Enhancing the MSME Islamic Financial Inclusion in Indonesia: An Institutional Theory Perspective

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The concept of financial inclusion is a complex problem, and it was constructed by several aspects ranging from socio-cultural, psychological, economic, geographical and political issues. Financial inclusion under the conceptualisation of institutional theory highlights the role of institutions in active markets, government, communities and societies in explaining the financial exclusion phenomenon, emphasising its vital position as the component in influencing the realisation of financial inclusion. By implementing this theory, the main objective of this study is to examine and identify the roles of involved institutions as a critical determining factor to attain Islamic financial inclusion for the Micro, Small, and Medium-sized Enterprise (MSME) sector in Indonesia by incorporating the notion of "Institutional Isomorphism" in their operation. This study suggests that by integrating the institutional pressure in the institutional environment of the three involving sectors, namely: The public sector, Islamic financial services providers and the MSMEs industry, this system will intensify the chance of the MSMEs sector in embracing Islamic financial inclusion, improve their productivity, and contribution to Indonesia's sustainable economy.

Keywords: financial inclusion, Indonesia, institutional theory, Islamic Financial Inclusion, MSME

INTRODUCTION

The idea of an inclusive financial system has been regarded recently as the requirement for the country's economic stability and development. Initially, the concept was introduced as a means to alleviate poverty and reduce income inequality and later on, it developed further into the prerequisite procedures to attain Sustainable Development Goals (SDGs). Financial inclusion drives income generation by increasing productive capacity, especially among those without assets to start with and facilitates inclusive growth. Financial inclusion is achieved through the harmonious connection among the financial inclusion pillars, which include the public sectors, private sectors, the MSME industries, and financial literacy capacity (Chibba, 2009). These pillars are interconnected and need to interact seamlessly to form a thriving economic ecosystem.

From the Islamic financial system standpoint, the achievement of financial inclusion is deemed critical for the growth of the Islamic economy. Therefore, Shariah acknowledges the financial inclusion mechanism for the better development of the economy and welfare of the Muslim society (Mirakhor & Iqbal, 2012; Mohieldin et al., 2012). However, the realisation of financial inclusion in Islamic finance should not neglect the Shariah ruling of prohibiting riba, excessive gharar, gambling, deceptive and unethical transaction, and avoiding impermissible trade and commodities. Subsequently, in treating the risk, the Islamic financial system has different traits compared to the conventional systems. The former encourages the risk-sharing mechanism, whereas the latter prefers a risk-transfer mechanism. In this regard, the result of financial inclusion accomplishment, according to the Islamic perspective, is certainly different compared to the conventional counterpart. Nevertheless, in reality, this Islamic concept of risk-sharing in the Islamic financial inclusion ecosystem is mostly absent in the Islamic financial industry since they have overused debt-like instruments, such as Murabahah, and rarely incorporate risk-sharing schemes, such as Mudharabah for their MSME clients, especially in Indonesia (IFC, 2010; Huda, 2012; Suharto & Fasa 2017, OJK, 2020).

Furthermore, the MSMEs sector has been regarded by the Indonesian government as the vital engine room for job creation and the booster of economic growth. The sector also contributed tremendously in assisting Indonesia's economy out of the global crisis in 2008 (Incubator, 2018), denoting its vital position for economic stability and sustainability. With the abovementioned facts, the growth of this sector is deemed critical in attaining sustainable economic development since the MSME sector could absorb a more substantial workforce compared to the large enterprise. It was featured in many studies that the primary constraint faced by the MSMEs sector to develop their business is access to finance. The sector needs a robust and reliable capital base to ensure its survivability in the market and sustainability in the economy. Hence, the inclusion of this sector into formal financial services will potentially promote Indonesia's economic growth, arguably by alleviating poverty, reducing unemployment, and lessening the gap of income inequality.

With respect to the above issues, to understand better the phenomena of financial inclusion, particularly from the Islamic financial inclusion of the MSMEs sector, this paper adopts the "Institutional Theory" perspective to discuss the issues and opportunities related to the MSMEs' Islamic financial inclusion in Indonesia. The institutionalism theory produces critical insights regarding the financial exclusion phenomenon; this theory refers to the analysis that comprehends the broad context and the primary institutions involved in the issue being studied. Regarding financial inclusion, this theory highlights the role of history, institutions in effective markets, governments, communities, and societies in understanding financial exclusion (Buckland, 2012).

Therefore, the main objective of this study is to examine and identify the roles of involved institutions as a critical determining factor to enhance Islamic financial inclusion for the MSMEs sector by incorporating the notion of "Institutional Isomorphism" in their operation. This study is based on the arguments since Islam encourages the concept of cooperation and assistance in goodness and piety (Al-Quran 5:2). Hence, the Islamic financial inclusion concept should be established based on cooperation and virtuous partnership (Saifurrahman & Kassim, 2020). Thus, it is conceivably suitable to integrate the conceptualisation of institutionalism to understand better how the role of institutions could influence the achievement of MSMEs' Islamic financial inclusion and eventually contribute to the welfare of society in Indonesia.

This paper adopts a qualitative method through library research by reviewing and analysing the pivotal literature related to institutional theory concepts, financial inclusion, and MSME in regard to the Islamic financial system in Indonesia. The paper also utilised secondary data from the Ministry of Cooperatives and SMEs to explore MSMEs' crucial position in Indonesia's economic stability and sustainability. The paper first discusses the definition and overview of financial inclusion. Subsequently, the paper attempts to give insights into Islamic financial inclusion and the relationship between financial inclusion and institutional theory. Moreover, the study tries to discuss the institution's role as the influencing factor in determining MSME Islamic financial inclusion by elaborating on three involved institutions: the public sector, the Islamic financial institution, and the MSME industry that formed top-down and bottom-up institutional structures. Eventually, after the problems and issues are identified, this paper will present and draw a conceptual framework by converging and connecting the notion of "Institutional Isomorphism" between three interrelated sectors to augment the MSME financial inclusion from the Islamic financial system standpoint.

FINANCIAL INCLUSION AND INSTITUTIONAL THEORY

Financial Inclusion: A Synopsis

Financial inclusion has been a primary concern for policymakers and governments in many countries recently. Presently, the concept has grown into a crucial requirement for financial stability and economic development since an inclusive financial system enables producers and consumers to smoothen their production and consumption of goods and services through which income is generated in the economy. The definition of financial inclusion can be traced back to its contrary element, which is financial exclusion; the concept of financial exclusion was defined by literature as the process that prevents several groups from obtaining access to the formal financial system (Leyshon & Thrift 1995; Sarma & Pais, 2011). From this definition, financial inclusion could be inferred as the process that includes all groups of society to gain access to formal financial services. As described by various literature, the concept of financial inclusion was defined as a system that provides a convenient way to access all types of financial products and services for all segments of society without any discrimination; financial products and services should be delivered and provided with decent quality and must be effectively utilised by all segment of society (United Nations, n.d.; Bank Indonesia, 2014a; World Bank, 2018).

As mentioned in several studies, there are two critical rationales for the recent focus on implementing the financial inclusion scheme. First, financial exclusion can threaten economic development since it will lead to an inadequate supply of financial infrastructure (Gurley & Shaw, 1955; Goldsmith, 1969; Diamond & Dybvig, 1983; Greenwood & Jovanovic, 1990; Angadi, 2003). Second, the government and policymakers discerned that financial inclusion implementation could increase growth through poverty alleviation (Cull et al., 2014). As disclosed by early theoretical literature, the increasing access to financial services by the individuals could shift their production and employment options, and therefore, could alleviate poverty (Banerjee & Newman, 1993; Aghion & Bolton, 1997). These theoretical assumptions were supported by several empirical studies implying that poverty and inequality are negatively associated with formal financial services access. In other words, the higher the access to formal financial services, the lower the poverty and inequality level (Honohan, 2004; Burgess & Pande, 2005; Clarke et al., 2006; Beck et al., 2007; Jeanneney & Kpodar, 2011; Sethi & Acharya, 2018).

In relation to the country's economic growth and governmental policies to promote financial inclusion, it also has a substantial beneficial effect for the individual. The empirical study and experiment suggest that the utilisation of bank account by the individual can increase savings (Aportela, 1999), promote female empowerment (Ashraf et al., 2010), and increase the consumption and productive investment of the entrepreneurs (Dupas & Robinson, 2009). Furthermore, the previous studies focused on the unbanked in the US argue that not having a bank account may have a wide range of detrimental effects (Allen et al., 2016). For example, the lack of a bank account can make liquidity management and payments difficult, resulting in high fees associated with the use of money orders or check-cashing services (Lusardi, 2011).

Islamic Financial Inclusion Concept

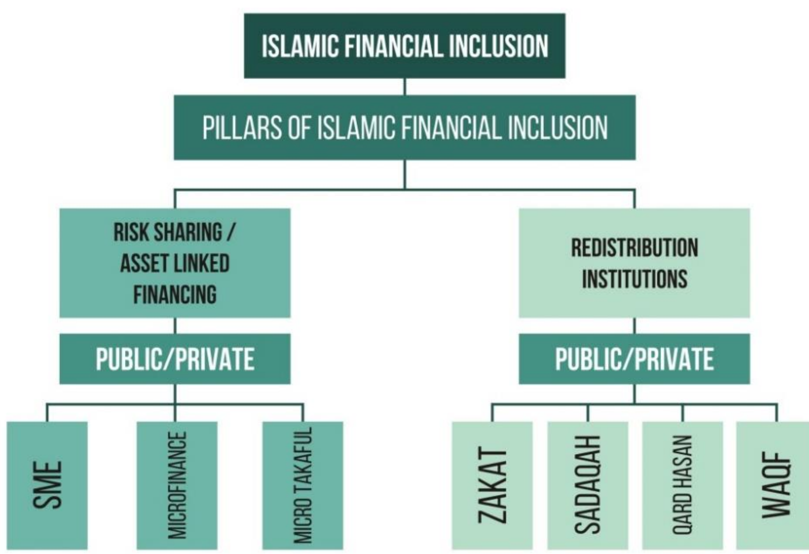
It is broadly known that the core economic principle of Islam is to achieve a prosperous, fair and egalitarian economic and social structure in which all members of society can maximise their intellectual capacity, promote and preserve their health, as well as proactively contribute to the economic growth and social development of society. In the context of financial inclusion, Islam emphasises an all-inclusive financial system explicitly from two distinct features of Islamic finance: First, through the mechanism of risk-sharing. Second, through the elements of wealth redistribution. These two features of Islamic financial inclusion differentiate its development path and implication significantly from the conventional concept of financial inclusion (Mirakhor & Iqbal, 2012).

Therefore, in establishing its all-inclusive finance pillars, Islamic finance builds its concept based on two main approaches. First is through promoting risk-sharing contracts that provide a viable alternative to conventional risk-transferring (debt-based) financing, and the other is through a specific instrument of wealth redistribution among the society (Mohieldin et al., 2012). The former approach consists of Shariah-compliant microfinance, small and medium enterprises (SMEs) and micro-takaful, which are designed to provide financial assistance to the poor, and thus, increase financial inclusion among the Muslim population. The risk-sharing contract will be utilised to develop these respective sectors. The latter approach, which is redistributive instruments of wealth, consists of zakat, sadaqah, qard hasan, and waqf. These instruments will assist and support the risk-sharing instrument to target the vulnerable sector of society so as to offer a comprehensive approach towards the reduction of poverty and building a healthy and sustainable economy (MIFC, 2015).

These two approaches of Islamic financial inclusion pillars are mainly established based on how the risk is perceived in Islam. Islam encourages the risk-sharing mechanism and avoids a risk-transfer based system. This is the main reason why Islam prohibits usury (Riba) and permits the trade and exchange contract; since the former is based on the risk-transfer concept, whereas the latter is based on the risk-sharing notion (Figure 1).

The foundation of the Islamic financial system has its epistemological roots firmly stated in the Al-Quran, particularly in Al-Baqarah (Al-Qur'an 2:275). Based on this verse, Islam prescribes that all economic and financial transactions must be conducted through a contract of exchange (al-Bay') and not through a contract of interest-based debt (Riba). Since in this verse, the permissibility of an exchange contract was mentioned prior to the prohibition of Riba; it is reasonable to argue that the contract that is based on exchange constitutes the necessary condition of a permissible contract. Based on identical logic, the requirement of no Riba constitutes the sufficient condition of the contract to be permissible (Mirakhor & Smolo, 2011; Askari & Mirakhor, 2014). In other words, the necessary condition of (Bay') and sufficient condition of (No Riba) must be combined for the contract to be considered Islamic. As mentioned by Mirakhor (2010), the classical Arabic lexicons of the Al-Quran explain contracts of exchange (Bay') as a contract involving an exchange of property in which there is an expectation of gains and probability of losses, signifying that there are risks involved in the transactions (Mirakhor, 2010). Subsequently, one reason for the prohibition of Riba is because this particular contract transfers all, or at least a major of the risk portion to the borrower, leaving them to deal with the risk by themselves (Mirakhor & Iqbal, 2012; Saifurrahman & Kassim, 2020).

FIGURE 1
CONCEPT OF ISLAMIC FINANCIAL INCLUSION



Adapted from: MIFC (2015)

Institutional Theory: An Overview

The concept of institutional theory argues that the institution operating in an identical or shared environment will have the equivalent pressure behind their policies and decision to follow similar practices (Meyer & Rowan, 1977; Tolbert & Zucker, 1983). The underlying reason for the institution to adopt a similar path and follow an endorsed practice due to a strategic interest in obtaining their legitimacy in their environment, and thus, creating isomorphism among institutions in a similar domain (Kostova & Roth, 2002; Chan & Makino 2007; Kostova et al., 2008; Scott, 2008; Meyer et al., 2010; Famiola & Adiwoso, 2016). According to DiMaggio and Powell (1983), they conclude that the net effect of institutional pressure is to increase the homogeneity of organisational structures in an institutional environment. The institutions will adopt identical structures as a result of three types of pressure, namely: coercive pressure, mimetic pressure, and normative pressure. These three types of pressure are known as "Institutional Isomorphism" (DiMagio & Powell, 1983).

Scott (2008) points out three institutional factors affecting different isomorphism models. These factors comprise a particular set of legal appeals, along with several motivations and adoption levels that describe the distinct models of cultural factor isomorphism in a designated nation. The factors namely are: regulatory, cognitive and normative. The regulatory factor covers the existing elements of institutional environments described in the laws, sanctions, rules and government regulations in which the institution conduct their operation. The excessive pressure from this aspect creates coercive isomorphism. Subsequently, the cognitive factor displays the effect of knowledge in a community and how people behave and resolve specific phenomena. The pressure from this cognitive aspect will create mimetic isomorphism. This isomorphism occurs due to the institutional response in the event of high uncertainties. The institutions that adopt the practices and patterns from other successful institutions are deemed competent in interpreting the local community's needs. Furthermore, the normative factor reflects the norms, values, beliefs and assumptions that guide the individual behaviour in a particular country (Scott, 2008). This factor could generate normative pressure that arises when the institution adopts specific patterns and practices deemed appropriate to the environment in which they operate (Kostova & Roth, 2002; Chan & Makino, 2007; Matten & Moon, 2008; Famiola & Wulansari, 2019).

Financial Inclusion Under the Conceptualisation of Institutional Theory

The concept of financial inclusion is a complex problem, and it was constructed by several aspects ranging from socio-cultural, psychological, economic, geographical and political issues. Institutional analysis theory gives crucial insights regarding financial exclusion. This theory refers to the analysis that comprehends the broad context and the primary institutions involved in the issue being studied. In relation to financial inclusion, this theory highlights the role of history, institutions in effective markets, governments, communities, and societies in understanding financial exclusion (Buckland, 2012).

The institutional theory rejects an analysis of financial inclusion/exclusion based merely on consumer choice. By utilising the institutional theory perspective, it could capture a better picture of processes and structures that are rooted in organisations, policies, and the market (Buckland, 2012). By adopting this theory, a deeper and more comprehensive understanding and exploration of financial inclusion could be attained through the role of institutional settings (Seman, 2016).

In general, institutional theory attempts to interpret the detailed and more resilient aspects of how institutions are created, maintained, altered, and dissolved (Scott, 2004). There is no single and universally accepted definition of an "institution" in the institutional school of thought. However, Scott (2001) defines that "Institutions are social structures that have attained a high degree of resilience. They are composed of cultural-cognitive, normative, and regulative elements that, together with associated activities and resources, provide stability and meaning to social life. Institutions are transmitted by various types of carriers, including symbolic systems, relational systems, routines, and artefacts. Institutions operate at different levels of jurisdiction, from the world system to localised interpersonal relationships" (Scott, 2001, p. 48).

In the context of the present study, this theory deals with the purposeful influence of government organisations, financial institutions, and the demand-side sector (particularly the MSME industry) in determining and realising financial inclusion. This could include the factors by which structures (such as rules, norms, and routines) may guide social behaviour that could generate and attain financial inclusion. It is essential to highlight that the study of financial inclusion based on an institutional theory perspective involves general theory in the aspect of economics, sociology, and political science rather than a theory specific to finance (Seman, 2016). Hence, within the institutional theory framework, this paper would suggest that the supply-side sectors, which consist of the public and financial sectors, as well as the demand-side sectors, are considered the critical factors associated with the realisation of the financial inclusion mechanism.

THE ROLE OF INSTITUTIONS IN ENHANCING MSME ISLAMIC FINANCIAL INCLUSION IN INDONESIA

Institution as the Influencing Factor in Determining MSME Islamic Financial Inclusion

Primarily, institutional creation and diffusion occur, where the top-down process allows higher-level structures to create the action and structure of the lower levels, whereas the bottom-up process generates, reproduces, and changes the context within, in which they operate (Scott, 2008). In other words, an institution found at one level of analysis often affects the behaviour of another institution on the lower level (Bjorck, 2004), where macro structures in society are bridged by organisational fields to microstructures in the organisation or even down to the individual actor level (Svejvig, 2009).

In this respect, it could be suggested that the role of the government (the higher-level structures) provides an essential function in framing the financial institution sector as well as the MSMEs industry (the lower-level structures) in realising financial inclusion. Furthermore, it could also be assumed that financial institutions (the higher-level structures) play an essential role in shaping the MSMEs sector (the lower-level structures) toward financial inclusion. Scott (2008) also stated that it is beneficial to look at various levels in a given study to enhance the understanding of institutional analysis, and this is one of the sturdy features of institutional theory since this theory is able to operate at multi-levels ranging from society, organisational field, and even individual actor level (Scott, 2008). The table below summarises the levels of institutional analysis with a particular example in the context of this paper (Table 1).

TABLE 1
LEVELS OF INSTITUTIONAL ANALYSIS

Level	Characteristic	Example
World System	Involve Societal level at International Level	Cross-Country Study Comparison
Societal	It is a population of organisations (such as competitors, exchange partners, funding sources, and regulators) operating in the same domain, as indicated by the similarity of their services or products.	Indonesia
Organisational Field	It is bounded by the presence of shared cultural-cognitive or normative frameworks or a standard regulatory system to constitute a recognised area of institutional life.	Financial System (Islamic or Conventional)
Organisational Population	A collection or aggregate of organisations that are alike in some respect; in particular, they are classes of	Banking and Non-Banking Sector (Islamic or Conventional)

	organisations that are relatively homogeneous in terms of environmental vulnerability.	
Organisation	The specific organisation within the organisational population	Specific Banking and Non-Banking institutions (Islamic or Conventional)
Organisation Sub-System	Specific unit/department within the organisation.	Management or MSMEs Financing department
Individual	Individuals or groups of individuals who affected the organisation	MSMEs Owner/Manager Poor/Low-Income group

Source: Adapted from Scott (2001) & Seman (2016)

By utilising the concept of "Institutional Isomorphism," as discussed earlier, the paper suggests that institutional pressure (coercive, mimetic, and normative) determines the decision of the top-bottom level. This would signify that within the institutional theory framework, Islamic financial inclusion for the MSMEs sector could be the result of the institutional pressure configuration within the financial inclusion factors and determinants. These factors include the government, the Islamic financial services sector, and the MSME industry.

MSME in Indonesia: Definition, Roles and Its Inclusion Condition into the Islamic Financial Services

SMEs in Indonesia are explicitly known as MSMEs, with another micro-segment of enterprises, since this smaller segment dominates the existence of all enterprises in Indonesia. The government of Indonesia needed to segregate the smaller segment of enterprises to produce a more precise definition of these micro sectors with the issuance of the MSMEs law in 2008. According to the Indonesia Regulations UU No. 20/2008, MSMEs are defined as "Small to Medium-sized enterprises that are owned and managed by individual or group with the total respective assets (excluding lands and enterprise's buildings) or annual revenues according to its segmentation" (Indonesia Regulation, 2008). By referring to the MSME regulation, the segmentation of the MSME sector could be classified according to its total assets (excluding land and enterprise buildings) and annual revenues, as shown in Table 2.

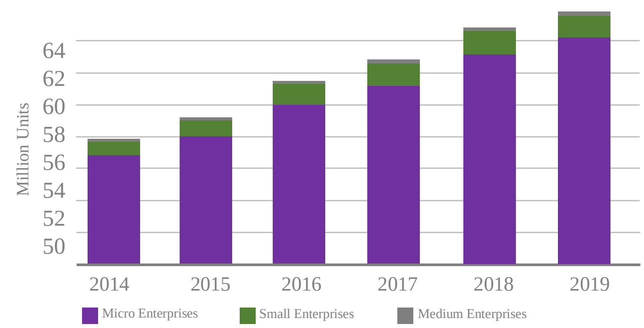
TABLE 2
INDONESIAN MSMES CLASSIFICATION ACCORDING TO ITS TOTAL ASSETS & REVENUES IN INDONESIAN RUPIAH (IDR)

Segmentation	**Classification**	
	Total Assets (excluding lands & enterprise buildings)	Annual Revenues
Micro	Maximum of IDR 50 million	Maximum of IDR 300 million
Small	> IDR 50 million – 500 million	> IDR 300 million – 2.5 billion
Medium	> IDR 500 million – 10 billion	> IDR 2.5 billion – 50 billion

Source: Indonesian Regulation UU No. 20/2008

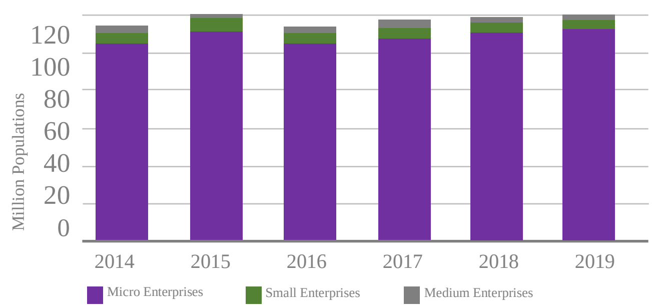
According to the Indonesian Statistic Centre (BPS), MSMEs could be categorised in accordance with their respective employees. Microenterprises could have a maximum of 5 employees, small enterprises could have 6 to 19 employees, while medium enterprises could have between 20 to 29 employees. If the enterprise employs more than 100 employees, the enterprise should be classified as a large enterprise (Bappenas, 2018a).

FIGURE 2
MSMES GROWTH IN INDONESIA



Source: MoCSMEs (2019)

FIGURE 3
MSMES WORKFORCE ABSORPTION



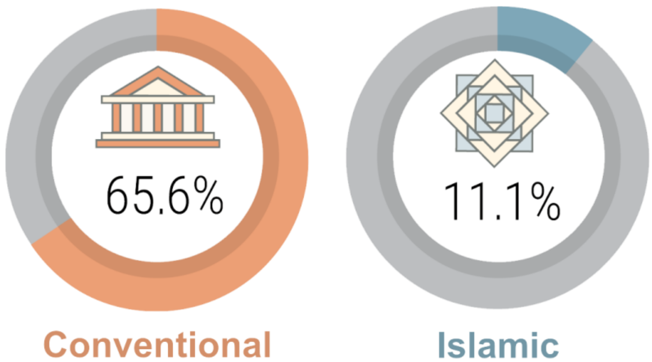
Source: MoCSMEs (2019)

Regarding the total number, MSME units were enormous and represented a critical position in the Indonesian business ecosystem. According to the data obtained from the Ministry of Cooperatives and SMEs (MoCSMEs) until 2019, it was reported that the total number of micro-enterprises reached up to 64,601,352 units, while small-enterprises 798,679 units, and medium-enterprises 65,465 units; in the meantime, the large-enterprise merely accounts for 5,637 units (MoCSMEs, 2019).

MSME sectors in Indonesia are continuously growing, expanding, and remaining solid since it was spread evenly in Indonesia and dominating the business sectors. As reported by the data of MoCSMEs, in 2019, MSMEs contributed up to 99.99% out of total enterprises in Indonesia with a total of 65,465,497 units, with the micro-segment dominating the sectors which contributed up to 98.67%, while small and medium enterprises contributed up to 1.22% and 0.10% accordingly (Figure 2) (MoCSMEs, 2019). MSMEs are argued to have more advantages than the larger enterprises segment due to their lower cost nature, higher flexibility, more specific sector, and faster innovation (Incubator, 2018).

Interestingly, during the global crisis, the MSMEs sectors remained intact and even contributed to aiding the Indonesian economy out of the global crisis. This critical role of MSMEs signifies that these sectors play a vital position in driving economic growth and contribute significantly to the country's GDP (Incubator, 2018). Furthermore, MSMEs could absorb a more considerable amount of the country's workforce; it was mentioned that MSMEs contribute up to 96.92% of the total workforce compared to the larger entity that merely accounts for 3.08% of the total workforce (Figure 3) (MoCSMEs, 2019). Due to this ability to absorb an extensive workforce, MSMEs tend to increase job opportunities and subsequently improve society's earnings. With these antecedent facts, the growth of MSMEs sectors surely will help foster Indonesian economic growth, increase job creation, and promote the effectiveness of the fiscal and monetary policy, and thus, contribute to enhancing financial and economic stability.

FIGURE 4
FINANCIAL INCLUSION INDEX - CONVENTIONAL VS ISLAMIC



Adopted from: OJK (2017)

Unfortunately, with its crucial position as one of the critical drivers for Indonesian economic growth and development, MSMEs sectors still confront numerous issues and challenges that inhibit its sustainability and development, from access to finance, competition, legal status, high cost of materials and labour, lack of rents/space, unskilled staff, and political instability. As disclosed by the International Labour Organisation (ILO) report (2019), it was mentioned that a significant issue confronting MSMEs in Indonesia is access to finance. The importance of finance varies from study to study but is always a feature. In one survey, 15% of MSMEs mentioned lack of finance as one of the top three business challenges. Informal MSMEs (19%) are obviously more affected, but semi-formal (10%) and formal MSMEs (11%) also face this obstacle. Obstacles that MSMEs consider more severe than access to finance were stated to be competition (66%), high costs of materials or labour (37%) and rents/lack of space (22%), in addition to the lack of skilled staff or difficulties in retaining skilled staff (23%) (ILO, 2019).

Moreover, concerning the Islamic financial inclusion levels, a survey carried out by OJK in 2017 disclosed that the Indonesian population merely scores around 11.1% on the Islamic financial inclusion index. This survey assesses and measures the financial inclusion levels of households and, to some extent, also covers the MSME industry (OJK, 2017). This shallow percentage of the Islamic financial inclusion index is a stark contrast against the 87.2% Muslim population of Indonesia (BPS, 2010). Although Indonesia has the highest Muslim population globally, its population does not substantially use nor benefit from Islamic financial products and services. The inclusion of Islamic financial services in Indonesia is significantly lower than the inclusion of the conventional counterpart, which stands at 65.6% (Figure 4) (OJK, 2017).

The Role of the Indonesian Government for MSMEs Islamic Financial Inclusion

This section will disclose the vital function of the Indonesian government in shaping the trail of Indonesia's MSMEs' Islamic financial inclusion from two aspects: First, from the aspect of the regulatory framework as a critical element to build the basis of MSMEs Islamic financial inclusion; and second, from the aspect of the public sector as a supporting component for MSMEs Islamic financial inclusion.

Regulatory Framework to Promote MSME Financial Inclusion

Since 2004, the government of Indonesia has strategically promoted MSMEs as the engines of sustainable and pro-poor growth. In consultation with all the relevant ministries and agencies, the government launched comprehensive economic policy reforms called the New Economic Policy Package in 2007 and 2008 (IFC, 2016). This package included policies to improve the investment environment, finance and infrastructure sector. The aim was to strengthen the MSMEs sector.

Furthermore, the government of Indonesia have significant incentives to develop this potential yet vulnerable sector by issuing holistic regulations that provide them with easier access to finance, a competitive business environment, development support, as well as informational and facility provision. These regulations include:

- The 20% mandatory minimum credit ratio for MSMEs financing that fully effective in 2018. This regulation applies to both the conventional and Islamic financial industries (Bank Indonesia Regulation, 2012)
- Issuance of MSMEs 2008 law as the enabling legislation for the sector that consists of supportive and protective measures (Indonesia Regulation, 2008)
- The introduction of the National Strategy for Financial Inclusion or known as SNKI (Strategi Nasional Keuangan Inklusif) in 2016 that aims to improve the coordination among various government agencies and access to finance for MSMEs (BPK RI, 2016; IFC, 2016)
- Implementation of online registration for the “Fiducia Agreement” in 2013 to eliminate the need to visit the Fiducia registration office and to increase the usage of movable collateral by MSMEs (IFC, 2016)
- Recently, the government also has reduced the tax rate for MSMEs from 1% to 0.5%, with effect from 1 July 2018 (ILO, 2019).

However, even the extensive regulation still has its flaws, and for the case of Indonesian MSMEs, it is confirmed by the high number of unbanked and underfunded MSMEs, MSMEs that stay informal with no permit, and financial industry perception of the high-risk business nature of MSMEs (IFC, 2016; ILO, 2019). These issues were arguably caused by several factors: From the vague definition of a 20% minimum credit ratio for MSMEs, causing the credit to be flooded to the less risky MSMEs industry (ILO, 2019); complicated and time-consuming procedures to obtain a permit for MSMEs (World Bank, 2014; IFC, 2016); and regulations that focus on Non-Performing Loans (NPL) causing the limited flexibility of financial industry, and hence making them reluctant to disburse financing to high-risk MSMEs sector (ILO, 2019).

Public Sectors and Government Programs to Support MSMEs Financial Inclusion

Besides the laws and regulations that enable the environment for the growth of the MSMEs sector, the government of Indonesia also established particular programs and the public sector to increase the opportunity for MSMEs to develop further; these programs and public sector include:

- Credit guarantee scheme, or known as KUR (Kredit Usaha Rakyat/ People Business Credit). The government covers 70% of the total credit for MSMEs disbursed by banks and even covers 80% of the total credit for the riskier sector, such as agriculture, fisheries, and forestry (Bank Indonesia, 2014b). KUR program is available in conventional and Islamic versions.
- PLUT KUMKM, or known as Integrated Support Centre for Cooperatives and MSMEs. This centre provides business consultation, mentoring, access to the business network and marketing (ILO, 2019)
- SMESCO (Small, Medium and Cooperatives Indonesian Company) and exhibitions to provide promotion services and marketing for Cooperatives and MSMEs (SMESCO, 2019)
- Corporate Social Responsibility (CSR) of State-owned enterprises to support MSMEs (IFC, 2016)
- National Islamic Economic and Finance Committee, known as KNEKS (Komite Nasional Ekonomi dan Keuangan Syariah), aims to promote the growth of Indonesian Islamic finance nationally and globally. The MSME sector was included as one of the four strategic keys in the Sharia Economy Masterplan issued by KNEKS and Bappenas in May 2019 (Bappenas, 2018a; Deloitte, 2019).

Unfortunately, with several support programs and the public sector provided by the Indonesian government to assist the MSMEs industry, there are still many issues of non-utilisation of government services by the MSMEs sector. According to the IFC survey (2016), most MSMEs (76%) are not using any government support programs. Informal MSMEs, in particular, almost never use these services except for participation in credit programs. The main reason for not using these mentioned public services is arguably due to informal MSMEs being hesitant to apply for training programs or exhibitions without the proper formal status. In fact, both small enterprises (78%) and medium enterprises (71%) have rarely benefited from government services. Another reason for not joining the government support is because the services are not relevant for their respective sector. Another critical reason for not participating is the lack of information about government programs (IFC, 2016). Additionally, Islamic KUR was merely achieving 0.6% of disbursement in 2019; the primary reason for this low percentage is due to the limited number of Islamic Financial Institutions (IFIs) that were entrusted to channel the Islamic KUR (Priyanka and Zuraya, 2019).

Islamic Financial Institution Serving the MSMEs Sector in Indonesia

As reported by ILO (2019), by international standards, Indonesian's financial sector as a general has been growing and increasing, but still lacking in terms of total financial assets as a percentage of GDP and the amount of credit to the private sector, at 103% and 25% respectively (ILO, 2019); This number comprises both conventional and Islamic financial industry sector, denoting the lack of financing disbursement to MSMEs sector both from the conventional and Islamic financial institution. In the context of IFIs, there are several Islamic financial service providers that offer financial products and services to the MSMEs sector in Indonesia, among others: Islamic banks, Islamic rural banks, Takaful Industry, Islamic Microfinance such as Baitul Maal wa Tamwil (BMT) and Islamic Cooperatives. Currently, Fintech could be a viable option for MSMEs financing due to its simplicity and fast procedures. So far, there are seven registered P2P industries that offer Shariah-based financing in Indonesia that also provide financing services to MSMEs (Duwitmu, 2019).

According to OJK (2019), in June 2019, the market share of Islamic banks in Indonesia only accounted for 5.95% of the total asset of the banking industry, while the market share of the Islamic financial industry merely accounts for 8.29% of the total asset of the financial industry in Indonesia (OJK, 2019). Although the market share of the Islamic financial sector is significantly lower compared to the conventional sector in Indonesia; however, it is crucial to highlight that this number only considers the Islamic financial industry from the aspect of banking, capital market, and non-banking financial institution. As mentioned by IFDI (Islamic Finance Development Indicator) report, the percentage does not include the numerous Islamic microfinance institutions; In fact, these institutions plays a more critical role compared to the Islamic bank in Indonesia since approximately 76% of the Indonesian population are considered unbanked (IFDI, 2019).

Despite the diversified source of financing for MSMEs, IFC (2016) and ILO (2019) surveys reported that the MSME sector is still underbanked and underfunded. This problem of lack of financial access is attributed to several factors, among others:

- General lack of financing products that were uniquely serving MSMEs in each of their respective segments and sectors (ILO, 2019). In the context of the Islamic banking industry, they overused the Murabahah financing to serve the MSMEs sector and were less likely to utilise Profit and Loss Sharing (PLS) schemes such as Mudharabah and Musharakah (IFC, 2010; Huda, 2012; Suharto & Fasa, 2017; OJK, 2020). This practice of excessive use of debt-based instruments is not in-line with the Islamic finance principle that supposedly uses the risk-sharing mechanism instead of the risk-transfer scheme, as discussed earlier in the Islamic financial inclusion concept.
- The inability of Financial Service Providers (FSPs), particularly the banks, to access credit risk of MSMEs sectors due to a lack of record and cash accounting from MSMEs (ILO, 2019)
- Many FSPs lack an understanding of the productive sectors in which the MSMEs operate. It is disclosed by ILO (2019), even with the currently available products, many bank field staff require training in MSMEs lending and how to assess financing applications concerning the background of the respective sectors in which MSMEs operate. Cooperatives know the needs

of their members better than banks know their customers, but cooperatives lack the liquidity to meet the financing demand

- Many FSPs do not have the required system, data, and infrastructure to expand the MSMEs financing, mainly among the smaller banks. It is reported by the ILO survey (2019), some FSPs try to address these issues by working via agents and other intermediaries such as fintech companies and using new forms of business information such as digital data. Nevertheless still, much more needs to be done to strengthen the MSMEs financing and expand the MSMEs market (ILO, 2019).

The Current Condition of MSMEs in Indonesia to Embrace Islamic Financial Inclusion

As mentioned earlier, MSMEs represent a critical position for Indonesia's economic ecosystem since the sector occupies nearly 99% of the country's total enterprise number and 96% of the country's employment, denoting the high concentration of MSMEs in the country. Nevertheless, even with the high concentration of the MSMEs sector, the industry only contributes up to 57% of the country's GDP (Bappenas, 2018b), signifying the sector's lack of efficiency and productivity in promoting economic growth. This phenomenon is caused by many constraints that perpetually impede their growth, from lack of access to formal financial services, market competition, political instability, and even corruption (Irjayanti & Aziz, 2012; IFC, 2014; ILO, 2019).

While Indonesian government are attempting to reduce the involuntary exclusion of the MSMEs by implementing specific credit guarantee schemes, establishing respective public sector to assist MSMEs, and even mandating the banks to provide a 20% minimum credit ratio for MSMEs to improve the inclusion of the sector, many Indonesian MSMEs are still facing financial constraints as its primary issues. This issue could be attributed to the demand-side condition of the MSMEs sector itself, and the sector might exclude from formal financial services voluntarily. It was disclosed by ILO (2019) that the majorities of Indonesian MSMEs are financially illiterate, hence, potentially lowering their chances of getting external financing and reducing the effectiveness of the government's financial inclusion programs.

Furthermore, the condition of low financial literacy level is more severe in the context of Islamic financial literacy compared to the conventional one. The literacy index merely stands for 8.1% of the entire Indonesian population (OJK, 2017); therefore, the index of Islamic financial literacy for MSMEs is assumed to be extremely low. This assumption was confirmed based on an empirical study conducted by Djuwita and Yusuf (2018) that measures the Islamic financial literacy level among micro-enterprises located in the Cirebon area. The study uses street vendors and stores located at At-Taqwa Mosque in Cirebon as a sample. The result implies that the majority of the street vendors and store owners have an unexpectedly low, even zero-level Islamic financial literacy. This contradicts the study assumption since the vendors and shops are located in the Mosque area; hence, they should have knowledge regarding Islamic financial products and services to some degree, but their findings stated otherwise.

Besides the financial literacy issues, several other factors hamper the realisation of the sector's financial inclusion; these factors include:

- Since MSMEs unit is scattered across the country, many industries operate in remote and rural areas, where it is difficult to connect and access banks or other FSPs.
- Many of these MSMEs sectors are operated by low-skilled and low-productive people; thus, imposing the high-risk project that occasionally made the FSPs reluctant to give them access to formal financial services.
- Many MSMEs are still lacking for required collateral; hence many FSPs unwillingly give them access to finance. While it could be argued that the banks or other FSPs need to be more flexible in this regard, for the moment, MSMEs need to provide collateral as a commitment to obtain finance from the banks or other FSPs (ILO, 2019).

The Convergence of Institutionalism in Enhancing MSME Islamic Financial Inclusion in Indonesia

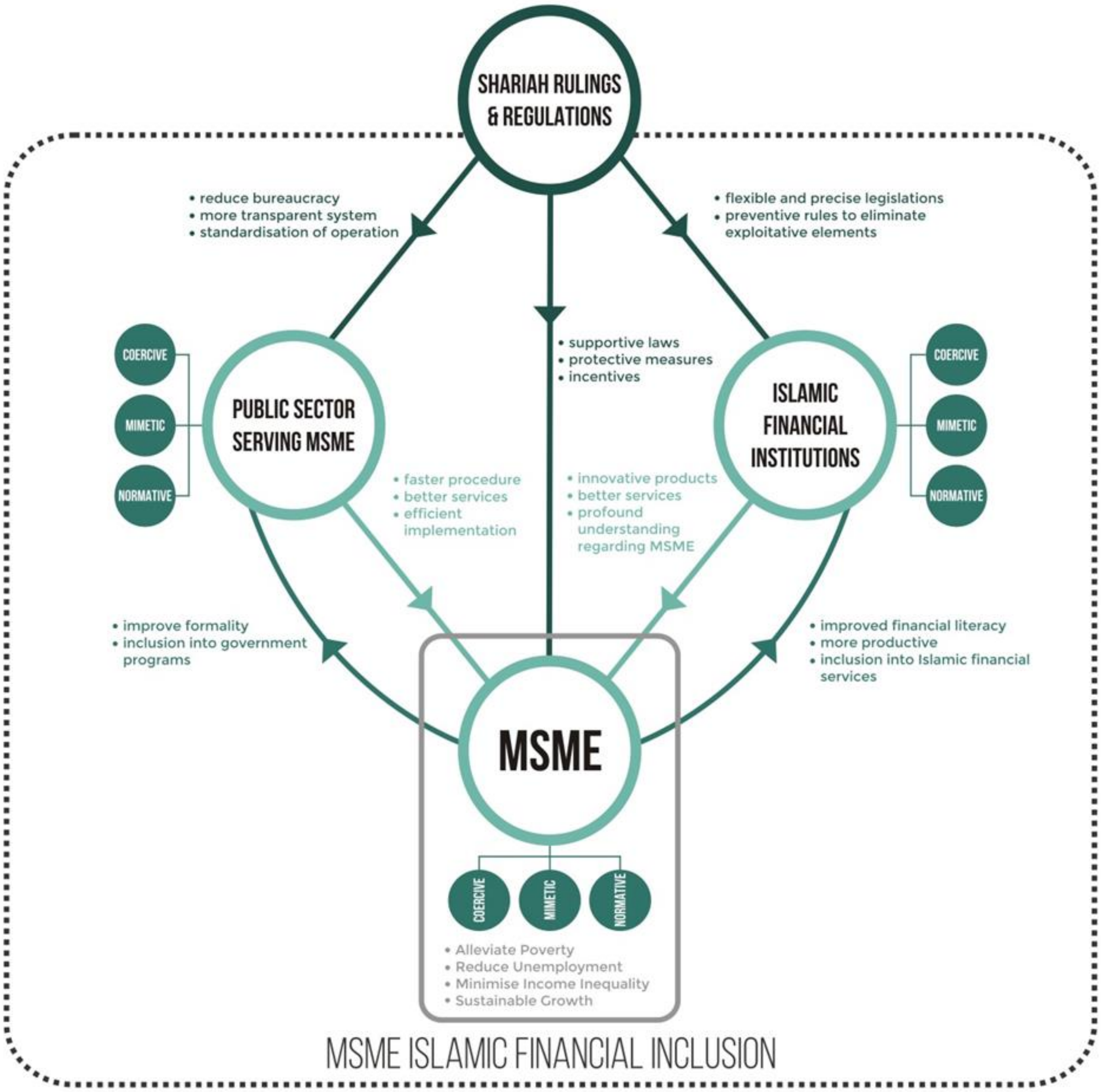
Figart (2013) suggests five institutional prerequisite for financial inclusion. First, people must have access to non-exploitative institutional arrangements for engaging in transactions necessary in the market economy. Second, financial inclusion means that individuals should be able to save for future needs and have access to credit if they need financing; this requires access to non-exploitative institutions that offer credit and the ability to protect savings. Third, financial inclusion implementation should incorporate the institutionalisation of social norms. Fourth, financial inclusion needs to encompass human diversity by embracing a range of institutional forms and strategies that improve capabilities. Fifth, while the individual development of diverse human actors is crucial, financial inclusion requires focusing on the communities and individual well-being. Hence, to incorporate these elements, all institutions involved in achieving financial inclusion should be encouraged to support community development since community development is vital to relate financial inclusion with economic inclusion (Figart, 2013).

With the abovementioned discussion on institutional isomorphism, the role of the Indonesian government, the position of IFIs, and the condition of MSMEs to embrace their Islamic financial inclusion, we may converge this concept of institutionalism along with the five institutional prerequisite to achieve financial inclusion (Figure 5).

First, in the regulatory aspect, as elaborated before, the higher-level institution could affect the lower-level institution in shaping their behaviour and framing their operation (Bjorck, 2004; Scott, 2008). Hence, the construction of effective regulation is essential to shape the trail of Islamic financial inclusion achievement in Indonesia. Raskin (2011) mentioned that one critical step to realising financial inclusion is a solid and robust regulatory framework. The aforementioned issues about the laws and regulations in Indonesia signify that the flaws in the regulation will establish the barriers and set-back to the achievement of MSMEs' Islamic financial inclusion. Therefore, flexible and reliable regulations need to be reviewed and applied to incorporate effective "coercive isomorphism" into three involved institutions: the public sector, Islamic financial institutions, and the MSME industry to augment MSMEs' Islamic financial inclusion. For example, since there are no standardised measures on how the credit assessment should be conducted by the FSPs in the MSME industry (ILO, 2019), the government could tackle this issue by establishing standardised assessment methods and introducing detailed guidance to evaluate the MSME units based on their diverse sector; hence, this standardisation could provide a clear path for IFIs and may increase the opportunity of healthy MSME in obtaining financing service; and in fact, it could facilitate more utilisation of risk-sharing financing scheme due to less asymmetric information. Moreover, the regulation also needs to integrate the elements of protective measures to prevent the public sector and the financial sector from exploiting the lowest level of the institution, which is the MSME.

Second, in the aspect of the public sector, Frumkin and Galaskiewicz (2004) suggest that a government organisation is more susceptible to institutional isomorphism compared to a non-government institution, confirming the needs of the public sector serving MSMEs to incorporate institutional isomorphism to achieve better MSMEs Islamic financial inclusion rather than as a catalyst for financial inclusion. This could be in the form of standardisation of operation, transparent procedures, and flexible bureaucracies as a response to coercive pressure; adopting approaches of the successful public sector that serve MSMEs in other provinces or other countries during strategic uncertainty as a response to mimetic pressure; and incorporating Islamic norms and social values to assist MSMEs as a response to normative pressure. The incorporation of institutional isomorphism into MSMEs' public sector will potentially minimise the issues of MSMEs informality, encourage more utilisation of government programs by MSME entrepreneurs, and improve the government programs' effectiveness towards MSME.

FIGURE 5
THE CONVERGENCE OF INSTITUTIONALISM IN ENHANCING MSME ISLAMIC FINANCIAL INCLUSION IN INDONESIA



Source: Authors' own

Third, in the aspect of IFIs, the concept of institutional isomorphism could be utilised to improve the function and the role of this sector as a supply-side provider of Shariah-based financial products and services. Such as collaboration with the credit rating agency to enhance the evaluation of MSMEs and to reduce information asymmetry in their financing contract as coercive responses, mimicking the steps and activities of a particular financial institution such as cooperatives and microfinance institutions that effectively serve MSMEs sector as mimetic responses; and active reaction to the specific demand, current trends and needs of MSMEs sector as normative responses, such as enhancing their internet/mobile banking services that were tailored for the MSME needs and incorporating the branchless banking and agents for better service coverage to reach out even to the remote area of Indonesia (Kustina et al., 2019; Prastiawan et al., 2021); The IFIs also need to consider in disbursing more Islamic credit guarantee schemes with no collateral requirement, such as Islamic KUR and prioritise it to the vulnerable MSME segment to increase its effectiveness. The credit guarantee scheme might reduce the bank's unwillingness to lend to MSMEs. Because, in case of MSME defaulting, the government could cover a certain percentage of the banks' losses (Yoshino & Hesary, 2018). The involvement of institutional isomorphism will reduce the constraint of MSMEs' Islamic financial inclusion from the supply-side aspect since this will influence product and service innovation, better motivation to serve MSMEs due to less asymmetric information, and more profound understanding of the productive sector of MSMEs; thus, improving their provision and assistance in fulfilling the MSMEs needs.

Fourth, in the aspect of MSME, the notion of institutional isomorphism could be implemented to increase the chance of the sector utilising more government programs and more inclusion in Islamic financial products and services. This could be in the form of pro-actively improving financial and technological literacy to understand diverse government regulations, programs, and various Islamic financial services aimed at MSMEs as a response to the coercive isomorphism, following specific standards of bookkeeping and accounting for better transparency and accountability as a response to mimetic isomorphism, and finally, incorporate Islamic values and social norms such as the acquisition of halal certification applicable to their business and participating in charities effort to help their community as a response to normative isomorphism. The integration of institutional isomorphism will improve the chance of MSMEs in achieving Islamic financial inclusion, strengthen their capital basis, enhance their skills and productivity, and contribute to the development of social well-being.

CONCLUSION

Islam encourages the notion of cooperation and assistance in the aspect of virtue, morality and piety (Al-Qur'an 5:2). Therefore, in achieving the Islamic financial inclusion agenda, the contribution and cooperation from all segments of society ranging from the individual, household, institution, community and country are highly necessary to ensure the equity and fair economic ecosystem. The synergy from all institutions involved in achieving MSMEs' Islamic financial inclusion should be considered to attain effective Sustainable Development Goals (SDGs) since MSMEs' development will contribute substantially to Indonesia's economic stability and sustainability and potentially will assist the country in alleviating the poverty and reducing the income inequality by creating substantial job opportunity and strengthening the community purchasing power.

Therefore, from the social implication aspect, by incorporating institutional isomorphism and implementing the five institutional prerequisites for financial inclusion realisation, this mechanism will strengthen the role of the institution as the critical determining factor to reinforce financial inclusion, particularly Islamic financial inclusion. The collaboration between the involving institutions from the public sector, Islamic banks, Islamic non-bank financial institutions, Islamic microfinance and cooperatives, as well as MSME stakeholders, are required to ensure the smooth implementation of the Islamic financial inclusion agenda for the MSMEs sector. Furthermore, the institutional pressure on the part of MSMEs will potentially affect their behaviour and improve their chance of embracing Islamic financial inclusion, augmenting their skills and productivity, and ultimately will translate into the welfare of society, providing that the Muslim-owned MSMEs integrate their Islamic norms and values of assisting others and participate in the philanthropic activity.

Nevertheless, since this study only focuses on Indonesia and emphasises more on the dimension of the three linked institutions that consists of the public sector, IFIs, and MSME segment under the purview of institutional theory; hence, the conceptual discussion of this paper was scoped around those three vital institutions that involve in the enhancement of MSME Islamic financial inclusion within the Indonesia horizon. Due to this limitation, this paper recommends that future studies should conduct a multiple theory comparison and broaden the institutions' scope, particularly the ones that involve in promoting and enhancing Islamic financial inclusion, to contribute more to the development of the institutional theory from the Islamic financial system perspective.

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