



Research paper

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Sharia-Based Ultra-Micro (UMi) Financing Model for MSMEs through Islamic Microfinance Institutions

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ABSTRACT

The halal industry in Indonesia holds significant potential as a driver of national economic growth, particularly in the financing of ultra-micro enterprises. Ultra-micro financing (UMi) through Islamic microfinance institutions (IKMS) is an inclusive and practical financing alternative for ultra-micro entrepreneurs in Indonesia. This study aims to analyze the Sharia-based ultra-micro financing (UMi) model through Islamic microfinance institutions (IKMS), identify its strengths and weaknesses, and evaluate its alignment with the principles of Maqashid Sharia. The study finds that integrating funds from the Government Investment Center (PIP) to institutions such as KSPPS, BMT, and LKMS serves as financing channels and as agents of community empowerment through sustainable approaches rooted in Islamic principles. This paper is a case study research with a qualitative-descriptive approach and is enriched with literature reviews to examine various dimensions of Sharia-based UMi financing. The analysis reveals that this model is superior to conventional financing models, as it prioritizes not only financial aspects but also social dimensions aligned with the objectives of maqashid sharia, including the preservation of wealth, life, intellect, lineage, and religion. Despite existing challenges such as limited human resources, underdeveloped digital infrastructure, and the need to balance social and business functions, institutional strengthening and adherence to Sharia principles within Islamic microfinance institutions (IKMS) can serve as key drivers in poverty alleviation and the enhancement of community welfare.

ABSTRAK

Industri halal di Indonesia memiliki potensi besar sebagai pendorong pertumbuhan ekonomi nasional, terutama dalam sektor pembiayaan usaha ultra mikro. Pembiayaan Ultra Mikro (UMi) melalui Institusi Keuangan Mikro Syariah (IKMS) merupakan salah satu alternatif pembiayaan yang inklusif dan solutif bagi pelaku usaha ultra mikro di Indonesia. Penelitian ini bertujuan untuk menganalisis model pembiayaan UMi berbasis syariah, mengidentifikasi kelebihan dan kekurangannya, serta meninjau kesesuaiannya dengan prinsip maqashid syariah. Studi ini mempromosikan integrasi dana dari Pusat Investasi Pemerintah (PIP) kepada lembaga-lembaga seperti KSPPS, BMT, dan LKMS yang tidak hanya menyalurkan dana, namun juga memberdayakan masyarakat melalui pendekatan yang berkelanjutan dan berbasis nilai-nilai Islam. Penelitian ini dilakukan dengan pendekatan kualitatif deskriptif dengan mengkaji sumber-sumber referensi untuk menelaah berbagai dimensi pembiayaan UMi syariah. Hasil analisis menemukan bahwa model ini lebih unggul dibandingkan dengan pembiayaan konvensional karena tidak hanya mengutamakan aspek finansial, namun juga sosial yang sejalan dengan tujuan maqashid syariah seperti pemeliharaan harta, jiwa, akal, keturunan, dan agama. Walaupun masih terdapat tantangan seperti keterbatasan SDM, infrastruktur digital, dan penyeimbangan fungsi sosial dan bisnis, penguatan kelembagaan dan prinsip syariah IKMS dapat menjadi penggerak penting dalam mengentaskan kemiskinan dan memperkuat kesejahteraan masyarakat.

1. Introduction

Micro, Small, and Medium Enterprises (MSMEs) have a significant impact on Indonesia's economy. According to the Ministry of Cooperatives and MSMEs (2024), MSMEs contribute more than 60% to the

Gross Domestic Product (GDP) and absorb around 97% of the national workforce. Despite their substantial contribution, MSME actors still face several challenges, one of which is limited access to easy and sustainable capital and financing. This condition has become a major obstacle for MSMEs in improving their capacity and competitiveness amid the constantly evolving economic landscape.

Table 1. MSMEs Growth by Year

Year	2019	2020	2021	2022	2023
Number of MSMEs (Bil)	65,47	64,64	65,46	65,65	66,66
Growth (%)	98%	2,24%	28%	0,70%	52%

The government has undertaken various efforts in this regard. The Ultra-Micro (UMi) financing model is one of the strategic initiatives aimed at supporting MSMEs that are not yet reached by formal financial institutions. This program is expected to accelerate business development among the lower-income population through non-bank financing schemes. However, the current implementation mostly relies on conventional interest-based mechanisms, which many business actors feel are not aligned with the sharia principles held by the majority of Indonesians.

The development of a sharia-based UMi financing model thus becomes an important alternative that is both inclusive and in line with Islamic values widely embraced in the country. Various Islamic Microfinance Institutions (IMFIs), such as sharia cooperatives, *Baitul Maal wat Tamwil* (BMT), and Islamic Microfinance Institutions (LKMS), hold considerable potential for implementing this type of financing. This model not only aims to avoid *riba* (usury), but also strives to achieve fairness and blessings in every transaction through profit-sharing contracts (*mudharabah* or *musharakah*) and other agreements that suit both parties' conditions. This approach also has the potential to strengthen the social aspects of community-based economic empowerment.

However, like all financial systems, both conventional and sharia-based financing models face their own unique implementation challenges. This also applies to the development of sharia-based UMi financing. Therefore, a comprehensive study is needed to design a relevant and applicable sharia financing model tailored to MSMEs' needs, so that innovative and practical solutions can be formulated to overcome the challenges faced in implementing sharia-based UMi financing. Such a study is expected to serve as a reference for policymakers, entrepreneurs, and financial institutions in designing adaptive and sustainable sharia financing schemes.

Through this research, the author aims to explore the development of sharia-based UMi financing that not only adheres to sharia principles but also considers real-world implementation challenges. The analysis also employs the *maqashid* sharia perspective to assess how well the model fulfills the core objectives of sharia. This approach provides a more holistic understanding of the benefits of the financing scheme, not only economically but also spiritually and socially. It is hoped that this study will make a tangible contribution to advancing Islamic financial inclusion in Indonesia.

Based on the above background, the objectives of this study are:

1. To analyze the sharia-based Ultra-Micro (UMi) financing model through Islamic microfinance institutions.
2. To identify the strengths and weaknesses of the sharia-based UMi financing model through Islamic microfinance institutions.
3. To identify potential models of sharia-based UMi financing through Islamic microfinance institutions.
4. To analyze the *maqashid* sharia perspective on the sharia-based UMi financing model implemented through Islamic microfinance institutions.

2. Literature Review

2.1 Government Investment Center/Pusat Investasi Pemerintah (PIP)

Minister of Finance Regulation Number 52/PMK.01/2007 stipulates that the Pusat Investasi Pemerintah (PIP) or Government Investment Center is a government investment implementing unit under the authority of and accountable to the Minister of Finance, through the Director General of Treasury. PIP carries out its duties by applying the Financial Management Pattern of a Public Service Agency (BLU). The main task of PIP is to coordinate financing activities for Micro, Small, and Medium Enterprises (MSMEs) in accordance with policies set by the Minister of Finance and in compliance with prevailing laws and regulations. In the distribution of ultra-micro financing, the PIP as a BLU does not directly disburse the funds, but does so through non-bank financial institutions that meet the eligibility criteria set by the Ministry of Finance (Ministry of Finance, 2020).

Government intervention through this program has had a significantly positive impact, contributing to the growing capacity of ultra-micro businesses in Indonesia. In addition to achieving its primary goal of providing business capital, PIP also supports the development of entrepreneurs' competencies through training and mentoring programs. Looking at the performance of the financing program to date, the UMi scheme has helped micro-entrepreneurs avoid falling into debt traps posed by online lending platforms and loan sharks. As of 2024, more than ten million entrepreneurs in Indonesia have received financing through PIP, with the total distributed amount nearing IDR 40 trillion (Havitz, 2023).

2.2 Previous Research

Numerous studies have applied the NASA-TLX method to assess mental workload across different sectors. Saputra and Herwanto (2022) studied carton factory workers and found that repetitive tasks and insufficient facilities led to high levels of effort and time demand. Chairunnisaa et al. (2022) explored administrative staff in educational institutions and observed elevated mental workload, particularly in temporal demand and frustration, due to workload imbalance and insufficient staffing. Indra et al. (2022) assessed water meter readers and identified effort and performance as key contributors to mental workload. Their study highlighted the role of supervisory guidance in reducing frustration levels. Qonita and Laksono (2022) focused on recycling warehouse operators and reported that mental workload was primarily driven by high temporal demand and frustration, resulting from unpredictable task targets and disorganized environments. Nur et al. (2020) studied nurses in ICU and ER units and concluded that emergency conditions significantly increased mental workload, especially in temporal demand and frustration. They recommended stress management training as an intervention. Adikarana et al. (2022) examined production workers in a metal industry and revealed high mental workload caused by cognitive strain and physical exhaustion. They proposed job rotation and shift adjustments to manage workload. Zain (2019) investigated contractor staff and found that discrepancies between expectations and work realities led to high mental workload. The most influential dimensions were mental demand and frustration, particularly in high-pressure projects.

2.2 Ultra-Micro Financing

According to Minister of Finance Regulation Number 193/PMK.05/2020, Ultra-Micro Financing (UMi) is a financing facility program provided to Ultra-Micro Enterprises, offered in both conventional and sharia-based financing schemes. This program is a government-initiated financing model aimed at supporting MSME actors (particularly ultra-micro enterprises) that have yet to gain access to formal financial institutions such as banks. It also serves as a continuation of the Kredit Usaha Rakyat (KUR) program, with the financing ceiling initially set at IDR 10 million, later increased to IDR 20 million, and disbursed through Non-Bank Financial Institutions (LKBB) (Hia et al., 2021). This adjustment was made to facilitate business expansion among micro-entrepreneurs who are still unable to access bank financing. Financing and accessibility for lower-middle-class communities are highly relevant to the concept of Islamic finance, as they place greater responsibility for social welfare and religious commitment on the path to achieving global economic development goals (Syamlan, 2021).

One of the main advantages of this program, as stated in the Ministerial Regulation, is the absence of collateral requirements, making it a viable option for entrepreneurs with limited assets. The program is not merely a financial instrument, but also a means to stimulate economic growth and competitiveness, encouraging micro enterprises to eventually connect with the formal financial system or become financially independent.

The UMi financing program is funded by the State Budget (APBN) and managed by the Pusat Investasi Pemerintah (PIP) as the coordinating body. Fund disbursement through LKBBs is conducted through formal partnership agreements between PIP and the appointed institutions (Dewantha, 2021). The selected LKBBs are institutions with established experience and extensive networks in micro-enterprise financing. The selection process also considers compliance with regulatory standards, including the application of Know Your Customer (KYC) principles and debtor mentoring initiatives as part of risk mitigation strategies against Non-Performing Loans (NPL) (Khaerul Masi, 2021). Consequently, the funds that have been disbursed but have not yet matured can be recycled to other ultra-micro enterprises, expanding outreach and support for business development.

Based on Annual Reports and official performance documents from the Government Investment Center (PIP), by the end of 2021, the UMi financing program had produced substantial outcomes in supporting the growth of ultra-micro enterprises across Indonesia. The APBN funds allocated for the program reached approximately IDR 10 trillion. From this allocation, around IDR 18.09 trillion was successfully disbursed to ultra-micro enterprises nationwide, benefiting approximately 5.39 million borrowers (Pusat Investasi Pemerintah, 2023).

2.3 Islamic Microfinance Institutions

The Islamic Microfinance Institutions Sector (IKMS) is a term introduced by the National Committee for Islamic Economy and Finance (KNEKS) to collectively refer to Islamic microfinance institutions in Indonesia inspired by the model of Baitul Maal wat Tamwil (BMT). However, under Law No. 1 of 2013, BMT is categorized as a type of Microfinance Institution (LKM), specifically referred to as a Balai Usaha Mandiri Terpadu. To avoid legal implications, the designation "BMT sector" was officially replaced by IKMS, which includes all BMT-inspired Islamic microfinance institutions, whether under the supervision of the Ministry of Cooperatives and SMEs or the Financial Services Authority (OJK).

IKMS serves dual roles: a commercial function and a social function. As a commercial entity, IKMS acts as a funding channel for providing working capital to micro-enterprises. As a social institution, IKMS contributes to poverty alleviation and provides business mentoring to its members (Aryo et al., 2020). Islamic microfinance can be regarded as an ideal model when both social and commercial aspects are balanced and integrated, ensuring that social values are not neglected (Otoritas Jasa Keuangan, 2025).

According to KNEKS (2020), IKMS plays a crucial role in empowering the ultra-microeconomic segment while maintaining the harmony between its dual functions. The strengthening of IKMS empowerment relies on three main pillars:

1. An effective supervisory system,
2. Institutional and financial capacity building, and
3. The enhancement of supporting infrastructure and digitalization.

Amid rapid technological advancement, digitalization has become a crucial factor in enabling these institutions to operate more optimally and sustainably.

2.4 Research Framework

The framework of thinking serves as a conceptual foundation that outlines the logical flow of the research process, from problem identification to the formulation of solutions or expected findings. In this study, the framework is constructed to illustrate the relationship between various variables and concepts related to the Sharia-based Ultra-Micro (UMi) financing model through Islamic Microfinance Institutions (IKMS). By referring to relevant theories and the data obtained, this framework guides the researcher in understanding how Sharia financing mechanisms are implemented, the potentials and challenges involved, and the extent to which the approach aligns with the principles of maqashid sharia. The development of this framework is expected to clarify the direction of analysis and facilitate the drawing of objective and structured conclusions.

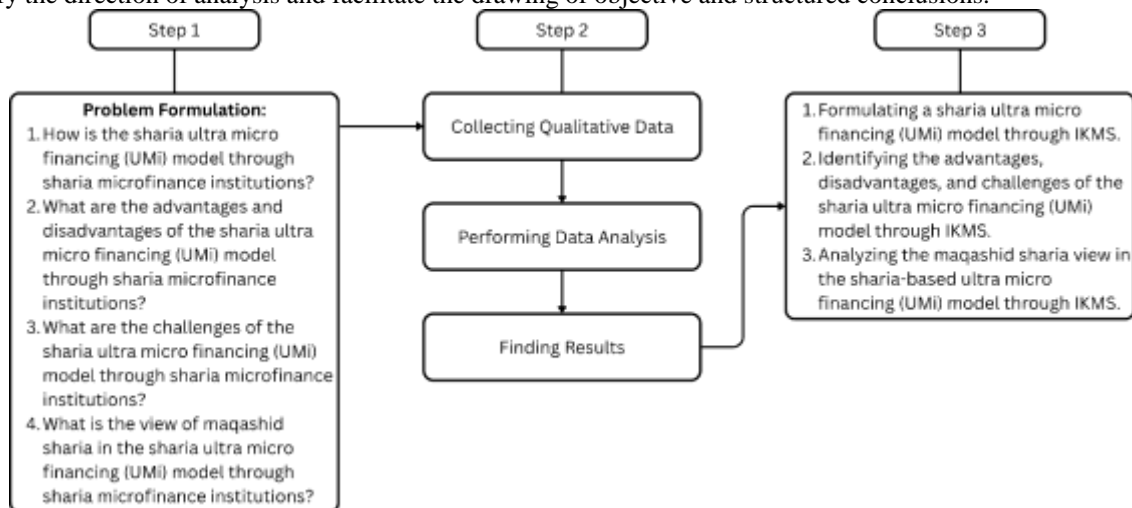


Figure 1. Research Framework

3. Methodology

3.1 Research Method

This study employs a descriptive qualitative approach. As explained by Sahir (2021), the qualitative approach aims to understand phenomena from the participants' perspectives and analyze data descriptively. A similar view is expressed by Sugiyono (2021), who states that the qualitative method is rooted in a particular philosophy to understand meaning in a scientific context. Based on these perspectives, this method was chosen because it allows the researcher to gain a deep understanding of a phenomenon based on perceptions and

meanings derived from data analysis. In the context of this research, the qualitative approach is used to explain the Sharia-based Ultra-Micro (UMi) financing model through Islamic Microfinance Institutions (IKMS), to identify its potentials and challenges, and to explore these aspects from the perspective of maqashid syariah.

According to Supriati (2013), the research object refers to the variable being studied in a specific location with the aim of obtaining specific information. Based on this definition, the object of this study is the Sharia-based Ultra-Micro (UMi) financing model through Islamic Microfinance Institutions (IKMS), which serves as the central focus to be explored scientifically.

3.2 Data Collection

Data were collected through a literature study. Sugiyono (2016) explains that a literature study involves the examination of theories, norms, and cultural aspects that develop within a particular social context. In this research, data were obtained from various relevant sources such as books, scientific journals, articles, and official documents from reputable institutions. The study aims to gather information related to Ultra-Micro (UMi) financing, Sharia financing mechanisms, the opportunities and challenges faced, as well as normative reviews based on the Qur'an and Hadith.

3.3 Data Analysis

The method of analysis used in this study is descriptive analysis. According to Sugiyono (2019), this analysis involves collecting factual data and organizing it to obtain a comprehensive picture of the research problem. The analysis is carried out through three main stages: data reduction, data presentation, and conclusion drawing. It also includes data triangulation as a means to ensure the validity of the findings.

1. Data Reduction

Data reduction is the initial process aimed at filtering and summarizing information from various sources such as interviews, observations, and documents. Irrelevant data are discarded, while important data are classified according to key themes, such as the role of PIP and IKMS, financing distribution schemes, and the implementation of programs in the financing sector.

2. Data Presentation

The reduced data are then presented in the form of descriptive narratives, tables, diagrams, or matrices. The goal is to clarify the relationships between key elements such as financing returns, the role of distributing institutions (e.g., BMT), and their impact on halal business actors.

3. Conclusion Drawing

The final step is to formulate preliminary conclusions from the analyzed data, followed by verification using triangulation or cross-validation techniques. These conclusions highlight key points such as the effectiveness of financing in supporting the halal industry and the challenges in implementing the related financing model. Validation is conducted to ensure that the analysis results truly represent field conditions and are scientifically accountable.

4. Discussion

4.1 Financing Model

Below is an illustration and explanation of the financing scheme model through revolving funds from the Government Investment Center (PIP):

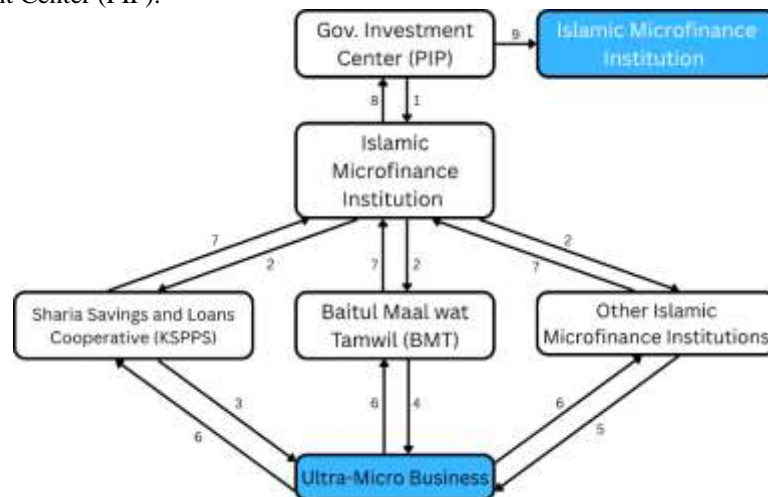


Figure 2. Financing Model

Source: Processed by Authors (2025)

1. The Government Investment Center (PIP) distributes a certain amount of revolving funds to Islamic Microfinance Institutions (IKMS).
2. The IKMS serving as distributors may include Sharia Savings and Loan Cooperatives (KSPPS), *Baitul Maal wat Tamwil* (BMT), and other Islamic Microfinance Institutions (LKMS).
3. KSPPS provides financing to business actors.
4. BMT provides financing to business actors.
5. LKMS provides financing to business actors.
6. Business actors repay the financing in the form of the loan amount and return (profit margin) as agreed upon in the contract to the KSPPS, BMT, and LKMS.
7. KSPPS, BMT, and LKMS receive the principal and returns from business actors, then return the principal to PIP, while the returns become the right of the IKMS.
8. PIP receives fund repayments from IKMS and redistributes the revolving funds to other IKMS.

Based on this model, there are at least three types of IKMS that can act as partners, namely:

4.1.1 Sharia Savings and Loan Cooperative (KSPPS)

In this scheme, the Sharia Savings and Loan Cooperative (KSPPS) acts as a distributor of revolving funds from the Government Investment Center (PIP). After receiving the principal funds, KSPPS distributes them to cooperative members who run micro and small enterprises, using Sharia contracts such as *murabahah* (cost-plus sale), *ijarah* (leasing), or *mudarabah* (profit-sharing). The returns from the financing become the right of the KSPPS, while the principal is gradually repaid to PIP as agreed.

As a Sharia cooperative, KSPPS is responsible for ensuring the sustainability and effectiveness of fund management. In practice, KSPPS managers apply prudential principles and monitoring systems to minimize non-performing financing. For example, KSPPS BMT Harber Tanggulasi Jepara demonstrated that effective monitoring could reduce the non-performing financing (NPF) ratio from 15% to 12% (Alfani & Solihin, 2023). Additionally, during crises such as the COVID-19 pandemic, KSPPS Istiqlal in Pekalongan managed to maintain liquidity and protect members' savings by reducing financing disbursement and rescheduling installments (Tarigan et al., 2023). This reflects the adaptive capacity of KSPPS in managing external funds responsibly and in accordance with Sharia principles.

4.1.2 Baitul Maal wat Tamwil (BMT)

Within the framework of this study, BMT acts as an Islamic microfinance institution that channels revolving funds from the Government Investment Center (PIP) to MSME actors. The received funds are disbursed through Sharia financing schemes such as *murabahah*, *ijarah*, and *mudarabah*. The returns from these contracts become the right of the BMT, while the principal is returned to PIP according to the agreement.

BMT's strength lies in its community-based approach, which enables social and personal assessments of enterprises, as well as providing business mentoring for clients. The role of BMT in promoting economic empowerment has been validated by various studies. During the pandemic, BMTs in several regions actively assisted MSMEs in surviving and growing through flexible financing strategies and low-risk approaches (Ma'ruf et al., 2022). Furthermore, BMT Assyafiyah demonstrated that community empowerment through productive financing can improve economic and social well-being, particularly in rural areas (Azizah et al., 2023). This role strengthens BMT not only as a revolving fund intermediary but also as a Sharia-based and participatory agent of economic development.

4.1.3 Other Islamic Microfinance Institutions (LKMS)

In this study, LKMS functions as a formal entity that receives and disburses revolving funds from the Government Investment Center (PIP) to MSME actors through Sharia financing contracts such as *murabahah*, *mudarabah*, and *ijarah*. The principal funds from PIP are distributed to selected clients, and all returns from the financing serve as operating income for LKMS. The principal is returned to PIP according to the agreed schedule. As institutions supervised by the Financial Services Authority (OJK), LKMS have a more formal management structure and implement professional risk monitoring and reporting systems.

The role of LKMS goes beyond financing distribution; it also includes efforts to strengthen the community economy. Research has shown that LKMS significantly contribute to the growth of micro-enterprises, reduce social inequality, and support more equitable income distribution (Kamilah & Nst, 2019). Nonetheless, internal challenges such as operational efficiency and limited human resources remain key concerns. Efficiency studies have shown that most LKMS operate below optimal efficiency standards, indicating the need for improved management and business strategies (Damayanti, 2018). Despite these issues, LKMS remain strategically important as the government's extension to distribute Sharia funds effectively and sustainably.

In addition to the distribution structure involving KSPPS, BMT, and LKMS, the strength of the Sharia-based ultra-micro financing model lies in the flexibility of utilizing various Sharia contracts tailored to the characteristics of the recipient businesses. Murabahah is used for financing trade goods or business assets, with a pre-agreed profit margin in a sale-purchase system. For businesses that require working capital and profit-sharing potential, mudarabah and musyarakah contracts are ideal as they offer equitable profit-sharing mechanisms. Meanwhile, ijarah is applied in the context of leasing equipment or business facilities.

Several studies have mentioned that the implementation of these contracts not only improves access to capital but also supports the sustainable economic growth of the lower-middle class (Ryandono et al., 2017). This model is further strengthened through the use of digital technology in the operations of distributing institutions. Several IKMS have begun developing online systems for transaction recording, financial reporting, and installment tracking. This digitalization contributes to greater service efficiency, easier access to information for business actors, and enhances transparency and accountability within Islamic microfinance institutions. With digital systems, financing applications and evaluations can be processed more rapidly, while also supporting data integration with government platforms like PIP. To support this, Indonesia requires a comprehensive approach that includes strengthening transparency, risk mitigation, and a regulatory framework across all Islamic Financial Institutions (Syamlan & Purba, 2025).

The effectiveness of this financing model is also reflected in tangible economic success indicators. Research by Harun (2024) shows that ultra-micro financing from non-bank Islamic financial institutions has significantly increased daily income and sales turnover of ultra-micro MSMEs, especially in North Sumatra. Beyond these indicators, the model's success can also be seen in repeat financing rates, business capacity growth, and improved financial literacy among MSME actors after receiving IKMS financing services. This demonstrates that the Sharia-based financing model is not only normatively relevant but also empirically effective in promoting the economic empowerment of the community.

4.2 Strengths and Weaknesses

After There are fundamental differences between the revolving fund financing model from the Government Investment Center (PIP) through Islamic Microfinance Institutions (IKMS) and the conventional Ultra-Micro (UMi) financing model as well as the existing Islamic UMi financing model in Indonesia. These differences relate to the institutional approach, financing principles, fund return mechanisms, and the economic empowerment roles performed by the respective institutions.

The implementation of Islamic principles in every transaction is the main advantage of this financing model. The use of Sharia contracts such as murabahah (cost-plus sale), ijarah (leasing), or mudarabah (profit-sharing) provides an alternative for business actors by offering financing based on justice and mutual risk sharing, without involving riba (usury) (Ministry of Finance, 2020). This contrasts significantly with conventional UMi financing, which typically applies fixed interest rates in every transaction and does not fairly consider risks borne by borrowers, as the main goal is profit-making.

The revolving fund mechanism in this model enables a sustainable financing cycle, as funds repaid by entrepreneurs through IKMS are reallocated to other partner distributors via PIP. The fund flow is not one-directional; instead, it is designed to rotate and be reused in future financing cycles. Once a borrower has completed their repayments based on the agreed Sharia contract, the principal is first returned to the IKMS, which then repays PIP. PIP subsequently reallocates the funds to other IKMS as financing sources for other entrepreneurs.

This system creates long-term financing opportunities for entrepreneurs and minimizes dependence on continuous government fund transfers (Dewantha, 2021). It is an efficient public funding model. The sustainability of this revolving cycle ensures equal opportunity for entrepreneurs in different regions to access funding for business development.

Furthermore, the model also integrates a community empowerment approach. IKMS partners of PIP (such as KSPPS, BMT, and LKMS) have strong ties with local communities. They not only serve as financing institutions but also provide skill training, business mentoring, and managerial capacity building for entrepreneurs. This approach plays an active role in building sustainable ultra-micro business capacity, which is generally lacking in conventional UMi models (Mendos et al., 2024). As community-based institutions, IKMS understand local cultures and economic potential. Therefore, they can adopt a more personal approach in providing services, optimizing mentoring and capacity-building efforts.

However, this financing model also faces several weaknesses that require attention. For instance, the administrative process can be complex due to the need for effective coordination between PIP (a government agency) and IKMS (scattered across Indonesia, including remote areas with limited transportation and communication infrastructure). A strong and transparent administrative system is essential to support proper

coordination and ensure that funds reach the intended beneficiaries. Timely, detailed, and accurate accountability reports on fund usage and returns are crucial to maintaining public accountability and complying with PIP's SOPs, to avoid delays in future disbursements and prevent moral hazard (KNEKS, 2020).

In practice, although this financing concept is ideal for supporting microenterprise development, the involvement of multiple institutions complicates administration. Many IKMS in rural areas still face technological limitations, preventing optimal digital financial reporting. This disparity causes inefficiencies and gaps in program implementation.

Operational capacity across IKMS is also uneven. Some institutions, especially in underdeveloped areas, struggle with governance, risk management, and transparent financial reporting (KNEKS, 2019). These challenges undermine the effectiveness and equity of fund distribution. Additionally, if PIP or related authorities fail to provide adequate oversight and support, there is a risk of financing misuse (Nazifah & Ikhwan, 2021).

Compared to conventional UMi financing, this model also has limited outreach. Institutions such as PT PNM (Permodalan Nasional Madani), which implement conventional UMi financing, have a broader national network, allowing them to reach even remote microentrepreneurs. In contrast, the PIP model depends on the readiness of each IKMS. Where IKMS capacity is inadequate, financing access for businesses is limited (Nurokhmah, 2021).

Moreover, in today's tech-driven financial landscape, digital reporting systems are crucial for efficiency. However, not all IKMS have easy digital access, and many still rely on manual reporting. Conventional UMi financing institutions have advanced a step further, using online-integrated systems such as the Program Credit Information System (SIKP). In contrast, many IKMS still use manual systems, resulting in slower data verification and performance monitoring (Juwita & Handayani, 2022).

Nonetheless, it's worth noting that the revolving fund model via PIP through IKMS is quite flexible and adaptive in crisis situations. For instance, during the COVID-19 pandemic, many IKMS adjusted their financing strategies by offering incentives and rescheduling repayments to help entrepreneurs maintain business continuity (Indonesia, 2020). If the aforementioned weaknesses are addressed, this financing model can become a highly inclusive and sustainable alternative, aligned with Sharia values, an important consideration for a predominantly Muslim country like Indonesia.

4.3 Identification of Challenges

Islamic Microfinance Institutions (IMFIs) in Indonesia face a number of challenges that significantly affect the effectiveness and sustainability of their operations. These challenges can be identified as follows:

4.3.1 Limited Human Resources

Human resources (HR) constitute a critical component of any organization and refer to the individuals within the institution who contribute to its operations through their expertise, creativity, motivation, and innovation (Yusmiar, 2014). In the context of IMFIs, the term specifically refers to individuals possessing adequate knowledge and skills in Islamic economics, regulatory frameworks, and Sharia-compliant operational practices. A shortage of such competent human resources presents a substantial barrier to the successful implementation of the IMFI model. This issue is particularly crucial as human resources are the backbone of a stable and sustainable organizational structure. As highlighted by Sawiyah (2024), HR capacity remains one of the main obstacles in the conversion process from conventional cooperatives to Sharia-based cooperatives in Banda Aceh. This constraint arises from a significant gap between the demand for and the availability of professionals trained in Islamic economics and finance.

4.3.2 Inadequate Infrastructure

The infrastructure of cooperative institutions can be categorized into two main aspects: physical and non-physical (M. & Sahoria, 2022). Physical infrastructure includes buildings, transportation facilities, and adequate office equipment. Non-physical infrastructure encompasses supportive regulatory frameworks, effective management systems, competent human resources, and strong networks with various stakeholders. Hendar and Kusnadi (2005) further argue that infrastructure also includes marketing and distribution systems, along with the utilization of information technology to ensure efficient and modern operations.

When compared to conventional microfinance institutions, IMFIs often lag behind in terms of non-physical infrastructure. A prominent issue is the limited availability of management systems that align with Sharia principles, which poses a challenge to operationalizing the IMFI model. Specifically, there is a need for Sharia-compliant accounting and risk management systems. Most existing systems remain heavily influenced by conventional management practices. Therefore, innovative frameworks must be developed to harmonize management systems with Islamic financial principles.

4.3.3 High Risk Exposure

According to the National Committee for Islamic Economy and Finance (KNEKS, 2020), Islamic

microfinance institutions tend to be less sustainable than conventional banking institutions. This is largely due to the perception that IMFIs carry higher risks. Ahmed (2002) identifies several contributing factors to this elevated risk profile, such as the socioeconomic conditions of IMFI clients, who are typically from lower educational backgrounds. This makes them more susceptible to adverse selection, i.e., the difficulty in distinguishing between high-risk and low-risk borrowers due to information asymmetry. Furthermore, the common practice of offering financing without collateral increases the potential for moral hazard, whereby borrowers may act irresponsibly due to a lack of direct risk-bearing consequences.

Unlike Islamic banks, which are not affected by problematic financing in their risk-taking (Syamlan & Jannah, 2019), Islamic microfinance institutions have distinct characteristics, which significantly influence the risks they undertake in the future. Therefore, in making these decisions, Islamic microfinance institutions need to consider directly related variables. There are at least four significant variables in determining customer preferences: education level, length of service, track record at BI, and branch location (Bonadilla, 2019)

4.3.4 Unpreparedness in Balancing Social and Commercial Functions

One of the most pressing challenges faced by IMFIs is their limited capacity to balance their dual role as both social and commercial entities. Indeed, the primary goal of mainstreaming Islamic social finance into commercial finance is to achieve inclusivity or improve social welfare, ultimately creating quality growth (Tamanni et al., 2022). Institutionally and financially, services provided to members are often more heavily weighted toward commercial operations (Baitul Tamwil), whereas the social function typically carried out through Baitul Maal has not been adequately developed. Field studies conducted by KNEKS in 2019 revealed that many IMFI administrators prioritize institutional sustainability via Baitul Tamwil activities, and only engage in Baitul Maal functions to a limited extent. Some even stated explicitly that social aspects were not a priority, citing the need to first ensure the institution's survival. This finding aligns with Sakai (2014), who observed that many BMTs (Islamic microfinance institutions in Indonesia) lack dedicated units for managing Baitul Maal, thus neglecting a core feature of Sharia-based finance.

4.4 The Maqashid Sharia Perspective

Financing for Micro, Small, and Medium Enterprises (MSMEs) through the UMi program and its relation to Islamic Microfinance Institutions (IMFIs) goes beyond the mere provision of capital. It incorporates the broader principles of *maqashid shariah* (the objectives of Islamic law). *Maqashid shariah* aims to preserve five fundamental aspects of human life: religion (*dīn*), life (*nafs*), intellect (*‘aql*), lineage (*nasl*), and wealth (*māl*). In the context of Shariah-oriented financing through the UMi program, the application of these principles can generate more holistic economic and social impacts, particularly in fostering sustainable enterprises based on IMFIs.

1. Preservation of Wealth (*Māl*):

UMi financing and IMFIs that operate under Shariah principles aim to assist MSMEs in managing their businesses in lawful and productive ways, minimizing waste, and enhancing financial well-being. From the perspective of *maqashid shariah*, wealth must be managed wisely and used for beneficial purposes, while avoiding *riba* (usury) and other harmful economic practices.

2. Enhancement of Social Welfare (Through *Sadaqah* and *Zakat*):

By integrating IMFIs into financing programs, UMi also contributes to social welfare, particularly by extending financial access to underserved communities excluded from conventional financial systems. *Maqashid shariah* emphasizes that the ultimate aim of financing is not merely material gain, but also the provision of equitable and just social benefits. This includes the effective management of *zakat* and *sadaqah* to support those in need.

3. Preservation of Life (*Nafs*):

Shariah-based financing, through UMi and IMFIs, helps entrepreneurs avoid the financial burdens that could jeopardize their livelihoods. Such programs ensure that financing is delivered in a fair and transparent manner, without exacerbating the economic pressures on individuals. This is crucial for maintaining the well-being of the individual (*nafs*) and their families, particularly by avoiding high-interest loans that could lead to long-term indebtedness.

4. Preservation of Intellect (*‘Aql*):

IMFIs offer opportunities for MSMEs to gain Shariah-based financial education and literacy. Financing guided by *maqashid shariah* supports informed decision-making in business management. This literacy is essential in helping entrepreneurs steer clear of harmful practices, such as *riba* or dishonest transactions.

5. Protection of Lineage (*Nasl*):

Shariah-based financing for MSMEs aims not only to improve the current economic condition of

entrepreneurs but also to ensure intergenerational sustainability. Within the *maqashid* shariah framework, success in business positively impacts family welfare, creates opportunities for future generations, and enhances their quality of life.

By integrating IMFIs into UMi financing schemes, fund management becomes more effective and aligned with Shariah principles. These principles extend beyond economic profit to include social welfare, education, and sustainable community development. The *maqashid* shariah framework ensures that financing programs benefit not only the direct recipients but also the broader society, promoting a more inclusive and sustainable economic system.

To reinforce Shariah principles in ultra-micro financing (UMi), the Indonesian Council of Ulama (Majelis Ulama Indonesia, MUI), through its National Shariah Board (Dewan Syariah Nasional – DSN-MUI), issued Fatwa No. 119 of 2018 on Ultra-Micro Financing. This fatwa serves as a vital legal foundation governing the operations of Shariah-compliant financial institutions in delivering financial services to lower-income segments, particularly micro and ultra-micro entrepreneurs who lack access to conventional banking.

The fatwa outlines two principal types of ultra-micro financing, multi-goods and multi-services, implemented through various Shariah contracts such as *murabahah*, *salam*, *istisna'*, *ijarah*, *kafalah*, and *wakalah*. It explicitly mandates that all transactions in ultra-micro financing must uphold justice, avoiding oppression or exploitation, as emphasized in QS. An-Nisa: 29, and must adhere strictly to the terms (*dhawabith*) and limits (*hudud*) of each contract employed.

As a concrete application, the KSPPS BMT Bahtera Pekalongan implements *murabahah* and *ijarah* contracts in accordance with DSN fatwas, supplemented by *wakalah* contracts to facilitate transactions and ensure transparency and trustworthiness in their execution. This approach reflects the actualization of *maqashid* shariah principles, such as the preservation of wealth, life, and intellect, within regulatory and operational practices.

5. Conclusion

The UMi financing model that integrates the Government Investment Center (Pusat Investasi Pemerintah, or PIP) with Islamic Microfinance Institutions (IMFIs) such as KSPPS, BMT, and LKMS offers an effective Shariah-based alternative for ultra-micro entrepreneurs. This model demonstrates superiority over conventional UMi schemes by implementing Shariah principles, ensuring sustainability through a revolving fund mechanism, whereby repayments from entrepreneurs are redistributed through PIP to other financing partners, and emphasizing empowerment beyond financial support. Additionally, this model tends to be more adaptive and prioritizes collective welfare compared to its conventional counterparts.

However, several challenges persist in its implementation, including limited digital infrastructure, complex administrative processes, and disparities across different regions where IMFIs operate. Key constraints such as the shortage of competent human resources, inadequate infrastructure, high operational risk, and institutional unpreparedness to balance social and business functions must be addressed to ensure the model's effectiveness.

Nevertheless, by integrating the principles of *maqashid* shariah within Shariah-compliant UMi financing schemes, IMFIs have the potential to generate positive impacts across five critical dimensions: the preservation of wealth (*māl*) through prudent financial management; enhancement of social welfare via *zakat* and *sadaqah*; protection of life (*nafs*) through non-burdensome financing; safeguarding of intellect (*'aql*) through financial literacy; and development of lineage (*nasl*) to support long-term family welfare and business sustainability. Shariah-based financing aligned with the DSN-MUI fatwas, and centered on welfare and justice, thus represents an inclusive and sustainable financing alternative, provided that its inherent implementation challenges can be minimized, or ideally, resolved entirely.

Based on the findings and discussions presented, this study offers several recommendations for relevant stakeholders to ensure the optimal and sustainable implementation of the Shariah-based ultra-micro financing (UMi) model through Islamic Microfinance Institutions (IMFIs):

1. For the Government and the Government Investment Center (PIP)

It is recommended that they continue to strengthen the institutional capacity of IMFIs through consistent training, technical assistance, and managerial support. The government should also accelerate the digitalization of IMFI reporting and monitoring systems, particularly in regions lagging behind in technological infrastructure. This can be facilitated through the development of integrated and user-friendly digital platforms. Furthermore, PIP is encouraged to design a performance evaluation system for IMFIs based on incentives and disincentives, in order to motivate financing agents to enhance their professionalism and accountability in distributing Shariah-based

UMi funds.

2. For Islamic Microfinance Institutions (IMFIs)

Institutions such as KSPPS, BMT, and LKMS are encouraged to strengthen the integration between their social and business functions. This can be achieved by establishing dedicated units for managing social funds (zakat, infaq, sadaqah, and waqf) in alignment with their productive financing activities. IMFIs should also enhance human resource competencies through continuous training, Shariah finance certification, and improved understanding of risk management and digitalization. Collaborations with local communities and civil society organizations are also recommended as a strategy to expand service outreach and build public trust in Islamic financial institutions.

3. For academics and researchers

Further studies are needed to deepen the understanding of the effectiveness of various Shariah contracts within ultra-micro financing schemes. Such research can contribute to designing financing models that are best suited to the unique characteristics of ultra-micro enterprises across different regions. Additionally, collaboration between academics, IMFIs, and government bodies is essential in developing contextual, applicable, and sustainability-oriented risk management and Shariah governance systems.

4. For ultra-micro entrepreneurs

It is important to enhance their Shariah financial literacy so they can better understand the contracts involved, their repayment obligations, and how to manage funds responsibly and productively. Entrepreneurs are also encouraged to actively participate in training and empowerment programs organized by IMFIs in order to improve their managerial skills and expand their business networks. The awareness and active participation of entrepreneurs are key factors in ensuring the success of inclusive and equitable Shariah-based financing programs.

Through strong synergy among all stakeholders, the Shariah-based ultra-micro financing model holds great potential to support the sustainable economic empowerment of low-income communities in line with the principles of maqashid shariah.

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