Islamic Financial Characteristics and the Sustainability of Islamic Banking in Indonesia: Challenges and Opportunities

Sri Dewi Yusuf
Institut Agama Islam Negeri Sultan Amai, Gorontalo, Gorontalo 96181, Indonesia
E-Mail: sridewiyusuf@iaingorontalo.ac.id

Muhamad Ichksanul A. Mokoagow
Postgraduate, Department of Islamic Economics, Institut Agama Islam Negeri Sultan Amai, Gorontalo, Gorontalo 96181, Indonesia
E-Mail: ichksanmokoagow99@gmail.com

Muhammad Nur
Postgraduate, Department of Islamic Economics, Institut Agama Islam Negeri Sultan Amai, Gorontalo, Gorontalo 96181, Indonesia
E-Mail: muhammadnur099@gmail.com

Spandi S. Rauf
Postgraduate, Department of Islamic Economics, Institut Agama Islam Negeri Sultan Amai, Gorontalo, Gorontalo 96181, Indonesia
E-Mail: spandi.aktif@gmail.com

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ABSTRACT

This research aims to examine the implementation of Islamic finance in Islamic banking in Indonesia based on the characteristics of Islamic finance, namely Tauhid (Monotheism), Adl (Justice), Nubuwwah (Prophethood), Khilafah (Stewardship), and Ma'ad (Afterlife). This study also aims to serve as a means for the Indonesian public to obtain information related to the application of financial systems in Islamic banking. The researcher employs a qualitative research method, using secondary data sourced from literature, including journals, articles, documentation, written texts, and relevant materials related to the research topic. The results of this study indicate that Islamic banks indeed practice their activities in accordance with Sharia regulations. The five values or characteristics of Islamic finance serve as the main foundation in its implementation. Firstly, in the concept of Tauhid, leaders consistently maintain their devotion to Allah. Moreover, Islamic banks make all policy decisions based on the Qur'an and Sunnah (traditions of the Prophet). Secondly, in terms of Adl, this principle is evident in the implementation of Islamic banking contracts, which do not prioritize personal gain in their collaborations. Thirdly, the principle of Nubuwwah, which prohibits monopolies and encourages cooperation in community building, aligns with one of the practices of the Prophet Muhammad during his time. Fourthly, Khilafah, through the practice of Islamic banking involving zakat contributions from its activities, demonstrates that Islamic banks in Indonesia do not forget their obligation to contribute to a just economy. Lastly, Ma'ad; Islamic banks always consider the ultimate outcome of their activities, as everything they undertake will be rewarded or punished in accordance with their deeds.

***Keywords**: Characteristics, Islamic Finance, Islamic Banking, Sharia Compliance, Financial System*

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ABSTRAK

Penelitian ini bertujuan untuk mengkaji implementasi keuangan syariah pada perbankan syariah di Indonesia berdasarkan ciri-ciri keuangan syariah, yaitu Tauhid (tauhid), Adl (Keadilan), Nubuwwah (Kenabian), Khilafah (Penatalayanan), dan Ma'ad (Akhirat).). Penelitian ini juga bertujuan untuk menjadi sarana bagi masyarakat Indonesia untuk memperoleh informasi terkait penerapan sistem keuangan pada perbankan syariah. Peneliti menggunakan metode penelitian kualitatif, dengan menggunakan data sekunder yang bersumber dari literatur, antara lain jurnal, artikel, dokumentasi, teks tertulis, dan bahan-bahan relevan yang berkaitan dengan topik penelitian. Hasil penelitian ini menunjukkan bahwa bank syariah memang menjalankan aktivitasnya sesuai dengan ketentuan syariah. Kelima nilai atau ciri keuangan syariah tersebut menjadi landasan utama dalam penerapannya. Pertama, dalam konsep Tauhid, pemimpin secara konsisten menjaga ketaqwaannya kepada Allah. Apalagi bank syariah mengambil semua keputusan kebijakan berdasarkan Al-Qur'an dan Sunnah (tradisi Nabi). Kedua, dari segi Adl, prinsip ini terlihat pada penerapan akad perbankan syariah yang tidak mengutamakan keuntungan pribadi dalam kerjasamanya. Ketiga, prinsip Nubuwwah yang melarang monopoli dan mendorong kerja sama dalam pembangunan masyarakat, sejalan dengan salah satu praktik Nabi Muhammad pada masanya. Keempat, Khilafah melalui praktik perbankan syariah yang melibatkan sumbangan zakat dari kegiatannya menunjukkan bahwa bank syariah di Indonesia tidak melupakan kewajibannya untuk berkontribusi terhadap perekonomian yang berkeadilan. Terakhir, Ma'ad; Bank syariah selalu mempertimbangkan hasil akhir dari kegiatannya, karena segala sesuatu yang dilakukannya akan diberi imbalan atau hukuman sesuai dengan perbuatannya.

***Kata kunci**: Karakteristik, Keuangan Islam, Perbankan Islam, Kepatuhan Syariah, Sistem Keuangan*

INTRODUCTION

The development of Islamic finance has shown rapid and dramatic changes and dynamics (Abdullah et al., 2013). The growth of various *sharia* financial institutions has been remarkable both domestically and internationally. Many legal issues are associated with the management of these Sharia financial institutions. However, behind this development, the waves of modernity and global industrialization have infiltrated the core of human life (Rafikov & Akhmetova, 2020). On a theoretical aspect, there is a need for the development of principles, philosophies, and the functional aspects of the financial system based on profit-loss sharing. On the operational side, attention needs to be paid to innovation, intermediation, discipline, and risk management, while on the implementation side, the application of the system must be adapted to regulations and the current economic conditions of society (Campiglio, 2016).

The presence of Islamic banks in Indonesia has reached over 20 years. From both institutional and financial performance perspectives, there has been improvement, along with an increase in the number of customers (Subkhan et al., 2023). As the performance continues to evolve, the challenges of developing the Islamic banking industry have increased, including operational aspects and the demand for ideal, workable, and prudent Islamic banking services that can serve a larger portion of the population. One of the primary considerations for the public in choosing a bank is accessibility, credibility, professionalism of service, and the facilities provided by Islamic banks, which should be more competitive in meeting market needs (Wulandari & Subagio, 2015).

The development of finance in Islamic banking is supported by the presence of the National Sharia Council of the Indonesian Ulema Council (Majelis Ulama Indonesia or MUI). In 1998, the MUI established an institution specifically dedicated to issuing *fatwas* (legal opinions) related to the *fiqh muamalah* (Islamic economics). This institution is called the National Sharia Council of the Indonesian Ulema Council (DSN-MUI). Since its establishment in 1998 until 2019, the DSN-MUI has issued numerous fatwas related to *fiqh muamalah*. The method for determining DSN fatwas follows the guidelines established by the Indonesian Ulema Council's Fatwa Commission.

According to the Guidelines and Procedures for issuing *fatwas*, every issue discussed by the fatwa commission (including *fatwas* related to Islamic economics) must be based on the Quran, *Sunnah* (the practices and teachings of the Prophet Muhammad), *Ijma'* (consensus among Islamic scholars), and *Qiyas* (analogy). Before a *fatwa* is issued, the opinions of the imams of the Islamic schools of thought regarding the issue to be addressed, along with their supporting evidence, must be carefully reviewed (Riaz et al., 2019). Therefore, Islamic banking should be a solution that is applied to improve the economy of the community, especially in Indonesia, considering that the majority of the Indonesian population is Muslim. However, it is regrettable that there are still many Muslim individuals who are not customers of Islamic banks. This may be due to a lack of information, understanding, and education among the public about the Sharia financial system implemented in Islamic banking (Berakon et al., 2022).

Based on the explanation above, it can be said that currently, many parties' questions or doubt the application of *sharia* principles in Islamic banking. This has led to negative perceptions among the public, claiming that Islamic banks are no different from conventional banks. However, Islamic banks operate based on the principles of Islamic *muamalat*, which refer to the provisions of the Quran and *Hadith* (teachings of the Prophet Muhammad). Within Islamic banking, there are concepts of *muamalat* that govern relationships and transactions among individuals. The Islamic financial system, which continues to grow and develop worldwide, offers a new hope as a solution to issues that conventional financial systems have been unable to address. According to Rethel (2011), the characteristics of Islamic finance that underpin the principles of financial system development include: *Tauhid* (God's oneness) '*Adl* (justice), *Nubuwwah* (prophethood), *Khilafah* (Government), and *Ma'ad* (Results)

Thus, this research was conducted with the aim of finding out the application of Sharia finance in Sharia banking in Indonesia based on the characteristics of Sharia finance, namely Tauhid (Oneness of God), Adl (Justice), Nubuwwah (Prophecy), Khilafah (Government), Ma'ad (Results). It is also hoped that this research can become a means for the Indonesian people to obtain information related to the implementation of the financial system in Sharia banking.

METHOD

In this study, the researcher used a qualitative research method. Qualitative research comprises methods for exploring and understanding meanings attributed by individuals or groups of people to social or humanitarian issues (Creswell, 2010). The type of data used by the researcher consists of secondary data derived from various literature sources, including journals, articles, documentation, written materials, and relevant information related to the research.

To support this research, the researcher employed several data collection procedures. Firstly, documentation was utilized by gathering data from scientific journals, articles, and reports that were relevant to the research. Secondly, interviews were conducted with individuals or parties associated with the research objectives. Thirdly, an intuitive-subjective approach was used, involving the researcher's opinions regarding the research issue. Lastly, a literature review was conducted by collecting data from books related to the research.

RESULTS AND DISCUSSION

Basic Principles of Sharia Banking

Islamic financial institutions, in this case, *sharia* banks, are based on principles of partnership, justice, transparency, universality, and conduct banking activities in accordance with *sharia* principles (Choiriyah et al., 2021; Ismail et al., 2020). Islamic banks operate in alignment with Islamic economic principles, upholding distinct characteristics. These principles encompass the prohibition of usury, a rejection of the concept of time value of money, viewing money as a medium of exchange rather than a commodity, refraining from engaging in speculative activities, and adhering to the principle that prohibits the use of two prices for a single item or the execution of two transactions within a single contract (Masruki et al., 2020). Islamic banks operate based on the profit-and-loss-sharing concept and do not use interest as a means of generating income or impose interest on the use of funds and loans because interest is considered usury and is prohibited (Grassa, 2012).

The business activities of both conventional banks and Islamic banks, including fundraising, fund disbursement, and providing other services, are similar. Islamic banks also engage in these three activities. The management of funds in Islamic banks is carried out to control the position of funds received from funding activities and channel them into financing. The relationship between Islamic banks and their customers is based on a partnership (Hoque et al., 2018). Fund management is aimed at achieving maximum profit, ensuring sufficient cash and assets, creating reserves, and providing funding for the community.

In carrying out its business, Islamic banks must remain guided by Islamic values. This principle is guided by the Al-Quran and *Hadith*. According to Aribi et al. (2020), the principles applied to Islamic financial institutions include the following: 1) Prohibition of usury in all transactions, clear origin of depositor funds, and Sharia-compliant business distribution; 2) Carrying out business and trading activities based on fairness and halal profits; 3) Paying zakat from the results of their activities; 4) Prohibition of running a monopoly; and 5) Working together in building society through business and trade activities that are not prohibited in Islam.

Sharia Bank Operational Products

In line with the functions outlined earlier, Islamic banks engage in the collection of funds, channeling of these funds, and providing various services to the public. Islamic banks source their funds primarily from their own capital and equity. Additionally, they rely on transaction deposits, which are considered risk-free and do not yield any rewards. These deposits can take the form of savings, readily withdrawable at any time without expiration, or checking savings accounts that offer cash savings and allow full withdrawals upon the user's request. Examples of these accounts include *giro qardh*, *wadiah yad dhamanah*, and *mudharabah*. In contrast to transaction deposits, investment deposits involve a certain predetermined period and are typically associated with *murabaha* commodities, unbound *wakalah* investments, and general *mudharabah* investments. However, it's important to note that investment deposits carry the risk of capital loss on the investments made (Dhar & Bakshi, 2015).

One common type of deposit is *wadiah*, which ensures that customer deposits are safeguarded and can be withdrawn at any time according to the customer's preferences. Essentially, if a customer wishes to withdraw funds, the Islamic bank is obligated to facilitate the withdrawal. Legally, *wadiah* shares similarities with qardh, with the bank being responsible for returning the deposit. *Wadiah* is commonly applied in the form of giro, where the bank receives deposits. In this arrangement, all profits generated from the deposited funds become the property of the bank, while customers enjoy asset security and other giro-related benefits. There are also various types of savings accounts available to customers.

Another significant product is *mudharabah*, characterized by customers investing their funds with the bank for profit generation. In this scenario, the bank serves as an investment manager for its customers, who entrust the management of their funds for profitable and sharia-compliant business endeavors. The profits from these business activities are then divided between the customer and the bank, as agreed upon in advance. Key components of *mudharabah* include fund owners, the shared effort, the predetermined ratio, and the consent granted for such arrangements.

Understanding Islamic Fund Distribution and Financing Products

The primary purpose of distributing funds to customers is to facilitate their access to the goods and services they require, whether through purchasing and selling, renting services, or acquiring both goods and services simultaneously. Fund distribution products for customers can be broadly categorized into four distinct types, each serving a unique purpose, namely: Principles of Buying and Selling. The principle of buying and selling entails the transfer of ownership of goods or objects (property transfer). In this process, the bank's profit margin is predetermined and incorporated into the selling price of the goods. Buying and selling transactions must be based on individual preferences and mutual consent.

Murabaha, for instance, is a contract for the sale and purchase of goods, specifying the purchase price and the agreed-upon profit margin between the seller and the buyer (Atal et al., 2020). *Murabaha* transactions can be initiated upon customer orders, with the bank acquiring the goods following the customer's request. Payments for *murabaha* are typically made in installments. Sharia-compliant banks procure the goods needed by customers and subsequently sell them at an agreed-upon profit margin. The selling price (principal financing + margin) is paid in monthly installments, as per the agreed-upon duration between the customer and the Islamic bank. Since the selling price is predetermined, the customer's installments remain fixed throughout the financing period. This financing method is widely employed for working capital or investment in the form of goods.

Salam, on the other hand, is a contract for the sale and purchase of pre-ordered goods, with deferred delivery by the seller, and immediate payment by the buyer, subject to specific conditions (Gundogdu, 2010). In this type of transaction, the specifications of the purchased goods, including type, quality, quantity, price, and delivery date, must be explicitly defined. The bank is not required to maintain an inventory of goods since it enters into a salam contract with a third party (second buyer).

Istishna' involves a sale and purchase contract between a buyer and a producer who also serves as the seller. Payment is facilitated by the bank, which can take the form of upfront payment, installments, or deferred payment according to the agreed-upon terms. Under this contract, the buyer commissions the producer to supply specified goods based on the buyer's requirements and sell them at a predetermined price. This form of financing is commonly used for manufacturing and construction projects. In *istishna*' contracts, the specifications of the goods must be clear, and the agreed selling price is fixed throughout the contract's validity period. However, if there are changes to the order after contract signing, any additional costs will be borne by the customer.

Ijarah represents a rental agreement between the owner of the leased asset (*ma'jur*) and the lessee (*musta'jir*) to receive compensation for renting the asset (Usmani, 2001). Banks provide financing for services or the use of assets to customers through this arrangement. Typically, customers make monthly rental payments to Islamic banks, with the agreed-upon amount specified in advance. This arrangement is used, for example, in BSI's Education Funding (financing for college) and Umrah Funding programs.

Musyarakah is a cooperative agreement among capital providers who pool their resources to pursue profits. This concept is applied in partnership or joint venture models, with profits distributed based on a pre-agreed ratio and losses shared according to each party's equity share. In *musyarakah*, both partners and banks contribute capital to finance specific businesses, whether existing or new. Both parties must be aware of the costs involved in project implementation and the project's duration. The partner reimburses the capital, along with the agreed-upon profit sharing, in stages or in a lump sum to the bank. Financing can take the form of cash, cash equivalents, or non-cash assets, including intangible assets. *Musyarakah* operates on a profit-sharing basis, with the bank typically covering around 70 to 80% of the business/investment capital requirements.

Mudharabah represents a business cooperation agreement between the fund owner (*shahibul maal*) and the fund manager (*mudharib*), with profit sharing ratios predetermined through an advance agreement. *Mudharabah* is another profit-sharing-based contract, in which Islamic banks fully provide the business/investment capital. Profits earned are distributed according to the agreed-upon ratio between both parties. In the event of business losses, all losses are borne by the fund owner, which is usually the bank, unless negligence or mismanagement of funds, such as misappropriation, fraud, or misuse of funds, is detected. The bank retains the right to oversee the implementation of the work but may not interfere in the customer's business. However, if the customer fails to fulfill their obligations, they may be subject to administrative sanctions.

Sharia Banking and Islamic Values Implementation

Within the principle of *Tauhid* (Oneness of God), it is profoundly acknowledged that all human beings are held accountable for their actions before Allah. Leaders are entrusted with the responsibility of maintaining their profound knowledge of Allah. Islamic banking unwaveringly upholds this principle by ensuring that all policymaking and decisions are firmly grounded in the Al-Qur'an and Sunnah, thus aligning seamlessly with the inherent characteristics of Islamic finance.

Justice, as commanded by Allah, means refraining from oppression and being oppressed. In the realm of economic activity, it translates to humans not causing harm to others or nature for personal gain. This principle resonates with *sharia* banking contracts like *musyarakah* and *mudharabah*. In *musyarakah*, profits are shared based on agreed ratios, and losses are distributed according to the equity ratios of each party. In *mudharabah*, profits follow predetermined ratios, and in the event of a business loss, all losses are borne by the fund owner, typically the bank. This holds true unless negligence or misconduct, such as fraud or misuse of funds, is established. Such practices are in line with Islamic teachings emphasizing consensual commerce.

Emulating the Prophet Muhammad Peace Be Upon Him (PBUH), who pioneered Islamic finance, is essential for every Muslim. Sharia banking's core principles prohibit monopolies and promote collaboration in societal development through business and trade activities not prohibited in Islam, as exemplified by the practices of the Prophet Muhammad PBUH. Banking's primary functions—collecting, distributing, and transferring funds—are integral to the lives of Muslims. During the Prophet's era, financial institutions like *Baitul Maal* were established to address the welfare and interests of Muslims transparently.

Government plays a crucial role in the economy in Islam. Sharia banking, by consistently paying zakat from its activities, fulfills its commitment to contributing to a just economy in line with Islamic principles. In the Sharia economic system, zakat serves as a source of state income. The principle of rewards, both in this world and the hereafter, is linked to individual actions. In the context of *sharia* banking as an economic entity, adherence to Sharia principles and applicable regulations leads to profits in this world and rewards in the afterlife for obedience to Allah and the Messenger. Conversely, deviations from Sharia principles result in corresponding consequences in both this world and the hereafter.

CONCLUSION

Considering the various explanations concerning the system adopted by Islamic banking, it becomes evident that the five core values or characteristics of Islamic finance serve as its foundational pillars. Firstly, the concept of *Tauhid* underscores the unwavering devotion of leaders to Allah. Additionally, Islamic banking adheres to the Quran and *Sunnah* in all aspects of policymaking and decision-making. Secondly, the Adl principle is exemplified through the implementation of Islamic banking contracts that prioritize collaboration over personal gain. Thirdly, the *Nubuwwah* Principle is reflected in the rejection of monopolies by Islamic banking, and its commitment to community development aligns with the practices of Prophet Muhammad PBUH during his era. Fourthly, the Khilafah principle, manifested through the practice of giving zakat from its activities, demonstrates Islamic banking's commitment to contributing to a robust economy in Indonesia. Lastly, the Ma'ad principle ensures that Islamic banking consistently considers the ultimate outcomes of its activities, understanding that every action will be rewarded according to its merits.

Hence, Islamic banking diligently adheres to *sharia* regulations. The application of these core characteristics of Islamic finance within Islamic banking serves as evidence that it is not merely a label, as some in society suggest, with no practical difference from conventional banking. The essence of implementing Islamic banking systems lies in the pursuit of practices that align with the inherent characteristics of Islamic finance, creating a system perpetually oriented toward *Maqasid Sharia*. Consequently, the paramount objectives of enhancing the welfare of the community will always take precedence.

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