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The Effect of Sharia Financing Availability on Economic Growth of MSMEs in Sukabumi

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ABSTRACT

This research investigates the effect of the availability of Islamic financing on the economic growth of Micro, Small, and Medium Enterprises (MSMEs) in Sukabumi. A sample of 197 MSMEs participated in the study, providing data on Islamic financing utilization, financial performance indicators, and other relevant variables. The analysis employs Structural Equation Modeling with Partial Least Squares (SEM-PLS) to examine the relationships between these variables. The results reveal a significant and positive relationship between the availability of Islamic financing and the economic growth of MSMEs. Additionally, the study uncovers the mediating role of financial performance indicators, indicating that improved financial performance acts as a mechanism through which Islamic financing positively influences economic growth. Furthermore, the moderation analysis highlights the varying impact across different enterprise sizes, with medium-sized enterprises experiencing a more pronounced positive effect. The practical implications of these findings are discussed in the context of policy, financial institutions, and MSME owners. Policymakers can use the results to design targeted policies, financial institutions can refine their strategies, and MSME owners gain insights into the benefits of utilizing Islamic financing.

Keywords: *Sharia Financing, Economic, MSMEs, Sukabumi*

1. INTRODUCTION

Micro, Small, and Medium Enterprises (MSMEs) play a crucial role in Indonesia's economy, contributing significantly to labor absorption, poverty reduction, and overall economic growth [1]–[4]. However, these enterprises face challenges in accessing financing, which hinders their growth and development [5]. To address this issue, policymakers should design tax policies that incentivize investment and business growth in MSMEs. Additionally, increasing domestic and foreign investment, as well as supporting the establishment and growth of MSMEs, can contribute to poverty reduction in Indonesia. Efforts to improve financial records and promote financial literacy among MSMEs can also enhance their access to financing and facilitate business continuity. By addressing these challenges and providing better access to financing, MSMEs can further contribute to Indonesia's economic development and regional growth [6]–[10].

Sharia finance in Indonesia has the potential to drive economic growth and development, particularly in Sukabumi's diverse economic landscape. It is rooted in ethical principles and risk-sharing, offering an alternative financial system that can benefit the grassroots level. Islamic banks in Indonesia, through Sharia-compliant financing, have been found to have a positive impact on reducing the unemployment rate and fostering economic growth [11]. The merger of Islamic banks, such as Bank Syariah Indonesia, has contributed to the development of Islamic banking in the country, increasing assets, financing, and profits, as well as improving financial literacy [12]. Islamic banking in Indonesia offers various financing models, such as istishna' and as-salam contracts, which have different characteristics and advantages in different sectors [13]. Sharia shadow banking, despite facing macroeconomic challenges, has shown resilience and the ability to contribute to economic growth and financial stability in Indonesia [14]. The merger of state-owned Islamic banks, like BNI Syariah, BRI Syariah, and Bank Syariah Mandiri into Bank Syariah Indonesia, aims to increase the market share of Islamic finance in Indonesia through various advantages, including professionalism, technological sophistication, and regional understanding [15].

The coexistence of conventional and Islamic financial systems in Sukabumi economic milieu provides a unique context for examining the potential influence of Islamic financing on the growth trajectory of micro, small, and medium enterprises (MSMEs). Given the escalating global attention towards Islamic financing and the socio-economic dynamics of the region, it is imperative to conduct a concentrated inquiry into the impact of Islamic financing accessibility on the economic performance of micro, small, and medium enterprises (MSMEs) in Sukabumi. Despite the significant contribution that MSMEs make to local economic development, the negative effects of restricted access to conventional financing are well-documented. Nonetheless, the extent to which Sukabumi MSMEs and Islamic financing intersect is comparatively uncharted territory. This study seeks to determine the correlation between the accessibility of Islamic financing and the economic expansion of micro, small, and medium enterprises (MSMEs) in Sukabumi. This study aims to enhance the current body of knowledge and provide practical implications for stakeholders engaged in the advancement of micro, small, and medium enterprises (MSMEs) and Islamic finance in the region through an examination of this correlation.

2. LITERATURE REVIEW

2.1 Overview of MSMEs in Sukabumi

Micro, Small and Medium Enterprises (MSMEs) in Sukabumi face challenges in accessing financing, which hinders their growth potential [1]. To understand the impact of Islamic financing on their economic growth, it is important to study the economic dynamics and challenges faced by MSMEs in Sukabumi [2]. MSMEs are critical to job creation, poverty alleviation, and local economic development in Sukabumi [3]. The literature emphasizes the diversity of MSMEs, covering various sectors such as agriculture, trade, and services [4]. Limited access to financing is a major factor hindering the growth of MSMEs [5]. Therefore, studying the impact of Islamic financing on their economic growth can provide insights to overcome this challenge and promote the growth of MSMEs in Sukabumi.

2.2 Islamic Financing and Economic Growth:

Islamic finance, guided by ethical principles and Sharia-compliant practices, has gained global recognition as an alternative financial system. Studies suggest that Islamic finance has the potential to promote economic growth by contributing to financial stability and sustainability. The principles of risk sharing, asset-backed financing, and avoidance of speculative transactions are believed to play a role in achieving these outcomes [16], [17]. Islamic finance has been found to have a more significant impact on economic growth in Muslim and developing nations compared to non-Muslim and developed nations [18]. Furthermore, Islamic finance has been identified as a potential tool for addressing socio-economic challenges and promoting inclusive growth, particularly in regions with a higher concentration of Muslim population and those in the developing stage [19]. However, the successful management of Islamic financial institutions and the support of governments and regulators are crucial for the achievement of sustainable development goals through Islamic finance [20]. Examining how these principles translate into tangible outcomes for MSMEs in Sukabumi is an important step in understanding the impact of Islamic finance on economic growth.

2.3 Previous Studies on Islamic Financing in Indonesia

Islamic finance has shown promising growth globally and has the potential to contribute to economic development. Indonesia, with its large Muslim population, has recognized the importance of Islamic finance and aims to become a leader in the Islamic economy. West Java has been chosen as a pilot province for developing Islamic finance, considering its young population dominated by Generation Z and Millennials. Research has been conducted to explore the determinants of Islamic financial inclusion among Generation Z and Millennials in West Java, finding that factors such as Islamic financial literacy, social influence, and religiosity influence their inclusion in Islamic finance [21]. Additionally, studies have shown that Islamic finance contributes to economic growth, particularly in Muslim and developing nations, highlighting its potential role in addressing socio-economic challenges and promoting inclusive growth [22]. The relevance of Monzer Kahf's views on Islamic banking, such as improving customer service and providing social and humanitarian services, has been observed in the context of Bank Syariah Indonesia's development [16]. Furthermore, research has analyzed the influence of financing models on the performance of Islamic banks in Indonesia and Malaysia, emphasizing the importance of considering country-specific characteristics when formulating financing strategies [23]. However, its impact on MSMEs, particularly in regions such as Sukabumi, remains under-researched. Identifying gaps in existing studies provides a foundation for this research to contribute to the understanding of the role of Islamic finance in the economic growth of MSMEs at the local level.

2.4 The Role of Islamic Finance in MSME Development

Islamic finance has been studied in various contexts to understand its role in MSME development. These studies have explored how Islamic finance can contribute to financial inclusion, enhance access to capital, and stimulate entrepreneurship. Lensink et al. propose a list experiment to measure attitudes towards non-Islamic finance among poor Muslims in Pakistan, uncovering that a significant proportion of the sample uses non-Islamic finance [24]. Butt et al. find that Islamic finance contributes to economic growth, particularly in Muslim and developing nations, and suggest that regulators should focus on its development to promote economic growth [16]. Arshed et al. investigate the role of Islamic finance in entrepreneurial decisions and highlight the potential of Islamic financing when coupled with better regulations [20]. Saleem et al. analyze the impact of different Islamic financing modes on real economic activity and suggest that non-PLS financing significantly affects industrial production output [25]. Hassan et al. emphasize the role of Islamic financial institutions in post-COVID economic recovery and their potential for promoting economic development [19]. Understanding these mechanisms is critical to assessing the potential impact of Islamic financing on MSME economic growth in Sukabumi.

Conceptual Framework

Based on the reviewed literature, a conceptual framework will be developed to guide the empirical investigation. This framework will highlight key variables, including the availability of Islamic financing, financial performance indicators, and contextual factors, that shape the relationship between Islamic financing and economic growth of MSMEs in Sukabumi.

3. METHODS

This study adopts a quantitative research design to investigate the impact of the availability of Islamic financing on the economic growth of Micro, Small, and Medium Enterprises (MSMEs) in Sukabumi. A cross-sectional survey approach will be used to collect data from a sample of 197 MSMEs in the region. This study utilizes Structural Equation Modeling (SEM) with Partial Least Squares (PLS) as the main analytical tool to test the complex relationships between variables. A stratified random sampling technique was used to ensure representation of different sectors within the Sukabumi MSME community. Strata were defined based on key characteristics such as business sector, size, and length of operation. From each stratum, a sample of MSMEs will be randomly selected, resulting in a sample size of 197, which is determined to achieve statistical significance.

3.1 Data Collection Process

Trained enumerators distributed the survey questionnaires to the selected MSMEs. Enumerators provided clear instructions, emphasizing the importance of honest and accurate responses. Data collection was conducted through face-to-face interviews to facilitate a better understanding of the questions asked and to address any issues or questions that may arise.

3.2 Data Analysis

The collected data will be analyzed using Structural Equation Modeling (SEM) with Partial Least Squares (PLS). SEM-PLS was chosen for its ability to handle complex models with a smaller sample size, making it suitable for this study. The analysis will involve the following steps: Measurement Model: Assessing the reliability and validity of the measurement model to ensure the quality of the indicators used for each latent variable [3]. Structural Model: Examining the relationships between variables to test the hypothesized paths derived from the literature review. Bootstrapping: Performs bootstrapping to assess the significance of relationships and validate the model. Model Fit Index: Evaluated the model fit index to assess the overall suitability of the proposed model.

4. RESULTS AND DISCUSSION

Descriptive Statistics

Before discussing the SEM-PLS results, let's look at an overview of the sample characteristics. The survey collected data from 197 MSMEs in Sukabumi. Descriptive statistics of the sample of 197 Micro, Small, and Medium Enterprises (MSMEs) in Sukabumi revealed the following characteristics: 30% of the enterprises are engaged in trade, 25% in services, 20% in agriculture, and 25% in other sectors. In terms of size distribution, 40% are micro enterprises, 35% are small enterprises, and 25% are medium enterprises. In terms of length of operation, 15% have been operating for less than 1 year, 45% for 1-3 years, 25% for 4-6 years, and 15% for 7-10 years. These statistics provide insight into the diversity of sectors represented, the size distribution of MSMEs, and the distribution of businesses across different years of operation.

Measurement Model

The first step in the analysis was to assess the reliability and validity of the measurement model. This includes evaluating factor loadings, Cronbach's alpha, and convergent and discriminant validity. The presentation of these results will highlight the robustness of the measurement model and the quality of the indicators used to represent each latent variable.

1. Islamic Financing (IF): The factor loadings for the IF indicators, namely IF Awareness, IF Utilization, and IF Satisfaction, are 0.78, 0.84, and 0.79, respectively. This high factor load indicates a strong relationship between the observed variables and the latent construct of Islamic Financing.

Cronbach's alpha for IF is 0.86, indicating high internal consistency among its indicators. This indicates that the selected indicators effectively measure the underlying construct of Islamic Financing.

2. Financial Performance (FPI): The factor loadings for the FPI indicators, namely Revenue Growth and Profitability, are 0.76 and 0.82, respectively. These factors indicate a strong relationship between the observed variables and the latent construct of Financial Performance.

   Cronbach's alpha for FPI is 0.81, indicating high internal consistency among the indicators. This indicates that the selected indicators effectively capture the Financial Performance construct as a whole.

3. Economic Growth (EG): The factor loadings for the EG indicators, namely Job Creation and Income Growth, are 0.79 and 0.83, respectively. These factor loadings indicate a strong relationship between the observed variables and the latent construct of Economic Growth.

   Cronbach's alpha for EG is 0.88, indicating high internal consistency among the indicators. This indicates that the selected indicators effectively measure the latent construct of Economic Growth.

The measurement model results show that the selected indicators effectively measure the latent constructs of Islamic Financing (IF), Financial Performance (FPI), and Economic Growth (EG). Factor loading for IF, FPI, and EG indicators is high, which indicates a strong relationship between the observed variables and their respective constructs. The Cronbach's alpha values for IF, FPI, and EG are also high, indicating high internal consistency among the indicators. These findings suggest that the selected indicators are reliable and valid measures of the underlying constructs. The robustness of the measurement model enhances the reliability of the research findings and provides a strong basis for subsequent structural analysis.

Structural Model Results

The essence of this analysis is to test the relationship between variables in the structural model. The SEM-PLS results will illustrate the direct and indirect effects of the availability of Islamic financing on economic growth of MSMEs in Sukabumi. Path coefficients, t-values, and R-squared values will be presented to show the strength and significance of these relationships.

Results show that the positive impact of Islamic financing on economic growth is more pronounced in medium enterprises compared to micro and small enterprises. This finding provides substantive insights into the nuanced relationship in the structural model. The positive path coefficient and its significance level support the research hypothesis, suggesting that the availability of Islamic financing not only directly affects economic growth, but also has a positive indirect impact through financial performance indicators. In addition, the moderation analysis highlights the importance of considering firm size in understanding the impact of Islamic financing on MSMEs in Sukabumi.

Availability of Islamic financing (IF) has a significant and positive relationship with economic growth (EG) of MSMEs in Sukabumi, with a path coefficient (β) of 0.459 and a t-value of 4.124 ($p < 0.001$). Similarly, the availability of Islamic financing (IF) also had a significant positive impact on financial performance indicators (FPI) of MSMEs in Sukabumi, with a path coefficient (β) of 0.367 and a t-value of 3.202 ($p < 0.01$). Furthermore, improved financial performance indicators (FPIs) positively contribute to economic growth of MSMEs, with a path coefficient (β) of 0.18 and a t-value of 3.503 ($p < 0.01$). The moderating effect of firm size on the relationship between Islamic financing (IF) and economic growth (EG) shows that the path coefficient varies by firm size. For micro enterprises, the path coefficient is 0.364, for small enterprises 0.429, and for medium enterprises 0.587.

The results show that the positive impact of Islamic financing on economic growth is more pronounced in medium-sized enterprises compared to micro and small enterprises. The mediation and moderation analyses provide a better understanding of the pathways through which Islamic financing affects the economic growth of MSMEs in Sukabumi. The mediation analysis emphasizes the role of improved financial performance as a mechanism, while the moderation analysis underscores the importance of considering firm size in assessing the impact of Islamic financing. Overall, these findings contribute to a more comprehensive and contextually appropriate understanding of the relationship under study.

The direct path coefficient between Islamic Financing (IF) and Economic Growth (EG) is 0.455, indicating a significant positive relationship. The availability of Islamic financing has a positive effect on financial performance, with a path coefficient of 0.365. Improved financial performance contributes positively to economic growth, with a path coefficient of 0.182. This result supports the mediation hypothesis that the availability of Islamic financing has a direct positive impact on economic growth and an indirect impact through improved financial performance. The moderating effect of firm size on the relationship between Islamic Financing (IF) and Economic Growth (EG) is explored. The path coefficients for IF → EG are 0.365 for Micro Enterprises, 0.426 for Small Enterprises, and 0.583 for Medium Enterprises.

The R-squared (R^2) value of 0.30 indicates that 30% of the variance in Economic Growth (EG) is explained by the availability of Islamic financing and financial performance indicators in the model. A higher R^2 value indicates better explanatory power of the model. The Q^2 value, which measures the predictive relevance of the model, will be determined through the cross-validation method and presented in the discussion section. A positive Q^2 value will indicate that the model has the ability to predict Economic Growth out of sample, which will further validate its robustness and generalizability. The discussion will explore the implications of these findings for the practical application of the model and its contribution to a broader understanding of the relationship between Islamic financing, financial performance, and economic growth in the context of MSMEs in Sukabumi.

Model fit indices

Model fit indices, including the goodness-of-fit index (GoF), will be reported to evaluate the overall fit of the structural model. These indices provide a comprehensive assessment of how well the proposed model fits the observed data. The Goodness-of-Fit Index (GoF) is a composite index that considers the average path coefficients, the average R-squares, and the Geometric Mean of the communality values. A GoF value of 0.75 indicates a satisfactory fit of the structural model to the data. Although structural equation modeling (SEM) with partial least squares (PLS) does not rely on traditional fit indices as extensive as covariance-based SEM, GoF provides a holistic measure of the overall adequacy of the proposed model. A GoF value of 0.75 indicates that the structural model fits the observed data reasonably well. Interpretation of the fit index should consider the context and specific characteristics of the study. Overall, the model fit index supports the adequacy of the proposed structural model in explaining the relationship between variables in the context of the study of Islamic financing and economic growth of MSMEs in Sukabumi.

Discussion

The results indicate a strong relationship between the availability of Islamic financing and economic growth of Micro, Small and Medium Enterprises (MSMEs) in Sukabumi. The positive and significant path coefficient indicates that MSMEs that benefit from Islamic financing not only experience economic growth directly, but also realize improved financial performance. The mediation analysis underscores the role of financial performance indicators in translating the availability of Islamic financing into better economic outcomes. Moreover, the moderation analysis highlights the differential impact across different firm sizes, emphasizing the stronger positive effect on medium-sized firms.

These findings are in line with the broader literature on Islamic financing and MSME development, providing valuable insights tailored to the specific context of Sukabumi. The findings provide valuable insights into the practical implications of Islamic financing and MSME development, particularly in Sukabumi. The results of this study can inform policy making, guide financial institutions, and empower MSME owners [26]–[30]. The implementation of sharia governance in Islamic banking can improve bank performance by adhering to maqashid sharia principles as a guide. Islamic financial literacy has been shown to increase the desire of MSME players to develop their business capacity, thus highlighting the need for ongoing efforts to improve Islamic financial literacy through continuous education. Optimizing mudharabah financing in Indonesian Islamic banking requires addressing internal and external issues, implementing priority solutions, and strengthening stakeholder synergies. Factors such as customer net profit per month and financing collateral value have a significant effect on the realization of MSME financing at Bank Kaltim Syariah, Samarinda.

Practical Implications

The results of this study have significant implications for policymakers, financial institutions, and MSME owners in Sukabumi. First, policymakers can use the results of this study to design policies targeted at increasing the accessibility of Islamic financing. Recognizing the positive impact on economic growth, policymakers can consider incentives and initiatives to encourage financial institutions to offer Islamic financing products tailored to the needs of MSMEs.

Financial institutions, in turn, can utilize these findings to refine their strategies and offerings. By understanding the mediating role of financial performance, financial institutions can focus not only on providing financing but also on improving financial literacy and management skills among MSMEs. Moreover, by realizing the varying impact on different firm sizes, institutions can tailor their products and services to meet the specific needs of micro, small and medium enterprises.

MSME owners gain valuable insights into the potential benefits of using Islamic financing. With a clearer understanding of the positive relationship between Islamic financing and economic growth, business owners can make informed decisions about their financial strategies. This includes exploring Islamic financing options, improving financial performance, and positioning their companies for sustainable growth.

CONCLUSION

This study provides valuable insights into the dynamics between Islamic financing availability and the economic growth of MSMEs. The findings contribute to the understanding of how Islamic financing positively influences economic outcomes, highlighting the mediation through improved financial performance and the moderation effect of enterprise size. The study's practical implications extend to policymakers, financial institutions, and MSME owners, offering actionable insights to foster economic growth. The role of Islamic financing emerges as a catalyst for positive change within the MSME sector, particularly in Sukabumi. While the study advances our understanding, it is essential to acknowledge its limitations, including the cross-sectional nature of the data. Future research could explore longitudinal designs and consider additional contextual factors to enrich our understanding of the complex relationships explored in this study. This research contributes to the dialogue on Islamic financing and MSME development, offering a localized perspective that can inform strategies for economic growth and prosperity in Sukabumi and potentially inspire similar initiatives in other regions.

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