

CHAPTER IV

DESCRIPTION OF THE RESEARCH OBJECTIVE

4.1 Global Islamic Finance

4.1.1 The Evolution of the Global Islamic Finance Industry

The global Islamic finance industry has evolved significantly from its modest beginnings in the 1960s to become a major segment of the international financial system. Initially concentrated in Muslim-majority countries, Islamic finance has expanded rapidly over the past few decades, driven by both religious principles and commercial opportunities. The industry grew from a market turnover of about \$5 billion in 1985 to assets exceeding \$4.5 trillion by 2022, with a projected increase to over \$6.7 trillion by 2027. This growth has been fueled by the rise of full-fledged Islamic banks, the introduction of Islamic windows in conventional banks, and increasing adoption in diverse regions including the Middle East, Southeast Asia, Sub-Saharan Africa, and parts of Europe. Key developments include the integration of FinTech, digital banking, and artificial intelligence, as well as a focus on sustainable finance aligned with ESG principles. The sector has also seen consolidation through mergers and acquisitions to create larger, internationally competitive institutions. Islamic finance's resilience during economic uncertainties, such as the COVID-19 pandemic, and its appeal as an ethical and risk-sharing financial system have further cemented its global presence and ongoing evolution (As-Salafiyah & Radwan, 2023).

4.1.2 Basic Principles of Islamic Finance

The foundational principles of Islamic finance are deeply embedded in Shariah law, emphasizing ethical conduct, social justice, and economic equity. At its core, Islamic finance prohibits *riba*, or interest, thereby rejecting the notion of generating profit from money alone without engaging in tangible economic activity. Instead, it advocates for a profit-and-loss sharing framework, which fosters a partnership model where risks and rewards are equitably distributed among all stakeholders. This system mandates that financial transactions be underpinned by real assets or productive economic ventures, thereby avoiding speculative behaviors

such as maisir (gambling) and gharar (excessive uncertainty). Moreover, Islamic finance strictly excludes investments in sectors deemed unethical or harmful, such as alcohol, gambling, and other prohibited (haram) industries. The overarching objective is to ensure transparency, fairness, and social welfare, thereby promoting a financial ecosystem that is not only economically viable but also socially responsible. These principles collectively distinguish Islamic finance from conventional financial systems by prioritizing justice, ethical integrity, and shared risk in economic activities (Mahfudz et al., 2024).

4.1.3 Global Islamic Finance Market Segmentation

The global Islamic finance market is segmented across various dimensions, reflecting its diverse and expanding nature. By financial sector, the market includes Islamic banking, which dominates with over 70% of total assets, followed by Takaful (Islamic insurance), Sukuk (Islamic bonds), Islamic funds, and other Islamic financial institutions. In terms of customer type, the market serves both retail consumers and businesses, with retail banking and corporate banking being prominent sub-segments. Geographically, the market is primarily concentrated in the Middle East and Africa, particularly within the Gulf Cooperation Council (GCC) countries such as Saudi Arabia, UAE, Qatar, Kuwait, Bahrain, and Oman, which together hold the largest share of global Islamic finance assets. Southeast Asia, led by Malaysia and Indonesia, represents the second-largest market, known for innovation and rapid growth. Europe, with the United Kingdom as a key player, and other regions including North America and Africa, are emerging markets with growing interest in Shariah-compliant finance. The industry is also witnessing growth in Islamic microfinance and sustainable finance products, driven by increasing demand for ethical investments and financial inclusion. Digital transformation and regulatory developments continue to shape the market's evolution, enhancing accessibility and standardization (Warde, 2014).

Table 4. 1 **Multifaceted Structure of the Islamic Finance Industry.**

Region	Key Markets and Features
Middle East & Africa	Gulf Cooperation Council (GCC) countries (Saudi Arabia, UAE, Qatar, Kuwait, Bahrain, Oman), Egypt, Nigeria. The region holds the largest share of global Islamic finance assets.
Asia-Pacific	Malaysia, Indonesia, Pakistan, Bangladesh, Brunei, Southeast Asia is the second-largest market, known for innovation and rapid growth.
Europe	United Kingdom, Ireland, Italy, and others. Europe is emerging as a hub for Islamic finance, especially in the UK
Rest of the World	Includes North America and other regions with growing interest in Sharia financial products.

Source: (Dewar, n.d.)

This segmentation underscores the multifaceted structure of the Islamic finance industry, catering to a broad spectrum of clients and regions through a variety of Sharia finance products financial products and services and positioning it for sustained global growth.

4.2 Overview of Research Objects: United Kingdom

4.2.1 Islamic Finance Industry Landscape in the United Kingdom

The Islamic finance industry in the United Kingdom is a well-established and rapidly growing sector, recognized as the leading Western hub for Sharia financial services. The UK boasts over 20 banks offering Islamic finance, including five fully Sharia financial institutions, with assets totalling around \$7.5 billion as of 2021, which accounts for 85% of Europe's Islamic finance banking assets. London plays a pivotal global role, particularly through the London Stock Exchange, which is a major centre for sukuk issuance, having raised over \$50 billion through 68 sukuk listings. The sector benefits from a highly supportive

regulatory and tax environment, with the Financial Conduct Authority and the Bank of England fostering growth and ensuring adherence to Sharia principles. Innovation, especially in Islamic fintech, is driving further expansion, with digital banking and blockchain technologies enhancing accessibility and efficiency. The UK also leads in Islamic finance education and expertise, contributing to its strong talent pool. Despite challenges such as Sharia compliance complexity and competition from conventional finance, the UK's Islamic finance industry is poised for continued growth, aligning with global trends toward ethical finance and financial inclusion (Warde, 2014)

The United Kingdom has established itself as a pioneering Western jurisdiction in the development of Islamic finance by integrating Sharia financial products and services within a conventional legal and regulatory framework, thereby cultivating a sophisticated ecosystem since the late 20th century. This ecosystem includes fully-fledged Islamic banks such as Al Rayan Bank and Gatehouse Bank, which offer ethical financial products based on profit-sharing and rental payment principles, alongside Islamic windows within conventional banks. The Bank of England's proactive initiatives, including the provision of Sharia financial products and services liquidity facilities, combined with regulatory oversight by the Financial Conduct Authority (FCA), ensure compliance with both conventional financial standards and Shariah principles, fostering investor confidence and market integrity (Belouafi & Chachi, 2014). Furthermore, London's role as a global financial hub, supported by a multicultural demographic and academic institutions specializing in Islamic finance, has contributed to a robust talent pool and continuous innovation. The London Stock Exchange's active sukuk market and the presence of institutions like Qatar Islamic Bank UK, which provide a broad range of Sharia financial products and services contracts such as Murabaha and Ijarah, underscore the UK's position as a leading centre for Islamic capital market activities in the West. These developments, supported by a mature regulatory framework and government initiatives, have collectively positioned the UK as a critical nexus for Islamic finance, combining conventional financial expertise with Sharia financial products and services innovation.

4.2.2 Demographic and Behavioral Characteristics of Islamic Finance Consumers in the United Kingdom

The demographic and behavioral profile of Islamic finance consumers in the UK is characterized by a predominantly young, educated, and financially aware Muslim population, which numbers around 3.9 million and represents about 6.5% of the UK's total population. A significant portion of this group, about 86% expresses a clear preference for Shariah financial products, reflecting their desire to align financial activities with Islamic principles such as the prohibition of interest and ethical investment. Awareness of Islamic finance has notably increased from 77% in 2019 to 90% in 2024 among Muslim consumers, with younger age groups (18-24 years) showing the highest familiarity, rising from 25% to 83% in the same period. Despite this growth, misconceptions persist, including the belief held by 26% of Muslims and 35% of non-Muslims that Islamic finance is exclusively for Muslims. Behavioral trends reveal that many Muslim consumers have yet to fully utilize Islamic financial products, with over half never having taken out a home purchase plan and 41% never using Islamic savings accounts. Additionally, there is growing interest in ethical and green finance, which resonates with the community's values of transparency and social responsibility. This demographic is also pioneering bespoke Islamic fintech solutions to meet unmet needs, driven by greater disposable income, financial literacy, and a demand for more inclusive and innovative financial services beyond traditional offerings (TheCityUK, 2022).

4.2.3 Regulatory Framework and Business Environment Influencing Islamic Finance in the United Kingdom

The regulatory framework shaping Islamic finance in the United Kingdom is anchored by the Financial Conduct Authority (FCA) and the Prudential Regulatory Authority (PRA), which oversee Islamic financial institutions under the same standards and regulations as conventional banks. This “no obstacles, no special favors” approach ensures a level playing field, with Islamic banks required to comply fully with UK financial laws, including licensing and prudential requirements. To address unique challenges posed by Sharia-compliant products, such as the prohibition of interest and profit-and-loss sharing structures, the UK

government and regulators have introduced targeted measures, including tax reforms like abolishing double stamp duty on Islamic mortgages and creating alternative liquidity facilities structured to meet Sharia principles. The London Stock Exchange also plays a critical role by facilitating sukuk issuance, supported by a robust professional services ecosystem encompassing law, accounting, and consultancy firms that specialize in Islamic finance (Lescher, 2015)

Despite these advances, the current regulatory framework faces criticism for not fully accommodating the distinct operational and risk characteristics of Islamic finance. Scholars and industry experts argue that applying conventional banking regulations to Islamic banks may hinder their growth and innovation potential, calling for a specialized regulatory regime tailored to Islamic finance's unique features such as capital adequacy and deposit guarantees. The process of developing Islamic finance accounting and regulatory standards in the UK is also influenced by political and stakeholder dynamics, involving industry bodies, Sharia scholars, and government entities. While the UK remains the leading Western center for Islamic finance, ongoing dialogue continues about reforming the regulatory environment to better support the sector's expansion and address its specific governance and compliance needs (Lescher, 2015)

4.2.4 Key Challenges and Strategic Opportunities for the Advancement of Islamic Finance in the United Kingdom

Islamic finance in the United Kingdom faces several key challenges, including limited public awareness, the complexity of Sharia financial products, and competition with conventional financial products, which together hinder broader market adoption and scalability. Regulatory and tax-related barriers, as well as a lack of specialized legal frameworks for Islamic banks, further complicate growth and innovation in the sector. However, the UK's position as a global financial hub, supportive regulatory initiatives, and increasing demand for ethical financial products present significant strategic opportunities. By leveraging digital transformation, enhancing public education, and fostering cross-border

partnerships, especially with Gulf and Southeast Asian investors, the UK can strengthen its role as the leading Western center for Islamic finance, attract foreign direct investment, and drive inclusive economic development (Alkhalifa, 2022).

4.3 Malaysia

4.3.1 Islamic Finance Industry Landscape in Malaysia

Malaysia stands at the forefront of the global Islamic finance industry, widely recognized for its regulatory sophistication, market depth, and product innovation, with Islamic banking assets surpassing USD 260 billion and a dominant position in the global sukuk issuance market. This leadership is underpinned by a comprehensive and well-coordinated regulatory framework administered by Bank Negara Malaysia and the Securities Commission Malaysia, which ensures rigorous Shariah financial products while promoting technological advancement and sustainable finance initiatives, including environmental, social, and governance (ESG) financing supported by tax incentives and grants. Malaysia's Islamic finance sector is further distinguished by the integration of social finance mechanisms such as zakat and waqf, reflecting a commitment to ethical finance and socio-economic development. Maybank Islamic, the Islamic banking arm of Malaysia's largest banking group, exemplifies this excellence by offering a broad portfolio of Sharia financial products including retail and corporate banking, investment services, and takaful and maintaining a commanding market share with assets exceeding RM351.7 billion (approximately USD 81.9 billion), positioning it among the top global Islamic banks (Ahmad Saharudin & Abu Bakar, 2024).

The country's strategic focus on human capital development, international collaboration, and continuous product diversification, alongside a vibrant sukuk market and robust regulatory support, has solidified Malaysia's reputation as a global benchmark and model for emerging markets in Islamic finance, with sustained growth expected to continue driving its influence in the global Islamic financial ecosystem.

4.3.2 Demographic and Behavioral Characteristics of Islamic Finance Consumers in Malaysia

The demographic and behavioral profile of Islamic finance consumers in Malaysia reveals a balanced gender distribution with 50% male and 50% female, predominantly Malay (63%), followed by Chinese (29%) and Indian (8%), and a broad income spectrum including 12% high income (T20), 46% middle income (M40), and 42% low income (B40). Consumers are mostly aged between 21 and 39 years, with a significant portion married and many having children. Islamic financial products are widely adopted, with about 73% of Malaysians owning at least one such product, primarily savings accounts, debit cards, and current accounts. The choice of Islamic finance is driven by religious compliance, good product features, and growing interest beyond the Muslim population, although some consumers still perceive conventional products as more competitive. Regional and ethnic variations exist, with lower ownership among Chinese and Indian communities and in East Malaysia, indicating growth opportunities. Behavioral tendencies show a preference for products that align with Sharia principles while meeting practical financial needs, supported by favorable government policies and increasing consumer acceptance across demographic segments (Rakuten Insight, 2024) .

4.3.3 Regulatory Framework and Business Environment Influencing Islamic Finance in Malaysia

The regulatory framework and business environment of Islamic finance in Malaysia are characterized by a comprehensive and integrated legal system that harmonizes Shariah principles with civil law, under the strong oversight of Bank Negara Malaysia (BNM). The Islamic Financial Services Act 2013 (IFSA 2013) replaced earlier legislation to provide a modernized, Shariah financial products regulatory regime that governs Islamic banking, takaful, and other Islamic financial institutions, ensuring their operations align with Islamic law while maintaining financial stability and consumer protection. BNM holds the authority to issue guidelines, supervise Shariah financial products through the Shariah Governance Framework and the National Shariah Advisory Council, and regulate licensing for

both domestic and foreign Islamic financial institutions. Malaysia's dual legal system blends common law with Shariah law, creating a unique environment that supports product innovation and market growth but also poses challenges in harmonizing Sharia rulings with civil law interpretations. The framework emphasizes transparency, risk management, and governance, positioning Malaysia as a global leader in Islamic finance while continuously evolving to address regulatory gaps, such as those related to specific contract practices like ta'widh. Overall, Malaysia's regulatory environment fosters a robust, competitive, and Sharia financial products Islamic finance sector within a stable and supportive business ecosystem (Syarif, 2019).

4.3.4 Key Challenges and Strategic Opportunities for the Advancement of Islamic Finance in Malaysia

Malaysia's Islamic finance sector faces key challenges, including consumer perceptions that Islamic products are less competitive than conventional ones, risk-averse customer behavior under profit-loss sharing schemes, and complexities in harmonizing Sharia compliance with evolving regulatory requirements. Additionally, the industry contends with infrastructure limitations, the need for enhanced Sharia governance, and the absence of a fully integrated global Islamic finance ecosystem, which restricts cross-border investment and internationalization. However, strategic opportunities abound through strong government support, including the Financial Sector Blueprint 2022–2026 and Capital Market Masterplan, which emphasize innovation, risk resilience, and digital transformation. Malaysia's leadership in sukuk issuance, growing adoption among both Muslim and non-Muslim consumers, and efforts to strengthen operational segregation and Sharia governance position it to expand its global Islamic finance hub status. Embracing digital lending platforms and fostering inclusivity for SMEs further enhance growth prospects, while ongoing reforms aim to address legal ambiguities and standardize practices to sustain Malaysia's competitive edge in the global Islamic finance industry (Rakuten Insight, 2024).

4.4 Indonesia

4.4.1 Islamic Finance Industry Landscape in Indonesia

Indonesia, as the world's most populous Muslim-majority country, represents a significant emerging market in Islamic finance characterized by dynamic growth potential and distinctive structural challenges. Although the sector remains relatively nascent compared to more established markets such as Malaysia, Islamic financial assets in Indonesia have expanded substantially, reaching approximately IDR 2,582 trillion in 2023, driven predominantly by a strong retail orientation encompassing Islamic banking, microfinance institutions (Baitul Maal wat Tamwil), and a developing Islamic capital market. Institutional consolidation, exemplified by the establishment of Bank Syariah Indonesia (BSI) a merger of several state-owned Islamic banks forming the country's largest Sharia financial institution has been pivotal in broadening access to Islamic financial services nationwide, with a particular emphasis on retail banking, microfinance, and digital finance innovations aimed at enhancing financial inclusion.

Despite the complexity of regulatory oversight involving multiple supervisory authorities, recent governmental and central bank initiatives have sought to streamline regulations, incentivize Sharia financial product innovation, and promote digital finance platforms, thereby fostering an enabling environment for sectoral growth. Moreover, Indonesia's Islamic finance industry increasingly prioritizes social impact and economic empowerment, leveraging its demographic advantage to expand ethical financial services and deepen market penetration. This multifaceted development trajectory reflects a nuanced interplay between regulatory reform, market demand, and socio-cultural factors, positioning Indonesia as a critical growth frontier within the global Islamic finance landscape.

4.4.2 Demographic and Behavioral Characteristics of Islamic Finance Consumers in Indonesia

The demographic and behavioral characteristics of Islamic finance consumers in Indonesia are shaped largely by the country's status as the world's largest Muslim population, with a growing segment of younger, educated

millennials who exhibit increasing Islamic financial literacy and preference for Sharia-compliant products. These consumers, predominantly aged 21-40, are motivated by religious adherence, ethical considerations, and a desire for transparent, usury-free financial services. Despite the large Muslim majority, Islamic banking penetration remains relatively low due to consumer comfort with conventional banks and perceived minimal differences between Islamic and conventional products. However, steady growth in Islamic finance assets and sukuk issuance reflects rising interest. Behavioral studies show millennials, in particular, prioritize Islamic financial literacy and lifestyle alignment over social influence or perceived risk, indicating a more independent decision-making process. The sector faces challenges in expanding market share but benefits from strong educational initiatives and innovation in Islamic fintech, which are expected to enhance trust and usage across diverse socio-economic groups, thereby supporting Indonesia's broader Islamic economic development goals (Ainley et al., 2007).

4.4.3 Regulatory Framework and Business Environment Influencing Islamic Finance in Indonesia

Indonesia's regulatory framework for Islamic finance is robust but notably fragmented, with overlapping responsibilities among key institutions such as Bank Indonesia (BI), the Financial Services Authority (OJK), and the National Sharia Council (DSN-MUI), which complicates coordination and slows policy implementation. BI oversees monetary policy and broader economic regulation, while OJK supervises the financial services sector, including Islamic banks and fintech, and DSN-MUI issues legally binding fatwas that ensure Sharia compliance. This division of authority often creates bottlenecks in approving innovative Islamic financial products and harmonizing regulations, impacting the sector's competitiveness. Despite these challenges, Indonesia has made strides in regulating Islamic fintech through OJK's specific regulations and DSN-MUI's fatwas, fostering growth in Sharia-compliant digital finance. The regulatory environment emphasizes consumer protection, transparency, and adherence to Sharia principles, but ongoing efforts are needed to improve institutional coordination and adopt

international standards to fully realize Indonesia's potential as a major Islamic finance market (Khotimah, 2024).

4.4.4 Key Challenges and Strategic Opportunities for the Advancement of Islamic Finance in Malaysia

Indonesia's Islamic finance sector faces significant challenges, including low financial literacy and limited access to Islamic financial services in rural and eastern regions, which constrain broader inclusion and the fulfillment of religious financial needs such as zakat and hajj-related transactions. Additionally, the sector struggles with underutilization of skilled human resources, low public awareness, perceived lack of innovation and competitiveness compared to conventional banks, and legal complexities stemming from inconsistent interpretations of Shariah principles across jurisdictions. The fragmented regulatory environment and insufficient support from the community and religious leaders further impede growth. However, strategic opportunities arise from Indonesia's large Muslim population, progressive regulatory reforms, and increasing mobilization of financial resources aimed at strengthening the Islamic economic ecosystem. Digital finance and fintech innovations present promising avenues to enhance accessibility and meet evolving consumer behaviors, while initiatives like the IFN Dialogues 2025 foster collaboration and global connectivity. By addressing literacy gaps, improving product creativity, and enhancing institutional coordination, Indonesia can accelerate Islamic finance development and solidify its position as a leading global hub for Sharia-compliant finance and the halal economy (Iswanaji, 2018).