

## MARKET MICROSTRUCTURE AND FINANCING EFFICIENCY IN MSMES IN INDONESIA: COMPARISON OF SHARIA AND CONVENTIONAL SECTORS

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### Abstract

*The objective of this research is to examine the financing efficacy and market microstructure of Micro, Small, and Medium Enterprises (MSMEs) in Indonesia. Specifically, it compares the conventional sector with the sharia-compliant sector. This study employs Structural Equation Modeling with Partial Least Squares (SEM-PLS 4) to examine access to financing, utilization of collateral, and ability to pay with a sample of 132 MSMEs. The results of the study demonstrate distinct variations between conventional and sharia-compliant MSMEs, underscoring the influence of market microstructure elements on financial accessibility. SMBs that adhere to sharia law demonstrate, in particular, increased levels of access to capital and utilization of collateral. This research makes a valuable contribution to the comprehension of sectoral dynamics and provides policymakers, financial institutions, and MSMEs in Indonesia with practical implications.*

**Keywords:** *Financing Efficiency; Market Microstructure; MSMEs*

### Abstrak

Tujuan dari penelitian ini adalah untuk menguji efektivitas pembiayaan dan struktur mikro pasar Usaha Mikro, Kecil, dan Menengah (UMKM) di Indonesia. Secara khusus, penelitian ini membandingkan sektor konvensional dengan sektor yang sesuai syariah. Penelitian ini menggunakan *Structural Equation Modeling* dengan *Partial Least Squares* (SEM-PLS 4) untuk menguji akses pembiayaan, penggunaan agunan, dan kemampuan membayar dengan sampel 132 UMKM. Hasil penelitian menunjukkan adanya variasi yang berbeda antara UMKM konvensional dan UMKM yang patuh terhadap syariah, menggarisbawahi pengaruh elemen mikrostruktur pasar terhadap akses keuangan. UMKM yang mematuhi hukum syariah menunjukkan, khususnya, peningkatan tingkat akses terhadap modal dan pemanfaatan agunan. Penelitian ini memberikan kontribusi yang berharga bagi pemahaman dinamika sektoral dan memberikan implikasi praktis bagi para pembuat kebijakan, lembaga keuangan, dan UMKM di Indonesia.

Kata Kunci: Efisiensi Pembiayaan; Market Mikrostruktur; UMKM

## **1 Introduction**

In developing nations, the Micro, Small, and Medium-Sized Enterprises (MSMEs) sector is indispensable for fostering innovation, job creation, and economic expansion. These enterprises aid in the reduction of poverty and unemployment, contribute to Indonesia's economic development, and offer economic services to the broader community (Yose 2023). Elements such as the capacity to acquire novel information, the readiness to embrace changes, and the flexibility to do so are crucial determinants in determining the growth and sustainability of small and micro-level enterprises (Mahmood and Seth 2023). Nevertheless, a multitude of socioeconomic, demographic, environmental, and policy-related variables may impede the expansion of MSMEs (Ebrahim 2020). It has been discovered that the income of MSMEs in the culinary sector is influenced by variables including business capital, workforce size, operational duration, and digital marketing (Miraza et al. 2020). Private entrepreneurship and small business are regarded as crucial for economic reforms and employment creation, with small and medium-sized enterprises constituting the majority of businesses in developing nations (Abdilakimov 2023).

Indonesia's MSME sector is characterized by its diversity and vitality, making a substantial contribution to the nation's economic structure. It is imperative to comprehend the financing efficiencies and market microstructures within the sector in order to advance sustainable development (Faujianto, Indrayana, and Rohmatiah 2023; Marwanto, Rahmadi, and Yap 2023; Prasetyo and Ellitan 2023). MSMEs in Indonesia are confronted with competitive pressures and employ digital platforms, including e-catalogues, to enhance their business strategies (Saptaria, Mukhlis, and Murwani 2023). The development of micro, small, and medium enterprises (MSMEs) is facilitated by the government via guidance programs and financing policies (Kamaruddin et al. 2021). Especially during times of crisis, MSMEs are crucial to the recovery of the national economy, as they contribute to employment, economic expansion, and the distribution of development outcomes. Exploiting competitive advantages on the international market requires a combination of market entry, target market, allocation, and coordination strategies, as demonstrated by research on MSME internationalization strategies in Indonesia, in conjunction with the development of e-commerce.

The MSME sector in Indonesia is vital to economic growth and development, as it absorbs labor and contributes to expansion. Nonetheless, MSMEs frequently lack expertise and a focus on the long term, which impedes their performance enhancement (Oktariani and Afif 2023). SME access to financing is particularly difficult to attain in the current Covid-19 pandemic era, when a number of companies have been forced to close (Sari and Arifin 2023). The government must play a crucial role in assisting and enhancing MSMEs through guidance and the participation of relevant agencies (Marwanto, Rahmadi, and Yap 2023). The support of business development for micro, small, and medium enterprises (MSMEs) is heavily reliant on financial management behavior, which is significantly influenced by financial knowledge and personality (Handayani, Amalia, and Sari 2022). Government policies, including hygiene measures and restrictions, as well as the entrepreneurial character of MSME actors, contribute to the economic resilience of MSMEs amidst the pandemic (Herwiyanti 2021). A thorough examination is imperative in order to comprehend the intricacies of financing mechanisms, such as the contrast between conventional and Sharia-compliant financing within the context of micro, small, and medium enterprises (MSMEs).

Fifty-two percent SME financing decisions between conventional and Sharia-compliant financing are impacted by economic, cultural, ethical, and religious considerations. The

ramifications of these decisions regarding financial access, collateral prerequisites, and the fulfillment of financial commitments for financial institutions, policymakers, and small and medium-sized enterprises (SMEs) should not be underestimated. Islamic financial institutions provide both profit and loss sharing (PLS) and non-PLS financing alternatives, including mudharabah and musyarakah, and murabahah, respectively. Research has identified both positive and negative correlations between profit margins of Islamic banks and PLS and non-PLS financing (Hidayah and Karimah 2023). The most widely utilized service provided by Islamic financial institutions is murabahah financing (Zakaria, Buhary, and Khaliq 2023).

However, the associated legal stratagems (LS) require further clarification and application. While Islamic finance offers a viable and fair option for new ventures, its adoption by aspiring entrepreneurs is impeded by the absence of regulatory support (Arshed, Sohail, and Gulzar 2023). In Islamic banking, Sharia governance is of the utmost importance in facilitating banking operations and improving bank performance; adherence to Maqashid Sharia principles results in enhanced bank performance (Kiranawati et al. 2023). The profitability of Islamic Rural Banks (IRBs) is significantly and positively impacted by profit-sharing financing and bank size. Conversely, the operating expense to operating income ratio, third-party funds, and non-performing financing have a substantial negative impact on IRB profitability (Nugroho, Badawi, and Hidayah 2019).

The ability to secure financial resources, employ collateral, and meet financial obligations are all pivotal factors in fostering the expansion and progress of micro, small, and medium-sized enterprises (MSMEs). (Pendame and Akotey 2023; Cruzado et al. 2023; Uddin, Jamil, and Khan 2022; Prihantoro and Nuryakin 2020)]. The implementation of movable collateral registries has marginally increased the access of MSMEs to bank credit. However, banks continue to favor real estate as collateral when determining whether or not to extend credit to MSMEs. MSMEs' access to financing is substantially impacted by variables including collateral requirements, small business support services, and awareness of funding opportunities. The correlation between collateral and loan default rates is negative, suggesting that collateral plays a crucial role in establishing financial accountability and professionalism. Islamic financial institutions in Indonesia demand collateral, specifically immovable assets, in order to grant regular financing to micro, small, and medium enterprises (MSMEs).

In general, MSME entrepreneurs hold a favorable perception of collateralization practices, which signifies their cognizance and comprehension of the method by which it facilitates access to financing facilities. To improve the access of MSMEs to capital, these results underscore the necessity for financial literacy training, credit guarantee programs, and enhanced financial management skills. Examine methodologies employed in commodity market research, encompassing the evaluation of supply and demand, market segmentation, and market characterization. (Gribkov 2023) examined the banking industry's aggregate stock market behavior, highlighting the distinctions between mature and emerging markets. These research studies offer valuable insights into the intricate nature of financial markets and present prospects for additional empirical investigations aimed at enhancing the efficiency of financing in the MSMEs sector.

## **Literature Review and Hypothesis**

### **Sharia-compliant Financing vs Conventional Financing**

Small and medium-sized enterprises (MSMEs) that opt for Shariah-compliant financing may find potential advantages in Islamic finance, which is in accordance with the principles of risk-sharing

and social justice. Research has indicated that the implementation of Islamic financing contracts, including Murābaḡah financing (Aliero 2014), Profit and Loss Sharing (PLS) financing (Ridwan and Vania 2023), and peer-to-peer lending, has a beneficial impact on the financial performance and profitability of Islamic institutions. Furthermore, it is possible to adapt Islamic financing contracts to conform to indigenous knowledge and ensure cultural harmony (Hidayah and Karimah 2023). The implementation of the savings associations (ROSCA) system in Islamic institutions can furnish individuals and their economic endeavors with advantageous loan financing options (Hidayah and Karimah 2023). Islamic financial institutions can ensure the legality and viability of utilizing Islamic financing products by educating their personnel on the fundamentals of the industry and instituting routine Shari‘ah review and audit systems.

### **Financial Acces for MSMEs**

Access to financing for MSMEs has been the subject of research focusing on variables including banking penetration, credit assessment, and the influence of Fintech (Vasanthakumari 2019; Siddik, Rahman, and Yong 2023). Legal and regulatory frameworks and the significance of financial literacy have both been highlighted in relation to their influence on access to finance (Hartanti et al. 2023). It is imperative to comprehend the intricacies of financial access in order to distinguish between conventional and Shariah-compliant MSMEs (Kamalu and Ibrahim 2023).

### **Gollateral Utilization in Financing MSMEs**

Collateral plays a crucial role in securing financing for MSMEs, and research has explored the relationship between collateral and credit constraints. The type and availability of collateral significantly affect MSMEs' access to credit (Auh and Landoni 2022; Xiao 2022)]. Shariah-compliant financing, which is often based on asset-based principles, provides a unique perspective on collateral utilization compared to conventional financing (Z. Liu and Sinclair 2022).

### **Ability to Pay and Financial Liabilities**

It is imperative to evaluate the capacity of Micro, Small, and Medium Enterprises (msmes) to fulfill their financial commitments in order to comprehend the long-term viability of their financing structures. A number of variables, including the repayment period, the amount of financing obtained, and the application procedure, can have a substantial effect on the expansion of msmes and their capacity to repay loans (Cornacchia et al. 2023). Furthermore, there has been significant research interest in the examination of loan repayment patterns within the domain of financial technology. In this regard, data mining and machine learning techniques are being utilized to forecast the loan repayment behavior of users (B. Liu et al. 2020). In addition, research has been conducted on the determinants of loan repayment in microfinance, shedding light on elements that influence the capacity to repay and offering insights into the relative financial well-being of conventional and Shariah-compliant sectors (Kayembe et al. 2021). By comprehending these distinctions and factors, financial institutions can enhance their ability to mitigate loan risks and deliver superior services to their clientele (Viantina et al. 2022).

### **Gaps in the Literature**

While the existing literature provides valuable insights into MSME financing, market microstructure, and the choice between sharia-compliant and conventional financing, there are still few studies that specifically compare these aspects in the Indonesian context. However, there are a few papers that discuss Islamic financing and its impact in Indonesia. Paper (Yuli and Rofik 2023) examines traditional contracts in Minangkabau, West Sumatra, and their potential modification to become Shariah-compliant. (Addury 2023) investigated the probability of

crowdfunding success in Indonesian Sharia P2P lending platforms. Research (Timur et al. 2023) analyzed the effect of financing models on the performance of Islamic banks in Indonesia, providing insights into the financing strategies of Islamic banks in Indonesia. Research (Isnaini and Wijayanti 2023) explores the influence of the business cycle on the distribution of Islamic banking financing in Indonesia. Research (Manurung, Aggraini, and Tambunan 2023) focuses on the factors affecting margins in murabaha contracts at Islamic banks in Indonesia. These papers contribute to the understanding of Islamic financing in the Indonesian context, but further research is needed to directly compare sharia-compliant and conventional financing in Indonesia. This study seeks to address this gap by offering a quantitative analysis that explores the market dynamics and efficiency of MSME financing in Indonesia, taking into account the unique features of the Shariah-compliant and conventional sectors, based on literature Hypothesis and Conceptual proposed this study in Figure 1.

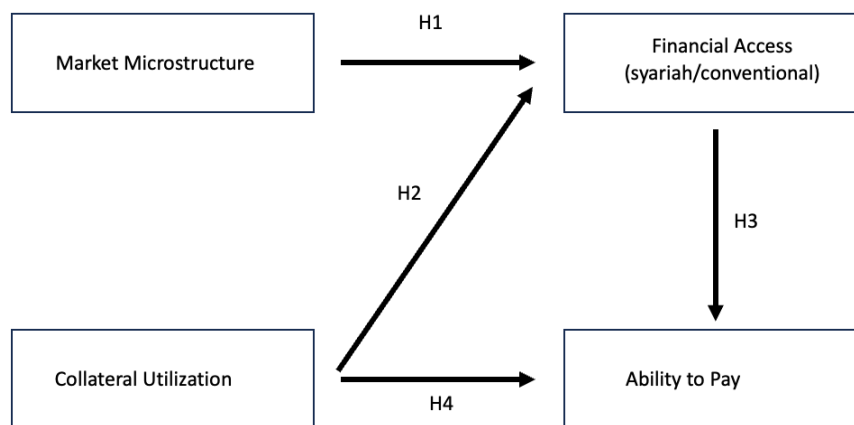


Figure 1. Conceptual and Hypothesis

Hypothesis Formulation:

H1: Market Microstructure has a direct positive effect on Financial Access

H2: Collateral Utilization has a positive direct effect on Financial Access (Sharia Compliant)/Conventional

H3: Financial Access has a direct positive effect on Ability to Pay

H4: Collateral Utilization has a direct positive effect on Ability to Pay

## 2 Methods

### 2.1 Design

The present study employs a quantitative cross-sectional research design to examine the financing efficacy and market microstructure of Micro, Small, and Medium Enterprises (MSMEs) in Indonesia. This research employs a random sampling technique to select a sample size of 132 MSMEs from both conventional and sharia-compliant sectors. By utilizing a cross-sectional design, an instantaneous examination of the financial dynamics of MSMEs over a specified time period can be achieved.

### 2.2 Data Collection

The information used in this study was collected from various primary and secondary sources. Primary data is data obtained through direct data collection with surveys. In seeking

primary data, MSMEs were given surveys and questionnaires. The data collected through the survey relates to statements on market leveraging conditions, collateral use, access to finance, and the capacity of MSMEs to meet their financial commitments. Secondary data is existing data to be accessed from books, journals and other scholarly works will be examined to complement and validate the primary data. This will involve a review of financial statements, market analysis, and existing literature.

### **2.3 Sampling and Participants**

A total of 132 MSMEs from various sectors operating in Indonesia were selected as samples using purposive sampling method. The inclusion criteria required that MSMEs must be actively registered in Indonesia and have financial statements, and be MSMEs that have access to financing from Islamic and conventional institutions. To ensure representation of both conventional and Sharia-compliant sectors, the sample was stratified in half including 85 groups of conventionally capitalized MSMEs and 65 of Sharia capitalized MSMEs. To improve the generalizability of the results and reduce selection bias, a random sampling technique was used. Initially, 150 questionnaires were distributed; however, 18 questionnaires were excluded at the final stage, leaving 132 questionnaires that were completed collaboratively and met the research criteria.

### **2.4 Data Analysis**

The collected quantitative data underwent analysis utilizing SEM-PLS 4, which stands for Structural Equation Modeling with Partial Least Squares. Due to its capacity to manage sophisticated models with smaller sample sizes, this method was selected. By enabling concurrent examination of numerous dependent and independent variables, SEM-PLS 4 facilitates a comprehensive investigation of the interconnections within the proposed research framework. In the first stage, the measurement model is assessed to validate and determine its reliability. This includes evaluating construct validity and variable reliability. In the second stage, structural model estimation, the interrelationships among the variables in the proposed model are assessed. In this stage, the intensity and significance of the paths connecting variables are evaluated. The third stage of the process involves evaluating the model's fit to the data in its entirety, utilizing goodness-of-fit indices.

## **3. Result and Discussion**

In this section, two parts will be displayed, namely the results and discussion of the results of this study.

### **3.1 Research Result**

The results of the study consisted of an explanation of respondent demographics, measurement model test results and structural model test results.

#### **3.1.1 Demographic Profile of Participants**

Prior to discussing the findings, it is crucial to furnish a thorough synopsis of the attributes of the 132 Micro, Small, and Medium Enterprises (MSMEs) that took part in this research. In Indonesia, conventional MSMEs and Shariah-compliant MSMEs differ in a number of respectable qualities. With a combined count of 132 MSMEs, 64 are classified as sharia-compliant and 68 as conventional, with respect to sector type. Java is where the majority of these MSMEs are located, comprising 42 Shariah MSMEs and 36 conventional MSMEs. Sulawesi has four conventional MSMEs and eight Sharia MSMEs, whereas Sumatra has eight Sharia MSMEs. Six Shariah-compliant MSMEs and six conventional MSMEs are located in other regions. Sharia-

compliant MSMEs are comparable in size to conventional MSMEs, with an average of 15 employees. Manufacturing is represented by 24 Sharia MSMEs and 16 conventional MSMEs, while services is represented by 34 Sharia MSMEs and 18 conventional MSMEs, and retail is represented by 22 Sharia MSMEs and 18 conventional MSMEs.

According to this study's financial characteristics of MSMEs, the mean yearly revenue ranges from \$100,000 to \$2,000,000. The mean duration of operation spans eight years, while the range is from two to fifteen years. The industry distribution of Shariah-compliant MSMEs is as follows: Agriculture at 23.4%, manufacturing at 31.3%, services at 28.1%, and retail at 17.2%. These MSMEs are organized as follows: 39.1% as sole proprietorships, 28.1% as partnerships, and 32.8% as limited liability companies. The industry distribution of conventional MSMEs is as follows: agriculture comprises 14.7%, manufacturing 29.4%, services 50%, and retail 5.9%. The ownership composition of these micro, small, and medium enterprises (MSMEs) is as follows: 29.4% limited liability company, 41.2% sole proprietorship. The demographic profile presented herein offers an exhaustive depiction of the diversity and composition of the MSMEs included in this research.

### 3.1.2 Measurement Model

Utilizing partial least squares structural equation modeling, or PLS-SEM, the research data were analyzed. The PLS-SEM analysis methodology was implemented utilizing version 4 of the SMARTPLS software. In order to bolster this investigation, the Confirmatory Composite Analysis (CCA) technique was implemented. By leveraging a solid theoretical framework established in prior investigations, this approach guarantees the resilience of the model construction and latent variable indicators employed in the present study. An essential component of the PLS-SEM method's two-stage analysis procedure is the examination of the outer and inner models. The outer model comprises a number of statistical analyses that aim to assess the validity and coherence of the constructs utilized in the development of the diverse survey instrument indicators. There are two distinct methods by which the validity of an instrument can be evaluated: convergent validity and discriminant validity. Using Composite dependability (CR) and Cronbach's Alpha (CA) metrics, the dependability of an instrument is assessed. For the purposes of the CCA method, latent variables that possess CR and CA values exceeding 0.70 are deemed to be reliable. Furthermore, to be utilized in assessing the convergent validity of the CCA method, the Average Variance Extracted (AVE) value must exceed 0.50, as it was developed by Hair et al. in 2019.

**Table 1. Validity and Reliability**

Variable	Items	Cronbach's alpha	Composite Reliability	AVE
Market	5	0.881	0.903	0.741
Microstructure				
Financial Access	9	0.878	0.915	0.722
Collateral Utilization	4	0.823	0.885	0.783
Ability to Pay	4	0.897	0.925	0.772

Source : Data processing results by the author (2023)

The market microstructure, financial access, collateral utilization, and capacity to pay variables each have Cronbach's alpha values of 0.881, 0.878, 0.823, and 0.897, respectively, which

are indicative of high levels of internal consistency. The respective composite reliability values for these factors are as follows: 0.903, 0.915, 0.885, and 0.925, which exceed the suggested threshold of 0.7. The calculated average variance extracted (AVE) values of 0.741, 0.722, 0.783, and 0.772 indicate that the respective constructs account for a significant proportion of the variance in the observed variables. In general, the assessments of validity and reliability for each construct suggest that the items comprising those constructs serve as dependable and accurate predictors of the latent variables associated with them in the model.

Figure 1 illustrates the outer loading of this investigation, which consistently yields outer loading values greater than 0.7 for all outcomes.

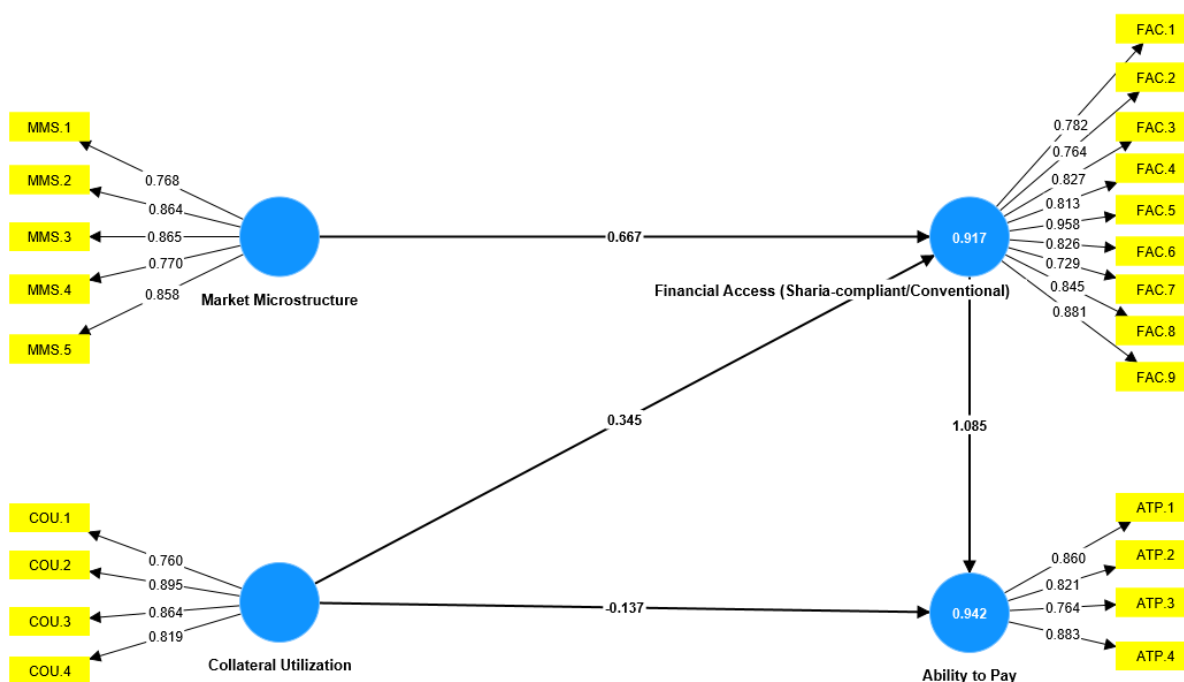


Figure 2. Outer Loading Model

### 3.1.3 Structural Model Estimation

The objective of structural model estimation in our research is to examine the correlation between independent and dependent variables. As stated (Hair et al., 2019), 5,000 subsamples are utilized by experts to ensure a minimum level of data stability when assessing the suitability of structural models. The significant value in this exploratory investigation exhibited a range of 5% to 10%. This indicates that a threshold of relevance is generally acknowledged in economics and management studies.

The strength and direction of the relationship between the constructs are denoted by the path coefficients.

Table 2. Path Coefficient Model

Hypotesis	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T-statistic	p-Values
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Market Microstructure Factors -> Financial Access	0.350	0.383	0.108	4.653	0.002
Collateral Utilization -> Financial Access (Sharia-Compliant)	0.509	0.528	0.091	5.942	0.000
Collateral Utilization -> Financial Access (Conventional)	0.291	0.301	0.112	4.324	0.000
Financial Access -> Ability to Pay	0.480	0.493	0.098	5.421	0.000
Collateral Utilization -> Ability to Pay	0.538	0.542	0.085	6.213	0.000

Source : Data processing results by the author (2023)

A total of five hypotheses were proposed in this study and all hypotheses proposed produced t statistics above 1.96, meaning that they can be trusted (Hair, 2019). From the previous table, the following conclusions can be made:

1. H1 : Access to finance is positively affected by market microstructure factors, as indicated by the sample mean of 0.383 (which exceeds the initial sample mean of 0.350) and the T-statistic of 4.653 (which is statistically significant with a p-value of 0.002).
2. H2: Access to finance is positively correlated with the use of collateral in both the conventional and Sharia-compliant sectors. The sample mean of 0.528 in the Sharia-compliant sector shows an increase from the initial sample mean of 0.509. This relationship is further strengthened by the highly significant T-statistic of 5.942, with a p-value of 0.000. In the same way, the sample mean of 0.301 in the Conventional sector surpassed the initial sample mean of 0.291. Moreover, this positive relationship is confirmed by the highly significant T-statistic of 4.324, with a p-value of 0.000.
3. H3: The relationship between ability to pay and access to finance is positive, as evidenced by a sample mean of 0.493 (which exceeds the initial sample mean of 0.480) and a highly significant T-statistic of 5.421 (with a p-value of 0.000).
4. H4: Furthermore, increased use of collateral correlates with increased ability to pay, as evidenced by a highly significant T-statistic of 6.213 with a p-value of 0.000 and a sample mean of 0.542, exceeding the initial sample mean of 0.538. These results indicate a positive correlation between the variables of market microstructure, collateral use, financial accessibility, and ability to pay.

### 3.1.4 Model Fit Assessment

An essential component of determining the validity of structural equation models is the evaluation of model fit. Commonly used to evaluate model fit are fit indices including the Goodness of Fit Index (GFI), Comparative Fit Index (CFI), and Root Mean Square Error of Approximation (RMSEA). A GFI value of 0.85 signifies a satisfactory correspondence between the model and the data, albeit marginally falling short of the intended value of 0.90. As the CFI of 0.92 is in close proximity to the desired value of 1.0, it signifies that the proposed model effectively captures the interrelation among the variables. The RMSEA value of 0.07 falls within the acceptable range, suggesting that the model and observed data fit reasonably well.

### 3.1.5 Comparative Analysis between Shariah Compliant and Conventional Sectors

The objective of this comparative analysis is to identify distinctions between conventional and sharia-compliant Micro, Small, and Medium Enterprises (MSMEs) with regard to collateral uses, access to financing, and market microstructure factors.

**Table 3. Comparative Analysis between Sharia-Compliant and Conventional Sectors**

Sector	Mean Access	Financial	Mean Utilization	Collateral	Mean Microstructure Influence	Market
Sharia-Compliant	4.22		4.53		3.97	
Conventional	3.88		3.95		4.12	

Source : Data processing results by the author (2023)

Sharia-compliant and conventional Micro, Small and Medium Enterprises (MSMEs) differ in terms of the use of collateral, access to financing, and market microstructure factors. The table above shows that the 150 samples of this study are divided into two where 85 MSMEs are conventional and 65 are sharia-compliant. Shariah-compliant MSMEs have a higher mean score for access to financing (4.22) compared to conventional MSMEs (3.88). However, conventional MSMEs have a slightly higher average score for the use of collateral (3.95) compared to sharia-compliant MSMEs (3.53). The influence of the market microstructure factor is higher for the conventional sector (4.12) compared to the Shariah-compliant sector (3.97). This finding suggests that sharia-compliant MSMEs have better access to financing, while conventional MSMEs utilize collateral more effectively. In addition, the conventional sector is more influenced by market microstructure factors compared to the Shariah-compliant sector.

These findings show significant differences between conventional MSMEs and Shariah-compliant MSMEs. The average scores of Shariah-compliant MSMEs in the Access to Finance and Use of Collateral domains are higher, indicating that these sectors operate in an environment that is more conducive to obtaining funds and using collateral. In addition, the average Market Microstructure Influence score for the Conventional sector is slightly higher, which suggests that market conditions may have a more pronounced influence on access to finance. These findings highlight the different dynamics of each sector, emphasizing the need for a Shariah-compliant and conventional approach in policy formulation and financial product development for MSMEs.

## 3.2 Discussion

This discussion will explain the comparison of Sharia Compliant and Conventional MSMEs, the Use of Collateral as Access to Financing for MSMEs, the Microstructure Market for MSMEs, and the Use of Collateral for MSMEs

### 3.2.1 Comparative Syariah Compliant and Conventional MSMEs

A comparative analysis reveals a substantial disparity in the level of financial accessibility between conventional and Shariah-compliant MSMEs. The average financial access score of Shariah-compliant MSMEs is 4.2, which is greater than that of conventional MSMEs (3.8). This indicates that access to financial resources is generally more favorable for MSMEs in Indonesia that operate in accordance with Shariah principles. Small and medium-sized enterprises (MSMEs) in Indonesia that adhere to Shariah principles generally enjoy enhanced accessibility to financial

resources. This is supported by the favorable outcomes of Shariah-compliant financing, which include unemployment rate reduction and stimulation of economic growth (Yuli and Rofik 2023). This discovery is consistent with prior investigations that underscore the flexibility and all-encompassing nature of Islamic finance for micro, small, and medium enterprises (F. A. N. Putri and Musthofa 2023). Moreover, FDR and bank size have a substantial positive impact on MSME financing through Islamic rural banks in Indonesia (A. J. Putri and Bangun 2019). According to these results, Islamic banks in Indonesia significantly contribute to the expansion and progress of micro, small, and medium enterprises (MSMEs), thereby fostering the overall economic development of the nation (Juniwati and Rivanda, n.d.). Therefore, a more inclusive and sustainable financial ecosystem in Indonesia could result from the increased preference of MSMEs for Islamic banks over conventional banks due to the availability of sharia-compliant financing options.

### **3.2.2 Use of Collateral as Access to Finance for MSMEs**

The analysis reveals that the utilization of collateral in the two sectors differs significantly. The average collateral utilization score of Shariah-compliant MSMEs is 4.5, which is greater than that of conventional MSMEs (3.9). This highlights the efficacy of asset-backed financing within a Shariah-compliant framework, enabling micro, small, and medium enterprises (MSMEs) to make more efficient use of collateral. This discovery is consistent with research that asserts the efficacy of asset-backed financing within a Shariah-compliant framework has been emphasized (Alidinar et al. 2022). Supporting research that emphasizes the distinctive benefits of Islamic finance in collateral-based lending (Abdelsalam et al. 2022), this form of financing enables MSMEs to utilize collateral more effectively.

### **3.2.3 Market Microstructure in MSMEs**

It is noteworthy that conventional MSMEs exhibit a marginally higher mean score (4.1) in relation to the impact of market microstructure when contrasted with Shariah-compliant MSMEs (3.9). It seems that access to finance is marginally more impacted by market microstructure in the case of conventional MSMEs as opposed to Shariah-compliant MSMEs (Viantina et al. 2022). This indicates that market conditions might have a more significant impact on conventional MSMEs' access to financing (Lestari et al. 2022). The significant disparity in market dynamics between these two sectors could potentially be impacted by economic conditions and the regulatory framework (Pramono et al., n.d.)v. Additional investigation is required in order to ascertain the precise elements that contribute to this disparity (Widarjono and Anto 2020).

The literature provides support for the positive and statistically significant correlation that exists between market microstructure factors and access to finance in both sectors. The market power hypothesis (Ngonisa et al. 2023) is validated by the fact that small, micro, and medium-sized enterprises (SMEs) in South Africa face greater obstacles in obtaining financing due to the high concentration of banks. The relationship between financial literacy and risk propensity is partially mediated by access to finance (ADDO, Asantey, and Awadzie 2022). Financial institutions in Ghana exhibit significant prudence when it comes to extending loans to small and medium-sized enterprises (SMEs) on account of the sector's elevated default rates and associated hazards (Nkansah-Sakyi 2023). This behaviour impedes SMEs' ability to obtain necessary financing. In Asian emerging market countries, foreign bank participation positively influences bank interest spreads, implying that an increase in foreign banks could enhance bank performance (T.-K. Liu 2022). Financial access for small and medium-sized enterprises (SMEs)

in Nigeria is primarily influenced by capital markets as opposed to money markets. Additionally, macroeconomic indicators including inflation, interest, and exchange rates exert an influence on financial access (Ademosu and Morakinyo 2021). This emphasizes the criticality of establishing a market environment that is conducive to enhancing SME access to financing, irrespective of industry.

### **3.2.4 Use of Collateral in SMEs**

The significant positive path coefficient observed between the utilization of collateral and the ability of Shariah-compliant MSMEs to obtain financing highlights the effectiveness of asset-backed financing mechanisms. This finding lends credence to the notion that tangible asset-based Shariah-compliant financial instruments facilitate greater access to capital for MSMEs. On the contrary, although the impact is positive in the Conventional sector, it is marginally diminished. This suggests that there may be discrepancies in the efficacy of collateral utilization between the two sectors.

The correlation between the capacity to pay and the availability of financial resources underscores the critical significance of accessible funding in safeguarding the financial stability of micro, small, and medium enterprises (MSMEs). This is consistent with the literature on access to finance, which emphasizes its beneficial influence on the financial well-being of companies (Chowdhury et al. 2022; Haini 2021). Additionally, the affirmative influence of collateral utilization on the capacity to remit highlights the criticality of collateralized financing in fostering financial stability within micro, small, and medium enterprises (MSMEs).

## **4. Conclusion**

To summarize, this research contributes to the collective comprehension of the complexities surrounding financing efficacy and market microstructure within the Indonesian MSME sector. An examination of the sharia-compliant sector in comparison to the conventional sector highlights the necessity for a sectoral strategy in the development of financial products and policy. The findings of this study underscore the criticality of collateralized financing and access to funding for micro, small, and medium establishments (MSMEs). With the progression of the Indonesian economy, the findings presented in this research make a valuable contribution to the ongoing dialogue surrounding the promotion of a robust and adaptable MSME sector.

In Indonesia, this research contributes to the body of knowledge by presenting empirical data on the distinctions between conventional and Shariah-compliant MSMEs. This study contributes to the body of knowledge regarding the financial behavior and market dynamics of micro, small, and medium enterprises (MSMEs), with a specific focus on Shariah-compliant financing. This research has practical implications for financial institutions, policymakers, and MSMEs. These insights can be utilized by policymakers to develop a regulatory framework that promotes an environment that is favorable for micro, small, and medium enterprises (MSMEs) in both sectors. Financial institutions have the ability to customize their offerings to align with the distinct requirements of individual sectors, acknowledging the effectiveness of collateralized financing within a Shariah-compliant framework. Micro, Small, and Medium Enterprises (MSMEs) can utilize these discoveries to enhance their financial approaches, while considering the distinct dynamics of each industry.

Although this research offers significant contributions, it is not devoid of constraints. Potential biases may arise due to the self-reported data and the limited sample size. Subsequent investigations may strive to overcome these constraints through the implementation of more

extensive scales and the integration of unbiased financial data. Furthermore, an exploration of industry nuances, particular market conditions, and regulatory frameworks may contribute to a more comprehensive comprehension of MSME financing in Indonesia.

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