

The Thirty Years of Indonesian Sharia Banking: Potential, Prospects and Challenges in the Era of Technological Disruption

*Potential, Prospects
and Challenges of
Sharia Banking*

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ABSTRACT

This study examines the development of Indonesian sharia banking over the past three decades, with particular attention to its regulatory evolution, economic potential, and challenges in the era of digital transformation. Using a descriptive-analytical approach based on secondary macro-financial data from regulatory authorities and official statistics, this research analyzes the performance and structural dynamics of sharia banking during the pre-pandemic, pandemic, and post-pandemic recovery periods. The findings indicate that despite consistent asset growth and improving financial performance indicators, the market share of sharia banking in Indonesia remains relatively limited compared to both conventional banking and leading Islamic finance countries. Key challenges include regulatory adaptation, human resource constraints, low levels of sharia financial literacy and inclusion, and the need for accelerated digital innovation. At the same time, Indonesia's large Muslim population, expanding halal industry, and supportive regulatory framework provide substantial opportunities for future growth. This study contributes to the literature by offering an integrated perspective that links regulatory development, financial inclusion, and digital transformation within the context of Indonesia's long-term economic agenda. The findings provide important policy and managerial implications for strengthening the role of sharia banking in promoting inclusive and sustainable economic development.

Keywords: Sharia banking; Islamic finance; digital transformation; financial inclusion; Indonesia

ABSTRAK

Penelitian ini mengkaji perkembangan perbankan syariah di Indonesia selama tiga dekade terakhir dengan menitikberatkan pada evolusi regulasi, potensi ekonomi, serta tantangan yang dihadapi di era transformasi digital. Penelitian ini menggunakan pendekatan deskriptif-analitis berbasis data sekunder makro-keuangan yang bersumber dari otoritas regulator dan statistik resmi. Analisis dilakukan terhadap kinerja dan

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dinamika struktural perbankan syariah pada periode sebelum pandemi, masa pandemi, dan fase pemulihan pascapandemi. Hasil penelitian menunjukkan bahwa meskipun perbankan syariah di Indonesia mengalami pertumbuhan aset yang konsisten dan perbaikan indikator kinerja keuangan, pangsa pasarnya masih relatif terbatas dibandingkan perbankan konvensional maupun negara-negara dengan industri keuangan syariah yang lebih maju. Tantangan utama yang dihadapi meliputi penyesuaian regulasi, keterbatasan sumber daya manusia, rendahnya tingkat literasi dan inklusi keuangan syariah, serta kebutuhan akan percepatan inovasi digital. Di sisi lain, besarnya populasi Muslim, pertumbuhan industri halal, dan dukungan kerangka regulasi memberikan peluang signifikan bagi pengembangan perbankan syariah di masa depan. Penelitian ini berkontribusi pada literatur dengan menyajikan perspektif terintegrasi yang mengaitkan perkembangan regulasi, inklusi keuangan, dan transformasi digital dalam konteks agenda pembangunan ekonomi jangka panjang Indonesia. Temuan penelitian ini memberikan implikasi kebijakan dan manajerial yang penting dalam memperkuat peran perbankan syariah untuk mendorong pembangunan ekonomi yang inklusif dan berkelanjutan.

Kata kunci: Perbankan syariah; keuangan Islam; transformasi digital; inklusi keuangan; Indonesia

INTRODUCTION

The establishment of Indonesia's first sharia-based bank, Bank Muamalat Indonesia (BMI), in 1992 marked a significant milestone in the country's financial landscape. This initiative emerged as an alternative to the long-standing debate among Indonesian Muslims regarding the permissibility of interest (riba) in conventional banking (Syarifuddin et al., 2021). The introduction of sharia banking aimed to provide a financial system that aligns with Islamic principles, ensuring transactions free from riba, gharar (uncertainty), and maisir (speculation). Over the past three decades, sharia banking has demonstrated steady growth, contributing to national economic capacity by leveraging Indonesia's large Muslim population, increasing middle-class prosperity, and improving awareness of Islamic finance (Ali et al., 2020).

Despite its progress, Islamic banking faces significant challenges, particularly in light of technological disruption, economic digitalization, and the aftermath of the COVID-19 pandemic, which has fundamentally reshaped global and domestic business landscapes (Luthfiatussa'dyah et al., 2022). The ability of Islamic banks to leverage financial technology (fintech), adapt to changing customer behaviors, and address regulatory adjustments will determine their long-term sustainability and competitiveness (Raouf & Ahmed, 2022). One pressing question is whether sharia banking can effectively promote inclusive economic growth, particularly by supporting micro, small, and medium enterprises (MSMEs), which constitute a crucial sector in Indonesia's economy. Indonesia continues to grapple with economic disparities stemming from unequal financial asset ownership, educational gaps, and limited employment opportunities (Nugroho et al., 2022).

In the last three decades, Islamic banking has become an integral part of the Indonesian economy. Therefore, it is important to evaluate its performance, including the extent to which it has overcome the challenges that have arisen during the COVID-19 pandemic and how it plans to deal with technological change and global economic uncertainty. The future of sharia banking as a driver of an inclusive economy and the main supporter of micro, small and medium business entrepreneurs is dependent on the ability to adopt new technology, the improve show is quality for service in customers, and meet the needs of the growing middle-class Muslim population. Sharia banking has now become the main financial solution for the majority of Indonesian Muslim communities. With increasing understanding of Islamic finance, it is natural that Islamic banking is seen as the main choice based on its competitive potential. The sharia principles that underlie sharia banking, such as the prohibition of usury, gharar, tadbis,

and maisir, as well as the principles of halal and trust, are very much in line with the values of most Muslim communities in Indonesia (Maraliza, 2024). Many people have experienced the benefits of sharia banking directly, and in the future, the Islamic values that are the basis of sharia banking can provide wider benefits to society.

This study is motivated by the urgent need to ensure Indonesia's Islamic banking sector remains relevant and competitive in the era of digital finance. As the world's largest Muslim-majority country, Indonesia has a unique opportunity to lead the global Islamic finance industry, particularly in areas such as digital Islamic banking, fintech integration, and ethical investment solutions (Smaoui & Khawaja, 2017). Furthermore, given the recent regulatory advancements such as Bank Indonesia's Blueprint for Islamic Economy 2019-2024 and the expansion of Islamic financial technology ecosystems, this research contributes by: (a) Providing empirical evidence on the role of Islamic banking in addressing economic inequality; (b) Assessing policy implications for regulatory bodies to enhance sharia banking's financial inclusivity; and (c) Offering strategic recommendations for Islamic banks to improve service quality, adopt innovative financial products, and expand market reach.

While numerous studies have explored the growth and performance of Islamic banking, limited research has examined the role of sharia banking in mitigating economic inequality and fostering financial inclusion in the post-pandemic era. Most existing literature focuses on Islamic banking's compliance with sharia principles, risk management, and financial stability (Sole, 2007), policy and regulation (Salmah & Devi, 2023), yet few studies comprehensively address how Islamic banking can utilize digital transformation to bridge financial inclusion gaps.

This study aims to fill this gap by evaluating: (a) Sharia Banking Potential, assessing the role of Islamic banks in fostering inclusive economic growth in Indonesia, particularly in supporting MSMEs and enhancing financial inclusion. This includes examining how sharia banking leverages its principles to create a more equitable financial system; (b) Sharia Banking Achievements and Prospects, analyzing the impact of digital banking and fintech integration on the operational efficiency and competitiveness of Islamic financial institutions. This section highlights the progress made by sharia banks in adopting technology and expanding their market share; (c) Sharia Banking Challenges, investigating the key obstacles faced by Islamic banks, including regulatory constraints, digital transformation barriers, and market competition. Additionally, this section explores post-pandemic recovery strategies to ensure resilience and long-term growth.

By addressing these issues, this research provides new insights into the evolving landscape of sharia banking in Indonesia, offering a forward-looking perspective on its potential to become a key driver of sustainable economic development.

Despite the growing body of literature on Islamic banking in Indonesia, existing studies largely concentrate on financial performance, sharia compliance, risk management, or institutional regulation in isolation. Limited attention has been given to an integrated analysis that simultaneously examines Islamic banking through the lenses of inclusive economic development, digital disruption, and sharia governance within a long-term national development framework. In particular, prior research rarely revisits the thirty-year trajectory of Indonesian sharia banking from the perspective of financial deepening and Indonesia's prolonged middle-income trap, nor does it adequately position sharia banking within the National Long-Term Development Plan (RPJPN) 2025–2045. This study contributes to the literature by offering a holistic and forward-looking perspective that integrates inclusive economy objectives, digital transformation challenges, and governance dynamics in sharia banking. By reinterpreting three decades of development within Indonesia's evolving macroeconomic and policy context, this article provides new insights into the strategic role of sharia banking as a catalyst for financial deepening, inclusive growth, and sustainable economic transformation in Indonesia.

LITERATURE REVIEW

Institutions and the Evolution of Supporting Regulations

The development of the sharia banking sector in Indonesia has progressed gradually in line with the evolution of its regulatory and institutional framework. The establishment of Bank Muamalat Indonesia on May 1, 1992 marked the initial phase of Islamic banking development, operating under Law No. 7 of 1992. At that time, sharia banking had not yet received explicit regulatory recognition, as the law merely acknowledged profit-sharing mechanisms without clearly defining sharia principles or permissible Islamic banking activities. A major regulatory advancement occurred with the enactment of Law No. 10 of 1998, which formally introduced the dual banking system and explicitly recognized the coexistence of conventional and sharia banking. This framework enabled both systems to operate simultaneously in mobilizing public funds and supporting national economic financing, while accommodating the diverse needs of Muslim and non-Muslim communities.

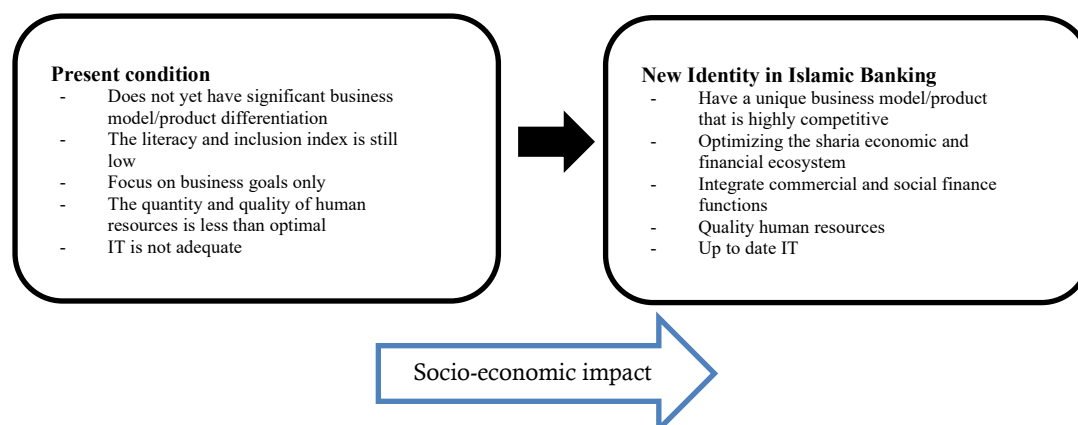
The regulatory foundation of sharia banking was significantly strengthened through Law No. 21 of 2008 on Sharia Banking, which provided a comprehensive legal basis for Islamic banking operations in Indonesia. This law clearly defined institutional forms, business activities, and governance structures of sharia banking, including Islamic commercial banks, sharia business units within conventional banks, and sharia-based financing institutions. Importantly, it reinforced the role of Islamic legal principles as the core foundation of sharia banking operations, thereby enhancing legal certainty and institutional legitimacy. With this regulatory clarity, the sharia banking industry gained a stronger platform to support sustainable sectoral growth and financial system stability.

A distinctive feature of Indonesia's sharia finance governance lies in the involvement of both state authorities and independent religious institutions. The National Sharia Council of the Indonesian Ulema Council (DSN-MUI) holds the authority to issue sharia financial fatwas, which serve as the normative foundation for Islamic banking products and contracts (Devi & Hamid, 2024). At the institutional level, compliance with these principles is overseen by the Sharia Supervisory Board (DPS), which operates within each sharia bank to ensure adherence to Islamic law. This dual governance structure reflects Indonesia's hybrid model of sharia financial regulation, combining formal state oversight with religious legitimacy.

From a macroprudential perspective, Bank Indonesia (BI) initially played a key role in supporting sharia banking development through liquidity and intermediation policies, including the Macroprudential Intermediation Ratio (RIM) and the Macroprudential Liquidity Buffer (PLM). These instruments were designed to strengthen banking intermediation quality and liquidity resilience, including for sharia banks. However, following the enactment of Law No. 21 of 2011 on the Financial Services Authority, regulatory and supervisory authority over the banking sector was formally transferred from BI to the Financial Services Authority (OJK) in 2013. Since then, OJK has become the central institution responsible for regulating and supervising both conventional and sharia banking in Indonesia.

Under OJK's leadership, the strategic direction of sharia banking development has increasingly emphasized structural transformation rather than mere asset expansion. This orientation is reflected in policy initiatives such as the Indonesian Sharia Banking Development Roadmap (RPPSI) 2020–2025, which identifies persistent challenges including limited business model differentiation, suboptimal human resource and technological capacity, and low levels of financial inclusion and literacy. At the same time, OJK recognizes significant growth opportunities arising from digital transformation, the expansion of the halal industry, and increasing public awareness of Islamic finance. In the long term, OJK envisions Indonesian sharia banking as a competitive and inclusive financial sector that contributes meaningfully to national economic development, social welfare, and the achievement of Sustainable Development

Goals, in alignment with the principles of Maqashid Shariah. The overall direction of this transformation is summarized in Figure 1.



Source: OJK, RPPSI 2020 – 2025

Figure 1. Direction of Indonesian Sharia Banking Transformation

According to the Financial Services Authority (OJK), the development of sharia banking toward 2025 is guided by the vision of establishing a resilient and highly competitive sharia banking sector that contributes significantly to national economic growth and social development. To achieve this vision, OJK has formulated three strategic policy priorities. First, strengthening the identity of sharia banking, which includes reinforcing sharia values, developing distinctive and competitive sharia-based products, enhancing capital adequacy and operational efficiency, and accelerating digital transformation. Second, strengthening the sharia economic ecosystem through greater synergy with the halal industry, improved coordination among sharia financial institutions, integration with Islamic social finance institutions, collaboration with relevant ministries and public institutions, and increased public awareness of sharia-based economic activities. Third, strengthening licensing, regulation, and supervision, which is implemented through the acceleration of licensing processes via technology adoption, the development of adaptive and credible regulatory frameworks, and the enhancement of supervisory effectiveness.

The OJK's sharia banking development roadmap is designed as a dynamic policy instrument that requires continuous evaluation and adjustment in response to changes in the strategic environment. This need for adaptability has become increasingly relevant following the enactment of the Financial Sector Development and Strengthening Law (Undang-Undang Pengembangan dan Penguatan Sektor Keuangan/UU PPSK), which was passed in December 2022 and promulgated as Law No. 4 of 2023 in January 2023. The new regulatory framework provides OJK with broader authority to refine, update, and strengthen sharia banking development strategies in line with evolving economic conditions, technological advancement, and long-term national development objectives.

Islamic banking development can be analyzed through several complementary theoretical perspectives, particularly institutional economics, inclusive finance, and Maqashid Shariah. From the perspective of institutional economics, the growth of sharia banking is closely linked to the quality of formal institutions, regulatory frameworks, and governance structures that shape incentives and reduce transaction costs. Strong legal foundations, regulatory clarity, and effective supervision are essential institutional conditions for fostering trust and long-term sustainability in Islamic financial institutions.

The inclusive finance perspective emphasizes the role of Islamic banking in expanding access to financial services for underserved populations, including micro, small, and medium enterprises (MSMEs). By promoting risk-sharing instruments and asset-based financing, sharia banking has the potential to support financial deepening and reduce economic inequality, particularly in emerging economies such as Indonesia. However, the effectiveness of this role depends on financial literacy, digital access, and institutional capacity.

Meanwhile, Maqashid Shariah provides a normative framework that distinguishes Islamic banking from conventional finance. Beyond profitability and efficiency, Islamic banking is expected to promote social justice, equitable wealth distribution, and economic welfare. Within this framework, governance quality, ethical compliance, and alignment between commercial and social finance become critical success factors. Integrating these three perspectives allows for a more comprehensive understanding of Islamic banking development, particularly in assessing its strategic role in supporting inclusive growth and sustainable economic transformation in Indonesia.

Economic Capacity and Human Resources

Indonesia has consistently implemented various policy initiatives aimed at increasing national income and reducing income inequality through inclusive economic development. Significant progress was achieved in 2004 when Indonesia transitioned from a low-income country to a lower-middle-income country. More recently, according to the World Bank classification as of July 1, 2023, Indonesia attained upper-middle-income status, with a gross national income per capita of USD 4,580 (PPP). At the same time, the country recorded a Gini ratio of 0.381 in September 2022, indicating a moderate level of income inequality. These achievements reflect improvements in overall economic performance, yet they also underscore persistent structural challenges in income distribution.

Despite this progress, Indonesia has remained trapped in the middle-income category for more than three decades, a condition commonly referred to as the *middle-income trap*. This situation is characterized by persistent poverty, pronounced regional disparities, and unequal income distribution across socioeconomic groups. Looking ahead, Indonesia faces additional structural challenges, including demographic transitions, rapid technological change, shifting geopolitical and geoeconomic dynamics, and the growing impacts of climate change. Addressing these challenges requires the effective mobilization of Indonesia's core development assets, including human capital, social and cultural capital, natural resources, and maritime potential.

The pursuit of higher-quality and more inclusive economic growth is further constrained by inequalities in access to education, employment opportunities, and ownership of physical and financial assets. Unequal access to education contributes to disparities in skill levels, which in turn limit employment opportunities for large segments of the workforce. As industries increasingly demand high-skilled labor, wage gaps tend to widen, while low-skilled workers who are unable to meet market requirements are often absorbed into the informal sector. This dynamic reinforces income inequality and constrains productivity growth.

Inequality in educational access is also closely linked to disparities in asset ownership and financial inclusion. Evidence from a survey conducted by the University of Indonesia's Demographic Institute in collaboration with the RAND Corporation in 2014 indicates that high-income groups enjoy significantly greater access to financial and physical assets than lower-income groups. The survey reveals that the richest 10 percent of the population control approximately 54 percent of total asset value in Indonesia (Table 1), highlighting the structural nature of wealth inequality and the urgency of strengthening inclusive financial and economic policies.

Table 1. Household Classification and Asset Ownership Value

Classification of household asset ownership	Asset ownership value
10% highest	54%
40% medium	41%
50% lowest	5%

Source: BI, 2017 processed

From a long-term perspective, Indonesia already has a National Long-Term Development Plan (RPJPN) 2025-2045, which was officially published by Bapenas in June 2023. In the RPJPN, it is stated that towards 100 years of Independent Indonesia, or what is known as Golden Indonesia, Indonesia's main vision is to become a sovereign, advanced, and sustainable archipelago. In its explanation, the vision for Indonesia 2045

has ideals and ambitions to become a high-income country. From an economic perspective, to achieve a Golden Indonesia 2045, Indonesia aspires to¹:

- a) Achieving the status of the world's fifth-largest economy with a GDP of US\$ 9.1 trillion;
- b) Attaining a per capita GDP equivalent to advanced countries at US\$ 30,300;
- c) Reducing unemployment to less than 4%;
- d) Decreasing poverty to 0% and narrowing inequality, with a Gini ratio ranging from 0.290 to 0.320;
- e) Improving the competitiveness of human resources with a Human Capital Index of 0.73;
- f) Establishing a more productive economic structure with a target average growth of 6-7% per year;
- g) Enhancing the ability to adapt to technology to address the disruptions of the Hyper-Digital era by building a digital transformation ecosystem.

To realize the vision of Golden Indonesia 2045, Indonesia must undertake a comprehensive and transformative development agenda grounded in strong collaboration among all national stakeholders. The strategic direction for achieving this vision is articulated in the National Long-Term Development Plan (RPJPN) 2025–2045, which is structured around eight development missions encompassing social transformation, economic transformation, governance reform, rule of law, diplomatic resilience, socio-cultural and ecological resilience, as well as equitable regional development supported by high-quality, environmentally sustainable infrastructure. This long-term development trajectory underscores the need for structural reforms that are adaptive to global and domestic changes shaping Indonesia's future.

In line with this agenda, studies conducted by Bappenas identify a set of global megatrends that will significantly influence Indonesia's development path toward 2045. The first megatrend relates to global demographic dynamics, as world population growth is projected to reach approximately 9.7 billion by 2050, creating both economic opportunities and pressures on employment, resources, and public services. The second megatrend involves geopolitical and geoeconomic shifts, marked by increasing global uncertainty and conflict risks, as evidenced by the Russia–Ukraine war and rising tensions in strategic regions such as the South China Sea, the Korean Peninsula, and the Taiwan Strait, all of which have implications for global trade and economic stability.

The third megatrend is technological disruption, characterized by rapid advancements in digital technologies such as artificial intelligence, blockchain, the Internet of Things, and automation systems. These developments are transforming production processes, financial systems, and labor markets, while simultaneously demanding higher levels of adaptability and digital readiness. The COVID-19 pandemic further accelerated this technological transition across sectors. The fourth megatrend concerns accelerating urbanization, with projections indicating that nearly two-thirds of the global population will reside in urban areas by 2050, primarily in emerging economies. Without adequate planning, this trend risks exacerbating congestion, inequality, and pressure on public infrastructure and services.

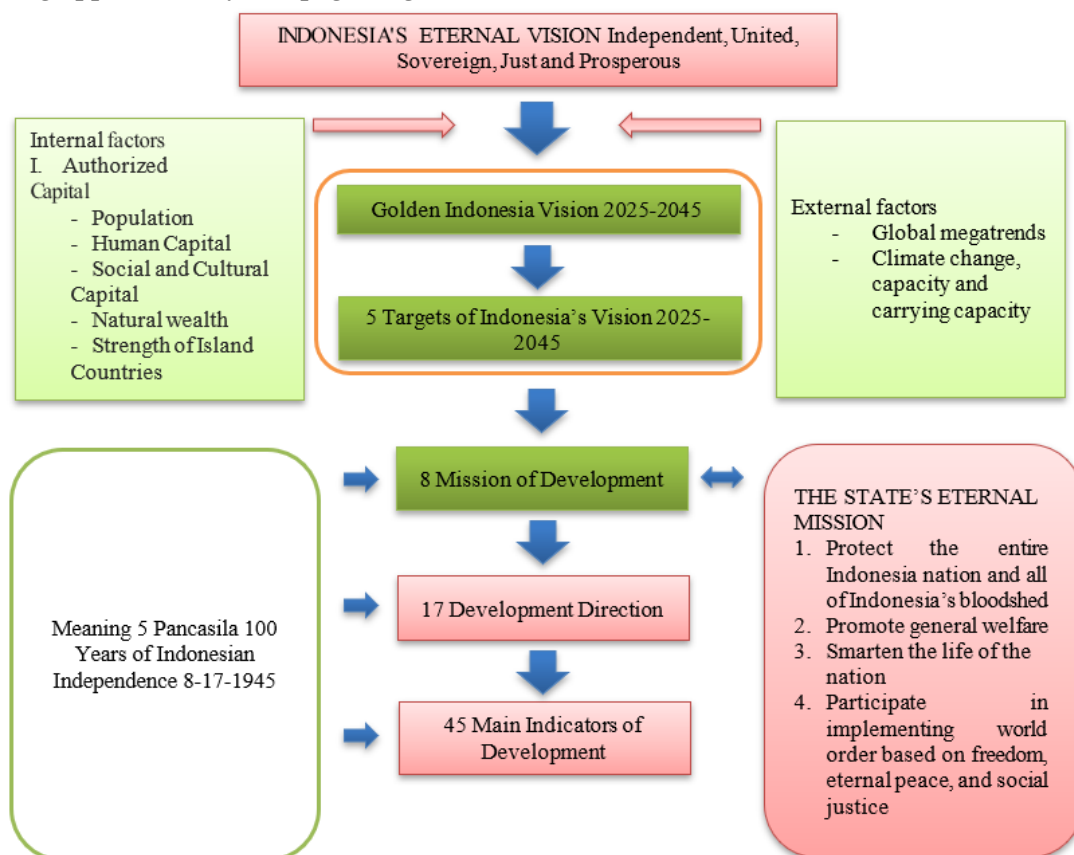
Additional megatrends include the increasing role of international trade and global production networks, as economic power shifts toward emerging economies, particularly in Asia and Africa, alongside deeper integration of global value chains. The sixth megatrend highlights changes in international finance, including innovations in fiscal and monetary systems such as the emergence of Central Bank Digital Currencies (CBDCs), which aim to enhance financial stability amid the growing risks associated with digital assets. Finally, the rapid expansion of the global middle class, projected to reach over 90 percent of the world's population by 2045, presents both opportunities for consumption-

¹ Kementerian Perencanaan Pembangunan Nasional Republik Indonesia/Badan Perencanaan Pembangunan Nasional, Rancangan Akhir Rencana Pembangunan Jangka Panjang Nasional 2025-2045, 2023.

driven growth and challenges related to social equity, employment creation, and political stability, particularly as the center of middle-class growth shifts toward Asia.

Collectively, these megatrends underscore the urgency for Indonesia to pursue an adaptive, inclusive, and forward-looking development strategy. Aligning national policies with these global dynamics is critical to ensuring that the vision of Golden Indonesia 2045 translates into sustainable economic growth, social resilience, and long-term competitiveness.

To understand the design of the 2025-2045 RPJPN prepared by Bapenas in a document totaling approximately 289 pages, figure 2 is a framework for the 2025-2045 RPJPN.



Source: Bapenas, Final Draft of RPJPN 2025-2045

Figure 1. RPJPN Framework of Thought Strategy 2025-2045 8/17/45 (17 August 1945) Based on Pancasila

An important issue identified in the RPJPN 2025–2045 is the limited explicit recognition of sharia economics within the overall framework of national economic transformation. This concern was formally raised by the Indonesian Muslim Scholars Association (ICMI) during a policy dialogue with Bapenas on August 14, 2023. In this forum, ICMI emphasized that sharia economics has not yet been explicitly positioned within the narrative of economic transformation under the eight national development agendas. Given the growing global market potential of the halal industry and Islamic finance, ICMI argued that sharia economics should be explicitly incorporated into the RPJPN as a strategic driver of Indonesia's long-term economic transformation, encompassing the halal industry in the real sector, the sharia financial industry, and Islamic social finance.

From a strategic development perspective, sharia economics is viewed not only as a stabilizing force during periods of global economic slowdown but also as a potential source of new and sustainable economic growth. In this context, ICMI proposed the integration of sharia economic instruments into the national development priorities, including their alignment with Indonesia's aspiration to become a global hub for halal products. Furthermore, ICMI highlighted the substantial potential of religious social funds as a key component of social transformation, particularly through the utilization

of zakat, infaq, sadaqah, and waqf (ZISWAF). Estimates indicate that the combined potential of zakat and cash waqf in Indonesia exceeds IDR 500 trillion annually, underscoring the importance of integrating Islamic social finance into poverty reduction and social welfare strategies. The persistent gap between the potential and realization of these funds reflects the need for stronger policy prioritization and institutional integration within national development planning.

In addition to policy and institutional challenges, the development of sharia banking in Indonesia continues to face constraints related to human resource capacity. The availability of professionals with strong competencies in both modern finance and Islamic jurisprudence remains limited (Ali et al., 2020). Many practitioners in sharia banking institutions, particularly at middle and senior management levels, possess formal training in conventional economics or banking but lack in-depth expertise in sharia principles. This skills mismatch constrains innovation and the effective implementation of sharia-compliant financial products. Consequently, sustained investment in human capital development—through specialized education programs, professional training, certification, and knowledge exchange—is essential to strengthening the long-term competitiveness and governance quality of Indonesia's sharia banking sector.

According to documents issued by the Ministry of Education and Culture, by 2021, there were 173 universities offering study programs in the field of Islamic Economics/Sharia Economics². Thus, if each study program produces an average of 20 undergraduate graduates each year, then in the next five years, there will be around 17,300 undergraduate graduates of Islamic Economics/Sharia Economics who are ready to become skilled workers in the sharia banking sector.

METHODS

The purpose of this study is to discuss the prospects and challenges based on theoretical and empirical views. The research methodology is descriptive analytical. In terms of prospects, the study discusses 3 macro aspects, availability of human resources, and financial performance in the era of turbulence. In terms of challenges, the study proposes 2 (two) important aspects for Islamic banking in Indonesia, namely the importance of digital innovation and governance, and low digital literacy and market share growth.

This study employs a descriptive-analytical research design to examine the development, performance, and challenges of sharia banking in Indonesia. The analysis is based on secondary macro-financial data, which are obtained from authoritative and official sources, including the Financial Services Authority (Otoritas Jasa Keuangan/OJK), Bank Indonesia (BI), Bappenas, and relevant national and international statistical reports. These data sources are selected to ensure reliability, consistency, and relevance to the Indonesian financial system.

The period of observation covers 2018–2023, encompassing the pre-pandemic period, the COVID-19 pandemic, and the post-pandemic recovery phase. This timeframe allows the study to capture structural changes, resilience, and adjustment dynamics of sharia banking amid economic shocks and accelerating digital transformation.

The analytical approach consists of two main techniques. First, descriptive trend analysis is used to examine the development of key macroeconomic indicators and sharia banking performance variables, including asset growth, market share, financing expansion, and financial soundness indicators. This technique enables the identification of long-term trends and short-term fluctuations in the industry. Second, a comparative regional analysis is applied to position Indonesia's sharia banking development relative to selected ASEAN countries, particularly Malaysia, Thailand, and Singapore, in terms of financial depth and market structure. This comparative perspective provides broader insights into Indonesia's relative performance and potential for financial deepening.

² Kementerian Pendidikan dan Kebudayaan, Statistik Pendidikan Tinggi 2021, Setjen Dikti, 2021.

By combining descriptive trend analysis and regional comparison, this study offers a comprehensive assessment of the evolution, prospects, and challenges of Indonesian sharia banking within both national and regional contexts.

It is important to note that this study does not aim to establish causal relationships, but rather to provide a descriptive and analytical assessment of structural trends and policy implications.

RESULTS

Sharia Banking Achievements and Prospects

Between 1992 and 2023, Indonesia’s macroeconomic conditions were highly dynamic, shaped by periods of growth as well as significant economic shocks. Two major crises marked this period with fundamentally different characteristics: the Asian Financial Crisis of 1997, which originated in the regional financial turmoil in Thailand, and the COVID-19 pandemic, which triggered a global health and economic crisis and ushered in the so-called “new normal.” To better capture recent economic dynamics and uncertainty relevant to future prospects, this study focuses on the 2018–2023 period, encompassing the pre-pandemic phase, the COVID-19 shock, and the subsequent recovery period.

During the post-pandemic recovery, Indonesia demonstrated notable economic resilience. In 2022, real Gross Domestic Product (GDP) grew by 5.3 percent, driven primarily by household consumption and gross fixed capital formation. Export performance also provided a strong contribution, as Indonesia recorded a trade surplus throughout 2022, largely supported by elevated global commodity prices, particularly coal as one of the country’s key export commodities. Despite these positive developments, inflationary pressures intensified, with annual inflation reaching 5.51 percent in 2022, mainly driven by adjustments in fuel prices and rising costs of essential goods, including food, beverages, and tobacco. While higher inflation led to some moderation in retail demand, overall consumer sentiment remained resilient, as reflected in the Consumer Confidence Index, which consistently stayed in the optimistic range (above 100). On the production side, economic activity remained relatively stable despite mild weakening toward the end of the year due to global economic slowdown, as indicated by the Manufacturing Purchasing Managers’ Index remaining in the expansionary zone (above 50) and supportive business activity survey results.

Within this macroeconomic context, Indonesia’s sharia financial services sector comprises three main subsectors: sharia banking, the sharia non-bank financial industry (including insurance and finance companies), and the sharia capital market (including government sukuk, corporate sukuk, and sharia mutual funds). As of December 2022, total sharia financial assets—excluding sharia equities—reached IDR 2,375.84 trillion (approximately USD 151.03 billion). Sharia banking assets accounted for IDR 802.26 trillion, representing year-on-year growth of 15.63 percent. This performance increased the market share of sharia banking to 7.09 percent in 2022, up from 6.74 percent in the previous year, and further to 7.31 percent by June 2023. Growth was observed across Islamic commercial banks, sharia business units, and sharia rural banks. This positive trend was also reflected in the expansion of financing and third-party funds, which grew by 20.44 percent and 12.93 percent year-on-year, respectively, indicating strengthening intermediation activity within the sharia banking sector.

Tabel 2. Development of Total Sharia Banking Assets (Trillion Rp)

Assets by Banking Type	Years				
	2018	2019	2020	2021	2022
Sharia Commercial Bank	316.69	350.36	387.03	441.79	531.86
Sharia Business Unit	160.63	174.20	196.88	234.96	250.24
SRB	12.36	13.74	14.96	17.06	20.16
Total	489.68	538.30	598.87	693.81	802.26

Source: OJK, 2023 data is processed

The growth of sharia banking mentioned above is technically operational, supported by developments in the distribution of banking infrastructure which are quite encouraging, with details as in table 3, below:

Table 3. Development of Sharia Banking Infrastructure in Indonesia

Bank's type	Number of Office
National Commercial Bank	13
Sharia Business Unit	20
SRB	171

Source: OJK, 2023 data is processed

Sharia financial assets in Indonesia demonstrated notable resilience and sustained growth during the COVID-19 pandemic period. In 2022, the total value of sharia financial assets increased by 15.87 percent year-on-year, rising from IDR 2,050.44 trillion to IDR 2,375.84 trillion. The sharia capital market accounted for the largest share of total sharia financial assets at 60.08 percent and recorded strong growth of 15.51 percent year-on-year, reflecting robust performance in sukuk and sharia-compliant investment instruments. Sharia banking, which represented 33.77 percent of total sharia financial assets, also experienced solid expansion, with asset growth of 15.63 percent year-on-year. Meanwhile, the sharia non-bank financial industry (IKNB)—comprising sharia insurance, financing companies, and other non-bank institutions—contributed approximately 6.15 percent of total sharia financial assets and posted the highest growth rate among subsectors at 20.88 percent year-on-year. The comparative composition of total financial assets and sharia financial assets in 2022 is presented in Figure 3.

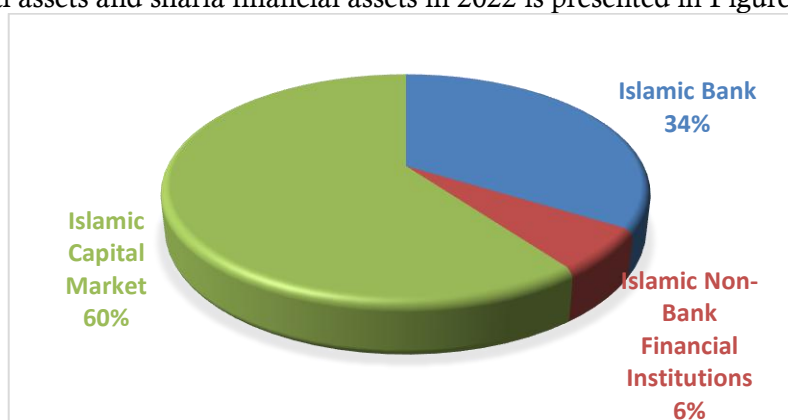


Figure 3. Share of Indonesian Financial Assets (2022, %)

Sources: Data is processed OJK 2023

Based on key financial performance indicators, Indonesia's sharia banking sector demonstrates a solid and resilient performance. The Capital Adequacy Ratio (CAR) of Islamic Commercial Banks (*Sharia Commercial Banks/BUS*) reached 28.09 percent, indicating a strong capital position. The quality of financing also improved, as reflected in the decline of Non-Performing Financing (NPF) for BUS and Sharia Business Units (*UUS*) to 2.31 percent, signaling effective risk management. In terms of profitability, the Return on Assets (ROA) of BUS–UUS stood at 1.90 percent, reflecting sustained earnings capacity. The intermediation function of sharia banking continued to strengthen, as evidenced by the Financing-to-Deposit Ratio (FDR) increasing to 81.10 percent, in line with Indonesia's ongoing economic recovery. This positive trend was further reinforced by a decline in the Operating Expenses to Operating Income (BOPO) ratio to 77.48 percent, indicating improved operational efficiency while maintaining prudential principles.

The global financial community has also recognized the development of sharia finance in Indonesia. The Islamic Finance Development Report 2022 ranked Indonesia seventh worldwide in terms of total sharia financial assets. This achievement is supported by strong domestic demand, as Indonesia has the world's largest Muslim population—approximately 237.56 million people, accounting for 86.7 percent of the national population. Moreover, Indonesia's sharia financial system is closely aligned with the real sector, particularly micro, small, and medium enterprises (MSMEs). With approximately

64.2 million MSMEs and estimated financing needs of around IDR 1,605 trillion, the real sector provides a substantial foundation for the expansion of sharia banking (Adityaswara et al., 2022).

Despite these encouraging developments, a comparative perspective reveals that the overall depth of Indonesia's financial sector—both conventional and sharia—remains relatively low when measured against Gross Domestic Product (GDP), particularly in comparison with other ASEAN countries. This structural limitation is presented in Table 4, highlighting the gap between financial sector growth and broader economic scale.

Table 4. Depth of Financial Subsector (Comparison with ASEAN-5 Countries (%))

Country	Bank Assets Per GDP	Capital Market Capitalization per GDP	Insurance Industry Assets per GDP
Indonesia	59,5	48,3	6,9
Malaysia	198,6	109,9	59,8
Philippines	99,2	93,2	3,5
Singapore	572,1	189,0	32,2
Thailand	146,6	120,9	6,9

Source: Presentation Material Arief Wibisono, 2023, Secretary of the Financial System Stability Committee³

Based on the comparative evidence presented in Table 4, four key observations can be drawn regarding the development of Indonesia's financial sector. First, the overall depth of Indonesia's financial system—measured by banking assets, capital market capitalization, insurance, and pension funds—remains relatively shallow compared to ASEAN-5 economies. Second, although the financial sector has recorded steady growth in recent years, its asset structure continues to be heavily dominated by the banking subsector. Third, the non-bank financial industry (IKNB), which plays a critical role in providing long-term financing, still accounts for a relatively small share of total financial assets and GDP. Fourth, these conditions collectively indicate that the fund-raising capacity of Indonesia's financial sector remains limited, despite the presence of substantial untapped potential for financial deepening.

Given that sustained economic development requires strong support from the financial sector, strengthening the intermediation function through comprehensive financial deepening becomes essential. A deeper financial system that is robust, innovative, inclusive, efficient, resilient, and trustworthy is expected to play a pivotal role in supporting long-term growth. In this context, financial deepening is anticipated to (a) expand access to financing for households and the corporate sector, (b) improve efficiency by reducing intermediation costs, and (c) enhance the overall resilience and stability of the financial system (Wibisono, cited in relevant policy discourse).

Overall, these indicators suggest that Indonesian sharia banking demonstrates strong financial resilience, yet remains structurally constrained in terms of market penetration and financial depth.

DISCUSSION

Sharia Banking Challenges

The COVID-19 pandemic during the 2020–2022 period posed significant challenges to the development of sharia banking in Indonesia. Nevertheless, the sector demonstrated resilience by adopting adaptive strategies that mitigated downside risks and facilitated a gradual return to normal business conditions. The observed growth in assets and improvements in financial performance indicators, however, do not eliminate future challenges. One of the most critical challenges facing sharia banking is the accelerating pace of digitalization and technological disruption. As in other industries, the sustainability and competitiveness of sharia banking increasingly depend on its capacity to respond to digital transformation, foster technological innovation, and strengthen governance frameworks. Ultimately, these capabilities are closely linked to the availability

³A. Wibisono, "Transformasi sektor keuangan pasca UU pengembangan dan penguatan sektor keuangan," presented at the Sosialisasi Workshop Resolution Plan dan Premi Program Restrukturisasi Perbankan, Jakarta, Nov. 8, 2023.

of professional and digitally competent human resources, which remain a key determinant of long-term relevance and competitiveness in the digital era (Indupurnahayu, 2023).

The rapid expansion of digital technologies has fundamentally reshaped business models and customer behavior, including in the sharia banking sector. To maintain relevance, Islamic banks are required to adopt innovative approaches and develop integrated digital ecosystems that enhance service efficiency, customer engagement, and cross-sector collaboration (Ali et al., 2021). Digital ecosystems and technological synergies—particularly between parent banks and subsidiaries—have the potential to improve operational efficiency by reducing costs and optimizing shared resources. Recognizing this potential, the Financial Services Authority (OJK), through the Indonesian Sharia Banking Development Roadmap (RP2SI), has explicitly encouraged the acceleration of sharia banking development through digitalization and institutional synergy across the industry (Rusyiana et al., 2019; Aisyah, 2024).

Despite encouraging progress in digital transformation, sharia banking in Indonesia continues to face structural demand-side challenges, particularly in terms of sharia financial literacy and inclusion. According to the National Survey on Financial Literacy and Inclusion (2022), the sharia financial literacy index stood at 9.14 percent, while the sharia financial inclusion index reached only 12.12 percent. These low levels indicate that the adoption of sharia financial services remains constrained by limited public understanding and awareness, despite the country's large Muslim population. This gap between potential demand and actual utilization poses a significant barrier to sustained market expansion.

Although the market share of Indonesian sharia banking has increased over the past decade, the pace of growth remains relatively slow. Between 2013 and June 2023, market share rose from 4.9 percent to 7.31 percent, representing an increase of only 2.41 percentage points over ten years. This growth has been partially driven by structural factors, such as the conversion of several regional development banks (BPDs) and the implementation of the Sharia Financial Institutions Qanun in Aceh, rather than organic market expansion. In contrast, international comparisons highlight Indonesia's relative underperformance. While Indonesia ranks among the top ten countries in terms of total sharia financial assets, it lags significantly behind Malaysia, where sharia banking assets reached approximately IDR 3,500 trillion by May 2023—around 4.5 times larger than Indonesia's—and market share increased from 28 percent in 2013 to 46 percent in 2023.

At the institutional level, the scale gap is even more pronounced. The largest Islamic bank in Saudi Arabia, Al Rajhi Bank, recorded assets of approximately IDR 2,900 trillion, while Maybank Islamic in Malaysia reached around IDR 940 trillion. By comparison, Indonesia's largest sharia bank, Bank Syariah Indonesia (BSI), held assets of approximately IDR 305 trillion in 2022. This disparity reflects the relatively underdeveloped state of Indonesia's sharia banking industry within the global Islamic finance landscape. One of the most critical strategic challenges, therefore, is to accelerate market share growth beyond the current threshold. Drawing on practitioner consensus and international best practices, sharia banking in Indonesia is expected to function as a genuine alternative within the national financial system—on par with conventional banking—only when its market share approaches 30 percent (Abdullah et al., 2024).

In addition, other challenges currently faced by Islamic banks include various aspects of service activities and product development. These challenges are not only limited to improving the quality of service to customers, but also include technical and operational aspects that must be strictly adjusted to sharia principles. This includes the implementation of a banking system that is in accordance with sharia provisions, supervision of the contracts used, and product innovation that maintains compliance with Islamic law, so that it is able to compete in the increasingly competitive financial industry (Andespa et al., 2024). Another challenge faced in the development of Islamic banking is the importance of increasing education and socialization regarding the products and services offered. This education must target various levels of society, especially more

inclusive groups so that they understand the benefits and mechanisms that differentiate Islamic banking from conventional banking. With increasing Islamic financial literacy, it is hoped that the public will be more confident and interested in switching to using Islamic-based banking services in accordance with Islamic principles (Pajaria, 2024).

Currently, the market share of Islamic banks is still far behind that of conventional banking. One of the main factors causing this gap is the lack of massive educational efforts, especially for inclusive community groups such as micro-entrepreneurs, low-income communities, and the five community groups that are the main targets of inclusive financial programs. This lack of understanding often makes them prefer conventional financial services that are already well-known and considered easier to access. Therefore, a more intensive and systematic strategy is needed to increase Islamic financial literacy in order to expand the reach of the Islamic banking market in Indonesia (Devi et al., 2023).

The development of Islamic banking in Indonesia has faced significant challenges, particularly in navigating the economic disruptions caused by the COVID-19 pandemic and the rapid advancements in financial technology. While the industry has demonstrated resilience through strategic adaptation, its long-term growth requires addressing key obstacles, including digitalization, financial literacy, and market share expansion. The formation of a digital ecosystem and enhanced technological innovation are critical to ensuring competitiveness and operational efficiency. Additionally, strengthening governance and developing professional human resources are essential for sustaining this growth. However, despite these efforts, Islamic banking in Indonesia still lags behind other major players globally, necessitating further policy support, public awareness campaigns, and inclusive financial initiatives. By addressing these structural challenges and enhancing market share beyond 10%, Indonesia's Islamic banking sector can position itself as a viable alternative within the national financial system and play a more significant role in global Islamic finance.

Despite the consistent growth of sharia banking assets and improving financial performance indicators, the market share of sharia banking in Indonesia has remained relatively stagnant at around 7 percent. This phenomenon indicates that asset expansion has not been accompanied by proportional market penetration. One key explanation lies in the structural dominance of conventional banking, which continues to benefit from broader branch networks, stronger brand recognition, and long-established customer relationships. In addition, a significant portion of asset growth in sharia banking has been driven by institutional consolidation and conversion policies—such as the merger forming Bank Syariah Indonesia (BSI) and the conversion of several regional development banks—rather than by organic expansion of retail and MSME-based customers. As a result, asset accumulation has increased faster than the number of new users, limiting the growth of market share.

Another critical factor contributing to the stagnation of market share is the persistently low level of sharia financial literacy and inclusion. Although Indonesia has the world's largest Muslim population, sharia financial literacy remains substantially lower than conventional financial literacy. This gap suggests that religious affinity alone is insufficient to drive adoption of Islamic banking services. Limited public understanding of sharia contracts, perceived complexity of products, and the assumption that Islamic banking services are less flexible or less competitive than conventional banking continue to discourage wider participation. Consequently, sharia banking faces a demand-side constraint, where potential users are not fully converted into active customers despite favorable demographic conditions.

When compared with Malaysia, the structural differences become more apparent. Malaysia's sharia banking sector has achieved a market share exceeding 40 percent, supported by a more integrated policy framework, stronger government commitment, and early adoption of Islamic finance as a core component of national financial development. Malaysia has successfully embedded Islamic banking within its broader financial ecosystem, supported by proactive regulatory incentives, standardized sharia governance, and systematic public education programs. Furthermore, Islamic banking products in

Malaysia are positioned not only as religiously compliant alternatives but also as competitive mainstream financial solutions, which has accelerated customer adoption and market deepening.

A comparison with Gulf Cooperation Council (GCC) countries further highlights Indonesia's relative underperformance. In countries such as Saudi Arabia and the United Arab Emirates, Islamic banking has reached a dominant or near-dominant position within the financial system. This success is largely attributed to strong alignment between regulatory frameworks, market demand, and institutional capacity. GCC countries benefit from high levels of capital concentration, standardized sharia governance, advanced digital banking infrastructure, and strong state support for Islamic finance as a strategic sector. Moreover, Islamic banking in these countries is closely integrated with capital markets and large-scale investment projects, enabling rapid scaling and deeper financial intermediation.

In contrast, Indonesia's sharia banking sector operates within a more fragmented financial ecosystem, characterized by lower financial depth and limited integration between banking, capital markets, and Islamic social finance instruments. While Indonesia possesses significant long-term potential, particularly through MSME financing and the halal industry, the realization of this potential requires structural reforms beyond asset growth. Strengthening financial literacy, accelerating digital transformation, enhancing governance quality, and aligning sharia banking more closely with national development priorities—such as financial deepening and inclusive growth—are essential to overcoming the current market share plateau.

Overall, these findings suggest that the challenge faced by Indonesian sharia banking is not merely a question of scale but of structural transformation. Without addressing demand-side constraints, governance effectiveness, and ecosystem integration, asset growth alone will not translate into meaningful expansion of market share or systemic impact. The experiences of Malaysia and GCC countries demonstrate that sustained market penetration requires coherent policies, strong institutional commitment, and strategic positioning of Islamic banking as a mainstream financial solution rather than a niche alternative.

CONCLUSION

As the primary banking regulator in Indonesia, the Financial Services Authority (OJK) plays a central role in shaping the development of sharia banking. From a macroeconomic perspective, the growth of sharia banking contributes to financial system stability and supports national economic resilience. This role is reinforced by the coordinated involvement of key stakeholders, including Bank Indonesia (BI) as the monetary authority, sharia advisory institutions such as the National Sharia Council (DSN) and the Sharia Supervisory Board (DPS), as well as banking management at the operational level. Effective synergy among these actors forms a comprehensive governance framework for sharia banking, which is essential for enhancing performance, maintaining prudential standards, and ensuring long-term sustainability. Within this framework, the availability of professional, competent, and innovative human resources becomes a critical prerequisite for enabling sharia banking to make a more substantive contribution to national economic development.

One of the distinctive features of sharia banking is its profit-and-loss sharing principle, which has the potential to attract a broader customer base and support asset growth when implemented transparently and competitively. To realize this potential, sharia banks must continuously improve service quality, strengthen product differentiation, and clearly communicate the value proposition of sharia-compliant financial services. Public trust and perceived benefits are crucial determinants of adoption; therefore, strengthening credibility and customer experience is fundamental if sharia banking is to compete on equal footing with conventional banks.

Based on the findings regarding growth dynamics and structural challenges, several strategic priorities emerge. First, strengthening human resources is essential, as limitations

in personnel with integrated competencies in both Islamic economics and modern finance continue to constrain operational effectiveness and innovation. Second, accelerating technological adoption and innovation is critical to improving service speed, security, and efficiency, particularly in response to digital-era demands and evolving real-sector needs. This effort requires sustained support from stakeholders, including policies that enhance the capital structure and investment capacity of sharia banks. Third, enhancing governance quality remains a key priority, as robust governance and strong sharia compliance are fundamental to building public trust and reinforcing the legitimacy of sharia banking as a financial intermediary. Finally, increasing sharia financial literacy and inclusion must be treated as a strategic priority, given their persistent role as demand-side constraints on market expansion.

Achieving meaningful progress in these areas requires strong collaboration among regulators, financial institutions, educational bodies, and the wider sharia economic ecosystem. Accelerating the penetration of sharia banking into the national financial system is necessary to support a gradual increase in market share, with the medium-term objective of exceeding 10 percent and the long-term aspiration of approaching 30 percent by the Golden Indonesia 2045 milestone. A stronger market presence would enable sharia banking to function as a credible alternative and strategic partner to conventional banking, thereby enhancing its contribution to inclusive growth, financial deepening, and socio-economic development in Indonesia.

Future research should focus on several critical areas to enhance the growth and competitiveness of Sharia banking. First, further studies on human resource development are needed to ensure that professionals in the Sharia banking sector possess both technical financial expertise and deep understanding of Islamic economic principles. Second, research on technological adoption and innovation in Sharia banking should explore how digital financial services can enhance operational efficiency and customer experience. Third, governance frameworks require further analysis to optimize regulatory policies that strengthen transparency, compliance, and risk management. Finally, future works should investigate the effectiveness of financial literacy and inclusion programs to assess their impact on increasing public participation in Sharia banking. Addressing these research gaps will support the long-term sustainability and expansion of Sharia banking, ultimately contributing to Indonesia's vision of achieving a significant Islamic finance market share by 2045.

Overall, the findings of this study indicate that Indonesian sharia banking has experienced consistent asset growth and improving financial performance over the past decade; however, this expansion has not translated into proportional market penetration, as reflected in the relatively stagnant market share of around 7 percent. This disparity highlights structural constraints within the industry, particularly the dominance of conventional banking and limited organic growth of retail and MSME-based customers. In addition, the persistently low level of sharia financial literacy and inclusion remains a key demand-side barrier, suggesting that demographic advantages alone are insufficient to drive broader adoption of Islamic banking services. Comparative analysis further reveals that Indonesia's sharia banking sector lags behind Malaysia and major GCC countries, where stronger policy alignment, institutional commitment, and ecosystem integration have enabled deeper financial intermediation and higher market shares. These findings underscore the strategic relevance of positioning sharia banking within Indonesia's long-term development framework, particularly the RPJPN 2025–2045, where financial deepening, digital transformation, and inclusive economic growth are critical to overcoming the country's prolonged middle-income trap.

Theoretical Implications

This study contributes to the literature on Islamic banking and financial development by reinforcing the view that the growth of sharia banking cannot be adequately explained solely through financial performance indicators or sharia compliance perspectives. By integrating the frameworks of institutional economics, inclusive finance, and Maqashid Shariah, this research demonstrates that Islamic banking development is a

multidimensional process shaped by regulatory quality, governance structures, and demand-side readiness. The findings suggest that asset growth without corresponding financial deepening reflects structural constraints rather than market inefficiency. Furthermore, positioning sharia banking within the context of Indonesia's prolonged middle-income trap provides a novel analytical lens for understanding the strategic role of Islamic finance in emerging economies.

Policy Implications (for OJK and Bank Indonesia)

From a policy perspective, the findings highlight the need for stronger coordination between regulatory authorities, particularly OJK and Bank Indonesia, to accelerate the structural transformation of sharia banking. Regulatory strategies should move beyond asset expansion targets toward policies that promote financial deepening, market penetration, and ecosystem integration. This includes strengthening sharia financial literacy programs, providing regulatory incentives for digital innovation, and enhancing the integration between sharia banking, capital markets, and Islamic social finance instruments. In addition, aligning sharia banking development more explicitly with national strategic agendas such as the RPJPN 2025–2045 would reinforce its role in supporting inclusive growth and long-term economic resilience.

Managerial Implications (for Sharia Banks)

At the managerial level, Islamic banks are encouraged to reposition their business strategies from asset-driven growth toward customer-based and value-driven expansion. Improving service quality, simplifying sharia products, and leveraging digital banking platforms are critical to expanding market reach, particularly among MSMEs and younger demographics. Management should also prioritize investment in human resource development to enhance both technical competencies and sharia governance capabilities. Strengthening internal governance and ensuring consistent sharia compliance will not only build public trust but also enable Islamic banks to compete more effectively with conventional banks in an increasingly digital and competitive financial environment.

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