Sustainable Financial Inclusion: The Role of Islamic Commercial Bank Financing in MSMEs

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| Article In	Abstract
Paper type: <u>Research paper</u> **Keywords:** *Islamic Commercial Banks; Financial Inclusion; Financing; Micro, Small and Medium Enterprises* **Article history:** *Received: June 2023* *Revised: -* *Accepted: August 2023* *Available online: August 2023*	*The presence of Islamic Commercial Banks is an alternative source of MSME financing. In general, MSMEs have classic problems in the form of low levels of financial literacy and inclusion in Islamic banking. This study aims to analyze how financial inclusion influences BUS on MSME financing in Indonesia. This study uses a quantitative descriptive method of Ordinary Least Square analysis. The estimation results show that dimensions d1 and d2 have a significant positive effect on MSME BUS financing in Indonesia. Meanwhile, the d3 dimension has a negative relationship and does not affect MSME BUS financing in Indonesia. This indicates that MSMEs do not make financing from BUS the ultimate goals of using banking services. The development of digital financing services is an alternative to fulfilling funds for MSMEs. Islamic banks must develop products and services that suit the needs of a diverse society. In addition, the government must have regulations that support and encourage the development of Islamic banking and financial inclusion.*

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Introduction

The Micro, Small and Medium Enterprises (MSMEs) sector has become a concern of the government, because of its contribution to the Indonesian economy. This was identified from the Data of the Indonesian Ministry of Cooperatives and UMKM in 2021, in total MSME units have a share of around 99% of total businesses in Indonesia. In addition, MSMEs themselves can absorb 97% of the workforce and contribute to Indonesia's GDP of 61.07%. But on the other hand, MSMEs have some classic problems. According to Westhead and Wright (2000), the main obstacle for MSME businesses regardless of size, location, or type of economic activity is lack of funds. In order to encourage the growth of MSMEs, Bank Indonesia issued Bank Indonesia Regulation number 14/22/PBI/2012 in which Commercial Banks in Indonesia are required to provide financing or credit to MSMEs. Islamic Commercial Banks (BUS) are financial institutions that have the largest assets in the Islamic banking sector, which are expected to be a solution for MSME financing. From 2017 to 2022, assets owned by Islamic Commercial Banks continue to

increase as illustrated in the following table:
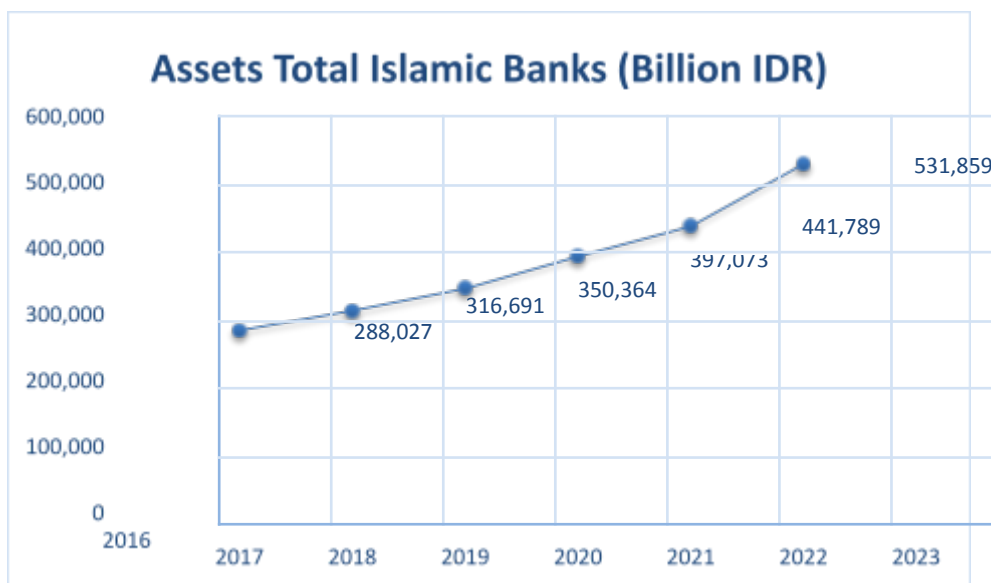
Source: Sharia Banking Statistic, 2022
Figure 1. Development of Asset in Islamic Commercial Bank in Indonesia 2017 – 2021

Assets owned by Islamic Commercial Banks have increased every year (Sharia Banking Statistics, 2022). However, Islamic Commercial Banks still need to pay attention to asset allocation due to the limited risk of the ratio of operating expenses to operating income (Aspiranti et al., 2019). The operational costs of Islamic Banks in Indonesia are still too expensive because the composition of funds originating from deposits is still dominant compared to savings at Islamic Banks.

On the other hand, from economic statistics for 2016, there are still many MSMEs using personal money as business capital due to limited access for MSMEs to banking. MSME units still have not received financing from financial institutions. Only a small number of MSMEs have the trust of financial institutions (Rahmat, 2021). Furthermore, Eton, et al., (2017), found that only a small proportion of MSMEs were able to meet the financing requirements from banks. Therefore, it is necessary to increase financial inclusion and literacy for MSMEs as explained in the Financial Services Authority Policy number 76/POJK.07/2016 chapter 11. Financial inclusion has 3 dimensions, namely banking penetration, availability of banking services and use of banking services (Sarma, 2012). In line with Bank Indonesia's findings, there are dominant factors in realizing financial inclusion, namely the availability, quality and use of financial products and services from financial institutions.

According to the 2022 National Financial Literacy and Inclusion Survey, the financial literacy level has only reached 49.68% and the financial inclusion rate has reached 85.10%. This figure has exceeded the government's target set in Government Regulation no. 82 of 2016 with a financial inclusion rate above 75%. The following is an overview of financial inclusion and literacy in Indonesia:
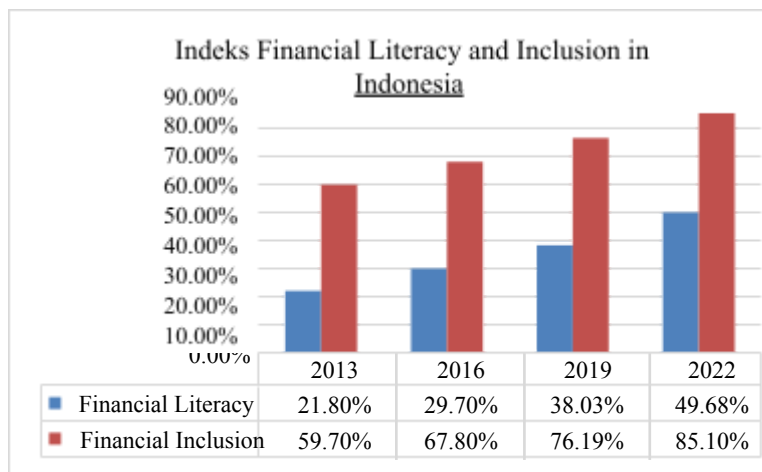
Source: National Survey of Financial Literacy and Inclusion OJK, 2022
Figure 2. Financial Literacy and Inclusion Index in Indonesia

When compared with the literacy levels of several countries in ASEAN, namely Singapore reaching 97.55%, Thailand 95.58% and Malaysia 88.37%, Indonesia is still below the three ASEAN countries. If Islamic financial literacy and inclusion are compared to conventional financial literacy and inclusion levels, then Islamic bank financial literacy is only 8.93%, far behind the national index of 38.03%. Furthermore, in terms of financial inclusion, Islamic banking is only 9.1%, the national index has reached 76.19%. Therefore, efforts are needed to increase Islamic financial literacy and inclusion, one of which is by optimizing the level of financial literacy and inclusion of MSMEs to obtain more optimal services and facilities from Islamic banking as a ta'awun-based bank (helping each other). Therefore, the purpose of this study is to see the effect of financial inclusion on MSME financing at BUS in Indonesia.

Literature Review

Financial inclusion refers to the availability and accessibility of various services, products, and financial institution facilities for both individuals and businesses, especially for groups that have been traditionally underserved or excluded from the formal financial system (World Bank, 2018). Based on previous research, the availability of access to capital services from banks is a major problem for MSME actors in encouraging MSME business growth (Schiffer & Weder, 2001). Terdapat beberapa pengukuran yang menujukan tingkat dari masing-masing indicator inklusi keuangan (Sarma, 2012) (Bank Indonesia, 2015), dimana pada banking penetration indicator is seen from the number of deposit account per 1000 adults, Inklusi keuangan memiliki 3 indikator yaitu banking penetration, availability of banking services and use of banking services, availability of banking services is measured by the availability of the number of bank branches and ATMs per 100.000 adult population, and use of banking services includes the number of MSMEs financing accounts per 1000 adults.

According to law 20 of 2008 concerning micro, small and medium enterprises, the definition of MSME is a productive economic enterprise that stands alone and is carried out by individuals or business entities. An indicator of financial inclusion that is significant for MSME growth is the availability of connections from various financial institutions, products and services tailored to the needs and capabilities of MSME players. Increasing financial inclusion provides the tools and resources needed by MSMEs to access capital and manage MSME finances effectively (Mangihut,

2023).

According to Lakuma, et al., (2019), financial inclusion and MSMEs have a positive relationship that refers to access and availability of financial services. Financial inclusion can provide MSMEs with opportunities to access new markets and expand their customer base, such as easy access to MSME customers in accessing banking services that lead to business growth (World Bank, 2014). Furthermore,

financial inclusion plays an important role in helping MSME financing in the banking sector (Lu, Liu & wu, 2020).

In order to promote Financial Inclusion, Islamic finance can act as a solution to increase the use of the banking sector. MSMEs are an important element for increasing financial inclusion in various countries in the world (Hakim et al., 2021). The large number of Indonesian people who are Muslim can increase the use of financial services in accordance with the provisions of Islamic law.

The role of Islamic finance has emerged in promoting financial inclusion. Islamic banking has activities in carrying out the intermediary function by collecting funds from parties with excess funds in the form of deposits to parties who lack funds in the form of financing. Islamic banking has interest-free instruments, which are financial institutions that operate in providing sharia products and services (Sudarwati & Yani, 2021). The instrument designs risk sharing in financial financing activities, one of which is MSME in accordance with the provisions of Islamic law. This can target all people from high to low incomes, thereby increasing the participation of MSMEs in the formal financial system (Bernie, et al, 2019).

Methodology

The design of this study is quantitative descriptive. Quantitative descriptive research was is a process of discovering knowledge by using data in the form of numbers used as a tool to find out information about what is to be searched for. This type of research aims to describe a symptom, variable, situation or event. The data was collected secondary from published institutional data namely Otoritas Jasa Keuangan, Bank Indonesia, Badan Pusat Statistik Indonesia. Other sources are obtain from article, journal and internet that are valid and relevant to this topic research. In this study, using the Ordinary Least Square (OLS) method to examine the relationship between one variable and the other with the type of time series data in the period per semester from 2014 – 2022. Model eatimasi dalam penelitian ini adalah:

$$PMK = \alpha_0 + \alpha_1 d_{1,t} + \alpha_2 d_{2,t} + \alpha_3 d_{3,t} + e_{,t}$$

Explanation:

α_0	= Konstanta
PMK	= MSMEs Financing
$\alpha_1, \alpha_2, \alpha_3,$	= Independent variable coefficient
d_{1t}	= Penetration of banking services
d_{2t}	= Availability of banking services
d_{3t}	= Use of banking services
t	= Semester time period
e_t	= Residual value (standar error)

This study uses data in the form of the amount of MSME financing (billions of rupiah) and the dimensions of Financial Inclusion namely d_1 (penetration of banking services) is seen from the number of deposit account (per 1000 adults), the d_2 dimension (availability of banking services) is measured by the availability of the number of bank branches and ATMs per 100.000 adult population, and the d_3 dimension (use of banking services) includes the number of MSMEs financing accounts (per 1000 adults). Therefore, this study produces the following hypotheses:

H₁ = There is a positive and significant relationship between the inclusion level of the penetration dimension of bank services and the distribution of MSME financing at Islamic Commercial Banks.

H₂ = There is a positive and significant relationship between the level of inclusion in the dimensions of the availability of bank services and the distribution of MSME financing at Islamic Commercial Banks.

H₃ = There is a positive and significant relationship between the level of inclusion in the dimensions of using bank services and the distribution of MSME financing at Islamic Commercial Banks.
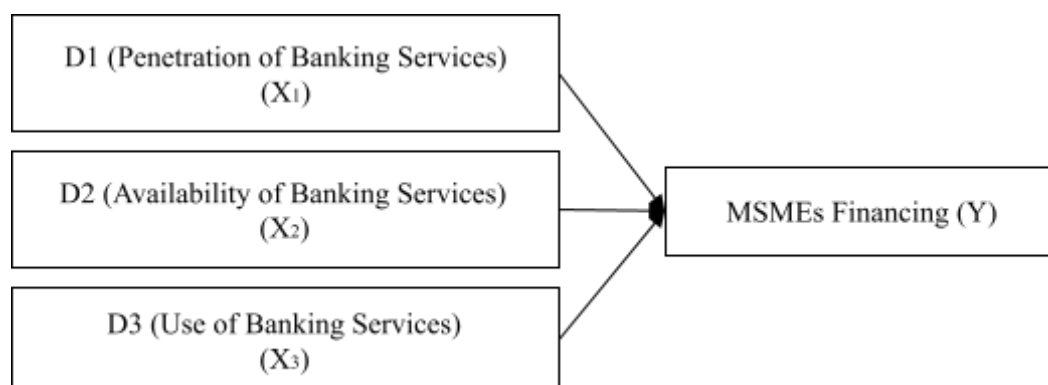

Figure 3. Analysis Model

Results and Discussion

This analysis explains the relationship between the independent variables and the dependent variable. To find out the relationship between variables using the regression model by passing the classic assumption test in the form of a normality test, linearity test, multicollinearity test, heteroscedasticity test, and autocorrelation test. This study will also carry out an economic analysis of the estimation results of the financial inclusion model for MSME financing distribution at Islamic Commercial Banks in Indonesia. The results of model estimation using E-views software version 9 are as follows:

Table 4. Estimation Results of the Financial Inclusion Model in Indonesia.

Dependent Variable: PMK

18 Observasi

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-1.83E+11	1.72E+13	-0.010618	0.9917
D1	1.75E+11	4.13E+10	4.244652	0.0008
D2	1.26E+13	4.51E+12	2.803621	0.0141
D3	-3.72E+11	2.71E+12	-0.137578	0.8925
R-squared	0.659314			
F-statistic	9.031204	Durbin-Watson stat		0.710891
Prob(F-statistic)	0.001402			

Source: The result of data processing by eviews 9

Explanation:
  d_1 = Penetration of banking services
  d_2 = Availability of banking services
  d_3 = Use of banking services

T-statistical test results

1. The probability result on variable d1 (banking penetration) is 0.008 at a significant level $\alpha = 0.05$ indicating $0.008 > 0.05$. Then H_0 is rejected, meaning that there is an influence between banking penetration on MSME financing at Islamic Commercial Banks in Indonesia.
2. The probability results on variable d2 (bank availability) yield a result of 0.0385 at a significant level $\alpha = 0.05$ indicating $0.0385 < 0.5$. Then Ho is rejected, meaning that there is influence between the availability of banks on MSME financing at Islamic Commercial Banks in Indonesia.
3. The probability results on variable d3 (banking use) obtain a result of 0.0842 at a significant level $\alpha = 0.05$ indicating $0.842 < 0.05$. Then Ho is accepted, meaning that there is no influence between the use of banking on MSME financing at Islamic Commercial Banks in Indonesia.

F test results

Based on Table 4, the estimation model yields an F-statistic probability of 0.001402, which means that the probability value is less than 0.05 (significance level). That is, H0 is rejected or H1 is accepted, so it can be concluded that the independent variables in this study simultaneously affect the dependent variable.

Coefficient of Determination

Based on table 4 using the e-views 9 program, an R2 estimate of 0.659314 is obtained indicating that 65.9 percent of MSME financing at Islamic Commercial Banks in Indonesia is influenced by financial inclusion. While the rest is explained by other variables that are not included in the research model.

The Effect of Penetration of Banking Services on MSME Financing in Islamic Commercial Banks in Indonesia

Bank service penetration has a positive influence on the distribution of MSME financing at Islamic Commercial Banks in Indonesia. Banking penetration is the depth of financial services that can influence the public to take advantage of financial services. On the other hand, banking penetration plays a role as a supply side in formal financial intermediaries that determines the amount of deposits (savings, demand deposits and time deposits) and the distribution of financing to the public as users. The large number of deposit accounts will have an impact on increasing the amount of funds that will be collected by banks. Therefore, as an intermediary institution, banks can channel these funds to finance MSMEs.

In fact, the penetration of Islamic banking in Indonesia is still far behind that of other countries. In 2020, the penetration of Islamic banking has only reached 6.51% or below 7%, while the penetration of Islamic banking in Malaysia has reached 30%. This can be caused by a lack of public information about Islamic commercial banks, the less widespread distribution of banks, the financial literacy and inclusion of Islamic commercial banks which are still low when compared to conventional banks and the capital of Islamic commercial banks which is still lacking.

The Effect of Availability of Banking Services on MSME Financing in Islamic Commercial

Banks in Indonesia

The availability of bank services has a positive influence on the distribution of MSME financing at Islamic Commercial Banks in Indonesia. The large availability of bank services as seen from the number of ATMs and bank offices can provide convenience for the public in transactions, one of which is in financing payments. Ownership of ATMs and branch offices is a component of assets owned by Islamic Commercial Banks. Islamic banking assets in Indonesia continue to increase every year. The Financial Services Authority in 2021 noted that BUS are the owners of the most total assets in sharia banking, namely 453.88 trillion rupiah.

On the other hand, in Muslim-majority countries, the number of assets in BUS in Indonesia still lags behind conventional banks, namely 10,112 trillion rupiah. This can be caused by a lack of public understanding of Islamic Commercial Banks in Indonesia. In addition to building branch offices and ATMs, Islamic banks can expand their network or access to the availability of Islamic banking for MSME actors by conducting massive outreach to MSME actors, one of which is related to sharia financing products, increasing collaboration with MSME stakeholders, developing a financial technology system to SMEs and others.

The Effect of Using Banking Services on MSME Financing in Islamic Commercial Banks in Indonesia

The use of bank services has no effect on MSME financing at Islamic Commercial Banks in Indonesia and the relationship has a negative direction. This is not in accordance with the hypothesis that has been made. The occurrence of this can be caused by several factors including:

1. The number of MSME customers in total BUS financing fluctuates from year to year and tends to decrease, so that it will have an impact on decreasing the distribution of financing to MSME as well. In fact, the proportion of total MSME financing customers to total financing customers in general from 2014 – 2021 is only 26%.
2. The bank's prudential attitude in carrying out its role as an intermediary institution. According to the OJK, one of the precautions taken by banks in disbursing financing to MSMEs is based on the ownership of savings and loans owned by MSMEs. This is done by banks to reduce bad financing for MSMEs. Based on OJK Sharia Banking Statistics data, MSME non-performing financing at Islamic Commercial Banks in 2021 has increased by 11.6% compared to 2020.
3. Many MSMEs are still unbankable. Steering Committee of the Indonesia Fintech Society (IFSoc) Hendri Saparini (2021), said that there are still many MSME actors who are unbanked or do not utilize banking products in transactions or financing. Therefore, financial institutions will have more confidence in channeling financing to non-MSMEs. In 2021, out of around 60 million MSMEs in Indonesia, only around
13.4 million MSMEs are considered bankable, while the rest are still considered unable to access bank credit (Rully R Ramli, 2021).

There are reasons why MSME actors do not use financial services in banks (Mekar, 2017), including: 1) the procedure for applying for a loan to a bank takes a lot of time and the process is difficult; 2) access to Islamic banking services is still not widespread in the community, so that not all MSMEs are not easy to reach banks; and 3) It is necessary to have collateral in the form of assets as collateral for the funds lent, while MSME actors are dominated by micro businesses which often do not have more assets.

Conclusion

The results of the study found: 1) Financial inclusion seen from the penetration of bank services (d1) and the availability of bank services (d2) has a positive and significant influence on MSME financing at Islamic Commercial Banks in Indonesia. 2) The use of bank services (d3) has no effect on MSME financing at Islamic Commercial Banks in Indonesia and the direction of the relationship is

negative. The magnitude of the variation in financial inclusion on sharia commercial bank financing is 65.9%. The remaining 34.1% is explained by other variables not included in the study.

Author's Contribution

This research is different from previous research, namely research on financial inclusion in general focuses more on conventional financial inclusion. There is still very little research on Islamic financial inclusion associated with MSMEs. This research data uses the latest data, namely until 2023. The analysis is complemented by phenomena that occur in the field.

Acknowledgements

Thank you to the Lecturer of the Development Economics Study Program who has brought the writer to this point. Thank you to Unisba Development Economics Study Program, always at the fore front of services.

Declaration of Competing Interest

This research was conducted without pressure from any party and was carried out in accordance with scientific principles.

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