



Factors Affecting the Distribution of Micro, Small and Medium Enterprises (MSME) Financing in Islamic Banks

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ABSTRACT

Purpose: This study aims to analyse the influence of the external and internal factors on medium and small micro Enterprise financing in Indonesia Islamic Bank. External factors consist of inflation, BI Rate and Exchange Rate, while the internal factors consist of ROA, CAR, BOPO, FDR and NPF.

Design/Method/Approach: The analysis technique used in this study is multiple regression with OLS approach. The data used in this study are monthly data from 2014-2018. Data obtained from OJK and Bank Indonesia reports.

Findings: The finding results of this study, change in macroeconomic conditions (external factor) will indirectly have an impact on the internal conditions of Islamic Bank and will have an impact on intermediation function, especially for the MSME sector, while partially the factors that influence MSME financing are only in inflation and Exchange rates, CAR, BOPO, NPF, FDR and BI Rate does not affect MSME financing because Islamic Bank do not use the interest system but instead use the profit sharing system.

Originality/Values: The main contribution of this study to industry players, Islamic bank and policy makers. Islamic bank must make more efforts to provide financing for MSME. Islamic Banks must be innovative and creative in creating and offering new products related to financing to MSME.

INTRODUCTION

Sharia Banking is an organized and separate banking system operating under the dominant Sharia law. The growth of Islamic banking in various countries including Indonesia has experienced ups and downs in accordance with the country's financial condition. Islamic banks are financial institutions that operate like conventional banks but adhere to Islamic principles. Therefore, these banks are not involved in usury or in any financial transactions that are contrary to Islamic principles.¹ One concrete example of a sharia-based economic system directly touches the economic sector of the lower classes of society, namely the partnership relationship between Islamic banks and micro entrepreneurs in rural areas.² This shows the importance of product innovation from Islamic banking to develop and strengthen small entrepreneurs.

In developing countries in Asia, micro, small and medium enterprises (MSMEs) have made significant contributions over the years measured in several ways, namely (1) a number of companies, (2) employment generation, (3) production and value added, (4) output aggregate or gross domestic product (GDP), (5) the number of companies established by women entrepreneurs and (6) industrial market areas³ Micro business is widely recognized as an engine of economic growth, this sector has been an influence on economists and policy makers around the world in their decisions regarding financial and economic development.⁴ So the need for improvement to help the development of MSMEs both in terms of capital by providing funding, training or others.

Banks, including Islamic banks, have the main duty to become intermediary institutions, which distribute funds optimally from surpluses to those who need funds. One way to do this is through financing small and medium businesses needs to be increased to enhance the role of

¹ Alharbi, Ahmad Thabet, "Determinants of Islamic Banks' Profitability: International Evidence," *International Journal of Islamic and Middle Eastern Finance and Management* Vol. 1, no. 11 (2015): 1–11.

² Abas, S., "The Role Of Sharia Banking In Strengthening The Micro, Small, And Medium Enterprises In North Maluku, Indonesia," *International Journal of Scientific & Technology Research* Vol. 6, no. 10 (2017): 331–36.

³ Tulus Tambunan, *Pembangunan Ekonomi Inklusif, Sudah Sejahtera Mana Indonesia?* (Jakarta: Pustaka LP3ES (Lembaga Penelitian, Pendidikan dan Penerangan Ekonomi dan Sosial, 2016), 21–43.

⁴ Yasmeeen Al Balushi and Stuart Locke, "Determinants of the Decision to Adopt Islamic Finance: Evidence from Oman," *International Journal of Islamic Finance* Vol. 11, no. 1 (2019): 6–25.

national banks as intermediary institutions.⁵ As an intermediary, financing is the main function for Islamic banks, so it needs to pay more attention to financing because it can improve economic performance. In financing, there are many factors that influence the financing both from within the bank itself and from outside the bank.

From the internal side of financing, banks need to consider the health of banks because healthy banks are more likely to conduct their finances well than unhealthy banks. The health of the bank is measured by the financial performance of the bank itself. Based on Bank Indonesia Circular Letter No.9 / 24 DPbS, it is stated that the soundness of banks is influenced by CAMELS such as Capital covering Capital Adequacy Ratio (CAR), Asset Quality including Non Performance Asset Finance (NPF), Management, Income including Return on Asset (ROA) and Operating Expenses against Revenue (BOPO), Liquidity including finance to deposit ratio (FDR), and Sensitivity.

Research on non-performing loans, estimates that the occurrence of bad loans can be seen from several factors including internal factors such as bank size, capital adequacy ratio (CAR) and operating costs compared to operating income (ROA).⁶ This means that Islamic bank financing for the MSME sector can also be influenced by internal factors (CAMELS).

On the outside of banks or external banks, Islamic banks are directly affected by macroeconomic conditions such as inflation, BI interest rates, and the exchange rate of financing to Islamic banks. In the research of Ibrahim and Suffian (2014) said that financing from Islamic banks is influenced by Macroeconomic factors, namely inflation and the BI rate. Nahar and Sarker (2016) contradict this finding and find that the exchange rate has a negative impact on the ability of Islamic bank financing.⁷ So this research focuses on the factors that influence financing for micro small and medium enterprises from Islamic commercial banks both from the external side and from the internal side. From the internal side it is measured through ROA, CAR, Bopo, FDR and NPF while from the external side it is measured by Inflation, BI Rate and Rupiah Exchange Rates.

⁵ Meydianawathi, "The Analysis of Bank Credit Bergaining Behaviour on SME Sektor in Indonesia," *Economy Study Bulletin*, 2017.

⁶ Moh Benny Alexandri and Teguh Iman Santoso, "Non Performing Loan: Impact of Internal and External Factor (Evidence in Indonesia)," *International Journal of Humanities and Social Science Invention* Vol. 4, no. 1 (2015): 87–91.

⁷ Nahar and Sarker, "Are Macroeconomic Factors Substantially Influential for Islamic Bank Financing? Cross-Country Evidence," *Journal of Business and Management* Vol. 18, no. 2 (2016): 20–27.

Many studies conducted by previous studies, including research conducted by Ibrahim (2011) related to the influence of Macroeconomic Variables on Sharia Financing in Malaysia, found that Islamic finance is driven by interest rates while minimally influenced by stock market fluctuations and does not affect the real sector,⁸ Ibrahim's research only counts on macroeconomic variables only, the difference with this study examines related internal and external factors that are not only macroeconomic factors but also factors from banks such as bank performance are also examined.

Amelia and Hardini (2017), found in their research related to financing at Islamic Finance Banks in Indonesia. DPK, FDR, Inflation, Exchange Rate significantly influence the distribution of financing to Islamic finance banks in Indonesia.⁹ In Alexandari's research (2015) internal and external factors that influence financing in Islamic banks are CAR, ROA, SIZE, GDP and Inflation. It is proven that ROA has a significant effect on financing. Nahar (2016) in his research found Exchange Rates have a negative effect on the ability of financing from Islamic banks.

Ali (2015) in a study entitled 'The Impact of Macroeconomic and Banking Factors on Credit Growth in the Albanian banking system. Finding credit growth is influenced by macroeconomic and banking variables. The result is GDP, inflation and the capital adequacy ratio have a positive impact on credit growth. Whereas interest rates, non-performing loans and bank sizes have a negative effect on loan growth in Perbankan.¹⁰

So in this study using factors derived from internal company, which is the bank's financial ratios including: FDR, Third Party Funds (DPK), ROA, NPF, CAR, and BOPO. External factors and internal factors that influence the provision of MSME financing in Islamic banks are interesting things to study. Based on the background that has been described, then the problem can be formulated in this study, namely: "How are the Effects of External Factors and Internal Factors on Distribution of MSME Financing provided by Islamic Banks?"

This study will contribute to Islamic Banking in order to maximize the business of channeling funds through financing but by taking into account the factors that influence the financing. For small and micro

⁸ Ibrahim, Mansor and Raditya Sukmana, "Dynamics of Islamic Financing in Malaysia: Causality and Innovation Accounting," *Journal of Asia-Pacific Business* Vol. 12, no. 1 (2011): 4–19.

⁹ Amelia, Erika and Hardini Eva Fauziah, "Determinant of Mudharabah Financing: A Study at Indonesian Islamic Rural Banking," *Etikonomi* Vol. 16, no. 1 (2017): 43–52, <https://doi.org/10.15408/etk.v16i1.4638>.

¹⁰ Ali, S., "Importance and Implications of CPEC in South Asia: The Indian Factor," *Journal of Indian Studies* Vol. 1, no. 2 (2015): 113–20.

entrepreneurs can use loans to Islamic banking in developing business with the right financial management context and not cheating.

METHODS

The data period for the BI rate variable, Inflation, Exchange Rates, ROA, CAR, BOPO, FDR and NPF starts from January 2014 to December 2018. According to data from the Central Statistics Agency, 2014 was the year in which SMEs in Indonesia developed so rapidly. The total amount of data in this study was 60 for each variable. Menurut Cohen, et al (2007) the larger the sample, the better the research, but there is a minimum number that must be taken by researchers, namely 30 samples.¹¹

The study was conducted by looking at the financial statements of Sharia Bank Statistics issued by Bank Indonesia and the Financial Services Authority (OJK), in addition to that the data was also obtained from the Central Statistics Agency (BPS). The object of this study is Islamic commercial banks in Indonesia. The method of multiple linear analysis uses the Ordinary Least Squer (OLS) method to measure parameters. The advantage of using the OLS method is the most suitable method of the coefficients for future predictions, given that all assumptions are met. Processing data using Eviews 9.

The OLS equation estimation in this study can be formulated as follows:

$$Y : \alpha + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \beta_5X_5 + \beta_6X_6 + \beta_7X_7 + \beta_8X_8 + e. (1)$$

Where:

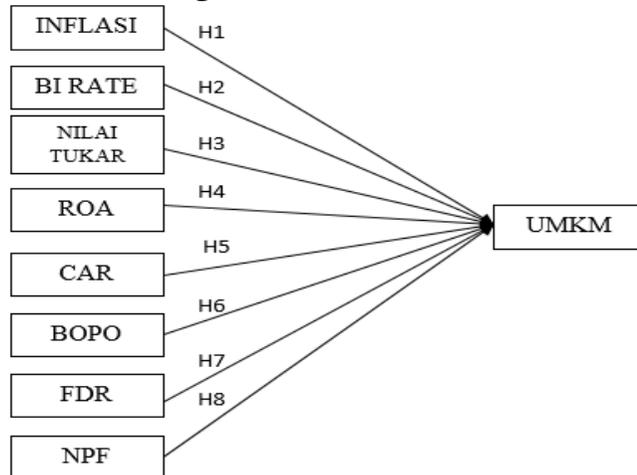
- Y : Variable Distribution of MSME Financing (MSME)
- α : coefficient
- β_1X_1 : Influence Coefficient
- β_2X_2 : Coefficient Effect of BI Rate
- β_3X_3 : Exchange Rate Coefficient
- β_4X_4 : coefficient of influence of ROA
- β_5X_5 : CAR Effect Coefficient
- β_6X_6 : Coefficient of Influence of BOPO
- β_7X_7 : Coefficient of Effect of FDR
- β_8X_8 : NPF Effect Coefficient
- e : error

Before testing multiple linear regression, a classic assumption test is needed first, the tests performed are tests of normality, multicollinearity,

¹¹ Cohen, *Research Methods in Education* (New York: Routledge, 2007).

heteroscedasticity, and autocorrelation. Normality test. With this model, the hypothesis used in this study is as follows:

Figure 1. Research Model



RESULT AND DISCUSSION

In this section discussing test results and followed by analysis, this study has carried out tests of the classic assumptions of normality, heteroskedacity, multicollinearity and autocorrelation. Table 1 shows the average standard deviation of each variable studied. In addition, the sequence of discussions will start from Inflation, BI Rate, Exchange Rate, ROA, CAR, BOPO, FDR and NPF.

Tabel 1. The Statistics Descriptive of Variabels

	N	Mean	Maximum	Minimum	St. Deviasi
UMKM	60	50635.95	109506.00	35662.00	17105.09
INFLASI	60	4.67	8.36	2.79	1.69
BI RATE	60	6.05	7.75	4.25	1.34
NILAI TUKAR	60	13267.48	15227	11404	868.71
ROA	60	0.85	1.41	0.08	0.33
CAR	60	16.52	21.39	14.09	2.9
BOPO	60	91.43	99.04	71.76	6.22
FDR	60	87.36	102.22	77.63	7.17
NPF	60	4.72	6.17	3.01	0.69

Based on table 1 the financing variables provided by Islamic Banks to MSMEs (Y) have an average of 50635.95 with the highest value of 109506.00 and a minimum value of 35662.00 and a standard deviation value of 17105.09.

Tabel 2. Model Feasibility Test Results

Sum of Squares	R-Squared	Adjusted R-Squared	F	Prob
2.69E+09	0.843998	0.819527	34.48975	0.0000

F test was performed to see the effect of independent variables on the dependent variable simultaneously. From table 2 we get the F test results of 34,48975 with a prob 0.0000 level, then the variable factors that influence MSME financing simultaneously have a positive effect. This shows that the overall change in inflation, exchange rate, BI rate, ROA, CAR, BOPO, and NPF significantly influences the distribution of Islamic bank financing to MSMEs. Changes in macroeconomic conditions (External Factors) indirectly have an impact on the internal conditions of Islamic banking, which in turn will have an impact on the function of inter-Islamic sharia banking in terms of financing provision, especially the MSME sector. From table 3 it is also found that R Squared or Determination coefficient is 0.843998 or 84.3998% which means

that the factors that influence MSME financing are 81.3998% while 18.6002% is influenced by other variables not examined in this study.

T test was conducted to see the effect of the independent variable partially on the dependent variable. If the significant value is less than 5%, it will indicate H1 is accepted and H0 is rejected. This means there is a significant effect of the independent variable on the dependent variable.

Tabel 3. Hypothesis Testing Results

Variabel	Coefficient	t	Prob
C	113921.4	1.399940	0.1676
INFLASI	2409.736	2.324665	0.0241
BI RATE	366.0391	0.200023	0.8423
NILAI TUKAR	-13.22132	-5.231295	0.0000
ROA	-8174.682	-1.858392	0.0689
CAR	3805.678	2.959197	0.0047
BOPO	618.6722	2.164145	0.0352
FDR	382.6111	0.802795	0.4258
NPF	-10006.74	-3.746266	0.0005

From table 3 shows that 5 variables are at the significant level of 0.05, namely Inflation, Exchange Rates, CAR, BOPO, and NPF. While the BI Rate, ROA and NPF variables have a negative influence on the distribution of Islamic Bank Financing to MSMEs. The t test results of this study can be explained as follows:

Influence of Inflation on the Distribution of MSME Financing

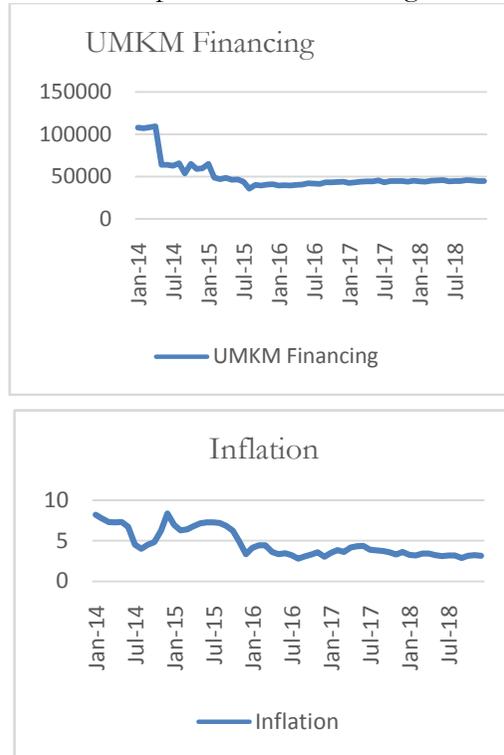
The results obtained in table 3, the inflation variable shows statistically significant results with a significant value of $0.0241 < 0.05$. While the t value of the Inflation variable is 2.324665 so it can be said that H1 is accepted. The results of this study are in line with research by Amelia (2017) who said inflation affects the distribution of funding. This result is also supported by Ali's study (2015) which found that inflation affects credit to banks. Uncontrolled high inflation can disrupt banking efforts in channeling funds to the public. A high inflation rate will make interest rates go down. The fall in the real interest rate affects two things, namely the reduced willingness of people to save and the

Factors Affecting the Distribution of Micro, Small and Medium Enterprises (MSME) Financing in Islamic Banks~ relatively low real interest rate compared to the real interest rate abroad that can result in the flow of foreign capital.

Graphically, it can be seen in Figure 2 that inflation and MSME Financing from 2014-2018 have almost the same lines every month. So that every increase in inflation will increase the distribution of MSME financing at Bank Syariah Indonesia.

Figure 2.

Graph of Inflation Development and Financing of UMKM 2014-2018



The Effect of the BI Rate on the Distribution of MSME Financing

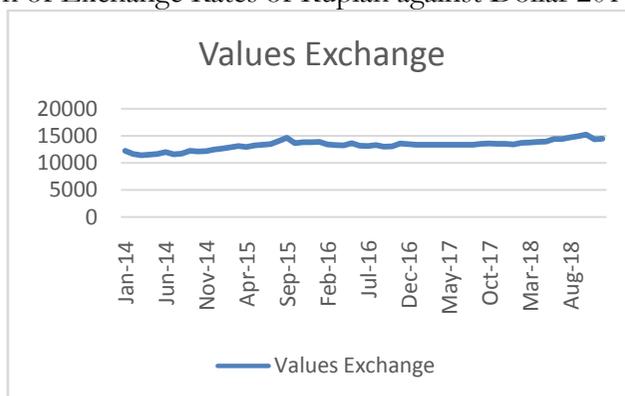
The results obtained in table 2, the BI Rate variable shows the results that have no effect on the distribution of Islamic bank financing to MSMEs. So H2 was rejected because it was not significant between the BI Rate on the Distribution of MSME financing in Islamic Banks. The BI Rate does not affect the distribution of financing to MSMEs because Islamic banks do not use interest rates but instead use the principle of profit sharing or profit sharing.

Effect of Exchange Rates on the Distribution of MSME Financing

In the exchange rate variable obtained a negative result in table 2, namely the significant value of the exchange rate of 0.000 is smaller than the 5% significant

level. The Exchange Rate variable has a negative effect on the distribution of MSME financing. Thus it can be said that H3 is accepted. This result is in line with research conducted by Nahar and Sarker (2016), where an increase of a country's exchange rate will increase net imports (higher imports than exports). This can increase consumption and will reduce production, and will have an impact on decreasing the volume of financing both in conventional banks and Islamic banks. From figure 3 it can be seen that the exchange rate movement graph is not in line with the growth of MSME financing, the relative exchange rate is contrary to the distribution of MSME financing.

Figure 3.
Graph of Exchange Rates of Rupiah against Dollar 2014-2018



Effect of ROA on Distribution of MSME Financing

ROA at a significant level of 0.05% has no effect. This shows that H4 was rejected. This research contrasts with research conducted by Alexandari (2015) which says ROA has a positive and significant effect on the distribution of financing to banks.

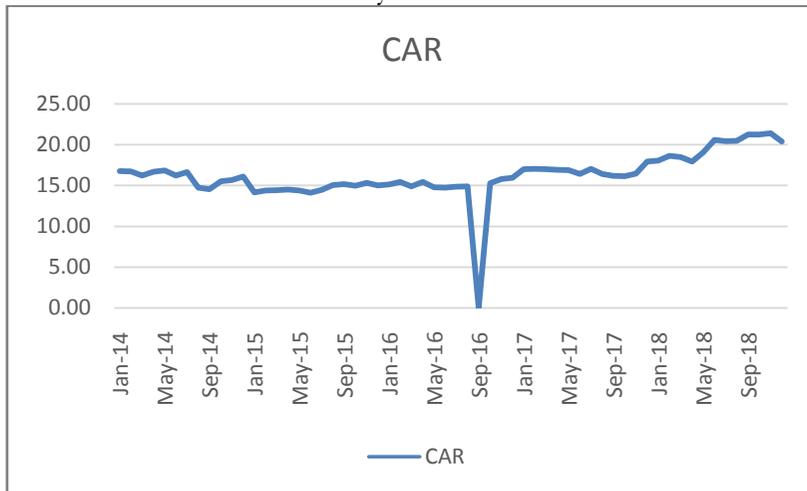
Effect of CAR on the Distribution of MSME Financing

The test results show that a significant value of 0.0047 is smaller than the 5% significant level. This shows that H5 is accepted, CAR has a positive and significant influence on the growth of MSME financing at Islamic Banks in Indonesia. So it can be said if CAR on Islamic Banks has increased it will have an impact on the growth of financing to MSMEs. This result is supported by Nugroho's (2017) study which found CAR to have a positive and significant effect on financing distribution.¹² CAR is a adequacy ratio that serves to accommodate the risk of loss that may be faced by the Bank. The higher the

¹² Nugroho, Alexandi and Widyastutik, "Analisis Pengaruh Kinerja BPRS Dan Kondisi Makroekonomi Terhadap Penyaluran Pembiayaan Modal Kerja Dan Investasi BPRS Indonesia (Periode 2011-2015)," *Al-Mizara'ah* Vol. 5, no. 2 (2017): 146-67.

CAR, the better the Bank's ability to bear the risk both from financing and earning assets at risk. So the Bank must continue to increase CAR so that the growth of financing for MSMEs continues to increase. From Figure 4 you can see the CAR graph which is in line with the distribution of MSME financing in Islamic Banks.

Figure 4.
CAR Chart of Bank Syariah Indonesia 2014-2018

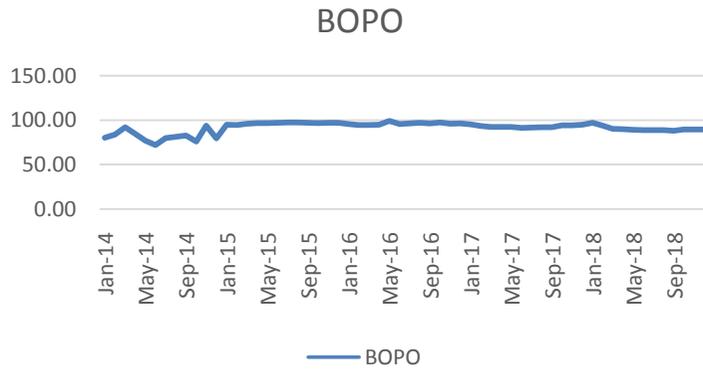


Effect of BOPO on the Distribution of MSME Financing

The test results show that the value that the significant value is 0.0325 which indicates less than 5%. This proves that H6 was accepted. BOPO has a positive and significant effect on the distribution of financing to MSMEs in Islamic Banks. This study is in line with the research of Purwanto (2018), who found BOPO to have a positive and significant influence on Financing.¹³ BOPO must be increased by Islamic Banks so that it will have a good impact on revenue and financing distribution.

¹³ Purwanto and Shopia Dwi Ratna, "Analysis of Determinant Factors toward Margin Murabahah of Indonesia Islamic Banks," *Journal of Business Studies and Management Review* Vol. 1, no. 2 (2018): 146–67.

Figure 5.
BOPO Graph of Bank Syariah Indonesia 2014-2018



The Influence of FDR on Distribution of MSME Financing

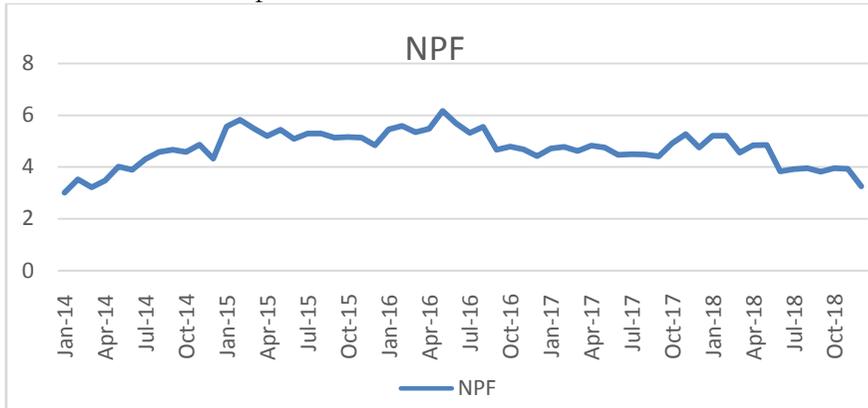
T test results show that the significance value is 0.4258 which indicates greater than 5% so H7 is rejected.

Effect of NPF on the Distribution of MSME Financing

T test results show that the significant value of NPF is 0.0005 which indicates less than 5%, so that the NPF can be said to have a negative effect on the growth of MSME financing at Islamic Banks in Indonesia, so it can be said that H8 is accepted. This result is supported by research conducted by Nugroho (2017), finding that NPF has a negative effect on working capital financing. In this case, after financing is given, banks are required to monitor the use of funds and the ability of compliance and customers to meet obligations. The lower the NPF, the better the financing provided to customers, including financing for MSMEs.

Figure 6.

NPF Graph of Sharia Bank Indonesia 2014-2018



CONCLUSION

External and internal factors affect the volume of SME financing extended by sharia banking in Indonesia simultaneously. While partially External Factors namely Inflation, and BI Exchange Rates that have a significant effect on MSME financing, and Internal CAR, BOPO factors have a positive effect on MSME financing. While NPF negatively affects MSME financing. Changes in macroeconomic conditions (external factors) will indirectly have an impact on the internal condition of sharia banking, which in turn has an impact on the sharia banking intermediary function, namely the financing function and especially in the MSME sector. Therefore, external and internal factors can simultaneously influence the volume of SME financing in relation to Islamic banking in Indonesia.

The results of this study have important implications for industry players, Islamic banks and policy makers. Islamic banks must make more efforts to provide financing for MSMEs. Islamic banks must be innovative and creative in creating and offering new products related to financing to MSMEs. This study has limitations because it only focuses on MSME financing in Islamic banks. However, this research can be further enhanced by considering conventional bank financing and other macroeconomic variables and subsequent research can examine the impact of financing provided by Islamic Banks on the development of MSMEs.[]

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