Journal of Islamic Economics Lariba

Impact of Islamic Financing on Working Capital Management of Micro, Small, and Medium Enterprises in Tanjungpinang City, Indonesia

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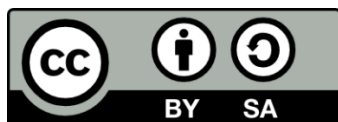
Abstract

The purpose of this study was to analyze the effect of Islamic financing on the ability of working capital management of micro, small, and medium enterprises (MSMEs) in Tanjungpinang City, the Riau Islands Province, Indonesia. This study uses primary data that is processed quantitatively by using multivariate regression analysis using Stata. Primary data in this study were obtained from respondents using questionnaires, and secondary data were obtained from Statistics Indonesia. The research location in this study was Tanjungpinang City. The sample was determined using non-probability sampling with a sample of 125 MSMEs. Data collection techniques were carried out by conducting interviews and questionnaires. The results showed that the factors of *musharakah* and *murabahah* financing affect the variables such as average billing period, average payment period, cash turnover, and the ratio of current assets to total assets in MSMEs in Tanjungpinang City. MSMEs can adopt Islamic financial models to reduce operational costs by eliminating interest rates.

Keywords: Islamic Financing; Micro, Small, and Medium Enterprises; *Murabahah*; *Musharakah*; Working Capital Management

INTRODUCTION

Indonesia's economic growth cannot be separated from the strategic role of Micro, Small and Medium Enterprises (MSMEs). Based on data from the Ministry of Cooperatives and MSMEs (2020), the number of MSMEs in Indonesia increased to 64.1 million in 2018 from the previous only 59.26 million units in 2015 and is expected to grow to 68.60 million in 2020. MSMEs can absorb approximately 97% of Indonesia's workforce. The contribution to the absorption of MSMEs is 116.97 million people, with a total workforce of 120.598 million. MSMEs have contributed to the value of the National GDP by 61.07%. MSMEs' productivity has increased quite significantly in 2 years. Productivity in 2015 was Rp. 27.93 million increased to Rp. 86.22 million in 2021 and is expected to grow to 182.59 million in 2020. Meanwhile, productivity per worker in the MSME sector has increased from Rp. 13.43 million (2015) to Rp. 46.50 million in 2017 and is estimated to grow to 101.39 million in 2020. This shows that MSMEs are spearheads in growing the Indonesian economy.

Tanjungpinang City, the capital of the Riau Islands Province, has developed in line with economic growth. MSMEs in the city of Tanjungpinang play an essential role in improving the economy of the city of Tanjungpinang (Hermawan, 2018). Based on data from the Department of Manpower, Cooperatives, and Micro Enterprises, Tan-jungpinang City MSMEs have experienced a very rapid increase. In 2014 the number of MSMEs was 6,102, increasing to 11,331 in 2020.

The MSME sector has many obstacles and challenges, although MSMEs are one of the spearheads in increasing Indonesia's economic growth. MSMEs are deemed less qualified to obtain capital credit financing facilities, so MSMEs must rely on internal funds to start and run their business (Adedeji, 2021). These obstacles also occur in MSMEs in Tanjungpinang City. As a micro-enterprise, it is only natural that MSMEs have weaknesses in business management, limitations in the quality of human resources (HR), and low access to financing by financial institutions, including banking institutions. Not a few MSMEs are still not able to achieve access to financing from banks. This is because MSMEs are felt to have no trans-parent financial management and lack of ability to manage business financial flows, including working capital management or working capital management (Hermawan, 2013).

Every time an entrepreneur runs a business, he or she needs sufficient working capital to support all business activities to earn a profit. Efficiency and effectiveness through managing the working capital of a business are expected to increase and stabilize the profit of a business (Anwar, 2018). Working capital management has an impact on business profits obtained. Profits earned regularly become a benchmark for determining the success or failure of a business, as well as a consideration for capital funding decisions by investors and credit (Harryani, et., al, 2014).

Islamic business funding by banking institutions is one solution to the uncertainty of business growth and the funding needs of small and vulnerable businesses (Sonita et., al, 2021). Islamic financing has successfully promoted collaborative business capital funding to help vulnerable businesses, such as MSMEs, with difficulty accessing funding. Sharia capital financing has succeeded in increasing the competitiveness of MSMEs through efforts to encourage the application of innovative finance, which results in sustainable MSMEs development (Adedeji, 2021).

Capital, working capital management, and business profitability are interrelated circles. As small business units, MSMEs do not always get opportunities for access to capital. Uncertainty in the growth of the MSMEs is one of the contributing factors. Working capital management can shift the uncertainty of MSMEs growth so that it has the opportunity to increase MSME business profitability. MSMEs' growth with a stable profit will automatically increase opportunities for access to MSMEs' capital.

Based on previous research, it is clear that Islamic-based business capital financing has increased MSMEs' growth opportunities. Adedeji (2021) states that sha-ria-based business capital financing can encourage one aspect of working capital management: innovative financial management. This research is still not enough to empirically prove how the role of Islamic-based financing affects the management of working capital for MSMEs. Even though the growth of MSMEs based on Islamic-based financing cannot be separated from the working capital management efforts carried out by MSMEs.

LITERATURE REVIEW

Islamic financial institutions have an impact on the needs of MSMEs. Islamic financing has a significant positive impact on the success of small businesses. As Islamic lenders' performance increases, so do MSMEs (Faisol, 2017). So it is concluded that Islamic bank funding has a substantial positive impact on the welfare and success of the MSMEs (Abosede et al., 2016; Adam, 2020). Conventional sources of financing for MSMEs are less available and expensive. Islamic financing is feasible as revolutionary financing in the region. Although it is not sufficient, it is available comparatively and easily. One of the roles of Islamic microfinance in developing the community's economy is providing financing capital to customers to develop their businesses (Tarigan & Bagaskara, 2022).

Islamic financing has been proven to affect the competitiveness of MSMEs. Partially, Islamic financing for MSMEs affects product prices, quality, and consumer experience with products. These three things show the value of the competitiveness of MSMEs. Competitiveness is the value of the success of a business that affects the profitability of a business and the growth of working capital. The success of a business cannot be separated from the performance of the business that has been done. Business performance can be measured through four indicators, namely: (i) sales development, (ii) working capital growth, (iii) customer growth, and (iv) increased profit (Adedeji, 2021). The average billing period and the average payment period as indicators and proxies of Working Capital Management positively impact a business' profitability (Enow & Brijlal, 2014). Then the quality of working capital management can be seen from the two proxies.

Cash is the most liquid asset or one of the highest elements of working capital. The more incredible cash a business owns, the higher the level of liquidity. It does not mean we have to maintain an extensive cash supply to manage a business. The greater the cash, the greater the amount of idle money that will reduce profits. In this case, managing cash flow is crucial in WCM and impacts business performance (Riyanto, 2011). The ratio of current assets to total assets impacts profits in a business. The higher the ratio value, the higher the business profit will be. The ratio value results from efforts to manage assets and working capital (Haryani, 2014). Cash

turnover and the ratio of current assets to total assets are WCM efforts that affect the profits of a business. Then the quality of Working Capital Management can be seen from the two proxies.

Islamic financing has an impact on the competitiveness and development of MSMEs. Working Capital Management impacts the performance and profits of a business. WCM can be a variable that can be influenced by Islamic financing. The average collection period is obtained by dividing receivables by sales multiplied by the number of days in 1 year. This value is used to evaluate billing and credit policies. The average payment period is calculated by dividing accounts payable by purchases or cost of goods sold and multiplied by the number of days in 1 year. This value is used to evaluate payment policies (Enow & Brijlal, 2014). The accounts receivable collection period is a number that shows the average time needed to collect receivables. Management must be able to manage receivables properly. Analyzing Accounts Receivable is very important for management to manage accounts receivable properly. One way to analyze accounts receivable is to use the average collection period of the collection method. The average receivable collection period is the time it takes for the company to collect its receivables (Anwar, 2018).

RESEARCH METHOD

This study uses primary data that is processed quantitatively using multivariate regression analysis. Sources of data in this study using primary data obtained from respondents using questionnaires and secondary data obtained from BPS data. The location of this study was carried out in Tanjungpinang City, Riau Islands Province. The method of determining the sample uses non-probability sampling so that the sample obtained is 125 SMEs. Data collection techniques were conducted by interviews and questionnaires distributed to MSMEs receiving Islamic financing. The dependent variables used are average billing period (Y_1), average payment period (Y_2), cash turnover (Y_3), and current assets ratio to total assets (Y_4), which are influenced by independent variables: *musharakah* financing (X_1) and *murabahah* financing (X_2).

There are some steps of analysis used in this study. The first step was descriptive statistics of the dependent and independent variables. The second step was a multivariate regression model that tested the independent variables and the multivariate normal distribution. The parameter estimation was based on the obtained multivariate regression equation. This step included bound variable normal distribution testing using the Doornik-Hansen test for multivariate normality using Stata. The test includes the following econometric models:

Model 1: $Y_1 = \alpha + \beta X_1 + e$

Model 2: $Y_2 = \alpha + \beta X_1 + e$

Model 3: $Y_3 = \alpha + \beta X_1 + e$

Model 4: $Y_4 = \alpha + \beta X_1 + e$

Model 5: $Y_1 = \alpha + \beta X_2 + e$

Model 6: $Y_2 = \alpha + \beta X_2 + e$

Model 7: $Y_2 = \alpha + \beta X_2 + e$

Model 8: $Y_2 = \alpha + \beta X_2 + e$

The best multivariate regression model in this study was selected using AIC (Akaike Information Criterion). This method has advantages compared to the coefficient of

determination (R^2) method, which has been widely used. The advantages of the AIC method are mainly in selecting the best regression model for forecasting purposes, which can explain the suitability of the model with existing data and values that occur in the future. After that, the estimation was conducted on multivariate regression parameters from the best AIC model results.

The third step was testing the model with residual assumptions closely related to the significance of the model, then testing simultaneously and partially. The test aims to meet the criteria of the multivariate regression model, including the residual criteria, which are identical, independent, and normally distributed. Some phases are used: (1) simultaneous testing of the significance of the model using Wilk's Lambda to determine the effect of the independent variables on the response variable simultaneously; (2) testing the significance of the model partially based on the independent variables that have a significant effect on the model; (3) testing the assumption of identical residuals using Box's M test with a criterion rejecting H_0 if μ > $X^2_{0.05,42}$; (4) independent residual assumption test using Bartlett Sphericity test with a criterion rejecting H_0 if $X^2_{stat} > X^2_{0.05,3}$; and (4) Testing the assumption that the residuals are normally distributed using the q-q plot. If $d_i^2 \leq X^2_{0,5;3}$ on the q-q plot more than 50%, then the residuals are normally distributed. The relationship between the dependent and the independent variables was determined by using an equation by looking at the value of the eta-square lambda.

RESULTS AND DISCUSSION

Respondents Profile

Respondents in this study were micro, small, and medium enterprises (MSMEs) that received Islamic financing from *musharakah* and *murabahah* contracts in Tanjungpinang City. A total of 125 respondents' data were collected through interviews and questionnaires. Respondents have various kinds of businesses or main products that are sold: clothing, daily goods, fruits, shoes, kitchen seasonings, stationery equipment and books, accessories, building supplies and equipment, electronic goods, cosmetics, chicken cuts, *bandrek*, gasoline, photocopies, furniture and furniture, curtains, glasses, carpets, chips, traditional cakes, children's toys, snacks and ready meals, *martabak*, medicines, souvenirs, perfume, women's jewelry, bedding, credit, *sembako*, shoes, service motorcycles, barking souvenirs, goat milk and herbs, tempeh and tofu, batik, fruit, kitchen spices, motorcycle/car washing services, engine oil replacement services, and coffee. Table 1 describes the profile of the respondents of this study.

In terms of the number of workers, most MSMEs in this study employed small employees. 38.4% of MSMEs employed one worker, 32% employed two workers, and 20% employed three workers. Only one enterprise employed more than ten workers. Previous studies (Kwiotkowska & Gębczyńska, 2022; Millán et al., 2022) show the importance of workers for developing small and medium enterprises. However, with most MSMEs in this study employing small number of employees, it might indicate that most MSMEs are in the early stage of their businesses and need for to pay more attention on their employees' well-being (Baek et al., 2022; Beninger et al., 2022). Most respondents (84%) declare that their businesses are in the middle level of competition. 4.8% of respondents admit they are in a high level of competition. With only 11.2% respondents

having low level of competition, it implies that most of MSMEs in this study face challenges in running their businesses. Naturally, small and medium enterprises with lower competition gain more profit and better condition for its workers and businesses (Bettiol, 2020; Nguyen & Vu, 2023).

Table 1
Profile of the Respondents

Characteristics	*N*	%
Number of Workers		
12	1	0.80
4	10	8.00
3	26	20.00
2	40	32.00
1	48	38.40
Total	125	100.00
Level of Business Competition		
Low	14	11.20
Mid	105	84.00
High	6	4.80
Total	125	100.00
Main Target Market		
Lower class (income up to 5 million/month)	118	94.40
Middle-Class (income 5 to 10 million/month)	7	5.60
Total	125	100.00
Type of Islamic Financing		
Musharakah	61	48.80
Murabahah	64	51.20
Total	125	100.00
Type of Islamic Financing		
Musharakah	61	48.80
Murabahah	64	51.20
Total	125	100.00

Source: Primary data (2022)

Table 1 also shows that main market of the respondents (94.4%) is lower-class families with monthly incomes of up to IDR5 million. Only 5.6% of respondents targeted middle-class families whose monthly incomes of IDR5 million up to IDR10 million. Islamic banks in Tanjungpinang City offer many financing products that MSMEs can use to improve their businesses. The scheme offered by Islamic banks can be in *musharakah* or *murabahah* products. The respondents of this study tend to use both products. *Musharakah* products were used by 48.8% of respondents, and *murbahah* products were used by 51.2%. Many studies indicated that many small and medium enterises in Indonesia rely on *musharakah* (Maulani et al., 2022; Nafisah et al., 2022) and *murabahah* (Rochmaniah & Oktafia, 2021; Syafitri, 2022) as two financing products offered by Islamic banks. It implies that MMSEs in Pangkalpinang City, as respondents of this study, also found the benefits of Islamic financing in *musharakah* and *murabahah*.

Working Capital Management of MSMEs

Working capital management is an activity related to the company's balance sheet management, namely the current assets and liabilities. Effective management of current assets and liabilities using the right policies will provide targeted benefits. The following variables are used as indicators of working capital management in the respondents of this study, which are divided based on the accepted Islamic financing scheme. Table 2 describes the working capital management of MSMEs in this study with *musharakah* and *murabahah* types.

Table 2
Working Capital Management of MSMEs

Variables	Type of Financing	
	Musharakah	*Murabahah*
Average Sales Per Year (Million Rupiah)	482	429
Average Debt Per Year (Million Rupiah)	114	101
Average Debt Turnover Ratio (Times/Year)	4	4
Average Debt Collection Period (Days)	108	101
Average Purchase Time of Raw Materials (Days)	241	215
Average Payment Period (Days)	66	59
Average Cash Turnover (Days)	133	130
Average Current Assets (Million Rupiah)	349	290
Average Total Assets (Million Rupiah)	463	363
Current Asset to Total Asset Ratio (%)	78.28	80.91

Source: Primary data (2022)

Average sales per year are essential for respondents to keep their business growing and obtain the desired profit. Respondents with *musharakah* financing have average sales per year of IDR482 million, or larger than those with *murabahah* financing of IDR429 million. Although it is not generally agreed, *musharakah* can give a higher benefit than *murabahah* in some Islamic financing case (Abdullah, 2022). Accounts payable are obligations that are borrowed to meet business needs and can be repaid quickly. The average debt per year of respondents with *musharakah* financing (IDR114 million) are higher than of respondents with *murabahah* financing (IDR101 million). The debt turnover ratio is a ratio that reflects the level of debt repayment by respondents to lenders. The lower the debt turnover ratio, the better, meaning that the longer the respondent pays his debt, the more he can use his money for other activities. The the average debt turnover ratio of respondents per year is four times for both *musharakah* and *murabahah* financing. Thus, respondents pay the loan four times a year.

One way to monitor business sales is to analyze relevant financial ratios, such as the average debt collection period. The average debt collection period of respondents with *musharakah* and *murabahah* financing is 108 days and 101 days, respectively. This means that as long as the business unit can pay the debt within that time, it can manage the amount of cash it has to pay for expenses and other bills. The average time for a high turnover of raw material purchases indicates that the business does not spend much money to buy raw materials and can optimize expenses. This calculation can measure the liquidation of a business in question. Respondents with *musharakah* financing in this study have an average purchase time of raw

materials of 241 days, while the ones with *murabahah* have 215 days.

The average payment period is the ability of the business unit or respondent to be able to repay the loan. Respondents with *musharakah* financing in this study have an average payment period of 66 days, while the ones with *murabahah* have 59 days. Cash turnover shows how often the company's cash rotates during sales. In other words, cash flow can show a business unit's ability to generate sales. The average cash turnover period is 133 days for respondents with *musharakah* financing respondents and 130 days for the ones with *murabahah*. Current assets are business unit assets with high liquidity value. In this study, respondents with musharakah financing have average current assets of IDR349 million. This number is higher than that of the respondents with *murabahah* financing, IDR290 million.

Total assets are the total assets owned by the business unit or respondent used to support the operational and financial activities of the business unit. The average total assets of respondents with *musharakah* financing is IDR463 million, and that with *murabahah* financing is IDR363 million. The current asset to total asset ratio explains how significant the portion of current assets is to total assets in the business unit, which will be related to the ability to pay obligations as a whole. The current assets to total assets ratio is 78.28 percent for respondents with *musharakah* financing and 80.91 percent for respondents with *murabahah* financing.

Multivariate Regression Analysis

The assumption that must be met in the multivariate regression analysis is that the response variables are normally distributed in multivariate. The hypotheses used are:

H_0: The response variable is normally distributed in multivariate

H_1: The response variable is not normally distributed in multivariate

Table 3 shows the Doornik-Hansen test for multivariate normality using Stata. The probability value (*p*-value) in the Doornik-Hansen line is 0.4157 > 0.05 (the significance level used is 0.05). This means that multivariate normality is met, and H0 is accepted. Namely, the response variable is normally distributed in multivariate.

Table 3
Doornik-Hansen Multivariate Normality Results

P-value	Chi2	Result
0.4157	8.563	*Multivariate Normality*

Source: Primary data, authors' estimation (2022)

The step for selecting the model using the AIC criteria is to form a model by including the predictor variables. The results of the multivariate regression model can be obtained using Stata. To identify the factors that influence the average billing period (Y_1), the average payment period (Y_2), cash turnover (Y_3), and the ratio of current assets to total assets (Y_4), the AIC criteria is used. The results show that the minimum value of AIC is -2.220631, and that the variables X_1 and X_2, have impact of dependent variables. Table 4 shows parameter estimation results obtained using Stata.

Table 4

Model Parameter Estimation

Dependent Variables	Parameter	$\hat{\beta}$	Std. Error	*t*-stat	Prob.
Y1	Intercept	0.375731	0.262306	1.432229	0.2222
	X1	0.001728	0.000806	2.072428	0.1096
	X2	0.002979	0.001141	2.671172	0.0575
Y2	Intercept	55.48427	8.625695	6.432591	0.0003
	X1	0.022719	0.028247	0.806086	0.4645
	X2	-0.062369	0.036624	-1.702892	0.1683
Y3	Intercept	0.131781	0.134728	0.977296	0.3883
	X1	0.000223	0.000424	0.526020	0.6276
	X2	0.000986	0.000537	1.691012	0.1616
Y4	Intercept	0.567001	0.296101	1.497612	0.0117
	X1	-0.005670	0.001269	4.376118	0.0191
	X2	0.009113	0.001678	5.411212	0.0065

Source: Primary data, authors' estimation (2022)

Wilk's Lambda test was used to test the model's significance simultaneously. Using Stata, the significance value of Wilk's Lambda is 0.000. Because the significance value is less than 0.05, H_0 is rejected so that at least one parameter affects the average billing period, average payment period, cash turnover, and the ratio of current assets to total assets. To test the significance of the model partially, Wilk's Lambda test was also used. For the *musharakah* financing variable, the Stata obtained a significance value (*p*-value) of 0.000. Because the significance value is less than 0.05, H_0 is rejected, so X_1 has a significant effect on the dependent variables Y_1, Y_2, Y_3, and Y_4. For *murabaha* financing variable, Stata obtained a significance value (*p*-value) of 0.000. Because the significance value is less than 0.05, H_0 is rejected, so X_2 significantly affects the dependent variables Y_1, Y_2, Y_3, and Y_4. Wilk's Lambda value is 0.003, so the value of $\eta\Lambda2 = 1 - 0.003 = 0.997$. So that the magnitude of the relationship between the dependent and independent variables is 0.997.

This study also tests IIDN residual assumption. For identical residual assumption test, the assumption in multivariate modeling is the homogeneous residual covariance variance matrix. The statistical value of the Box's-M test is 2.716, and the p-value is 0.343. Because the *p*-value is more significant than 0.05, then H_0 is accepted, which means the residual variance-covariance matrix is homogeneous, and it can be concluded that the residuals are identical. In addition to the assumption of a homogeneous residual covariance variance matrix, the assumption of independent residuals must also be met. Testing this assumption is done by using the Bartlett Sphericity test. By using $\alpha = 0.05$, we get $\chi_{0.05;4}2 = 7.554$. Because the value of $\chi_{hit}2$ 4.732 is smaller than the value of $\chi_{0.05;4}2 = 7.554$, then accept $H0$ so that the residual is independent.

Last test is normal distributed residual assumption test. The assumption must be met because the residuals have a multivariate normal distribution. The probability value (p-value) in the Doornik-Hansen line is 0.4157 > 0.05 (the significance level used is 0.05). This means that multivariate normality is met and H0 is accepted, namely Residual with multivariate normal distribution. Based on the data analysis and testing of these assumptions, it can be concluded that *musharakah* and *murabahah* financing positively affects MSME working capital management

in Tanjungpinang City. This result restates previous findings on the significant roles of Islamic financing instruments in enhancing small and medium enterprises (Thaker et al., 2020; Hidayah et al., 2021), especially those in need of working capital but limited to current banking regulations.

CONCLUSION

Based on the data analysis and assumption testing results, it can be concluded that *musharakah* and *murabahah* financing positively affects MSME working capital management in Tanjungpinang City. The recommendation from the results of this study is that it is expected that more banks should develop using Islamic banking interest-free loans to fund uncompetitive MSMEs due to the scarcity of economic resources and high capital costs. This will benefit many MSMEs in Tanjungpinang City, high bank loan rates prevent MSMEs from experiencing liquidity problems, and financial institutions can fund entrepreneurial activity programs through Islamic interest-free loans aimed at current and prospective business owners. MSME owners equipped with the proper working capital management skills can increase their chances of success.

This research implies that when competing with large modern companies in the market, MSMEs must use and adopt an Islamic financial model in their operations. Islamic finance reduces operational costs by eliminating interest rates while providing room for more innovative pricing and customer-focused products at competitive prices. MSMEs should take advantage of the opportunities offered by Islamic finance and adopt sustainable business practices.

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