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# The waqf: a global financial instrument

Mara Bisi<sup>1\*</sup>, Wisam Zreg<sup>2</sup>

<sup>1</sup> University of Turin, Department of Management “*Valter Cantino*”  
Corso Unione Sovietica 218bis, Italy  
Corresponding author: mara.bisi@unito.it

<sup>2</sup> University of Turin, Department of Law  
Lungo Dora Siena 100, Italy

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## Abstract

The article investigates waqf as a classical Islamic institution that has evolved from a charitable endowment into a versatile contemporary legal and financial tool. It first reconstructs the terminological, historical, and structural features of waqf, clarifying its links with inheritance law, its main types (charitable, family, and mixed), and the roles of actors such as the waqif and the mutawalli. The analysis then adopts a comparative-law perspective to explore the relationship between waqf and the common law trust. It examines both functional and structural analogies – notably asset segregation, perpetuity, and the pursuit of public benefit – and reports on scholarly debates about possible historical connections between the two devices, while refraining from any deterministic genealogy. These similarities help explain the contemporary mobility and partial interchangeability of waqf and trust, as demonstrated by the growing reliance on trust instruments in jurisdictions where waqf regulation applies, including dynamic commercial environments such as Dubai. The core of the contribution focuses on India as a legal “laboratory” where common law, Islamic law, and Hindu law intersect. The article traces the historical development of waqf in the subcontinent, from its medieval implantation and colonial reconfiguration to the present framework shaped by the Waqf Act 1995, the Income Tax Act 1961 and the recent Waqf (Amendment) Act 2025. Attention is paid to governance arrangements (Waqf Boards and related institutions), fiscal treatment, and ongoing constitutional challenges to the 2025 reform. By combining historical and functional comparisons, the article demonstrates how waqf operates today as a complex, contested, yet promising instrument of ethical and sustainable finance, capable of supporting social welfare and poverty reduction while raising delicate questions about religious autonomy, minority protection, and the balance between state control and community self-government.

**Keywords:** Waqf, Trust, India, Ethical and Sustainable Finance



## 1. Introduction

One of the most significant economic characteristics of the Islamic world before the colonial period was the welfare mechanism, which, at no cost to the authorities, was constituted by the waqf instrument. In addition to its welfare function, the waqf instrument aimed to reduce social differences (Çizakça, 1998).

If, on the one hand, some authors speak of the decline of the waqf, it should, however, be observed that the Islamic majority States continue to consider the waqf an important institution to be preserved, so much so that in some cases it is also included in constitutional provisions, as in Jordan and Iraq. These countries regulate the methods of control and management of the waqf, one of the thorniest issues of contemporary times.

In addition to its historical dimension, the waqf, given its similarity to the trust instrument, represents a versatile legal institution of ethical finance, a helpful tool to reduce poverty and social inequity.

The article will first analyse the historical, definitional, and structural dimensions of the waqf, and subsequently explore any connections with the trust instrument according to the views of different authors. Eventually, it will outline the characteristics of the institution in India, a multicultural, multi-confessional state, with an essential Muslim minority, whose statute has always been the subject of heated political, legal and sociological debates (just think of the highly divisive topic of codification)<sup>1</sup>.

The methodology employed in this study is that of comparative law. The choice of a comparative framework responds to the nature of the research subject itself: the waqf is an institution that cannot be fully understood within the boundaries of a single legal system. Its development has always been conditioned by interaction with different legal traditions—Islamic, Hindu, and common law—and its present-day applications extend far beyond the societies in which it first emerged. A comparative approach, therefore, allows us to situate the waqf within a broader constellation of legal institutions, highlight functional analogies and divergences, and examine the transformations it has undergone in response to shifting social, political, and economic contexts.

At the core of the analysis lies the method of taking institutions, describing their essential characteristics, and then examining them in relation to both their historical origins and contemporary functions. The inquiry begins with the waqf in its classical Islamic formulation, which is analysed not merely as a religious or charitable endowment but as a legal mechanism for the segregation of property with a long-lasting purpose. This definitional step is crucial: comparative law requires that institutions be clearly delineated before any attempt is made to draw parallels or contrasts with others. The waqf is then often juxtaposed with the trust, a typical product of the common law tradition, which has likewise been conceived as an instrument for asset segregation and management, benefiting designated beneficiaries. By focusing on these two institutions, the methodology enables us to place the waqf within the broader global discourse on endowments, foundations, and fiduciary mechanisms.

The comparative approach employed here is both historical and functional. Historical analysis is indispensable to understand how the waqf has evolved from its earliest formulations in the Arab-Islamic world to its present-day applications in diverse jurisdictions. For this reason, particular attention is devoted to the Indian subcontinent, where the waqf was transplanted during the Islamic conquest and later subjected to the profound influences of colonial administration and post-independence statutory reforms. The Indian experience represents a legal laboratory in which the waqf has been systematically compared to the trust, both in legislative provisions and in judicial interpretations. The Mussalman Waqf (Validating) Act of 1913, the Wakf Acts of 1954 and 1995, and the Income Tax Act of 1961 all illustrate how Indian law has progressively assimilated the waqf into the broader category of charitable and religious endowments, drawing explicit analogies with private and public trusts (we will

<sup>1</sup> Here follows a brief glossary of the main terms referring to the subject:

**Waqf al-Khayri:** charitable or public waqf, where the endowed property is dedicated to public welfare and charitable purposes, such as supporting schools, hospitals, or other community services. The proceeds from a **waqf al-khayri** are used to support the community or societal good, and the benefit extends to a wider group of people rather than a specific family or individual.

**Waqf al-Ahli:** family or private waqf, where the endowment is dedicated to the benefit of the founder's family members, descendants, or specific individuals. The revenues from a waqf al-ahli are generally used to benefit a specific group of people, usually the family or relatives of the person who established the waqf.

**Mutawalli:** the administrator or trustee of a waqf. This individual or entity is responsible for managing and overseeing the waqf property, ensuring that it is used in accordance with the founder's intentions, and that the proceeds are distributed appropriately.

**Arkan:** the essential components or pillars required for the establishment of a valid waqf. These generally include: the waqif (the founder, *infra*), the mawquf (the property or endowment), the muqtaf (the beneficiary), the mutawalli (the administrator, *supra*)

**Waqif:** the person who establishes the waqf by donating property, money, or assets for charitable or religious purposes.

**Mawquf Qurba:** waqf property that is dedicated specifically to seeking closeness to Allah (i.e., for religious purposes or acts of piety). The term "qurba" means "nearness" or "proximity," indicating that the donation or endowment is made with the intention of earning divine reward.



then analyze the impact of the new Waqf reform of 2025 on this topic). Examining this trajectory provides a concrete demonstration of how an institution of Islamic origin has been reshaped through interaction with a different legal culture. The functional dimension of comparison complements the historical inquiry. Here, the analysis considers the purposes served by the waqf across time and space: the promotion of religious life, the financing of education and health services, the preservation of family wealth, and, more recently, its potential role as a vehicle for ethical and sustainable finance. By assessing how these functions have shifted in response to social needs and legal constraints, the study evaluates both the resilience of the waqf and the challenges it faces in adapting to modern financial and regulatory environments. At the same time, the trust is examined by many authors as a common law analogue that has similarly been used to manage property, pursue charitable purposes, and provide flexibility in inheritance planning. The comparison is not intended to suggest a direct derivation, but rather to highlight the convergences that make the waqf intelligible in global terms.

This methodological orientation entails several steps. First, the conceptual framework of the waqf is reconstructed through doctrinal sources, including fiqh literature and later statutory enactments. Second, the historical phases of its evolution are identified, with emphasis on moments of legal transplantation and adaptation, such as the colonial codifications and the recent constitutional debates in India. Third, the waqf is examined in its contemporary regulatory environment, with a focus on its institutional governance, fiscal treatment, and contested constitutional status. Finally, the institution is placed alongside the trust, and their similarities and differences are articulated to draw out the comparative insights that each sheds on the other.

The methodology is also normative in the sense that it considers not only how the waqf has functioned in the past, but also how it might function in the future. The comparative analysis is therefore attentive to difficulties—such as inefficiencies in management, risks of state overreach, or lack of transparency—as well as to potentialities, particularly in the realm of ethical and sustainable finance. By treating the waqf as a dynamic institution rather than a static relic, the research seeks to capture how it can continue to serve as a meaningful tool for social welfare and community development within modern legal systems. The choice of comparative law as a methodology is justified by the very hybridity of the waqf's legal trajectory. The institution originated in Islamic law, developed through centuries of practice across the Muslim world, and in India was explicitly assimilated to the logic of the trust. This cross-cultural evolution makes it an ideal subject for comparative inquiry. Moreover, the trust itself, though often viewed as a peculiarity of the common law, has found resonance in civil law jurisdictions, and some scholars argue that encounters with Islamic law may have influenced it. By setting the waqf and the trust in dialogue, the study participates in a broader conversation about the circulation of legal ideas and how institutions migrate, adapt, and transform across jurisdictions.

In sum, the methodology of this research is comparative in both its historical and functional dimensions. It begins with a careful delineation of the waqf, tracing its origins and development, situating its evolution within the Indian subcontinent, and examining its convergence with the trust as a global fiduciary institution. It then evaluates the present challenges and opportunities of the waqf as a legal instrument of ethical finance. This approach enables a nuanced understanding of how a traditional Islamic institution has endured and adapted across centuries and diverse legal systems, and how it may continue to evolve.

## 2. Terminological roots and origin of the *waqf*

### *Introduction*

Before addressing the subject of the waqf institution's origin and its subsequent evolution in the Arab-Islamic world, we need to focus on some definitive issues. Several scholars identify the Arabic word from which the term waqf derives with the verb *waqafa*, which is often translated as “*to stop or to hold*” (Abbasi, 2012). Other scholars, however, selected both the terms *waqafa* and *habasa*, which would express the same concept but are not used in the same way, as precursors of the waqf (D'Emilia, 1938).

Scholars therefore questioned, based on the root of the word, what could be a valid definition of the institution of waqf: according to many of them, the meaning of the institution of waqf and, consequently, its definition have changed during the years, also due to the evolving needs underlying its creation with respect to the early days of the institute's formation. According to Kur'an, for example, the term waqf is associated with the block of asset expropriation and the block of changes in asset management in accordance with the founder's directions (Kuran, 2001).

### *Historical Background and Legal Sources*

Having briefly clarified the terminological issue, we should analyse the historical background of the institute. This aspect of Islamic law has not been regularly addressed for several reasons, the most significant of which is the scarcity of reliable sources on the matter during the early phase of Islam (Morgan 2001; Cahen 2020). One of the major problems concerning the sources of the waqf, or rather regarding the origin of the institution, is the absence of comments on the matter in the collections of



hadīth (the sayings, facts and unsaid of the prophet) or fiqh. Indeed, we find the waqf discipline in the secondary sources of Islamic law. Nevertheless, this analysis is crucial for understanding the needs that drove its creation and the functioning of the segregation mechanism.

We do not find a specific reference to the waqf institution in the Koran. However, it contains a general exhortation for Muslims to donate to charity. Without any particular provision, it can be assumed that, according to the Koran, a donation to charity is made through the transfer of absolute ownership title to the beneficiary, who is consequently given the power to dispose of the donated goods (Syed, 2006).

On the other hand, some events testify to the existence of an ancient form of asset segregation for charitable purposes. Kuran, in his initial considerations regarding the institute, defined the ancient waqf, maintaining that in 750 AD, it represented a charitable instrument to support or donate public goods (Kuran, 2001). According to Schacht's reconstruction, however, one of the original waqf's functions was to contribute to the assets of the wealthiest individuals to support the war effort and allow the expansion of the Islamic world.

In analysing the sources of the waqf discipline, we find various approaches and provisions. This aspect is also since secondary sources refer to and belong to very different socio-cultural contexts (Cahen, 2020).

The authors of the first collections on the subject attempted to seek in the practice of the prophet and his successors what the institution preceding the waqf was based on, and what it was created for. However, this form of research may not be reliable (Cahen, 2020).

Classical jurists considered the waqf as a perpetual and inalienable endowment. However, it appears that this concept already represents an evolution of the institution. In Malik's time, the most common form of habs was a right for life, similar to the discipline of usufruct: in this case, the property could revert to the settlor or his heirs in the event of the beneficiaries' death. However, it was Malik himself who questioned this form of institution by proposing instead that ownership of the assets could only return to the heirs of the settlor, who would not acquire ownership but rather a form of usufruct; according to Oberauer, this idea is the basis for the creation of the waqf figure (Oberauer, 2013).

According to Kuran, the waqf would have had predecessors in the Persian, Egyptian, Jewish, Byzantine, and Roman traditions; however, its structure sufficiently differed from the others, making it appear as a purely Islamic institution. Indeed, he claims that its distinct identity has become a source of 'cross-civilizational emulation'.

The first Islamic waqfs were likely created immediately after the birth of Islam; however, the term waqf already existed and served to indicate the conquered lands that were permanently set aside for the benefit of the Muslim community (Kuran, 2001). In any case, scholars agree in believing that waqf acts began to be recorded and known after the first two centuries of the Hegira and found widespread diffusion around the 12th century. In the last centuries of the Middle Ages in Europe, we find many documents establishing waqfs: this fact allowed scholars to access fundamental information on the instrument and on the economic and social context surrounding the waqf during that period.

The lack of documents in the previous period mainly derives from the fact that a waqf could also be established orally and from the fact that the fiqh works were composed in the middle of the 3rd century AD and considered reconstructions by scholars of previous centuries (Cahen, 2020).

#### *The first nature of the waqf*

Other interesting questions on the ancient waqf institution arise. One of them regards its public or private nature. The prophet himself would set up several foundations for his lieutenants and family, as well as for all those who were in the path of God; after his death, his family claimed his assets, but most of the Caliphs, including 'Omar ibn al-Khaṭṭāb, always considered them belonging to the Islamic community (Cahen, 2020).

Another question concerns the relationship between the assets of the foundation and the settlor's family. Often, relatives were included as beneficiaries of the endowment, together with the poor or the pious purpose of segregated assets, and had some rights on the surplus income produced by the waqf; in other cases, the family was instead directly indicated as the sole beneficiary and the charitable purpose was only remote and, in any case, subordinated to the family. Eventually, there was the case of a family not indicated as the beneficiary of the provision: in this instance, they had the right to support themselves with the foundation's income (Cahen, 2020).

Another issue concerns the type of property that can be transferred to waqfs. Kozlowski emphasises that in the early days, there was perhaps greater elasticity regarding the segregated assets, as they could also include money, not just land. The veto on the segregation of money was after the ancient institute. However, it is widely believed that, since the early Islamic centuries, the waqf has served as a means for the preservation of wealth (Kozlowski, 1985).

The waqf, precisely because of its characteristics, represented an essential legal instrument for the spread of Islam itself, through the construction of places of worship, schools, hospitals and caravanserais, also allowing the accumulation of assets, even by women, a peculiarity less present in the so-called Western world, in the same period.



From a historical point of view, precisely because fixed assets had been created, both the colonial forces and the Arab national States attempted to de-immobilize waqf assets, on the one hand to limit the accumulation of assets in the hands of opposing elites, coming above all from the religious world, and, on the other hand, to allow a greater circulation of real estate wealth: just think that during the Ottoman Empire about a third of all productive lands were donated to waqfs (Kuran, 2001).

### **3. Different types of *waqf***

#### *Introduction and basic notions*

From a structural point of view, the waqf presents specific essential elements (arkan), such as the existence of a settlor (waqif), of an object (mawquf) and the qurba (pious purpose), understood in an extremely broad sense, since it includes both the provisions for the fulfillment of a religious duty, typically the construction of a mosque, or activities of a charitable nature or of a public utility nature, as well as the presence of beneficiaries, i.e. the subjects who are entitled to the enjoyment of the income of the property (manfac). It should be noted that the settlor freely designates these beneficiaries, provided that they remain within the framework of the "*pious purpose*" (Castro, 2017).

#### *The specific types of waqf*

There are two traditional types of the institute, to which a third must be added (Castro, 2017).

The first is the waqf al-khayri (charity), whose function consists of allowing the achievement of a pious purpose (qurba) through the immobilisation of assets.

The second type is the al-ahli (family) waqf, an institution developed for private purposes linked to one's family. This form of waqf is significant as it is connected to the Islamic inheritance system, involving the perpetual transmission of property through the acquisition of usufruct rights by descendants on the income of the assets (Hoexter, 1998). The family waqf also represents a valid alternative to inter vivos donation, as it allows to avoid the application of the Islamic discipline inherent to inheritance for a portion of the assets. These are, however, only usufruct rights conferred for all future generations, hypothetically forever (Powers, 1999).

The founder of a charitable waqf retained no rights or financial interests; on the contrary, in the case of a family waqf, the mutawalli, who manages the waqf assets, could also be the founder and obtain a large sum of money from the property as compensation for his activities. Usually, the mutawalli's income was considered a surplus compared to the expenses incurred for the waqf (Kuran, 2001).

In Islamic law, there was a form of weakness in the protection of property rights, so that the waqf also represented a different way to protect assets. However, even in the case of family waqf, it was expected that some community service would also be provided with the income from the waqf, to respect the charitable function of the institute (Kuran, 2001).

The third type of waqf is the one created by Abu Yusuf, the disciple of the founder of the Hanafi school of Islamic law. According to this jurist, no examination of the property in waqf is required by the settlor. The latter could attribute the loss of the property to himself, considering himself the first beneficiary, with the consequence that the charitable character of the institution is blurred. This third type of waqf, therefore, allows the constituent to have the availability of manfac, but not that of the property.

Another form of distinction depends on the beneficiaries of the pious foundation. As a result, there would be three distinct structures: the pious foundations (such as those created for mosques), which are entirely public in nature and have this special regime also because they provide the less well-off with the opportunity to access their own spiritual sphere. Then there are charitable institutions established for the less well-off, which can be of both public and private nature. Finally, there is the waqf of a family nature considered a form of perpetual trust for the benefit of the family and of a solely private nature as long as the lineage remains alive; only where there are no longer descendants of the family, this type of waqf becomes public in nature and is made available to the community, generally for people experiencing poverty (Morgan, 2001).

There are two additional legal forms in the category of public waqf: one involves donating a specific asset to the waqf, and the other consists of donating a particular amount of money to the waqf. At the same time, the second is a donation of income or assets for the benefit of a previously existing waqf. In the late Middle Ages, there was an expansion of waqfs of the second type, marked by the establishment of large foundations (Cahen, 2020).

The waqf also served various social purposes, including bringing water to the population and defending the country. Waqfs, therefore, can be broadly categorised into those for the benefit of all, those for private purposes (such as tax purposes), and others that are mixed or intended for specific groups of people.

Lastly, a further possible division of the types of waqf is based on the objective, or lack thereof, of promoting Islam. It should be noted that in the 18th century in Turkey, religious or charitable waqfs represented approximately 60% of existing waqfs; in fact, it was believed that the waqf served as a financing of Islam as a society (Kuran, 2001).



#### 4. Purpose of the *waqf*

##### *The strict connection between the waqf and inheritance law*

It is now interesting to analyse the purpose of the waqf: both at the origin of its creation and as a means for its evolution. Many scholars attribute the reason behind the birth of the waqf to the inapplicability of the Koranic inheritance law for assets conferred in waqf (Syed, 2002).

Within the Koran, some rules pertain to the division of hereditary assets. These rules are particularly stringent and limit the testator's freedom to dispose of his own assets. In summary, there are two classes of heirs: those who have the right to a share of the inheritance and the agnates that are hierarchically ordered. Initially, they were conceived as harsh rules intended to preserve family well-being and prevent conflicts within the family (Powers, 1999).

In the case of estate succession, Islamic inheritance follows two phases: first, the sharers satisfy their rights to the inheritance, and then the closest agnate will obtain the residue. In any case, the subject close to death has no possibility of deciding according to these rules how to distribute his assets in the event of death (Powers, 1999).

In the first two centuries of the Hegira, there existed divisible inheritance, thus implying the subsequent fragmentation of capital. Consequently, one way or another, many attempted to circumvent these rules, also because there was no limit to inter vivos provisions (Powers, 1999). Having considered that, *'as part of the larger Islamic inheritance system, endowment law accorded Muslim proprietors a legal means to circumvent the effects of the Islamic inheritance rules by allocating usufruct rights to specific people in specified amounts and to regulate the transmission of those rights from one generation of beneficiaries to the next. Over time, the institution appears to have contributed to the physical integrity of both urban and rural property. Whether or not it also contributed to the economic viability of the local economy is a subject that deserves further investigation'* (Powers, 1999: 24).

Keep in mind that one of the hereditary possibilities at the time of the division of Islamic law was considered the partition by usufruct, through which all the heirs could enjoy the assets or profits of the hereditary estate in rotation. However, if one of the heirs insisted on requesting the ordinary division, he would have prevailed over any request for partition by usufruct (Standish Grove Grady, 1984).

##### *Other purposes*

However, waqfs also had other functions. Indeed, many of them were also created for the purpose of giving shelter to travellers, giving alms, granting loans and offering safekeeping of valuables (Hoexter, 1998).

Furthermore, a large percentage of waqfs under the Ottoman Empire were created due to the lack of suitable and effective means for the protection of property rights. The State was the owner of most of the land and often confiscated it; consequently, individuals perceived the need to preserve their family assets.

For other scholars, the waqf had the function of supporting the family. Sometimes, the scope of the operation was twofold: on the one hand, the waqfs were established to defend the family's heritage, and on the other, to exclude daughters from succession, as a form of defence of the patriarchal family (Cahen, 2020).

Usually, the settlors of waqfs received economic benefits themselves. Indeed, they were often the first beneficiaries and were rewarded with economic security of the assets, for example, the exemption from confiscation by the State, with the condition that they also used their funds for public purposes. Subsequently, there were increasing protections for waqf settlors, such as tax reductions. The first form of waqf was therefore probably a form of compromise between the wealthy, who could have some benefits, and at the same time also put their wealth at the service of the State (Kuran, 2001).

It should be underlined that the tradition of providing an exemption from State expropriation of the lands conferred in waqf, where a public purpose was conceived, has also created a negative vision of the sovereign who proceeded with the confiscation despite this. The waqf, in fact, conferred in a certain sense a good reputation and therefore provided status and authority (Kuran, 2001).

Among the various purposes for the creation of a waqf, there was also the idea of piety, in the sense of pietas, although it was not the first intent to move subjects to segregate their assets (Kuran, 2001).

A further reason for the creation of the waqf could have consisted in becoming the bearer of an ideology and helping it to grow, providing funds, especially for the political purposes of the settlor; for example, waqfs were often created for schools, but the founder expected the teachers who taught there to be faithful to them (Kuran, 2001).

The waqf also served to obscure assets, given the limited means in the world of Islam to protect assets against opportunistic taxation and expropriation (Kuran, 2001).

Similarly, the institute has been used for money laundering: for example, it could also be used to legitimise confiscations that did not comply with the canons of legality (Kuran, 2001).

The waqf, therefore, represents a versatile tool, which adapts to multiple legal needs, including contemporary ones, as new forms of revisiting the waqf in the financial sector have been developed, such as waqf crowdfunding, as a means of raising



funds to pursue goals of social integration and economic development (Miglietti, 2022) or the operation of the waqf in the context of the blockchain (Rashid, 2018) or attention to the environment (green waqf).

## 5. Legal structure

### *The difficulties of the legal discipline of waqf*

The waqf in Islamic law can be regulated under three disciplines: successions, donations or charitable provisions. The choice between these three areas is linked to the Islamic school that deals with it (Abbasi, 2012).

Notwithstanding the applicable discipline, generally three requirements are considered basic for the waqf: irrevocability, perpetuity and inalienability. However, even in this field, not all schools share the same thoughts, especially regarding the essentiality of the requirement itself (Gaudiosi, 1988). For example, there is also a doctrinal opinion that considers the temporary nature of the waqf admissible (Abbasi, 2012).

In any case, it appears that its charitable nature should be deemed essential as well, as the waqf dedicated only to wealthy people is null and void.

Another issue addressed by scholars concerned the type of assets that could be contributed to the waqf.

The most interesting discussion centred on the possibility of establishing waqfs with sums of money. The cash waqf in Islamic doctrine has been recognised as a legitimate form of charitable endowment since the 8th century. However, a problem remained: the ban on levying interests. To overcome this problem, jurists of the time argued that waqf funds should be distributed based on mudaraba, a partnership between the mutawalli and the person who would borrow them (Syed, 2002; Jaiyeoba et al., 2015). Initially, in the Hanafi and Hanbalita schools, the waqf of consumable goods, including money, could not be considered valid as it could not last forever; however, in some parts of the Ottoman Empire, the practice of cash waqf was accepted, and perpetuity was achieved through the investment of money. This practice eventually became generally accepted (Abbasi, 2014). It can therefore be observed that, in any case, nowadays it is possible to establish a cash waqf. Many countries that make use of the Islamic waqf as a tool for sustainable finance allow cash waqfs; for instance, Malaysia (Fairuz Ramli, Shaari, Syamsul Bakhri, 2022; Ab Shatar W.N., Hanaysha J.R., Tahir P.R., 2021; Ali, Markom, 2020) and Singapore (Mahadi, 2015).

Regarding the legal structure of the waqf, it is noted that the term waqf refers to the foundation, the term waqif corresponds to the settlor, while the mutawalli is the person in charge of asset management.

Indeed, to administer the waqf, there must be a mutawalli, and the rules created by the settlor must specify how to appoint future managers. The mutawalli will always have to manage the assets in accordance with the provisions of the Waqf Act (Abbasi, 2014).

According to the Hanafi school, the settlor coincides with the figure of the mutawalli and upon his death, the successor will be appointed based on the testamentary provisions. In the absence of these provisions, a waqf of a public nature for indeterminate subjects could be managed by the State. In contrast, in the case of waqfs of a private nature, the related right is attributed in proportion to the beneficiaries' shares (Abbasi, 2012).

The role of mutawalli could also be attributed to a woman, but only with reference to the managerial component, separated from any religious duties. Such duties can only be performed by a man.

In any case, during the Umayyad caliphate, for example, the administration of the waqf was typically assigned to the qadi (Syed, 2006).

The qadi had the power to supervise the administration of waqf by the mutawalli. Between the years 661 and 750 AD, during the Umayyad dynasty, a specific governmental body was also responsible for regulating public waqfs (Abbasi, 2012).

In any case, the settlor's powers do not cease upon the establishment of the waqf. If the qadi is required to choose the mutawalli, preference will be given to the names indicated by the settlor's relatives or heirs.

However, it must be kept in mind that waqf management could prove to be challenging, since the mutawalli could also be incapable. This situation is well known and often leads to misuse and poor administration of the foundation (Pa. Diwan and Pe. Diwan, 1992).

Furthermore, as the supervision work carried out by the qadis could not be considered sufficient, this problem increased, especially in cases of waqfs of a religious nature where there were no beneficiaries interested in their management. Because of this, there were several attempts to move the management to a governmental level: a first example was the Ottoman Land Code of 1858, which created a Ministry of Awqaf, structured at an administrative level in all the provinces, but only covered the so-called untrue waqf (waqf ghayr sahih) made by the sultan or with his permission. In any case, even public control was not considered significant enough, and sometimes management was then entrusted to companies that enjoyed wide freedom (Syed, 2006).

From a formal point of view, to validly create a waqf, there must also be an unambiguous declaration to this purpose, even in oral form, made by the settlor. It should also be noted that so-called illusory - or simulated-waqfs may exist, which are such



only in appearance, but there has been no segregation of assets. In this case, if the deed of transfer of the assets is completely missing, then the illusory waqf will be considered ineffective. On the contrary, if this act exists, those who have an interest in asserting the simulation will have to provide proof (Pa. Diwan and Pe. Diwan, 1992; Singh, 1998).

Furthermore, it is noted that the different schools of thought do not agree on the nature of the possession of assets in waqf as a prerequisite for the validity of the waqf itself (Pa. Diwan and Pe. Diwan, 1992).

#### *The ownership of waqf property*

Another issue concerns the ownership of the assets transferred into the waqf. In the times of Abū Ḥanīfa, it was believed that the settlor of the waqf retained ownership of the assets in any case, and the waqf did not have a perpetual character. Abu Yusuf's vision, however, is the same that will later be espoused by the Hanafi school, which considers three essential elements of the waqf in reference to property: the property of the founder expires at the moment of the creation of the waqf, the ownership of the assets belong perpetually and irrevocably to God and the fruits of ownership are used for the good of humanity (Pa. Diwan and Pe. Diwan, 1992).

There is a hypothesis that the assets in the waqf can revert to the ownership of the settlor: this would occur when these assets are destroyed or become unusable for the purpose indicated in the waqf. On this point, Abū Yusūf instead maintained that in any case the goods conferred must be intended for the community and, specifically, for people with low incomes (Abbasi, 2012).

These dilemmas regarding property ownership created additional management difficulties. Some authors then argued that ownership belonged to the beneficiaries; others, however, contended that the settlor did not retain ownership of the property rights on tied assets (Abbasi, 2012).

Furthermore, some scholars even believe that in some waqfs it is mixed, and this would lead to the possibility of State intervention on the matter. In theory, given that even the family waqf is for charitable purposes since the usufruct, once the possible beneficiaries have been exhausted, belongs to the less well-off, state intervention in the matter would always be justified. Initially, this control task was entrusted to the qadi. The same conclusions are also reached in the schools of thought that support God's ownership of the goods conferred in waqf (Abbasi, 2012). In this perspective, the qadi was entrusted with a supervisory function in managing waqf assets, as in the case where the waqf deed had not specified rules for appointing the *mutawalli*'s successor (Gaudiosi, 1988).

## 6. Relations with the trust

### *Introduction*

From a comparative point of view, it is necessary to observe how many people, of different legal traditions, have attempted to create instruments to achieve perpetual maintenance of property, to avoid its hereditary division. However, neither the English, having introduced the rule against perpetuities, nor the Romans left room for this specific possibility. The waqf has therefore remained, in a certain sense, a unique institution (Pa. Diwan and Pe. Diwan, 1992).

Nonetheless, there are structural similarities between the trust and the waqf, to the extent that some scholars have analysed the relations between the two institutions, suggesting that the trust may have descended from the Islamic tool. It is also essential to notice that the purposes of the two instruments are quite similar and respond to basic needs of the society; this concept is particularly revealed while analyzing the history of the trust as it appears from a common law point of view (Virgo, 2018, Keeton & Sheridan 1971, Holdsworth, 1923, Riddal, 2002, Clements & Abass, 2018). Specifically, the idea was to permit persons who did not have the opportunity to own certain goods (such as the friars of St. Francis) to achieve social purposes or to avoid the application of specific laws (inheritance or fiscal imposition).

The similarities, though, also concern the structure of the two institutes. It appears that the *waqif* renounces the property, which is to be held in perpetuity by the *mutawalli*, with a right of *usufruct* granted to the beneficiary. This type of structure clearly resembles that of the English uses and the trust, namely for what concerns the separation of legal and equitable ownership (Gaudiosi, 1988; Heffening, 1960).

We do not engage in that theoretical debate, though it could be interesting for the present purpose to report some opinions.

According to Cattan, for example, the trust and the uses derive from the waqf: in fact, both institutions are aimed at binding certain assets, for a specific time or indefinitely, with simultaneous renunciation of the title of ownership, usufruct of the assets in favor of the beneficiaries who may not even be alive at the time of the establishment of the trust or waqf (Catton in Syed, 2002).

There would then be a further analogy between the two institutions: perpetual bonds and blocked large capitals, sometimes going against growth and development. Consequently, these contributions, even those in waqf, were identified as 'dead hand', not dissimilar to the in mort main donations made in England, often in favour of the Church (Morgan, 2001).

In English law, the uses were introduced in the 13th century by the Franciscan friars for pious or charitable purposes (according to many scholars, although not all agree): the waqf would therefore, in any case, precede the creation of the uses. It has been



argued that there were many possible moments of contact between the English and the Arabs which may have led to the knowledge of the waqf by the English as an inspiration for the creation of the uses (*ex multis*, Van Thomas Wynen, 1949, Hang Wu, 2018, Gvelesiani, 2020, Abdullah, 2016, Rosen, 2000, Kuran, 2001). For example, one hypothesis connects the two institutes to the pilgrimages to the Holy Land of the 11th and 12th centuries, the Crusades, as well as the journey of Saint Francis to Egypt in 1219 (Catton in Syed, 2002).

#### *The Merton College case*

To delve further into the topic, the author who has dealt most with this matter is Monica Gaudiosi, who argued plainly that the trust originated from the waqf.

According to the author, in particular, there is a trace of this thesis in the constitution of Merton College, Oxford, dating back to 1264, whose constitution, the *Regula Mertonensis*, represents the basis of the modern system of British colleges. Specifically, Merton College was initially established as a charitable trust, defined as unincorporated, i.e., without legal personality, which, for this very reason, was very similar to a waqf (Gaudiosi, 1988).

The moment in which the trust was born, in the author's words, is also the exact moment in which there was greater contact between the world of Islam and the United Kingdom. For example, the Franciscan friars were very present in Western Asia, and Saint Francis himself was in Islamic territories between 1219 and 1220, without even mentioning the Crusades (Gaudiosi, 1988).

Religious orders, such as the Knights and Templars, proliferated during that period, with bases in Jerusalem (e.g., the Knights Templar) and London (the Order of the Templars). The forms of these orders seem, for example, to have been an inspiration for the development of the Inns of Court in England in the 14th century. It was, in fact, supported by scholars of the subject that the Inns of Court were created like the Islamic Colleges of Law, which included a building with a mosque and a separate inn (Gaudiosi, 1988).

The founder of Merton College was Walter de Merton, who held the office of Lord Chancellor of England on several occasions. He also had connections with the New Temple, which served as the English headquarters of the Knights Templar of Jerusalem. This very Temple later became one of the Inns of Court in England. Furthermore, Water De Merton had relations with Sicily, which was a significant vector of Islamic culture in Europe, having also been subjected to its domination (Gaudiosi, 1988).

The Statutes of Merton College of 1264 did not provide for a structure with legal personality, and the College acquired it only in 1274. The author therefore maintains that in the Statutes of 1264, the figure which was not conferred legal personality would have essentially consisted of a waqf. Indeed, it respected all the conditions as well as the formalities. This was also because the Statutes provided support in perpetuity for the students of the College, essentially serving as a contribution to charity, which also involved real estate. Many scholars of the time, the author reports, wondered exactly where Water De Merton had drawn inspiration from; according to Gaudiosi, it was precisely from the discipline of waqf in Islamic law (Gaudiosi, 1988).

However, some differences remain between the two disciplines: on the one hand, the waqf of a private nature, once its main purpose has been fulfilled, continues to exist with a charitable purpose, whereas this does not happen for the trust of a private nature. On the other hand, another incisive difference concerns the ownership of assets conferred in trust or waqf (Gaudiosi, 1988).

Furthermore, another difference is the existence of the rule against perpetuities in England, which aims to prevent the immobilisation of wealth. Again, the ownership of the property in the trust is in the hands of the trustee, while in the case of a waqf, the ownership is not with the mutawalli (Catton in Syed, 2002).

Finally, the contribution to the waqf would remain inalienable forever, and the beneficiaries would retain rights only towards the income, or fruits, of the assets, which are therefore given in usufruct to them; all this does not happen in the trust, as the property can be sold (Morgan, 2001). This, perhaps, is the most significant difference: the waqf is a static perpetuity (Abbas, 2012, p. 26).

In any case, many authors maintain that nowadays, even in Arab countries where the waqf discipline is in force, a greater use of the trust instrument is actually emerging, especially in the United Arab Emirates (Morgan, 2001).

## 7. The waqf in India

### *The origins of the waqf in India*

When it comes to the so-called Islamic world, India is not often considered because there is a tendency to overlap it with Arab majority countries. On the contrary, India is the third State in the world by number of Muslims, after Pakistan and Indonesia. India, from this perspective, represents a legal laboratory, also due to its essential legal pluralism and historical-cultural stratification. In this context, the history and application of the waqf must be considered in light of the intersection between common law, Hindu law, and Islamic law.



The instrument of waqf was introduced in India during the Islamic conquest. In the year 930, Muhammad Bin Qasim had temporarily occupied Sind in northwestern India (now Pakistan). Still, there is no evidence that waqfs were established at the time, although scholars tend to lean towards a possible use of the instrument for the construction of mosques (Syed, 2006). The first recorded waqf in India appears to date back to the late 12th century, when it was created by Muhammad ibn Sam, one of the Ghurid sultans, who segregated the income of a single village to support a mosque in the city of Multan (Kozlowski, 1985).

During their reign, Islamic rulers had established waqfs not only for the creation and maintenance of places of worship, but also for the support of educational institutions. However, in 1828, the British abolished the system and took possession of all the lands and revenues of the waqfs, which were used to sponsor English and Christian education in schools (Syed, 2006).

#### *The waqf under British colonialism*

When the English subsequently arrived on Indian territory, the first objective of the colonisers was to clarify the ownership and provenance of all the lands in the country, starting with Bengal. One of the first implemented operations aimed at establishing a tax on land ownership, even if this attempt did not have much success. Subsequently, the English sought to establish a permanent settlement, appointing a person responsible for collecting land taxes. To this end, the title of owners of the lands that formed his estate was entrusted to the zamindars (literally *'he who holds the land'*) (Kozlowski, 1985).

The Privy Council had initially also denied the validity of the waqf. It was only in 1913, with the enactment of the Mussalman Waqf (Validating) Act, that the possibility of establishing a waqf with the contribution of any property was officially guaranteed (Syed, 2002).

The British controlled the waqfs until 1863, when the Secretary of State in England decided to issue the Religious Endowments Act. This act repealed the previous provisions on waqf management and established local committees to oversee the management of waqf properties. The waqf management problem was further exacerbated after the abolition of the qadi system in 1864 (Syed, 2006).

Later, in 1923, the Mussalman Waqf Act was enacted. It required the mutawalli to provide the courts with all information regarding the management of the waqf, including the accounting records. The Courts could then analyse these documents, but with little power to intervene, as they could only issue a fine if the accounting records were not kept (Syed, 2006).

There were then isolated experiments in Bengal (1934), Delhi (1943) and Uttar Pradesh (1936) aimed at entrusting control over management to institutionalized subjects and, similarly, in Bombay in 1935 a new amendment act was issued of the Mussalman waqf Act of 1923 (called Mussalman Waqf – Bombay Amendment – Act of 1935) through which special District Waqf Committees were established (Syed, 2006).

#### *The waqf in contemporary India*

The management of waqfs in India has always been highly complex, although this instrument is used and forms part of a broader collection of charitable endowments that can be established in the subcontinent. A contemporary wave of thought is keen on regrouping these different instruments under the general category of public trusts (Shah, 1964). Within this category fall many other tools, such as the waqf, an institute that aims to achieve a public and charitable purpose.

Although this was surely within the institute's definition, it is equally clear that its functions are varied and can serve multiple purposes. Nonetheless, it is essential to remember that there is an ultimate charitable purpose that renders the instrument more suitable as a tool for sustainable finance.

Even so, the difficulties encountered in managing the institute in contemporary India were essentially the same for all public trusts, namely, controlling asset management when there are no identifiable beneficiaries.

For the purposes of controlling waqfs in India, several governmental waqf institutions were introduced with the Waqf Act of 1995 for the supervision of waqf management. They are: the Waqf Boards located in each state and each Union Territory, a Chief Executive Officer, appointed by the State Government after consulting the State Waqf Board, State Government, the Central Government, the Central Waqf Council and the Waqf Section of the Government of India, which have a political direction function with regards to waqfs (Syed, 2006).

Furthermore, regarding the regulation of waqfs, the Indian Government enacted the Income Tax Act of 1961, which established that public and charitable waqfs are exempt from income tax, basing this provision on a comparison with the trust instrument (Syed, 2006).

We also need to highlight that the Indian waqf management system is decentralised and characterised by poor transparency, with mechanisms of corruption and a lack of community participation within the institutions responsible for controlling waqfs (Owais, Abdul Manaf, 2023).

Furthermore, the Indian Islamic finance system remains underdeveloped, limiting the full potential of waqf in combating poverty and inequality. It is, however, essential to remember that India proposed a model based on cash waqfs for poverty reduction, which is a significant concern for many Muslim communities in the subcontinent (Owais, Qutaiba, 2023).



The most recent reform, the Waqf (Amendment) Act, 2025, introduces structural innovations that have immediately been challenged before the Supreme Court through numerous constitutional petitions. Among the most debated provisions is the abolition of the so-called waqf by user, which can no longer be created without a written deed, together with the new requirement that the founder of a waqf must have been a Muslim for at least five years, a condition perceived as discriminatory. The Act also excludes properties belonging to scheduled tribes from being transferred into waqf, while at the same time reforming the composition of Waqf Boards to permit the appointment of non-Muslim members, raising the question of the possible consequence that the Boards may even have a non-Muslim majority. Furthermore, the application of the Limitation Act of 1963 and of the doctrine of adverse possession to waqf properties undermines the traditional principle of “once a waqf, always a waqf.” Taken together, these measures are widely viewed within the Muslim community as a serious interference with religious autonomy and as reforms that weaken the distinctive Islamic character of the waqf. The pending judicial review will therefore be decisive in determining whether the reform can withstand constitutional scrutiny, considering the principles of equality, non-discrimination, freedom of religion, and property protection, as well as more broadly in clarifying the balance between minority rights and state powers within India’s pluralistic constitutional order.

## **8. Last thoughts. Conclusions**

In the pre-modern period, the Islamic welfare system was substantially based on the waqf mechanism, whereby specific key sectors were supported by this institution, including education, health, water supply, food assistance for the poor, the maintenance of mosques, the salaries of imams, and the support of orphans. There are many problems associated with the waqf, including the institution's restrictive regulations and equally problematic management. Nevertheless, it remains a vital and flexible tool, and potentially a harbinger of solutions to some of the major challenges of modernity.

In an era attentive to the value dimension of the economy and finance, it should be remembered that in the juridical construction of the waqf, its ethical substratum clearly emerges, since, as we have seen, the provisions in favour of charity, as well as public utility purposes, are included. The waqf, despite its ancient lineage and some characteristics that make it rigid, at least compared to the trust, is experiencing a period of revitalisation, with original experiments such as waqf crowdfunding or cash waqf.

Precisely because it is an instrument of ethical finance, the waqf lends itself to carrying out support functions for impoverished sections of the population, especially when public decision-makers opt for courageous policies, as in the case of India.

Despite the debate within Islamic law, it has been observed that for some legal schools, the cash waqf is admissible, which would effectively allow the lending of money, thereby overcoming the impediment of interest rates, which are prohibited under Islamic law.

India represents a peculiar case because, despite having a substantial Islamic minority, the third-largest in the world in absolute terms, it still has a poorly developed Islamic finance system, making it quite complex to activate ethical banking and finance mechanisms, such as cash waqf (Rashid, 2018). The first Indian Islamic bank was established in Kerala in 2011, giving rise to a legal case that ultimately came before the High Court of Kerala. According to the appellants-opponents, this form of bank would have represented a violation of the principles of secularism and non-equidistance of the Indian State with respect to religions.

It is essential to note that India is not the only country to have adopted this specialised legal tool. Many other countries have developed a form of sustainable finance through the Islamic waqf, as seen in Malaysia and Singapore (e.g., Khaliq, Hussin, Mohammad, 2019; Ibrahim, 2018; Papa, Santostasi, 2019), while also facing similar difficulties in managing waqf property.

The case of Singapore, a country with a non-Muslim majority, is particularly interesting in the context of the waqf sector, being cited as a success story and best example in many forums (Saad et al., 2013: 744). In this country, waqf assets are managed by the Majlis Ugama Islam Singapore (MUIS), a public body established to oversee the overall religious life of Muslims and play a significant role in establishing and managing regulations governing Muslim life in Singapore (bin Abbas, 2012). One of the key features of this management lies in the principle of financial optimisation (Rusydiana & Ali, 2024).

From a regulatory perspective, MUIS, established by the Administration of Muslim Law Act (AMLA) of 1966, serves as the central authority responsible for supervising waqf assets. It has the power to regulate, appoint, supervise, and remove waqf trustees to ensure efficiency and prevent mismanagement (Rusydiana & Ali, 2024).

A modern aspect of waqf management in Singapore is the transformation of unproductive waqf properties into high-value commercial assets, often through MUIS-controlled entities, such as Warees (Waqf Real Estate), which was founded in 2001. Warees has played a crucial role in revitalising waqf assets through real estate investments, property development, and strategic financing, such as the redevelopment of waqf properties on Bencoolen Street, one of Singapore's main roads. Specifically, this project resulted in the construction of a 12-story multipurpose building, which incorporates a mosque, residential apartments, office spaces, and commercial units (Nagaoka, 2016).



Furthermore, Singapore has adopted the practice of Istibdal Waqf (substitution of waqf assets) as a strategy to optimise waqf management. This process involves replacing underutilised or deteriorating waqf properties with new assets that generate higher returns (Bte Abdul Karim, 2010, p. 148). The concept of Istibdal has been the subject of academic debate (Rusydiana & Ali, 2024). Still, MUIS issued a fatwa supporting its permissibility, also to prevent underperforming waqf assets from being acquired by the government under Singapore's Land Acquisition Act (Nagaoka, 2016: 16).

Another innovation in waqf management in Singapore, representing the modern use of waqf, is the introduction of cash waqf, which allows donors to contribute funds that are invested in real estate and secure financial instruments. Returns from cash waqf investments have provided long-term financial support to Islamic educational institutions, including madrasahs. Between 2012 and 2016, cash waqf investments generated approximately USD 1.96 million in returns, benefiting religious and social institutions (Rusydiana & Ali, 2024).

In conclusion, waqf management in Singapore represents an exemplary model of integrating Islamic philanthropic principles with efficient financial and legal institutions (Rusydiana & Ali, 2024).

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# Exploring Risk Management Practices and Fiqh Muamalat to Improve the Performance of Islamic Microfinance Institutions

Helmi Muhammad<sup>1\*</sup>, Abdillah Ubaidi<sup>2</sup>, Sholeh Wafie<sup>3</sup>, Niki Puspita Sari<sup>4</sup>, Yulianti M. Manan<sup>5</sup>

<sup>1</sup> Universitas Islam Raden Rahmat, Faculty of Economics and Business, Jl. Raya Mojosari No. 2 Kepanjen, Malang, Indonesia.  
Corresponding author: helmimuhammad@uniramalang.ac.id  
ORCID  0000-0002-1884-8857

<sup>2</sup> Universitas Islam Raden Rahmat, Faculty of Economics and Business, Jl. Raya Mojosari No. 2 Kepanjen, Malang, Indonesia.  
ORCID  0000-0002-1399-4898

<sup>3</sup> Universitas Nahdlatul Ulama Pasuruan, Jl. Raya Warung Dowo, Pasuruan 67171, Indonesia

<sup>4</sup> Universitas Islam Raden Rahmat, Faculty of Economics and Business, Jl. Raya Mojosari No. 2 Kepanjen, Malang, Indonesia.  
ORCID  0000-0001-6825-4312

<sup>5</sup> Universitas Islam Raden Rahmat, Faculty of Economics and Business, Jl. Raya Mojosari No. 2 Kepanjen, Malang, Indonesia.

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## Abstract

The purpose of this study is to explore risk management practices and fiqh muamalat to improve the performance of Islamic microfinance institutions. This study focuses on BMT UGT Nusantara, one of the largest Islamic microfinance institutions (IMFIs) in Indonesia. Due to the site's unique characteristics, the study design is a descriptive exploratory, single-case study with a holistic approach. Data were acquired using various methodologies, including in-depth interviews with informants, field observations, focus group discussions, and document reviews. The Interactive Model is used to analyze data, which is then tested for validity through the evaluation of credibility, transferability, dependability, and confirmability. This study highlights several substantial findings, including the successful implementation of risk management practices at IMFIs. Risk management involves understanding, identifying, mitigating, and assessing risks. Despite the lack of standards and the perception that risk management is only partial, risk management practices have improved financial and organizational performance. Sharia compliance risk is the most widely acknowledged, while finance and liquidity risk are the most anticipated. The practice of Islamic jurisprudence (fiqh muamalat) is efficiently implemented by integrating Sharia compliance as an operational system and Sharia practices as a work culture, which fosters ethical behavior and is acknowledged as a good risk management practice.

**Keywords:** Risk Management; Fiqh Mualamat; Performance; Islamic Microfinance Institutions



## 1. Introduction

Baitul Mal Wat Tamwil (BMT) is an Islamic microfinance institution in Indonesia that offers Islamic-based savings and loan services through cooperatives (Sakai, 2010; Wijaya et al., 2019). As an Islamic cooperative, BMT is a blend of value-based organizations, characterized by membership, contractual duties to its members, and adherence to Islamic ideals in its governance system (Rahajeng, 2022). BMT can improve household welfare, especially for people who cannot meet bank standards (Smolo & Ismail, 2011; Wafi & Muhammad, 2023). In fact, after taking out BMT loans, household assets increased substantially, demonstrating that saving may help the community even in the face of unstable income patterns (ZahidMahmood et al., 2017). As a result, BMT is considered a significant Islamic financial inclusion strategy that focuses on financing the poor and microenterprises excluded from the commercial banking system to increase welfare.

The presence of BMT in Indonesia has made it an alternative financial service provider. First, BMT was established at the grassroots level, making it easier for prospective clients, particularly MSMEs, to trade and alleviating poverty in the household sector (Adnan & Ajija, 2015; Bin Mislan Cokro Hadisumarto & Ghafar B. Ismail, 2010; Septianingsih et al., 2024). Second, BMT in various Indonesian regions has demonstrated that it has eliminated the practice of usury, or lending money at interest, which is prohibited by Islam (Kamal et al., 2024). Third, as an Islamic microfinance institution, BMT has weathered the crisis and is regarded as an ethical project (Calder, 2020; M. Iqbal, 2020). As a result, BMT has experienced rapid growth over the last three decades (Fianto et al., 2019). According to the Indonesian BMT Association/Absindo (2019), the number of BMTs increased from its inception in 1990 to more than 4,000 over the next three decades (Mawardi et al., 2020). According to data released by the National Economic and Finance Committee in 2018, at least 4,500 BMT units were established. Furthermore, according to data from the Indonesian BMT Association (Absindo), there were 324 BMTs in 2021, with a total of three million members and 1,315 offices. The progressive development of BMT in Indonesia is closely tied to the large number of middle and lower classes. Of the overall population of approximately 265 million people, 40% are classified as middle class, while 20% are classified as lower class (Septianingsih et al., 2024).

According to the Indonesian National Economic and Finance Committee (KNEKS), the widespread growth and distribution of BMT is not matched by effective data management. Furthermore, many BMTs struggle to maintain performance and survival (Septianingsih et al., 2024). Previous research has indicated that BMT's overall performance in Indonesia was poor for several reasons (Rahajeng, 2022; Seibel, 2012). First, authorities paid less attention to BMT than to folk credit banks and commercial banks, both in terms of operational and financial data. Second, because there is no regulation or control, consumers assume a greater risk while saving money in BMT. Third, BMT's human resources lack the necessary skills and experience to understand BMT procedures, manage cooperatives effectively, and maintain high standards of product or service quality. Misalignment of management between short-term deposits and long-term financing raises financing and liquidity risks in BMT (Mutamimah et al., 2022). Although conformity with Sharia has not been fully implemented, it poses a particular risk to BMT. Because sharia compliance is more than just a requirement for a corporate operational system, it must also be a work culture that ensures halal business transactions through the practice of fiqh muamalat (Muhammad, 2020).

Another aspect is low-income finance, which causes significant knowledge asymmetry. Customers with variable income and no loan guarantees present a set of risk profiles for BMT. As a result, many BMTs cease operations because they are unable to foresee inherent risks in the early phases, particularly those related to financing, liquidity, and Sharia compliance (Mutamimah et al., 2022; Wafi & Muhammad, 2023). Furthermore, BMT operates in delicate and harsh environmental conditions, which pose significant risks. Even concrete facts demonstrate the prevalence of deviations from Islamic standards, including a series of fraud cases among BMTs that cost more than Rp1,143.69 billion (USD 80.54 million) per year (Rahajeng, 2022). This suggests that in Islamic financial institutions, Sharia compliance is viewed as a need for corporate operating processes rather than a work culture. Consider that the practice of fiqh muamalat must not only be contained in a system of company standard norms but must also be incorporated into everyday traditions, creating a habit and even a work culture. The practice of good fiqh muamalat is positively correlated with Sharia compliance, which entails risk mitigation. Given the importance of BMT to the Indonesian economy while confronting significant risks, it is critical to achieve a competitive advantage and improved performance through effective risk management. The primary focus is on the risks of financing, liquidity, and Sharia compliance, which are commonly found in BMTs and have a direct impact on performance. Furthermore, a thorough comprehension of the practice of fiqh muamalat is required to mitigate any potential risk.

To date, little attention has been paid to the practice of risk management in BMT, despite the high rate of performance failure and deviation from Islamic values. Previous research has demonstrated that the risks associated with Sharia compliance,



funding, and operational/liquidity issues have a direct impact on financial performance and sustainability (Mutamimah et al., 2022; Wafi & Muhammad, 2023). Other studies focus on the internal control system and the low implementation of authorization and consultation with the Sharia Supervisory Board (Wardiyono, 2012), as well as the influence of BMT funding (Adnan & Ajija, 2015; Bin Mislan Cokro Hadisumarto & Ghafar B. Ismail, 2010). Globally, the study of identifying risk in Islamic Microfinance Institutions (IMFIs) in Malaysia encompasses Shariah risk, operational risk, and credit risk (Rozzani et al., 2017), as well as the causes of payment failure among Grameen Bank customers in Bangladesh (Kassim & Rahman, 2018). Even among the most recent literature on Islamic microfinance institutions published in respectable international journals, only 6 publications (8%) of 71 papers address risk management and governance (Rohman et al., 2021). This demonstrates the little interest and attention IMFIs have in risk management methods. Meanwhile, it appears to contradict the practice of risk management, which is dominated by financial institutions or Islamic banks (Al Mustofa et al., 2025; Grira & Labidi, 2021; Mustapha et al., 2021; Riaz et al., 2025; Srairi, 2025).

The study's findings on IMFIs' risk management underline the importance of financial, operational/liquidity, and Sharia compliance risks at the corporate operations level. While the failure and fraud of BMT, which is a risk of non-compliance with Sharia, must be assessed considering the practice of fiqh muamalat, good fiqh muamalat reduces the practice of non-compliance with Sharia, leading to less risk. Previous investigations have provided only a partial analysis of risk management, and none have addressed the use of Islamic law (fiqh muamalat) to mitigate Sharia compliance risk. As a result, this study offers a fresh and comprehensive perspective: the integration of risk management practice and Islamic law (fiqh muamalat) as a risk-mitigation measure, which warrants further empirical research. It is also scientifically proven that effective risk management practices boost firm performance. Consequently, the purpose of this research is to investigate how risk management practice and Islamic law (fiqh muamalat) could assist IMFi in improving its performance. This study also makes a more in-depth contribution by extending academic literature on BMT's risk management and fiqh muamalat practices. This study focuses on BMT UGT Nusantara, one of Indonesia's major Islamic microfinance organizations with a 25-year history. BMT UGT Nusantara currently has total assets exceeding 3 trillion, over 606,000 members, and 298 service branches throughout Indonesia. Interestingly, the managers of BMT UGT Nusantara generally have only a non-formal education, specifically from Sidogiri Islamic Boarding School in East Java, Indonesia. This issue is significant due to BMT UGT Nusantara's involvement in reducing poverty and enhancing family, social, and economic development in Indonesia. As a result, managers at BMT UGT Nusantara must grasp risk management and control to ensure continuity and overcome future uncertainties. The typology of risk management practices and fiqh muamalat serves as a reference for shaping Indonesia's BMT operational environment.

## 2. Literature review

### 2.1 Basic Risk Definitions

Risk definitions vary significantly depending on the perspective of specific scientific disciplines. In economics and finance, risk refers to the uncertainty of future consequences with a probability greater than one and an unknown result (Bhatti & Misman, 2010), as well as the likelihood of an investment returning less than predicted (Mohd Noor et al., 2018). Risks are also defined as the likelihood of an event resulting in a negative state, allowing the value of income and assets to drop (Manan & Shafaii, 2015). Risk is defined as uncertainty in decision-making and the probability of damage or negative impact resulting from an unanticipated situation (Bouslama & Lahrichi, 2017). Risk definitions also encompass the possibility of losses, injuries, damage, or other adverse events occurring due to external or internal exposure (Akram & Rahman, 2018). As a result, risk will significantly impede the IMFI's ability to achieve its objectives. If a manager fails to handle this risk effectively, it will hurt performance and may lead to IMFI bankruptcy. According to Islamic jurisprudence, there is a proportional link between risks and returns, which is combined with the restriction on producing without obligation (Al-Suwailem, 2012).

IMFIs must sustain a competitive advantage in the face of severe competition and numerous threats by focusing on efficiency and productivity. As a result, IMFIs must continue to define and identify risks that arise during their business operations. Generally, financial institutions face both systematic and non-systematic risks (Yurdakul, 2014). Systematic risk is a business risk that originates from outside sources and cannot be controlled or removed, but must be overcome. Political conditions, the Covid-19 pandemic, market shifts, exchange rate fluctuations, and other macroeconomic developments are all examples. Meanwhile, diversification can help minimize non-systematic risks, such as operational, reputational, and Shariah concerns (Al Rahahleh et al., 2019). All these risks have a detrimental impact on the institution's performance if they are not appropriately managed. Although it does not rule out other sorts of risks, IMFIs confront the most significant risks, which are funding, liquidity, and Sharia compliance. According to Mutamimah et al. (2022), IMFIs always anticipate financing and



liquidity risks, as they have a direct impact on financial performance and sustainability. In contrast, Sharia compliance risks are the most common and unique challenges for IMFIs.

### *2.2 Risk Management of Islamic Microfinance Institutions*

Islamic Microfinance Institutions (IMFIs) operate differently from conventional ones, as they employ interest-free systems. IMFIs serve the community by providing various forms of finance, including profit-sharing systems, such as buying and selling, leasing, and interest-free loans (Mutamimah et al., 2022). As a result, IMFIs have a distinct risk profile because the risk is shared by the IMFIs and their clients (Wulandari et al., 2016). The unique qualities and nature of IMFIs, particularly the profit-sharing system approach, significantly alter the level of risk they confront because they deal with various goods that are not available in conventional financial institutions. Furthermore, IMFIs manage risks associated with unsecured loans, such as *Qardhul Hasan*, which carries a significantly greater risk threshold. Indeed, many Muslim clients come from low-income families that seek Islamic financial services (Manan & Shafai, 2015). The risks in IMFIs, if not managed appropriately, will result in losses that adversely affect health. Because each IMFI has a unique and sometimes severe risk profile, it is critical that they adopt risk management strategies to mitigate any existing risks. Risk management is a key strategy that financial institutions employ to mitigate various forms of risk.

Islamic microfinance institutions play a crucial role in promoting financial inclusion and poverty eradication initiatives. The source of funds for the impoverished presents a significant difficulty for IMFIs. Limited financial access restricts their potential to serve a larger segment of the community that requires financial services (Kassim & Rahman, 2018). Furthermore, the quality of financial performance impacts the long-term viability of IMFIs. As a result, filtering is a crucial aspect of risk management, particularly for individuals from vulnerable areas (Septianingsih et al., 2024). Risk management involves identifying risks, collecting or combining similar risks, assessing them, controlling risks, and monitoring their progress (Manan & Shafai, 2015). Risk management in financial institutions aims to enhance future financial performance and sustainability (Kiptoo et al., 2021). Long-term sustainability is a challenge for IMFIs since it promotes economic empowerment and boosts community income and welfare (Abdul Rahman & Dean, 2013). The preceding discussion demonstrates the relevance of risk management for IMFIs in improving their efficiency for the benefit of the larger community. Studies on risk management in IMFIs have primarily focused on operational issues (Kassim & Rahman, 2018; Mutamimah et al., 2022; Rozzani et al., 2017; Wafi & Muhammad, 2023) and have not included fiqh muamalat as a risk mitigation strategy. As a result, the focus of this research is on integrating risk management practices with fiqh muamalat in Islamic financial institutions.

### *2.3 Practice of Fiqh Muamalat in Risk Management*

The identity of Islamic financial institutions is said to be a unique financial system, using at least five religious features that distinguish them from conventional financial institutions: the prohibition of usury, paying attention to illicit, *halal*, *gharar* (speculative), or *maysir* (gambling), implementing zakat (the prescribed purifying alms), and the existence of the Sharia Council (Sharia Board) (El-Gamal, 2006; Lewis & Algaoud, 2001). The operating premise of these Islamic financial organizations is to promote a just society, minimize exploitation, and emphasize the principles of collaboration and brotherhood. This laudable goal can only be achieved by adhering to the strict Sharia norms and applying fiqh muamalat (Z. Iqbal & Mirakhor, 2011). From another perspective, the purpose of Sharia in the Islamic financial system is to direct humans away from the homo economicus style, which is synonymous with obtaining material benefits, and toward the homo islamicus, which is based on morals and ethics and avoids greed and consumerism (Audretsch et al., 2007; Gümüsay, 2015; Mohamed Aslam Haneef, 1995).

The use of fiqh muamalat in Islamic financial institutions must adhere to Islamic law in numerous ways (Muhammad, 2020). First, the law governing the marketed product must be based on Sharia (*al-Muamalah al-Madiyah*); second, the transaction procedure must also be based on Sharia (*al-Muamalah al-Adabiyyah*); and third, the purpose must be Sharia-compliant (*al-Maqashid al-Sharia*). Compliance with Sharia in various instances ensures that every financial transaction adheres to Sharia principles, thereby lowering risk. Sharia compliance is not only required for company operational processes in Islamic financial institutions, but it must also be ingrained in the workplace culture. That is, fiqh muamalat must be observed in daily traditions as well as organizational habits, rather than only being specified in the company's standard rules framework. Practicing fiqh muamalat correctly and ethically ensures that business transactions are halal and avoids the possibility of deviations in Sharia compliance and value. As a result, IMFIs have an interest in maintaining the simultaneous practice of fiqh muamalat and risk management since they mutually support one another.



### **3. Methodology**

#### *3.1 Research Design*

This study aims to describe the practice of risk management and fiqh muamalat in Islamic microfinance institutions through a series of in-depth inquiries. The descriptive exploratory technique is utilized to capture the breadth of individual backgrounds (Brink & Wood, 1998; Merriam, 2009). We employ a holistic single-case approach (Yin, 2014) to explain the practice of risk management and fiqh muamalat, while focusing on a narrow yet in-depth site to arrive at a specific notion. Furthermore, the case study approach is ideal for capturing the wealth of individual backgrounds that are too complex to investigate through surveys or studies. The research locus must be unique to meet the parameters required for case study research (Yin, 2014). Therefore, the focus of this study was on BMT UGT Nusantara, Indonesia, because it fulfills these criteria. First, BMT UGT Nusantara is one of the largest Islamic Microfinance Institutions (IMFIs) in Indonesia, with 298 units and offices nationwide. Second, BMT UGT Nusantara is run by students and alumni of Sidogiri Islamic Boarding School and other Islamic boarding schools who do not have university education qualifications. Third, BMT UGT Nusantara was named the pilot and referral IMFI for Islamic boarding schools in Indonesia.

#### *3.2 Data Collection*

We collect primary data through in-depth interviews using previously prepared interview protocol guidelines, field observations, focus group discussions, and document reviews (Sekaran & Bougie, 2016; Yin, 2014). We conducted in-depth interviews with informants to obtain complete information about risk management practices and fiqh muamalat. We purposefully selected key informants based on the established criteria. Other informants were chosen using the snowball method based on the main informant's suggestions. All possible informants were selected based on their expertise and qualifications in management and fiqh muamalat. We conducted in-depth interviews with 16 informants to gather critical information across various functions, with face-to-face sessions lasting between one and three hours (Table 1). We began the conversation by assuring the informant that her identity and all information provided would be kept private and would not be revealed in the publication. We then recorded the interview using an appropriate digital recording device to ensure data security. This investigation was conducted from February to December 2024. Following that, we created a transcript of our recorded emic data to facilitate systematic management and analysis of textual data, as well as the extraction of significant information (McLellan et al., 2003). The informants are summarized in the table below.

**Table 1.** Summary of Interviews

No	Informant's Status	Length of Work (Years)	Number of Hours	Office Affiliation
1	Chairman	23	2	BMT UGT Head Office, Pasuruan
2	Sharia Supervisory Board Member	14	3	BMT UGT Head Office, Pasuruan
3	Finance Manager	12	2	BMT UGT Head Office, Pasuruan
4	Risk Control Manager	14	3	BMT UGT Head Office, Pasuruan
5	Head of Financing Division	16	1	BMT UGT Head Office, Pasuruan
6	Branch Office Head	18	1	BMT UGT Klampis, Bangkalan
7	Branch Office Head	11	1	BMT UGT Pringsewu, Lampung
8	Branch Office Head	15	1	BMT UGT Malang, Kota Malang
9	Branch Office Head	10	1	BMT UGT Riam Durian, Kalteng
10	Branch Office Head	12	1	BMT UGT DKI, Jakarta
11	Branch Office Head	17	1	BMT UGT Glenmore, Banyuwangi
12	Branch Office Head	11	1	BMT UGT Denpasar, Bali
13	Branch Office Head	17	1	BMT UGT Pamekasan, Madura
14	Branch Office Head	17	1	BMT UGT Ambulu, Jember
16	President Director	8	2	PT USID, Vendor IT BMT UGT

*Source: Authors' elaboration*



### 3.3 Analysis

The data analysis step focuses on identifying patterns and models of relationships between data, as detailed descriptions gathered during the investigation. We analyze data using the Interactive Model (Miles et al., 2014) since the flow of activities and data gathering is an interactive cyclical process. This study consists of four stages: data gathering, data reduction, data presentation, and generating conclusions, all of which are repeated and simultaneous until the data is considered saturated (Miles et al., 2014). To verify that the findings of data analysis are accounted for, we test data validity using four criteria (Morrow, 2005). The four criteria are credibility (achieved through the techniques of extending involvement, continuous observation, triangulation of data sources, peer debriefing, and member checks), transferability (achieved through thick description), dependability, and confirmability (both are achieved through intensive audits, discussions with experts, and focus group discussions).

## 4. Results

This study focuses on the practice of risk management and fiqh muamalat in Islamic microfinance institutions at BMT UGT Nusantara in Indonesia. The first emphasis is on the practice of risk management, while the second is on the use of fiqh muamalat in risk management. In the next part, we present the findings and describe the study's focus.

### 4.1 Risk Management Practices

The study's findings on our risk management practices are organized into four categories: risk perception, risk identification, risk mitigation, and risk management impacts.

#### Risk Perception

We explored how BMT UGT Nusantara managers perceived risk definitions. The next Table 2 summarizes the answers provided by the informants.

**Table 2.** Risk Perception

Informant	Informant Answer Questions about Risk Perceptions
1,3, 4	<ul style="list-style-type: none"><li>Risk is a shift or difference in unanticipated outcomes.</li></ul>
1,2,5	<ul style="list-style-type: none"><li>Risks, on the one hand, can have negative consequences (<i>mafsadah</i>), but they can also create possibilities.</li></ul>
1,2,5,7	<ul style="list-style-type: none"><li>Risk is interpreted as sunatullah, Allah SWT's mandate for creating all that is coupled.</li></ul>
1,3,4,5,8,9	<ul style="list-style-type: none"><li>For every obstacle perceived as a risk, Allah SWT undoubtedly provides a solution.</li></ul>

Source: Authors' elaboration

The informant has a different definition of risk; however, informants' understanding of risk is generally influenced by the financial industry. Some sources define risks as changes or differences in unanticipated results. Risks, on the one hand, have the potential for negative or destructive consequences (*mafsadah*) that must be avoided for a business to succeed; on the other hand, risks can create opportunities and encourage people to generate income. According to informants who are alumni of the Sidogiri Islamic Boarding School, the two potential threats are also viewed as sunatullah, Allah SWT's command for creating all that is paired. The informants also believe that for every obstacle perceived as a risk, Allah SWT provides an easy answer. This concept motivates individuals to look for ways (endeavor) to turn every obstacle they face into a source of achievement and a chance to succeed. Informants' perceptions of the concept of risk contain a broader scope than existing definitions.

#### Risk Identification

We investigate the types of risks that exist in BMT UGT Nusantara. The informants provide a variety of answers, which are presented in Table 3.



**Table 3.** Risk identification

Informant	Risk Type	Answer Questions About Risk Identification
1,3,4,5,6	• Business Risk	• Business risk (failure or bankruptcy).
1,3,4,5,8,9	• Financial Risk	• Risk financing, non-performing loan, liquidity risk, and profit margins.
1,2,3,4,5,6, 7,8,9,10	• Non-Financial Risk	• Sharia compliance, operational risk, human resource risk, deaths, accidents, information technology, public trust, and market risk or competition.

Source: Authors' elaboration

The findings of the investigation reveal that the risks that develop at BMT UGT Nusantara, in general, are similar to those that occur in other business institutions, namely business risks, financial risks, and non-financial risks. According to the informants, business risks are intimately tied to BMT UGT Nusantara's overall business activity. Financial risks include the risk of failure (bad loans), reduced profit margins, and liquidity risk, whereas operational and human resource risks are non-financial. Other informants mention various risks, including death, accidents, information technology issues, public trust, and market concerns. According to BMT UGT Nusantara managers, such risks are considered both material and short-term. Furthermore, there are major concerns in this business, including Sharia risk. Among the many risks indicated by the informants, three emerged as the most significant: financial risk, liquidity risk, and Sharia compliance risk.

#### *Risk Mitigation*

Informants understood that potential risks must be anticipated, necessitating the implementation of strategic and technical precautions. Table 4 presents the informants' responses to risk mitigation.

**Table 4.** Risk Mitigation

Informant	Steps	Answering Questions about Risk Mitigation
1 1,2,3,4,5,6, 8,9,10,12,16	• Strategic • Technical	• Risk Control Manager. • Customer analysis using the 5 C approach (character, capacity, capital, collateral, and condition); risk reserves for each financing, financing revitalization schemes through rescheduling, restructuring, or collateral takeover, savings withdrawals must be made through tellers during operating hours, withdrawals above Rp. 10 million must be confirmed the day before, control or limitation of cash available at each branch office, collateral binding and legal completeness, standard operating procedures, <i>takaful</i> (insurance), internal control unit, public accounting firm audit, fiqh muamalat practice, strengthening the role of the Sharia Supervisory Board (SSB) of BMT UGT Nusantara, each branch head plays a role as SSB, information system training program, contract training, contract certification test and comprehensive managerial system, strengthening spirituality.

Source: Authors' elaboration

Investigations on risk mitigation practices at BMT UGT Nusantara yielded various strategic and technical recommendations. In strategic steps, the Risk Control Manager is primarily responsible for risk management, which is governed by a set of regulations. At the technical level, it refers to the types of dangers that arise. For example, mitigation strategies for financing risks include monitoring client conditions, analyzing the ability to pay on time, assessing the collateral provided, and implementing preventive actions such as evaluating the 5 C's (character, capacity, capital, collateral, and condition). A risk reserve of 0.5% of each loan is established. A financial rejuvenation plan is implemented through rescheduling, restructuring, or collateral takeover. To mitigate liquidity risk, a rule is in place that requires savings withdrawals to be conducted through tellers during business hours, rather than through account officers or field workers. Furthermore, withdrawals above IDR 10 million must be confirmed the day before, either by a person in an officer position, or over the phone. Other mitigation strategies for inter-branch and head office activity include regulating or limiting cash availability at each branch and reporting it to the head office to prevent theft. Sharia compliance risks are fully foreseen. The research also revealed that to enable successful Sharia compliance, the Sharia Supervisory Board (SSB) at BMT UGT Nusantara must perform optimally. In addition to



ensuring excellent governance, each branch manager serves as an SSB, which requires technical training and passing contract certification.

#### *The Impact of Risk Management*

Good risk management improves the performance of financial institutions. This finding is supported by other informants' responses, as indicated in Table 5 below.

**Table 5.** Impact of Risk Management Practices

Informant	Risk Management Impact	Answers to Questions about Risk Management Impact
1,3,4,5,8,9	<ul style="list-style-type: none"><li>• Financial Performance</li><li>• Organizational Performance</li></ul>	<ul style="list-style-type: none"><li>• Profitability increases due to operational cost efficiencies.</li><li>• Liquidity is more stable and well-maintained.</li><li>• Better prepared to face macroeconomic changes such as pandemics, globalization, and political issues.</li><li>• Adaptability to developments in information and technology.</li><li>• Improved organizational governance, ensuring sustainability.</li><li>• Fraud can be effectively anticipated.</li><li>• Institutional reputation is maintained, increasing public trust.</li><li>• Confidence that every problem has a solution increases self-trust.</li><li>• Be calmer when facing problems.</li></ul>
1,3,4,5,7		
1,3,4		
1,3,5		
1,3,4,5,6		
3,4,5,14,15		
1,2,4,5,7,8		
1,2,4,7,9		
2,3,4,6,11,12		

*Source: Authors' elaboration*

BMT UGT Nusantara's risk management practices have a favorable impact, benefiting the institution in both the short and long term. This indicates that risk management practices demonstrate good organizational governance, which in turn improves reputation and public trust, thereby contributing to sustainability. Overall, effective risk management practices significantly impact both financial and organizational performance. Risk management assists BMT UGT Nusantara in increasing its profitability, cost efficiency, and liquidity availability. Meanwhile, risk management enables BMT UGT Nusantara to address macro and global changes, adapt to information and technology developments, improve organizational governance, anticipate various forms of fraud, maintain the institution's reputation, increase public trust, boost self-confidence, and handle problems more effectively.

#### *Practice of Fiqh Muamalat in Risk Management*

The research findings indicate that the practice of Islamic jurisprudence (fiqh muamalat) begins with the implementation of Islamic sharia, which governs living. At BMT UGT Nusantara, Islamic sharia is practiced in several ways, including performing the Duha prayer, reciting the Quran before office hours, and praying the *Dhuhr* and *Asr* prayers in congregation. Additionally, staff members pray together after office hours and conduct weekly religious studies. The findings show that the practice of fiqh muamalat at BMT UGT Nusantara not only focuses on the tangible characteristics of the transactions but also emphasizes the procedure (ethical) and goals of the transaction. The informants, the majority of whom had received religious instruction at Islamic boarding schools, understood the significance of using fiqh muamalat in economic operations. This scenario is unique in that the management of BMT UGT Nusantara had previously obtained their understanding of fiqh muamalat while attending an Islamic boarding school and now practices it. The practice of fiqh muamalat at BMT UGT Nusantara is based on the Quran, Sunnah, and *ijtihad* (a serious legal inquiry). Informants further stated that BMT UGT Nusantara's product contracts include references to fatwas from the National Sharia Council (DSN) and the Indonesian Ulema Council (MUI). Furthermore, the BMT UGT Nusantara Sharia Supervisory Board performs numerous legal studies using DSN-MUI fatwas and traditional Islamic sources, which are published in a contract law guidebook.



## 5. Discussion

Financial institutions' performance suffers when risks are not appropriately managed. Furthermore, excessive financial losses threaten the futures of financial institutions (Al Rahahleh et al., 2019). However, if the risk can be foreseen, it can be used as a positive motivator to improve performance and increase the likelihood of profit (Harland et al., 2003; Holton, 2004). As a result, BMT UGT Nusantara's management must be aware of the risks. Understanding risks will enable the manager of BMT UGT Nusantara to select the best approach and implement actions to mitigate them. In general, UGT Nusantara's BMT manager's grasp of risk definitions is consistent with those of prior studies (Akram & Rahman, 2018; Bouslama & Lahrichi, 2017; Manan & Shafai, 2015). They state that risk is the uncertainty associated with business activities and the likelihood of an incident affecting the organization's objectives. Thus, the management of BMT UGT Nusantara understands the importance of developing a strategy to mitigate potential risks.

Informants identified financial risk as critical. BMT UGT Nusantara's contribution to poverty eradication and economic growth is directly felt by the community through credit distribution. Customers with variable incomes and little loan collateral, on the other hand, fall into a variety of financing risk profiles. Informants also said that, in addition to financial risk, liquidity risk is critical to BMT UGT Nusantara's operations. They argued that IMFs would lose client trust if they were unable to provide money when withdrawals were made. As a result, liquidity risk management is conducted to maintain a healthy financial circulation. In addition to these two main dangers, the risk of Sharia compliance is a major problem. They explained that each product offered must adhere to the contract, and any variation will result in non-halal transactions. As a result, increasing the practice of Islamic jurisprudence (fiqh muamalat) at BMT UGT Nusantara is essential. This evidence supports the concept that, in addition to Sharia compliance, halal responsibility must be introduced into the workplace culture (Hassan & Mollah, 2018; Muhammad, 2020).

According to the research findings, risk mitigation practices at BMT UGT Nusantara are mostly focused on financial risks such as financing and liquidity. Non-financial risks, such as those associated with Sharia compliance, are also a concern in fiqh muamalat practice. BMT UGT Nusantara utilizes an information system to support risk mitigation and collaborates with PT USID as an information system (IS) service provider. Informants further stated that a variety of IS training programs, contract training, contract certification tests, and managerial processes have been established to enhance human resource expertise. Our findings also revealed that IS has arranged for profit-sharing installments. This practice supports the previous finding that information technology and risk management are critical for every organization that wants to survive (Mayer et al., 2019). Furthermore, the use of IS is a significant predictor of successful risk management (Saeidi et al., 2019; Wafi & Muhammad, 2023). This finding is consistent with previous research, which has revealed that information systems play a crucial role in ensuring Sharia compliance (Ayedh et al., 2021). Additional studies suggest that IS can influence organizational characteristics and performance (Dewett & Jones, 2001). As a result, aligning information systems with Sharia principles and existing norms will reduce overall risk while providing effective internal control for organizations.

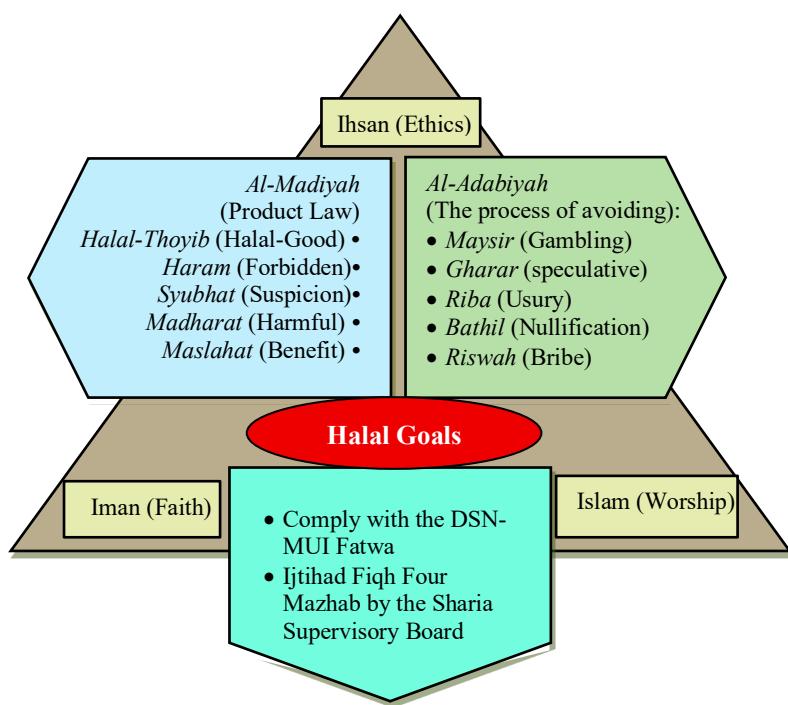
The findings of this study show that risk management has various positive effects on the performance of BMT UGT Nusantara, depending on which risk management aspects are addressed. However, it is worth noting that risk management has a positive impact on both financial and organizational performance. This finding is consistent with prior research showing that risk management improves corporate performance and value creation (Chairani & Siregar, 2021; Ghazieh & Chebana, 2021). The findings of this study indicate a significant improvement in the function of risk control managers at BMT UGT Nusantara. This development leads to a stronger supervisory function, particularly an improved internal control system. As a result, companies, particularly Islamic microfinance institutions, perform better when risk management is implemented effectively. Furthermore, the existence of BMT UGT Nusantara to date demonstrates the effectiveness of risk management practices. This suggests that risk management is crucial in times of uncertainty, enabling businesses to respond effectively and correctly, and fostering flexibility and resilience (Settembre-Blundo et al., 2021).

Their dedication to adopting Sharia produces a work attitude that values honesty, integrity, non-arbitrariness, and accountability for assigned responsibilities. The incorporation of Islamic law into company culture is critical for preserving a balance of faith. Understanding Islamic jurisprudence (fiqh muamalat) and adherence to Sharia in Islamic financial institutions, which is based on Islamic Sharia practices and faith in God, will have an impact on the institution's and its workers' ethical behavior (*ihsan*). This will prevent actions that are detrimental to the institution, thus facilitating risk management. Sharia practice, which is part of the work culture at BMT UGT Nusantara, suggests psychological sensitivity as well as work ethics. This informant's statements are consistent with previous research findings indicating that Sharia practices have societal consequences and promote self-actualization (Al-Krenawi & Graham, 2000). The practice of Islamic Sharia strives not only to

maximize profits but also to pay attention to moral and ethical principles known in Islam as *akhlaq* (Chapra, 2008; Naqvi, 1994), which lead to a sense of God, or another perspective known as *taqwa*-centric (Dusuki, 2008).

The proper application of Islamic jurisprudence (fiqh muamalat) leads to ethical business operations that are grounded in Islamic law (Figure 1). This remark supports a prior study that Islam prevents individuals from acting at will and justifying any means, such as gambling, cheating, usury (*riba*), and other negative activities, and emphasizes moral responsibility (Sachedina, 2001). Islamic ethics distinguishes between what is allowed and what is not, what is *halal* (permissible) and what is *haram* (forbidden). Strong Islamic jurisprudence (fiqh muamalat) fosters robust business ethics. This effort is carried out by delivering specialized contract education and training to all branch managers who make transaction contract decisions in their respective regions. Lower-level employees also receive general contract education and training using an information system. The purpose is to gain a complete understanding of Sharia-compliant business ethics. A thorough understanding of Islamic jurisprudence (fiqh muamalat) applied in business will mitigate any potential risks. As a result, good Islamic jurisprudence practices integrated into workplace culture embody ethics and are acknowledged as a risk management technique. This study demonstrates that firms that implement a code of ethics in any form can influence risk management practices (Francis & Armstrong, 2003; Luo & Bhattacharya, 2009). The figure below depicts Islamic jurisprudence practices at BMT UGT Nusantara (Muhammad, 2020).

**Figure 1.** Practice of Fiqh Muamalat



Source: Muhammad (2020)

## 6. Conclusion

As one of the largest Islamic microfinance institutions in Indonesia, BMT UGT Nusantara is committed to enhancing financial and organizational performance through effective risk management practices and the implementation of Islamic jurisprudence (fiqh muamalat) as a cornerstone of its ethical work culture. The findings of this study support this conclusion. BMT UGT Nusantara, an Islamic microfinance institution (IMFIs), employs effective risk management. The risk management practices encompass recognizing risks, identifying them, reducing them, and understanding the impact of risk management. Despite the lack of standards and the perception that risk management is only partial, these practices have improved financial and organizational performance. Sharia compliance risk is the most widely recognized risk at BMT UGT Nusantara, while



financing and liquidity risks are the most anticipated, as both have a direct impact on financial and organizational performance. The practice of fiqh muamalat at BMT UGT Nusantara is well-executed, with Sharia compliance serving as an operational system and Sharia practices as a work culture. This integration encourages ethical behavior and is acknowledged as a method that influences risk management practices.

This research offers beneficial implications for risk management strategies at IMFIs, which can improve financial and organizational performance. Serious efforts are required within IMFIs to develop human resource capabilities, such as technical risk management skills and a comprehensive understanding of Sharia principles. The findings recommend a novel approach to risk management practices, contributing to the body of knowledge in the field of risk management. This research is recognized as a case study, but it could potentially serve as a reference for IMFIs in Indonesia. Developing a multi-case study using an inductive approach, for example, is expected to complement the findings, including a comparison of the risk management practices of IMFIs with those of their conventional microfinance institution counterparts.

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# Cross-Country Comparison of Zakat Management Model for Economic Resilience: Insights from Indonesia and Malaysia

Aryadimas Suprayitno<sup>1\*</sup>, Widya Sartika Hasibuan<sup>2</sup>

<sup>1</sup>\* Department of Islamic Economics, Master of Science in Islamic Economics Program, Universitas Airlangga, Indonesia.

Corresponding Author: aryadimassuprayitno@gmail.com

ORCID  0009-0006-2872-1151

<sup>2</sup> Development Economics Study Program, Universitas Sumatera Utara, Indonesia.

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## Abstract

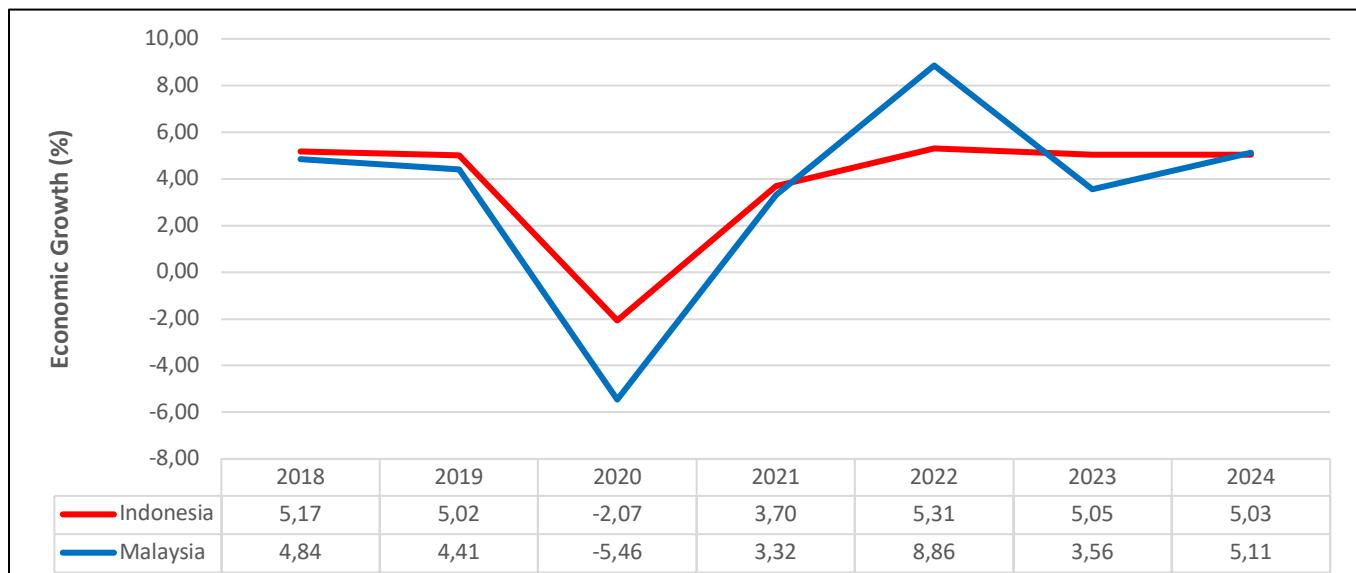
The negative economic growth observed in Indonesia and Malaysia has led to the classification of both nations as experiencing an economic recession. This situation arises from a reduction in total household expenditure, despite an increase in zakat collection. The management of zakat in Indonesia and Malaysia, in light of the economic recession, is implemented through various programs. This research aims to conduct a comparative examination of zakat management in Indonesia and Malaysia during economic downturns, with a particular emphasis on policy responses to the recession triggered by COVID-19. Subsequently, this investigation employs a qualitative descriptive methodology grounded in secondary data sourced from zakat institutions, governmental reports, and scholarly literature. The findings elucidate four notable distinctions in zakat management between Indonesia and Malaysia: the focus on resource allocation, the prioritization of beneficiaries, the sustainability of impact, and the originality of programs. Indonesia focuses on directing zakat towards economic initiatives, whereas Malaysia places greater importance on its distribution for consumptive purposes. Indonesia has delineated six priority clusters of mustahik affected by the COVID-19 pandemic, whereas Malaysia has categorized only three priority clusters of mustahik. Malaysia employs a unique methodology, characterized by a thorough focus on distributing consumptive zakat to meet pressing household needs. The execution of the program is expected to enhance overall household consumption, thereby aiding in the recovery from economic recession by restoring public purchasing power. This study advances the framework for zakat distribution, contributing to informed decision-making in the realm of policy development during economic crises. This research provides a comprehensive analysis of the allocation of zakat funds as a mechanism for social safety and economic resilience, highlighting exemplary practices from Indonesia and Malaysia, two leading Muslim-majority countries.

**Keywords:** Zakat; Zakat Management; Zakat Distribution; Zakat Governance; Government Policy; Comparative Analysis.

## 1. Introduction

The COVID-19 pandemic profoundly impacted the global economy, resulting in a decline in economic growth that varied according to the financial resilience of households (McKibbin & Fernando, 2023). Communities facing economic challenges tend to be more vulnerable to the repercussions of the epidemic compared to their wealthier counterparts. Barro & Sala-i-Martin (2004) contend that one can assess the economic performance of nations by juxtaposing their growth rates. The COVID-19 pandemic has had a significant impact on global economic growth. In 2023, Indonesia and Malaysia distinguished themselves as leading nations within Southeast Asia in the State of Global Islamic Economy (SGIE), with Malaysia achieving the top position and Indonesia attaining third place. Figure 1 below exemplifies the economic growth trajectories of Indonesia and Malaysia.

**Figure 1.** Economic Growth in Indonesia and Malaysia

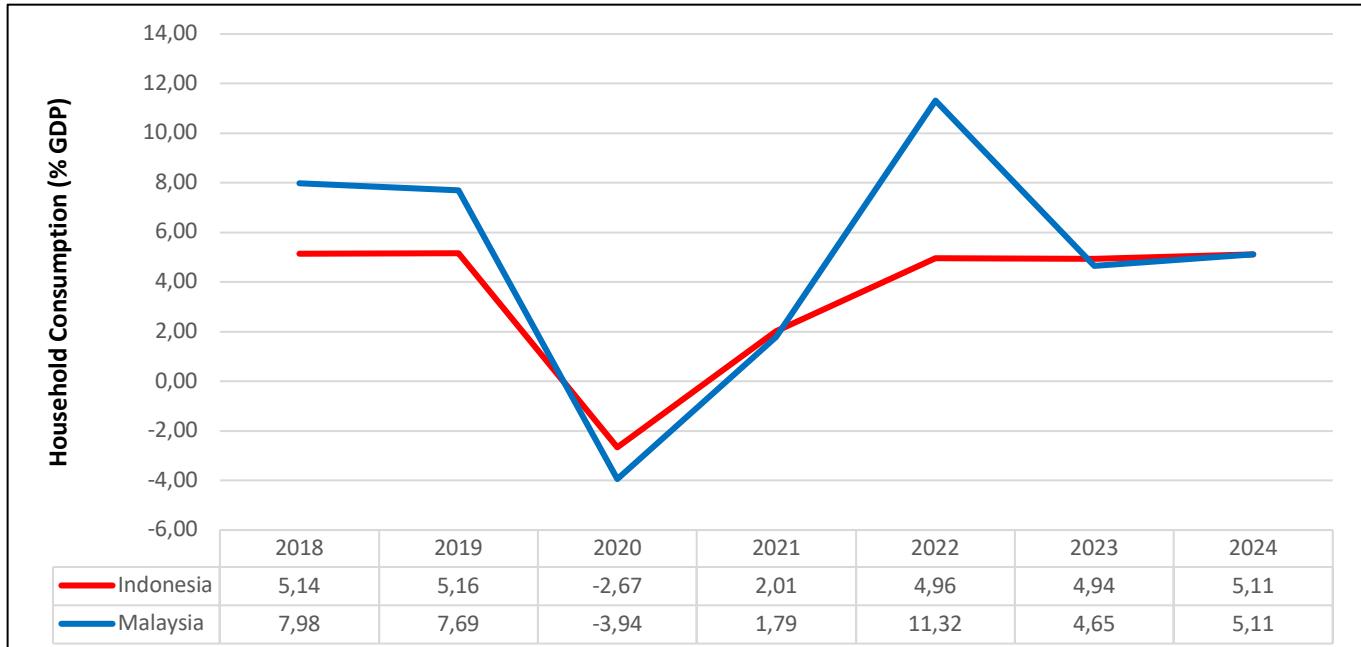


Source: *World Bank*

In the two years preceding the pandemic, Indonesia and Malaysia demonstrated steady economic advancement; however, they faced a notable decline in 2020. The COVID-19 pandemic in 2020 led to a notable economic decline, as evidenced by Indonesia's contraction from 5.02% in 2019 to -2.07%, while Malaysia experienced a drop from 4.41% to -5.46%. In the following year, both countries experienced a gradual recovery, achieving a 3% growth rate in 2021. Indonesia has maintained a growth rate of 5% through 2024, akin to levels observed a decade prior, suggesting that it has not yet surpassed the middle-income trap.

Conversely, Malaysia demonstrated fluctuating effects during the post-recovery period, surging to 8.86% in 2022, followed by a decrease to 3.56% in 2023, and then experiencing a resurgence to 5.11% in 2024. The notable decline in economic growth rates in Indonesia and Malaysia in 2020 has been officially recognized, with both countries now classified as experiencing economic recession (Baharuddin, 2021; Lativa, 2022). According to Gaski (2012), a recession is characterized by a sustained decline in GDP over two consecutive quarters, resulting in negative economic growth. An economy that heavily depends on the global market is prone to experiencing periods of economic decline. Modrek et al (2013) posited that a reduction in household expenditure serves as a significant driver of economic downturn. Figure 2 illustrates the patterns of household consumption in Indonesia and Malaysia.

**Figure 2.** Household Consumption in Indonesia and Malaysia



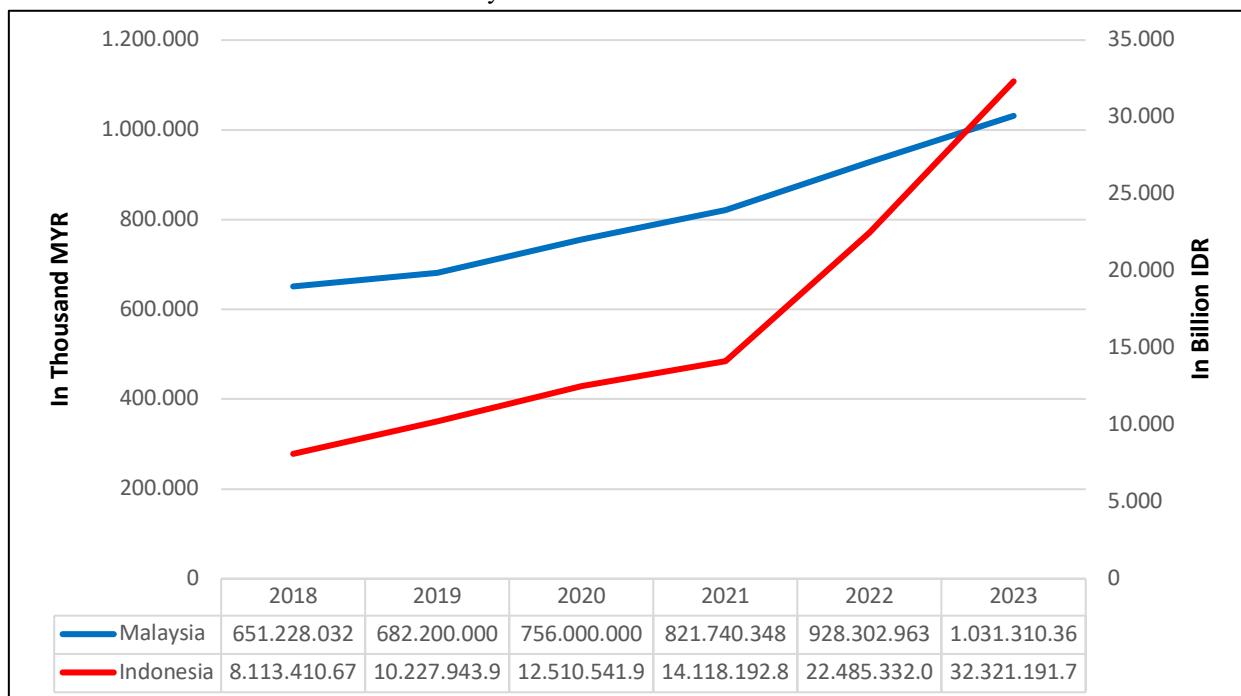
Source: Badan Pusat Statistik dan Department of Statistics Malaysia

Household consumption, which affects the evaluation of economic growth, experienced a significant decline in 2020. In 2018 and 2019, consumer expenditure in Indonesia and Malaysia was elevated, but it plummeted quickly during the initial phases of the COVID-19 pandemic. Indonesian household consumption decreased from 5.16% in 2019 to -2.67% in 2020. Malaysia likewise had a more pronounced decrease, from 7.69% to -3.94%. The reduction in home consumption during the COVID-19 pandemic prompted the government to implement measures, including the provision of social assistance, to stimulate household spending (Georgarakos & Kenny, 2022). This stimulus progressively increased consumption levels in both nations in 2021, reaching 2.01% and 1.79%, respectively. The increase in the three years following the pandemic demonstrates that household consumption in both nations responded robustly to post-pandemic circumstances, driven by consistent growth.

Zakat, a fundamental tenet of Islam, significantly contributes to the equitable allocation of resources to individuals in need, particularly in supporting household expenditures during times of crisis. Throughout the pandemic, zakat serves not merely as a tool for immediate assistance to mustahik (zakat beneficiaries) but also as a strategy to foster enduring economic recovery. The proficient management of zakat ensures its distribution to support affected individuals and families, thereby aiding their survival and facilitating their reintegration into a productive society. The importance of professional zakat governance, which focuses on empowering mustahiq through sustainable production, could be an effective approach in the pursuit of poverty eradication (Herianingrum et al., 2023). Zakat Mal, unlike Zakat Fitrah, has a broader scope and significant potential as a productive instrument for economic development (Farouk et al., 2018; Kahf, 1989; Khasandy & Badrudin, 2019). Zakat Fitrah is consumptive and periodic in nature, limited to fulfilling basic needs during Eid al-Fitr, whereas Zakat Mal can be utilized for empowerment programs such as microenterprise financing, skills training, and strengthening food security (Widiastuti, Auwalin, et al., 2021; Widiastuti et al., 2022). This positions zakat not only as a social instrument but also as a mechanism for long-term economic empowerment (Prawoto & Basuki, 2024; Safitri et al., 2024). By allocating zakat to initiatives that empower mustahiq, such as skills training or micro-enterprise support, zakat transcends mere temporary help and functions as a mechanism to bolster the economic autonomy of recipients. This approach will have a more lasting impact and reduce reliance on social aid, thereby expediting economic recovery and progressively lowering poverty rates. Compared to taxation, zakat holds an advantage in its religious legitimacy, which encourages higher compliance among muzakki, as well as its clear allocation to the eight asnaf, thereby directly targeting the poor and vulnerable groups (Nayak & Hegde, 2023). In the context of economic recovery, zakat functions as an automatic stabilizer because resources transferred from higher-income groups are

allocated to mustahik with a higher marginal propensity to consume (MPC), thereby enhancing aggregate consumption, strengthening purchasing power, and ultimately supporting sustainable economic recovery (Obeidat, 2024). Consequently, zakat collection may be designated for particular beneficiaries due to its classification in the faith. The following Figure 3 illustrates zakat collection data in Indonesia and Malaysia from 2015 to 2022.

**Figure 3.** Zakat Collection in Indonesia and Malaysia



Source: National Zakat Statistics BAZNAS and Annual Report of the Malaysian Zakat Collection Centre

The collection of zakat in Indonesia and Malaysia, including Zakat Mal and Zakat Fitrah, had an upward trend from 2015 to 2021. The continuous rise in zakat collection during the pandemic can be explained by its dual nature as both a religious obligation and a voluntary act of solidarity. This strong philanthropist tendency is largely shaped by Islamic principles, which emphasize that charitable giving serves as a means to avert potential adversities (Faza & Indriani, 2022). Unlike discretionary charitable giving, zakat is a compulsory duty for Muslims whose wealth meets the nisab threshold, which ensures a relatively stable inflow of funds even during economic downturns. This mandatory character sustains compliance and explains why zakat payments increased despite declining household spending in 2020. At the same time, the COVID-19 crisis heightened social awareness and moral responsibility (Ali et al., 2021; Nihlén Fahlquist, 2021), motivating many muzakki (payers) to increase their contributions beyond the minimum requirement. Thus, while precautionary savings behavior contributed to reduced private consumption, zakat payment remained resilient due to its theological legitimacy and the perceived urgency to support vulnerable groups affected by the crisis. The pandemic also underscored the role of zakat in strengthening economic resilience. By transferring resources from higher-income groups, who typically have a lower marginal propensity to consume, to mustahik (recipients), who tend to spend additional income immediately, zakat served as an automatic stabilizer. This redistribution not only alleviated poverty but also sustained aggregate demand, thereby mitigating the contraction in household consumption. This investigation builds upon the work of Nofianti et al (2024), which analyzed cash waqf management across Indonesia, Malaysia, and Turkey. However, their study lacks a specific framework model that visualizes the distribution of zakat. Furthermore, although zakat significantly contributes to bolstering economic resilience, especially in times of crisis, there exists a notable scarcity of scholarly attention directed towards comparative studies of zakat management strategies among nations that share similar religious demographics yet possess divergent institutional frameworks. A distinctive model that has been previously established is halal food security grounded in waqf; however, it remains uncertain whether this approach can ensure



resilience during periods of economic upheaval (Hasibuan & Lubis, 2024). Conversely, the investigation conducted by Bilo & Machado (2020) focuses on a comparative analysis of Jordan and Sudan in relation to social protection, a matter of micro-level significance, while this study aspires to engage with more expansive, macro-level issues. Many current investigations predominantly concentrate on individual nation case studies or broad assessments of zakat efficacy, failing to connect these analyses to macroeconomic indicators, such as household consumption and economic growth. Recent research conducted by Shikur et al (2025) delves into the intricate micro-level dynamics of zakat payment behavior in Ethiopia. This methodology was subsequently expanded upon by Chy (2025), who provided a detailed analysis of the criteria for zakat empowerment within the UK context. In parallel, Jamaludin et al (2025) investigated various aspects of public trust in organizations responsible for zakat administration. In contrast, many previous studies explored the viability of integrating blockchain technology within the framework of zakat governance (Hassan et al., 2022; Kassim et al., 2023; Santoso et al., 2020; Susanto et al., 2025). Although these studies contribute to local understanding, they are constrained by their singular emphasis on national contexts and their inadequate exploration of zakat as a tool for economic resilience during global crises, including the COVID-19 pandemic. This research examines the disparity by analyzing the methods through which Indonesia and Malaysia, two predominantly Muslim nations with distinct zakat management frameworks, can effectively distribute zakat to mitigate the economic consequences of the COVID-19 recession. This research identifies strategic variances and policy advancements, facilitating the formulation of strategies for zakat institutions to enhance the effectiveness of Islamic social finance in crisis management. This research also introduces frameworks that various zakat institutions may implement as effective risk management approaches.

## **2. Literature Review**

### *2.1 Role of Zakat in Resilience*

The Zakat Foundation of America defines zakat as “increase,” or in growth. The word also connotes “blessings” (barakah), “purification” (taharah), or “commendation” (mad). Zakat is named as such for three spiritual reasons reflected in the Arabic word: (1) God promises the blessing of “growth” in the wealth of any who pay from their money and property the charity He has obliged; (2) the Zakat-Charity “purifies” its giver of sin; and (3) Zakat may suggest ‘sweetening,’ implying that wealth on which Zakat has not been duly paid remains bitter in this life and the Hereafter. Furthermore, it is essential to comprehend the notions of *“Muzakki”* and *“Mustahik”*. *Muzakki* (a Zakat payer) is an individual who contributes Zakat funds and *Mustahik* (a Zakat receiver) is an individual who fulfills one of the eight conditions for *asnaf* (Zakat recipients) as defined by Islam. The criteria encompass individuals lacking wealth (Fakir), those whose income is inadequate for daily necessities (Poor), enslaved individuals (Riqab), individuals burdened by substantial debts they cannot repay (Gharim), recent converts to Islam (Mualaf), individuals engaged in righteous endeavors for the sake of God (Fi Sabillah), travelers (Ibnu Sabil), and officials responsible for zakat administration (Amil Zakat) (Kahf, 1989; Widiastuti et al., 2022).

Zakat serves as a crucial mechanism for alleviating poverty by providing financial assistance to individuals in need (*asnaf*), thereby empowering them to meet their essential needs and improve their economic situation. This contribution not only mitigates the immediate financial strain but also enhances individuals' economic agency, cultivating enduring economic resilience. Herianingrum et al (2024) elucidate the effective utilization of zakat as a mechanism for alleviating poverty in Indonesia, thereby showcasing its potential to bolster economic resilience through empowerment. Furthermore, zakat plays a pivotal role in fostering sustainable economic development by promoting social equity and mitigating income inequalities.

Initiatives bolstered by zakat, particularly those focused on enhancing the welfare of farmers and fostering financial inclusion within agricultural domains, fortify the economic underpinnings of communities and facilitate sustainable development over time. Mongkito et al (2025) highlight that the function of zakat in enhancing farmers' welfare contributes to the development of more stable agricultural economies, which are essential for fostering sustainable communities. Zakat serves a crucial function in promoting economic development and stability. Historically, the adept management of zakat has been associated with notable economic advancement, exemplified during the governance of Caliph Umar Ibn Abdul Azis. The effective allocation of zakat during that time played a significant role in fostering economic prosperity and ensuring stability. Contemporary research,



including findings by Sarea (2020), indicates that zakat has the potential to invigorate aggregate production and bolster GDP growth, thereby improving overall economic resilience by providing stability during times of crisis. The correlation between zakat and the United Nations' Sustainable Development Goals (SDGs) reinforces its significance in fostering enduring economic sustainability. Initiatives such as the Ummah Economic Development Zone (ZPEU) in Malaysia amalgamate zakat with contemporary technological advancements and strategic collaborations to foster socioeconomic sustainability. According to Majid et al (2024) these initiatives, zakat has the potential to advance the Sustainable Development Goals while enhancing the resilience of local economies, especially within the framework of community development. Furthermore, zakat facilitates the flow of wealth and mitigates the tendency to hoard, thereby fostering ethical investment practices. Through the facilitation of investments in the halal sector and the promotion of ethical business practices, zakat fosters consumer trust and bolsters the development of industries that adhere to the principles of Islamic finance. Hak et al (2024) examine the ways in which zakat has influenced the expansion of the halal industry in Indonesia, highlighting its significance in promoting ethical economic practices that enhance economic resilience.

### *2.2 Comparative Models of Zakat Governance*

The governance of Zakat varies across nations, influenced by their distinct socio-economic, political, and cultural landscapes. In Malaysia, a centralized model of zakat governance is employed, incorporating technology to enhance transparency and efficiency in the zakat collection and distribution processes. Nofianti et al (2024) observe that while Malaysia has established a centralized system bolstered by extensive regulations, a significant challenge persists in the form of legal inconsistencies across states, potentially obstructing the uniform implementation of waqf nationwide. This model demonstrates efficiency in the management and distribution of waqf; however, it is imperative to address the legal disparities among states to facilitate effective waqf management universally. Conversely, Turkey embraces a decentralized framework propelled by the involvement of non-governmental organizations and active community engagement. This model provides enhanced adaptability for local communities to administer waqf. However, it encounters obstacles related to standardization and uniform oversight. Putriani et al (2020) underscore that although decentralization fosters opportunities for community-driven initiatives, there is a pressing need for enhanced monitoring mechanisms to guarantee accountability and efficiency in the management of zakat nationwide.

Indonesia employs a hybrid model that integrates governmental oversight with the active participation of the private sector in managing zakat. Yahya (2020) observes that although this model facilitates enhanced local adaptability, Indonesia encounters considerable difficulties in harmonizing diverse zakat institutions and fostering public confidence in zakat administration. One of the initiatives aimed at enhancing zakat governance in Indonesia involves incorporating technology within zakat institutions, as examined by Widiastuti et al (2021)[author]. It is proposed that augmenting the technological capabilities of zakat institutions may significantly enhance transparency and efficiency in the management of zakat throughout Indonesia, thereby directly influencing the elevation of public trust.

Meanwhile, throughout the Gulf region, zakat administrations prioritize fostering confidence in the distribution of zakat funds to avert connections with terrorist activities, hence rendering transparency imperative (Al-Shamali & AlMutairi, 2022). Prior to Bahrain, Zakat may be expedited during an economic recession to mitigate its effects by facilitating debt repayment, enhancing output, increasing employment, and boosting revenue (Abdelbaki, 2013). Moreover, Uzbekistan is considering the incorporation of zakat incentives into its taxation framework to mitigate tax evasion and enhance the significance of zakat institutions in the national economy. Asadov et al (2024) suggest that integrating zakat incentives into the tax framework could enhance the contribution of zakat to economic development while simultaneously addressing the issue of tax evasion. This further underscores the necessity of a methodical approach to public education regarding zakat obligations, which is essential for the effective implementation of this system.

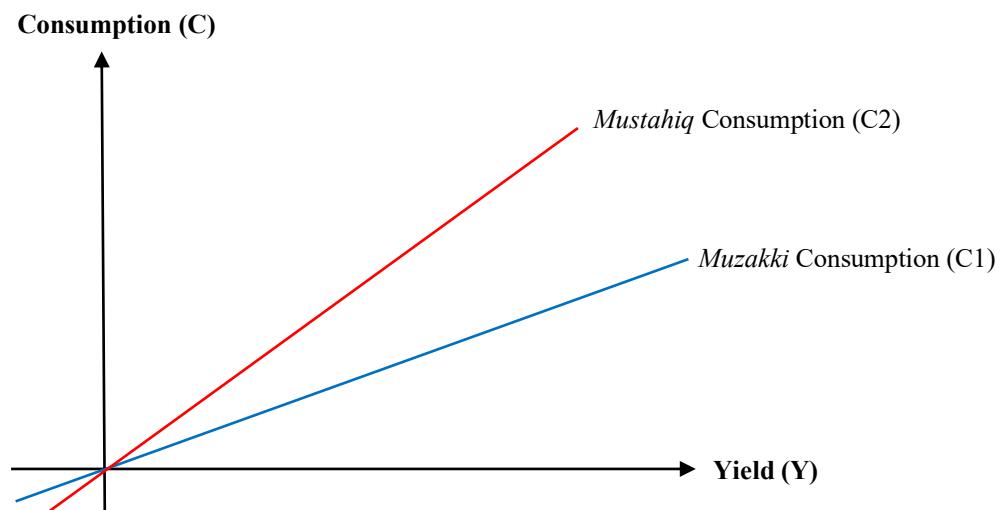
### *2.3 Zakat and Consumption in Islam*

The term zakat, when examined etymologically, encompasses three distinct meanings: blessing, development, and cleansing. The notion of zakat is delineated in Surah At-Taubah, verse 103, which asserts: "Take zakat from their wealth, to purify and

sanctify them, and pray for them.” Certainly, your supplication bestows upon them a profound sense of peace within their hearts. Allah possesses the attributes of being All-Hearing and All-Knowing. Thus, Zakat manifests as a significant socio-economic practice of devotion, playing a crucial role in the community's economic development (Muhammad, 2020). The income from Zakat can be categorized into six distinct forms of wealth. The obligatory forms of zakat include gold and silver, agricultural products, commercial goods, livestock, discovered items, and resources extracted from mining operations. The implementation of zakat can potentially harmonize with various governmental or international efforts, such as the Sustainable Development Goals (SDGs), as long as it conforms to the eight Asnaf Zakat. Surah At-Taubah, verse 60, articulates that zakat is designated solely for the poor, the needy, those who administer it, individuals whose hearts are to be reconciled (new converts), for the emancipation of slaves, for those burdened by debt, for the cause of Allah, and for the traveler, as a mandate from Allah. Allah possesses complete knowledge and profound wisdom. The method for assessing zakat management could be executed through the lens of Maqashid Syariah (Hapsari & Abidin, 2016).

The congruence of zakat initiatives with Maqashid Syariah could establish a foundation for the distribution of zakat aimed at achieving collective well-being. The consumption theory in Islam, as articulated by Metwally and Ausaf, posits that the Marginal Propensity to Consume (MPC) among mustahik is greater than that of muzakki. The Marginal Propensity to Consume (MPC), Average Propensity to Consume (APC), and overall consumption within the Islamic economy are observed to be elevated in comparison to those in the conventional economy (Tika Widiastuti et al., 2022). Within the framework of Islamic consumption, zakat influences the consumption patterns of both muzakki and mustahik. The curve representing the consumption function within the Islamic context is illustrated in Figure 4 below.

**Figure 4.** Consumption Curve for *Muzakki* and *Mustahiq*



Source: Lisnawati (2019)

The figure illustrates that the consumption level (MPC) of mustahik surpasses that of muzakki. The economy of the mustahik has been enhanced through the provision of zakat (Lisnawati, 2019). The requirement of zakat ensures that the income of the muzakki is not entirely allocated for personal consumption, but is also disseminated to the mustahik via zakat mechanisms. The role of consumption within the framework of Islam is articulated as follows (Hapsari & Abidin, 2016):

The equation for the consumption of Muzakki can be expressed as  $C = C_0 + b(Y - Z)$ .

The consumption of Mustahik can be expressed as  $C = Z = C_0$ .



The consumption equation of muzakki elucidates that the income obtained has been subjected to zakat deductions prior to its allocation for consumption purposes. The reliance of mustahik on zakat is predicated on the premise that their needs remain unmet.

Research has consistently shown that lower-income demographics, including those who are financially disadvantaged, exhibit a greater marginal propensity to consume compared to their higher-income counterparts. Individuals belonging to middle- and higher-income brackets typically exhibit a diminished marginal propensity to consume, as they are more inclined to allocate a portion of their increased earnings towards savings or investments. Evidence from South Korea indicates that as the transfer size increased, the marginal propensity to consume (MPC) decreased, implying that households with higher incomes were less inclined to utilize the additional funds (Beik et al., 2023, 2024)

Zakat offers strategic benefits compared to subsidies in terms of economic development and social resilience, especially in Muslim-majority nations (Tika Widiastuti et al., 2022). Zakat, as a religious duty, possesses significant moral credibility and fosters voluntary community involvement, rendering it a viable financial resource that does not impose on the state budget. In contrast to subsidies, which rely on fiscal policy and are susceptible to political influence, zakat is administered by community-based institutions, resulting in more precise and effective distribution. Moreover, zakat possesses not only consumptive attributes but also transformative potential through initiatives that empower recipients, fostering economic independence and reducing reliance. During crises such as the COVID-19 pandemic, zakat can serve as a tool for local economic resilience, bolster social solidarity, and enhance public accountability through transparent methods rooted in spiritual and social principles.

### **3. Methodology**

This research employs a descriptive qualitative methodology alongside a comparative framework to examine the distinctions in zakat management practices between Indonesia and Malaysia in the context of the economic downturn induced by COVID-19. Data were sourced from official zakat institutions, such as Badan Amil Zakat Indonesia (BAZNAS Indonesia) and Majlis Agama Islam Wilayah Persekutuan in Malaysia, as well as national statistics, zakat agency reports spanning from 2015 to 2024, academic journals, and government policy documents. The validity of the data was confirmed through the use of audited reports from esteemed authorities and by implementing data triangulation, which involved cross-referencing with peer-reviewed literature and official statistics.

Indonesia and Malaysia were selected due to their shared characteristics as nations with a predominant Muslim population, each having well-established zakat institutions and notable governmental involvement in the realm of Islamic social finance. Both nations experienced similar macroeconomic disturbances during the COVID-19 pandemic, characterized by declines in household consumption and increases in unemployment rates. Nevertheless, they illustrate varying models of zakat governance; Indonesia utilizes a hybrid state-private framework, while Malaysia embraces a more centralized and corporatized structure. This juxtaposition presents a significant opportunity to assess the influence of diverse institutional frameworks on the effectiveness of zakat management during periods of economic turmoil. The analysis employs a descriptive-comparative methodology, incorporating data reduction that aligns with the research focus. It categorizes information into four key aspects: fund distribution focus, mustahik priority, program impact sustainability, and the unique approaches of each country. Data is presented through tables and diagrams, leading to conclusions drawn from a comparative examination of zakat management practices and their relationship with household economic resilience.

This analysis utilizes two fundamental macroeconomic indicators: economic growth and household consumption. The data on economic growth are obtained from the World Bank and various national statistical agencies, while the information on household consumption is sourced from Statistics Indonesia and the Department of Statistics Malaysia. The examination centers on the zakat management framework within Islamic social finance, including distribution methodologies, forms of support, and trends of empowerment or consumption aimed at mustahik.



#### **4. Result and Discussion**

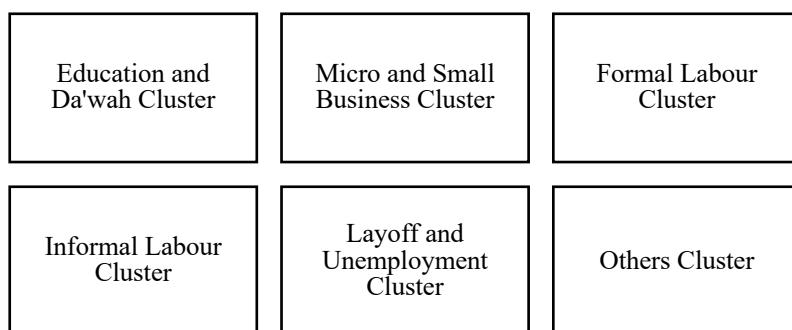
##### *4.1 Zakat Management in Indonesia during the COVID-19 Pandemic*

The administration of zakat in Indonesia is systematically structured into five fundamental sectors: economics, education, humanitarian initiatives, social services, and religious outreach. The National Amil Zakat Agency (BAZNAS) is the exclusive institution established by the Indonesian government, as per Presidential Decree No. 8 of 2001, tasked with collecting and distributing Zakat, Infaq, and Sedekah (ZIS) on a national scale. The legal framework was further enhanced through the enactment of Law Number 23 of 2011 concerning Zakat Management, which solidified BAZNAS's position as the authoritative entity for national zakat administration. BAZNAS functions as a non-structural government agency, operating autonomously while maintaining accountability to the President via the Minister of Religious Affairs. Consequently, BAZNAS, in partnership with the government, holds the responsibility of supervising zakat administration in alignment with Islamic principles. The principles encompass trust, benefit, justice, legal clarity, integration, and responsibility. The agency plays a crucial role in ensuring the equitable and efficient administration of zakat, promoting transparency, and upholding adherence to the principles of Islamic law in the allocation of zakat. BAZNAS has delineated six facets to serve as guidelines for the management of zakat in the context of the COVID-19 pandemic, as follows (BAZNAS, 2020):

1. Distribution of zakat funds for COVID-19 handling in accordance with sharia and applicable regulations in Indonesia;
2. The distribution of zakat funds for COVID-19 handling does not violate the established health protocols;
3. The mechanism for distributing zakat funds for COVID-19 handling uses a push approach (approaching those in need), not a pull approach (gathering those in need);
4. Strengthening coordination with the government/COVID-19 task force in the distribution of aid;
5. Establishing six clusters of target beneficiaries; and
6. Establishing two program groups as vehicles for distributing aid.

The six clusters that are the target beneficiaries of zakat assistance during the COVID-19 pandemic can be seen in the following Figure 5 (BAZNAS, 2020):

**Figure 5.** Clusters of Beneficiaries of BAZNAS RI Zakat Assistance



*Source: BAZNAS Report on COVID-2019 Pandemic Response, 2020*



The detailed grouping of mustahik targets for each cluster is detailed in Table 1 below:

**Table 1.** Cluster and Target of Mustahiq BAZNAS RI in Countering the Impact of COVID-19

No	Cluster	Target of Mustahiq
1.	Education and Da'wah Cluster	Honorary teachers/lecturers, clerics, Quran teachers, and mosque caretakers
2.	Micro and Small Business Cluster	Salons, Barbers, Small Food Stalls, and Street Vendors
3.	Formal Labour Cluster	Parking Attendants, Rickshaws, Office Boy, Masseurs, and School Canteen
4.	Informal Labour Cluster	Factory Workers
5.	Layoff and Unemployment Cluster	Factory Workers who were laid off
6.	Others Cluster	According to the assessment results of the BAZNAS Programme Implementation Team

*Source: BAZNAS Report on COVID-2019 Pandemic Response, 2020*

In implementing its assistance programme across the six designated clusters, BAZNAS also operates two dedicated “vehicle-based initiatives” designed to enhance outreach and service delivery. These programmes serve as logistical support mechanisms to ensure the timely and effective distribution of aid. The two “vehicle programmes” are as follows:

**1. Health Emergency Programme**

- a. Health Programme
  - Education and Socialisation of Clean and Healthy Lifestyle
  - Disinfectant Spraying
  - Sink Installation
- b. Curative Programme
  - Provision of Personal Protective Equipment for Health Workers
  - Provision of Isolation Room

**2. Socio-economic Emergency Programme**

- a. Strengthening Food Security
  - Family Logistics Package
  - Distribution of Zakat Fitrah
- b. Curative Programme
  - Cash for Work Programme
  - *Mustahik* Cash Assistance Programme



The management of zakat funds in the realisation of the two vehicle programs can be seen in Table 2 below:

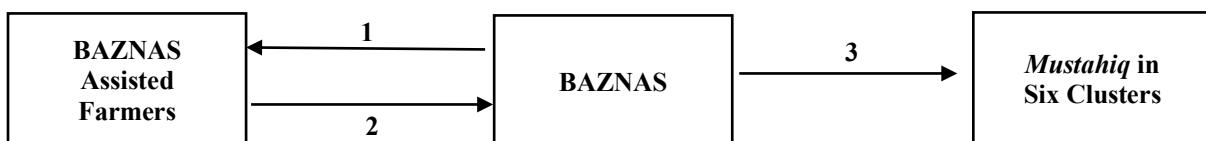
**Table 2.** Realization of Zakat Funds in Distributing the COVID-19 Program in Indonesia

No	Programme Area	Zakat Fund Realization
<b>Health Emergency Programme</b>		
1.	Health Programme	IDR 268,777,411
2,	Curative Programme	IDR 1,823,852,122
<b>Darurat Sosial Ekonomi</b>		
1,	Family Logistics Package	IDR 933,710,000
2,	Distribution of Zakat Fitrah	IDR 170,868,000
3,	Cash for Work	IDR 3,830,125,000
4,	Mustahik Cash Assistance Programme	IDR 70,200,000
<b>Total Zakat Fund Realization</b>		IDR 7,097,532,533

Source: BAZNAS Report on COVID-2019 Pandemic Response, 2020

The implementation of zakat fund distribution demonstrates a significant emphasis on remedial and socio-economic initiatives. This study examines socio-economic emergency programmes due to their significant role in enhancing overall household consumption levels. The Family Logistics Package initiative aims to enhance the capabilities of farmers supported by BAZNAS. BAZNAS extends financial support to mustahik farmers to enhance food production, procures their harvests, and subsequently distributes the products to mustahik clusters impacted by the pandemic. This mechanism serves a dual purpose: it not only allocates assistance but also fosters enduring economic circulation within the grassroots community. The operational framework of this program is illustrated in Figure 5 below:

**Figure 5.** Empowerment-based Family Logistics Mechanism



Source: Authors' elaboration

The explanation of the Empowerment-Based Family Logistics mechanism is as follows:

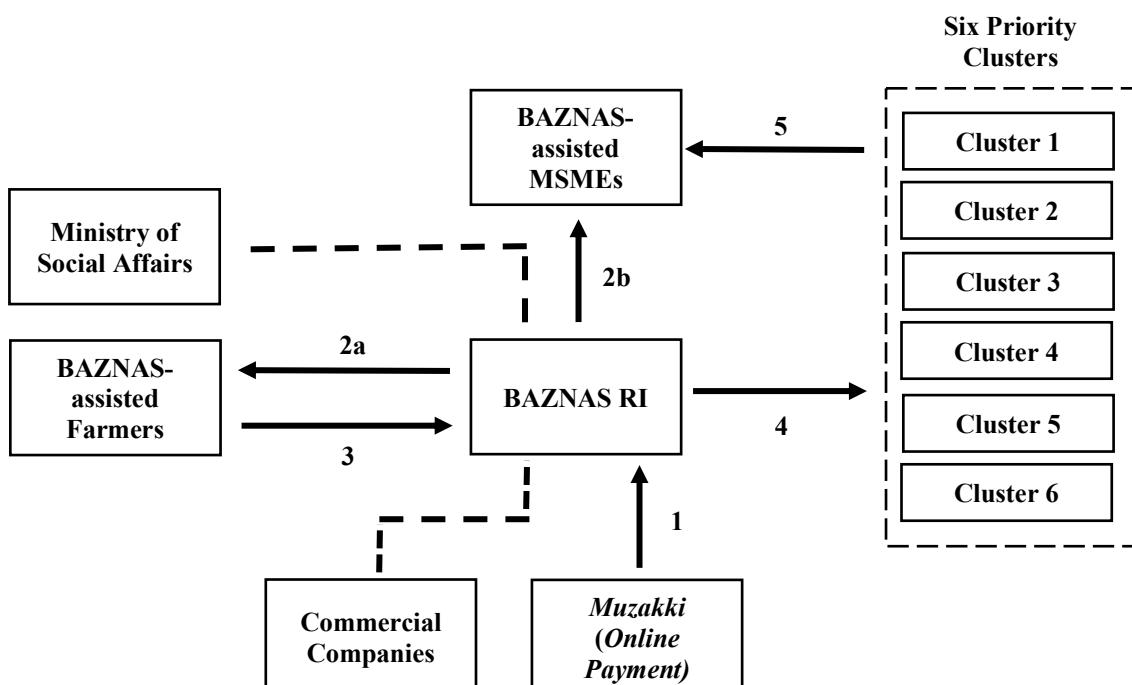
1. BAZNAS provides capital assistance to farmers who are classified as mustahik to improve welfare. The capital assistance is funded from zakat funds for land rent, equipment, and product marketing access assistance,
2. BAZNAS assisted farmers in selling their crops to BAZNAS, and BAZNAS assisted farmers get income from the sales.
3. BAZNAS distributes crops to mustahik who are classified as clusters of BAZNAS beneficiaries during the COVID-19 pandemic. The Family Logistics Programme increases household consumption of assisted farmer families and mustahik who are members of six clusters.

The forthcoming initiative is Cash for Work, a program that engages mustahik in BAZNAS activities. This initiative is categorized into three distinct groups: Vulnerable Groups (those at risk of poverty), MSMEs, and individuals with disabilities. The implementation of zakat distribution for vulnerable groups, specifically mustahik (those eligible to receive zakat), aims to meet both immediate and long-term needs through a range of customized interventions. In the context of mustahik, a direct cash allocation is designated for each activity performed, thereby ensuring that these individuals receive prompt financial assistance that corresponds to the tasks they are involved in. This cash transfer system ensures that assistance is both prompt and directly linked to the recipients' contributions, thereby promoting economic autonomy and sustainability among them. For

micro, small, and medium enterprises (MSMEs), a pivotal initiative centers on reimbursing businesses for vital goods, particularly through a framework that aids enterprises like Z-Mart, which are nurtured under zakat programs. These enterprises receive zakat funds to acquire groceries, thereby supporting their operations and ensuring the livelihood of their employees. This initiative promotes the development of small enterprises, ensuring their ongoing ability to serve the local community while simultaneously contributing to the wider economy, thereby generating a multiplier effect that advantages both the business and its surrounding environment. A significant initiative focuses on individuals with disabilities, where zakat is utilized to enhance the capabilities of the mustahik in alignment with their unique skills and competencies. Through the acknowledgment of the abilities and potential inherent in individuals with disabilities, zakat programs aim to create opportunities for their participation in meaningful endeavors that promote both financial autonomy and social integration. This empowerment strategy ensures that individuals with disabilities are not merely recipients of charity but active contributors within the workforce.

The concluding initiative, Mustahik Cash Assistance, aims to address urgent living needs, providing a safety net for individuals facing pressing financial difficulties. This initiative is crucial in ensuring that vulnerable groups can meet their basic needs during times of economic uncertainty, such as during a crisis, while also laying the groundwork for more sustainable long-term solutions. Figure 6 illustrates the framework of zakat management in Indonesia amid the COVID-19 Pandemic, incorporating the Family Logistics and Cash for Work programmes, with oversight from the Ministry of Social Affairs.

**Figure 6.** Zakat Management in Indonesia during Pandemic



Source: Authors' elaboration

The explanation of the mechanism in Figure 6 is as follows:

1. Muzakki facilitates the transfer of zakat to BAZNAS via Online Payment, as opposed to visiting the service office in person. This approach is consistent with the findings of Mutmainah et al (2024), which indicate that online zakat payments during the COVID-19 pandemic can enhance the willingness of muzakki to fulfill their zakat obligations. Widiastuti, Cahyono, et al (2021) contend that the amalgamation of zakat and technology has the potential to enhance the governance of zakat institutions to its fullest extent. Hudaefi et al (2022) noted that prior to disbursing zakat during the COVID-19 pandemic, muzakki tended to consult information on the BAZNAS website to enhance their understanding of zakat. An



additional option is that the muzakki may also provide non-monetary support, including assistance with clothing, food, and beverages. Furthermore, organizations in the role of muzakki not only allocate zakat funds but also engage with BAZNAS to create employment opportunities for mustahik

2. BAZNAS is required to collaborate with the Ministry of Social Affairs to validate those in need of assistance through zakat. The zakat funds collected from the muzakki are distributed through two programs, namely:

**2a: Family and Farmer Mentorship Logistics Program**

BAZNAS provides business capital to the fostered farmers who are classified as mustahik,

**2b: Programa de Efectivo por Trabajo**

BAZNAS provides incentives to fostered MSMEs to enhance digital marketing and offers special discounts for registered mustahik.

3. The farmers under the foster program market their produce to BAZNAS. The proceeds from these sales will increase the income of the fostered farmers, subsequently boosting aggregate household consumption. This model perpetuates the economic cycle of purchasing and selling farmers' harvests, thus fostering a sustainable economic system.
4. BAZNAS extends support to six priority clusters of mustahik amidst the COVID-19 pandemic through three distinct packages. The initial package comprises food assistance derived from the harvests of supported farmers. The subsequent package entails temporary financial support. The third package comprises discount vouchers for shopping at MSMEs supported by BAZNAS. The implementation of these three packages is poised to enhance the overall consumption levels of mustahik households.
5. Beneficiaries from six priority clusters can acquire products from supported MSMEs at reduced prices by utilizing discount vouchers. This acquisition enhances the consumption patterns of beneficiary households while concurrently promoting the sustainable sales of supported micro, small, and medium enterprises. This model sustains the momentum of the business economy during the challenging period brought about by the pandemic-induced economic downturn.

The integrated zakat management scheme illustrated demonstrates a dynamic and adaptive approach by BAZNAS in responding to the socioeconomic challenges posed by the COVID-19 pandemic. By leveraging digital payment systems, institutional collaboration, and targeted assistance packages, the mechanism not only facilitates efficient zakat collection but also ensures its strategic distribution to mustahik through productive and consumptive channels. The inclusion of mentorship programs, employment creation, and support for MSMEs reflects a holistic model that goes beyond immediate relief, aiming to stimulate local economic activity and foster long-term resilience. This scheme is particularly important as it exemplifies how zakat, when managed innovatively and inclusively, can serve as a powerful instrument for social protection, economic empowerment, and sustainable development during times of crisis.



During the post-recovery period in 2021, BAZNAS's program orientation underwent a strategic shift from productivity-based initiatives, such as empowerment and income-generating activities, to more consumptive assistance aimed at fulfilling immediate basic needs. This transition is further illustrated in the following Table 3, which outlines the specific forms and mechanisms of support implemented during that phase.

**Table 3.** Zakat Allocation on Post-Recovery

<b>No</b>	<b>Programme Area</b>	<b>Zakat Fund Realization</b>	
<b>National Action Plan Programme</b>			
1.	Grave Digger Assistance Package	IDR	1,960,964,800
2.	Personal Protective Equipment Assistance for Grave Diggers	IDR	1,311,563,421
3.	Isolation Room Support	IDR	1,397,902,900
4.	Immunity Package Assistance	IDR	14,397,902,900
5.	Emergency Tent Assistance	IDR	738,763,000
6.	Oxygen Support in Healthcare Facilities	IDR	3,547,058,475
<b>Protect Religious Leader Programme</b>			
1.	Immunity Package	IDR	532,900,509
2.	Vaccination Package	IDR	1,577,284,186
3.	Salaries of Religious Teachers in Remote Areas	IDR	738,763,000
<b>Protect SME Programme</b>			
1.	Cash Capital Assistance	IDR	21,460,029,065
2.	Shop Assistance	IDR	672,145,000
<b>Protect Orphan Programme</b>			
1.	Orphan Education Scholarship	IDR	738,763,000
<b>Total Zakat Fund Realization</b>		IDR	30,005,706,235

Source: *Outlook Zakat Indonesia, 2022*

BAZNAS's zakat allocation for post-pandemic recovery emphasizes support for MSMEs to avert their collapse. Furthermore, it emphasizes the provision of immunological packages to high-risk areas. This indicates that the allocation of zakat for pandemic recovery is threefold more than during the pandemic itself.

#### *4.2 Lesson Learned from Zakat Management in Indonesia*

The insights gained from zakat management in Indonesia throughout the pandemic underscore the significance of uniting diverse stakeholders to enhance economic resilience. The Ministry of Social Affairs plays a pivotal role in facilitating the distribution of zakat, exemplifying the crucial collaboration between governmental bodies and zakat institutions. The collaboration between governmental entities and groups supported by BAZNAS, including farmers and MSMEs, exemplifies the effective utilization of zakat for economic recovery in times of crisis, thereby safeguarding the livelihoods of the most vulnerable sectors. Furthermore, the incorporation of technological advancements in zakat governance, particularly through online payment platforms for muzakki (donors), has emerged as a pivotal factor in enhancing the efficacy of both zakat collection and distribution. BAZNAS RI's capacity to manage zakat donations via digital platforms has enhanced donor accessibility and expedited the distribution process to beneficiaries. This model represents a crucial advancement in the modernization of zakat management in Indonesia, positioning zakat as a means for sustainable socio-economic development rather than merely a temporary relief solution. Third, the framework comprising six priority clusters, as illustrated in the diagram, offers a systematic method for zakat distribution, concentrating on the most pressing areas of need during the pandemic. The alignment of these clusters with Indonesia's overarching economic recovery initiatives is noteworthy, as they channel zakat funds into sectors that demand urgent focus, including health, agriculture, and small and medium-sized



enterprises. The precise delineation of priority areas enables zakat institutions to allocate their resources with efficacy, thereby fostering economic stability and enhancing resilience within at-risk communities.

Furthermore, the interplay between commercial enterprises and zakat institutions, as illustrated in the scheme, is instrumental in broadening the reach of zakat distribution. Organizations have the capacity to engage in zakat through their corporate social responsibility (CSR) initiatives, thereby ensuring that zakat transcends individual contributions and is integrated into more comprehensive community support systems. This collaboration aims to connect the private sector with social welfare initiatives, aligning economic contributions with the principles of social justice. Ultimately, the insights derived from Indonesia's zakat management model highlight the imperative for ongoing innovation and adaptation within the governance frameworks of zakat institutions. The integration of digital tools and the systematic targeting of priority clusters underscore the importance of evolving zakat management structures, which will be crucial in addressing future socio-economic challenges. Indonesia's case illustrates the capacity of zakat to address not only immediate challenges but also to play a crucial role in enhancing the long-term economic stability of communities, offering a framework for other nations facing comparable socio-economic and cultural circumstances.

#### *4.3 Zakat Management in Malaysia during the COVID-19 Pandemic*

The administration of zakat in Malaysia, under the auspices of the Federal Territory Islamic Religious Council (MAIWP), has instituted a program titled the COVID-19 Emergency Zakat Assistance. This initiative encompasses five distinct programs designed to address the challenges posed by the COVID-19 pandemic. These include monthly financial support, supplementary special zakat assistance, respiratory aid, daily food provisions during large-scale social restrictions (PSBB), and the provision of pillows and mattresses for the homeless. The administration of zakat in Malaysia amidst the COVID-19 pandemic prioritized consumptive necessities, specifically addressing fundamental and health-related requirements (Hambari & Zaim, 2020). The implementation of the MAIWP program is illustrated in Table 4 below:

**Table 4. Realization of Zakat Funds in the Distribution of COVID-19 Programs in Malaysia**

No	Programme Area	Zakat Fund Realization
1	Monthly Financial Assistance	MYR 9,670,000
2	Additional Spesific Zakat Assistance	MYR 12,100,000
3	Respiratory Aid Assistance	MYR 3,270,000
4	Daily Food Assistance during PSBB	MYR 49,000
5	Pillow and Mattress Assistance for the Homeless	MYR 15,000
<b>Total Realization of Emergency Zakat Assistance</b>		<b>MYR 25,104,000</b>

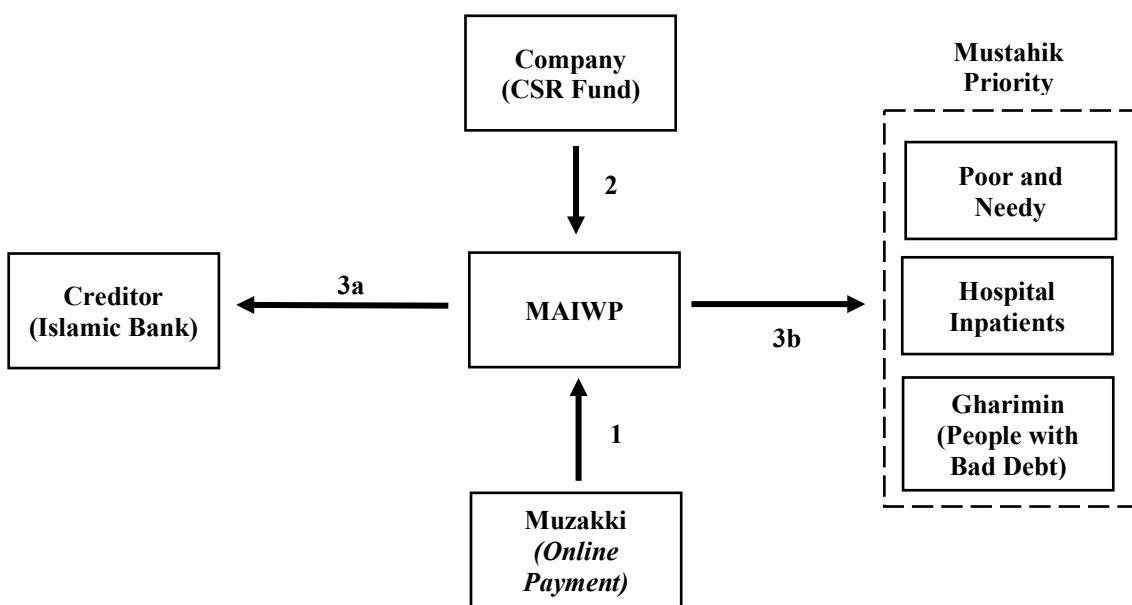
*Source: Majelis Agama Islam Wilayah Persekutuan Website*

The comprehensive analysis of zakat fund realization, as shown in Table 3, underscores the financial obligations undertaken by MAIWP to bolster these initiatives. The overall disbursement of emergency zakat assistance reached MYR 25,104,000, distributed among the five programs, with the most substantial allocation designated for monthly financial support and supplementary specific zakat aid. It is important to recognize that addressing the fundamental daily requirements of individuals, including access to food and essential healthcare services, aligns with the urgent priorities established during the pandemic. This distribution corresponds with Oikawa's (2022) argument that the most critical challenge faced during the pandemic in Malaysia was the reduction in household consumption levels, especially concerning essential needs.

Figure 7 illustrates the framework for zakat management in Malaysia during the COVID-19 pandemic, carefully designed to effectively direct resources to those who require assistance the most. The amalgamation of diverse zakat initiatives, encompassing efforts to deliver respiratory assistance and nutritional support, guaranteed that at-risk communities obtained prompt aid. By prioritizing consumptive needs, MAIWP not only delivered immediate relief but also significantly contributed to alleviating the economic repercussions of the pandemic, particularly for households facing income loss and rising living expenses. Beyond the prompt financial aid, the incorporation of support for the homeless via the supply of pillows and

mattresses exemplifies a comprehensive strategy in the allocation of zakat. This initiative aims to address the needs of a significantly underrepresented segment of the population, seeking to improve their fundamental living conditions during a period of turmoil. The deliberate coordination of zakat funds with urgent needs reflects a meticulous strategy for resource management in times of crisis, thereby augmenting the efficacy of zakat as a mechanism for promoting social welfare.

**Figure 7.** Zakat Management Scheme in Malaysia during the COVID-19 Pandemic



Source: Authors' elaboration

The explanation of the mechanism is as follows:

1. Muzakki distributes zakat to MAIWP through Online Payment, rather than coming directly to the service office. This method aligns with research, which states that paying zakat online in Malaysia during the COVID-19 pandemic increases muzakki trust and minimizes risk.
2. The company distributes zakat funds as part of its corporate social responsibility (CSR) to MAIWP. The company's CSR funds serve as a promotional tool to the public in the company's halal label.
3. Zakat collection and CSR funds are allocated to two priority channels:
  - 3a:** The management of zakat funds in Malaysia during the COVID-19 pandemic participated in helping individuals who were unable to continue paying financing instalments (gharimin) in Islamic banking. Therefore, MAIWP fulfilled its debt repayment to the concerned creditor (Yamaludin et al., 2023).
  - 3b:** The management of zakat funds is also focused on three clusters: the poor, hospital inpatients who require respiratory equipment assistance, and gharimin. The assistance provided to the poor and gharimin is in the form of cash assistance. The assistance provided to hospitalised patients is respiratory equipment assistance.

#### 4.4 Lesson Learned from Zakat Management in Malaysia

The insights gained from zakat management in Malaysia throughout the COVID-19 pandemic underscore the importance of harmonizing corporate social responsibility with zakat distribution to enhance economic resilience. The diagram illustrates the process by which corporations allocate zakat funds to MAIWP (Majlis Agama Islam Wilayah Persekutuan) through corporate social responsibility initiatives, highlighting a synergistic partnership between the private sector and zakat institutions.



Engaging the private sector in zakat management promotes a more comprehensive approach, enabling corporate entities to make significant contributions to alleviating economic challenges during periods of crisis. Furthermore, the digitalization of zakat collection has proven to be an essential facilitator in improving the efficiency and accessibility of zakat payments. The online payment system enables muzakki (donors) to contribute zakat without the necessity of a physical visit to service offices. This approach not only mitigates the risks associated with physical transactions but also fosters trust among donors, as highlighted by Mahmood et al (2022). The digital platform enables broader engagement, which is essential for ensuring a consistent influx of zakat resources during crises such as the pandemic.

Furthermore, the distribution of zakat funds to two primary avenues supporting the impoverished and aiding hospital inpatients and individuals in debt demonstrates the focused strategy employed by zakat institutions in Malaysia. The emphasis on these sectors signifies a calculated approach to addressing pressing socio-economic issues, ensuring that zakat funds are allocated to regions most severely impacted by the pandemic. The prioritization of individuals burdened by bad debt (gharinim) underscores the multifaceted role of zakat in facilitating financial recovery, tackling not only immediate necessities but also enduring economic challenges. The involvement of creditors, particularly Islamic banks, in zakat management presents a compelling case for examination. The partnership between zakat institutions and creditors provides essential support to individuals struggling to maintain their financing obligations amid the pandemic. This collaboration highlights the adaptability of zakat in addressing the financial challenges faced by individuals, underscoring the notion that zakat should be viewed not only as a charitable act but also as a tool for economic revitalization and debt relief. Ultimately, the strategic emphasis on clusters like respiratory equipment support for hospital patients illustrates the flexibility of zakat management systems in Malaysia. The distribution of zakat resources for medical supplies and equipment amid the pandemic illustrates the potential of zakat to be utilized in addressing particular, unexpected challenges. This flexible approach ensures that zakat remains relevant and effective in addressing both immediate and long-standing socio-economic challenges, thereby enhancing the resilience of communities and individuals during times of crisis.

#### *4.5 Comparative Analysis of Zakat Management in Indonesia and Malaysia in General*

The management of zakat in Indonesia and Malaysia presents a compelling juxtaposition, characterized by distinct approaches shaped by their respective regulatory environments, institutional frameworks, and the integration of technological advancements. Both nations strive to enhance the importance of zakat in alleviating poverty and promoting social welfare; nonetheless, they face distinct challenges and opportunities that shape their approaches. The framework of institutions involved in Zakat management can be classified into three distinct categories: corporatized, semi-corporatized, and non-corporatized. Daud et al (2025) elucidate how these classifications profoundly influence zakat compliance behavior and the overall efficacy of zakat management. In light of the significant progress observed within the Malaysian zakat sector, it is imperative to acknowledge the governance and innovation challenges that institutions continue to encounter. There is a pressing need for the refinement of governance frameworks to address the excess of non-distributed zakat funds and to optimize the collection and distribution methodologies. Moreover, Hamid et al (2020) elucidated that Malaysian zakat institutions have embraced the wakalah zakat method, which actively engages zakat payers (muzakki) in the distribution process, thereby augmenting accountability and efficiency. The incorporation of technological innovations, including Automated Data/Account (AD/AC) and Zakat Performance/Zakat Reporting (ZP/ZR) systems, has yielded beneficial outcomes for zakat institutions; however, there exists considerable opportunity for enhanced technological integration (Abdullah, 2023).

In contrast, Indonesia employs a hybrid approach to zakat management, combining governmental oversight with private sector involvement. This approach aims to harmonize regulatory oversight with local flexibility, while addressing issues related to coordination and public confidence (Hasan & Pasyah, 2019). The administration of zakat in Indonesia is presently evolving from conventional methods, wherein zakat contributors directly allocate resources to beneficiaries, to a more contemporary and systematic approach. This progression is crucial for maximizing the efficacy of zakat in the realm of poverty alleviation. The National Board of Zakat (BAZNAS) occupies a crucial position in this context, emphasizing both disaster relief and the systematic distribution of zakat (Hulwati et al., 2024; Pericoli, 2023). The endeavors pursued by BAZNAS underscore the crucial role of zakat in mitigating the effects of disasters and promoting humanitarian initiatives. Furthermore, Indonesian zakat institutions are progressively emphasizing productive zakat, which seeks to empower beneficiaries by assisting them in the



establishment or enhancement of microenterprises (Arifin & Anwar, 2021). This strategic emphasis aims to cultivate economic independence among zakat beneficiaries, thus augmenting the overall effectiveness of zakat in addressing poverty.

#### *4.6 A Comparative Review of Zakat Management in Indonesia and Malaysia during the COVID-19 Pandemic*

The management of Zakat in Indonesia and Malaysia throughout the COVID-19 pandemic reveals notable distinctions. As previously discussed, these differences are illustrated in Table 5 below:

**Table 5.** A Comparative Review of the Distribution of Zakat Funds in Handling Recession due to the COVID-19 Pandemic in Indonesia and Malaysia

No	Aspect of Difference	Indonesia	Malaysia
1	Focus on Fund Distribution	Productive	Consumptive
2	Priority of Mustahik	Six Priority Clusters	Three Priority Clusters
3	Sustainability Impact	Long term, due to empowerment initiatives	Short term, but more focus on specific Mustahik targets
4	Program Uniqueness	Empowerment mechanism involving farmers and SMEs	More focused Mustahik targets, such as prioritizing distribution for poor, gharimin, and homeless

Source: Authors' elaboration

This study not only identifies differences but also rigorously evaluates the efficacy of the zakat policies implemented by each country. Indonesia's model, centered on empowerment, reveals enduring advantages by invigorating productive endeavors among the mustahik, promoting sustainable income generation, and strengthening local economic cycles. This methodology may act as a paradigm for Malaysia and other nations aspiring to transcend mere consumptive assistance in favor of foundational poverty alleviation strategies. In contrast, Malaysia's strategic and adaptive approach to zakat distribution, exemplified by targeted assistance for gharimin and those in medical care, underscores the significance of accurate beneficiary identification and health-oriented support in times of crisis. Indonesia might consider implementing targeted disbursement strategies to more effectively support particular vulnerable populations. The interplay of these models can enhance the effectiveness of zakat in providing both urgent assistance and fostering enduring economic stability.

In light of the merits inherent in both models, it is important to acknowledge the persisting limitations that warrant consideration. In Malaysia, a significant institutional challenge lies in the inadequate disbursement of zakat funds, frequently attributed to bureaucratic inefficiencies and rigorous eligibility verification procedures. This may result in postponements in the provision of assistance and unutilized funds, particularly during critical periods of necessity such as the pandemic. Furthermore, although Malaysia's emphasis on consumption caters to immediate welfare needs, it may fall short in fostering sustainable economic recovery in the long run. Indonesia faces challenges in harmonizing its decentralized zakat management system, resulting in fragmented initiatives and varying degrees of implementation consistency. Identifying and addressing these institutional limitations is crucial for enhancing the effectiveness of zakat in promoting economic resilience.

## **5. Conclusion**

This research highlights the significant differences in zakat governance between Indonesia and Malaysia as they respond to the economic crisis triggered by the COVID-19 pandemic. The four primary factors that distinguish the two nations encompass the orientation of fund allocation, the priority demographics of beneficiaries, the sustainability of impact, and the distinctiveness



of the programs executed. Indonesia prioritizes the empowerment of economic beneficiaries through a productive methodology, whereas Malaysia places greater emphasis on supporting consumers to fulfill the fundamental needs of vulnerable communities. Despite their differing methodologies, both exhibit commonalities in the implementation of digital-based zakat payment systems, which have demonstrated an enhancement in muzakki trust and the precision of zakat management.

Considering these findings, it is advisable for the governments of Indonesia and Malaysia to continue enhancing their digital infrastructure, with a particular focus on expanding internet accessibility and promoting investment in the Islamic financial technology sector. The digitalization of zakat represents a forward-thinking approach to broaden the pool of zakat contributors and enhance the efficiency of zakat allocation. Indonesia might consider establishing a zakat gharimin initiative targeting individuals burdened by digital debt, including online loans, as a means of addressing modern economic challenges. Moreover, zakat should be established as a tangible public policy tool for tackling the socio-economic challenges faced by the community, rather than being viewed solely as a ritual duty. Consequently, enhancing the governance of zakat necessitates cooperative efforts among nations with significant Muslim populations. Cooperation platforms like the Organization of Islamic Cooperation (OIC) and ASEAN serve as valuable avenues for exchanging best practices, technological advancements, and harmonizing cross-border zakat policies. Collaborative benchmarking and digitalization initiatives will enhance transparency and facilitate a more effective expansion of zakat distribution outreach.

Future research should focus on investigating the enduring effects of different zakat models on financial inclusion, poverty reduction, and economic recovery following crises. Engaging in comparative research that encompasses a greater number of Muslim-majority countries will deepen our comprehension of the institutional efficacy and policy advancements related to zakat. Furthermore, the expansion of zakat model replications to nations with minority Muslim populations is essential for uncovering contextually relevant and inclusive strategies for global zakat governance.

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# IMPACT OF HIGH-PERFORMANCE WORK SYSTEM (HPWS) ON EMPLOYEE JOB ENGAGEMENT AND JOB PERFORMANCE WITH MODERATING ROLE OF ISLAMIC WORK ETHICS

**Qayyum Iqbal<sup>1</sup>**

Riphah International University, Pakistan  
ORCID  <http://orcid.org/0009-0004-0509-6846>

**Sidra Bano<sup>2\*</sup>**

\*Contact Author University of Molise, Department of Economics, Campobasso, Italy, Email: [sidra.awan7079@gmail.com](mailto:sidra.awan7079@gmail.com)  
ORCID  <https://orcid.org/0009-0002-0814-1468>

**Muhammad Aqib Khursheed<sup>3</sup>**

Gabriele d'Annunzio University of Chieti-Pescara, Italy.  
ORCID  <https://orcid.org/0009-0002-5118-1297>

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## Abstract

The current study examines the impact of High-Performance Work System (HPWS) on Employee Job Engagement (EJE) and Job Performance with the moderation of Islamic Work Ethics (IWE). The cross-sectional data are collected from the primary source using a self-administered questionnaire. The sample size is 318, and the data is collected from the education sector of Pakistan. For the data collection, the convenience sampling technique is used. The present study shows that the High-Performance Work System has a significant effect on Employee Job Engagement and Job Performance. The present study also shows that Islamic Work Ethics has a positive and significant effect on Employee Job Engagement and job performance; however, the moderating effect is not supported by the results. This study will help the education sector and other policymakers use fair HRM practices in the workplace. This study is limited to a single source of data and a cross-sectional design due to time constraints; however, in the future, many other outcomes and variables can be explored through a longitudinal design in other sectors or industries. Additionally, the study contributes to the literature on High-Performance Work Systems (HPWS), employee engagement, and Islamic Work Ethics (IWE) by addressing gaps identified in previous studies.

**Keywords:** High Performance Work System, Human Resource Management practices, Job Engagement, Job Performance, Islamic Work Ethics



## 1. Introduction

Research on human resource management has gained increasing importance in recent decades as organizations strive to enhance productivity, adaptability, and employee engagement. Within this broader context, the concept of High-Performance Work Systems (HPWS) has emerged as a central theme in both theory and practice. Originating in the 1970s, HPWS represents a set of integrated human resource practices designed to enhance organizational effectiveness by cultivating employee skills, commitment, and performance. This historical evolution illustrates how HPWS has become a cornerstone in industrial relations, organizational behavior, and HRM research, linking human capital practices directly to sustainable competitive advantage. HPWS implementation offers a competitive advantage by enhancing employee commitment through exploring both positive and negative perspectives. The HPWS is considered key to maintaining global competitiveness (Witczak-Turek & Turek, 2021). Guest (2002) suggests the critical perspective of HPWS differentiates between the soft and hard use of HRM practices, focusing on systems and enhancing commitment. According to Huselid (1995), the "HPWS is considered as an umbrella term for the range of innovative HRM practices, work processes and organizational structure which are used in the form of bundles that are mutually reinforcing and produce synergistic benefits."

To cope with continuous change in a dynamic environment and rapid innovation, organizations shift their work nature to be more self-directed and decentralized, allowing employees to take the initiative in solving problems and changing the existing organizational settings (Parker, Williams, & Turner, 2006). According to Mahdi, Liao, Muhammed, and Nader (2014), a High-Performance Work system is "a focus on investment in people, employee empowerment, good communication systems, performance management, fairness in setting pay, promotion on the lines of merit, job security, and low-status differentials". High-Performance Work System is perceived to create value for an organization by creating value for employees, improving productivity, and reducing costs. According to Zhang, Di Fan, and Zhu (2014), it is challenging to improve human resources, particularly in terms of measuring organizational performance. Beekun (1997) defined Islamic Work Ethics (IWE) as "the set of moral principles that distinguish what is right from what is wrong in the Islamic context". According to Belschak and Hartog (2010), employees' proactive behavior is "Employees able and willing to proactively engage problems or potential problems in the workplace, as well as self-direction and self-motivation".

Snape and Redman (2010) examined the effect of HPWS on employee engagement with work and proactive behavior, showing that a positive relationship exists between HPWS and employee engagement, job satisfaction, and job performance. These factors, in turn, contribute to employees' proactive behavior because they are committed to the organization. HPWS positively changes the employee's attitude and behavior, making them feel important to the organization, which in turn encourages them to participate more in the organization's development and growth. A positive relationship was found between HPWS and the range of employees' gains, including positive psychological implications and increased autonomy, in studies of HRM practices (Den Hartog, Boon, Verburg, & Croon, 2013). The consultative elements of HPWS practices contribute to employees' well-being, job satisfaction, and job engagement by enhancing their sense of confidence, worth, and value (Wood & de Menezes, 2011). HPWS practices enhance employees' skill development, which increases their participation and ultimately their behavior towards work and organizational change. It is positively related to the employee's mood and way of thinking.

According to Bateman and Crant (1993), proactive behavior refers to motivated, change-focused behavior at work. Crant (2000) defined proactive behavior as "taking initiative in improving current circumstances; it involves challenging the status quo rather than passively adapting present conditions" (p. 436). The proactive employees act with mindfulness and are more assertive. According to Parker et al. (2006), proactive behavior encompasses behaviors such as searching for ways to change current circumstances, problem-solving, planning, and anticipating future outcomes.

Beekun (1997) defined Islamic Work Ethics (IWE) as "the set of moral principles that distinguish what is right from what is wrong in the Islamic context". Lipset (1990) has historically demonstrated that for the adequate performance of a task, cultural norms and beliefs are crucial, and the internal value of work lies in its quality of performance. It is considered a virtue to dedicate oneself to work. It is derived from the intentions of the work rather than a result of the work. It is necessary to have justice and generosity in the workplace to establish a welfare society. It is an obligation to engage in economic activities to earn a living, and there is no meaning to life without work.

Pakistan's economic environment is characterized by fluctuating inflation rates, periodic unemployment challenges, and overall economic uncertainty, which can influence employee attitudes and engagement levels (World Bank, 2022; State Bank of Pakistan, 2021). Economic instability often increases job insecurity and stress, potentially reducing discretionary effort and motivation. In this context, organizational practices such as High-Performance Work Systems (HPWS) and the reinforcement



of ethical values through Islamic Work Ethics (IWE) become particularly important, as they provide stability, fairness, and motivation that can mitigate the negative effects of economic pressures on employee engagement and performance.

The HRM concept has garnered considerable attention across various sectors, including banking, insurance, and others. Organizations in Pakistan face constraints in improving performance due to employee beliefs and religious considerations, which impact economic development. Islamic Work Ethics (IWE) has not received adequate attention in the banking sector, highlighting the importance of cultural norms in employee satisfaction and engagement. The impact of HPWS on employee engagement, with a moderating role of Islamic Work Ethics (IWE), was not studied together in the banking sector of Pakistan. Secondly, High Performance Work System (HPWS) practices may intensify work, offer employees more discretion and support, in exchange for increased compliance, creative capability, and engaged behaviors. According to Huang et al. (2017), there is a need to explore the impact of HPWS in a collectivistic context, where people are often motivated to work hard for the group's interest, and work intensification might not be a significant issue in such a context. This is a new perspective on research on HPWS in the global market. The most important thing is that this concept needs to be explored in Pakistan's education sector.

In contrast to the social exchange theory, the findings of this study show a positive and significant relationship between High-Performance Work System (HPWS) and employee job engagement. Additionally, we found that job performance and High-Performance Work System (HPWS) are also positively associated. Furthermore, the association between High-performance work system (HPWS) and employee job engagement and performance was hypothesized to be positively moderated by Islamic Work Ethics (IWE), but the results didn't support this moderation effect.

This study will inform the management of the banking sector in Pakistan about how Islamic Work Ethics, or a religious perspective, influences the attitudes and behaviors of employees. This study will greatly aid organizations in improving the effectiveness of employee productivity and their positive attitude towards work, thereby creating value for the organization by developing a strong workforce, enhancing efficiency, and reducing costs. This will contribute to the body of work on HRM by researching the neglected area of employee behavior as the primary recipients of HPWS. The organizations will understand why HPWS affects employees and their psychological outcomes, and how these outcomes may relate to proactive work behavior. They will understand that the fairness perception of HPWS has a strong influence on the employee's reaction and behavior.

The findings of the study will not only contribute to the banking sector of Pakistan, but many other sectors can also use this research as a guideline. By incorporating religious beliefs and Islamic work ethics, they could achieve the desired output. This research will serve as a guideline for those unfamiliar with ethical behavior in the workplace, enabling them to understand the importance of these beliefs. It will also help policymakers design policies that consider ethics in every decision-making process and operational level.

Despite extensive research on High-Performance Work Systems (HPWS) and their impact on employee performance and engagement, important gaps remain unaddressed. Much of the existing literature has been developed in Western contexts, often overlooking cultural and ethical dimensions that shape employee behavior in non-Western environments. In particular, the role of Islamic Work Ethics (IWE) has received limited empirical attention, despite its strong relevance in Muslim-majority societies. Additionally, within the education sector of developing countries, few studies have examined how HPWS practices influence job engagement when mediated or moderated by ethical values. This study addresses these gaps by integrating HPWS, job engagement, and IWE within the context of Pakistani higher education institutions. In doing so, it contributes to both the theoretical advancement of HRM and the practical understanding of how ethical and cultural factors interact with work systems in shaping employee outcomes.

The rest of the study is divided into sections: literature review, methodology, results analysis, discussion, and conclusion.

## **2. Literature review**

Organizations today are not only challenged with managing day-to-day operations but also with adapting to rapid and multifaceted changes in their external and internal environments. These changes include technological advancements, increasing globalization, evolving workforce demographics, and shifting employee expectations regarding meaningful work and ethical practices. Such dynamics require organizations to implement sustainable strategies, such as High-Performance Work Systems (HPWS), to remain competitive while ensuring employee engagement and improved performance. To meet these demands, organizations must have a strong workforce that is proactive and productive. One way to accomplish this is



through the development of a High-Performance Work System (HPWS). Huselid (1995) refers to HPWS as an “umbrella term for the range of innovative HRM practices, work processes, and organizational structures which, when used in bundles, are mutually reinforcing and produce synergistic benefits. Supporting this, Rasool and Nouman (2013) introduced the Total Strategic Resource Approach, which combines universalistic theory, contingency theory, and the resource-based view model. HPWS practices have sub-dimensions, including merit-based, job-environment, and organizational HR practices, enabling HRM to integrate systems without altering core practices, impacting employees’ attitudes and behaviors. However, the term lacks a universally agreed-upon meaning due to varying theoretical approaches.

According to Rich et al. (2010), employee job engagement is the active involvement of workers at work, driven by their own beliefs and energy. The concepts of Job Performance, defined by Jex, Adams, Bachrach, and Sorenson (2003) as “all the behaviors that employees engage in at work” are in line with this engagement. By incorporating these components into HPWS, a proactive and effective workforce is promoted.

Moreover, Islamic Work Ethics (IWE) are essential in situations where moral principles direct organizational procedures. According to Beekun (1997), IWE is “the set of moral principles that distinguish what is right from what is wrong in an Islamic context. By establishing a framework for workforce behavior, these ethical standards ensure that employee conduct aligns with organizational goals. While HPWS has been extensively studied, fewer works have systematically examined IWE in HRM contexts. This study strengthens the review by integrating IWE literature, particularly its influence on employee motivation, perceptions of fairness, and ethical behavior in organizational settings.

The previous study reported that the elements of HPWS contribute to well-being and job satisfaction by enhancing security, worth, and an individual’s sense of value (Wood & de Menezes, 2011). Another study reported a strong association between HPWS and effective commitment, as it is based on positive behavior and emotional intelligence.

### *2.1. HPWS and Job Engagement*

Prior research suggests that High-Performance Work Systems (HPWS) are strongly associated with positive employee outcomes when implemented as coherent bundles of human resource practices (Snape & Redman, 2010). Drawing on social exchange theory (Blau, 1964), employees interpret supportive HR practices, such as training, participation in decision-making, and performance-based recognition, as signals of organizational investment, which in turn foster loyalty, motivation, and engagement (Den Hartog et al., 2013). For example, well-structured training programs not only enhance job skills but also cultivate positive attitudes and organizational commitment (Cooper & Taqueti, 2004). In addition, flexible work arrangements that provide autonomy over time and location have been shown to improve productivity, confidence, and work-life balance, thereby strengthening employee satisfaction and engagement (Hill et al., 2001; Weinert et al., 2008; Sanchez-Hernandez & Grayson, 2012). However, not all findings are uniformly positive. Jensen et al. (2013) caution that excessive demands from HPWS may increase work pressure, potentially reducing job satisfaction and engagement. This highlights the need for a balanced perspective that recognizes both the enabling and constraining effects of HPWS on employee engagement.

H1: HPWS is positively related to employee engagement.

### *2.2. HPWS and Job Performance*

Jex et al. (2003) defined job performance as “all the behaviors that employees engage in at their work”. According to Mahmood, Iqbal, and Sahu (2014), the implementation of fair HRM practices in organizations always motivates employees to perform their duties more honestly and effectively. The fair execution of Human Resource Management (HRM) practices, including equitable compensation, training, and development, enhances employee commitment and job performance. According to Yung Chou and Lopez-Rodriguez (2013), social exchange theory also plays a significant role in job performance, as employees’ reactions to their behavior, perceptions of the organization, and equity perceptions of the methods used in the organization greatly influence job performance.

Favorable HRM practices create positive relationships between employees and management, motivating them to increase their performance. (Moazzezi, Sattari, & Bablan, 2014). Employees should be considered dynamic and powerful workforce assets, as they are not just servants but also valuable assets.

Human attitudes, skills, and behavior are significantly influenced by HRM practices, which contribute to enhanced job performance (Katou, 2008). Jobs are made more attractive to employees by the introduction of friendly and flexible arrangements (Lings & Greenley, 2001). Flexible work arrangements attract more qualified teachers and reduce costs for



employers. Flexible work arrangements also enhance job satisfaction and retention, resulting in increased productivity and overall organizational profitability.

In some countries, temporary hiring is employed to achieve flexible working conditions; however, this trend varies worldwide. (Shuck & Wppard, 2010). To alleviate the tension between workers' work and life roles, organizations have implemented various work-life policies (Ryan & Kossek, 2008). In the context of our country, private school teachers are both hired on a temporary basis, and the permanent faculty is provided with flexible schedules; action is selected depending on the situation. When these school teachers are hired on a temporary basis, this gives relief to the teachers from several upcoming problems from which they might suffer in the absence of flexible work arrangements. Teachers working under flexible work arrangements show a positive attitude towards their job. For example, it is evident from their attitude that they are very much satisfied with their job (Wickramasinghe & Jayabandu, 2007).

HPWS in HRM practices directly impacts job performance through fair incentives, salary enhancements, bonuses, and rewards, motivating employees and demonstrating the organization's commitment to their well-being. In this way, employees become committed and satisfied, due to which their performance increases (Altarawmneh & Al-Kilani, 2010).

H2: HPWS is significantly related to job performance.

### *2.3. IWE and Job Engagement*

Islamic Work Ethics (IWE) emphasize principles such as fairness, honesty, hard work, and social responsibility, which have been shown to positively influence employee commitment and engagement (Sadozai et al., 2013). When organizations embed these principles into HRM practices such as compensation, promotions, appraisals, and performance evaluations, employees perceive operations as just and value-based, which in turn enhances loyalty and performance (Abdul Jalil & Abdul Rahman, 2010). Conversely, when employees feel that they are not treated ethically in accordance with Islamic principles, they may disengage, seek opportunities elsewhere, or even resort to counterproductive behaviors (Treviño et al., 2006).

IWE also enhances job involvement by encouraging employees to perceive work as both a moral duty and a spiritual obligation. As highlighted by Prophet Muhammad (S.A.W.W.), work is a virtuous act that not only sustains life but also cleanses sins, making it an integral part of Islamic teachings (Ali & Al-Owaihan, 2008). Empirical findings support this perspective: Khan, Abbas et al. (2015) found a significant positive relationship between IWE and job involvement, while Yousef (2000) noted that higher levels of IWE are associated with greater workplace satisfaction. This suggests that employees guided by IWE are more likely to put in their full effort, align with organizational goals, and contribute to long-term performance.

From a theoretical standpoint, social exchange theory (Blau, 1964) helps explain these dynamics. When employees perceive that their organization upholds ethical principles aligned with Islamic values, they are more inclined to reciprocate with loyalty, commitment, and higher engagement. On the other hand, perceived violations of fairness and justice may weaken this exchange, reducing motivation and attachment. Taken together, these insights highlight the pivotal role of IWE in shaping employee behavior in HRM settings and underscore its importance as a moderating factor in the relationship between HPWS, job engagement, and performance.

H3: Islamic Work ethics have a direct relationship with Employee Engagement.

### *2.4. IWE and Job Performance*

According to Debeljak, Krkac, and Ragab Rizk (2008), "Islamic work ethics is a direction towards work and approaches work as a valuable asset in the human's lives." Islamic work ethics have a direct relationship with employees' job performance, as they contribute to employee satisfaction, increased commitment, and loyalty, ultimately improving job performance (Jalil, Azam, & Rahman, 2010). Organizational justice is crucial in maintaining job performance, as employees who perceive unethical treatment or unfair treatment may seek opportunities elsewhere (Linda K. Treviño et al., 2006). According to Snipes et al. (2005), Job satisfaction is an emotional state of individuals towards their jobs.

Haroon, Zaman, and Rehman (2012) conducted a research study in Pakistan's healthcare sector. They found that IWE and job satisfaction were positively correlated with each other ( $r = 0.38$ ,  $p < 0.01$ ). Regression analysis indicated that IWE had a significant impact on job satisfaction ( $\beta = 0.754$ ,  $R^2 = 0.135$ ,  $p < 0.05$ ). Bockris and Khan (2013) conducted a study with 182 working individuals in Pakistan, finding that IWE and job satisfaction were significantly and positively correlated ( $r = 0.26$ ,  $p$



$< 0.01$ ). Regression analysis further indicated that IWE has a positive effect on job satisfaction ( $\beta = 0.19, p < 0.05$ ). They stated that the teachings of Islam and IWE suggest that there is no life without work.

The Quran says, “word of thy Lord doth find its fulfillment in truth and in justice; none can change His words” (Quran 6:115).

In the Islamic context, fair practices, such as redistributing wealth in those who deserve it, making decisions that are appropriate to the situation, and placing employees in positions that match their abilities, motivate employees and foster trust in the organization, ultimately leading to improved job performance.

H4: Islamic Work Ethics has a positive and significant relationship with job performance.

#### *2.5. Moderating Role of Islamic Work Ethics between HPWS and Job Engagement*

Islamic Work Ethics significantly influences employee attitudes and behavior by providing them with information about what is right and wrong (Ghorbani et al., 2014). Organizational human resource policies and practices are crucial for employee engagement.

Islamic Work Ethics moderate the relationship between HPWS practices and job performance, as employees are motivated when they understand fair treatment and reasonable compensation. This motivation leads to increased job performance and loyalty. According to Jaros (2007), the importance of positive job experience and organizational practices in fostering employee commitment and engagement. Islamic work ethics practices, which ensure honesty and fairness, can strengthen the relationship between HPWS and employee engagement. Based on social exchange theory, Haar and Spell (2004) suggest that employees show great commitment because the organization meets their expectations.

According to Cojuharenco and Patient (2013), employees' behavior and attitude towards the organization depend on trust, fair treatment, and ethical guidelines. Employee loyalty and satisfaction increase when fair remuneration and ethical treatment are provided, leading to increased attention to work and improved job performance.

H5: The relationship of HPWS and Job Engagement is moderated by Islamic Work Ethics in a way that this positive relationship is strong when Islamic Work Ethics is high.

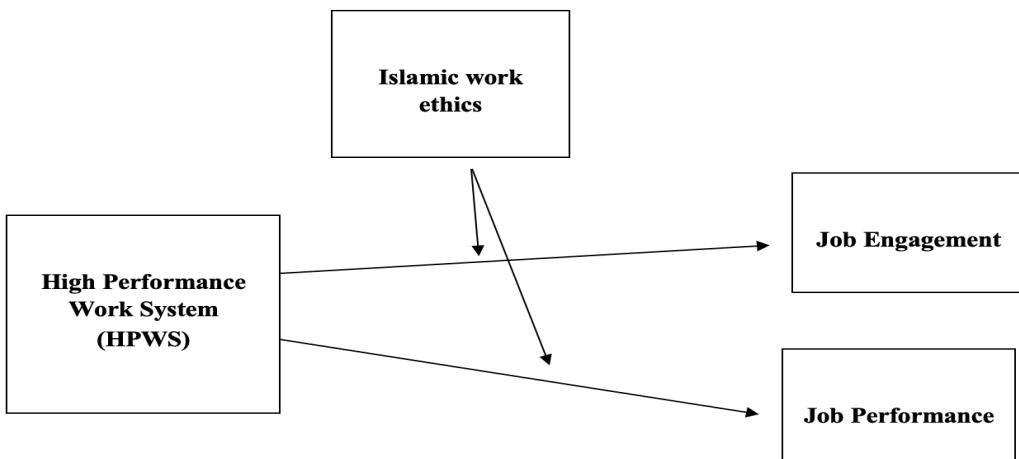
#### *2.6. Moderating Role of Islamic Work Ethics between HPWS and Job Performance*

Islamic work ethics influence employee attitude and behavior by providing them with information about what is right and wrong (Ghorbani et al., 2014). The human resource policies and practices of an organization have a significant impact on employee behavior and performance. According to Huselid (1995), job performance is influenced by the effectiveness of HRM practices, as employees are motivated when they understand fair treatment and reasonable compensation.

The organizational justice theory also supports the relationship, as justice is important for all employees; however, employees from different cultures may behave differently (Crawshaw et al., 2013). According to Cojuharenco and Patient (2013) organizational justice theory supports this relationship, as employees' behavior and attitude towards organizations depend on trust in fair treatment and perception of organizational justice. Employees are more loyal and satisfied when they receive fair remuneration and ethical treatment, leading to improved job performance.

H6: The relationship of HRM practices and Job Performance is moderated by Islamic Work Ethics in a way that this positive relationship is strong when Islamic Work Ethics is high.

**Figure 1.** Research Model



Source: Authors' elaboration

“While prior research has established the positive effects of HPWS on employee outcomes, many studies have examined these relationships in Western contexts, with limited attention to culturally specific factors such as Islamic Work Ethics (IWE) (Huselid, 1995; Sun et al., 2007; Ali, 1988). Furthermore, although employee engagement is often recognized as a mediator between HPWS and performance, few studies have explored how ethical frameworks influence this process. By critically evaluating these studies, it becomes evident that the interaction between high-performance practices and IWE remains underexplored. This gap underscores the need for the present research, which investigates how HPWS, moderated by IWE, affects job engagement and performance, providing insights relevant to organizations operating in Islamic cultural contexts.”

### 2.7. Theoretical Framework

This study is grounded in social exchange theory (Blau, 1964), which provides a theoretical basis for examining the relationship between High-Performance Work Systems (HPWS), job engagement, and job performance, with Islamic Work Ethics (IWE) as a moderator. The survey design was selected as the most appropriate approach to capture employee perceptions of HR practices, ethical values, and behavioral outcomes in organizational settings. Validated scales for HPWS, employee engagement, job performance, and IWE were adopted from prior studies to ensure construct reliability and validity. A stratified random sampling technique was employed to achieve representativeness across different organizational sectors, and data were analyzed using structural equation modeling (SEM), which is suitable for testing complex relationships and moderating effects. These methodological choices ensure that the study’s arguments are built on a strong theoretical foundation and supported by a rigorous empirical design.

High-Performance Work Systems (HPWS) affect employee outcomes through the lens of social exchange theory (Blau, 1964). When organizations implement HR practices such as training, performance-based rewards, and participatory decision-making, employees perceive these practices as signals of organizational support and investment. This perception triggers a sense of obligation to reciprocate with positive attitudes and behaviors, such as higher engagement and stronger performance (Snape & Redman, 2010; Alves et al., 2013). Specifically, HPWS enhances employees’ skills and autonomy, which increases their confidence and intrinsic motivation, leading to deeper psychological engagement. In turn, engaged employees are more likely to exert discretionary effort, demonstrate proactive behavior, and contribute to organizational effectiveness (Kahn, 1990; Saks, 2006). Thus, the mechanism linking HPWS to job performance operates through increased job engagement, making engagement a key mediator in this relationship.

The moderating role of Islamic Work Ethics (IWE) is expected because it shapes how employees interpret and respond to HR practices implemented under High-Performance Work Systems (HPWS). Employees with strong adherence to IWE perceive organizational practices through the lens of fairness, justice, and moral responsibility. When HPWS are consistent with these



values, such as offering equitable rewards, transparent appraisals, and opportunities for participation, employees guided by IWE are more likely to view them positively, thereby enhancing engagement and performance (Ali & Al-Owaihan, 2008; Khan et al., 2015). Conversely, in the absence of strong ethical values, the same practices may be interpreted with skepticism, limiting their effectiveness. From a social exchange perspective (Blau, 1964), IWE amplifies the reciprocity mechanism by encouraging employees to reciprocate with loyalty and discretionary effort in response to supportive HR practices. Empirical studies have also shown that IWE fosters organizational commitment, job satisfaction, and involvement (Yousef, 2000; Rokhman, 2010), suggesting its potential to strengthen the HPWS–engagement–performance pathway. Therefore, IWE is theorized as a boundary condition that enhances the positive influence of HPWS on employee outcomes.

### 3. Methodology

#### 3.1. Research Design

This exploratory study examines the impact of High-Performance Work Systems (HPWS) on employee job engagement and performance, with Islamic Work Ethics serving as a moderating factor. The research is conducted at universities in Rawalpindi and Islamabad (Unit of analysis), using self-administered questionnaires for data collection. Cross-sectional data have been collected in this study. The primary reason for using self-administered questionnaires as a survey method was that, in the past, most research has employed this technique for data collection in similar studies. Moreover, being cost-effective, it has the advantage of less interference from the researcher, hence reducing the possible bias from the respondent. This technique helps respondents complete the questionnaires with ease, allowing most to be master's (55%), bachelor's (32.4%), and MPhil (12.6%) degree holders. to take their time for a justified and well-thought-out response. The study was conducted in Rawalpindi and Islamabad, two major urban centers in Pakistan. These cities were selected because they host a diverse range of organizations, including public and private sector firms, which allows for broader generalizability of findings within urban workplaces. Additionally, their geographic proximity and accessibility facilitated efficient data collection while maintaining a representative sample of employees across different industries. This selection provides a practical and relevant context for examining how High-Performance Work Systems (HPWS) and Islamic Work Ethics (IWE) influence job engagement and performance.

#### 3.2. Population and Sampling

##### 3.2.1. Population

The study involved distributing 450 questionnaires to universities in Rawalpindi and Islamabad, yielding a 71% response rate, with males comprising 79% and females 21%, based on age, education, and experience.

##### 3.2.2. Demographics of the Respondents

**Table 1. Age**

<b>Age</b>	<b>Frequency</b>	<b>Percent</b>	<b>Valid Percent</b>	<b>Cumulative Percent</b>
<b>Valid</b>	20-30	135	42.5	42.5
	31-40	183	57.5	100.0
	Total	318	100.0	

Source: Authors' elaboration

The table above shows the respondents' ages in relation to the research. There are 135 individuals aged 20-30 years, and 183 are aged 31-40.



**Table 2.** Gender

<b>Gender</b>		<b>Frequency</b>	<b>Percent</b>	<b>Valid Percent</b>	<b>Cumulative Percent</b>
<b>Valid</b>	Male	250	78.6	78.6	78.6
	Female	68	21.4	21.4	100.0
	Total	318	100.0	100.0	

Source: Authors' elaboration

The gender table indicates that 68 females are contributing to the current research, while 250 male respondents participate in the study.

**Table 3.** Marital Status

<b>Marital Status</b>		<b>Frequency</b>	<b>Percent</b>	<b>Valid Percent</b>	<b>Cumulative Percent</b>
<b>Valid</b>	Married	181	56.9	56.9	56.9
	Unmarried	137	43.1	43.1	100.0
	Total	318	100.0	100.0	

Source: Authors' elaboration

The analysis reveals that 181 respondents are married, accounting for 56.9% of the total respondents, and 137 are unmarried, which is 43.1%.

**Table 4.** Qualification

		<b>Frequency</b>	<b>Percent</b>	<b>Valid Percent</b>	<b>Cumulative Percent</b>
<b>Valid</b>	Bachelor	103	32.4	32.4	32.4
	Master	175	55.0	55.0	87.4
	MS/MPhil	40	12.6	12.6	100.0
	Total	318	100.0	100.0	

Source: Authors' elaboration

The research, conducted in a government sector organization, reveals that the majority of respondents hold degrees from various institutes, with 32.9% having a bachelor's degree, 55.0% having a master's degree, and 12.6% having an MS/MPhil degree.

**Table 5.** Experience

		<b>Frequency</b>	<b>Percent</b>	<b>Valid Percent</b>	<b>Cumulative Percent</b>
<b>Valid</b>	Below 5	72	22.6	22.6	22.6
	5-10	155	48.7	48.7	71.4
	10-Above	91	28.6	28.6	100.0
	Total	318	100.0	100.0	

Source: Authors' elaboration

The respondents 72 are having the experience less than 5 years, 155 are having 5-10 years' experience, and 91 are having 10 and above years or more of experience in different departments

### 3.2.3. Sampling Technique

Convenience sampling falls under the non-probability sampling category, where all individuals do not have an equal chance of being selected.



### 3.3. Scale and Measures

#### 3.3.1. High Performance Work System

The High Performance Work System will be measured by fifteen (15) items taken from the (Delery & Shaw, 2001). One of its items is “Associates in this job have a reasonable and fair complaint process”. The Cronbach’s Alpha reliability of the scale was 0.731. The responses were obtained through a 5-point Likert scale, ranging from 1 (strongly disagree) to 5 (strongly agree).

#### 3.3.2. Job Engagement

The Job Engagement will be measured by twelve (12) items taken from the (Delery and Shaw, 2001). One of its items is “Do you have the opportunity to do what you do best every day?” The Cronbach’s Alpha reliability of the scale was 0.81. The responses were obtained through a 5-point Likert scale, ranging from 1 (strongly disagree) to 5 (strongly agree).

#### 3.3.3. Job Performance

This variable was measured by using a scale with 5 items Podsakoff and MacKenzie, 1989). One of the sample items was “I fulfill all responsibilities required by my job.” Cronbach alpha reliability of this scale is 0.770 which indicates the satisfactory measuring reliability. The responses were obtained through a 5-point Likert scale, ranging from 1 (strongly disagree) to 5 (strongly agree).

#### 3.3.4. Islamic Work Ethics

This variable was measured using scale of Ali (1992) with 17 items scale. One of the sample items was “Producing more than enough to meet one’s personal needs contributes to the prosperity of society as a whole.” The Cronbach’s alpha reliability of this scale is 0.846, indicating satisfactory measurement reliability. The responses were obtained through a 5-point Likert scale, ranging from 1 (strongly disagree) to 5 (strongly agree).

**Table 6.** Instrumentation sources, Items & reliabilities

Variables	Sources	Items	Reliability
<b>HPWS (IV)</b>	Delery and Shaw (2001)	15	0.731
<b>Employee Engagement (DV)</b>	Delery and Shaw (2001)	12	0.81
<b>Job Performance (DV)</b>	Podsakoff and MacKenzie (1989)	5	0.806
<b>Islamic Work Ethics (Mod.)</b>	Ali, (1992)	17	0.846

Source: Authors’ elaboration

#### 3.3.5. Control Variables

Previous research suggests that demographics such as age, gender, experience, education, and salary significantly influence job performance and satisfaction. In this research, the demographic variables used are gender, age, experience, and marital status. Through a one-way ANOVA test, it has been observed that the results for gender, age, experience, education, and marital status are significant, with p-values of 0.02 and 0.055, respectively. The results for experience and marital status are insignificant. Therefore, the variables of gender, age, experience, education, and marital status are controlled in this result to examine the actual outcomes.

**Table 7.** Summary of Control Variables

S#	Variables	Control Variables
1	Employee Engagement	Gender, Education, Age, Experience, Marital Status
2	Job Performance	Gender, Education, Age, Experience, Marital Status

Source: Authors’ elaboration



### 3.3.6. Data Analysis Procedures

The study investigates the impact of high-performance Work systems (HPWS) on employee job engagement and performance, with a moderating role of Islamic Work Ethics (IWE). Data was collected from universities in Rawalpindi and Islamabad and analyzed using SPSS (Statistical Package for Social Sciences) software. The research aims to help organizations enforce justice in the workplace, such as employee duties, remuneration, wages, recruitment, promotions, and social responsibilities. This will enhance employee performance and nurture their skills at work. Management should also conduct training programs that adhere to Islamic work ethics. The research highlights the importance of generosity and justice in promoting employee welfare.

## 4. Result Analysis

### 4.1. Descriptive Analysis

The table below presents the descriptive statistics of the Mean, Standard Deviation, Skewness, and Kurtosis of the data. The values are as follows: High Performance Work System (HPWS), Mean = 3.595, S.D. = 0.809; Islamic Work Ethics (Moderator), Mean = 2.879, S.D. = 0.741; Employee Job Engagement (EJE), Mean = 2.270, S.D. = 0.786; and Employee Job Performance, Mean = 4.041, S.D. = 0.609. Whereas the Skewness and Kurtosis values also explain the perfect values, as the values are close to zero.

**Table 8.** Descriptive Analysis

Variables	(N=318)									
	N	Min	Max	M	SD	Skewness		Kurtosis		
	Statistic	Statistic	Statistic	Statistic	Statistic	Statistic	Std. Error	Statistic	Std. Error	
<b>IWE</b>	318	1.00	5.00	2.879	0.741	-.088	.137	.014	.273	
<b>EJE</b>	318	1.00	5.00	2.270	0.786	.754	.137	.684	.273	
<b>EJP</b>	318	1.57	5.00	4.041	0.609	-.579	.137	.942	.273	
<b>HPWS</b>	318	1.00	5.00	3.595	0.809	-.379	.137	.098	.273	

Source: Authors' elaboration

### 4.2. Correlation Analysis

A statistical mechanism is typically used to determine the degree of association between two variables. It determines the connections among different variables. It examines the nature of the relationship between dependent and independent variables. In the view of Zhan et al. (2005) the correlation index, it is used to measure the strength of the relationship among different variables. The range of the correlation index (r) typically spans from -1 to +1. The Pearson correlation matrix explains the significance, direction, and potential of the correlation among the variables. There is a perfect correlation among the variables of the study when the correlation index equals 1. Conversely, when the correlation index equals 0, it means that there is no correlation among the variables. The Pearson correlation table shows that all the direct variables have a significant positive relationship.

The table below shows the correlation analysis of the relationship between the independent variable and the dependent variable. HPWS and employee job performance have a strong and positive relationship, with a correlation coefficient of .412 and a p-value of less than 0.01. The other relationships, such as HPWS, have a significant relationship with Employee Job Engagement (r = .197\*\*). All the values show a positive and strong relationship, with less than 8, indicating that no Multicollinearity issue was found in the data. For the assessment of Multicollinearity, another test was run, which identified that the values of VIF are within the range suggested by different researchers.

To assess potential multicollinearity among predictors, variance inflation factors (VIF) and tolerance values were calculated. All VIF values were below 5, and all tolerance values exceeded 0.2, indicating that multicollinearity is not a concern. These results confirm that the predictors HPWS, Islamic Work Ethics (IWE), and their interaction terms contribute unique variance to the regression models, supporting the validity and reliability of the estimated relationships.



**Table 9.** Correlation

<i>(N=318)</i>						
<i>Variables</i>	<i>SD</i>	<i>Reliability</i>	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>
<i>IWE</i>	0.741	.846	1			
<i>EJE</i>	0.786	.855	.379**	1		
<i>HPWS</i>	0.609	1.232	.432**	.197**	1	
<i>EJP</i>	0.809	.806	.321**	.258**	.412**	1

\*\*. Correlation is significant at the 0.01 level (2-tailed),

\*\*\*. Correlation is significant at the 0.001 level (2-tailed)

n=318

Source: Authors' elaboration

#### 4.3. Regression Analysis

##### 4.3.1 Moderation Regression Analysis

Moderation analysis talks about the strength of the relationship that either the moderator strengthens or weakens the relationship.

**Table 10.** Moderation Regression Analysis

<i>Predictor</i>	<i>Employee Job Engagement</i>			<i>Job Performance</i>		
	<i>B</i>	<i>R2</i>	$\Delta R2$	$\beta$	<i>R2</i>	$\Delta R2$
<i>Step I</i>						
<i>Control Variable</i>		.006			.004	
<i>Step II</i>						
<i>HPWS</i>	.185***	.042	.036***	.309***	.170	.166***
<i>IWE</i>	.398***	.145	.139***	.262**	.105	.101***
<i>Step III</i>						
<i>Interaction</i>	-.035n.s	.147	.001	-.030n.s	.197	.001

\*. Correlation is significant at 0.05 level (1-tailed)

\*\*. Correlation is significant at the 0.01 level (2-tailed),

\*\*\*. Correlation is significant at the 0.001 level (2-tailed)

n=318, ns=none significant

Source: Authors' elaboration

The above table of regression analysis reveals that the independent variable, High Performance Work System (HPWS),  $\beta = 0$ , has a significant relationship with employee job engagement ( $\beta = .185$ ,  $p < 0.001$ ). Based on the results, we accepted the hypothesis stated as "High Performance Work System has a significant relationship with Employee Job Engagement" is accepted. The table also shows that the independent variable, i.e., High-Performance Work System, with the other dependent variable, i.e., Employee Job Performance, has values ( $\beta = .309$ ,  $p < .001$ , Significant) that meet the significance criteria, so we accept the hypothesis. The above result shows that IWE has a direct influence on employee engagement ( $B = 98$ ,  $\Delta R^2 p < .001$ ,  $\Delta R^2 = .139$ ). It can be said that the third hypothesis, "Islamic Work ethics has a direct relationship with Employee Engagement," is supported by the result. Similarly, the fourth hypothesis "Islamic Work ethics has a direct relationship with job Performance" is also supported by the results (Beta=.262, P<=.01,  $\Delta R^2 = .101$ ).

The moderation analysis was tested with an interaction term, as shown in the above regression table, and revealed an insignificant relationship with our dependent variable (Employee Job Engagement), with a Beta value of -.035 (n.s.) and the interaction term. So the results do not support our moderation-related hypothesis. Similar to the other dependent variable (Employee Job Performance) and interaction term, which also reveal a beta value of -.030, n.s., indicating that it does not



support the hypothesis, as per the guidelines of different researchers. Although moderation was not statistically supported, this outcome suggests that IWE may function more as a direct predictor rather than a contextual moderator. This finding highlights the need to further explore boundary conditions and cultural contexts in future research.

**Table 10.** Moderation Regression Analysis

<b>Hypotheses</b>	<b>Description</b>	<b>Results</b>
<b>Hypothesis 1.</b>	HPWS is positively related with the employee engagement	Supported
<b>Hypothesis 2.</b>	HPWS is positively related with the job performance	Supported
<b>Hypothesis 3.</b>	Islamic Work ethics has direct relationship with Employee Engagement	Supported
<b>Hypothesis 4.</b>	Islamic Work ethics has direct relationship with job Performance	Supported
<b>Hypothesis 5.</b>	The relationship of HPWS and Job Engagement is moderated by Islamic Work Ethics in a way that this positive relationship is strong when Islamic Work Ethics is high	Not Supported
<b>Hypothesis 6.</b>	The relationship of HPWS and Job performance is moderated by Islamic Work Ethics in a way that this positive relationship is strong when Islamic Work Ethics is high	Not Supported

Source: Authors' elaboration

## 5. Discussion

### 5.1 Discussion of Hypothesis

The first hypothesis (HPWS is positively related to employee engagement) is supported by the above results, and past studies also support the above results. According to Snape and Redman (2010), based on social exchange theory, with the help of HPWS, organizations support employee development by enhancing employees' job skills, enriching jobs, and encouraging the active participation of employees in the decision-making process, and employees act reciprocally in job engagement and become loyal towards work and organization and take initiatives to problem solving. The recent studies suggest that the social exchange relationship between employee engagement and HPWS also find in the international context, on the base of social exchange theory, the effective execution of HPWS create feelings and emotions in the mind of employees which contributes to organization in the international context as Chinese culture based on highly collectivistic culture and group-oriented Chinese employees are motivated to work hard for the company and for the collective good as to get mutual benefit(Hofstede, 1984). When HRM practices are applied fairly within the organization, it creates a positive relationship between employees and the organization's management. The rich and positive connection between employees and management will motivate employees to increase their performance, as they will consider themselves important to the organization (Moazzezi et al., 2014). Employees should be considered as a source of dynamic and powerful workforce assets because they are not just the servants of the organization; they are valuable assets as well.

The second hypothesis (HPWS is positively related to job performance) is supported by the above results, and past studies also support this result. Jex et al. (2003) defined job performance as "all the behaviors that employee engage at their work". According to Mahmood et al. (2014) the implementation of fair HRM practices in organizations always motivates employees to perform their duties more honestly and effectively. They become committed towards the organization and their job performance increases. The fair execution of HPWS in the terms of fair compensation and training and development, employees become committed towards an organization because they receive growth in the career, learning opportunities and advancements and they perform their jobs more efficiently and effectively. When HRM practices are applied fairly within the organization, it creates a positive relationship between employees and the organization's management. The rich and positive connection between employees and management will motivate employees to increase their performance, as they will consider themselves important to the organization (Moazzezi et al., 2014). Employees should be considered as a source of dynamic and powerful workforce assets because they are not just the servants of the organization; they are valuable assets as well. HPWS in the form of HRM practices has a direct relationship with job performance because fair incentive plans based on fair performance appraisal reports, salary enhancements, bonuses, and rewards are useful strategies to motivate employees and reassure them that they are important to the organization and that the organization cares about them. In this way, employees become committed and satisfied, which in turn leads to increased performance (Altarawmneh & Al-Kilani, 2010).



The third hypothesis (Islamic Work Ethics has a direct relationship with Employee Engagement) is also supported by the above results. According to Sadozia (2013), a positive relationship is found between Islamic Work Ethics and employee commitment in the form of work engagement because Islamic Work Ethics develops a positive image in the mind of employees that the organization uses fair practices and ethics in the organizational operations, such as compensation, promotions, appraisal, and performance evaluations. They develop a positive attitude, and in turn, they become committed to the work and work honestly. When employees perceive that they are not treated ethically according to Islamic principles and organization is not treating their employees fairly then they look for opportunities in their own way and they conduct unethical behavior in the workplace to balance the injustice due to which they unable to fully concentrate on their tasks and assigned duties and their performance goes down as they waste their most of time in conflicting with the organization for unfair treatment and injustice (Linda K Treviño et al., 2006). The Quran says, “word of thy Lord both finds its fulfillment in truth and in justice; none can change His words” (Quran 6:115).

Similarly, the fourth hypothesis (Islamic Work ethics has a direct relationship with job performance) is also supported by the above results. According to Debeljak et al. (2008) “Islamic work ethics is a direction towards work and approaches work as a valuable asset in human lives.” Islamic work ethics have a direct relationship with the job performance of employees (Jalil et al., 2010).

According to Abdul Jalil and Abdul Rahman (2010) when organizations use Islamic work ethics in their operations, it helps in the satisfaction of employees, and they become more committed and loyal, due to which their job performance increases as they are motivated that they are treated according to Islamic principles. There is a strong relationship between ethics-related outcomes and perceived general fair treatment within an organization (Linda Klebe Treviño & Weaver, 2001). When employees perceive that they are not treated ethically according to Islamic principles and organization is not treating their employees fairly then they look for opportunities in their own way and they conduct unethical behavior in the workplace to balance the injustice due to which they unable to fully concentrate on their tasks and assigned duties and their performance goes down as they waste their most of time in conflicting with the organization for unfair treatment and injustice (Linda K Treviño et al., 2006). According to Robbin (2005), job satisfaction refers to the emotional states individuals experience towards their jobs. This implies that an employee with a high job satisfaction level will have a more positive attitude toward their job and vice versa. Islamic work ethics and job satisfaction are closely related, and research studies also support the fact that Islamic work ethics have a positive impact on both employee satisfaction and organizational performance. (Yousef, 2001; Vitell and Davis, 1990). The fifth hypothesis (the relationship between HPWS and Job Engagement is moderated by Islamic Work Ethics, such that this positive relationship is stronger when Islamic Work Ethics is high) is not supported by the results. Pakistan has weak economic conditions, and employees are more focused on the good salaries and remuneration instead of recognition and training and development, and that is the reason they do not give more attention to ethics, because they try hard to find the means for getting a salary, specifically in educational institutes, as most of the teachers are contract-based. Secondly, this sample size is not enough for this model, and it cannot analyze the results effectively. According to Baker, Hunt, and Andrews (2006) “we have lost the distinction between what is legal and what is illegal, and also don’t know about ethics. No one hates people who get their money through illegal means. Society is not acting as a restraint”. This unexpected finding suggests that in resource-constrained contexts, financial and contractual considerations may outweigh the ethical or religious drivers of engagement. Future research should disentangle these contextual effects.

Similarly, the sixth hypothesis (The relationship of HPWS and Job Engagement is moderated by Islamic Work Ethics in a way that this positive relationship is strong when Islamic Work Ethics is high) is also not supported by the results. Pakistan is an Islamic country, and HRM practices in the educational sector already include some elements of ethics in implementing these practices. When researchers try to use Islamic work ethics as a moderator, it becomes part of HRM practices and acts as an independent variable instead of moderating the relationship of HRM practices with job satisfaction, due to which hypothesis 6 is not supported.

Although the moderation analysis did not support the hypothesized role of Islamic Work Ethics (IWE) in strengthening the relationship between HPWS and employee engagement/performance, several factors may explain this result. First, employees in the sampled organizations may already perceive high baseline levels of ethical practices, leaving limited variability for moderation to manifest. Second, cultural or organizational norms in Rawalpindi and Islamabad may influence how employees interpret HPWS and IWE, potentially reducing the observable moderating effect. Third, measurement limitations or overlapping constructs between IWE and employee engagement could attenuate the moderation. These considerations suggest that while IWE is theoretically important, its moderating role may be context-dependent or require more precise operationalization in future research.



The findings of this study offer valuable insights into how High-Performance Work Systems (HPWS) impact employee engagement and performance, as well as the interaction between Islamic Work Ethics (IWE) and these processes. Consistent with social exchange theory, employees perceive supportive HR practices as signals of organizational investment, which fosters engagement and discretionary effort. However, the lack of significant moderation by IWE suggests that the influence of ethical values may be context-dependent or potentially saturated among the sampled employees. These insights extend prior research by emphasizing that while HPWS are broadly effective, the alignment of organizational practices with employees' ethical frameworks may vary in impact across different cultural or organizational contexts. Moreover, the study highlights practical implications for HR managers, indicating that combining high-performance practices with ethical considerations can enhance engagement and performance, but the moderating effect of ethics may not be uniform across all settings.

### *5.2 Managerial Implications*

This research underscores the significance of incorporating Islamic Work Ethics (IWE) into organizational practices to boost employee satisfaction, engagement, and job performance. The findings demonstrate a significant positive relationship between IWE and both employee job satisfaction and performance, underscoring that ethical and fair treatment is critical in fostering commitment and motivation.

From a practical standpoint, organizations, regardless of size, can benefit from incorporating IWE principles into HRM policies. Managers are encouraged to implement transparent appraisal systems, ensure fair workload distribution, design ethics-based training programs, and maintain justice and generosity in matters such as recruitment, promotions, compensation, and social responsibilities. Aligning HR practices with employees' ethical expectations not only enhances engagement and performance but also strengthens organizational legitimacy and sustainability.

For policymakers, the study suggests revising workplace regulations and ethics guidelines to reflect Islamic ethical principles, thereby promoting a culture of fairness, responsibility, and respect in organizational settings. These measures bridge the gap between theory and practice by translating the insights on HPWS and IWE into actionable strategies that improve both employee well-being and organizational outcomes, fostering a high-performing and ethically grounded workplace.

### *5.3 Limitations and Directions for Future Research*

The study collects data from private colleges in Rawalpindi, using convenience sampling. The cross-sectional nature of the sample makes it challenging to generalize the results and draw causal inferences. Future studies should consider other organizational behaviors, such as performance, locus of control, turnover intentions, and citizenship behavior.

## **6. Conclusion**

This study examines the impact of High-Performance Work Systems (HPWS) on Employee Job Engagement (EJE) and Job Performance, with Islamic Work Ethics (IWE) as a potential moderator. Data were collected via a self-administered questionnaire from 318 employees in Pakistan's education sector using a convenience sampling approach. The results indicate that HPWS significantly enhances both employee engagement and job performance, while IWE also exerts a positive and significant direct effect. However, the hypothesized moderating role of IWE was not supported in this context.

These findings provide practical insights for the education sector and policymakers, emphasizing the importance of implementing fair and ethical HRM practices to improve employee outcomes. The study also contributes theoretically by integrating HPWS, job engagement, and IWE, thereby extending understanding of how ethical frameworks interact with high-performance HR systems. Limitations include reliance on cross-sectional, single-source data, suggesting that future research could adopt longitudinal designs, explore additional outcomes, or examine other sectors to validate and extend these findings.

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# Exploring the Potential of Islamic Finance in Bridging the Financial Inclusion Gap: A Systematic Review of Literature

Bronson Mutanda<sup>1\*</sup>, Bomi Cyril Nomlala<sup>2</sup>

<sup>1</sup> Manicaland State University of Applied Sciences, City of Mutare, Manicaland Province, Zimbabwe.

Corresponding Author: valemutanda@gmail.com

ORCID  0000-0003-3438-2126

<sup>2</sup> University of Kwa-Zulu Natal, Durban, Kwa-Zulu Natal, South Africa.

ORCID  0000-0001-5471-1172

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## Abstract

Financial exclusion remains widespread and continues to constrain the livelihoods of low-income groups and other marginalised communities worldwide. Islamic finance has expanded rapidly in both Muslim-majority and non-Muslim countries as an alternative means of accessing capital and financial services that comply with the prohibition of riba (interest) and broader Sharī'ah principles. By incorporating fairness, risk-sharing, and contractual discipline into financial transactions, Islamic finance aims to foster a more stable and inclusive economic order. This article presents a systematic review of the literature on the contribution of Islamic finance to bridging the financial inclusion gap, with a particular focus on its effectiveness, constraints, and emerging opportunities. Guided by the Preferred Reporting Items for Systematic Reviews and Meta-Analyses (PRISMA) protocol, a structured search of the Scopus database identified 78 peer-reviewed articles published between 2013 and 2024, of which 29 met the inclusion criteria. The evidence suggests that Islamic banking, microfinance, social finance instruments, and Sharī'ah-compliant fintech can expand access to finance for both Muslims and non-Muslims seeking interest-free products, particularly in underserved market segments. Profit- and loss-sharing contracts, asset-backed modes of financing, and redistributive tools such as zakat and Islamic insurance (takaful) are highlighted as key mechanisms. At the same time, the review documents challenges, including low levels of Islamic financial literacy, regulatory and institutional constraints, uneven geographic penetration, and the phenomenon of financial migration, whereby customers shift from conventional to Sharī'ah-compliant institutions without necessarily increasing overall inclusion. The review concludes that, if appropriately supported by policymakers through enabling regulation, consumer protection, and investment in digital infrastructure, Islamic finance can complement conventional finance in reducing financial exclusion and advancing inclusive and socially just economic development. Future research should deepen comparative analyses across regions and products, and explore how Islamic finance can better serve women, youth, and micro-entrepreneurs facing multidimensional exclusion and inequality.

**Keywords:** Islamic finance; Riba; Conventional banks; Sharia; Muslims; Financial inclusion



## 1. Introduction

The worldwide Islamic finance sector began in the 1960s and 1970s with the multilateral founding of the Islamic Development Bank and the establishment of the first contemporary Sharī'a-compliant financial institutions in Malaysia and a few Middle Eastern nations (Development Bank & Financial Services Board, 2015). Although the majority of Islamic finance is managed by private entities, governments, and the majority of Muslims and those involved in development cooperation are becoming increasingly interested in better controlling how this money is collected and utilized for development (OECD, 2020). Islamic law, based on the teachings of the Qur'an, known as Sharia, forbids Muslims from engaging in any financial dealings involving riba (interest) (Demirguc-Kunt et al., 2014; Rammal, 2020). According to Sharia Enterprise Theory, property is the exclusive domain of Allah, with people merely being entrusted with managing a deposit so that the property might be utilized by others (Dewi, 2022). Islamic banks operate as institutions that accept funds from the public and manage them by investing in profitable business ventures, utilizing a profit-sharing model. Because of this, Muslims are unable to deal with traditional financial institutions since they are unable to pay or receive interest (Jaffe, 2002). The creation of Islamic financial institutions emerged as a means of servicing this niche market (Senghore, 2023). Sharia Boards (SBs) ensure that all products and services provided by Islamic banks adhere to the fundamentals of Sharia law (Haridan, Hassan, & Karbhari, 2018). They regulate and assess all new products offered by Islamic financial institutions, rendering decisions on a case-by-case basis about whether they comply with Sharia law. Currently, the \$2.5 trillion Islamic finance sector is spread across over 80 countries, with most of its value concentrated in a small number of financial markets (Domat, 2024). According to data gathered by the research division of the Union of Arab Banks, over 95% of the world's sharia-compliant assets are concentrated in just 10 countries (Global Finance Magazine, 2024). The role that Islamic finance and banking play in fostering financial inclusion cannot be overemphasized. Financial inclusion plays a crucial role in achieving the United Nations Sustainable Development Goals (UNSGSA, 2018). The importance of financial inclusion was highlighted in seven of the 17 Sustainable Development Goals (SDGs), including those addressing poverty, hunger, health, and gender equality (UNSGSA, 2018).

Islamic finance encompasses a diverse range of organizations and procedures that offer clients high-value services in accordance with the principles of Sharī'ah (Islamic law) (Jouti, 2018). By embracing fintech, digital banking, microfinance, capital markets, insurance, and the latest financial innovations, such as crowdfunding and cryptocurrencies, this financing system has kept pace with the rapid transformations in the financial markets (Global Finance Magazine, 2024). According to Alsmadi (2025) and Cherqaoui (2022), Sharia-compliant fintech companies are emerging globally, both in Islamic and non-Islamic countries, with the potential to attract millions of young Muslim customers and expand financial services to underserved populations. According to future projections, there will be a continued growth in Islamic financing instruments due to two factors: a strong adherence to ethical values (with 76% of Muslims considering religion to be very important and 66% of Muslim consumers willing to pay more for ethical products) and relatively high demographic growth (the global Muslim population is expected to grow from 1.7 billion in 2014 to 2.2 billion Muslims by 2030) (DinarStandard, 2019; Jouti, 2018).

When it comes to its clients, an Islamic bank views itself as a trader and investor, whereas banks in general view each other as either creditors or debtors (Ekonomi et al., 2020). In addition to avoiding interest-based transactions, which are forbidden by Islamic Sharia, Islamic finance, in its broader sense, also aims to abstain from immoral behavior and actively contribute to the realization of the objectives and purposes of an Islamic economy (Islamic Banking Department, 2008). In all commercial transactions, Sharia-compliant finance encourages the sharing of profits and losses, as well as risk. While historically the core principles of numerous major religions (Judaism and Christianity foremost) have prohibited the receipt and payment of interest, Islam stands out in that its adherents' attitudes regarding interest-bearing credit have remained relatively unchanged (Demirguc-Kunt et al., 2014). The article on Islamic finance published in February 2013 explained it as follows: "*In an Islamic bank, the money provided in the form of deposits is not loaned, but is instead channeled into an underlying investment activity, which will earn profit. The depositor is rewarded by a share in that profit, after a management fee is deducted by the bank*" (Association of Chartered Certified Accountants [ACCA]). There are several financing products included in the interest-free Islamic finance system (Makroekonom & Arasindak, 2022). There are two types of Islamic finance available to clients of Islamic financial institutions: equity-based financing and asset-based financing. Among these financing products are murabaha, mudaraba, musharake, salam, exception, and icare, and these happen to be among the most well-known interest-free financing products (Hassan & Mollah, 2018). Research indicates that, compared to other Islamic financial instruments, the financial sector utilizes murabaha at a rate of between 80 and 95 percent (Warde, 2000).



In a *Murabaha* agreement, the financial institution buys the desired good on behalf of the client and then sells it to them in monthly installments at the original price plus a mutually agreed-upon additional markup (Young, 2020). Unlike a conventional interest payment, the monthly installments remain unchanged even if payments are not made on time. Because Islamic banks are bound by the religious doctrine that views money as merely a medium of exchange with no intrinsic worth, they are not allowed to charge interest on loans. Instead, they must impose a fixed fee in order to proceed with their everyday business (Latif, 2013; Young, 2020). Businesses use this type of financing when purchasing machinery, equipment, or raw materials. Additionally, *murabaha* is commonly used for short-term transactions, such as providing importers with letters of credit (Young, 2020). Islamic banks facilitate easy access to essential goods for their consumers through the payment mechanism known as murabaha, which is both user-friendly and compliant with Islamic law. The profitability of Islamic commercial banks increases with the amount of murabaha funding they provide to their clients (Dewi, 2022). Murabahah is the most popular type of financing in demand among customers (Dewi, 2022).

*Mudaraba* is another financial product offered under Islamic finance; in this product, the client offers effort and knowledge and the bank provides resources, or "capital," with profits divided at a predetermined ratio (OECD, 2020; Gundogdu, n.d.; Latif, 2013). The bank bears all of the losses, while the client is adequately protected by limited liability measures (Mahlaba, 2021). Therefore, those involved realize their returns by sharing in the venture's revenues (OECD, 2020; Rammal, 2020). The parties achieve this by agreeing on a predetermined rate for sharing the profit, which ensures that the division of profit is always proportionate and cannot be a lump sum or guaranteed return (Rammal, 2020). The financier gets the principal amount and the pre-agreed portion of the earnings after the business activity is completed (Rammal, 2020). One of the terms of *Mudaraba* is that unless the venture's risk is shared, the financier is not entitled to a fixed rate of return or to any increase in the principal amount. A variation of *Mudaraba* is called *Musharaka*, in which the financial institution is one of many investors and everyone shares in the gains and losses (Demirguc-Kunt et al., 2014). According to Usmani (1998), the term *Musharakah* in Arabic means sharing. The fundamental idea of a *Musharakah* contract is comparable to that of an English law partnership contract, in which one or more parties join together to establish a firm by contributing capital, materials, and/or intellectual property (Imamnazarov, 2020; Nurhayati & Wasilah, 2016). A few other Islamic financial products are *Istisna*, *Salam* (Advance Payment-Deferred Delivery Sale), *Ijarah* (Leasing), and *Musawamah*. The contribution of Islamic banking and finance to financial inclusion is a topic of discussion among academics. According to some academics (Jouti, 2018), Islamic banking and finance promote financial inclusion, whereas other scholars (Warsame, 2015; Hadji, 2021; Sain et al., 2018; Abdul & Asutay, 2022; Ali et al., 2019) suggest the opposite. Against this backdrop, it is crucial to examine the role of Islamic financial institutions in promoting financial inclusion, especially among underserved Islamic communities.

## 2. Methodology

This section outlines the methodology employed to identify and analyze relevant literature for the review. Specifically, it provides an overview of the research design, including the criteria for selecting studies (inclusion and exclusion criteria), the process of data extraction, and the strategies employed to ensure data reliability and validity.

### 2.1 Research Design

This systematic review utilizes the Preferred Reporting Items for Systematic Reviews and Meta-Analyses (PRISMA) guidelines to investigate the potential of Islamic finance in bridging the financial inclusion gap. The PRISMA framework ensures transparency, reproducibility, and quality in systematic reviews. The PRISMA methodology was adopted owing to its comprehensiveness and wider applicability. PRISMA has been applied to several studies across various fields. The research began by specifying the research question: What role does Islamic finance play in fostering financial inclusion? The next step involved conducting a comprehensive literature search. An electronic database (Scopus) was utilized to select articles on Islamic finance from relevant journals. The PRISMA flowchart shown in Figure 1 below outlines the procedures followed to retrieve articles for this review from the Scopus database. As a search strategy, the researchers used Boolean operators AND/OR in order to get articles for the research. In addition, the terms were arranged in the following form: *TITLE-ABS-KEY "Financial inclusion OR Integration" AND ("Islamic AND finance OR banking OR Accounting")*. The terms used in the search process were examined in the study's text, titles, keywords, and abstracts in the Scopus database, spanning the period from 2013 to 2024.



## *2.2 Inclusion and exclusion criteria*

Following the literature search, titles and abstracts were screened for relevance, and full-text articles were assessed for eligibility based on predetermined inclusion criteria. These criteria included peer-reviewed articles, English-language publications, studies focusing on Islamic finance and financial inclusion, and publications from 2013 to 2024. After identifying eligible studies, duplicate publications were removed, and the remaining studies underwent data extraction and analysis. The inclusion and exclusion criteria played a crucial role in guiding the authors' search for relevant studies that directly addressed the research questions. Through applying these criteria, the authors were able to filter out studies that were not aligned with the research objectives, resulting in a more focused and relevant set of studies. However, the authors acknowledge that the inclusion and exclusion criteria had some limitations. One notable limitation was the reliance solely on empirical articles, which may have overlooked valuable theoretical insights from conference papers, book chapters, and other relevant publications. While empirical articles provided rich, real-world experiences, the absence of theoretical perspectives may have resulted in an incomplete understanding of the research topic. Furthermore, language barriers presented another challenge, as the authors were unable to access research papers published in languages other than English. This limitation may have excluded relevant studies from non-English-speaking countries, potentially introducing a bias in the sample of studies reviewed. Despite these limitations, the authors believe that the inclusion and exclusion criteria helped to ensure a focused and relevant review of the literature.

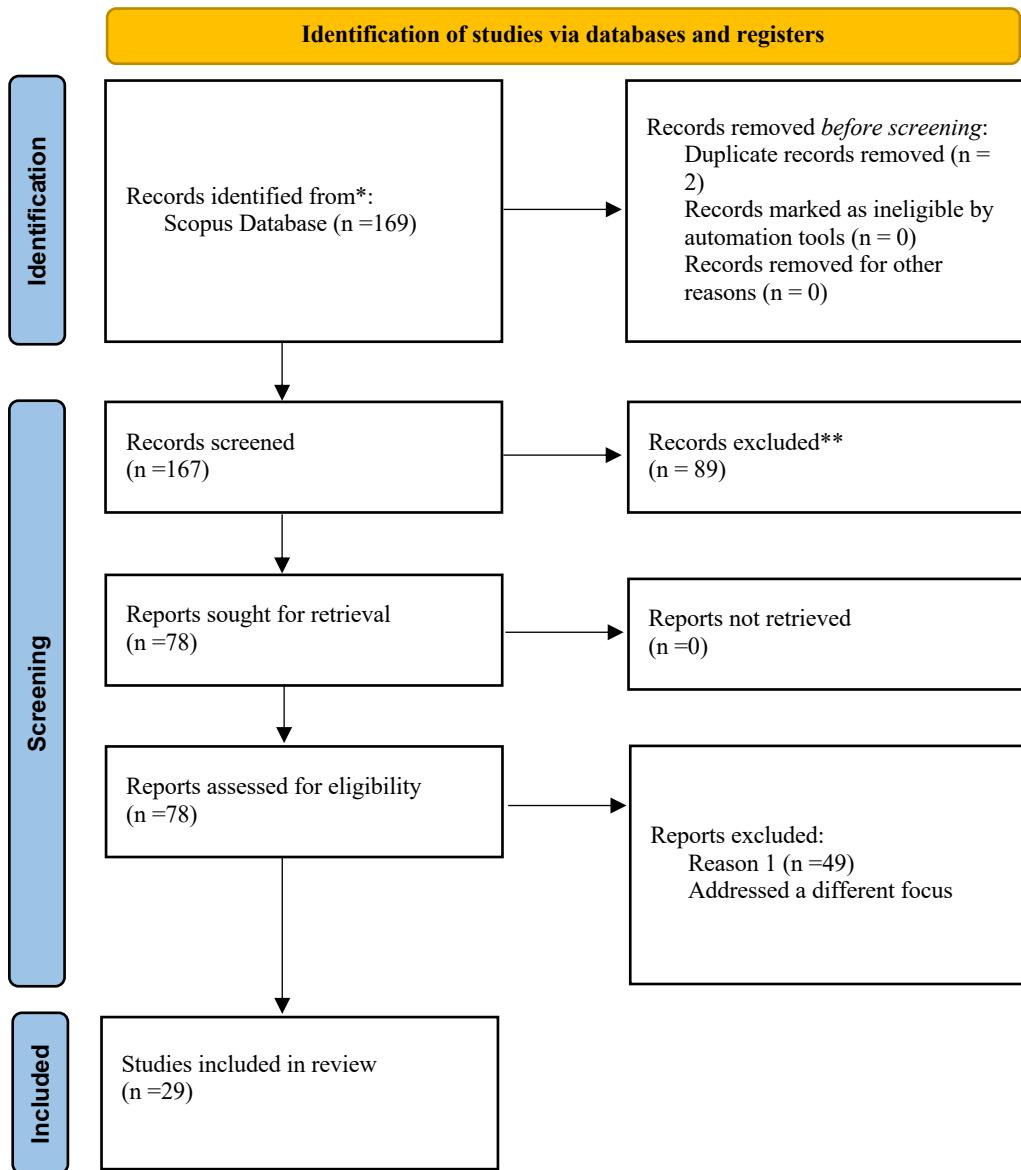
## *2.3 Data Extraction*

The data extraction process commenced with exporting relevant information from identified studies into a Microsoft Excel sheet via a CSV file. The extracted data included abstracts, authors' details, research paper titles, citation counts, and publication years. To ensure the extracted abstracts aligned with the research objectives, a thorough review was conducted. This meticulous examination enabled the researcher to verify whether the abstracts provided the necessary information. Following the initial review, a rigorous screening process was undertaken to finalize the list of documents for inclusion. This involved scrutinizing the titles and abstracts of the exported studies to determine their relevance. To minimize potential bias and ensure objectivity, a coding system was implemented. Abstracts were assigned a binary code: 0, indicating exclusion, and 1, indicating inclusion. To address potential biases, the researchers employed a dual-coding approach, in which both authors independently coded the data. This systematic approach ensured consistency and reliability in the selection process. To further ensure the integrity of the screening process, the researchers engaged in a collaborative discussion to examine the reasons behind the rejection of certain papers. This debriefing session provided valuable insights into the decision-making process, clarifying any discrepancies and reinforcing the consistency of the inclusion and exclusion criteria.

## *2.4 Data Reliability*

Following the rigorous data screening process, the researchers calculated Cohen's Kappa coefficient to evaluate inter-rater reliability. This statistical measure quantifies the agreement between two raters, adjusting for chance agreement (Pykes, 2022). Cohen's Kappa coefficient is calculated as the probability of agreement minus the probability of random agreement, divided by one minus the probability of random agreement. Cohen's Kappa is a widely accepted metric for assessing inter-rater reliability, particularly for qualitative items. Cohen suggested the Kappa result be interpreted as follows: values  $\leq 0$  as indicating no agreement and 0.01–0.20 as none to slight, 0.21–0.40 as fair, 0.41–0.60 as moderate, 0.61–0.80 as substantial, and 0.81–1.00 as almost perfect agreement (Pykes, 2022). In this study, the calculated Cohen's Kappa coefficient was 0.8934, indicating an almost perfect agreement between the two researchers. This high level of concordance validates the reliability of the screening process.

**Figure 1.** The PRISMA process adopted in screening the literature for analysis



Source: Authors' elaboration

The first search yielded 168 documents. The researcher then considered keywords such as "financial inclusion," "Islamic banking," "Islamic finance," "Islamic banks," "Islamic microfinance," "Islamic social finance," and "Islamic fintechs" to filter these documents. This filtering process saw 115 documents remaining and 52 documents being excluded. The researcher also used the subject area as a filtering criterion, limiting the documents to Economics, Econometrics and Finance, Business, Management, and Accounting, and Computer Science. Researchers considered articles from these subject areas because they are likely to give relevant information. The filtering process also excluded conference papers, books, and review papers, resulting in 35 documents being screened out, leaving us with a total of 79 articles. The research also filtered all articles written in languages other than English. Only one article was filtered using these criteria, resulting in 78 articles for the researchers. The rationale for using language as a filtering process is that researchers can only read articles written in English and not in any other language. Following this entire procedure, researchers exported the data into Microsoft Excel using CSV format, including

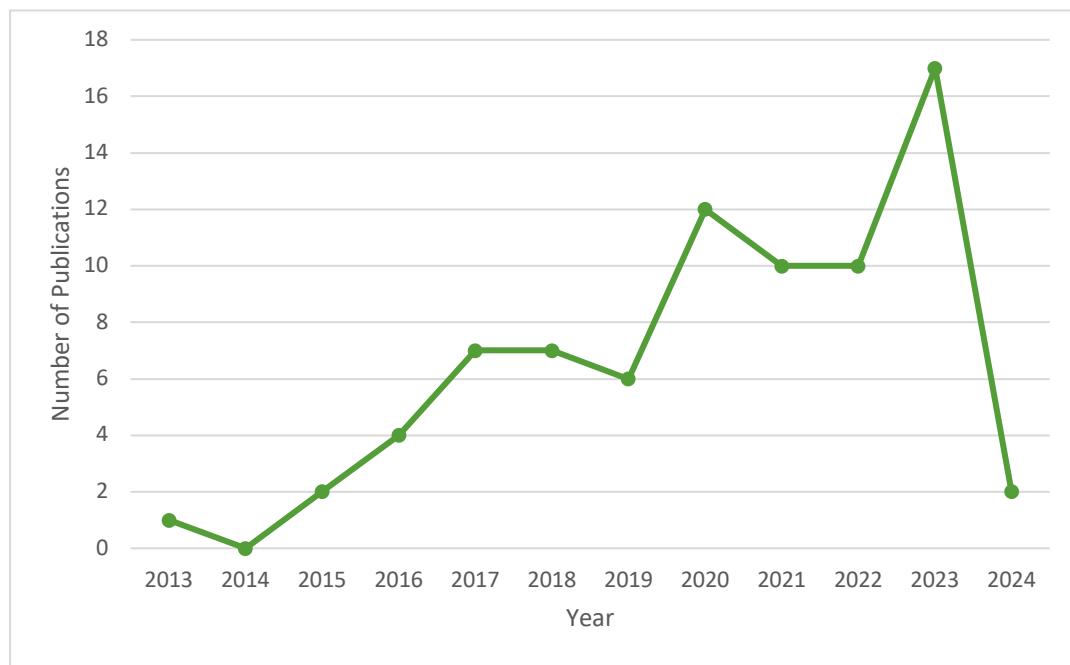


keywords, abstracts, authors, publishers, and the number of citations. A comprehensive analysis was conducted on the remaining 78 studies, examining the abstract, full text, and conclusion content. At this point, 49 studies were eliminated because they did not address the research's main objective.

### 3. Results

Before the final screening of the retrieved documents, researchers observed that most publications on Islamic finance and financial inclusion were from 2023, followed by 12 publications in 2020, and 10 publications in both 2021 and 2022. Figure 2 below represents the trend of publications related to Islamic finance and financial inclusion. From this graph, it's clear that scholars are giving more attention to the subject in question. It is also revealed through Figure 2 that in 2014, there was no publication on Islamic finance and financial inclusion. This graph represents that Islamic finance and financial inclusion are gaining more attention among scholars.

**Figure 2. Number of Publications on Islamic Finance and Financial Inclusion from 2013-2024**



Source: Authors' elaboration

**Table 1. Documents by Country or Territory, Affiliation, and by Author**

Top 10 Countries with research on Islamic finance and banking	Number of Publications	Percentage
Malaysia	23	29.5%
Indonesia	9	11.5%
Pakistan	6	7.7%
United Kingdom	6	7.7%
Nigeria	5	6.4%
Saudi Arabia	5	6.4%
Turkey	5	6.4%
India	4	5.1%
UAE	4	5.1%
Australia	3	3.8%
Top 10 Authors on Islamic banking and finance		



Shaikh, S.A.	5	6.4%
Alam, M.R.	3	3.8%
Banna, H.	3	3.8%
Hassan, M.K.	3	3.8%
Ahmad, R.	2	2.6%
Ali, M.M.	2	2.6%
Devi, A.	2	2.6%
Kassim, S.	2	2.6%
Nawaz, T.	2	2.6%
Saifurrahman, A.	2	2.6%
<b>Top 10 Affiliates</b>		
International Islamic University Malaysia	6	7.7%
International Islamic University Malaysia, Institute of Islamic Banking & Finance	6	6.4%
Universiti Malaya	4	5.1%
University of New Orleans	3	3.8%
Shaheed Zulfiqar Ali Bhutto Institute of Science and Technology, Karachi	3	3.8%
Islamic Research and Training Institute	2	2.6%
Central Bank of Nigeria	2	2.6%
Universiti Utara Malaysia	2	2.6%
University of Plymouth	2	2.6%
University of Sharjah	2	2.6%

Source: Authors' elaboration

From the 78 documents that remained after filtering, researchers discovered that 23 documents were written by scholars in Malaysia, and 9 were written by scholars in Indonesia. Pakistan and the United Kingdom had equal numbers of publications (i.e., 6 papers). In Africa, there were five papers on Islamic finance, and these publications are similar to those from Saudi Arabia and Turkey. India and the United Arab Emirates each had 4 papers. As shown in Table 1 above, it's clear that the countries included are those at the top of the list in Islamic finance and banking research. This can also imply that these are the countries where Islamic finance and banking have been adopted. Table 1 also lists the top ten universities and institutions where scholars specializing in Islamic finance and financial inclusion are affiliated. Additionally, documents by affiliation are also listed in Table 1. As shown in Table 1 above, most of the publications are from universities in Islamic countries, and Malaysia is dominating the list.

### *3.1 Summary of documents excluded*

A total of 49 documents were excluded after it was determined that they did not focus sufficiently on the Islamic objectives of the study in question. Although the discussion touched on Islamic finance and financial inclusion, the focus was not directly related to the objectives of the current study. A study carried out by Hassan, Hossain, and Ahmed (2022) aimed to estimate the influence of the relative strength of Islamic finance on GDP growth for Organisation of Islamic Cooperation (OIC) countries, as well as the whole world. The focus of the research does not adequately address the subject in question. Another document excluded for not addressing the subject in question is a research by Saifurrahman and Kassim (2023), the main focus was to explore and analyse the credit risk assessment procedure conducted by the Indonesian Islamic banks to address the issue of asymmetric information among their micro-, small- and medium-sized enterprise (MSME) clients. A study by Ibrahim and Kahf (2020) was also removed after it was found that the study's focus was on investigating the potential applications of Sharīfah-compliant instruments to safeguard investments and attract investors to Islamic venture capital (IVC). Although a study by Mohamed and Elgammal (2023) appeared to be addressing the subject in question, the focus was slightly different since it was mainly concerned about how donations influence financial inclusion outcomes for both Islamic and conventional MFIs. Setiawati, Nidar, Anwar, and Masyita (2018) conducted a study to assess the financial literacy of participants in Islamic banking. Although the study was relevant to the study in question, the major focus of the current study was on the use of Islamic financial services.

Banna, Hassan, Ahmad, and Alam (2022) conducted a study to investigate the role of digital financial inclusion (DFI) in stabilizing the Islamic banking sector during the current COVID-19 pandemic. Although the study included the financial



inclusion aspect, its focus was not aligned with the current research objectives. Another paper excluded from the study is that of Aysan, Dolgun, and Turhan (2013), who carried out a study on the performance of participation banks (PBs) and analytically discussed the participation banking industry in Turkey. Although the study indicated that participating banks are promoting financial inclusion, its primary focus was not on financial inclusion, which is why it was excluded from the current study. Abbas et al. (2019) also conducted a study to describe the earnings growth and marketability generated by Islamic banks in Indonesia, and to investigate the effects of a moderated mediation model on the nexus between Islamic financial inclusion, literacy, marketability, and earnings growth. Due to the study's focus, researchers decided to exclude it since it does not address the objectives of the study in question. In general, all studies excluded from the study did not address the objectives in question, which explains why they were excluded. Although some articles addressed issues closely related to Islamic finance and financial inclusion, the findings were not clear regarding the interplay between the two. The screening process was carried out by both researchers, who at the end of the process calculated the coefficient of agreement (Cohen's Kappa coefficient) in order to deal with bias. The Cohen's Kappa coefficient was found to be 0.8934, indicating a very strong level of agreement between the two researchers.

### 3.2 Role of Islamic Finance in Fostering Financial Inclusion

As shown in Table 2, research has consistently shown that Islamic banking has a positive impact on financial inclusion. Consequently, Islamic financial institutions have assumed the responsibility of providing Sharia-compliant financing options to the Muslim community, thereby meeting their financial needs while adhering to Islamic principles. This supports Chapra's (1982) theory of banking, which posits that the development of credit constitutes the foundation for the purchasing power of parties involved in financial transaction agreements. Studies by Warsame (2015), Saiti et al. (2022), Kamalu and Ibrahim (2021), Worasutr et al (2024), and Jan et al. (2018) demonstrate that Islamic banking attracts new clients and encourages migration from conventional banks. This shift is largely driven by Muslims' positive perception of Islamic banks, leading to increased account openings (Saiti et al., 2022). Moreover, Islamic banking has been found to promote financial inclusion among low-income individuals and Muslims, who may not have had access to traditional banking services (Siddiqui et al., 2021). Islamic fintech has also emerged as an effective solution for underserved individuals, offering efficient alternatives for financing (Tajudin et al., 2020). Additionally, Takaful insurance has been shown to contribute positively to financial inclusion in countries like Indonesia (Alhammadi, 2023). However, regional disparities persist. Middle-income MENA countries experience greater financial inclusion benefits from Islamic banking (Khmous et al., 2020), while Islamic equity modes of financing face challenges due to high agency costs (Shaikh, 2017). Furthermore, insurance access and savings penetration remain poor in Islamic MENA countries (Ramaian et al., 2023). To optimize the potential of Islamic banking for financial inclusion, policymakers and practitioners must address these challenges. Restructuring Islamic equity modes of financing to mitigate agency costs and exploring strategies to improve insurance access and savings penetration in Islamic MENA countries are crucial. Governments can also play a vital role in promoting Islamic fintech and addressing regional disparities. In conclusion, the evidence suggests that Islamic banking has a significant impact on financial inclusion. By leveraging Islamic fintech, Takaful insurance, and addressing regional disparities, Islamic banking can further enhance financial inclusion, particularly for low-income individuals and Muslims.



Table 2. Summary of Literature Review Research Findings

Author (s)	Paper Title	Year	Citations	Findings
Warsame, M	The role of Islamic finance in enhancing the economic prospects of Kenyan Muslims: An empirical study on Kenyan Islamic banking sector	2015	01	The study revealed that there is both migration from conventional banks to Islamic banks as well as financial inclusion of new clients because of the introduction of Islamic banking sector
Saiti B.; Ardo A.A.; Yumusak I.G.	Why Muslims subscribe to Islamic banking?	2022	13	Muslims' perception towards Islamic Banks is highly positive and therefore open accounts with these financial institutions
Khrous D.F.; Besim M	Impact of Islamic banking share on financial inclusion: evidence from MENA	2020	11	The effect of Islamic banking on financial inclusion is found to be greater in middle-income MENA countries
Shaikh S.A.	Poverty alleviation through financing microenterprises with equity finance	2017	10	Islamic equity modes of financing in their current baseline structure suffer from high agency costs and therefore little impact in fostering financial inclusion
Alhammadi S.	Expanding financial inclusion in Indonesia through Takaful: opportunities, challenges and sustainability	2023	01	Results revealed a positive impact of Takaful insurance and financial inclusion in Indonesia
Kamalu K.; Ibrahim W.H.B.W	Islamic banking development and financial inclusion in OIC member countries: the moderating role of institutions	2021	03	Data from 30 Organisation of Islamic Cooperation (OIC) member countries over the period 2013-2018 suggests that Islamic banking promotes financial inclusion
Jan S.; Khan Z; Karimullah	Institutionalizing justice in Islamic finance	2018	08	Development of Islamic banking institutions contribute to financial inclusion
Tajudin M.; Omar R.; Smedlund A.; Aziz R.P.	Financing with heart and intelligence: augmenting intimacy and sustainability through Islamic fintech	2020	08	Islamic fintech offers an effective and efficient alternative to financing the underserved individuals and enhance financial inclusion
Siddiqui T.A.; Naushad M.; Farooque M.K.U.	A study on Islamic finance as an approach for financial inclusion in India	2021	02	Islamic finance system was chosen by those, particularly Muslims, who did not have good employment and sufficient income and therefore promotes financial inclusion of the poor
Ramaian Vasantha N.; Liew C.Y.; Kijkasiwat P.	Exploring financial inclusion in MENA countries: an entropy weight approach	2023	0	Financial inclusion has improved in Middle East/North Africa countries. However, insurance access and penetration savings were poor in the Islamic MENA countries
Ali M.M.; Devi A.; Furqani H.; Hamzah H.	Islamic financial inclusion determinants in Indonesia: an ANP approach	2020	27	Islamic finance and banking in Indonesia is promoting financial inclusion and is influenced by two main drivers: the supply and the demand of Islamic financial services
Karlan D.; Osman A.; Shammout N.	Increasing Financial Inclusion in the Muslim World: Evidence from an Islamic Finance Marketing Experiment	2021	03	Islamic finance increased the application rate for loans from 18 percent to 22 percent.



Zulkhibri M.	Financial inclusion, financial inclusion policy and Islamic finance	2016	30	Most Muslim countries lag other emerging economies in both respects, with a rate of financial inclusion of only 27%
Abdul Razak A.; Asutay M.	Financial inclusion and economic well-being: Evidence from Islamic Pawnbroking (Ar-Rahn) in Malaysia	2022	12	Adoption of Bancatakāful partnerships contributed to improving the indicators of financial inclusion.
Tlemsani et al	Digitalization and sustainable development goals in emerging Islamic economies	2023	0	Islamic digital finance has the potential to contribute significantly to achieving the UN SDGs by promoting financial inclusion
Hadji Latif S.D.	Knowledge and attitudes towards Islamic banking in the Philippines	2021	04	Attitudes of the Muslim society toward Islamic banking are favorable and opportunities provided encourage exploitation of Islamic financial services
Gherbi A.A.	The Role of Bancatakāful in Developing and Protecting the Islamic Financial Industry	2020	0	Adoption of Bancatakāful partnerships contributes to improving the indicators of financial inclusion
Irimia-Diéguez et al	Predicting the intention to use Paytech services by Islamic banking users	2024	0	Paytech digital payment services allowed access to financial services to the entire Muslim population regardless of their location and perceived trust had a highly significant direct effect on the intention to use these services
Baber H.	Financial inclusion and FinTech: A comparative study of countries following Islamic finance and conventional finance	2020	32	Islamic finance countries are more inclusive in terms of financial inclusion and women are financially more empowered as compared to those in countries using conventional finance
Nawaz T.	Lifting the lid on financial inclusion: Evidence from emerging economies	2018	05	Islamic banks are serving as the ultimate source of financial inclusion in the society
Saifurrahman A.; Kassim S.H.	Regulatory issues inhibiting the financial inclusion: a case study among Islamic banks and MSMEs in Indonesia	2023	0	Regulatory imbalances and restrictions demotivate and hinder the efforts of Islamic banks in providing access to finance for the MSME segment, hence, encumbering the achievement of the financial inclusion agenda
Ahmad S.; Lensink R.; Mueller A.	The double bottom line of microfinance: A global comparison between conventional and Islamic microfinance	2020	25	Results reveal that the market for Islamic microfinance has grown in recent years, and is likely to continue growing in every region of the world
Tabash M.I	Critical challenges affecting Islamic banking growth in India using Analytical Hierarchy Process (AHP)	2017	05	Although Islamic banks increase financial inclusion, lack of awareness for Islamic banking instruments is slowing it down
Fairuz et al	Do mosques use Islamic bank services? Evidence from Indonesia	2020	01	Findings revealed that only a few mosques have adapted financial service
Abdullahi A.; Othman A.H.A.	Financial inclusion enhancement through the adoption of Islamic microfinance in Nigeria	2021	09	Intention toward the exploitation of Islamic microfinance is high in Nigeria



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Kannaiah D.; Masood Y.; Choudary Y.L.	Growth of Islamic banking in India: Discriminant analysis approach	2017	05	Participants revealed a positive attitude towards adoption of Islamic finance and banking
Tahiri Jouti A.	Islamic finance: financial inclusion or migration?	2018	21	Islamic finance can not only enhance financial inclusion but also create financial migration. Islamic finance can contribute to the effort of including “self-excluded” people with religious concerns as well as people without access to financial services
Ali M.M.; Sakti M.R.P.; Devi A.	Developing an Islamic financial inclusion index for Islamic banks in Indonesia: a cross-province analysis	2019	5	The level of Islamic financial inclusion in Indonesia is relatively low at the national level

Source: Authors' elaboration



## 4. Discussion

### 4.1. Debating the Role of Islamic Finance in Financial Inclusion

The dawn of Islamic finance has sparked a contentious discussion about whether it is driving financial migration or financial inclusion. While some academics agree that Islamic finance is helping to achieve the Sustainable Development Goals of poverty alleviation and inclusivity, others contend that it is bringing about financial migration. According to a study conducted by Warsame (2015), Islamic finance has been found to promote financial inclusion in Kenya. According to Warsame (2015), the Central Bank of Kenya's authorization of Islamic banks marked a significant advancement in financial inclusion because the newly formed Islamic banks would provide Muslims with financial services that align with their religious beliefs. Warsame (2015) did note, however, that there was also a financial migration occurring, with a significant number of Muslims moving from traditional banks to financial institutions that adhere to Sharia. Khmous and Besim (2020) also found, through a study conducted in MENA countries, that Islamic finance plays a significant role in fostering financial inclusion. However, financial inclusion in these countries has been observed to be significantly small, signaling that Islamic finance is not doing enough to cater to the financially excluded. The results by Khmous and Besim (2020) are consistent with the study results of Ramaian et al. (2023), who conducted a study in the MENA countries with the objective of determining their financial inclusion index. According to Ramaian et al. (2023), Islamic nations have seen improvements in overall financial inclusion. Notably, all MENA nations are classified as low- or medium-income countries on the inclusion index (Ramaian et al., 2023). It was noted that the Islamic MENA nations had low insurance penetration and access (Ramaian et al., 2023). Similar findings are also reported in a study conducted by Saiti, Ardo, and Yumusak (2022) in Nigeria. Saiti et al. (2022) discovered that the notable growth recorded by banks since the inception of the Islamic banking system is slowing down due to religiously induced sentiments and criticisms championed by certain non-Muslim segments of society. Interestingly, even with the impish hype and publicity, non-Muslims make up a significant customer base of the Islamic banks in Nigeria (Saiti et al., 2022). Contrary to the literature that applauds Islamic finance as a vehicle for financial inclusion, Shaikh (2017) argues, based on research findings, that Islamic equity modes of financing, in their current baseline structure, suffer from high agency costs and therefore have little impact on fostering financial inclusion. These findings are consistent with the results of studies carried out by Saiti et al. (2022) and Khmous and Besim (2020). It is worth noting that, although academics commend Islamic banking and finance for promoting financial inclusion, its impact remains relatively small.

Studies by Franciosi (2025) and Alhammadi (2023) acknowledge the role that Islamic finance plays in fostering financial inclusion. Alhammadi (2023) argued that through Takaful insurance offered by Sharia-compliant financial institutions, financial inclusion has been rising, and this has had a positive influence on economic growth. The results by Alhammadi (2023) are consistent with those of Kamalu and Ibrahim (2021), who, in a study conducted in Organisation of Islamic Cooperation (OIC) member countries from 2013 to 2018, observed that Islamic banking promotes financial inclusion. In agreement with the results of a study carried out by Alhammadi (2023), the findings of Ali et al. (2020) revealed that Islamic financial inclusion in Indonesia is influenced by two main drivers: supply and demand. In order of increasing level of relevance, the demand factors for Islamic financial inclusion include financial literacy (0.27), social influence (0.17), socioeconomic factor (0.19), religious devotion (0.22), and financial literacy (0.27). Based on their relative importance, human capital (0.32), products and services (0.24), infrastructure (0.18), and rules and regulations (0.17) are the main supply-side drivers of Islamic financial inclusion (Ali et al., 2020). Jan, Khan, and Karimullah (2018) also posited that the development of Islamic finance and banking is making a significant contribution to the Sustainable Development Goals of inclusivity and poverty alleviation. Tlemsani et al. (2023) also argued that Islamic digital finance has the potential to contribute significantly to achieving the UN SDGs by promoting financial inclusion, encouraging ethical investments, supporting small and medium-sized enterprises, promoting sustainable investments, and leveraging technology to expand access to Islamic financial services and support sustainable investments. In the same line of argument are the results from a study carried out by Tajudin et al. (2020), who posited that Islamic fintech in Finland and Malaysia offers an effective and efficient alternative for financing underserved individuals and enhances financial inclusion. This clearly reveals that the Islamic financial system has adopted financial technology that is playing a significant role in encouraging financial inclusion in the two countries.

A study conducted by Siddiqui, Naushad, and Farooque (2021) in India aimed to compare participants' preferences between conventional finance and Islamic finance. The results showed that Islamic finance was chosen by individuals, particularly Muslims, who had limited employment opportunities and insufficient income. Siddiqui et al. (2021) recommended that the extensive formalization of Islamic finance in India will lead to higher financial inclusion. In light of this observation, Islamic



finance has been found to contribute significantly to the financial inclusion of a substantial number of people in India. The findings by Siddiqui et al (2021) agree well with the findings of a study by Karlan, Osman, and Shammout (2021), who discovered that the introduction of Sharia-compliant financial institutions in Jordan increased the application rate for loans from 18 percent to 22 percent, an increase in demand that is equivalent to a 10 percent decrease in interest rates. This clearly reveals that Islamic finance plays a significant role in promoting financial inclusion in areas where religion is a barrier to mainstream financial participation. The same observation was also made by Shaikah (2023), who conducted a study in Pakistan and found that Islamic banks are facilitating financial inclusion for those who wish to avoid ribā. However, Shaikah (2023) emphasized the need for concerted efforts to enhance competitiveness and distinguish Islamic financial products in Pakistan regarding their distributional impact.

Ali, Sakti, and Devi (2019) conducted a study to measure an Islamic financial inclusion index in Indonesia, based on three dimensions: accessibility, availability, and usage of Islamic banking services. The study by Ali et al (2019) found that the level of Islamic financial inclusion in Indonesia is relatively low at the national level. The findings also revealed a positive correlation between the Islamic Financial Inclusion Index and the Human Development Index. As a result of the research findings, Ali et al (2019) suggested that both policymakers and the Islamic financial industry should play a greater role in improving financial access to low-income segments. The findings by Ali et al. (2019) are consistent with those from a study by Khmous and Besim (2020), who argued that although Islamic financial institutions' products play a significant role, financial inclusion in MENA countries remains very low. This serves as a call for policymakers to make efforts to promote Islamic finance as a vehicle for fostering financial inclusivity in societies. Abdul and Asutay (2022) investigated the role that Islamic pawn broking or ar-rahān financing facility has played in improving the financial inclusion and well-being of society. The findings demonstrate that financial inclusion through patronizing ar-rahān has significantly improved the well-being of the clients. The usage of ar-rahān financing for production purposes related to economic activity is significant in enhancing individual well-being, resulting in micro-balancing and improving the financial and socio-economic development (Abdul and Asutay, 2022). Abdul and Asutay (2022) also concluded that ar-rahān helps overcome voluntary financial exclusion due to Shari'ah compliance in the face of the social failure of Islamic banking, which then contributes to the clients' lives in their everydayness, particularly those with non-liquid small assets kept for security purposes.

A study conducted by Hadji (2021) in the Philippines to explore the knowledge and attitudes of the Muslim society toward Islamic banking revealed that the attitudes of the Muslim society toward Islamic banking are favorable, explaining why it plays a significant role in fostering financial inclusion. In line with the findings of a study by Hadji (2021), a study by Hamzat and Nwanko (2023) discovered that unbanked Muslim women in Lagos (Nigeria) are aware of Islamic banks' product offerings and are willing to open an account with an Islamic bank. This aligns with the existing literature evidence that Islamic finance can enhance financial inclusion. Hadji (2021) posited that attitudes towards Islamic finance in the Philippines are influenced by the opportunities that Islamic banking can provide to society, religious motivation, and awareness toward Islamic banking. Product and marketing strategies, as well as the Shari'ah reputation of Islamic banks, are also found to be significant in influencing their attitudes toward Islamic banking. All these factors, taken together, have made Islamic financial services attractive to the people of the Philippines. Results of the study by Hadji (2021) are congruent with those of a study by Kannaiah, Masood, and Choudary (2017), who revealed that there is a favorable perception towards Islamic banking in India, especially from the city of Hyderabad, since it has a lot of institutions that run courses on Islamic banking.

Sain, Rahman, and Khanam (2018) argued for the importance of Islamic finance in Australia, citing that Muslim communities are financially excluded primarily due to their faith and religious beliefs, as Islam prohibits Riba (interest), which is widely practiced in conventional banking and finance operations. Sain et al (2018) indicated that the Muslim community in Australia remains excluded, citing religious reasons. For this reason, Sain et al. (2018) argued that Islamic finance can enhance financial inclusion in Australia. However, Sain et al. (2018) highlighted that the level of awareness about Islamic finance products and services in Australia remains limited. Additionally, the lack of Islamic financial products and services is a contributory factor to financial exclusion in Australia (Sain et al., 2018).

Contrary to findings acknowledging the role played by Islamic finance in fostering financial inclusion, Jouti (2018) argued that introducing Islamic finance can lead to financial migration to Islamic banks, which can take many forms and depend on various factors that necessitate a thorough analysis. Another study, carried out by Ledhem (2022), indicates that Islamic finance plays a significant role in enhancing financial inclusion in Algeria; however, its impact is yet to be observed due to the low share of Islamic banking in the total banking sector. In this regard, Jouti (2018) indicated the need for policymakers to differentiate between financial inclusion and financial migration. While some scholars (Jouti, 2018; Shaikh, 2017) indicate that Islamic finance is not contributing towards financial inclusion, a good number (Warsame, 2015; Hadji, 2021; Sain et al., 2018; Abdul



& Asutay, 2022; Ali et al., 2019) argue that it is fostering financial inclusion. It must be noted that despite some challenges and shortfalls surrounding Islamic finance and banking, the role it plays in financially including Sharia-compliant groups must not be underestimated. From the discussions above, the majority of scholars acknowledge the role that Islamic finance is playing in promoting financial inclusion.

## 5. Conclusion

The introduction of Islamic financial services has created an opportunity for Islamic communities to access financial services that align with their religious beliefs. Although there are debates regarding the role played by Islamic financial systems in fostering financial inclusion, the majority of scholars agree that they are indeed contributing immensely to financial inclusivity. A literature search also revealed that Africa as a whole is lagging behind in research on Islamic finance, which may also be an indicator of a slow adoption of the Islamic financial system. From the findings of the study, it can also be concluded that Islamic financial systems and banking are most prevalent in countries that are in the MENA and those in the Organisation of Islamic Cooperation (OIC). The majority of African countries are lagging behind in research on the subject in question. The study also led to the conclusion that when Islamic financial services are provided alongside conventional financial services, people prefer Islamic financial services because there is no riba (interest) payment, which leads to financial migration. In general, the study concludes that Islamic financial services are playing a significant role in achieving the United Nations Sustainable Development Goals of inclusivity and poverty alleviation.

Given the above, it is prudent for governments in Africa and worldwide to facilitate the development of Islamic financial institutions within their nations. Most importantly, policymakers need to consider the needs of marginalized population groups so that the nation can achieve the Sustainable Development Goals. Governments should promote more Islamic banking and incentivize investments in technology, which helps expand financial inclusion. This study also serves as a reference for regulators in formulating effective policy strategies to strengthen and expand Islamic financial inclusion, particularly in areas where Islamic financial systems have been adopted. However, there is a need for policymakers to develop systems that are effective enough to prevent financial migration, which may ultimately undermine conventional financial institutions.

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# The Nexus of Accounting and Dispute Resolution in Islamic Banking and Finance Law

Sanaa Kadi<sup>1</sup>

<sup>1</sup> University of Helsinki, Finland.

Institutional email address: [sanaa.kadi@helsinki.fi](mailto:sanaa.kadi@helsinki.fi)

ORCID  0000-0001-9002-8629

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## Abstract

This paper examines the impact of accounting for Islamic finance in dispute resolution within Islamic banking and finance (IBF) law. The global expansion of the IBF industry has heightened the necessity for robust dispute resolution mechanisms capable of addressing complex financial arrangements. These mechanisms must reconcile conventional legal frameworks with Islamic commercial law, requiring interdisciplinary expertise in both finance and jurisprudence. A significant challenge arises from the inadequate integration of accounting practices with Islamic finance dispute resolution. Financial records, essential for validating contractual adherence to Sharia principles, are often misinterpreted or underutilized in legal contexts due to a lack of expertise among judges, lawyers, and accountants in both Islamic finance and its accounting standards. The study adopts a legal approach, employing an analytical design to examine the fundamental principles and processes of dispute resolution in Islamic finance. The legal analysis will involve a comprehensive review of relevant legal sources, including Islamic law, national laws and regulations, court judgments, legal opinions, and industry standards. The study shows that the promotion of legal certainty will require a strong base of legal and Islamic finance professionals and the competence and awareness of accountants, lawyers, and judges to understand the principles of IBF. The study also shows that financial records, statements, and documentation have a significant role in resolving disputes. Accounting records can provide evidence of transactions and terms agreed upon. Properly documented and transparent accounting practices can help clarify the nature of the dispute and contribute to finding a fair and efficient resolution in the context of Islamic financial disputes.

**Keywords:** Accounting for Islamic finance; AAOIFI standards; Islamic finance reporting practices; Sharia-compliance; Legal certainty; Accounting and auditing

## 1. Introduction

Islamic banking and finance (IBF) is a subject of significant academic and practical interest due to its global reach, with Islamic financial institutions (IFIs) operating worldwide (Biancone et al., 2020). Islamic finance is adapting to varied legal and regulatory frameworks as well as different cultural contexts (Aqib Ali, 2023). The IBF has a social impact, as it focuses on the principles of Islamic moral economy (Meskovic et al., 2021), promotes financial inclusion (Franciosi, 2025), and provides access to capital for small- and medium-sized enterprises, while also supporting socially responsible investments (Brescia et al., 2021). Islamic finance is based on the sharing of risk and profit in the various financing contracts, rather than on interest and interest payments. (Khavarinezhad et al., 2021).



The IBF also offers research opportunities for scholars from various fields, including finance, economics, law, and Islamic studies (Secinaro et al., 2021). This interdisciplinary nature of IBF research has led to an innovative research venture and a new collaboration. (Khan et al., 2022)

Accounting for Islamic finance refers to the specific set of accounting principles and procedures designed to satisfy the requirements of IsFIs and transactions. Accounting for Islamic finance involves developing accounting standards and practices that adhere to the principles of Sharia. It entails creating accounting frameworks that reflect the performance of IsFIs while ensuring compliance with Islamic principles (Suryanto & Ridwansyah, 2016). Several organizations and standard-setting bodies, such as the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), work on developing and harmonizing accounting standards specific to Islamic finance to ensure consistency and transparency across the industry (Hassan & Aliyu, 2018). These standards provide guidelines for financial reporting, auditing, and disclosure in Islamic financial institutions, facilitating the growth and credibility of the Islamic finance sector. (El-Halaby et al., 2020; Hassan & Raza Rabbani, 2023; Tasnia et al., 2023)

The intersection of accounting practices and dispute resolution mechanisms in IBF represents a critical yet underexplored junction. The need for robust accounting standards and effective dispute resolution mechanisms is becoming increasingly significant, particularly in light of the role of Islamic principles in shaping financial and legal practices. Despite this, a comprehensive exploration of how these principles influence the governance and operations of IsFIs, particularly in the context of dispute resolution, remains limited in the existing literature.

This paper aims to bridge this gap by examining the intricate relationship between Islamic principles and accounting for Islamic finance. While conventional literature has traditionally focused on secular economic models, the interplay between religious values and financial transactions offers a unique perspective that has not been extensively explored. This study sets out to position Islamic accounting within the broader context of Islamic finance, shedding light on its distinctive principles and practices.

The objective of this paper is to elucidate how accounting practices influence the process of resolving disputes within the context of Islamic finance. By scrutinizing the fundamental principles of Islamic accounting and their application in real-world dispute resolution scenarios, this research aspires to provide notable findings for practitioners, policymakers, and scholars alike. Understanding the role of accounting in resolving financial disputes is essential not only for enhancing the efficacy of dispute resolution mechanisms but also for ensuring the overall integrity and stability of IsFIs.

To position this research within the existing body of knowledge. The study conducted a thorough literature review. This comprehensive review aimed to identify any prior intersections between dispute resolution and accounting within the context of Islamic finance. However, the search yielded limited results, emphasizing the novelty and significance of this study. Additionally, the study scrutinized the research output of the literature on accounting, seeking potential links to dispute resolution. While the accounting literature is extensive, the specific connections between accounting methodologies and dispute resolution strategies in the context of Islamic finance have been notably absent from scholarly discourse.

Against this backdrop, this paper aims to bridge this gap by exploring the impact of accounting practices on the resolution of financial disputes within IsFIs. Understanding the complex relationship between accounting practices and dispute resolution mechanisms is not only crucial for enhancing the efficacy of dispute resolution processes but also for ensuring the overall integrity and stability of IsFIs.

In the subsequent sections, this paper will review the existing literature, identifying gaps and limitations in the current knowledge. The methodology section outlines the research approaches and tools used to investigate the intersection between accounting and dispute resolution in Islamic finance. Following this, the study's findings will be presented, analyzed, and discussed in detail. The paper will conclude by summarizing the key insights, their implications, and avenues for future research, thereby contributing to a deeper understanding of the intricate relationship between accounting practices and dispute resolution mechanisms in IBF.

## **2. Literature review**

### *2.1 Mitigating uncertainty from classical contracts to modern practice*

Within Islamic commercial law, the concept of *gharar*, which denotes excessive uncertainty, risk, or ambiguity in a contract, plays a fundamental role in ensuring transactional fairness. A key distinction is made between the theoretical existence of a commodity and the seller's practical ability to deliver it. For example, while a bird exists in the sky or a fish in the sea, the



inherent uncertainty in capturing them renders a contract for that specific animal invalid due to *gharar*. (El-Gamal, 2006; Milenovic & Milenovic, 2016)

This principle emerged from the vibrant commercial practices of early Islamic society, where goods were often traded unseen, before being physically possessed, or prior to their acquisition. The intersection of these dynamic market customs with religious law necessitated the development of precise juridical rules to mitigate speculative risk. Consequently, Islamic jurisprudence established clear prohibitions against contracts involving excessive *gharar*. This ethical framework is rooted in the Quran's prohibition of games of chance and is elaborated upon in the traditions of the Prophet Muhammad. Specific examples of forbidden transactions include the sale of an unborn animal separate from its mother and the sale of milk while still in the animal's udder. These regulations were designed to eliminate ambiguity, ensure mutual consent, and uphold the ethical standards that underpin Islamic economic principles. (El-Gamal, 2001; Hasanuzzaman, 1991)

Islamic law places a strong emphasis on transparency and the removal of doubt in financial dealings. This is explicitly commanded in the Quran, which provides direct guidance on contractual obligations. A seminal verse in Surah Al-Baqarah (2:282) offers a detailed injunction on the necessity of written documentation. (A'yuni & Wahyudi, 2024)

This verse, considered the longest in the Quran, instructs believers to reduce their debt contracts to writing, witnessed by impartial parties. Its primary objective is to ensure evidential clarity, protect the rights of all parties involved, and prevent future disputes, amnesia, or denials of the terms agreed upon. While the verse specifically addresses debt, its underlying principles have been extended by Islamic jurists to form a general ethical and legal framework for commerce. It establishes written testimony as the preferred standard for validating agreements, moving beyond mere oral trust to create a system of verifiable accountability that upholds justice (*adl*) and fulfills the duty of faithful stewardship (*amanah*).

The IBF sector has challenges related to dispute resolution mechanisms. For IBF-related conflicts, arbitration should take precedence as the primary means of settling disputes in modern society. In the contemporary financial landscape, it is essential to establish fundamental principles that ensure financial intermediation supports the real economy rather than exploiting it. Islamic finance, rooted in principles of socio-economic justice and cooperation, has the potential to address this need. (Ghaffour, 2017)

It is also essential to be familiar with the applicable law in legal matters; several international councils have been established, including the Institute for Islamic Research at Al-Azhar University in Cairo, the Islamic Jurisprudence Institute of the Islamic League in Mecca, and the Fiqh Academy of the Organization of Islamic Cooperation (OIC) in Jeddah. The Fiqh Academy plays a crucial role in Islamic jurisprudence (Jackson-Moore, 2009), particularly when Sharia-compliance arguments are raised by the parties. If one of the parties raises a Sharia-compliance argument, the contract faces Sharia risk, which may lead to its invalidation because Sharia compliance must be respected and extends to any future conflict, even though the contract was validated by a Sharia supervisory board (Blanke, 2019). It is therefore important to ensure Sharia compliance in IBF operations. The IBF provides the legal mechanisms to ensure legal certainty in various Islamic financial products. Many challenges can be related to the interpretation and application of Sharia principles within the national legal framework.

A gap exists between the Islamic contract in a traditional context and the Islamic financial transaction as it is presented in modern finance. This is connected to the pressure to comply with the current complex financial system (Hamour et al., 2019). Since Islamic transactions often use Arabic terms alongside English terms, it is easy to localize the statutes of each transaction used in IBF. However, from the legal concept of each term, there are many similarities and differences between Islamic banking and conventional banking products and services. Furthermore, customers may be unknowingly influenced by the messaging and branding, which can impact their choices regarding Islamic financial products and potentially lead to financial decisions based on incomplete information.

## *2.2 Accounting, dispute resolution, and the global challenges of Islamic financial institutions*

It is important to distinguish between the different environments where IsFIs operate: the first environment applies Sharia principles and thus IsFIs follow the governing laws such as in Iran and Sudan; the second environment is that in which Islam is predominant and where IsFIs are operating along with conventional financial institutions; and the third environment is predominantly non-Muslim, and this is made up of the Western countries (Karbhari et al., 2004).

Included among the main obstacles facing the development of IBF in Western countries are, first, the negative attitude towards the needs of IsFIs and then conceptual problems such as the lack of standardization, compliance with regulations and the local legislation, capital and liquidity requirements, tax discrimination, financial instruments, accounting practices, liquidity and risk



management, lack of qualified staff, marketing of the Islamic products and services, and the competition from the conventional financial sector. (Karbhari et al., 2004)

Several contracts exist in the IBF sector, and predetermined guidelines govern every single financial product or service (Bellalah & Masood, 2013). However, some research has investigated the legal and economic aspects of Islamic finance and found that although some Islamic financial contracts are structured according to Islamic law, their underlying economic substance is essentially the same as that of conventional financial contracts (Hamour et al., 2019).

### 2.3. Mitigating uncertainty through Sharia-compliant accounting

The spread of Islamic banking institutions around the world, along with the entrance of many conventional banks into the Islamic financial market, is a strong indication of the evolution of the IBF sector (Slimene et al., 2014). Islamic finance focuses its efforts on meeting the financial needs of the rapidly growing Muslim community, based on Islamic principles (Hassan, 2022). Among the primary factors contributing to the significant growth of the global Islamic economy are the support of a substantial Muslim population (Alshater et al., 2022; Zucchelli, 2022), increased adherence to Islamic values, and the rapid digital revolution (Muryanto, 2022). Islamic banks share the same principles as social banks, both of which are rooted in ethical finance and emphasize social and economic roles (Aboul-Dahab, 2023).

Muslim countries tend to implement conventional procedures instead of reinforcing the various existing processes in Islamic dispute resolution (Oseni & Ahmad, 2015). This can be explained by the significant influence that Western law has on the national laws of Muslim countries. In the context of commercial transactions, it is essential to recognize that the prohibition of *gharar* does not hinge on the mere existence of commodities; rather, it pertains to the seller's ability to fulfill the contractual obligation by delivering the sold object. If a contract involves potential *gharar*, making it impossible for the seller to fulfill their duties, the contract is deemed void, its validity being contingent on the extent of *gharar* present. Through the application of analogy (*qias*) in Islamic law, principles devised to eliminate ambiguity in sales contracts have been extended to derivatives, *istisnaa* contracts (contracts involving manufacturing), *salam* (sales entailing upfront payment for future delivery), and *ijarah* (lease contracts) within the framework of Islamic law (Asni et al., 2024). Despite the theoretical invalidity of such contracts due to the absence of items at the contract's inception, the application of these principles becomes relevant in specific scenarios (Jobst & Solé, 2012). The principles of avoiding *gharar* (excessive uncertainty) in Islamic commercial transactions have a direct bearing on accounting practices for Islamic finance. In the context of financial transactions, accounting in Islamic finance must adhere to these principles to ensure transparency, accuracy, and fairness.

In specific circumstances where economic and public interests (*maslaha*) take precedence, contracts that would normally be deemed invalid due to the absence of items at the contract's initiation may be considered valid. The prohibition of *gharar* in contracts under Islamic law is motivated by various factors, including the prevention of fraud. For instance, a contract involving the acquisition of someone else's property through the sale of inaccessible goods can lead to disputes and legal conflicts between the parties. Similarly, agreements that entail the formation of another actual or future contract can raise issues of uncertainty. According to Islamic legal principles, agreements must always result in immediate and definite obligations. *Gharar*, if present to a significant degree, can render a contract null and void. Alternatively, it may serve as a basis for indemnity and compensation, contingent upon its degree and extent. (El-Gamal, 2001)

For instance, scholars emphasize the importance of conducting thorough Sharia audits during the practical implementation of home financing agreements. This measure is essential to prevent the inclusion of *gharar* elements, which could potentially expose the bank to unforeseen reputation risks, during the execution of the agreement (Oseni et al., 2019). When recording financial transactions involving uncertain future outcomes, such as investments or sales contracts, IsFIs need to apply rigorous accounting standards that align with Sharia principles. The accounting methods employed must accurately reflect the level of uncertainty associated with the transactions, ensuring that stakeholders, including investors and clients, are provided with clear and reliable financial information.

Additionally, adherence to Sharia-compliant accounting practices helps IsFIs avoid disputes related to *gharar* (Oseni et al., 2019). Transparent and accountable accounting ensures that financial transactions are conducted with clarity, reducing the risk of ambiguity and uncertainty. By implementing robust accounting standards rooted in Islamic economic thought, IsFIs can uphold the ethical principles of fairness and justice, contributing to the overall stability and credibility of the Islamic finance industry.



#### *2.4. Existing accounting principles in Islamic banking and finance*

The criterion for evaluating the investment of any commercial activity is the value of accounting profits. Accounting profits contribute to reviewing the structure of contracts and predicting future financial flows. However, the most important role of accounting profits is to help stakeholders, especially investors, in making informed decisions about their future (Susilowati et al., 2023). Accounting profits consist of two components: 1) cash flow during a specific duration and 2) earnings accrual over a period of time. However, the latter is considered more important than the cash earnings themselves. This is due to the fact that managers often manipulate the company's profits and use accruals to produce profits that differ from the actual profits, enabling managers to meet the expectations of financial analysts and meet market expectations. Like any other industry, bank managers adjust the profits for the same purposes (Asl & Doudkanlou, 2022). Hassan and Raza Rabbani (2023) studied the impact of the AAOIFI governance disclosure on the performance of IsFIs. A thorough analysis of literature related to AAOIFI accounting standards was conducted, examining the diverse roles played by AAOIFI in setting standards for accounting, auditing, governance, and ethics in global IsFIs (Kouzo & Falikhatum, 2023). Their findings underscore the pivotal role of AAOIFI in shaping accounting standards for IsFIs, significantly contributing to the positive trajectory of the Islamic finance industry (Sembiring & Muhajir, 2024). AAOIFI's proactive involvement in issuing and developing accounting and auditing standards emerges as a key driver behind the enhanced financial performance of IsFIs. Furthermore, the study identifies notable research gaps, highlighting the imperative for future scholarly inquiries in these specific domains (Hassan & Raza Rabbani, 2023).

In Islamic finance, governance adheres to fundamental principles, including accountability, responsibility, trustworthiness, independence, competence, and confidentiality, as mandated by Sharia law (A'yuni & Wahyudi, 2024). These principles are pivotal in shaping corporate governance within the Islamic banking system and are foundational to the operation of entire Islamic financial centers. Consequently, Islamic banking is constrained to transactions deemed acceptable under Islamic law, engaging solely in ethical investing and moral purchasing practices. (Lanzara, 2021; Mergaliyev et al., 2019). Contrastingly, conventional literature has not explored the intersection of religion with economics and accounting in depth, despite the clear relevance of examining these connections. Historically, religion has played a significant role in shaping and upholding ethical standards, including truthfulness, fairness, and justice. When these principles are prevalent within a society, it becomes apparent that the community enjoys a heightened level of trust in both business transactions and financial matters. (Lewis, 2001)

#### *2.5. Dispute resolution in Islamic banking and finance*

Disputes in IBF law refer to disagreements or differences that may arise between parties involved in a financial transaction or contract that follows Islamic law. These disagreements can occur for numerous reasons, such as the misinterpretation of contract terms, breach of contract terms, fraud, or contraventions of other laws. Disputes may also arise due to non-compliance with Sharia principles.

Diverse types of legal disputes can arise in the IBF sector. Disputes may have a contractual aspect or be related to Sharia compliance. Disputes can arise when parties have different interpretations of the legal principles or when there are misunderstandings about the terms of the financial agreement. When a conflict arises in an Islamic financial transaction, it should be resolved in a manner consistent with the principles of Islamic finance, which are based on fairness, transparency, and the prevention of exploitation. Furthermore, clear and well-documented accounting practices can effectively elucidate the essence of disputes within the IBF. Disputes in business transactions have always been a part of the landscape. A contracting party might not be able or willing to respect its obligations. The other party may be disappointed with how the agreement is accomplished. There may even be a major conflict between the contracting parties regarding what was agreed upon during the contract's conclusion. Disputes are unavoidable, which renders the presence of dispute resolution procedures widespread. (Ghaffour, 2017)

Disputes may also involve regulatory disputes or have another aspect, such as a conflict with the constitutional law of a specific jurisdiction or the governing law, particularly in cross-border transactions. Dispute resolution can become relevant when there is disagreement over the interpretation or implementation of Sharia-compliant financial contracts, investment agreements, or other financial arrangements. However, the legal framework of dispute resolution in IBF law in most countries is insufficient and lacks harmonization (Al Rahahleh et al., 2019), especially in its application and interpretation of Islamic law (Oseni & Ahmad, 2015).



### *2.6. Gaps and challenges in current research*

Despite the Islamic finance industry's significant growth and maturation, persistent regulatory and consumer protection challenges reveal critical vulnerabilities even within established jurisdictions such as Malaysia, a leading hub in Islamic banking and finance. Notably, issues including non-transparent contractual terms, misleading product disclosures, and inadequate consumer safeguards continue to undermine market integrity and trust. Although regulatory bodies such as Bank Negara Malaysia (BNM) have introduced extensive measures, including standards, guidelines, and market conduct initiatives, to strengthen governance and empower consumers, a discernible implementation gap remains between policy intent and practical outcomes.

However, the central bank of Malaysia, BNM, continuously implements market conduct and consumer empowerment initiatives to protect consumers from these practices by issuing standards and guidelines that enhance governance, fairness, and transparency (Oseni, Hassan, et al., 2019). The research gap resides in the insufficient alignment between high-level regulatory frameworks and their effective translation into enforceable, day-to-day operational practices. This disconnect is particularly evident in the persistent lack of standardized legal documentation, inconsistent Shari'ah compliance verification, and divergent interpretations of regulatory requirements across institutions. As a result, despite robust oversight, structural ambiguities persist, perpetuating consumer risks, impeding dispute resolution mechanisms, and ultimately compromising legal certainty and equitable outcomes for all stakeholders in IBF transactions.

Islamic banks generate profits through Sharia-compliant financing methods such as mudarabah (profit-sharing), murabaha (cost-plus financing), rather than conventional interest-based transactions. A crucial question involves how these institutions measure and report their financial performance in accordance with appropriate accounting standards.

However, a significant challenge emerges in the accounting and reporting of these transactions. Often, a gap exists between the legal form of Islamic financial contracts and their economic substance from a Sharia perspective. This divergence creates complications in financial reporting, as the accounting treatment may not fully capture the true nature of the transactions or their compliance with Islamic principles (Sharairi et al., 2023). The identification of this "substance gap" is particularly important for accounting professionals and standard-setters, as it affects how Islamic banks' financial results are measured, presented, and understood by stakeholders. This issue spans the entire process from initial contract design to final financial reporting outcomes (Hamour et al., 2019). The operational efficacy of financial institutions is contingent upon the integration of contemporary management practices, robust supervisory mechanisms, and advanced risk-calculation models, complemented by sophisticated accounting frameworks. Furthermore, Islamic finance incorporates profit and risk-sharing arrangements between lenders and borrowers, predicated on pre-agreed ratios. This structure may incentivize borrowers to pursue higher-risk ventures, thereby elevating the risk profile of banks' financing portfolios. Consequently, financial institutions have adopted more stringent credit rationing policies to mitigate associated exposures (Masood & Bellalah, 2013).

## **3. Methodology**

This study employs a mixed-method research design, integrating a systematic literature review with qualitative legal analysis to investigate the interplay between accounting practices and dispute resolution within IBF law (Kadi, 2022). A central aim of this research is to determine whether a direct and consequential link between these two domains is substantiated within existing scholarly discourse.

The methodology entails a comprehensive examination of academic literature, legal sources, including Sharia law, national regulations, international standards, and judicial rulings, as well as industry practices. Through this analysis, the study aims to identify prevalent trends, challenges, and the specific role of accounting standards in resolving financial disputes in IBF. Furthermore, the research assesses relevant regulatory frameworks to evaluate their alignment with accounting principles and their facilitative or constraining role in dispute resolution processes. By synthesizing findings from this multi-faceted evidence base, the study ultimately aims to propose recommendations for enhancing accounting-informed dispute resolution mechanisms, thereby contributing to the sector's stability and development.

### *3.1 Materials*

The research methodology involves a thorough selection of both primary and secondary sources to ensure a comprehensive analysis of accounting practices and dispute resolution within IBF. Primary sources include regulations specific to Islamic



finance, Sharia principles, and guidelines issued by Islamic scholars and institutions. Official reports and publications from regulatory bodies, financial statements, and annual reports of IsFIs constitute essential primary materials. Additionally, court judgments and legal precedents pertinent to IBF are incorporated for a nuanced analysis.

Secondary sources complement the primary data. Academic research papers, scholarly articles, books, and book chapters on IBF provide significant findings. Industry reports, conference proceedings, seminar papers, and expert critiques contribute to the secondary data. Utilizing both primary and secondary sources ensures the accuracy, reliability, and depth of the analysis.

### **3.2 Methods**

This study employed a systematic literature review to map the scholarly discourse at the intersection of accounting, dispute resolution, and Islamic finance. The data collection protocol was designed to be iterative and precise. Initially, a broad search was conducted using the keywords "Islamic banking and finance" AND ("legal" OR "law") to capture the wider legal and regulatory landscape. This initial dataset was then refined using the keywords "accounting" AND "dispute resolution" to specifically target literature addressing the accounting-related aspects of financial conflicts.

The retrieved corpus was subsequently subjected to a thematic and bibliometric analysis. Key trends were identified by analyzing publication frequencies, prominent journals, and the geographical affiliation of authors. This analytical approach served a dual purpose: first, to identify the core academic outlets and intellectual communities engaged with this niche field; and second, to perform a comparative geographical analysis. The objective of this comparison was to evaluate whether the regions demonstrating the strongest scholarly interest in accounting and dispute resolution (as measured by publication output) corresponded with jurisdictions known for their advanced and well-established dispute resolution frameworks in finance, such as Malaysia, the UK, and the GCC states. This comparison offers critical insight into whether academic research aligns with practical, jurisdictional excellence in handling Islamic finance disputes.

Scholarly Output, as evaluated through SciVal, serves as a valuable metric indicating the productivity of a particular academic or research entity. It quantifies the number of publications attributed to this entity within the Scopus database.

### **3.4 Limitations**

The rigorous methodology used ensures a thorough exploration of accounting practices and their role in dispute resolution within the dynamic landscape of IBF. However, the study acknowledges the potential variation in interpretations of Sharia principles among scholars and institutions, which may lead to diverse perspectives on the legal aspects of IBF. The research aims to provide a balanced analysis considering these interpretations. Additionally, while Scopus is widely used, it may not encompass all relevant publications due to language, date, access restrictions, or biases, which could potentially impact the general representation of the results.

## **4. Results**

In conventional finance, the Basel Committee on Banking Supervision (BIS) has a significant role in setting global banking standards and promoting the stability and soundness of the international banking system (*The Basel Committee Charter*, 2018). The BIS plays key roles in responsible innovation and safe competitive financial services (BIS, 2021; Paltrinieri et al., 2021). The committee has developed several key international regulatory frameworks, including Basel I, II and III, that provide guidance to banking supervisors on best practices to enhance corporate governance related to financial institutions (BIS, 2021; *The Basel Committee Charter*, 2018). Correspondingly, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), Islamic Financial Services Board (IFSB), Bank Negara Malaysia (BNM), and other standard-setting bodies delivered standards and guidelines to promote governance in the global Islamic finance industry and emphasize the pivotal role of Sharia principles in establishing this governance (AAOIFI, n.d.; Sharairi et al., 2023).

There have been high-profile cases in Islamic banking and financial law that have had a significant impact on the industry. They highlight the complexities and challenges involved in applying traditional legal frameworks to Islamic financial contracts, and demonstrate the importance of developing a robust legal and regulatory framework to support the industry's growth. In modern international contracts, contracting parties must always specify the governing law. (Hasan & Asutay, 2011)

The prohibitions within Islamic finance, which aim to foster justice and fairness, address potential future disagreements. Scholars highlight the importance of acknowledging ignorance and risks that can lead to conflicts, especially in the era of



Fintech and digital currencies, where the concept of *gharar*, or excessive risk, has gained significance. The evolving landscape requires IBF regulatory bodies to enhance the Sharia compliance of financial contracts, products, and services. This imperative is not just about justice but also about ensuring the reliability of the IBF sector while preventing fraud and safeguarding its reputation from potential damage (Suryanto & Ridwansyah, 2016).

There are two distinct categories of human resources within IsFIs: Sharia specialists rooted in traditional Islamic teachings but lacking modern financial expertise, and bankers proficient in financial practices but with limited understanding of Islamic law (Akbar et al., 2023). This dichotomy underscores the challenges existing in the IBF sector. However, these challenges do not indicate a bleak future for IsFIs. On the contrary, they serve as crucial elements guiding the implementation of solutions for operational enhancement. The findings emphasize the urgent need for regulators, policymakers, and practitioners to collaborate, ensuring the seamless functioning of IsFIs in the future. This collaboration is crucial to addressing existing challenges and laying a robust foundation for the industry's growth.

Many reported cases in Islamic finance disputes have been related to debt-based financing methods such as *murabaha*, BBA, and *bay al-Inah*. This trend underscores the dominance of debt-based financial products and services in the Islamic finance sector. Islamic financial products involved in these cases were relatively simple and straightforward, with complexities emerging only in cases like *East Cameron Partners*, which involved *sukuk*-related issues. Considering the innovative financial engineering and the growing issuance of *sukuk* in diverse structures, including cross-border transactions across jurisdictions, future Islamic finance disputes are anticipated to become more intricate. Potential challenges may arise due to severe criticisms of existing *sukuk* structures, which could lead to legal disputes (Hasan & Asutay, 2011). The complexity of IBF cases is expected to increase due to innovative financial engineering and the development of diverse financial products, including cross-border transactions involving different jurisdictions. The potential legal challenges may stem from criticisms of existing Islamic financial contracts, which could impact public trust in their Islamic validity and compliance with Sharia principles. Several key dispute resolution mechanisms are employed to address conflicts and disagreements. Each mechanism has a specific objective tailored to the dispute. These mechanisms play a crucial role in ensuring the integrity and stability of the IBF sector (Dahlan, 2018).

The increasing sophistication of financial engineering and the diversification of Sharia-compliant financial products, particularly within cross-border transactions involving multiple legal jurisdictions, are anticipated to elevate the juridical complexity of disputes within the IBF sector. This trajectory may give rise to significant legal challenges, particularly stemming from doctrinal criticisms regarding the Sharia compliance of contemporary financial contracts, thereby potentially eroding public trust in their religious validity. Against this backdrop of escalating juridical and doctrinal challenges, this study sought to investigate whether accounting frameworks, through their capacity to enhance transparency, standardize documentation, and provide auditable evidence, could serve as a stabilizing mechanism within Islamic finance dispute resolution. The research specifically examined the potential for accounting practices to mitigate ambiguities in contractual interpretation and reinforce the evidential basis for resolving Sharia-related disputes.

#### *4.1 Absence of a direct link in the literature between dispute-resolution mechanisms and accounting practices*

To establish a connection between accounting and dispute resolution in the context of Islamic finance, an extensive review of existing literature on dispute resolution and accounting was conducted to determine whether accounting practices have a tangible impact on dispute resolution. The outcome revealed a lack of direct connection between dispute-resolution mechanisms and accounting practices. Despite the fundamental role that accounting plays in shaping financial narratives and providing essential data for legal proceedings, the existing literature does not explicitly establish a direct link between accounting methodologies and the resolution of disputes.

As accounting practices are fundamental to ensuring financial transparency and accountability, understanding how these practices intersect with dispute resolution mechanisms can enhance the integrity of financial transactions within the Islamic finance industry (Saadah, 2022). By linking accounting practices with dispute resolution, a more robust framework for accountability can be developed. In legal proceedings, accurate financial information is paramount; if accounting practices could influence the resolution of disputes, legal strategies could be tailored accordingly. Knowledge of how financial records impact dispute outcomes can guide legal professionals in presenting arguments and evidence, leading to fair and more informed decisions (Oseni et al., 2016).



#### 4.2. The intersection of accounting practices, IBF principles and standards, legal frameworks, governance structures, and dispute resolution

The resolution of disputes within the IBF sector frequently centres on financial discrepancies and compliance with established accounting standards. Consequently, rigorous accounting practices, robust auditing mechanisms, and adherence to recognised accounting frameworks, such as those issued by the AAOIFI, are indispensable for the equitable and efficient settlement of such disputes. Furthermore, disputes within Islamic finance are frequently characterised by divergent interpretations of Sharia principles and their application within commercial contracts. A nuanced comprehension of Islamic legal doctrines (*fiqh al-muamalat*) is therefore fundamental to adjudicating conflicts pertaining to religious permissibility (*halal*) and ethical compliance in financial transactions. The resolution of such disputes necessitates recourse to classical juridical sources and contemporary *fatawa* to ensure alignment with the objectives of Islamic law (*maqasid al-Sharia*), thereby upholding the theological integrity of IBF institutions. Disputes arising within IsFIs necessitate resolution mechanisms grounded in a specialized understanding of Islamic banking principles and the distinct nature of Sharia-compliant financial intermediation. The unique contractual forms and profit-sharing arrangements inherent to these institutions mandate expertise that integrates conventional financial acumen with juristic comprehension of *fiqh al-muamalat* to ensure equitable and religiously valid outcomes (Astuti & Raharja, 2024). Disputes within Islamic finance often arise from corporate governance challenges, particularly regarding the oversight exercised by Sharia supervisory boards. The resolution of such conflicts necessitates a rigorous understanding of governance architectures, including the delineation of responsibilities between conventional management structures and religious supervisory entities. Effective adjudication hinges on interpreting institutional mandates, fiduciary duties, and compliance mechanisms specific to IsFIs, ensuring alignment with both corporate law and Sharia principles. (Yusof et al., 2024)

The key phrase relevance, as shown in Table 1, indicates a strong intersection between accounting practices, Islamic finance principles, legal frameworks, and governance structures within the IBF, all of which are crucial components in resolving disputes.

These keywords represent crucial aspects of the IBF sector. Disputes in this context can encompass financial, ethical, legal, and governance-related issues. Therefore, expertise in accounting, adherence to Islamic principles, knowledge of Sharia law, understanding banking operations, and awareness of corporate governance structures are all crucial in preventing or effectively resolving potential disputes within IBF.

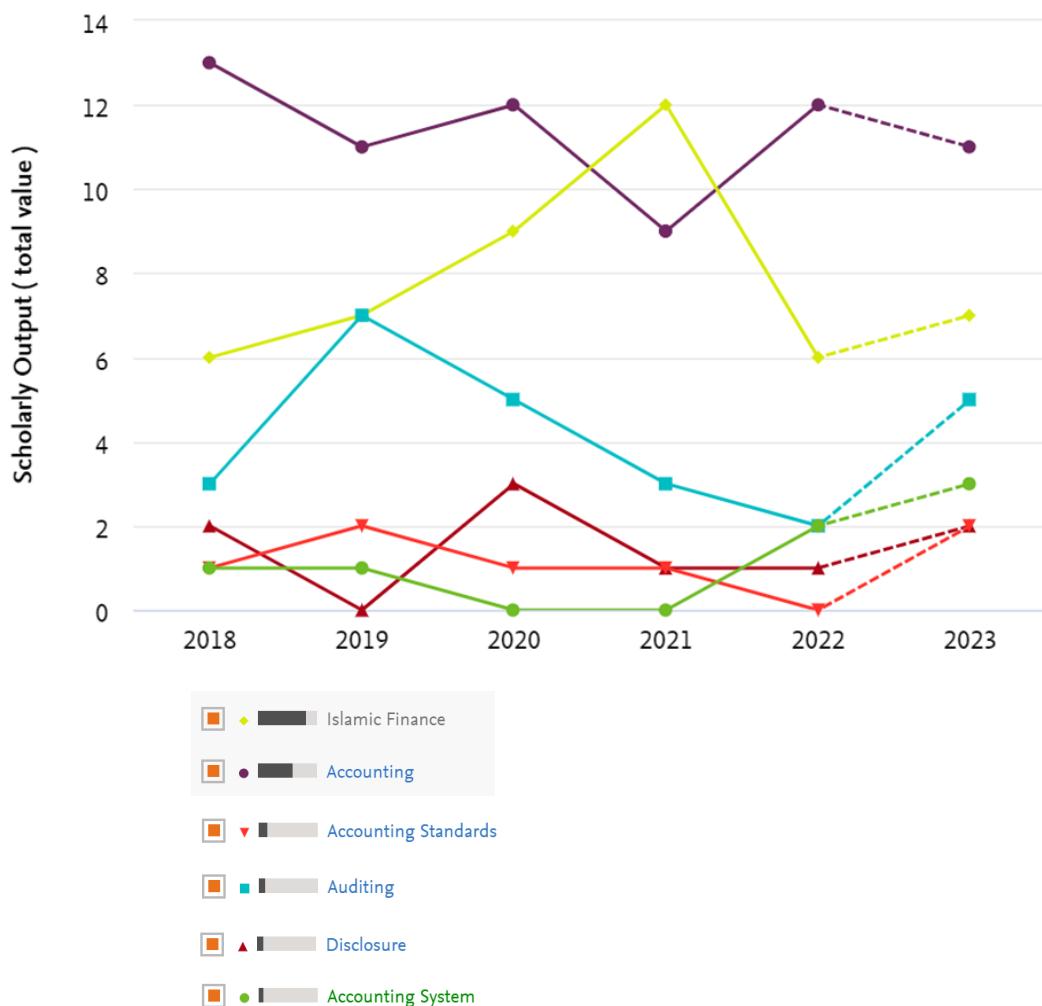
**Table 1.** Key phrase relevance by scholarly output from 2018-2023

<b>Key phrase</b>	2018	2019	2020	2021	2022	2023	2018–2023
Accounting	13	11	12	9	12	11	68
Islamic	10	10	9	13	13	13	68
Islamic Financial Institutions	7	10	10	8	5	9	49
Islamic Finance	6	7	9	12	6	7	47
Finance	5	6	9	4	9	9	42
Auditing	3	7	5	3	2	5	25
Banking	4	3	2	5	2	3	19
Islamic Banking	5	2	3	2	3	2	17
Boards	1	2	3	2	3	4	15
Sharia	1	3	1	2	2	6	15
Corporate Governance	1	1	3	1	3	2	11

Key phrase	2018	2019	2020	2021	2022	2023	2018–2023
Islamic Law	3	3	1	0	1	0	8
Accounting Standards	1	2	1	1	0	2	7
Accounting System	1	1	0	0	2	3	7
Supervisory Board	0	1	3	1	1	1	7
Bibliometric Analysis	0	0	1	3	0	1	5
Profitability	1	0	1	2	0	1	5
Audit	1	1	1	0	0	0	3

*Source: Author elaboration using SciVal.*

**Figure 1.** Accounting key phrase relevance by scholarly output from 2018-2023



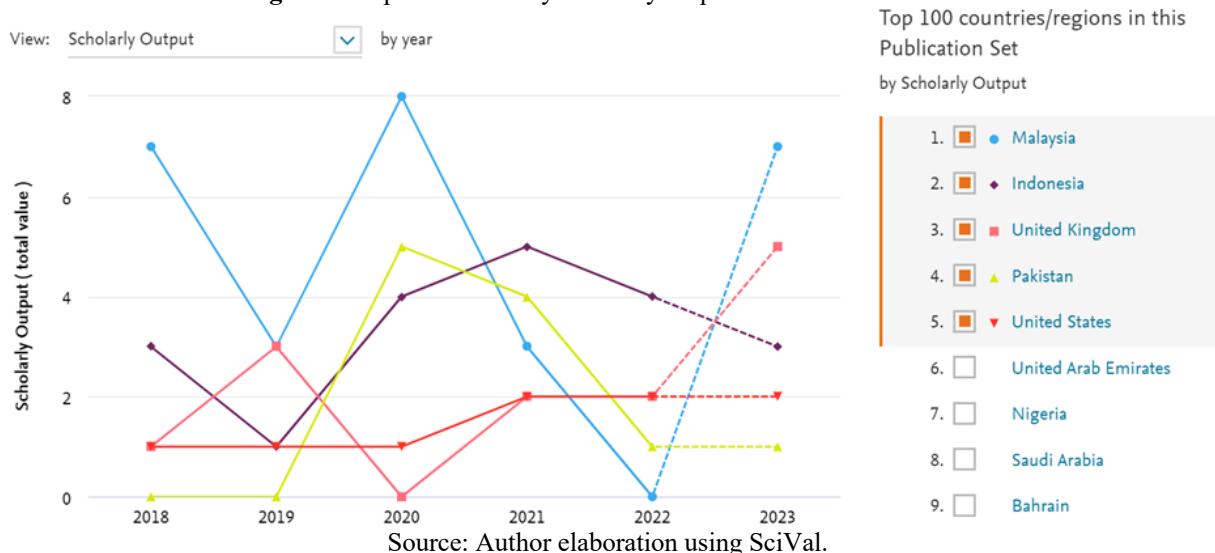
*Source: Author elaboration using SciVal.*

The relevance of accounting key phrases in scholarly output from 2018-2023 reveals interesting trends (Figure 1). While the topic of auditing peaked in relevance in 2019, indicating a significant focus within academic research, the key phrases “accounting standards,” “disclosure,” and “accounting system” have garnered increased attention in the period 2022-2023. This shift in focus suggests a growing interest in specific aspects of accounting practices, indicating a potential evolution in research priorities in the field of accounting for Islamic finance (Kulikova & Mukhametzyanov, 2024).

#### 4.3. Global Centers of Islamic Finance Research: Scholarly Leadership in Accounting and Dispute Resolution

The robust scholarly output from countries such as Malaysia, Indonesia, the United Kingdom, Pakistan and the United States underscores the significant role of research in shaping the landscape of Islamic finance, particularly in the fields of accounting and dispute resolution. These nations, recognized as leaders in Islamic finance scholarship, have consistently contributed to the academic discourse, illuminating the intricate relationship between accounting practices and effective dispute resolution mechanisms (Ilham Akbar & Mukhlisin, 2024).

**Figure 2. Top 5 countries by scholarly output from 2018 to 2023**



This pattern of prolific research activity strongly suggests that advancements in accounting methodologies have a direct influence on the development of dispute resolution mechanisms within Islamic finance. The continuous scholarly endeavors in these countries serve as catalysts, fostering innovations and best practices that enhance the legal certainty of the IBF sector. By bridging the gap between theoretical research and practical application, these active countries set a precedent for other jurisdictions, emphasizing the mutual relationship between accounting accuracy, robust dispute resolution frameworks, and the overall stability and growth of the IBF sector (Ismail et al., 2025). As research continues to flourish in these regions, the global Islamic finance community can anticipate a future characterized by heightened legal certainty, transparency, and trust, essential elements for the sustainable evolution of the industry (Figures 2, 3).

**Figure 3.** Visualization of the most active countries/regions by scholarly output



*Source: Author elaboration using SciVal.*

**Table 2.** Most active institutions with the top 5 by scholarly output on accounting for Islamic finance

Rank	Source Title	Type	Scholarly Output	Years Analyzed
1	Journal of Islamic Accounting and Business Research	Journal	12	2018–2022
2	Islamic Accounting and Finance: A Handbook	Book	3	2018–2022
3	Academy of Accounting and Financial Studies Journal	Journal	2	2020–2023
4	Critical Perspectives on Accounting	Journal	2	2018–2020
5	Library Philosophy and Practice	Journal	2	2019–2022

*Source: Author elaboration using SciVal.*

The leading Journal in the field of accounting for Islamic finance is the *Journal of Islamic Accounting and Business Research*, with 12 articles. It is followed by three publications on accounting: *Islamic Accounting and Finance: A Handbook*, published in 2023. The third position is shared equally by the *Academy of Accounting and Financial Studies Journal*, *Critical Perspectives on Accounting*, and *Library Philosophy and Practice* (table 2). The findings concerning the most active journal in the field of Islamic finance and in accounting is illustrated in Alshater et al. (2021) Alshater et al. (2021), and also by Brescia, Sa'ad, Alhabshi, Hassan, and Lanzalonga (2021); both papers found that the *Journal of Islamic Accounting and Business Research* serves as a vibrant platform for advancing accounting and business expertise rooted in Islamic principles. Its aim is to positively impact societies globally, fostering their well-being.

## 5. Discussion

The findings, prominently illustrated in Figures 1-3 and Tables 1-2, highlight the robustness of accounting research in Malaysia, Indonesia, and the UK. These results provide compelling evidence of the high level of scholarly activity in these countries, underscoring their pivotal roles in shaping the global landscape of accounting awareness.

Moreover, these results hold deeper implications, particularly concerning the development of case law in IBF. The correlation between the intensive research outputs in accounting and the evolution of dispute case law in IBF in these countries is obvious.



The proactive research efforts in Malaysia, Indonesia, and the UK have not only contributed significantly to the academic understanding of accounting principles but have also laid the foundation for the legal frameworks governing IBF practices.

The effective resolution of disputes in Islamic banking and finance law is paramount for the industry's growth and sustainability. The efficient management of disputes is crucial in maintaining the trust and confidence of stakeholders. Initially, we may face different types of disputes in IBF law: first, the disputes may have a contractual aspect; second, the disputes can be related to Sharia compliance; third, they can be regulatory disputes; and last but not least they can have another aspect such as a conflict with the constitutional law of a specific jurisdiction or a conflict of governing law especially in cross-border transactions. Moreover, the conflict may be connected with other national regulations, such as tax or consumer law, and so forth. In this context, accounting plays a pivotal role, as it provides the financial and evidentiary pillar for dispute resolution processes.

In addition to their pivotal role in shaping the financial performance of institutions, accounting practices also hold immense significance in the context of dispute resolution within European financial institutions.

### *5.1. The development of Islamic finance dispute resolution in a non-Muslim jurisdiction: The United Kingdom's experience*

The United Kingdom has the most advanced Islamic financial sector in Europe (di Mauro et al., 2013) with six Islamic banks providing diverse Islamic financial products (Jirvaj, 2022), especially with the growth of the *sukuk* market in 2017 (Siddiqui & Rizvi, 2022) and the number of Muslims living in Britain, which is about 3% of the population (Bellalah & Masood, 2013). Regarding Islamic financial technology regulations in the United Kingdom, it is interesting to point out that the top ten of the Global Islamic Fintech (GIFT) index scores are countries with a majority Muslim population or that adhere to the OIC, except for the United Kingdom, which is classified fifth in the GIFT index scores. Thus, a wide range of factors have contributed to the rapid growth of FinTech in the UK. Among these factors are the active Islamic FinTech community, the presence of many Islamic FinTech companies, the increasing FinTech sector, and a ready-made pool of talent in advanced Islamic financial and technology sectors, along with regulatory support (Adebesin, 2024; Muryanto, 2022).

In some of the most significant international legal cases in IBF, the choice of jurisdiction was Western courts, i.e., in the UK and in New York (Blanke, 2019). In *Beximco Pharmaceuticals Ltd & others v. Shamil Bank of Bahrain EC* [2004], it was held that English law is the applicable law; in *Islamic Investment Company of the Gulf (Bahamas) Ltd v. Symphony Gems NV and others* [2002] (Hasan & Asutay, 2011), the English court ruled that even if delivery did not happen, this was because Symphony Gems did not oversee the necessary measures (Jackson-Moore, 2009). The court's ruling in most of the cases showed that conventional courts were not capable of dealing with IBF disputes effectively.

Even though the development of IBF in Western countries has been slower compared to its development in Islamic countries, IsFIs have managed to exist in the West for more than 40 years. The establishment of IsFIs in non-Muslim countries was a natural process due to globalization and the growth of the Muslim community. (Amuda & Al-Nasser, 2024)

As a result, there has been a notable increase in IBF cases, reflecting both the opportunities and challenges faced by IsFIs operating within the UK legal framework. The Dana Gas case, *Dana Gas PJSC v. Dana Gas Sukuk Ltd & Ors* [2017] EWHC 2928, was an interesting legal dispute involving the UAE-based energy company and its *sukuk* holders. The case was considered by the UK's High Court and the UAE's Supreme Court. The Dana Gas company announced in 2017 that its USD 700 million *sukuk* was no longer Sharia-compliant and therefore unenforceable, as the scholarly consensus was said to have changed since its issuance in 2003 (Ghaffour, 2017). The Dana Gas case sparked discussions within the Islamic finance industry about the importance of adopting more robust, standardized, and transparent practices, precise legal documentation, clear dispute resolution clauses, and addressing potential conflicts between Sharia principles and legal systems (Ercanbrack, 2019).

### *5.2. Malaysia as a legal pioneer: The development of Islamic banking case law in a dual-system jurisdiction*

Malaysia remains one of the prominent centers for the IBF industry. The legal foundation for Islamic finance in Malaysia has undergone numerous improvements through the years to serve the growing industry. The Sharia Advisory Councils of the Securities Commission and Bank Negara Malaysia (BNM) were established to promote Sharia legal certainty. The Central Bank of Malaysia Act 2009 officially established a dual system of finance in the state to facilitate the gradual improvement of the Islamic financial system, aiming to make it a competitive sector with its conventional counterpart. The Islamic Financial Services Act 2013 revised the earlier laws on Islamic banking and *takaful* (Islamic insurance), intending to improve the



standards of Islamic finance law in Malaysia. Currently, Islamic finance in Malaysia is globally recognized for its thorough legal framework (Ghaffour, 2017).

Malaysia has established a robust legal framework for Islamic finance, enabling the effective and unified implementation of Sharia principles within Malaysian law. However, new challenges need the promotion of a continuous certainty. This necessitates excellence at both the institutional and judicial levels. Judges and arbitrators must ensure that disputes are resolved by applying the law, rather than exercising absolute discretion. The courts also ensure that these laws are clear and understandable. For Islamic finance, the Sharia Advisory Councils (SACs) of Bank Negara Malaysia and the Securities Commission have performed a complementary function by providing the courts with Sharia certainty. This task does not substitute for the function of the judiciary in maintaining legal certainty. Instead, the SACs helped the courts by providing consistency and regularity in the interpretation of Sharia rules relevant to Islamic finance (Ercanbrack, 2019).

The involvement of Sharia Advisory Committees (SACs) serves a pivotal role as central authorities responsible for delivering definitive Sharia rulings. This function is integral to guiding the application of these rulings to the specific nuances of individual cases, offering a level of certainty crucial for the formulation of final judgments by the courts. A systematic framework has been established to facilitate legal professionals, including judges, arbitrators, and entities within the Islamic finance sector, in seeking guidance from SACs on matters necessitating the interpretation of Islamic law. Issues falling outside the jurisdiction of SACs are reserved for adjudication within the formal court system. The composition of SACs, notably comprised of former judges, ensures their effective operation within the parameters of their expertise. To enhance procedural legitimacy, considerable efforts have been dedicated to ensuring meticulous documentation and public accessibility of the reasoning behind SAC decisions. Beyond the purview of the courts and SACs, an additional crucial institutional component consists of financial regulators, signifying a comprehensive ecosystem of regulatory oversight in Islamic finance (Ghaffour, 2017).

Revisiting the discourse on potential disagreements, scholars commonly cite ignorance and risk as sources of conflicts that lead to the nullification of various contracts. Legal disputes may still arise in contractual agreements that lack specific provisions, such as in cases involving concealed defects, damages, or faulty commodities. In such scenarios, justice is administered by resolving the dispute through compensation mechanisms devised in accordance with their respective schools of jurisprudence (El-Gamal, 2001).

### 5.3 Legal precedents as a determinant of evolving accounting practices

According to Hasan & Asutay (2011), one of the main ambiguous areas in IBF is getting an appropriate legal regime and framework. In Islam, it is extremely important to uphold justice; therefore, in the case of disputes, it is essential to settle and resolve any litigation. Regarding the disputes in the field of IBF, it is essential to understand which judge is qualified to resolve such disputes: the civil court or the Islamic court, especially in a global context (Rasyid, 2013). In reality, several Islamic financial dealings are ruled by English law (Hasan & Asutay, 2011). Another issue is whether it is preferable to opt for the court or for alternative solutions, such as negotiation, mediation, an ombudsman, or arbitration, before resorting to the court as a last resort. Additionally, the judge needs to be competent in the field of IBF, a thing that is not always feasible (Rasyid, 2013). Additionally, a Sharia legal issue can be resolved by referring it to different schools of jurisprudence, all of which offer legitimate solutions from a Sharia perspective (Ghaffour, 2017). Moreover, the majority of legal cases in IBF opt for the argument of non-compliance with the contract under Sharia rules when one of the parties or the defendant fails to fulfill their obligations under the agreement or simply fails to pay (Hasan & Asutay, 2011). Additionally, there is a noticeable influence in the Islamic finance sector stemming from the globalization of business law practices, global investment banks, accounting companies, and legal corporations. (Bälz, 2008)

Over the last few decades, several Islamic finance law cases have been brought before courts in various legal jurisdictions. This has led to uncertainties among various market stakeholders concerning the security of their investments (Hasan & Asutay, 2011).

In Islamic finance, dispute resolution is getting more consideration. The standard common law legal system is the most prevalent in the world. A significant volume of commercial disputes is resolved by the common law legal system. Accessible, clear, and predictable laws guarantee a secure environment that enables sustained business development. Dispute resolution within a comprehensive legal system will foster the evolution of the law. For example, significant decisions can influence policies, improve risk management practices, and lead to better outcomes for businesses. (Ghaffour, 2017; Hassan et al., 2019) Legal cases concerning the sale and purchase contract (Bai' Inah) emphasized numerous significant points to consider in the context of IBF dispute settlements. The court decisions guided IsFIs to develop improvements concerning the legal



documentation for Bai` Inah contracts themselves (Ghaffour, 2017). It is essential to recognize the key issues in dispute settlements within Islamic banking and finance. The objective of this research is to get a thorough understanding of the foundational principles that underpin dispute resolution in IBF.

The task of maintaining legal certainty in Islamic finance is challenging, first because Sharia principles and requirements must be integrated into national law from its religious foundations; additionally, these principles, which derive from the early centuries of Islam, need to be practical within the framework of modern finance. (Ghaffour, 2017)

The legal and regulatory certainty provided in Malaysia has made a significant contribution to the development of a sound and continuously evolving Islamic financial system and to its continued status as a prominent Islamic financial hub; legal certainty should lead to effective dispute resolution. Sharia rules need to be incorporated into the regulations and applied to modern settings. These issues are amplified by the rapidly transforming world. The prospect for the legal order is to apply standards of Islamic law to innovative products while remaining transparent. This implies flexibility with modern solutions while still being loyal to the principles of Islamic law. Certainty regarding Sharia rulings relevant to a specific Islamic financial service is crucial. Legal certainty is just as crucial as the legal enforceability of obligations in the event of non-compliance with Sharia rules by an Islamic financial product. Ambiguity in the legal framework can lead investors to doubt such financial products and consider them high-risk instruments. This also has a significant impact on the entire Islamic finance market. (Ghaffour, 2017)

On the other side, according to Hassanein and Mostafa (2022), even though the academic literature on IBF is abundant and research in this field has received significant commitment during the last decade, it was argued that the evolution is still in progress; accordingly, previous studies in the field have produced intensive literature principally on the performance of IBF. Earlier literature has also focused on examining the corporate governance systems of Islamic banks, as well as the structures of *sukuk* markets and the *takaful* system. In addition, the literature has also investigated some ethical problems related to IBF (Hassanein & Mostafa, 2022; Rifas & Minaz, 2025). Thus, many issues, such as IBF case law, remain undeveloped. Literature on accounting for Islamic finance and its intersection with dispute resolutions is very scarce. This is due to the lack of published cases, despite Malaysia's significant role in the development of the IBF legal framework.

The findings also noted that accounting was linked to the calculation of *zakat*, an important element in the IBF industry; while this was not the primary aim of this research, it emerged as a significant point of interest.

This observation highlights a significant connection between conventional accounting frameworks and the specific religious obligation of *zakat* computation. The identification of this link, though incidental to the study's primary objectives, constitutes a significant emergent finding. It underscores the pervasive role of accounting as a foundational tool that extends beyond mere financial reporting into the realm of religious compliance and ethical practice within Islamic economics (Ibrahim et al., 2024). Such findings highlight the interdisciplinary nature of the field and suggest fertile ground for future dedicated research. It posits that accounting systems are not agnostic but can be directly engaged in fulfilling the spiritual and social mandates that reinforce the Islamic finance industry.

#### *5.4. Accounting as a governance mechanism: Translating Islamic principles into financial practices*

The study noted a recurring thematic link between accounting and *zakat* computation within the literature. Although peripheral to the core focus of this study, this relationship underscores the broader relevance of accounting in fulfilling religious and ethical obligations within Islamic finance.

Furthermore, analyzing the intersection between accounting and dispute resolution in Islamic finance has provided significant findings. By analyzing the existing literature and examining key trends and phrases, the study highlighted several crucial points: accounting, by nature, involves meticulous record-keeping, documentation, and financial reporting. It captures the essence of all financial transactions, from profit and loss reports to balance sheets. This financial data is a fundamental source when disputes arise in the IBF sector. One of the primary areas where accounting plays a crucial role in dispute resolution is the accurate representation and assessment of financial transactions, ensuring they comply with Shariah principles. Regardless of the dispute resolution mechanism chosen, whether it involves profit-sharing ratios, the validity of specific transactions, or the determination of financial misconduct, accounting data forms the basis for building a case, defending a position, or reaching an equitable solution.

Additionally, accounting serves as a primary mechanism to mitigate elements such as *riba* and *gharar* through two core functions: measurement and disclosure, which ensure transparency by quantifying and clearly reporting transactional risks and obligations, where Sharia-compliance auditing verifies that operations adhere to Islamic principles, thereby reducing ambiguity,



preventing disputes, and strengthening institutional credibility. In essence, accounting translates the religious prohibition of *riba* and *gharar* into enforceable financial governance.

### *5.5. Recommendations and future directions*

Salami, Tanrıvermiş, and Abubakar (2022) present insightful solutions to enhance the relevance of Islamic finance research for various stakeholders, including businesses and the public. One of their key recommendations is that researchers in Islamic finance, especially those utilizing accounting ratios in their studies, should consider the specific International Financial Reporting Standards (IFRS) regulations applicable in the jurisdiction where the research is conducted. Neglecting these regulations, especially in cross-border studies, could potentially impact the outcomes. These suggestions are equally pertinent in the field of legal research, where scholars often rely on economic findings to devise sustainable solutions and aid decision-making processes. Legal experts, who may not possess a strong background in econometric modeling research methods, prioritize economic outcomes to inform their analyses (Salami et al., 2022). In the context of legal research, these recommendations hold significance; in other words, legal scholars typically lack extensive expertise in economic modeling and accounting (Kamla & Haque, 2019). Their emphasis lies in deriving meaningful economic outcomes to discover enduring solutions and interventions, thus helping decision-making processes.

As the domestic and global Islamic finance sectors expand, there is a corresponding need to enhance the skilled workforce. Professionals engaged in structuring financial products, such as lawyers and scholars from Sharia supervisory boards, play a crucial role by offering significant insights to clients about Sharia compliance and legal regulations (Nomran & Haron, 2019). This expertise aids in the creation and refinement of product documentation. Legal experts well-versed in both accounting and Sharia requirements can present stronger arguments in legal proceedings. Certification initiatives and specialized seminars are essential in providing legal professionals with a comprehensive understanding of both practical Sharia principles and fundamental legal expertise (Ghaffour, 2017).

The development of specialized accounting standards for financial reporting is crucial due to the difficulties faced by IsFIs in aligning with established accounting frameworks such as the International Financial Reporting Standards (IFRS) or the Generally Accepted Accounting Principles (GAAP). These conventional standards tailored for conventional financial institutions are frequently inadequate in addressing the complexities of Islamic financial transactions.

Several studies highlighted the importance of regulators establishing standards akin to those set by Bank Negara Malaysia, especially as the market explores innovative approaches (Qimyatussā‘adah & Abdul Sayeed, 2024). Such standards would serve as a crucial resource for IsFIs and legal experts, aiding in the structuring of Islamic finance products and the development of essential legal documentation. To achieve a high level of legal certainty, it is vital to foster individual excellence among legal and Islamic finance professionals (Ghaffour, 2017). In the study by Rehman et al. (2020), it was found that while most Islamic banks in Pakistan demonstrate important levels of composite Corporate Social Responsibility (CSR) practices, an imbalance exists in the disclosure of specific dimensions within these practices. Financial obligations often take precedence over other dimensions, resulting in a lack of comprehensive and systematic reporting. The scattered information in annual reports poses accessibility challenges for potential customers, impacting their perception of the banks' social, ethical, and moral responsibility, which are crucial aspects in considering their adherence to Sharia principles (Zafar, 2024).

To address these issues, several studies propose a unified index that merges the standards of the AAOIFI and the Global Reporting Initiative (GRI). This new index aims to standardize CSR disclosure in Islamic banks, aligning with internationally accepted standards within the Sharia framework. Mandating this index could enhance CSR disclosure, potentially addressing the current challenges of voluntary compliance (Rehman et al., 2020; Zafar, 2024).

Similarly, the relationship between robust accounting research and the maturation of dispute case law in IBF highlights the symbiotic nature of academic scholarship and legal developments. The rigorous exploration of accounting standards, financial practices, and reporting methodologies provides a solid foundation upon which legal experts can construct relevant dispute resolution frameworks. As accounting research continues to develop, it undoubtedly catalyzes the refinement and sophistication of dispute resolution mechanisms within the IBF sector.

The correlation between the thriving academic works in accounting and the advancement of dispute case law in IBF serves as a testament to the interdisciplinarity of knowledge. Collaborative efforts between accounting scholars and legal experts are imperative in ensuring the continuous integration of financial best practices with legal frameworks, thereby fortifying the integrity and efficacy of the IBF sector globally.



## 6. Conclusion

This research aimed to identify a direct link between accounting practices and dispute resolution procedures in IBF law. Although the analysis did not find explicit evidence of a direct connection in the existing literature, it did reveal significant structural and thematic correlations. Thematic and bibliometric analysis showed a clear alignment between scholarly activity and practical legal development. Jurisdictions known for advanced dispute resolution frameworks, such as Malaysia, Indonesia, and the United Kingdom, were also the most prolific contributors to academic research on the topic. This suggests that vibrant scholarly discourse is closely associated with the development of sophisticated dispute resolution mechanisms.

Islamic accounting professionals are involved in contract disputes where financial transactions or contract clauses are under scrutiny. They can help interpret financial terms and conditions, ensuring a fair resolution for all parties involved.

This study has contributed to the literature by shedding light on the often-overlooked connection between accounting practices and dispute resolution mechanisms in Islamic finance. By examining key concepts, including auditing, accounting standards, and financial reporting, the study offered a nuanced understanding of how these elements intersect and influence dispute resolution strategies. Furthermore, the formulation of distinct accounting standards for Islamic financial reporting is imperative. This necessity arises from the inherent challenges encountered by IsFIs when adhering to existing accounting frameworks, such as International Financial Reporting Standards (IFRS) or local Generally Accepted Accounting Principles (GAAP). These conventional standards, which are often designed around traditional institutions and financial practices, frequently prove inadequate in accommodating the complexities of Islamic financial transactions (Morshed, 2024).

From a practical perspective, the findings emphasize the importance of integrating robust accounting practices within the Islamic finance industry. Clear financial reporting, adherence to the AAOIFI accounting standards, and transparent disclosure mechanisms are pivotal not only for the industry's credibility but also for effective dispute resolution. IsFIs can enhance their dispute-resolution processes by ensuring accurate accounting practices, which in turn fosters trust and confidence among stakeholders. The intersection between accounting for Islamic finance and dispute resolution arises when financial expertise is required to clarify, analyze, or interpret financial data within the context of legal disputes or disagreements.

It is essential to acknowledge the limitations of this study. The research, while comprehensive, is not exhaustive. The dynamic nature of both Islamic finance and accounting practices implies that some important sources may not be openly accessible, potentially limiting the scope and depth of the findings. Additionally, although the scope of the analysis is extensive, it may not encompass every niche aspect of this complex relationship.

Future scholars can investigate specific areas highlighted in this study in depth. Exploring the impact of emerging technologies, such as blockchain and artificial intelligence, on accounting practices and dispute resolution in Islamic finance could be a promising avenue (Calandra et al., 2022). Additionally, comparative analyses of dispute-resolution mechanisms across various IsFIs could provide significant insights into best practices.

In summary, the study underscores the integral role of accounting in facilitating effective dispute resolution within the Islamic finance industry. By recognizing the symbiotic relationship between accounting principles and resolution strategies, practitioners and policymakers can foster a more robust and resilient financial ecosystem. Despite the challenges and complexities, this intersection offers fertile ground for continued scholarly exploration, ensuring the ongoing refinement of both accounting practices and dispute resolution methods in the field of Islamic finance.

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## Appendices

### Appendix 1. List of publications on accounting for Islamic finance (Source: Scopus)

Year range	2018 to 2023			
Subject classification	ASJC			
Types of publications included	All publication types			
Self-citations	-			
Data source	Scopus			
Date last updated	4 October 2023			
Date exported	12 October 2023			
91 publications				
Title	Authors	Year	Scopus Source title	Citations
Risk-adjusted profitability and stability of Islamic and conventional banks: Does revenue diversification matter?	Paltrinieri, A.  Dreassi, A.  Rossi, S.  Khan, A.	2021	Global Finance Journal	40
Influential and intellectual structure of Islamic finance: a bibliometric review	Alshater, M.M.  Hassan, M.K.  Khan, A.  Saba, I.	2021	International Journal of Islamic and Middle Eastern Finance and Management	33
A survey on Islamic Finance and accounting standards	Hassan, M.K.  Aliyu, S.  Huda, M.  Rashid, M.	2019	Borsa Istanbul Review	31
Dual board governance structure and multi-bank performance: a comparative analysis between Islamic banks in Southeast Asia and GCC countries	Nomran, N.M.  Haron, R.	2019	Corporate Governance (Bingley)	30
Do corporate social responsibility disclosures improve financial performance? A perspective of the Islamic banking industry in Pakistan	Rehman, Z.U.  Zahid, M.  Rahman, H.U.  Asif, M.  Alharthi, M.  Irfan, M.  Glowacz, A.	2020	Sustainability (Switzerland)	29
Islamic accounting, neo-imperialism and identity staging: The Accounting and Auditing Organization for Islamic Financial Institutions	Kamla, R.  Haque, F.	2019	Critical Perspectives on Accounting	25
What do we know about zakat literature? A bibliometric review	Alshater, M.M.  Saad, R.A.J.  Abd. Wahab, N.  Saba, I.	2021	Journal of Islamic Accounting and Business Research	18
The impact of the Shariah Board's characteristics on the financial soundness of Islamic banks	Khalil, A.  Boulila Taktak, N.	2020	Journal of Islamic Accounting and Business Research	18
Accounting and pseudo spirituality in Islamic financial institutions	Hidayah, N.N.  Lowe, A.  Woods, M.	2019	Critical Perspectives on Accounting	15
Examining the role of sharia supervisory board attributes in reducing financial statement fraud by Islamic banks	Anisykurlillah, I.  Jayanto, P.Y.	2020	Banks and Bank Systems	14



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	Mukhibad, H.  Widyastuti, U.			
Islamic finance: Ethical underpinnings, products, and institutions	Hassan, A.  Mollah, S.	2018	Islamic Finance: Ethical Underpinnings, Products, and Institutions	14
A Contemporary review of islamic finance and accounting literature	Hassan, M.K.  Aliyu, S.  Hussain, M.	2022	Singapore Economic Review	14
A Bibliometric Analysis of Islamic Accounting Research Indexed by Dimensions.ai	Rusydiana, A.S.  Taqi, M.  Firmansyah, I.  Assalafiyah, A.  Kustiningsih, N.	2020	Library Philosophy and Practice	12
Corporate governance, Shariah governance, and credit rating: A cross-country analysis from asian islamic banks	Mansoor, M.  Ellahi, N.  Hassan, A.  Malik, Q.A.  Waheed, A.  Ullah, N.	2020	Journal of Open Innovation: Technology, Market, and Complexity	10
Takaful operators: analysing segregated accounts between operator/participants	Alkhan, A.M.  Hassan, M.K.	2020	Journal of Islamic Accounting and Business Research	8
Financial and Accounting Principles in Islamic Finance	Alamad, S.	2019	Financial and Accounting Principles in Islamic Finance	7
Business Ethics in the Middle East	Sidani, Y.	2018	Business Ethics in the Middle East	6
Determinants of technical efficiency of Islamic banks in GCC countries	Ben Mohamed, E.  Meshabet, N.  Jarraya, B.	2021	Journal of Islamic Accounting and Business Research	6
Electronic financial disclosure: Islamic banking vs conventional banking in GCC	Sarea, A.M.  Musleh Al-Sartawi, A.M.A.  Khalid, A.A.	2018	Lecture Notes in Computer Science (including subseries Lecture Notes in Artificial Intelligence and Lecture Notes in Bioinformatics)	5
Factors influencing the selection of unit trust funds among Malaysian retail investors	Mohammed Kamil, N.  Subramiam, M.  Ali, H.E.  Musah, M.B.  Alex, A.	2018	Journal of Islamic Accounting and Business Research	5
Sharia governance standards and the role of AAOIFI: a comprehensive literature review and future research agenda	Hassan, M.K.  Raza Rabbani, M.	2023	Journal of Islamic Accounting and Business Research	5
Accounting standards and value relevance of accounting information: a comparative analysis between Islamic, conventional and hybrid banks	Agbodjo, S.  Toumi, K.  Hussainey, K.	2021	Journal of Applied Accounting Research	5
Corporate governance and Islamic bank accountability based on disclosure—a study on Islamic banks in Indonesia	Mukhibad, H.  Yudo Jayanto, P.  Suryarini, T.  Bagas Hapsoro, B.	2022	Cogent Business and Management	5
Islamic corporate governance and financial statements fraud: A study of islamic banks	Mukhibad, H.  Jayanto, P.Y.  Anisykurillah, I.	2021	Journal of Governance and Regulation	5
The ideological character of accounting textbooks: Insights from Indonesian accounting lecturers	Irsyadillah, I.	2019	Journal of Accounting in Emerging Economies	5
Level of Maqāsid ul-Shari'ah's in financial reporting standards for Islamic financial institutions	Mukhlisin, M.	2021	Journal of Islamic Accounting and Business Research	5
Women directors and market valuation: What are the "Wonder Woman" attributes in banking?	Alharbi, R.  Elnahass, M.  McLaren, J.	2022	Journal of International Financial Markets, Institutions and Money	4
Islamic law and international commercial arbitration	Bhatti, M.	2018	Islamic Law and International Commercial Arbitration	4
Does risk governance mediate the impact of governance and risk management on banks' performance? Evidence from a selected sample of Islamic banks	Jallali, S.  Zoghlaei, F.	2022	Journal of Financial Regulation and Compliance	4
Does cost-inefficiency in Islamic banking matter for earnings uncertainty?	Boubaker, S.  Uddin, M.H.  Kabir, S.H.  Mollah, S.	2023	Review of Accounting and Finance	4
Exploring Compliance of AAOIFI Shariah Standard on Ijarah Financing: Analysis on the Practices of Islamic Banks in Malaysia	Saleem, S.  Mansor, F.	2020	Journal of Risk and Financial Management	3



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Determinants of implementation of accounting standards for Islamic financial institutions in Iraq: A conceptual framework	Mohammed, A.M.	2018	Academy of Accounting and Financial Studies Journal	3
Salam for import operations: mitigating commodity macro risk	Anwer, Z.	2020	Journal of Islamic Accounting and Business Research	3
Charting future growth for Islamic finance talents in Malaysia: a bibliometric analysis on the Islamic finance domains and future research gaps	Abd. Wahab, N.  Mohd Yusof, R.  Zainuddin, Z.  Shamsuddin, J.N.  Mohamad, S.F.N.	2023	Journal of Islamic Accounting and Business Research	3
The significance and performance analysis of Malaysian real estate investment trusts	Khairulanuar, A.J.  Chuweni, N.N.	2020	International Journal of Law and Management	3
The rise and fall of institutional entrepreneurship in Islamic financial reporting standardisation projects	Abras, A.  Al Mahameed, M.	2022	Accounting Forum	3
The substance and form of Islamic Finance instruments: an accounting perspective	Ebrahim, A.  Abdelfattah, T.	2021	Journal of Islamic Accounting and Business Research	3
A proposed framework for implementing risk-based Shari'ah audit	Sani, S.D.  Abubakar, M.	2020	Journal of Financial Reporting and Accounting	3
Developments in Islamic finance literature: Evidence from specialized journals	Hanif, M.  Zafar, K.	2020	Journal of King Abdulaziz University, Islamic Economics	3
Saudi Arabia's small and medium enterprises (SMES) sector post-Covid-19 recovery: stakeholders' perception on investment sustainability	Alharbi, R.K.	2022	International Journal of Organizational Analysis	3
Zakat accounting information system in private higher education	Doktoralina, C.M.  Bahari, Z.	2018	European Research Studies Journal	2
Potential application of Istisna' financing in Malaysia	Hasmawati, A.  Mohamad, A.	2019	Qualitative Research in Financial Markets	2
The impact of Shariah Advisory Board characteristics on the financial performance of Islamic banks	Haddad, A.  Bouri, A.	2022	Cogent Economics and Finance	2
Current status of Indonesian journals in the field of Islamic economics and finance	Handoko, L.H.	2020	Science Editing	2
Mind the gap: theories in Islamic accounting and finance, Islamic economics and business management studies	Mukhlisin, M.  Ismail, N.  Jamilah Fikri, R.	2022	ISRA International Journal of Islamic Finance	2
Fintech and Islamic banking growth: new evidence	Sidaoui, M.  Ben Bouheni, F.  Arslankuyag, Z.  Mian, S.	2022	Journal of Risk Finance	2
Zakat Calculation Software for Corporate Entities	Ahmed, M.U.  Kasri, N.S.B.	2021	Islamic FinTech: Insights and Solutions	2
The present and future labour Shariah auditor market	Omar, M.	2019	International Journal of Innovation, Creativity and Change	1
The intention of small and medium enterprises' owners to participate in waqf: the case of Malaysia and Indonesia	Laila, N.  Ratnasari, R.T.  Ismail, S.  Mohd Hidzir, P.A.  Mahphoth, M.H.	2023	International Journal of Islamic and Middle Eastern Finance and Management	1
Open innovation in shariah compliance in Islamic banks – Does shariah supervisory board attributes matter?	Mukhibad, H.  Nurkhin, A.  Anisykurlillah, I.  Fachrurrozie, F.  Jayanto, P.Y.	2023	Journal of Open Innovation: Technology, Market, and Complexity	1
Current trends and future impacts of fintech in Islamic finance	Yasini, S.  Yasini, M.	2018	Fintech in Islamic Finance: Theory and Practice	1
A study on the integration of islamic social finance through accounting and auditing organization for Islamic financial institutions (AAOIFI)	Shabbir, M.S.  Bilal, M.K.  Ur Rehman, H.  Cheema, A.A.	2020	International Journal of Advanced Science and Technology	1
An econometric understanding of Fintech and operating performance	Ben Bouheni, F.  Tewari, M.  Sidaoui, M.  Hasnaoui, A.	2023	Review of Accounting and Finance	1
Financial reporting dimensions of intangibles in the context of islamic finance	Alhabshi, S.M.  Agil, S.K.S.  Ahmed, M.U.	2018	Al-Shajarah	1
Islamic financial services industry: Aspirations and achievements	Hanif, M.  Ayub, M.	2022	Business Ethics, Environment and Responsibility	1
Good governance based on maqāsid al-shari'ah in management of tabling masjid: A case study of Malaysia	Zakariyah, L.  Sarif, S.M.  Osman,	2018	Islamic Quarterly	1



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	R.A.H.  Rahman, S.A.			
Critical assessment of Islamic financial assets pricing in South-East Asia: evidence from NARDL modelling	Salami, M.A.	2020	Journal of Financial Reporting and Accounting	1
Al Meezan Investment Management Limited: evolution of Sharī'ah-compliant mutual funds	Sharif, S.  Ahson, S.  Noor, H.	2020	Emerald Emerging Markets Case Studies	1
AAOIFI Gold Standard and its Impact on Turkish Financial Markets	Çakar, R.	2021	Hittit Theology Journal	1
Corporate social responsibility and Islamic and conventional banks performance: a systematic review and future research agenda	Tasnia, M.  Syed Jafaar Alhabshi, S.M.  Rosman, R.	2023	Journal of Sustainable Finance and Investment	1
The association between islamic bank performance and islamic social responsibility in supporting SDGs: The different between Indonesia and Malaysia	Khansa, F.N.  Violita, E.S.	2021	IOP Conference Series: Earth and Environmental Science	1
Talent development and retention from the bankers' perspectives: A study at Islamic Banks in Malaysia	Kamil, B.A.M.  Yahya, K.K.  Salleh, M.C.M.  Iqbal, F.I.	2018	Journal of Social Sciences Research	1
Does Islamic banking differ from conventional banking?	Abu-Abbas, B.M.	2019	Islamic Quarterly	0
The usefulness of financial accounting systems in Islamic Education Institutions: Lessons learned	Murdayanti, Y.  Purwohedi, U.	2018	Academy of Accounting and Financial Studies Journal	0
Islamic Accounting and Finance: A Handbook	Hussainey, K.  Lawati, H.A.	2023	Islamic Accounting and Finance: A Handbook	0
Development of Islamic Banking in Russia Based on the Example of LLC Financial House Amal	Garifullin, I.I.  Daryakin, A.A.  Galeeva, G.M.	2018	Studies on Russian Economic Development	0
Islamic finance: XXth April international Academic Conference on Economic and Social Development 9-12 April 2019, Moscow, Russia	Dzhangiryan, S.	2019	Ekonomicheskaya Sotsiologiya	0
Islamic Finance Reform: A Few Points to Ponder	Nienhaus, V.	2020	Journal of King Abdulaziz University, Islamic Economics	0
Performance of Islamic Microfinance Institutions: Accounting for Well-Being	Siti-Nabiha, A.K.  Norfarah, N.	2020	Global Journal Al-Thaqafah	0
Financing and returns of Sharī'ah-compliant contracts and sustainable investing in the Islamic banking of Oman	Alshubiri, F.  Al Ani, M.K.	2023	Economic Change and Restructuring	0
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# The Jurisprudential and Economic Foundations of Build-Operate-Transfer (BOT) Contracts and their Role in Managing Liquidity in Islamic Banks

Ahmad Asad Muhamoud Ibrahim<sup>1\*</sup>, Ahmed M. Alsaad<sup>2</sup>

<sup>1</sup> Department of Islamic Banking and Finance, Bahrain Institute of Banking and Finance.  
Building 1456, Road 4034, Block 340, Manama, Kingdom of Bahrain.  
Corresponding Author: asad@bibf.com

<sup>2</sup> Yarmouk University, Jordan.

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## Abstract

This paper examines the jurisprudential and economic foundations of Build–Operate–Transfer (BOT) contracts and evaluates their role as a Sharī‘ah-compliant mechanism for managing excess liquidity in Islamic banks. Using a descriptive and analytical methodology, the study traces the historical emergence of BOT-type arrangements, clarifies their legal nature within contemporary concession and public–private partnership (PPP) frameworks, and outlines the main contractual parties, phases, and variants (such as BOOT, DBFO, and related models). On the Sharī‘ah side, the paper analyses classical and modern fiqh discussions and positions of leading Sharī‘ah bodies, showing that BOT structures can be accommodated as composite contracts built primarily on *istishnā‘* and *ijārah*, supported by the general principle that the default rule in transactions is permissibility. Attention is given to the *maqāṣid al-Sharī‘ah* (objectives of Islamic law) served by BOT, including the provision of public utilities, preservation and development of assets, risk sharing, and promotion of real-sector investment. Economically, the study argues that conventional, debt-based financing contributes only limitedly to added value and national production, whereas BOT contracts are intrinsically tied to the creation, operation, and eventual transfer of productive infrastructure. When deployed by Islamic banks, BOT arrangements enable the mobilisation of surplus liquidity into large-scale projects through instruments such as sukuk issuances, syndicated financing, and dedicated investment funds, while transferring construction and operational risks to specialised private entities and preserving final public ownership of strategic assets. The paper concludes that, under appropriate Sharī‘ah structuring and regulatory support, BOT contracts can serve as an effective tool for liquidity management in Islamic banks, simultaneously advancing sustainable development, providing fiscal relief to governments, and enhancing the social utility of Islamic finance.

**Keywords:** Build–Operate–Transfer (BOT); Islamic banks; Islamic finance; Public–private partnerships (PPP); Sharī‘ah-compliant contracts; Sukuk.



## 1. Introduction

Praise be to Allah, the Lord of all worlds, and prayers and peace be upon the noblest of messengers, our master and prophet Muhammad, and upon his family and companions.

Islamic law (Sharia) clarifies which transactions are prohibited and delineates them explicitly, while all other transactions are considered permissible (halal). The fundamental principle in transactions is permissibility, which provides flexibility in accommodating the new types of transactions that emerge in human life. Human beings, by nature, are progressive and seek means to facilitate their lives through relationships with others. Through contracts and transactions, they need to discipline such relations. Among these needs is the establishment of projects that secure general public necessities, such as transport, education, healthcare, and large-scale projects requiring significant capital, which may exceed the capacity of the States to provide. Consequently, states often turn to large companies or banks to finance these projects and services.

Infrastructure projects and their facilities are the backbone of economic and social development worldwide. Without adequate infrastructure, the desired process of development cannot progress. The establishment or modernization of infrastructure is a fundamental pillar of development, particularly in transport, communication, and service sectors.

Most countries, especially developing ones, strive to adopt new project management methods, particularly for large-scale projects aimed at providing robust infrastructure—such as airports, seaports, road networks, electricity grids, and other public utilities. These projects often require contracting with individuals or private-sector companies, which establish, operate, and finance the projects through a modern application known as the Build-Operate-Transfer (BOT) system. This system involves construction, operation, and eventual transfer of ownership.

This system is defined as: “A framework through which public investment projects are financed, constructed, managed, and maintained by the private sector—either a single private company or a consortium of local or international companies—via a project company. The project company undertakes construction, implementation, management, and maintenance for a specified concession period granted by the host state, enabling the company to recover its project costs and achieve a satisfactory return on investment. Upon completion of the concession period, the project company transfers ownership of the project’s assets to the state in good condition, without restrictions or conditions.”

The BOT system involves two primary parties: the host State and the project-executing company. The modes of engaging with the Build-Operate-Transfer system vary, yielding multiple forms that share common content but differ in implementation. All variations focus on financing, establishing, managing, and operating infrastructure projects, as well as industrial and residential complexes, and land reclamation, thereby forming practical applications for investment models under BOT systems.

The significance of this topic lies in the fact that the BOT system represents a form of international investment that emerged in developed countries in response to specific needs. From a legal and economic perspective, the BOT model represents a modern concession-based infrastructure delivery mechanism rather than a mere contractual technique. Contemporary legal scholarship emphasizes that BOT arrangements are designed to allocate financing, construction, and operational risks to private investors for a defined concession period, while preserving the public nature of infrastructure assets through eventual transfer to the state (Eventia, 2017). This dual character, private execution combined with public ownership objectives, places BOT contracts within the broader family of public utility concession and public-private partnership (PPP) frameworks, rather than conventional procurement contracts.

This system has increasingly gained relevance under the effects of globalization, which accelerates the dissemination and unification of many economic policies and practices. This contractual system achieves two simultaneous objectives (McCarthy and Tiong, 1991):

- Implementing large-scale projects efficiently and within the specified timeframe.
- Relying on local and foreign private sector financing.

Thus, the importance of these contracts becomes evident. This system reduces the financial burdens and associated risks on the state. It assists countries with limited investment capacity in establishing projects that require substantial funding, without straining their budgets with debt. After completion, the project is transferred to the government at the end of the contract and becomes State property. The executing company benefits financially according to the agreement, typically through fees collected from users of the project facilities. This mechanism allows investors to cover project costs, operating expenses, and maintenance, while obtaining the desired profit. Using this approach, several modern countries have successfully developed



public facilities and ensured a comfortable life for their citizens.

## 2. Origin of the Contract

The term B.O.T. is an acronym derived from the first letters of three words: Build, Operate, and Transfer. It is not a legal term per se, but rather a practical term that emerged from the evolution of investment methods, project financing systems, and the diversification of economic development models.

The first person to use this term was the Turkish Prime Minister Turgut Özal<sup>1</sup> in the early 1980s<sup>2</sup>. Although B.O.T. projects began under this name around the mid-1980s, various countries had long adopted policies to rely on the private sector for infrastructure projects.

Some scholars argue that France was a pioneer in this field, having developed the Le Concession des Services Publics (public utilities concession) system, which, in concept and legal nature, is essentially an application of the B.O.T contract. In 1782, the French government granted the concession for water distribution in Paris to a private company, the Périé Brothers. The company expanded rapidly, but political events at the time affected the agreement, leading the city of Paris to revoke the concession after the French Revolution. The concession system gained significant traction in France after 1830 and was later extended to Spain, Italy, and Germany<sup>3</sup>.

Arguably, the first and most famous BOT-type project in the world was the Suez Canal, established through a concession contract signed in 1854 between the Egyptian government and the Compagnie Universelle du Canal Maritime de Suez, headed by Ferdinand de Lesseps. The canal was inaugurated in 1869 with a concession period of ninety-nine years, which was terminated earlier than scheduled following its nationalization in 1956. However, the Suez Canal was not an isolated case. Comparable concession-based arrangements resembling modern BOT structures were implemented in several countries during the nineteenth and early twentieth centuries. In France, public utility concessions (concessions de services publics) were widely used for water supply, canals, and urban infrastructure, allowing private operators to finance, build, and operate facilities before transferring them back to public authorities. In the United Kingdom, private companies constructed and operated toll roads, bridges, and railways under long-term concession agreements. Similarly, in the United States, privately financed toll roads, canals, and later railroads were developed through concessionary frameworks that enabled investors to recover costs through user fees. These historical precedents demonstrate that BOT-type arrangements have deep roots in international practice and evolved as pragmatic responses to fiscal constraints faced by governments, long before their formal recognition as modern public–private partnership models (Auriol and Picard, 2011)<sup>4-5-6</sup>.

The United States has been familiar with the B.O.T. system since the Industrial Revolution, when roads were built and operated by the private sector in exchange for user fees. The federal government encouraged private investment in road and bridge construction under the Federal-Aid Highway Act, which was signed into law on December 18, 1956. This approach was reinforced under President Bill Clinton, who issued Decision No. 12893 on December 28, 1994, to promote investment through the B.O.T. system.

Developing countries also adopted this system. For instance, the Philippines enacted Law No. 7718 of 1994, “the Foreign Investment Act of the Philippines,” which amended sections of the previous law, No. 6957 of 1990, entitled “Law Allowing Financing, Construction, Operation, and Maintenance of Infrastructure Projects by the Private Sector.” Under this system, the Philippine government established a gas turbine power station in 1989.

The B.O.T. system also appeared in Hong Kong, where the Hong Kong Energy Corporation built a gas station and began operations in the Hong Kong tunnel in 1986, at a cost of \$442 million. Similarly, South Vietnam used B.O.T. to construct an underwater tunnel beneath the Saigon River.

<sup>1</sup> See: [http://moc.gov.kh/laws\\_regulation/ank-bot.htm](http://moc.gov.kh/laws_regulation/ank-bot.htm)

<sup>2</sup> See: <http://en.wikipedia.org/wiki/Build-Operate-Transfer>, p.1

<sup>3</sup> Larry D. Qi & Susheng Wang, BOT Contracts: Incentives and Efficiency, pp. 1, 4, 16.

<sup>4</sup> OECD – Public-Private Partnerships and Concessions (Historical Background):

<sup>5</sup> OECD – Public-Private Partnerships and Concessions (Historical Background):

<https://www.oecd.org/governance/public-private-partnerships/>

<sup>6</sup> OECD – Public-Private Partnerships and Concessions (Historical Background):

<https://www.oecd.org/governance/public-private-partnerships/>



Arab countries were not isolated from the B.O.T. system. In Egypt, the first serious application of B.O.T projects occurred in the mid-1990s through the Ministry of Electricity, driven by several factors: rising demand for electricity across sectors—especially industrial and urban—necessitating the addition of new power plants totaling 3.9 million kW by 2010 at an estimated cost of \$2.7 billion, rising external debt of the Egyptian Electricity Authority (about 2.14 billion Egyptian pounds), reluctance of some foreign lenders to provide loans without private sector participation, and availability of foreign currency liquidity in Egyptian banks willing to finance private-sector-implemented electricity projects.

To create a suitable legal environment, the Egyptian government amended certain laws, including Law No. 100 of 1996, which modified Law No. 12 of 1976 that established the Egyptian Electricity Authority. This was followed by Cabinet Resolution No. 4 of 1998 regarding the Sidi Krir steam power plant. Other Egyptian ministries adopted the same approach, including the Ministry of Transport, which issued Law No. 269 of 1996 amending provisions of Law No. 84 of 1968 on public roads and Law No. 3 of 1997 regarding airport concessions, as well as Law No. 22 of 1998 adding provisions to Law No. 1 of 1996 on specialized ports.

The maritime transport sector in Egypt also gained significant experience in B.O.T. investments, with both the General Authority for Roads, Bridges, and Land Transport and the National Authority for Tunnels implementing B.O.T. projects.<sup>7</sup>

Lebanon followed a similar path. On 3 August 1994, a B.O.T. contract was signed between the Lebanese government and France Télécom International (FTMI) to implement and operate a cellular telephone project for a period of ten years. On 7 February 1996, Lebanon's Public Investment Promotion Corporation signed a B.O.T contract with Mohammed Abdul Mohsen Al-Kharafi & Sons, a Kuwaiti company, to finance and operate parking facilities at Beirut International Airport for fifteen years, after which the facilities were returned to the Lebanese state in good condition.<sup>8</sup>

Kuwait also adopted the B.O.T system in various projects, notably the development of the international airport and the construction and operation of the Sulaibiyah sewage treatment plant in 2001.<sup>9</sup>

In Syria, B.O.T. contracting began for major projects. On 12 February 2001, the Syrian General Telecommunications Corporation signed a B.O.T. contract with Investcom Global Ltd. to establish a GSM cellular phone network. The Ministry of Transport launched numerous B.O.T projects, including the Free Zone Port on the Syrian coast and the construction of new quays at Tartous and Latakia ports, as well as the operation of existing quays and yards under B.O.T contracts.

The Tartous Port Company issued a B.O.T. project on 8 September 2005 to construct a quay and requested price offers for additional quays on 25 January 2006. In Damascus, in January 2008, a B.O.T. contract was signed with the Syrian Holding Company to develop a comprehensive city centre project, including a conference center, administrative offices, a five-star hotel, shopping centres, cinemas,<sup>10</sup> and parking facilities.<sup>11</sup>

Finally, Jordan modernized, expanded, and developed Queen Alia International Airport under a B.O.T contract, and Turkey implemented Istanbul International Airport through a B.O.T agreement.

### **3. Definition of the B.O.T. Contract and Its Forms**

#### *3.1. Definition of the B.O.T. Contract*

A B.O.T. contract is a contractual relationship concluded between the State and a private sector entity, which supervises the project. The contract typically involves the construction (usually infrastructure) and management of the project for a specified period at the private entity's own expense and risk, without the government incurring any cost. The private entity recovers its expenses from its own capital, repays any financing, and distributes profits to its shareholders. At the end of the contract period, the supervising company transfers the project to the government in good and usable condition.

The project operates under the supervision and oversight of the State or one of its agencies, and the investor is obliged to

<sup>7</sup> See: <http://en.wikipedia.org/wiki/Build-operate-transfer> , p.1

<sup>8</sup> See: <http://www.worldbank.org/html/fpd/water/wstoolkits/Kit3/kit3-21.html>

<sup>9</sup> Build-Own-Operate-Transfer (BOOT) Projects, <http://www.mcmullan.net?eclj/BOT.html>

<sup>10</sup> Al-Bashbishi, Amal Najah, Build-Operate-Transfer System, Kuwait, Arab Planning Institute, B.O.T Journal on Development Issues in Arab Countries, No. 32, August 2004, Year 3, p.10

<sup>11</sup> Ibid, p.11



transfer ownership of the project to the State at the end of the contract without compensation.

B.O.T. projects refer to public projects financed by local or foreign private sector entities, which design, construct, and manage the project for a predetermined period. During this period, the contractual relationship between the State and the executing company (the project company) is based on a concession contract, allowing the project company to earn revenue from the project during the concession period. Upon completion, the project company transfers the project assets to the government in good condition, as agreed upon in the contract, without any payment from the government<sup>12</sup>.

From the perspective of international investment law, BOT contracts are commonly classified as a distinct category of international investment contracts rather than ordinary commercial agreements. Legal scholarship emphasizes that BOT arrangements raise fundamental questions regarding their legal nature, particularly whether they should be characterized as administrative contracts, private commercial contracts, or contracts of a special legal nature.

Comparative legal analysis reveals that BOT contracts frequently incorporate elements of public law, owing to their connection with public utilities and state sovereignty, alongside private law mechanisms related to financing, operation, and risk allocation. Consequently, a growing body of legal literature supports the view that BOT contracts constitute contracts of a special legal nature, governed by a hybrid legal regime that integrates both public and private law considerations, depending on the governing legal system and contractual terms. Legal doctrine further explains that the classification of BOT contracts cannot be resolved through a single rigid criterion. Instead, contemporary jurisprudence adopts a dual-standard approach that combines both legal and economic considerations. Under this approach, a BOT contract may acquire its international and legal character not merely due to the nationality of the contracting parties, but rather because of its direct connection to international economic interests, long-term development objectives, and cross-border capital flows. This functional approach provides greater flexibility in assessing BOT contracts and reflects their practical role in international investment frameworks<sup>13</sup>.

### *3.2. Form of B.O.T. Contracts*

B.O.T. contracts (Build, Operate, and Transfer) come in various forms. These derived contracts differ from the main B.O.T. contract in some or all of their elements, as follows: <sup>14</sup>

- **Build, Own, Operate, and Transfer (B.O.O.T):**

This variation, commonly referred to as BOOT, differs from the classic B.O.T model in that the private party contracting with the grantor owns the project assets during the concession period and then returns them. Ownership affects project financing and the suitability of the private party for the contract.

- **Design, Build, Finance, and Operate (D.B.F.O):**

In this model, the project executor designs, finances, and operates the project in accordance with government regulations. The government receives compensation for the land and a share of project revenues as a concession fee and may transfer the concession to another investor with appropriate compensation.

- **Build, Own, Lease, and Transfer (B.O.L.T):**

Under this contract, the State entrusts the investor to build, operate, and lease the project to third parties during the term of the contract. This allows the investor to cover costs and earn profits from lease revenues while obliging the investor to transfer the project to the state at the end of the contract.

- **Lease, Renovate, Operate, and Transfer (L.R.O.T):**

Here, the executing entity leases the project, renovates it, operates it, collects its revenues, and returns the project to the State

<sup>12</sup> Naif, Abdul Latif, Public Utilities Commitment Contracts – BOT (Build, Operate, Transfer)

<sup>13</sup> Legal adaptation of international investment contracts (the B.O.T and Franchise contracts as a model), ELBAHITH for Academic Studies, Volume: 80 / Issue: 80 / Year: 2008 / Page: 214

<sup>14</sup> Al-Islambouli, Dr. Ahmad Muhammad Khalil, The Islamic Legal Perspective on the Build, Operate and Transfer (BOT) Model, King Abdulaziz University, 2012, p.19



at the end of the lease period.

- **Build, Transfer, and Operate (B.T.O):**

In this type, the government contracts with a private investor to build the project or public facility and then transfers ownership to the government. The government then contracts separately to operate and manage the project during the concession period, allowing the government to retain initial ownership. Common applications include hotels.

- **Build, Own, and Operate (B.O.O):**

The investor finances, builds, and operates the project for the duration of the contract, but is not obligated to transfer ownership to the State. Ownership remains with the investor until the project reaches the end of its useful life, at which point the government compensates the owners for their shares.

- **Modernize, Own, Operate, and Transfer (M.O.O.T):**

This model applies to existing projects requiring modernization with technology unavailable to the state. The investor owns the project during the modernization phase, shares revenues with the state, and eventually transfers the project back to the government.

### *3.3. Parties and Pillars of the Contract*

Several parties are involved in a B.O.T. contract, each with specific roles and responsibilities concerning the project.

- **The Government or its Authorized Agency (Government Agency):**

The government, or the agency representing it, is responsible for ratifying the contract. Its duties include:

- Granting the second party (the project sponsor) approval to build, operate, and lease the project for the agreed period.
- Supervising and controlling all project activities and services.

- **The Project Sponsor (Sponsor):**

The sponsor is the party responsible for the project, typically consisting of a group of financiers willing to invest in and fund the project. The sponsor may take the form of an institution, a company, a limited liability company, or a consortium. The sponsor is responsible for the financial aspects of the project during its construction and operational phases.

- **The Financier (Investor):**

In large-scale projects, financing is often provided by a consortium of banks that extends loans to the project sponsors. Banks usually require financial guarantees for the project and may agree to cover any cost overruns not included in the original agreement. It is essential to define the expected project financing at all stages to assess and manage risks and evaluate the impact on the loans.

- **The Contractor:**

The contractor, which may be a company or an individual within the sponsor consortium, is responsible for constructing the project. The contractor ensures project completion within the agreed-upon timeframe, budget, and specifications, and bears full responsibility for project risks.

- **The Operation and Maintenance Contractor:**

This entity signs a contract with the project sponsor to operate and maintain the project for the long term and may include members of the sponsor consortium. The key responsibility is to operate, maintain, and fulfil the requirements stipulated in the operation and maintenance agreement throughout the contract period.



- Transfer of Ownership:

Upon contract completion, the project is transferred to the State. Conditions for transferring the project to the government often include an offtake agreement, in which the government agrees to purchase the project output—whether water, electricity, or medical services—at an agreed price and quantity. The project sponsor remains financially responsible during the construction and operational phases. The sponsor ensures project completion on time, within budget, and according to agreed specifications while assuming all associated risks. The sponsor signs the operation and maintenance contract with the government for the contract's long term, possibly including members of the project consortium.

#### **4. Jurisprudential Foundations**

Contemporary Sharī‘ah literature does not treat BOT contracts as a single nominate contract with a fixed legal characterization. Rather, jurists have proposed multiple approaches to the fiqhī classification (tak्यif fiqhī) of BOT arrangements. These include viewing BOT as a composite and newly emergent contract (‘aqd mustahdath murakkab), as well as drawing analogies with established Sharī‘ah contracts such as istiṣnā‘, ijārah, ju‘ālah, and time-bound partnership structures. Other scholarly approaches emphasize public interest considerations (maṣlaḥah) and concessionary principles, particularly where BOT contracts are used to develop public infrastructure and utilities. Authoritative Sharī‘ah bodies and senior jurists have explicitly addressed BOT-type arrangements (Noor et al., 2014). The International Islamic Fiqh Academy and the Al-Baraka Fiqh Symposium have discussed the permissibility of BOT applications, particularly in relation to public utilities and waqf development, subject to compliance with Sharī‘ah rules governing ownership, liability, contractual clarity, and risk allocation. Prominent scholars, including Abdul Wahab Abu Sulayman and Muhammad Taqi Usmani, have emphasized that BOT contracts may be deemed Sharī‘ah-compliant when structured through valid underlying contracts, most notably istiṣnā‘ for construction and ijārah for operation, while avoiding ribā-based financing and excessive gharar. Islamic jurisprudence has devoted increasing attention to the Sharī‘ah characterization (tak्यif fiqhī) of BOT contracts, recognizing them as part of the broader category of modern and composite contracts. Classical jurists did not explicitly address BOT; however, contemporary scholars have demonstrated that its underlying structure finds support within established Islamic legal principles through analogy, synthesis, and foundational maxims.

Prominent fiqh studies conclude that BOT contracts may be accommodated within Islamic law through multiple juristic approaches, including classification as a composite contract that combines istiṣnā‘ for construction, ijārah for operation, and transfer of ownership upon completion, or as a newly emergent contract validated by the principle that the original rule in transactions is one of permissibility (Noor and Yunus, 2014)<sup>15</sup>. The Build-Operate-Transfer (B.O.T) contract comprises four primary agreements:

- Construction Contract
- Operation Contract
- Maintenance Contract
- Transfer of Ownership Contract (returning the project to its owners).

Each of these main contracts has precise specifications and conditions agreed upon by the contracting parties. These details are meticulously recorded in the agreements, ensuring that no aspect of the project is left unchecked. Upon closer examination, each of these four contracts may include multiple subcontracts, such as:

- Construction Contract: The term “construction” is not limited to literal building, but encompasses establishing a project according to its nature, whether it is a building, canal, bridge, highway, or similar infrastructure. Construction requires tangible resources and, therefore, involves subcontracts for procurement, leasing, warranties, insurance, and other related agreements. It also necessitates specialized skills and crafts, including architectural planning, engineering, electricity, plumbing, carpentry, and decoration, among others.

<sup>15</sup> *Journal of Dirāsāt: Sharī‘ah and Law Sciences*, 44(4), 2017. “The Build-Operate-Transfer (B.O.T.) Contract in Islamic Jurisprudence. Page 241.



- Operation and Maintenance Contracts: These require defining the project's conditions, precise descriptions, and public usage fees, which must be documented in the agreement to ensure a clear transfer of the project to local stakeholders.

From a jurisprudential perspective, a B.O.T. contract can be classified under several Islamic contract types, provided it avoids prohibited elements. These include:

- New Contract (عقد جديد)
- Manufacturing Contract (Istisna'a) predominance
- Analogy to Waqf reconstruction
- Lease (Ijara)

New Contract – B.O.T as a Modern Transaction: This contract is essentially a new, comprehensive contract composed of multiple types and stages, reflecting the Islamic legal principle: "The origin of transactions is permissibility." This principle is further clarified: "Contracts, conditions, and transactions are permissible unless explicitly prohibited by God; any act not forbidden is inherently allowed."<sup>16</sup> Thus, modern transactions, such as B.O.T., fall under this principle, with additional detailed conditions for validity, including ensuring that all essential elements and terms are fulfilled, whether in the primary or subcontracts. The B.O.T. contract incorporates:

- Construction (requiring technical and engineering work across multiple disciplines)
- Operation
- Maintenance
- Transfer of ownership

#### Contract 1: Construction Contract (Muwakala / Istisna'a)

The Islamic Fiqh Academy of the Organization of Islamic Cooperation (OIC) defined this contract in Resolution No. 129(3/14), detailing the contractual and Sharia-compliant frameworks:

- Agreement on total cost based on detailed plans and specifications.
- Agreement on unit pricing per quantity and detailed drawings.
- Agreement on cost-plus-profit models, requiring transparent financial reporting by the contractor.

This contract is permissible under Islamic law, whether the contractor provides both materials and labour (Istisna'a) or labour only (Ijara), subject to agreed wages and Sharia conditions. Provisions may include:<sup>17</sup>

- Penalty clauses (unless due to force majeure)
- Deferred or installment payments
- Approval for modifications or additions, with or without additional compensation depending on prior agreement
- Liability for defects and adherence to contractual obligations
- Restrictions on subcontracting if personal execution is stipulated
- Warranty conditions, with permissible duration and scope<sup>18</sup>

<sup>16</sup> *Journal of Dirāsāt: Sharī'ah and Law Sciences*, 44(4), 2017. "The Build–Operate–Transfer (B.O.T.) Contract in Islamic Jurisprudence. Page 241.

<sup>17</sup> Decision No. 65(3/7) on Istisna' Contract, after the preamble:

First: The Istisna' contract, which concerns work or goods, is binding on both parties if all its pillars and conditions are met.

Second: Conditions of Istisna': (a) Specify the type, kind, quantity, and required specifications; (b) Specify the term.

Third: Payment can be deferred entirely or in installments for specific periods.

Fourth: It may include a penalty clause as agreed by the contracting parties, unless force majeure occurs. Decisions and Recommendations of the International Fiqh Academy affiliated with the Organization of Islamic Cooperation, Jeddah, 2nd Edition (Damascus: Dar al-Qalam, Jeddah: International Fiqh Academy, 1409 AH/1988), p.144.

<sup>18</sup> Decisions and Recommendations of the 14th Session of the International Fiqh Academy, Doha, Qatar, 8–13 Dhu al-Qi'dah 1423 AH / 11–16 January 2003, p.7



#### Contract 2: Operation Contract (Ijara)

The operation phase allows the contractor to recoup expenses through usage fees from the public. This is an Ijara on labour, where the benefit of work is compensated. The contractor employs skilled personnel to manage the operation efficiently<sup>19</sup>.

#### Contract 3: Maintenance Contract (Ijara on Work)

Maintenance ensures the project remains functional and preserves its intended use until it is returned to the original owners. This is considered an independent contract within the broader B.O.T. framework.

#### Predominant Istisna'a Contract

The B.O.T contract's construction phase aligns primarily with Istisna'a, as the project cannot exist without it. This contract requires:

- A defined subject (the project) with specified materials and technical standards
- Agreed completion timeframe
- Known cost, consistent with the Islamic definition of Istisna'a: "A sale of a specified item to be manufactured for a known price."<sup>20</sup>

The International Fiqh Academy's Resolution No. 65(3/7) (Jeddah, 1992) stipulates:

- Validity requires all elements and conditions to be met
- Detailed specifications of the manufactured item
- Clearly defined deadlines
- Deferred or instalment payment options
- Optional penalty clauses agreed upon by both parties<sup>21</sup>

#### Analogy to Waqf Reconstruction

B.O.T contracts may be analogized to Waqf (endowment) repair agreements when a waqf property deteriorates. Scholars permit reconstructing the waqf using private investment, after which the property is returned to its original function. Contemporary Sharī'ah scholarship further supports the legitimacy of BOT contracts by drawing analogies with classical jurisprudential precedents involving land rehabilitation, waqf development, and long-term usufruct arrangements. These precedents demonstrate that Islamic law has historically accommodated contractual structures whereby private parties invest resources, operate assets for a defined period, and ultimately return ownership to the original holder. Such analogies reinforce the view that BOT contracts, when free from ribā, excessive gharar, and unlawful conditions, are consistent with Sharī'ah objectives related to public interest, asset preservation, and equitable risk allocation<sup>22</sup>

#### Lease (Ijara) Analogy

This contract is classified under the contract of (renting houses)<sup>23</sup>, as there are texts in the Maliki school that provide numerous examples applicable to this categorization, including:

<sup>19</sup> Abu Sulayman, Abdul Wahab Ibrahim, *Fiqh al-Mu'amalat al-Haditha* with Introductions, 1st Edition (Dammam: Dar Ibn al-Jawzi, 1426 AH), p.277

<sup>20</sup> Ibn 'Abidin, Muhammad Amin ibn 'Umar, *Radd al-Muhtar 'ala al-Dur al-Mukhtar* (Hashiyat Ibn 'Abidin), Beirut: Dar Ihya' al-Turath al-'Arabi, Vol. 4, p.212

<sup>21</sup> International Fiqh Academy affiliated with the Organization of Islamic Cooperation – Jeddah, *Decisions and Recommendations of Sessions 1–10, Decisions 1–97*, 2nd Edition, edited by Abdul Sattar Abu Ghuddah (Jeddah: International Fiqh Academy, 1418 AH/1998), p.144

<sup>22</sup> Hashiyat *Radd al-Muhtar 'ala al-Dur al-Mukhtar*, *Sharh Tanwir al-Absar*, 2nd Edition (Egypt: Mustafa al-Babi al-Halabi Library and Printing), Vol. 3, p.382, *Journal of Dirāsāt: Sharī'ah and Law Sciences*, 44(4), 2017. "The Build–Operate–Transfer (B.O.T.) Contract in Islamic Jurisprudence. Page 241-250

<sup>23</sup> The Malikis define rent (karā') as "the sale of usufruct of immovable property such as houses and lands," distinguishing it from Ijarah, which is "the sale of usufruct of movable property or services for consideration." See: Abu Abdullah Muhammad al-Ansari al-Rassa', *Sharh Hudud Ibn 'Arfa*, 1st Edition, edited by Muhammad Abu al-Ajfn and Taher al-Ma'muri (Beirut: Dar al-Gharb al-Islami, 1993), Vol. 2, pp.516, 524



“Ibn al-Qasim’s case: Ibn al-Qasim said regarding a man who said, ‘Give me your plot of land so that I may build on it for ten dinars, or with what it yields, on the condition that I occupy it each year for one dinar until I repay what I spent on it and repair it?’

He said: If he specified the amount with which he will build it and what it will be per year, then it is permissible; and if he did not specify, then it is not valid.”

Muhammad ibn Rushd said: “This is like the case in the lease of houses reported by Ibn al-Qasim in his book on renting houses, and as he said, if he specified the amount for building but did not specify what it will be per year, the rent is unknown. If he specified what it will be per year but did not specify the building amount, the rent is known, but its duration is unknown. If he specified both, then the rent is known for a known term, and it is permissible.

It is permissible even if he did not specify the building type or purposes because the lessee is like an agent in that regard; if he builds the plot in the manner it is supposed to be built, he is bound as if he had delegated someone to buy cloth or a slave on his behalf; whatever is similar binds him. And if he specified the building and the number of years of occupancy, it is permissible.”<sup>24</sup>

“He was asked by Malik regarding a man who leased a ruined plot on condition that he spend on it, and that the rent be thus and so. Malik said, “I think that the expenditure should be specified and deducted from the rent for the duration of the lease.” It was asked: Should the rent be in dirhams? He said: No, the parts should be: his expenditure is ten dinars, and the rent for twenty years is half a dinar per year, or less, or more, depending on the years and portions; accordingly, the lessee rents it, and the owner leases it.”

Muhammad ibn Rushd said: “This matter is correct and clear in meaning; because if the lessee rented the plot for ten years, one year for ten dinars on the condition that he builds the plot for the owner, if he stipulated that the expenditure be deducted from the rent, it is not permissible, because if the rent is not in cash, the set-off rule does not apply. Therefore, the expenditure must follow immediately, and he should pay rent according to the portion he occupied, step by step, as the law requires.”

Ibn al-Mawaz said: “And if the building is for the owner of the plot, and he specifies what is built and the cost, which is included in the rent, it is valid, like in al-Mudawwana; because if he spends more than the rent, the excess is advance from the lessee to the owner, and it counts as rent and advance.

Ibn al-Mawaz said: And if the building is for the lessee, there is no need to specify what is built or the expenditure, nor is it preferable to stipulate this in the original rent. If he builds, whenever he leaves, the owner may require the value of what he built to be given or order its dismantling.

And Ibn al-Mawaz said: If the building is for the lessee, it is not preferable to stipulate it in the original rent, because if it is stipulated, the rent occurs on the condition that the lessee takes the building value from the owner at the end of the lease period. This is due to uncertainty (gharar) and is not permissible. Additionally, it was not reported that the rent should be in dirhams if he spends dinars, and the expenditure should be kept separate from the rent. This is because it entails a lack of precision in accounting; the rent is only permissible for occupancy of the property on a step-by-step basis. For example, if he says: I lease your plot for twenty years for ten dinars, half a mithqal per year, provided I spend one hundred dirhams from my funds, it is a valid lease. Or if he says: I lease your plot for one hundred dirhams for twenty years, provided I spend ten dinars on it, it is a valid lease.”<sup>25</sup>

Thus, operating the project under the Build-Operate-Transfer (BOT) contract and collecting fees from users who benefit from the project is akin to occupying the plot in exchange for building and using it. It represents the value of construction, and the recovery of the project’s capital and expected profits is akin to the benefit received by the occupant of the plot in exchange for its construction.”

<sup>24</sup> Ibn Rushd, Abu al-Walid al-Farabi, *Al-Bayan wa al-Tahsil wa al-Sharh wa al-Tawjih wa al-Ta‘liq fi Masa’il al-Mustakhrijah*, edited by Ahmad al-Sharqawi Iqbal and Muhammad al-Haji (Beirut: Dar al-Gharb al-Islami, 1404/1984), Vol. 8, p.461

<sup>25</sup> Ibn Rushd, *Al-Bayan wa al-Tahsil*, Vol. 9, p.17



## **5. Role in Managing Excess Liquidity**

This contract has become widespread in many contemporary countries. Its primary purpose is to secure the necessary funding for large-scale projects that require substantial financial resources, whether these projects belong to the State, institutions, or private companies. It also aims to involve Islamic banks in development plans and to benefit from their technical and financial expertise. This contract is concluded by two or more parties who agree to finance a facility or project, manage it for a specified period, recover the invested capital along with the expected return, and finally deliver the project in proper working condition to the concerned authority. As a result, the financial burden of establishing and constructing projects shifts from the public sector to the private sector, including management, operation, and revenue collection, until costs are covered and the private sector obtains an adequate return during the concession period. Ownership, management, and operation of the project are then transferred back to the public sector.<sup>26</sup>

How is this contract used in financing?

Contractual Agreement: A contractual agreement is established between one or more Islamic banks and the party seeking financing (which may be governmental, corporate, or individual).

Project Award and Final Agreement: Once the project tender is awarded, the final contract is executed to determine the rights and obligations of all parties involved.

Project Duration: The project period, during which the financiers benefit, is agreed upon. At the end of this period, the project is delivered to the requesting party.

Procurement and Construction: The financing bank(s) enter into agreements with contractors and suppliers for the necessary project equipment. To avoid the impact of price fluctuations, a fixed amount is agreed upon for the equipment, and the project must be delivered in a condition suitable for use as stipulated.

Operation and Revenue Management: An operating company is contracted to manage and maintain the project and to collect the project's revenues, which are deposited into a designated account agreed upon by the parties.

Security and Documentation: The bank reserves the right to request all necessary guarantees to secure its rights, which may include state guarantees, mortgages, or joint guarantees from multiple parties. In the cases mentioned above, the bank's rights are preserved since the project is initially registered under its name and on its behalf. In other cases, proper documentation is required according to Islamic law or legal systems that do not contradict Shariah principles or established legal rules.

Pooling Resources and Sukuk Issuance: If some Islamic banks lack sufficient liquidity, multiple banks or Islamic financial companies may jointly participate in the project, or they may adopt an investment fund approach. Alternatively, a joint-stock company may be established for the project, and its shares may be offered for public subscription, provided that the company's founding contract and bylaws require that founders and shareholders transfer their shares to the public sector after the concession period ends. Another method involves issuing sukuk (Islamic bonds) to sell the service that the company will produce; each sukuk represents a precisely defined quantity of the produced service. The benefit from these sukuk is set for a future, defined period and is sold at a price lower than the immediate-use price of the same service.

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<sup>26</sup> 'Ikrimah Sabri, "Build-Operate-Transfer (BOT) Contract in the Development of Waqf and Public Utilities," paper presented to the International Fiqh Academy, 19th Session, UAE, Sharjah, 2008; see also Abdul Sattar Abu Ghuddah, "Build-Operate-Transfer (BOT) Contract and its Application in Waqf and Public Utilities," 19th Session, UAE, Sharjah, 2008



The range of projects financed through this type of contract is broad, including:

- Electric power generation, distribution, and transmission projects
- Telecommunications (wired and wireless)
- Highway and expressway construction linking economic and urban zones
- Dams, irrigation networks, water pipelines and storage facilities
- Land, air, and sea transportation, as well as navigational canals <sup>27</sup>

## **6. Shariah Objectives of the Build-Operate-Transfer (B.O.T) Contract**

For any contract, whether traditional or modern, to be valid, it must align with Shariah objectives and personal interests that do not conflict with Islamic legal principles. This is a fundamental criterion for the validity of contracts, both old and new. Therefore, it is necessary to evaluate the Shariah standard after verifying the contract's compliance with essential conditions, pillars, and its freedom from causes of corruption or nullity. The B.O.T. contract encompasses a set of Shariah-compliant objectives that achieve benefits for stakeholders. The well-being of stakeholders is of considerable importance in Islamic law: "The foundation of Shariah is wisdom and the welfare of human beings in their worldly and spiritual affairs. It is entirely based on justice, mercy, public interest, and wisdom. Any matter departing from justice to injustice, from mercy to its opposite, from benefit to harm, or from wisdom to futility is not part of Shariah. Shariah embodies Allah's justice among His servants, His mercy among His creation, His governance on earth, and His wisdom. It guides the insightful and heals all ailments, and the B.O.T contract integrates Shariah objectives in ways rarely achieved by other contracts, encompassing public welfare, individual benefit, and the growth of wealth."

Key Shariah Objectives of the B.O.T Contract:

Meeting societal needs: Contributing to human comfort and public welfare through systematic and well-executed projects.

Wealth development and lawful investment: Investing capital in projects beneficial to society, fostering economic growth.

Reducing financial burdens on States, especially those that are economically weak.

Preservation of assets: Maintaining property for extended use and sustained benefit.

Capacity building: Providing necessary expertise and training, developing communities in construction and maintenance, promoting self-reliance in future projects.

Establishing infrastructure: Facilitating large-scale projects that require substantial financing beyond the capacities of state budgets.

Engaging the private sector: Encouraging private investment in infrastructure development, with the government committing to purchase a minimum output, ensuring project costs are covered, and a reasonable profit is achieved.

Reducing market and credit risks: The state often acts as the sole client, minimizing financial exposure for private investors.

Promoting circulation of wealth: Facilitating economic activity among the state, private sector, and individuals, ensuring equitable distribution of financial opportunities.

Through these objectives, the B.O.T. contract:

- Ensures public welfare by providing liquidity for major state projects without depleting government reserves.
- Secures private benefits by enabling individuals and institutions to invest capital and earn returns.
- Generates employment opportunities, mitigating unemployment and its associated social risks, including crime, by providing stable incomes to workers and their dependents.

<sup>27</sup> See: 'Ikrimah Sabri, "Build-Operate-Transfer (BOT) Contract in the Development of Waqf and Public Utilities," 19th Session, UAE, Sharjah, 2008; see also Abdul Sattar Abu Ghuddah, "Build-Operate-Transfer (BOT) and Its Application in Waqf and Public Utilities," and Muhy al-Din, Ahmad, Application of BOT Contract in Waqf Development, and Taqi al-Din al-'Uthmani, Build, Operate and Transfer Contracts from a Shari'ah Perspective, and Atiyah, Abdul Qadir Muhammad, Commercial, Economic and Social Feasibility Studies of BOT Projects, and Ghanem, Muhammad, Infrastructure Projects under the BOT System.



In essence, the B.O.T contract harmonizes public interest, economic efficiency, and Shariah compliance, making it a strategic tool for sustainable development and wealth circulation in society.

## 7. Conclusion

This study has examined the jurisprudential and economic underpinnings of the Build-Operate-Transfer (BOT) model and its applicability as a Shariah-compliant instrument for financing large-scale development projects. The analysis reveals that traditional, debt-based financing contributes only marginally to real value creation and national output at the local level, whereas well-structured BOT arrangements are inherently linked to productive investment, risk sharing, and service provision. By reallocating the burden of financing, construction, and operation from the public to the private sector, BOT contracts enable governments to implement capital-intensive infrastructure projects without resorting to additional public debt, while preserving ultimate public ownership of strategic assets. From an Islamic finance perspective, BOT contracts can be framed through accepted Sharī‘ah contracts, primarily *istīṣnā‘* and *ijārah*, thus allowing Islamic banks to deploy excess liquidity in a manner consistent with both legal and ethical requirements. When properly structured, BOT arrangements not only fund projects that serve the public interest but also generate competitive returns for investors, thereby enhancing the economic function and social utility of capital.

In light of these findings, the paper recommends that Islamic banks gradually shift from predominantly debt-based instruments to genuine investment-based structures, with BOT playing a central role in their asset allocation strategies. The required capital can be mobilized through the issuance of BOT-backed sukuk and through syndicated participation by multiple Islamic financial institutions. Furthermore, the establishment of specialized investment funds dedicated to BOT projects would facilitate the pooling of substantial resources for financing major public and private initiatives. Activating and mainstreaming the BOT contract along these lines would substantially improve the management of excess liquidity in Islamic banks while advancing broader developmental and Sharī‘ah objectives.

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