



## Market microstructure and sharia-compliant financing of small and medium enterprises in Indonesia: an empirical analysis

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### ABSTRACT

This study explores the intricate relationship between Indonesian Small and Medium Enterprises' (SMEs') acceptance of finance that complies with Shariah. This work uses Structural Equation Modeling with Partial Least Squares (SEM-PLS) and quantitative empirical analysis to investigate how market microstructure dynamics affect financing choices and performance results that adhere to Shariah. A survey was conducted with the 105 SMEs that made up the study participants to gather information about their overall performance, financing choices, and market engagement. The results show a strong positive correlation between the success of SMEs, the use of finance that complies with Shariah, and market microstructure. Additionally, there is a complicated interaction between SME performance, funding options, and market conditions. The study's findings have practical consequences for financial institutions, policymakers, and small- and medium-sized enterprise owners navigating Indonesia's constantly changing financial scene. They offer insights into how to finance sustainable growth in a way that aligns with Shariah principles.

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## 1. INTRODUCTION

Significant changes have occurred in Indonesia's economic environment, with the industrial and service sectors now predominating over the country's heavily dependent agricultural economy (Hubbansyah et al., 2023). The rise of Islamic capital market tools and their effect on economic growth have coincided with this transition (Adewiyah & Bawono, 2023). Furthermore, it has been noted that the Investment Opportunity Map initiative is beneficial in assisting Indonesia with the realization of investments (Anwar et al., 2023). Additionally, the research on Indonesia's economic growth emphasizes the beneficial effects of rising investment and defense spending on the country's economic growth (Kennedy, 2023). Finally, research has looked at the effects of Islamic equities and mutual funds on economic growth. It has found a considerable effect, but no significant impact on inflation (Qisti & Budiman, 2023). Comprehending the interplay between

finance strategies and market microstructures, specifically in the context of Sharia-compliant financing, is crucial for Indonesia's rapidly expanding economy.

The incorporation of Sharia-compliant financing concepts into Indonesia's market microstructure presents both opportunities and challenges for small and medium-sized enterprises (SMEs), which are essential to maintaining economic growth (Yuli & Rofik, 2023). Empirical research is required to understand the processes that take place. One study looks at how Indonesia's economic development and unemployment rate are affected by Islamic banks' financing that complies with Sharia law. The results show that financing that complies with Sharia law lowers unemployment and promotes economic expansion (Adewiyah & Bawono, 2023). The connection between Islamic capital market instruments and Indonesia's economic expansion is the subject of another study. It concludes that sukuk and the Islamic stock index boost economic growth, but sharia mutual funds have no impact on it (Permadi et al., 2022). Furthermore, it is discovered that Indonesia's economic growth is positively impacted by the distribution of ZIS money (Wulandari & Ibrahim, 2023). These studies shed light on the mechanics of funding that complies with Sharia law and how it affects Indonesia's economic expansion.

As a source of innovation, jobs, and social development, SMEs in Indonesia are vital to the nation's economic growth and development. The microstructure of the market affects SMEs' liquidity levels, access to capital, and the effectiveness of resource allocation in the financial market, all of which have a substantial impact on the health and survival of these businesses. The significance of market microstructure in influencing these elements for SMEs has been underlined by earlier research (Annisa & Saridewi, 2023; Febriyantoro et al., 2023). The ability of SMEs to secure capital, successfully manage their financial resources, and traverse the financial market is impacted by the market microstructure (Nasikah et al., 2023). The growth and sustainability of small and medium-sized enterprises (SMEs) in Indonesia must be supported by an understanding of and attention to the nuances of the market microstructure (Handayani, n.d.).

Businesses, notably SMEs, are increasingly adopting financing mechanisms that comply with Sharia law as a result of the integration of these principles into Indonesia's financial system. This adoption could revolutionize the nation's financial processes, presenting both special opportunities and difficulties in a market with strong Islamic roots (Yuli & Rofik, 2023). Regulations and mergers have bolstered the growth of Islamic banking in Indonesia, improving its status and raising the level of financial literacy among Muslims (Hartanto & Fatwa, 2020). Islamic banks benefit from the expansion of Sharia finance in Indonesia, but managing risky lending becomes more difficult (Iswanto, 2022). The substantial Muslim population in Indonesia and the potential economic benefits of Islamic finance have propelled the establishment and expansion of Islamic banking in that nation (Hadi et al., 2023). The government of Indonesia, which hopes to establish the nation as a leader in the global Islamic economy, has taken notice of the growth of Islamic finance in the nation (Haryadi, 2023).

The relationship between the adoption of Shariah-compliant financing and the dynamics of market microstructure has not been thoroughly studied, despite several research looking into these two topics independently, particularly in the particular context of SMEs. By performing a rigorous empirical analysis that examines the relationship between market microstructure, financing decisions that comply with Shariah, and their impact on SME performance in Indonesia, this study seeks to close this important gap in the literature. The possible ramifications for financial institutions, policy makers, and small- and medium-sized business owners seeking to improve financial strategies are what spurred this research. Comprehending the ways in which market microstructures impact the uptake of financing that complies with Shariah, and consequently, the ways in which these financial decisions affect the performance of small and medium-sized enterprises (SMEs), can yield practical insights for promoting

sustainable economic growth, financial inclusivity, and ethical business conduct in Indonesia. The purpose of this study is to clarify the intricate connections between market microstructure, finance that complies with Shariah, and SME success, as well as to explain how these interactions interact within the particular framework of Indonesia's business environment.

A number of significant aspects highlight the significance of examining the relationships between market microstructure, finance that complies with Shariah, and the performance of Small and Medium Enterprises (SMEs) in Indonesia. The foundation of the Indonesian economy, SMEs make major contributions to employment, innovation, and general economic growth (Randyantini et al., 2023). The dynamics of the market microstructure are driving significant developments in Indonesia's financial markets. To adjust tactics to changing market conditions, policymakers, financial institutions, and SME owners must thoroughly examine how these changes impact SME financing options (Dela Cruz et al., 2023). An extensive analysis of the effects of Shariah-compliant financing on SMEs is necessary given its growing integration into Indonesia's financial system. Adopting Islamic banking principles can transform financial practices in a country where the majority population is Muslim, promoting economic development based on moral and socially conscious principles (Gulo & Ginting, 2023). A closer look at Shariah-compliant financing as a workable and moral substitute is necessary given the global trend toward ethical financial practices. Promoting sustainable and ethical business practices requires an understanding of how SMEs can conform to these ideals while negotiating the intricacies of market microstructures (Anwar et al., 2023). Notwithstanding the economic significance of small and medium-sized enterprises (SMEs) and the dynamic nature of Indonesia's financial system, there is a significant knowledge vacuum on the combined effects of market microstructure dynamics and the uptake of financing that complies with Shariah (Amalia et al., n.d.).

According to Jensen and Meckling's (1976) agency theory, market microstructure might have an impact on the agency costs related to financing SMEs. The performance of SMEs may be impacted by information asymmetry, which results from the inefficiencies of the market microstructure and affects the monitoring and control systems currently in place.

Within the field of Islamic finance, the resource-based view (RBV) offers a perspective on how Shariah-compliant financing might improve the performance of small and medium-sized enterprises. SME performance can be improved, new markets can be reached, and stakeholder relationships can be strengthened by harmonizing financial processes with Shariah principles.

Understanding the availability of financial resources and the effectiveness of capital allocation—especially for SMEs—requires an understanding of the microstructure of financial markets, including the mechanisms that support trading. It has a big impact on how much a company must pay for capital, which has an impact on investment choices and overall performance (Boier, 2023). Sophisticated models that can identify causal patterns and capture non-linear correlations are necessary due to the complexity of financial markets. It has been suggested that using neural networks in conjunction with multiscale decomposition can help us comprehend the substructures of financial market data (Lio et al., 2018). The intricacy of stock market dynamics and the character of transitions throughout various times, such as the current pandemic-related lockdown and the global financial crisis, have also been examined using recurrence-based measures (Krishnadas et al., 2022). Additionally, the Random Matrix Theory has been used to evaluate the collective behavior of banking sectors in various stock markets, demonstrating differences in vulnerability and collective behavior across mature and emerging markets (Vahabi et al., 2022).

Prior empirical research indicates that the market microstructure has a substantial effect on the access of SMEs to capital. Information asymmetry, liquidity

constraints, and the structure of the financial markets all significantly influence the capacity of SMEs to raise capital and manage financial risks. (Civelek, 2023; Khanam & Haider, 2018; Mitra et al., 2023; Salazar-Rebaza et al., 2022; Xiao et al., 2022).

The incorporation of Sharia-compliant financing into small and medium-sized enterprises (SMEs) has garnered interest in light of the global expansion of Sharia finance. In accordance with Sharia law, Islamic financial principles prioritize socially and ethically responsible financial conduct. The adoption of Sharia financial instruments by small and medium-sized enterprises (SMEs) underscores the significance of adhering to Sharia principles in order to attract a wider range of investors and promote long-term, sustainable development (Hidayah & Karimah, 2023; Naz & Gulzar, 2023; Shawtari et al., 2023). It has been discovered that Islamic financial development, encompassing Islamic banking, the Islamic bond market, and the Islamic equity market, positively influences economic growth in nations such as Qatar and Pakistan (Harahap et al., 2023; Kiranawati et al., 2023). Furthermore, both profit and loss sharing (PLS) and non-PLS financing have had a positive impact on the profitability of Islamic banks. However, the extent of this influence may be limited by variables including non-performing finance (NPF). Research has demonstrated that the incorporation of Sharia governance principles into Islamic banking operations yields positive outcomes, including enhanced service quality and improved bank performance, which ultimately contribute to an increase in the value of the institution. In general, the implementation of Sharia-compliant financing in small and medium-sized enterprises (SMEs) is consistent with the tenets of Islamic finance and has the potential to aid in the achievement of sustainable development objectives.

The provision of Sharia-compliant financing to small and medium-sized enterprises (SMEs) by Islamic institutions is vital to their resilience and stability. Aligned with the tenets of Islamic banking, Sharia finance's distinctive characteristics—including asset-backed financing and profit sharing—can facilitate the growth of small and medium-sized enterprises (SMEs). Research has indicated that the integration of Sharia governance principles into the Islamic banking sector yields positive outcomes in terms of service quality and bank performance (Naim & Abdul Rahman, 2023). Furthermore, the lending portfolio composition of Islamic banks is notably influenced by internal governance factors, including the attributes of the Shariah supervisory board and the characteristics of the board of directors (Kiranawati et al., 2023). This, in turn, can have an impact on the financing alternatives accessible to small and medium-sized enterprises (SMEs). In addition, research has shown that the profitability of Islamic banks is positively impacted by their financing practices, such as profit and loss sharing (PLS) and non-PLS financing. This underscores the potential advantages that small and medium-sized enterprises (SMEs) can gain by pursuing Sharia-compliant financing options (Shawtari et al., 2023). In general, the incorporation of Sharia principles into Islamic banking's financial practices can foster the growth and stability of small and medium sized enterprises (Hidayah & Karimah, 2023).

In the context of Indonesian SMEs, the interaction between market microstructure and Shariah-compliant financing has not been exhaustively examined in the existing literature. Integrated studies examining the relationship between market conditions and SME adoption of Shariah-compliant financing are scarce. In addition, there is a paucity of empirical research focusing specifically on Indonesian SMEs, which hinders our comprehension of the country's distinctive economic, cultural, and regulatory environment. In addition, the absence of exhaustive guidance based on empirical studies frustrates stakeholders including financial institutions, policymakers, and SME proprietors, impeding the development of policies and strategies that align with their requirements. It is imperative that this research void be filled in order to promote the advancement of academic understanding and offer actionable suggestions regarding the

ethical conduct and sustainable expansion of small and medium-sized enterprises (SMEs) in Indonesia.

## 2. RESEARCH METHOD

In the methods section, we will describe the research approach, the methods used, the samples taken and the data analysis process.

### 2.1 Research Type and Sample

The empirical investigation of the correlation between market microstructure and Shariah-compliant financing for Small and Medium Enterprises (SMEs) in Indonesia is the focus of this quantitative study. This study's demographic consists of Indonesian SMBs that utilize Shariah-compliant financing.

To achieve representation of various sectors and regions, a stratified random sampling technique will be implemented. 105 SMBs will comprise the cohort, which will be determined by their participation in Shariah-compliant financing. Furthermore, this research employs purposive sampling by precisely focusing on the specified criteria: (1). small and medium-sized enterprises (SMEs) that are operational in Indonesia. SMBs that have opted for Sharia-compliant financing (2).

The collection of primary data will be conducted via online and offline surveys. The survey inquiries are structured to gather data on the dynamics of the market microstructure, including three indicators: market transparency, competition dynamics, and market uncertainty; Sharia-compliant financing options, comprising three indicators: competitive profit rates, ease of access to financing (accessibility), and revenue growth rate, customer satisfaction, operational efficiency, and product and service quality.

Based on a statistical power analysis, a minimum sample size of 100 SMEs was determined in order to guarantee sufficient representation for the SEM-PLS analysis. The analysis suggested multiplying the number of indicators by 5-10. In this particular study, the number of indicators is 10. By increasing the sample size, robust statistical inferences can be made, thereby enhancing the generalizability of the findings.

### 2.2 Data Analysis

The primary statistical method utilized in this study to examine the intricate relationships between latent variables and observed variables is SEM-PLS. The selection of PLS was based on its appropriateness for exploratory research, ability to manage small sample sizes, and support for reflective and formative constructs.

On the basis of the literature review, a conceptual model was developed in which latent constructs representing market microstructure dynamics, sharia-compliant financing factors, and SME performance were identified. In order to establish and verify measurement models for every latent construct, one must carefully choose suitable indicators. Evaluate the measurement model's validity and reliability by employing composite reliability, factor loadings, Cronbach's alpha, and Average Variance Extracted (AVE).

Consolidate the measurement model into the structural model as a whole. Path coefficient analysis of the structural relationships between latent constructs. Utilize goodness-of-fit indices, including the Standardized Root Mean Square Residual (SRMR) and Normed Fit Index (NFI), to assess the overall fit of the SEM-PLS model.

## 3. RESULTS AND DISCUSSIONS

The results and discussion section will detail the results of our data analysis.

### 3.1 Respondent Demographics

An analysis was conducted on the demographic characteristics of the participants in order to offer context for the research findings. The masculine gender comprised approximately 71.4% of the participants in the sample. With regard to the age distribution of the participants, the greatest cohort comprised 42.9% of those aged 25 to 34. With regard to their academic qualifications, a significant proportion of the participants held a Bachelor's degree (57.1%), whereas 28.6% possessed a Master's degree or higher. The sample consisted of individuals from various business sectors, with the service industry comprising the largest proportion (38.1%). The demographic data presents significant insights regarding the composition of the sample and aids in the interpretation of the study's findings.

### 3.2 Measurement Model Results

The results of the measurement model are displayed, encompassing composite reliabilities, factor loadings, and the Average Variance Extracted (AVE). The dependability and accuracy of every latent construct and its corresponding indicators are examined.

Table 1. Measurement Model Values

Variable	Items	Code	Loading Factor	Outer VIF
Market Microstructure	Cronbach's Alpha = 0.826, Composite Reliability = 0.866, AVE = 0.663.			
	1. In my opinion, there has been an efficient interaction between business actors in the market micro around my MSME business.	MM.1	0.788	2.194
	2. Information on business opportunities and business opportunities and risks in the market micro is easy for me to access.	MM.2	0.866	2.382
	3. I think there has been level of competition among MSMEs in market micro around my business.	MM.3	0.887	1.865
	4. Changes in the market microstructure that may affect my MSME business.	MM.4	0.768	2.764
	5. In my opinion, there is level of trust between business actors in the market microstructure.	MM.5	0.822	2.267
Sharia-compliant Financing (SCF)	Cronbach's Alpha = 0.857, Composite Reliability = 0.892, AVE = 0.625.			
	1. I currently use Islamic financing as a source of funding.	SF.1	0.789	1.694
	2. In my opinion, the factors of compliance with sharia principles, competitive interest rates, ease of access and reputation of Islamic institutions most influence my decision to choose Islamic financing.	SF.2	0.821	2.111
	3. I am very familiar with the principles of Islamic financing.	SF.3	0.840	2.178
	4. I have trust in financial institutions that provide Islamic financing.	SF.4	0.945	1.750
	5. Are there any specific challenges such as complicated application process, higher interest rate or limited information that I face in using Islamic financing.	SF.5	0.831	2.348
SMEs Performance (SMEP)	Cronbach's Alpha = 0.904, Composite Reliability = 0.925, AVE = 0.699.			
	1. I assess the good financial performance of your MSME over the past 12 months.	MP.1	0.853	2.180
	2. My SMEs managed to maintain or increase their market share in the period.	MP.2	0.894	1.674

3. I saw growth in the number of customers or clients over the past year.	MP.3	0.736	2.765
4. My SME's marketing strategy has proven effective in increasing visibility and presence in the market.	MP.4	0.826	1.543
5. The level of customer satisfaction with the products or services offered by my SMEs.	MP.5	0.837	2.012
6. My SMEs has successfully maintained or improved the quality of its products or services over the past year.	MP.6	0.778	2.632
7. I assess the operational efficiency of your SMEs in resource management and business processes.	MP.7	0.763	2.487
8. My SMEs has been successful in responding to market changes and business competition.	MP.8	0.868	1.793

Source: Data processed by the author (2023)

The results of the measurement model indicate that all latent constructs—six inquiries regarding market microstructure, six inquiries regarding Islamic financing, and eight inquiries regarding MHM performance—are reliable and valid. As suggested by Hair (2019), all significant factor loadings exceed 0.7, signifying that the factor loadings satisfy the SEM-PLS criteria for validity and reliability. Furthermore, the constructs exhibit Cronbach's alpha values exceeding 0.7, consistent composite reliability surpassing 0.8, and high average variance exceeding 0.5. These results substantiate the measurement model's robustness and conformity with the SEM-PLS validity and reliability criteria. Furthermore, questionnaire items are assessed using an outer VIF that is free from multicollinearity. As stated by Hair (2019), symptoms of multicollinearity are deemed absent if the value does not surpass 3.00. The findings of this investigation consistently indicate that the outer VIF remains below 3.00.

### 3.3 Structural Model Results

In order to evaluate the outcomes of the structural model, bootstrapping is performed with a focus on the path coefficient and its importance. Based on Hair's (2019) findings, a t statistical value surpassing 1.96 indicates reliability. The results of this research hypothesis are presented in Table 2.

Table 2. Research Hypothesis Results

Hypothesis	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T-statistic	p-Values	Results
MM -> SCF	0.427	0.417	0.084	5.673	0.000	Supported
SCF -> SMEP	0.348	0.338	0.094	4.219	0.000	Supported
MM -> SMEP	0.318	0.309	0.101	2.984	0.001	Supported

Source: Data processed by the author (2023)

The primary objective of this research endeavor is to examine the correlation between Shariah-compliant financing (SCF), market microstructure (MM), and the performance of small and medium enterprises (SMEs) in Indonesia. By examining the original sample statistics, such as means, standard deviations, t-statistics, and p-values, conclusions regarding the support or absence thereof for each hypothesis could be drawn. Empirical evidence strongly supports the hypothesis that a positive correlation exists between Market Microstructure (MM) and the adoption of Shariah-compliant Financing (SCF). Strong support was given to the hypothesis positing a positive correlation between Shariah-compliant financing (SCF) and the performance of small and medium-sized enterprises (SMEP). The data further corroborated the hypothesis that examined the correlation between Market Microstructure (MM) and Small and Medium Enterprise Performance (SMEP).

The data strongly support Hypothesis (1), which posits that Market Microstructure (MM) positively influences Sharia-compliant Financing (SCF). The t-statistic value of 5.673 is deemed to be highly significant ( $p < 0.001$ ), suggesting that,

according to the null hypothesis, there is a substantial difference between the original sample mean and the sample mean. This implies that there is a significant correlation between Market Microstructure and the probability that Small and Medium Enterprises will implement Sharia-compliant financing. Strong support exists for Hypothesis (2), which states that Sharia-compliant financing (SCF) positively correlates with the performance of small and medium-sized enterprises (SMEP). Based on the t-statistic value of 4.219 ( $p < 0.001$ ), it can be concluded that small and medium-sized enterprises (SMEs) that implement Sharia-compliant financing generally achieve substantially superior performance outcomes in comparison to those that do not utilize these financing methods. Additionally, support is found for Hypothesis 3, which investigates the correlation between Market Microstructure (MM) and Small and Medium Enterprise Performance (SMEP). With a t-statistic value of 2.984, which is statistically significant ( $p = 0.001$ ), it can be concluded that an enhanced SME performance is associated with a favorable market microstructure.

### 3.4 Model Fit

In order to evaluate model fit in Structural Equation Modeling (SEM), a number of fit indices and statistical measures are utilized. The chi-square test of model fit ( $\chi^2$ ) is a commonly employed method for evaluating the discrepancy that exists between the expected and observed covariance matrices. A value of 0.95 on the Comparative Fit Index (CFI), which compares the fit of the null model to the hypothesized model, signifies a satisfactory fit. The Root Mean Square Error of Approximation (RMSEA) quantifies the discrepancy per degree of freedom; an acceptable approximation is denoted by a value of 0.07. The SRMR, which measures the average absolute difference between predicted and observed correlations, is a metric used to assess the quality of a fit. A value of 0.06 signifies a satisfactory fit. While the chi-square test has the capability to generate statistically significant p-values, the support of the other fit indices indicates that the SEM fits the data well.

To determine the predictive accuracy and explanatory power of the Structural Equation Model, the coefficient of determination ( $R^2$ ) and predictive relevance ( $Q^2$ ) were computed. The  $R^2$  values suggest that the exogenous latent constructs in the model account for 42% of the variance in SME Performance (SMEP) and 56% of the variance in Sharia-compliant Financing (SCF). Moderate to substantial levels of explanatory power are denoted by these values. With 45% of the variance in Sharia-compliant Financing (SCF) and 38% of the variance in SME Performance (SMEP) accurately predicted out of the sample, the  $Q^2$  values indicate that the model has good predictive relevance. The model demonstrates robustness in predicting the dependent variables, as evidenced by these values.

### 3.5 Discussion

The intricate interplay among market microstructure, Sharia-compliant financing, and SME performance in Indonesia is highlighted by the empirical findings. Consistent with expectations, the adoption of Sharia-compliant financing is positively impacted by market microstructure, highlighting the significance of market conditions in determining the financing decisions of SMEs. This finding aligns with prior investigations. The negative correlation between market microstructure and SME adoption of Sharia-compliant financing suggests that market conditions play a significant role in determining the financing options of these companies (Adewiyah & Bawono, 2023). Additionally, Study (Addury, 2023) underscores the significance of taking into account the distinct attributes of the Islamic banking sector in each respective country during the development of financing strategies. Furthermore, (Febriandika et al., 2023) the ability to implement financial technology and (Febriandika et al., 2023) financial literacy positively impact the sustainability of small and medium-sized

enterprises (SMEs) in Indonesia. Small and medium-sized enterprises (SMEs) may be able to increase their financial resources and enhance their strategies by implementing financial technology and fostering financial literacy. In summary, this research emphasizes the significance of financial literacy, market conditions, and financing models in determining the viability and performance of small and medium-sized enterprises (SMEs) in Indonesia.

The substantial influence of Shariah-compliant financing on the performance of small and medium-sized enterprises (SMEs) provides further evidence for the economic feasibility and favorable consequences linked to the observance of Islamic financial principles. The results of this study carry significance for policymakers and financial institutions that aim to foster the sustainable expansion of small and medium-sized enterprises (SMEs) by means of Shariah-compliant financing initiatives. Multiple studies have substantiated the correlation between Shariah-compliant financing and the performance of small and medium-sized enterprises (SMEs). The operational efficiency of Islamic institutions in Bangladesh has been exemplary, with greater liquidity risk resulting in superior efficiency scores (Chowdhury et al., 2023). CAR, FDR, and inflation all have a substantial adverse impact on non-performing financing in Indonesia (Iswanto, 2022), whereas GDP and Mudharabah Financing have a substantial positive influence. NPF moderates the positive impact of PLS and non-PLS financing on the profitability of Islamic rural banks (Hidayah & Karimah, 2023). Non-performing loans are impacted differently by various Islamic banking financing instruments, with Murabahah having a negative impact and Ijarah, Mudharabah, and Musyarakah having positive impacts (Fitri Komariyah & Mulyono, n.d.). Islamic intellectual capital and corporate social responsibility exert a substantial positive influence on the performance of Islamic maqashid, whereas the Islamic performance index does not demonstrate a statistically significant impact. The impact of Islamic intellectual capital and Islamic corporate social responsibility on maqashid sharia performance may be moderated by corporate governance (Izzah et al., 2023). The implications of these results extend to policymakers and financial institutions seeking to promote the sustainable expansion of small and medium-sized enterprises (SMEs) via sharia-compliant financing endeavors.

Furthermore, the correlation between market microstructure and SME performance indicates that an opportune market setting not only promotes the implementation of Shariah-compliant financing, but also significantly enhances the overall performance of SMEs. This finding underscores the significance of a conducive market framework for the prosperity of small and medium-sized enterprises (SMEs) in Indonesia, which is consistent with prior research (D'souza et al., 2022; Febriyantoro et al., 2023; Fikri & Firmansyah, 2022).

The impact of Sharia-compliant financing, which indicates that the relationship between financing options and performance may vary by SME scale. These insights can guide customized interventions and support mechanisms for SMEs of different sizes.

### 3.6 Practical Implications

The practical implications of the study's findings extend to policy makers, financial institutions, and SMEs proprietors. Recognizing the significance of market conditions in shaping financing decisions underscores the necessity for focused interventions aimed at enhancing market microstructure components that are favorable to Shariah-compliant financing. By applying these insights, policymakers can develop regulations and incentives that promote the establishment of an environment that facilitates the adoption of Shariah-compliant financing by SMEs.

The performance of small and medium-sized enterprise (SME) proprietors can be enhanced by Shariah-compliant financing, particularly in the service sector. By applying these findings, financial institutions that specialize in Islamic financing can customize

their offerings and services to align with the unique requirements of small and medium-sized enterprises (SMEs), thus cultivating symbiotic partnerships.

### 3.7 Limitations and Future Research Directions

Although this study yielded valuable insights, it is not without its limitations. Despite being meticulously calculated, the sample size might not encompass the complete range of diversity present in the SME sector of Indonesia. Self-reporting bias may also compromise the precision of responses. Subsequent investigations may overcome these constraints through the incorporation of a more extensive and heterogeneous sample, the implementation of a longitudinal design, and the examination of supplementary contextual elements that might impact the correlation between Shariah-compliant financing, market microstructure, and SME performance.

## 5. CONCLUSION

In summary, this research provides significant contributions to the understanding of the interplay between Shariah-compliant financing and market microstructure as they pertain to Small and Medium Enterprises (SMEs) in Indonesia. Structural Equation Modeling with Partial Least Squares (SEM-PLS) empirical analysis has uncovered significant correlations between SME performance, financing decisions, and market conditions. The results underscore the significant impact that favorable market microstructure has on the extent to which small and medium-sized enterprises (SMEs) employ Shariah-compliant financing, which ultimately results in enhanced performance outcomes. This study has practical ramifications for financial institutions, policymakers, and SME proprietors. These insights can be employed by policymakers to develop regulations and incentives that promote an environment that is favorable to Shariah-compliant financing. The products and services of financial institutions specializing in Islamic finance can be tailored to the particular requirements of SMEs. Recognizing the potential positive effects that Shariah-compliant financing options may have on the overall performance of a business, SME proprietors are encouraged to investigate them. Notwithstanding its merits, this research possesses certain constraints, including a small sample size and the possibility of self-reporting bias.

Further investigation in this area may be warranted through the implementation of a longitudinal design and the utilization of a larger, more diverse sample, in order to enhance the generalizability of the results. Furthermore, a more comprehensive examination of distinct market microstructure components and their varying effects on small and medium-sized enterprises (SMEs) in various sectors could enhance our comprehension of this intricate correlation. This research aims to fill a void in the current body of knowledge by examining the correlation between Shariah-compliant financing, market microstructure, and the performance of small and medium-sized enterprises (SMEs) in Indonesia. In the context of Indonesia's dynamic economy, these insights serve as a fundamental basis for well-informed decision-making, thereby bolstering the expansion and long-term viability of small and medium-sized enterprises (SMEs).

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