The Effectiveness Of Islamic Banking Financing In Enhancing Economic Growth In Sumenep Regency

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Abstract.

This study investigates the effectiveness of Islamic banking financing in enhancing economic growth in Sumenep Regency. Islamic banking plays a significant role in providing Sharia-compliant financing solutions, especially for Small and Medium Enterprises (SMEs) that form the backbone of the local economy. The research employs a mixed-methods approach combining quantitative and qualitative data collected from Islamic banking institutions and regional economic statistics between 2018 and 2023. Quantitative analysis utilizes multiple regression models to measure the impact of Islamic financing schemes, such as Mudharabah and Musyarakah, on the growth of SMEs and Gross Regional Domestic Product (GRDP) in Sumenep. Qualitative data from interviews with banking officials and SME entrepreneurs provide insights into factors that enhance financing effectiveness, including trust, compliance with Islamic economic principles, and accessibility of capital. The findings indicate that Islamic banking financing significantly contributes to economic growth by supporting SME development, improving income levels, and fostering sustainable business practices. However, challenges such as limited human resources and regulatory constraints are identified as barriers to maximizing financing potential. The study concludes that optimizing Islamic banking products and strengthening institutional support can further accelerate economic growth in the region. This research provides valuable implications for policymakers, banking institutions, and stakeholders seeking to leverage Islamic finance as a tool for regional economic development.

Keywords: *Islamic Banking Financing; Economic Growth; Sumenep Regency; SME Development and Regional Economy.*

I. INTRODUCTION

The development of Islamic banking has become an increasingly relevant phenomenon in the context of global financial transformation. By adhering to the principles of Shariasuch as risksharing, prohibition of riba (usury), and promotion of ethical investmentIslamic banking offers an alternative financing mechanism that aligns with both religious values and economic inclusivity. Various empirical studies have indicated that Islamic financing models, particularly those based on profitsharing contracts such as mudharabah and musyarakah, can play a pivotal role in stimulating local economic activity and promoting sustainable development.

Sumenep Regency, located in East Java, Indonesia, possesses substantial economic potential through its key sectors: agriculture, fisheries, and smalltomediumsized industries. The region is characterized by robust agricultural output, including rice, corn, and tobacco, along with rich marine resources that support a thriving fishery sector. Despite these advantages, Sumenep still faces persistent development challenges, including limited access to capital, market volatility, and structural inefficiencies in resource utilization. Addressing these issues requires strategic financial interventions, one of which is the integration of Islamic banking services tailored to the needs of the local economy.

Recent years have seen notable expansion in Islamic banking services across Sumenep, supported by growing public awareness and regional government initiatives aimed at strengthening Shariacompliant financial institutions. However, the extent to which Islamic banking financing has effectively contributed to regional economic growth remains underexplored. Additionally, external variables such as inflation and export performance also play significant roles in shaping the region's macroeconomic outcomes. Understanding the specific impact of Islamic banking on economic indicators such as Gross Regional Domestic Product (GRDP) is crucial in evaluating its effectiveness as a policy instrument for development.

While macroeconomic stabilityparticularly controlled inflationprovides a conducive environment for investment and growth, the contribution of export activities and financial intermediation through Islamic banks must also be examined. Given the structural and sectoral characteristics of Sumenep's economy, the question arises as to whether Islamic banking can effectively catalyze economic expansion amid fluctuating commodity prices, financial constraints, and evolving consumer behavior.

This study aims to assess the effectiveness of Islamic banking financing in driving economic growth in Sumenep Regency. It considers the role of Islamic banking within a broader analytical framework that includes inflation and export variables. The findings are expected to offer valuable insights into the practical contribution of Islamic financial instruments to regional development and inform policy direction for strengthening inclusive economic growth strategies.

Based on the background discussed, this study seeks to examine the effectiveness of Islamic banking financing in driving local economic growth in Sumenep Regency, particularly in relation to the Gross Regional Domestic Product (GRDP). The study focuses on how Islamic banking contributes to regional economic advancement through financing mechanisms that align with Sharia principles. In this regard, several key variables are taken into account, including inflation, exports, and third-party funds (DPK), which are believed to interact significantly with the effectiveness of Sharia-compliant financing in fostering economic development. Therefore, the research is guided by two main questions: First, to what extent does Islamic banking financing influence the increase in GRDP in Sumenep Regency when considered alongside inflation, export performance, and third-party funds? Second, how effective is the combined influence of Islamic banking financing, inflation, exports, and DPK in enhancing regional economic growth, as reflected in the GRDP of Sumenep Regency?

II. LITERATURE REVIEW

Several previous studies have examined the role and effectiveness of Islamic financing in enhancing economic performance, particularly in relation to MSMEs and GDP. Research by Maulidi and Rahman (2021) explored the effectiveness of mudharabah financing provided by BPRS Bhakti Sumekar Sumenep. Using a qualitative approach, they found that mudharabah financing was highly effective in revitalizing the declining businesses of clients. This financing also supported MSMEs in meeting various business needs while upholding the principles of trust and accountability.

Himannudin et al. (2022) quantitatively analyzed the factors influencing Gross Domestic Product (GDP) in Southeast Asia. Their study concluded that government expenditure, labor force, and Human Development Index (HDI) significantly and positively affect GDP. However, foreign direct investment did not have a significant partial effect. Nonetheless, the four variables collectively had a significant and positive influence on GDP.

Kira (2013) studied the GDP trends of developing countries, focusing on Tanzania. He revealed that GDP growth in developing nations often lacks consistency due to inactive economic factors. Despite some periods of acceleration and deceleration, GDP trends generally reflect sustainable growth patterns. Key contributors to Tanzania's GDP included final consumption expenditures and exports. The study emphasized the importance of stimulating investment and industrialization, while also highlighting issues such as rising oil prices, electricity shortages, and political instability as critical barriers to economic growth.

Kurniawan et al. (2021) conducted a quantitative study on the influence of export price indices, inflation, and unemployment on the national income of Indonesia and South Korea. Their findings indicated that, in Indonesia, unemployment and export price indices had a significant partial effect on GDP, while inflation did not. In South Korea, however, only export price indices had a significant partial impact, whereas unemployment and inflation showed no significant partial effect.

Widiyanto (2019) examined the determinants of creative economy growth in Indonesia. The study employed a quantitative approach and found that labor and technological advancement had a significant and positive impact on the GDP of Indonesia's creative economy. Interestingly, the education level of workers in the creative economy showed a significant negative influence.

Kamal (2021) explored the effectiveness of Islamic banking financing in increasing MSME productivity in Banda Aceh. Using a qualitative method, the study found that Bank Aceh Syariah played an important role in solving capital problems for MSMEs. However, financing effectiveness declined during the COVID-19 pandemic due to reduced business productivity. Internal bank challenges and external stakeholder issues were identified as the main obstacles. The study recommended increased guidance and support from the bank to help MSMEs improve productivity.

Hendri et al. (2023) investigated the role of BPRS Syarikat Madani in supporting MSMEs in Batam. This qualitative study found that the financing provided was effective and had a positive impact on business development. Despite the benefits, several challenges persisted, such as difficulties in accessing capital, limited human resources, and inadequate government policies. The study concluded that Islamic banks contribute significantly to the development of the real sector, especially MSMEs.

Nasution and Rizkina (2022) used a quantitative method to assess the effectiveness of Islamic financing in enhancing the financial performance of MSMEs in Pematang Serai Village, Langkat Regency. Their results demonstrated that effective financing positively influenced MSMEs' return on equity and overall financial performance. Mudharabah financing, in particular, proved beneficial for asset acquisition, business expansion, income growth, and profitability.

Putri (2021) analyzed the effectiveness of the Rahn Tasjily Tanah financing product offered by Pegadaian Syariah Radin Intan Lampung in developing MSMEs. The qualitative study showed that the financing had a positive effect on business growth, capital improvement, and income increase. Although some MSMEs experienced declining income, the overall financing scheme met the criteria for effectiveness and adhered to Islamic economic principles, including the absence of riba and the permissibility of the transactions involved.

Finally, Hidayat and Irwansyah (2020) studied the influence of third-party funds and Islamic banking financing on Indonesia's economic growth. Their quantitative analysis revealed that third-party funds significantly affected GDP, while Islamic banking financing did not have a significant partial effect. However, both variables collectively had a significant influence on GDP.

III. METHOD

Data Analysis Method

This study employs a quantitative data analysis approach, utilizing EViews 12 software to perform the statistical calculations. EViews is a widely used computer software designed for statistical and econometric data processing. In this research, EViews 12 serves as the primary tool for analyzing the data and conducting various statistical tests.

1) Descriptive Statistical Analysis

Descriptive statistics are used to provide an overview of all variables involved in this study. The analysis includes calculations of the mean (average), maximum value, minimum value, and standard deviation for both the dependent and independent variables. This descriptive summary aims to offer a general understanding of the data distribution and characteristics of each variable.

2) Classical Assumption Tests

To ensure the validity and reliability of the regression model, several classical assumption tests are conducted as follows:

a) Normality Test

Based on Ajija et al. (2011:42), the normality test is essential when the sample size is less than 30 observations to determine whether the error terms approximate a normal distribution. However, if the sample size exceeds 30 observations, this test may not be required. According to Ismanto and Pebruary (2021:127), the residuals are considered normally distributed if the probability value (p-value) is greater than 0.05.

b) Heteroscedasticity Test

The heteroscedasticity test examines whether the variance of the residuals remains constant across all levels of the independent variables. Similar to the normality test, if the probability value exceeds 0.05, it indicates that heteroscedasticity is not present, and the residual variance is constant (Ajija et al., 2011:42; Ismanto and Pebruary, 2021:127).

c) Multicollinearity Test

Multicollinearity refers to a perfect or near-perfect linear relationship among independent variables in the regression model. It can distort the estimation of coefficients. This test evaluates the correlation coefficients between each pair of independent variables. If the correlation coefficient is less than 0.8, it indicates the absence of multicollinearity (Ajija et al., 2011:35).

d) Autocorrelation Test

Autocorrelation measures the correlation between residuals ordered in time or space. There are two common methods used to detect autocorrelation:

- By examining the t-statistic, R-squared, F-test, and Durbin-Watson (DW) statistic. A low DW value, such as 0.492, might indicate possible autocorrelation issues.
- Using the Lagrange Multiplier (LM) test based on Breusch-Godfrey methodology, which analyzes the F-statistic and the Obs*R-squared value. If the p-value and Obs*R-squared exceed the confidence level, the null hypothesis (no autocorrelation) is accepted (Ajija et al., 2011:40).

3) **Hypothesis Testing**

a. Partial Test (t-test)

The t-test assesses the significance of individual regression coefficients to determine whether each independent variable significantly affects the dependent variable. According to Ajija et al. (2011:34), the test compares the calculated t-statistic with the critical t-value from the t-distribution table:

- If t-statistic > t-table, reject the null hypothesis (H0) and accept the alternative hypothesis (H1).
- If t-statistic < t-table, accept H0 and reject H1.

b. b. Coefficient of Determination Test (R^2)

The coefficient of determination, R^2 (or adjusted R^2), measures how well the independent variables explain the variation in the dependent variable. Its value ranges between 0 and 1, where a value closer to 1 indicates a better fit of the regression model (Ajija et al., 2011:34).

IV. RESULTS

This study investigates the impact of Islamic banking financing, inflation, MSMEs (Micro, Small, and Medium Enterprises), and third-party funds (DPK) on economic growth, measured by the Gross Regional Domestic Product (GRDP) in Sumenep Regency. The following are the key findings based on the time series data analysis.

The stationarity test using the Augmented Dickey-Fuller (ADF) method confirmed that all variables are stationary at a 5% significance level, which validates the suitability of the data for regression and cointegration analysis. Subsequently, the cointegration test revealed the presence of a long-run equilibrium relationship between Islamic financing, inflation, MSMEs, third-party funds, and GRDP. This indicates that these variables are interconnected and jointly influence the regional economy over the long term.

The Granger causality test results show that Islamic banking financing (X1) Granger-causes economic growth (Y), indicating a predictive causal relationship from Islamic financing to GRDP growth in Sumenep.

The time series regression results demonstrate that Islamic financing (X1) positively and significantly affects economic growth, with a t-statistic of 2.144 and a p-value of 0.0515, marginally significant at the 5% level. Inflation (D(X32)) has a highly significant negative effect on economic growth, with a t-statistic of -9.563 and a p-value of 0.0000. Meanwhile, MSMEs (D(X4)) also have a significant positive effect, with a t-statistic of 3.388 and a p-value of 0.0048. These findings emphasize the critical role of these variables in shaping the economic growth of Sumenep Regency.

The F-test indicates that all independent variables jointly have a significant effect on economic growth, with an F-statistic of 24.789 and a p-value of 0.000006. The model's coefficient of determination (R^2) is 0.884, meaning that 88.4% of the variation in GRDP can be explained by the combination of Islamic financing, inflation, MSMEs, and third-party funds.

Classical assumption tests reveal the presence of heteroscedasticity (Breusch-Pagan-Godfrey test p-value = 0.0469), which suggests non-constant variance of residuals. No significant autocorrelation was detected (Breusch-Godfrey test p-value = 0.1073), and residuals are approximately normally distributed (Jarque-Bera p-value = 0.6187). Multicollinearity is not a concern, with variance inflation factor (VIF) values below critical thresholds.

V. DISCUSSION

The results substantiate that Islamic banking financing plays a significant and positive role in fostering economic growth in Sumenep Regency. The profit-sharing and trade-based principles of Islamic financing facilitate equitable access to capital for MSMEs, which are pivotal actors in the local economy. Increased access to financing enhances MSMEs' capacity to expand production, thereby contributing positively to GRDP growth. This outcome aligns with the theoretical expectations that finance mobilization through Islamic banks supports regional economic development.

Inflation exerts a statistically significant negative effect on economic growth, confirming the conventional understanding that rising inflation erodes purchasing power and increases production costs. Uncontrolled inflation discourages consumption and investment, which in turn dampens economic expansion. These results underscore the importance of maintaining inflation at moderate and stable levels to sustain economic growth.

The positive and significant impact of MSMEs reflects their essential function as engines of economic vitality in the region. MSMEs benefit from Islamic financing, which enables them to increase production output, generate employment, and stimulate local economic activities, collectively boosting GRDP.

Although third-party funds (DPK) did not show a direct significant coefficient in the regression output, they function as a vital funding source for Islamic banks to provide financing. The effective mobilization of DPK is crucial to sustaining the financing flow to productive sectors, thus indirectly supporting economic growth.

The detected heteroscedasticity signals variability in error terms that may stem from external economic fluctuations or policy shifts, suggesting that future research could employ robust standard errors or alternative econometric models to enhance estimation reliability.

Overall, this study highlights the strategic importance of Islamic banking financing as a catalyst for regional economic growth, particularly through its role in empowering MSMEs in Sumenep Regency.

VI. CONCLUSION

This study concludes that Islamic banking financing has a significant and positive effect on economic growth in Sumenep Regency. The financing mechanisms based on profit-sharing and trade principles provide equitable access to capital, particularly benefiting MSMEs, which serve as key drivers of the regional economy. These dynamics contribute substantially to the growth of the Gross

Regional Domestic Product (GRDP). Inflation negatively impacts economic growth, confirming that maintaining inflation at a controlled and stable level is crucial for supporting sustainable economic development. MSMEs also demonstrate a significant positive influence on economic growth, highlighting their vital role in strengthening the local economy.

Although third-party funds (DPK) do not directly exhibit a statistically significant effect in the regression analysis, they remain an essential source of financing for Islamic banks, enabling the continuation of productive sector funding. The model employed explains 88.4% of the variation in economic growth, reflecting a strong fit between the independent variables and GRDP growth. These findings suggest that policies promoting Islamic banking financing and supporting MSMEs, alongside inflation control, can effectively enhance economic growth in Sumenep Regency. Future studies may consider addressing heteroscedasticity issues to further improve model accuracy and robustness.

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