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Islamic Financial Literacy, Religiosity, and MSME Compliance with Sharia Financing: Does Mental Accounting Matter?

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ABSTRACT

Purpose: This study examines the effect of Sharia financial literacy and religiosity on micro, small, and medium enterprises' (MSMEs) compliance with Sharia financing contracts. In particular, it explores the mediating role of mental accounting in shaping contract adherence.

Method: The research employed a quantitative survey design with 100 MSMEs under Perumda Pasar Jaya Jakarta that had participated in Sharia financing for at least one year. Data were collected through structured questionnaires and complemented with qualitative interviews. Structural Equation Modeling–Partial Least Squares (SEM-PLS) was applied to test direct and mediating effects.

Findings: The results demonstrate that both Sharia financial literacy and religiosity exert positive and significant effects on MSMEs' compliance with Sharia financing contracts. However, the mediation analysis reveals that mental accounting does not significantly mediate these relationships, suggesting that while entrepreneurs understand and value Sharia principles, limited financial buffers and urgent liquidity needs prevent them from consistently applying structured accounting practices. Qualitative evidence confirms that many MSMEs mix business and personal funds, rely on fluctuating cash flow, and occasionally delay repayment despite strong religious motivation.

Novelty/Value: Unlike in conventional finance, where mental accounting is often framed as a cognitive bias, in Islamic finance, it can function as a constructive form of self-control. By separating accounts for obligatory payments, including zakah and debt repayment, MSMEs with relatively high religiosity treat financial discipline as part of their religious duty. At the same time, Islamic financing practices grounded in ukhuwah and maslahah provide flexibility when liquidity constraints occur, making mental accounting a unique and contextually embedded mechanism for SMEs.

Keywords: Islamic Financial Literacy, Mental Accounting, MSMEs, Religiosity, Sharia Financing, Islamic Finance.

INTRODUCTION

Micro, small, and medium enterprises (MSMEs) play a crucial role in Indonesia's economic growth by providing employment, supporting household incomes, and fostering innovation across diverse sectors. According to government statistics, MSMEs account for over 60 percent of Indonesia's gross domestic product (GDP) and contribute to more than 97 percent of national employment (Coordinating Ministry for Economic Affairs of the Republic of Indonesia, 2025). Their contribution is not only economic but also social, as MSMEs sustain household livelihoods and reduce poverty levels in both urban and rural areas. Their agility and adaptability make them important actors in stabilizing the economy during crises, including the COVID-19 pandemic, when many large businesses contracted but MSMEs remained active in local supply chains (World Economic Forum, 2023). This resilience was particularly evident in developing countries, where SMEs maintained their role by focusing on local supply chains (Martins et al., 2023).

Despite their significant contribution, MSMEs frequently encounter financing challenges, particularly in accessing capital from formal financial institutions (Lukiyanto & Wijayaningtyas, 2020; Tambunan et al., 2022). Conventional banks often require collateral, formal documents, and long credit histories that many MSMEs cannot provide, a challenge also highlighted by Vaghera & Mashekwa (2025) as a major barrier to SME financing. Informal financing, while easier to obtain, often comes with high interest rates and exploitative terms (Mpofu & Sibindi, 2022; Kumar & Sumalatha, 2024). Against this backdrop, Sharia-based financing has emerged as an important alternative that aligns with Islamic values and principles. By avoiding riba (interest), gharar (uncertainty), and maisir (speculation), Sharia financing seeks to provide justice, risk-sharing, and ethical responsibility in financial transactions (Hasan, 2016). In theory, the Islamic financial system is well-suited to SMEs because it is based on participatory schemes such as mudarabah and musyarakah. These arrangements provide risk-sharing and longer repayment opportunities, which are particularly compatible with SMEs that often operate with limited capital (Djemaa, 2018).

However, compliance with Sharia financing contracts remains a persistent issue. Many MSMEs struggle to consistently fulfill their contractual obligations, which can lead to defaults or non-performing financing (NPF). Similar patterns are reported in a large-scale study across six European countries, where SMEs were found to face higher default risks than large corporations due to greater reliance on short-term debt and higher refinancing risk (Cathcart et al., 2020). This challenge is also evident in Indonesia, where Islamic banks record higher levels of non-performing financing in SMEs compared to conventional banks, partly because of asymmetric information and the predominance of short-term financing schemes (Muhmad et al., 2020). Other evidence shows that SME financing, whether equity or investment-based, has lower quality and higher default risk than non-SME financing, highlighting the ongoing challenges in this sector (Fakhrunnas & Ramly, 2017). These defaults not only harm Islamic financial institutions but also undermine confidence in the broader Islamic economic system. Non-compliance often results in financial losses for both lenders and borrowers and erodes the trust that sustains Sharia-based partnerships. This phenomenon raises a fundamental question: what factors determine MSMEs' compliance with Sharia financing contracts, and how can behavioral aspects such as mental accounting influence financial discipline?

Previous studies have provided partial answers. Research has shown that Sharia financial literacy significantly enhances contract compliance by equipping entrepreneurs with stronger knowledge of Islamic finance principles and contractual obligations. This is consistent with findings in the literature, which emphasize that financial literacy improves individuals' ability to manage debt, understand repayment structures, and make responsible financing decisions, thereby reducing the risk of default and strengthening compliance with contractual terms (Saifurrahman & Kassim, 2021). As financial literacy is a crucial component of human capital that shapes financial behaviour (Rohmania & Sholihah, 2023; Aisyah et al., 2024), improving Sharia financial literacy not only facilitates better decision-making but also strengthens compliance with financing contracts. Similarly, religiosity has been found to influence ethical financial behavior.

In addition to financial literacy, religiosity has also been identified as an important determinant of financial behavior and compliance in Sharia financing. Prior studies demonstrate that religiosity shapes entrepreneurs' values and behavior, with practicing Muslim entrepreneurs showing greater respect, commitment, and adherence to religious and traditional norms, while non-practicing Muslim entrepreneurs tend to be more independent in their choices and more inclined toward worldly gratifications. Empirical evidence from SMEs in West Java further confirms that religiosity improves business performance and loan repayment responsibilities, thereby reducing non-performing loans (Wijaya et al., 2024). Broader evidence also indicates that religiosity can shape financing outcomes at the institutional level, where both Islamic and conventional banks operating in highly religious areas report lower default rates due to customers' risk-averse, trustworthy, and ethical behavior (Irfani et al., 2017). These findings suggest that religiosity, whether at the individual or community level, plays a crucial role in promoting repayment discipline and strengthening compliance with Sharia financing contracts.

While financial literacy and religiosity can directly encourage MSMEs to fulfill their financing obligations, both factors also shape the way entrepreneurs manage their money. With better knowledge and stronger religious commitment, mental accounting that is often seen as a weakness can instead become a discipline that helps prepare funds for repayment, thereby reinforcing compliance with Sharia financing contracts. Thaler (1999) originally introduced the concept to explain how individuals categorize money into different "mental accounts," often leading to suboptimal or irrational decisions. Later studies, such as Silva, Moreira, and Bortolon (2023) demonstrated that mental accounting effects on decision-making processes related to savings, investment, debt and consumption. While traditionally framed as a cognitive bias leading to suboptimal choices, mental accounting can also be conceptualized as a constructive discipline, where deliberately separating funds serves as a tool for financial self-control and goal-oriented decision-making.

In an Islamic context, however, mental accounting can take on a different meaning. When entrepreneurs allocate funds for specific purposes, such as debt repayment, it can reflect a sense of discipline in managing resources. Islamic principles emphasize that debt is a serious obligation, and fulfilling it is a critical aspect of responsible financial management. More recent evidence shows that overspending, which often leads to excessive debt and financial instability, can also be controlled through mental accounting practices, particularly when supported by Islamic values of moderation (Mohd et al., 2025). Since Islam teaches that debt must be repaid as a moral duty, mental accounting becomes not only a way of managing money but also a moral discipline that helps prevent overspending, ensures repayment, and strengthens compliance with Sharia financing contracts.

Nevertheless, gaps remain in the literature. While Sharia financial literacy, religiosity, and mental accounting have each been studied individually, few studies (Asniyati & Yaya, 2020; Rahmawati et al., 2023) integrate these three variables into a single framework. Moreover, the mediating role of mental accounting—how literacy and religiosity may influence compliance with Islamic financing through mental accounting—has not been sufficiently addressed. This gap is particularly relevant in Indonesia, where MSMEs represent a large portion of the economy and Islamic financing is rapidly growing but still faces compliance issues. This study fills the gap by analyzing how Sharia financial literacy and religiosity influence MSME compliance with Sharia financing contracts, with mental accounting tested as a mediating variable. The present study offers a novel perspective by conceptualizing mental accounting not as a behavioral bias but as a constructive mechanism shaped by religious obligations and financial literacy. This approach highlights its potential role in guiding SMEs' financial discipline within the ethical framework of Islamic finance.

The study specifically aims to measure three relationships. First, it examines the direct effect of Sharia financial literacy on contract compliance, asking whether knowledge of Islamic financial principles translates into responsible repayment behavior. Second, it investigates the direct effect of religiosity on contract compliance, analyzing whether moral and spiritual values provide additional motivation for entrepreneurs to remain disciplined. Third, it evaluates the indirect effect of literacy and religiosity on compliance through mental accounting, testing whether mental accounting acts as a bridge between knowledge, faith, and behavior.

These objectives are supported by three theoretical perspectives. First, the Theory of Planned Behavior (I Ajzen, 1991) emphasizes that attitudes, subjective norms, and perceived behavioral control shape behavioral intentions. In this context, Sharia financial literacy enhances perceived control, religiosity strengthens subjective norms, and positive attitudes toward Sharia compliance reinforce the intention to fulfill obligations. Second, the Mental Accounting Theory (Thaler, 1999) explains how individuals allocate resources into separate accounts, which can sometimes cause distortions. However, within a Sharia framework, this practice can encourage compliance by ensuring that funds allocated for repayment are not diverted to other uses. Third, the Theory of Religious Commitment (Finney, 1978) views religiosity as a multidimensional construct that guides both ethical conduct and financial decision-making. Taken together, these three theories provide complementary behavioral, cognitive, and spiritual foundations for understanding MSME compliance with Sharia financing contracts.

The research employs a quantitative survey design, using 100 MSMEs under Perumda Pasar Jaya Jakarta as respondents. These MSMEs were purposively selected, having participated in Sharia financing for at least one year. Data were collected through structured questionnaires and analyzed using Structural Equation Modeling–Partial Least Squares (SEM-PLS). This technique allows for robust testing of both direct and mediating effects in complex models (Carlos & Bernardes, 2025). By applying SEM-PLS, the study ensures that the relationships between literacy, religiosity, mental accounting, and compliance are statistically validated.

This study provides multiple contributions. Theoretically, it contributes to Islamic behavioral finance by reinterpreting mental accounting as a positive mechanism of discipline, rather than simply a cognitive bias. It also extends Islamic accounting literature by integrating religiosity, literacy, and behavioral constructs into a unified framework. Practically, the findings provide guidance for Islamic financial institutions. By promoting Sharia financial literacy and strengthening religious motivation, they can encourage entrepreneurs to adopt positive mental accounting practices that enhance compliance and reduce default rates. At the societal level, this study highlights how combining financial knowledge with religious values can support MSME sustainability and contribute to the broader goals of Islamic economics, including fairness, trust, and social justice.

LITERATURE REVIEW

This study draws on two interrelated perspectives, the Theory of Planned Behavior (TPB) and Mental Accounting, which have been reviewed and contextualized from the Islamic finance perspective to reflect how Sharia principles influence intention, cognitive processing, and financial decision-making. These theories provide the basis for understanding not only the rational and psychological drivers of financial behavior but also the moral and spiritual commitments that underpin adherence to Islamic contractual obligations.

Theory of Planned Behavior (TPB) and Compliance

TPB provides a strong foundation for explaining individual decision-making in financial compliance. According to TPB, intention is the primary determinant of behavior, shaped by attitudes, subjective norms, and perceived behavioral control (Ajzen & Kruglanski, 2019). Within the context of Sharia financing contracts, MSME actors' willingness to comply is not only influenced by rational evaluations of benefits but also by their perception of religious and social expectations, as well as their confidence in fulfilling contractual obligations.

Recent studies confirm that TPB remains relevant in predicting ethical and compliance-related behaviors. A study on MSMEs in Semarang demonstrated that perceived behavioral control positively influenced the intention to repay debt, and together with repayment intention, significantly shaped actual debt repayment behavior (Santoso et al., 2024). Likewise, a study on tax compliance among high-income professionals in Jordan extended TPB with moral intensity, fairness, and customs tax, confirming that attitude, perceived behavioral control, and subjective norms significantly influence compliance behavior, which reinforces the robustness of TPB across diverse ethical and regulatory contexts (Al-Zaqeba, 2022). Consistent with the Theory of Planned Behavior (TPB), Muzakki's intentions to pay zakah are influenced by attitudes, subjective norms, and perceived behavioral control, including factors such as transparency, promotion, and regulatory support (Antonio et al., 2020). Thus, TPB offers a comprehensive framework for understanding how literacy and religiosity shape the intention of MSMEs to adhere to Sharia financing agreements, suggesting that compliance behavior is a product of both cognitive awareness and social-religious influence.

Mental Accounting in Islamic Finance

While TPB highlights the role of intention, Mental Accounting Theory provides insight into the cognitive mechanisms that channel knowledge and values into practical financial decisions. Traditionally, mental accounting is viewed as a tendency to categorize resources into separate accounts that may lead to irrational spending or biased financial behavior (Thaler, 1999). However, in the Islamic context, this categorization is not inherently negative, especially when linked to debt repayment obligations, which are considered a moral and religious commitment. By allocating funds specifically for debt repayment, zakat, or halal expenditures, mental accounting functions as a self-control mechanism (Shah et al., 2025) that helps MSMEs uphold their financial and ethical responsibilities (Asniyati & Yaya, 2020). Beyond intention and cognitive categorization, compliance with Sharia contracts ultimately reflects an ethical commitment to uphold promises and agreements. In Islamic finance, fulfilling contracts is not merely a legal obligation but also a religious duty grounded in the Qur'anic injunction to honor covenants (Qur'an 5:1). Studies have shown that individuals who perceive debt repayment as a religious duty are more likely to honor their obligations, integrating ethical considerations into their financial decisions (Siregar & Umuri, 2025).

Religiosity and Financial Behavior

Religiosity can be broadly understood as the extent to which individuals internalize and practice the teachings, values, and rituals of their religion in daily life. In Islamic thought, religiosity is comprehensively framed through three dimensions: Islam (ritual observance), Iman (faith and conviction), and Ihsan (moral and spiritual excellence) (Mahudin et al., 2016). These interconnected elements provide the foundation for self-regulation and guide behavior, including financial decision-making. As a result, higher levels of religiosity are expected to guide Muslims toward responsible financial practices, reducing excessive risk-taking and aligning financial choices with spiritual accountability. Empirical studies in Indonesia confirm this link, showing that the centrality of religion together with Islamic financial literacy significantly improves financial management and well-being, even though financial literacy tends to exert a stronger direct effect (Wijaya et al., 2024). Complementary evidence from Muslims in Indonesia also indicates that religiosity positively shapes saving intentions and saving behavior, although the effect size remains relatively small (Alfi et al., 2022)

The influence of religiosity extends beyond saving and resource allocation into debt management and financial institution selection. A study of government employees revealed that individuals with stronger religious norms tend to carry lower levels of financial debt, which in turn reduces debt-related stress (Sipon et al., 2014). This demonstrates how religiosity not only fosters self-control but also mitigates vulnerability to financial strain. Similarly, evidence from Pakistan shows that religiosity, captured through practice, knowledge, and experience, positively influences customers' preferences for Islamic banks, underscoring the role of religious commitment in shaping economic choices (Nazir & Saqib, 2024). These findings suggest that religiosity is both a personal and structural determinant of financial behavior, influencing a wide spectrum of actions from saving and borrowing to debt management and institutional trust, thereby positioning it as a crucial element in understanding Muslim financial decision-making.

Hypotheses Development

Islamic Financial Literacy Positively Influences Compliance with Sharia Financing Contracts

Islamic financial literacy refers to the knowledge and understanding of Sharia-compliant financial principles, such as the prohibition of riba (interest), gharar (excessive uncertainty), and maysir (gambling), alongside the promotion of fairness, transparency, and ethical responsibility in financial transactions. Islamic financial literacy, grounded in the objectives of Maqasid al-Shariah, is essential for shaping financial behaviors and decision-making in accordance with Islamic finance principles (Bakar et al., 2024). Having Islamic financial literacy helps entrepreneurs comply with Sharia financing contracts because they understand their obligations, how repayments work, and the ethical consequences of not following the rules. Recent studies confirm that higher financial literacy strengthens responsible and ethical financial behavior (Abdallah et al., 2024) and reduces the likelihood of defaults in MSME financing. Islamic financial literacy positively shapes individuals' attitudes, subjective norms, and perceived behavioral control (Muninggar et al., 2025), which in turn promote Sharia-compliant financial behavior, including adherence to contractual obligations.

On the positive side, financial literacy enables MSMEs to manage limited resources more effectively, understand the benefits of timely repayment, and make informed decisions about financing participation. This aligns with the Theory of Planned Behavior (Ajzen, 1991), as literacy enhances perceived behavioral control and shapes intentions to comply with Sharia principles. Empirical evidence indicates that MSMEs with better financial literacy demonstrate higher repayment discipline (Carlos & Bernardes, 2025), lower non-performing financing ratios, and thereby improved trust in Islamic financial institutions.

However, the positive impact of financial literacy may not be uniform. Some studies argue that knowledge alone does not guarantee ethical behavior or compliance. External factors, such as weak enforcement, limited institutional trust, and economic pressures, can undermine the influence of literacy on contract adherence (Tambunan et al., (2022); Lukiyanto & Wijayaningtyas (2020). Entrepreneurs might possess high financial knowledge but still default due to cash flow shortages, opportunistic behavior, or misaligned incentives. This highlights that literacy, while necessary, is not a sufficient condition for compliance without supportive institutional and contextual factors. Despite these caveats, the weight of recent empirical evidence leans toward a positive effect of Islamic financial literacy on financing contract compliance, particularly when combined with complementary behavioral and religious influences. Therefore, this study posits the first hypothesis.

H1: Islamic financial literacy has a direct, positive influence on MSMEs compliance with Sharia financing contracts

Mental Accounting Mediates the Relationship between Financial Literacy and Contract Compliance.

Financial literacy equips entrepreneurs with the ability to interpret, plan, and monitor financial obligations, but the pathway to actual compliance often depends on how individuals cognitively structure their financial decisions. Mental accounting theory in behavioral finance studies explains that individuals categorize resources into "mental accounts" that guide spending, saving, and repayment priorities (Nie & Song, 2025). Financially literate individuals who also apply mental accounting are more likely to allocate specific funds toward loan repayment, thereby enhancing contract compliance. A study published by Masrizal et al. (2025) demonstrates that financial knowledge, skills, and behavior significantly enhance market discipline. Notably, financial behavior mediates the relationship between financial skills and knowledge and market discipline (Puspita & Wardani, 2022). This suggests that individuals with higher financial literacy are better equipped to make informed decisions, leading to improved adherence to financial agreements, including Sharia-compliant financing contracts. Andarsari & Ningtyas (2019) also show that higher financial literacy leads to better financial behavior, including budgeting, saving, and managing debt, which in turn enhances compliance with financial obligations.

Nevertheless, some studies question whether mental accounting consistently strengthens the effect of financial literacy. Nicholson (2024) highlights that mental accounting can sometimes distort rational decision-making, as entrepreneurs may over-prioritize certain accounts (e.g., daily operations) at the expense of loan repayment, undermining compliance. Similarly, Javareshk (2024) argues that excessive compartmentalization of resources may create financial rigidity, leading to inefficiencies when unexpected liquidity shocks occur. While financial literacy enhances the technical knowledge needed for compliance, without flexible and adaptive mental accounting, this knowledge may not fully translate into consistent repayment behavior. Despite these criticisms, the prevailing evidence supports the mediating role of mental accounting in bridging the gap between knowledge and practice, particularly within Sharia financing systems that emphasize accountability and structured repayment. Thus, this study proposes the following second hypothesis.

H2: Mental accounting mediates the positive relationship between financial literacy and compliance with Sharia financing contracts.

Mental Accounting Mediates the Relationship between Religiosity and Contract Compliance

Religiosity shapes individuals' ethical values and motivates adherence to Sharia principles, but translating these values into actual financial compliance often requires a cognitive mechanism such as mental accounting. Mental accounting provides a structured way for religious entrepreneurs to allocate resources in line with their faith-based obligations, such as zakat, halal income management, and repayment of contracts. Prior research has demonstrated that religiosity fosters disciplined behavior across multiple contexts. In organizational settings, religiosity was found to reduce opportunistic behavior and mitigate contract breaches in B2B relationships (2021). Similarly, in the financial sector, provinces with higher religiosity exhibited higher financing volumes and lower levels of non-performing financing (Wijaya, et al., 2024). At the consumer level, religious-based ethics, particularly knowledge of and perceived risk of riba, were shown to reduce Buy-Now-Pay-Later re-usage intention among Muslim consumers (Aji et al., 2024). Collectively, these findings indicate that religiosity provides a normative and behavioral framework that encourages discipline, risk aversion, and responsibility in financial decision-making, thereby supporting the argument that religiosity enhances disciplined financial behavior, especially when reinforced through structured mechanisms such as mental accounting practices.

While religiosity may shape mental accounting practices that prioritize debt repayment in accordance with religious injunctions, the financial realities faced by micro and small enterprises (MSEs) often complicate such disciplined behavior. Prior research on European SMEs (Kaya, 2024) shows that late payments significantly undermine financial resilience, increasing liquidity risks and limiting access to credit through mechanisms such as credit rationing and higher borrowing costs. Similarly, large-scale evidence from six European countries demonstrates that financial leverage has a disproportionately stronger effect on SMEs' default risk compared to large corporations, largely because SMEs rely more heavily on short-term debt and therefore face higher refinancing risks (Cathcart et al., 2020). These findings imply that MSEs' ability to consistently prioritize debt repayment may be constrained not by religious intention but by external financial vulnerabilities such as liquidity shortages, leverage structures, and cash flow volatility. Despite these concerns, the dominant evidence indicates that religiosity more effectively drives contract compliance when mediated by structured mental accounting practices, particularly in contexts where Sharia financing enforces ethical accountability. This study proposes the third hypothesis.

H3: Mental accounting mediates the positive relationship between religiosity and compliance with Sharia financing contracts

Religiosity Positively Influences Contract Compliance

Religiosity, particularly within the Islamic framework, provides a moral compass that guides financial behavior and shapes individuals' attitudes toward fulfilling contractual obligations. Highly religious individuals are more likely to internalize Sharia principles such as amanah (trustworthiness) and adl (justice), which emphasize the ethical imperative of honoring commitments. Recent studies highlight that religiosity significantly influences ethical financial behavior and compliance in Islamic financial transactions. For example, Saifurrahman & Kassim (2021) show that religiosity strengthens Muslims' willingness to comply with Islamic banking contracts, while Hanwen et al., (2016) find that stronger religiosity is linked to lower loan interest spreads and more favorable loan terms, such as larger loan amounts and performance-based pricing. A lower interest spread means that lenders view borrowers as less risky and more trustworthy, so they are willing to lend at cheaper rates. Implicitly, religiosity can enhance commitment to repay debt and comply with financial contracts, as lenders perceive religious borrowers as more reliable.

On the other hand, some scholars argue that religiosity alone does not always translate into financial discipline or contract compliance. Research on financial well-being among Muslim respondents found that religiosity had a direct positive effect on overall well-being, but did not significantly influence financial behavior itself (Budiyanto et al., 2024). A study by Amissah & Swierczvnska (2021) using World Values Survey data found a significant negative relationship between religiosity and financial development, particularly in less financially developed countries, while the relationship became insignificant in more advanced economies. These findings imply that religiosity by

itself may not consistently foster financial discipline or contractual compliance, and that broader institutional and structural conditions play an important role in shaping financial behavior. Overall, despite these critiques, recent evidence supports the dominant view that religiosity exerts a positive influence on contract compliance, especially in contexts where Islamic values are socially and institutionally reinforced. Therefore, this study proposes the fourth hypothesis.
H4: Religiosity Positively Influences Compliance with Sharia Financing Contracts

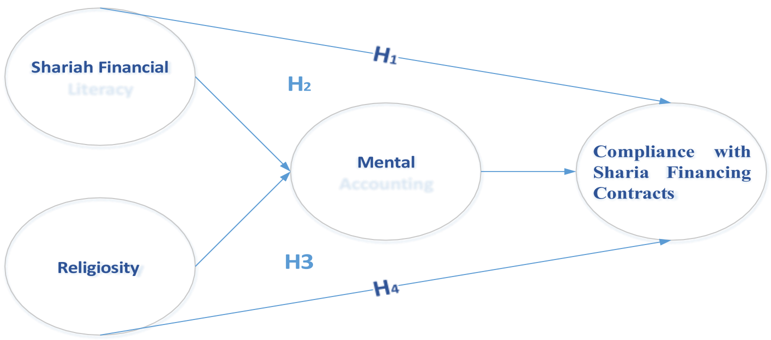


Figure 1. Research Framework

The conceptual framework in Figure 1 illustrates the relationships between Islamic financial literacy, religiosity, and contract compliance in Sharia financing, with mental accounting serving as a mediating mechanism. Islamic financial literacy is expected to enhance individuals' understanding of rights and obligations in financing contracts, thereby strengthening their commitment to compliance. Likewise, religiosity promotes moral and spiritual values that motivate borrowers to fulfill their contractual duties in accordance with Sharia principles. However, these influences may not operate automatically; they often require a cognitive process such as mental accounting, which enables individuals to categorize, allocate, and prioritize financial resources effectively. Mental accounting thus acts as a bridge that translates financial knowledge and religious values into disciplined repayment behavior and contractual compliance.

RESEARCH METHOD

The study was conducted at Perumda Pasar Jaya Jakarta, a regional-owned enterprise of the special capital region (DKI) of Jakarta that manages 15 traditional markets across the city. The site was selected for three main reasons. First, Perumda Pasar Jaya has established a structured program for the development of micro, small, and medium enterprises (MSMEs) through sharia-compliant financing in collaboration with partner financial institutions, making it an ideal context to examine the relationship between Islamic financial literacy, religiosity, mental accounting, and contract compliance. Second, the MSMEs under its management represent a wide variety of sectors, including food, clothing, and handicrafts, thereby offering heterogeneity that enhances the representativeness of the findings. Third, Jakarta, as Indonesia's economic hub, provides a dynamic environment in which MSMEs encounter both opportunities and challenges unique to urban business ecosystems.

For this study, the focus was placed on MSMEs operating in three of the most prominent markets under Perumda Pasar Jaya: pasar Tanah Abang (textiles and accessories), pasar Senen (food products and souvenirs), and pasar Mayestik (clothing and general merchandise). Concentrating on these three markets provided a diverse yet manageable scope of analysis, ensuring that the study captured sectoral variation while remaining grounded in the realities of sharia-based financing practices. To ensure representativeness while maintaining feasibility, the sample size was determined using Slovin's formula with a 5 percent margin of error, yielding a total of 100 MSMEs. Probability sampling through simple random sampling was employed, ensuring that each enterprise had an equal chance of being selected and minimizing potential bias. Respondents were required to meet specific criteria: they had to be active MSME owners currently engaged in sharia financing, have at least one year of experience managing the financing, and voluntarily consent to participate.

Data collection was conducted through structured questionnaires distributed directly to respondents with an informed consent. The study employed four main variables: two independent variables, one mediating variable, and one dependent variable. Each construct was measured using previously validated instruments, adapted to the Sharia financing context of MSMEs. All items were operationalized on a five-point Likert scale ranging from 1 ("strongly disagree") to 5 ("strongly agree"). The first independent variable, Islamic financial literacy (X_1), encompassed knowledge, ability, attitude, and confidence in managing sharia-based financial decisions, measured through eight indicators adapted from Mahmoud et al. (2025). The second independent variable, religiosity (X_2), was assessed using six indicators reflecting belief, worship practices, and the implementation of religious values in economic life, following the framework of Abror et al. (2021). The mediating variable, mental accounting (Y_1), captured cognitive and emotional processes in financial decision-making through six indicators on fund categorization, expenditure evaluation, and post-purchase emotions, adapted from Adiputra et al. (2024). The dependent variable, contract compliance (Y_2), measured adherence to sharia contractual obligations using seven indicators, including contractual conformity, zakat management, and transaction reporting, based on the scale developed by Hikmah & Oktaviana (2019). Prior to full deployment, the questionnaire was pre-tested with 30 MSME owners to ensure clarity, reliability, and validity.

A mixed-method design was adopted to combine the breadth of survey data with the depth of qualitative interviews. Surveys captured general patterns of financial behavior, while interviews provided contextual insights into how religiosity and financial literacy influence compliance with Sharia financing, allowing for triangulation and richer interpretation of the findings. Data were collected from 100 MSMEs owners in three traditional markets under Perumda Pasar Jaya, complemented by in-depth interviews with 10 respondents for triangulation. A purposive sampling was employed to select ten MSME owners with extensive experience in Sharia-compliant financing and active involvement in daily business operations. Participants were drawn from existing professional networks to ensure both accessibility and relevance, with the key criterion being repeated engagement with Islamic financial institutions. Although not statistically representative, this sample was intended to provide information-rich cases that offer nuanced insights into how religiosity and financial literacy shape contract compliance, thereby deepening the interpretation of survey results through triangulation. A structured questionnaire was developed through a literature review and pilot testing to ensure validity and reliability.

The data were analyzed using Structural Equation Modeling–Partial Least Squares (SEM- PLS). This method was chosen because it is appropriate for small sample sizes and models with mediating variables. The analysis involved two steps: evaluation of the measurement model to confirm reliability and validity, and testing of the structural model to assess direct and indirect effects, with significance levels obtained through bootstrapping. Ethical considerations were observed throughout the research process. All participants were provided with informed consent forms outlining the objectives of the study, the voluntary nature of participation, and assurances of confidentiality and anonymity. Respondents were informed that their answers would be used solely for academic purposes and that they could withdraw at any time without consequence.

Nevertheless, the study acknowledges certain limitations. Since the research was confined to MSMEs under Perumda Pasar Jaya Jakarta, the findings may not fully generalize to other regions or financing institutions. In addition, reliance on self-reported questionnaires may be subject to social desirability bias, particularly in relation to sensitive constructs such as religiosity. Finally, the cross-sectional design restricts the ability to capture changes in compliance behavior over time.

RESULTS AND DISCUSSION

Respondent Characteristics

Table 1 presents the demographic and business characteristics of the 100 respondents. In terms of gender, the sample was relatively balanced, with 58 percent male and 42 percent female respondents. With regard to age, most respondents were in the productive age range of 31–40 years (45 percent), followed by 41–50 years (33 percent), and 20–30 years (22 percent). This distribution suggests that Sharia-based financing is predominantly utilized by entrepreneurs in their mature working years, who may possess both the experience and financial responsibility required to sustain business operations.

Table 1. Respondent Characteristics

Category	Sub-Category	Percentage
Gender	Male	58
	Female	42
Age	20-30 years	22
	31-40 years	45
	41-50 years	33
Education Level	Senior High School	60
	Diploma / Undergraduate	35
	Post Graduate	5
Business Sector	Food	40
	Fashion	30
	Handicraft /Others	30
Business Tenure	1-3 years	25
	4-6 years	50
	>6 years	25

Source: Data from questionnaires – processed (2025).

Educational attainment varied across the sample. The majority of respondents (60 percent) had completed senior high school or its equivalent, while 35 percent held a diploma or undergraduate degree, and 5 percent possessed a postgraduate qualification. In terms of business sectors, 40 percent of respondents operated in the culinary and food industry, 30 percent in fashion and clothing, and 30 percent in handicrafts and other sectors. The dominance of culinary businesses reflects the high consumer demand in Jakarta's urban economy, while the presence of fashion and handicraft enterprises highlights sectoral diversity within the MSMEs studied. Business tenure also revealed a balanced distribution. Half of the respondents (50 percent) had been operating their businesses for 4–6 years, while 25 percent had been in business for 1–3 years and another 25 percent for more than six years.

Overall, the demographic and business characteristics of the respondents indicate that the sample is heterogeneous yet balanced, aligning with the study's aim of examining Islamic financial literacy, religiosity, mental accounting, and contract compliance across a representative group of MSMEs in Jakarta.

Financing Profile of Respondents

As shown in Table 2, the majority of respondents (75 percent) received financing through Murabahah contracts (cost-plus sale), which remains the most dominant financing scheme due to their relative simplicity, fixed repayment structure, and suitability for trading-based businesses. A smaller proportion of respondents engaged in Mudarabah contracts (profit-sharing) at 15 percent and Musharakah contracts (partnership) at 10 percent. These findings confirm that while profit-and-loss sharing mechanisms are promoted in Islamic finance, Murabahah remains the most practical and widely adopted form of Sharia financing among MSMEs.

Table 2. Financing Profile of Respondents

Classification Type	Description	Percentage of Respondent
Type of Contract	Murabahah	75
	Mudarabah	15
	Musyarakah	10
Financing Amount	IDR 5-10 million	30
	IDR 11-20 million	50
	>IDR 20 million	20
Tenure	12 months	40
	24 months	45
	>24 months	15
Payment Compliance	On time	65
	Ever late	35

Source: Data from questionnaires – processed (2025).

With respect to the amount of financing obtained, half of the respondents (50 percent) reported financing between IDR 11–20 million, while 30 percent received smaller financing in the range of IDR 5–10 million, and the remaining 20 percent accessed larger funds exceeding IDR 20 million. In terms of tenure, financing was relatively evenly distributed across different repayment periods. About 40 percent of the respondents obtained financing with a 12-month tenure, while 45 percent had a 24-month tenure, and 15 percent received financing for periods exceeding two years. The repayment behavior of respondents further illustrates the compliance patterns within the financing scheme. A majority of 65 percent reported making repayments on time, reflecting a generally strong adherence to contractual obligations. However, 35 percent of respondents admitted to experiencing delays in repayment, highlighting potential challenges in cash flow management among certain businesses.

These findings demonstrate that MSMEs under Perumda Pasar Jaya rely predominantly on Murabahah contracts with modest financing amounts, relatively short repayment periods, and overall positive repayment behavior, though with a non-negligible segment experiencing repayment difficulties.

Descriptive Statistics of Variables

Table 3 presents the descriptive statistics of the main research variables, including Islamic financial literacy (IFL), religiosity (REL), mental accounting (MA), and financing contract compliance (FCC). The results demonstrate notable variations across indicators, providing a nuanced understanding of respondent behavior.

Table 3. Descriptive Statistics of Variables

Variable	Dimension	Mean	Standard Deviation	Category
IFL	Understanding of contracts (4 questions)	4.12	0.65	High
	Knowledge of the prohibition of usury (4 questions)	4.35	0.58	Very High
REL	Awareness / concern for zakat (3 questions)	4.20	0.72	High
	Worship intensity / Religious observance (3 questions)	3.95	0.81	Moderate
MA	Account segregation / Separation of accounts (3 questions)	3.40	1.02	Moderate
	Fund recording / Accounting of funds (3 questions)	3.15	0.95	Moderate
FCC	Accuracy / Timeliness of payments (4 questions)	4.25	0.75	High
	Transaction reporting (3 questions)	3.80	0.88	Moderate

IFL: Islamic Financial Literacy
REL: Religiosity
MA: Mental Accounting
FCC: Compliance with Sharia Financing Contracts
Source: Data processed – SEM-PLS (2025).

In terms of Sharia financial literacy, respondents reported relatively high levels of understanding. The indicator of knowledge of the prohibition of riba achieved the highest mean score (M = 4.35, SD = 0.58), categorized as very high. This suggests that respondents are strongly aware of the fundamental prohibition of interest in Islamic finance. Similarly, understanding of contracts (M = 4.12, SD = 0.65) was rated high, reflecting that respondents generally comprehend the principles of Sharia-compliant contracts. Together, these findings indicate that respondents possess solid foundational knowledge of Islamic financial principles.

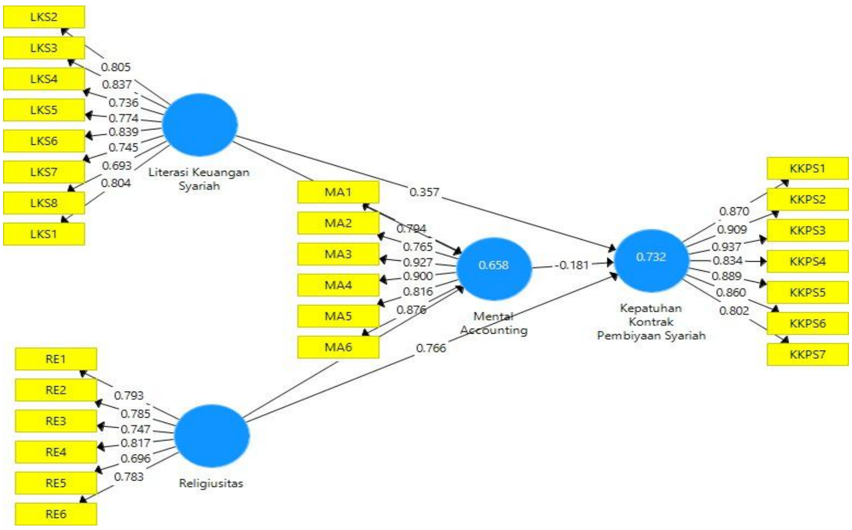
With respect to religiosity, the indicator of worship intensity (M = 4.20, SD = 0.72) was categorized as high, while zakat awareness (M = 3.95, SD = 0.81) was rated as moderate. These results suggest that while religious practices are consistently maintained at a high level, awareness and active engagement in zakat obligations vary among respondents. This may reflect differences in financial capacity, access to zakat institutions, or the perceived relevance of zakat in their business operations.

The results for mental accounting reveal the lowest mean scores among the measured constructs, indicating relative weaknesses in financial management practices. Both separation of accounts (M = 3.40, SD = 1.02) and fund recording (M = 3.15, SD = 0.95) were rated moderate. These findings suggest that respondents still face challenges in maintaining systematic financial records and distinguishing between personal and business finances, which may have implications for long-term business sustainability and repayment performance.

Finally, contract compliance indicators showed comparatively strong results. Timely repayment (M = 4.25, SD = 0.75) was rated high, indicating that most respondents fulfill their financing obligations punctually. Meanwhile, transaction reporting (M = 3.80, SD = 0.88) was categorized as moderate, suggesting some gaps in providing detailed or formal reporting of financial activities. This indicates that while respondents are generally reliable in meeting repayment commitments, transparency in financial reporting requires further improvement. The lower compliance observed in reporting compared to repayment may be explained by several factors. Many MSMEs lack access to standardized bookkeeping tools and often depend on informal cash-based records. In addition, limited human resource capacity in financial management further constrains their ability to prepare accurate and timely reports. Unlike repayment, which is enforced through clear contractual obligations, reporting is perceived as less binding and therefore receives less priority

Hypotheses Testing

The results of the PLS algorithm analysis indicated that the model required refinement by examining the outer loadings. According to Ghozali & Latan (2015) indicators with outer loadings below 0.6 in explanatory model analysis must be excluded.



Notes: Literasi Keuangan Syariah = Islamic Financial Literacy; Religiusitas = Religiosity; Kepatuhan Kontrak Pembiayaan Syariah = Compliance with Sharia Financing Contracts

Figure 2. Algoritma PLS SmartPLS

Figure 2 presents the final model, showing that all factor loadings exceed 0.7, which is considered ideal. This finding demonstrates that the retained indicators are significant and valid measures of their respective constructs.

The construct reliability and validity test further confirmed the robustness of the measurement model. All outer loadings exceeded the 0.7 threshold as presented in the Table 4. Cronbach's alpha values for each construct were above 0.7, composite reliability values surpassed 0.6, and the average variance extracted (AVE) exceeded 0.5. These results satisfy the criteria for internal consistency reliability and convergent validity (Hair et al., 2017), ensuring that all constructs and indicators met the required statistical standards.

Table 4. Results of the Reflective Model

Variable	Indicator	Outer Loadings	Cronbach's Alpha	Composite Reliability	AVE
Islamic Financial Literacy	LKS1	0.804	0.908	0.926	0.609
	LKS2	0.805			
	LKS3	0.837			
	LKS4	0.736			
	LKS5	0.774			
	LKS6	0.839			
	LKS7	0.745			
	LKS8	0.693			
Religiousity	RE1	0.793	0.863	0.898	0.595
	RE2	0.785			
	RE3	0.747			
	RE4	0.817			
	RE5	0.696			
	RE6	0.783			
Mental Accounting	MA1	0.794	0.921	0.939	0.720
	MA2	0.765			
	MA3	0.927			
	MA4	0.900			
	MA5	0.816			
	MA6	0.876			
Sharia Financing Contract Compliance	KKPS1	0.870	0.947	0.957	0.761
	KKPS2	0.909			
	KKPS3	0.937			
	KKPS4	0.834			
	KKPS5	0.889			
	KKPS6	0.860			
	KKPS7	0.802			

Notes: LKS, RE, MA, KKP are questionnaire items.
Source: Data processed – SEM-PLS (2025).

To assess discriminant validity, the Fornell–Larcker criterion was employed. A construct is considered to have good discriminant validity if its square root of AVE is higher than its correlations with other constructs. Table 5 shows that the correlation of each construct with itself was higher than with other constructs. For instance, the variable of Sharia financing contract compliance demonstrated the highest correlation with its own indicators compared to correlations with other constructs. The lowest Fornell–Larcker value was found in religiosity (0.771), which was still higher than its correlations with Sharia financing contract compliance (0.872), Sharia financial literacy (0.781), and mental accounting (0.848). This confirms that the model achieved satisfactory discriminant validity.

Path coefficient analysis was then conducted to evaluate the relationships among variables at a significance level of 0.05, with T-statistics > 1.96 indicating significance (Ghozali & Latan, 2015). The sign of the original sample values in Table 6 indicates the direction of the relationship: a positive coefficient suggests that an increase in the independent variable leads to an increase in the dependent variable, while a negative coefficient implies the opposite.

Table 5. Fornell-Larcker Criteria for Discriminant Validity Model

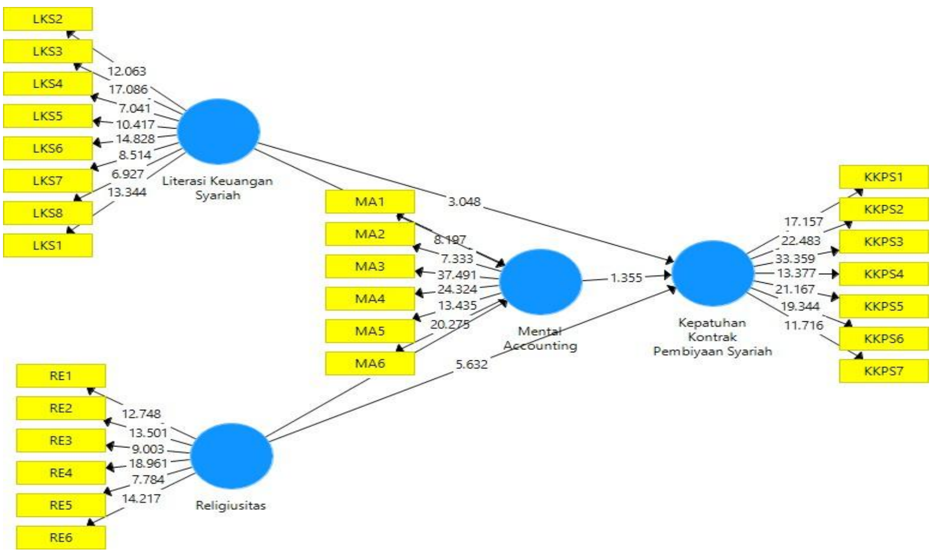
	Compliance with Sharia Financing Contracts	Islamic Financial Literacy	Mental Accounting	Religiousity
Compliance with Sharia Financing Contracts	0.872			
Islamic Financial Literacy	0.639	0.781		
Mental Accounting	0.626	0.585	0.848	
Religiousity	0.805	0.507	0.781	0.771

Source: Data processed – SEM-PLS (2025).

Table 6. Structural Model

Hypotheses	**Original Sample (O)**	**Sample Mean (M)**	**Standard Deviation (STDEV)**	**T Statistics (|O/STDEV|)**
H1 : Islamic Financial Literacy -> Compliance with Shariah Financing Contract	0.357	0.336	0.117	3.048
H2 : Shariah Financial Literacy -> Mental Accounting -> Compliance with Shariah Financing Contract	-0.046	-0.050	0.043	1.082
H3 : Religiousity -> Mental Accounting -> Compliance with Shariah Financing Contract	-0.118	-0.122	0.092	1.280
H4 : Religiousity -> Compliance with Shariah Financing Contract	0.766	0.801	0.136	5.632

Source: Data processed – SEM-PLS (2025).



Notes: Literasi Keuangan Syariah = Islamic Financial Literacy; Religiusitas = Religiosity; Kepatuhan Kontrak Pembiayaan Syariah = Compliance with Sharia Financing Contracts

Figure 3. Bootstrapping SmartPLS

The bootstrapping analysis results, presented in Table 6 and Figure 3, reveal the following findings. First, Hypothesis 1 was supported: Sharia financial literacy had a positive and significant effect on Sharia financing contract compliance, with a T-statistic of 3.048 (> 1.96) and an original sample value of 0.357. Second, Hypothesis 2 was not supported: Sharia financial literacy had a negative but insignificant indirect effect on Sharia financing contract compliance through mental accounting, with a T-statistic of 1.082 (< 1.96) and an original sample value of –0.046. Third, Hypothesis 3 was not supported: religiosity exerted a positive and insignificant influence on Sharia financing contract compliance through mental accounting, with a T-statistic of 1.280 (> 1.96) and an original sample value of -0.118. Finally, Hypothesis 4 was supported: religiosity demonstrated a positive and significant effect on Sharia financing contract compliance, with a T-statistic of 5.632 (> 1.96) and an original sample value of 0.766.

Discussion and Analysis

The Effect of Sharia Financial Literacy on Contract Compliance in Sharia Financing

The empirical results from the PLS analysis indicate that Sharia financial literacy has a positive and significant effect on contract compliance in Sharia financing among MSME respondents. The path coefficient (0.357) and T-statistic value (3.048 > 1.96) confirm that higher levels of understanding in Sharia-based financial principles enhance the ability and willingness of MSMEs to comply with contractual agreements. This finding is consistent with the notion that Islamic financial literacy, grounded in the objectives of Maqasid al-Shariah, shapes ethical financial behavior and decision-making (Bakar et al., 2024). In practice, MSMEs that understand concepts such as the prohibition of riba, gharar, and maysir, alongside the importance of fairness and contractual obligations, are more inclined to honor repayment commitments and maintain discipline in financing relationships.

The mechanism is straightforward: when MSME owners have better Sharia financial literacy, they face less uncertainty, make decisions with greater confidence, and feel more responsible for their obligations. Such clarity reinforces their commitment to contractual compliance. Evidence in the literature supports this view: higher financial literacy strengthens responsible and ethical financial behavior (Abdallah et al., 2024), lowers the risk of default among SMEs (Carlos & Bernardes, 2025), and improves debt management and repayment discipline (Saifurrahman & Kassim, 2021).

The descriptive evidence aligns with these statistical results. Respondents scored 4.12 (high) on understanding Sharia contracts and 4.35 (very high) on knowledge of riba prohibition. On the compliance side, timely repayment scored 4.25 (high), while transaction reporting scored 3.80 (moderate). This suggests that while MSMEs are strong in their awareness of Sharia rules and repayment discipline, their reporting practices are less consistent. Qualitative interviews illustrate these dynamics. One respondent admitted:

> *"I know murabahah is a profit-based sale, but I sometimes get confused calculating the margin. What matters is that it's halal."*

Consistent with previous studies, financial literacy is not only a matter of knowledge but also part of broader human capital development that influences financial behavior (Rohmania & Sholihah, 2023); (Aisyah et al., 2024). Enhancing Sharia financial literacy, therefore, improves MSMEs' decision-making capacity and strengthens their contractual commitment. Theoretically, these findings support the Theory of Planned Behavior (Ajzen, 1991), where financial literacy strengthens perceived behavioral control and compliance intentions. Consistent with Muninggar et al. (2025), literacy not only informs attitudes but also aligns subjective norms with Sharia-compliant conduct.

Mental Accounting Does Not Mediate the Relationship between Financial Literacy and Contract Compliance

The results of the mediation analysis show that Mental Accounting does not significantly mediate the relationship between Sharia financial literacy and compliance with Sharia financing contracts, as reflected in the T-statistic of 1.082, which is below the threshold of 1.96, and an original sample estimate of –0.046. This insignificant indirect effect suggests that while Sharia financial literacy has a positive direct influence on compliance (as shown in H1), this effect does not operate meaningfully through mental accounting. In other words, the financial literacy of MSMEs actors does not automatically translate into structured cognitive categorization of financial resources that would enhance contract compliance.

This finding is somewhat surprising, given that previous studies have often highlighted the importance of mental accounting as a behavioral mechanism that connects financial knowledge to actual financial decision-making. Thaler (1999) introduced the concept of mental accounting as a framework for understanding how individuals allocate and monitor financial resources in separate cognitive "accounts." Nie and Song (2025) argue that categorizing resources into mental accounts strengthens repayment priorities. Similarly, Masrizal et al. (2025) show that financial knowledge and skills improve discipline through financial behavior, while Andarsari & Ningtyas (2019) find that higher literacy enhances budgeting, saving, and debt management, which support repayment obligations.

Why then does this study not confirm such mediation? A possible explanation lies in the specific context of MSMEs. Although Islamic financial literacy provides MSMEs with an understanding that debt repayment is obligatory and that renegotiation with lenders is the proper course of action in cases of financial difficulty, this knowledge does not consistently translate into disciplined repayment practices. Ideally, financially literate entrepreneurs would apply mental accounting by systematically allocating specific reserves for loan repayment, thereby ensuring that contractual obligations are prioritized. However, the realities of MSMEs' operations often hinder the implementation of such practices. For many small businesses, limited resources mean that urgent expenditures, such as covering operational costs or maintaining working capital, take precedence over repayment allocation. When faced with liquidity pressures, MSMEs tend to act rationally by directing scarce funds toward immediate survival needs rather than maintaining strict repayment accounts. Entrepreneurs frequently postpone repayment or request restructuring. The interviews underscore this tension: while respondents acknowledged repayment as obligatory, they also admitted diverting funds to pressing business needs when revenues declined.

> *"I was once late because sales dropped. I asked for leniency from Perumda, and alhamdulillah, they gave relief."*

Moreover, mental accounting itself is not without criticism. Nicholson (2024)argues that rigid compartmentalization can distort rational choices, as entrepreneurs may prioritize operational accounts over repayment. Javareshk (2024) similarly notes that excessive separation of funds can reduce financial flexibility in the face of liquidity shocks. For MSMEs with volatile cash flows, strict mental accounting may even hinder rather than help repayment, especially when urgent business expenses take precedence. This resonates with the descriptive evidence, where reporting discipline lagged behind repayment, suggesting that structured categorization of resources is not consistently practiced.

Mental Accounting Does Not Mediate the Relationship between Religiosity and Contract Compliance

The analysis reveals that Mental Accounting does not significantly mediate the relationship between religiosity and Sharia contract compliance, as indicated by a T-statistic of 1.280, which is far below the critical value of 1.96, and an original sample path coefficient of –0.118. This insignificant effect suggests that, while religiosity itself plays a strong direct role in shaping ethical financial behavior and compliance, its impact is not transmitted through mental accounting practices. In other words, religious values do not necessarily encourage MSME actors to cognitively segment and monitor funds in the manner conceptualized by mental accounting; instead, religiosity motivates compliance more directly through moral and spiritual obligation. Fulfilling Sharia-based contracts is viewed as an act of obedience to God and fulfillment of amanah. Qualitative findings provide further support for this interpretation. One respondent candidly noted:

> *"Business and personal money are often mixed. When it is time to pay installments, sometimes I need to search for funds first."*

This statement shows that MSMEs often lack clear and consistent financial management. The line between business and personal money is blurred, making debt repayment highly dependent on unstable cash flow. Descriptive statistics reinforce this pattern: account separation scored 3.40 (moderate) and fund recording 3.15 (moderate), suggesting that structured financial practices exist but are not applied systematically. These findings indicate that although MSMEs may intend to comply with Sharia

contracts, the absence of strong financial buffers and reliable accounting mechanisms constrains their ability to manage funds in a disciplined way. This explains why mental accounting does not significantly mediate the relationship between religiosity and contract compliance. Prior research supports this interpretation: Kaya (2024) and Cathcart et al. (2020) show that SMEs' financial behavior is shaped more by liquidity risks, refinancing pressures, and cash flow volatility than by ethical intention. In other words, religiosity can strengthen commitment, but financial vulnerabilities often prevent entrepreneurs from translating that commitment into consistent fund allocation.
In addition to liquidity constraints, mental accounting did not emerge as a significant mediator, likely reflecting practical challenges faced by MSMEs. Limited record-keeping capacity, informal accounting practices, and the mixing of business and personal funds, as reported by interviewees, can hinder the structured application of mental accounting, even when owners are aware of Sharia principles.

Nevertheless, the present results are in line with prior research showing that religiosity has a direct impact on ethical financial behavior. Budiyanto et al. (2024) found that religiosity positively affects well-being but does not significantly shape financial practices. Similarly, Amissah & Swierczynska (2021) demonstrated that religiosity does not always predict disciplined financial behavior in less financially developed economies. These findings reinforce the current study's conclusion that religiosity primarily motivates compliance through moral and spiritual channels rather than financial cognition.

Religiosity Positively Influences Compliance with Sharia Financing Contracts

The results demonstrate that religiosity has a positive and significant influence on MSMEs' compliance with sharia financing contracts ($\beta = 0.766$; $t = 5.632$). This finding supports hypothesis 4, which proposes that religious values provide an ethical foundation for financial discipline and reinforce the commitment to honor contractual obligations. Descriptive indicators further substantiate this finding: worship intensity was reported at a high level (mean = 4.20 out of 5.00), suggesting that respondents generally exhibit strong religious devotion, while concern for zakat was recorded at a moderate level (mean = 3.95). This implies that while religious rituals are consistently observed, the translation of religious values into financial practices, such as zakat and charitable giving, appears more varied among respondents. The qualitative data provide additional insight into how religiosity is internalized in financial behavior. One entrepreneur explained:

> *"Whenever I finish repaying a loan, I give 2.5% in charity. It is a form of gratitude because the financing was sharia-based".*

Such reflections illustrate that repayment obligations are not only fulfilled but are also accompanied by acts of religious gratitude, which strengthen the moral dimension of contract compliance.

This finding is consistent with previous studies. Saifurrahman & Kassim (2021) found that religiosity strengthens Muslims' willingness to comply with Islamic banking contracts. Hanwen et al. (2016) demonstrated that stronger religiosity is associated with lower loan interest spreads and more favorable credit terms. Most importantly, a large-scale cross-country study covering 51 nations (Chen et al., 2014) documented that stronger religiosity is significantly correlated with lower borrowing costs, indicating that religiosity fosters greater risk aversion and higher ethical standards, which reduce default risk and enhance repayment reliability. Their analysis further shows that this effect becomes stronger in environments where political rights are well established, suggesting that religiosity interacts with institutional settings to promote financial discipline. These studies highlight that religiosity fosters trustworthiness and reduces perceived borrower risk, thereby supporting greater compliance with financial obligations.

CONCLUSION

This study demonstrates that Sharia financial literacy and religiosity are fundamental drivers of contract compliance among MSMEs. Entrepreneurs with a deeper understanding of Sharia principles— such as the nature of contracts, the prohibition of riba, and Islamic business ethics—are more likely to honor their financing obligations with discipline and transparency. Similarly, religiosity emerges as a strong determinant of compliance, as spiritual values of honesty, responsibility, and piety shape financial behavior in accordance with religious teachings. These findings affirm that internal factors of knowledge and faith provide a solid foundation for Sharia-compliant practices, thereby reinforcing the sustainability and stability of MSMEs in the long run. The analysis also reveals that mental accounting, while influenced by both literacy and religiosity, does not significantly mediate their effects on contract compliance. This suggests that although MSMEs may adopt certain financial categorization practices, these are not the decisive mechanisms that translate religious or financial knowledge into compliance. Instead, external pressures such as economic constraints, limited capital, and market volatility play a stronger role in shaping repayment decisions. The finding highlights a contextual reality: compliance in this setting is guided more by ethical and spiritual imperatives than by structured financial management systems.

The contribution of this study lies in clarifying the relative weight of cognitive and value-based determinants in Sharia financing. It advances the behavioral finance literature by showing that mental accounting may not fully capture how religiosity operates in a Muslim-majority context, where moral obligation can bypass cognitive frameworks. For practitioners, the results emphasize the importance of strengthening literacy programs and religious education to sustain compliance, while for policymakers, the findings point to the need for supportive policies and institutional guidance that reinforce these internal drivers. Nonetheless, this study is not without limitations. The focus on MSMEs within a single institutional context limits the generalizability of the findings across different business sectors or geographic regions.

The findings of this study generate several implications for practice. For MSMEs, strengthening Sharia financial literacy is essential, not only through formal training on contracts, risk management, and Islamic business ethics but also by embedding religious values into daily business operations. Entrepreneurs who internalize such principles are better equipped to manage their obligations responsibly and transparently. Likewise, fostering religiosity in the entrepreneurial setting—such as by cultivating honesty, accountability, and commitment—can serve as an intangible asset that promotes compliance and long-term business sustainability.

Islamic financial institutions can support MSMEs by implementing practical measures to reinforce financial literacy and religiosity. These measures may include offering targeted workshops on budgeting and fund management, supplying simple digital tools to facilitate account separation, and integrating routine counselling or reminders about ethical and religious principles in client interactions. Flexible repayment options and restructuring schemes may also help MSMEs navigate economic pressures without jeopardizing their compliance. At the policy level, government agencies and regulators are urged to provide stronger institutional support through incentive programs, legal protection, and collaboration with religious organizations, thereby reinforcing a more holistic ecosystem for Sharia-based financing.

From an academic standpoint, the results highlight opportunities for further exploration. Since mental accounting was found to have limited mediating effects, future studies should incorporate additional explanatory variables such as macroeconomic conditions, institutional trust, or social support systems that may interact with financial literacy and religiosity in shaping compliance. A qualitative research design would also provide a richer understanding of why mental accounting is less influential in this context. For instance, experimental or longitudinal designs could be applied to examine whether entrepreneurs with stronger self-control are better able to prioritize contractual obligations, or whether structured financial planning routines (e.g., separating business and personal accounts, budgeting practices) enhance compliance with Sharia financing. Such approaches would provide more fine-grained evidence on the behavioral dynamics underpinning MSMEs' financial decision-making. Expanding the study across different business sectors, including larger corporations or individual borrowers, would further enhance generalizability. Moreover, theoretical development is needed to adapt the concept of mental accounting within an Islamic framework, potentially giving rise to a "Sharia-oriented mental accounting" model that explicitly integrates ethical and spiritual dimensions into financial categorization. Advancing these lines of inquiry would not only strengthen academic discourse but also generate knowledge that directly benefits practitioners and policymakers in promoting more sustainable Sharia-compliant financing.

Authors' Contribution

All authors equally contributed to the conceptualization, research, data collection, data analysis, and writing the manuscript. The second author revised the article based on the reviewers' comments and finalized it.

Conflict of Interest

The authors declare no competing interests.

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Availability of Data and Materials

The data and materials can be requested from the corresponding author, along with reasons for the requirement.

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