

# Implementation of Shariah Finance to Increase the Welfare of Micro, Small, and Medium Business

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**Abstract:** This study aims to find out the efforts that have been made by LKS in implementing Islamic finance, the obstacles encountered and the role of LKS in implementing Islamic finance for MSME. This study was a qualitative approach in the form of a case study in Batam City. The results showed that the obstacles faced, limited human resources and service offices, constrained by collateral as a second way out because financing must remain secure, internal services are not optimal, understanding and awareness of the community are still happy with instant loans, do not want to be complicated so that more people make transactions with financial institutions conventional rather than LKS which assumes the process seems complicated. Micro entrepreneurs need the role of LKS, especially in terms of capital used to expand the market and develop their business so that it contributes greatly to the national economy, LKS with the institution of Bank Riau Kepri Syariah (BRKS) can provide a way out to meet the needs of a consumptive society and can cover the needs MSME investment.

**Keywords:** Islamic Finance, Increasing Welfare, and Economic Growth

## Introduction

Social issues related to poverty and income inequality are still major unresolved problems in Indonesia until now. This shows that modern theory which says that economic growth will be able to solve the problem of poverty and create an equal distribution of income through the trickledown effect scheme is no longer relevant, especially in developing countries including Indonesia ([Mujib, 2017](#)). Economic development in Indonesia has faced an economic paradox between economic growth and income distribution (Susilowati, et.al. 2007). One of the pillars of the country's economy both in the world and in Indonesia is Micro, Small, and Medium Enterprises (MSMEs), where MSMEs can provide jobs for workers who don't get jobs in the government or private companies. MSMEs themselves do not have high standards in recruiting employees so that they can help the community's economic problems more ([Muffrikha & Latifa, 2021](#)).

The development of the banking sector can encourage economic growth. The results of his research prove that banking services such as lending can increase economic growth. Contrary to the statement above, Asia's economic growth has not been supported by public access to financial institutions. Indonesian people's access to financial institutions is also still low ([Djohar Arifin, 2014](#)).

Based on data from the World Bank, the Global Financial Inclusion Index (2011) explained that Indonesia's Financial Inclusion Index was only 19.6 percent. This is still far below other countries such as Malaysia at 66.7 percent, the Philippines at 26.5 percent, Thailand at 77.7 percent, Vietnam at 21.4 percent, India at 35.2 percent, China at 63.8 percent, Russia at 48.2 percent, Brazil at 55.9 percent. Therefore, increasing public participation in the use of financial services is an important issue on the policy agenda of several developing countries which have underdeveloped banking and financial systems and often only want to serve high-income customers or large companies ([Hindardjo et al., 2022](#)), because the unequal distribution of financial services will hinder the growth and development of several small businesses and poor families ([Azzery, 2022](#)). Based on a survey in the 2009 World Bank Report, Improving Access to Financial Services in Indonesia, commercial banks that dominate Indonesia's financial sector only serve a small proportion of families in Indonesia in which access to capital (credit) was only 17% of the total population of Indonesia borrow from banks, and about a third borrow from the informal sector. Based on this, around 40% of Indonesia's population falls into the category of financially excluded, and marginalized from access to credit. The main reason for not borrowing was due to incomplete documents, which indicated the unavailability of collateral as a second problem. This low access to financial services is not only due to the limited banking penetration rate, but also due to

limited education, limited access to payment transactions, limited access to savings, limited access to credit, and limited access to insurance services.

This is also because the poor do not have sufficient collateral as required by banks to obtain loans and the lack of interest from owners of financial institutions to work on the business in this sector ([Marwiyah et al., 2022](#); [Rosyad et al., 2022](#)). In its implementation, financial institutions cannot be seen narrowly only by expanding public access to the formal financial sector and increasing public interest in having savings accounts at banks, but also must be more encouraged in providing credit/microcredit facilities both for individuals and for MSMEs.

Institute for Development of Economic and Finance (Indef) senior economist Didin S Damanhuri said that banks must be able to meet the financing needs of the micro, small, and medium enterprise (MSMEs) sector to encourage economic growth. This is because business actors will be able to boost economic growth in addition to the government and public consumption ([A'yun et al., 2022](#); [Hidayat, Mahardiko, et al., 2020](#)). He said that so far banks have not optimized lending to MSME actors and have only tended to accommodate the financing needs of large-scale entrepreneurs. In fact, according to him, MSME players are the biggest investors in the economic structure so if there is no support for MSME actors it will hinder economic growth. 99.98 percent of the structure of the business world consists of MSMEs, thus only 0.02 percent consists of large entrepreneurs, but 90 percent of bank credit is given to large entrepreneurs ([Dirsa et al., 2022](#); [Hindardjo et al., 2021](#)). Thus, banks only target large-scale business actors and pay less attention to MSME actors, so they still find it difficult to access credit financing. If the financing provided by the bank has reached all MSME actors, economic growth can reach 7-8%. If banks facilitate financing in the MSME sector.

The previous research conducted by Fitriastutik et al stated that the Financial Services Authority, inclusive finance is all efforts that aim to eliminate all forms of price and non-price barriers to public access in utilizing financial services so that they can provide significant benefits to improving people's living standards, especially for areas with areas and conditions geographical areas that are difficult to reach or border areas ([Fitriastuti & Utomo, 2014](#); [Isroani et al., 2022](#)). In the Pillars of Immortals, financial policy is a form of financial service deepening aimed at the public at the bottom of the pyramid to utilize formal financial products and services such as means of keeping money safe (keeping), transfers, savings and loans, and insurance. This is done not only by appropriately providing products but in combination with various aspects. The financial inclusion strategy is not an isolated initiative. ([Andrianto & Firmansyah, 2019](#)) So involvement in inclusive finance is not only related to the duties of Bank Indonesia but also regulators, ministries, and other institutions

in efforts to provide financial services to the wider community. Through the national financial inclusion strategy, it is hoped that collaboration between government institutions and stakeholders will be created in a good and structured manner ([Khoiruddin, 2013](#)).

This paper will discuss how to implement Islamic finance to serve as an alternative to solving the problems experienced by MSMEs in Indonesia in the financial sector to prosper MSMEs. Another purpose of this article is to introduce and convey how MSME economic actors manage money in investments with relatively low capital and explain to MSME actors how to obtain capital that is protected from usury to create financial stability in their businesses.

## Research Method

### Types of research

This study uses a type of qualitative research. According to Sugiyono (2008), qualitative research is used when you want to examine an object as it is and there is no manipulation so that the object's condition will remain the same from the time the researcher enters until he finishes researching the object. ([Soendari, 2010](#)) The approach used in this research is phenomenology. The phenomenological approach intends to gather information from people who have experienced events or individual experiences related to a matter. The reason for using this approach is to find out more about the description of the implementation of Islamic finance carried out by BMT Rukun Abadi and the impact felt by MSMEs after obtaining funding from BMT Rukun Abadi.

### Place and time of research

This research was carried out at Islamic Microfinance Institutions (LKMS), namely at BMT Rukun Abadi in Bengkulu, Batam City, and SMEs that received funding from BMT Rukun Abadi. This research was conducted with a time of approximately 1 month.

### Data Types and Sources

The data source used in this study is primary data obtained by researchers directly from observations and interviews. Secondary data is in the form of data that is not directly obtained by researchers or in the form of documents.

### Collection Techniques

Data This research uses data collection techniques by observing or observing directly. The interview technique uses semi-structured interviews which aim to help reveal things that

happened to the informants. Another data collection technique used is the study of documents such as notes about an event.

## Result and Discussion

### Efforts of LKS in Implementing Islamic Finance

Several steps have been formulated into a policy and program carried out by the Batam Branch of Riau Kepri Syariah Bank (BRKS) in implementing Islamic finance, especially in providing financing for micro, small and medium enterprises, namely: a). by issuing banking products and services such as savings of various kinds, from general savings to savings intended for students and students; b). has a micro-financing service product, which has been focused on micro-entrepreneurs from the start, of course, with the advantages and conveniences that can be accessed by micro-entrepreneurs; c). these access facilities include frequent low-cost market operations, basic food assistance, mass circumcisions, and socialization of products; d). consistently deploying the marketing team for both financing products and funds and other services so that they can be accessed by the lower middle class; e). planned financing products: for micro-enterprises People's Business Financing (PUR).

The products that have been offered: 1). Microfinance for micro, small and medium entrepreneurs (murabahah contract), 2). KPR financing is beneficial for both subsidized and non-subsidized home ownership using contracts (IMBT / Ijarah Muntakiya Bi Tamlik), and murabahah contracts, 3). Other products; benefit savings (wadiyah contract); simple savings (student savings) and students (wadiyah contracts); micro savings (wadiyah contract); pilgrimage (contract murabaha); deposits (mudharabah contracts); giro (wadiyah contract). The number of customers who made financing within the last one year was murabaha contracts totaling 173 customers, financing < 75 million totaling 2,096 customers, and segmentation < 500 million totaling 10,770 customers.

### Principles of the Sharia Financial System

Shari'ah financial system is a set of rules and laws collectively referred to as shari'a, governing the economic, social, political, and cultural aspects of Islamic society. The word sharia is derived from the rules laid down by the Quran and the descriptions and actions performed by the Prophet Muhammad. (better known as sunnah). ([Iskandar at el., 2017](#)) The basic principles of the shari'ah financial system can be summarized as follows:

- a. Prohibition of interest Prohibition of usury can be interpreted in terms that means “excess” and interpreted as “an increase in capital that cannot be justified in loans or

sales” which is a basic tenet of the Islamic financial system. More precisely, all positive and predetermined rates of return related to the term and principal amount of the loan (ie, guaranteed regardless of the performance of the investment) are considered riba and are prohibited.

- b. Money as “potential capital” Money is treated as potential capital and becomes real capital only when it is combined with other resources to carry out productive activities. Islam recognizes the time value of money, but only when money is the capital, not the potential capital.
- c. Sharing the risk Due to the prohibition on interest, providers of funds finance investors and not creditors. Providers of financial capital and entrepreneurs share business risks in exchange for profit sharing. Financial transactions must reflect a symmetric distribution of risk returns that will be faced by the parties involved.
- d. Prohibition of speculative behavior The Islamic financial system prohibits hoarding and transactions involving extreme uncertainty, gambling, and risk.
- e. Sanctity of contracts Islam upholds contractual obligations and disclosure of information as a sacred duty. This is intended to reduce the risks from uneven information and moral risks.
- f. Activities following Shari'a Only activities that do not violate the rules of Shari'a qualify for investment.
- g. Social justice in principle, every transaction that leads to injustice and exploitation is prohibited.

## Definition of MSMEs

Productive business units that stand alone, which are carried out by individuals or business entities in all economic sectors are the purpose of MSMEs. In principle, the distinction between Micro Enterprises (UMI), Small Enterprises (UK), Medium Enterprises (UM), and Large Enterprises (UB) is generally based on initial asset value (excluding land and buildings), average annual turnover, or the number of permanent workers. However, the definition of MSMEs based on these three measurement tools differs by country. Because of this, it is indeed difficult to compare the importance or role of MSMEs between countries. The micro and small and medium business sector is a sector that has high adaptability to economic conditions and can survive the competition from big businesses. People are more familiar with MSMEs, which are called home businesses that cannot stand alone, they will work together with other businesses to support their operations. Production, distribution, and direct consumers are the most important elements to maintain business continuity. (Wijayanti & Adityawarman, 2022).

Micro, Small, and Medium Enterprises is an abbreviation of UMKM. So that UMKM consists of three forms of business based on their scale, which include; Micro Enterprises, Small Enterprises, and Medium Enterprises. Below can be explained the meaning of the three based on the law; 1. What is meant by micro-businesses are productive businesses owned by individuals and/or individual business entities that meet the criteria for micro-enterprises as regulated in this Law. Asset criteria: Maximum 50 million, turnover criteria: Maximum 300 million rupiahs. 2. Small business can be interpreted as a productive economic business that stands alone, which is carried out by individuals or business entities that are not subsidiaries or not branches of companies that are owned, controlled, or become part either directly or indirectly of medium or large businesses. that meet the criteria for Small Enterprises as referred to in this Law. Asset criteria: 50 million - 500 million, turnover criteria: 300 million - 2.5 billion rupiah. 3. Medium Enterprises are productive economic enterprises that stand alone, carried out by individuals or business entities that are not subsidiaries or branches of companies that are owned, controlled, or become part of either directly or indirectly with Small Businesses or large businesses with total assets net or annual sales proceeds as stipulated in this Law. Asset criteria: 500 million - 10 billion, turnover criteria: > 2.5 billion - 50 billion rupiah (UU No. 20 of 2008).

## Implementation of LKS in MSME Financing

From the discussion above, it can be understood that Small and Medium Enterprises (SMEs) need the role of LKS, especially in terms of capital used to expand markets and develop their businesses so that they contribute greatly to the national economy. This LKS can be formed because it is driven by the community's need for capital used in developing its business. The problem of capital requirements experienced by many people has been responded to positively by some people who are willing to lend some of their money for MSME capital. Funds lent to customers come from the LKS' own money or money from customers who keep their money in the LKS. (Amalia, 2014)

Judging from the potential and funding sources that are already running, LKS has quite good funding in serving its customers and in managing sharia-based funds (Hindardjo & Wajid, 2017). If the management of funds carried out by the LKS can coordinate with each other, then this can be used as a major strength. An example that can be taken is the management of Zakat, Infaq, and Sadaqah (ZIS). The determination of the programs that are run leads to the right target.

MSMEs need the role of LKS, especially in terms of capital used to expand markets and develop their businesses so that they contribute greatly to the national economy. This LKS can be formed because it is driven by the community's need for capital used in developing

their business. LKS with its ZISWAF funds which will later be collaborated with zakat management organizations (Baznas and Laznas) will be able to provide a way out to fulfill the needs of the Rukun Abadir community that are consumptive and can cover the needs of the Rukun Abadir for MSME investments. Suggestions for further research are those that measure how much influence the existence of Islamic financial institutions has on poverty alleviation, or economic growth both in Batam and in Indonesia.

## Values and Beliefs

Access or availability of financial services Access is the main thing that is needed in carrying out financial inclusion ([Mujib, 2017](#); [Scott et al., 2000](#)). The more open access to financial services, it is hoped that MSMEs will get capital assistance more easily, which can be used to empower their businesses. The right strategy is needed to open access so that financial services can be reached by MSMEs. BMT Rukun Abadi opens access to financial services by using the strategy of establishing microfinance institutions close to economic centers or markets because there are certainly micro-business units in the market that need funding to develop their business. BMT by using a ball pick-up system also makes it easier for MSMEs to get access to financial services. Officers will come to provide socialization to prospective customers directly related to products from BMT ([Arifudin & Rosyad, 2021](#); [Sudarsono, 2003](#)). Registration to become a member can also be done right away after the prospective customer has prepared the requirements so that traders do not need to come to the BMT office.

## Ability to Use Financial Services

Customers or MSMEs who have easy access to financial services also need to know about the products provided by BMTs or those that will be taken by MSMEs. It is hoped that increased access will also be matched by increasing financial literacy so that MSMEs or in general the public in utilizing financial services is also balanced with knowledge of these products ([Ahmad Sumiyanto, 2008](#)). One way to support increased financial literacy is when BMT officers pick up the ball. Officers will provide promotion programs and products owned by BMT. Education on financial services provided is important so that customers can use financial services properly. This can be done well by BMT Rukun Abadi because they have a ball pick-up system, so they can come and convey information directly to prospective customers ([Khoiruddin, 2013](#)).

Requirements that need to be met when you want to become a customer of BMT Rukun Abadi ([Hidayat, Franky, et al., 2020](#); [Hidayat, Mahardiko, et al., 2020](#)), both for saving and applying for loans have been given the convenience. This convenience is in the form of a ball



pick-up system that makes it easier for customers to make transactions so they don't have to come to the office, as well as ease in submitting credit and collateral requirements. Collateral depends on the value of the loan submitted.

BMT Rukun Abadi in disbursing funds can also be done quickly. If you use a savings system, when you want to take part of the savings, you don't need to come to the office and you only need to convey the withdrawal to the officer, then the next day it can be taken, as well as with a loan, if you have been a long-time customer, disbursement can be done quickly. Funding for new customers requires an in-depth survey first, and after it is decided to provide a loan, in about 3 days the loan can be disbursed. BMT Rukun Abadi provides physical capital in financial terms in the form of fast disbursement of funds so that customers can immediately use these funds to meet their economic needs.

BMT has provided many conveniences to assist the public in obtaining banking financial services, apart from in terms of loans as well as when making payments. BMT sometimes provides concessions in the form of delaying payments by communicating with officers and explaining the problems being faced. Installment payments can also be made every day so that it is not a burden for customers because they usually use a savings system. One day when they need it, it will be deducted from the savings they have, so that by using a customer saving system such as MSMEs it will be easier to repay. The capital model used by MSMEs, apart from making loans, is by saving because saving will feel easier to do than having to pay off large amounts every month. BMT Rukun Abadi has made it easier for MSMEs to choose the funding they can afford. The many facilities provided by BMT Rukun Abadi in the hope that the community can help their economy because those who previously could not reach banking financial services are now able to get funding to develop their business.

## Conclusions

Based on the theory and research described, BMT Rukun Abadi has carried out the Islamic financial inclusion program well, as well as with financial literacy, but it is still not optimal in assisting customers. The practice of the Islamic financial inclusion program using social capital is reflected in the financial inclusion indicators that have been implemented. Access to sharia financial services provided by BMT Rukun Abadi is sufficient to contribute to providing capital for the community, especially for traders or MSMEs. The Islamic financial inclusion program can provide convenience for MSMEs in reaching financial services. In addition to getting capital, MSMEs are also given the convenience of making installments and leeway when obstacles occur. The contribution of BMT to MSMEs after receiving

funding, even though the value is small and as a complement, can help improve the MSME economy. This research is limited to the financial inclusion program for MSME empowerment in BMT Rukun Abadi. Future research is expected to be able to examine financial inclusion programs for all customers at Islamic microfinance institutions. For BMT Rukun Abadi, it is hoped that they can carry out empowerment programs by providing training or assistance to customers, both in the form of entrepreneurship training and financial management training so that in addition to obtaining capital, customers also have additional insight into developing their business and can improve their standard of living.

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