

ISLAMIC BANK FINANCING AND IT'S IMPACT ON SMALL MEDIUM ENTERPRISE'S PERFORMANCE

Faisol

Nusantara University of PGRI Kediri East Java Indonesia
faisol@unpkediri.ac.id

Abstract.

The purpose of this paper is to examine the influence of Islamic bank's financing toward the business performance. Besides that, this paper is going to analyze how far the influence of Islamic bank financing toward Small Medium Enterprises (SME's) welfare. This research is using partial least square analysis. The population of this research is all of the small medium enterprises especially farmers and industries in the District of Kediri who got Islamic bank financing for one year. The results showed that the Islamic bank financing has significant influence with a positive direction on the SMEs's performances. This means that when the Islamic bank financing improved, will improve the SMEs's performance. Further Islamic bank financing has a significant effect with positive direction towards the SMEs's Welfare.

Keywords: Islamic Bank Financing, business performance, welfare, small and medium enterprises

Abstrak.

Tujuan dari penelitian ini ialah untuk menguji pengaruh pembiayaan bank syariah terhadap kinerja bisnis. Selain itu, penelitian ini bertujuan pula untuk menganalisis seberapa jauh pengaruh pembiayaan bank syariah terhadap kesejahteraan sektor usaha kecil dan menengah (UKM). Penelitian ini menggunakan teknik analisis partial least square. Populasi yang digunakan dalam penelitian ini adalah usaha kecil dan menengah di Kabupaten Kediri yang mendapatkan pembiayaan bank syariah selama satu tahun. Hasil menunjukkan bahwa pembiayaan bank syariah memiliki pengaruh yang positif terhadap kinerja UKM. Hal ini menunjukkan bahwa jika pembiayaan bank syariah meningkat, maka kinerja dari sektor UKM akan meningkat pula. Lebih lanjut, hal ini menunjukkan bahwa pembiayaan bank syariah memiliki pengaruh signifikan terhadap kesejahteraan dari sektor UKM.

Kata Kunci: pembiayaan bank syariah, kinerja usaha, kesejahteraan, usaha kecil dan menengah

Received: December 4, 2016; Revised: February 10, 2017; Approved: March 10, 2017

INTRODUCTION

Small and medium sized enterprises (SME's) have been billed as the engine of social economic growth and poverty reduction through the creation of employment opportunities and generation of income particularly in developing countries. Statistics indicate that formal SMEs contribute up to 45% of total employment and up to 33% of national income (gross domestic product) in emerging economies and 51% in high-income countries respectively. In the face of growing demands for social services, the dwindling tax revenue sources and the bulging levels of public debt that undermine governments' capacity to meet its social obligations, SMEs, if well facilitated, could help ease these burdens. Although the sector has remained significantly underfunded, banks are increasingly looking at developing products and services to cater to these businesses. Additionally, the SME's preference for Shariah compliant banking services has also opened up significant opportunities for banks to invest in this segment. Islamic finance has tremendous potential to serve as a tool for financial inclusion through leveraging the entrepreneurial potential of micro, small and medium enterprises (MSMEs) across sectors and bringing the financially underserved into the economic mainstream is not in doubt, as evidenced in policy reports by the World Bank and the Islamic Development Bank. The G20's long-term commitment to financial inclusion of SMEs is demonstrated by the G20 principles for innovative financial inclusion issued in 2015.

The presence of Islamic banks in the banking industry is expected to contribute in the real sector in fact it is the primary duty of Islamic banks. Banking activities in the real sector, among others, is to channel financing to scores of business. In terms of financing, Islamic banks differ from conventional banks. Activity in the finance portfolio will increase the venture capital sector. Islamic banking in its efforts to boost the real sector can be seen in the data published by Indonesia Bank through Islamic Banking Statistics data published every month. Financing provided by Islamic Bank based types of transaction as shown in Table 1. The data shows the composition of funding channeled Syaria Banks and Sharia Business Unit between the years 2007-2014.

Based on data in Table 1 shows the composition of funding channeled by Islamic Banks and Sharia Business Unit between the years 2007- 2014, in which the distribution of funding with murabahah shows the highest number compared with other financing. This indicates that Islamic Bank in financing distribution is more directed at low-risk financing

are Murabahah, and the next stage leads also on financing of musyarakah because there is a sharing of risk and return to the customer.

Basically SMEs have always faced different kinds of main difficulties were related to capital, management skills, mastery of technology, the availability of raw materials, marketing, skill, and labor wage. Among these problems, the most frequently encountered are the limitations of capital or financing, marketing difficulties followed as the second major problem, and the problem of raw material shortages.

Table 1. Financing Composition of Islamic Commercial Bank and Islamic Business Unit (Billion IDR)

Akad	2010	2011	2012	2013	2014
Mudharaba	8.631	10.229	12.023	13.625	14.354
Musharaka	14.624	18.960	27.667	39.874	49.387
Murabaha	37.508	56.365	88.004	110.565	117.371
Salam	0	0	0	0	0
Istishna	347	326	376	582	633
Ijara	2.341	3.839	7.345	10.481	11.620
Qardh	4.731	12.937	12.090	8.995	5.965
Others	0	0	0	0	0
Total	68.181	102.655	147.505	184.122	199.330

Source: Islamic Bank Statistics, Bank of Indonesia, 2015

Around 50% of the total micro, small, and medium enterprises (SMEs) are lack of capital. According to the survey 50 percent of their main problems is the shortage of venture capital, and then mentioned the difficulty in marketing at 24%, lack of expertise 7%, and other factors, which reached 19%. The SME's sector contributes to the national economy because it is able to absorb 107 million workers, or about 97.2% of the total workforce in Indonesia. The contribution of SMEs to absorb the labor force is much larger than the big business sector around 2.8 percent. SMEs is in dire need of financing in the framework of development efforts, but still hard to get easy access to the formal financial institutions, including the Islamic Bank, so it is not uncommon their financing needs financed by creditor.

Ulama Council of Indonesia also stated that many Muslim businessmen is located on the bottom layer. Moslem businessmen rarely can reach intermediate layer especially in the upper layers. Therefore, the increase of Islamic bank financing needs to be done not only for moslem SMEs but also non-moslems in the sense that SME financing is really rahmatan lil 'alamin, so it applies to all SMEs, both Muslims and non-Muslims. Thus the existence of Islamic banks, in particular related to its ability to finance, should be done in the spirit of mutual help, this principle is clearly stated in the Qur'an that "but help ye one

another unto righteousness and pious duty. Help not one another unto sin and transgression, but keep your duty to Allah. Lo! Allah is severe in punishment” (Qur’an, al Maidah: 2).

Poverty in rural areas is crucial problem that cannot be delayed in its overcoming and should be a top priority of economic development and social welfare. Therefore, Kediri regency had made development based on agriculture, especially in agribusiness. In efforts to develop agro-industry or agribusiness that is still the key problems about the lack of capital, in addition to technology and marketing.

The motivations of this study are: *First*, problems of capital in agriculture need to be examined as to how the role of Islamic bank financing in agriculture. Islamic bank financing with profit loss sharing system is an appropriate financing to be distributed on the agribusiness, which is full of a risk business (Sutawi, 2008). But in reality the data Islamic Bank in the District of Kediri shows the distribution of funding for the agricultural sector ranged from 6.5% of the total financing distributed. This shows the commitment of Islamic banks to the agriculture sector, as a leading sector in the district of Kediri including agribusiness SMEs is still very low.

The increase of Islamic Bank Financing is expected to improve business performance as stated by Gronroos (1990) that the stronger the relationship between small businesses and the bank then will make the better performance. In addition to improving business performance, Islamic bank financings are expected to take effect in improving the SME’s well being. So, after getting Islamic bank financing, it is expected venture capital or infrastructure of agribusiness SMEs are fulfilled in facilities, so they can improve performance in performing activities of production to marketing its products in order to achieve growth in assets and profitability.

Agribusiness is a business in which agriculture can also be judged performance, which included assets, income, sales and prices. Based on the data of the main problems of SMEs, hence their lack of capital will reduce the ability of agribusiness in providing raw materials, and this will have an impact on the lack of creative ability or in product innovation. Therefore, it is needed the fulfillment of financing capital including Islamic bank. If SMEs are still experiencing problems such as raw materials, marketing, capital and the other then its business performance will decline. This is due to businesses that lack of capital. Lack of capital will had an impact to difficulty in providing raw material,

innovation, etc. So that sales, profits and assets of the business as an indicator of business performance will also decrease.

The second motivation is the level of agribusiness SME's welfare as the welfare conditions had been experienced by farmers and other small businesses in general relatively low both in terms of material and spiritual. This happens in most small agribusiness entrepreneurs in rural areas, they are generally difficult to maintain the sustainability of its business, due to the difficulty in obtaining capital. So, the fulfillment of venture capital is one of the solutions that are needed by agribusiness SME's in order to achieve their welfare.

Islamic economics looked at not only from the world alone, but prosperity is based Maqashid Sharia includes the first *ad-Din* (faith) shown its ability in running the instructions of Islamic religion, which is measured from the zakah, infaq, and shadaqah issued by SME's agribusiness financed Islamic banks. The second is *an-nafs* (life), which is the working conditions indicated on the ability in keeping the soul in this case measured from the cost of food shopping nutritious capable issued by SME agribusiness financed by Islamic bank. The third element of maqashid sharia is *al-aql*, which is the well-being shown from the ability in maintaining reasonable measured of expenditure in increasing skill in the field of business. The fourth is *an-nasl*, which is wellbeing presented from the ability in keeping the offspring measured from the expenditure to improve the quality of life of children (school, course, investment land, rice fields). The final element is *al-maal* (wealth), which is welfare indicated the amount of income received from agribusiness SMEs receiving financing Islamic banks.

This study is also the replication of the study conducted by Herianingrum (2014). In her study used a sample of 70 employers of *tijarah zira'ah* with quantitative and qualitative approaches. The results showed that the Islamic bank financing has an influence on the performance *tijarah zira'ah* businessman. Besides that, the Islamic bank financing has a significant influence on the welfare. The difference in this study with previous research is years observed in this study took years 2013-2015, with a total sample of 71 SMEs in the District / City of Kediri.

Based on the above phenomenon, namely the impact of the distribution of Islamic bank financing to performance in the form of profits, business assets and also for the SME's welfare, so the purpose of this study was to analyze the influence of Islamic bank financing to the SME's performance. Besides that, this paper also going to examine

the influence of Islamic bank financing influence on the SME's welfare. This paper finally is going to analysis the influence of the SME's performance effect on their welfare.

METHOD

The population of this research is all SMEs in the district/city Kediri who got the financing from Islamic banks. The sample of this research is consisting of 240 entrepreneurs. The place of Kediri has been chosen because there is a high potential in the small business agribusiness, but it still needs to be done to explore the potential of these improvements.

The Partial Least Square (PLS) was used to determine the effect of exogenous variables to variable endogen. Partial least squares models that can be analyzed and presented in order to provide a representative result, then the model must be tested first with inner and outer models. Model latent variables and indicators in this study are described as follows:

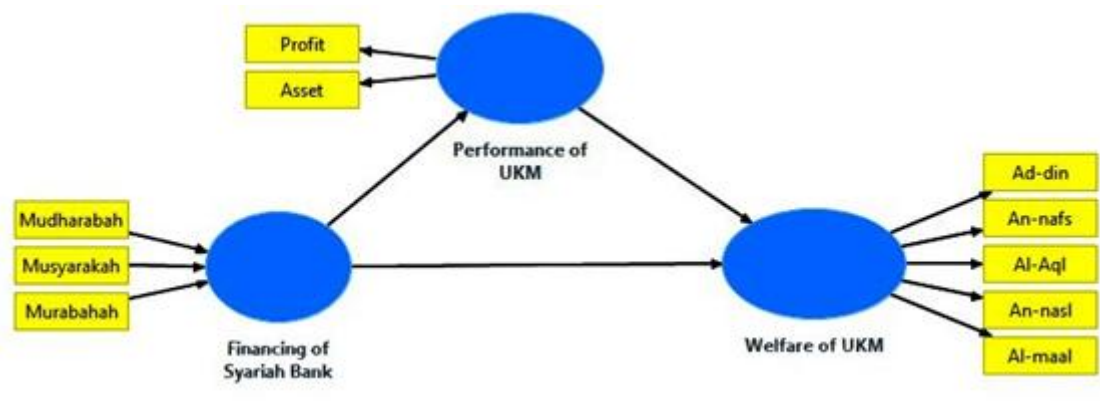


Figure 1. Research Model

Based on figure 1, it can be described that Islamic bank financing will influence to SME's performance and welfare. The model used in this study consistent with the previous research. The Islamic bank financing with profit and loss sharing is as a suitable financing for SME's business. Sutawi, (2008), Manzilati (2015), Siddiqui, (2006).

RESULT AND DISCUSSION

In this research used the analysis of inner model and outer model. Inner model is the specification of relation between latent variables while the outer model is the specification of the relation between latent variable with indicators. In this step, described about validity of test results on variables. The validity test used outer weight because the

variable is formed formatively, that is by comparing the value of the t statistic with t table of each indicator. Based on the results can be explained that the outer weight indicator X_{11} , X_{12} , and X_{13} is significant. As shown in Table 2 below:

Table 2. Result of Outer Weight form Bootstrapping

No	Indicators	Original Sample	Sample Mean (M)	Standard Error	t-statistic	P Values
1.	Mudharaba	0,402	0,410	0,037	10,951	0,000
2.	Musyaraka	0,308	0,306	0,035	8,699	0,000
3.	Musyaraka	0,383	0,377	0,048	7,989	0,000

Resource: Smart PLS 3 Result

The test result of confirmatory factor indicates that each indicator has a value of loading factor of greater than 0.5. This means that all indicators of the variable are declared valid to be an indicator of the endogenous variables SME's performance. The test result of confirmatory factor is described in Figure 2.

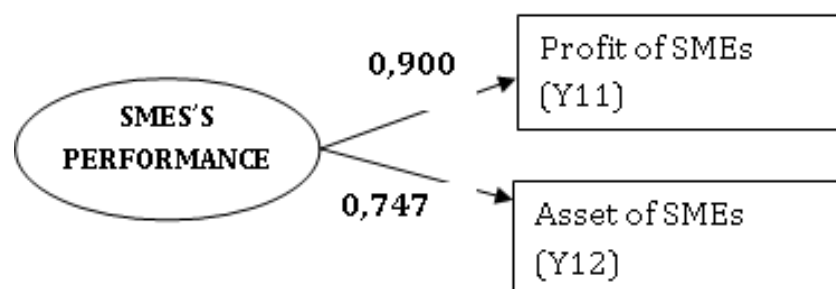


Figure 2. Result of Loading Factor on variables SMEs performance

The test results of confirmatory factor indicate that each indicator has a value of loading factor of greater than 0.5. This means that all indicators are considered valid to be an indicator of welfare variables of SME's. The results can be seen in the Figure 3.

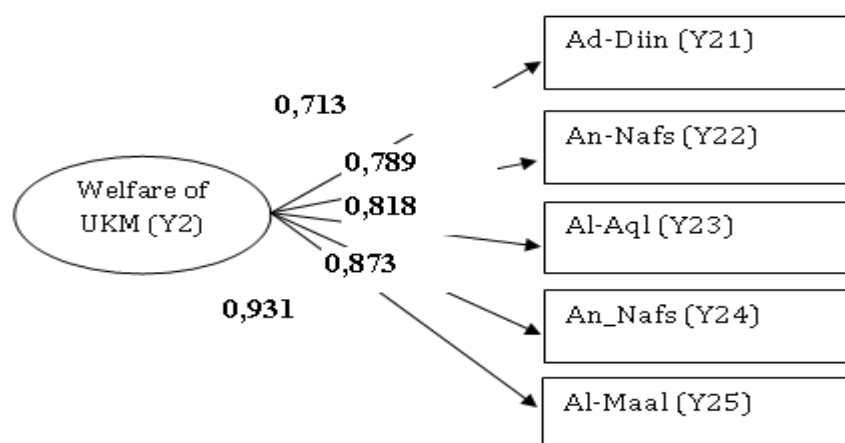


Figure 3. Result of loading factor on welfare of SMEs

The reliability test is to examine the composite reliability for each construct. The result is shown in Table 3. Based on the Table 3, that all of constructs have a composite reliability values greater than 0.60. These illustrate that the Islamic bank's financing, the business performance of SMEs and the SMEs welfare have a good reliability.

Table 3. Result of Composite Reliability Test

No.	Variable	Composite Reliability
1	Islamic bank's financing	0,941
2	Performance of UKM	0,811
3	Welfare of UKM	0,916

To view the discriminant validity is to see the value of Average Variance Extracted (AVE). Based on the discriminant validity test results showed all of variables have good discriminant validity (above 0.5). Results can be seen in the Table 4.

Table 4. Result of Average Variance Extracted (AVE) Test

No.	Variable	Average Variance Extracted
1	Financing Syariah Bank	0,841
2	Performance of UKM	0,684
3	Welfare of UKM	0,686

The results indicate that a significant difference between the positive trending variable of Islamic bank financing, SMEs' performance and SMEs' welfare. The first result shows that Islamic bank financing has significant influence towards SME's welfare. Besides that, the Islamic bank financing has a significant effect towards prosperity. SME's Performance has positive significant effect on welfare.

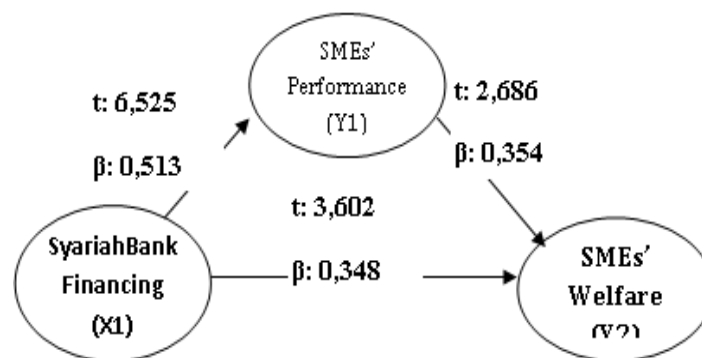


Figure 4. Result of Partial Least Square Test

Results of testing the path coefficients are shown in Table 5 indicate that the variable of Islamic bank financing has significant influence with a positive direction on the SMEs' performance with coefficient parameters of 0,513 and the statistical value of 6,525 t (t statistic > 1,960). The Islamic bank financing had a significant effect on the welfare with

coefficient of 0,354. The SME's performance has significant influence towards prosperity with coefficient of 0.348.

Table 5. Result of Path Coefficients

Variables	Coefficients path	Sample Mean (M)	Standard Error	t Statistic	p values
Islamic bank financing > SMEs' performance	0,513	0,519	0,079	6,525	0,000
Islamic bank financing > SMEs' Welfare	0,354	0,362	0,098	3,602	0,000
SME's performance > SME's Welfare	0,348	0,362	0,130	2,686	0,007

Based on the results of calculations PLS show that the Islamic bank financing has significant influence toward the SMEs' performance with a positive direction. This means that the better condition of Islamic bank financing, the better the SME's performance. In other words, if the Islamic bank financing were given to SME's to be improved both in quality and quantity, it will be increased on the SME's performance. This means that by getting the Islamic bank financing will enhance the SMEs' ability to provide capital or means of business, thus increasing productivity and increased sales revenue and profit increases so achieved performance increases. This results in line with the previous research (Manzilati, 2015) stated that profit and loss sharing system has been encouraged the small and medium enterprise to be more sustainable by reducing internal principal agents problems.

This means that the better the Islamic bank financing, the better the well being of SMEs will be. In other words, if the Islamic bank financing is granted to SMEs increased both the quality and quantity will be able to improve the SME's welfare. Basically funding channelled to SMEs will affect the business conduct of SMEs, namely the existence of sufficient working capital will provide peace, tranquillity in the business, so that the creativity of the business increases, business expansion and opportunities owned businesses also increased. This finding in line with (Manzilati, 2015) that stated the Islamic bank financing should be given premier attention by the respective bodies and agencies as current practices seldom offer this mode to businesses particularly smaller enterprises.

The study found favourable finding in support of moslem scholar's view that this particular funding method is able to meet the true spirit of equitable distribution of income and wealth, hence materialising the goals of the shariah (maqashid al-shariah) in the

economy. In addition, they viewed that a balanced proportion of equity and debt in a firm's financial structure would be able to yield a handsome return as the mode promotes participation and hard work while at the same time motivates business expansion and growth. The study also supported the previous studies done by Siddiqui (2007), Abozaid and Dusuki (2007), Manzilati (2015), Siddiqui (2006).

There are several factors that determined the Islamic bank financing. Wahyudi (2016) found that only deposit funds that had an impact on financing in Islamic business unit. Ali and Miftahurrohman (2016) found that third party funds, return on asset, inflation, GDP, capital adequacy ratio and credit interest rate had an impact on financing in the Indonesian Islamic banking industry. Husaeni (2017) said that third party funds, capital adequacy ratio, and financing to deposit ratio had significant effect on financing in Islamic rural banks.

Another strategy to accelerate the Islamic banking growth is through spin-off. Although Al Arif (2015a) found that spin-off policy doesn't had an impact on financing growth in Islamic banking. Al Arif (2015b) also found that the spin-off policy had an effect to operational efficiency. Rusydiana (2016) said that there are several strategies to resolve the problems of Islamic banking industry in Indonesia. First, strengthen the capital, business scale, and efficiency. Second, improve the quantity and quality of human resource. Third, improve the structure funds and harmonization of regulation.

CONCLUSION

The results proved that if the Islamic bank financing granted to SME's would improve its performance. Islamic Bank Financing has significant effect on the welfare. It proved that increased funding channeled to the SME's increasing prosperity of SMEs. SME's performance has significant effect on welfare with a positive direction. Improved performance be represented with asset and profit, will make easier for SMEs to reach the better welfare. The suggestion is governments have to proactively develop progressive policies and create an enabling environment that supports the growth of SMEs by expanding innovative sources of funding such as Islamic finance. Appropriate policies and resources have to be deliberately focused on developing human capital, the enforcement of contracts, tax laws, research and quality data generation and management. Well-facilitated SMEs can transform into corporate entities of repute that help address some of the

inefficiencies experienced by governments of developing countries in executing their mandates in the provision of social services.

REFERENCES

- Abozaid, A & A.W.Dusuki. (2007). The Challenges of Realising Maqasid al-Shari'ah in Islamic banking and Finance. *Proceeding Paper presented at IIUM International Conference on Islamic Banking and Finance*, IIUM Institute of Islamic Banking and Finance, 23-25 April, Kuala Lumpur.
- Al Arif, M.N.R. (2015a). The Effect of Spin-off Policy on Financing Growth in Indonesian Islamic Banking Industry. *Al-Ulum*. Vo. 15 (1): 173-184.
- Al Arif, M.N.R. (2015b). Keterkaitan Kebijakan Pemisahan Terhadap Tingkat Efisiensi Pada Industri Perbankan Syariah di Indonesia (The Relationship Between Spin-off Policy and Efficiency in The Indonesian Islamic Banking Industry). *Jurnal Keuangan dan Perbankan*. Vol. 19 (2): 295-304.
- Ali, H. & Miftahurrohman. (2016). Determinan yang Mempengaruhi Pembiayaan Murabahah Pada Perbankan Syariah di Indonesia (Determinants of Murabahah Financing in The Indonesian Islamic Banking Industry). *Esensi Jurnal Bisnis dan Manajemen*. Vol. 6 (1): 31-44.
- Gronroos, C. (1990). Relationship Marketing Logic. *Asia Australia Marketing Journal*. Vol. 4 (1): 7-19.
- Herianingrum, S. (2014). Pengaruh Pembiayaan Bank Syariah terhadap Kinerja Usaha dan Kesejahteraan Pengusaha Kecil Tijarah Zira'ah di Jawa Timur (The Impact of Islamic Bank Financing to Business Performace and Welfare of Tijarah Zira'ah Businessman in East Java). (*Unpublished Dissertation*). Surabaya: Universitas Airlangga.
- Husaini, U.A. (2017). Determinan Pembiayaan Pada Bank Pembiayaan Rakyat Syariah (Financing Determinants in The Indonesian Islamic Rural Bank). *Esensi: Jurnal Bisnis dan Manajemen*. Vol. 7 (1): 49-62.
- Manzilati, A. (2015). How Profit and Loss Sharing System Encourage Small & Medium Enterprices Sustainability. *Review of Integrative Business & Economics Research*. Vol. 4 (3): 99-107.
- Rusydia, A.S. (2016). Analisis Masalah Pengembangan Perbankan Syariah di Indonesia: Aplikasi Metode Analytic Network Process (The Development Problems Analysis

- of Islamic Banking in Indonesia: Application of Analytic Network Process Method). *Esensi: Jurnal Bisnis dan Manajemen*. Vol. 6 (2): 237-246.
- Sutawi. (2008). Pembiayaan Syariah Pada Usaha Mikro, Kecil, dan Menengah Sektor Agribisnis Dengan Pola Kemitraan (Islamic Financing in Agriculture Micro, Small, and Medium Enterprise With Partnership Scheme). *Jurnal Keuangan dan Perbankan*. Vol. 12 No. 3: 147-458.
- Siddiqui, S.H. (2006). Islamic Banking: True Modes of Financing. *Journal of Islamic Banking and Finance*. Vol. 23 (4): 102-117
- Siddiqui, A.S. (2007). Establishing the need and suggesting a strategy to develop 'Profit Loss Sharing Islamic Banking (PALSIB)'. *Proceeding at IIUM International Conference on Islamic Banking and Finance*, IIUM Institute of Islamic Banking and Finance, 23-25 April, Kuala Lumpur.
- Wahyudi, A. (2016). Determinan Pembiayaan Murabahah Pada Unit Usaha Syariah: Model Regresi Panel (Determinants of Murabahah Financing in Islamic Business Unit). *Esensi: Jurnal Bisnis dan Manajemen*. Vol. 6 (2): 227-236.