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Navigating Risk and Profit in Sharia Investment: Its Impact on MSME Sustainability in Central Java with a Focus on Social Investment

Paramita Andiani[1], Bhaswarendra Guntur Hendratri[2], Salwa Aulia Novitasari[3]
[1,3] Nusa Putra University
[2] Universitas Pangeran Diponegoro Nganjuk

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ABSTRACT

This study examines the impact of risk and profit on the sustainability of Micro, Small, and Medium Enterprises (MSMEs) in Central Java, focusing on the mediating role of social investment within Sharia-compliant financial practices. Employing a quantitative approach, data were collected from 85 MSMEs through structured questionnaires and analyzed using SPSS version 25. The findings reveal that financial risk negatively affects MSME sustainability, while profitability positively influences it. Social investment practices, such as zakat and waqf, play a significant mediating role, reducing the negative impact of risk and enhancing the positive influence of profitability on sustainability. These results highlight the importance of integrating ethical and socially responsible financial practices in fostering resilience and growth among MSMEs. The study underscores the potential of Sharia investment principles in addressing the unique challenges faced by MSMEs, offering practical insights for policymakers and business stakeholders.

Corresponding Author:

Name:
Institution:
Email:

1. INTRODUCTION

Micro, Small, and Medium Enterprises (MSMEs) play a pivotal role in the economic development of Indonesia, contributing significantly to employment generation and poverty alleviation. In Central Java, MSMEs constitute a substantial portion of the regional economy, showcasing resilience in the face of economic challenges. However, these enterprises often grapple with limited access to financial resources, high operational risks, and an uncertain profit landscape, which threaten their sustainability. To address these challenges, the adoption of Sharia-compliant investment practices has gained prominence as a viable alternative, integrating ethical financial principles with economic growth objectives. The role of MSMEs in Indonesia, particularly in Central Java, is crucial for economic development, employment generation, and poverty alleviation. Despite their significance, MSMEs face challenges such as limited financial resources and high operational risks. The adoption of Sharia-compliant investment practices has emerged as a promising solution to these challenges, integrating ethical financial principles with economic growth objectives. This approach not only aligns with the cultural and religious context of Indonesia but also offers a sustainable financial model for MSMEs. MSMEs contribute significantly to Indonesia's GDP, accounting for over 60% and employing more than 97% of the workforce [1], [2], and they are vital in delivering essential goods and services, especially in rural and urban communities, playing a key role in economic resilience during crises [3], [4]. Nevertheless, limited access to financial resources remains a major hurdle affecting their ability to expand and innovate [1], while high operational risks and an uncertain profit landscape further threaten their sustainability [4]. In response, Islamic finance practices have shown potential in enhancing the growth and well-being of MSMEs by providing ethical and moral financial solutions [5], as Sharia-compliant financial institutions offer greater access to capital, which is crucial for business development and achieving economic goals [2]. Furthermore, Islamic finance integrates ethical business practices that foster innovation and sustainable growth [5], supporting the resilience of MSMEs by aligning financial practices with spiritual and ethical values, which are important internal factors for business sustainability [4].

Sharia investment emphasizes risk-sharing, social justice, and the avoidance of exploitative practices, aligning financial goals with social and moral imperatives. This unique approach not only aims to generate profits but also supports the broader socio-economic welfare of the community. Social investment, as a key component of Sharia finance, underscores the importance of ethical contributions to societal development, including philanthropy, equitable wealth distribution, and support for underserved segments. For MSMEs, such an approach holds promise in mitigating financial risks and fostering long-term sustainability. Sharia investment, with its emphasis on risk-sharing, social justice, and ethical practices, aligns financial objectives with broader socio-economic welfare, making it particularly beneficial for micro, small, and medium enterprises (MSMEs). This approach not only aims to generate profits but also supports sustainable development and equitable wealth distribution. Sharia finance, through its unique principles, offers a promising framework for MSMEs to mitigate financial risks and achieve long-term sustainability. Sharia finance promotes risk-sharing, which is a core principle that enhances financial inclusion and distributive justice, achieved through equity-based financing models like mudharabah and musharakah, encouraging collaboration between capital providers and entrepreneurs, thus reducing reliance on interest-based instruments [6], [7]. By avoiding riba (interest), gharar (uncertainty), and maysir (gambling), Sharia financing provides a fairer and more transparent financial system, particularly beneficial for MSMEs seeking ethical and sustainable growth [8]. Islamic investment is deeply rooted in ethical conduct, emphasizing justice, participation, and cooperation, and avoids exploitative practices such as monopolies and usury, ensuring protection for both affluent and indigent parties [9]. The commitment to ethical investments extends to avoiding projects that harm the environment or society, thereby promoting sustainable development and social welfare [10]. Furthermore, Sharia financing models like mudharabah provide significant potential for empowering small and medium entrepreneurs by sharing profits and risks equitably, fostering economic empowerment and reducing disparities, thus creating opportunities for MSMEs to thrive [6], while Islamic financial institutions, including banks and cooperatives, play a crucial role in providing access to capital for MSMEs, enhancing productivity and employment opportunities [8].

Despite its potential, the relationship between Sharia investment, risk, profit, and MSME sustainability remains underexplored, particularly in the context of social investment. Understanding these dynamics is crucial for optimizing financial strategies that enhance the viability of MSMEs while maintaining their adherence to Sharia principles. This study addresses this gap by investigating the impact of risk and profit on MSME sustainability, with a focus on the mediating role of social investment in Central Java. The research adopts a quantitative methodology, surveying MSME owners and managers to assess their perceptions and experiences with Sharia-compliant investment practices.

2. LITERATURE REVIEW

2.1 MSMEs and Their Economic Significance

Micro, Small, and Medium Enterprises (MSMEs) are crucial to Indonesia's economy, contributing around 60% to GDP and employing nearly 97% of the workforce [11], [12]. In Central Java, MSMEs are deeply rooted in traditional industries, serving as economic drivers and social safety nets, particularly for rural communities [11], [13]. Despite their significance, MSMEs face persistent challenges such as limited access to formal financial capital [13], inadequate infrastructure, low technology adoption [12], and poor integration into global markets [1]. Addressing these issues requires improved access to capital, technology support [12], empowerment through equitable resource distribution [11], and macroeconomic stability initiatives like inflation and exchange rate management [14].

2.2 Sharia Investment Principles

Sharia-compliant investment, grounded in Islamic financial principles, offers a unique approach to finance that emphasizes ethical practices, risk-sharing, and fairness. This system prohibits interest (riba), speculation (gharar), and investments in haram activities, instead promoting equity-based financing mechanisms like mudarabah and musharakah, aiming to foster social and economic justice, which makes Sharia investment particularly appealing for micro, small, and medium enterprises (MSMEs) that align with Islamic values. The risk-sharing mechanisms inherent in Sharia finance provide a safety net for MSMEs, enabling them to navigate financial uncertainties more effectively. Sharia-compliant finance promotes ethical investments that enhance societal welfare, attracting both Islamic and non-Islamic investors interested in ethical financial solutions [15], [16] with risk-sharing and profit-sharing principles central to promoting justice and equity in the economy [17]. Sharia financing also provides fairer and more transparent access to financing, reducing economic inequality and encouraging collaboration between capital owners and entrepreneurs [8], while Islamic financial institutions, such as Islamic banks and cooperatives, significantly contribute to improving public welfare through the MSME sector [8]. Although Sharia-compliant funds exhibit high adherence to Islamic principles, they sometimes underperform compared to conventional funds in terms of returns and risk [18], and challenges remain, including limited public understanding of Sharia products and restricted access to financial institutions in certain regions [8].

2.3 *Risk and Profit in MSME Sustainability*

Effective risk management and profitability are crucial for the sustainability of Micro, Small, and Medium Enterprises (MSMEs). Risk management strategies help MSMEs navigate financial risks, operational challenges, and market volatility, thereby enhancing their resilience and ability to maintain profitability. Profitability, in turn, allows these enterprises to reinvest in their operations, expand, and innovate, ensuring long-term viability. Effective risk management begins with identifying and assessing potential risks, such as market changes and operational uncertainties, which can negatively impact business sustainability [19], [20]. Strategies like product diversification, financial management, and digital technology adoption have been shown to stabilize income and improve operational efficiency [21], although MSMEs often face challenges such as limited resources and lack of risk management knowledge, necessitating collaborative support from government and stakeholders to provide training and access to technology [21]. Comprehensive financial planning and sustainable investment are critical for enhancing business sustainability, and integrating ESG factors into investment decisions can further support long-term growth [22]. By minimizing risks, MSMEs can protect their financial health and improve operational efficiency, laying the foundation for long-term success [20]. Moreover, for MSMEs adhering to Sharia principles, profitability must align with ethical guidelines, requiring additional adjustments in financial strategies to ensure compliance [22].

2.4 *Social Investment in Sharia Finance*

Social investment in Sharia finance promotes societal well-being through mechanisms like zakat, waqf, and socially responsible investments, which redistribute wealth, support underprivileged groups, and foster social cohesion in line with Sharia objectives. For Micro, Small, and Medium Enterprises (MSMEs), social investment enhances resilience, sustainability, stakeholder relationships, reputation, and funding opportunities. Zakat mobilizes resources for economic development and poverty reduction [23], [24], waqf provides sustainable funding for social projects [25], and sadaqah supports financial inclusion and social cohesion [24]. These practices strengthen MSME stakeholder engagement [23] and enable capital access through waqf and sukuk [25]. Additionally, Islamic social finance contributes to achieving 11 of the 17 Sustainable Development Goals (SDGs) by promoting economic, social, and environmental sustainability [26], with Indonesia and Malaysia at the forefront of research and implementation [26].

2.5 *Previous Studies on Sharia Investment and MSMEs*

Several studies have explored the intersection of Sharia investment and MSME development. Sharia-compliant financing mechanisms have significantly enhanced the financial performance and sustainability of MSMEs in Malaysia and Indonesia by offering ethical investment opportunities through platforms like Sharia FinTech and microfinance institutions. Sharia FinTech promotes financial inclusion and sustainable entrepreneurship while aligning with Sustainable Development Goals [27]. Sharia microfinance institutions support MSMEs, particularly in rural areas, by facilitating access to capital and providing entrepreneurial education, thereby contributing to economic stability and community empowerment [18], [28]. Islamic financing models such as mudharabah effectively boost MSME financial performance by supporting asset purchases and business development [29], while principles like profit-sharing and interest-free financing enhance profitability and revenue growth [30]. Despite these achievements, broader discussions on the implications of risk, profit, and social investment within Sharia finance remain limited in the current literature.

2.6 *Research Gaps and Theoretical Framework*

Despite the growing body of literature on Sharia finance and MSMEs, significant gaps remain in understanding the interplay between risk, profit, and sustainability, particularly through the lens of social investment. This study addresses these gaps by examining the mediating role of social investment in the relationship between risk, profit, and MSME sustainability. The theoretical framework combines stakeholder theory, which emphasizes balancing the interests of customers, employees, and the community to achieve sustainable business outcomes, with the principles of Islamic finance that provide a normative foundation for ethical and socially responsible investment practices. By integrating these perspectives, this study seeks to offer a comprehensive understanding of how Sharia-compliant investment strategies can enhance the sustainability of MSMEs in Central Java, with particular attention to the pivotal role of social investment.

3. METHODS

This study employs a quantitative research design to examine the impact of risk and profit on the sustainability of Micro, Small, and Medium Enterprises (MSMEs) in Central Java, with a focus on the mediating role of social investment in Sharia-compliant financial practices. The research aims to capture numerical data and analyze the relationships between key variables using statistical tools, ensuring a systematic and objective approach to understanding the studied phenomena. The population for this study comprises MSMEs in Central Java that engage in or are influenced by Sharia-compliant financial practices. A purposive sampling technique was applied to select 85 MSMEs that meet specific criteria: active for at least two years, employing or familiar with Sharia-compliant financial strategies, and willing to participate and provide reliable data. The sample size of 85 is considered adequate for statistical analysis, ensuring representativeness while maintaining feasibility for in-depth data collection.

Primary data were collected through a structured questionnaire distributed to MSME owners and managers, designed to measure key variables such as financial risk, profitability, social investment practices, and sustainability outcomes. A Likert scale ranging from 1 (strongly disagree) to 5 (strongly agree) was used to capture respondents' perceptions and attitudes. The questionnaire consisted of several sections: demographic information (business age, size, industry type, and respondent’s role), risk and profit measures (perceived financial risks and profit margins), social investment practices (engagement in initiatives aligned with Sharia principles such as zakat and waqf), and MSME sustainability indicators (business growth, market stability, and resilience). The key variables were operationalized as follows: risk was measured by assessing the likelihood and impact of financial uncertainties, profit was gauged through perceptions of margins and financial stability, social investment through engagement in ethical financial initiatives, and MSME sustainability by business continuity, competitiveness, and adaptability to challenges.

The data collected were analyzed using SPSS version 25. Descriptive statistics were used to summarize demographic information and general trends. Reliability analysis was conducted using Cronbach's alpha to ensure the consistency and reliability of the measurement scales. Correlation analysis was performed to assess the strength and direction of relationships between variables, while regression analysis was applied to determine the impact of risk and profit on MSME sustainability and to explore the mediating role of social investment. These analytical techniques ensured a comprehensive and statistically sound exploration of the research questions.

4. RESULTS AND DISCUSSION

4.1 Demographic Profile of Respondents

The demographic data of the respondents revealed that the majority of MSMEs (65%) had been operating for 3–7 years, 25% had been operating for more than 7 years, and 10% had been active for less than 3 years. The sample comprised enterprises from various industries, with the highest representation from the food and beverage sector (40%), followed by retail (30%), handicrafts (20%), and services (10%). In terms of respondent roles, most participants were business owners (60%), while the remaining 40% were managers.

Descriptive statistics provided an overview of the key variables, showing that the average score for financial risk was moderate ($M = 3.2$, $SD = 0.8$), indicating that MSMEs faced some degree of uncertainty in their operations. The average score for perceived profitability was moderately high ($M = 3.8$, $SD = 0.7$), reflecting relatively stable financial conditions among respondents. Engagement in Sharia-based social investments, such as zakat and waqf, had a mean score of 4.0 ($SD = 0.6$), suggesting strong alignment with ethical practices. Meanwhile, MSME sustainability recorded a mean score of 4.2 ($SD = 0.5$), indicating a high level of resilience and long-term viability.

4.2 Correlation Analysis

Correlation analysis revealed significant relationships between the variables, where risk was negatively correlated with MSME sustainability ($r = -0.415$, $p < 0.01$), indicating that higher perceived risks were associated with lower sustainability. Profit was positively correlated with sustainability ($r = 0.626$, $p < 0.01$), suggesting that higher profitability contributed to improved business resilience. Additionally, social investment showed a strong positive correlation with sustainability ($r = 0.702$, $p < 0.01$) and acted as a buffer against risks.

4.3 Regression Analysis

Regression analysis provided deeper insights into the relationships among variables, showing that financial risk had a significant negative effect on MSME sustainability ($\beta = -0.356$, $t = -4.201$, $p < 0.01$), while profitability had a significant positive effect on sustainability ($\beta = 0.455$, $t = 5.308$, $p < 0.01$). When social investment was introduced as a mediating variable, the negative effect of risk on sustainability diminished ($\beta = -0.151$, $t = -2.102$, $p < 0.05$), and the positive effect of profitability on sustainability strengthened ($\beta = 0.551$, $t = 6.206$, $p < 0.01$). These findings suggest that social investment partially mediates the relationship between financial risks, profitability, and MSME sustainability.

Discussion

The results confirm that financial risks negatively impact MSME sustainability, aligning with previous research by [31]–[33]. The uncertainty in market conditions, operational challenges, and limited access to capital increases vulnerability, particularly for smaller enterprises. However, the mediating effect of social investment indicates that Sharia-compliant practices can mitigate these risks by fostering a supportive community and encouraging ethical financial behaviors. Profitability also emerged as a significant positive driver of MSME sustainability, consistent with [33], [34], where stable profit margins provide MSMEs with resources necessary for reinvestment, innovation, and market expansion. The enhanced effect of profitability when combined with social investment highlights the importance of integrating ethical practices into financial strategies.

Furthermore, social investment was shown to strengthen the relationship between profitability and sustainability while simultaneously reducing the negative impact of financial risks. This finding is in line with [35], [36], who emphasize the role of social investment in fostering trust and community support. For Sharia-compliant MSMEs, social investment not only fulfills ethical obligations but also enhances business resilience by building stronger stakeholder relationships, thereby supporting long-term sustainability.

Implications for Sharia Investment and MSMEs

The findings of this study highlight the potential of Sharia-compliant financial strategies to address the unique challenges faced by MSMEs in Central Java. By prioritizing social investment, enterprises can achieve a balance between risk management, profit generation, and ethical considerations. Policymakers and financial institutions should promote awareness and access to Sharia-compliant investment options to support MSME growth and sustainability.

5. CONCLUSION

This study provides valuable insights into the interplay between risk, profit, and social investment in determining the sustainability of MSMEs in Central Java. The findings highlight the negative impact of financial risks and the critical role of profitability in promoting business resilience. Most notably, social investment practices, rooted in Sharia principles, act as an effective mediator by mitigating risks and amplifying the positive effects of profitability on sustainability. The integration of ethical and socially responsible financial practices not only aligns with religious values but also fosters trust and strengthens community ties, enabling MSMEs to navigate market uncertainties and sustain long-term growth.

Policymakers and financial institutions should prioritize the promotion of Sharia-compliant financial strategies and improve MSME access to such investment opportunities to build more resilient and sustainable MSME ecosystems, ultimately benefiting local economies and communities. Future research could expand the sample size and adopt mixed-method approaches to explore the nuanced dynamics of Sharia-compliant financial practices across different regions and industries, thereby providing a more comprehensive understanding of their impact on MSME sustainability.

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