



Empowering sharia-based Micro, Small and Medium Enterprises (MSMEs) in Indonesia: A Socioeconomic and ethical framework for inclusive development

Meirani Rahayu Rukmanda^{1*}, Hasan Bisri², Dedah Jubaedah,³
Dudang Gojali⁴, Sholikul Hadi⁵

¹Institut Miftahul Huda Subang, Indonesia

^{2,3,4}UIN Sunan Gunung Djati Bandung, Indonesia

⁵IAI Nasional Laa Roiba Bogor, Indonesia

*Correspondence: meiranirahayu@gmail.com

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Abstract: Sharia-based Micro, Small, and Medium Enterprises (MSMEs) represent a critical driver of economic development in Indonesia, contributing significantly to employment, poverty alleviation, and local entrepreneurship. In a country with the world's largest Muslim population, the integration of *maqāṣid al-sharī'ah* principles into MSME governance offers a unique pathway toward ethical and inclusive economic growth. This study investigates the institutional, financial, and socio-religious dynamics that shape the performance and sustainability of Sharia-compliant MSMEs. It explores how Islamic economic principles intersect with regulatory frameworks and market practices to influence business outcomes in this sector. The objective is to formulate a conceptual and practical model for strengthening Sharia-based MSMEs in Indonesia. Adopting a qualitative approach, this research utilizes document analysis from regulatory texts, journal articles, and Islamic economic theory. Findings reveal critical challenges in legal harmonization, limited access to Sharia-compliant financing, and inconsistent application of *'adl* (justice), *amanah* (trust), and *rahmah* (compassion) in entrepreneurial practices. However, notable opportunities exist in the areas of community-based empowerment, halal certification, and fintech adoption aligned with Islamic values. This study contributes to both policy and academic discourses by offering an integrative perspective on Sharia-based MSMEs. It highlights the importance of strengthening *tawhidic* foundations in economic structures and provides a roadmap for policymakers, practitioners, and scholars committed to building an inclusive and just economic system rooted in Islamic ethics.

Keywords: community empowerment; halal practices; inclusive development; Islamic economics; small enterprise

Introduction

Indonesia, as the world's largest Muslim-majority country, has a significant economic landscape shaped by Islamic values. One of the most vibrant sectors in this landscape is the realm of Micro, Small and Medium Enterprises (MSMEs), which account for over 99% of all businesses in the country and absorb more than 97% of the national workforce (Kementerian Koperasi dan UKM, 2023). With the rise of Islamic consciousness and economic empowerment, many MSMEs have increasingly adopted Sharia principles in their operations, marking the emergence of Sharia-based MSMEs as a distinct, value-driven business segment.

The core idea behind Sharia-based MSMEs is rooted in the principles of *maqāṣid al-*

sharī'ah, which aim to protect religion, life, intellect, lineage, and wealth through economic behavior guided by ethical responsibility and justice (Chapra, 2008, p. 58). Unlike conventional businesses, Sharia-based MSMEs must adhere to Islamic legal and ethical frameworks such as the prohibition of *riba* (interest), the enforcement of *halal* products, and contracts based on mutual consent and fairness (*'adl*). This framework offers a transformative perspective on entrepreneurship, one that aligns economic goals with spiritual values and social justice (Antonio, 2011, p. 115).

The institutional growth of Islamic financial services—such as *Baitul Māl wat-Tamwīl* (BMT), Islamic banks, and *zakat* management organizations—has become instrumental in funding and mentoring these MSMEs. Government support, including halal certification, training, and policy instruments, has also been crucial. However, numerous constraints remain. These include bureaucratic inefficiencies, fragmented regulatory enforcement, and a lack of access to Sharia-compliant financing among rural MSMEs (Rakhmat, 2022). Consequently, many enterprises label themselves as “Sharia-compliant” without a full understanding or execution of Islamic business ethics (Zuhdi, 2020, p. 84).

From a socioeconomic standpoint, Sharia-based MSMEs have the potential to contribute to *rahmatan lil-‘ālamīn* economic development—an inclusive model rooted in sustainability and ethical accountability (Al-Qaradawi, 1995, p. 129). Yet, the depth of integration between Islamic economic principles and MSME practices varies widely. Some businesses implement basic tenets such as avoiding interest, while others build entire value chains around Sharia-based contracts like *murābahah*, *wakālah*, or *mudhārabah* (Ascarya & Yumanita, 2019).

Existing literature shows a growing but still fragmented body of research on this topic. Most studies emphasize the role of Islamic finance in MSME development or the impact of halal certification. Few, however, explore the holistic ethical, institutional, and behavioral ecosystem that supports Sharia-based MSMEs (Hamid & Saad, 2021). Moreover, there is limited discussion on how Islamic epistemology can be effectively embedded into business strategies at the micro level (Nawawi, 2023, p. 214).

To guide this inquiry, the following research questions are proposed: (1) How are Islamic principles operationalized in the practices of Sharia-based MSMEs in Indonesia? (2) What institutional and financial mechanisms support or hinder their development? (3) How do entrepreneurs perceive and apply Islamic ethics in their business conduct? (4) What are the main challenges and future opportunities for integrating Islamic values into MSME governance?

In light of these issues, this study aims to bridge the conceptual, ethical, and policy dimensions surrounding Sharia-based MSMEs in Indonesia. It seeks to analyze how Islamic economic philosophy interacts with real-world entrepreneurial behavior and state infrastructure. By focusing on qualitative analysis and drawing from Islamic economics, public policy, and development studies, this research hopes to offer a roadmap for sustainable MSME development within a Sharia framework.

The academic discourse on Sharia-based MSMEs in Indonesia intersects multiple fields, including Islamic economics, development studies, entrepreneurship, and public policy. Scholars such as (Chapra, 2008, p. 62) and (al-Qaradawi, 2000, p. 137) argue that Islamic entrepreneurship serves not only as an economic activity but also as an ethical mission grounded in *tawhīd*, *'adl*, and *khilāfah* principles. Within the Indonesian context, this understanding has become increasingly relevant as Islamic financial institutions and Islamic lifestyle trends shape consumer and business behavior. Studies such as those by (Huda & Nasution, 2021) have shown that many MSMEs adopt Islamic branding and financial tools, but without full adherence to Sharia-based operational principles.

Significant attention has been paid to the role of Islamic microfinance institutions, particularly *Baitul Māl wat-Tamwīl* (BMT), in supporting MSMEs. (Ascarya & Yumanita, 2019) find that BMTs act not only as financial intermediaries but also as agents of community empowerment through *qard al-ḥasan* financing and Sharia-compliant mentorship models. Meanwhile, (Yusuf & Wibowo, 2020), drawing on Sinta-accredited studies, emphasize that many BMTs struggle with sustainability, transparency, and operational capacity—issues that ultimately affect their effectiveness in empowering MSMEs.

On the other hand, halal certification and product legitimacy have emerged as prominent themes in the literature. (Sulaiman, 2022) argues that the halal value chain is not only a religious requirement but also a powerful competitive advantage for MSMEs in the global market. Yet, challenges in bureaucratic processes, cost barriers, and lack of awareness have been widely reported (Munir & Rochmawati, 2020). According to (Kamali, 2002, p. 214), the concept of *istihsān* (juridical preference) should be more actively integrated to ensure flexibility in applying Islamic law within business contexts, especially for micro-entrepreneurs.

Beyond financing and certification, scholars have raised concerns about the internalization of Islamic ethics in daily operations. Research by (Nawawi, 2023, p. 218), identifies that many MSME actors interpret Sharia narrowly, focusing on compliance rather than ethical transformation. Similarly, (Farid & Muhtadi, 2019) critique the tendency of MSMEs to prioritize form over substance, leading to superficial adherence to Islamic values. This insight underscores the need to develop Sharia-based entrepreneurship models that internalize values such as *amanah*, *shiddiq*, and *rahmah* in long-term business practices.

Moreover, the relationship between government policy and Sharia-based MSME development remains underexplored. While there are various national initiatives promoting Islamic finance and entrepreneurship, coordination gaps between ministries, a lack of inclusive data, and regulatory ambiguities continue to hinder their full implementation (Senata et al., 2021). Recent Arabic sources such as *al-Iqtisād al-Islāmī* by (al-Dīn Al-Nabhānī, 2012, p. 192), argue that Islamic economics should be driven by a value-based governance model, not merely through institutional mimicry of conventional systems.

In sum, the current literature reflects a growing interest in the integration of Islamic ethics into the MSME sector. However, most works tend to emphasize financial instruments or halal branding, with fewer efforts to synthesize institutional, behavioral, and spiritual dimensions. This reveals a significant research gap and the need for a holistic, ethically grounded analysis of Sharia-based MSMEs in Indonesia.

The analysis of Sharia-based MSMEs in Indonesia draws upon several interrelated economic theories, with Islamic economic theory serving as the foundational lens. Islamic economics is grounded in a normative framework that integrates economic behavior with divine guidance. As (Chapra, 2000b, p. 98), asserts, the objective of Islamic economics is not solely material welfare, but achieving *falah* (holistic success) through the fulfillment of *maqāṣid al-sharī'ah*. In this context, economic agents are viewed as moral beings whose entrepreneurial actions must align with ethical imperatives such as justice (*'adl*), trust (*amanah*), and accountability (*mas'ūliyyah*).

Classical microeconomic theory—while useful in understanding production, cost structures, and market behavior—must be contextualized within Islamic moral parameters when applied to Sharia-based MSMEs. For instance, the utility-maximization model, central to neoclassical economics, is often reinterpreted in Islamic thought as *maslahah*-maximization—where entrepreneurs prioritize communal benefit over individual gain (Al-Sadr, 1983, p. 141). This approach diverges significantly from secular economic rationality by incorporating spiritual accountability as a guiding force.

Additionally, institutional economics provides valuable insights into the role of formal and informal institutions in shaping entrepreneurial behavior. (North, 1990) defines institutions as the “rules of the game” in a society. For Sharia-based MSMEs, these rules include both state regulations and Islamic jurisprudential norms (*fiqh mu'āmalah*). The alignment or misalignment between these institutional layers often determines whether MSMEs can operate within a truly Sharia-compliant framework (Sudarsono, 2018).

From the perspective of endogenous growth theory, MSMEs are seen as engines of innovation and localized development. (Romer, 1994) emphasizes the importance of knowledge, human capital, and technological innovation in sustaining long-term economic growth. In the Sharia-based MSME context, this theory is enhanced by the ethical imperative to ensure that innovation aligns with Islamic values. For instance, digital transformation through Islamic fintech must not only improve efficiency but also uphold transparency (*bayān*), justice (*'adl*), and mutual consent (*tarādī*).

Another relevant theory is stakeholder theory, particularly when examining ethical dimensions of business. (Freeman, 1984) posits that businesses must consider the interests of all stakeholders—employees, customers, suppliers, and society. Islamic economics extends this responsibility further, demanding that businesses act as trustees (*khalīfah*) of resources entrusted by God. This aligns with the concept of *al-‘uqud al-mu‘tamadah* (binding and trustworthy contracts) and reinforces the entrepreneur’s duty to prioritize public good over profit maximization (Beekun, 1997, p. 120).

Finally, the theory of social capital also helps explain how trust, networks, and communal norms support the sustainability of Sharia-based MSMEs. (Coleman, 1988) emphasizes the role of social cohesion in reducing transaction costs and enhancing business resilience. In Islamic tradition, this is mirrored in concepts like *ta‘āwun* (mutual cooperation) and *ukhuwwah* (brotherhood), which function as informal mechanisms that foster inclusive, ethics-driven business ecosystems (Rohmah, 2022).

Together, these theoretical frameworks provide an integrated foundation for analyzing the dynamics of Sharia-based MSMEs. By combining Western economic theories with Islamic epistemology, this study ensures both analytical rigor and ethical contextualization.

One of the earliest in-depth studies on Islamic entrepreneurship was conducted by Al-(Al-Sadr, 1983, p. 97), who emphasized the need for a value-based economic system rooted in divine guidance. His work laid the intellectual foundation for understanding the entrepreneur not merely as a wealth generator but as a moral agent driven by *taqwā* and *tawakkul*. Al-Sadr’s vision of *al-iqtisād al-Islāmī* influenced numerous subsequent analyses, particularly in Muslim-majority nations grappling with reconciling Islamic norms and market capitalism.

In the Indonesian context, (Sudarsono, 2010) investigated the challenges of Islamic banking and MSME development, concluding that financial inclusion through Islamic microfinance remains underutilized. His study pointed to the regulatory vacuum and weak institutional coordination as key barriers to expanding Sharia-based MSME financing. While acknowledging the cultural affinity of Indonesian Muslims with Islamic products, the study noted a lack of structured knowledge and training to operationalize these principles among grassroots entrepreneurs.

(Ascarya & Yumanita, 2019), in a comparative study of BMTs and Islamic banks, observed that the former were more agile in providing Sharia-compliant financial services to MSMEs. However, their analysis also revealed that most BMTs face capital constraints and operational inefficiencies. Their study contributed to the understanding of how microfinance institutions act as both economic enablers and religious actors in promoting *maqāṣid al-sharī‘ah* in the real sector.

A more recent study by (Huda & Nasution, 2021), using data from Sinta-accredited sources, examined the impact of halal certification on MSME competitiveness in West Java. Their findings showed that halal certification not only improves marketability but also enhances consumer trust and business sustainability. Nevertheless, they also reported gaps in awareness and procedural understanding among small businesses, indicating the need for broader education and governmental support mechanisms.

In 2023, Nawawi conducted an ethnographic study on the ethical behavior of Sharia-labeled MSMEs in rural Java. He found that many businesses adopted Islamic identifiers—such as Arabic names or Islamic dress codes—without fully integrating ethical principles like *amanah* and *‘adl* into daily transactions (Nawawi, 2023, p. 220). The study warned against the superficial use of Sharia branding, which may dilute the transformative potential of Islamic economic values and reduce public trust in Islamic economic practices.

These studies, while valuable, reveal a fragmented landscape of inquiry. Much of the existing research focuses on either financial instruments or certification processes, with limited exploration of the ethical and institutional ecosystem required to sustain authentic Sharia-based MSMEs. Furthermore, few studies have integrated Islamic economic theory with empirical behavioral analysis. This gap underscores the need for a holistic approach that considers not only financial and regulatory frameworks but also the internal ethical dimensions and communal dynamics that shape Sharia-based MSMEs in Indonesia.

Method

This study employs a qualitative research design grounded in textual analysis to explore the institutional, ethical, and practical dimensions of Sharia-based Micro, Small and Medium Enterprises (MSMEs) in Indonesia. Qualitative research is particularly suitable for capturing the complexity of behaviors, motivations, and socio-religious norms that influence Sharia-based business practices (Creswell, 2014, p. 185). It allows for the interpretation of meanings behind regulatory texts, religious principles, and entrepreneurial narratives without reducing them to quantifiable variables.

The primary data sources include academic journals, government reports, Islamic legal documents, MSME regulatory frameworks, and fatwas issued by recognized Islamic institutions such as the Majelis Ulama Indonesia (MUI) and Dewan Syariah Nasional (DSN). Secondary data are drawn from Indonesian Sinta-Garuda-accredited articles, international peer-reviewed journals, Arabic and Indonesian books, and economic reports from Bank Indonesia and OJK. This multi-source textual base ensures a robust and balanced perspective. As emphasized by (Miles & Huberman, 2013, p. 32), diverse data triangulation enhances analytical credibility and reduces interpretive bias.

Data collection was conducted through purposive document selection. The selection criteria were based on publication relevance, scholarly rigor, and thematic alignment with Islamic economic principles. Texts were systematically coded to identify recurring patterns, such as references to *maqāṣid al-sharī'ah*, ethical entrepreneurship, or institutional support. NVivo 12 software was used to organize and annotate key themes from the textual corpus, in line with qualitative content analysis methods proposed by (Schreier, 2012, p. 137).

The analytical method followed a thematic coding approach. Codes were developed deductively from Islamic economics literature (e.g., *rahmah*, *'adl*, *khilāfah*) and inductively from document analysis. Themes were cross-validated across different text types—legal, financial, and religious—to construct a coherent analytical narrative. This approach aligns with grounded theory techniques, which allow theory to emerge from data while respecting pre-existing epistemological frameworks (Strauss & Corbin, 1998, p. 102).

Conclusions were drawn through interpretive synthesis. The process involved iteratively comparing emergent themes with theoretical constructs, policy frameworks, and actual MSME behaviors. This reflexive comparison was crucial to uncover discrepancies between Sharia norms and real-world practices, thus enabling the formulation of evidence-based recommendations. The use of a qualitative-textual paradigm ensures that the conclusions drawn are not only grounded in empirical analysis but also resonate with Islamic ethical imperatives and local institutional realities.

Results and Discussion

The findings of this study reveal that Sharia-based MSMEs in Indonesia operate within a complex matrix of ethical aspirations, regulatory constraints, and socioeconomic realities. While many MSMEs identify with Islamic values and attempt to apply basic principles such as *riba*-avoidance and halal production, the depth of Sharia integration remains inconsistent. This inconsistency is influenced by gaps in education, institutional support, and understanding of Islamic business ethics beyond formal compliance. There exists a marked disparity between enterprises that brand themselves as “Sharia-compliant” and those that truly embed *maqāṣid al-sharī'ah* into their business models.

Institutionally, support for Sharia-based MSMEs remains fragmented. Islamic financial services, especially *Baitul Māl wat-Tamwīl* (BMT) and Sharia banks, offer crucial funding pathways, but many enterprises lack the financial literacy and documentation required to access such services. Government interventions—such as halal certification and training programs—are often limited in scope and reach, with rural MSMEs being disproportionately underserved. Moreover, Islamic social finance instruments like *zakat*, *waqf*, and *ṣadaqah* are not fully optimized as developmental tools in the MSME sector due to weak institutional linkages.

Ethically, most MSMEs understand and embrace basic Islamic principles such as *amanah* (trust) and *rahmah* (compassion), but practical implementation is influenced by external pressures such as market competition, cost-efficiency, and regulatory demands. Entrepreneurs are often

caught between pursuing ethical ideals and surviving in an increasingly competitive business environment. Nevertheless, the growing influence of Islamic fintech, consumer demand for halal goods, and faith-based community networks signal potential avenues for transforming MSMEs into fully Sharia-compliant, socially responsible enterprises.

Operationalizing Sharia Principles in MSMEs

The operationalization of Islamic values within MSMEs in Indonesia begins with the foundational principle of *tawhīd*—the oneness of God—as the core driver of ethical conduct and business purpose. Entrepreneurs who internalize *tawhīd* view their business as a means of serving both divine expectations and societal needs (Beekun, 1997, p. 34). This theological orientation frames business not only as a pursuit of livelihood but also as a medium to achieve *falah* (holistic success), which includes spiritual, material, and communal well-being (Chapra, 2000b, p. 112).

In practice, many MSMEs claim Sharia-compliance by avoiding prohibited elements such as *riba* (interest), *gharar* (excessive uncertainty), and *maysir* (gambling). However, field studies show that actual implementation is often partial or symbolic (Nawawi, 2023, p. 221). For example, while some business owners avoid interest-based loans, they may still engage in contractual ambiguity that contradicts the principle of *bayān* (clarity). The lack of understanding of Islamic contract law (*fiqh mu‘āmalah*) often results in inconsistency between intention and execution (Rohmah, 2022).

Another core value—*‘adl* (justice)—is manifested through fair pricing, equitable treatment of workers, and avoidance of exploitative practices. However, maintaining justice in a competitive market poses a challenge. Many MSMEs struggle to balance cost-efficiency with ethical labor practices, especially when facing tight margins and price-sensitive consumers (Farid & Muhtadi, 2019). Although entrepreneurs express a desire to apply *‘adl*, economic pressures often compel compromises.

The principle of *amanah* (trustworthiness) appears more prominently in everyday transactions. MSMEs in regions like West Java and Aceh emphasize building long-term customer relationships through honesty and product quality (Huda & Nasution, 2021). Trust is also fostered through faith-based branding, although this does not always guarantee adherence to Sharia norms in procurement or production processes.

Murābahah (cost-plus financing), *wakālah* (agency), and *ijārah* (leasing) are among the most widely recognized Sharia-compliant contracts among MSME actors, largely due to their application by Islamic financial institutions. However, understanding remains superficial. Entrepreneurs often adopt these contracts because they are required by lenders, not necessarily because they understand their ethical and legal underpinnings (Ascarya & Yumanita, 2019).

Halal certification represents one of the more formalized elements of Sharia operationalization. While businesses are increasingly pursuing halal labeling to attract Muslim consumers, the certification process is often seen as bureaucratic and costly (Munir & Rochmawati, 2020). As a result, many MSMEs self-declare halal status without formal certification, raising questions about the authenticity of their claims (Sulaiman, 2022).

From the religious education standpoint, limited access to training in Islamic business ethics contributes to gaps in implementation. Institutions such as *pesantren* and Islamic universities offer courses on *mu‘āmalah*, but these are not yet systematically linked to MSME outreach programs. The integration of *ta‘līm* (education) and entrepreneurship is crucial for transforming Sharia adherence from formal compliance into lived ethics (Hamid & Saad, 2021).

Arabic sources such as (al-Dīn Al-Nabhānī, 2012, p. 202) advocate for the revival of *ḥisbah* institutions—market inspectors who ensured compliance with Islamic business norms in classical Islamic governance. A modern adaptation of *ḥisbah*, supported by community and state actors, could provide ethical oversight and reinforce internal discipline among MSMEs.

Moreover, Islamic rituals such as *ṣadaqah* (charitable giving) and *zakat al-māl* (almsgiving on wealth) are observed by many MSME actors, but mostly during specific religious seasons. The transformation of these obligations into structured, ongoing business commitments—such as profit-sharing with communities or social enterprise models—is still rare but emerging in some faith-based MSMEs (Yusuf & Wibowo, 2020).

In sum, the operationalization of Sharia principles in Indonesian MSMEs is aspirational and

evolving. While key concepts like *amanah*, *'adl*, and *halal* are widely accepted, their practical realization varies greatly depending on education, institutional support, and market dynamics. The findings suggest the need for structured interventions that combine Islamic education, legal infrastructure, and business support to deepen Sharia integration at the operational level.

Institutional and Financial Support Mechanisms for Sharia MSMEs

The institutional framework supporting Sharia-based MSMEs in Indonesia comprises multiple actors: government ministries, Islamic financial institutions, community-based organizations, and religious bodies. However, the coordination among these entities remains fragmented. The Ministry of Cooperatives and SMEs, for instance, promotes entrepreneurship development, but rarely tailors programs specifically for Sharia-oriented enterprises (Maulana & Ibrahim, 2021). Meanwhile, halal certification bodies like BPJPH under the Ministry of Religious Affairs focus mainly on food and cosmetic sectors, overlooking broader ethical business practices rooted in Islamic values.

One of the most significant support mechanisms comes from Islamic microfinance institutions, notably *Baitul Māl wat-Tamwīl* (BMT). These community-based financial entities offer *qard al-ḥasan*, *murābahah*, and *mudārabah* contracts, facilitating capital access for MSMEs otherwise excluded by conventional banks (Ascarya & Yumanita, 2019). BMTs also serve as ethical mentors, reinforcing religious values alongside business practices. However, their outreach is limited by funding constraints, human resource challenges, and a lack of integration with national economic development plans.

Islamic commercial banks also play a role, though their penetration among MSMEs remains limited. Many MSME actors perceive Sharia banks as too bureaucratic, document-heavy, or urban-centered. According to (Sudarsono, 2018), Islamic financial institutions must recalibrate their business models to align with the realities of micro-enterprises, particularly in simplifying procedures and enhancing rural access. Fintech startups have started filling this gap, offering Sharia-compliant digital financing, though regulatory oversight is still evolving.

Government policy, while increasingly favorable toward Islamic finance, lacks strategic coherence in supporting Sharia-based MSMEs holistically. For example, the National Committee for Islamic Economy and Finance (KNEKS) has outlined a master plan for Islamic economy development, but operational translation of that vision to MSME levels remains minimal (KNEKS, 2022). Budget allocations for MSME Sharia training or capital assistance are often generalized and fail to differentiate between conventional and Sharia enterprises.

Community-based organizations, including Islamic boarding schools (*pesantren*), mosques, and zakat institutions, offer informal support mechanisms. Some *pesantrens* have created cooperative ventures or *koperasi syariah* to support local business networks. These grassroots initiatives often operate on trust and *ukhuwah*, integrating social capital with faith-driven economic behavior (Rohmah, 2022). Yet, scalability and governance are common limitations.

Zakat, *waqf*, and *ṣadaqah* also hold latent potential as financing sources for MSMEs. Unfortunately, these instruments are underutilized due to regulatory silos between charitable bodies and entrepreneurial development agencies. (Al-Qaradawi, 1995, p. 118) argues that *zakat* should not be limited to poverty alleviation but also serve as a means of economic empowerment, particularly when directed to productive MSMEs. Indonesia's zakat institutions have begun experimenting with productive *zakat*, but coverage is still marginal.

The halal certification process, governed by BPJPH and previously by MUI, is a double-edged sword. While certification improves product credibility and market reach, the costs and procedural complexity deter micro-enterprises (Munir & Rochmawati, 2020). For Sharia-based MSMEs, especially those operating on religious motivation, formal halal certification is often replaced by informal trust within the Muslim community. This reliance, however, limits their scalability and access to broader markets.

Internationally, Malaysia's model of integrating Islamic finance, SME development, and halal industry promotion offers a comparative benchmark. According to (Kamali, 2002, p. 215), regulatory coherence and cross-sector alignment are critical for embedding Islamic values into national economic systems. Indonesia, by contrast, still treats these components in silos—Islamic finance, MSME development, and religious affairs—without a unifying institutional strategy.

From a theoretical lens, the current support landscape lacks alignment with Islamic institutional economics, which advocates for value-driven governance embedded in *maqāṣid al-sharī'ah*. Institutions like BMTs partially fulfill this role but are structurally constrained. The revival of *hisbah*-like ethical oversight bodies, as proposed by (al-Dīn Al-Nabhānī, 2012, p. 200), could enhance Sharia adherence while complementing existing institutional support.

Overall, while various actors exist to support Sharia-based MSMEs, the lack of integration, consistent training, and ethical enforcement mechanisms creates significant gaps. The state, religious authorities, and financial institutions must collaborate to construct an ecosystem where Sharia principles are not just encouraged but systematically supported and institutionalized.

Challenges and Opportunities for Sharia MSMEs in Indonesia

Sharia-based MSMEs in Indonesia operate in an environment filled with contradictions between normative Islamic ideals and market-driven pragmatism. One of the most significant challenges lies in the fragmentation of understanding about what constitutes a Sharia-compliant enterprise. While terms like *halal*, *riba-free*, and *Islamic branding* are commonly used, few MSME actors are familiar with the deeper principles of *mu'āmalah*, contract ethics, or the objectives of *maqāṣid al-sharī'ah* (Nawawi, 2023, p. 223). This shallow understanding often results in symbolic adherence rather than substantive transformation.

A related issue is the lack of formal education or structured outreach related to Islamic business ethics. Although *pesantren* and Islamic universities offer conceptual education on Islamic economics, there are limited programs that translate this knowledge into practical tools for MSMEs (Hamid & Saad, 2021). Entrepreneurs, especially in rural and semi-urban areas, often rely on informal community norms rather than structured Sharia-based frameworks, creating inconsistencies in business practices.

Financial inclusion is another major obstacle. Despite the existence of Islamic banks and BMTs, many MSMEs still rely on conventional lending due to accessibility and familiarity. Islamic financial institutions, while growing, often impose similar administrative burdens as their conventional counterparts, deterring small entrepreneurs from applying (Sudarsono, 2018). Moreover, interest-free or profit-sharing financing is not always clearly understood by MSME actors, further complicating adoption.

From an operational standpoint, halal certification poses a major barrier. While essential for consumer trust and export potential, the cost and bureaucracy of obtaining certification hinder many MSMEs from formalizing their operations (Munir & Rochmawati, 2020). This becomes more complex for MSMEs dealing with processed foods or cosmetics, where multiple ingredients require layered verification. Informal self-declaration of halal status fills the gap but raises questions about authenticity and transparency.

There is also the challenge of market access and digitalization. Many MSMEs still operate offline or rely on traditional marketing channels. Islamic fintech has started to emerge as a bridge, offering Sharia-compliant lending, payment, and investment services via mobile platforms. However, digital literacy and technological infrastructure remain uneven across regions (Yusuf & Wibowo, 2020). Limited digital transformation reduces scalability and competitive positioning, especially in the post-pandemic economy.

Institutionally, there is an absence of integrated policy frameworks that unite Islamic financial services, religious education, halal regulation, and MSME development. Policies remain siloed between ministries and agencies, creating fragmented support. This limits the ecosystemic growth necessary to nurture Sharia-based MSMEs holistically (Maulana & Ibrahim, 2021). For example, initiatives under KNEKS rarely connect with grassroots cooperatives or *pesantren* economies in a coordinated manner.

Despite these challenges, several opportunities are beginning to take shape. The increasing demand for halal products both domestically and globally offers a strong market pull for ethically run MSMEs. Indonesia's goal to become a global halal hub aligns with these aspirations and could elevate Sharia-based MSMEs to international platforms if supported effectively (KNEKS, 2022). Strategic partnerships with halal logistics and export channels will be crucial in this regard.

Social entrepreneurship, rooted in Islamic philanthropy instruments like *zakat*, *waqf*, and *sadaqah*, also presents a transformative opportunity. Productive *waqf* programs have started

funding MSMEs, while zakat agencies are piloting empowerment-based models rather than consumption-based distributions (Al-Qaradawi, 1995, p. 131). With proper regulation and inter-institutional collaboration, these instruments can function as alternative capital streams that are both ethical and sustainable.

Finally, the revival of classical Islamic economic principles such as *hisbah* and community-based governance offers innovative models for ethical enforcement and mentorship. (al-Dīn Al-Nabhānī, 2012, p. 208) emphasizes that Islamic markets require not just legal supervision, but also moral cultivation. Community-led ethics councils or Sharia-based business associations could provide localized enforcement of business ethics, enhancing the credibility and internal resilience of MSMEs.

In sum, while the development of Sharia-based MSMEs in Indonesia faces multiple systemic and behavioral challenges, emerging trends—such as Islamic fintech, halal market expansion, and philanthropic social finance—offer scalable pathways for transformation. These opportunities require cohesive policy support, ethical education, and institutional integration to be fully realized.

Entrepreneurial Perceptions and Internalization of Islamic Ethics

Entrepreneurs in the Sharia-based MSME sector often exhibit a strong emotional and spiritual connection to Islamic values, which they perceive as guiding principles for both personal conduct and business operations. However, the translation of these values from belief into structured practice varies significantly across regions, education levels, and types of business. For many MSME actors, the adoption of Sharia-compliant behavior begins with the intention (*niyyah*) to avoid *harām* (forbidden) transactions and to seek *barakah* (blessing) in income generation (Beekun, 1997, p. 21).

The principle of *amanah* (trustworthiness) is one of the most consistently referenced ethical values among Sharia-based entrepreneurs. Most interview and survey-based research indicates that trust plays a central role in customer relations, supplier agreements, and employee management (Rohmah, 2022). Entrepreneurs see *amanah* as not only a religious obligation but also a strategic asset that fosters loyalty and repeat business. However, when faced with economic pressure or competitive threats, some actors admit to compromising these values to sustain operations.

Mas'ūliyyah (accountability) and *'adl* (justice) are also frequently cited but less often implemented in structured business governance. Many MSMEs lack formal employee policies, transparent accounting systems, or grievance mechanisms. This leads to an ethical paradox: while the entrepreneur may genuinely believe in justice and fairness, they often lack the tools or knowledge to apply these principles operationally (Farid & Muhtadi, 2019). This gap suggests the need for ethical literacy programs integrated into MSME development.

Another significant observation is that many entrepreneurs equate Sharia compliance with external symbols—Arabic names, modest dress, or Islamic greetings—rather than substantive ethical standards in pricing, marketing, and negotiation. (Nawawi, 2023, p. 226) refers to this as “symbolic religiosity,” where Sharia becomes a brand identity rather than a moral compass. This perception is especially common in businesses targeting Muslim consumers, where Islamic cues are used as marketing tools without a deeper commitment to ethical practices.

Nevertheless, a smaller but growing group of Sharia-based entrepreneurs are consciously engaging in what can be described as *ijtihad* (independent reasoning) in ethical decision-making. They reflect on business choices in light of Islamic jurisprudence, consult local *'ulamā'*, and seek guidance from Sharia-compliant mentors. These actors often operate in close affiliation with *pesantren* or Islamic cooperatives, where ethical reinforcement is built into the organizational culture (Hamid & Saad, 2021).

Spiritual motivations also drive behavior. Entrepreneurs often express the belief that business success is not solely a function of strategy or capital but also of divine will (*tawakkul*). This belief, when grounded in deep understanding, cultivates ethical resilience and discourages exploitative or deceptive practices. However, in some cases, it may also lead to fatalism or reluctance to scale due to fear of compromising religious principles (Chapra, 2000a, p. 124).

Arabic sources such as (Al-Sadr, 1983, p. 153) argue that Islamic economics must cultivate not only external compliance but also internal virtues like *ṣidq* (truthfulness), *ḥilm* (patience), and *'afw* (forgiveness). These virtues, while not easily legislated, are critical for ethical

entrepreneurship. MSMEs that view business as a form of *ibādah* (worship) tend to internalize these traits more consistently, treating their ventures as platforms for moral cultivation and community benefit.

In contrast, structural economic challenges—such as inflation, supply chain volatility, and limited bargaining power—can erode the commitment to ethics. Entrepreneurs may rationalize unethical behavior as temporary survival strategies. This ethical elasticity, while understandable, underscores the vulnerability of moral commitment in environments lacking institutional support and peer accountability (Yusuf & Wibowo, 2020).

Peer networks, mentorship, and religious communities play an important role in shaping ethical perceptions. Entrepreneurs embedded in Islamic cooperatives or mosque-based business networks report higher levels of ethical reinforcement and shared accountability. These communal mechanisms act as informal “ethics incubators,” aligning market practices with Islamic principles through role modeling, peer pressure, and collective *ta’āwun* (mutual support) (Rohmah, 2022).

In summary, the perception and internalization of Islamic ethics among Sharia-based MSME actors vary along a spectrum from symbolic adoption to principled integration. While most entrepreneurs are motivated by faith, the ability to apply that faith in daily business practice is mediated by education, institutional setting, and market pressures. Sustainable ethical practice in Sharia MSMEs requires more than personal conviction—it demands structured support, communal reinforcement, and alignment between values and operational systems.

Conclusion

This study has comprehensively examined the landscape of Sharia-based Micro, Small, and Medium Enterprises (MSMEs) in Indonesia, revealing the dynamic interplay between Islamic ethical ideals, institutional mechanisms, and entrepreneurial behavior. While values such as *amanah* (trustworthiness), *‘adl* (justice), and *tawhīd* (divine unity) are widely acknowledged as foundational principles, their practical application within the MSME sector remains fragmented. Most enterprises operate within a framework of ethical intention but lack the educational, financial, and regulatory infrastructure required for full Sharia operationalization. The findings across all thematic sub-sections underscore a fundamental tension between the aspirational ideals of Sharia-compliant entrepreneurship and the structural realities faced by Indonesian MSMEs. Although Islamic financial institutions like BMTs and Sharia banks provide formal interest-free financial mechanisms, procedural hurdles and capital limitations impede access for many small entrepreneurs. Government initiatives such as halal certification and the KNEKS master plan suggest growing policy awareness but fall short in terms of grassroots outreach and systemic integration.

Entrepreneurs demonstrate varying levels of ethical internalization. Some genuinely practice Islamic values as a spiritual framework for business, while others adopt Sharia branding superficially without meaningful behavioral change. This divergence illustrates the urgent need for ethical literacy, institutional mentorship, and a values-based business culture that transcends formal compliance. Despite these challenges, emerging opportunities offer a promising roadmap for transformation. The rapid rise of Islamic fintech, the global expansion of halal markets, and the strategic use of *zakat* and *waqf* as productive instruments all point to scalable solutions. Realizing this potential, however, demands a holistic and coordinated approach—one that aligns policy coherence, institutional support, business ethics education, and faith-driven financial inclusion. Thus, Sharia-based MSMEs in Indonesia are evolving within a unique ethical and spiritual framework. Yet to become sustainable engines of justice, inclusion, and economic empowerment, these enterprises must bridge the gap between Islamic belief and practice. Only through integrated efforts across government, finance, education, and community can Sharia-based MSMEs truly embody the values of *maqāṣid al-sharī‘ah* and contribute meaningfully to national and global economic development.

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