

## THE ROLE OF SHARIA BANKING ON MSMEs THAT IMPLIED ON INDONESIAN ECONOMIC GROWTH

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### Abstract

This is a descriptive qualitative study that employs secondary material acquired from a variety of sources in the form of theories, reports, research findings, and so on. The goal of this study is to examine the influence of Islamic banking in MSMEs in the growth of the Indonesian economy. The years 1997 and 1998 saw terrible economic conditions; nonetheless, only the MSME sector (micro, small, and medium companies) was able to recover and grow after the crisis. The number of micro, small, and medium-sized enterprises (MSMEs) does not drop, but rather increases. One of the key goals of Sharia banking projects in the country's economic development process is the supply of capital through micro, small, and medium firms. Along with the Indonesian government's emphasis on the development of micro, small, and medium-sized firms (MSMEs), the Islamic banking industry helps to the empowerment of these MSMEs, which will eventually progress economic sectors and boost economic growth.

**Keywords:** *Islamic Banking; MSMEs; Indonesian economy.*

### A. INTRODUCTION

The global financial crisis immediately had a negative impact on Indonesia's economy, making it more difficult for people to make ends meet. The years 1997 and 1998 were marked by challenging economic conditions; yet, the micro, small, and medium-sized enterprise (MSME) sector was the only one that managed to maintain its vitality (Komara et al., 2020). According to data that was published by the Central Statistics Agency, the number of micro, small, and medium-sized enterprises (MSMEs) did not decrease after the economic crisis. In fact, their growth increased significantly, and they were even able to absorb 85 million to 107 million workers until the year 2012. During that year, there were 56,539,560 business owners operating in Indonesia. Of this total, there were 56,534,592 units that were classified as MSMEs, which accounts for 99.99 percent. Large-scale firms make up the remaining 0.01 percent, or 4,968 units, of the total (Suci, 2017).

Hoping to rise from adversity and stabilize the economy, the State makes capital loans to foreign parties. It turned out that this step actually made the nation less independent and dependent on foreign aid (Prawoto, 2009). Seeing this reality, we should see opportunities to maintain the sustainability and development of MSMEs as a solution to the country's economic problems. To overcome the problems of our country which always relies on dependence on foreign aid, one effective step is to use microfinance as the main method (Putri, 2017). The contribution of this approach consists of diversifying the main actors of development, namely the community (ie through the development of MSMEs), financing development using the community's own financial sources and implementing a development approach that has the potential to be sustainable (Amah, 2013).

In running their business, MSMEs often experience various difficulties and obstacles, where in their business development MSMEs often face problems that include marketing, capital, and management problems (Bismala, 2016). Around 57% of micro and small businesses in Indonesia experience difficulties in running their business, with the main difficulties faced are capital difficulties, which are 31.11%, raw material difficulties are

24.80%, and marketing difficulties are 24.60% which make a significant contribution. very important (Indonesia, 2010)

However, conventional financing systems that apply an interest system often result in MSMEs facing difficulties in obtaining business financing (Sari, 2022). The tendency to increase bank interest rates causes MSME business actors in particular and people who have limited economic capacity to no longer be able to pay off their debts to the bank, and finally the bank will confiscate their property to pay off their debts, because the bank certainly will not want to be harmed (Damanhuri & Findi, 2014). Because of this, the community members and business actors who participate in micro and small scale economies require a method of funding that is more conducive to the development of businesses, namely a method of profit-sharing (Ashira, 2020). The Islamic banking system, which is a type of financial institution with operational principles based on the concept of Islamic sharia and which prohibits interest (riba) and applies a profit-loss sharing system for each transaction, is capable of carrying out this kind of transaction. Islamic sharia is a body of law that guides the conduct of Muslims (Antonio, 2001).

## **B. LITERATURE REVIEW**

### **1. Bank**

According to Law Number 10 of 1998 Concerning Amendments to Act Number 7 of 1992 Concerning Banking, banks are defined as an agency that collects funds from the public in the form of savings and distributes them to the public in the form of credit and or other forms in order to raise the general quality of life. This is done in order to improve the standard of living. several individuals. A bank's classification is determined not only by the type of commercial enterprise it engages in but also by its form of legal entity, its establishment and ownership, its target market, its function, its ownership status, its operational activities, the creation of demand deposits, its organizational system, and its geographical location (Muktar, 2016). It is possible to classify banks according to the benefits or services they provide for the utilization of customers' cash, whether those funds come from deposits or loans:

- a. The term "conventional bank" refers to a financial institution that, as part of its business operations (including soliciting deposits and making loans), offers and collects compensation in the form of interest or a predetermined sum of compensation equal to a predetermined percentage of the funds for a predetermined time period. This particular percentage is predetermined on an annual basis.
- b. A sharia bank is a bank that, in the course of its operations, including both the solicitation of money and the disbursement of those funds, gives and enforces rewards on the basis of sharia principles, such as the practice of buying and selling as well as profit sharing (Hasyim, 2016)

Islamic banking is based on sharia principles, economic democracy, and the idea of prudence, as stated in Article 2 of Chapter 2 of Law No. 21 of 2008. All Islamic banking activities are based on this tenet, which also allows Islamic banks to weather a crisis. It is the mission of Islamic financial institutions to aid national development efforts in order to create social harmony and equity for all citizens (Article 3 of Law No. 21 of 2008). Article 4 of Law No. 21 of 2008 further explains the functions of Islamic banks:

- a. The function of collecting and disbursing public revenues must be performed by Sharia Banks and Sharia Business Units.
- b. As baitul mal institutions, Islamic banks and business units can perform socially beneficial activities such as receiving and distributing zakat, infaq, alms, and other charitable donations and remitting them to zakat administration organizations.
- c. Sharia Banks and Sharia Business Units have the ability to collect social funds that are generated from cash waqf and then allocate those money to waqf managers (nazhir) in

accordance with the wishes of the waqf giver. From the previous explanation, the function of Islamic banks can be manifested as an intermediary agent, namely the intermediary party between the community and the community, and between the community and the government in terms of collecting and distributing funds. Furthermore, Islamic banks also function as fund and investment managers (investment and financing managers), providers of banking services as conventional banks but with notes according to sharia corridors, and managers of social functions (Amah, 2013).

## **2. Micro, Small and Medium Enterprises (MSMEs)**

TAP MPR No. XVI/MPR-RI/1998 on Economic Politics in the Context of Economic Democracy, Micro, Small, and Medium Enterprises need to be empowered as an integral part of the people's economy that has the position, role, and strategic potential to realize a more balanced, developing, and just national economic structure. MSME is defined by Law No. 20 Article 1 of 2008, which replaced Law No. 9 Article 1 of 1999, which originally defined the term in terms of micro, small, and medium enterprises (MSMEs). The new definition of MSME is as follows:

- a. A productive business that is owned by individuals and/or individual business entities that satisfy the criteria for a Micro Business as governed in this Law is referred to as a Micro Business.
- b. A productive economic business that stands alone and is 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 from Medium Enterprises or Large Businesses that meet the criteria is considered to be a small business. Small businesses can be either sole proprietorships or partnerships. In accordance with this Law, a Small Business is defined as.
- c. Medium enterprises are economically productive firms that operate on their own and can be run by persons or organisations (Suci, 2017).

## **C. METHOD**

The literature studies gathered from various sources were employed in this paper's investigation. This descriptive qualitative study discusses the importance of Islamic banking in MSME operations in the development of the Indonesian economy. This work relies on qualitative data derived from secondary sources, such as theories, reports, and research findings. The Library Study method is the data gathering approach required in this work; this method is used to assess the results of the data obtained by searching various reference sources connected to the problem, which can provide solutions by evaluating existing data. The literature review used in this study is used by looking for previous literature relating to the theme to be presented, which is then collaborated with the writer's thoughts to find a form of conceptual understanding that can provide information for the larger community in general and writers in particular about the themes discussed) (Zulkarnaen, et. al. 2020)

## **D. RESULT AND DISCUSSION**

Banks have a big role, in collecting funds from the public and then channeling them as business capital, so as to create economic growth. This illustrates how financial institutions play a very important role in the country's economic development. With capital, it is possible to turn things that are not useful into useful things. The problem is that it is relatively difficult for small or micro businesses to access capital, due to several things, such as:

1. The bank's administrative system is convoluted and requires a guarantee that is commensurate with the money lent.

2. Small business actors are generally grassroots groups from the community who are not familiar with the technical languages of banking.

This is where Islamic financial institutions will play a role in the future, particularly the ability to reach the lower classes without imposing too many constraints and using simpler language. In fact, the quantity of funds raised by Indonesian financial institutions is relatively significant, and if all of them were allocated to MSMEs, it would be more than enough to further empower these MSMEs. According to the news, "Total Assets of Financial Institutions Reached Rp. 7,800 Trillion Rupiah." Only 3.49 percent of the entire financial assets of Rp. 7,800 trillion are owned by Islamic financial institutions, although the number of banking financing in the MSME sector continues to expand. It was 633.945 trillion in 2005, 737.355 trillion in 2009, and 926,782 trillion in 2010 (Bank Syariah Mandiri website).

Conventional banks, as well as LKS, are seeing a growth in the assets and funding of MSMEs. There were only two Islamic Commercial Banks in 2000; by 2012, that number had risen to eleven. Islamic financial institutions' assets have also grown over time. In 2012, total assets were recorded at 149 trillion dollars, with 116 trillion dollars in third-party funds collected and 106 trillion dollars in overall financing.. Since last time, this number has increased.

According to the findings of the research conducted by Linda Tamim Umairah in 2016, the Effect of Third Party Funds has a positive effect on the Real Sector Economic Growth in Indonesia. This indicates that the real sector economic growth is positively correlated with the amount of third party funds that are in circulation. The term "third party funds" refers to customer funds that have been entrusted to Sharia Banks or Sharia Business Units with wadi'ah contracts or other contracts that are in accordance with sharia principles. These funds can come in the form of savings, demand deposits, or other forms that can be equated with this term.

(Harrison, P., 1999) in his research explains that the intermediation function of financial sector institutions will encourage economic growth. This is because it will reduce costs in project appraisal. If the number of projects increases in a growing economy, the bank will enter the market as a form of bank activity and increase the profits. Financing provided by Islamic banks is based on the type of user and business category, one of which is MSMEs (Micro, Small and Medium Enterprises).

Based on data from the 2016 Sharia Banking Statistics, the total working capital and investment provided by Islamic banks and sharia business units to MSMEs amounted to Rp54,530 billion. Although the financing provided to MSMEs is lower than the financing provided to non MSMEs and with a total of 18 million customers, which is only 8.94% of the total Muslim population in Indonesia, it has influenced economic growth of 68.4%. So if the entire Muslim population in Indonesia, amounting to 207 million people, invest their funds in Islamic banks, we can imagine how fast our economy will be. However, to encourage public interest in investing their funds through Islamic banks, it is necessary to realize that the public must first believe that Islamic banks are able to realize their investment goals. This lack of trust has made many people refrain from investing through Islamic banks. The availability of information that convinces customers of the ability of Islamic banks is one of the tools to develop public trust.

In addition to the role of Islamic banking in helping economic development through empowering MSMEs, Islamic banking also contributes to attracting foreign investors to Indonesia, especially from Middle-Eastern countries. The existence of various sharia investment opportunities in Indonesia has attracted investors from other countries to invest in Indonesia. Furthermore, Islamic banking as a form of sharia economic movement encourages the emergence of ethical economic behavior among the people of Indonesia. Islamic economics is an economy that is in favor of truth and justice and rejects all forms of economic behavior that are not good, such as usury, speculation and uncertainty.

Mudharabah financing is only an option for the borrower if they have a genuine need for funds for their business. This does not include personal purposes. Profit is generated from the established business, and that profit is distributed in accordance with the terms of the agreement that was reached between the parties (akad). On the basis of these presumptions, it is impossible to apply this profit-sharing scheme to prospective borrowers in order to satisfy their need for consumption. This Islamic financial institution is still merely an alternative in the community; however, in the not too distant future, it should ideally become the primary solution in reducing poverty, enhancing the economy of the community, and empowering MSMEs. When compared to conventional banks, Islamic financial institutions adhere to the principle of justice and equality between institutions that provide loans and their customers. This is in contrast to conventional banks, which impose interest on loans and do not see how the business results (profit) obtained by customers. Islamic financial institutions also provide loans. In addition, the focus of Islamic banks is not necessarily on making a profit, but rather on serving the needs of the community. What the government actually requires is for Islamic financial institutions to be able to provide services to legitimate commercial enterprises. The confidence of financial institutions (even banks owned by the government) in extending loans to small business owners is not founded on theoretical concepts, but rather on practical knowledge gained through years of operation. At the worldwide level, it began when Muhammad Yunus, a laureate of the Nobel Peace Prize, formed Grameen Bank as a specialized financial institution with the purpose of providing financing to small enterprises (Solihin, 2008).

The urge to empower the MSME sector by Islamic financial institutions is greater than that of conventional banks. Financing for underprivileged small businesses has the potential to be developed based on these Islamic values. Some of the Islamic financial institutions organize several small and medium-sized business groups. They organize borrowers and provide financial assistance. The aim is to strengthen their capacity in terms of business planning on a micro scale. Thus, LKS (Islamic Financial Institutions) can act as one of the partners of small or micro entrepreneurs, not only providing light capital assistance, but also providing guidance and empowerment. The presence of easily accessible Islamic financial institutions coupled with micro-credit organized by the government, for example the KUR (People's Business Credit) program, will gradually reduce the practice of moneylenders in the community. So here, there is cooperation between the government, BUMN and the private sector (including Islamic financial institutions), to eradicate the practice of moneylenders while empowering small and micro entrepreneurs (Muheramtahadi, 2017).

## **E. CONCLUSION**

We may draw the conclusion that Islamic banking, which adheres to the rules of Islamic sharia, plays a significant part in the development and empowerment of micro, small, and medium-sized enterprises (MSMEs), which in turn drives the wheels of the Indonesian economy. The practice of Islamic banking offers support, both directly and indirectly, to the significant function that micro, small, and medium-sized businesses play in the expansion of the economy, the preservation of economic stability, the recruitment of labor, the distribution of the results of development, and the growth of the business world. This sector should receive special attention not only from the government and investors, but also from MSME actors themselves and the banking sector. This is because MSMEs play an important role in the development of business in Indonesia and are also the precursors to the growth of large businesses. monies sent from those who have excess funds to those who need funds via effective funding sources, which will subsequently drive economic sectors and boost economic growth. funds transferred from those who have excess funds to those who need funds. Islamic

banking also plays a part in luring international investors to Indonesia by providing a number of different alternatives for Islamic investment in the country.

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