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ANALYSIS OF MICROFINANCING IN THE DEVELOPMENT OF MSME CUSTOMERS

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Abstract

The development of micro, small, and medium enterprises (MSMEs) is crucial for contributing to national economic growth. By fostering business development, MSMEs play a significant role in reducing unemployment and increasing employment and business opportunities. In this context, Bank Syariah Indonesia (BSI) serves as an institution that prioritizes community service and economic support. One of the essential functions of Sharia microfinancing is to provide capital to customers, enabling them to enhance existing businesses or establish new ventures. This research aims to investigate the impact of microfinancing on customer development at BSI, specifically examining aspects such as financial stability and business growth. This study employs a qualitative descriptive methodology, utilizing field research that gathers primary and secondary data. Data collection techniques include interviews and document analysis. Findings from this research will provide valuable insights into the effectiveness of Sharia microfinancing in supporting MSMEs and enhancing community economic development.

Keywords: Financing, MSME Development, BSI

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INTRODUCTION

In the context of modern banking, both Islamic and conventional banks play a crucial role in collecting and distributing public funds. However, Islamic banks are distinguished by their adherence to the principles of Islamic Sharia, economic democracy, and the principle of prudence, which form the foundation of their operational guidelines. These principles are designed to ensure fairness, justice, and ethical considerations in all transactions. Islamic banking aims to support national development by promoting justice, equality, and the equitable distribution of wealth, contributing to the overall welfare of society (Rahman & Handayati, 2023).

Conventional banks, like Islamic banks, operate by collecting funds from the public and redistributing them in the form of credit or other financial products. However, the key difference lies in the methods of profit generation and fund distribution. Conventional banks typically offer incentives such as interest (referred to as "flowers" in the Indonesian context) and other benefits to attract public savings (Rahman & Pratikno, 2022). In contrast, Islamic banks operate under Sharia principles, avoiding interest (riba) and ensuring all financial activities are free from elements of uncertainty (*gharar*) and gambling (*maysir*).

The uniqueness of Islamic banking lies in the fact that all transactions are based on specific contracts, which must comply with Islamic law. These contracts, such as *mudarabah* (profit-sharing) and *murabaha* (cost-plus financing), have been standardized and issued by the National Sharia Council of the Indonesian Ulema Council (DSN MUI) to ensure their alignment with Sharia principles (Adiyadnya et al., 2020). In this way, Islamic banks serve not only as financial institutions but also as ethical entities aiming to foster social welfare and economic equity.

Bank Syariah Indonesia (BSI), as a key player in the Islamic banking sector, is tasked with offering a range of Sharia-compliant financial services, including financing and facilitating money circulation. Financing in Islamic banking, commonly referred to as "financing" rather than "credit," is not merely a difference in terminology. It represents a core aspect of Islamic financial services, wherein funds or assets are provided under specific

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contracts that ensure compliance with Sharia principles. These contracts have been endorsed by the DSN MUI, providing a framework for Islamic banks to support the community through ethical financial practices (Aladejebi, 2019).

Moreover, Islamic banks also contribute to economic development by supporting businesses and individuals through ethical financing schemes that align with the values of social justice and welfare. Through these mechanisms, Islamic banks aim to balance profitability with the responsibility of fostering a just and equitable society.

Despite the shared functional role between conventional and Islamic banks, the philosophical underpinnings of Islamic banking distinguish it as a system rooted in justice and ethical considerations. Islamic banking is founded on the principles of justice (*adl*) and balance (*tawazzun*), with the primary objective of achieving public welfare (*maslahah*) through financial practices that avoid harm and promote fairness (Rahman et al., 2023). These principles ensure that Islamic banking does not merely replicate conventional banking models but provides an ethical alternative designed to promote socio-economic justice.

In summary, while Islamic and conventional banks share a common functional role in the economy, Islamic banking is guided by a distinct set of principles rooted in Sharia law. This system seeks to promote not only economic growth but also the ethical distribution of wealth and the welfare of society. Islamic banks, like BSI, serve as critical institutions in advancing these objectives by offering Sharia-compliant financial services that adhere to the ethical standards set by Islamic law.

LITERATURE REVIEW

Microfinance has been a vital tool for providing financial services to individuals, small and medium-sized enterprises (SMEs), and marginalized communities that have historically been excluded from traditional banking services. Since the 1980s, it has offered micro-lending, micro-savings, micro-insurance, and money transfer services to foster economic empowerment and financial inclusion. However, the development of microfinance has seen substantial transformations over the decades, particularly in the integration of technology, regulatory frameworks, and a shift towards self-sustaining financial models.

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Evolution of Microfinance and Its Sustainability

While microfinance initially relied heavily on foreign donor support, it has increasingly evolved toward self-sustainability and commercial financing. This shift is a result of the growing role of domestic savings, social impact investors, and innovative financing platforms like crowdfunding (Ledgerwood, 1999). Recent studies highlight the need to critically analyze this evolution to understand the long-term sustainability of microfinance institutions (MFIs), both in financial and social terms. The balance between financial viability and the original mission of poverty alleviation remains a significant concern for MFIs today (Kusumastuti, 2021).

Challenges in Financial Structures and Risk Management

The literature extensively documents the unique financial structures of MFIs, including the central role played by foreign donors and the institutions' heterogeneous nature in terms of size, location, and legal status (Garcia-Pérez et al., 2018). However, the review does not adequately address how modern MFIs navigate the complexities of these financial structures. More importantly, the risk management strategies employed by MFIs need deeper exploration. Morduch (1999) highlights the importance of risk mitigation strategies, but contemporary studies suggest that the financial and operational risks faced by MFIs have become more diverse. Issues like credit risk, market fluctuations, and operational challenges require more comprehensive analysis and solutions.

Linking Microfinance to Sustainable Development

The concept of sustainability has grown beyond financial sustainability to encompass social and environmental goals, aligning with the United Nations' Sustainable Development Goals (SDGs). The role of MFIs in promoting sustainable development through financial inclusion, gender equality, and reducing poverty has been explored by various scholars. However, the reviewed literature inadequately connects these contributions of microfinance to broader sustainability goals. A deeper examination of how MFIs contribute to long-term social and environmental sustainability would strengthen this review. Specifically, MFIs'

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efforts in achieving a balance between financial, social, environmental, and governance aspects should be more critically assessed (Steffen et al., 2015).

RESEARCH METHOD

In this study, a **descriptive research** method was employed using a **qualitative approach** to explore the dynamics of microfinancing in the development of **Micro, Small, and Medium Enterprises (MSMEs)** at **Bank Syariah Indonesia (BSI)**. Descriptive research helps in systematically portraying a situation or phenomenon as it occurs, offering a detailed understanding of the processes and strategies used in the field. The qualitative approach is particularly suitable as it allows for a rich and nuanced exploration of the practices, perspectives, and experiences of those involved in the microfinancing system.

Primary Data: The primary data was collected through **observations** and **interviews**. The observations were carried out directly at BSI's branches, where the researchers could observe how microfinancing mechanisms are applied and managed in real time. In addition to this, **semi-structured interviews** were conducted with relevant stakeholders, including **MSME owners**, **BSI officers**, and policymakers, to gather their perspectives on the challenges and successes of the microfinancing system. The use of **semi-structured interviews** is beneficial as it provides a flexible framework where interviewees can express their views more freely, yet still aligned with the research objectives. A list of interview guidelines was used to ensure consistency in data collection (Rahman, Mukhlis, et al., 2023).

Secondary Data: Secondary data was gathered from various sources, including **financial reports** of BSI, **regulations** related to microfinancing, **previous research studies**, and relevant literature on MSME development. These data sources helped in providing context and supporting the primary data by offering a broader understanding of how microfinancing strategies align with both national policies and global trends in Islamic finance.

The research focuses on two key areas: a) **Microfinancing in MSME development**, where the study analyzes how microfinancing services are structured and delivered to MSMEs

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by BSI; and b) **Types of MSME development**, where various MSME models and their growth trajectories through BSI support are evaluated.

RESULTS AND DISCUSSION

In this study, financing is primarily viewed through the lens of bank-customer agreements, as defined by Kasmir (2009), with the understanding that financing requires the borrower to repay both the principal and any associated interest within an agreed period (Rahman, 2023). While this explanation covers the basics of financing, it does not thoroughly differentiate between types of financing mechanisms such as micro-financing and traditional bank loans. Thus, this section aims to explore these mechanisms in greater depth and offer more specific insights into their impact on Micro, Small, and Medium Enterprises (MSMEs).

Micro-financing is a critical tool for empowering entrepreneurs, especially those from lower socioeconomic classes who require capital to grow their businesses. According to Kunaifi and Qomariyah (2021), micro-financing is specifically tailored to the needs of small-scale entrepreneurs, where the funds are allocated for working capital and business investments. The purpose of micro-financing is to enhance business growth and foster sustainable economic development among MSMEs. However, while the text discusses micro-financing, it does not delve into the risks and challenges associated with providing these types of loans, especially to repayment schedules and customer default risk.

Financing Mechanisms

Financing, as mentioned in the text, is not just a tool for providing capital but is an integral part of business development. For MSMEs, financing helps improve working capital and opens opportunities for scaling operations. As mentioned, financing is built on three pillars: trust, an agreed-upon time frame, and risk assessment. While these elements are crucial, the text would benefit from a clearer exploration of how these factors interact in real-world scenarios. For example, when a bank provides financing to MSMEs, it faces the risk that the borrower might not repay the loan on time, particularly if the business faces unexpected challenges like market fluctuations or economic downturns. The discussion of

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the risk associated with repayment schedules could be expanded by exploring how the length of time impacts the level of risk the bank assumes. A more in-depth analysis would enhance the understanding of the interaction between financing terms and bank risk management.

Moreover, the focus on MSMEs is crucial as they play a significant role in driving the economy, particularly in Indonesia. The text provides a general description of MSMEs, including their size, scope, and contribution to economic growth. However, it lacks empirical data to substantiate these claims. For instance, it would strengthen the argument if the discussion included statistical data on MSMEs' contributions to GDP, employment, or specific examples of MSME success stories in the region. Providing actual data on MSME performance would align the discussion more closely with established economic literature and offer a more robust basis for analysis.

MSME Development and Challenges

While MSMEs are presented as key drivers of economic growth, the text does not adequately discuss the challenges they face, particularly in the context of financing. MSMEs often struggle with limited access to traditional bank financing due to high collateral requirements, a lack of financial literacy, and a lack of formalized business structures. The text touches on the need for good customer relationships and product quality but overlooks the importance of addressing these structural barriers. A discussion of the role of government policies, microfinance institutions, or non-governmental organizations in addressing these challenges would provide a more comprehensive understanding of how MSMEs can overcome financing barriers.

One key issue that could be expanded is the role of technology and innovation in MSME development. The text mentions that MSMEs should "utilize social media" for promotion and customer relationship management. However, this idea could be further explored by discussing how digital platforms and fintech solutions are revolutionizing access to financing for MSMEs. For example, the rise of crowdfunding platforms, peer-to-peer lending, and other digital financial services have provided new avenues for MSMEs to access the capital they need without relying solely on traditional banking institutions. Integrating

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these modern financing solutions into the discussion would provide a more holistic view of the financing landscape for MSMEs.

Risk Management in Financing

The text briefly mentions that banks take on significant risks when providing financing to customers. However, there is room for a more detailed discussion on how banks manage these risks, especially in the context of micro-financing. Microfinance institutions (MFIs) and banks involved in MSME financing often use various tools to mitigate risk, such as credit scoring, collateral requirements, and loan guarantees. Additionally, Islamic finance mechanisms like profit-sharing (*Mudharabah*) or leasing (*Ijarah*) offer alternative models where risk is shared between the lender and the borrower. Including a discussion of these risk mitigation strategies, particularly in the context of Islamic finance, would deepen the understanding of how banks can provide financing while minimizing default risk.

Another element that could enrich the discussion is the concept of financial inclusion. One of the main purposes of micro-financing is to provide financial services to underserved populations who are typically excluded from the formal financial system. Discussing financial inclusion would provide a broader context for understanding the importance of micro-financing in promoting economic equity and reducing poverty. Additionally, this section could explore how micro-financing contributes to greater financial literacy among MSMEs, enabling them to better manage their businesses and reduce the risk of default.

Profit Sharing and Economic Impact

The text touches on the idea that financing is provided with the expectation of profit-sharing. In Islamic finance, profit-sharing models such as Mudharabah and Musyarakah are used to align the interests of the financier and the entrepreneur. However, the discussion could benefit from a more nuanced explanation of how these models work in practice. For example, Mudharabah involves the financier providing capital while the entrepreneur manages the business, and profits are shared according to a pre-agreed ratio. In the event of a loss, the financier bears the financial loss, while the entrepreneur loses only their time and effort. This risk-sharing mechanism is crucial in promoting fairness and economic justice,

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which are core principles of Islamic finance. A more detailed explanation of these models would provide valuable insight into how profit-sharing can be used to support MSME growth while minimizing risk for both parties.

Furthermore, the economic impact of micro-financing on MSMEs and the broader economy could be explored in greater depth. For example, micro-financing has been shown to have a significant multiplier effect, where increased access to capital leads to greater business productivity, job creation, and overall economic growth. Empirical studies have demonstrated that micro-financing not only benefits the individual business owner but also has positive spillover effects on the community and local economy. Including such evidence would strengthen the argument that micro-financing is a powerful tool for economic development.

In conclusion, the results and discussion presented here offer a broad overview of financing mechanisms and their impact on MSMEs. However, the discussion could be significantly improved by including more empirical data, exploring the challenges faced by MSMEs in greater depth, and incorporating modern technological and financial innovations. Furthermore, a more detailed analysis of risk management strategies and profit-sharing models, particularly in the context of Islamic finance, would provide a richer understanding of the subject matter. By addressing these gaps, the discussion would offer a more comprehensive and nuanced analysis of the role of financing in MSME development and economic growth

CONCLUSION

Financing serves as a crucial contractual arrangement between financial institutions and clients, wherein the institution provides funds that the client is obliged to repay within a specified timeframe. This financing encompasses a variety of options, including interest-bearing loans and micro-financing, aimed at supporting entrepreneurs in their business endeavors. Key elements of the financing process include trust—the assurance that clients will honor their repayment obligations—contractual agreements detailing terms and conditions, and the duration of repayment, all of which impact the risk assumed by banks.

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Micro, small, and medium enterprises (MSMEs) play a vital role in economic development by contributing significantly to Gross Domestic Product (GDP) and job creation. These enterprises have access to a range of financing options, such as working capital, investment funds, multipurpose loans, and Sharia-compliant financing, enabling them to expand and innovate. Financial institutions like BSI are committed to bolstering MSMEs by providing necessary funds and fostering strategic partnerships that promote sustainable growth.

To facilitate the growth of MSMEs, it is essential to nurture strong customer relationships, leverage social media for marketing and communication, enhance product quality, understand market demands, and engage in continuous product and marketing innovation. Overall, providing financial support and assistance to MSMEs is fundamental for driving economic growth and ensuring stability in the broader economy.

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