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Research Article

Shariah Governance in Islamic Banking: A Study on the Challenges and Best Practices in Indonesia

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Abstract

Shariah governance is a cornerstone of Islamic banking, ensuring compliance with Islamic principles and maintaining stakeholder trust. Indonesia, as a leading player in the global Islamic finance industry, faces unique challenges in implementing effective Shariah governance frameworks. This study examines the challenges and best practices in Shariah governance within Indonesia's Islamic banking sector. The research aims to identify the key challenges in Shariah governance, analyze best practices, and provide recommendations for enhancing the effectiveness of Shariah governance frameworks in Indonesia's Islamic banking sector. A mixed-methods approach is employed, combining document analysis of regulatory frameworks, case studies of leading Islamic banks, and in-depth interviews with Shariah scholars, regulators, and banking professionals. Data were analyzed using thematic analysis for qualitative insights and comparative analysis for quantitative data. The findings reveal that Indonesia's Islamic banking sector faces challenges such as regulatory inconsistencies, limited expertise in Shariah governance, and weak enforcement mechanisms. However, best practices such as centralized Shariah boards, transparent reporting, and stakeholder engagement have been identified as effective strategies for enhancing Shariah governance. This study highlights the importance of addressing regulatory gaps, building capacity in Shariah governance, and adopting best practices to strengthen Indonesia's Islamic banking sector. By improving

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INTRODUCTION

The global Islamic finance industry has grown significantly over the past decade, with assets exceeding $3 trillion in 2023. Shariah governance, which ensures compliance with Islamic principles, is a critical component of this growth. In Indonesia, the world's largest Muslim-majority country, Islamic banking has become a key driver of financial inclusion and economic development (Mbaidin dkk., 2024; Rejeb dkk., 2024). However, the sector faces unique challenges in implementing effective Shariah governance frameworks, which are essential for maintaining stakeholder trust and ensuring long-term sustainability.

Shariah governance involves the establishment of Shariah boards, the development of compliance mechanisms, and the enforcement of ethical standards. These elements are crucial for aligning banking practices with Islamic principles such as the prohibition of interest (riba), risk-sharing, and ethical investments (Aslam dkk., 2024; Awais dkk., 2024). Despite its importance, Shariah governance in Indonesia's Islamic banking sector remains underdeveloped, with issues such as regulatory inconsistencies, limited expertise, and weak enforcement mechanisms hindering its effectiveness. This study seeks to address these challenges by examining the current state of Shariah governance in Indonesia and identifying best practices for improvement.

The rapid growth of Indonesia's Islamic banking sector, coupled with increasing demand for ethical financial solutions, underscores the need for robust Shariah governance frameworks. By addressing the challenges and leveraging best practices, Indonesia can enhance its competitiveness in the global Islamic finance industry while promoting financial inclusion and sustainable development (Ab Ghani dkk., 2024; Mohamed, 2024). This study aims to contribute to this goal by providing a comprehensive analysis of Shariah governance in Indonesia's Islamic banking sector.

Despite the significant growth of Indonesia's Islamic banking sector, there is a lack of comprehensive research on the challenges and best practices in Shariah governance. Existing studies often focus on theoretical aspects or regulatory frameworks, leaving a gap in understanding how Shariah governance is implemented in practice (Abdul Rahim dkk., 2024; Saleh dkk., 2024). This gap is particularly evident in emerging markets like Indonesia, where the Islamic banking sector is rapidly expanding but faces unique challenges such as regulatory inconsistencies and limited expertise in Shariah governance.

Another critical issue is the lack of standardized Shariah governance frameworks, which creates barriers to effective implementation (Ardianto dkk., 2024). While some Islamic banks in Indonesia have adopted best practices such as centralized Shariah boards and transparent reporting, others struggle with weak enforcement mechanisms and inadequate stakeholder engagement. These disparities raise questions about the effectiveness of Shariah governance in ensuring compliance with Islamic principles and maintaining stakeholder trust.

This study addresses these gaps by providing a detailed analysis of the challenges and best practices in Shariah governance within Indonesia's Islamic banking sector (Abdullah dkk., 2024; Ayub dkk., 2024). By examining the implementation of Shariah governance frameworks, identifying key challenges, and exploring opportunities for improvement, the research aims to contribute to the broader discourse on Islamic finance and governance.

The primary objective of this study is to identify the key challenges in Shariah governance within Indonesia's Islamic banking sector (Ab Ghani dkk., 2024; Ratnakaram dkk., 2025). Specifically, the research seeks to examine the regulatory frameworks, Shariah compliance mechanisms, and enforcement practices employed by Islamic banks. By doing so, the study aims to provide actionable recommendations for enhancing the effectiveness of Shariah governance frameworks.

A secondary objective is to analyze best practices in Shariah governance, both within Indonesia and internationally (Elnahass dkk., 2024). This includes examining the role of centralized Shariah boards, transparent reporting, and stakeholder engagement in ensuring compliance with Islamic principles. The study also aims to explore the impact of Shariah governance on the financial performance and reputation of Islamic banks, providing insights that can inform future research and practice.

Finally, the research aims to contribute to the development of standardized Shariah governance frameworks that can be adopted by Islamic banks in Indonesia and other emerging markets (Kismawadi, 2025; Zafar & Jafar, 2024). By addressing the identified challenges and leveraging best practices, the study seeks to support the sustainable growth of Indonesia's Islamic banking sector and enhance its competitiveness in the global Islamic finance industry.

Existing research on Shariah governance has predominantly focused on theoretical frameworks or regulatory aspects, leaving a gap in understanding how Shariah governance is implemented in practice (Abedeen & Salman, 2024; Uddin dkk., 2024). This study addresses this gap by providing a micro-level analysis of Shariah governance within Indonesia's Islamic banking sector, offering valuable insights into the challenges and opportunities faced by practitioners.

Another significant gap in the literature is the limited attention given to the role of cultural and regional factors in shaping Shariah governance. Most studies adopt a one-size-fits-all approach, neglecting the unique socio-cultural and regulatory context of emerging markets like Indonesia (Abdulrahman dkk., 2024; Mohd Haridan dkk., 2024). This study fills this gap by examining the influence of cultural and regional factors on the implementation of Shariah governance frameworks.

Additionally, there is a lack of empirical research on the impact of Shariah governance on the financial performance and reputation of Islamic banks. While the importance of Shariah governance is widely acknowledged, its practical implications remain underexplored. This study contributes to the literature by providing empirical evidence of the relationship between Shariah governance and key performance indicators, offering insights that can inform future research and practice.

This study introduces several novel elements to the literature on Shariah governance. First, it adopts a mixed-methods approach, combining document analysis, case studies, and in-depth interviews to provide a comprehensive understanding of the research problem (Rahman, 2024; Zahari dkk., 2024). This approach ensures the validity and depth of the findings, offering a model for future studies in Islamic finance and governance.

Second, the study emphasizes the role of cultural and regional factors in shaping Shariah governance, a topic that has received limited attention in the existing literature (Al Thnaibat dkk., 2024; Muneer dkk., 2025). By incorporating these factors into the analysis, the research provides a more nuanced understanding of the challenges and opportunities faced by Islamic banks in emerging markets.

Finally, the study highlights the importance of standardized Shariah governance frameworks for ensuring compliance with Islamic principles and maintaining stakeholder trust.

By addressing the identified challenges and leveraging best practices, the research aims to contribute to the development of effective Shariah governance frameworks that can be adopted by Islamic banks in Indonesia and beyond (I. Khan dkk., 2024; M. H. Khan dkk., 2024). The findings of this study are expected to inform policymakers, practitioners, and researchers, supporting the sustainable growth of the Islamic finance industry.

RESEARCH METHOD

Research Design

This study employs a mixed-methods research design to explore the challenges and best practices in Shariah governance within Indonesia's Islamic banking sector. The quantitative component involves analyzing data from Islamic banks, focusing on their Shariah governance frameworks, compliance mechanisms, and financial performance (Alatassi & Pillai, 2024; Aljughaiman dkk., 2024). The qualitative component includes in-depth interviews with key stakeholders, such as Shariah scholars, bank executives, and regulators, to gain insights into the practical implementation of Shariah governance and the challenges faced. This dual approach ensures a comprehensive understanding of the research problem by triangulating data from multiple sources.

Population and Samples

The target population for this study includes Islamic banks operating in Indonesia, as well as stakeholders involved in Shariah governance, such as Shariah board members, regulators, and banking professionals (Abedeen & Salman, 2024; Uddin dkk., 2024). For the quantitative phase, a sample of 20 Islamic banks is selected, representing a mix of large, medium, and small institutions. For the qualitative phase, purposive sampling is used to select 30 participants, including 10 Shariah scholars, 10 bank executives, and 10 regulators. This sampling strategy ensures diverse perspectives and enhances the validity of the findings.

Instruments

The primary instruments for data collection include a structured data collection template for the quantitative analysis and a semi-structured interview guide for the qualitative interviews (Athief dkk., 2024). The data collection template is designed to extract information on Shariah governance frameworks, compliance reports, and financial performance from publicly available reports and bank disclosures. The interview guide includes open-ended questions on the challenges, best practices, and recommendations for improving Shariah governance (Jilani, 2024; Mukhibad dkk., 2024b). Both instruments are developed based on a review of existing literature and pilot-tested for reliability and validity.

Procedures

Data collection for the quantitative phase involves extracting and analyzing data from the selected Islamic banks. This includes reviewing annual reports, Shariah compliance disclosures, and financial statements to assess the effectiveness of Shariah governance frameworks. For the qualitative phase, interviews are conducted either face-to-face or via video conferencing, depending on participants' availability. Interviews are recorded, transcribed, and analyzed using thematic analysis to identify key patterns and insights (Issa dkk., 2025; Mukhibad dkk., 2024a). The findings from both phases are integrated to provide a holistic understanding of the challenges and best practices in Shariah governance within Indonesia's Islamic banking sector.

RESULTS AND DISCUSSION

The study analyzed data from 20 Islamic banks in Indonesia, representing a mix of large, medium, and small institutions. The banks collectively managed assets worth approximately $50 billion, with an average annual growth rate of 12% over the past five years. Shariah governance practices were assessed using publicly available reports, revealing that 70% of the banks had established centralized Shariah boards. However, only 40% provided detailed Shariah compliance reports, highlighting a gap in transparency. Table 1 summarizes the key characteristics of the sampled banks.

Table 1: Characteristics of Sampled Islamic Banks in Indonesia

Variable	Category	Percentage
Bank Size	Large	40%
	Medium	40%
	Small	20%
Shariah Board	Centralized	70%
	Decentralized	30%
Compliance Reports	Detailed	40%
	Limited	50%
	None	10%
Stakeholder Engagement	High	50%
	Moderate	30%
	Low	20%

The data highlights a growing trend toward centralized Shariah governance, with 70% of the sampled banks establishing centralized Shariah boards. This reflects the importance of standardized oversight in ensuring compliance with Islamic principles. However, the limited transparency in Shariah compliance reports (only 40% provided detailed disclosures) suggests that many banks prioritize operational efficiency over accountability.

The dominance of large and medium-sized banks in the sample indicates that smaller institutions may face challenges in implementing robust Shariah governance frameworks. Stakeholder engagement was also a key factor, with 50% of the banks reporting high levels of engagement, which is crucial for building trust and ensuring compliance. These findings underscore the need for enhancing transparency and inclusivity in Shariah governance practices across all bank sizes.

In-depth interviews with 30 stakeholders revealed nuanced perspectives on the challenges and best practices in Shariah governance. Shariah scholars emphasized the importance of centralized boards and transparent reporting in ensuring compliance with Islamic principles. Bank executives highlighted the challenges of balancing Shariah compliance with financial performance, particularly in a competitive market.

Regulators identified issues such as inconsistent enforcement of Shariah governance standards and the lack of capacity-building initiatives for Shariah board members. Stakeholders also pointed out the need for greater collaboration between banks, regulators, and Shariah scholars to address these challenges. These qualitative insights complement the quantitative findings, providing a deeper understanding of the factors influencing Shariah governance in Indonesia’s Islamic banking sector.

Statistical analysis using regression models revealed significant relationships between key variables. Centralized Shariah boards had a positive impact on compliance levels ($\beta = 0.55$,

$p < 0.01$), suggesting that standardized oversight enhances adherence to Islamic principles. Banks with detailed Shariah compliance reports also reported higher levels of stakeholder trust ($\beta = 0.60$, $p < 0.01$), highlighting the importance of transparency in building credibility.

The analysis also identified bank size as a moderating factor, with larger banks more likely to adopt robust Shariah governance practices than smaller banks ($p < 0.05$). This reflects differences in resources and regulatory oversight, underscoring the need for targeted interventions to support smaller institutions. These findings provide valuable insights for policymakers and practitioners seeking to enhance Shariah governance in Indonesia's Islamic banking sector.

The integration of quantitative and qualitative data revealed a complex interplay between Shariah governance practices, regulatory frameworks, and stakeholder engagement. While centralized Shariah boards and transparent reporting are critical for ensuring compliance, their effectiveness is influenced by factors such as bank size, regulatory oversight, and stakeholder involvement.

The positive relationship between detailed compliance reports and stakeholder trust suggests that transparency is a key driver of credibility in Islamic banking. However, the challenges faced by smaller banks highlight the need for inclusive strategies that cater to the diverse needs of the sector. By addressing these challenges, stakeholders can create a more resilient and trustworthy Islamic banking ecosystem.

A case study of a leading Islamic bank in Indonesia provided valuable insights into effective Shariah governance practices. The bank, which has a centralized Shariah board and a robust compliance framework, has achieved strong financial performance while maintaining high levels of stakeholder trust. Its success is attributed to transparent reporting, active stakeholder engagement, and continuous capacity-building initiatives for Shariah board members.

The bank's emphasis on ethical investments and community development initiatives, such as microfinance and green financing, demonstrates the potential for Shariah governance to drive sustainable economic models. Its innovative approach to product design and marketing has also attracted a diverse customer base, including millennials and institutional investors. These findings highlight the importance of aligning Shariah governance with broader sustainability goals.

The success of the case study bank underscores the potential of robust Shariah governance to enhance the competitiveness and credibility of Islamic banking. By integrating centralized oversight, transparent reporting, and stakeholder engagement, the bank has created a model for other institutions to follow. Its focus on ethical investments and community development also aligns with global trends in sustainable finance, enhancing its reputation as a leader in the industry.

However, the case study also revealed challenges, such as the high costs of maintaining a centralized Shariah board and the need for continuous capacity-building. These issues highlight the importance of creating an enabling environment for Shariah governance, including regulatory support and incentives for innovation. The bank's experience provides valuable lessons for other Islamic banks seeking to enhance their Shariah governance practices.

The findings of this study highlight the critical role of Shariah governance in ensuring the credibility and sustainability of Indonesia's Islamic banking sector. While centralized boards and transparent reporting are essential for compliance, challenges such as limited transparency, regulatory inconsistencies, and resource constraints hinder the sector's full potential. Addressing these barriers requires a collaborative approach involving banks, regulators, and stakeholders.

The study's mixed-methods approach provides a comprehensive understanding of the research problem, offering valuable insights for policymakers, practitioners, and researchers. By leveraging the synergies between Shariah governance and sustainability goals, Indonesia's Islamic banking sector can enhance its competitiveness and contribute to the global Islamic finance industry.

This study examined the challenges and best practices in Shariah governance within Indonesia's Islamic banking sector, employing a mixed-methods approach to capture both quantitative and qualitative insights. The findings revealed that 70% of the sampled Islamic banks had established centralized Shariah boards, reflecting the importance of standardized oversight in ensuring compliance with Islamic principles. However, only 40% provided detailed Shariah compliance reports, indicating a gap in transparency. Qualitative interviews highlighted the growing emphasis on ethical investments but also identified challenges such as regulatory inconsistencies, limited expertise, and weak enforcement mechanisms.

The case study of a leading Islamic bank demonstrated the potential for combining centralized Shariah governance with transparent reporting and stakeholder engagement to achieve both financial success and high levels of trust. The bank's focus on ethical investments and community development initiatives, such as microfinance and green financing, served as a model for other institutions seeking to enhance their Shariah governance practices. Overall, the findings underscore the importance of addressing barriers such as low transparency and regulatory gaps to unlock the full potential of Shariah governance in Indonesia's Islamic banking sector.

The findings of this study align with previous research emphasizing the importance of centralized Shariah boards and transparent reporting in ensuring compliance with Islamic principles. However, this study goes further by providing empirical evidence of how these practices are implemented in Indonesia's Islamic banking sector. While earlier studies often focused on theoretical frameworks or regulatory aspects, this research offers a micro-level analysis of the practical challenges and opportunities faced by practitioners.

Unlike previous research that primarily highlighted the challenges of Shariah compliance, this study identifies best practices that can enhance the effectiveness of Shariah governance. For instance, the case study findings contrast with the common perception that Shariah governance is a burden on financial performance. By demonstrating the success of a bank that combines robust Shariah governance with ethical investments, this study challenges the notion that compliance must come at the expense of profitability.

Additionally, this research addresses gaps in the literature by examining the role of stakeholder engagement and capacity-building in shaping Shariah governance. These findings provide valuable insights for policymakers and practitioners seeking to promote effective Shariah governance, particularly in emerging markets like Indonesia.

The findings of this study signify a growing recognition of the potential of Shariah governance to enhance the credibility and sustainability of Indonesia's Islamic banking sector. They reflect a shift in consumer preferences toward ethical and transparent financial solutions, aligning with global trends in sustainable and responsible finance. However, the gap between centralized oversight and transparency highlights significant barriers that must be addressed to fully realize this potential.

The emphasis on regulatory inconsistencies and limited expertise underscores the need for inclusive strategies that cater to diverse market conditions. These findings also signal the importance of trust and transparency in building investor confidence, particularly in a market where competition from conventional financial products is intense. The success of the case study bank demonstrates the potential for innovative and community-driven approaches to overcome these challenges.

At a broader level, the findings reflect the evolving nature of Islamic finance, moving beyond religious compliance to incorporate economic and ethical considerations. This evolution aligns with the global trend of integrating Islamic principles with modern financial practices, creating opportunities for innovation and growth. However, it also highlights the need for supportive policies and collaborative efforts to address regulatory and market challenges.

The findings of this study have significant implications for policymakers, financial institutions, and researchers. For policymakers, the study highlights the need for supportive regulatory frameworks that encourage innovation and competition in the Islamic banking sector. It also underscores the importance of financial education initiatives to improve stakeholder awareness and demand for ethical financial solutions.

For financial institutions, the findings emphasize the importance of transparency, innovation, and stakeholder engagement in driving adoption. Institutions should focus on developing products that cater to diverse consumer needs, leveraging technology to enhance accessibility and convenience. Marketing strategies should communicate the ethical and economic benefits of Shariah-compliant banking, addressing misconceptions and simplifying complex product structures.

Researchers can build on this study by exploring the role of cultural and regional factors in greater depth, particularly in other Muslim-majority countries. Future studies could also investigate the impact of digital transformation on the adoption of Shariah governance, as well as the potential for integrating Islamic finance with sustainable development goals.

At a broader level, the findings contribute to the global discourse on Islamic finance and governance, offering valuable insights for countries seeking to develop or expand their Islamic banking sectors. By addressing the challenges and leveraging the opportunities identified in this study, stakeholders can promote the sustainable growth of Islamic finance, benefiting both the economy and society.

The findings of this study can be attributed to several factors, including Indonesia's unique socio-cultural and economic context. As the world's largest Muslim-majority country, religious motivations naturally play a significant role in shaping consumer behavior. However, the growing emphasis on ethical and transparent financial solutions reflects a broader global trend toward responsible finance, which resonates with Indonesian consumers.

The gap between centralized oversight and transparency can be explained by the lack of standardized Shariah governance frameworks and inconsistent enforcement of regulations. These barriers are compounded by the complexity of some Shariah-compliant products and the intense competition from conventional financial institutions. The success of the case study bank demonstrates that these challenges can be overcome through innovative and community-driven approaches, highlighting the importance of tailored solutions.

The regional disparities observed in the findings reflect the uneven distribution of financial resources and regulatory maturity across Indonesia. Urban areas, with their higher levels of investor awareness and better access to financial services, are naturally more receptive to ethical investments. In contrast, rural areas face unique challenges that require targeted interventions to bridge the gap.

Based on the findings, several recommendations can be made to promote effective Shariah governance in Indonesia's Islamic banking sector. Policymakers should prioritize the development of standardized Shariah governance frameworks and sustainability regulations to create an enabling environment for ethical investments. Financial education initiatives should be expanded to improve stakeholder awareness and demand for Shariah-compliant products, particularly in rural areas.

Financial institutions should focus on enhancing transparency and accountability in their Shariah compliance disclosures. Innovative product designs, such as green sukuk and renewable energy funds, should be developed to cater to the growing demand for ethical investments. Partnerships with local communities and religious leaders can help build trust and increase adoption, particularly in underserved areas.

Future research should explore the role of digital transformation in driving the adoption of Shariah governance, as well as the potential for integrating Islamic finance with sustainable development goals. Comparative studies in other Muslim-majority countries can provide valuable insights into the global dynamics of Islamic finance, informing strategies for growth and innovation.

Ultimately, the findings of this study call for a collaborative and inclusive approach to promoting effective Shariah governance in Indonesia's Islamic banking sector. By addressing the identified challenges and leveraging the opportunities, stakeholders can unlock the full potential of Shariah-compliant banking, contributing to the sustainable development of Indonesia and beyond.

CONCLUSION

This study reveals that Shariah governance plays a critical role in ensuring the credibility and sustainability of Indonesia's Islamic banking sector. The findings highlight that 70% of the sampled banks have established centralized Shariah boards, reflecting the importance of standardized oversight. However, only 40% provide detailed Shariah compliance reports, indicating a transparency gap. Challenges such as regulatory inconsistencies, limited expertise, and weak enforcement mechanisms were identified, while best practices like transparent reporting and stakeholder engagement were shown to enhance trust and compliance.

This research contributes conceptually by demonstrating how Shariah governance can align Islamic banking practices with ethical and sustainability goals, bridging the gap between theory and application. Methodologically, the study employs a mixed-methods approach, combining quantitative analysis of bank data with qualitative insights from stakeholders, to provide a comprehensive understanding of the research problem. This approach enhances the validity and depth of the findings, offering a model for future studies in Islamic finance and governance.

This study has several limitations, including a sample size that may not fully represent the diversity of Indonesia's Islamic banking sector and a reliance on self-reported data, which may introduce biases. Future research should expand the sample size, incorporate longitudinal data, and explore the impact of digital transformation on Shariah governance. Comparative studies across other Muslim-majority countries could also provide valuable insights into the global dynamics of Islamic finance and governance.

AUTHOR CONTRIBUTIONS

Look this example below:

Author 1: Conceptualization; Project administration; Validation; Writing - review and editing.

Author 2: Conceptualization; Data curation; In-vestigation.

Author 3: Data curation; Investigation.

CONFLICTS OF INTEREST

The authors declare no conflict of interest

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