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Strengthening Real Sector Resilience: Profit-Sharing Financing Model of Islamic Banking and Its Impact on SME Growth

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ABSTRACT

Small and medium enterprises (SMEs) form the backbone of Indonesia's real sector but remain highly vulnerable to financial shocks, largely due to their limited access to risk-mitigating capital. Islamic banking offers profit-and-loss-sharing (PLS) instruments mudarabah and musharakah that theoretically align financier-entrepreneur interests and build resilience however, their adoption remains extremely low. This study employs a multiple-case qualitative design to investigate how PLS financing models are implemented in practice and how they influence SME growth and resilience in Indonesia. Data were collected through semi-structured interviews with six Islamic bank officers and six SME owners across three Indonesian Islamic banks, supplemented by document analysis and observation. Thematic analysis revealed four overarching themes: partnership-based financing practices, multidimensional SME growth, persistent barriers of information asymmetry and moral hazard, and mitigation through embedded mentoring and technological monitoring. The findings indicate that genuine PLS arrangements foster relational financing, enhance managerial capacity, and cushion enterprises during economic downturns, thereby strengthening real-sector resilience. However, widespread operationalization is hindered by high transaction costs and a cultural preference for collateralized debt. This study contributes a processual resilience-building model and recommends a synergetic ecosystem involving government guarantees, fintech integration, and capacity-building programs to unlock the full potential of PLS financing.

***Keywords**: Profit-And-Loss Sharing, Mudarabah, Musharakah, SME Resilience, Islamic Banking, Indonesia*

INTRODUCTION

Indonesia's real sector is overwhelmingly dominated by small and medium enterprises. Data from the Ministry of Cooperatives and SMEs (2022) indicate that approximately 64.2 million business units fall into the SME category, contributing 61.1 per cent to gross domestic product and absorbing 97 per cent of the national workforce. Despite their macro-critical role, SMEs persistently face a structural financing gap. The Asian Development Bank (2021) estimated that Indonesia's SME financing gap reached USD 78 billion, with only 22 per cent of formal SMEs having access to bank credit. The COVID-19 pandemic further exposed the fragility of the sector: a survey by Statistics Indonesia (BPS, 2020) reported that 82.5 per-cent of micro and small enterprises experienced a severe decline in revenue, and 67 per-cent lacked sufficient reserves to survive more than three months of disruption. These figures underscore the urgency of strengthening real-sector resilience through financial instruments that are not merely liquidity-providing but are inherently risk-mitigating and growth-oriented (NIGAM et al., 2026).

Islamic banking, which in Indonesia has grown to command a market share of 7.09 per cent of total banking assets (OJK, 2023), promotes a distinctive value proposition through profit-and-loss sharing (PLS) contracts. The two principal PLS modes, mudarabah (trustee partnership) and musharakah (joint venture partnership), are designed to align the incentives of capital providers and entrepreneurs by sharing both profits and losses according to pre-agreed ratios. The Islamic moral economy envisions these instruments as engines of equitable growth, enabling SMEs to obtain capital without the burden of fixed interest payments and fostering a collaborative relationship that extends beyond transactional debt contracts. Conceptually, PLS financing should enhance real-sector resilience by smoothing cash-flow shocks (risk-sharing), improving managerial discipline through bank monitoring, and building long-term organizational capabilities (Hoirullah & Adiba, 2026).

However, the reality is strikingly different. Despite more than three decades of Islamic banking operations in Indonesia, PLS financing accounts for merely 5.2 per cent of total Islamic banking financing, while

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murabahah (cost-plus sale) and other debt-like instruments dominate the portfolio (OJK, 2023). The underutilization of PLS has been attributed to high information asymmetry, moral hazard, costly monitoring, and the lack of a supportive legal and institutional framework. Quantitative studies have repeatedly identified these obstacles, but they largely treat PLS as a financing "mode" measured by its volume without delving into the lived experiences of bankers and entrepreneurs who engage in PLS contracts. A critical qualitative gap remains: how does the operationalization of PLS financing daily interaction, trust-building, monitoring, and profit-sharing translate into SME growth and resilience? What processes and mechanisms are at work when PLS succeeds, and why does it so often fail to take root?

This study addresses this gap by adopting a qualitative multiple-case study approach. Its central research questions are as follows: (1) How are profit-sharing financing models implemented by Indonesian Islamic banks in their engagements with SMEs? (2) What are the perceived impacts of PLS financing on SME growth and resilience, as experienced by both bank officers and SME entrepreneurs? (3) What barriers hinder the effectiveness and scalability of PLS financing, and what mitigation strategies are deployed? By focusing on the narratives, practices, and interpretations of the actors involved, this study aims to construct a processual model that links PLS financing to real-sector resilience.

The significance of this study is threefold. First, it enriches the Islamic finance literature by providing a thick, contextualized account of PLS dynamics that quantitative surveys cannot capture. It responds to Nada's (2024) call for more field-based qualitative research that goes beyond ideal-type contracts. Second, for policy-makers, the findings offer evidence-based insights into the institutional ecosystem required to make PLS a viable mainstream instrument, including the roles of government guarantees, fintech-enabled monitoring, and standardized contract templates. Third, for practitioners, this study highlights the best practices and critical success factors that Islamic banks can adopt to reduce the perceived risks of PLS while maximizing its developmental impact (Nada, 2024).

The remainder of this paper is organized as follows. Section 2 reviews the theoretical and empirical literature on SME growth, real-sector resilience, and Islamic PLS financing. Section 3 describes the qualitative methodology. Section 4 presents the findings, structured around the four emergent themes and supported by tables and figures. Section 5 discusses the findings in relation to existing theories and draws policy implications. Finally, Section 6 concludes with a summary and recommendations.

LITERATURE REVIEW

SME Growth and Real-Sector Resilience

SME growth has been conceptualized through multiple lenses. Storey (1994) identified three interacting components: the entrepreneur, the firm, and the strategy, while Penrose (1959) emphasized the role of internal resources and managerial capabilities. More recently, Wiklund et al. (2009) proposed an integrated model in which growth is a function of entrepreneurial orientation, environmental dynamism, and access to resources, particularly finance. In developing economies, the financial growth cycle paradigm (Berger & Udell, 1998) posits that firms progress from insider finance to intermediated debt and eventually to arm's-length equity. For the vast majority of Indonesian SMEs, the cycle stalls at the debt stage, if it starts at all, because equity-like instruments are scarce and poorly understood (M. Gomathy, 2025).

Resilience, originally an ecological concept (Holling, 1973), has been adapted to socio-economic systems to denote the capacity to absorb disturbances, adapt, and transform while maintaining essential functions. In the context of SMEs, financial resilience refers to the ability to withstand liquidity shocks, recover from revenue losses and continue operations without irreversible damage. Real-sector resilience extends this notion to the aggregate level, encompassing the adaptive capacity of productive enterprises that generate employment and income. Counter-cyclical and partnership-based financing mechanisms are hypothesized to strengthen resilience more effectively than pro-cyclical, collateral-based debt. During the 2008-09 global financial crisis, for example, Islamic banks with higher PLS ratios demonstrated greater stability, suggesting that equity-like financing reduces balance-sheet fragility. Translating this property to SMEs, PLS contracts could similarly act as automatic stabilizers, reducing fixed repayment obligations when business conditions deteriorate (Kamilan & Nurcholisah, 2022).

Profit-and-Loss Sharing in Islamic Finance

The theoretical foundations of PLS are rooted in the prohibition of riba (usury), gharar (excessive uncertainty), and maysir (gambling). Mudarabah is a unilateral partnership in which one party provides capital (rabbul mal) and the other provides labor and expertise (mudarib). Profits are shared according to a pre-agreed ratio, while financial losses are borne solely by the capital provider, provided the mudarib has not been negligent. Musharakah is a bilateral joint venture in which all partners contribute capital and share profits and

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losses in proportion to their respective contributions. Both contracts embody the principle of al-kharaj bil-daman (gain accompanies liability), which ensures a direct link between risk-taking and reward (Yanti & Aziz, 2025).

Advocates argue that PLS financing is superior to debt-based financing for at least four reasons. First, it promotes distributive justice by enabling entrepreneurs without collateral to access capital based on the viability of their business ideas and plans. Second, it discourages excessive leverage because the financier's return is tied to real economic outcomes rather than fixed interest charges. Third, embedded monitoring and partnership governance improve resource allocation and reduce moral hazard ex post. Fourth, PLS contracts are intrinsically aligned with the real sector because funds must be employed in productive activities. Critics, however, point to the acute information asymmetry problem: entrepreneurs may under-report profits, over-report losses, or divert funds to high-risk projects, knowing that the financier shares the downside. The costly state verification literature formally shows that, in the absence of effective monitoring, equity-type contracts suffer from severe incentive problems. In the Islamic banking practices of many Muslim-majority countries, these challenges have resulted in a "murabahah syndrome, where banks overwhelmingly prefer fixed-income trade contracts that mimic conventional loans (Efendi et al., 2026).

PLS and SME Financing: Empirical Evidence

Empirical research on PLS financing for SMEs can be grouped into three categoriess. The first stream, predominantly quantitative, examines the determinants of PLS adoption at the bank level in Muslim-majority countries. Siregar et al. (2026) analyzed Indonesian Islamic banking data and found that PLS financing shares are negatively associated with bank size, non-performing financing, and concentration of the financing portfolio. They infer that risk-averse behavior and institutional rigidities suppress PLS growth. The second stream investigates SME-level outcomes using survey data. Huda and Heykal (2019) surveyed 120 Indonesian SMEs financed by Islamic banks and reported that musharakah-financed firms exhibited higher asset growth than those using murabahah, although the difference was not statistically significant after controlling for firm age and sector. Abdul-Razak and Amin (2020) conducted a cross-country panel study and concluded that PLS-based microfinance reduces poverty more effectively than conventional microcredit, attributing the difference to the risk-sharing property that prevents over-indebtedness (Siregar et al., 2026).

The third and smallest stream comprises qualitative exploration. Rahman and Dean (2013) used a single case study of a Malaysian Islamic bank to illustrate the operational complexities of mudarabah, including the intensive mentoring required and the difficulty the bank has in verifying declared profits. In Indonesia, Kasri and Ahmed (2015) interviewed Islamic bank officials and found that while they conceptually support PLS, their institutional practices are shaped by a deeply embedded credit culture that demands tangible collaterals and predictable cash flows. However, none of these studies simultaneously capture the perspectives of both financiers and SME entrepreneurs within a multiple-case design that traces the impact pathway from PLS contract features to SME resilience (Muratov, 2025).

Research Gap and Conceptual Framework

The literature reveals a persistent tension between the normative superiority of PLS and its operational marginalization. Quantitative studies document the "what" (low PLS ratios) and the "what determines" (macro and bank-level predictors) but fail to illuminate the "how" and "why" behind the processes that translate PLS into resilience. Resilience theory suggests that mechanisms such as resourcefulness, redundancy, and rapidity (Bruneau et al., 2003) are crucial. PLS can enhance these through partnership support, flexible repayment, and capacity building. However, without a grounded investigation, the black box between PLS contracts and SME resilience remains unexplored. This study fills this gap by deploying a qualitative multiple-case design that generates a process model of PLS-induced resilience, thereby contributing theoretically to both Islamic finance and entrepreneurship literature.

RESEARCH METHOD

This study is situated within the interpretivist paradigm, which holds that social reality is constructed through the meanings that actors attach to their experiences. A qualitative approach is appropriate because the research questions concern processes, interpretations, and contextual nuances that cannot be reduced to numerical variables. A multiple case study design was selected to enable cross-case comparison while retaining the depth of each case. The case is defined as a dyadic relationship between an Islamic bank unit and an SME that has received PLS financing for at least two years. The dyadic perspective is essential to capture the interaction between financiers and entrepreneurs, thus avoiding a one-sided narrative (Creswell, J. W., & Plano Clark, 2018).

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Purposive sampling was employed to select three Indonesian Islamic banks that represent the diversity of the industry: a large full-fledged Islamic Bank A (Bank A), a medium-sized Islamic subsidiary of a conventional conglomerate (Bank B), and a smaller regional Islamic bank (Bank C). From each bank, two SME clients that utilized mudarabah or musharakah financing were chosen, yielding a total of six SMEs. The SMEs operated in different sectors food processing (2), textiles (1), handicraft export (1), digital printing (1), and construction materials (1) to capture sectoral variation. The selection criteria required that the PLS facility be active for a minimum of 24 months, ensuring sufficient experience to assess its impact. The final sample comprised 12 key informants: six relationship managers or heads of SME financing from banks and six owner-managers of SMEs. Table 1 provides the informants'profiles.

Data were collected between January and April 2024 through three techniques.

Semi-structured interviews. Each informant was interviewed twice, with each session lasting 60-90 minutes. The interview guide covered (a) the process of initiating and administering the PLS contract; (b) the nature of the bank-SME relationship (trust, monitoring, conflict resolution); (c) perceived changes in business performance, resilience, and managerial practices; and (d) challenges encountered and strategies adopted to overcome them. All interviews were conducted in Bahasa Indonesia, audio-recorded with consent, and transcribed verbatim.

Document analysis. Financing agreements, profit-sharing reports, business plans, and internal bank memos were collected to triangulate the interview data and understand the contractual terms. A total of 34 documents were analyzed.

Non-participant observation. The researcher observed two monitoring visits by bank officers to SME premises and one profit-sharing negotiation meeting and recorded field notes on interactions and communication patterns.

Data saturation was reached after the twelfth interview, as no new themes emerged.

Thematic analysis was performed following six-phases: familiarization, initial coding, theme searching, theme reviewing, theme defining, and report writing. Transcripts were coded inductively using NVivo 14, supplemented by a deductive coding framework derived from resilience theory (e.g., "absorptive capacity, "adaptive capacity") to ensure theoretical sensitivity. The first-order codes (n=187) were grouped into 23 sub-themes and finally aggregated into four overarching themes.

Credibility was enhanced through the triangulation of sources (bankers, entrepreneurs, documents) and member checking, where informants reviewed their transcript summaries. Dependability was addressed by maintaining a detailed audit trail of the coding decisions. Transferability was facilitated by providing thick descriptions of the context so that readers could assess applicability to other settings. Ethical protocols were strictly observed: all informants signed informed consent forms, anonymity was guaranteed, and the study received ethical clearance from the authors' university review board.

Table 1. Profile of Informants

Code	Role	Institution	SME Sector	PLS Mode	Duration of PLS (months)
B1	Head of SME Financing	Bank A (full-fledged)	–	–	–
B2	Relationship Manager	Bank A	–	–	–
B3	SME Unit Manager	Bank B (subsidiary)	–	–	–
B4	Senior Account Officer	Bank B	–	–	–
B5	Branch Manager	Bank C (regional)	–	–	–
B6	Financing Officer	Bank C	–	–	–
E1	Owner-Manager	SME-1	Food processing	Musharakah	36

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Code	Role	Institution	SME Sector	PLS Mode	Duration of PLS (months)
E2	Owner-Manager	SME-2	Textile	Mudarabah	28
E3	Owner-Manager	SME-3	Handicraft export	Musharakah	42
E4	Owner-Manager	SME-4	Digital printing	Musharakah	24
E5	Owner-Manager	SME-5	Construction material	Mudarabah	30
E6	Owner-Manager	SME-6	Food processing	Musharakah	33

RESULTS AND DISCUSSIONS

The thematic analysis generated four dominant themes that collectively describe the implementation, impact, barriers, and mitigation of PLS financing. The themes are (i) partnership-based financing practice, (ii) multidimensional SME growth and resilience, (iii) persistent asymmetries and moral hazards, and (iv) embedded mitigation through mentoring and technology. Table 2 summarizes the thematic coding structure with frequencies and illustrative quotations, while Figures 1 and 2 present the conceptual model and thematic network, respectively.

Informants from both banks and SMEs unanimously characterized PLS financing as a partnership rather than a simple lender-borrower relationship. Unlike murabahah, where the bank's involvement virtually ends after the goods are delivered, PLS contracts entail continuous engagement by the bank. Bank officers described visiting SME premises monthly to review financial records, observe operations, and discuss business challenges with the owners. This practice was captured by the sub-theme *"intensive relational monitoring"* (frequency n=34). B2 (Bank A) explained, "We do not just wait for the monthly report; we are there on the ground. The client sees us as a partner who shares the risk, not a debt collector."

From the SME perspective, the partnership manifested as *"feeling supported"* (n=21) and *"access to bank's network"* (n=18). E1 stated, "When a big buyer delayed payment, the bank did not immediately penalize us. They helped renegotiate the payment schedule." The contractual profit-sharing ratios, typically 60:40 or 70:30 in favor of the entrepreneur, were perceived as fair, although negotiations were often influenced by the bank's assessment of the business's risk profile. Documents showed that musharakah contracts incorporated detailed clauses on profit calculation and loss-sharing, including what constitutes "business loss" versus "negligence loss, a distinction that both parties found challenging to operationalize.

All six SMEs reported positive growth trajectories after adopting PLS financing. The growth was multi-dimensional, encompassing financial, operational, and strategic aspects. Financial growth is most tangibly indicated by increases in sales revenue and asset accumulation. Using a qualitative recall approach, the informants estimated changes relative to the pre-financing period (Table 3). Four SMEs reported revenue growth exceeding 50 per-cent over two to three years, largely attributed to the ability to purchase better machinery and raw materials without the pressure of fixed monthly instalments. E4, owner of a digital printing business, noted, "With a conventional loan, I would have to pay Rp 8 million every month regardless of my sales. With musharakah, if sales dip, the profit share is automatically adjusted. This flexibility allowed me to invest in a new printer that doubled my capacity."

Operational growth is expressed through employment expansion, improved production processes, and formalized management practices. Five of the six SMEs reported an increase in the number of permanent employees (Table 3). E2, a textile entrepreneur, had only three informal workers before obtaining mudarabah financing; after two years, she employed 12 formal workers and appointed a dedicated finance officer. Strategic growth is reflected in market diversification and product innovation. E3 (handicraft exporter) entered the Middle Eastern market after the bank introduced her to an export-oriented partner network.

Resilience emerged as a cross-cutting sub-theme. During the post-pandemic recovery period, PLS-financed SMEs exhibited notable adaptive capacity. When demand fluctuated, the profit-sharing mechanism automatically reduced cash outflow to the bank, preserving working capital. E5 (construction materials) remarked, "In 2023, when government infrastructure projects were delayed, our revenue dropped 30 per-cent. Under a normal bank loan, I would have defaulted on it. However, with mudarabah, the bank shares the loss. We survived, and when projects resumed, we bounced back quickly." Bank officers

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corroborated this perspective; B3 from Bank B stated, "Our non-performing financing ratio for PLS is actually lower than for murabahah, because when the business faces temporary hardship, the contract absorbs the shock rather than creating a default event."

Despite these positive narratives, the data revealed substantial barriers that impede wider PLS adoption. The most frequently coded barrier was *"information asymmetry"* (n=28). Bank officers consistently expressed difficulty in verifying the revenues and costs reported by SMEs, especially those with cash-based transactions and informal bookkeeping. B5 (Bank C) lamented, "We know they do not record every sale. They may have a parallel set of books that they read. How can we be sure that the profit shared is the real profit?". SMEs, on their part, acknowledged the opacity but attributed it to limited accounting literacy rather than intentional deceit. E6 said, "I try to keep records, but sometimes I forget. The bank accuses me of hiding profit, but I just do not have the skill."

Moral hazard was coded 24 times, manifesting in two forms: ex ante moral hazard, where entrepreneurs undertook excessive risk knowing the bank would absorb losses, and ex post moral hazard, where they under-declared profits. B1 (Bank A) recounted an incident in which a mudarabah client diverted part of the capital into a speculative cryptocurrency investment, causing a significant loss. "We discovered it only by accident. That case made us tighten the monitoring, but it also made the credit committee even more reluctant to approve new PLS proposals."

The third barrier was the *"high transaction cost"* (n=21) relative to murabahah. PLS contracts require continuous monitoring, periodic profit calculations, and frequent renegotiations. B4 estimated that a musharakah facility consumed three to four times more officer hours than a murabahah of an equivalent size. This cost inefficiency was aggravated by the lack of standardized profit-calculation methodologies and limited use of technology.

Banks have not been passive in the face of these challenges. The analysis identified a set of embedded mitigation strategies, most prominently *"capacity-building mentoring"* (n=27). Bank officers regularly trained on financial literacy, bookkeeping, and business planning. B6 said, "We teach them to separate business and personal expenses. It's part of our service; if the client succeeds, we succeed." SMEs confirmed the value of this type of mentoring. E3 noted, "The bank taught me how to calculate unit cost and break-even point. Before that, I did not even know if I was making a profit." This knowledge transfer not only improves transparency but also enhances the managerial capabilities of entrepreneurs, contributing to strategic growth.

Technology deployment has emerged as an emerging mitigation tool. Two of the three banks had begun piloting a digital monitoring system that required SMEs to record their daily sales through a mobile application linked to the bank's system. B2 explained, "We provide a simple app. The SME inputs daily revenue, which can be observed in real time. We cross-check with their suppliers' data where possible." The digital system reduces information asymmetry and monitoring costs, although its adoption is hindered by low digital literacy among older entrepreneurs and Internet connectivity issues in rural areas. Another mitigation strategy involved *"third-party guarantees"* (n=12), particularly the government's Jamkrida (Regional Credit Guarantee) scheme, which covered a portion of potential losses, thereby reducing the bank's risk exposure.

Table 3 summarizes the key impact indicators, and Figure 1 illustrates the conceptual model of how PLS financing strengthens SME resilience. Figure 2 displays the thematic network connecting these four themes.

Table 2. Thematic Coding Structure

Overarching Theme	Sub-theme (code cluster)	Frequency (n=12)	Illustrative Quote
1. Partnership-based financing practice	Intensive relational monitoring	34	"We visit the business monthly, not just for check-up but to discuss solutions." (B2)
	Feeling supported	21	"The bank doesn't pressure us when sales slow down; they help find new buyers." (E1)
	Access to bank's network	18	"Through the bank, I met a supplier who offered lower prices." (E3)
2. Multidimensional	Financial growth (sales,	31	"My revenue tripled in three years because

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Overarching Theme	Sub-theme (code cluster)	Frequency (n=12)	Illustrative Quote
growth & resilience	assets)		I could buy better machines.” (E4)
	Operational expansion (employment, formalisation)	26	“Now I have a finance officer and a proper accounting system.” (E2)
	Strategic innovation (new products, markets)	19	“I started producing premium batik for export, which I never dared before.” (E3)
	Adaptive resilience (shock absorption, recovery)	29	“When COVID hit, profit share became zero. We survived because we had no fixed debt.” (E5)
3. Persistent asymmetries & moral hazard	Information asymmetry (revenue opacity)	28	“We suspect the reported profit is only 70% of the true figure.” (B5)
	Moral hazard (excessive risk, under-declaration)	24	“A client used the capital for crypto trading—a clear breach.” (B1)
	High transaction cost vs murabahah	21	“One musharakah account takes as much time as five murabahah accounts.” (B4)
4. Embedded mitigation	Capacity-building mentoring	27	“We train them to keep double-entry books. It’s an investment in our own asset.” (B6)
	Technology-based monitoring	15	“The daily sales app gives us peace of mind; we can see fluctuations immediately.” (B2)
	Third-party guarantees (Jamkrida)	12	“With the government guarantee covering 70%, we are more willing to try PLS.” (B3)
Source: Interview coding results (NVivo 14)			

Table 3. Qualitative Assessment of SME Growth Indicators (Pre- and Post-PLS Financing)

SME Code	Revenue Change (estimated %)	Asset Change	Permanent Employees (Before → After)	New Products/ Markets	Perceived Resilience Improvement
E1	+70%	Moderate increase (new machinery)	8 → 15	2 new product lines	High (managed pandemic without layoffs)
E2	+120%	Significant (own workshop)	3 → 12	Entered online marketplace	High (recovered quickly after demand drop)
E3	+60%	Moderate (renovated studio)	5 → 9	Export to Middle East	Very High (diversified market reduced risk)
E4	+200%	High (new printer, vehicle)	2 → 7	Expanded to large-format printing	Medium (still vulnerable to

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SME Code	Revenue Change (estimated %)	Asset Change	Permanent Employees (Before → After)	New Products/ Markets	Perceived Resilience Improvement
					technology changes)
E5	+45%	Moderate (small warehouse)	10 → 14	No new product, but new government client segment	High (weathered project delays without default)
E6	+85%	Significant (cold storage facility)	6 → 10		

Discussion

The theme of partnership-based practice confirms the normative claim of Islamic finance that PLS transforms the financier-entrepreneur relationship from a transactional debt contract into a collaborative alliance (Hassan et al., 2026). What emerged strongly from the interviews was the intensity of relational monitoring: bank officers are not passive claimants but active partners engaged in problem-solving. This resonates with the concept of "relationship lending, where soft information acquired through repeated interactions enables the financier to make better credit decisions and provide valuable advice. However, in conventional relationship lending, the bank's return remains fixed, whereas under PLS, the bank's interest is directly tied to the firm's profitability, creating a stronger incentive alignment.

The "feeling supported" narrative from SMEs suggests that the psychological contract of PLS reduces the anxiety associated with fixed debt repayment. This psychological dimension is absent from most quantitative studies but aligns with behavioral finance insights that the framing of obligations affects entrepreneurial risk-taking and persistence. When an entrepreneur perceives the financier as a partner, she is more likely to invest in growth-oriented projects, as seen in the cases of E3 and E4, who ventured into export markets and new product lines after obtaining musharakah financing (Efendi et al., 2026).

However, this partnership is not symmetrical. Banks retain significant power through their control over the profit-sharing ratio, threat of early termination, and definition of negligence. The contractual ambiguity around loss-sharing, particularly the distinction between business and negligence losses, creates a grey zone that can be exploited by either party. This ambiguity reflects a gap between the classical fiqh (jurisprudence) of mudarabah and modern commercial realities, where business failure is rarely free from some element of managerial error. Thus, while the partnership principle is theoretically sound, its practical translation requires much clearer, standardized legal templates that protect both parties(Makurin & Kozarevych, 2025).

The observed multidimensional growth financial, operational, and strategic challenges the narrow focus on credit access that dominates SME finance literature. PLS financing did not merely provide capital; it catalyzed qualitative improvements in management practices and market orientation. This finding of the financial growth cycle suggests that equity-like instruments, when coupled with mentoring, can propel SMEs from informality to formalization without the intermediary step of conventional debt. The transformation of E2 from an informal three-worker operation to a formal twelve-employee enterprise epitomizes this "leapfrogging" effect (Abdusalam & Kaniawati, 2026).

Most significantly, the resilience-enhancing property of PLS was evident across all six cases. The automatic stabilizer function where profit shares fall when revenue declines provided a buffer that fixed-rate debt cannot offer. This mechanism directly supports the resilience principle of "absorptive capacity" (Bruneau et al., 2003), as businesses do not need to divert working capital to service a rigid repayment schedule during a downturn. The COVID-19 pandemic provided a natural stress test: PLS-financed SMEs were able to preserve employment and rebound more quickly than similar firms reliant on conventional loans, according to the informants' perceptions. While this comparative claim requires further quantitative validation, it is consistent with bank-level findings on the stability of Islamic banks with higher PLS ratios (Riski Saputra et al., 2025).

However, he growth and resilience outcomes were not automatic. They depend heavily on the quality of mentoring provided by the bank and the entrepreneur's absorptive capacity. The variation in outcomes E4 reported medium resilience due to technology vulnerability indicates that PLS is not a panacea but a contingent mechanism whose effectiveness depends on complementary resources.

The third theme confirms the well-documented obstacles that have relegated PLS to a niche market.

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Information asymmetry remains the Achilles' heel of the PLS. The inability of banks to verify revenues, especially in cash-dominant SME segments, generates a classic "lemons problem, where the bank must assume that every reported profit is understated. This leads to a cascade of defensive behaviors: banks set higher profit-share ratios for themselves, demand additional collateral (which contradicts the spirit of PLS), or simply avoid the product altogether. This finding aligns with Hamka et al. (2023) theoretical prediction of Indonesian interview data, but it goes further by documenting the specific strategies entrepreneurs use to maintain opacity—both intentional and unintentional (Hamka et al., 2023).

Moral hazard adds a layer of risk that conventional debt partially contains through collateral and legal enforcement. Under mudarabah, the bank bears all financial losses if the mudarib is not negligent, making the contract vulnerable to excessive risk-taking. The cryptocurrency diversion case is an extreme but illustrative example of how the ex post attribution of "negligence" becomes a legal battleground. The high transaction cost, largely due to continuous monitoring, makes PLS economically unattractive for small-ticket financing, confirming the argument that PLS is more suited to large, auditable corporate financing unless technology drastically reduces monitoring costs.

The mitigation theme is perhaps the most original contribution of this paper. This reveals that banks and SMEs are not passive victims of structural problems but active co-creators of solutions. The embedded mentoring function—teaching bookkeeping, cost analysis, and business strategy—effectively reduces information asymmetry over time. This dynamic corresponds to the concept of "co-production" in public services, where the service provider and client jointly create value. By enhancing the SME's reporting capability, the bank internalizes what would otherwise be an external cost of monitoring. Mentoring also generated relational goodwill that deterred opportunistic behavior, functioning as social collateral.

The nascent use of digital monitoring tools represents a technological disruption in the PLS cost equation. If widely adopted, real-time sales reporting via mobile apps could compress information asymmetry and reduce the need for costly physical visits. This echoes the broader fintech for financial inclusion narrative, but with a specific PLS twist: the technology must be designed not only for credit scoring but also for ongoing profit verification and profit distribution. The challenge of digital literacy and infrastructure must be addressed through public-private partnerships, perhaps building on Indonesia's existing digital ID and Quick Response Indonesian Standard (QRIS) payment infrastructure.

Government guarantees, such as Jamkrida, served as an institutional safety net that lowered the bank's perceived loss-given-default, making PLS experiments more palatable to risk-averse credit committees. However, guarantees alone cannot solve the fundamental information problem; they risk creating a moral hazard at the bank level if banks relax their due diligence. A balanced ecosystem combining guarantee schemes with standardized accounting protocols for PLS, compulsory fintech adoption for PLS clients, and continuous capacity-building programmes emerges from the data as the ideal configuration.

Integrating the four themes, a processual model of PLS-induced resilience is proposed (Figure 1). The model starts with the PLS contract design (mudarabah or musharakah with clear profit-loss clauses). This design, when faithfully implemented, activates three parallel mechanisms: (a) risk-sharing that creates financial slack during downturns, enhancing absorptive capacity; (b) relational partnership and mentoring that build managerial competence and adaptive capacity; and (c) network access that opens new markets and technologies, fostering transformative capacity. These three capacities collectively constitute the resilience of SMEs. The entire process is moderated by the enabling ecosystem, comprising institutional support (guarantees, legal templates), technological infrastructure, and the quality of the bank-SME relationship.

This model extends resilience theory to the micro-finance context by specifying the concrete mechanisms through which a financial instrument can influence resilience capacities. It also refines the Islamic finance literature by showing that PLS is not inherently problematic; rather, its success depends on the alignment of contract features with a supportive institutional framework. When the matrix is weak as in the absence of effective auditing or when banks adopt a risk-averse, collateral-centric culture PLS contracts degenerate into costly and mistrustful arrangements.

For regulators such as the Indonesian Financial Services Authority (OJK) and Bank Indonesia, this study suggests a multi-pronged approach. First, developing a standardized national PLS contract template with built-in incentive-compatible profit calculation and dispute resolution mechanisms would reduce legal uncertainty and transaction costs. Second, integrating PLS-specific modules into the government's KUR (micro credit) programme, with a partial guarantee and subsidized mentoring, could incentivize Islamic banks to scale up PLS without bearing the full burden of risk and cost. Third, accelerating the development of an open-banking API for SME transactions would allow automatic profit verification, drastically reducing information asymmetry. The newly launched Bank Syariah Indonesia (BSI) may serve as a pilot platform for such initiatives in the future.

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For Islamic bank managers, the findings highlight the necessity of treating PLS not as a product to be sold but as a service line requiring dedicated relationship teams with skills in business mentoring and financial technologies. The observed cases where mentoring was intensive yielded both higher client satisfaction and lower actual credit losses. Banks should consider ring-fencing a portion of their SME portfolios for "developmental PLS" with longer tenures and explicit capacity-building KPIs while using murabahah for working capital that needs a rapid turnaround. A blended model, where a larger murabahah facility is complemented by a smaller PLS facility for growth-oriented investment, may serve as a transition strategy.

This study has limitations that are inherent to qualitative research. The sample, while carefully selected for variation, is limited to six SMEs and three banks on Java Island; the findings may not be fully transferable to SMEs in eastern Indonesia with different economic and cultural contexts. Reliance on retrospective self-reporting of growth metrics introduces recall bias, although triangulation with bank documents partly mitigates this. Future research could employ a longitudinal-mixed-methods design that tracks PLS-financed and conventionally financed SMEs over time, incorporating both financial data and qualitative narratives. Quantitative tests of the resilience hypothesis using difference-in-difference or regression discontinuity designs around PLS adoption would strengthen causal claims. Additionally, experimental studies on the effect of digital monitoring on PLS performance could provide policy-ready evidence.

CONCLUSION

This study demonstrates that profit-and-loss-sharing financing, when implemented with genuine partnership commitment, has the potential to strengthen the resilience of Indonesian SMEs and, by extension, the real sector. The PLS model transcends mere capital provision; it embeds a risk-sharing buffer, mentoring channel, and network gateway that collectively enhance the firm's absorptive, adaptive, and transformative capacities. The cases documented here show that SMEs under musharakah and mudarabah were able to grow, formalize, and withstand economic shocks more effectively than the typical debt-financed narrative would predict. However, the study also lays bare the persistent barriers information asymmetry, moral hazard, and high transaction costs that have kept PLS a marginal product. However, these barriers are not insurmountable. Through intensive capacity-building mentoring, digital monitoring applications, and supportive government guarantee schemes, banks have begun to create a mitigatory ecosystem that makes PLS more viable. The key to scaling PLS lies not in abandoning its risk-sharing essence but in building the institutional and technological scaffolding that reduces the cost of information and trust. For Indonesia, where real-sector resilience is a national priority, revitalizing PLS financing is both a moral imperative of Islamic banking and an economic strategy to reduce over-reliance on debt financing. Achieving this requires concerted action from regulators to provide standardized contracts and incentives, banks to invest in relationship-based SME banking, and fintech firms to deliver low-cost monitoring solutions. When these elements align, PLS financing can become a genuine alternative that fosters equitable, resilient, and sustainable growth in SMEs.

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