

A Systematic Review of Shariah-Compliant Hedging: Foundations, Instruments, Practices, and Challenges

Shariah Hedging
Concepts Practices
Challenges

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ABSTRACT

Islamic finance has grown significantly, creating a demand for risk management tools that comply with religious principles prohibiting interest, excessive uncertainty, and gambling. This study aims to review the concepts, instruments, practices, and challenges of Shariah-compliant hedging to understand its alignment with Islamic principles and market needs. A systematic literature review was conducted, analyzing 25 publications from 2015 to 2025, including a comprehensive literature review to identify theoretical foundations, instrument designs, and implementation gaps. The findings reveal that instruments like unilateral promise-based forwards, commodity trade-based swaps, forward sales, manufacturing contracts, and earnest money contracts enable risk management but face challenges such as high transaction costs and regulatory disparities. This review uniquely synthesizes theoretical and practical insights, highlighting tensions between Shariah authenticity and economic efficiency. Despite progress, issues like form-over-substance criticisms and lack of standardized regulations persist, limiting market accessibility. The study concludes that Shariah-compliant hedging is viable but requires innovation in instrument design and regulatory harmonization to balance ethical compliance with financial competitiveness, offering valuable insights for practitioners and policymakers seeking to advance Islamic risk management.

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Keywords: Islamic Derivatives, Islamic Finance, Murabahah, Risk Management, Shariah Hedging.

ABSTRAK

Keuangan Islam telah berkembang pesat, menciptakan permintaan akan perangkat manajemen risiko yang sesuai dengan prinsip-prinsip agama yang melarang bunga, ketidakpastian yang berlebihan, dan perjudian. Studi ini bertujuan untuk meninjau konsep, instrumen, praktik, dan tantangan lindung nilai yang sesuai dengan Syariah untuk memahami keselarasannya dengan prinsip-prinsip Islam dan kebutuhan pasar. Tinjauan pustaka sistematis dilakukan, menganalisis 25 publikasi dari tahun 2015 hingga 2025, termasuk tinjauan pustaka komprehensif untuk mengidentifikasi landasan teoretis, desain instrumen, dan kesenjangan implementasi. Temuan penelitian mengungkapkan bahwa instrumen seperti forward berbasis janji unilateral, swap berbasis perdagangan komoditas, penjualan forward, kontrak manufaktur, dan kontrak uang muka memungkinkan manajemen risiko tetapi menghadapi tantangan seperti biaya transaksi yang tinggi dan disparitas regulasi. Tinjauan ini secara unik mensintesis wawasan teoretis dan praktis, menyoroti ketegangan antara keaslian Syariah dan efisiensi ekonomi. Meskipun ada kemajuan, isu-isu seperti kritik bentuk-dibandingkan-substansi dan kurangnya regulasi standar tetap ada, membatasi aksesibilitas pasar. Studi ini menyimpulkan bahwa lindung nilai yang sesuai dengan Syariah memang layak dilakukan tetapi memerlukan inovasi dalam desain instrumen dan harmonisasi regulasi untuk menyeimbangkan kepatuhan etika dengan daya saing keuangan, menawarkan wawasan berharga bagi praktisi dan pembuat kebijakan yang ingin memajukan manajemen risiko Islam.

Kata kunci: Derivatif Islam, Keuangan Islam, Murabahah, Manajemen Risiko, Lindung Nilai Syariah.

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INTRODUCTION

Risk management is fundamental to modern financial practice, with hedging as the primary mechanism for mitigating adverse market exposure. Conventional finance relies on derivatives, futures, forwards, swaps, and options to enable efficient risk transfer between market participants. Integrating hedging within Islamic finance, however, presents unique challenges given Shariah principles prohibiting *riba* (interest), *ghavar* (excessive uncertainty), and *maisir* (gambling/speculation) (Gheeraert & Weill, 2015; Hasan et al., 2022). These prohibitions require Islamic financial institutions to develop alternative instruments that align with religious principles while meeting the sophisticated risk management needs of modern markets (Ahmad & Halim, 2014; Shinkafi & Ali, 2018). The global Islamic finance industry has grown significantly, with increasing demand for Shariah-compliant financial services from Muslim populations, multinational corporations, and sovereign entities operating in Muslim-majority countries (Hanif & Ayub, 2022). This growth highlights the need for innovative hedging tools that comply with Islamic law while ensuring financial stability (Mi'raj & Ulev, 2024).

The debate over derivatives permissibility in Islamic finance has intensified as global Muslim populations seek financial services aligning with religious convictions while meeting sophisticated risk management needs (Elnahass et al., 2021; Do et al., 2024). Conventional hedging focuses primarily on risk transfer through derivatives, while Islamic hedging emphasizes risk sharing under Shariah compliance (Hassan et al., 2019; Abdul-Rahim et al., 2023). This fundamental difference requires developing alternative instruments and structures that achieve hedging objectives without violating Islamic law (Hayat & Kraeussl, 2011; Hearn et al., 2012). Despite significant progress, there remains a critical gap in understanding how these instruments balance Shariah authenticity with practical effectiveness. According to Saleem et al. (2024), many Islamic hedging instruments achieve outcomes similar to conventional derivatives, raising concerns about their adherence to the spirit of Islamic principles. Similarly, Narayan and Phan (2019) note that while Islamic finance has developed innovative tools, the lack of comprehensive studies evaluating their authenticity and market impact limits their adoption. This research gap underscores the need for a systematic review that not only examines the instruments and practices but also critically assesses their alignment with Shariah objectives and their practical utility in modern markets.

This topic's significance extends beyond academic discourse as the global Islamic finance industry has grown substantially. Islamic financial institutions, multinationals operating in Muslim-majority countries, and sovereign entities increasingly need sophisticated risk management tools that comply with Shariah principles. Recent studies examining risk management effectiveness show the practical need for sophisticated hedging mechanisms in Islamic finance markets (Saleem et al., 2024; Oudat et al., 2024). Standardized documentation has facilitated Islamic hedging market growth globally, though challenges remain in achieving widespread adoption and market liquidity. For instance, the development of frameworks like the *Tahawwut* Master Agreement has streamlined transactions, but regulatory disparities across jurisdictions continue to hinder cross-border adoption (Mi'raj & Ulev, 2024). These challenges highlight the importance of understanding both the theoretical foundations and practical applications of Shariah hedging.

The study seeks to provide a critical evaluation of how Islamic hedging instruments achieve risk management objectives while adhering to Shariah principles, offering insights into their authenticity and effectiveness. This comprehensive review aims to synthesize existing knowledge on Shariah hedging, addressing the research gap by examining its theoretical foundations, instrument architecture, practical implementation, and ongoing challenges. By analyzing a wide range of literature, this review will contribute to a deeper understanding of Islamic risk management practices and their alignment with ethical and financial goals. The study provides valuable insights for academics, practitioners, regulators, and policymakers seeking to understand the current state and future trajectory of Islamic risk management practices.

LITERATURE REVIEW

Philosophical and Shariah Foundations

The philosophical underpinnings of Islamic finance shape the development of Shariah-compliant hedging, emphasizing risk-sharing over risk transfer. According to Hanif and Ayub (2022), Islamic finance is built on the principle of *al-ghurm bi al-ghurm* (profit with risk), which requires that financial transactions involve shared risk rather than speculative gain. This principle creates tension with hedging, as the goal of reducing risk may conflict with the requirement to bear risk for legitimate profit (Maghrebi et al., 2015). Studies highlight that Shariah prohibitions on *riba* (interest), *gharar* (excessive uncertainty), and *maisir* (gambling) necessitate alternative structures for hedging that avoid these elements (Sakti et al., 2016). For instance, scholars argue that Islamic hedging must prioritize real economic activity, ensuring transactions are linked to tangible assets or productive purposes (Izzeldin et al., 2021; Ledhem & Mekidiche, 2021; Haikal et al., 2024). However, the application of *maqāṣid al-sharī'ah* (Shariah objectives) to justify hedging remains debated, as some argue it selectively overrides specific prohibitions to meet market demands (Asutay & Yilmaz, 2025). This raises questions about whether current hedging practices align with the ethical and spiritual goals of Islamic finance or merely serve as technical compliance mechanisms.

The distinction between Islamic and conventional hedging has been a focal point in the literature. Kabir et al. (2015) note that while conventional hedging relies on risk transfer through derivatives, Islamic hedging emphasizes mutual risk-sharing, often through complex structures like commodity-based contracts. Yet, critics argue that these structures sometimes replicate conventional outcomes, undermining their authenticity (Tashfeen et al., 2022). The literature also points to the challenge of balancing Shariah compliance with market competitiveness, as Islamic institutions strive to offer risk management tools comparable to conventional derivatives (Minhat & Dzolkarnaini, 2017; Saiti et al., 2018; Narayan & Phan, 2019). These discussions reveal a gap in understanding how philosophical principles translate into practical hedging solutions that maintain both religious integrity and financial viability.

Islamic Hedging Instruments

The development of Shariah-compliant hedging instruments has been a key focus of Islamic finance research, driven by the need for risk management tools that adhere to Shariah principles (Maruly, 2023; Nikmah et al., 2024; Syahpria et al., 2024). According to Khan and Rashid (2020), instruments such as *wa'ad*-based foreign exchange forwards and *murabahah*-structured profit rate swaps have emerged as alternatives to conventional derivatives. These instruments use unilateral promises or commodity transactions to avoid *riba* and *gharar*, though their economic outcomes often mirror those of conventional tools (Smaoui & Khawaja, 2017). For example, *wa'ad* structures involve binding promises to exchange currencies at a future date, while *murabahah* swaps use sequential commodity trades to generate cash flows similar to interest-based swaps (Abdurohman, 2019). Studies also highlight the use of *salam* and *istisna'* contracts, which are rooted in real economic activities like agriculture and manufacturing, as more authentic hedging tools (Mawar, 2024). However, their application for financial hedging often distorts their original purpose, raising concerns about regulatory arbitrage (Paltrinieri et al., 2023).

The literature identifies significant challenges in developing these instruments. Mohamad et al. (2014) argue that while instruments like *'arbum* (earnest money) offer limited option-like functionality, their restricted scope limits their effectiveness for sophisticated risk management. Additionally, the complexity of these structures increases transaction costs, making Islamic hedging less competitive than conventional alternatives (Sakti et al., 2016). Recent studies suggest that innovation in instrument design is critical to addressing coverage gaps and improving efficiency, but achieving this without compromising Shariah authenticity remains a challenge (Tashfeen et al., 2022). The

literature thus reveals a need for further research into designing instruments that balance practical utility with adherence to Islamic principles, a gap this review seeks to address.

Challenges and Regulatory Issues

The implementation of Shariah-compliant hedging faces significant challenges, particularly related to regulatory disparities and authenticity concerns. According to Sakti et al. (2016), the form-over-substance criticism is a major issue, as many Islamic hedging instruments achieve outcomes nearly identical to conventional derivatives through complex legal structuring. For instance, *murabahah* swaps involve commodity trades that serve no productive purpose beyond technical compliance, raising questions about their alignment with Islamic ethical goals (Khan & Rashid, 2020). Regulatory fragmentation across jurisdictions further complicates implementation, as different Shariah interpretations lead to inconsistent standards (Asutay & Yilmaz, 2025). Malaysia has developed comprehensive frameworks for Islamic hedging, but these differ from the more conservative approaches in Gulf Cooperation Council (GCC) countries, creating obstacles for cross-border transactions (Haikal et al., 2024).

The literature also highlights practical challenges such as higher transaction costs and limited market liquidity. Smaoui and Khawaja (2017) note that the complexity of Islamic hedging instruments increases costs, making them less accessible to smaller institutions. Additionally, the lack of standardized global regulations hinders market development, as institutions face varying legal enforceability and documentation requirements (Paltrinieri et al., 2023). According to Mohamad et al. (2014), low awareness and limited expertise among corporate clients further limit adoption. These challenges underscore a critical gap in the literature: the need for empirical studies that evaluate the effectiveness of Islamic hedging practices and propose solutions to harmonize regulations while preserving Shariah authenticity. This review aims to address this gap by synthesizing existing knowledge and identifying pathways for future development.

RESEARCH METHODS

This study employs a systematic literature review to analyze the development, instruments, practices, and challenges of Shariah-compliant hedging in contemporary Islamic finance, aiming to provide a comprehensive understanding of how these mechanisms align with Islamic principles. The research synthesizes academic literature, regulatory documents, and industry practices to examine the evolution of Shariah-compliant hedging as a risk management instrument that adheres to Islamic principles. The review focuses on identifying key themes, including philosophical foundations, instrument design, regulatory frameworks, and implementation challenges, to offer insights for academics, practitioners, and policymakers. To ensure rigor, the study adopts a structured approach to literature selection and analysis, prioritizing high-quality sources and minimizing potential biases in the review process. This review follows the PRISMA framework (Moher et al., 2009) and applies Braun and Clarke's (2006) thematic analysis approach, supported by NVivo software for coding consistency.

Literature searches were conducted from January to March 2025 using academic databases such as Scopus, Web of Science, Islamic Finance Research Database, and various journal repositories. Search terms included "Shariah hedging," "Islamic hedging," "Islamic derivatives," "risk management Islam," "*wa'ad*," "*murabahah* swap," "*salam*," "*istisna*," "*arbutun*," and related terminology to capture relevant studies. To maintain quality, only articles from reputable journals, defined as those indexed in high-impact databases like Scopus or Web of Science with a clear peer-review process, were included. Inclusion criteria encompassed publications from 2015 to 2025, reflecting the contemporary Islamic finance era, peer-reviewed articles in English, and studies focusing on Shariah foundations, instruments, implementation, or hedging challenges. Exclusion criteria eliminated general Islamic banking articles without a hedging focus, conventional derivatives without an Islamic perspective, and publications lacking rigorous methodological approaches.

Initial searches yielded 156 documents, which were screened by title and abstract to identify 45 relevant articles. Full-text assessment resulted in 25 publications meeting the quality criteria, sourced from reputable journals. A three-stage coding process, following a thematic analysis framework, identified six main themes: (1) philosophical and Shariah foundations, (2) Shariah hedging instrument architecture, (3) documentation standardization and regulation, (4) cross-sector implementation practices, (5) challenges and criticisms, and (6) future development directions. This thematic framework ensures a cohesive analysis, connecting theoretical insights with practical applications to provide a clear narrative of Shariah hedging's evolution and challenges.

RESULTS

Emergent Tensions in Shariah Foundations

Our analysis reveals tensions in Islamic hedging's theoretical foundations. While Islamic finance builds on *al-ghurm bi al-ghunm*, that profit must come with proportional risk, which creates challenges in hedging practices (Maghrebi et al., 2015; Hanif & Ayub, 2022). If risk is inherent and necessary for legitimate profit, how can hedging, which explicitly aims to reduce or eliminate risk, be justified within Islamic frameworks? This theoretical tension remains largely unresolved in contemporary Islamic finance literature. Scholars argue that Islamic hedging must align with Shariah principles prohibiting *riba* (interest), *gharar* (excessive uncertainty), and *maisir* (gambling), requiring structures that emphasize risk-sharing over risk transfer (Haikal et al., 2024). However, the practical application of these principles often leads to complex workarounds that raise questions about their authenticity.

The claimed distinction between Islamic "risk sharing" versus conventional "risk transfer" appears more rhetorical than substantive upon examination. According to Paltrinieri et al. (2023), Islamic hedging instruments, despite complex structuring, often achieve economic outcomes virtually identical to conventional derivatives. This similarity suggests that the risk-sharing narrative may serve to legitimize otherwise prohibited instruments rather than represent genuine philosophical innovation (Narayan & Phan, 2019). Moreover, Islamic hedging's concentration among large financial institutions indicates that these instruments primarily serve capital market efficiency rather than the broader risk-sharing ideals promoted in Islamic economic theory. This raises practical implications for smaller institutions, which may struggle to adopt these complex structures due to limited resources, potentially widening the gap between large and small players in the Islamic finance sector (Smaoui & Khawaja, 2017).

The three core Shariah prohibitions create implementation challenges that question the authenticity of current solutions. *Riba* prohibition forces Islamic instruments to use complex commodity structures, such as *murabahah* chains, generating cash flows economically equivalent to interest payments. This raises concerns about whether technical compliance achieves the intended spiritual objective of avoiding usury (Sakti et al., 2016). *Gharar* limitations paradoxically increase transaction uncertainty and costs, as instruments must be restructured to meet technical requirements while maintaining commercial viability, potentially creating greater uncertainty than conventional alternatives (Kabir et al., 2015). *Maisir* restrictions require linking transactions to "real economic activity," yet most Islamic hedging involves commodity trades with no delivery intention, creating artificial economic activity serving no productive purpose beyond regulatory compliance. For practitioners, this means higher operational costs and complexity, which may deter adoption, particularly in markets with limited Shariah expertise (Shamshiyev & Azrak, 2024). These findings highlight the need for a deeper evaluation of how Shariah principles are applied in practice to ensure both ethical alignment and market competitiveness.

Islamic Hedging Instrument Analysis

Our examination of Islamic hedging instruments reveals significant gaps between theoretical principles and practical implementation. Islamic foreign exchange forwards exemplify the central contradiction in Islamic financial engineering. According to Khan and Rashid (2020), *wa'ad* (unilateral binding promise) mechanisms technically avoid conventional forward contract structures, yet the economic substance remains identical, predetermined currency exchange at future dates. The dual *wa'ad* structure represents sophisticated legal structuring rather than genuine innovation, as both parties effectively commit to transactions despite the promises' technically unilateral nature (Abduruohman, 2019). This raises questions about whether such instruments represent authentic compliance or rule-avoidance undermining Islamic law's spirit while satisfying its letter. Practitioners face challenges in justifying these instruments to Shariah boards, as the similarity to conventional forwards may lead to skepticism among conservative scholars, limiting their adoption in certain jurisdictions (Heravi & Sharofiddin, 2025).

Islamic profit rate swaps reveal contemporary Islamic hedging's most problematic aspect: transforming *riba*-based transactions through artificial commodity trading. Sequential *murabahah* transactions create structures where institutions trade commodities they never intend to use, generating profit margins that mirror prohibited interest rates (Smaoui & Khawaja, 2017). This practice results in increased transaction costs with no genuine economic benefit, effectively making Islamic finance more expensive while achieving outcomes similar to conventional alternatives. These higher costs can reduce the competitiveness of Islamic financial institutions, particularly for smaller banks or firms serving cost-sensitive clients, such as retail investors or small businesses (Beck et al., 2013; Bitar et al., 2018; Mawar, 2024). Commodity-based instruments, including *salam* and *istisna'* contracts, appear more authentic as they involve real economic activities like agricultural production and manufacturing. However, their practical application as hedging instruments often distorts their original purposes, turning them into tools for regulatory arbitrage rather than supporting real economic development (Paltrinieri et al., 2023).

The case of Indonesian pilgrimage fund management illustrates both the potential and problems of Islamic hedging (Ismal & Septiana, 2019). While technically successful in managing currency exposure, the implementation required complex workarounds that increased costs and administrative burden compared to conventional alternatives. This has practical implications for stakeholders, particularly low-income pilgrims who bear these additional costs, raising ethical questions about whether the benefits of Shariah compliance justify the economic inefficiencies (Shamshiyev & Azrak, 2024). *'Arbun* (earnest money) demonstrates the limitations of replicating conventional financial instruments within Islamic constraints. Its restricted functionality compared to conventional options, requiring actual asset availability and limiting speculation, renders it inadequate for sophisticated risk management needs, forcing institutions to accept suboptimal hedging or seek creative interpretations (Uluyol, 2024). These limitations highlight the need for innovative instrument designs that can meet modern risk management demands without compromising Shariah principles, a challenge that practitioners must address to expand market adoption (Al-Zaqeba & Basheti, 2024).

Regulatory Framework and Standardization Findings

Our analysis of regulatory approaches reveals systematic fragmentation in development efforts. Standardized documentation, such as the *Tahawwut* Master Agreement, provides legal, Shariah, and operational frameworks that enable efficient transaction documentation while ensuring compliance (Febrina & Abdulah, 2024). However, this standardization masks disagreements about the permissibility and structure of Islamic hedging instruments across jurisdictions. Malaysia leads with comprehensive frameworks covering Islamic foreign exchange forwards, profit rate swaps, and cross-currency swaps, but this reflects regulatory permissiveness rather than scholarly consensus

(Anggraeni et al., 2025). GCC countries generally support framework adoption through national Shariah authority endorsements while maintaining jurisdiction-specific requirements that often contradict Malaysian approaches, complicating cross-border transactions (Heravi & Sharofiddin, 2025).

Regulatory disparities create implementation obstacles for international transactions, as different Shariah interpretations, legal frameworks, and documentation requirements hinder cross-border hedging activities. According to Smaoui and Khawaja (2017), legal enforceability of Islamic contracts varies across common law and civil law jurisdictions, requiring careful structuring of close-out netting, collateral arrangements, and dispute resolution mechanisms. This fragmentation poses practical challenges for multinational corporations and financial institutions operating in multiple jurisdictions, as they must navigate conflicting regulations, increasing compliance costs, and delaying transactions (Paltrinieri et al., 2023). Indonesia has developed local frameworks for Islamic hedging within its dual banking system, creating another interpretation of acceptable Islamic practice (Anggraeni et al., 2025). European and non-Muslim majority jurisdictions focus on accommodating Islamic finance through existing regulatory frameworks, often resulting in adaptation where Islamic finance conforms to conventional requirements rather than maintaining authentic principles (Febrina & Abdulah, 2024).

The practical implications of regulatory fragmentation are significant for market development. Smaller institutions, lacking the resources to navigate complex regulatory landscapes, may be excluded from adopting Islamic hedging, creating a two-tier system where only large players can afford compliance (Shamshiyev & Azrak, 2024). Furthermore, the absence of universal Shariah standards limits market liquidity, as investors hesitate to engage in markets with inconsistent rules (Al-Zaqeba & Basheti, 2024). Regulators and industry leaders must work toward harmonizing standards to facilitate cross-border adoption and enhance market accessibility, particularly for smaller institutions serving local communities (Sakti et al., 2016). These findings underscore the need for coordinated efforts to develop globally accepted frameworks that balance Shariah compliance with practical feasibility.

Implementation Evidence and Market Reality

Our empirical analysis reveals contradictory findings that question conventional assumptions about Islamic finance practices. According to Abdul-Rahim et al. (2023), Islamic banks show higher hedging adoption than expected, despite Shariah constraints that should limit such activities. This contradiction raises questions about whether Islamic banks genuinely differ from conventional banks or simply employ complex structures to achieve identical outcomes. This has practical implications for regulators, who must scrutinize whether high adoption reflects authentic compliance or regulatory arbitrage, potentially undermining the credibility of Islamic finance (Narayan & Phan, 2019). The concentration of Islamic hedging among large institutions reveals significant inequality within the sector. Smaller Islamic banks often lack the resources to implement complex Shariah-compliant structures, forcing them to accept suboptimal risk management or abandon hedging entirely (Smaoui & Khawaja, 2017).

Corporate adoption patterns demonstrate the pragmatic rather than principled nature of Islamic hedging usage. Multinational corporations operating in Islamic markets often view Shariah-compliant hedging as a market access tool rather than a reflection of religious conviction (Mawar, 2024). This instrumental approach suggests that demand is driven by commercial necessity, which may limit the development of hedging tools tailored to smaller, faith-driven firms, affecting market inclusivity (Uluyol, 2024). Research on demand factors indicates that price, documentation, bank reputation, awareness, and ownership influence adoption decisions (Mohamad et al., 2014). However, low awareness among corporate clients suggests that challenges are more related to marketing and education than product viability. Practitioners must invest in awareness campaigns to expand adoption, particularly among smaller firms that could benefit from Shariah-compliant risk management (Shamshiyev & Azrak, 2024).

Government and sovereign usage of Islamic hedging instruments presents additional contradictions. The Indonesian hajj fund example, while technically successful, raises ethical questions about imposing higher costs on pilgrims, many of whom save for years to afford the pilgrimage (Ismal & Septiana, 2019). This regressive impact highlights the need for cost-effective hedging solutions that prioritize accessibility for low-income stakeholders, a key concern for policymakers aiming to uphold Islamic finance's social objectives (Al-Zaqeba & Basheti, 2024). Recent studies on dual banking systems show that the theoretical benefits of Islamic risk management may not translate into practical advantages, reflecting methodological issues in Islamic finance scholarship (Sakti et al., 2016). These findings suggest that practitioners and researchers must collaborate to develop empirical studies that validate the effectiveness of Islamic hedging, ensuring it delivers tangible benefits to diverse market participants (Heravi & Sharofiddin, 2025).

DISCUSSION

This review highlights the complex interplay between Shariah compliance and the practical demands of modern financial markets in the evolution of Islamic hedging. According to Khan and Rashid (2020), the core challenge lies in the *form-over-substance* critique, where instruments like *murabahah*-structured swaps achieve economic outcomes nearly identical to conventional derivatives through complex legal structuring. This raises a fundamental question about whether Islamic hedging truly adheres to the ethical and spiritual objectives of Islamic finance or merely serves as a costly workaround to satisfy technical compliance. The reliance on artificial commodity trades, such as those in *murabahah* swaps, increases transaction costs without delivering genuine economic value, making Islamic hedging less competitive (Smaoui & Khawaja, 2017). For practitioners, this poses a dilemma: balancing the need to meet market expectations with the imperative to uphold Shariah authenticity, particularly in jurisdictions with strict scholarly oversight (Tashfeen et al., 2022). These findings suggest that Islamic finance must address the gap between theoretical ideals and practical outcomes to maintain its credibility.

The regulatory fragmentation across jurisdictions further complicates the adoption of Shariah-compliant hedging. As noted by Anggraeni et al. (2025), Malaysia's permissive frameworks contrast with the more conservative approaches in GCC countries, creating inconsistencies that hinder cross-border transactions. This lack of harmonization not only increases compliance costs but also limits market liquidity, as investors hesitate to engage in markets with varying Shariah standards (Al-Zaqeba & Basheti, 2024). The Indonesian hajj fund case illustrates how complex hedging structures, while technically compliant, impose higher costs on stakeholders, raising ethical concerns about accessibility for low-income groups (Ismal & Septiana, 2019). These challenges highlight the need for regulators to develop unified standards that facilitate global adoption while preserving Islamic principles, a task that requires collaboration between scholars and policymakers (Heravi & Sharofiddin, 2025). The absence of such standards risks perpetuating a two-tier system where only large institutions can afford sophisticated hedging tools.

Technological innovation offers potential to address some of these challenges, but it also introduces new complexities. Ali et al. (2024) suggest that blockchain and smart contracts can enhance transparency and reduce operational costs in Islamic hedging by automating compliance checks. However, these technologies cannot resolve the conceptual contradictions, such as the *form-over-substance* issue, and may even highlight the artificial nature of some structures (Asutay & Yilmaz, 2025). Digital asset tokenization, for instance, could link hedging to real assets, addressing concerns about artificial transactions, but its development requires alignment with Shariah principles (Mawar, 2024). This underscores the importance of involving Islamic scholars in technological innovation to ensure compliance without sacrificing efficiency (Haikal et al., 2024). The literature also points to the need for more empirical research to evaluate the effectiveness of these innovations, as current studies often rely on theoretical assumptions rather than practical evidence (Uluyol, 2024).

The practical implications of these findings are significant for stakeholders in Islamic finance. For financial institutions, the high costs and complexity of Shariah-compliant hedging necessitate investment in education and awareness to increase adoption, particularly among smaller firms and retail clients (Mohamad et al., 2014). Regulators must prioritize harmonizing Shariah standards across jurisdictions to reduce compliance burdens and enhance market liquidity, enabling broader access to hedging tools (Ayub et al., 2024). Policymakers, especially in Muslim-majority countries, should focus on developing cost-effective solutions that align with Islamic finance's social objectives, such as supporting low-income stakeholders like pilgrims (Ismal & Septiana, 2019). Researchers play a crucial role by conducting empirical studies to assess the real-world impact of Islamic hedging, addressing methodological gaps, and providing evidence-based insights for market development (Heravi & Sharofiddin, 2025). The success of Shariah hedging depends on balancing religious authenticity with market competitiveness, ensuring that Islamic finance delivers both ethical integrity and practical value to its diverse stakeholders.

CONCLUSION

This comprehensive review confirms that Shariah-compliant hedging has evolved significantly, moving from theoretical discussions to practical applications in Islamic finance. Instruments like *wa'ad*-based foreign exchange forwards and *murabahah* swaps demonstrate the industry's ability to develop risk management tools that align with Shariah principles, while *salam*, *istisna'*, and *'arbutun* highlight efforts to link hedging to real economic activities. However, challenges such as *form-over-substance* criticisms, high transaction costs, and regulatory disparities across jurisdictions persist, questioning the authenticity and efficiency of these practices. This study contributes to the literature by synthesizing insights on the theoretical foundations, instrument designs, implementation practices, and ongoing challenges, offering a critical perspective on how Islamic hedging balances religious compliance with market needs. The findings underscore the importance of maintaining a balance between ethical integrity and the practical demands of modern financial markets to ensure Islamic finance remains competitive and true to its principles.

The findings have significant implications for practitioners, regulators, and policymakers, who must address high costs and regulatory fragmentation to make Shariah hedging more accessible, especially for smaller institutions and low-income stakeholders like pilgrims. However, this review is limited by its reliance on existing literature, which lacks sufficient empirical data on the real-world effectiveness of Islamic hedging instruments. Future research should focus on conducting empirical studies to evaluate the performance of tools like *wa'ad* and *murabahah* swaps in diverse markets. Additionally, exploring the role of technology, such as blockchain, in reducing costs and enhancing compliance could provide new pathways for innovation. These efforts will help strengthen Islamic hedging's role in global finance while upholding its ethical foundations.

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