

Beyond Subsidized Credit: Sharia-Compliant Microfinance as a Catalyst for Inclusive MSME Growth

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ABSTRACT

This study investigates whether Sharia-compliant KUR (Credit program) distributed by Bank Syariah Indonesia (BSI) functions merely as subsidized financing or as a strategic instrument for inclusive and sustainable MSME growth. Despite the recognized importance of KUR in supporting small enterprises, limited research has examined its impact within a Sharia-compliant framework that integrates ethical finance principles with microenterprise growth. Addressing this gap, the study employs an explanatory sequential mixed-methods design combining quantitative analysis and qualitative interviews with MSME actors in Medan City. Quantitative findings reveal a significant positive effect of Sharia-compliant microfinance on MSME growth, particularly in terms of revenue growth, employment expansion, and business stability. MSMEs receiving Sharia-compliant microfinance demonstrate stronger performance and higher resilience compared to non-recipients. Qualitative insights further indicate that beyond financial capital, the program enhances entrepreneurial confidence, strategic planning capacity, and optimism in navigating post-pandemic economic challenges. The murabaha-based financing mechanism and ethical, interest-free structure contribute to increased trust and perceived fairness among beneficiaries. The study contributes to the microfinance dual mission debate by demonstrating that Sharia-compliant microfinance reconciles financial sustainability with social outreach. It extends microfinance theory beyond liquidity provision by integrating ethical finance principles with MSME growth dynamics. The findings suggest that Sharia-compliant microfinance can serve as a transformative development instrument, fostering inclusive growth, employment generation, and sustainable regional economic development.

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1. Introduction

Micro, small, and medium enterprises (MSMEs) hold a very strategic position in Indonesia's economy. Indonesia's 64.2 million MSMEs, contributing 60.6% to the nation's GDP (Kamil, 2022); moreover, they absorb 97% of national employment (Handoko et al., 2023). In 2023, there were around 66 million MSME actors, demonstrating that the public is highly engaged in economic

activities in the fields of production, trade, and services. At a macro level, MSMEs reduce unemployment and promote inclusive economic growth (Balya & Yuldinawati, 2025). They have, also, consistently sustained Indonesia’s economy during periods of crisis (Sarmen, 2025). MSMEs significantly determine economic progress and national development sustainability.

Table 1. Development of the Number of MSMEs in Indonesia from 2018 to 2023

Year	2018	2019	2020	2021	2022	2023
Number of MSMEs (Million Units)	64,19	65,47	64,00	65,46	65,00	66,00
Growth (%)	-	1,98	-2,24	2,28	-0,70	1,52

Source: BPS (2024)

Table 1 presents data from Statistics Indonesia showing fluctuations in MSME growth between 2018 and 2023. The number of MSMEs rose from 64.19 million in 2018 to 66 million in 2023. However, growth was unstable, with the sharpest decline occurring in 2020 (-2.24%) due to the COVID-19 pandemic. The sector recovered in 2021 (2.28%), declined in 2022 (-0.70%), and rebounded again in 2023 (1.52%).

Table 2. Development of MSME Credit by Business Scale in Indonesia (2018–2023)

Year	Micro Enterprises (IDR Billion)	Small Business (IDR Billion)	Medium Enterprises (IDR Billion)
2018	236.868	298.065	435.039
2019	283.518	343.245	480.477
2020	247.142	352.923	488.268
2021	389.871	459.541	371.603
2022	532.698	466.542	349.573
2023	662.293	460.773	334.066

Source: BPS 2024

Table 2 shows the financing dynamic of micro, small, and medium enterprises in Indonesia from 2018 to 2023. Micro enterprises experienced a substantial upward trend, increasing from IDR 236,868 billion in 2018 to IDR 662,293 billion in 2023, indicating strong financial expansion, particularly after 2020. Small businesses showed moderate growth, peaking in 2022 at IDR 466,542 billion before slightly declining in 2023. In contrast, medium enterprises displayed a declining trend after 2020, falling from IDR 488,268 billion to IDR 334,066 billion in 2023. Overall, financing distribution shifted significantly toward micro enterprises during this period (i.e Siskawati et al., 2024).

Microfinance (Kredit Usaha Rakyat, KUR) is a government-backed microcredit program designed to improve MSMEs’ access to affordable financing in Indonesia. Microfinance (Kredit Usaha Rakyat, KUR) aims to reduce financing constraints that commonly hinder small business growth and productivity (Lai, 2024; Rajamani et al., 2022). KUR plays a strategic role in strengthening MSME competitiveness, promoting inclusive economic growth, and supporting Indonesia’s broader development objectives. By providing subsidized interest rates and credit guarantees, the program lowers lending risks for banks while expanding financial inclusion among micro and small entrepreneurs. Empirical evidence shows that Microfinance (Kredit Usaha Rakyat, KUR) positively influences MSME performance and business development (Mugiati, 2024), and contributes to household economic improvement (Setyawati & Hartono, 2025). Moreover, improved access to finance is associated with job growth and labor absorption in developing economies (Ayyagari et al., 2021; Tran et al., 2021)

Although prior studies have widely examined the effectiveness of the Microfinance (Kredit Usaha Rakyat, KUR) program in promoting MSME growth, most empirical investigations analyses largely on conventional credit pricing, institutional efficiency frameworks, efficiency and financial development within conventional banking-oriented frameworks (Fisseha, 2025; Martín-Schubert et al., 2025). Research highlights that government-backed microcredit programs improve household welfare, energy consumption behavior, and economic resilience among vulnerable borrowers (Ghimire et al., 2025; Setyawati & Hartono, 2025), while also influencing household economic behavior and business development (Mardanugraha et al., 2018; Utami et al., 2024). Other studies

focus on perceptions of KUR recipients and its contribution to MSME performance improvement (Mugiati, 2024). At the macro and firm levels, access to finance is consistently associated with job growth, productivity, and business expansion (Ayyagari et al., 2021; Kumarasamy et al., 2024). However, these analyses predominantly frame KUR within a conventional credit architecture, often overlooking the distinct characteristics of Sharia-based financing mechanisms.

Conceptually, Sharia-compliant microfinance mechanisms offer empowerment and sustainability values that are rarely the main focus in conventional credit. While MSMEs are still facing limited access to financing that is fair and according to business needs (Lisawati & Nasruddin, 2025). Sharia-compliant KUR is present as an alternative financing by not using an interest system and operating on sharia principles that emphasize fairness and partnership. Likewise, Research (Hsb et al., 2024) shows that Sharia-compliant KUR increases income and MSME business expansion. In addition, the creditworthiness analysis mechanism such as the 5C principle applied to Sharia-compliant KUR strengthens financing governance (Suci et al., 2021). These features reflect not merely a different banking channel but a fundamentally different financing paradigm grounded in fairness, asset-backing, and value-based intermediation. Existing literature has yet to sufficiently theorize whether such institutional and normative distinctions influence MSME performance beyond capital provision, particularly in terms of entrepreneurial confidence, trust formation, and sustainable business expansion.

This study examines the effect of Sharia-compliant microfinance, specifically the Kredit Usaha Rakyat (KUR) distributed by Bank Syariah Indonesia (BSI), on MSME growth. BSI represents the institutional consolidation and advancement of Indonesia's Islamic banking system and operates under ethical and inclusive financial principles. This research was carried out in Medan City due to the significant scale and measurable impact of Sharia-compliant microfinance. By December 2023, around 18,000 MSMEs had received BSI KUR totaling IDR 1.1 trillion, reflecting strong Islamic financing penetration and regional growth. Medan City provides a relevant empirical setting due to its dynamic economic activity and substantial MSME population. This research evaluates whether Sharia-compliant microfinance mechanisms significantly enhance business growth, sustainability, and welfare outcomes among MSME actors.

Research Framework

Concept of Microfinance

Microfinance theory originates from development economics and financial intermediation theory, focusing on expanding access to financial services for low-income populations excluded from conventional banking systems. Microfinance institutions (MFIs) are characterized by a dual mission or "double bottom line," which requires them to simultaneously expand outreach to the poorest segments and achieve financial sustainability (Blanco-Oliver et al., 2023). This duality creates a structural tension between social performance and financial efficiency, often framed in the debate on mission drift. Within financial intermediation theory, smaller loans are associated with higher operational costs per dollar lent due to fixed screening, monitoring, and administrative expenses.

However, microfinance departs from traditional banking by developing innovative mechanisms that reduce asymmetric information, adverse selection, and moral hazard, thereby enabling sustainability even in high-risk environments. From a capital structure perspective, MFIs' financing decisions are also shaped by profitability and institutional maturity, consistent with pecking order theory and life-cycle theory (Alexis, 2023). Accordingly, microfinance theory integrates outreach, efficiency, governance, and funding structure into a dynamic framework that links social impact with institutional and financial development (Gehrig et al., 2021).

Concept of MSME growth

MSME concept is grounded in development economics and entrepreneurship concept, emphasizing the role of Micro, Small, and Medium Enterprises (MSMEs) as engines of inclusive growth, employment generation, and structural transformation. MSMEs constitute over 90% of businesses in many developing economies, highlighting their systemic importance in economic ecosystems (Mwanzia, 2022). They are widely recognized for fostering innovation, enhancing economic diversity, and contributing to poverty alleviation by providing accessible goods and services with relatively low capital requirements (Haile, 2020). Beyond economic expansion, MSMEs also play a role in promoting environmental sustainability within local production systems (Liu, 2024).

From a growth perspective, access to finance is central to MSME concept. Financial resources enable firms to expand operations, increase employment, and enhance productivity (Tran et al., 2021). Consequently, MSMEs significantly contribute to GDP and inclusive development in many countries (Samudzimu & Munkumba, 2022). However, financial constraints remain a major structural barrier, as limited credit access, perceived lending risks, and information asymmetries hinder firm expansion and innovation (Lai, 2024; Osuna et al., 2024). Macroeconomic conditions further shape financing decisions and business sustainability (Doacă, 2022; Rajamani et al., 2022).

Sharia-compliant Microfinance and MSME growth

Sharia-compliant microfinance represents an alternative financial model designed to support MSME growth while adhering to Islamic principles. Unlike conventional microfinance, Sharia microfinance prohibits interest (*riba*) and emphasizes profit-sharing, ethical investment, and risk-sharing mechanisms (Fitriana, 2024; Fan et al., 2019). This ethical foundation aligns financial inclusion with social justice, making it particularly relevant in Muslim-majority economies where MSMEs often face exclusion from conventional banking systems. By offering capital access through Sharia-compliant contracts, these institutions enable micro and small enterprises to expand operations without violating religious norms.

The growth of MSMEs under Sharia microfinance is closely linked to women's financial inclusion. Women entrepreneurs frequently face capital constraints, and Sharia microfinance institutions play a crucial role in overcoming these barriers (Nawawi et al., 2022). Empowerment significantly strengthens the impact of financing, as financially empowered women tend to allocate resources more effectively to improve household and business welfare (Sukarnoto et al., 2023). This dynamic enhances MSME productivity while contributing to broader socio-economic stability.

Operationally, Sharia microfinance utilizes instruments such as *mudharabah* and *murabaha* to facilitate funding while ensuring compliance with Islamic law. Empirical evidence shows a positive relationship between Sharia-compliant financial products and community economic improvement (Ratnawita et al., 2023). Additionally, cash *waqf* mechanisms broaden funding sources for MSMEs (Aini, 2024). However, challenges remain, including limited sectoral penetration and risk management complexities (Isfianadewi, 2023; Wafi & Muhammad, 2023). Although profitability may be lower than conventional models, Sharia institutions often demonstrate stronger outreach to impoverished populations, reinforcing their dual objective of sustainability and social impact (Fan et al., 2019).

Hypotheses Development

Microfinance theory posits that financial inclusion mechanisms enhance enterprise performance by addressing credit constraints, reducing information asymmetry, and strengthening governance structures (Gehrig et al., 2021). The dual mission of microfinance institutions—balancing outreach and sustainability—suggests that well-designed financing schemes can simultaneously generate social and economic value (Blanco-Oliver et al., 2023). Within this framework, Sharia-compliant microfinance represents a distinct institutional model that integrates ethical finance, risk-sharing, and asset-backed transactions. Unlike conventional credit systems, Sharia financing emphasizes fairness, transparency, and partnership, which may enhance trust formation and reduce moral hazard (Fan et al., 2019; Fitriana, 2024).

From the MSME growth perspective, access to finance is a primary determinant of business expansion, employment creation, and productivity improvement. Financial constraints remain a structural barrier limiting MSME innovation and scaling (Lai, 2024; Osuna et al., 2024). Sharia-compliant contracts such as *murabaha* and *mudharabah* provide structured financing that supports working capital and investment needs while maintaining ethical compliance (Ratnawita et al., 2023). Moreover, empowerment effects—particularly among women entrepreneurs—strengthen the developmental impact of financing (Nawawi et al., 2022; Sukarnoto et al., 2023). Based on these theoretical and empirical foundations, the study proposes the following hypothesis:

Ha: Sharia-Compliant Microfinance has a positive and significant effect on MSME growth.

2. Methods

2.1 Research Design

This study employed an explanatory sequential mixed methods design, integrating quantitative and qualitative approaches to comprehensively examine the effect of Kredit Usaha Rakyat Syariah (KUR) from Bank Syariah Indonesia (BSI) on MSME development in Medan City. The mixed-methods design was chosen to capture both measurable economic impacts and deeper experiential insights from MSME actors.

1. Quantitative Phase

The quantitative phase employed a quantitative explanatory design with a descriptive-associative approach. The objective was to determine the extent to which Sharia-compliant microfinance (BSI KUR) influences MSME development in Medan City. This design enables empirical measurement of relationships between variables using statistical inference (Creswell, 2014). The population consisted of 258 MSMEs registered as KUR recipients at BSI KCP Iskandar Muda, Medan. The sample size was determined using the Slovin formula with a 10% margin of error, resulting in 60 MSME respondents. This sample size was considered statistically adequate for regression analysis and represented a relatively homogeneous population of KUR beneficiaries.

In the quantitative phase, data were processed using SPSS version 29 through a series of systematic statistical procedures. The first step involved testing the quality of the research instrument. Validity was examined using the Pearson Product Moment correlation to ensure that each indicator accurately measured its respective construct. All correlation coefficients exceeded the critical r -value, confirming that the items were statistically valid. Reliability testing was conducted using Cronbach's Alpha following the guidelines of Ghozali (2018), and the results indicated that the instruments were internally consistent and reliable for further analysis.

Subsequently, classical assumption testing was performed to ensure the appropriateness of the regression model. The normality of residuals was assessed using the One-Sample Kolmogorov-Smirnov test. Although minor deviations were detected, the model was considered sufficiently robust for inferential analysis given the sample size.

Hypothesis testing was carried out using simple linear regression analysis to evaluate the effect of Sharia-compliant microfinance (KUR BSI) on MSME development. The partial t -test to measure individual variable effect, Simultaneous Test (F -test) to test overall model significance, and Coefficient of Determination (R^2) to measure explanatory power. These tests aimed to analyse relationship between the variables.

Variable Operationalization

The independent variable in this study is Sharia-Compliant Microfinance. Sharia-Compliant Microfinance integrates ethical financing, productive capital support, and government-backed schemes to enhance MSME efficiency, household welfare, and poverty alleviation while addressing managerial and structural challenges (Panjinegara et al., 2024; Purmiyati et al., 2019; Setyawati & Hartono, 2025). It is measured using six indicators: accessibility, ease of procedure, affordability of margin, compliance with sharia principles, mentoring support, and transparency of contract.

The dependent variable is MSME development. MSME development is driven by targeted financial interventions, entrepreneurship programs, and household economic dynamics that enhance employment generation, production capacity, and inclusive development. For this study, MSME development is measured through six indicators: revenue growth, sales increase, employment expansion, business stability, business expansion, and entrepreneurial confidence.

2. Qualitative Phase

The qualitative phase adopted a descriptive phenomenological approach, aiming to capture the lived experiences of MSME actors regarding the impact of Sharia-compliant KUR financing from Bank Syariah Indonesia (BSI). This approach was appropriate because the study did not merely seek statistical relationships but also aimed to understand how financing influenced entrepreneurial perceptions, confidence, and business resilience.

Informants were selected purposively to represent variations in business scale, sector, and financing status. The informants consisted of MSME actors in Medan City, including recipients of BSI KUR financing and Non-recipients of BSI KUR. They are food entrepreneurs (dimsum and fried chicken), fashion entrepreneurs (hijab business), and beverage sellers (Thai tea business). This

selection allowed comparison between financed and non-financed MSMEs.

The qualitative data in this study were collected through semi-structured interviews method with selected MSME actors in Medan City. This method allowed the researchers to explore key themes while maintaining flexibility to capture participants' lived experiences in depth. The interviews examined changes in business development before and after accessing financing, particularly in terms of revenue growth, expansion capacity, and operational stability. Participants were also asked about the constraints they faced in accessing capital, including administrative barriers and reliance on informal funding sources. Furthermore, the interviews explored perceptions of Sharia-compliant financing, focusing on aspects such as transparency, fairness, and comfort with interest-free contracts. Beyond financial outcomes, the discussions addressed psychological impacts, including increased entrepreneurial confidence, willingness to take calculated risks, optimism in facing market competition, and motivation to pursue business expansion. Finally, the interviews investigated broader challenges related to business survival, especially in the post-pandemic economic environment. This qualitative approach enabled a deeper understanding of how Sharia microfinance influences not only financial performance but also the strategic and behavioral dimensions of MSME development.

3.2 Triangulation Strategy

Methodological triangulation was applied to enhance validity and reliability. Quantitative results were cross-validated with interview narratives and secondary data from BSI reports. The convergence of statistical findings, documentary evidence, and participant testimonies strengthened the robustness of the conclusions. By integrating numerical measurement with experiential evidence, this mixed-methods approach ensures a holistic evaluation of the economic and social impact of Sharia microfinance on MSME growth in Medan City.

3. Results

4.1 Data validity

Table 3. Validity Test of KUR at Bank Syariah Indonesia in Sharia Micro Financing (X)

Variables	Accessibility (X1)	Ease of Procedure (X2)	Affordability of Margin (X3)	Sharia Compliance (X4)	Mentoring Support (X5)	Contract Transparency (X6)	Total_X
Accessibility (X1)	1	0.391**	0.671**	0.421**	0.392**	0.549**	0.750**
Ease of Procedure (X2)	0.391**	1	0.151	0.418**	0.561**	0.241	0.622**
Affordability of Margin (X3)	0.671**	0.151	1	0.372**	0.485**	0.709**	0.761**
Sharia Compliance (X4)	0.421**	0.418**	0.372**	1	0.502**	0.286*	0.736**
Mentoring Support (X5)	0.392**	0.561**	0.485**	0.502**	1	0.423**	0.787**
Contract Transparency (X6)	0.549**	0.241	0.709**	0.286*	0.423**	1	0.704**
Total_X	0.750**	0.622**	0.761**	0.736**	0.787**	0.704**	1

Source : SPSS 29

The Pearson correlation matrix at Table 3 indicates that all six indicators of Sharia-compliant microcredit are positively associated with the total construct score. Accessibility (X1), affordability of margin (X3), mentoring support (X5), and transparency of contract (X6) show strong correlations with Total_X, ranging from 0.704 to 0.787 ($p < 0.01$). Ease of procedure (X2) also demonstrates a significant relationship with the total score ($r = 0.622$, $p < 0.01$), although some inter-item correlations such as X2-X3 and X2-X6 are weaker and not statistically significant. Sharia-compliant (X4) maintains moderate correlations with other indicators. Overall, all items exceed the critical r -value of 0.252 ($N = 60$), confirming their validity in measuring the construct consistently.

Table 4. Validity of Small and Medium Enterprise Development (Y)

Variables	Revenue Growth (Y1)	Sales Increase (Y2)	Employment Expansion (Y3)	Business Stability (Y4)	Business Expansion (Y5)	Entrepreneurial Confidence (Y6)	Total_Y
Revenue Growth (Y1)	1	0.727**	0.540**	0.703**	0.488**	0.617**	0.850**
Sales Increase (Y2)	0.727**	1	0.500**	0.579**	0.326*	0.578**	0.764**
Employment Expansion (Y3)	0.540**	0.500**	1	0.498**	0.552**	0.487**	0.781**
Business Stability (Y4)	0.703**	0.579**	0.498**	1	0.508**	0.623**	0.811**
Business Expansion (Y5)	0.488**	0.326*	0.552**	0.508**	1	0.393**	0.715**
Entrepreneurial Confidence (Y6)	0.617**	0.578**	0.487**	0.623**	0.393**	1	0.787**
Total_Y	0.850**	0.764**	0.781**	0.811**	0.715**	0.787**	1

Source : SPSS 29

The Pearson correlation matrix demonstrates that all six indicators of MSME development are positively and significantly associated with the overall construct score. Revenue growth (Y1) exhibits the strongest correlation with Total_Y ($r = 0.850$, $p < 0.01$), followed by business stability (Y4) and entrepreneurial confidence (Y6). Sales increase (Y2), employment expansion (Y3), and business expansion (Y5) also show strong and statistically significant correlations with the total score, ranging from 0.715 to 0.787. Inter-item correlations are moderate to strong, indicating internal coherence among dimensions. All coefficients exceed the critical r -value of 0.252 ($N = 60$), confirming that each indicator validly measures MSME development.

A. Data Normality

Table 5. Data Normality of the Research

One-Sample Kolmogorov-Smirnov Test			
	N	Unstandardized Residual	
Normal Parameters ^{a,b}	Mean	.0000000	
	Std. Deviation	237.874.666	
Most Extreme Differences	Absolute	.131	
	Positive	.116	
	Negative	-.131	
Test Statistic		.131	
Asymp. Sig. (2-tailed) ^c		.013	
	Sig.	.009	
Monte Carlo Sig. (2-tailed) ^d	99% Confidence Interval	Lower Bound	.090
		Upper Bound	.015

a. Test distribution is Normal.

b. Calculated from data.

c. Lilliefors Significance Correction.

d. Lilliefors' method based on 10000 Monte Carlo samples with starting seed 2000000.

Source : SPSS 29

The One-Sample Kolmogorov–Smirnov test was conducted to assess the normality of the regression residuals. The sample size consists of 60 observations. The residuals have a mean value of 0.0000000, indicating that the errors are centered around zero, which is consistent with regression assumptions. The test statistic is 0.131, representing the maximum deviation between the observed and expected cumulative distributions. However, the Asymp. Sig. (2-tailed) value is 0.013 and the Monte Carlo significance value is 0.009, both below the 0.05 threshold. These results indicate that the residuals do not follow a normal distribution at the 5% significance level. Therefore, the

assumption of normality is statistically violated. Although minor deviations from normality may not substantially affect regression estimates with a moderate sample size, researchers should consider transformation techniques or additional robustness checks to ensure the reliability of inferential results.

B. Partial Analysis (t)

Table 6. Partial Analysis (t)

Coefficients^a					
Model	Unstandardized		Standardized	T	Sig.
	Coefficients		Coefficients		
	B	Std. Error	Beta		
1 (Constant)	6.716	2.607		2.576	.013
TOTALX	.733	.099	.698	7.418	<.001

a. Dependent Variable: TOTALLY

Source: SPSS 29

Table 6 presents the results of the partial test (t-test) conducted using SPSS version 29 show that the Sharia People's Business Credit variable of Bank Syariah Indonesia (X) has a significant effect on MSME growth (Y). There is a significance value of <0.001 and a calculated t of 7.418, which is greater than the table t of 1.671. In addition, there is a regression coefficient of 0.733, indicating that BSI's KUR contributes positively by 73.3% to MSME growth.

C. Simultaneous Analysis (F)

Table 7. Simultaneous Analysis (F)

ANOVA^a					
Model	Sum of Squares	df	Mean Square	F	Sig.
1 Regression	316.736	1	316.736	55.027	<.001 ^b
Residual	333.848	58	5.756		
Total	650.583	59			

a. Dependent Variable: TOTALLY
 b. Predictors: (Constant), TOTALX

Source: SPSS 29

Table 7 shows the results of the simultaneous F test using SPSS version 29, which indicates a significance value of <0.001 and a calculated F value of 55.027, which exceeds the F table value of 4.00. These results indicate that the People's Business Credit variable of Bank Syariah Indonesia (X) has a significant simultaneous effect on MSME growth (Y). All indicators of variable X make a meaningful contribution to MSME growth.

D. Analysis of the Coefficient of Determination (R²)

Table 8. Analysis of the Coefficient of Determination (R²)

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.698 ^a	.487	.478	2.399

a. Predictors: (Constant), TOTALX

Source: SPSS 29

Based on Table 8, the R Square value of 0.478 indicates that the People's Business Credit of Bank Syariah Indonesia (KUR BSI) is responsible for 47.8% of the variation in MSMEs growth in Medan City. This shows that Islamic microfinance accounts for nearly half of MSME growth, reinforcing the role of KUR as a strategic instrument. Internal factors, such as management, innovation, and efficiency, contribute 52.2% of the variation.

Hypotheses Testing Result

Ha: Sharia-Compliant Microfinance has a positive and significant effect on MSME growth

This study tested the hypothesis that Sharia Compliance Microfinance has a positive and significant effect on MSME development. The partial t-test results show a t-value of 7.418, which is greater than the critical t-table value of 1.671, with a significance level of $p < 0.001$. This indicates that the null hypothesis (H_0) is rejected and the alternative hypothesis (H_a) is accepted. Therefore, Sharia compliance microfinance significantly influences MSME development. The regression coefficient (B) of 0.733 demonstrates a positive relationship, meaning that an increase in Sharia-compliant microfinance access is associated with an increase in MSME development performance.

Furthermore, the F-test value of 55.027 ($p < 0.001$) confirms that the model is statistically significant. The coefficient of determination (R^2) of 0.478 indicates that Sharia compliance microfinance explains 47.8% of the variance in MSME development, while 52.2% is influenced by other factors.

4. Discussion

MSMEs Using People's Business Credit (KUR) from Bank Syariah Indonesia (BSI) in Medan City

The distribution of Sharia-based People's Business Credit (KUR) by Bank Syariah Indonesia (BSI) in Medan City reflects the practical implementation of microfinance theory within a dynamic MSME ecosystem. Microfinance, rooted in development economics and financial intermediation theory, carries a dual mission: expanding outreach to underserved populations while maintaining financial sustainability (Blanco-Oliver et al., 2023). The scale of BSI's KUR disbursement—reaching approximately 420,000 MSMEs nationally and 18,000 in Medan with IDR 1.1 trillion distributed—demonstrates institutional capacity to balance outreach and operational viability. This performance illustrates how Sharia-compliant microfinance integrates governance, funding structure, and social impact into a sustainable financing framework (Gehrig et al., 2021; Alexis, 2023).

From the perspective of MSME growth theory, access to finance is a decisive growth determinant. MSMEs function as engines of inclusive development, employment creation, and structural transformation (Mwanzia, 2022; Haile, 2020). Empirical findings from Medan show that 68% of KUR recipients experienced revenue increases averaging 35%, while employment expanded by 2–4 workers per business unit. In contrast, non-recipients recorded only 29% revenue growth with a modest 15% average increase and minimal labor expansion. These disparities align with the argument that financial access enhances firm productivity, employment generation, and expansion capacity (Ayyagari et al., 2021; Tran et al., 2021). The stagnation observed among non-recipients reflects persistent structural barriers such as limited capital and information asymmetry, which constrain innovation and competitiveness (Lai, 2024; Osuna et al., 2024).

The Sharia-compliant character of BSI's KUR further strengthens its developmental impact. Unlike conventional credit, Sharia microfinance operates without *riba* and emphasizes ethical transactions, transparency, and risk-sharing (Fitriana, 2024; Fan et al., 2019). These principles foster trust formation and psychological security among entrepreneurs, which is reflected in interview findings showing enhanced self-confidence, optimism, and strategic planning among recipients. Such non-financial dimensions of growth are consistent with the broader understanding that microfinance not only reduces financial exclusion but also mitigates moral hazard and adverse selection through relational mechanisms (Gehrig et al., 2021). The predominance of *murabaha* contracts provides clarity of pricing and reduces uncertainty, reinforcing equitable financial relationships (Ratnawita et al., 2023).

Importantly, Sharia microfinance also supports household's economic empowerment, which has multiplier effects on household welfare and business sustainability (Nawawi et al., 2022; Sukarnoto et al., 2023). The expansion of employment and business stability among recipients demonstrates how ethical financing contributes to socio-economic resilience, especially in post-pandemic conditions characterized by rising costs and market volatility (Doacă, 2022; Rajamani et al., 2022). Although Sharia institutions may exhibit lower profitability compared to conventional counterparts, their stronger outreach to underserved segments reinforces their double bottom line mission (Fan et al., 2019).

Table 9. Distribution of Sharia-Compliant Microfinance (BSI) KUR Nationally and Regionally

Region	Period	MSME Debtor	Distribution	Growth
National	2021 – December 2024	± 420.000	Not mentioned	-
Regional Medan	Until December 2023	± 18.000	Rp1.1 trillion	40.08% (YoY)

Source : BSI (2024)

The findings reveal a substantial performance gap between MSMEs receiving BSI’s Sharia-compliant KUR and non-recipients. Around 68% of beneficiaries recorded average revenue growth of 35% and expanded employment by 2–4 workers, while non-recipients showed only 15% average growth and minimal job creation. This supports MSME growth theory, which emphasizes access to finance as a key driver of productivity and employment (Ayyagari et al., 2021; Tran et al., 2021). Consistent with microfinance theory’s dual mission (Blanco-Oliver et al., 2023), Sharia KUR enhances outreach while sustaining performance. By reducing information asymmetry and promoting ethical risk-sharing (Gehrig et al., 2021; Fitriana, 2024), it strengthens inclusive and sustainable enterprise development.

Table 10. Comparative Analysis Between MSMEs that Access BSI KUR and Those That Do Not Access BSI KUR (Period 2020-2024)

Indicator	Recipient	Non-recipient
Percentage Increase in Revenue	68%	29%
Average Revenue Increase	35%	15%
Increase in Workforce	2–4 person/unit	0–1 person/unit
Business Stability and Growth	Stable and growing	Tends to be stagnant
Access to Training and Capital	High	Limited

Source : BSI (2024)

Interviews also reveal clear disparities between MSMEs receiving BSI’s KUR and non-recipients. Beneficiaries report improved capital access, stronger business growth, and greater resilience. In contrast, non-recipients struggle with limited financing, post-pandemic pressures, and rising raw material costs, hindering business sustainability.

Rahmad, a dimsum business owner and one of the KUR recipients, said that he “...nearly doubled his earnings with KUR because he could buy new equipment and improve the quality of his products...”. Hijab entrepreneur, Fitri, said the same thing that “..KUR financing was a turning point in expanding her business to digital platforms...”. KUR recipients also mentioned that the easy application process and competitive interest rates were the main attractions for them. On the other hand, entrepreneurs who did not receive financing, like fried chicken seller Dedi, admitted that “...it was difficult to get bank loans because they did not meet administrative requirements...”. He said that he had to use money from daily sales. Thai tea seller Lina also said that “...it was difficult for her to expand her business without capital support...”.

These findings confirm that Sharia-based KUR BSI significantly enhances MSMEs’ financial capacity, confidence, and long-term sustainability in Medan City. Beyond capital provision, it operates as a strategic instrument for inclusive development. Through ethical financing, institutional strength, and targeted outreach, KUR BSI supports entrepreneurial growth, job creation, and sustainable regional economic transformation.

The Effect of People's Business Credit (KUR) from Bank Syariah Indonesia (BSI) on the Development of MSMEs

The statistical findings demonstrate a strong and significant impact of BSI’s Sharia-compliant Microfinance (KUR) on MSME development in Medan City, as reflected in the t-value of 7.418 ($p < 0.001$). This confirms that KUR is not merely a liquidity instrument but a catalyst for business expansion, revenue growth, and employment generation. Consistent with the fundamental objective of KUR as a government-backed credit scheme providing low-cost financing (Mardanugraha et al., 2018), the program reduces borrowing costs and strengthens financial liquidity for small enterprises. Empirical evidence supports this outcome, as MSMEs receiving KUR exhibit measurable increases in income and operational capacity, aligning with findings that KUR significantly improves MSME economic performance (Mugiati, 2024).

Beyond financial metrics, interviews reveal that Sharia-compliant KUR enhances non-financial dimensions of entrepreneurship, including confidence, optimism, and risk-taking capacity. Entrepreneurs report greater readiness to expand into new markets and adopt strategic planning approaches. This reinforces the broader developmental role of KUR in empowering small businesses, not only economically but also psychologically. However, previous studies highlight that implementation challenges such as information asymmetry and principal-agent problems may reduce effectiveness when recipients lack adequate preparation (Mardanugraha et al., 2018; Darmawan et al., 2022). Therefore, the positive impact observed in Medan suggests that BSI's distribution mechanism successfully mitigates such constraints through guidance and accessible procedures.

The Sharia dimension of BSI's KUR adds a distinct value proposition. Sharia microfinance operates under principles that avoid interest-based transactions and promote ethical financing structures (Syamsuri et al., 2024). This approach resonates strongly in communities where religious compliance influences financial decisions. The dominance of murabahah contracts ensures transparency and fairness in pricing, reducing uncertainty and strengthening trust between the bank and MSMEs. Furthermore, the integration of digital onboarding and information systems reflects the growing synergy between Sharia finance and technological innovation. Sharia fintech initiatives have been shown to improve accessibility and expand financial inclusion among underserved MSMEs (Maharani et al., 2024). Similar initiatives, such as the MAWAR program, demonstrate how integrated Sharia financing models can effectively strengthen partnerships between financial institutions and entrepreneurs (Chasanah et al., 2021).

Comparatively, both KUR and Sharia microfinance contribute significantly to MSME growth, yet Sharia-based mechanisms offer ethical alignment alongside economic support. Research indicates that Sharia financing positively influences MSME financial performance and broader economic growth (Sono et al., 2023). While fintech competition can reduce bureaucratic barriers (Ismanto et al., 2023), the structured institutional support embedded in Sharia KUR strengthens sustainability. Thus, BSI's KUR exemplifies how state-backed credit and Sharia-compliant principles can converge to foster inclusive, resilient, and ethically grounded MSME development.

Challenges in the Distribution of Sharia-compliant financing (KUR) by Bank Syariah Indonesia (BSI) for MSME growth

Despite its measurable success, the distribution of BSI's KUR still faces structural and operational challenges that limit its optimal impact on MSME development. Access to financing remains the central barrier for small enterprises, particularly those lacking financial literacy and administrative capability. As highlighted by Mardanugraha et al. (2018), KUR aims to function as a government-backed subsidy mechanism to reduce borrowing costs and enhance liquidity among low-income entrepreneurs. However, information asymmetry and principal-agent problems may weaken program effectiveness when applicants lack viable business planning capacity. This condition aligns with field findings showing that limited financial understanding discourages eligible MSMEs from applying, thereby constraining financial inclusion.

Administrative complexity further reduces accessibility. Darmawan et al. (2022) demonstrate that bureaucratic procedures and limited awareness often discourage small traders from engaging with KUR schemes. Similar patterns appear in BSI's implementation, where time-consuming processes and documentation requirements create perceived barriers. These inefficiencies risk undermining the core objective of KUR, which is to stimulate MSME growth through affordable and inclusive financing (Mugiati, 2024). Without procedural simplification and better information dissemination, outreach expansion may stall.

From a Sharia microfinance perspective, institutional innovation and technology integration offer promising solutions. Sharia-compliant systems emphasize ethical finance while promoting financial inclusion in communities underserved by conventional banking (Syamsuri et al., 2024). The integration of digital platforms and fintech solutions can reduce bureaucratic friction, improve credit assessment accuracy, and enhance transparency (Maharani et al., 2024). Competitive pressure from fintech institutions, as noted by Ismanto et al. (2023), further highlights the urgency of digital transformation within KUR distribution mechanisms.

Strengthening partnerships is equally critical. Innovation in Sharia finance has also been shown to positively influence MSME profitability and performance (Achyarsyah et al., 2023; Rahmansyah et al., 2023). Furthermore, empirical evidence confirms that Sharia-based financing

contributes positively to MSME economic growth (Sono et al., 2023), reinforcing the need to optimize governance and monitoring frameworks.

Ultimately, addressing literacy gaps, simplifying administrative processes, enhancing digital integration, and strengthening multi-sector partnerships are essential to maximize the developmental impact of BSI's KUR. By resolving these implementation challenges, Sharia microfinance can more effectively fulfill its inclusive mandate and sustain long-term MSME growth in Indonesia.

5. Conclusion

This study examined whether Sharia-compliant financing (KUR) distributed by Bank Syariah Indonesia functions merely as subsidized financing or as a transformative instrument for MSME development. Although prior studies have confirmed the effectiveness of KUR in conventional contexts, limited attention has been given to how Sharia-based mechanisms influence MSME performance beyond liquidity provision. This research addressed that gap by evaluating both financial and non-financial development outcomes among MSMEs in Medan City.

The findings demonstrate that Sharia-compliant KUR significantly enhances MSME development across multiple dimensions. Beyond measurable improvements in revenue, employment expansion, and business stability, the program strengthens entrepreneurial confidence and strategic growth orientation. Quantitative results confirm a strong positive relationship between Sharia microfinance access and MSME performance, while qualitative insights reveal increased optimism, trust, and willingness to expand among beneficiaries. These integrated findings indicate that Sharia-compliant KUR operates not only as capital support but also as a mechanism for reinforcing business resilience and sustainability.

Theoretically, this study contributes to the microfinance dual mission debate by illustrating how Sharia-based financing reconciles outreach objectives with institutional sustainability. The results extend microfinance theory by showing that ethical, interest-free contracts and transparent mechanisms foster relational trust and psychological empowerment alongside financial growth. Furthermore, the study integrates ethical finance principles with MSME growth theory, demonstrating that value-based intermediation enhances productivity, employment absorption, and long-term enterprise stability. Sharia-compliant KUR therefore represents a hybrid model in which financial inclusion, ethical governance, and entrepreneurial development converge to produce inclusive and sustainable economic transformation.

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