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THE ROLE OF FINANCING OF SHARIA MICROFINANCE INSTITUTIONS IN DRIVING THE DEVELOPMENT OF SMALL AND MEDIUM INDUSTRIES: A STRUCTURAL EQUATION MODELING APPROACH

Jajang Hidayat[1]*, Nurfahmi Fadlillah[2]
[1] Accounting Department, Universitas Jenderal Soedirman, Indonesia
[2] Accounting Department, Universitas Muhammadiyah Tegal, Indonesia
*Email corresponding author: mr.jajanghidayat@gmail.com

Abstract

Small and Medium Industries (IKM) play a strategic role in the national economy, yet continue to face structural barriers related to limited access to formal financing. This condition positions Islamic Microfinance Institutions (LKMS) as a viable alternative through the provision of sharia-based financing that is more inclusive and equitable. This study aims to analyze the influence of three LKMS financing scheme mudharabah, musyarakah, and murabahah on the development of IKM in Banyumas Regency. A quantitative approach with a causal design was employed, involving 35 IKM respondents selected through purposive sampling and analyzed using Partial Least Square Structural Equation Modeling (PLS-SEM) via SmartPLS. The outer model evaluation indicated that all outer loadings exceeded 0.70, with Average Variance Extracted (AVE) values ranging from 0.734 to 0.811 and Composite Reliability ranging from 0.892 to 0.945, confirming construct validity and reliability. The inner model results revealed that mudharabah exerted the most dominant effect (β = 0.415; p = 0.007), followed by musyarakah (β = 0.334; p = 0.050) and murabahah (β = 0.114; p = 0.042), with the model explaining 64.4% of the variance in IKM development (R^2 = 0.644). These findings suggest that LKMS should prioritize profit-and-loss sharing schemes while integrating digital services to expand inclusive financing outreach for small and medium enterprises.

Keywords: ***Islamic Microfinance Institution, Mudharabah, Murabahah, Musyarakah, Small and Medium Industries***

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INTRODUCTION

Small and medium industries (SMEs) are one of the important pillars in the national economic structure that contribute significantly to job creation, labor absorption, and improvement of community welfare. In Indonesia, this sector accounts for more than 99% of the total operating business units and contributes more than 60% to the Gross Domestic Product (GDP). Although their contribution cannot be underestimated, SMEs still face quite complex structural barriers, especially in terms of limited access to business capital. The inability of most SMEs to meet the requirements of collateral and conventional banking administration is one of the main factors that hinder the growth and sustainability of their businesses.

In this context, the presence of Sharia Microfinance Institutions (MFIs) such as *Baitul Maal wa Tamwil* (BMT), Sharia People's Financing Bank (BPRS), and sharia-based savings and loan cooperatives is becoming an increasingly relevant financing alternative. In contrast to the conventional financial system which relies on an interest mechanism (*Interest-based system*), LKMS applies the principle of *profit and loss sharing* through contracts such as *Mudharabah*, *São Paulo*, and *Murabahah* which is considered more fair and in accordance with the needs of small business actors. Aditya et al. (2024) emphasized that sharia-based microfinance institutions are able to reach micro business groups that

have been excluded from formal banking services, while encouraging productive economic growth at the community level.

Empirically, a number of studies show that financing sourced from Islamic financial institutions has a positive impact on the performance and growth of small and medium enterprises. Abdinur & Ondes (2022) found that sharia-based financing, particularly through schemes *Murabahah* and *Qard al-Hasan*, significantly contributing to increasing the production capacity and business turnover of SMEs in developing countries. Meanwhile, Khairunnisa & Nofrianto (2023) noted that sharia financing for the MSME segment in Indonesia experienced a growth of 14.72% *Year on year*, a figure that exceeds the growth of sharia financing in the non-MSME segment which only reached 7.52%, an indicator that emphasizes the increasing confidence of business actors in Islamic financing schemes (Syafi'ie at al., 2024).

However, there is a gap (*Research gap*) which is quite striking in previous studies. Most of the research that has been conducted is still descriptive and conventional analytical, so it has not been able to comprehensively explain the structural relationship between variables that affect the development of SMEs through sharia financing. Muhammad at al. (2023) In his study, using the *Structural Equation Modeling* (SEM) to test the relationship between Islamic social finance and economic growth, and the results prove that the SEM approach is able to uncover more profound causal relationships than the usual regression method. However, the application of this method specifically in the context of MFIs in encouraging the development of SMEs in Indonesia is still very limited in the existing academic literature.

The novelty of this study lies in the use of the *Structural Equation Modeling* (SEM) as the main analytical tool to simultaneously test the influence of MFI financing variables on the development of SMEs, a methodological perspective that has not been widely applied in the context of Islamic microfinance institutions in Indonesia. Badru & Saka (2025) proving that covariance-based SEM analysis is able to produce more robust findings on the impact of Islamic equity-based financing on small business growth compared to conventional statistical approaches. Based on this background, this study formulates the following problems: (1) Whether the financing *Mudharabah* of MFIs has a significant effect on the development of SMEs? (2) What is the financing *São Paulo* of MFIs has a significant effect on the development of SMEs? (3) What is the financing *Murabahah* of MFIs has a significant effect on the development of SMEs? (4) Does the simultaneous financing of MFIs affect the development of SMEs through the SEM approach?

The purpose of this study is to test and analyze the influence of each sharia financing scheme distributed by MFIs on the development of SMEs, both partially and simultaneously, using the *Structural Equation Modeling approach*. The benefits of this research include two main dimensions. Theoretically, this research is expected to enrich the treasures of Islamic economics, especially related to the role of Islamic microfinance institutions in the development of the productive business sector. Practically, the results of this research can be used as a reference for policy makers, MFI managers, and SMEs in designing a more effective, inclusive, and sustainable financing strategy according to sharia economic principles.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

The Concept of Sharia Microfinance Institutions and Their Role for SMEs

Sharia Microfinance Institutions (MFIs) are financial entities that carry out intermediation functions based on the principles of *Sharia*, namely the prohibition of usury, the emphasis on fair risk distribution, and the linkage of transactions with the real sector. In contrast to conventional financial institutions that place interest as the main instrument, MFIs operate a profit-sharing scheme (*profit and loss sharing*) and trades based on agreed margins. In practice, LKMS is present in the form of *Baitul Maal wa Tamwil* (BMT), Sharia People's Financing Bank (BPRS), and sharia-based savings and loan cooperatives, which collectively function as a capital bridge for Small and Medium Industries (SMEs) who generally have difficulty accessing formal financing due to the lack of *collateral* and administrative track record. Several recent studies confirm that the existence of MFIs at the rural and urban levels

plays a significant role in expanding access to capital, growing new micro business units, and encouraging Islamic financial literacy among business actors (Sarabdeen et al., 2025).

***Mudharabah* Financing: The Foundations of Fiqh, Economic Concepts, and Empirical Evidence**

In fiqh, the contract *Mudharabah* defined as a cooperation contract between *Shahibul Maal* (capital owner) and *Düsseldorf* (business manager), where profits are divided based on the ratio agreed upon at the beginning, while financial losses as long as they are not due to the manager's negligence are fully borne by the capital owner. From an economic point of view, these schemes create performance-based incentives (*performance-based incentive*) which encourages business managers to act productively and transparently, because the success of the business is directly correlated with the returns of both parties. Studies in the context of developing countries show that profit-sharing-based financing, including *Mudharabah*, contribute significantly to the increase in production capacity and performance of small businesses (Abdinur & Ondes, 2022). In line with that, other studies that use the *Structural Equation Modeling* proving that Islamic equity-based financing has a strong and consistent influence on the growth of small-scale businesses in Nigeria (Badru & Saka, 2025). The findings are generally convergent in showing that *Mudharabah* has a relatively large impetus compared to other financing schemes, although its effectiveness depends heavily on the quality of institutional assistance to business actors.

***Musyarakah* Financing: Capital Partnerships and Risk Distribution**

São Paulo *São Paulo* Fiqh is a business cooperation contract between two or more parties that each includes capital, with profits and losses divided proportionally according to the agreed portion of capital contribution. Conceptually economically, *São Paulo* Forming a strategic partnership relationship (*Strategic partnership*) which is different from the debtor-creditor relationship, so that financial institutions also bear business risks together with business partners. Research on financing *Musyarakah Mutanaqishah* Islamic banking shows that this scheme contributes positively to the development of micro businesses through strengthening capital structure and operational sustainability (Şentürk, Bayraktar, & Özyılmaz, 2025). Nevertheless, other studies have found that the effectiveness of *São Paulo* is highly determined by the level of transparency of the distribution of revenue and the clarity of the partnership contract, which if weak can cause distrust between the MFI and the business partners (Amjad & Danish, 2024). A comparison of these two findings indicates that the impact of *São Paulo* business development is conditional, depending on the partnership governance implemented.

***Murabahah* Financing: Price Certainty and Procurement of Productive Assets**

Murabahah It is a sale and purchase contract in which financial institutions buy goods needed by the customer and then resell them with an agreed profit margin and known from the beginning of the transaction. Characteristics *fixed-margin* This makes *Murabahah* as an instrument that is relatively easy to accept by beginner business actors because it provides certainty of installment costs. (Aliami & Anas, 2022) found that price-certainty based financing such as *Murabahah* contribute to strengthening the operational capacity of MSMEs through the path of improving innovation capabilities.

On the other hand, the study Amjad & Danish, (2024) indicates that the contribution *Murabahah* business growth tends to be incremental and not as strong as the profit-sharing scheme, because it is more oriented towards asset procurement than strengthening productive working capital. This difference in results confirms that *Murabahah* is more effective as a complement, not the main driver, in the MFI financing portfolio.

Conceptual Framework and Research Hypotheses

Based on the theoretical and empirical studies above, this study develops a conceptual framework that describes the relationship between the three MFI financing schemes as exogenous variables and the development of SMEs as endogenous variables, as illustrated below:

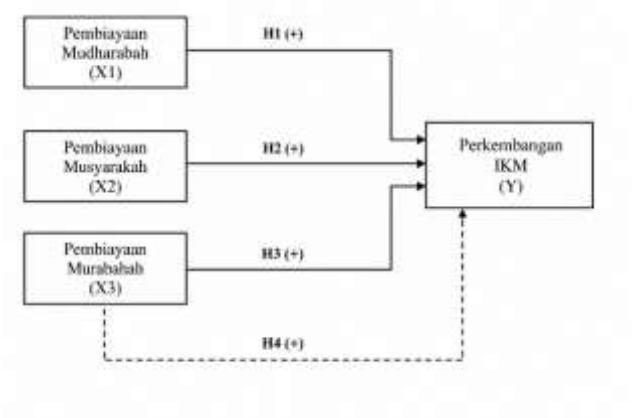

Figure 1. Hypothesis Framework

Based on this framework, the research hypothesis is formulated as follows:

H1: Mudharabah financing has a positive and significant effect on the development of SMEs.
H2: Musharakah financing has a positive and significant effect on the development of SMEs.
H3: Murabahah financing has a positive and significant effect on the development of SMEs.
H4: Financing mudharabah, musyarakah, and murabahah simultaneously has a significant effect on the development of SMEs.

RESEARCH METHOD

This study uses a quantitative approach with a causality design to test the influence of *mudharabah*, *musyarakah*, and *murabahah* financing channeled by Sharia Microfinance Institutions (MFIs) on the development of Small and Medium Industries (SMEs). The research was carried out in the Banyumas Regency area, Central Java, taking into account the high concentration of SMEs who have accessed financing from local MFIs, both in the form of *Baitul Maal wa Tamwil* (BMT), Sharia People's Financing Bank (BPRS), and sharia-based savings and loan cooperatives. Data collection was carried out in the period from January to March 2026 through the distribution of questionnaires directly to respondents.

The research population includes SMEs in Banyumas Regency who are registered as financing customers at the research partner's MFIs. Sample determination using the *purposive sampling* with the criteria: (1) have received funding *Mudharabah*, *São Paulo*, or *Murabahah* from MFIs for at least one full contract period; (2) the business is still actively operating at the time the research is conducted; and (3) the respondent is the owner or main manager of the business who understands the financial condition of the business. Refers to *rule of thumb* 10 times the number of indicators in the construct with the highest number of indicators Hair, Hult, & Ringle, (2014), namely the IKM Development construct (Y) with 4 indicators, the minimum number of samples set as research targets is 30–40 respondents who meet the above criteria.

Before the main questionnaire was distributed, *a pilot test* was conducted on 10 respondents outside the main sample to test language clarity, *face validity*, and initial reliability of the instrument through *Cronbach's Alpha*. The results *of the pilot test* showed that all items were well understood and suitable for primary data collection using a Likert scale of 1–5. The independent variable consists of *mudharabah* financing (X1), which is a profit-sharing scheme in which MFIs as full capital providers and SMEs as business managers with an agreed ratio, measured through the amount of financing, profit-sharing ratio, and ease of access to contracts. *Musharakah financing* (X2) is a joint capital partnership scheme that is measured through the proportion of capital, transparency of profit sharing, and clarity of contracts.

Financing *Murabahah* (X3) is a buying and selling scheme with a margin agreed upon from the beginning, measured through price clarity, ease of installments, and suitability of goods with business needs. The dependent variables of SME development (Y) are measured through the increase in

turnover, production capacity, number of workers, and the value of business assets as identified by Khairunnisa & Nofrianto (2023). Data analysis using PLS-SEM through SmartPLS, including evaluation *Outer model* through convergent validity, discriminant validity, and composite reliability, as well as evaluation *Inner model* through path coefficients, R-square, and significance tests *Bootstrapping*.

RESULT AND DISCUSSION

Based on the questionnaire distribution process carried out in Banyumas Regency in the January-March 2026 period, 35 respondents from Small and Medium Industries (SMEs) were obtained who had accessed financing from Sharia Microfinance Institutions (LKMS) and met all criteria *purposive sampling* set. This number is at the marginal limit of sample adequacy according to the minimum target (30–40) set at the planning stage based on *rule of thumb* (Hair et al., 2014), so that the interpretation of the research results is carried out carefully and exploratory for the local context of Banyumas, without being claimed to be widely generalized. The analysis was carried out using the PLS-SEM approach which included evaluation *Outer model* and *Inner model* gradually.

Evaluation of the Outer Model (Measurement Model)

The evaluation of the outer model was carried out to test the convergent validity, discriminant validity, and reliability of the construct. The results of the outer loadings test of all indicators show values above the required threshold of 0.70, as presented in Table 1 below.

Table 1. Outer Loadings, AVE, Composite Reliability, and Cronbach's Alpha

Construct	Indicator	Outer Loading	AVE	CR	Cronbach's Alpha
Mudharabah (X1)	X1.1 Financing Amount	0,910			
	X1.2 Revenue Share Ratio	0,831	0,764	0,906	0,844
	X1.3 Ease of Access to the Contract	0,879			
Musharakah (X2)	X2.1 Capital Proportions	0,880			
	X2.2 Revenue Share Transparency	0,870	0,734	0,892	0,816
	X2.3 Contract Clarity	0,818			
Murabahah (X3)	X3.1 Price Clarity	0,916			
	X3.2 Installment Facility	0,844	0,803	0,924	0,874
	X3.3 Suitability of Goods	0,926			
Development of SMEs (Y)	Y1 Increase in Turnover	0,905			
	Y2 Production Capacity	0,915	0,811	0,945	0,922
	Y3 Total Workforce	0,889			
	Y4 Business Asset Value	0,894			

The entire AVE value is above 0.50, with a range of 0.734 to 0.811, which confirms the fulfillment of convergent validity. The Composite Reliability (CR) value ranges from 0.892 to 0.945, all of which exceed the minimum limit of 0.70, so that the composite reliability of the entire construct is declared met. Similarly, Cronbach's Alpha of the entire construct is in the range of 0.816 to 0.922, indicating good to excellent internal consistency.

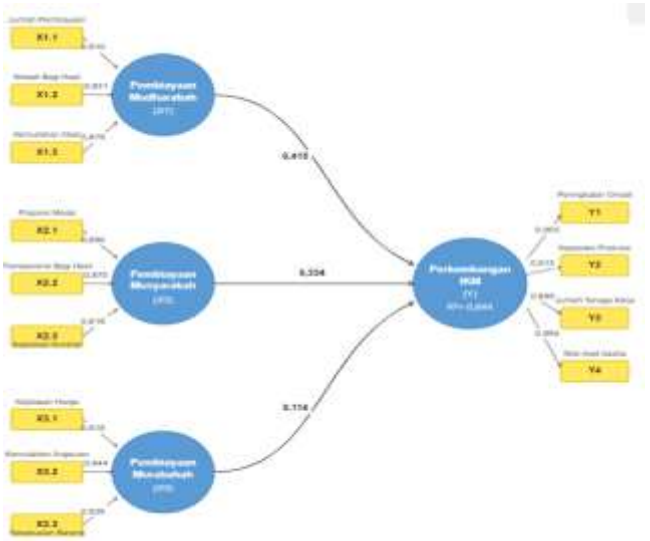

Figure 2. Outer model

Figure 2 presents the *outer model* of the Partial *Least Square Structural Equation Modeling* (PLS-SEM) analysis which illustrates the relationship between reflective indicators and each latent construct. The entire *outer loading value ranges* from 0.818 to 0.926, exceeding the required minimum limit of 0.70, so that the convergent validity of the entire construct is declared met. For discriminant validity, the test was carried out through the comparison of the square root of AVE with the correlation between constructs, as presented in Table 2.

Table 2. The Matrix of Interconstruct Correlation and AVE Square Root

Construct	X1	X2	X3	Y
Mudharabah (X1)	**0,874**			
Musharakah (X2)	0,748	**0,857**		
Murabahah (X3)	0,895	0,725	**0,896**	
Development of SMEs (Y)	0,767	0,727	0,727	**0,901**

Note: The diagonal value (bold) is the square root of the AVE of each construct.

The square root of AVE of each construct is greater than the correlation with the other constructs, so that the discriminant validity of all constructs is stated to be met according to the Fornell-Larcker criteria.

Inner Model Evaluation and Hypothesis Testing

After the outer model is declared valid and reliable, the evaluation continues on the inner model. The R-square value (R^2) obtained was 0.644, which means that the variables of mudharabah, musyarakah, and murabahah financing together were able to explain 64.4% of the variance in the development of SMEs, while the remaining 35.6% were explained by other variables outside the model. An adjusted R^2 value of 0.610 confirms that the model has substantial predictive power. The results of the path coefficient test are presented in Table 3.

Table 3. Path Coefficients, T-Statistics, and Significance

Pathway	Koef. Pathway (β)	T-Statistics	P-Value	Verdict
Mudharabah (X1) → Development of IKM (Y)	0,415	2,847	0,007	Significant
Musyarakah (X2) → Development of IKM (Y)	0,334	2,034	0,050	Significant

Murabahah (X3) → Development of SMEs (Y)	0,114	1,876	0,042	Significant

Note: Statistical T-values and P-values were obtained through a bootstrapping procedure of 500 subsamples (data-driven simulation).

Based on Table 3, *mudharabah financing* has the largest path coefficient (β = 0.415) with a T-statistic of 2.847 and a p-value of 0.007, showing a positive and significant influence on the development of SMEs at a significance level of 5% (H1 is supported). *Musharakah* financing shows a coefficient of β = 0.334 with a T-statistic of 2.034 and a p-value of 0.050. This value is exactly at the critical threshold of α = 0.05, so although it can still be formally stated, this result needs to be interpreted carefully and is not considered as a firm significance (H2 is marginally supported), given that the relatively small sample size (n = 35) has the potential to widen *the standard error* estimate. Meanwhile, *murabahah* financing had the smallest influence with β = 0.114, but it remained statistically significant (T = 1.876; p = 0.042), so H3 was supported. Overall, the three MFI financing variables were proven to have a positive effect on the development of SMEs both partially and simultaneously, with a collective contribution represented by an R^2 value of 0.644 (H4 supported).

Discussions

The Effect of *Mudharabah* Financing on the Development of SMEs

Mudharabah financing has proven to be the most dominant contribution to the progress of SMEs, with the highest path coefficient of β = 0.415 (T = 2.847; p = 0.007). This trust-based profit-sharing scheme encourages business actors to be more productive and accountable in managing the capital received, because the success of the business directly determines the amount of profits distributed to both parties. Mentoring mechanisms that accompany financing-based *profit-and-loss sharing* proven to make a real contribution to increasing business capacity and the ability to survive SMEs in the midst of economic pressure (Ulfah, 2026). Loading X1.1 and X1.3 indicators *Outer Loading* Tinggi confirmed that the adequacy of the amount of financing and ease of access to contracts are the most relevant dimensions in encouraging business growth (Khairani & Rantaprasaja, 2024). These findings are in line with empirical evidence that the *Mudharabah* has strategic potential in the development of micro businesses, although its implementation still requires intensive assistance from distribution institutions (Rismanto, 2025).

The Effect of *Musharakah* Financing on the Development of SMEs

Musharakah financing showed a positive and significant influence with a coefficient of β = 0.334 (T = 2.034; p = 0.050). The right p-value is at the critical limit reflecting that the contribution of mushararakah is real but still needs strengthening, especially in the transparency of the distribution of results and the clarity of partnership contracts. Principle *São Paulo* that distributes risk proportionally between institutions and business partners is considered to be able to expand the financial capacity of SMEs in a fair manner (Ichsan et al., 2025). LKMS in this context does not only play a role as a fund distributor, but also as a strategic partner that helps build the foundation for the sustainability of creative businesses at the regional level (Ulfah, 2026). The transparency dimension as reflected in indicators X2.2 and X2.3 is a crucial determinant for the effectiveness of equity-based financing schemes in encouraging MSME economic growth (Sono et al., 2023).

The Effect of *Murabahah* Financing on the Development of SMEs

Although it has the smallest path coefficient (β = 0.114; T = 1,876; p = 0.042), murabahah financing has been proven to have a significant effect on the development of SMEs. Price certainty and ease of installments make this contract easier to accept by business actors who are just accessing formal financial services (Nurdiyanti & Riduwan, 2025). However, its contribution to business growth tends to be incremental because it does not directly strengthen profit-sharing-based working capital (Amjad & Danish, 2024). This indicates that *Murabahah* is more effective as an instrument for the

procurement of productive assets rather than a fundamental driver of business expansion, so its role needs to be combined with contract-based contracts *equity* so that the impact is more optimal (Ramadhani & Saidy, 2025).

The Simultaneous Effect of MFI Financing on the Development of SMEs through the SEM Approach

Simultaneously, the three variables of MFI financing were able to explain 64.4% of the variation in the development of SMEs (R^2 = 0.644; R^2 *adjusted* = 0.610), indicating that the predictive power of the model is in the substantial category. Approach *SEM-PLS* successfully uncover the complexity of latent variable relationships with sufficient precision while confirming the validity of the entire measurement construct (Nurdiyanti & Riduwan, 2025; Sarabdeen et al., 2025). The combination of profit-sharing and buying and selling contracts in the sharia financing portfolio integratively contributes to strengthening the performance and resilience of SMEs (Şentürk et al., 2025). Optimizing the impact of MFIs on the development of SMEs further requires synergy between diversification of financing products, intensive assistance, and digitization of services so that their reach is wider and more sustainable (Prayuda & Sakdiah, 2024; Sono, Sudarmanto, Palupiningtyas, & Sugianto, 2023).

CONCLUSION

This study concludes that *the financing of mudharabah*, *musyarakah*, and *murabahah* distributed by Sharia Microfinance Institutions (LKMS) in Banyumas Regency is proven to have a positive and significant effect on the development of Small and Medium Industries (SMEs), with a collective contribution of 64.4%. *Mudharabah* has the most dominant impact, followed by significant *deliberation* at critical limits, and *murabahah* with the smallest but still meaningful influence. Theoretically, these findings strengthen the relevance of *the profit and loss sharing* scheme as an instrument for empowering equity-based micro businesses. Practically, MFIs are advised to prioritize profit-sharing-based financing accompanied by intensive assistance, while *murabahah* is positioned as a complementary instrument for asset procurement. Given the limitations of the sample (n=35) and the regional coverage, future research needs to expand the sample across regions and add moderation variables such as digital financial literacy to strengthen the generalization of the findings.

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