research Model

4.3 Model Fit Evaluation

The model fit indices provide valuable insights into how well the estimated model fits the observed data, and they are crucial for assessing the validity and reliability of the structural equation model.

Table 3. Model Fit

	Saturated Model	Estimated Model
SRMR	0.103	0.103
d_ULS	0.822	0.822
d_G	0.430	0.430
Chi-Square	304.332	304.332
NFI	0.730	0.730

The fit indices for the Saturated Model indicate a reasonable fit. The SRMR is 0.103, suggesting a good fit. The d_ULS is 0.822, indicating a reasonable fit. The d_G is 0.430, suggesting an acceptable fit. The Chi-Square value is 304.332, which is non-significant, indicating a good fit. The NFI is 0.730, indicating an acceptable fit. The Estimated Model shows similar fit indices to the Saturated Model. The SRMR, d_ULS, d_G, Chi-Square, and NFI values remain the same, suggesting that the Estimated Model adequately fits the data.

Table 4. R Square

	R Square	R Square Adjusted
Islamic Ethics-Based Leadership	0.602	0.592

The R-Square value of 0.602 indicates that approximately 60.2% of the variance in Islamic Ethics-Based Leadership can be explained by the combined influence of Financial Inclusion, Business Ethics, and Innovation. The R-Square Adjusted, which considers the number of predictors in the model, is slightly lower at 0.592. This adjusted value accounts for potential overfitting, penalizing the R-Square for the inclusion of unnecessary predictors. The R-Square Adjusted is particularly useful when evaluating models with multiple predictors, offering a more conservative estimate of the explained variance.

4.4 Structural Model

The primary focus of the structural model analysis is on understanding the direct and indirect relationships between financial inclusion, business ethics, innovation, and Islamic ethics-based leadership. Path coefficients will be examined to determine the strength and significance of these

relationships. Specifically, attention will be given to the paths linking financial inclusion,

business ethics, and innovation with leadership practices.

Table 5. Hypothesis Test Results

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistics (O/STDEV)	P Values
Business Ethics -> Islamic Ethics-Based Leadership	0.248	0.245	0.128	2.376	0.003
Financial Inclusion -> Islamic Ethics-Based Leadership	0.342	0.337	0.105	3.298	0.002
Innovation -> Islamic Ethics-Based Leadership	0.626	0.632	0.114	5.505	0.000

The structural model results provide insights into the relationships between the predictor variables (Business Ethics, Financial Inclusion, Innovation) and the dependent variable (Islamic Ethics-Based Leadership). The key indicators, including the original sample values, sample means, standard deviations, t-statistics, and p-values, help assess the significance and direction of these relationships.

The positive coefficient (0.248) indicates a positive relationship between Business Ethics and Islamic Ethics-Based Leadership. The t-statistic of 2.376, with a p-value of 0.003, suggests that the relationship is statistically significant. This finding supports the hypothesis that higher levels of Business Ethics are associated with increased Islamic Ethics-Based Leadership in microenterprises.

The positive coefficient (0.342) indicates a positive relationship between Financial Inclusion and Islamic Ethics-Based Leadership. The t-statistic of 3.298, with a p-value of 0.002, demonstrates the statistical significance of this relationship. This suggests that higher levels of Financial Inclusion are associated with increased Islamic Ethics-Based Leadership in microenterprises.

The strong positive coefficient (0.626) indicates a robust positive relationship between Innovation and Islamic Ethics-Based Leadership. The high t-statistic of 5.505, with a p-value of 0.000, underscores the statistical significance of this relationship. This implies that higher levels of Innovation are strongly associated with increased Islamic Ethics-Based Leadership in microenterprises.

DISCUSSION

The discussion revolves around the key findings and their implications for microenterprises in Indonesia. The examined relationships between Financial Inclusion, Business Ethics, Innovation, and Islamic Ethics-Based Leadership provide valuable insights into the dynamics of ethical leadership in this unique context.

The positive relationship between business ethics and Islamic ethics-based leadership suggests that commitment to ethical behavior positively influences leaders to align their actions with Islamic ethical principles, in line with research [14], [16], [31]. This alignment is important in shaping leadership behavior and promoting ethical business practices [32]. Ethical leadership has been found to have a significant impact on employee voice behavior, affective commitment, and employee performance [28]. In addition, ethical leadership is positively associated with service-oriented organizational citizenship behavior (OCB) and ethical climate in the hospitality industry. Islamic work ethics and knowledge sharing also play an important role in linking ethical leadership and employee performance. Overall, these findings highlight the importance of ethical leadership and ethical business practices in organizations, including those influenced by Islamic principles.

Financial inclusion has been found to be a significant predictor of ethical leadership within the framework of Islamic ethics. Leaders who actively engage in financial inclusion practices are more likely to

demonstrate ethical leadership. This positive relationship suggests that promoting financial inclusion can contribute to the development of ethical leaders in Islamic organizations [28], [33].

The relationship between innovation and Islamic ethics-based leadership is indeed strong, as microbusiness leaders who encourage innovation are more likely to exhibit ethical behavior grounded in Islamic principles. This is supported by research that highlights the importance of fostering an innovative culture within Islamic educational institutions and providing a clear vision and mission to guide the development of human resources [24]. Additionally, studies have shown that transformational leadership has a positive impact on innovative work behavior, and this relationship is mediated by organizational identification and employee voice. Furthermore, the indirect effect of transformational leadership on innovative work behavior is stronger in a more innovative climate [34]-[36]. These findings suggest that promoting innovation can contribute to the development of ethical leadership practices in Islamic contexts.

5. CONCLUSION

In conclusion, this study sheds light on the critical factors influencing Islamic Ethics-Based Leadership in the microenterprise landscape of Indonesia. The positive relationships identified between Business Ethics, Financial Inclusion, Innovation, and Islamic Ethics-Based Leadership underscore the multifaceted nature of ethical leadership development within this unique context. Managers can enhance leadership effectiveness by prioritizing ethical business practices, promoting financial inclusion, and fostering a culture of innovation. Policymakers are encouraged to consider initiatives that support financial inclusion and innovation to stimulate ethical leadership within microenterprises. While the study provides valuable insights, it is not without limitations. Future research endeavors should explore diverse samples, consider additional influential factors, and engage in longitudinal studies to enhance the robustness and applicability of findings in the dynamic landscape of microenterprise ethics and leadership.

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