

Original Research Article

The Role of Islamic Bank Financing in Increasing the Productivity of MSMEs in Indonesia

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Article History

Received: 02.07.2024

Accepted: 10.08.2024

Published: 14.08.2024

Journal homepage:

<https://www.easpublisher.com>

Quick Response Code



Abstract: The purpose of this study is to identify the role of Islamic financing in increasing the productivity of MSMEs in Indonesia by analyzing how the influence of Islamic investment financing and Islamic working capital financing on the productivity of MSMEs. The quantitative approach is used in this study with the type of secondary data compiled in the form of panel data. Data sources are obtained from the publication of the Central Statistics Agency (BPS) and the Financial Services Authority (OJK) using data samples covering 33 provinces in Indonesia with a time span from 2018-2022. In addition to using independent variables and dependent variables, this study also involves two control variables, namely the number of workers and internet users. After testing the results show that Islamic bank financing has an important role in increasing the productivity of MSMEs in Indonesia, it can be seen from the significance of Islamic investment financing and Islamic working capital financing on the productivity of MSMEs. As for together, all variables have an effect on MSMEs.

Keywords: Islamic Bank Financing, MSMEs, Productivity.

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BACKGROUND

Micro, Small, and Medium Enterprises (MSMEs) are part of a sector that has contributed to economic growth. MSMEs play a role in increasing state income and reducing unemployment. Even the MSME sector was proven to be able to survive during the economic crisis in 1998 (Imani, 2018). The Ministry of

Cooperatives, Small and Medium Enterprises reported that MSMEs have a significant role in the recovery of the country's economy. Currently there are 64.2 million MSMEs that contribute 61% to Indonesia's GDP. MSMEs have the ability to absorb 97% of the total national workforce, which is approximately 119.6 million Indonesians.

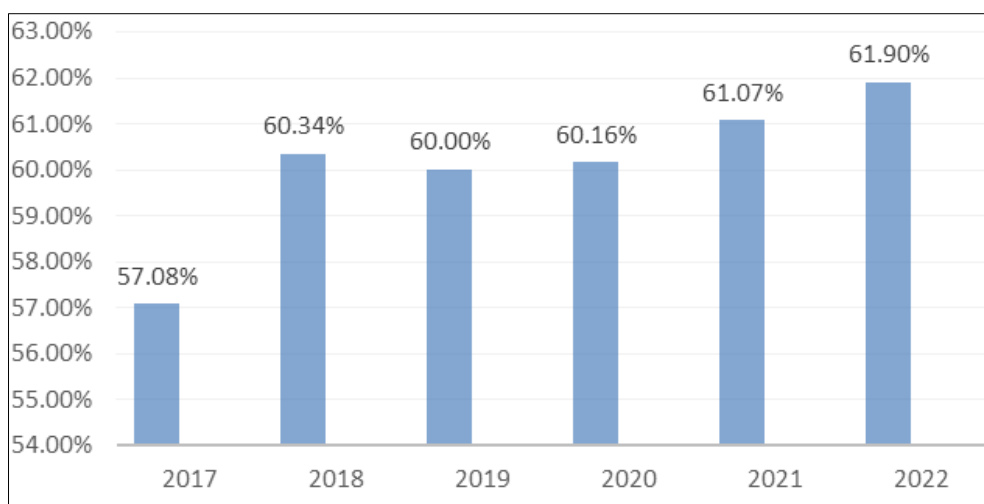


Figure 1.1: Contribution of MSMEs to Indonesia's GDP
 Source: Ministry of Cooperatives, Small and Medium Enterprises

In recent years, economic growth in many developing countries, especially in Indonesia, has been significantly driven by the contribution of Micro, Small and Medium Enterprises (MSMEs), which are part of the economic sector. In addition to providing employment opportunities, MSMEs also play a role in improving income distribution. However, behind its role that has the potential to improve the economy, there are still various problems in it (Rachmawati & Yasin, 2022). One of them is the limitation of productive resources, especially in funding or the required capital is difficult to obtain, thus hindering them from developing a larger market (Niode, 2019). Indonesia, which in fact is one of the countries with the largest Muslim population in the world, should

be an important alternative in providing financing solutions in accordance with sharia principles. By not contradicting the Islamic Bank operates based on the principle of profit sharing and the avoidance of usury (interest), which not only offers a good financing model but also in line with financial needs, both in the form of working capital and investment. Article 19 of Law No. 21 of 2008, regulates the manner in which Islamic Banks provide financing. This article explains the scope of Islamic Banks to carry out activities and also the type of business. Islamic banks through channeled financing can develop the community's economy and reduce poverty and even the impact can absorb more labor so as to reduce unemployment (Suretno & Bustam, 2020).

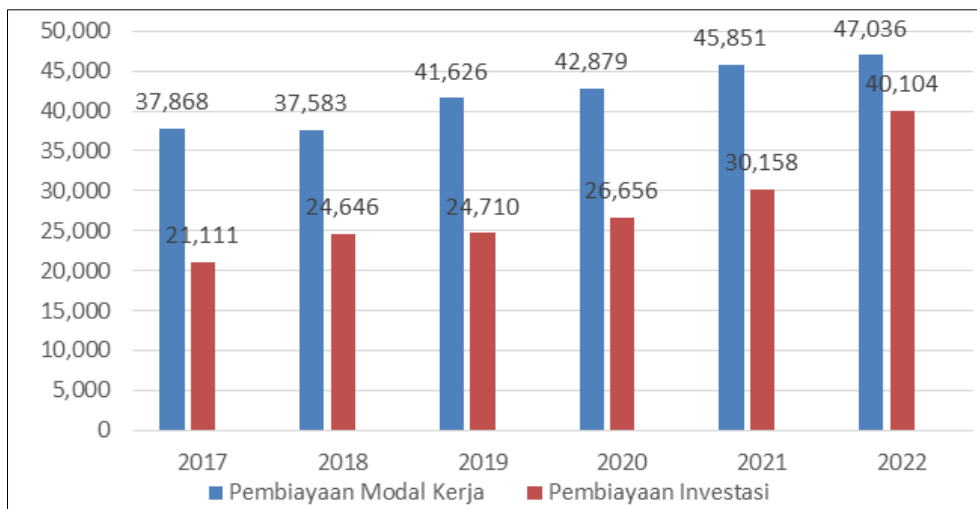


Figure 1.2 Financing of Working Capital and Investment Period 2017 – 2022
 Source: Islamic Banking Statistics (Processed)

It can be seen in Figure 1.2 that Islamic Banking financing for MSMEs continues to increase every year in the 2017-2022 period which is expected to encourage the development of MSMEs so that they can contribute to advancing the Indonesian economy. Sharia financing can

help MSMEs obtain working capital, investment, and business expansion to grow. Thus, MSMEs have the ability to increase their production capacity, which in turn will result in increased MSME productivity.

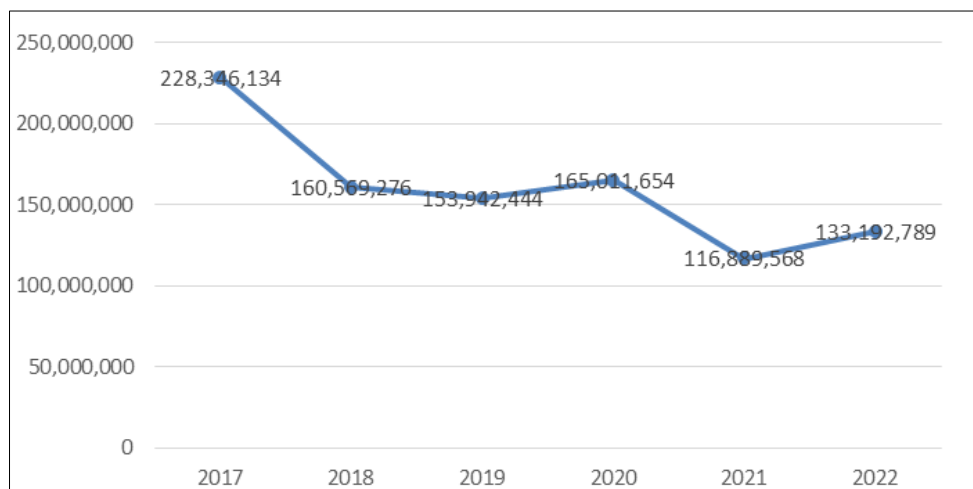


Figure 1.3 Output value of MSMEs from 2017 – 2022
 Source: BPS (Processed)

Figure 1.3 illustrates that in the period 2017 - 2022 the output value of MSMEs experienced fluctuating developments, meaning that the output value of MSMEs was not in line with the increase in Islamic Bank Financing for MSMEs which increased every year. According to Syaparuddin (2017) In Islamic production theory, to increase the amount of output produced, it is necessary to increase production factors, one of which is capital. Conversely, if the capital used increases, it will increase the amount of output. However, as shown by the previous data, the theory does not match the reality on the ground. Therefore, this study will investigate how Islamic banking contributes to increasing the productivity of small and medium enterprises (MSMEs) in Indonesia during the period 2018-2022.

Research linking Islamic bank financing and MSMEs has been done before, but the scope is still limited. Limitations in terms of variables as well as the time period and population used are less specific in describing the performance of MSMEs. Rachmawati & Yasin (2022) conducted a study on the impact of Islamic financing on MSME growth, but only for BSI KCP Mojopahit 2 customers. Likewise Litriani (2018) analyzing Islamic working capital financing on customer income does not mention the performance of MSMEs. Alghifary *et al.*, (2021) conducted research on the effect of syariah bank financing on the output value of small and medium enterprises (MSMEs), but the time used has not covered the Covid-19 pandemic.

Research conducted by Faisol (2017) Islamic bank financing shows positive results on the performance of MSMEs. Berliana & Suri (2023) and Sriyono *et al.*, (2024) his research on MSME financing channeled by Islamic banks has an important role in the development of MSMEs because it offers financing instruments that are fair and not burdensome and in accordance with Islamic principles by sharing risks and profits. Research Manzilati (2015) aims to identify how the profit loss sharing system encourages the progress of MSMEs. This research uses a qualitative approach. The results found are that the profit sharing system can encourage progress in the MSME sector because of the fair sharing of risks and profits between the parties involved. Pramana & Indrarini (2017) identifies Islamic BPR financing based on Maqashid Sharia that can improve the welfare of MSMEs. The research was conducted with a descriptive qualitative methodology using primary data and interviews. The results found are that after obtaining financing from BPR Syariah, it is proven that MSMEs can improve welfare due to increased business results. Then customers can also improve their welfare such as increasing zakat, infaq, sadaqah as well as meeting daily needs, education and investment for the future.

Furthermore, research conducted by Suretno & Yusuf (2021) found different results stating that 80% of Islamic bank financing channeled was in the form of

consumptive financing which had no impact on MSMEs, even research by (A. D. Amri *et al.*, 2023) found that financing for MSMEs channeled by Islamic banks did not contribute directly to the economy. Arulraj & Annamalai, (2020) in his study of small companies in India, he stated that Islamic bank financing, which is a source of external financing, does not necessarily have an impact on business performance. Because research on Islamic bank financing and MSMEs has found inconsistent results, this research will fill the gap from previously researched research by linking Islamic bank financing in the form of working capital and investment financing with MSME productivity covering one Indonesia and the period from 2018-2022. The findings of this study are expected to help both parties to decide on policies in order to support national economic growth in a sustainable manner.

Theoretical Study

Islamic banking includes all businesses, institutions, and procedures in conducting business that have a relationship with Islamic banks, one of which is an Islamic business unit. Chapter I Article 1 of Law Number 21 Year 2008 explains the definition of Islamic banks and then divides Islamic banks into Islamic people's financing banks and Islamic commercial banks. Similar to conventional commercial banks, Islamic banks have business units that also apply sharia principles in their operations, which are referred to as Islamic business units (Alghifary *et al.*, 2021) Islamic bank financing is divided into several categories, namely working capital financing, investment and consumption. (Prayogi & Siregar, 2017) Islamic banks offer another option through a profit system that is in accordance with Islamic principles, in contrast to conventional banks that use an interest system. For profit sharing, or profit sharing, which has been determined in the initial contract, capital owners and capital managers work together in a profit sharing system. This system can build justice so that no one is harmed. (Ramadhanty & Auwalin, 2021). The use of the interest system includes usury, while the Qur'anic verse prohibits usury in this Islamic banking. It is found in surah Ali Imron verse 130 which means: "The verse is the first verse revealed about the prohibition of usury, and the usury in question is usury nasiah with another name usury jahiliyah which was always done by the Arabs. When someone has a loan and cannot pay it within the specified time, Ibn Jarir says that there will be an additional certain amount as compensation for the suspension. And it is prohibited by Allah SWT. In channeling its funds, one of the targets of Islamic Banks is Micro, Small and Medium Enterprises (MSMEs). In article 128 paragraph (1) of PP 7/2021, local governments and municipalities offer cheap and simple financing options for micro and small businesses. Thus, only companies that meet the requirements of micro and small businesses are eligible to provide cheap and simple financing with subsidies. Here are the criteria for MSMEs:

Table 2.1 Criteria for Micro, Small and Medium Enterprises

| Kriteria | Usaha Mikro | Usaha Kecil | Usaha Menengah |
|-------------------|-------------|-----------------------|------------------------|
| Kekayaan Bersih | ≤ 50 Juta | 50 Juta – 500 Juta | 500 Juta – 10 Miliar |
| Penjualan Tahunan | ≤ 300 Juta | 300 Juta – 2,5 Miliar | 2,5 Miliar – 50 Miliar |

Source: PP 7/2021

Islam has principles in every walk of life including in the production sector, which means that in order to achieve profitability, a company must also strive to improve the welfare of individuals involved in these production activities. (Alghifary et al., 2021) In his book, Karim (2007) explains how Islamic production and conventional production theory differ in terms of production cost analysis. According to him, because interest costs are part of fixed costs. In conventional production cost analysis, producers have to pay interest no matter how much output they produce. Compared to Islamic production costs that use a profit-sharing system, the total cost will be higher. In addition, in the Islamic production principle, there is a profit system that includes a profit-sharing agreement that serves as a guideline for the capital owner and the manager. The principle of mudharabah stipulates an agreed-upon share if the business makes a profit. However, the capital manager is responsible for losses incurred by his negligence.

Research Manzilati (2015) aims to identify how the profit loss sharing system encourages the progress of MSMEs. This research uses a qualitative approach. The results found are that the profit-sharing system can encourage progress in the MSME sector because of the fair distribution of risks and profits between the parties involved. Research Pramana & Indrarini (2017) identifies Islamic BPR financing based on Maqashid Sharia that can improve the welfare of MSMEs. The research was conducted with a descriptive qualitative methodology using primary data and interviews. The results found are that after obtaining financing from BPR Syariah, it is proven that MSMEs can improve welfare due to increased business results. Then customers can also improve their welfare such as increasing zakat, infaq, sadaqah as well as meeting daily needs, education and investment for the future. Based on the explanation of previous research, this study will conclude a hypothesis that Islamic bank financing affects the productivity of MSMEs.

RESEARCH METHODS

This research uses a quantitative approach, which is a collection of procedures that produce information using numerical data to analyze unknown objects (Fatihudin, 2020) The author will conduct his tests using multiple linear regression analysis methods to determine the answers to the questions described in the formulation of research problems. This study uses panel data, which is a combination of time series data and cross section data using annual secondary data obtained from the publication data of the Financial Services Authority

(OJK) and the Central Statistics Agency (BPS). All Islamic Commercial Banks and Islamic Business Units registered with the Financial Services Authority (OJK) and micro and small business units registered with BPS are used as the population for this study. This panel data consists of a combination of time series and cross section data. With annual secondary data obtained from the publication of the Financial Services Authority and the Central Bureau of Statistics (BPS). This population is then presented based on provinces in Indonesia. Sampling using purposive sampling method, namely provinces that have and publish data recorded at OJK and BPS, therefore a sample of 33 provinces in Indonesia was obtained because it excluded the provinces of South Papua, Central Papua, Southwest Papua, Papua mountains and North Kalimantan with the period 2018-2022.

Some of the variables used to analyze are dependent variables, independent variables and control variables. The independent variables are Islamic bank financing in the form of Islamic investment financing and Islamic working capital. Then the control variables involved in this study are the number of workers and internet users. Furthermore, the dependent variable is the productivity of MSMEs in the form of the output value of the MSME industry. MSME productivity is the product of MSME industrial activities, from the data of the central statistics agency (BPS, 2024). Then converted in units of millions of rupiah which are presented according to provinces in Indonesia. Furthermore, as an independent variable, Islamic financing is divided into two, namely Islamic working capital financing, which is the distribution of capital for consumable business needs. Meanwhile, Islamic investment financing is the distribution of capital that is not consumable such as the purchase of assets or business expansion measured in billion rupiah. (OJK, 2024). To get good and unbiased results and avoid the occurrence of omitted variables, the regression model in this study involves the use of two control variables. The first control variable used includes internet user data that has been made public by the Central Statistics Agency (BPS). Using percentages, this data refers to households that have accessed the internet in the last three months. Then the second control variable uses the number of workers because it can support the productivity of MSMEs. The data is accumulated by province with units of millions of people.

Data Analysis

Inferential statistics is the analysis used in this study to generate solutions to previously formulated problems. Using multiple linear regression analysis, this method examines the impact of Islamic bank financing

as the independent variable on MSME productivity as the dependent variable. The panel data regression technique was chosen for this study because it is considered better at analyzing the dynamics of change on an ongoing basis and producing more accurate impact estimates than time-series or crosssection data alone (Gujarati, 2009). Before analyzing panel data regression, what must be done is to choose the best model used to analyze. The model selection includes common effect model (CEM), fixed effect model (FEM), and random effect model (REM). The tests are Chow Test, Housman Test and LM Test. Furthermore, before starting the model selection test, the regression formula is made first, which is arranged in the model equation. To avoid Multicollinearity, namely there is a correlation between independent variables in the regression model, this study uses two models with the same dependent variable and control variable, as follows:

$$(1) UMKM_{it} = \beta_0 + \beta_1 MODAL_{it} + \beta_2 TK_{it} + \beta_3 INT_{it} + \epsilon$$

$$(2) UMKM_{it} = \beta_0 + \beta_1 INV_{it} + \beta_2 TK_{it} + \beta_3 INT_{it} + \epsilon$$

- Description:
- UMKM : MSME Productivity (Billion Rupiah)
 - MODAL : Sharia Working Capital Financing (Billion Rupiah)
 - INV : Sharia Investment Financing (Billion Rupiah)
 - INV : Internet Users (Percentage)
 - I : 33 Provinces in Indonesia
 - t : Period of 2018-2022

RESULTS AND DISCUSSION

Descriptive Analysis

Eviews version 13 as an analytical tool to process the data obtained. The author then conducts descriptive analysis to provide a basic description of the statistical data on the variables used. These results include the average, maximum, and minimum values for each variable during the observation period and object.

Table 4.1: Descriptive Statistics of Research Variables

| | UMKM | MODAL | INV | INT | TK |
|--------------|------------|----------|----------|----------|----------|
| Mean | 14926171 | 1302.879 | 883.5818 | 74.45782 | 286154.5 |
| Median | 4903134. | 442.0000 | 404.0000 | 76.57000 | 121193.0 |
| Maximum | 121234464. | 12187.00 | 9641.000 | 95.44000 | 2438770. |
| Minimum | 820335.0 | 1.000000 | 1.000000 | 29.50000 | 9449.000 |
| Std. Deviasi | 26569908 | 2330.329 | 1596.019 | 13.08626 | 518820.3 |

Based on the results of the descriptive statistics in table 4.1, it can be determined that the average productivity of MSMEs per province is IDR 14.93 billion per year. West Java Province produced the highest value of MSMEs, IDR 121.23 billion, in 2020, while West Papua Province produced the lowest value, IDR 820 million, in 2020. The findings of the analysis show that West Java, representing the island of Java, controls the operations of MSMEs and their development contributes to the Indonesian economy, which in fact the province of Java contributes more to the Indonesian economy.

The descriptive analysis can be seen that Islamic bank financing which is more channeled to MSMEs between Islamic working capital and sharia investment is Islamic working capital financing with an average of Rp 1.30 trillion per province per year. Meanwhile, Islamic investment financing for MSMEs only amounted to IDR 883 billion. Based on this research, so far MSMEs have received a larger portion of funding from Islamic banks in the form of working capital than investment. DKI Jakarta was recorded to have the largest distribution of Islamic bank financing, reaching Rp. 12.19 trillion for Islamic working capital

financing in 2022 and Rp. 9.64 trillion for Islamic investment financing in 2018. And the provinces that received the lowest distribution of Islamic bank financing were West Papua province in 2022 and Maluku in 2021 for Islamic working capital financing which only reached a value of IDR 1 billion. Likewise, with Islamic investment financing, NTT province in 2021 is the province with the lowest distribution of investment financing, which is only IDR 1 billion.

Model Testing

Researchers must go through several testing procedures, namely the chow test and Hausman test to determine which of the three models between CEM, FEM, and REM is the most suitable before conducting regression analysis.

Table 4.2: Testing Model 1

| Effect Test | Prob. | Result |
|--------------|--------|--------------------|
| Chow Test | 0.0000 | Fixed Effect Model |
| Hausman Test | 0.0000 | Fixed Effect Model |

Source: Processed Data

Table 4.3: Testing Model 2

| Effect Test | Prob. | Result |
|--------------|--------|---------------------|
| Chow Test | 0.2043 | Random Effect Model |
| Hausman Test | 0.2489 | Random Effect Model |

Source: Processed Data

After the Chow Test, the probability value of models 1 and 2 was found to be $0.0000 > 0.05$, meaning that the model chosen is the Fixed Effect Model. Then the Hausman Test is carried out to determine the best REM or FEM model. The probability value of models 1 and 2 in the Hausman Test shows greater than 0.05, so the model chosen is the Random Effect Model. After conducting several series of model selection tests, it is

concluded that the Random Effect (REM) model is the best model in this study.

Regression Results

The effect of Islamic bank financing on MSME productivity will be measured because it has determined which model works best for panel data. Islamic bank financing which is the independent variable in this first model is Islamic working capital financing. Then the dependent variable, namely MSME productivity, will be analyzed for its determination factor. The internet users and MSME labor act as control variables. Random Effect Model (REM) is the model used in this regression based on the findings of the model test that has been carried out.

Table 4.4 Regression Results Model 1

| Variable | Coefficient | Std. Error | t-statistic | Prob. |
|---------------------|-------------|------------|-------------|--------|
| C | 6.028808 | 0.718573 | 8.389969 | 0.0000 |
| MODAL | 0.000101 | 2.92E-05 | 3.451781 | 0.0007 |
| TK | 0.790660 | 0.058122 | 13.60352 | 0.0000 |
| INT | 0.002922 | 0.003345 | 0.873710 | 0.3836 |
| F-statistic | 110.8795 | | | |
| Prob. (F-statistic) | 0.000000 | | | |
| R-Squared | 0.673850 | | | |
| Adjusted R-square | 0.667773 | | | |

Source: Processed Data

The regression results using the Random Effect Model produce a mathematical equation, namely:

$$UMKMit = 6.02880 + 0.00010MODALit + 0.79066TKit + 0.00292INTit + \epsilon$$

The regression results are then used as a guide to determine the significance of the independent variable on the dependent variable. For this reason, the way to make a decision on significance is:

1. H_0 accepted if the Prob value. > 0.05 , meaning that MSME productivity is not significantly influenced by Sharia Working Capital Financing.

2. H_1 accepted if the Prob. Value < 0.05 , meaning that MSME productivity is significantly influenced by Sharia Working Capital Financing.

Based on the regression results that have been presented, the working capital financing variable has a probability value of 0.0007. Because $0.0007 < 0.05$ H_a is accepted, and it is determined that there is an influence with a positive relationship between MSME productivity and working capital financing by Islamic banks. MSME productivity will grow by IDR 0.00010 billion, or equivalent to IDR 1 million, every time an Islamic bank increases working capital financing by IDR 1 billion.

Table 4.5: Regression Results Model 2

| Variable | Coefficient | Std. Error | t-statistic | Prob. |
|---------------------|-------------|------------|-------------|--------|
| C | 6.028808 | 0.718573 | 8.389969 | 0.0000 |
| MODAL | 0.000101 | 2.92E-05 | 3.451781 | 0.0007 |
| TK | 0.790660 | 0.058122 | 13.60352 | 0.0000 |
| INT | 0.002922 | 0.003345 | 0.873710 | 0.3836 |
| F-statistic | 110.8795 | | | |
| Prob. (F-statistic) | 0.000000 | | | |
| R-Squared | 0.673850 | | | |
| Adjusted R-square | 0.667773 | | | |

Source: Processed Data

The regression results using the Random Effect Model resulted in a mathematical equation, namely:

$$UMKMit = 5.79226 + 0.00014INVit + 0.82095TKit + 0.00138INTit + \epsilon$$

The regression results are then used as a guide to determine the significance of the independent variable on the dependent variable. For this reason, the way to make a decision on significance is:

1. H_0 accepted if the Prob value. > 0.05 , meaning that MSME productivity is not significantly influenced by Sharia Working Capital Financing.
2. H_1 accepted if the Prob. Value < 0.05 , meaning that MSME productivity is significantly influenced by Sharia Working Capital Financing.

Based on the regression results that have been presented, the Sharia investment financing variable has a probability value of 0.0005. Because $0.0005 < 0.05$, H_0 is accepted, and it is determined that there is an influence with a positive relationship between investment financing by Islamic banks and MSME productivity. The coefficient value of investment financing, which is Rp 0.00014, indicates that MSME productivity will increase by Rp 0.0001 billion, or 1.4 million, for every Rp 1 billion spent by Islamic banks on investment financing. Then the role of the control variable used in this analysis, namely the labor variable, with a significance value of 0.0000 in both models. Because $0.0000 < 0.05$ it means that the MSME labor variable has a significant influence on MSME productivity. The internet user variable has a probability value in model 1 which is 0.3836. In model 2, the probability value of the internet user variable is 0.6895. Because the probability value of the internet user variable in both models > 0.05 means that internet users do not have a significant effect on the productivity of MSMEs.

The regression results from models 1 and 2 show that the probability value of F is at 0.00 or $0.00 < 0.05$ indicating that the combined variables between the independent variables and the control variables in this research model have a significant impact on the productivity of the research MSMEs. Thus from the regression findings that there is a slight difference in the coefficient of determination (R-square) between the values of models 1 and 2. Model 1 The results show that the independent variables and their control variables can contribute 66.78% to explain their influence on MSME productivity. While the remaining 33.22% is explained by other variables outside the variables in this study. In addition, model 2 R-square or the coefficient of determination is 0.6694. The results show that the independent variables and their control variables can contribute 66.94% to explain their effect on MSME productivity. Other factors not related to the variables studied explain about 33.06%.

The explanation of the overall regression results provides a finding that the distribution of financing from Islamic banks in the form of investment is better and more effective than working capital financing to increase the productivity of MSMEs, which in this study is

represented by the value of MSME output. Whether seen from the coefficient or the significance of each, investment financing has a better impact than working capital financing. The effectiveness of investment financing on MSME development has been proven by Amri *et al.*, (2022) In the long run, investment financing has a positive and significant impact on small and medium enterprises (MSMEs). And not in line with research Alghifary *et al.*, (2021) which states that working capital financing increases the output value of MSMEs better than investment financing. Because it is used for sustainability, investment financing functions better for the long term with investment financing MSMEs can procure new assets and technology that can strengthen competitiveness in the market. This allows MSMEs to continue to grow, thereby increasing their contribution to the economy. In addition, Islamic financing that encourages MSMEs to develop and grow can also create more new jobs, which in turn will increase the number of workers owned by MSMEs so as to increase productivity in a sustainable manner. Meanwhile, working capital financing generally focuses on shortterm operational needs such as purchasing materials or paying employee salaries. Although it is important for smooth business operations, working capital financing generally only increases productivity in the short term.

Apart from that, this research shows that Islamic bank financing has an effect on the productivity of MSMEs with a positive and significant relationship. Financing in the form of working capital or investment both play an important role in the productivity of MSMEs. The findings are in line with research conducted by Faisal (2017) The results found that Islamic bank financing has a positive influence on MSMEs to improve their performance. Berliana & Suri (2023) and Sriyono *et al.*, (2024) Their study shows that MSME financing at Islamic banks offers financing instruments that are fair and not burdensome and in accordance with Islamic principles by sharing risks and profits, thus playing an important role in the development of MSMEs. Because it has greater capital, Islamic bank financing can help businesses grow (Putri, 2021). In addition, the findings of this study are inconsistent with previous research from Suretno & Yusuf (2021) claiming that 80% of Islamic bank financing channeled is in the form of consumptive financing which has no impact on MSMEs, even research by Amri *et al.*, (2023) found that financing for MSMEs channeled by Islamic banks did not contribute directly to the economy. Arulraj & Annamalai (2020). In his study of small firms in India, he found that business performance is not always affected by Islamic bank financing, which is a source of finance from external sources. The results found show the significance of Islamic bank financing as capital and labor, proving that the production function theory is still relevant to be used as a reference in increasing the productivity of MSMEs. Alghifary *et al.*, (2021) The Indonesian government is

committed to encouraging small and medium enterprises (MSMEs) through Islamic financing. A number of policies have been made and have shown good results, but there are still problematic issues that must be resolved to ensure that MSMEs can optimally utilize Islamic financing.

CONCLUSIONS AND SUGGESTIONS

This analysis leads to the conclusion that, from 2018 to 2022, working capital and investment financing of Islamic banks positively affect the productivity of MSMEs in Indonesia. Two control variables are included in the study: labor, which produces significant results on MSME productivity, and internet users, which produces insignificant results on the same measure. Together all of the following variables have a large impact on the productivity of Indonesian MSMEs between 2018-2022: internet users, labor, financing for Sharia-compliant working capital, and Sharia investment financing. The research findings show that Islamic banking financing significantly improves MSME productivity, and Islamic investment financing is more successful in improving MSME productivity than Islamic working capital.

Furthermore, the results of this study can also be a consideration for Islamic banks in financing distribution and also for business actors who use it. Islamic banks can prioritize investment financing facilities to encourage the productivity of MSMEs to increase. And the government is expected to support the ease of financing distribution through regulations to strengthen the position of Islamic banks as an alternative to providing capital. The author realizes the limitations in this study, namely the financing used to represent Islamic banks is still limited, namely only two types of financing and does not make comparisons with conventional credit regarding effectiveness against MSMEs. Future researchers are expected to use financing variables that are adjusted to the type of contract to fill the gap. And conduct a comparative analysis between Islamic financing and conventional credit to see the effectiveness on the productivity of MSMEs.

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Cite This Article: Ela Supriani, Metasari Kartika, Nurul Bariyah (2024). The Role of Islamic Bank Financing in Increasing the Productivity of MSMEs in Indonesia. *East African Scholars J Econ Bus Manag*, 7(8), 342-350.
