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Perceptions and Utilization of Islamic Financing Among Micro, Small, and Medium Enterprises (MSMEs) in Bangka Belitung: A Descriptive Qualitative Study

Septian Azmiadi, Arif Eko Prasetyo, Devi Valeriani,
Roky Apriansyah

Universitas Bangka Belitung, Bangka, Indonesia
septian@ubb.ac.id

Abstract. The Micro, Small and Medium Enterprises (MSMEs) play a vital role in keeping the economy afloat in the region particularly in those regions that depend on the commodity such as Bangka Belitung. Although the institutional spread of Islamic banking has occurred, there is a comparatively low level of use of Islamic financing by the MSME actors. The research at hand will study the perception and the utilization of Islamic financing by MSMEs in Bangka Belitung. The qualitative method was a descriptive one that used primary data that was gathered using questionnaires to 25 respondents who were involved in different business activities. The results show that 22 respondents know about the existence of Islamic financing products, but 15 respondents never accessed the Islamic bank financing. Meanwhile, 23 respondents save to ensure capital rotation of their business and 13 respondents consider Islamic financing very useful in development of MSME. The paper concludes that the awareness rates are rather high, yet the actual application remains low because of informational barriers and reasons associated with the level of confidence.

Keywords: Micro Small and Medium Enterprises (MSMEs), Islamic banking, Awareness, Perceptions, Utilization, Savings Behavior, Business Capital, Perceived Impact.

1 Introduction

Indonesia has a productive system comprising of Micro, Small and Medium Enterprises (MSMEs). They are the masters of the business people, they create the largest portion of the national value added, they absorb the largest majority of the jobs, and thus, they become the focus of concern, in areas of inclusive growth, reduction of poverty and stabilization of the region economically. The literature on Indonesian and comparative SME also suggests that MSMEs are more adaptable when the macroeconomic turmoil occurs and that is why they are always the shock absorbing factor whenever the financial and real-sector turmoil occurs. The long-term patterns of development and even more recent policy terms of post-crisis recovery and entrepreneurship development have reflected this structural position in the case of Indonesia [1-3].

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Access to finance has been one of the most insatiable constraints to the development of MSMEs, although it is macroeconomically important. A considerable portion of existing literature confirms this hypothesis by showing that external financing is more scarce to small firms than to large firms since small firms have higher chances of operating at lower levels of collateral, and less good financial records and increased information asymmetry. This restricts their possibilities to invest, even to smooth out the cash flow, to experiment with technology and produce more. Evaluations of MSME access to formal finance continue to be a crucial bottleneck to enterprise upgrading and broader financial inclusion, especially in non-urban and non-industrial regions, in Indonesia [2, 4, 5].

This is a financing problem that is particularly applicable in Bangka Belitung in which the economic performance in the region is still closely tied to the activities that are linked to commodities. Recent provincial data and the provincial reports conducted by bank Indonesia show that commodity and mining sector dynamic has a significant impact on growth dynamics in the province. Meanwhile, local incomes and business activity have been strained on by the ineffectiveness of exports and reduction in the mining-related activity. The strains of MSMEs in working-capital in the environment will increase even more due to the increased sensitivity of household demand and liquidity positioning in the local market to commodity cycles and industry crunches. Of particular importance to the stability of local businesses are, among others, the diversified and adaptive financing facilities [6-8].

This background has an alternative theoretically suitable form of financial intermediation within the Islamic banking. The Law No. 21 of 2008 on Sharia Banking consolidated the dual banking system of Indonesia by giving the legal basis of the activities of the Islamic banking system as compared to conventional system. Theoretically, Islamic finance is founded on asset-backed financing, the transparency of contracts and risk-sharing/trade-based schemes to circumvent the interest-based financing and ensure that finance is more aligned with the underlying productive activity. The specified features have made the topic of Islamic finance topical not only to the religious financial request, but also to the broader terms of ethical finance, inclusion, and sustainable development [9-11].

Islamic finance has a promising future especially in the development of MSMEs. Previous studies indicate that Islamic banking is able to aid financial inclusion, targeting underserved populations which might otherwise be locked out of mainstream finance. At the same time, its rationale of risk sharing can theoretically be to fit in the entrepreneurial need of financing. The other signifier that Islamic banks can be more active in the provision of small firms is also in the emerging markets where it is quite clear that under some institutional settings, the Islamic banks can be a little more active in the provision of small firms. In the meantime, regulatory design, quality of governance, product structure, and institutional capacity are also referred to in the literature as some of the prominent areas where the real contribution of the Islamic finance can be established in terms of development [11-14].

But, in Indonesia, the relationship between Islamic finance and MSME development is not a given. Risk-sharing and efficiency analysis on the one hand showed that Islamic banking could be used in the increased result of the allocative efficiency in financing structures, which are designed and carried out in a proper manner. Conversely, empirical and case-based research findings indicate that Islamic banks are struggling with factual constraints on their delivery to MSMEs, such as managing costs, asymmetric information, legal and regulatory frictions and inability to scale up real risk-sharing contracts. The conditions under which Islamic finance would prove helpful to MSMEs are, therefore, reportedly an Indonesian manifestation of both supply-side institutional settings, and demand-side preparedness of firm [15-17].

The other important stream of the literature is on adoption behavior. Studies on Islamic financial services have continuously discovered that awareness does not necessarily translate into usage. The customer perceptions and trust towards the use of the Sharia compliance, along with the perceived complexity of the use of the Islamic financial products, the institutional familiarity and trust on the use of the Sharia compliance, influence the adoption of the use of the Islamic financial products by the potential users. It can be more urgent in the case of small firms since the financial decision-making activities are inextricably connected with life and death, uncertainty of the cash flow and trust. The recent works on MSMEs and Islamic finance, in turn, observe that the behavioral and institutional aspects tend to be salient in the model of adoption choices in comparison to product knowledge [18-20].

This is especially true of Indonesia whereby, the Islamic banking institutions and assets have been on the upward trend. The penetration of the MSMEs as compared to the conventional credit market is however low. The official data of the OJK revealed that the Islamic banking and BPRS assets were still on the increase, and this is a pointer to the institutional growth in the country. The presence of the asset growth is however not a definite indication that local MSMEs are employing the Islamic financing to an extensive or effective use. This lack of connection shows that there might be an awareness-utilization gap, where entrepreneurs may know about Islamic finance on the normative level but fail to use it because of procedural reasons, perceived risk, lack of familiarity with institutions, or the lack of trust in unfamiliar contracts [18, 19, 21].

So this is a question of analysis to Bangka Belitung. The province possesses a good sociocultural base of Sharia compliant finance, and an in-province economy that could be supported by other diversified and robust MSME financing platforms. Also explained by BPRS information system of OJK is that inclusion architecture of Islamic rural banking infrastructure is a sub-set of Indonesian inclusion architecture, but the local presence does not necessarily mean that the actors of the local business know, believe, and act in using such institutions. That is why the localized empirical evidence in relation to the determination of the awareness of the Islamic financing among the MSMEs in Bangka Belitung and its transformation into the actual utilization and the presence of behavioral and institutional frictions to restrict the intermediation role of Islamic finance in the region is needed.

In this regard, this paper explores the correlation between the awareness and use of Islamic financing by MSMEs in Bangka Belitung. Placing the analysis within the framework of a commodity oriented regional economy and two banking national system, the study aims to introduce the concept of whether the principal detriment is ignorance and the inadequacy of the institutional mediation or the reluctance of the behavior towards the formal Islamic financial products. In so doing, it contributes towards the body of literature on financial inclusion, Islamic banking and MSME development by not only shifting the focus off on the product sensitization but the dynamics on the local economic environment, the accessibility of the institutions and the behavior of financing.

2 Literature Review

2.1 MSMEs in the Indonesian Economic Structure

This is attributed to the fact that the legal framework that regulates the Micro, Small and Medium Enterprises (MSMEs) in Indonesia are enshrined in the law No. 20 of 2008. Enterprises are classified according to the law based on their assets holdings and annual turnover value and micro, small and medium enterprises are defined based on financial capacity and size of their business (Republic of Indonesia, 2008). The regulation is based on this categorization of state support, financial inclusion policies and development programs. The further reform of the policy under the influence of the Job Creation Law streamlined the procedures of licensing opportunities and formalization of MSME in the country and provided it with the strategic niche in the country development [2].

The most widespread type of business organization in Indonesia is MSMEs, which have over 60 percent of the national GDP, and about 97 percent of the labor force [22]. Empirical evidence on the role of MSMEs in poverty reduction and income distribution is upheld by the fact that there are no diversifications in terms of industries in the areas.

International evidence also suggests that MSMEs are an element of resilience to the economy as they absorb labour by the economies when the macroeconomic shock strikes and also they create domestic demand [3]. The adaptability, low fixed cost and high embeddedness (local) makes MSMEs stabilizers of the emerging economies.

In a new article that researches the crisis of the COVID-19, it is discovered that MSMEs have reacted in an unequally, yet notable, way to specific conditions, such as a diversified source of financing and an opportunity to go digital. Indonesia had an even more transitory and faster recovery in MSMEs compared to larger firms in some sectors because their cost designed flexibility [2].

The resilience is however conditional as it is based on access to working capital. Economic constraints, according to the research, place a person at a greater risk of the crisis [23]. Thus, the inclusive financial intermediation is under reinforcement, the subject of the MSME sustainability.

2.2 Conceptual Framework Islamic Financing

Difference between Lending (Qardh) and Commercial Financing. The Islamic financing makes a distinction between qardh (benevolent loan) and commercial financing contracts. Qardh is an interest free loan, not-profit and is mostly provided to social causes. In its turn, commercial financing is based on the contract of assets or partnerships which give rise to the permitted profit [11]. One can attribute this difference to the fact that initially money can never be a commodity, a medium of exchange. The trade, investment or productive risk sharing activities are supposed to generate a profit as compared to lending with interest.

Legal Basis: Law No. 21/2008. Indonesia liberalized Islamic banking through the Law No. 21 of 2008 on Islamic Banking which legalized a dual banking system and supervision systems of operating, governing and Sharia (Republic of Indonesia, 2008). The assets of Islamic banking have been growing steadily with assistance of regulatory consolidation under OJK and the merger of Bank Syariah Indonesia (BSI) in 2021 [21]. This has recently been supported by empirical research that showed that regulatory reinforcing works in promoting institutional stability and the trust that the people have in the Islamic banks. ([15], Pacific-Basin Finance Journal).

Intermediation Function. The Islamic banks are financial intermediaries that collect money in their capacity of surplus units (depositors/investors) and loan it to deficit units (entrepreneurs) in the form of Sharia-compliant contracts. The main features of risk-sharing and asset-backing are not typical of the traditional banks. [3]. Empirical comparisons show that Islamic banks are relatively stable in the periods of systemic shocks because they have lower leverage, and asset-backed structures [24].

2.3 Islamic Financing Instruments

The Islamic financing instruments are developed on asset-backing, risk and interest sharing and prohibition of interest-based lending. These instruments can broadly be grouped into profit-and-loss sharing contract, trade-based financing as well leasing-based arrangements. Each of the classes portrays a variation of risk, ownership and structure of returns in the Islamic financial intermediation system.

Profit-and-Loss Sharing (PLS) Contracts. Islamic finance is theoretically based on profit-and-loss sharing (PLS) contracts. These are instruments, which are expected to ensure that incentives between the capital providers and the entrepreneurs are aligned, where returns are determined by the performance of the business and not paying some interest.Mudharabah is a form of a partnership where one of the partners (rab al-mal) contributes capital and the other partner (mudarib) contributes managerial skills. Profits are divided in an agreed ratio and only shared by the capital provider except in cases of negligence or misbehaviour proven. This type of contract is business enterprise and capital efficiency oriented. Recent empirical research suggests that mudharabah plans can maximize the incentive-compatibility and help decrease the moral hazard in instances of effective governance and monitoring systems ([11, 14]. Structural problems, though, are asymmetric information, and cost of monitoring, which constrain its use in practice. Musyarakah is a joint-venture structure based on which all the parties will contribute capitals and share the profits and losses equally. Compared to mudharabah, musyarakah presupposes the common capital ownership and, thus, the distribution of the risk among the partners more fairly. The contract is thought to be fairer because there is an equal exposure to risk. Nonetheless, musyarakah should be well supervised and strictly regulated to prevent agency problems and adverse selection [15]. Better still, in the principles of risk-sharing, its complexity of operation frequently places a limit on its use in large scale in banking portfolios. Although normative focus on PLS instruments in the Islamic finance theory, empirical studies have shown that their portfolio share is still comparatively low in comparison to the trade-based contracts because of increased informational and risk management costs.

Trade-Based Financing Contracts. The prevalent form of Islamic banking portfolio in the modern world is trade-based contracts. These instruments result in returns as per the asset transfer and markup schemes as opposed to direct profit sharing. Murabahah is a sale contract with costs plus where a financial institution buys an asset and then resells the asset to the client at a certain mark. Firstly it is announced and accepted and there is transparency of the contract. Murabahah operates the Islamic banking portfolios across all regions of the world because it has stable cash flows and less risky than PLS contracts [21]. The asset backing condition and disclosure system of the structure makes it Sharia compliant even though the opinion that murabahah is too close to the traditional debt structures is criticized.

Salam is also a type of forward contract as all payments are made prior to the delivery of goods later. This tool can be particularly useful in agricultural financing, where farmers require funds before harvest. Salam helps to improve the availability of liquids among manufacturers and stabilize supply chains. But the volatility of prices and risk of delivery must be properly specified in the contract. Istishna is mostly used in the financing of manufacturing and construction. In the context of this contract, payment can be made in the form of progressive payments based on the project milestones. Istishna is also involved in the infrastructure development and the development of the SME production which is achieved through funding the production stages according to the production cycles. The recent literature has stipulated that the trade based contracts continue to be common in the Islamic banking systems since they reduce the uncertainty and credit risk as compared to the PLS contracts [24].

Leasing-Based Financing Contracts. Leasing agreements offer Sharia-compliant capital goods funding by not requiring instant ownership transfer. Ijarah is the kind of lease that involves the sale by the financial institution to the client of usufruct of an asset over a specified period with exchange of rental payments. The financier will be the owner during the lease period. Ijarah is particularly suitable when it comes to MSMEs, which require productive assets but lack sufficient initial capital. Ijarah Muntahiya Bittamlik (lease-to-own) is a combination between leasing and progressive transfer of the ownership at the expiry of the contract. This design will enhance access to capital by SMEs without asset-backing. The leasing agreements are considered to be effective and help the small business that require machinery, equipment or automobiles without investing in them [11].

2.4 Principles Underlying Islamic Banking

The Islamic banking is a normative and institutional framework which is founded on Sharia principles. These are the principles on which the design of contracts, risk distribution, and financial intermediation are based. The justice (adl) doctrine ensures the fairness of contractual agreements and prohibits the exploitative financial relationships. Justice is operationalized by fair proportions of profit sharing, open pricing and well established responsibilities between the parties. The characteristic of the Islamic finance is risk-sharing. The incentives of the capital providers and entrepreneurs are matched by productive activity, which is linked to returns. Islamic contracts allocate the risk according to capital contribution and contract as compared to traditional debt contracts where the risk is transferred to the borrowers disproportionately.

The prohibition of riba (interest) does not permit it to give profits simply because time has passed. Rather, profit has to be made out of trade, leasing or investment of real economic assets. This prohibition is intended to reduce financialization of speculation and promote asset backed intermediation. Transparency and gharar minimization demand that there is transparency in the terms of a contract, that there is disclosure of prices and that there is not undue uncertainty. The principle deals with the issue of asymmetric information and increases the trust in the market. Finally is the principle of maslahah (common good and productivity) which brings out the social economic role of finance. It is anticipated that Islamic banking will allow inclusive growth, financial stability, and social development. Recent empirical research has indicated that the compliance with these principles has a positive effect on the outcome of financial inclusion and social welfare, especially in the emerging markets [12].

A combination of all these principles distinguishes the Islamic banking and traditional finance in both normative and operational sense. Nevertheless, the extent to which theoretical constructs of ideals of risk sharing have been converted to practical banking portfolios is an empirical contest of the modern Islamic finance research.

3 Methodology

3.1 Research Design

The study research design is descriptive qualitative research design, which will investigate the perception and trends in the use of Islamic financing among the Micro, Small and Medium Enterprise (MSME) players in Bangka Belitung. The descriptive qualitative method is used in those situations when it is important to explore the social and economic phenomenon according to the specific contextual environment without manipulation of the variables and experimental control. The design will make it possible to gain a deeper insight into the ways MSME actors perceive the Islamic financing mechanisms, evaluate its benefits, and choose whether to utilize it.

The design is selected according to the methodological argument that qualitative descriptive studies can be particularly suitable to explain the behavioral patterns, institutional mindsets, and localized economic processes [25]. Using a descriptive approach to the study of financial inclusion, one may determine the existing gaps in awareness, as well as constraints connected with confidence and structural barriers that cannot be determined with the help of a purely quantitative model. In this way, contextual interpretation is taken into consideration in the study, although the systematic arrangement of data is maintained.

3.2 Data Source and Respondent Characteristics

The research is based on primary data which will be obtained using structured questionnaires to 25 respondents who are actively involved in business activities in Bangka Belitung. The questionnaire was framed on three important dimensions that included: (1) awareness of the Islamic financing products, (2) experiences and utilization of Islamic banking services and (3) perceived benefits and constraints of the Islamic financing.

The mix of the respondents is heterogeneous in terms of the economic role and demographics. Participants are independent entrepreneurs with micro or small businesses, students with side businesses and employed persons running second jobs to earn extra income. The age group of respondents will be 17-70 years old, and it will be possible to cover both young players of the entrepreneurship and business elders.

The heterogeneous composition of the sample offers a bigger outlook on the perceived concept of Islamic financing by various groups of people with diverse socio-economic backgrounds. Financial literacy and risk tolerance of younger respondents might be different than older respondents. Similarly, full-time entrepreneurs may have the capability of financing and exposing themselves to risks as compared to part-time business operators. Despite the small sample size, the variety of respondent profiles allows the exploration of the insights into the perception patterns in the local MSME ecosystem.

3.3 Analytical Technique

The analytical model has thematic qualitative analysis and descriptive statistical interpretation to ensure numerical elucidation and interpretative richness. Firstly, the descriptive statistical analysis will be employed in summarizing the responses of the questionnaire in terms of its frequency and percentage distribution. This approach would gauge the percentage of the respondents who are conversant with Islamic financing, who have utilized the Islamic banking services, who have savings to rotate their business capital and who perceive Islamic financing to be helpful. In exploratory research involving small samples, frequency analysis may be particularly relevant as it provides simple, well-understood signs of trends in the responses with little to no movement beyond an extrapolation of the statistics.

Second, thematic analysis of qualitative responses on the motivations, perceived benefits, and barriers to the use of Islamic financing are analyzed. The common patterns in reasoning of the respondents such as fears of complexity of the processes, trust in Sharia compliance or even a wish to be conversant with traditional banking can be discovered through thematic analysis. By using the systematic system of sorting answers, the most important themes of perception are recognized and explored in contrast to the general theoretical discourse of the subject of financial inclusion and the behavior in Islamic banking.

The blend of the descriptive statistical and thematic analysis methods allows the study to achieve a decent balance between the quantitative and contextual interpretation. This two-sided approach reinforces the explanatory powers of the results by establishing the trend of the numerical responses to the causative behavioral and institutional explanations of the adoption of Islamic financing by actors of MSME.

4 Results and Discussion

4.1 Respondent Profile

This research used 25 respondents who were involved in business in Bangka Belitung. These respondents are full time entrepreneurs, students who are involved in micro-businesses and employed people who are running side businesses. The age groups are between 17 and 70 years and there is intergenerational involvement in micro and small business (see Table 1).

Table 1. Distribution of respondents by occupational status.

Occupational Category	Frequency	Percentage (%)
Full-time Entrepreneurs	10	40%
Students with Micro-Businesses	8	32%
Employees with Side Businesses	7	28%
Total	25	100%

The distribution shows that 40% of respondents are full-time entrepreneurs, while 60% combine business activities with education or formal employment. This heterogeneity provides insight into varying financing needs and risk preferences.

4.2 Respondent Profile

One of the central variables examined in this study is the level of awareness regarding Islamic financing products (see Table 2). The results indicate that 88% of respondents are aware of Islamic financing products. This suggests that informational exposure to Islamic banking services in Bangka Belitung is relatively widespread. However, awareness alone does not necessarily imply product adoption.

Table 2. Awareness of islamic financing.

Category	Frequency	Percentage (%)
Aware	22	88%
Not Aware	3	12%

Category	Frequency	Percentage (%)
Total	25	100%

4.3 Utilization of Islamic Financing

Although awareness levels are high, the utilization rate presents a different pattern. The statistics indicate that two out of five people have never tapped Islamic financing (see Table 3). This finding highlights an awareness–utilization gap. Qualitative answers point to lack of confidence, a lack of knowledge on the process of financing, the perceived administrative sophistication and a sense of familiarity with traditional banking institutions as factors that affect this gap.

Table 3. Experience in accessing Islamic financing.

Category	Frequency	Percentage (%)
Have Accessed	10	40%
Never Accessed	15	60%
Total	25	100%

4.4 Savings Behavior and Business Capital

The study also explored savings behavior as an indicator of financial discipline and internal capital formation (see Table 4). A substantial majority (92%) maintain savings to support business capital rotation. This reflects a precautionary financial behavior among MSME actors, indicating awareness of liquidity management even in the absence of formal financing.

Table 4. Ownership of savings for business capital.

Category	Frequency	Percentage (%)
Have Savings	23	92%
No Savings	2	8%
Total	25	100%

4.5 Perceived Benefits of Islamic Financing

Perceptions regarding the usefulness of Islamic financing were also assessed (see Table 5). More than half of respondents (52%) perceive Islamic financing as highly supportive for MSME development. Positive perceptions are generally associated with the absence of interest (riba), profit-sharing mechanisms, and the principle of fairness embedded in Sharia-compliant contracts.

Table 5. Perceived impact of islamic financing on MSME development.

Category	Frequency	Percentage (%)
Highly Supportive	13	52%
Moderately Supportive	7	28%
Uncertain / No Opinion	5	20%
Total	25	100%

4.6 Discussion

The results indicate that there is a huge disparity between awareness and utilization. Although the awareness is 88, only 40 use it. Such inconsistency implies that exposure to information does not generate enough strong forces to cause adoption. Behavioral factors that appear to be the most important ones are risk aversion, institutional trust, complexity of the procedure and familiarity with traditional banking. The high percentage of savings (92) shows that MSME players are more oriented towards self-financing strategies that may be due to risk aversion. This may be a sign of the structural characteristics of micro enterprises which would be not keen to expose themselves to external financing but rather keep a liquidity position.

Besides, the latent demand potential is suggested by positive attitude towards Islamic financing (52% highly supportive). However, the institutional practices on product socialization, streamlining of processes and enhancing financial literacy are necessary to convert positive perceptions into life financing decisions.

High-Impact Discussion, Theoretical Contribution, and Policy Implication. This research has revealed that there is an existing structural gap on the knowledge and the application of Islamic financing by MSMEs in Bangka Belitung. Although the availability of information on the Islamic financial products appears to be fairly widespread, there is a lack of efficient utilization of these instruments. This pattern suggests the notion that the most significant constraint is not the existence of financial product or information asymmetry, but the frictions that are a part of the regional financial intermediation system. In particular, behavioral risk aversion, institutional awareness of conventional banking, and the perceived administrative burden are the factors that determine the decision to finance MSMEs. The behavioral and institutional determinants associated with the adoption of Islamic finance include the attitudes towards Islamic banking, perceived benefits, and trustworthiness of financial institutions as crucial elements to determine SMEs financing decisions [19].

In the financial theory perspective, the trend observed in preference of internal financing among MSME that is observed in this study is in line with the pecking order theory which states that a company should utilize internal finances sources before turning to external financing due to the information asymmetry and transaction costs. This financing structure is especially acute with small firms as they are usually characterized by a lack of collateral and an increased borrowing risk. Therefore, MSMEs might be dependent on internal savings as a precautionary measure so that they can be able to keep their heads above water and stay operationally flexible. However, excessive dependence on internal funding may confine the possibilities of long-term investment and expansion of business, which will slow down the productivity growth and competitiveness in the regional economy.

The results also show that Islamic financing is yet to be a catalytic process of inclusive regional development. In theory, the Islamic banking institutions would need to enhance the financial inclusion through offering ethical and risk sharing financing services, which contribute to financing the entrepreneurial activities. However, empirical data indicate that the role that Islamic banks play in financing MSMEs differs widely in terms of country and institutional background. Using the Islamic banks as an example, comparative research reveals that the participation of Islamic banks can be active in the MSME financing markets, although it depends on the regulatory frameworks, institutional capacity, and risk management strategy (Ibrahim and Rizvi, 2022).

Interestingly, in this study, although there is relatively low usage of Islamic financing, normative perceptions towards Islamic financial institutions are very positive among MSME actors. Most of the interviewees acknowledge Islamic financial institutions as a source of ethical principles, justice and compliance with Sharia especially the prohibition of interest (riba). The positive ethical perception of Islamic banking is a massive literature and religiosity, ethical orientation and perceived Sharia compliance have been discovered to be a major customer attitude determinant with Islamic financial services [18, 26].

The working model of Islamic finance does not however give us a different factor to the little transformative impact in this study. Practically, Islamic financial institutions are more inclined to use financing based on the murabahah structure which is similar to the traditional debt contract instead of using real profit-and-loss sharing instruments like mudarabah and musharakah. To a large extent, this tendency in the structure is preconditioned by the risk management factors due to the fact that the profit-sharing contracts are also linked with the augmented degree of monitoring expenses and predisposition to information asymmetry. Islamic banks are therefore inclined to concentrate on asset-based financing tools that are more differentiated in terms of repayment plans and provide less risks. It has already been mentioned that the percentage of profit-and-loss sharing contracts in the Islamic banking portfolios of the world is very small, despite them being the most important element of the theoretical model of Islamic finance [16].

The distinction of the Islamic finance i.e. the possibility of promoting entrepreneurship through risk-sharing joint venture is therefore not fully attained in practice yet. The equity-based contracts of murharabah and musharakah offer hypothetical flexible financing arrangements, in accordance with the uncertain income flows that dominate

MSMEs. Nonetheless, unless there are institutional innovations, which alleviate information asymmetry and monitoring costs, financial institutions might still opt to use low-risk trade-based financing structures.

Combined, these results indicate that institutional changes and behavioral change are needed to further institutionalize the role of Islamic financing in MSME development. The Islamic financial institutions need to initiate MSME targeted financing activities and increase the supply of risk-sharing instruments on the supply side. Behavioral barriers to adoption on the demand side could be minimized via policies to enhance financial literacy and establish confidence in Islamic financial institutions. Such measures would help Islamic finance to serve its goal as an inclusive and equitable economic development tool.

Theoretical Contribution. This paper contributes to the prior research on the topic of financial inclusion and Islamic finance by finding a behavioral-institutional intermediation gap in regional financial ecosystems. Even though the reason why the adoption of Islamic financial products is rather low (compared to the level of financial literacy or lack of awareness among the actors of the small business) is commonly explained in the current literature, the current findings suggest that the existing explanations may be incomplete. The biases in behavior risk preferences and institutional familiarity may represent a constraint to successful utilization of Islamic financial products even though the MSME actors are knowledgeable enough about the products. The pre-existing empirical research indicated that the use of psychological attitudes, institutional credibility, and trust in the financial intermediaries is also significant in the adoption of the Islamic financial services by small firms [18, 19]. The results indicated the informational factors alone is not the sole determinant of decision to deal with the Islamic financial institutions but rather the behavioral and institutional perceptions internalized within the local financial ecosystems.

Theoretically, these results are an extension of the literature on financial constraints and financing behavior of MSMEs. The classical financial constraint theory emphasizes that small firms tend to be unable to access external financing due to asymmetric information, the inability to secure collateralization and high transaction costs (Beck and Demirguc-Kunt, 2006). However, as recent tendencies in the research on financial inclusion demonstrate, the barriers to access are not the sole means in which to explain the behavior of MSME financing, particularly in emerging economies where informal means of financing continue to be prevalent. Research in the Islamic banking context also shows that perceived Sharia compliance, ethical orientation, and institutional trust is a key determinant of the demand of the Islamic financial services [16, 20]. The MSME financing decisions, in their turn, should be considered not only in the prism of the structural constraints of capital but also in the prism of behavioral and institutional ones.

In this regard, the present work is innovative, because it brings the knowledge of behavioral finance into the understanding of the Islamic financial intermediation. The behavioral finance literature emphasizes the fact that economic decision making is not necessarily driven by the solely rational model of decision making due to cognitive biases, risk perception and familiarity effects [27]. Status quo bias in MSME financing can be manifested in the form of entrepreneurs still associating with the more traditional financial institutions that they already know well even when there is another financing tool such as Islamic financing. This administrative inertia can be enhanced by the perceived administrative complexity and uncertainty over Islamic financial contracts. Empirical evidence also shows that trust asymmetry between small firms and financial institution is a major factor when it comes to deciding whether entrepreneurs are willing to engage with formal financial institutions (Ibrahim and Rizvi, 2022).

As these dimensions of behavior are integrated, this paper makes a step forward to create a more nuanced interpretation of Islamic financial intermediation within the regional economies. Specifically, it indicates that the increase in the Islamic banking resources in the national scales does not necessarily mean that the same is reflected in the regional scales in the segments of MSMEs. Unremitting adoption gaps can be co-located with institutional growth of Islamic financial institutions in the event that behavioural friction and institutional familiarity biases are unaddressed. This has been reflected in recent research studies on effectiveness of Islamic banking in financing small businesses, which note the high levels of interactions between institutional design, risk management behavior, and behavioral perceptions in the determination of the effectiveness of Islamic financial inclusion programs [28].

All these outcomes can facilitate a behavioral-institutional approach to Islamic financial inclusion. This approach does not consider MSME financing constraints as the problem of financial access but rather the interaction between institutional frameworks, behavioral biases, and trust relationships within the financial ecosystems in the regions. This would be a more comprehensive explanation of why high asset growth rates in Islamic financial systems might not be embraced by MSMEs in the field.

Policy Implication for Bangka Belitung. Policymaking-wise the lack of Islamic financing by MSMEs is a missed opportunity to enhance inclusive regional development. The local governments in Bangka Belitung should go beyond the old-fashioned financial literacy schemes and adopt institutional facilitation schemes that are active in interconnecting MSMEs to Islamic financial institutions. Empirical studies of the subject matter of Islamic financial inclusion in Indonesia indicate that effective financial inclusion must be an outcome of a concerted effort of the state institutions, financial intermediaries, and participants of the MSMEs rather than a reliance on awareness campaigns alone [17].

Moreover, the institutional and regulatory impediments can also impede the growth of Islamic financing of MSMEs even in the presence of Sharia-based financial products. The research into the Indonesian financial system demonstrates that regulatory frameworks, institutional alignment, and funding systems have a great impact on the capacity of Islamic banks to access MSME segments and inclusive economic development [29, 30].

In addition, Islamic funding can be applied to boost resilience and productivity of MSMEs through improved access to ethical financing systems and investments capital. Indonesia demonstrates that institutional cooperation and policy support can make Islamic financial practices a good contributor to MSME development and economic welfare [31]. Therefore, the regional policy frameworks should concentrate on institutional links among MSME.

Three strategic interventions are particularly relevant:

Regional Financial Intermediation Platforms. Local governments may be active players in promoting institutionalised partnerships between Islamic banks, MSME associations, cooperatives and local development agencies. These sites would be institutional bridges in which information asymmetry is reduced, communication between financial institutions and entrepreneurs is improved and cost of transactions is reduced in accessing financing in both directions. The alignment of financial products with the actual needs of local enterprises can be facilitated by integrated MSME databases, coordinated forums, joint financing schemes and so on.

Adaptive Islamic Financing Schemes for MSMEs. Contracts provided by Islamic financial institutions in the form of financing should also be more amenable to the nature of small business operations, in terms of their unpredictable cash flows and limited collateral base. This would be advantageous as more risk-sharing instruments such as partnership-based financing structure would be utilized to render financing arrangements more flexible and responsive to the uncertainties faced by MSMEs. This strategy would make the Islamic finance more developmental as opposed to the traditional trade-based financing systems.

Trust-building and Institutional Outreach Programs. In alleviating behavioral resistance and institutional trust building, outreach programs, business mentoring, financial advisor services, and demonstration projects on the successful MSME-Islamic bank partnerships with the government can help. By enhancing the institutional bond between the Islamic financial institutions and the MSMEs, Bangka Belitung will be able to convert the Islamic finance into a normatively desirable system into a real source of inclusive economic development in regions.

5 Conclusion and Recommendation

This study has found that there is a knowledge-practice gap between the knowledge and practice of Islamic financing in MSMEs in Bangka Belitung. The knowledge of the Islamic financial products is relatively high but the usage is relatively low because of barriers to financial intermediation like lack of trust, lack of knowledge of contracts and accessibility problems. On a micro level, the reliance on self-finance is more likely among MSMEs due to risk aversion, their familiarity with traditional banking methods, and perceived complexity of administration. Despite the common view on the legitimacy of the Islamic finance as the method of fairness and sharing risks, the practice of the Islamic finance is still predominantly characterized by low-risk schemes which limits its transformative capacity. To conclude, even though Islamic financing has a huge potential, its use is not high now. To enhance adoption, financial literacy needs to be enhanced, institutional support should be reinforced, and financial products should be designed to serve the needs of MSMEs better to enable inclusive economic development.

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