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THE ROLE OF PROFIT-LOSS SHARING IN DEVELOPMENT of MSMEs

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Abstract: This study provides an overview of the development of MSMEs from the perceptions of MSMEs, not from the perspective of Islamic financial institutions. The purpose of this study is to show the development model of MSMEs through a profit-loss sharing agreement that is applied to the type of bound investment. It is applied in the *mudharabah muqayyadah* contract through the principle of profit sharing distribution. The method used in this study is a survey of MSMEs. The results of this study indicate that the development of MSMEs can be carried out with a *mudharabah muqayyadah* agreement through the principle of profit sharing distribution. To develop MSMEs in order to gain increased revenue, enlarge business scale, and diversify businesses, there needs to be a fair distribution of profit-loss sharing with the principles of revenue sharing, profit sharing, and agreed risk builders despite restrictions in business management such as the type of business determined by the owner of the fund, there are limits in the management of funds, as well as restrictions in running a business or investment, where businesses run must be guided by sharia principles.

Keywords: *development of MSMEs; mudharabah muqayyadah; profit-loss sharing*

1. Introduction

MSMEs is Micro, Small, and Medium Enterprises. MSMEs have a weak point in capital both in terms of resources and numbers, limited ability to manage businesses, and skills in organizing in terms of marketing (Suci, 2017). Capital adequacy and easy access to capital are factors that support business development (Sakur, 2011). MSMEs are expected to be able to make a positive contribution to Indonesia's economic growth, even though the business competition climate with various digital and conventional marketing models continues. Actually capital financing has been provided by Islamic financial institutions through the concept of profit-loss sharing, but shows no contribution to the Islamic financial institutions (Afkar, 2017b). It is different from what is explained by (Faisol, 2017) that the financing provided has shown a positive contribution to the welfare of MSMEs.

The development of MSME requires the support of all parties, especially financial institutions, this is due to the lack of capital and access to obtain capital. This financial institution support will provide opportunities in developing MSMEs to become better financially business. As we know in Indonesia, the two-way financial system runs, namely Islamic finance and conventional finance. The role of conventional financial institutions is no doubt by providing various kinds of working capital loans and other loans, while the role of Islamic financial institutions cannot also be underestimated because it has provided various kinds of financing based on sharia principles that prioritize welfare.

The development of MSMEs in order to be able to increase income, a larger scale of business, and diversification of businesses according to people's perceptions can be done with profit sharing media and types of capital *mudharabah mutlaqah* (Afkar, et al 2019). This capital with a *mudharabah* agreement is a type of capital with a profit-loss sharing scheme, where each actor, namely the capital owner (*Shahibul Maal*) and the fund manager (*Mudharib*) shares profits and shares risks. The view in *mudharabah mutlaqah* sees freedom in managing funds, freedom in determining the type of business to be managed, and freedom in conducting business without the intervention of the capital owner, but that freedom remains within the sharia corridor.

Previous studies provide an overview of the development of MSMEs in Indonesia that make a positive contribution to the economy. However, it has not yet provided a description of an appropriate model for developing MSMEs when viewed from problems such as lack of capital and access to obtain capital. The statement was also supported by (Purnamasari and Darmawan, 2017) where the development of MSMEs is also required financing with sufficient capital schemes and in accordance with the business undertaken. Besides that, actually financing with a profit sharing principle scheme is ideal for MSMEs, but caution is needed in managing because it requires high trust (Bhakti, 2013). It is because the profit sharing is an uncertainty-based contract or called a Natural Uncertainty Contract (NUC) that requires trust between the two parties involved (Susilo and Anam, 2018)

The concept of profit-loss sharing in sharia capital financing in previous studies places more emphasis on the financial side of bank institutions, cooperatives, and other similar financial institutions. This means that they still do not see the needs of potential financing customers who need funds for business development. As done by (Afkar, 2017) in his research explaining that MSMEs financing by Islamic banks has a positive impact on profitability, meaning that financing carried out by Islamic banks in Indonesia is able to contribute to profits where surely MSMEs financed also get a share of profit or additional income. Even though financing with profit does not dominate like *murabaha* financing (Trimulato, 2016).

The results of the research (Jalil and Sabri, 2016) explain that capital financing through *mudharabah* and *musyarakah* is feasible given to MSMEs in Malaysia. While what is done in Saudi Arabia, the financing model with the type of profit sharing provides an illustration to facilitate MSMEs to gain access to business capital in the context of developing MSMEs (Alghamdi, 2017). Some research results illustrate that the revenue sharing scheme has a positive impact on MSMEs, Even though financing with profit does not dominate like *murabaha* financing (Trimulato, 2016). But the problem is that when the fund manager enters into a contract with the owner of the fund by intermediation of financial institutions such as banks and non-bank financial institutions, which are listed in the contract are like the types of contracts that are already common, in detail each part may still not be accommodated.

Financing of MSMEs carried out by Islamic financial institutions with profit-loss sharing schemes using *mudharabah* and *musyarakah* contracts implicitly written. However, information such as providing freedom to manage a business or providing limitations in managing a business may not be included in the contract. Therefore in this study, we want to discuss the development of MSMEs through the principle of profit sharing distribution carried out with the *mudharabah*

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contract scheme. Mudharabah contract will be discussed with the deepening of the type of *mudharabah muqayyadah* contract, this is done because previous research (Afkar, 2019) has explained that mudharabah mutlaqah influences the development of MSMEs through the principle of profit sharing distribution.

2. Literature Review

Agency Theory

Agency theory discusses the role of agents in a company which certainly contributes in managing the company in order to continue to benefit according to the wishes of the owner of the company. This agency theory was developed by Jensen and Meckling (1976) who actually had agency costs in managing the company and the emergence of information asymmetry when the role of agents who should contribute in managing the company to company owners. The asymmetry of this information can be in the form of less detailed information and can be collected information deliberately not provided so that the company owner does not get the information in full.

Agency theory is used in this study as a basis for looking at the relationship between fund managers *(mudharib*) and fund owners (*Shahibul maal*). The owner of the fund certainly wants the rate of return on investment of funds from the business which will be managed by the fund manager. Funds managed by fund managers (*mudharib*) are recorded as *shirka* funds or business investment funds that are bound. The purpose of this tied investment is the type of investment in which the form of business, type of business, management of funds for businesses is limited by the owner of the funds (*shahibul maal*) of course remains in the sharia corridor (Nurhayati and Wasilah, 2015).

Profit sharing or profit sharing must be agreed from the beginning of the contract so that it is clear and no party will be disadvantaged. The management of a business that is run must be under fair supervision so that no party feels under pressure. Business activities that are managed are carried out by the fund manager (*mudharib*) in full so that the owner of the funds (*shahibul maal*) is not allowed to interfere in managing the business, only in the form of sharia supervision and reporting of business and financial activities in the context of sharing the results of joint profits or ratios. In agency theory, the absence of intervention from the fund owner (*shahibul maal*) can provide an opportunity for information asymmetry regarding business activities by cheating. This makes mudharabah requires the trust of those involved in the mudharabah agreement to run the business.

Development of MSMEs

Development in the simplest sense is an improvement effort. If it is related to the development of MSMEs, then it can be interpreted as an effort to improve MSMEs through appropriate methods so that it can be used as a guide or design for developing MSMEs. The research (Afkar et al, 2019) explains that the development of MSMEs indicators can be seen from the increase in income, business scale development, and business diversification. The development of MSMEs certainly starts from the problems that exist in an effort to increase revenue and develop a larger business so that the type of business can vary. These problems such as lack of capital and access to obtain capital (Suci, 2017), as well as the need for types of capital financing with sufficient schemes and appropriate business undertaken (Purnamasari and Darmawan, 2017).

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Micro business is the backbone of the economy in Indonesia so that a lot of workers are absorbed in the micro business sector (Suhendri, et al, 2017). Small businesses need to be supported to keep moving towards the sustainability of their business development in order to be able to contribute in improving quality and quantity. Sustainability of small and medium micro businesses can also be done by applying a triple bottom line (Istikhoroh, et al, 2018). The ability to manage micro, small and medium business owners needs attention, especially in micro businesses that still need income development (Afkar et al. 2019).

The support of conventional and sharia financial institutions is needed in the development of MSMEs (Suci, 2017), especially in Islamic financial institutions because these institutions are institutions engaged in the real sector (Afkar, 2015). Financing products carried out by Islamic financial institutions must be guided by Islamic principles by prioritizing mutual benefit. Togetherness in developing this business, one of which can be done with *mudharabah* contract, where the benefits obtained are done by way of profit sharing through an agreement with the parties involved (Chateradi and Hidayah, 2017).

Profit-Loss Sharing Scheme

Profit-Loss sharing schemes for business activities can be carried out with *mudharabah* and musyarakah contracts (Wasilah and Nurhayati, 2015), where *Mudharabah* is a type of full capital financing from capital owners to fund managers with the distribution of profits according to the agreement and the distribution of risk of loss is fully deferred by the capital owner if losses occur not due to negligence of business managers (Afkar, 2015), while *Musyarakah* is a collaboration in managing businesses where each party deposits capital, then an agreement is made in the distribution of profits but in sharing the risk of loss in accordance with the portion of capital provided (Karim, 2010).

Profit-Loss sharing system is identical to Islamic financial institutions because it is a system that is applied to justice for the parties involved, in addition to revenue-sharing is also a system that is implemented through the agreement of the parties involved (Afkar, 2011). Profit sharing is actually a contract that is used to finance business activities. This type of revenue sharing is a contract that does not have certainty in revenue so it cannot be sure of the amount of revenue to be shared, but from the beginning there must be an agreement in terms of profit sharing and risk sharing (Afkar, 2019).

Distribution of profit sharing agreed by the two parties involved in the profit-loss sharing contracts will provide the same responsibility, where each party has their respective roles, namely the first party is called the owner of the funds (*shahibul maal*) and the second party is referred to as the fund manager (*mudharib*). In the National Sharia Council Fatwa No. 15/DSN-MUI/IX/2000 explained that in the distribution of results can use the principle of profit sharing and revenue sharing. Distribution of profits by way of profit sharing is done by giving each part by calculating the net profit on operating results, while the distribution of results by way of revenue sharing is done by sharing profits with the calculation of income that has not been reduced by operational costs and non-operational costs. In addition to profit sharing there is also a risk sharing, namely the distribution of financial losses wholly borne by the owner of the fund, while non-financial losses are borne by the fund manager if the managed business suffers a loss that is not caused by negligence in managing the business (Nurhayati and Wasilah, 2015).

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Distribution of profit-loss sharing made with this agreement from the beginning has become the basis for continuing the contract. The contract used in the profit-sharing scheme which is fully funded by the owner of the fund is referred to as a *mudharabah* contract. *Mudharabah* has a practical off-balance sheet contract or type of *mudharabah* contract practically. The agreement is not recorded in the financial statements but only practical in the implementation of what is called *wa'ad*. There are three types of *mudharabah*, namely *Mudharabah Mutlaqah*, *Mudharabah Muqayyadah*, and *Mudharabah Mustyarakah*.

Mudharabah Mutlaqah is a type of contract that gives freedom to fund managers to manage businesses including types of businesses, running businesses, and financial management, but still within sharia principles (Nurhayati and Wasilah, 2015). *Mudharabah muqayyadah* is a type of investment contract that is bound because there are restrictions in managing businesses ranging from type, location, form, and so on (Afkar, 2015). Whereas *mudharabah mustyarakah* is a contract that provides an opportunity for fund managers (*mudharib*) to participate in including their capital after the business is running (Karim, 2010).

3. Research Methods

This research uses quantitative methods through surveys. This research approach has a difference with other research that is trying to deepen the development of MSMEs seen from the perceptions of MSMEs managers with a background in capital access issues. The development of MSMEs (Y) as an endogenous variable is seen from the increase in income ($Y_{2.1}$), business scale development ($Y_{2.2}$), and business diversification ($Y_{2.3}$). The role of revenue sharing is seen from the principle of profit sharing distribution (Y1) as an intervening variable that is using revenue sharing ($Y_{1.1}$), profit sharing ($Y_{1.2}$), and risk sharing ($Y_{1.3}$). Whereas in accessing capital, try to use the mudharabah muqayyadah (X_2) or investment type bound as an exogenous variable as seen from the type of Business determined by the owner of the fund ($X._1$), Limitation in Fund Management ($X._2$), Limitation in running a business / investment ($X._3$).

The population in this research is MSMEs in East Java. The sample in this study is the Mojokerto and Blitar areas. The sampling technique in this study uses non-random sampling by ranking using the lowest rank 2 with the assumption for increasing MSMEs so that the sampling is done directly. Whereas to determine the number of respondents in this study carried out by adding up the indicators of each variable that is 3 x 3 = 9, then added to the research variable that is 9 x 3 = 27, then added to the sample area used in this study is 27 x 2 = 54, so that in this study obtained by 54 respondents. The distribution of respondents in each region using proportional techniques in accordance with the number of MSMEs in each region

Table 1. Proportion of Respondents

City	Number of MSMEs	Proportion of percentage	Proportion of Respondents
Blitar	21.291	(21.291 / 38.771) x 100 = 55 %	54 x 55 % = 30
Mojokerto	17.480	(17.480 / 38.771) x 100 = 45	54 x 45 % = 24

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		%	
Jumlah	**38.771**	**100%**	**54**

Sources : processed

Data analysis techniques use the Warp PLS multivariate analysis. To test each indicator variable can be seen in the outer model so that it will look convergent and discriminant validity, and also to measure the reliability of each variable in this study. The results of hypothesis testing can be seen from the inner model, so that it will be known the influence of exogenous variables on endogenous through intervening variables.

4. Result and Discussion

4.1 Result

Outer Model

Table 2. Validity Test Result

Indicator	Loadings Factor and Cross Loadings			Type	SE	p-value	Result
	X	Y_1	Y_2				
$X_{.1}$	(0.401)	0.259	0.323	Reflective	0.117	<0.001	Valid
$X_{.2}$	(0.803)	0.559	-0.774	Reflective	0.101	<0.001	Valid
$X_{.3}$	(0.852)	-0.649	-0.036	Reflective	0.099	<0.001	Valid
$Y_{1.1}$	-1.260	(0.726)	0.316	Reflective	0.104	<0.001	Valid
$Y_{1.2}$	0.819	(0.821)	-0.651	Reflective	0.100	<0.001	Valid
$Y_{1.3}$	0.205	(0.908)	-0.465	Reflective	0.097	<0.001	Valid
$Y_{2.1}$	-0.055	0.010	(0.900)	Reflective	0.098	<0.001	Valid
$Y_{2.2}$	-1.320	0.460	(0.535)	Reflective	0.112	<0.001	Valid
$Y_{2.3}$	0.813	-0.308	(0.829)	Reflective	0.100	<0.001	Valid

Sources : Processed by Warp PLS

The validity test results indicate that each indicator used in this study is valid. The validity of each indicator in this study is indicated by the value of loadings factor and cross loadings. Table 1 shows that the loadings factor value of each indicator in this study > 0.300 so that it can be said to meet convergent validity. While the loadings factor value for each indicator in this study > the value of the cross loadings for each other indicator, so it can be said to meet the criteria of discriminant validity.

Table 3. Reliability Test Result

Variable	Composite Reliability	Cronbach's Alpha	Result
X	0.742	0.789	Reliable
Y_1	0.861	0.754	Reliable
Y_2	0.808	0.739	Reliable

Sources : Processed by Warp PLS

The reliability test results indicate that the variables used in this study as a whole can be said to be reliable. Table 2 shows that the Composite Reliability value > 0,700 and Cronbach's Alpha value > 0,600. So in this research it can be concluded that the variable *Mudharabah Muqayyadah* (X), the Principles of Profit Sharing Distribution (Y1), and the Development of MSMEs (Y2) are reliable.

Inner Model

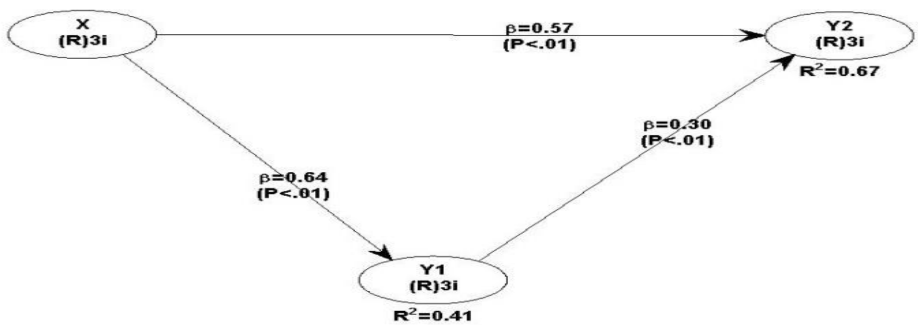

Figure 1
Development of MSMEs Model

Development of MSMEs Model can be explained in Figure 1 which shows the *Muqayyadah Mudharabah* Contract (X) has a path coefficient value of 0.64 and p-value <0.01, meaning that the *mudharabah muqayyadah* contract (X) has a significant effect on the principle of profit sharing distribution (Y_1) with a value of R^2 of 0.41 or 41% directly affects the Principles of Profit Sharing Distribution. Besides the *Mudharabah Muqayyadah* contract (X) has a path coefficient value of 0.57 and p-value <0.01, meaning that the *mudharabah muqayyadah* contract (X) has a significant effect on the development of MSMEs (Y_2). While the profit sharing distribution principle (Y_1) has a path coefficient value of 0.30 and p-value <0.01, meaning that the profit sharing distribution principle (Y_1) has a significant effect on the development of MSMEs (Y_2) with an R2 of 0.67 or 67% which directly affects the development of MSMEs.

Table 4. Indirect Effects

Number of paths with 2 segments				**P values of indirect effects for paths with 2 segments**			
	X	Y_1	Y_2		X	Y_1	Y_2
X				X			
Y_1				Y_1			
Y_2	0.192			Y_2	0.019		

Sources : Processed by Warp PLS

Table 4 explains the indirect effect of exogenous variables on endogenous variables through intervening variables. Indirect path coefficient values obtained by 0.192 with a p-value of 0.019 < 0.05. These results indicate that the development of MSMEs (Y_2) is significantly influenced by the

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Mudharabah Muqayyadah contract (X) through the mediation of the Profit Sharing Distribution Principle (Y_1).

Table 5. Contribution of Variable

Variabel	Total Effect	Squared	%	Contribution in %
X_1 to Y_1	0.640	0.4096	100	40.96
X_1 to Y_2	0.767	0.5883	100	58.83
Y_1 to Y_2	0.300	0.0900	100	9.00

Sources : Processed by Warp PLS

The contribution of each variable in this study is shown in Table 5, the *Mudharabah Muqayyadah* contract (X) contributes to the profit sharing distribution principle (Y_1) of 40.96%. *Mudharabah Muqayyadah* contract (X) contributed 58.83% to the Development of MSMEs (Y_2). While the Profit Sharing Distribution Principle (Y_1) contributed to the development of MSMEs (Y_2) by 9.00%.

Table 6. Goodness of Fit Inner Model

No	Model Fit and Quality Indices	Fit Criteria	Result	Justification
1	Average Path Coefficient (APC)	$p \leq 0.05$	0.505, P<0.001	good
2	Average R-squared (ARS)	$p \leq 0.05$	0.539, P<0.001	good
3	Average Adjusted R-squared	$p \leq 0.05$	0.527, P<0.001	good
4	Average block VIF (AVIF)	Acceptable if ≤ 5, ideally ≤ 3.30	2.103	ideal
5	Average full colliniearity VIF (AFVIF)	Acceptable if ≤ 5, ideally ≤ 3.30	2.408	ideal

Sources : Processed by Warp PLS

The results of table 6 analysis show the average path coefficient (APC) of 0.505 with a significance level of p-value < 0.001. This means that the coefficient on each path has a significant influence on the exogenous variables on the endogenous variables and also the intervening model on the endogenous variables. Average R-squared (ARS) shows 0.539 with p-value p < 0.001 and Average Adjusted R-squared is 0.527 p-value p <0.001. This means that the average influence is 52.70%. While the Average block VIF (AVIF) value of 2.103 <3.300 <5.000 is included in the ideal category, and the Average Full Collinieartity VIF (AFVIF) value of 2.408 <3.300 <5.000 is included in ideal conditions. This means that the results of this analysis indicate that each variable in this study is free from multicollinearity.

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4.2 Discussion

MSMEs is one of the forms of business that contributes to economic growth of 57.84% to 60.34% and employment of 96.99% to 97.22% so as to get income to meet needs (Kemenperin.go.id, 2016). Therefore, the opening up of MSMEs is needed to contribute even more to economic growth. The development of MSMEs means having a positive domino effect on other sectors which will certainly contribute more to the economy. It is not easy to develop MSMEs in business competition that is developing from traditional to digital, so the ability to manage businesses in accordance with industry developments must always be followed by MSMEs.

The development of MSMEs from several studies shows that there are weaknesses in capital, access to capital, to the source and use of capital (Suci, 2017). Therefore we need the role of financial institutions to support the development of MSMEs, both conventional financial institutions and Islamic financial institutions. Such support is certainly expected to have mutualism or mutual benefit for each party involved. Financial institutions benefit financially and MSMEs can benefit in the form of capital to increase business income, increase the scale of the business to become larger, and can diversify the business. However, several studies have not provided an overview of the perceptions of MSMEs related to the desired capital needs, still more explanation on the side of financial institutions.

Mutually beneficial cooperation can be reflected in one of the financing products that provides opportunities for mutual cooperation, namely mudharabah. Cooperation in the form of this business is carried out by means of investment which is referred to as syirkah funds. Mudharabah is a form of cooperation by not providing certainty of results so that it is a natural uncertainty contract (Afkar, 2019). This uncertainty is accommodated in the form of profit sharing ratio based on the National Sharia Council Fatwa No.15/DSN-MUI/IX/2000 concerning the Principles of Distribution of Business Results in Islamic Financial Institutions.

The results of this study indicate that the development of MSMEs can be carried out by means of the *mudharabah muuqayyadah* contract through the principle of profit sharing distribution. This means that the development of MSMEs can be done by way of tied investment where *shirka* funds managed by *mudharib* are given limits of expansion from objects, locations, types of businesses, and so on. This result is also supported by (Afkar et al, 2019) that the development of MSMEs can also be carried out with the mudharabah mutlaqah agreement through the principle of profit sharing distribution. Although *mudharabah mutlaqah* differs from *mudharabah muqayyadah*, the perception of MSMEs entrepreneurs to develop their business can still be achieved because through sharing the results obtained by agreement, both in profit and risk sharing. Likewise, it was said (Jalil and Sabri, 2016) that *mudharabah* contracts are more suitable to assist the development of MSMEs. These results need to be balanced with the knowledge of sharia products including sharia services, because sharia financial literacy is needed for individuals and entrepreneurs to make decisions in using Islamic products (Panghayo and Musdholifah, 2018)

The problem that needs to be discussed is the need for high trust in *mudharabah* contracts. Why high trust is needed, because in this mudharabah contract the Islamic financial institutions do not participate in managing the business that is run so that they do not know the ins and outs of the business directly, Islamic financial institutions are limited to supervision such as ensuring that their business forms are in accordance with sharia and timeliness in reporting results effort. In addition (Nuha and Mulazid, 2018) sharia compliance in managing the business is also needed to ensure that what is done in the contract is in accordance with sharia guidelines related to profit sharingWhereas in agency theory, it is explained that the existence of a fund owner and fund manager will provide an opportunity for information asymmetry that may be detrimental to the owner of the fund through fraud in reporting or other fraud. Indeed, early or preventive fraud cannot be detected (Afkar, 2016), generally fraud will be seen when a report is detected and a repressive action is subsequently carried out to provide a deterrent effect.

5. Conclusions

Development of MSMEs requires support from the government and financial institutions, especially financial institutions engaged in the real sector such as Islamic financial institutions. The development of MSMEs can be carried out with a *mudharabah muqayyadah* contract through the principle of profit sharing distribution. Togetherness of the agreement fund in managing the business is very needed to form a bigger and more useful business. The trust and commitment of the parties involved are also very necessary so that the business that is run continues. Commitment in running a business is needed by MSMEs even though it is limited starting from the object, type of business, location, and funding because with the sharing of profits through revenue sharing, profit sharing, and risk sharing must be passed together in order to achieve an increase in business income, increase business scale, and the ability to diversify businesses.

Financial institutions should pay attention to the needs of MSMEs to develop their businesses to become bigger so that they will make a greater contribution to the economy. Provide easy access to capital and profit sharing in accordance with the agreement and fair so as to provide mutual benefits and bear joint risks. Capital schemes that are appropriate to the needs and represent the aspirations of MSMEs will have a greater positive impact on development of MSMEs. Togetherness, togetherness, agreement, and trust will provide benefits for all.

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