

ANALYSIS OF THE CONTRACT MECHANISM IN SHARIA VENTURE CAPITAL AND ITS RELEVANCE TO MSME FINANCING

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Abstract

Sharia Venture Capital is an alternative financing instrument that offers a partnership-based scheme oriented toward fairness and free from elements of usury. This study aims to analyze the contractual mechanisms used in Sharia venture capital and their relevance for financing Micro, Small, and Medium Enterprises (MSMEs). The research was conducted using a qualitative approach through a literature review that examines the concept of Sharia venture capital, contract structures, and the characteristics of MSME financing needs. The analysis shows that the most commonly used contracts in Sharia venture capital are musyarakah, mudharabah, and wakalah bil ujah. Each contract has distinct characteristics that address the needs of partnership-based financing, risk-sharing, and business mentoring. The study finds that this financing model is highly relevant for MSMEs, particularly because it does not require collateral, emphasizes profit-sharing, and provides managerial support. However, its implementation still faces several challenges, such as low Islamic financial literacy and the limited number of Sharia venture capital institutions in Indonesia. This study is expected to serve as a foundation for developing a more inclusive and Sharia-compliant MSME financing model.

Keywords: Sharia Venture Capital, Musyarakah, Mudharabah, MSME Financing, Islamic Economics

INTRODUCTION

The growth of the Islamic economy in Indonesia has shown significant development in line with increasing public awareness of financial instruments that comply with Sharia principles, as explained by Muhammad Syafi'i Antonio (2001). This progress is evident not only from the rising number of Islamic financial institutions but also from the expanding variety of financing products offered. In this context, MSMEs represent a highly strategic sector because they contribute substantially to employment and GDP. However, MSMEs continue to face the classic issue of limited access to financing. Many MSME actors lack collateral, adequate financial administration skills, or a strong business track record, making conventional interest-based financing a burden that hinders business growth. This aligns with Umer Chapra's (2000) critique that interest-based systems often fail to support the growth of

small productive sectors.

To address these needs, Sharia venture capital has emerged as an innovative partnership-based financing model. According to Mulyana (2019), Sharia venture capital not only provides funding but also offers technical assistance, managerial support, and business capacity development. In this framework, the relationship between investors and MSMEs becomes more collaborative rather than merely creditor–debtor. This partnership character is consistent with the profit and loss sharing principle described by Iqbal and Mirakhor (2011), where each party shares risks and returns fairly. As a result, Sharia venture capital presents a more inclusive alternative by supporting MSMEs financially as well as in terms of knowledge and business management. Thus, this mechanism is considered capable of bridging the gap between MSMEs' capital needs and the limitations of existing financing instruments.

Despite its promising concept, the implementation of Sharia venture capital still faces several challenges. Zawawi (2019) notes that the number of Sharia venture capital institutions in Indonesia remains very limited, and most do not yet have standardized contracts. In addition, Islamic financial literacy among MSME actors remains relatively low. In practice, many MSMEs are unfamiliar with partnership-based equity financing schemes and are more accustomed to traditional loan structures. This condition indicates that the challenges in developing Sharia venture capital lie not only on the institutional side but also on the readiness of MSME actors. Nevertheless, the author argues that Sharia venture capital has strong potential to become a long-term solution for MSMEs because its partnership attributes promote more equitable and sustainable business relationships.

Therefore, examining the contractual mechanisms used in Sharia venture capital becomes crucial. This study focuses on three main contracts *musyarakah*, *mudharabah*, and *wakalah bil ujah* to understand how each can be applied within Sharia-based venture capital financing schemes. In addition to summarizing existing findings, this study also aims to provide new insights into the compatibility of Sharia venture capital with the characteristics of Indonesian MSMEs, particularly in the context of collateral-free financing, risk-sharing mechanisms, and the effectiveness of business mentoring. Through this approach, the study seeks to offer a more comprehensive and relevant understanding for the future development of the Sharia MSME financing ecosystem.

IMPLEMENTATION METHOD

This study uses a qualitative research method with a library research approach as its primary framework. The selection of this method is based on the need to explore, understand, and interpret various theoretical perspectives related to Sharia venture capital and its application in MSME financing. The data sources consist of a wide range of literature, including foundational Islamic economics books, national and international academic journals that discuss venture capital mechanisms, Sharia-compliant contracts, and MSME development, as well as regulatory documents such as DSN-MUI fatwas and OJK regulations that provide formal guidelines for Islamic financial practices in Indonesia.

The process of data collection is carried out by systematically reviewing and examining relevant written materials. Each source is evaluated based on its credibility, relevance, and

contribution to the research focus. After the data are gathered, the study employs content analysis techniques to identify recurring concepts, interpret thematic patterns, and connect theoretical findings with the practical context of Sharia venture capital. Through this approach, the study aims to highlight essential themes, such as the principles underlying Sharia contracts, their operational characteristics, and their potential role in addressing financing constraints experienced by MSMEs.

The analytical stage involves several steps, including data reduction to filter out information that does not directly support the research objectives, data classification based on thematic categories, and critical interpretation to develop a coherent and comprehensive understanding of the topic. This procedure follows the analytical framework suggested by Ismal (2011), emphasizing systematic reasoning and structured interpretation. To ensure the reliability and validity of the findings, the study incorporates triangulation by comparing insights from multiple credible academic sources, enabling a more balanced and well-supported conclusion.

RESULTS AND DISCUSSION

1. Concept of Sharia Venture Capital

Sharia venture capital is a form of financing characterized by high risk yet offering the potential for substantial returns, particularly when directed toward startups or MSMEs with strong growth prospects. Warde (2000) explains that this scheme emphasizes equity-based funding rather than debt, meaning the investor shares risks with the business owner. This model is highly relevant within the framework of Islamic economics because it aligns with the prohibition of interest while promoting the development of productive sectors.

From an Islamic economic perspective, Sharia venture capital aligns with the fundamental principles of partnership, as it involves capital participation, business assistance, and fair risk-return sharing. Lewis and Algaoud (2001) highlight that these principles form the core foundation of *musyarakah* and *mudharabah* contracts, which underpin Sharia-based venture capital financing. This concept shifts the financial relationship from creditor–debtor to a cooperative partnership in which both parties act as strategic partners with shared interests in the success of the business.

Beyond providing capital, Sharia venture capital firms act as active partners in developing the financed businesses. This is reflected in additional functions such as mentoring, monitoring, managerial training, and continuous support in business strategy. Santoso (2022) notes that this mentoring role distinguishes venture capital from other Sharia financial institutions. Islamic banks, for example, tend to use debt- or sale-based contracts that require scheduled repayments, resulting in limited involvement in MSME operations.

With a stronger orientation toward business development, Sharia venture capital offers a more inclusive approach for MSMEs lacking collateral or adequate financial records. This model enables a more equitable and transparent relationship in which investors not only pursue profit but also contribute to building the business capacity of their partners. Additionally, the risk-sharing mechanism encourages both parties to make prudent decisions, enhance management quality, and strengthen business sustainability. In this context, Sharia

venture capital can be seen as a strategic instrument for supporting Sharia-based economic growth while empowering the MSME sector more structurally.

2. Contract Mechanisms in Sharia Venture Capital

a. Musyarakah Contract

Musyarakah is a partnership-based contract in which two or more parties collaborate by combining their respective capital to operate a business, with profits shared according to a predetermined ratio agreed upon at the beginning of the partnership. Antonio (2001) highlights that the essential characteristic of musyarakah lies in the capital contribution from each partner, which automatically grants them proportional ownership in the business entity. In the context of Sharia venture capital, this contract is commonly applied when MSMEs are able to provide at least a minimal amount of capital as a form of commitment and shared responsibility in running the venture.

One of the strengths of the musyarakah model is its flexibility, particularly in determining profit-sharing arrangements and allocating business risks. Karim (2014) explains that musyarakah creates a more equitable financing framework because gains and losses are distributed based on each party's capital portion, ensuring fairness and preventing one-sided burden. This partnership system also opens opportunities for investors to be directly involved in managerial decision-making, especially in strategic components such as business planning, monitoring activities, and assessing performance outcomes.

This direct engagement is considered highly beneficial in minimizing the probability of business failure. According to Zainuddin (2018), close collaboration between investors and MSME actors has been shown to improve management quality, reinforce operational discipline, and elevate competitiveness by ensuring that MSMEs receive continuous guidance throughout the business cycle. Consequently, musyarakah becomes an ideal financing option for MSMEs that already possess a basic operational structure but require additional capital, managerial support, and broader business networks to achieve sustainable growth.

b. Mudharabah Contract

Mudharabah is a profit-sharing partnership contract established between the provider of capital (shahibul maal) and the entrepreneur or business manager (mudharib), where both parties agree on a predetermined profit-sharing ratio before starting the business. Iqbal and Mirakhor (2011) emphasize that mudharabah is particularly suitable in situations where the business operator does not possess initial capital, as the full financial responsibility rests on the investor. Within the framework of Sharia venture capital, this contract plays a crucial role in facilitating early-stage MSMEs that demonstrate strong business potential and managerial competence but face barriers due to limited financial resources. This relevance is further supported by Rahmawati (2021), who states that mudharabah provides significant access for new entrepreneurs to obtain financing without requiring them to shoulder financial risk at the beginning of their business operations.

Although mudharabah offers notable advantages, this contract also entails inherent challenges, especially related to the potential for moral hazard. Khan and Ahmed (2001) point out several risks that may emerge during implementation, such as a lack of transparency in

financial reporting, inaccurate or manipulative bookkeeping, and managerial decisions that deviate from the agreed terms, all of which can negatively impact the investor. To mitigate these risks, the *mudharabah* scheme necessitates strong governance practices, including intensive supervision, periodic reporting procedures, and comprehensive monitoring mechanisms. These components are essential to ensure that the partnership operates securely, remains aligned with Sharia principles, and upholds fairness for both parties involved.

c. Wakalah bil Ujrah Contract

Wakalah bil ujrah is an agency contract in which one party grants authority to another to perform certain tasks on its behalf in exchange for a service fee. Ascarya (2013) explains that this contract is widely applied in Islamic financial institutions when professional expertise is required to manage specific activities that the principal cannot undertake independently. Within the Sharia venture capital framework, wakalah bil ujrah functions as a supporting contract that enables the venture capital firm to act as an investment manager appointed by the investor. Through this delegated authority, the firm is responsible for conducting feasibility assessments, selecting potential business partners, monitoring the progress of funded ventures, and overseeing portfolio performance.

Although wakalah bil ujrah is not the main contract in equity-based financing schemes, its role remains essential in ensuring that the investment management process is carried out effectively and responsibly. Rifai (2020) notes that under this contract, the venture capital company can provide professional oversight, conduct risk analysis, and formulate investment recommendations based on objective evaluation criteria. This structured and accountable management process strengthens governance and minimizes the possibility of mismanagement during the venture's development.

In practice, the use of wakalah bil ujrah contributes to enhancing the integrity and transparency of Sharia venture capital operations. By allowing investors to rely on a specialized intermediary, this contract helps mitigate information asymmetry and ensures that business decisions are made with adequate technical expertise. Consequently, wakalah bil ujrah supports the overall investment framework by promoting better risk control, improving decision-making quality, and maintaining compliance with Sharia principles throughout the financing process.

3. Relevance of Sharia Venture Capital for MSME Financing

Sharia venture capital is highly relevant to MSME financing needs because it offers a partnership-based funding mechanism without requiring collateral. Mulyana (2019) explains that such an approach provides greater opportunities for MSMEs that often face capital constraints and lack assets to pledge. Through equity participation and profit-sharing arrangements, MSMEs are not burdened by fixed repayments unlike interest-bearing loans. This supports Chapra's (2000) view that profit-sharing models foster a more stable and equitable financial system, particularly for small businesses sensitive to liquidity pressures.

Beyond financing, Sharia venture capital also provides substantial value-added support through intensive mentoring in management, marketing, business planning, and risk handling. Santoso (2022) notes that such assistance significantly enhances MSME capacity, especially

among early-stage entrepreneurs lacking strong managerial experience. With active investor involvement, strategic decisions are made through more careful analysis, thereby reducing the risk of business failure and strengthening long-term sustainability.

Despite its potential, the implementation of Sharia venture capital in Indonesia remains limited. Zawawi (2019) highlights that the number of Sharia venture capital institutions is still very small, resulting in limited access for MSMEs to this equity-based financing. Another challenge is the low level of Sharia financial literacy among MSME actors, many of whom are unfamiliar with the benefits, mechanisms, and responsibilities involved in Sharia-compliant financing. Zainuddin (2018) emphasizes that this lack of understanding often becomes a major barrier to the expansion of Sharia financial instruments.

Therefore, strengthening the relevance of Sharia venture capital to MSME financing requires more comprehensive efforts, including innovative contract structures to better suit MSME needs, simplified financing processes, and improved education and financial literacy. Supportive regulations and the use of financial technology can further expand access and enhance the sustainability of Sharia venture capital as a strategic instrument for empowering MSMEs in Indonesia.

CONCLUSION

Islamic venture capital has significant potential as a financing instrument for MSMEs through the mechanisms of *musyarakah*, *mudharabah*, and *wakalah bil ujah* contracts. These three contracts offer financing flexibility, risk-sharing arrangements, and managerial assistance that align with the needs of MSMEs. The relevance of Islamic venture capital continues to strengthen because it can provide financing support without collateral and is oriented toward partnership-based cooperation. However, its implementation still faces several challenges, including the limited number of institutions, low financial literacy among MSME actors, and difficulties in business monitoring. Strengthening regulations, innovating contract structures, and improving education are strategic steps to enhance the role of Islamic venture capital in the development of MSMEs in Indonesia.

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