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Sharia Economy, Islamic Financial Performance and Factors That Influence It—Evidence from Indonesia

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Abstract: The contribution of SMEs to economic growth is supported by the development of the sharia economy by the government, making SMEs one of the main pillars in Indonesia's economic development. This study aimed to analyze the influence of the digital economy, financial literacy, human capital, the role of Islamic financial institutions, government support for strengthening the Islamic economy and the Islamic financial performance of SMEs in Makassar City, Indonesia. This study used a quantitative method with a survey approach. Data were obtained through questionnaires distributed to 350 respondents with a sampling method. The results of this study indicated that the strengthening of the sharia economy, the Islamic financial performance of SMEs, economic digitalization and financial literacy are determined by factors of human capital, the role of Islamic financial institutions and government support. Regarding human capital, the roles of Islamic financial institutions and government support affect the Islamic financial performance of SMEs with a coefficient of determination of 58.5%. Human capital, the role of Islamic financial institutions, government support and financial performance have a positive correlation with the strengthening of the sharia economy with a coefficient of determination of 71.6%. This study supports the improvement of government policies and the construction of financial facilities in improving the Islamic financial performance of SMEs and encourages the strengthening of the sharia economy in Makassar City, South Sulawesi, Indonesia. The limitation of this research is that the research object was only carried out on SMEs in Makassar City; thus, similar research can be increased at the national level to describe the strengthening of the sharia economy and the improvement of the financial performance of SMEs as a whole in Indonesia.

Keywords: sharia economy; Islamic financial performance; digital economy; financial literacy



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1. Introduction

In 2019, the Indonesian government through the Ministry of National Development Planning/Bappenas launched the 2019–2024 Indonesian Sharia Economic Master Plan. The Indonesian government conducted this because, so far, Indonesia has not been able to play an optimal role in responding to the very rapid development of the world's Islamic economy and finance in the last two decades. Indonesia, as a country with the largest Muslim population in the world, only ranks tenth as a country producing halal products at the international level ([Indonesia Ministry of National Development Planning 2019](#)). Halal in Arabic means that which is lawful, permissible, approved and legal; the opposite of halal is haram, which means prohibited or forbidden ([Abdallah 2021](#)).

The Indonesian government seeks to realize the master plan by setting the milestones for the Islamic economic development, especially to seriously strengthen and support

Indonesia's sharia economy. The establishment of this sharia economic development milestone starts from strengthening legal aspects and coordination, strengthening halal lifestyle campaigns, creating a conducive atmosphere for sharia economic development by increasing the role of stakeholders including sharia SMEs in building a halal industry, and creating access to sharia financial institutions to strengthening international economic cooperation through the halal international center, including strengthening the digital economy based sharia, strengthening Islamic financial literacy, improving the quality of human capital who care about digital and sharia compliance and increasing the role of Islamic financial institutions and support of the government.

This milestone in the strengthening of the sharia economy can be seen in Figure 1.

2019	2020	2021	2022	2023	2024
Strengthening legal aspect and coordination					
Natural Campaign on "Halal Life Style"					
Encourage the establishment of national halal fund					
Establishment of halal hub to strengthen domestic halal industry					
Establishment and activation of Islamic inclusive financial service board that based in Indonesia					
Strengthening cooperation of international economy through international halal center					

Figure 1. The milestones for the sharia economic development. Source: (Indonesia Ministry of National Development Planning 2019).

In line with this, Indonesia's economic growth after the COVID-19 pandemic has shown signs of improvement, marked by an increase in the supply and demand for goods and services in the market. One of the factors that made Indonesia quickly recover from the economic downturn due to the pandemic was the implementation of the sharia economy, which was supported by the strengthening of the halal product chain ecosystem and the halal industry (Limanseto 2022). Indonesia is a country that is quite resistant to pandemic attacks and is quick to make improvements with the growth of its halal ecosystem. The growth of the halal ecosystem is mainly dominated by the SME sector, especially sharia-based SMEs (Deuraseh et al. 2020). SME sharia is characterized by its business activities that are always based on Islamic principles and values, such as being free from the practice of usury, gambling and fraud (Alamsyah et al. 2022). Sharia is the rule by which the Muslim world is governed (or should govern itself) and forms the basis for the relationship between humans and God, between individuals, whether Muslim or non-Muslim, and between humans and the things that are part of creation (Bassiouni 2012). The sector that has the most dominant role in increasing sharia economic growth from various businesses managed by SMEs is the tourism sector, with a market share of 27.5%, followed by the food and beverage sector at 13.8% and the fashion sector at 13.4% (DinarStandar 2020; Hidayat 2021). Meanwhile, Indonesia's total sharia assets reached USD 10.5 billion, although it was still far behind Malaysia, which had total sharia assets of USD 133 billion (Kunjana 2021).

The contribution of sharia SMEs to economic growth is supported by the government's seriousness in developing the sharia economic sector and making SMEs one of the main pillars in economic development (Indonesia Ministry of National Development Planning 2019). The number of SMEs is quite large and is spread throughout Indonesia with a fairly high absorption of labor and an abundance of natural resource wealth as an economic source of raw materials, as well as a fairly flexible business organization as a factor that encourages the strengthening of the sharia economy in Indonesia (Juminawati et al. 2021; Surya et al. 2021; Menne et al. 2022). This is a golden opportunity for SMEs to show their

maximum participation in economic growth. SMEs also have the opportunity to build organizational performance and improve their financial performance as well as increase business productivity by taking advantage of the economic digitization momentum as part of financial innovation and financial literacy. This contribution is a positive thing in achieving high economic growth and achieving sustainable development goals towards a prosperous society.

However, some sharia-based SME business platforms in Indonesia have several obstacles. The challenges and obstacles are as follows: (i) the weak role of economic digitalization, (ii) low innovation and financial literacy, (iii) sluggish investment climate and access to capital in the sharia sector and (iv) inadequate regulatory support for the implementation of a conducive sharia economic business (Santarelli and D'Altri 2003; Oshora et al. 2021; Barus and Soemitra 2021). Several studies that support this research, among others are as follows: (1) Research conducted by Bikse et al. (2021) concluded that the trend of using digitalization for companies in Latvia is growing, especially among companies that have been operating for a long time, while new companies are still constrained by human capital and digital mastery. (2) Research conducted by Messabia et al. (2022) examined the efforts of SMEs in the Outaouais Region, Canada, to overcome the COVID-19 crisis, where to overcome this problem entrepreneurs showed resilience, innovation, strategic management funds and Canadian government support to SMEs through their assistance programs. (3) Research conducted by Cueto et al. (2022) concluded that the pandemic encouraged SME players to innovate entrepreneurship with a digital platform approach; however, SME players experienced obstacles in terms of weak digital skills, low quality internet infrastructure and the existence of restrictions everywhere. (4) Research by Chen et al. (2021) revealed that the barriers to digital transformation for SMEs are due to a lack of funding, low digital capabilities, the low quality of human capital and technical barriers. (5) Research conducted by Stalmachova et al. (2022) concluded that digital transformation has brought companies to new roles and functions and led to business sustainability in the long term. Thus, in contrast to the results of previous studies, this research focused more on the Islamic financial literacy and open innovation that can encourage increased productivity and Islamic financial performance of SMEs, and this can spur the strengthening of the sharia economy nationally. (6) In an effort to increase the role of Islamic financial institutions, Kooli et al. (2022) stated in their research results that Islamic financial institutions can develop several financing schemes that can assist SMEs in obtaining easy access and funding assistance, as well as carry out innovation efforts to have an impact on increasing productivity and Islamic financial performance from SMEs.

The urgency of this study is oriented to the use of financial literacy and financial innovation in supporting the improvement of financial performance, the productivity of SMEs and the strengthening of the sharia economy. Thus, the increase in SME performance is influenced by (i) the use of the digital economy platform in every business activity and SME financial literacy, (ii) the alignment of every business transaction with adherence to sharia economic values and (iii) the human capital, the role of Islamic financial institutions and government support. Based on the considerations above, in an effort to revitalize the sharia economy and improve the financial performance of SMEs, this study focused on the formulation of the following problems: (1) How do financial literacy and innovation improve the Islamic financial performance of SMEs? (2) What is the role of economic digitalization in spurring the strengthening of the sharia economy? (3) How is the human capital, the role of Islamic financial institutions, and government support improving the Islamic financial performance of SMEs and strengthening the sharia economy?

The completion of this research used a quantitative approach to analyze the Islamic financial performance of SMEs and the strengthening of the sharia economy. Makassar City was chosen as the research location, with the consideration that Makassar City has a fairly large number of SMEs and is one of the largest cities in Indonesia that has an important role in national economic development. This research will also contribute to the development of SMEs and the strengthening of sharia economics with the following details: (a) will

be taken into account in decision making policy makers in producing policies related to strengthening the sharia economy, (b) will become the basis for SMEs to take advantage of economic and sharia digitalization financial literacy as an effort to improve performance and sharia finance business productivity, (c) will become the basis for the development of economic digitalization, financial literacy and the Islamic financial performance of SMEs.

2. Literature Review

2.1. Financial Literacy Dan Innovation to Increase Islamic Financial Performance

The role and contribution of sharia SME in increasing national economic growth and sustainability development can be achieved by increasing business effectiveness, including by strengthening financial literacy and financial innovation (Ye and Kulathunga 2019; Hehanussa and Syarifuddin 2021; Istifadhoh et al. 2021; Mavlutova et al. 2022). Financial literacy refers to the knowledge and skills related to financial concepts, calculations and applications (Huston 2010; Lusardi and Mitchell 2011). This financial literacy can cover private people or the business world, including SMEs, and financial literacy is a way for individuals and the business world, and even the national economy, to reach financial sustainability (Swiecka et al. 2020). Financial literacy can also increase the knowledge, attitudes, skills and behavior needed in the context of making appropriate financial decisions and in turn reach the level of welfare for SMEs (Rieger 2020; Rabbani et al. 2021a).

Meanwhile, financial innovation through economic digitalization, the touch of technological innovation and the use of fintech in the economic and financial fields can encourage the increase of financial performance (Parida et al. 2019; Poon et al. 2020; Najib et al. 2021). The main role and function of financial innovation is to obtain better services, more choices and lower prices, to simplify the transaction chain and to reduce operational costs (Reinartz et al. 2019; Sima et al. 2020; Remondino and Zanin 2022). Financial literacy can lead companies to understand business developments and changes from financial reports and products of financial institutions. Economic business sustainability requires the support of all stakeholders, harmonizing government policies and integration with Islamic financial institutions in expanding and strengthening sharia economics and finance (Franzoni and Allali 2018). Furthermore, economic growth will be closely related to the financial innovation such as the digitalization of the economy and business modernization and a healthy and sharia-compliant investment climate (Toader et al. 2018; Lee et al. 2018; Bahrini and Qaffas 2019).

The strengthening of SMEs is carried out by the government in an effort to encourage the improvement of the Islamic financial performance of SMEs and the national economic development goals by providing business licensing facilities, as has been the case so far with various forms of online services. This concept is a model of empowering economic digitalization within the scope of government to provide facilities and the synchronization of all stakeholders throughout the archipelago (Surya et al. 2021). In addition, the ease of the financial use of technology as part of economic digitalization can provide flexibility in SME financial transactions that enable the development of an efficient and effective business order. Various circumstances influence SMES in adopting Islamic economic digitalization such as knowledge about Islamic economy, perceptions, expectations, social responsibility aspects, facilities and Islamic values. The business continuity of Islamic SMEs is strongly supported by the adoption of Islamic fintech and financial literacy (Arner et al. 2020; Faiz 2020; Rabbani et al. 2021b). Some attributes can be attached to digital economics, such as digitalization, namely business transactions using information and technology devices; virtualization, namely changing business mechanisms from physical goods to virtual goods; molecularization, namely the status of heavy organizations changing into light organizations that are more flexible; internetworking, which can help in building interconnections and forming economic networks; disintermediation, i.e., eliminated peer-to-peer (Hartono 2016).

Financial innovation can encourage the sustainability of SME business life. This financial innovation can be found in the form of financial technology, but this financial

technology must be supported by good financial literacy. Financial innovation and financial literacy can expand access to various financial institutions, improve financial stability, overcome financial inclusion and encourage progress in economic development while prioritizing compliance with sharia values. Improving the Islamic financial performance of SMEs can also be influenced by other factors, such as technology, organization and environment (Qalati et al. 2021), social responsibility of the community by Islamic financial institutions (Mallin et al. 2014; Menne et al. 2016; Akben-Selcuk 2019) and productivity and business sustainability (Soytas et al. 2019). Digitalization economy can also be built together with partners of financial institutions and other partners with application models, such as peer-to-peer lending models, crowdfunding, digital payments, cryptocurrency, blockchain and so on (Faiz 2020; Khan and Rabbani 2020; Syed et al. 2020). Thus, economic digitalization, Islamic fintech and financial literacy are the main pillars in innovation for the progress and sustainability of Islamic SMEs businesses (Menne et al. 2022; Srisusilawati et al. 2021; Surya et al. 2022). Thus, the digitalization of the economy and financial literacy can also be performed by improving the quality of human capital in a sustainable and based-on-information technology (Dariah et al. 2022; Prado et al. 2022; Yang et al. 2022).

2.2. Digital Transformation of the Economy and Islamic Financial Performance

The digital economy transformation is able to accelerate SME business development, which is marked by a shift in business activities from offline to online and the increasingly massive use of digital economic platforms among SME managers. This digital transformation was more pronounced during the COVID-19 pandemic, which forced SMEs to survive in the midst of increasingly fierce business competition. The optimal use of digital economy is an unavoidable choice to replace conventional patterns that have been used so far. Digital transformation is an option in order to meet customer desires and be more in line with consumer expectations (Santoso et al. 2020; Azevedo and Almeida 2021; Irawan et al. 2022).

Financial performance can be measured by two approaches, namely the approach to market prices and accounting values as fundamental values (Garcia-Castro et al. 2010; Lassala et al. 2017). The approach used in this research was the accounting value approach, which is measured by several financial ratios such as liquidity, activity and profitability ratios. An Islamic financial performance measurement can still use measurements in existing accounting approaches that are based on more informative values than the market price approach because the value presented in accounting reports shows the actual state of events that occur in the companies, and generally, stock prices are the basis for the market value approach (Kieso et al. 2011; Menne et al. 2022). However, it is important to understand that the measurement of Islamic financial performance still refers to the adherence to Islamic values.

The Islamic financial performance of SMEs can also be measured using parameters commonly used by other entities. This measurement is based on several characteristics presented in the basic framework for the preparation and presentation of Islamic financial statements such as being relevant, comparable, reliable, easy to understand and consistent. If these characteristics can be met by sharia SMEs in the assessment of their financial reporting instruments, then SMEs' financial reports can be categorized as quality financial reports. Accounting can also explain the performance and financial condition of Islamic SMEs in a certain period even on a certain date, where this information can be used by users of financial statements in making decisions and predicting future performance (Kieso et al. 2011; Martani et al. 2012; IAI (Ikatan Akuntansi Indonesia) 2021). Digital transformation is very helpful for companies in improving sustainability reporting and supporting the strengthening of the sharia economy.

The contribution of sharia SMEs through improving their Islamic financial performance can spur economic growth in a region and can increase the gross domestic product (GDP) nationally (Saleh et al. 2020; Surya et al. 2021; Liu et al. 2022). Gross domestic product (GDP) can be measured by total production and is based on the market value of all goods and services produced in an area within a certain time unit. It is calculated in

nominal (monetary values) and real values (Yue et al. 2014; Szustak et al. 2022). Thus, at a macro level, it can be said that economic growth can be created by relying on government policies that create public trust and healthy business growth and development, including sharia SMEs (Burger et al. 2015; Pu et al. 2021). The view of macroeconomic theory considers that income can be permanently maintained and even increased, which is based on the principle of sustainable development despite the event of a reduction in the capital stock (Surya et al. 2021; Soyer et al. 2020). Problems can arise if economic development is faced with endemic occurrences such as COVID-19 and its derivatives such as the delta variant virus, omicron and other types that can have a negative impact on the cash flow of a number of businesses, trigger a decrease in people's purchasing power, disrupt the supply chain of goods and services and destabilize the economy as a whole (Yu et al. 2020; Sombultawee et al. 2022; Tinungki et al. 2022). However, in some cases, Islamic institutions have the ability to adapt and survive the crisis stronger than conventional institutions (Lynch 2022; Tok and Yesuf 2022).

2.3. Human Capital, the Role of Islamic Financial Institution and Government Support

Human capital is described as a situation where the human capital involved in SMEs have special skills and abilities in utilizing technology tools and how investment in an individual's education and training is similar to business investments in equipment. This human capital is intended to respond to the increasingly dynamic development of the business world by utilizing economic digitalization and financial literacy as its main capital. Good human capital can encourage an increase in the quality of the organization in facing various challenges, it can spur an increase in the quality of financial transactions and in the end it can encourage an increase in productivity and growth in the financial performance of SMEs (Becker 1994; Lengnick-Hall et al. 2011; Maksum et al. 2020; Hernita et al. 2021; Kooli and Abadli 2022).

The quality of human capital is also one of the important factors in increasing the role and function of economic digitalization and financial literacy (Hernita et al. 2021; Glavina et al. 2021; Kuchciak and Warwas 2021). The quality of human capital can be improved by various treatments, such as training, formal and non-formal education, giving new skills to Islamic SMEs actors, the mastery of information technology, the strengthening of communication, increasing electronic-based transaction skills, increasing business productivity, improving professionalism and increasing the role of economic digitalization (Surya 2015). This quality improvement is followed by the achievement of efficiency and effectiveness goals. The efficiency of cost, energy and time is effectiveness in terms of optimizing the role and function of human capital. At present, the ability of human capital can be measured in various perspectives both from physical and non-physical abilities, the extent to which human capital process all their potential towards comparative advantage and competitive advantage (Harmen and Pitaloka 2014; Hamadamin and Atan 2019; Kucharcíková and Miciak 2021).

The role of Islamic financial institutions and government support is a very important requirement in increasing the competitiveness of SMEs. The involvement of financial institutions and government support can play a role in overcoming capital problems, financial reporting assistance, government policies that are conducive to the business world, providing information technology facilities, CSR contributions from financial institutions and various other supports for the development of sharia SMEs. The financial inclusion of Islamic SMEs is important in efforts to foster capital, as long as the access and network of Islamic SMEs to Islamic financial institutions (IFIs) is well established (Doh and Kim 2014; Songling et al. 2018; Nawaz 2018; Setijawan et al. 2021). On the other hand, Islamic financial institutions can improve the implementation of convenience in financial services for sharia SMEs by participating in the digital economy, utilizing digital platforms and various other digital business instruments. This strategy can reduce bureaucracy and the length of administrative activities in banking and can eliminate the gap between large companies and SMEs, as well as provide opportunities for sharia SMEs to grow and develop so

that income distribution between various sectors and types of business can be created, and this is in order to realize social justice for society (Gheeraert 2014; Iqbal et al. 2021; Alhammadi 2022).

Support by the government is intended as various forms of government policies in maintaining business stability, such as during a pandemic with lockdowns, social restrictions and so on. Other policies can be seen in the provision of capital assistance and the provision of licensing facilities for SME businesses. Business efficiency and effectiveness by the government can continue to be developed in order to encourage economic growth, especially in developing countries such as Indonesia, both for short term and long terms goals (Saleem et al. 2021a; Menne et al. 2022).

2.4. Strengthening for Sharia Economy

Sharia economy is one of the strengths in supporting the strength of the national economy, especially now that sharia economy is no longer the domain of Muslims alone but also that of the non-Muslim community (Suryani 2012; Yusuf et al. 2020; Purnamasari and Galih 2021). In the master plan concept, Indonesia established several Islamic economic concepts, such as strengthening the legal aspects of sharia economics, socializing the concept of halal living, increasing the role and function of sharia financial institutions nationally, professionally reforming halal institutions, increasing the role of sharia inclusive financial services and increasing the quantity and quality of international cooperation (Jie et al. 2019; Ministry of Finance, Republic of Indonesia 2021; Amin 2021).

Sharia SMEs have contributed to the strengthening of the sharia economy as shown in Figure 1; since 2019, legal aspects and the coordination of various elements have been strengthened, including sharia SMEs as one of the Islamic economic actors. Furthermore, sharia SME business will be controlled and conditioned on the creation of a halal lifestyle, national halal fund in 2020, 2021, and 2022, then in 2023 and 2024 the launch and activation of sharia inclusive financial services and strengthening international economic cooperation through international halal centers. SMEs need to be strengthened in terms of the international market by building dynamic international marketing capabilities based on digital marketing (Reimann et al. 2021; Kim and Lim 2022). Government support, strengthening the position of financial institutions, the performance of sharia SMEs and the internationalization of Islamic finance have triggered the strengthening of the sharia economy in Indonesia (Kieso et al. 2011; Saputri 2020; Sohibien et al. 2022).

The strengthening of the sharia economy contributes to economic growth and can increase the gross domestic product (GDP) nationally (Surya et al. 2021; Saleem et al. 2021b; Jailani and Adinugraha 2022). The measure of total production is a formulation of gross domestic product (GDP), which is assessed based on a monetary assessment of all levels of goods and services produced in a region or region within a predetermined period of time (Surya et al. 2021). Thus, at a macro level, it can be said that economic growth can be created by relying on government policies that generate public confidence, especially in the government's alignment with the sharia economic domain (Nurdiana et al. 2021; Huntjens and Kemp 2022). Problems will arise if economic development is associated with outbreaks of endemic diseases such as COVID-19, which hit almost the entire world impacted the decline of people's ability to transact, disrupting patterns and mechanisms for the distribution of goods and services as well as having an impact on the social stability of the community (Fan et al. 2022). However, in many cases, the Islamic economy was able to survive even if the pandemic hit a region (González et al. 2019; Abbass et al. 2022; Albaity et al. 2022). Many businesses accelerated business activities from offline to online as well as using digital economic technology (Liu et al. 2022; Lu et al. 2021; Stofkova et al. 2022).

3. Research Method

3.1. Research Design

This research used a quantitative approach with a survey method. This approach was intended to test and analyze the strengthening of the sharia economy and the Islamic financial performance of SMEs in Makassar City based on economic digitalization and Islamic financial literacy. Furthermore, the analysis and testing focused on the role of economic digitalization, financial literacy, human capital, Islamic financial institutions and government support. Data were collected through observation, questionnaire instruments and documentation. Furthermore, this research was also intended to obtain respondents' views based on the use of economic digitalization and financial literacy in increasing the productivity and financial performance of SMEs. This study is also predictive in the sense that each word of influence in the results of the study shows the prediction of the relationship between the independent variable and the dependent variable to arrive at the conclusion of the study. For this purpose, this research used an analysis tool based on SEM (Structure Equation Model) PLS (Partial Least Square) (Hair et al. 2014; Fàbregues et al. 2020).

This research approach was designed to explain various phenomena related to the development of SMEs, especially in the current era of economic digitalization and the development of the sharia economy. The basic considerations are based on the following: (i) SME actors in Makassar City do not yet fully have the same capabilities related to the use of economic digitalization, (ii) Islamic financial literacy has not been fully controlled and empowered by SME actors, (iii) human capital has not been too strong or optimal in supporting the improvement of SMEs financial performance, (iv) the role of Islamic financial institutions in assisting SMEs in financing and financing is not optimal, (v) government support is not optimal in providing various information technology facilities, policies and regulations to support the improvement of SME financial performance and the strengthening of the sharia economy. In addition, this approach was chosen because (a) the number of SMEs is quite large and is spread across 15 sub-districts in Makassar City, (b) the uniqueness and diversity of the types of SME businesses make it possible to conduct searches related to the use of technology for SMEs, (c) the digital platform that is quite varied allows for many choices for SMEs in the use of technology and (d) the assessment of financial performance and economic business sustainability requires a fairly broad and complex assessment.

3.2. Study Area

This research was carried out in Makassar City with the consideration that Makassar City is known as one of the largest cities in Indonesia and has quite good economic growth compared to other regions. The area of Makassar City is about 175.77 Km² and is inhabited by around 1,526,677 people spread over 15 sub-districts. Furthermore, in this city, there are approximately 5387 SMEs involving 9696 workers and operating in various business sectors, such as (1) culinary business, (2) tourism business, (3) electronic and telecommunication business, (4) clothing and textile business, (5) cosmetic business, (6) souvenir business, (7) agriculture and (8) automotive business. This research was carried out for approximately 5 months from November 2021 to March 2022. Data collection was adjusted to the location of each SME in the sub-districts in Makassar City as presented in Figure 2. Other considerations were based on equal opportunities for all SMEs in Makassar City, whether they are in densely populated sub-districts or not or whether they are in sub-districts that are close to the city center or far away, and this was intended to measure the development of the sharia economy proportionally throughout the Makassar City area.

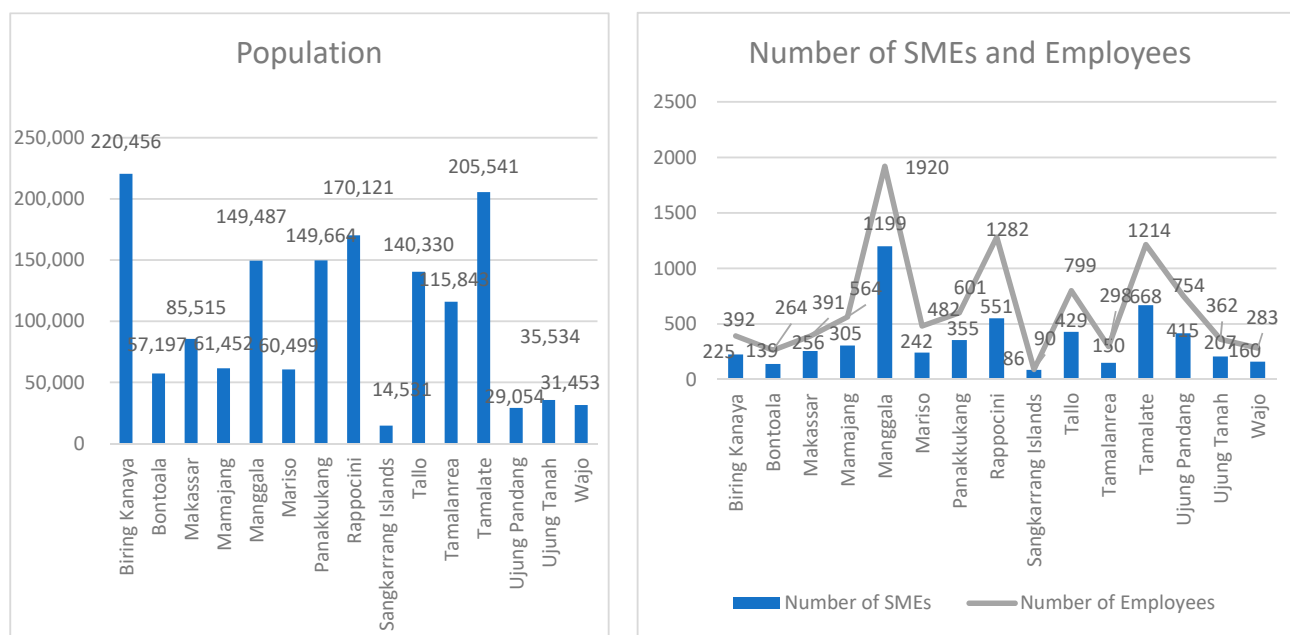


Figure 2. The population, number of SMEs, and the workforce involved in SMEs in Makassar City. Source: BPS Kota Makassar (2021).

3.3. Method of Collecting Data

Data were collected in the field using three methods, namely: (i) observation, carried out by observing the location and activities of SMEs in Makassar City, (ii) survey, used to assess the conditions and characteristics of SMEs in Makassar City, the number of employees, the age of businesses, the access to technology and linkages with financial institutions, and this method used a questionnaire instrument and (iii) documentation, intended as a method used to obtain the number of SMEs in Makassar City.

The questionnaire was developed from the variables and indicators involved in the research, starting with the identity of SMEs, followed by questions related to the variables and indicators described as follows: independent variables consist of digital economy as an independent variable measured by indicators such as digitization, virtualization, molecularization and disintermediation; financial literacy as measured by several indicators such as the understanding of financial products, the utilization of financial products, the ability to prepare financial reports, and skills in reading financial statements; human capital is measured by several indicators, such as mastery of technology, education, experience, organization and communication; the role of Islamic financial institutions as measured by the indicators ease of access and capital assistance; government support as measured by several indicators, such as the determination of policies, guidance and development and provision of facilities. The dependent variable consists of two, namely Islamic financial performance as measured by several indicators such as profitability, liquidity and activity, and Islamic economy as measured by the indicators the strengthening of legal aspects, the coordination of the sharia economy, the concept of halal living and the strengthening of the halal industry.

The data used in the study were divided into two categories, namely (i) primary data were data obtained directly from the field using a questionnaire interspersed with interviews with several respondents to strengthen the results of collecting data through questionnaires. This was conducted after tabulating and analyzing the data, and there were several things that needed to be confirmed to the respondent. (ii) Secondary data were data obtained through documents issued by SMEs or issued by the government related to SME activities and reporting. Furthermore, SMEs that were used as objects in this study are SMEs that carry out business activities in Makassar City, and in carrying out their activities,

they always use digital business as an inseparable tool in business activities in the era of the industrial revolution 4.0.

3.4. Research Respondents

Data were collected by distributing questionnaires to 350 SME respondents, which were conducted online. Respondents were spread across 15 sub-districts in Makassar City (Figure 3). The questionnaire was given in the form of closed questions with five alternative answers on five interval scales. The intervals used in the questionnaire are (i) strongly disagree, (ii) inappropriate, (iii) neutral, (iv) appropriate or (v) very appropriate.

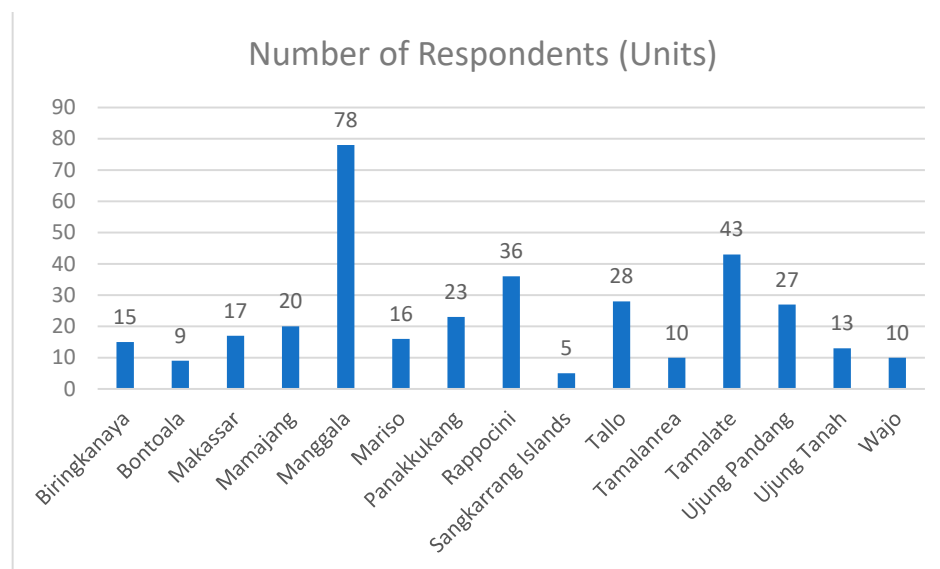


Figure 3. Number of respondents. Author's elaboration.

The selected respondents were a sample of the UKM population in Makassar City, which was obtained using a proportional sampling technique that was able to understand the focus of the research and the goals to be achieved well and to pay attention to the characteristics of the businesses developed by UKM in Makassar City.

The determination of respondents refers to the method of determining the sample developed by [Sekaran and Bougie \(2013\)](#). The formulation used in this study is presented as follows:

$$n = \frac{Z^2 \alpha p q}{d^2} \quad (1)$$

where n is the sample size, Z is the level of confidence according to the standard normal distribution (95%), α is the expected population proportion (in decimal form), p is the estimated proportion of the SME population (50%), $q = 1 - p$, d = tolerated margin of error. From the total SME population of 5387 units, 350 SMEs were the sample of this study, with details as follows.

3.5. Data Validity and Reliability

The validity test was used to confirm that the variables involved in this study are valid and can be acquired for any SME business. Validity testing was performed with Pearson's product moment by analyzing the correlation of each question item with a predetermined score for each variable. The formulation used in this study was Pearson product moment ([Hidayat 2012](#)) and was assisted by the PLS 3 SEM device, described as follows:

$$r_{xy} = \frac{n \sum X_i Y_i - \sum X_i \sum Y_i}{\sqrt{n \sum X_i^2 - (\sum X_i)^2} \sqrt{n \sum Y_i^2 - (\sum Y_i)^2}} \quad (2)$$

where r_{xy} is the correlation coefficient, n is a value that indicates the number of respondents, the value of $\sum X$ is the score of items, $\sum Y$ is the total value of each respondent, $\sum X^2$ is the total squares of each item, $\sum Y^2$ is the total squares of the total scores obtained by each respondent and $\sum XY$ is the result of multiplying the value of the questionnaire with the total value sourced from the respondent. The values mentioned above were then processed using PLS tools, and the validity of each indicator could be tested by looking at the results of the outer loading of each indicator. If the test results showed that the outer loading value was greater than 0.7 (>0.7), then the indicator was said to be valid. The results of the outer loading test of each indicator can be seen in Table 1 below.

Table 1. The results of testing construct validity for each indicator. Source: Analysis results.

Variables	Indicator	Outer Loading	Description
Digital Economy (X_1)	$X_{1,1}$	0.800	Valid
	$X_{1,2}$	0.815	Valid
	$X_{1,3}$	0.779	Valid
	$X_{1,4}$	0.572	Invalid
Financial Literacy (X_2)	$X_{2,1}$	0.822	Valid
	$X_{2,2}$	0.909	Valid
	$X_{2,3}$	0.362	Invalid
	$X_{2,4}$	0.883	Valid
Human Capital (X_3)	$X_{3,1}$	0.786	Valid
	$X_{3,2}$	0.869	Valid
	$X_{3,3}$	0.851	Valid
	$X_{3,4}$	0.814	Valid
The Role of IFIs (X_4)	$X_{4,1}$	0.925	Valid
	$X_{4,2}$	0.829	Valid
	$X_{4,3}$	0.072	Invalid
Government Support (X_5)	$X_{5,1}$	0.902	Valid
	$X_{5,2}$	0.860	Valid
Financial Performance (Y_1)	$Y_{1,1}$	0.919	Valid
	$Y_{1,2}$	0.902	Valid
Sharia Economics (Y_2)	$Y_{2,1}$	0.936	Valid
	$Y_{2,2}$	0.928	Valid

Table 1 above shows that the indicator of the digital economy variable, the indicator of the financial literacy variable and the indicator of the role of IFIs variable had an outer loading value that was smaller than 0.70 (<0.70); thus, it was considered invalid to be included in the analysis. Thus, the indicator was excluded from the model and was not included in the subsequent analysis. Furthermore, this research instrument was also tested as a whole to measure the fulfillment of the validity requirements. The AVE value shown by each variable showed a value greater than 0.6 (>0.6); thus, all variables were declared valid. The results of the research instrument validity test are presented in Table 2 below.

Table 2. The results of testing the validity of the research instrument.

Variables	Average Variance Extracted (AVE)	Description
Digital Economy (X_1)	0.678	Valid
Financial Literacy (X_2)	0.770	Valid
Human Capital (X_3)	0.690	Valid
The Role of IFIS (X_4)	0.771	Valid
Government Support (X_5)	0.777	Valid
Financial Performance (Y_1)	0.829	Valid
Sharia Economic (Y_2)	0.869	Valid

Source: Analysis result.

Meanwhile, the reliability test was intended to measure the variables used to be safe and that can work well and are used properly at different times and conditions. A variable was said to be reliable if the Cronbach alpha and composite reliability values were equal to or above 0.70 (>0.70), both for each variable and for all variables in the model.

The testing technique used in this analysis was a split-half correlation based on a formulation known as the Spearman-Brown formulation. The interval scores of consecutive odd items were summed to obtain the total odd hemisphere score. Meanwhile, the intervals of consecutive even items were summed so that the total value of even splits was obtained. After that, the total value of odd and even hemispheres correlated with the correlation coefficient formulation as follows:

$$r_i = \frac{2r_b}{1 + r_b} \quad (3)$$

showing reliability of all instruments, while the correlation used the product moment for the first and second halves. The significance coefficient test was carried out by a *t* test (with a significance level of 5%) with the following formula:

$$t = \frac{r_i \sqrt{(n-2)}}{\sqrt{1-r_i^2}}; \text{ db} = n - 2 \quad (4)$$

The results of testing the construct validity and reliability of all the variables involved in this study can be shown in Table 3 below.

Table 3. The test results of the reliability construct.

Variable	Cronbach's Alpha	Composite Reliability	rho_A	Description
Digital Economy (X ₁)	0.763	0.863	0.768	Reliable
Financial Literacy (X ₂)	0.851	0.909	0.865	Reliable
Human Capital (X ₃)	0.850	0.899	0.854	Reliable
The Role of IFIs (X ₄)	0.714	0.871	0.790	Reliable
Government Support (X ₅)	0.714	0.874	0.727	Reliable
Financial Performance (Y ₁)	0.795	0.907	0.800	Reliable
Sharia Economic (Y ₂)	0.849	0.930	0.851	Reliable

Based on Table 3 above, the results of the analysis showed that all the variables in this study, including digital economy (X₁), financial literacy (X₂), human capital (X₃), the role of IFIs (X₄), government regulation (X₅), Islamic financial performance (Y₁) and the strengthening of the sharia economic revival (Y₂), all met the reliable category, because the values of Cronbach's Alpha, Composite Reliability and rho_A of each variable were greater than 0.70 (>0.70); thus, all research variables were considered reliable.

3.6. Data Analysis Method

The quantitative data analysis method was used to analyze the effect of economic digitalization, sharia fintech, human capital, the role of financial institutions and government regulatory support on SMEs' financial performance and the strengthening of the sharia economy. The formulation used to perform this analysis was multiple linear regression with details of the independent variables as follows: X₁ (digital economy) was measured by the indicators digitalization, virtualization, molecularization and disintermediation; X₂ (financial literacy) was measured by several indicators such as the understanding of financial products, the utilization of financial products, the ability to prepare financial reports and skills in reading financial statements; X₃ (human capital) was measured by several indicators, such as mastery of technology, education, experience and organization, as well as communication; X₄ (the role of Islamic financial institutions) was measured by the indicators ease of access and capital assistance; X₅ (government support) was measured by several indicators, such as the determination of policies, guidance and development and

the provision of facilities. The dependent variables consisted of two, namely Y_1 (Islamic financial performance) which was measured by several indicators such as profitability, liquidity, and activity, and finally, Y_2 (sharia economy) was measured by the indicators strengthening the aspects of legality, coordinating the sharia economy, the concept of halal living, and strengthening the halal industry.

The influence and relationship of each variable described above were tested using a multiple linear regression approach. This analysis was used to determine how much influence economic digitalization (X_1), financial literacy (X_2), human capital (X_3), the role of Islamic financial institutions (X_4) and government support (X_5) have on Islamic financial performance (Y_1) and sharia economy (Y_2), and this analysis can also be used to predict the value of the dependent variable if all the values of the independent variable are known. The multiple linear regression analysis model as mentioned before is represented in Figure 4 below.

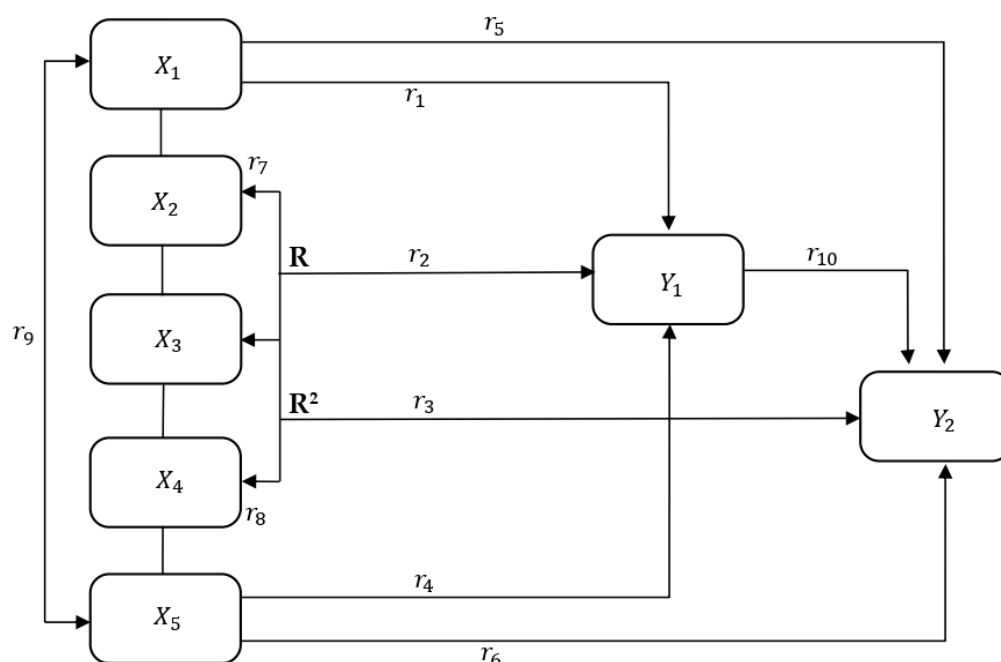


Figure 4. Multiple linear regression model.

The relationship of each of these variables was formulated with the following formula:

$$r_{xy} = \frac{\sum xy}{\sqrt{(\sum x^2)}\sqrt{(\sum y^2)}} \tag{5}$$

where r_{xy} is the correlation coefficient between the values of x and y . This correlation coefficient predicts a linear relationship from the original data to produce a straight-line correlation. The values of x and y are the deviations from the average value for each variable value of X and Y , while $\sum xy$ is the product of the product of the values of x and y , x^2 is the square of the x value and y^2 is the square of the y value. Thus, the multiple linear regression model can be shown as follows:

$$Y_1 = a_0 + a_1X_1 + a_2X_2 + a_3X_3 + a_4X_4 + a_5X_5 + e \tag{6}$$

$$Y_2 = a_0 + a_1Y_1 + e \tag{7}$$

This formulation shows the relationship of the independent variables $X_1, X_2, X_3, X_4,$ and X_5 to the two variables Y (Y_1 and Y_2) as the dependent variables. The dependent variable Y_2 also measures the influence of the variable Y_1 . This is to measure the relationship

between variable with Y_1 and Y_2 . Meanwhile, the SEM application could be used in this study with the following formula:

$$\eta = \alpha + B\eta + \Gamma\xi + \zeta \quad (8)$$

$$\eta - B\eta = \alpha + \Gamma\xi + \zeta \quad (9)$$

$$(I - B)\eta = \alpha + \Gamma\xi + \zeta \quad (10)$$

$$\eta = (I - B)^{-1}\alpha + \Gamma\xi + \zeta \quad (11)$$

where α is the intercept vector, B and Γ are the coefficients matrix and $\zeta = \zeta_1, \zeta_2, \zeta_m$ is the error vector in the structural equation; element B presents variable influence η and variable η other, and element Γ presents a direct influence of variables ξ in variable η . It is assumed that ξ is not correlated with ζ , and $I - B$ is nonsingular. Furthermore, the intercept vector is $m \times 1$, η is the endogenous latent variable $m \times 1$ and B is the coefficient matrix of the endogenous latent variable $m \times m$. Γ is the coefficient matrix of the exogenous latent variable $m \times n$, ξ is the exogenous latent variable vector $n \times 1$ and ζ is the structural model error vector relationship between η and ξ size $m \times 1$. Furthermore, random vector η and ξ are not measured directly but through the indicator, namely the variables $YT = (y_1, y_2)$ and $XT = (X_1, X_2, \dots, X_p)$.

4. Results

4.1. Determinants of Strengthening Sharia Economy and Financial Performance

The development of sharia economy and finance has increased in the last two decades, both in global and national contexts. The total expenditure for the halal food and halal lifestyle sector has set a figure of USD 2.1 trillion in 2017 and will continue to increase and is predicted to reach USD 3 trillion in 2023. This growth is strongly influenced by the increase in the number of Muslim populations in the world today and will continue to increase to 27.5% of the total population of the earth in 2030. This increase in population certainly has a significant influence on the increasing need for halal products and the sharia economy in general ([Indonesia Ministry of National Development Planning 2019](#); [Bank Indonesia 2017](#)).

Sharia finance practices by SMEs themselves are characterized by the use of a digital business platform that is easier and more flexible, as long as the use of the application is free from cases prohibited by sharia, such as usury, gambling and fraud. The use of business digital platforms starts from social media facilities, such as WhatsApp, Instagram, Facebook and others, and is more refined to the use of more specific sharia fintech applications, such as peer-to-peer lending, crowdfunding and e-commerce. Some SMEs also take advantage of accounting applications such as accurate, zahir accounting, e-filing and others ([Faiz 2020](#)).

Quantitative research results based on multiple linear regression analysis that were carried out showed that there are several factors that influence the sharia economy and the financial performance of sharia SMEs such as (i) digital economy, (ii) financial literacy, (iii) human capital, (iv) the role of IFIs and (v) government support. The test results show the significance value of the regression coefficient as presented in Table 4 below.

From Table 4 above, the variables that affect the financial performance of Islamic SMEs are human capital, the role of Islamic financial institutions and government support with t-count values of 3018, 3694 and 4860, which are greater than t-table 1.92. Similarly, the variables that affect Islamic economic revival are human capital and government support, with t-count values of 2.352 and 3.279, respectively, which are greater than the t-table value of 1.92. While the variables that have no effect on the financial performance variable are digital economy (1509) and financial literacy (1549), and the variables that do not affect the Islamic economic revival variable are digital economy (0.539) and financial literacy (0.628).

Meanwhile, financial performance has a significant influence on Islamic economic revival with a value of 4264. This shows that government support, the role of Islamic financial institutions, human capital and financial performance can encourage the creation of an Islamic economic revival.

Table 4. Summary of the results of the regression coefficient significance test.

Correlation	Coefficient	Error	T-Count	T-Table
Digital Economics toward Financial Performance	0.075	0.050	1.509	1.92
Digital Economics toward Sharia Economy	−0.003	0.056	0.539	1.92
Financial Literacy toward Financial Performance	0.085	0.055	1.545	1.92
Financial Literacy toward Sharia Economy	0.034	0.054	0.628	1.92
Human Capital toward Financial Performance	0.231	0.076	3.018	1.92
Human Capital toward Sharia Economy	0.210	0.089	2.352	1.92
The Role of IFIs toward Financial Performance	0.213	0.058	3.694	1.92
The Role of IFIs toward Sharia Economy	0.004	0.056	0.778	1.92
Government Regulation toward Financial Performance	0.316	0.065	4.860	1.92
Government Regulation toward Sharia Economy	0.256	0.078	3.279	1.92
Financial Performance toward Sharia Economy	0.448	0.105	4.264	1.92
Regression Residual	R Square	R Square Adjusted		
Financial Performance	0.585	0.577		
Islamic Economic Revival	0.716	0.709		

The results of this PLS SEM analysis can then explain the relationship model between digital economy, financial literacy, human capital, the role of Islamic financial institutions and government support for financial performance and Islamic economic revival, as shown in Figure 5 below.

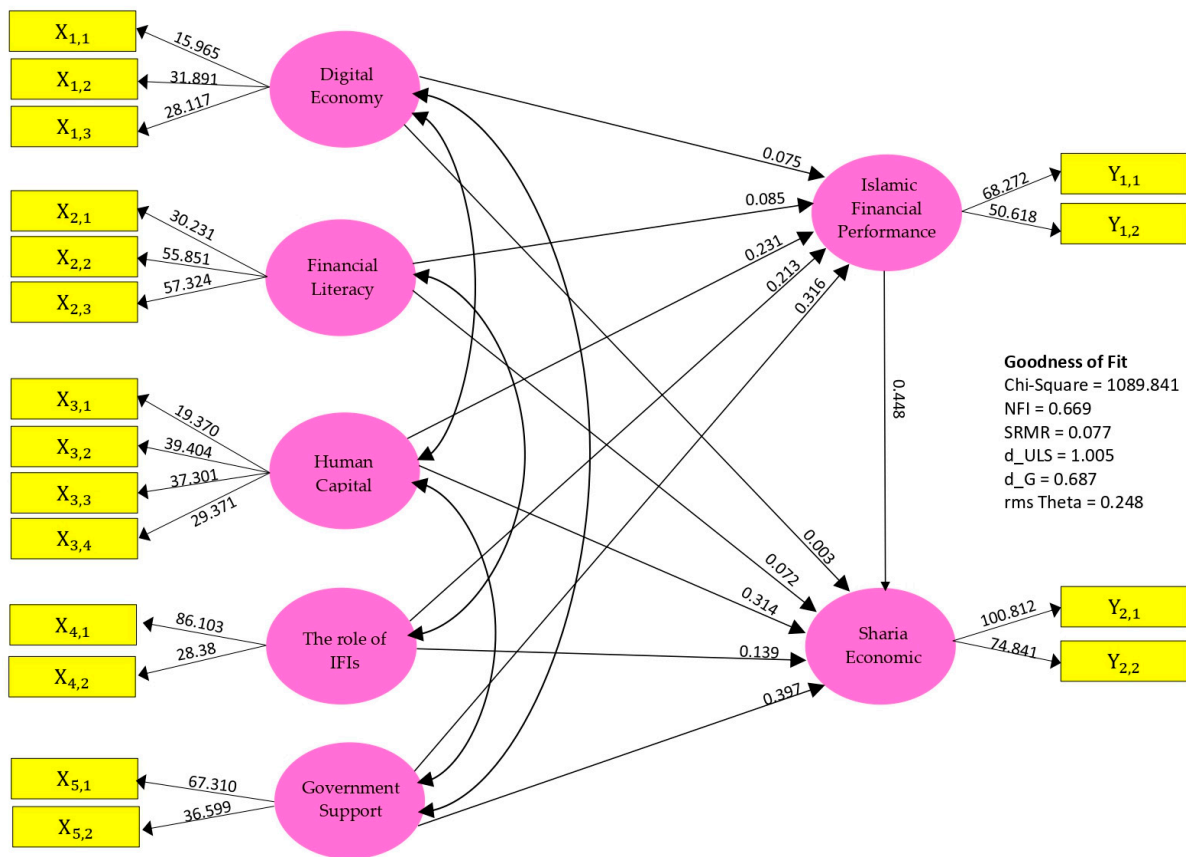


Figure 5. PLS SEM analysis results.

Figure 5 above shows a model of the relationship between digital economy, financial literacy, human capital, the role of IFIs, government support, Islamic financial performance and the strengthening of the sharia economy. The results of the PLS SEM analysis of the model developed in this study met the model fit category, marked by test results that showed numbers that matched the goodness of fit test categorization. The Chi-Square test results showed a value of 1089.841, with the NFI = 0.669, being between 0 and 1 and closer to the number 1. The SRMR value = 0.077 met the criteria lower than 0.08, and the d_{ULS} value = 1.005, d_G = 0.687 and $rms\ Theta$ = 0.248. Likewise, the total influence of the digital economy on Islamic financial performance was 0.075 or 7.5%, financial literacy was 0.085 or 8.5%, human capital was 0.231 or 23.1%, the role of IFIs was 0.213 or 21.3% and government support was 0.316 or 31.6%. Meanwhile, the total influence of digital economy on the strengthening of the sharia economy was 0.003 or 0.3%, financial literacy is 0.072 or 7.2%, human capital is 0.314 or 31.4%, the role of IFIs is 0.139 or 13.9% and government support is 0.397 or 39.7%, and finally the total influence of Islamic financial performance against the strengthening of the sharia economy of 0.448 or 44.8%.

4.2. Development of Financial Literacy and Digital Economy of SMEs

The financial literacy of most SMEs in Makassar City, Indonesia, is still low. The results showed that most SMEs do not understand Islamic financial products well. SME actors also do not fully understand the process of preparing financial reports or do not have the ability to read information from financial reports. A total of 56% of respondents stated that they did not understand items related to financial literacy (not yet literate), there were still as many as 29% who did not understand financial literacy (lack of literacy), 14% of SMEs players were sufficient in understanding financial literacy (sufficient literacy) and 1% among SME actors already understood financial literacy well (well literate). The low understanding of SME actors regarding financial literacy is due to some SMEs having an educational background, not accounting and finance. However, some SMEs use accounting software in the preparation of financial reports, especially SMEs with an educational background in information technology. Information related to this is presented in Figure 6 below.

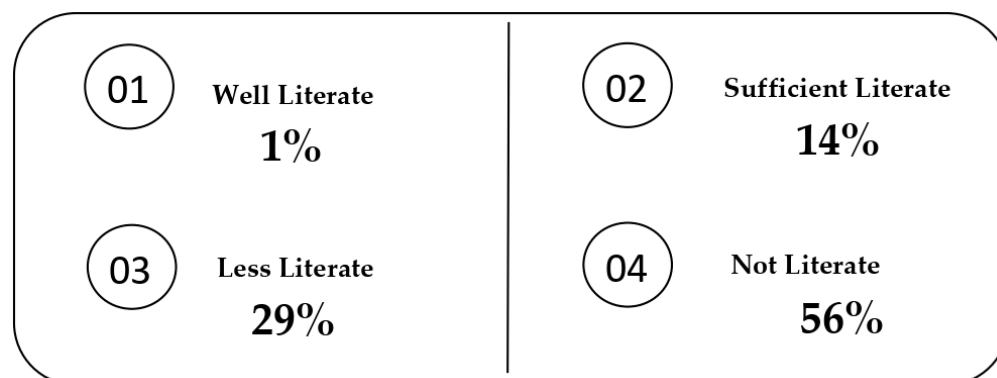


Figure 6. Financial literacy level of SMEs in Makassar City. Source: Analysis results.

SME financial literacy, which is still low as shown in Figure 6 above, shows the situation that occurs in the research location. Thus, maximum efforts are needed by all components of the nation, especially from the government to improve the financial literacy capacity of SMEs in order to further increase SME support for strengthening the sharia economy and increasing economic growth and achieving sustainability development goals.

Thus, the development of SME organizations in Makassar City, Indonesia, is carried out by digitalizing the economy and financial literacy, especially in the face of increasingly difficult business challenges and with the COVID-19 pandemic. SMEs are trying to develop their business and integrate business with digital platforms (Pu et al. 2021). Based on the results of interviews with several respondents, it shows that the pandemic has forced SMEs to take advantage of technology; thus, although some SME business actors are old, they are

forced by circumstances to use technological tools. Applications that are commonly used range from social media, such as Facebook, IG, WhatsApp and others, while the use of fintech is assisted by the Quick Response Code Indonesian Standard (QRIS) program from Bank Indonesia (BI). QRIS is one of the standard payment transaction models that uses QR codes. The government's support is felt by SMEs by socializing the use of QRIS; thus, with this application, SMEs can feel ease, fluency, comfort and security in their activities.

One of the important roles of economic digitization is also found in the field by increasing business turnover and business visibility in search engines (online world). The number of SMEs connected to digital platforms will increase by 2021 to 105% to 16.4 million SMEs. However, in particular, some SME players in Makassar City, Indonesia, only use a simple digital business platform that is commonly used by the public with the consideration that their inventory is easily subject to price fluctuations, thus having difficulty updating prices at any time.

5. Discussion

The Indonesian government with its sharia economy master plan requires strengthening the sharia economy. Strengthening the sharia economy is a solution that can be played by sharia SMEs with several factors such as increasing the use of digital economy and sharia financial literacy, developing human capital as an important tool in utilizing the digital economy and sharia financial literacy. The role of IFIs also has an important role in the sharia financial performance of SMEs and in strengthening the sharia economy, especially in terms of providing financing and capital assistance to sharia SMEs. This financing and capital assistance can increase capital turnover and increase the volume of SME transactions, and of course, this assistance still refers to the sharia scheme as the goal of the Ministry of National Development Planning/Bappenas master plan towards strengthening the sharia economy. No less important role in achieving the strengthening of the sharia economy and improving the sharia financial performance of SMEs is the support from the government in the form of policies that favor the achievement of the objectives of strengthening the sharia economy. This policy can be extended not only to the legal aspect but also to the guidance and development of SMEs. Development guidance and assistance can be in the form of education and training, the socialization of government programs and policies, as well as the preparation of facilities and infrastructure for economic digitization and financial literacy, such as the improvement of network quality, the addition of supporting equipment for telecommunication networks, the improvement of equipment to increase productivity and network accessibility, as well as the development of digital and sharia economic fintech platforms that are cheap, environmentally friendly, flexible and easy to use.

Meanwhile, the Islamic financial performance of SMEs is determined by the extent to which SMEs take advantage of digital economy and Islamic financial literacy. Some SME players in Makassar City, Indonesia, use social media that is easy and cheap, while SME players are challenged to access a more flexible digital economy platform and affiliate with competent partners. The sharia financial performance of SMEs is also largely determined by the capacity of qualified human capital and has good competence in integrating economic digitization with the theory of production and product marketing. SMEs also really need the support and participation of Islamic financial institutions and government support in the form of socializing the use of the digital economy and Islamic financial literacy, training in preparing financial reports and various supporting programs that lead to improving the Islamic financial performance of SMEs. The role of Islamic financial institutions can be provided in the form of easy and inexpensive service assistance, as well as effective financing by prioritizing sharia values in every business transaction. The role of the government is felt by sharia SMEs in the form of protective policies. The issuance of laws related to strengthening the sharia economy, such as Law no. 33 of 2014 concerning Halal Assurance Products, which began to be effectively used in 2019, became a haven for SMEs to improve their sharia financial performance towards SMEs that are strong and have sharia

character, thereby contributing to the achievement of the goal of sharia economic revival, spurring and triggering the nation's healthy economic growth.

6. Conclusions

The Indonesian sharia economic master plan 2019–2024 encourages strengthening the sharia economy and national economy sustainability. The strengthening of the sharia economy is fully supported by the capacity of human capital, the role of IFIs and government support. The development of human capital is intended to improve the quality and skills of human capital in the use of digital economy and Islamic financial literacy. Skills in using digital economy and Islamic financial literacy encourage increased productivity and Islamic financial performance of SMEs. The role of Islamic financial institutions is shown in the form of providing access and financing assistance to SMEs. This role creates conditions for the establishment of a healthy and productive SME sharia business life structure, and this encourages the achievement of the strengthening of the sharia economy. In line with that, the number of SMEs that utilize the facilities of Islamic financial institutions is increasing from year to year. Government support is very important in sustaining the strengthening of the sharia economy. One of the government's supports is the master plan of the Indonesian Ministry of National Development Planning, which started in 2019 and targets 2024 as the year of strengthening the sharia economy, with the main target being to increase international cooperation through international halal centers. Digital economy and financial literacy also show a link with the strengthening of the sharia economy; although, in this study, the significance is still low, but they remain an integral and comprehensively integrated part of efforts to revitalize the Islamic economy.

Sharia SMEs rely on increasing human capital, the role of Islamic financial institutions and government support as the main force in improving Islamic financial performance. From the results of the study, it was found that human capital has the ability to take advantage of the digital economy and financial literacy to encourage increased sales and the growth of SME turnover. In addition, the use of Islamic financial institution products by SMEs has increased significantly; this increases the opportunity for SMEs to receive financing and capital assistance, thereby encouraging the improvement of the Islamic financial performance of SMEs and innovation and business development.

This research still leaves a number of limitations, especially from the research instrument, which is still limited; thus, it requires further study. Further research can be developed by expanding the scope of problems experienced by SMEs that encourage increased Islamic financial performance and the strengthening of the sharia economy, such as (i) increasing the role of the digital economy and financial literacy through empowering SMEs in rural areas and (ii) increasing government support and policies as well as developing financial facilities to encourage improvement in the Islamic financial performance of sharia SMEs and to encourage the strengthening of the sharia economy in Makassar City, South Sulawesi, Indonesia.

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