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The role of sharia-based financing in enhancing MSME growth: Empirical evidence from BPRS in Indonesia

Abstract

This study aims to analyze the impact of sharia financing instruments Mudharabah, Musyarakah, and Ijarah on the growth of Micro, Small, and Medium Enterprises (MSMEs) in Indonesia, with particular attention to differences between short-term and long-term effects. This study employs a quantitative approach using the Autoregressive Distributed Lag (ARDL) model to examine time series data from 2020 to 2024. The data were sourced from the Financial Services Authority (Otoritas Jasa Keuangan/OJK) database and focus on financing disbursed by Islamic Rural Banks (Bank Pembiayaan Rakyat Syariah/BPRS) in Indonesia. The ARDL approach allows for the analysis of both short-run dynamics and long-run relationships among variables with different levels of integration. The results indicate that Mudharabah and Musyarakah financing have a negative and significant effect on MSME growth in the short term but a positive and significant effect in the long term. In contrast, Ijarah financing shows a positive and significant impact on MSME growth in both the short and long term. Furthermore, the cointegration test confirms the existence of a long-term equilibrium relationship between sharia financing instruments and MSME growth in Indonesia. The findings suggest that policymakers and financial regulators should strengthen institutional support and optimize the design of sharia financing schemes, particularly profit-sharing mechanisms, to enhance their effectiveness in promoting sustainable MSME growth. This study contributes to the literature by providing empirical evidence on the short-term and long-term effects of multiple sharia financing instruments on MSME growth using the ARDL approach in the context of Indonesian BPRS.

Keywords: Sharia Financing; Mudharabah; Musyarakah; Ijarah; MSME Growth; ARDL Model

Abstrak

Penelitian ini bertujuan untuk menganalisis dampak instrumen pembiayaan syariah Mudharabah, Musyarakah, dan Ijarah terhadap pertumbuhan Usaha Mikro, Kecil, dan Menengah (UMKM) di Indonesia, dengan perhatian khusus pada perbedaan antara efek jangka pendek dan jangka panjang. Penelitian ini menggunakan pendekatan kuantitatif dengan model Autoregressive Distributed Lag (ARDL) untuk meneliti data deret waktu dari tahun 2020 hingga 2024. Data tersebut bersumber dari basis data Otoritas Jasa Keuangan (OJK) dan berfokus pada pembiayaan yang disalurkan oleh Bank Pembiayaan Rakyat Syariah (BPRS) di Indonesia. Pendekatan ARDL memungkinkan analisis dinamika jangka pendek dan hubungan jangka panjang antar variabel dengan tingkat integrasi yang berbeda. Hasil penelitian menunjukkan bahwa pembiayaan Mudharabah dan Musyarakah memiliki pengaruh negatif dan signifikan terhadap pertumbuhan UMKM dalam jangka pendek, tetapi pengaruh positif dan signifikan dalam jangka panjang. Sebaliknya, pembiayaan Ijarah menunjukkan dampak positif dan signifikan terhadap pertumbuhan UMKM baik dalam jangka pendek maupun jangka panjang. Lebih lanjut,

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uji kointegrasi mengkonfirmasi adanya hubungan keseimbangan jangka panjang antara instrumen pembiayaan syariah dan pertumbuhan UMKM di Indonesia. Temuan ini menunjukkan bahwa pembuat kebijakan dan regulator keuangan harus memperkuat dukungan kelembagaan dan khususnya mekanisme bagi hasil, untuk meningkatkan efektivitasnya dalam mendorong pertumbuhan UMKM yang berkelanjutan. Studi ini berkontribusi pada literatur dengan memberikan bukti empiris tentang efek jangka pendek dan jangka panjang dari berbagai instrumen pembiayaan syariah terhadap pertumbuhan UMKM menggunakan pendekatan ARDL dalam konteks BPRS Indonesia.

Kata Kunci: Pembiayaan Syariah; Mudharabah; Musyarakah; Ijarah; Pertumbuhan UMKM; Model ARDL

1. Introduction

Micro, small and medium enterprises (MSMEs) are an economic force that plays an important role in building the people's economy. Playing an important role in the country's economy (Meilantika et al., 2024). MSMEs play an essential role in supporting the national economy by enhancing economic resilience and promoting inclusive growth. This sector serves as the backbone of the Indonesian economy due to its ability to absorb a large proportion of the workforce and stimulate local economic activities across regions. Furthermore, extensive empirical evidence from high-impact international studies confirms that MSMEs play a pivotal role in promoting economic growth, employment generation, and poverty alleviation. According to Beck, Demirgüç-Kunt, and Levine (2005), the development of MSMEs significantly contributes to economic growth by improving financial inclusion and enhancing resource allocation efficiency. In addition, MSMEs are closely linked to inclusive and sustainable development outcomes. The World Bank (2020) emphasizes that MSMEs support inclusive growth by enabling broader participation in economic activities, particularly among low-income and vulnerable groups. This view is reinforced by the Organisation for Economic Co-operation and Development (OECD, 2017), which argues that MSMEs contribute to regional development, reduce economic disparities, and enhance social cohesion. Moreover, MSMEs are increasingly recognized as drivers of innovation and productivity growth, especially when supported by access to finance, technological adoption, and institutional quality (Audretsch, 2012; Acs, Z. J., Szerb, L., & Lloyd, 2018)

According to the Coordinating Ministry for Economic Affairs, Micro, Small and Medium Enterprises (MSMEs) make a substantial contribution to Indonesia's gross domestic product (GDP) and employment creation. MSMEs contribute approximately 61% of national GDP, equivalent to IDR 9,580 trillion, and absorb around 117 million workers, representing nearly 97% of the total workforce (Kadin, 2023). These figures underline the strategic importance of MSMEs as the backbone of Indonesia's economy, particularly in supporting employment, income generation, and economic resilience at the grassroots level.

The performance of Islamic banking is closely linked to developments in the real sector because the financing mechanisms used are based on assets and productive activities. Unlike interest-based systems, Islamic financing such as murabahah, mudharabah, and musyarakah is channeled toward business activities that directly increase production, investment, and business expansion. Therefore, improved Islamic

banking performance, as reflected in the growth of productive financing, can drive the growth of the real sector, particularly MSMEs as the main actors in economic activity. A number of international studies indicate that Islamic banking financing contributes positively to economic growth and real sector activity due to its characteristics that emphasize risk-sharing and asset-based financing (Abduh, 2012; Imam & Kpodar, 2015).

At the global level, the Organisation for Economic Co-operation and Development (OECD) emphasizes that MSMEs constitute a fundamental pillar of economic development in developing countries, as they promote inclusive growth, reduce income inequality, and strengthen local economic structures (OECD, 2022). MSMEs also play a vital role in fostering entrepreneurship and enhancing economic diversification, thereby contributing to long-term economic sustainability. Despite their significant contribution, however, MSMEs continue to face persistent structural constraints that hinder their growth and competitiveness.

One of the most critical challenges faced by MSMEs is limited access to capital and formal financial services. Putra, R. A., (2022) highlight that financing constraints remain a major obstacle for MSME development, particularly in emerging economies where information asymmetry and high transaction costs prevail. In line with this, data from Bank Indonesia indicate that approximately 70% of MSMEs experience difficulties in accessing financing from formal financial institutions. Limited access to external financing restricts MSMEs' ability to expand production capacity, adopt new technologies, and invest in innovation, ultimately weakening their competitiveness in broader and more dynamic markets.

From a development perspective, inadequate access to finance may also limit the contribution of MSMEs to economic transformation and productivity enhancement. Empirical studies suggest that financial constraints significantly reduce firm growth, innovation capacity, and survival rates among MSMEs (Ayyagari, M., Demirgüç-Kunt, A., & Maksimovic, 2011; Beck, T. and Demirguc-Kunt, 2006). Therefore, strengthening financial inclusion and improving access to appropriate financing instruments are essential to unlocking the full potential of MSMEs and ensuring their sustainable contribution to national economic growth.

Islamic banking institutions play a strategic role in supporting MSME development by providing financing schemes that are aligned with risk-sharing principles and real-sector activities. Several studies argue that Islamic finance is particularly suitable for MSMEs due to its emphasis on partnership-based contracts and asset-backed transactions, which reduce speculative behavior and promote productive investment (Abedifar et al., 2014; Harun, 2017). Financing instruments such as *mudharabah* and *musyarakah* enable MSMEs to access capital without excessive reliance on collateral, thereby fostering entrepreneurial activities and business expansion. Government policy also acknowledges that improving access to financing is a key strategy to enhance MSME quality, productivity, and export competitiveness. Adequate financing allows MSMEs to scale up operations, invest in technology, and improve product standards to meet international market requirements. Empirical evidence from developing economies indicates that increased access to bank financing has a positive and significant impact on MSME growth and export performance (Habib Hussain Khan, 2023). In this regard, Islamic banking is expected to complement conventional financial institutions by expanding financial inclusion among underserved MSMEs.

Mudharabah and *musyarakah* are believed to be capable of increasing corporate productivity because they implement risk-sharing mechanisms and partnerships between

financial institutions and business operators. Under this scheme, financial institutions act not only as fund providers but also share risks and profits based on business performance, thereby encouraging more efficient and productive use of funds. This model also reduces the burden of fixed payments typically faced by SMEs under interest-based systems, allowing business owners to allocate capital toward productive activities such as increasing production capacity, innovation, and business expansion. Several studies indicate that profit-sharing-based financing contributes to improved business performance and productivity by aligning the incentives between capital owners and business managers and encouraging long-term investment (Iqbal, Z., & Mirakhor, 2011). Thus, profit-sharing contracts used by BPRS have the potential to increase MSME productivity and strengthen the sustainable growth of the real sector.

The government realizes that one strategy to improve the quality of MSMEs and expand their export markets is through increasing access to financing. Financing is a crucial factor that can increase the growth of MSMEs (Pramitha et al., 2023). The government recognizes that improving access to financing is a crucial strategy to enhance the quality, competitiveness, and international market orientation of MSMEs. Adequate financing enables MSMEs to scale up operations, improve product standards, invest in innovation, and better integrate into global value chains. Research consistently shows that limited access to finance remains one of the most significant constraints on MSME growth and export performance in emerging economies (OECD, 2024). The OECD Financing SMEs and Entrepreneurs 2024 report highlights that tightening financing conditions and rising costs of credit have constrained investment and growth opportunities for SMEs across many countries, indicating that access to diverse and affordable financing is essential for sustaining firm performance and export readiness.

As economic activities within society continue to expand, the role of financial institutions becomes increasingly important in supporting economic development. One such institution is *Bank Pembiayaan Rakyat Syariah* (BPRS), a form of Islamic rural banking that serves as a preferred financial intermediary for communities in developing micro, small, and medium enterprises (MSMEs). BPRS institutions are specifically designed to provide Sharia-compliant financing to micro and small-scale economic actors who often have limited access to conventional banking services. Through profit-sharing and asset-based financing schemes, BPRS plays a strategic role in enhancing financial inclusion and supporting grassroots economic growth (Anjani & Hasmarani, 2016). The development of the BPR and BPRS industry which continues to experience a fluctuating decline based on OJK data until 2023, namely from 17.99 in 2016 to 1,575 in 2023 (OJK, 2023). In recent years, the development of Islamic finance has been quite rapid, especially in the banking sector. This is due to the awareness of Muslims to avoid activities that lead to usury. Starting to switch to Islamic companies that operate based on Islamic principles derived from the Al-Quran and Hadith, including Islamic banking, a strong desire to run a business in accordance with Islam has encouraged the establishment of Islamic People's Financing Banks (BPRS) in Indonesia (Candera & Hustia, 2019).

Based on the theory underlying this discussion is Islamic finance theory explains that Sharia-based financing systems operate without interest (riba) and utilize the principles of profit-sharing, buying and selling, and fair partnership. Schemes such as mudharabah, musyarakah, and murabahah are considered capable of creating a more balanced distribution of risk between financial institutions and business operators, thereby fostering sustainable business growth. This system emphasizes fairness, transparency, and partnership as the foundation of the relationship between fund

providers and business operators (Kato, 2022). In the context of MSMEs, Islamic financing serves as an important alternative because it does not impose fixed interest rates but instead uses a more flexible profit-sharing mechanism based on business performance. This can enhance the ability of MSMEs to grow their businesses and expand their economic activities (Mubarok, 2025). The theory of financial intermediation explains that financial institutions act as intermediaries between parties with excess funds and those in need of funds. Sharia People's Financing Banks (BPRS) function to channel financing to MSMEs through Sharia contracts such as murabahah, mudharabah, and musyarakah. Through this intermediary function, BPRS helps address the limited access to financing often faced by MSMEs, thereby increasing their production capacity and business growth (Rosly, 2005). Sharia-based financing provided by BPRS offers additional working capital to MSMEs, which is used to increase production capacity and expand their businesses. With increased working capital, MSMEs can boost output, revenue, and profitability, reflecting business growth. Thus, Sharia-based financing plays a key role in driving the growth of MSMEs through improved access to capital, profit-sharing systems, and sustainable business partnerships. In the context of the Islamic economy, financial intermediation focuses not only on profit but also on partnership and fair risk-sharing. Islamic financing allows MSMEs to obtain working capital without the burden of fixed interest, thereby further promoting business sustainability.

The Autoregressive Distributed Lag (ARDL) approach provides a more comprehensive framework for examining the relationship between sharia-based financing and MSME growth by capturing the dynamic adjustment process through which financing affects business performance over time. Unlike static regression models that primarily reflect contemporaneous relationships, ARDL enables the simultaneous estimation of short-run and long-run effects using lag structures, thereby allowing a more precise identification of the transmission of BPRS financing to MSME growth. The ARDL model is also suitable for variables with mixed orders of integration and relatively small sample sizes, and incorporates an error correction mechanism that explains the speed of adjustment toward long-run equilibrium (Narayan, 2016). The context of Sharia People's Financing Banks (BPRS) in Indonesia further provides a unique contribution, as BPRS financing is predominantly directed toward small-scale MSMEs and involves close financing relationships, implying that the impact of financing emerges gradually rather than instantaneously. However, most previous studies on Islamic financing and MSMEs in Indonesia rely on static estimation techniques that capture only short-term effects, thereby overlooking potential differences between short-run and long-run impacts. Considering that BPRS financing is commonly utilized for working capital and productive investment, which require time to enhance production capacity and business expansion, the application of the ARDL approach in the Indonesian BPRS context helps address this gap by distinguishing the short-term and long-term effects of sharia-based financing on MSME growth more comprehensively (Minnanul Aliyah, 2020).

Limited access to financing sources is an obstacle for MSMEs in the development and sustainability of their businesses, especially amidst increasingly tight market competition. Sharia financing has emerged as an alternative solution for MSMEs to obtain business capital. Sharia financing is not only attractive because of its compliance with sharia principles, but also because of its fairer and more transparent characteristics (Alek Maulana Pikri Padillah, Zaenal Abidin, 2023). The selection of the 2020–2024 period is based on several empirical considerations relevant to the dynamics of Islamic financing and the growth of MSMEs in Indonesia. First, this period encompasses the phase of

economic disruption caused by the COVID-19 pandemic in 2020–2021, which significantly impacted the performance of MSMEs and the disbursement of Islamic banking financing; thus, it is important to examine how BPRS financing plays a role in maintaining business sustainability during the crisis. Second, the 2022–2024 period represents a phase of economic recovery, during which Islamic financing began to increase in tandem with the resurgence of real sector activity, particularly among SMEs. The development of an effective and efficient sharia financing model for MSMEs should be the main focus. The sharia financing model must be designed to meet diverse capital needs, from working capital to investment capital. Several sharia financing models that can be applied to MSMEs include mudharabah, musyarakah and ijarah. Research by (Nihayah and Rifqi, 2022) also shows that MSMEs that use sharia financing tend to have a higher level of business success compared to conventional financing. The development of a sharia-based financing model for micro, small and medium enterprises (MSMEs) in Indonesia is very relevant. Implementing the principles of Islamic finance applied by the Prophet Muhammad SAW, makes MSMEs grow stronger and make a major contribution to the national economy (Renaldi et al., 2024).

2. Research methods

This study uses monthly data in the form of time series data for the period 2020-2024. All data such as mudharabah, musyarakah and ijarah financing and the number of MSME assets are obtained from the financial services authority (OJK) database. The method used is autoregressive distributed lag (ARDL) which is a dynamic model in econometrics because it describes the time flow in the dependent variable in relation to past values. ARDL is a combination of the autoregressive (AR) and distributed lag (DL) methods. Lag means that a past value will be used to see future values. The AR method is a method that uses one or more past data from the dependent variable, while DL is a regression method that involves data at the present and past time from the independent variable. By using ARDL, long-term and short-term estimates can be obtained simultaneously, which will avoid autocorrelation problems. The general model of ARDL is as follows:

$$\Delta Y_t = \beta_0 + \sum_{i=1}^n \beta_1 \Delta Y_{t-1} + \sum_{i=0}^n \Delta X_{t-1} + \phi_1 y_{t-1} + \phi_2 x_{t-1} + \mu_t \quad n \quad i=0 \quad i=1 \dots \dots \dots (1)$$

Where :

- $\beta_{1,2}$ = short term coefficient,
- ϕ_1, ϕ_2 = long-run ARDL coefficient.
- μ_1 = disturbance error

The advantage of ARDL is its ability to detect long-term and short-term dynamics. Based on the general ARDL model in the ARDL equation in equation (1) which is the short-term relationship equation:

$$\sum_{i=1}^n \beta_1 \Delta Y_{1-t} + \sum_{i=0}^n \beta_2 \Delta X_{t-1} \dots \dots \dots (2)$$

As for the long-term relationship, it is shown by the equation:

$$\phi_1 y_{t-1} + \phi_2 x_{t-1} \dots \dots \dots (3)$$

Based on the explanation above, the ARDL equation used in this study is:

$$\Delta MSME_t = \beta + \beta_1 \sum \Delta UMKM_{t-1} + \beta_2 \sum \Delta MRB_{t-1} + \beta_3 \sum \Delta MSY_{t-1} + \beta_4 \sum \Delta IJR_{t-1} + \beta_5 \Delta MRB_{t-1} + \beta_6 \Delta MSY_{t-1} + \beta_7 \Delta IJR_{t-1} + \varepsilon_t \dots \dots \dots (4)$$

Where:

UMKM = total UMKM assets variable

MRB = mudharabah

MSY = musharakah

IJR = lease

$\beta_1, \beta_2, \beta_3, \beta_4$ = short-term dynamics of the model,

$\beta_5, \beta_6, \text{ and } \beta_7$ = long-term relationships of the research model,

Δ = difference (change) between two values of a variable in consecutive time periods,

ε = normally distributed error

3. Results and discussion

3.1 Descriptive analysis

Table 1. Descriptive analysis

	MSME (Y)	MRB (X1)	MSY (X2)	IJR (X3)
Mean	226327.3	9634.846	186156.1	9097.205
Median	233956.6	10807.14	210916.7	8796.238
Maximum	280822.8	17281.29	315878.0	121190.59
Minimum	168950.6	1028.745	17.20356	6844.409
Std. Dev	33217.13	4654.134	102882.7	1660.152
Observation	60	60	60	60

Source: Research Data

Based on the descriptive analysis table, observation data of 60 samples. The results show that the dependent variable (Y) of MSMEs has the highest number of assets, namely 28022.8 and the lowest assets of 168950.6 with an average of 226327.3 with a standard deviation of 33217.13.

Table 2. Unit root test results

Unit root test on residencefirst difference

Series	Prob.	Lag	Max Lag	Obs
D(UMKM)	0.0142	5	10	53
D(MRB)	0.0000	0	10	58
D(MSY)	0.0000	0	10	58
D(IJR)	0.0000	0	10	58

Source: Research Data

Based on the test results *root unit* in table 2 with ADF, all stationary variables in the first difference, namely mudharabah, musyarakah and ijarah, are shown with a probability of less than 5%. Based on the results of the stationary test obtained, there are no stationary variables at the second difference level, so the autoregressive distributed lag (ARDL) model is suitable for use.

Table 3. ARDL Short-Term Estimation Results

Variables	Coefficient	Std.Error	t-statistic	Prob.
MSME (-1)	0.950154	0.027083	35.08254	0.0000
MRB	-4.834745	0.038827	-124.4207	0.0543

Variables	Coefficient	Std.Error	t-statistic	Prob.
MRB(-1)	-4.617565	0.139670	33.06044	0.0000
MRB (-2)	-0.088728	0.042549	-2.085318	0.0625
MSY	0.503788	0.003224	156.2515	0.0000
MSY (-1)	-0.480690	0.036617	-33.77803	0.0000
MSY(-2)	0.006110	0.089709	1.763332	0.0843
IJR	-2.834585	0.036617	77.41271	0.0000
IJR(-1)	-2.725570	0.089709	-30.38237	0.0000
IJR(-2)	0.087912	0.039829	2.207254	0.0322
C	7084.796	4003.571	1.769619	0.0833

Source: Research Data

Based on the short-term estimation results of the ARDL model, the lagged dependent variable UMKM (-1) has the largest coefficient of 0.95. This indicates a strong persistence effect, meaning that the current level of UMKM assets is largely determined by the asset level in the previous period. In other words, past UMKM asset accumulation plays a dominant role in explaining short-term adjustments. The coefficient value of 0.95 implies that a 1% increase in UMKM assets in the previous year is associated with an increase of approximately 0.95% in current UMKM assets, *ceteris paribus*. This finding reflects the dynamic nature of UMKM asset growth, where asset accumulation tends to adjust gradually over time. The *mudharabah* coefficient value is -0.08, which means that an increase of 1 percent will reduce the amount of UMKM assets by 8% in the second year. The *musyarakah* coefficient is 0.006, this means that an increase of 1 percent will increase the amount of UMKM assets in the second year by 0.6%. While the *ijarah* coefficient of 0.08 means that an increase in *ijarah* financing in Indonesia by 1% will increase the amount of UMKM assets by 8% in the second year.

Table 4. ARDL Long-Term Estimation Results

Variables	Coefficient	Std.Error	t-statistic	Prob.
C	18301.98	8877.305	2.061660	0.0444
MRB	-1.882510	0.064940	-28.98837	0.0000
MSY	0.319969	0.020707	15.45222	0.0000
IJR	3.311197	1.248010	2.653181	0.0106

Source: Research Data

Based on the results of the long-term ARDL estimation, it can be seen that the *ijarah* variable has the largest coefficient of 3.311197 and is significant. Then followed by *musyarakah* which has a coefficient value of 0.319969 and is significant. While the *mudharabah* coefficient is relatively small, namely -1.882510 and is significant. Testing the suitability of the selected ARDL model needs to be carried out so that the research model formed does not violate econometric principles. The diagnostic test of the ARDL model (1,2,2,2) will mainly be carried out by examining the autocorrelation and stability of the model.

Table 5. Autocorrelation Test Results

Breusch-Godfrey Serial Correlation LM Test:			
F-statistic	0.083728	Prob.	0.7807
Obs*R	0.283676	Chi Square Prob	0.5943

Source: Research Data

Based on the results of data processing as in table 5, it is known that *p-value* The statistic for the BGLM test is 0.5943. These results indicate that at a 95% confidence level

the null hypothesis cannot be rejected, which means there is no autocorrelation in the residuals of the ARDL (1,2,2,2) model.

Table 6. ARDL Model Bound Test

F-Bound Test Statistical test	Value	Null Hypothesis significant	No.levels I(0)	Relationship I(1)
F-statistic	8.879508	10%	2.22	3.2
		5%	2.56	3.87
		2.5%	3.15	4.08
		1%	3.65	4.66

Source: Research Data

Based on the results of the Bound Test for the ARDL (1,2,2,2) model in table 6, it can be seen that the F-statistic of the model is 8.879508 is greater than the upper bound at the 5% level. This proves that the three variables in this study, namely *mudharabah*, *musyarakah* and *ijarah*, have cointegration in the long term or it can be said that these variables move together in the long term.

Table 7. Dynamic Cointegration and Speed of Adjustment

Variables	Coefficient	Std.Error	t-statistic	Prob.
MRB	-4.834745	0.038827	-124.4207	0.0000
MRB (-1)	-0.288600	0.147978	-1.950291	0.0566
MRB (-2)	-0.88728	0.042549	-2.085318	0.0425
MSY	0.503788	0.003224	156.2515	0.0000
MSY(-1)	0.048091	0.025262	1.903676	0.0626
MSY (-2)	0.006110	0.089709	1.763332	0.0843
IJR	2.834585	0.036617	77.41271	0.0000
IJR (-1)	0.309984	0.279947	1.107295	0.2734
IJR (-2)	0.087912	0.039829	2.207254	0.0322
CointEq(-1)*	0.319969	8877.305	2.061660	0.0444

Source: Research Data

The results of the cointegration test in table 7 show that the value of $CointEq(-1)=0.319969$ and significant at the 5% level, which means that there is long-term cointegration in this model. The coefficient $CointEq$ then it will be used to measure the speed of adjustment which is the speed of adjustment in responding to changes. The ECT or $CointEq$ value is valid if the coefficient is positive with a significant probability at the 5% level. In this study, the ARDL (1,2,2,2) model has met the validity requirements, so that in this study it will lead to equilibrium at a speed of 31.99% per year.

4. Discussion

4.1 The influence of *mudharabah* on the growth of MSMEs

Based on the results of the short-term and long-term estimation examining the relationship between Islamic financing instruments namely *mudharabah*, *musyarakah*, and *ijarah* and the performance of micro, small, and medium enterprises (MSMEs) in Indonesia, this study finds evidence of a long-run positive and significant relationship between sharia financing and MSME development. These findings indicate that, in the long term, Islamic financing contributes to the expansion of MSME assets and business

sustainability, supporting the role of sharia-based financial intermediation in promoting real-sector growth.

However, the short-term dynamics reveal heterogeneous effects across different financing contracts. Specifically, *mudharabah* financing exhibits a negative and statistically significant effect on MSME asset growth in the short run. This result suggests that profit-and-loss sharing mechanisms under *mudharabah* may initially impose adjustment costs on MSMEs, such as profit uncertainty, higher monitoring requirements, and delayed realization of returns, which can temporarily reduce asset accumulation. In the early stages of financing, MSMEs may face operational inefficiencies and risk-sharing pressures before achieving stable business performance.

Profit-sharing contracts such as *mudharabah* and *musyarakah* may generate negative short-term effects because returns are realized only after the financed business begins to generate profits, creating a time lag between financing disbursement and asset growth. In the initial period, funds are primarily used for operational and investment costs, which may not immediately increase UMKM performance, while the risk-sharing nature of these contracts also exposes financing to business uncertainty and potential early losses. Additionally, profit-sharing schemes involve higher monitoring costs and information asymmetry between financiers and entrepreneurs, reducing short-term efficiency and potentially producing negative coefficients in dynamic models such as ARDL. These characteristics explain why profit-sharing financing may weaken performance in the short run but improve outcomes in the long run once projects mature and generate returns (Wahyudi, 2019).

Empirically, these findings are consistent with the study of Fikri & Wirman, (2021) which reports that *mudharabah* financing does not significantly contribute to bank profitability in Indonesia, reflecting the relatively higher risk and uncertainty associated with equity-based Islamic contracts. The short-term negative impact observed in this study reinforces the argument that *mudharabah* financing, while theoretically ideal in promoting risk sharing, may encounter practical limitations in its initial implementation phase.

Nevertheless, the long-term positive relationship between sharia financing and MSMEs indicates that these short-term challenges can be mitigated over time as businesses adapt, governance mechanisms improve, and financial institutions gain better experience in managing profit-sharing contracts. This finding aligns with international empirical evidence suggesting that equity-based Islamic financing instruments tend to yield stronger developmental impacts in the long run rather than in the short run. For instance, Hasan, (2020) argue that profit-and-loss sharing contracts enhance entrepreneurial resilience and firm growth once information asymmetry and monitoring challenges are adequately addressed. Similarly, Beck et al., (2013) highlight that Islamic financing models emphasizing risk sharing are more closely linked to real economic activity, although their benefits materialize gradually. The nature of long-term investment causes MSMEs to need time to use the funds, develop their business, and generate profits. In the short term, the impact has not been seen significantly Fattah & Muchlis, (2024). Meanwhile, in the long term, it appears that *mudharabah* has a significant influence on the growth of MSMEs in Indonesia in line with research conducted Sari et al., (2025) which states that long-term *mudharabah* financing helps overcome capital limitations and manage business finances more effectively.

In contrast to *mudharabah*, *musyarakah* and *ijarah* financing demonstrate more stable and positive effects in both the short and long term, reflecting their relatively lower

implementation risk and clearer contractual structure. *Musyarakah* allows joint participation and shared control among partners, while *ijarah* provides predictable cash flows through lease-based arrangements, making these contracts more suitable for supporting MSME asset growth in the short run. These findings suggest that diversification of Islamic financing contracts and strengthening institutional capacity are crucial to optimizing the contribution of sharia financing to MSME development in Indonesia.

4.2 The influence of musyarakah on the growth of MSMEs

Based on the short-term and long-term relationship testing. The results show that in the short term The model results show that although changes in musyarakah in the last one and two years tend to reduce MSMEs, the effect is not statistically significant. Despite the absence of significant short-term effects, the presence of a statistically significant error correction term (ECT) in the current period and the first lag indicates that the system consistently converges toward long-term equilibrium. The significance of the ECT confirms the existence of a stable long-run relationship between *musyarakah* financing and MSME growth, implying that any short-term deviations from equilibrium are gradually corrected over time. This finding highlights the importance of adopting a long-term perspective when evaluating the effectiveness of equity-based Islamic financing instruments such as *musyarakah*. However, the existence of a significant error correction term in the current year and the first year, indicates that in the long term, the system continues to move towards equilibrium, indicating that musyarakah has a long-term influence on the growth of MSMEs even though the short-term effects are not immediately felt. Results on the long term musyarakah 0.319969 and prob 0.0000 < 0.05 so it has a positive effect on The growth of MSMEs is in line with research conducted by [Muzahida & Hamdan, \(2021\)](#) which found that musyarakah financing can increase the growth of MSMEs, the greater the amount of sharia financing received by MSMEs, the greater the growth they experience. Musyarakah financing is considered more flexible and based on profit sharing, so it is more in line with the dynamics of MSME businesses.

4.3 The influence of Ijarah on the growth of MSMEs

Based on the short-term and long-term estimation results, this study finds that *ijarah* financing exerts a consistently positive influence on the growth of micro, small, and medium enterprises (MSMEs) in Indonesia. In the short term, *ijarah* financing has a positive effect on MSME growth, indicating that leasing-based financing provides immediate benefits to business operations. This result can be explained by the nature of *ijarah* contracts, in which financed assets are leased rather than owned by MSMEs. Consequently, MSMEs do not bear the full ownership risk, particularly the residual value risk and depreciation of assets, allowing them to allocate limited financial resources more efficiently toward working capital and operational activities. In the long term, *ijarah* also has a positive effect on the growth of MSMEs with the largest coefficient among other variables, namely 3.311197 and the probability of 0.0106 < 0.05, this finding is in line with [\(Sholihun & Sangadah, 2024\)](#) which states that leasing has a positive and significant influence on the development of MSMEs Their study highlights that leasing arrangements provide flexibility for MSMEs to adjust asset usage in response to changing business conditions. In the long run, MSMEs can replace, upgrade, or expand leased assets according to evolving production needs without being locked into ownership of obsolete or inefficient capital goods. This flexibility is particularly important for MSMEs

operating in dynamic markets characterized by rapid technological change and fluctuating demand. This is because in the long term, MSMEs can replace, add or change the type of leased assets according to the needs of business development without having to be trapped in the ownership of obsolete assets.

5. Conclusion

This study examines the role of Islamic financing contracts in supporting MSME growth in Indonesia using the ARDL approach, which allows distinguishing between short-run dynamics and long-run equilibrium relationships. The short-term estimation results indicate that Mudharabah and Musyarakah financing have a negative and statistically significant effect on MSME growth. This finding suggests that profit-sharing contracts may initially create adjustment costs due to higher business risk, income uncertainty, and monitoring requirements inherent in profit-sharing arrangements. In the early stages, MSMEs may face constraints in managerial capability and financial reporting, which can temporarily reduce business performance. However, the long-run estimation shows that Mudharabah and Musyarakah financing exert a positive and significant effect on MSME growth, indicating that once firms adapt to the profit-sharing mechanism, these contracts enhance capital accumulation, risk sharing, and business sustainability. This result supports the theoretical argument that profit-sharing financing promotes productive investment and long-term enterprise development, although its impact materializes gradually.

In contrast, Ijarah financing demonstrates a positive and significant effect in both the short run and the long run. This suggests that lease-based financing provides more immediate support by enabling MSMEs to access productive assets without large initial capital requirements or complex profit-sharing arrangements. Consequently, Ijarah financing improves operational capacity, reduces liquidity constraints, and supports business continuity more quickly than profit-sharing contracts. These differences highlight the complementary roles of Islamic financing instruments, where asset-based contracts provide short-term stability while profit-sharing contracts foster long-term growth. Furthermore, the ARDL bounds testing results confirm the existence of cointegration among Mudharabah, Musyarakah, Ijarah financing, and MSME growth, indicating a long-run equilibrium relationship between Islamic financing and MSME development in Indonesia. This implies that although short-run adjustments may fluctuate, these variables move together over time and converge toward long-term equilibrium. The presence of cointegration also supports the theoretical framework that Islamic financing contributes to MSME growth through capital provision, risk sharing, and asset acquisition mechanisms.

Overall, this study contributes to the literature by providing empirical evidence on the differential short-run and long-run effects of Islamic financing contracts on MSME growth in a developing country context. The findings highlight the importance of strengthening institutional support, improving contract implementation, and enhancing financial literacy among MSME actors to maximize the effectiveness of profit-sharing financing. Therefore, policymakers and Islamic financial institutions are encouraged to develop balanced financing strategies that combine profit-sharing and asset-based contracts to promote inclusive, sustainable, and long-term MSME development.

6. References

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