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Pathways to SME Sustainability Integrating: Islamic Finance, Islamic Finance Literature and Government Support for Small and Medium Enterprises

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Abstract

MSMEs play a progressively important role in Indonesia's economic growth, particularly in the context of sharia economic development. The government and Islamic financial institutions (IFIs) have actively supported the empowerment of MSMEs in order to accomplish the Sustainable Development Goals (SDGs). This research aims to conduct a more in-depth analysis of the level of success achieved by these efforts. This research aims to utilize quantitative methods to identify the factors that influence the decision-making process of Micro, Small, and Medium Enterprises (MSMEs) when accessing Islamic financial services. Additionally, it seeks to measure the impact of these factors on the performance of MSMEs. The research results are expected to offer more efficient policy recommendations to enhance the involvement of IFIs in promoting sustainable growth of MSMEs. Research indicates that sharia finance does not have a significant impact on the sustainable performance of MSMEs. However, it is worth noting that sharia financial literacy does have a significant influence on the sustainable performance of MSMEs. Islamic finance exerts a substantial impact on the sustainable performance of micro, small, and medium enterprises (MSMEs). Moreover, the government's responsibility is to effectively regulate the connection between sharia finance and sharia financial literacy in order to enhance the long-term performance of micro, small, and medium enterprises (MSMEs).

Keywords: *Islamic Finance, Islamic Literacy Finance, Sustainability SMEs, SMEs, SDGs.*

Introduction

Sharia finance basically refers to financial practices regulated by Islamic law, such as carrying out business activities that avoid interest or usury by using the Mudarabah and Musharaka systems (Ghlamallah et al. 2021). The development of Sharia finance continues to grow, showing great potential in supporting sustainable development goals (SDGs). Sharia finance as an alternative strategy for MSMEs, Sharia finance as an alternative financing strategy because the Sharia payment system is lighter than conventional finance.

This shows that there are many alternatives that are considered capable of supporting MSMEs. Thus, Sharia finance is a financial practice regulated by the Islamic economic system whose goal is socio-economic equality and equal allocation of resources (Aburime & Alio, 2009). Therefore, Sharia finance has the idea of financing based on offering interest-free loans using the Mudarabah and Musharaka systems (Ghlamallah et al. 2021; Adelekan, 2021; Sonitaet al. 2021).

To realize the Sharia financial industry, the Ministry of National Development Planning (BAPPENAS) introduced the 2019-2024 Indonesian Sharia Economic master plan. This shows that the development of the halal industry is not based on the Sharia aspect which has opportunities for the halal industrial subsector. These opportunities include: 1. Sharia financing which is increasingly developing, 2. Opportunities for cooperation in obtaining financing from banking and tribal issuance, and 3. Development and implementation of Sharia insurance schemes. In this way, the Indonesian government is trying to realize

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Sharia economic development for MSMEs in building a halal industry, in particular strengthening legal and coordination aspects, strengthening the 'Halal' logo and creating access to Sharia finance.

The government hopes that MSMEs can contribute to sustainable development in Indonesia and play a role in the SDGs (Sustainable Development Goals). The Ministry of National Development Planning (BAPPENAS) specifically hopes that MSMEs will play a big role in the economy, especially the SDGs, in order to achieve goals, economic growth and stability, infrastructure, industry and innovation. The Indonesian government is committed to establishing the SDGs as an economic development platform that focuses on empowering MSMEs to achieve the SDGs. In relation to Indonesia's SDGs, Islamic financial institutions (IFIs) have a contribution to realizing sustainable economic growth in developing MSMEs.

Apart from the role of the government, one of the strengthening needed by MSMEs is to increase financial management capabilities and financial literacy. Financial literacy is a level of knowledge, skills and beliefs that influence attitudes and behavior to improve the quality of decision making and financial management (Djuwita & Yusuf, 2018). Sharia financial literacy is an expansion of financial literacy with elements that are in accordance with Islamic law in it. The involvement of Sharia banking in MSMEs is expected to encourage growth and increase market share. Islamic financial inclusion is financial literacy (Ali et al. 2020; Janah, 2021).

According to several studies (Mawardi et al., 2018; A. Z. Anwar et al., 2019; Qoyum & Fauziyyah, 2019; Nurasyiah et al., 2022; M.K. Anwar et al., 2023; Puspitasari et al., 2023; Mujiatun et al., 2023) Sharia financial practices can increase financial accessibility in supporting the development of MSMEs. Therefore, Sharia financial practices encourage inclusive economic growth by growing the digital ecosystem (Aminullah et al. 2022). MSME development is also relevant because it examines several factors that influence MSME growth.

Some studies categorize it into two sides. First, the demand side is to assess the perceptions and knowledge of MSMEs in accessing Islamic financial institutions. Second, to identify factors why IFI is used or not as a source of financing. Where, IFI plays a role in supporting MSMEs towards the SDGs. However, the government has not yet found a role in supporting Islamic finance, sharia finance literacy in the sustainability of MSMEs. Therefore, this research seeks to include the government's role in supporting Islamic finance, sharia finance literacy towards the sustainability of MSMEs.

Literature Review

Islamic Finance

Islamic finance has become part of the international financial services sector and gained prominence as an innovative financial tool to provide solutions to recurring economic uncertainties in general and the funding needs of SMEs in particular (Adelekan, 2021; Sonita, Miswardi & Nasfi, 2021; Shah, Sukmana & Fianto, 2021). Islamic finance is based on limiting costs or receiving fixed and guaranteed returns. Islamic finance promotes collaborative financing, which can help vulnerable communities and small businesses gain access to funding. This can also help the implementation of innovative finance, resulting in increased sustainable development. Islamic Finance is Islamic finance which has become part of the financial services sector and has become an innovative financial tool to provide solutions to economic uncertainty and the funding needs of MSMEs. Islamic finance is based on limiting costs or receiving fixed and guaranteed returns.

Sustainability SME

SME sustainability is sustainability for MSMEs consisting of achieving a balance between financial, human and material resources. It further states that MSMEs implement the goal of ensuring sustainable national consumption and production (Pomare, 2018). From the description above, it is evident that MSMEs are proven to be able to develop a country's economic growth. However, there has been no research that summarizes the above factors in the SDGs framework. Regarding Indonesia's SDGs, Islamic Financial Institutions (IFIs) are expected to make a contribution to realizing sustainable economic growth, one of the

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structures is by developing MSMEs. SDGs and MSMEs seen from the mission aspect indirectly have a close economic and social relationship (George et al. 2016; UN DESA, 2017; UNDESA, 2017). The UN-driven SDGs are believed to be critical to addressing the global economic and social challenges faced by international and national employers today.

Islamic Financial Literacy

The Sharia Financial Literacy component which this research uses as a benchmark for measuring Sharia Financial Literacy adapts the financial literacy research category so that it is not changed from a Sharia Finance perspective. The four components of financial literacy are as follows: First, Fundamental Finance of the Qur'an and Sunnah, Islamic finance, especially the use and handling of certain prohibited commodities, distribution of profits and risks in business, as well as the application of zakat and takaful in it. business, is the main source of rules and regulations in Sharia Financial Literacy (Antara et al., 2016). (2) Credit/Loans According to Pambekti (2020), all human needs are met through the activities of conventional financial institutions which essentially consist of lending and borrowing and buying and selling money. The profits from these transactions are ultimately obtained from the obligation to pay interest which is compensation between the capital provider and the capital user. The definition of financial instruments is expansive and adaptable in Islam (Bhala, 2012). Because Islamic financial institutions can be used for various purposes, they are said to be flexible.

Government

Government is an important need in increasing the competitiveness of MSMEs. The involvement of government support and financial institutions plays a role in overcoming capital problems, financial reporting assistance, government policies that are conducive to MSMEs, providing technology and so on. The government has committed to establishing the SDGs as an economic development platform that focuses on empowering MSMEs to achieve the SDGs because they have an important role in driving the community's economy, especially in supporting poverty alleviation and creating a sustainable business environment. achieving the SDGs (Pomare, 2018). In this way, the Government also hopes that MSMEs can contribute to sustainable development in Indonesia or play a role in the SDGs (Sustainable Development Goals).

Metode Penelitian

This research was conducted at Medan City UKM. The sampling technique used is random sampling, namely taking samples randomly from a predetermined population. Determining the minimum sample size for SEM according to Hair et al (2010) is (Number of indicators + number of latent variables) x (10 times). Therefore, the maximum sample = 18 x 10 = 180 respondents. The sample in this study was 180 SMEs. To test the validity and suitability of the model, Loading Factor and Average Variance Extracted (AVE) are used. The data analysis technique uses the Structural Equation Model (SEM) method to test the hypothesis in this research.

Result and Discussion

Measurement Model

Convergent validity is part of the measurement model which in SEM-PLS is usually called the outer model, while in covariance-based SEM it is called confirmatory factor analysis (CFA) (Mahfud and Ratmono, 2013). There are two criteria to assess whether the outer model (measurement model) meets the convergent validity requirements for reflective constructs, namely (1) loading must be above 0.7 and (2) p value is significant (<0.05) (Hair et al. 2013 ; Mahfud and Ratmono, 2013).

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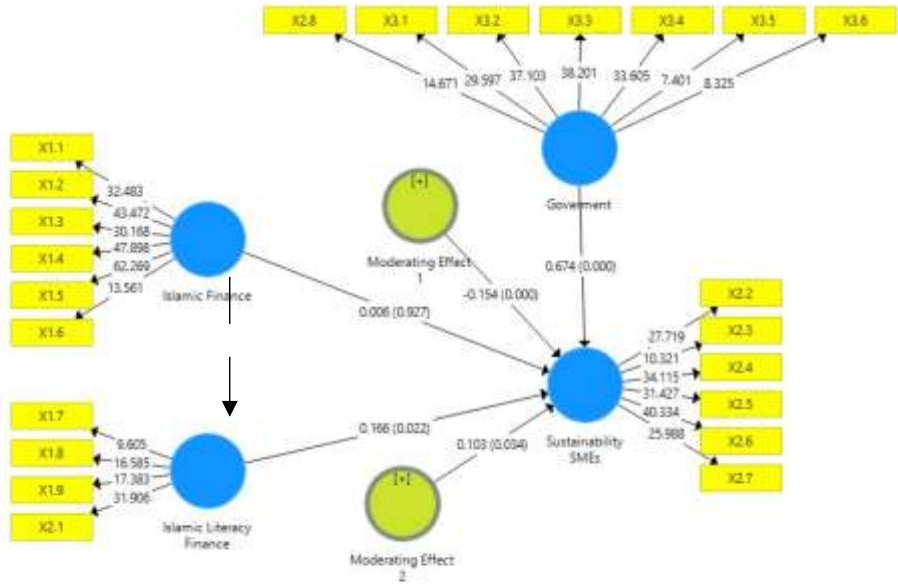

Figure 1. Validity Testing based on Factor Loading

Table 1. Measurement Model

Construct	Measurement Items	Loading Factor	AVE	CR	CA
Islamic Finance	IF1	0.862	0.726	0.940	0.923
	IF2	0.884			
	IF3	0.846			
	IF4	0.886			
	IF5	0.897			
	IF6	0.724			
Islamic Literacy Finance	ILF1	0.722	0.641	0.877	0.833
	ILF2	0.834			
	ILF3	0.844			
	ILF4	0.797			
Government	G1	0.750	0.614	0.917	0.893
	G2	0.831			
	G3	0.867			
	G4	0.857			
	G5	0.858			
	G6	0.646			
	G7	0.638			
Sustainability SMEs	SS1	0.839	0.681	0.927	0.905
	SS2	0.704			
	SS3	0.879			
	SS4	0.833			
	SS5	0.889			
	SS6	0.794			

Based on testing the validity of factor loadings in Table 1 and Figure 1, all loading values are > 0.7, which means they have fulfilled the validity requirements based on the loading values, while testing the validity of all AVE values > 0.5, which means they have fulfilled the validity requirements based on AVE, it is known all CR values are > 0.7, which means they meet the reliability requirements based on CR. And finally, it is

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known that all CA values are > 0.7, which means that they have met the reliability requirements based on Cronbach's alpha.

Significance Test of Influence (Boostrapping)

Tabel 2 Boostrapping

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistics (|O/STDEV|)	P Values
Islamic Finance -> Sustainability SMEs	0.006	0.016	0.071	0.086	0.932
Islamic Literacy Finance -> Sustainability SMEs	0.166	0.166	0.079	2.102	0.036
Islamic Finance -> Islamic Literacy Finance	0.787	0.787	0.038	20.874	0.000
Moderating Effect 1 -> Sustainability SMEs	-0.154	-0.158	0.045	3.419	0.001
Moderating Effect 2 -> Sustainability SMEs	0.103	0.100	0.051	2.045	0.041

Sumber: olah data Smart Pls

Based on the results in Table 2, it is known:

- Islamic finance has a P-Values = 0.932 > 0.05 with a path coefficient value (original sample) of 0.006, indicating that Islamic finance does not have a significant effect on the sustainability of Smes.
- It is known that Islamic literacy finance has a positive effect on the sustainability of SMS, with a path coefficient value (original sample) of 0.166, and is significant, with P-Values = 0.036 < 0.05.
- It is known that Islamic finance has a positive effect on Islamic finance literacy, with a path coefficient value (original sample) of 0.787, and is significant, with P-Values = 0.000 < 0.05.
- Government significantly moderates the relationship between Islamic finance and sustainability SMS, with P-Values = 0.001 < 0.05.
- Government significantly moderates the relationship between Islamic finance literacy and SMS sustainability, with P-Values = 0.041 < 0.05.

R Square

Table 3. R Square

	R Square	R Square Adjusted
Islamic Literacy Finance	0.619	0.617
Sustainability SMEs	0.778	0.772

Sumber: olah data Smart Pls

Based on the results in Table 3, it is known:

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- The R-square value of Islamic Literacy Finance is 0.619, which means that Islamic Finance is able to influence Islamic Literacy Finance by 61.9%. while 38.1% was influenced by variables not included in the research model.

- The R-square value of SMes Sustainability is 0.778, which means that Islamic Finance and Islamic Literacy Finance are able to influence SMes Sustainability by 77.8% and the remaining 26.2% is influenced by other variables.

Discussion

The Influence of Islamic Finance on Smes Sustainability

The research results show that Islamic finance does not have a positive and significant effect on the sustainability of SMS. Even though Islamic finance offers great potential to encourage business sustainability, its impact is not yet significant due to several inhibiting factors. Lack of awareness and understanding of the principles of Islamic finance among business actors, especially SMEs, as well as limited infrastructure such as limited Islamic financial products and services, are the main obstacles. Apart from that, the lack of policy support in the form of consistent regulations and incentives for Islamic financial institutions and business actors also hampers the growth of this sector. Challenges in implementing the principles of transparency, accountability and business ethics in Islamic finance, as well as external factors such as unstable global economic conditions and competition from conventional financial institutions, are also inhibiting factors. To maximize the potential of Islamic finance in encouraging business sustainability, awareness needs to be increased, infrastructure developed and policy support strengthened. Research by Saqib et al (2017) states that Islamic financing in Pakistan has no impact because most SMEs are faced with a lack of collateral for loans and asymmetric information which prevents financial institutions from lending money. The director of the research institute Next Policy assesses that the main factor causing sharia finance to still not have an impact is because the development of sharia banking has so far been dominated by a bottom up approach and there is still minimal support from the Republican government (2024).

The Influence of Islamic Literacy Finance on Smes Sustainability

The research results show that Islamic Literacy Finance has an influence on Smes Sustainability. Islamic financial literacy has a close relationship with SME sustainability. These results are in accordance with the Knowledge Based View (KBV) theory which provides the view that organizational knowledge plays an important role in creating sustainable performance, so that in this research business sustainability is greatly influenced by the level of financial literacy of MSME players. Knowledge and financial management skills help improve business sustainability because they can ensure they are able to overcome dynamic economic turmoil. This is in line with research (Ardila et al., 2021; Aribawa, 2016; Hilmawati & Kusumaningtias, 2021; Sari et al., 2022; Widayanti et al. al., 2017; Ye & Kulathunga, 2019) which states that financial literacy influences business sustainability.

Financial literacy can influence a person's way of thinking about a company's financial condition and making strategic financial decisions, so that business owners can manage their finances well Qiny et al (2023). The ability to manage good finances is really needed by SMEs to improve their business performance. Financial literacy is needed to improve business performance so that managed businesses can develop well (Aribawa 2016). A good understanding of the principles of Islamic finance allows SMEs to access funding more easily and fairly, manage finances efficiently and responsibly, improve business ethics by considering social and environmental impacts, and build sustainable business models by considering economic and social aspects. , and the environment. The higher the Islamic financial literacy among SMEs, the greater their opportunity to apply Islamic finance principles in running their business, thereby encouraging inclusive and sustainable economic growth.

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Muslims are required to be knowledgeable in both religious and world affairs, including experience in financial matters. Because success in Islam includes success both in this world and the hereafter (Al-falah), it needs to be emphasized that Islamic financial literacy is a religious obligation for every Muslim in the realization of Al-falah. Financial literacy literally means having the ability to understand Islamic financial concepts and inculcate good financial behavior guided by Sharia which will result in wise and wise financial decisions. With the increasing number of bankruptcy cases, and poor personal financial records reported, people wonder whether Muslims understand and apply the principles of Islamic finance Qiny et al (2023).

High knowledge of financial literacy can be used to increase business capacity so as to form a competitive advantage. MSMEs need to have managers who are financially literate so that they can carry out risk management practices in an efficient way to gain a competitive position in the market (Songling et al., 2018). Financial literacy plays an important role in business performance and sustainability, especially in financial matters, such as in risk mitigation and decision making (József et al., 2021). Financial literacy can also help optimize a company's capital structure so that it will have an impact on growth. Financial literacy will increase the effectiveness of MSMEs in preparing financial information which can later increase their ability to access external finance (Hussain et al., 2018).

The Influence of Islamic Finance on Islamic Financial Literacy

Islamic finance has a significant positive influence on Islamic financial literacy. As the Islamic financial sector grows, access to Islamic financial products and services is becoming easier, encouraging Islamic financial institutions to improve the quality of their services and education. Intensive promotion and education from various parties, as well as positive examples of the success of Islamic companies and financial institutions, have increasingly increased public awareness of the principles and practices of Islamic finance. This has a positive impact on increasing public participation in the Islamic finance sector, encouraging demand for high-quality products and services, and supporting inclusive and sustainable economic growth. (Hanik, 2018). If people can access financial products and services easily, then people will be more productive and knowledge of financial literacy will increase so that the objectives of formulating the pillars of this inclusive financial strategy will be achieved, namely 1) Equal distribution of income throughout Indonesia from Sabang to Merauke , 2) It will organically reduce the level of poverty in the region, 3) it will create a stable financial system.

Government Moderates the Relationship Between Islamic Finance and Sustainability Smes

Strengthening sharia-based SME businesses through Government support is an effort to support the improvement of SME financial performance towards achieving national economic development goals and is carried out by providing ease of business licensing through Online Single Submission (OSS). Based on the research results, it shows that the government is moderating Islamic financial literacy and the sustainability of SME businesses in Medan City. The sustainability of sharia SME business can be supported by the sharia financial system and financial technology. The Islamic financial system will encourage access to finance, increase financial and social stability, address financial inclusion, and encourage progress in economic development Rabbani et al (2021). Sharia financial institutions are presented to contribute to strengthening sharia SMEs so that they can eliminate gaps as well as equalize income between various sectors and types of business in the context of realizing social justice Gheeraert (2014). The presence of sharia financial institutions can also reduce the dominance of conventional financial institutions and alternative financial institutions to encourage increased capacity and continuity of SME businesses. Ahmed (2010). In addition, the presence of financial institutions is expected to provide access for SMEs to utilize funds while still accommodating Ishak (2016) sharia compliance.

Government Moderates the Relationship Between Islamic Literacy Finance and Sustainability Smes

The government has a crucial role in encouraging business sustainability through financial literacy by providing supporting infrastructure and regulations, implementing awareness and education programs, as well as providing support and facilitation for business actors. Through a comprehensive financial literacy program, the government can help business actors manage their finances responsibly, access appropriate funding, and develop sustainable businesses. Apart from that, improving the quality of human resources through financial education and professional training in the financial sector, including sharia finance, is also the key to building a healthy and sustainable economic ecosystem.

As stated in the Indonesian Sharia Economic Masterplan (MEKSI) 2019-2024, the Indonesian Government has a vision of becoming the world's leading sharia economic center (Ministry of the Economy of the Republic of Indonesia, 2022). To achieve this, efforts will continue to be made to increase the level of sharia financial literacy through increasing education and outreach programs to the community, increasing innovation, capability and competitiveness of the sharia financial services industry. For example, policies that have been implemented by Malaysia include tax incentives in sharia banking in the form of exemptions from certain taxes, stamp duty and the provision of tax deductions for home credit loans by individuals (National Sharia Finance Committee, 2019). The government plays an important role in strengthening the relationship between Islamic financial literacy and SMES sustainability.

Conclusion

The research results show that Islamic financial literacy has a significant positive influence on the sustainability of micro, small and medium enterprises (MSMEs) or Sustainability Smes. Even though Islamic finance has great potential to encourage business sustainability, its impact is not yet significant due to several inhibiting factors, such as lack of awareness and understanding of Islamic finance principles among business actors, limited infrastructure, and lack of policy support. This research also shows that the government has an important role in moderating the relationship between Islamic finance and Islamic financial literacy and business sustainability. The government can increase Islamic financial literacy by providing supporting infrastructure and regulations, running awareness campaigns and educational programs, as well as providing support and facilitation for business actors. Improving the quality of human resources through financial education and professional training in the financial sector, including sharia finance, is also the key to building a healthy and sustainable economic ecosystem. To maximize the potential of Islamic finance in encouraging business sustainability, awareness needs to be increased, infrastructure developed and policy support strengthened. The government plays an important role in encouraging the growth of the Islamic financial sector and increasing Islamic financial literacy, so that it can create a greater positive impact on business sustainability and inclusive and sustainable economic growth.

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