El-kahfi: Journal Of Islamics Economics
ejournal.mannawasalwa.ac.id/index.php/elkahfi

Islamic Financial Inclusion and the Empowerment of Micro Enterprises in Remote Regions

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Article Information:
Received Februari 20, 2025
Revised Maret 24, 2025
Accepted Maret 29, 2025

Keywords: *Islamic Finance, Microenterprises, Financial Inclusion, Sharia Contracts, Rural Development*

Abstract

This study explores the role of Islamic Financial Institutions (IFIs) in enhancing access to microenterprise financing in rural Indonesia through a qualitative literature review approach. Drawing on 25 peer-reviewed sources published between 2019 and 2024, the research identifies four key dimensions: institutional outreach, rural access barriers, effectiveness of sharia contracts, and integration of social and digital finance. Findings reveal that although IFIs have grown significantly in terms of assets and regulatory structure, their inclusion strategies remain inadequate for rural populations. Sharia-based contracts like mudharabah and musyarakah are underutilized due to operational complexities and lack of financial literacy. Moreover, the integration of zakat and other social finance tools with digital platforms is still fragmented. The study emphasizes that Islamic finance must move beyond formal compliance toward ethical inclusivity by addressing structural, behavioral, and technological barriers. The research concludes that achieving maqashid shariah in microfinance requires institutional reform, cross-sector collaboration, and a renewed commitment to justice, transparency, and community empowerment.

How to cite:	Meili Mahera, R., Ilham, M., & Albahi, M. (2025). Islamic Financial Inclusion and the Empowerment of Micro Enterprises in Remote Regions. El-Kahfi | Journal of Islamic Economics, 6(01), 183-196. https://doi.org/10.58958/elkahfi.v6i01.491
E-ISSN:	2722 – 6557
Published by:	Manna wa Salwa College of Islamic Economics, Tanah Datar, West Sumatra, Indonesia

INTRODUCTION

In recent years, the growth of Micro, Small, and Medium Enterprises (MSMEs) in Indonesia has shown a significant upward trend, particularly in informal sectors located in remote areas. However, many micro-entrepreneurs still face difficulties in accessing formal financing aligned with Islamic financial principles (Fitriani & Laily, 2024; Ramadhan & Sukmana, 2020). According to Statistics Indonesia (BPS, 2022), more than 64% of MSMEs in rural areas do not have direct access to formal financial institutions. This indicates a serious disparity in financial inclusion between urban and rural regions (Khusnul & Wira, 2021; Maryam & Irwan, 2020). As a result, rural MSMEs tend to rely on informal lenders, exposing them to high-interest risks.

This access limitation is exacerbated by low levels of financial literacy, particularly in understanding Islamic financing schemes among rural communities (Santi Arafah, 2023; Hidayatullah et al., 2019). The public often associates financing with interest-based systems, thus expressing reluctance even when the services are sharia-compliant. According to the 2022 National Survey on Financial Literacy by OJK, only 36% of people outside Java understand basic Islamic finance principles. Meanwhile, institutions like Bank Syariah Indonesia (BSI) and various Islamic microfinance institutions have started offering digital-based services since 2021 (Nengsih, 2023; Norrahman, 2023).

Islamic Financial Institutions (IFIs) should ideally be at the forefront of addressing financing access challenges in remote areas, given their social mandate and inclusivity principles (Zulkifli, 2017; Ahmad Hamid et al., 2024). Their role goes beyond providing funds—they are responsible for guiding MSMEs in understanding fair and sharia-compliant financing models such as mudharabah and musyarakah (Suprihatin & Bahrum, 2023; Yudi, 2024). These services serve as both financial instruments and da'wah tools for systemic economic empowerment.

However, the effectiveness of Islamic financing schemes often encounters structural obstacles. These include discrepancies in institutional financing standards and the lack of data integration between financial institutions and local governments (Katman & Firawati, 2021; Handini, 2019). Desita Fitriani & Laily (2024) found that misalignment between risk profiles and financing schemes leads to the rejection of many MSME proposals during preliminary stages. This highlights the need for IFIs to intensify their mentoring role.

Islamic financing is not just about providing interest-free capital—it is a strategic instrument for fostering sharia-based financial inclusion and sustainable economic development (Safriadi, 2021; Zahra & Iqbal, 2023). Within the maqashid shariah framework, justice and empowerment are core indicators that must manifest in financing structures (Furqani, 2021; Cahyanti, 2022). Therefore, the involvement of IFIs in strengthening community-based productive sectors is both timely and essential.

Equitable and inclusive financing must involve Islamic financial institutions actively targeting marginalized economic groups. According to OJK (2021), Islamic banking assets grew by 13.11% year-on-year, yet less than 20% of this growth reached MSME financing. This gap suggests that despite increased capacity, IFIs have limited penetration into the micro sector (Arafah, 2023; Ramadhan & Sukmana, 2020), which calls for affirmative strategies to decentralize financial access.

A major barrier faced by MSMEs in remote regions is their inadequate financial documentation, which complicates creditworthiness assessments. Deni Darmawati (2018) and Ahmad Hamid et al. (2024) concluded that MSMEs with structured financial records are three times more likely to receive formal financing. Hence, integrating financial literacy and managerial training into Islamic financing ecosystems is crucial for equitable access.

The application of mudharabah and musyarakah contracts—hallmarks of Islamic finance—often fails due to entrepreneurs' limited understanding of profit-sharing mechanisms. In many cases, MSMEs misinterpret profit-sharing as fixed repayment obligations akin to interest, leading to disputes and dissatisfaction (Dimitra & Yuliastuti, 2012; Khoirun Nisak, 2013). This underlines the importance of embedding education into financing schemes.

In response to digital transformation, Islamic financial institutions have started offering digital financing products. However, adoption in remote areas remains limited due to poor infrastructure and low digital literacy (Norrahman, 2023; Hidayatullah et al., 2019). This reveals that technological innovation without inclusive strategies will fail to reach its core targets—the marginalized micro-entrepreneurs.

In Islamic economic thought, financing is not merely a commercial tool but a social responsibility mechanism. Instruments like zakat, infaq, and qardh al-hasan should be integrated into financing systems to support unbankable MSMEs (Nengsih, 2023; Safriadi, 2021). Unfortunately, the implementation of these redistributive mechanisms remains fragmented and lacks institutionalization.

Research by Katman & Firawati (2021) reveals that MSMEs financed through Islamic institutions report 17% higher return on investment than those using conventional loans. This shows the trust and efficiency embedded in sharia-compliant systems. To scale this impact, however, adaptive and context-aware distribution models are essential. From a maqashid shariah perspective, empowering small businesses aligns with the preservation of wealth (hifzhul maal) and life (hifzhul nafs). Thus, Islamic financial support for micro-sectors is not only an economic issue but a moral imperative promoting distributive justice (Furqani, 2021; Zahra & Iqbal, 2023). This elevates the study of IFI roles beyond technical debates into normative Islamic economic discourse.

According to BSI (2023), demand for microfinancing in rural areas grew by 21%, yet only 42% of that demand was fulfilled. Constraints include lack of collateral, low administrative eligibility, and limited rural branch coverage (Fitriani & Laily, 2024; Maryam & Irwan, 2020). These barriers highlight the urgency to reposition IFIs functionally within grassroots economic landscapes. International studies emphasize that Islamic finance can significantly contribute to sustainable development by emphasizing justice, transparency, and social responsibility (Ali & Syed, 2020; Chapra, 2019). However, in Indonesia, such a value-based intermediation model remains underutilized in MSME financing programs despite the potential of IFIs.

Previous research has predominantly focused on urban-based Islamic financing or medium-scale sectors, leaving remote MSME issues underexplored. This study offers a fresh perspective by focusing on IFIs' roles in regions with low literacy and limited physical access. Using a literature-based approach, this research builds a contextual conceptual framework for Islamic financial inclusion (Nazir, 2003; Hendryadi et al., 2019). This research presents a novelty by synergizing three critical dimensions: Islamic finance, MSME empowerment, and remote area context. Unlike prior studies that focused solely on financial outputs, this study addresses the broader inclusion process, encompassing institutional readiness, local characteristics, and sustainability factors (Desita Fitriani & Laily, 2024; Ahmad Hamid et al., 2024).

Its urgency lies not only in academic contribution but also in policy relevance. Indonesia's National Committee for Sharia Economics and Finance (KNEKS) has promoted micro-sector Islamic finance, yet few studies provide implementable policy pathways for grassroots application (KNEKS, 2022; Ramadhan & Sukmana, 2020). This research supports advocacy for sharia-based inclusive financing in underdeveloped regions.

From a scholarly perspective, this article enriches the Islamic finance literature through a thematic and localized approach. Similar studies are scarce, particularly those analyzing the effectiveness of Islamic financing for geographically marginalized MSMEs (Khusnul & Wira, 2021; Yudi, 2024). This opens up prospects for developing community-based Islamic finance models as alternatives to centralized paradigms.

Methodologically, this study employs a qualitative literature review, allowing in-depth and reflective exploration of academic texts, regulations, and policy reports. Through a critical synthesis approach, the authors aim to identify patterns in IFI interventions within the MSME sector (Nazir, 2003; Hendryadi et al., 2019). This approach is considered appropriate given the limited primary data available from rural contexts.

By addressing marginalization, structural challenges, and the unique features of Islamic finance, this article seeks to strengthen the role of IFIs in inclusive development. More than descriptive analysis, it aspires to be a practical and theoretical contribution for scholars, policymakers, and industry stakeholders. Ultimately, Islamic finance should not only grow in numbers—but in its real impact on the grassroots economy.

METHODS

This research employs a qualitative approach through a structured literature review, allowing for an in-depth, interpretive understanding of how Islamic Financial Institutions (IFIs) contribute to microenterprise financing, particularly in underserved rural contexts. A qualitative review is ideal when investigating complex, contextual phenomena that cannot be easily quantified but require synthesis across multiple dimensions (Amin et al., 2021; Khalid & Uddin, 2020). The use of literature review as a research strategy enables the researcher to identify theoretical gaps, build conceptual frameworks, and critically evaluate current knowledge on Islamic microfinance and financial inclusion (Rahman & Mustafa, 2022; Wahyuni & Bakar, 2021). This method is suitable in conditions where primary data collection is constrained by geography, time, or budget.

The data used in this study are secondary sources obtained from academic and institutional publications published between 2019 and 2024. The inclusion criteria were as follows:

- Published in peer-reviewed journals, books, or institutional reports
- Focused on Islamic finance, MSMEs, financial inclusion, or qualitative Islamic economics
- Written in English or Bahasa Indonesia
- Indexed in reputable databases such as Scopus, DOAJ, Google Scholar, or Sinta 1–2

The main sources include:

- Journal articles (e.g., International Journal of Islamic and Middle Eastern Finance and Management, Review of Islamic Economics)
- Reports from OJK (2022–2023), KNEKS (2022), and Bank Syariah Indonesia (2023)
- Recent books and proceedings from Islamic finance conferences (2020–2023)

The data collection was conducted in three sequential phases:

- Exploration phase: Search using keywords such as “Islamic microfinance”, “rural MSMEs”, “sharia financing”, “financial inclusion”, and “Islamic banking” in databases like Scopus and Google Scholar.

- Screening phase: Abstracts and titles were reviewed for thematic relevance. Studies were included only if they aligned with the objectives of Islamic microfinance and inclusive development.
- Extraction and coding phase: Key concepts and themes were identified using qualitative reference management tools such as Mendeley and Zotero, and annotated manually for analytical rigor.

This study used thematic analysis to categorize and interpret key findings from the literature. The thematic coding was based on Braun and Clarke’s (2019) six-phase method:

- Familiarization with the texts
- Generation of initial codes
- Search for patterns or emerging themes
- Review of the themes
- Definition and naming of themes
- Final synthesis and narrative construction

Themes were clustered into four macro-categories:

- Institutional capability of IFIs
- Barriers to access faced by rural MSMEs
- Contractual models (e.g., mudharabah, musyarakah)
- Social inclusion and digital strategies

This process ensured that the analysis was both structured and flexible, providing space for cross-source comparisons (Kamarudin & Hassan, 2020; Farooq & Nisar, 2021).

The study maintains rigor through strategies aligned with Guba and Lincoln's (updated model by Taherdoost, 2021) trustworthiness criteria:

- Credibility: Ensured by cross-checking between empirical and theoretical data
- Transferability: Strengthened through contextual detail and scope definition
- Dependability: Achieved by using consistent analytical procedures across sources
- Confirmability: Maintained by an audit trail using reference managers

Furthermore, expert validation was conducted through peer discussions with scholars in Islamic economics and MSME development (Rahim et al., 2023).

RESULT AND DISCUSSION

RESULT

The literature review revealed that Islamic Financial Institutions (IFIs) play a crucial role in promoting micro-enterprise financing, particularly in rural and underserved regions. The findings are grouped into four major themes derived from the thematic analysis approach:

- Institutional Capacity and Outreach
- Access Barriers in Rural Communities
- Effectiveness of Sharia Contracts (e.g., Mudharabah, Musyarakah)
- Integration of Social Finance and Digital Inclusion

These themes emerged consistently across 25 peer-reviewed studies published between 2019 and 2024. Each theme is supported by empirical evidence or conceptual analysis that highlights both strengths and gaps in current Islamic microfinance practices.

No	Author(s) & Year	Topics	Key Findings	Relevance to Research
1	Fitriani & Laily (2024)	Musyarakah in Rural IFIs	Musyarakah supports MSMEs but requires simplification.	Validates contract viability in remote financing.
2	Zahra & Iqbal (2023)	Islamic Finance & Social Empowerment	IFIs enhance equity via ethical finance.	Demonstrates empowerment potential.
3	Arafah (2023)	Financial Inclusion via Sharia Models	Literacy gap remains key barrier.	Supports financial literacy integration.
4	Ramadhan & Sukmana (2020)	Islamic MFIs in Java	Outreach in rural areas is limited.	Shows need for geographical distribution.
5	Ahmad Hamid et al. (2024)	Mudharabah for Microfinance	High participation but complex implementation.	Informs contract application challenges.
6	Norrahman (2023)	Fintech & Sharia Finance	Rural fintech uptake is inconsistent.	Links digital strategy to inclusion.
7	Wahyuni & Bakar (2021)	Digital Islamic Banking for MSMEs	Connectivity issues hinder adoption.	Highlights UX and infrastructure gaps.
8	Maryam & Irwan (2020)	IFI in NTB	IFIs boost inclusive regional growth.	Strengthens rural impact thesis.
9	Katman & Firawati (2021)	Inclusive Sharia Strategies	Product diversification improves outreach	Informs product strategy for LKS
10	Yudi (2024)	Islamic Banking Growth in Indonesia	Institutional support led to rapid expansion.	Provides contextual growth trends.
11	Desita & Fauzatul (2024)	Sharia Contracts & MSME Growth	MSMEs respond positively to sharia financing.	Supports model responsiveness.
12	Nengsih (2023)	Zakat Integration	Social finance expands access.	Supports integrated Islamic finance model.
13	Siddiqui & Khan (2022)	Islamic Ethics in Financing	Ethical practices boost trust and adoption.	Validates IFI legitimacy in rural areas.
14	Ali & Syed (2020)	Sharia Finance & SDGs	Aligns with UN development goals.	Supports sustainability framework.
15	Kamarudin & Hassan (2020)	Mapping IFI Outreach	Spatial analysis helps identify exclusion zones.	Informs policy targeting.
16	Rahim et al. (2023)	CSR & Social Impact	CSR enhances social trust and loyalty.	Reinforces social capital value of IFIs
17	Hidayatullah et al. (2019)	Regional Service Gaps	Large access disparities persist.	Justifies focus on remote region inclusion.
18	KNEKS (2022)	Sharia Policy for	Lack of operational	Hi19ghlights

No	Author(s) & Year	Topics	Key Findings	Relevance to Research
		Microfinance	guidelines limits practice	regulatory gap.
19	Farooq & Nisar (2021)	Profit-Sharing Effectiveness	Works well with proper risk training.	Emphasizes training for effective use.
20	Khalid & Uddin (2020)	Literacy & Sharia Access	Poor understanding limits adoption.	Core barrier validated.
21	Amalia & Yusuf (2023)	Empowerment via Sharia Intermediaries	Intermediaries drive community-level change.	Strengthens inclusion thesis.
22	Lubis & Huda (2022)	Digital Access to Sharia Finance	User experience is poorly localized.	Informs digital development strategy.
23	Sholeh & Munir (2021)	Behavioral Finance in Islamic Lending	Misinterpretation of contracts reduces participation.	Supports behavioral framing of IFI adoption.
24	Fadilah & Sari (2023)	Governance & MSME Finance	Governance structure affects access to capital.	Connects management to access issues.
25	Ismail & Latif (2021)	Trust in Sharia Finance	Trust and familiarity are key to adoption.	Highlights psychosocial dimensions of inclusion.

Here is the expanded thematic discussion, directly derived from the above 25 literature sources:

Institutional Capacity and Outreach

Findings show a clear increase in asset size and product range among Islamic Financial Institutions (Yudi, 2024; KNEKS, 2022). However, this growth has not been proportionately distributed to rural areas. Studies confirm a centralized concentration of sharia financing in urban centers, leaving a distributional gap in outreach (Ramadhan & Sukmana, 2020; Maryam & Irwan, 2020; Hidayatullah et al., 2019). Spatial mapping studies further suggest that expanding the network of LKS in tier-3 regions could significantly increase MSME access (Kamarudin & Hassan, 2020).

Access Barriers in Rural Communities

A recurring barrier across studies is the limited financial literacy and low documentation skills among rural microentrepreneurs (Arafah, 2023; Khalid & Uddin, 2020; Zahra & Iqbal, 2023). Misinterpretation of contracts—especially those involving profit-and-loss schemes—leads to distrust and low uptake (Sholeh & Munir, 2021). Several studies advocate for integrated literacy programs as a prerequisite for effective IFI service delivery.

Effectiveness of Sharia Contracts

While mudharabah and musyarakah offer ethical and fair financial models, their use remains limited due to administrative complexity and perceived risks (Ahmad Hamid et al., 2024; Farooq & Nisar, 2021). IFIs often default to murabahah because of its ease of execution, despite it being more debt-like. Evidence suggests that contract education and risk training can increase both trust and performance in shared-risk contracts (Fitriani & Laily, 2024).

Social Finance Integration and Digital Inclusion

Modern IFIs are increasingly incorporating zakat, waqf, and CSR mechanisms into their microfinance portfolios (Nengsih, 2023; Rahim et al., 2023). These channels offer non-commercial entry points for vulnerable MSMEs. On the digital front, however, low connectivity, limited digital trust, and poor UX design in rural platforms are major barriers (Wahyuni & Bakar, 2021; Lubis & Huda, 2022; Norrahman, 2023). As such, digital transformation must be accompanied by community-based education and platform redesign to be effective.

DISCUSSION

Institutional Capacity and Outreach

The literature reviewed indicates that although Islamic Financial Institutions (IFIs) in Indonesia have recorded robust asset growth in recent years (Yudi, 2024; KNEKS, 2022), their outreach remains largely urban-centric. This concentration in metropolitan and tier-1 cities contradicts the ethical imperative of Islamic finance, which advocates inclusive growth and socio-economic justice. Ramadhan and Sukmana (2020) found that only 18% of Islamic financing products reach rural communities, despite rural MSMEs constituting more than 60% of the total enterprise population in Indonesia.

Several empirical studies, including Maryam and Irwan (2020), demonstrate that the lack of rural penetration by IFIs is not due to a lack of demand, but rather due to weak institutional frameworks for last-mile delivery. Compared to Malaysia's TEKUN Nasional program, which integrates community-based outreach mechanisms, Indonesian IFIs lack a robust network of localized financing nodes. This hinders their capacity to respond to the nuanced financial needs of micro-entrepreneurs in remote regions. Institutional capacity is not limited to asset strength or regulatory compliance—it also involves adaptive governance, training, and a cultural understanding of underserved communities. According to Zahra and Iqbal (2023), the inability of IFIs to design inclusive operational models contributes significantly to their ineffectiveness in rural zones. Hence, institutional growth should be assessed not only vertically (in volume) but also horizontally (in inclusion).

Islamic economic scholars have long emphasized the distributive role of IFIs. Prof. M. Umer Chapra argues that institutions in Islamic finance must embed social equity into their business models, not as corporate social responsibility but as a structural mission (Chapra, 2019). This view is shared by Hasan (2020), who insists that the maqashid al-shariah must be mainstreamed within institutional strategy, particularly in how financing is allocated across different socio-economic groups. The Qur'an also reinforces the role of financial institutions in ensuring fair distribution of resources. Surah Al-Hashr [59:7] states:

"...so that it may not circulate solely among the rich among you."

This verse provides a fundamental foundation for the role of IFIs as agents of wealth redistribution. The modern interpretation of this verse underpins the responsibility of Islamic institutions to go beyond profit-seeking and ensure the equitable flow of capital. However, findings by Wahyuni and Bakar (2021) show that many IFIs continue to operate under risk-averse principles, preferring urban clients with complete documentation and collateral. This institutional behavior contradicts the Islamic finance ethos of uplifting the poor and supporting unbankable communities. The absence of micro-targeting tools and inclusive risk assessments further compounds this exclusion.

Some successful models do exist. For instance, the linkage program between BSI and local Islamic cooperatives in South Sulawesi has allowed microenterprises to access capital with reduced bureaucratic hurdles. This localized partnership approach offers a potential blueprint for expanding institutional outreach (Fitriani & Laily, 2024). Unfortunately, such models are still isolated and have not been adopted nationally.

From a policy perspective, institutional outreach must also align with government strategies such as the National Sharia Economic Masterplan. Yet, according to KNEKS (2022), there is limited synergy between IFIs and public institutions in executing inclusive finance mandates. This gap in coordination results in duplicated efforts, limited data sharing, and missed opportunities for scale.The author believes that the future of Islamic finance depends not only on regulatory reform but on a shift in institutional mindset—from capital preservation to social transformation. IFIs must adopt community-centric governance, invest in human capital development, and strengthen grassroots financing infrastructure. Without such reorientation, the noble goals of Islamic finance may remain theoretical.

In conclusion, institutional capacity in Islamic finance should be measured not just by profitability but by its capacity to realize maqashid al-shariah in practical, inclusive, and measurable ways. This requires strategic partnerships, innovative delivery models, and above all, a genuine commitment to justice (‘adl) as commanded in Islam. The Qur’an and Islamic economics offer the moral imperative—now institutions must bring that mandate to life.

Access Barriers in Rural Communities

Access to Islamic financing among rural microenterprises is severely hindered by a combination of structural, behavioral, and informational barriers. Studies by Arafah (2023) and Zahra & Iqbal (2023) emphasize that one of the most prominent limitations is low financial literacy, which prevents rural entrepreneurs from understanding even the basic features of Islamic financial products. This challenge is compounded by a lack of standardization in contract terms and the complexity of sharia-based instruments like mudharabah or musyarakah. The findings from Khalid and Uddin (2020) further reinforce this concern by revealing that nearly 70% of rural MSMEs are unfamiliar with the mechanisms of Islamic banking, even though they express strong religious preferences. This paradox highlights a missed opportunity for IFIs to connect religious identity with financial empowerment. The communication gap between institutions and rural communities is not only technical—it is also cultural and educational.

Other empirical studies point out that administrative barriers such as lack of documentation, no business legality, or absence of collateral disqualify most rural clients from formal financing (Ramadhan & Sukmana, 2020; Maryam & Irwan, 2020). This institutional rigidity pushes entrepreneurs toward informal lenders, which often contradicts Islamic principles and exposes them to exploitation through riba-based schemes. Islamic financial scholars argue that this failure of inclusion contradicts the core mission of Islamic finance. According to Asutay (2021), Islamic finance must not mimic conventional finance with Arabic terminology but must build distinctive institutions that cater to underserved segments. He emphasizes the importance of ethical intermediation that reduces barriers instead of replicating them.

This view is reflected in the Prophet Muhammad's (PBUH) hadith:

"The best of people are those who are most beneficial to others."

(HR. Ahmad, no. 23408)

This narration provides a moral imperative for IFIs to actively reduce exclusionary practices and build bridges of benefit (manfa'ah) with communities that have historically been left behind. Some progressive Islamic financial models have begun to tackle these barriers through literacy training and shariah socialization programs. Desita & Fauzatul (2024) report that MSME literacy programs conducted in collaboration with Islamic universities significantly improve understanding of contracts and repayment behavior. These programs not only educate but also foster trust between the lender and borrower. Additionally, mobile-based solutions, such as digital onboarding and voice-based interfaces, have shown early promise in reducing access barriers (Lubis & Huda, 2022; Norrahman, 2023). However, these technologies must be adapted to local dialects, cultural norms, and technological infrastructure to be effective in remote areas.

Policy-level frameworks also contribute to access limitations. The KNEKS (2022) report indicates that despite strategic national goals to empower rural MSMEs through Islamic finance, implementation is still fragmented. There is insufficient cooperation between ministries, local governments, and financial institutions to create a seamless and accessible financing pathway. From the author's perspective, solving access barriers requires a multi-layered approach. Institutions must simplify documentation, provide contract simulations, offer localized advisory services, and build partnerships with religious and educational institutions in rural areas. Financial access should not be a reward for the compliant but a right for all who seek justice-based economic participation.

In conclusion, rural inclusion is not simply a logistical challenge—it is a moral, legal, and social obligation in Islamic finance. Institutions must reengineer their systems to accommodate informal realities without compromising sharia compliance. As stated in the Qur'an, "Allah intends for you ease and does not intend for you hardship" (QS. Al-Baqarah: 185). This divine principle must guide the redesign of Islamic financial access in Indonesia and beyond.

Effectiveness of Sharia Contracts

Sharia-compliant contracts such as mudharabah and musyarakah are often hailed as ethically superior alternatives to conventional interest-based lending. However, literature reveals significant implementation challenges that limit their effectiveness, especially in rural financing. Ahmad Hamid et al. (2024) and Fitriani & Laily (2024) show that while these contracts promise fairness and risk-sharing, they are rarely applied in practice due to institutional preferences for simpler, less risky contracts like murabahah. Empirical evidence suggests that many Islamic Financial Institutions (IFIs) are reluctant to use mudharabah or musyarakah because they involve intensive monitoring, profit-sharing disputes, and higher information asymmetry (Farooq & Nisar, 2021; Siddiqui & Khan, 2022). This operational complexity often leads IFIs to treat clients similarly to conventional banks, thereby diluting the transformative potential of Islamic financial principles.

Moreover, the success of these contracts requires a certain level of entrepreneurial maturity and trust, which many micro-entrepreneurs—especially in rural areas—may lack due to low financial literacy or limited business experience (Khalid & Uddin, 2020; Arafah, 2023). Thus, the idealistic framework of risk-sharing often clashes with the practical realities on the ground. Nonetheless, some localized success stories provide counterexamples. In South Sulawesi, musyarakah mutanaqisah was effectively used to finance agricultural cooperatives, with IFIs acting as silent partners and training providers (Desita & Fauzatul, 2024). The partnership led to increased productivity, lower default rates, and enhanced community trust. This case proves that with the right institutional design and capacity-building, sharia contracts can be both ethical and effective.

Prominent Islamic economists such as Muhammad Nejatullah Siddiqi and Umer Chapra have emphasized the moral and economic superiority of equity-based contracts. Siddiqi (2020) argues that mudharabah reflects the Qur'anic ethos of mutual benefit and justice more than debt-based structures. Chapra (2019) similarly criticizes the excessive reliance on fixed-return instruments in Islamic banking, calling for a return to value-adding partnerships. The Qur'an itself promotes shared benefit and trust-based cooperation, as illustrated in Surah Al-Mutaffifin [83:1–3]:

"Woe to those who give less [than due], who, when they take a measure from people, take in full. But when they give by measure or weight to them, they cause loss."

This verse underscores the importance of fairness, balance, and reciprocity—principles embedded in contracts like mudharabah and musyarakah. Another major factor affecting contract effectiveness is legal infrastructure. Many IFIs lack access to proper dispute resolution mechanisms for non-performing mudharabah projects. Unlike collateral-based murabahah where recovery is straightforward, equity-based contracts require complex legal support to enforce agreements, which are often missing in remote and rural jurisdictions (Katman & Firawati, 2021). Policy responses to this challenge remain limited. KNEKS (2022) recognizes the underutilization of mudharabah/musyarakah and recommends incentivizing IFIs to adopt them through tax breaks or capital requirement relaxations. However, these incentives are not yet implemented at scale, and many institutions remain risk-averse.

From the author's point of view, improving the effectiveness of sharia contracts requires a three-tier approach: (1) training IFI staff in risk-sharing mechanisms and ethical finance, (2) educating clients through contract simulations and business coaching, and (3) reforming legal systems to support profit-sharing enforcement. Without these pillars, sharia contracts risk becoming symbolic rather than transformative.

In essence, equity-based sharia contracts are the soul of Islamic finance—offering a unique model that aligns economic activities with justice and cooperation. However, realizing their full potential requires a commitment to structural reform, stakeholder education, and institutional courage. As Allah says in Surah Al-Baqarah [2:275]:

"Allah has permitted trade and has forbidden riba."

This verse mandates that Muslims pursue trade with fairness and shared risk, a principle best embodied through contracts like mudharabah and musyarakah.

Social Finance Integration and Digital Inclusion

Social finance instruments such as zakat, waqf, and qardhul hasan represent the ethical backbone of the Islamic economic system. Yet, findings show that their integration into formal microfinance frameworks remains limited. Nengsih (2023) and Rahim et al. (2023) report that most IFIs treat social finance and commercial finance as two separate tracks, rather than building a hybrid model that allows seamless transitions between charitable and productive capital. Empirical studies from Malaysia and Sudan show that when zakat and qardhul hasan are used as seed funding, they reduce entry barriers and increase repayment discipline (Ali & Syed, 2020). These instruments can serve as ethical capital cushions for MSMEs that cannot initially qualify for profit-sharing contracts. Unfortunately, in Indonesia, this mechanism is rarely standardized or scaled.

The Qur'an places a strong emphasis on the circulation of wealth for the benefit of society. Surah At-Taubah [9:60] identifies mustahiq zakat, including the poor, debt-ridden, and those striving in Allah's cause. The inclusion of entrepreneurs and producers within these categories is accepted by contemporary ulama, thereby justifying zakat-backed microfinance as part of the maqashid al-shariah framework. In addition to social finance, digital inclusion has emerged as a key theme in the literature. Wahyuni & Bakar (2021) and Lubis & Huda (2022) highlight that while digital Islamic banking platforms are increasingly available, their adoption in rural areas is hindered by trust deficits, interface complexity, and poor infrastructure.

These challenges indicate that digital literacy and cultural contextualization are just as important as technological availability. Studies show that when platforms use local languages, audio guides, and simple interfaces, adoption rates increase significantly (Norrahman, 2023). Thus, inclusive design is not merely a technical issue but a justice issue in Islamic finance. Digital waqf platforms and mobile-based zakat distribution, which are already piloted in Jakarta and West Java, demonstrate the possibility of merging social finance with digital access. However, scaling such innovations requires cooperation among stakeholders, including fintech startups, IFIs, zakat institutions, and local governments. Islamic economic scholars such as M. Umer Chapra and Abdul Aziz Choudhury argue that the future of Islamic finance lies in value-based intermediation—where social value and technological efficiency are integrated (Chapra, 2019). They caution against replicating fintech for its own sake without preserving the ethical spirit of Islamic economics.

From a prophetic standpoint, the hadith "Verily, Allah loves that when anyone of you does a job, he should perfect it" (HR. Al-Bayhaqi) applies to financial innovation. The pursuit of sharia-compliant fintech must be accompanied by ihsan (excellence), ensuring the digital systems reflect justice and utility. The author contends that social finance and digitalization are not two separate paths but converging tools for economic justice. The strength of Islamic finance lies in its ability to harmonize tradition and innovation, spirit and system, intention and impact. Institutions must evolve to serve both financial inclusion and moral obligation.

In summary, integrating zakat and digital sharia finance is not only feasible but imperative. Islamic financial institutions must move toward hybrid models that provide access, flexibility, and trust for vulnerable communities. Only then can Islamic finance fulfill its dual mandate: economic empowerment and spiritual responsibility.

CONCLUSION

This study reveals that while Islamic Financial Institutions (IFIs) in Indonesia have achieved considerable growth, significant gaps remain in terms of inclusion, accessibility, and ethical effectiveness—particularly for rural microenterprises. Institutional structures are still heavily urban-oriented; access barriers are cultural, educational, and administrative; equity-based contracts face operational constraints; and the integration of social finance with digital inclusion remains fragmented. Through a structured literature review of 25 recent studies, this research demonstrates that meaningful Islamic finance reform must be holistic—combining institutional transformation, literacy-based outreach, sharia contract optimization, and the ethical use of digital and social finance tools. This reflects the Quranic imperative for fairness, trust, and the equitable circulation of wealth.

Future efforts must move beyond formal compliance and embrace the spirit of Islamic economics rooted in ʻadl (justice), ihsan (excellence), and maslahah (public interest). Only through such efforts can Islamic finance evolve into a truly inclusive engine for social development in Indonesia and beyond.

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