INTEGRATION OF MUSHARAKAH FINANCING IN THE DEVELOPMENT OF MSMES IN DEVELOPING COUNTRIES: SHARIA AND SUSTAINABLE FINANCE PERSPECTIVES

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Abstract

MSMEs (Micro, Small, and Medium Enterprises) play an essential role in the economies of developing countries. However, they often face difficulties in accessing financing that aligns with sustainable finance and Sharia principles. Musharakah financing, based on the principle of profit sharing, is an alternative that can support the development of MSMEs, particularly in developing countries that prioritize the Sharia economy. This research aims to analyze the integration of musharakah financing in the development of MSMEs in developing countries, as well as evaluate the benefits and challenges related to the application of sharia principles and sustainable finance in this context. This research employs a qualitative approach, utilizing case studies in several developing countries, including Indonesia and Malaysia. Data were collected through interviews with MSME actors, Islamic financial institutions, and relevant government agencies. The analysis was carried out by comparing musharakah financing practices in the MSME sector and their impact on business sustainability. The results of the research indicate that musharakah financing can enhance MSMEs' access to capital in a more equitable and sustainable manner. However, the main challenges include a lack of understanding of Sharia concepts and regulatory barriers that hinder optimal development. Musharakah financing has demonstrated the potential to stimulate local and global economic growth when supported by the right policies.

INTRODUCTION

MSMEs (Micro, Small, and Medium Enterprises) have a very strategic role in the economies of developing countries. (Hayati & Fatarib, 2022; Munthe et al., 2023; Tekola & Gidey, 2019). According to the World Bank, micro, small, and medium-sized enterprises (MSMEs) contribute more than 60% to the gross domestic product (GDP) in developing countries while also absorbing the majority of the workforce. (Kurniadi et al., 2024). However, the main obstacle faced by MSMEs is access to adequate financing. In many cases, MSMEs in developing countries face difficulties in obtaining loans from conventional financial institutions due to stringent requirements and high interest rates. (Billah et al., 2024). Musharakah financing, a form of funding based on profit sharing in the Islamic financial system, offers alternative solutions that are fairer and align with the principles of sustainable finance. (Abasimel, 2023; Mubyarto et al., 2024; Yustiardhi et al., 2020).

The integration of musharakah financing in the development of MSMEs is crucial because it can promote financial inclusion in sectors that have been traditionally marginalized. Several studies show that funding sharia-based, especially musyarakah, can provide a safer and more sustainable financing alternative for MSMEs (Ali et al., 2024; Suraiya, 2022). However, despite this enormous potential, challenges remain in implementing musharakah financing in developing countries, particularly in terms of regulation, public understanding, and the capacity of Islamic financial institutions. (Kulmie, 2024). Therefore, this research is highly relevant to understanding how musharakah financing can contribute to the development of MSMEs in the context of sustainable and Sharia finance.

According to data from Bank Indonesia (2022), the MSME sector in Indonesia has only accessed around 18% of the total financing disbursed by financial institutions. On the other hand, data from the Financial Services Authority (OJK) (2022) shows that the Islamic finance sector in Indonesia has experienced significant growth, with a contribution to GDP reaching 6.88%. In this case, musharakah financing has the potential to be a primary solution to address the issue of access to financing for MSMEs, as it is based on profit sharing, which can alleviate the burden on these enterprises. Musharakah also supports the principle of sustainable finance by prioritizing direct involvement in financed projects or businesses, thereby reducing risks and encouraging more stable growth.

Several previous studies have discussed the integration of musharakah financing in the MSME sector. Research by Haji & Rehman (2021) revealed that musharakah financing can improve the performance of MSMEs in Pakistan, especially in the agribusiness and manufacturing sectors. Another research by Abdullah and Noor (2021) shows that musharakah financing can increase the competitiveness of MSMEs in Malaysia by providing more flexible and affordable working capital. In addition, Hidayat et al. (2021) also found that musharakah financing can reduce MSMEs' dependence on high-interest-based loans and reduce the risk of business failure. However, despite numerous studies conducted, a gap remains in understanding how the implementation of musharakah financing can contribute to sustainable economic development in developing countries.

Although numerous studies have examined musharakah financing, most previous studies have focused on the context of countries with more established Sharia economies, such as Malaysia and Indonesia. In addition, many studies only examine the financial aspects of musharakah financing without considering sustainability factors in the development of MSMEs. Another gap is the lack of studies that link musharakah financing with government policies and the role of Islamic financial institutions in strengthening MSMEs in developing countries, especially in the context of a sustainable economy.

This research offers novelty by combining the concepts of musharakah financing, Sharia economy, and sustainable finance in the development of micro, small, and medium-sized enterprises (MSMEs) in developing countries. One of the new aspects offered is an understanding of the challenges and opportunities associated with implementing musharakah financing within a sustainable economy, particularly in developing countries. This research also examines the integration of government policies and Islamic financial institutions, an area that remains underexplored in the existing literature.

Most previous studies on musharakah financing have been conducted in countries with mature sharia economic ecosystems, such as Malaysia and Indonesia. However, there are still few studies that discuss the implementation of musharakah financing in the context of developing countries in general, especially those with regulatory challenges and low Sharia financial literacy. Previous studies tend to separate the research on Sharia finance and sustainable finance. The integration of these two approaches is very relevant to answering the challenges of inclusive, fair, and environmentally friendly financing for MSMEs. This research fills the gap by combining the principle of profit-sharing in Islam with the approach of economic sustainability.

The main objective of this research is to analyze how musharakah financing can be integrated into the development of MSMEs in developing countries, with a focus on business sustainability and contribution to the local economy. This research also aims to evaluate existing policies and provide recommendations for Islamic financial institutions and the government in increasing MSMEs' access to sustainable financing.

The benefits of this research are expected to contribute to the development of musharakah financing theory and practice in the MSME sector. This research is also likely to provide valuable insights for the government, Islamic financial institutions, and practitioners on optimizing musharakah financing as a more inclusive and sustainable alternative for promoting economic growth in developing countries.

METHOD

This research employs a qualitative approach, specifically an analytical descriptive research design. This research aims to analyze and describe in depth the integration of musharakah financing in the development of micro, small, and medium-sized enterprises (MSMEs) in developing countries, with a particular focus on those related to Sharia principles and sustainable finance. This research also aims to identify challenges and opportunities in the implementation of musharakah financing, as well as provide recommendations to increase MSMEs' access to sustainable funding.

The population in this research consists of MSMEs operating in developing countries, with a primary focus on Indonesia and Malaysia. The sample of this research consists of 20 MSMEs that have utilized musharakah financing in their operations. The sample selection was carried out using a purposive sampling technique, where MSMEs were selected that met specific criteria, including those that had obtained musharakah financing within the last three years and operated in economic sectors with sustainable growth potential (such as agribusiness, manufacturing, and technology). Additionally, this research involves five Islamic financial institutions that provide musharakah financing to MSMEs.

The research instruments used in this research are in-depth interviews and document analysis. Interviews were conducted with MSME owners, MSME financial managers, and managers of Islamic financial institutions involved in musharakah financing. The interview instrument will be in the form of an interview guide, designed to explore the understanding of musharakah financing, its impact on the development of MSMEs, and the challenges faced by MSME actors in accessing this type of financing. In addition, documents related to policies and financial statements relevant to musharakah financing are also analyzed to provide a clearer picture of this financing practice.

Data collection in this research was conducted using three primary techniques. First, in-depth interviews are conducted in a semi-structured manner with MSME owners and Islamic financial institutions. This interview aims to explore the experiences, perceptions, and challenges faced by MSME actors related to musharakah financing. Second, participatory observation was conducted by researchers on several selected MSMEs to monitor the implementation of musharakah financing in their daily business activities. Third, document analysis is also conducted by reviewing various relevant documents, including MSME financial statements, annual reports of Islamic financial institutions, and government policies related to musharakah financing.

This research procedure is carried out in several stages. The first stage involves the preparation and collection of initial data, which includes identifying and selecting

MSMEs and Islamic financial institutions to be used as research samples. After that, the researcher conducted licensing and arranged interview schedules with relevant parties. The second stage involves conducting interviews with MSME owners and Islamic financial institutions, using interview guidelines that have been prepared. In the third stage, the researcher made direct observations on the implementation of musharakah financing in MSMEs, which is the object of the research. After the data is collected, the fourth stage is data collection and analysis, where data obtained from interviews and observations are analyzed thematically to identify the main patterns related to musharakah financing. The final stage involves preparing a research report that includes findings, analysis, and recommendations derived from the research process.

The data analysis in this research employed thematic analysis techniques, aiming to identify the primary themes related to the implementation of musharakah financing, its challenges, opportunities, and the contribution to the development of MSMEs. The analysis process begins with transcribing data from interviews to facilitate the processing of information. Furthermore, the collected data will be coded based on relevant themes, including the impact of musharakah on the sustainability of MSMEs, success factors, and obstacles encountered. After that, the main themes will be identified and interpreted to uncover the meaning contained in the data. To increase the validity of the research results, the data triangulation technique was employed, involving the comparison of results from interviews, observations, and document analysis. Finally, based on the analysis results, the researcher will compile findings and conclusions that include recommendations for the development of MSMEs through musharakah financing.

RESULT AND DISCUSSION

Application of Musharakah Financing to MSMEs in Developing Countries

Musharakah financing has become a crucial option in supporting the development of MSMEs in developing countries, particularly in sectors that focus on enhancing local economic growth and sustainability. Based on the results of interviews with 20 MSME actors involved in this research, the majority stated that musharakah financing is more profitable than conventional loans, as the profit-sharing mechanism implemented is considered fairer. In this case, musharakah financing can encourage more MSMEs to access the financial resources they need without being burdened by high interest.

However, even though musharakah has proven effective in increasing business capital, the challenges faced by MSMEs in accessing it remain substantial. According to data collected by the OJK Financial Services Authority (2022), fewer than 25% of MSMEs in Indonesia access sharia financing, and most of them are unfamiliar with the concept of musyarakah. This lack of understanding is the main obstacle to the optimal implementation of musharakah financing.

Meanwhile, the results of the document analysis indicate that Islamic financial institutions in Indonesia and Malaysia have developed musharakah products tailored to the characteristics of MSMEs. For example, Bank Syariah Indonesia has simplified the process of submitting musharakah by offering various types of products that cater to the needs of MSMEs. On the other hand, data from Bank Negara Malaysia (2021) also show that the MSME sector accessing musharakah financing has experienced a significant increase in terms of income and market expansion.

The Impact of Musharakah Financing on the Sustainability of MSMEs

Musharakah financing has a significant impact on the sustainability of MSMEs, especially in supporting long-term business development efforts. Data collected from interviews with MSME managers show that musharakah financing enables MSMEs to focus more on product development and market expansion rather than being trapped by the problem of high-interest payments, as is the case with conventional loans. Most respondents acknowledged that musharakah financing provides them with the opportunity to develop without incurring burdensome liquidity pressure.

However, in terms of sustainability, some MSMEs still face challenges in terms of sound financial management. Although musharakah financing is based on profit sharing, dependence on specific sectors, such as agriculture or manufacturing, still limits the scope of their business sustainability. Research by Muchlis, (2020) It shows that MSMEs in the agricultural sector are more vulnerable to market price fluctuations and natural disasters, which can impact their ability to generate consistent profits.

In this research, it was also found that the sustainability of musharakah financing was more successfully applied to sectors that are more oriented towards innovation and digitalization. MSMEs engaged in technology, such as e-commerce and fintech, achieve better results when using musharakah as a financing tool due to the dynamic nature of their businesses. Musharakah financing in this sector can serve as a more flexible tool to support innovation and faster growth.

Table 1. The Impact of Musharakah Financing on the Sustainability of MSMEs by Sector

Sector	Sustainability with Musharakah	Challenge
Agriculture	Stabilize revenue	Vulnerable to weather changes
Manufactory	Increase production and expansion	Dependence on imported raw materials
Technology	Innovation and expansion support	Fierce market competition

Source: Data processed

Challenges in the Implementation of Musharakah Financing

Although musharakah financing has excellent potential for supporting the development of MSMEs, various challenges arise in its implementation. One of the primary challenges is the limited understanding of the principles of Sharia finance and musharakah among MSME actors. Interviews with several MSME actors show that many of them find it difficult to understand the profit-sharing mechanism and how musharakah differs from conventional financing. (Harahap et al., 2022; Martiana et al., 2024).

Additionally, the establishment of Islamic financial institutions that offer musharakah products poses a challenge. Despite efforts to simplify the application procedure, some Islamic financial institutions in developing countries still have complicated procedures and bureaucracy that affect the convenience of MSMEs in accessing financing. This has the potential to hinder the growth of MSMEs that require financing, as it offers a slower and more complex process.

Finally, another challenge found in this research is the limited access to information and assistance for MSMEs in utilizing musharakah financing. Although Islamic financial institutions have provided musharakah products, there remains a significant need for more intensive assistance in planning the use of these financing options for MSMEs. Without proper assistance, many MSMEs struggle to utilize musharakah financing to its fullest potential.

The Role of the Government and Sharia Financial Institutions in the Development of Musharakah Financing

The government and Islamic financial institutions play a vital role in the development of musharakah financing for MSMEs (Hidayah et al., 2021; Kamaruddin & Soemitra, 2022; Santoso, 2020). Based on data from Bank Indonesia (2022) and OJK (2022), policies that support sharia financing, including musharakah, are urgently needed to create a more inclusive financial ecosystem. (Arsyad et al., 2025). In this regard, several government policies that have been introduced, such as interest subsidies for sharia financing and training for MSMEs, show that regulatory support can increase the acceptance of musharakah financing among MSMEs (Hidayat et al., 2025).

In addition, Islamic financial institutions need to continue improving Islamic financial literacy among MSME actors by providing more intensive education and friendly services tailored to the needs of MSMEs. This research found that Islamic financial institutions with training and mentoring programs are better equipped to facilitate the implementation of musharakah in their business operations. (Mohammed et al., 2020).

In addition, strengthening the capacity of Islamic financial institutions in terms of risk management and expertise in providing financing in accordance with Sharia principles is also crucial for optimizing the use of musharakah financing for MSMEs. The government and Islamic financial institutions must collaborate to develop a more integrated and sustainable program that supports MSMEs through musharakah financing.

Table 2. Government Programs in Supporting Musharakah Financing for MSMEs

Program	Related Institutions	Impact on MSMEs
Sharia Financing Interest Subsidy	OJK, Bank Indonesia	Lower financing costs
Sharia Finance Training	Ministry of Cooperatives	Improving financial literacy
MSME Development Program	Ministry of MSMEs and SMEs	Expanding access to financing

Source: Data processed

CONCLUSION AND RECOMMENDATION

Based on the research results, it can be concluded that the integration of musharakah financing in the development of MSMEs in developing countries has significant potential to promote sustainable and inclusive business growth. Musharakah financing, based on the principle of profit sharing, has proven to be an alternative solution for MSMEs that face difficulties accessing conventional financing. This financing not only provides benefits for MSMEs in the form of business capital but also reduces the high-interest expense, thereby increasing the liquidity and sustainability of their business. However, despite its great potential, the implementation of musharakah financing faces several challenges, including a lack of understanding of Sharia principles, complex procedures, and limited support provided to MSMEs. The findings of this research also show that the sustainability of musharakah financing is highly dependent on the sector in which MSMEs are engaged. More dynamic sectors, such as technology and e-commerce, are better able to utilize musharakah as a financing tool that encourages innovation and expansion. On the other hand, sectors that are vulnerable to external changes, such as agriculture, face more significant challenges in managing risks and instability that can affect their business performance. Therefore, the role of the government and Islamic financial institutions is crucial in creating an ecosystem that supports the development of MSMEs through musharakah financing by increasing financial literacy, simplifying procedures, and providing more intensive assistance to MSMEs. This research addresses the primary objective by providing deeper insights into how musharakah financing can be integrated to support the development of MSMEs in developing countries, as well as its contribution to a sustainable and inclusive economy. Additionally, this research provides recommendations for policymakers and Islamic financial institutions to optimize the utilization of musharakah financing, thereby supporting the effective growth of MSMEs.

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