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(AICIF)

VOLUME 1

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CONTENT

PREFACE

بسم الله الرحمن الرحيم

السلام عليكم ورحمة الله وبركاته

The 5TH ASEAN'S INTERNATIONAL CONFERENCE ON ISLAMIC FINANCE (AICIF) was jointly organized by Universiti Islam Sultan Sharif Ali and Co-partners (Universiti Islam Antarabangsa, Malaysia; Universitas Islam Negeri Sunan Kalijaga, Jogjakarta, Indonesia; Universitas Islam Sultan Agung, Semarang, Indonesia; Universitas Darussalam Gontor, Indonesia; Mindanao State University of Philippines; Universiti Fatoni, Thailand) convened at Parkview Hotel, Jerudong, Brunei Darussalam on 13-14 December 2017. The conference centred on six sub-topics, namely, capital market, compliance and governance, Islamic banking, Islamic social finance and Islamic economics.

The 5th AICIF was guided by the three pillars under the vision of ASEAN: A Community of Opportunities that are, ASEAN Political-security Community, ASEAN Economic Community (AEC) and ASEAN Socio-cultural Community. AEC envisions ASEAN as a single market and production base, a highly competitive region, with equitable economic development, and fully integrated into the global economy. AEC can be realized, if ASEAN moves towards free movement of goods, services, and investments as well as freer flow of capital and skills. A free movement of services means that Islamic finance has an important role in realizing such goals.

The discussion on capital market highlighted the instruments that are traded in those market such as mutual funds, shares and sukuk. The discussion also highlighted that capital markets are increasingly interconnected in a globalized economy.

The sub-theme on compliance and governance raised the issues of having a good governance and a complaint based Islamic financial institutions. Both are important to have an impact on the transparency of the guidelines and the performance of Islamic financial institutions.

There are several issues that were reported by several papers in this conference on Islamic banking. Among the issues are: the future demand for Shariah-compliant financial services which remains bright, an effort to establish a complete set of eco-system in Islamic finance that comprises halal products and services, green environment and maqasid shariah, bridging Islamic financial literacy and halal literacy: The way forward is to create a Halal Ecosystem.

The discussion on Islamic social finance covered three main instruments namely waqf, zakat and microfinance. These instruments were recognized as tools to help in realizing the objectives of socio-economic development. The sub-theme on Islamic economics mooted the idea that Islamic finance leads to development. Islamic finance had grown in response to demand or supply. Both might boost the development of Islamic finance (e.g. demand for Islamic financial services and supply of funds for helping the economic development).

Abdul Ghafar Ismail and
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Chief Editors

ISLAMIC FINANCIAL INCLUSION: SUPPLY SIDE APPROACH

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ABSTRACT

Financial inclusion becomes an interesting factor to be studied nowadays, because financial inclusion is one of the determinants of success of SMEs in obtaining capital for business development. SMEs can be a container to drive the real sector, because the majority of business units in Indonesia is SME, but SMEs have capital constraints that can not develop properly. Therefore, this study aims to analyze the level of inclusion of Islamic finance for SMEs, as well as the level of profit loss sharing and non-performing loans for SMEs. The population in this study are all financial statements of Sharia Commercial Bank and Sharia Business Unit in Indonesia. The sample is the financial report of Sharia Commercial Bank and Sharia Business Unit from 2014-2016. Data analysis was conducted using descriptive analysis. Financial inclusion in this case is viewed from the supply side (supply side), namely the amount of financing disbursed to SME and non-SME the level of profit sharing, and problematic financing experienced by SME and non-SME. The results show that the level of inclusion of Islamic finance for SME in Indonesia is quite high but majority still use murabahah (buy-sell) contract in which the involvement of SME in moving the real sector is not maximized, SME financing rate is higher than non-SME financing and non-performing financing for SME is higher than non-SME financing.

Keywords: Islamic Financial Inclusion; Small Medium Enterprise; Profit-Loss Sharing and Non-Performing Financing

Introduction

Poverty is an unresolved problem up to now. Various efforts have been made by the government, but have not shown significant results. Based on BPS data 2015, the number of poverty in Indonesia has reached to 28.51 million people (11.13 percent). One effort to reduce poverty is through the empowerment of MSMEs, because the majority of business units in Indonesia is SMEs. BPS data 2015 shows that the number of MSMEs in Indonesia is recorded at 57.9 million business units, or about 23.2 percent of the total population of Indonesia which amounts to 250 million people. In addition, 97% of the employees in Indonesia are absorbed in the sector of MSMEs which is able to contribute 60% of Gross Domestic Product. If MSMEs can be optimally empowered, then it means poverty can be lowered, and job opportunities can be improved.

But in reality, the performance of some MSMEs has slow development. This is due to various unresolved classic problems to date, especially capital or financing issues, making it difficult for SMEs to compete with large companies (Abor and Quartey, 2010). Therefore, in order for MSMEs to compete, MSMEs need to be made easier to get capital with affordable cost.

Sharia banking is an intermediary institution that collects funds and distributes community funds based on sharia principles. The availability of financial institutions such as banking can be a major factor in the development, growth and success of MSMEs (Ou & Haynes, 2006; Cook, 2001). The presence of sharia banking as a solution to alleviate capital difficulties for MSMEs through murabaha, mudharaba, musyarakah contract, and qordhul hasan contract. This is very reasonable because sharia banks apply contracts of sale and purchase and profit sharing and not interest, so as not to burden MSMEs' customers. The involvement of MSMEs in financing and its management is very high, so it can encourage its business to develop well. The attractiveness of SMEs to sharia banks depends on the level of financial inclusion of MSMEs to sharia banks. Financial inclusion is the availability of access for SMEs to utilize the products and / or financial services owned by sharia banking to encourage their business development. Therefore, encouraging researchers to analyze how the inclusion of sharia finance for MSMEs and NON-MSMEs in Indonesia.

LITERATURE REVIEW

Sharia Financial Inclusion for MSMEs

The definition of financial inclusion is very varied. The Global Financial Development Report (2014) defines that Financial Inclusion as "the proportion of individuals and firms that use financial services has become a subject of considerable interest among policy makers, researchers and other stakeholders". Meanwhile, financial inclusion according to the World Bank is an activity that aims to minimize price constraints and physical access in using the services and financial institution services, including accessing to credit, saving and other banking services. Financial inclusion according to OJK (2016), is the availability of access for MSMEs to utilize financial products and / or services in financial services institutions in accordance with the needs and characteristics of MSMEs, so as to compete globally. The purpose of financial inclusion is: a. To improve MSMEs access to financial institutions, products and services offered by sharia banking institutions, b.

Improving banking financial services; and c. Increasing the benefits of banking products and services used by MSMEs. The function of financial inclusion according to OJK (2016), among others: a. To plan, organize and implement financial inclusion; b. To monitor and evaluate public access to financial institutions. c. To innovate skim products, banking services and non-banking services in accordance with the needs and character of MSMEs as customers.

MSMEs access to sharia banking is viewed from two sides, namely from the demand side and from the supply side. From the demand side, among others are the level of MSMEs literacy, income level, preference of MSMEs in conducting financial transactions through banking and non-banking, as well as cultural factors. As for the supply side, among others are factors of the scope of Islamic banking services, administrative procedures that are easily accessible to MSMEs, financial products that fit the characteristics of MSMEs, the level of profit sharing, the cost to use sharia banking products and services, as well as easy access to loan repayment for MSMEs, and the absence of non-performing loans for MSMEs.

Several indicators that can be used as measures of financial performance of inclusion according to Bank Indonesia, among others: a). Access Availability: Measuring the ability of MSMEs in using sharia banking products and services as well as profit sharing on mudharaba, musharaka or murabaha financing. b). Usage: meaning financial inclusion is done by measuring the amount and variety of sharia banking products and services used by MSMEs. c). Quality: this is done by measuring whether the components of sharia banking products and services have met the needs of MSMEs. This is very reasonable because MSMEs have several characteristics, among others: the location spreads across regions in Indonesia, even to rural, non-bankable MSMEs, MSMEs which are generally owned by family (family business). d). Welfare: the extent to which sharia banking loan funds can improve the performance of MSMEs. Thus, with the increased access to finance, it can ease access to capital so that MSMEs can compete globally.

The Six Pillars of Financial Inclusion

Pillar 1 Financial Education.

Aiming to increase public knowledge and awareness about the products and services offered by bank and non-bank financial institutions, understanding of risk management, understanding and intelligence in financial management.

Pillar 2 Public Financial Facility

The role of government is needed to provide financing assistance for MSMEs so that the real sector will run optimally. The assistance can be KUR (Business Credit for People), mentoring and monitoring of MSMEs activities.

Pillar 3 Financial Information Mapping

This pillar aims to improve the ability and the capacity of MSMEs in accessing banking and non-banking, so it will be easier to recognize which MSMEs are bankable or non-bankable, and identify potential customers according to customer characteristics so as to facilitate sharia banking in providing services to MSMEs.

Pilar 4: Policy/Supported Regulation.

The implementation of an inclusive financial program requires policy support by both the government and Bank Indonesia to improve access to financial services. The initiatives to support these pillars include these followings: a) Policies to encourage the socialization of financial services products in accordance with the needs of the community, b) developing product scheme which is appropriate to the needs of the community, c) encouraging changes of provisions while maintaining prudential principles proportionally) drafting mechanism of regulation for channeling relief funds through banks, e) strengthening the legal basis to enhance consumer protection of financial services, f) developing inclusive finance-related studies to determine the policy direction sustainably.

Pillar 5 Intermediation Facility and Distribution Channel.

Aiming to raise awareness of financial institutions about the existence of potential segments in the community and to extend the reach of financial services by utilizing alternative distribution methods. Some aspects of this pillar include: a) facilitating intermediation forums by bringing together financial institutions with productive (viable and unbanked) community groups to address asymmetric information issues; b) enhancing cooperation among financial institutions to increase business scale; c) exploring several possible products, service, services and innovative distribution channels while still paying attention to prudential principles.

Pillar 6 Consumer Protection.

Aiming for the public to have a guarantee of security in interacting with financial institutions in utilizing the products and services of financial services offered. The components on this pillar include: a) product transparency, b) handling customer complaints, c) mediation, d) consumer education.

The six pillars are further elaborated into programs that have been adapted to the category of population undertaken by Bank Indonesia and the relevant Ministries. Some examples of the programs that are being done are as follows:

Sharia Bank Financing Contract

There are several sharia bank financing contracts, among others: Mudharaba is a transaction agreement, in which sharia banks as owners of capital lend funds as capital to MSMEs that act as fund managers. The compensation is in the form of profit-sharing. It means if the business gets profit, then the profit will be divided for the banks and MSMEs according to the agreement of both parties. However, if the business suffers losses then the banks must bear all the losses, while MSMEs get nothing from the management of these funds. the mudharaba contract is aimed in order to run a business, trade or jihad in the way of Allah, as the word of God in the sorah Al-Muzzammil, verse 20.

Murabaha is a trading contract in which sharia bank as a seller, while MSMEs as a buyer, with margin as a consequence. Margin is the difference between the selling price and the purchase price. The delivery of goods in the sale and purchase of murabaha is done at the time of the transaction, while the payment made by MSMEs is by installments. In Islam, buying and selling as a means of helping to help between fellow human beings approved by Allah SWT. "Allah have justified sellings and buyings and forbiden usury".

According to Syamsuddin (Ihsan, 2011), there are several reasons why murabahah contract is very popular in sharia banking operations; first seen from the side of sharia banks that short-term investment is quite easy, benefits derived from the mark up can be determined and ascertained, and away from the uncertainty and minimization of the risks existing in profit sharing system; secondly seen from the customer side, murabaha does not allow sharia banks to interfere with business management.

Musharaka is a contract in which sharia banks and MSMEs are both as shohibul maal, and both get a profit share or bear the loss according to the agreement.

METHOD OF THE STUDY

This is a descriptive study that describes how the level of financial inclusion for MSMEs toward Sharia Banks. The population in this study were all financial statements of Sharia Commercial Bank and Sharia Business Unit in Indonesia. Sampling technique was done by purposive sampling, obtaining the data of sharia banking report 2014-2016. Data analysis was conducted using descriptive analysis through some analysis, among others: a). What level is the proportion of Islamic bank financing for the contracts: mudharaba, musharaka, or murabaha, b). What level is the proportion of sharia bank financing for MSMEs and non MSMEs? This is as an indicator of the level of financial inclusion of MSMEs to Sharia Banks from the Supply Side. c). What is the level of Non-Performing Financing for both MSMEs and non MSMEs. d). What level is the profit-sharing income for financing: mudaraba, musharaka, or murabaha.

FINDINGS AND DISCUSSION

Sharia banking as an intermediary institution that connects between the receipt of funds and the distribution of funds with sharia principles. To assess the level of inclusion (access) of MSMEs to sharia banking, it can be measured by: among others: a). What level is the proportion of sharia bank financing for the contracts: mudharaba, musharaka, murabaha. b). What level is the proportion of sharia bank financing for MSMEs and non MSMEs? c). What is the level of Non-Performing Financing for both MSMEs and non MSMEs? d). What level is the profit-sharing income for financing: mudharaba, musharaka, and murabaha.

a). **The Level of Proportion of Sharia Bank Financing for the Contracts: mudharaba, musharaka, murabaha, and Qard.**

Table 1: Sharia Bank Financing

	2014	2015	2016
1. Profit Sharing Financing a. Financing to Non-Bank Customers			
Mudharaba	14.354	14.820	14.643
Musharaka	49.336	60.713	66.731
b. Financing to other banks			
Mudharaba	695	878	912
Musharaka	142	103	106
2. Credit a. Credit for non-bank			
Murabaha	117.371	122.111	128.624
Qard	5.965	3.951	3.951
b. Credit for Bank			
Murabaha	9	7	20
Qard	0	0	1

Source : Sharia Banking Statistic, 2016

Table 1 shows that both on profit sharing and receivable financing, the results indicated that the Murabahah contracts dominate the sharia banking portfolio in 2014-2016 with a value of 117,371; 122.111; 128,624 and Qard 5,965, 3,951 and 3,951 which are higher than financing to bank customers in 2014-2016 for Mudharabah contract amounting to 14,354, 14,820 and 14,643, while Musharaka contracts in 2014-2016 was amounted to 49,336; 60,713; and 66.731. But for Murabahah financing to banks in 2014-2016, it was amounted to 9, 7, 20 and Qard of 0, 0, and 1 where the value is smaller than the financing to other banks where financing Mudharabah 2014-2016 year of 695,878, and 912. The same is true with Musharaka financing in 2014-2016 which was amounted to: 142, 103, and106. The results show that sharia banks have been actively involved in financing real sectors through MSMEs reflected in musharaka, mudaraba and murabaha financing to non-bank customers with greater value than bank customers. However, in majority of either financing to non-bank customers or banks, murabaha financing was the majority, compared to mudharaba and musharaka financing.

Murabaha contract is more interesting than Mudharaba and Musharaka. The reasons are: a) Murabaha which is a trading contract is easy to understand and easier to calculate, so it is in demand by sharia banking and customers, b). The risk of murabaha is lower than mudharaba and musharaka. c). Islamic banks take role as intermediary institutions that have the task of raising funds and channeling funds to the community. As a party trusted by the customer, Islamic banks should be able manage funds customers to be channeled to MSMEs whose use is to improve the performance of MSMEs.

In fact, the contract of mudharaba and musyarakah is a contract that can move MSMEs according to the missions of sharia banks, because both contracts involve both parties in managing business and responsible if the business has risk, but the value is very small.

Table 2: Profit Sharing Revenue for Sharia Banks

	2014	**2015**	**2016**
Distributed Financing	21.976	24.977	7.335
Profit Sharing Revenue			
Mudharaba	1 .723	1.890	752
Musharaka	4 .657	5 .633	3.672
Credit Revenue			
Murabaha	14.128	15.773	8915
Ujroh	205	373	199
Istisna	76	92	56

Source: Sharia Banking Statistic, 2016

Table 2 shows that financing distributed by sharia banks in 2014 amounted to 21,976 and increased in 2015 by 24,977. However, the decline happened in 2016 which only amounted to 7,335. Meanwhile, Mudharaba revenues amounted to 1,723, 1890, and 752. Musyaraka revenues amounted to 4,657, 5,633 and 3,672. Murabaha revenues in 2014-2016 amounted to 14,128, 15,773, and 8915, Ujroh of 205, 373, and 199. While Istisna revenues of 76, 92 and 56. This means that murabahah revenue, during 2014-2016 was greater than mudharaba or musharaka revenues.

Table 3: Financing and Non-Performing Credit

	2014	**2015**	**2016**
Mudharaba	14354	14820	14643
NPF	519	323	360
	0,0362	0,022	0,025
Musharaka	49336	60713	66731
NPF	2844	3091	3347
	0,058	0,051	0,050
Murabaha	117371	122.111	1.543.491
NPF	4844	5502	7576
	0,041	0.045	0.049

Source: Sharia Banking Statistic, 2016

Table 3 shows that the highest Non-Performing Financing or Non-Performing Credit in 2014 was in musyarakah contract compared to mudharabah and murabahah contracts. Where the the value of NPF of musyarakah contract in 2014 was 0,058, while non-performing credit for murabaha equaled to 0,041, while mudharaba was 0,0362. Similarly, the same is true with non-performing credit in 2015-2016, where musharaka financing had the highest risk of non-performing credit compared to murabaha and mudharaba financing. It is interesting that mudharaba financing has the lowest Non Performing Financing or non-performing credit value during 2014-2016 compared to murabaha or musharaka financing with the values (0.0362, 0.022, 0.025) <(0.041, 0.045 and 0.049 and 0.058, 0.051 and 0.050). These results indicate that sharia banks have been able to manage the risks of mudharaba financing well.

Table 4: MSMEs-Non MSMEs Financing and Non Peforming Credit (NPF)

	2014	2015	2016
UMKM	40.205	33.382	31.149
NPF	2.839	2.275	2.409
NPF/UMKM	0,071	0,068	0,077
BUKAN UMKM	37.729	46.567	47.286
NPF	1.904	2.643	2.860
NPF/NON-UMKM	0,050	0,057	0.0605

Source: Sharia Banking Statistic, 2016

Table 4 shows that the financing of sharia banks to MSMEs from 2014-2016 decreased with the value of 40,205, 33,382, 31,149. The financing of sharia banks to NON-MSMEs from 2014-2016 increased by 37.727, 46, 567 and 47, 286. However, if compared with the role of sharia banking financing to MSMEs, the value of sharia banking financing to MSMEs was larger than NON-MSMSe in 2014-2016 with the value of 40,205, 33,382, 31,149 which are greater than 37,727, 46, 567 and 47, 286. The value of non-performing credit or NPF MSMEs in 2014-2016 increased by 0.071 0.068 0.077, but the value of non-performing credit or NPF MSMEs in 2014- 2016 was getting down with the values of 0.050, 0.057 and 0.0605.

These results indicate that the level of financial inclusion for MSMEs toward sharia banks for MSMEs is decreasing, and the role of sharia banks to empower real sectors is also decreasing. The risk of non-performing credit for MSMEs is higher than non-MSMEs.

Table 5: Average Margin Rate on Sharia Banking Financing

Average Margin	**2014**	**2015**	**2016**
Working Capital			
MSMEs	19,95	19,52	19,28
Non MSMEs	15,27	12,27	11.39
Investment			
MSMEs	15,07	16,00	14,99
Non MSMEs	13,56	11,74	10,85
Consumption (Non MSMEs)	11,93	12,56	11,78

TingkSSumbeS
Source: Sharia Banking Statistic, 2016ta PembiayaaTi

Table 5 shows that the average margin rate of working capital and investment of 2014-2016 disbursed to MSMEs was higher than the average margin rate of working capital and investments disbursed to Non-MSMEs. This means that the income received from sharia banks and MSMEs of working capital and investment financing through sharia banking in fact is higher than the average margin of non MSMEs. This also means that the working capital disbursed by sharia banks to MSMEs has good prospects for both parties. Financial inclusion can benefit both parties, both banking and MSMEs.

Table 6: MSMEs-Non MSMEs Financing and NPF Credit
Tingkat Margin Rata-rata Pembiayaan

	2014	**2015**	**2016**
WORKING CAPITAL			
MSMEs	33.904	26.650	26.871
NPF	2.446	1.808	1.997
NPF/ MSMEs	**0,072**	**0,067**	**0,0735**
NON MSMEs	28.730	36.990	25.157
NPF	1.735	2.076	2.100
NPF/ NON MSMEs	**0,060**	**0,056**	**0,083**

Source: Sharia Banking Statistic, 2016

Table 6 shows that the proportion of funds disbursed to MSMEs is greater than Non-MSMEs, meaning that the level of financial inclusion for MSMEs towards Islamic banks is high. This is shown by the data that working capital to MSME in 2014 amounted to 33,904 which is larger than financing to non-MSMEs which only amounted to 28,730. It also means that sharia banks have been very responding to capital needs for the development of MSMEs in Indonesia. However, the risk of non-performing credit for financing of MSMEs in 2014 was greater than for non-MSME financing. The same is true for financing of SMEs in 2015 and 2016.

CONCLUSION

In general, this study concludes that: a). The level of financial inclusion for MSMEs towards Islamic banks is higher than NON-MSMEs, but majority is disbursed into financing by murabahah scheme rather than mudharaba or musharaka. This is indicated by the majority of sharia banking funds to empower the real sector through MSMEs.
c). The average margin rate of working capital and investment of 2014-2016 disbursed to MSMEs is greater than the average margin level of working capital and investment disbursed to Non-MSMEs. This means that the benefits for both sharia banks and MSMEs both working capital and investment financing are higher than Non-MSMEs.
d). The proportion of funds disbursed to MSMEs is higher than Non-MSMEs in 2014-2016, meaning that the level of financial inclusion of Supply Side for MSMEs is higher than NON-MSMEs and other sectors. This means that the concern of sharia banks to channel funds to MSMEs is higher than other sectors. However, the risk of non-performing credit for MSMEs financing 2014-2016 is greater than non-MSMEs financing.

LIMITATION AND SUGGESTION

There are several limitations in this study, among others are: a). This study only measures the level of supply-side literacy, so that future research can be developed for the demand side of inclusion. b). The level of non-performing credit is dominated by MSMEs financing and therefore it requires financial literacy, education, and mentoring for MSMEs, and more effective monitoring so that loan funds can be allocated to develop their business better. c) The data used in this study were only secondary data, to sharpen the analysis, it needs to be developed with a questionnaire addressed to MSMEs as well as to sharia banking. Thus, this study can be developed by knowing the financial inclusion both supply and demand side, so the result will be better. d). The design of this study is descriptive research, so that future research can be developed with qualitative and quantitative research.

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