



Do Internal Factors of MSMEs Matter in Islamic Bank Financing Decision?

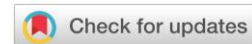
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ABSTRACT

Keywords:
MSMEs;
Religiosity;
Islamic Bank;
Financing.

The existence of an Islamic bank is expected to play a role in increasing and equalizing the economy, including in supporting the growth of MSMEs. Therefore, it is important to know the character of MSMEs in determining Islamic financing. This study aims to examine the effect of the MSME's firm age (calculated from firm incorporation), firm size (as measured by asset ownership) and the level of religiosity of MSME managers in Islamic banks' financing decisions. This study is quantitative by nature, and the sample of this study comprised 147 MSMEs. Based on the regression analysis, the results found that the firm size is not proven to be influential. Meanwhile, the firm age had a negative effect and the level of religiosity had a significant positive effect on Islamic bank financing decisions. The results of this study contribute to enriching a clear understanding through empirical evidence about how internal factors of MSMEs can influence their behavior in making financing decisions from Islamic banks.

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INTRODUCTION

The growth of the Islamic business sector has been increasing as well as the increased awareness of the Muslim community towards halal products. It leads many entrepreneurs to focus on providing products and services based on Islamic values, including in the financial sector (Usman et al., 2017). This situation has caused the Islamic finance industry and Islamic banking flourished and recognized by the International Monetary Fund (IMF). Islamic banking becomes one of the industries that have grown rapidly in the last four decades in the international financial system (Sabiou & Abduh, 2020) and have the potential to keep growing (Kammer, et al., 2015; Sayani and Miniaoui, 2013; Al Balushi, Locke & Boulanouar, 2019). In Indonesia, the development and contribution of Islamic banks are fast and continues to grow¹ (Ismail, 2010; Wibowo and Dewi, 2016; Usman, et al., 2017). Up to 2019, it was recorded that Islamic Commercial Banks and Sharia Business Units could provide financing of IDR 355,182B. This shows that the existence of Islamic banks plays a role in economic growth and development (Kammer, et al., 2015; Bananuka, et al., 2019).

Along with its growth, Islamic banking has become a major focus for the business community and academia (Bananuka, et al., 2019; Sabiu & Abduh, 2020). Even though Islamic banking already has a specific target market, the Muslim community, according to Suhartanto, et al., (2018) Islamic banks still experience difficulty in attracting customers, because they still have to compete with conventional banks (Al Balushi, et al., 2019). In addition, as a service industry, it is important to understand consumers (Sayani & Miniaoui, 2013) and know the factors that can attract consumers or maintain their loyalty to Islamic banks (Sayani & Miniaoui, 2013).

Literature from several countries has shown several factors influencing a person in selecting Islamic bank financings, such as attitudes, subjective norms (social influence), culture, government support, trust, information sources, bank reputation, and perceived risk (Islam, 2012; Sayani & Miniaoui, 2013; Abou-Youssef et al., 2015; Souiden & Rani, 2015; Usman, et al., 2017; Suhartanto, et al., 2018; Bananuka, et al., 2019).

Bananuka et al. (2019) found that there is a significant positive effect of the attitude, subjective norms (social influence), and religiosity of MSMEs' managers in Uganda on the intention to choose Islamic banking. It is similar to the research of Abou-Youssef, et al. (2015). He also pointed out that consumers' religiosity has a significant effect on their attitudes towards Islamic banking in Egypt. Furthermore, older people tend to be more religious than young people. The same research finding is also found by Souiden & Rani (2015) who conducted research in Tunisia.

The study of Sayani & Miniaoui (2013) through 246 respondents in the United Arab Emirates, found that bank reputation and expected return on deposits were not the determinants of bank selection. However, religious preference becomes the most important consideration in selecting between Islamic and conventional banks. In contrast to research from Uganda, Egypt, Tunisia, and the United Arab Emirates, research on the use of Islamic banking in Bangladesh did not show any influence of religiosity (Islam, 2012). This is because most of the Muslims in Bangladesh believe that there is no significant difference between the products and services offered by Islamic banks and conventional banks.

¹ Data from OJK (financial service authority) shows that in 2000 there were only two Islamic Banks, whereas, in 2019, there were 14 Islamic Banks. Three sharia business units in 2000 became 20 in 2019. Meanwhile, there were only 79 sharia public financing banks in 2000 and it became 164 in 2019.

In Indonesia, the results of research on the selection of Islamic banks are not too different from some studies abroad. [Usman et al. \(2017\)](#) revealed that religious norms play an important role. However, the results of his research also show that religion does not always play an important role in Muslims' decisions to take Islamic banks. Only customers with a higher level of religiosity tend to choose Islamic banks. The research by [Suhartanto, et al. \(2018\)](#) who tested 200 customers of Islamic banks in Bandung Indonesia, also found that religiosity and trust have a positive effect on customer loyalty to Islamic banks.

From several previous studies, almost all respondents in these studies were customers of Islamic banks or conventional banks without considering their profession or business ownership. The existence of Islamic banks is expected to play a role in improving the country's economy ([Sabiuh & Abduh, 2020](#)). Meanwhile, MSMEs are one of the sectors that essential to create the country's economic resilience ([Huda, 2012; Kammer, et al., 2015; Aziz, 2017; Rahman, 2017](#)). As reported by [Komite Nasional Keuangan Syariah \(KNKS\) \(2019\)](#), Indonesia has a high global Islamic financial market and still needs to strengthen in several aspects including MSMEs.

Recently, the problem of attitudes, awareness, preferences and the willingness to choose Islamic bank financing is still important to discuss ([Al Balushi, et al., 2019](#)) along with the possibility of growth in Islamic banking and the awareness of the Muslim community in Islamic financial products. Therefore, this research that discusses how does the company or industry's attitude toward Islamic banking is still needed ([Abdesamed & Wahab, 2015; Al Balushi, et al., 2019](#)). This is also interesting because Indonesia is a country with the largest Muslim population in the world. Moreover, it is also important to know the major contribution of organizational behavior in search of excellence (*fastabiqul khairat*) ([Wibowo & Dewi, 2016](#)). Therefore, this study aims to develop several previous studies by examining the influence of MSME managers' religiosity on Islamic bank financing decisions. In addition, this research also aims to examine the company's internal factors that can affect MSME financing decisions. The internal factors are the firm age and the size of the company. Those internal factors so far have not been given much attention in research ([Abdesamed & Wahab, 2014](#)).

The results of this study are expected to contribute both in the academic field, for policymakers, or the MSMEs concerned. For education, the results of this study can enrich a clear understanding through empirical evidence about how internal factors of MSMEs can influence their behavior in making financing decisions from Islamic banks. This research is also expected to be an important reference for policymakers on how the needs of capital and access to its sources can be met evenly across all firm sizes. This study can also expand the literature on how MSMEs' preferences in choosing sources of funds for their business.

RESEARCH METHOD

Hypothesis Development

Sharia finance is the provision of financial services under sharia principles ([Kammer, et al., 2015; Sabiuh & Abduh, 2020](#)). [Diana Yumanita \(2010\)](#) explained sharia principles as "the rules of the agreement based on Islamic law between banks and other parties for the deposit of funds and/or financing business activities, or other activities that are declared in accordance with Sharia".

Meanwhile, according to IMF, sharia principles in financial services are "the principles that prohibit interest (*riba*) with excessive speculation (*gharar*), gambling

(*maysir*), and the financing of illegal activities which are harmful to society” (Kammer, et al., 2015).

Theoretically, this principle prohibits banks or financial institutions to offer a fixed rate of return on deposits and/or interest on loans (Chong and Liu, 2009; Sabiu & Abduh, 2020). Based on this definition and a theoretical perspective, Islamic banking is different from conventional banks, because the standard used is sharia principles. Additionally, there is a unique feature of Islamic banks, namely the profit-loss sharing system. This is based on the concepts of *mudharabah* (profit sharing) and *musyarakah* (joint ventures) under Islamic agreements or contracts (Chong & Liu, 2009).

Not only growing in number but the role of Islamic banks in supporting the growth of MSMEs also improving. Based on data from the OJK (financial service authority), financing or working capital provided from Islamic banks to MSMEs has increased from IDR35,827B in 2016 to IDR37,868B in 2017, and in 2019 it became IDR38,584B. This shows an increase in interest from the MSMEs towards Islamic bank financing and hopes to continue increasing (Abduh & Azmi Omar, 2012; Kammer et al., 2015), as a choice for MSMEs' managers who are not willing to apply for financing at conventional banks for religious purpose.

The role of Islamic banks is inevitable from supporting the development of MSMEs (Rahman, 2017). Along with the growth of MSMEs, the increase in Islamic banks is expected to play an active role in providing business capital for MSMEs. Moreover, it also can encourage the survival and development of MSMEs. One of the functions and activities of Islamic banks is channeling funds in form of financing. Financing broadly means financing or funding issued to support investments that aim to increase profitability, reduce risk, or company liquidity. Currently, MSMEs financing still attracts a lot of attention to economists and policymakers (de la Torre et al., 2010; Wahab & Abdesamed, 2012; Abdesamed & Wahab, 2015).

The literature from several previous studies has shown several factors that can influence a person's decision to choose Islamic bank financing. The factors are both internal and external factors of the company, such as attitudes, subjective norms (social influence), culture, government support, trust, information sources, bank reputation, and risks (Islam, 2012; Sayani & Miniaoui, 2013; Abou-Youssef et al., 2015; Souiden & Rani, 2015; Usman, et al., 2017; Suhartanto, et al., 2018; Bananuka, et al., 2019). Meanwhile, this research focuses on internal factors, namely, firm age, firm size, and the level of religiosity of MSMEs' managers.

Age

The stages of business development usually go through several phases along with the length of time the business has been run. Younger MSMEs tend to have unstable rates of growth and profits. Additionally, business failures due to poor business practices and business management are also common in younger businesses (Wasiuzzaman & Nurdin, 2019).

This instability usually makes MSMEs reluctant to take external sources of capital and prefer internal sources of funds, such as from business profits, family, or friends (Haron & Ibrahim, 2016). This is because companies that are still in their early stages will avoid risk. As the result, they will prefer sources of capital that have the lowest risk, for instance, internal funding sources. According to Pecking Order Theory by Myers & Majluf (1984).

Besides, older companies are expected to have a reputation in applying for funding to financial institutions (Marshall, et al., 2016), so it eases them to make decisions to get funding from Islamic banks. Younger companies also tend to have poor management, which causes a high level of information asymmetry. Thus, it is more difficult for younger MSMEs to obtain loans (Wasiuzzaman & Nurdin, 2019). Hence, the hypothesis in this study is:

H¹: firm age has a positive effect on Islamic bank financing decisions.

Size

Bank financing is an important source of external financing for small businesses. However, many small companies are reluctant to get loans from banks because of credit risk (Abdesamed & Wahab, 2014). Apart from limited knowledge about financing and transaction costs related to financing, Cassar (2004) has also proven that the size of the company is also the reason why they are reluctant to seek outside capital sources.

According to Cassar (2004), it is also important to observe the influence of firm size concerning certain financing decisions. Theoretically, firm size will influence the decision of the manager to apply for a bank loan. It is because, the bigger the company, the greater the need for funds. Therefore, the larger MSMEs will apply for bank financing more often than the smaller MSMEs. Therefore, the hypothesis is:

H²: Firm size has a positive effect on Islamic bank financing decisions.

Religiosity

Religiosity can be defined as a person's commitment to follow the religious principles established by God (Abou-Youssef et al., 2015). Similar to Bloodgood, et al. (2008) religiosity is defined as an understanding and a form of commitment to follow a set of religious principles. Specifically, Suhartanto, et al. (2018) explained religiosity as a person's commitment who has a religion to obey God's rules which impacts not only social communication but also decisions in choosing or consuming a product or service.

Based on the Divine Command Theory, a person will do the right or wrong things based on his religious beliefs. Something ethically right depends on God's command, while something ethically wrong depends on God's prohibition (Al-Aidaros, et al., 2013). A religious person shows his adherence to the provisions of religion and encourages them to behave under the provisions of their religion (Suliswanto, et al., 2020).

As a Muslim, the things that are prohibited by Allah are clearly stated in the Quran and the Sunnah. Including suggestions for making *mu'amalah* transactions or buying and selling based on Islamic law. Another theory is the Theory of Planned-Behaviour. This theory reveals that individual behavior is influenced by three main factors. They are beneficial behavior, social pressure (subjective norms), and behavior control. In general, the more favorable the attitude is, and the greater the perceived social pressure and behavioral control, it results in the stronger one's intention to take certain actions (Ho, et al., 2008). Meanwhile, social pressure can come from the environment or the way of life as a Muslim who has to carry out everything according to God's command. Therefore, from the two theories above, it is possible if a person with a high level of religiosity, or a person with a good understanding, will tend to choose financing from an Islamic bank. Thus, the third hypothesis is:

H³: religiosity has a positive effect on Islamic bank financing decisions.

Research Sample

The samples of this study comprised the managers of MSMEs in Semarang and around. The MSMEs' managers referred to someone who makes financing decisions related to MSME business activities. This study only selected MSMEs that have taken financing from Islamic banks or are in the process of the financing application. This is to ensure that the sample knows well the requirements to get financing from Islamic banks. This research is a quantitative study with primary data. The data were obtained through a questionnaire given to MSMEs' managers.

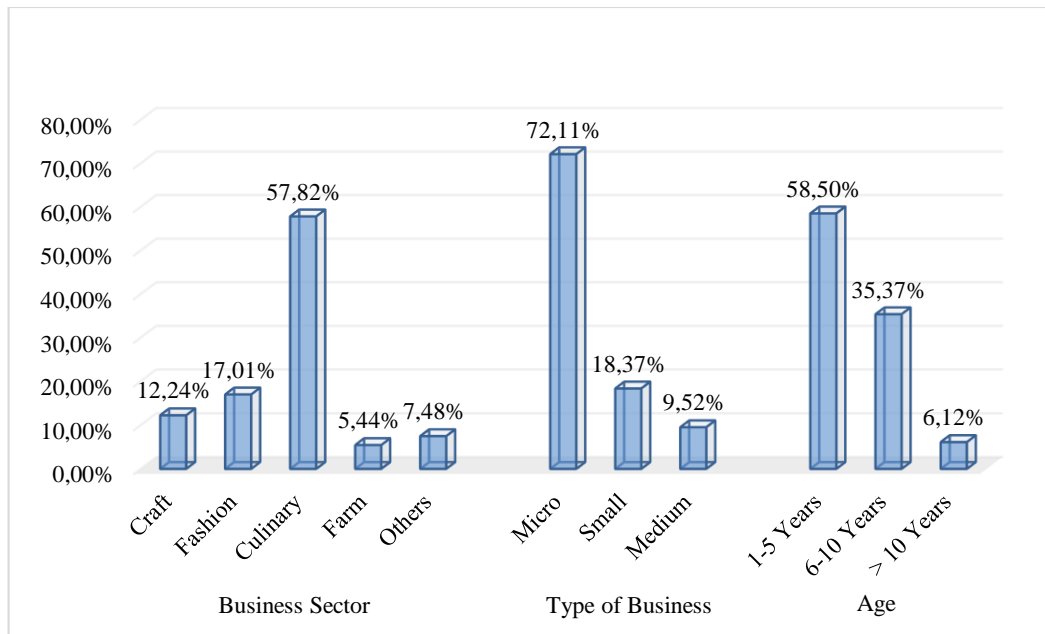


Figure 1. Brief Description of Research Sample

This study used 147 MSMEs as the research sample. The sample consists of various business sectors and types with a business age between 1 year to more than 10 years, as presented in **figure 1**. Based on the business sector, the sample is dominated by businesses from the culinary sector, as many as 57.82% (85 MSMEs), while from the fashion, craft, and farm sectors respectively 17.01% (25 MSMEs), 12.24% (18 MSMEs) and 5.44% (8 MSMEs). When viewed from the type of business, most of the samples are micro-enterprises, as much as 72.11%, while the rest are small and medium enterprises which are 18.37% and 9.52%, respectively. In addition, this study also uses samples with varying levels of business experience. As many as 58.50% (86 MSMEs) are MSMEs aged between 1-5 years, and 35.37% (52 MSMEs) are businesses with 6-10 years of experience, while the rest are more than 10 years.

Measurement Variables

The instrument used in this study was the adoption of several previous studies and has met the validity and reliability tests for each indicator of each variable. The independent variables in this study were firm age, firm size, and religiosity. Firm age is measured from the time the business was established. Firm size is based on the number of assets owned by MSMEs.

The ownership of assets becomes one of the considerations for MSMEs in obtaining external funds. Meanwhile, the variable of religiosity is measured by several dimensions that have been adopted from several previous studies, which are based on two Islamic principles, namely relationship with God (*hablun minallah*) and relationship with human (*Hablun Minannas*) (Usman, et al., 2017).

The question items were adopted by Souiden & Rani (2015), Suhartanto, et al. (2018), Rehman & Shabbir (2010), Abou-Youssef, et al. (2011), Abou-Youssef, et al. (2015) with five dimensions that were originally developed by Glock (1962) and Glock & Nicosia (1964). The question items used to describe a person's religiosity are from five dimensions. They are ideology, ritualistic, intellectual, consequences, and experiences. The statement items are measured on a 5-point Likert scale ranging from 1 strongly disagree to 5 strongly agree.

The dependent variable in this study is the decision of MSMEs to take financing from Islamic banks. It is adapted from the research of Souiden & Rani (2015) and Suhartanto, et al. (2018) regarding the intention and loyalty toward an Islamic bank. Financing decisions are measured by questions that describe the desire of MSMEs' managers to use financing from Islamic banks. The questions include how far the MSMEs' managers want to use Islamic bank financing for their business needs, and how they might recommend financing from Islamic banks to the people around them.

Data Analysis

Before analyzing the data, the researchers examined the data first by looking at the completeness of the data from each questionnaire obtained. From 185 data, 21% of the data or 38 responses cannot be used because the respondent did not answer every question completely. As the result, only 147 data can be used. The data were analyzed using SPSS. Regression analysis was used to see the influence of predictor variables (firm age, firm size, and religiosity) on the criterion variable (decision to take funding in Islamic Bank). In connection with the research objectives, this study used the following research model:

$$F_i = \alpha + \beta_1 Age_i + \beta_2 Size_i + \beta_3 Religiosity_i + \varepsilon_i$$

Information:

- Age_i : firm age
 $Size_i$: firm size
 $Religiosity_i$: The level of religiosity of MSMEs' managers
 $Financing_i$: Islamic bank financing decision

Descriptive Statistics

The descriptive statistics in **Table 1** shows that the samples (MSMEs) in this study are those whose businesses have been running for more than 5 years. The average value for the independent variable Firm size is 22,445,918 IDR.

On the other hand, from the definition of MSMEs, the average MSMEs in this study is Micro Enterprises that have asset ownership of less than 50,000,000 IDR. Meanwhile, the religiosity variable, shows that the average value of religiosity is 103.70. It indicates that on average, the respondents have a high level of religiosity. Whereas the average dependent variable –funding decisions in Islamic banks, which is

15.12 of 20. This indicates that the average MSMEs' managers in Semarang and around are interested in taking funding from Islamic banks.

Table 1. Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Age	147	1.00	20.00	5.3946	3.23626
Asset	147	200,000.00	485,000,000.00	22,445,918.3673	59,956,353.27715
Religiosity	147	76.00	115.00	103.7075	9.40505
Financing	147	6.00	20.00	15.1224	2.84749
Valid N (listwise)	147				

RESULT AND DISCUSSION

The results of the classical assumption test, as a requirement of a regression test, show that all the data used in this study have met the classical assumption test. The results are presented in **Table 2**. The results of the classical assumption test show that there is no multicollinearity with a tolerance value of no less than 0.1 and a VIF value of more than 10. Likewise, in the heteroscedasticity and linearity tests, there are no independent variables whose results are significantly less than 5% and insignificant normality value. This shows that the data in this study have met the classical assumption test, as a condition in the Ordinary Least Square.

Table 2. Classical Assumption Test

Model	Multicollinearity		Heteroscedasticity	Normality	Linearity
	Collinearity Statistics		Sig.	Asymp. Sig. (2-tailed)	Deviation from Linearity
	Tolerance	VIF			
1 (Constant)			,342	0,200	
Age	,944	1,059	,569		,676
Size	,935	1,069	,763		,170
Religiosity	,984	1,017	,562		,052

a. Dependent Variable: Islamic Financing

The results of the regression analysis in **Table 4** show that the significance value for the firm age variable is 0.040 (significant at the 5% significance level) with a coefficient value of -0.142. The same results are also shown in the correlation analysis in Table 3. The correlation results are -0.174 and it is significant at the 5% significance level. These results indicate that the firm age has a negative effect on the decision of MSMEs to take financing from Islamic banks. Thus H^1 was rejected.

The results of this study support the research by [Marshall, et al. \(2016\)](#), found that firm age has a negative effect on the bank loan. Companies that are still in the early stages tend to need capital for business expansion ([Haron & Ibrahim, 2016](#)), so that the business growth process can run well with sufficient capital needs.

Therefore, younger companies will seek more external capital, such as from banks, including Islamic banks. Moreover, younger business actors with an entrepreneurial orientation will tend to take risks in their business processes. Taking risk is associated

with a company's readiness to make bold and courageous resource commitments to organizational initiatives with uncertain returns (Eggers, et al., 2017). In conclusion, the instability of the management system within the company does not prevent younger firms from obtaining capital external sources.

Table 3. Result of Correlation Analysis

		Correlations			
		Financing	Age	Size	Religiosity
Financing	Correlation	1			
Age	Correlation	-.174*	1		
Size	Correlation	.028	.226**	1	
Religiosity	Correlation	.403**	-.046	.106	1
		N	147	147	147

* Correlation is significant at the 0.05 level (2-tailed).

** Correlation is significant at the 0.01 level (2-tailed).

The second predictor variable, firm size shows the results of the analysis in **table 4**, with a Sig value of 0.777 (insignificant). In other words, firm size has no effect on the decision of MSMEs to take financing from Islamic banks. The same results are also shown from the correlation analysis in **Table 3**. It has significant correlation results of 0.028, thus H^2 was rejected.

This results are in contrast with the result of Marshall, et al. (2016) which found that the size of the company is an important factor in determining the source of loan. It shows that MSMEs do not take firm size as a consideration when they decide to take funding from Islamic banks. This is because currently it is easier to obtain additional business capital from banks, and the government has even created a special business financing program for small entrepreneurs. However, the results of this study support the research by Wasiuzzaman & Nurdin (2019), Aysan, et al., (2016), Al Balushi, et al., (2019), Basha, M. B., et al., (2021), Sabiu & Abduh, (2021), Alharbi, et al., (2021) found that the size of the company does not affect the decisions of MSMEs in Malaysia to apply for financing.

Table 4. Result of Regression Analysis

		Coefficients ^a				
Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	
	B	Std. Error	Beta			
1	(Constant)	2.823	3.228		.874	.383
	Age	-.142	.068	-.161	-2.074	.040*
	Size	.104	.366	.022	.284	.777
	Religiosity	.119	.023	.393	5.175	.000**

a. Dependent Variable: Islamic Financing

* Significant at the 0.05 level

** Significant at the 0.01 level

The results of the regression analysis in **table 4**, show that religiosity has a sig value of 0.000 (significant at the 1% significance level) with a coefficient value of 0.119, this

is in line results in the correlation analysis in **Table 3** which is 0.403 with a 1% significance level.

These results indicate that the level of religiosity of MSMEs' managers has a positive effect on the decision of MSMEs to take financing from Islamic banks. Thus, H³ was accepted. This also proves that the decision of a Muslims to take financing from Islamic banks is influenced by their belief. This supports several previous studies that show religion as an important factor influencing one's preference for using Islamic banking such [Abdesamed & Wahab, \(2015\)](#), [Wibowo & Dewi, \(2016\)](#), [Suhartanto, et al., \(2018\)](#).

CONCLUSION

This study aims to examine the effect of the MSME's firm age, firm size and the level of religiosity of MSME managers in Islamic banks' financing decisions. Based on the regression analysis, the results found that firm age and firm size of the MSME's has a negative effect on the decision to take financing from Islamic banks. While the level of religiosity of MSMEs' managers has a positive effect on the decision to take financing from Islamic banks. These results contribute both in the academic field, for policymakers, or the company concerned. For education, the results of this study can enrich a clear understanding through empirical evidence about how the firm size, firm age, and the level of religiosity of MSMEs' managers can influence their behavior in making financing decisions from Islamic banks.

However, the measurement of firm size in this study only examined the age of the business and did not see the characteristics of MSMEs' managers, as decision-makers. The negative effect could be because the respondents in this study were people with characters who tend to take risks rather than avoid risks. Therefore, further research can elaborate on the personal characteristics of MSMEs' managers in the early stages that affect MSMEs' decisions to take external funding.

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