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The Role of Islamic Microfinance Institutions in Promoting Development and Sustainability Agricultural Entrepreneurship Sector

Syaiful Muhamad Irsyad
Universitas Pendidikan Indonesia, Bandung, Indonesia
s.m.irsyad@upi.edu

Rumaisah Azizah Al Adawiyah
Universitas Pendidikan Indonesia, Bandung, Indonesia
rumaisah.azizah@upi.edu

Imas Nurani Islami
Universitas Pendidikan Indonesia, Bandung, Indonesia
imas.nurani@upi.edu

Dhidhin Noer Ady Rahmanto
Universitas Alma Ata, Yogyakarta, Indonesia
dhidhin@almaata.ac.id

Abstract

As one of the largest food-producing nations, Indonesia faces challenges in meeting domestic demand, making sustainability in agriculture a critical issue. One major hurdle is the limited financial resources available to farmers, underscoring the necessity for accessible microfinance. Islamic Microfinance Institutions (IMFIs) offer financing based on Islamic principles, providing unique opportunities to support farmers. This study explores the role of IMFIs in promoting development and sustainability in Indonesia's agricultural sector. A qualitative approach was employed, and interviews with key stakeholders were conducted to assess IMFIs' contributions to addressing financial constraints and fostering sustainable practices. The findings highlight the potential of IMFIs in enhancing agricultural entrepreneurship and supporting the achievement of Sustainable Development Goals (SDGs). The research results state that IMFIs has great potential to revolutionize financing in the agricultural sector, advancing SDG 1 (no poverty), SDG 2 (no hunger), and SDG 12 (responsible consumption and production). This research aims to guide IMFIs and policymakers in implementing effective strategies for sustainable development in agriculture.

Keywords: *Agriculture Entrepreneurship, Islamic Microfinance, Sustainable Development Goals (SDGs)*

INTRODUCTION

The Sustainable Development Goals (SDGs), introduced by the United Nations (UN) in 2015, consist of 17 distinct objectives aimed at addressing global challenges and promoting sustainable development. Countries worldwide are striving to achieve these targets by 2030. These goals encompass a broad range of areas, including poverty reduction, zero hunger, and economic growth (United Nations, 2015). However, achieving these goals presents significant challenges, particularly for developing countries like Indonesia, which face socio-economic barriers. A key challenge is empowering the agricultural sector, which is vital for supporting the livelihoods of millions, ensuring food security, and fostering economic stability—critical elements in realizing the Sustainable Development Goals.

In Indonesia, the agriculture sector plays a crucial role in the economy, contributing significantly to the country's GDP and providing employment for a large portion of the population. According to a World Bank (2022), approximately 43% of Indonesia's population resides in rural areas, and nearly 29% of the workforce is employed in agriculture. In 2020, primary agricultural production accounted for 13.7% of the nation's GDP. Despite the economic disruptions caused by the COVID-19 pandemic, the agricultural sector demonstrated resilience, with the GDP growth rate in the sector increasing by 1.77% in 2020, 1.87% in 2021, and 2.25% in 2022 (BPS, 2022). This highlights the sector's ability to withstand global crises, unlike many industries that faced significant declines. In recognition of its importance, President Joko Widodo emphasized on May 15, 2023, that agriculture is a strategic sector affecting both production and consumption and is integral to many livelihoods (BPS, 2023). Strengthening the agriculture sector is essential for Indonesia to achieve its Sustainable Development Goals (SDGs), particularly those focused on poverty reduction, hunger eradication, and sustainable economic growth.

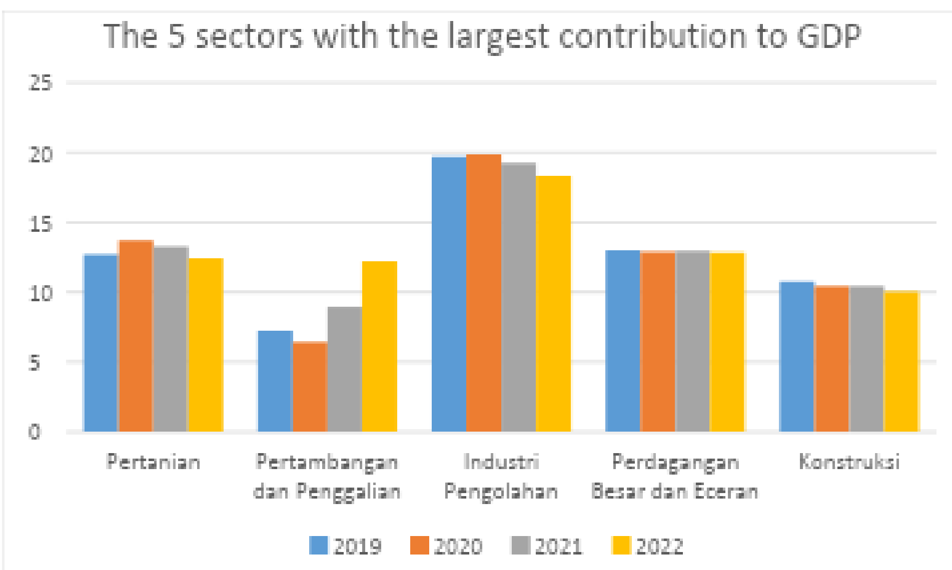

Figure 1. The 5fivesectors with the largest contribution to GDP 2019-2022
Source: Badan Pusat Statistik

Despite its significant, the agricultural sector in Indonesia faces several persistent challenges, including limited access to adequate infrastructure, vulnerability to climate change, and a pressing need for financial support and investment. According to the Financial Services Authority (2020), the sector has yet to become a dominant recipient of productive financing from banks in Indonesia. Research by Suryani et al. (2023) and Pasaribu et al. (2021) highlights that smallholder farmers often struggle to access formal financial institutions due to a lack of collateral, payment systems misaligned with their production cycles, and complex banking procedures. these financial constraints hinder farmers' ability to invest in their business, improve productivity and enhance overall sectoral growth.

Given these financial barriers, financial institutions play a crucial role in bridging the financing gap for agricultural entrepreneurs. As key financial intermediaries, banks facilitate access to credit, provide financial services, and develop innovative financial products tailored to economic development (Al-Kubati & Selvaratnam, 2023). However, conventional banking institutions primarily serve middle- to upper-income clientele due to strict lending requirements, including collateral, stable income verification, and formal creditworthiness assessments. This structural limitation often excludes small-scale agricultural entrepreneurs, who operate within informal or semi-formal economic frameworks and lack access to conventional financing. Consequently, alternative financial mechanisms are required to support this underserved segment and promote inclusive agricultural development.

Recognizing these limitations, Islamic Microfinance Institutions (IMFIs), such as *Baitul Maal wat Tamwil* (BMT), provide a more inclusive financial model tailored to the needs of small-scale agricultural entrepreneurs. Unlike conventional banks, IMFIs integrate financial inclusion with ethical and social objectives, ensuring that financial services align with Islamic finance principles. Widiana & Annisa (2017) emphasize that Islamic microfinance has substantial potential in supporting the agricultural sector due to its focus on social equity, poverty alleviation, and ethical investment. Through Sharia-compliant financing mechanisms, such as *qard al-hasan* (benevolent loans), *murabahah* (cost-plus financing), and *mudharabah-musharakah* (profit-sharing partnerships), IMFIs offer financial solutions that allow smallholder farmers to access capital without the burden of interest-based debt. These mechanisms accommodate the seasonal nature of agricultural income, making them particularly relevant for rural farmers. Furthermore, BMTs, which are widely recognized at the grassroots level, play a crucial role in fostering local economic resilience and advancing financial inclusion—both essential components in achieving the SDGs.

Numerous studies highlight the essential role of Islamic Microfinance Institutions (IMFIs) in promoting agricultural entrepreneurship in Indonesia, and their contribution to achieving the Sustainable Development Goals (SDGs). Alfian et al. (2025) emphasize that Islamic social finance mechanisms, such as zakat and waqf, address financial challenges while fostering social equity and environmental sustainability. Dirie et al. (2023) stress the potential of IMFIs to bridge funding gaps in high-risk agricultural sectors, enhancing food security and economic growth. Maulana et al. (2024) discusses the potential of instruments like green sukuk to finance environmentally friendly agricultural projects, despite regulatory and literacy challenges. Sabiti and Effendi (2017) reveal a positive impact of Islamic microfinance on micro-business performance and household welfare in Bogor, West Java. Febianto et al. (2019) highlight the role of *Baitul Mal wa Tamwil* (BMT) in Bandung in enhancing both financial capacity and spiritual well-being among agricultural entrepreneurs. Despite these contributions, further research is needed to explore innovative financing solutions to improve IMFIs' sustainability and effectiveness in supporting agricultural entrepreneurship aligned with the SDGs. Anwar et al. (2021) and Yumna (2019) also underscore the importance of accessibility, credit screening, and monitoring to maintain the sustainability of IMFIs while noting challenges such as high operational costs and low repayment rates. Additionally, studies by Nurhayati et al. (2020) and Dirie et al. (2024) highlight how zakat-based programs empower disadvantaged communities and promote financial independence, suggesting the need for ongoing exploration of financing innovations in agricultural sectors to align with the SDGs.

This study specifically examines the role of Islamic Microfinance Institutions (IMFIs) in supporting agricultural entrepreneurship to advance the Sustainable Development Goals (SDGs). It distinguishes itself by focusing on the underexplored region of West Java, providing a unique geographical perspective on how IMFIs operate in high-risk agricultural sectors. It aims to analyze how IMFIs contribute to supporting agricultural entrepreneurs in Indonesia toward achieving the SDGs, particularly in poverty reduction, food security, and sustainable economic growth. Additionally, the study seeks to identify the opportunities and challenges faced by IMFIs in promoting agricultural entrepreneurship and to explore how these institutions can bridge the financing gap for high-risk agricultural sectors. By addressing the financial barriers faced by agricultural entrepreneurs, Islamic microfinance institutions play a vital role in empowering these entrepreneurs, fostering sustainable economic growth, and advancing the SDGs in developing nations. This study also provides practical policy recommendations to improve the sustainability of IMFIs. To address these research objectives, a deductive qualitative methodology was employed, utilizing in-depth interviews with key stakeholders, including IMFIs practitioners and experts. The data collection focuses on insights from experienced practitioners and experts representing IMFIs, ensuring a comprehensive understanding of institutional roles, operational challenges, and strategic approaches. This approach provides a deeper understanding of the mechanisms through which IMFIs contribute to sustainable agricultural entrepreneurship while aligning with the broader goals of sustainable development.

Due to time and capability limitations, this study has several boundaries. First, the research focuses on microfinance institutions and the agricultural sector to explore the current role of Islamic Microfinance Institutions (IMFIs) in supporting the agricultural sector. Second, the study is limited to BMT as a microfinance institution because *Baitul Maal wat Tamwil* (BMT) aims to improve the quality of economic enterprises for the welfare of its members in particular and society in general. Third, the research is confined to microfinance institutions and the agricultural sector in the West Java region, specifically Bandung and Majalengka.

LITERATURE STUDY

Agriculture Entrepreneurship

The agricultural sector has undergone profound transformations driven by a range of factors, including globalization, market expansion, population growth, community development, rising unemployment, shifts in the agricultural labor force, structural reforms, evolving agricultural policies, trade liberalization, food security concerns, and increasing environmental challenges. These dynamic changes have reshaped agricultural practices, supply chains, and the socio-economic landscape, presenting both opportunities and complex challenges for sustainable agricultural development. To address these changes effectively, promoting an entrepreneurial culture and mindset within agriculture is crucial (Higgins & Morgan, 2000).

Agricultural entrepreneurship is a specialized branch of entrepreneurship that involves taking risks to launch ventures related to agricultural production, services, or commerce. This approach is seen as a promising strategy for rural development. According to Barani & Zarafshani (2009), three key factors are critical to advancing entrepreneurship in the agricultural sector: 1) Reducing unnecessary government interventions to increase freedom in the sector, 2) Investing in infrastructure that supports agricultural development, 3) Ensuring investment security and improving conditions conducive to entrepreneurship in agriculture.

Islamic Microfinance

Microfinance has gained prominence in recent years as a tool for poverty alleviation. It is argued that by providing small loans, microfinance enables disadvantaged individuals to invest in self-employment, which increases income, consumption, and further investment, thus breaking the cycle of poverty (Khan, 2009).

Microfinance typically offers small loans, savings, and insurance services to micro-entrepreneurs and small businesses to help improve their standard of living. These programs often focus on providing financial services to individuals traditionally excluded from conventional banking systems. Key features of microfinance programs include: 1) Short-term loans, typically for less than 12 months, with frequent repayments, 2) Alternative collateral models, such as collective guarantees from community groups. 3) Simplified processes are designed for easy access by low-income borrowers (Khan, 2009).

As microfinance continues to expand, it directly and indirectly impacts financial development, environmental sustainability, and social inclusion by generating jobs, fostering self-reliance, and protecting individuals from adverse circumstances (Haidar & Satifa, 2022). However, Islamic Microfinance Institutions (IMFs) face challenges related to both financial performance and social impact. To achieve sustainability, IMFs must balance financial viability with their mission to serve underserved populations (Zamir & Shabbir, 2021).

In line with Islamic finance principles, microfinance must adhere to the prohibition of *riba'* (interest) and instead utilize ethical financing tools such as careful hasan (interest-free loans), *murabahah* (cost-plus financing), and *ijarah* (leasing). Participatory models like Mudharabah and *musharakah* offer further opportunities for risk-sharing and entrepreneurship support (Rahman, 2010).

The United Nations' Sustainable Development Goals (SDGs) set an ambitious global development agenda from 2015 to 2030, with the primary objective of eradicating poverty and promoting prosperity worldwide (Mohieldin & Aboulmagd, 2015). Unlike the more targeted Millennium Development Goals (MDGs), the SDGs cover a broader range of objectives, requiring substantial resource mobilization.

Despite the rapid growth of Islamic financial assets—estimated to have surpassed USD 2 trillion in 2014—critics argue that Islamic finance has not fully achieved its social objectives. Incorporating *Shari'ah*-based principles into Islamic finance operations could enhance its contribution to the SDGs (Mohieldin & Aboulmagd, 2015).

Microfinance plays a pivotal role in advancing sustainable development by addressing the SDGs' primary goal of poverty eradication. Through microfinance, impoverished communities can access financial resources, invest in self-employment, and break the cycle of poverty (Haidar & Satifa, 2022).

Conceptual Framework

Islamic microfinance plays a crucial role in supporting agricultural entrepreneurship, particularly by providing funding assistance to underserved populations. This financial support can drive innovation and economic growth within rural areas, contributing to poverty alleviation and improved livelihoods. By fostering entrepreneurship in the agricultural sector, Islamic microfinance can directly assist governments in achieving several of the United Nations' Sustainable Development Goals (SDGs), especially those related to poverty reduction, hunger eradication, and economic growth.

Islamic microfinance institutions (IMFs) operate based on *Shari'ah* principles, offering interest-free loans (*qardhul hasan*) and promoting risk-sharing arrangements like *Mudharabah* (profit-sharing) and *musharakah* (joint ventures). These financing models align well with the SDGs by supporting ethical and sustainable business practices while ensuring that disadvantaged communities gain access to capital.

The connection between Islamic microfinance, agricultural entrepreneurship, and the SDGs can be illustrated through a framework where: 1) Islamic Microfinance provides ethical and interest-free financing solutions, 2) Agricultural Entrepreneurship is nurtured, leading to increased productivity, job creation, and rural development, 3) This, in turn, supports the Sustainable Development Goals (SDGs), particularly those focused on eradicating poverty (SDG 1), promoting food security (SDG 2), and fostering inclusive economic growth (SDG 8).

Figure 2. Conceptual framework of Islamic microfinance contributions

METHOD

This research employed a qualitative descriptive approach, as it sought to unravel complex human behaviors and institutional practices without reliance on numerical data or statistical analysis. As Creswell (1994) suggests, qualitative research unfolds organically within natural settings, offering the researcher a lens into the rich tapestry of real-life experiences through direct engagement. This approach was chosen to provide nuanced descriptions, interpretations, and insights drawn from the intricate dynamics of the studied context. This type of research is a case study of IMFI's role in implementing effective policy strategies for sustainable development in the agricultural sector. A case study is a research method that examines in depth certain individuals, organizations, businesses, or institutions (Gillham, 2000). According to Mills et al. (2018), case studies have several main characteristics, namely: 1) Focuses on the relationship between various factors that form the context of a particular entity, such as an organization, event, phenomenon, or individual, 2) Explore the relationship between contextual factors and the entity that is the object of research, 3) Specifically aims to gain an understanding of the interaction between contextual factors and these entities, so that they can produce new theories or contribute to existing theories.

The focus of this study was on Islamic microfinance institutions (IMFIs), specifically Baitul Maal Wa Tamwil (BMT), which play a pivotal role in supporting the agricultural entrepreneurship sector. The qualitative data were primarily collected through semi-structured interviews, allowing for an in-depth exploration of IMFIs' contributions to sustainability and development. The interview guide (see Appendix 1) was designed to probe participants' understanding of the Sustainable Development Goals (SDGs), their involvement in promoting these goals, and the challenges they encounter in aligning their operations with such global benchmarks. This guide was based on prior research methodologies, with modifications tailored to meet the unique aims of this study (Airfare et al., 2023).

Participants were selected using purposive and snowball sampling methods, leveraging both industry networks and professional recommendations. The inclusion criteria for IMFIs involved registration with the Ministry of Cooperative and SMEs of the Republic of Indonesia, a minimum asset value of five billion Rupiah, proximity to a major agricultural hub as identified by the Central Bureau of Statistics, and a strategic focus on SMEs, particularly in the agricultural sector. Two founders/owners of IMFIs, each with 5 to 10 years of experience, were chosen as the study sample. Participants in this research include BMT Talaga and experts in the field of BMT. Participants were selected because they met the criteria, namely being registered with the Ministry of Cooperatives and SMEs of the Republic of Indonesia, close to agricultural centers, and the founder or owner of IMFI had 5 to 10 years of experience.

Interviews were conducted face-to-face at the participants' offices to allow for deeper engagement, although Zoom was also offered as an alternative to accommodate logistical constraints. Each interview lasted between 60 to 90 minutes and was audio-recorded with the participant's consent. The interview sessions took place between May and August 2024. Data from these interviews were analyzed using the qualitative analysis framework proposed by Miles and Huberman (1994), which comprises three interconnected steps: (1) data reduction, (2) data display, and (3) drawing and verifying conclusions. This method enabled a systematic dissection of the data, ensuring that key themes were extracted and examined rigorously.

To fortify the study's credibility and external validity, member checking was employed. Interview transcripts were returned to participants for verification, ensuring that their perspectives were accurately captured and interpreted. This iterative process, a cornerstone of qualitative rigor, as highlighted by Guba & Lincoln (2004), bolstered the trustworthiness of the findings. The absence of discrepancies between the initial transcripts and participant feedback reinforced the validity of the conclusions drawn. Furthermore, an exhaustive audit trail was maintained throughout the research process, meticulously documenting every methodological decision, thereby enhancing the transparency and reliability of the study.

All participants granted informed consent for the use of their interview data, which further ensured that the ethical standards of the research were upheld. This commitment to ethical rigor, coupled with a robust methodological framework, underscores the reliability and depth of the findings presented in this study.

RESULTS AND DISCUSSION

The analysis of qualitative data from interviews with experts in Islamic microfinance institutions (IMFIs) such as BMT specializing in the agricultural sector revealed several key themes that reflect both the opportunities and challenges faced by Islamic microfinance in contributing to the Sustainable Development Goals (SDGs). The findings are organized under two main themes: (1) The Sustainability of Agricultural Entrepreneurship and (2) Opportunities in the Agricultural Entrepreneurship Sector.

THE ACHIEVEMENT OF IMFIs IN SDGs

Access to Finance for Smallholder Farmers

Islamic microfinance institutions (IMFIs) serve as a key factor in supporting small industries, particularly agriculture, by combining commercial and social objectives. One of their unique strengths is their ability to reach un-bankable clients, facilitated through a system of "customer intimacy." As one expert explained:

> *"So, as long as customer intimacy, which builds up based on the emotional touch, is running, the collection process in microfinance differs significantly from that of traditional banks. Unlike banks, where customers often visit the institution, microfinance institutions take a more proactive approach by going directly into the field to collect payments, this kind fosters a stronger connection with clients and enhances trust. It's appreciated by the clients themselves, as the institution demonstrates a hands-on commitment to supporting them. In microfinance, this practice is often referred to as 'picking up the ball,' highlighting a personalized service approach that sets it apart from conventional banking practices."-EP." (EP)*

The customer intimacy approach represents a distinctive strategy that sets Islamic Microfinance Institutions (IMFIs) apart from conventional banking institutions. This approach enables IMFIs to extend broader access to small entrepreneurs by focusing on understanding and addressing the specific needs of their target clients, including their daily necessities, as what previous studies have underlined that the role of IMFIs are essential in blending commercial and social objectives (Dusuki, 2008; Obaidullah & Khan, 2008). A key feature of this approach is the implementation of a joint responsibility system, wherein members collectively bear financial risks and burdens. This fosters a sense of community and mutual support among clients, distinguishing IMFIs from traditional banking practices in which the collective financial responsibility would mitigate defaults among the clients (Gine & Karlan, 2014).

In the agricultural sector, IMFIs have demonstrated their critical role in facilitating growth and resilience despite the inherent risks associated with this industry. Agriculture holds significant potential in Indonesia, given its status as an agrarian country with vast untapped resources. A compelling example of this is BMT Talaga, an Islamic microfinance institution based in Majalengka, West Java, which has achieved considerable success in supporting small entrepreneurs within the agricultural sector. According to the institution's management, more than 50% of BMT Talaga's assets are allocated to agricultural financing, underscoring its commitment to this sector.

BMT Talaga's financing model is characterized by flexibility and affordability, providing essential financial access to farmers who face barriers to obtaining funding from conventional financial institutions. One of its innovative solutions is the provision of seasonal financing products tailored to the agricultural harvest cycle. For instance, farmers repay loans after the harvest, a system widely known as YARNEN (an abbreviation of "bayar panen" or "pay after harvest"). This financing arrangement aligns repayment schedules with farmers' income cycles, reducing financial strain and fostering greater financial stability.

To further mitigate risks associated with agricultural financing, BMT Talaga employs a co-financing model, requiring farmers to contribute a portion of the capital for their businesses. This shared ownership incentivizes farmers to remain committed to their ventures, as their investment is at stake. The practice also ensures that financing is used effectively, as farmers are more likely to exercise prudence and diligence when their resources are involved. Additionally, the amount of financing provided by BMT Talaga is customized to each farmer's specific needs and circumstances, ensuring that the support is both adequate and sustainable.

The efforts of IMFIs, particularly through institutions like BMT Talaga, significantly enhance the sustainability and growth of smallholder farmers' businesses. The funding provided is often utilized for business expansion, such as purchasing agricultural tools, seeds, and fertilizers. This support not only improves productivity but also strengthens the resilience of the agricultural sector, contributing to broader socio-economic development.

In conclusion, the customer-focused strategies employed by IMFIs, combined with innovative financial products like YARNEN and co-financing models, exemplify their pivotal role in addressing the unique challenges faced by small entrepreneurs, particularly in agriculture. YARNEN financing model established by BMT Talaga provenly show the innovative Islamic financial products, as the challenges in the agricultural sector and underserved communities might face (Alaro & Alalubosa, 2018). By bridging the gap between conventional financing and the needs of underserved communities, IMFIs contribute to a more inclusive and sustainable economic landscape with its unique features (Dusuki, 2008).

Social Equity and Poverty Alleviation

One significant contribution of Islamic Microfinance Institutions (IMFIs) to smallholders and farmers lies in their implementation of the joint financing system, which integrates Islamic financial principles with localized practices. This approach has proven effective in fostering an Islamic financing framework that resonates with community values and is readily accepted by local populations (Barus, 2021; Mubarrok et al., 2023). For instance, BMT Talaga has successfully employed financing models based on the Murabaha contract, a straightforward and easily comprehensible agreement well-suited to the educational levels of farmers. This simplicity has facilitated deeper market penetration into areas surrounding BMT Talaga, enabling the institution to empower local economies through targeted, community-based financing.

BMT Talaga's approach is deeply rooted in personal and cultural engagement. The institution begins by identifying regions with favorable business potential and the financial capacity to meet repayment obligations. Once a suitable area is identified, BMT Talaga introduces Sharia-compliant, community-oriented financing schemes. This model mirrors the Grameen system in Bangladesh, which leverages localized community networks to enhance financial accessibility (Encyclopedia Britannica, 2025). A key factor in the success of this community-based approach is the emotional connection established with clients, which fosters social cohesion and encourages timely repayments. As one expert explained:

> *"They often feel a deep sense of embarrassment if they fail to fulfill their financial obligations. It becomes a matter of personal honor and community pride— 'How could I not pay back BMT after all they've done?' This emotional connection is rooted in the* strong

communal ties fostered by the institution. The community-based model creates a pattern of social responsibility and accountability, similar to the dynamics observed in social gatherings. For instance, in social settings such as communal meals or collective savings groups, individuals feel shame if they fail to contribute or fulfill their commitments, particularly after being hosted or supported by others. This sense of obligation is why the Grameen program operates effectively—it leverages social norms and communal accountability. In this context, relationship management becomes far more critical than transactional mechanisms. By cultivating trust and fostering a sense of belonging, financial institutions like BMT create an environment where clients are intrinsically motivated to uphold their responsibilities. This relational approach not only ensures repayment but also strengthens social cohesion within the community." – EP.

BMT Talaga further adapts its financing models to align with the unique needs of farmers, particularly in addressing the seasonal nature of agricultural income. Given the cyclical nature of harvesting, IMFIs have developed flexible financing options tailored to farmers' cash flow patterns, which makes it essential (Agri Studoc, 2024). One manager elaborated:

"In the past, the repayment schedule was set to every four months, meaning that financing was repaid three times a year. However, after careful analysis and experience, we encountered numerous challenges with this structure. As a result, it became apparent that the repayment terms required modification. In response, we introduced the concept of 'seasonal financing,' where repayments are spread over 3-4 months. This adjustment better aligns with the needs of our clients, as they do not require funds upfront; rather, they often need financial support only after a month or so. As a consequence, we are currently experiencing a period of lower financing activity, with less demand for funds. However, we anticipate a surge in financing needs around September or October, as this is the peak season. BMT is continuously analyzing farmers' financial patterns to ensure that our offerings remain responsive to their needs. Our financing model also allows for repayment flexibility. For instance, if a farmer has access to funds from other sources during the first season, they are free to use that to make an early payment. Nonetheless, it is generally advisable for clients to repay their financing as soon as possible. Ideally, any outstanding balance should be cleared within three months." - BM1.

This adaptive approach to financing not only supports the financial well-being of farmers but also ensures the sustainability of IMFIs themselves by stabilizing their cash flow. By aligning repayment schedules with farmers' income cycles, IMFIs like BMT Talaga mitigate risks associated with delayed payments while enhancing their operational resilience.

In short, the localized and culturally sensitive financing models employed by IMFIs contribute significantly to social equity and poverty alleviation. By addressing the unique needs of smallholders and farmers—through mechanisms such as Murabaha contracts, seasonal financing, and community-based approaches—IMFIs foster financial inclusion, strengthen agricultural sustainability, and build resilient communities. This dual emphasis on economic empowerment and social solidarity positions IMFIs as vital agents of inclusive development.

Promotion of Sustainable Agricultural Practices

Islamic finance principles discourage exploitation and encourage fair practices, promoting sustainability in agriculture. IMFIs like BMT Talaga actively support environmentally friendly farming methods and fair-trade practices, aligning with the Islamic concept of *Taawun* (mutual assistance) as highlighted in table 1, which is advancing the role of Islamic finance in SDGs and promoting sustainable agriculture (Ahmed et al., 2024; Bhagat et al., 2024).

The financing models used by IMFIs, including *Salam* and *Musyarakah Mutanaqisah*, aim to promote fair and sustainable practices. These models help farmers expand their businesses without falling into exploitative debt, fostering long-term economic and social sustainability (Zulfikar et al., 2023).

Table 1. The Role of IMFIs in Promoting Sustainable Financial Practices

Key Insights	Examples	Long-term Impact	Islamic Finance Principles in IMFIs	Products Used by IMFIs	Examples of Fair Practices in Financing
Islamic principles of finance discourage exploitation and encourage fair practices, promoting sustainability.	IMFIs support eco-friendly agricultural techniques and fair-trade practices (Taawun).	The connection between sustainability and Islamic ethics in finance shows a holistic approach to economic development.	IMFIs encourage small farmers to expand their businesses, reflecting fair practices and promoting sustainability. Financing agricultural sectors face liquidity barriers, often leading to financing for wholesalers with large capital.	BMT Talaga uses products like Salam and Musyarakah Mutanaqisah, but primarily relies on Murabahah.	IMFIs use Taawun funds to assist customers facing difficulties in repayment, preventing non-performing loans.

Challenges in the Agricultural Entrepreneurship Sector

Risk Management and Crop Failure

Agriculture is inherently risky due to factors like crop failure and natural disasters. IMFIs, such as BMT Talaga, mitigate these risks through financial products like *Mudharabah* (profit-sharing) and *takaful* (Islamic insurance), which share the risk between the farmer and the institution.

Table 2. Addressing Agricultural Risks through Islamic Microfinance Institutions (IMFIs)

Key Insights	Expert Opinions	Possible Solutions	Challenges in Agricultural Financing
Discuss the challenges related to agricultural risk, such as crop failure and natural disasters, and how IMFIs handle these risks.	Insights from microfinance institutions, such as BMT Talaga, on the financial risks they face when offering loans in high-risk agricultural sectors.	Risk-sharing financial products, such as Mudharabah (profit-sharing) or takaful (Islamic insurance), could help mitigate agricultural risks.	The agricultural sector is vulnerable to systemic risks like natural disasters and crop failure, making it challenging to finance.

However, IMFIs also face reputational risks, particularly in community-based financing, which is sometimes viewed negatively if not supported by a clear social mission. As one expert observed:

> *The main issue we are currently facing in the field is reputational risk. 'Bank Emok' follows a group-based lending model, which is now associated with a negative stigma. In reality, this model is fundamentally similar to the Grameen approach, as it was originally designed to be accessible and inclusive for low-income individuals. However, over time, these institutions have been perceived negatively due to their unsustainable practices. This highlights a critical issue: when financial institutions focus solely on financial gains without incorporating a social mission, the consequences can be detrimental. One of the biggest challenges today is over-indebtedness—an excessive accumulation of financing. The widespread adoption of the Grameen model by multiple financial service providers has resulted in a single borrower receiving funding from five to ten different institutions. Consequently, many borrowers fall into a cycle of debt, where they take on new loans simply to repay existing ones—a phenomenon commonly referred to as 'digging one hole to fill another'. In economic terms, this situation resembles a financial bubble, which can eventually collapse. This is the key reason why 'Bank Emok' has gained a negative reputation, despite its original mission being well-intended."*

There needs an economic scale to make it profitable in the agricultural sector, in several Islamic microfinance institutions as well, the one that gets funding mostly from middlemen (tengkulak) or wholesalers, as it gives faster cashflow, which for farmers to be profitable as well need at least a big amount of capital, especially in terms of the farmland.

> *"In Indonesia, many individuals are engaged in agricultural activities, but these efforts of do not reach the scale of an agricultural economy. The principle of* ***economies of scale*** *is not fully realized—at least, not if the goal is to build a profitable business. However, if the objective is merely employment, then the situation remains unchanged. The agricultural sector can be divided into two categories: those who work as laborers (farm workers) and those who operate as agricultural entrepreneurs. If the goal is* ***economic prosperity****, then one must become an agricultural entrepreneur. Farm workers, as we know, earn very little daily. In reality, most farm workers remain poor, and even among*

*agricultural entrepreneurs, only a small percentage achieve significant wealth. This is largely due to the **minimum economic scale** required for profitability in agriculture. Research suggests that a minimum landholding of **at least 2 hectares** is necessary for farming to be financially viable. Any land area smaller than this is unlikely to be profitable. As a result, from the perspective of financial institutions, farmers with at least **2 hectares of land** are considered more **financially viable** and bankable."*

Related to the wholesaler. Indeed, this remains a challenge, as the wholesaler or so-called as tengkulak gives the farmers not only capital funds but also to fulfill their daily needs with high interest in return, which needs a solution

Another challenge in agriculture is related to commodity prices. The BMT Talaga Manager said that, according to their interview findings with the farmers, price risk is more often becoming an obstacle than the risk of crop failure or disease attacks. Price risk is prone to competition with wholesalers, compared with economic conditions, whether locally or nationally.

Irregular financial cycles affected by the irregular cash flow of the farmers also becoming a challenge for the IMFIs and the farmers. BMT Talaga Manager acknowledged that there are fluctuations in the financing cycle. In certain months, such as October and December, there is a spike in financing demand, while in other months, such as January to March, there is a significant decline, which poses a challenge for managing liquidity.

Additionally, price volatility poses a greater challenge than crop failure. IMFIs must continuously manage the liquidity challenges caused by irregular cash flows from farmers, as demand for financing fluctuates throughout the year.

Limited Financial Literacy Among Farmers

One of the main obstacles to effective microfinance use in agriculture is the limited financial literacy among farmers. Most farmers are familiar only with basic contracts like murabahah, while more complex Islamic financial products are less understood. This presents a challenge for IMFIs, which must invest in educating farmers on various financing options to improve participation and sustainability.

Table 3. Enhancing Financial Literacy Among Farmers through IMFIs

Key Insights	Institutional Efforts	Suggestions for Improvement
Lack of financial literacy is a barrier to the effective use of microfinance services by farmers.	Efforts (or lack thereof) made by IMFIs to educate farmers on financial products and sustainability practices.	IMFIs could partner with NGOs or government programs to provide training and financial education.

As the knowledge of farmers are limited, most of farmers only know certain products in IMFIs, which is murabahah. This is what makes IMFIs also, The problem of farmers is indeed around knowledge and financial literacy. This makes financing in the agricultural sector in practice, would not put the consumers focus on one sector, but also on another sector. Not only in the agriculture sector

> *"Currently, there are no active initiatives in this area. Previously, there was an institution called Agri Bank under BRI, but it was rebranded as Raya Bank after failing to sustain its operations. This underscores the complexity of agricultural finance. Like it or not, human resources remain the most critical factor. The agricultural sector often struggles due to a lack of competent human resources. In addition to technical expertise, individuals in this field must also possess financial literacy and strong financial management skills. Ironically, many agricultural graduates end up working in banks, likely because the sector itself is perceived as less attractive—this poses a significant challenge. I agree with the view that the agricultural workforce should not be excessively large. From an economic scale perspective, land size plays a crucial role in determining prosperity. When land holdings are too small, achieving financial well-being becomes difficult. This results in a* ***low farmer exchange rate****, as the business scale remains limited."*

Another challenge in IMFIs financing the farmers related to limited financial literacy is the type of contract that farmers understand. As most of the education levels of farmers are low, understanding various types of Islamic financial contracts remains a challenge. Therefore, in the case of BMT Talaga, it often uses murabahah contract, which is considered simpler.

Regulatory Challenges and Institutional Constraints

IMFIs also face challenges related to regulatory frameworks and bureaucratic obstacles. Policies and regulations are not always supportive of Islamic finance growth, particularly in sectors like agriculture. There is a need for closer collaboration between IMFIs and government bodies to streamline processes and create policies that better support sustainable agriculture.

Table 4. Addressing Regulatory Challenges for IMFIs

Key Insights	Expert Views	Recommendations
Identify the challenges IMFIs face due to regulatory frameworks, bureaucracy, and the lack of supportive policies.	Insights from institutions on how governmental policies could be more aligned with Islamic finance principles to promote growth.	Propose policy changes or collaborative efforts with regulators to overcome these institutional challenges.

Comparative Analysis of Opportunities and Challenges

Balanced Perspective

The opportunities presented by Islamic microfinance institutions (IMFIs) in supporting agricultural entrepreneurship are balanced by significant challenges. On the one hand, IMFIs like BMT Talaga have the potential to empower smallholder farmers through personalized, flexible financing options, particularly in unbankable markets. On the other hand, they face constraints such as financial literacy, systemic agricultural risks, and fluctuating cash flows.

Trade-offs and Constraints

IMFIs, particularly BMTs (Baitul Maal wat Tamwil), focus on small and medium-sized enterprises (SMEs) that traditional banks often avoid due to their higher failure rates. However, the nature of microfinance requires a dynamic approach, as relying solely on strategies like the joint liability system (Grameen model) is not always effective in the current competitive landscape. As one practitioner noted:

> *"Various strategies can be implemented, including those that leverage opportunities based on an institution's strengths. However, the approach varies depending on the analysis conducted, meaning that different financial institutions may adopt different strategies. This dynamic nature ensures continuous adaptation. For example, in the past, Itqon relied on a group-based lending model because there were no competitors in the market. However, with increasing competition today, adjustments must be made. One should never become complacent, as others are also continuously evolving and improving. Even banks have now adopted the Grameen model, as seen with BTPN Syariah. Consequently,* ***learning and growing*** *must become core values of any institution. A company that ceases to learn and grow will inevitably fall behind. A strong culture of* ***learning and growth*** *can lead to significant business opportunities and meaningful innovations, ultimately fostering customer loyalty. In turn, customer loyalty becomes a key financial asset. Additionally, institutions must focus on building* ***robust systems rather than relying solely on exceptional individuals****. If an organization depends too much on a single figure and that person is no longer present, the company risks instability. Therefore, businesses should not be designed to last only as long as their founders—it is a dangerous approach. This is why I prioritize leadership succession and talent development. Continuous adaptation to change is essential for long-term sustainability."*

It is undeniable that economies of scale remain a priority for experts and practitioners when providing financing to customers. This focus often results in a preference for larger, more established enterprises, leaving smaller agricultural entrepreneurs struggling to access financial support. Key barriers include rigid financing schemes, limited risk mitigation strategies, and a lack of tailored financial products that accommodate the unique and seasonal nature of agricultural activities.

While Islamic microfinance institutions (IMFIs) offer greater flexibility in adapting their strategies, they face an ongoing challenge in balancing growth promotion with risk management. For instance, BMT Telaga has introduced customized financial products such as YARNEN (pay after harvest), which provide farmers with payment flexibility. However, these models must also address capital constraints and sustainability issues, particularly when considering the variable financial conditions of small farmers.

By adapting financing contracts to align with farmers' specific needs, IMFIs can improve financial accessibility while offering better risk-sharing mechanisms. Such innovative approaches not only support small-scale agricultural entrepreneurs but also play a crucial role in fostering sustainable agricultural development and advancing the Sustainable Development Goals (SDGs).

SME Financing and the Agricultural Sector

The agricultural sector poses a unique challenge due to its cyclical nature. For example, larger landowners often succeed because they can smooth out cash flow issues by rotating crop cycles, whereas small farmers with limited land struggle to maintain consistent income streams. As one practitioner stated:

It ultimately depends on the financial product. In the eyes of financial institutions, both agricultural laborers and agribusiness entrepreneurs are considered potential borrowers. Agricultural laborers, for instance, can access specialized financing designed for low-income individuals, such as the Grameen model. Meanwhile, MSME financing products can be tailored for agribusiness entrepreneurs. In practice, agribusiness entrepreneurs operate in different areas—some are engaged in on-farm activities, while others focus on agricultural trade. Large-scale land holdings are essential for managing cash flow efficiently. In plantation businesses, for example, different sections of the land can be harvested at different times, ensuring a continuous cash flow. However, for those with limited land, managing the harvest cycle becomes more challenging, making financial sustainability difficult. As a result, agricultural businesses that achieve significant success are typically those with large land holdings. This is one of the primary challenges in the agricultural sector, except for cases where technology has been effectively integrated into farming operations.

The Role of Islamic Finance in Achieving Sustainability

The consideration of IFIs is related to the ability to pay its farmers, so knowing the characteristics of farmers is also important. Again, as BMT Talaga has given some examples, the IMFI should consider the cash flow condition of the farmers. Therefore, in this case, IMFIs should have a framework for adapting to the characteristics of the farmers.

Based on the results, IMFIs impact sustainability, specifically the SDGs. First, IMFIs play a role in SDG 1, poverty eradication, by providing access to finance for small farmers. Different from banking, which focuses on commercial purposes, IMFIs tend to focus on a cultural approach in providing access to farmers for instance BMT Talaga provides flexible access to capital, enabling farmers to increase their production and welfare. Second, the role of IMFIs also contributes to SDG 8, decent work, and economic growth, as IMFIs facilitate local economic growth through Sharia-based financing that encourages agricultural businesses to become more sustainable. Third, IMFIs also support sustainability in consumption and production as in SDG 12. With a community approach that takes local resources into account, IMFIs ensure that farmers are less dependent on external financing. Farmers are encouraged to use capital efficiently and responsibly, supporting a more environmentally friendly production system.

Table 5. Aligning Islamic Finance with SDGs in Agriculture

Ethical Finance	Impact on SDGs	Future Outlook
How Islamic principles in finance align with sustainability goals in agriculture.	Link findings to global goals such as poverty reduction (SDG 1), zero hunger (SDG 2), and responsible consumption (SDG 12).	Based on interview insights, predict how IMFIs might evolve or innovate to address future challenges.

"In West Java, research has already been conducted on the issue of over-indebtedness. Reflecting on the 2007 microfinance crisis in India, one of its primary causes was over-indebtedness, where a borrower tragically resorted to self-immolation due to excessive debt collection pressure. This highlights the importance of responsible finance, which

emphasizes ethical and sustainable financial practices. Financial institutions should not merely focus on asset expansion and increasing the number of borrowers. Conventional institutions often overlook these aspects. In response to such incidents, the Indian Parliament imposed a moratorium on loan repayments to financial institutions, which led to the collapse of many microfinance institutions at the time. Consequently, regulatory measures have now been enforced, limiting individuals to a maximum of three active loans to prevent excessive borrowing and ensure financial sustainability."

The role of the importance of making sure SMEs have 5C

In the context of MSMEs, financial assessment primarily revolves around the 5C principle. The actual loan amount is not a major concern if the borrower's repayment capacity is sufficient. Essentially, we perceive all opportunities as potential, provided that the alignment between their needs, preferences, and desires matches the offered financial product. This explains why Grameen Bank has been successful despite targeting a market segment that conventional banks typically avoid—because their approach is well-matched to the segment's characteristics. In the SEPM framework, there are seven key dimensions. Among, the first is that financial institutions must have clear social goals. The second is that the leadership must be committed to achieving these social objectives. The third is that financial institutions must design products that align with the needs and preferences of their target market. For instance, in the agricultural sector, fixed monthly installments are not always suitable, as cash flow is typically generated only at the time of harvest. Therefore, installment structures must be adjusted accordingly. In banking, there is a product known as a grace period, which allows borrowers to delay repayments until they begin generating income. However, since banks need a continuous revenue stream, they offer another facility called interest during construction (IDC), where an additional loan is provided solely to cover interest payments. This way, two facilities are provided: one for working capital and another for IDC, ensuring that the bank maintains its revenue while supporting the borrower—creating a win-win situation for all parties involved.

IMFIs have products according to their customers' needs. For example, customers in the wholesaler category would have a bigger financing fund, while small farmers use a joint pattern that considers their cash flow patterns. This means that IMFIs should give more opportunities to a wider range of farmers.

As in addressing seasonal challenges in the agricultural sector, product diversification is also becoming fundamental, such as IMFIs could provide products that are more appropriate to farmers' conditions. For instance, introducing financing based on profit sharing or mudharabah or musyarakah agreement to mitigate risk.

Another recommendation for IMFIs and regulators is Financial Literacy Improvement: BMT Talaga can strengthen financial literacy for farmers through special education or training programs that focus on understanding the Sharia financial system and capital management.

CONCLUSION

Islamic microfinance institutions (IMFIs) are pivotal in fostering agricultural entrepreneurship, significantly contributing to sustainability, and achieving key Sustainable Development Goals (SDGs). By prioritizing customer intimacy and offering customized financing models, such as the YARNEN (pay-as-you-harvest) system, IMFIs provide smallholder farmers with essential financial access. This support enhances farmers' business capacities and mitigates the risks associated with conventional financing mechanisms. Beyond driving economic growth, IMFIs promote social equity by delivering inclusive financial services to underserved and un-bankable populations.

However, IMFIs face several challenges, including limited financial literacy among clients, cyclical financing demands, and regulatory hurdles. Addressing these issues requires strategic interventions, such as forming partnerships with agribusinesses, implementing robust financial literacy programs, and advocating for regulatory reforms that encourage sustainable agricultural practices. Despite these challenges, IMFIs possess immense potential to revolutionize financing in agriculture, advancing SDG 1 (no poverty), SDG 2 (zero hunger), and SDG 12 (responsible consumption and production). By doing so, they contribute to building a more resilient, equitable, and inclusive agricultural sector.

RECOMMENDATIONS

Managerial Implication

IMFIs should diversify their financial products to meet the varying needs of farmers. While joint liability models like Grameen work well for some, larger-scale farmers might benefit more from profit-sharing agreements (Mudharabah) or partnership-based financing (Musyarakah). Establishing strategic partnerships with agribusinesses and NGOs can enhance support for farmers by improving access to essential resources such as fertilizers, seeds, and equipment, enabling them to scale their operations sustainably. Additionally, adopting a cash flow-based financing model, like that used by BMT Talaga, can help IMFIs align repayment schedules with the agricultural cycle, reducing financial strain and minimizing defaults. Strengthening financial literacy is also crucial, as educating farmers on Sharia-compliant financial systems and sustainable capital management through regular training programs can foster responsible borrowing and spending habits. While for Policymakers, Policymakers should create a more supportive regulatory environment for Islamic microfinance by streamlining processes that allow financial institutions to offer diverse products such as Mudharabah and takaful (Islamic insurance), which can help mitigate risks in the agricultural sector. Additionally, governments can incentivize sustainable farming practices through financial incentives, tax breaks, or subsidies, encouraging IMFIs and farmers to adopt environmentally friendly methods. Capacity building is also essential, and policymakers can facilitate this by providing grants or low-interest loans to IMFIs, enabling them to develop innovative financial products tailored to the unique challenges faced by smallholder farmers. Monitoring Over-indebtedness: In response to concerns about over-indebtedness, regulators should establish safeguards to prevent excessive borrowing and ensure that IMFIs adopt responsible lending practices. Limiting the number of active loans a farmer can have may help prevent financial distress.

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