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Islamic fintech in Indonesia: Sharia compliance as a driver of competitive digital economy

[a,1] Amrullah*, [a,2] Ketina Widiana, [a,3] Afroh Hana Taqiya

[a] Islamic Banking Department, Faculty of Islamic Studies, Universitas Ahmad Dahlan, Indonesia

[1] amrullah@pbs.uad.ac.id; [2] 2211032028@webmail.uad.ac.id; [3] 2311032066@webmail.uad.ac.id

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ABSTRACT

This study examines the development of Islamic fintech in Indonesia and its role in supporting the competitive advantage of the digital economy. One crucial aspect in supporting the digital economy is the establishment of Sharia compliance parameters. The study reveals that adherence to Sharia parameters not only ensures that fintech products and services align with Islamic principles but also enhances consumer and industry trust, thereby strengthening the competitive edge of Indonesia's digital economy. Utilizing a qualitative descriptive method, this research highlights that consistent implementation of Sharia compliance in the Islamic fintech industry can have a significantly positive impact, both on the industry's growth and on the overall welfare of society. The results of this study are expected to contribute to the development of better policies and practices in the Islamic fintech sector and to enhance the understanding of its strategic role within Indonesia's digital economy ecosystem.

Introduction

Economic development in every country will always be encouraged in order to achieve public welfare. Regardless of the fluctuating conditions of the global economy caused by various factors, economic growth will always be sought. One of the potentials to drive economic growth that has attracted the interest of experts in recent decades is the digital economy. Since the 1990s, the great potential possessed by the digital economy has been recognized by various groups, ranging from business people, consultants, journalists to researchers (Li et al, 2020). One of the early figures who introduced the concept of the digital economy was Tapscott (1996) who stated that the digital economy is a new type of economy characterized by the exclusive use of digital information. However, the digital economy is not limited to the information and communication technology (ICT) market alone. Tang (2020) cites the definition of the digital economy from the World Economic Forum and the G20, namely:

"*a broad range of economic activities that use digitized information and knowledge as key factors of production, modern information networks as an important activity space, as well as information and communications technology to drive productivity growth*."

The growth of productivity to drive the global economy through the penetration of ICT into economic activities in recent decades is increasingly significant, especially in several Asian countries such as China and India. The country has recently risen to become a global economic power to rival the United States and Europe, one of which is thanks to the utilization of digital economic strategies. Li et al, (2020) describe that the functional effects of the digital economy are able to remove market barriers and influence the participation of Asian countries in global supply chains and the digitization of the manufacturing industry.

A new era has begun in which ICT has a role in driving national economic growth, which in turn is expected to create general public welfare. Based on research conducted by the United Nations, the integration of the digital economy with traditional economic practices has the potential to improve people's lives (UNCTAD, 2019). Indonesia is of course expected to be able to maximize the potential benefits of the digital economy. To realize this, Indonesia's competitiveness in the digital economy sector needs to be improved.

One form of digital technology innovation that has recently developed and has great potential to support the competitiveness of Indonesia's digital economy sector is fintech or financial technology. Fintech is an innovation born from the penetration or utilization of technological developments into the economic sector, especially the financial sector. It has the potential to have a positive impact on the economy, one of which is in increasing financial inclusion (Ozili, 2018). Especially with the emergence of Islamic fintech, which is present to provide technology-based financial alternatives and in line with Islamic values. Islamic fintech plays an important role given its compatibility with the conditions of Indonesian society, which is predominantly Muslim. So that sharia fintech has the potential to open wider opportunities for the development of the national digital economy through fintech means.

This paper aims to examine the development of Islamic fintech and its role in supporting the competitive advantage of the digital economy in Indonesia. One important aspect of Islamic fintech that can support the digital economy is the establishment and implementation of its sharia compliance parameters. Although there have been many studies on Islamic fintech, not many have elaborated on this. This study shows that compliance with sharia parameters not only ensures that fintech products and services comply with sharia principles, but also increases consumer and industry confidence, which in turn strengthens the competitiveness of Indonesia's digital economy.

Method

This research uses a descriptive qualitative method to examine the development of Islamic fintech in Indonesia and its role in supporting the competitive advantage of the digital economy. This method was chosen because it provides flexibility in exploring in-depth and holistic information about the phenomenon being studied. The main focus of this method is to understand how the implementation of sharia compliance parameters affects the Islamic fintech industry and its contribution to the competitiveness of the digital economy.

Result and Discussion

Development of Sharia Fintech in Indonesia

The development of information and communication technology has penetrated into various lines of life, including the economy, especially the financial sector. Financial technology or plural abbreviated as fintech is an innovation in the financial services industry that utilizes these technological developments. In Indonesia itself, fintech has emerged and developed rapidly, presenting alternative financial services for the community with various features and conveniences from the effects of the technology offered. With such a large population and a high internet penetration rate, where 77.02 percent of Indonesia's 272.68 million population is connected to the internet (APJII, 2022), it certainly makes this country a potential market for fintech development.

The significant growth of the national fintech industry can be seen from the number of fintech start-ups that have emerged and the amount of investment that has been poured there. Fintech Indonesia (2021) reports that more than 25 percent of new fintech start-ups in the Southeast Asia region come from Indonesia. The amount of investment in the fintech industry reached USD 904 million or 23 percent of the total accumulated investment in the fintech industry in Southeast Asia in 2021. From the demand side, fintech growth is also supported by high public interest. Statistical data from Bank Indonesia shows that in December 2021 there were more than 602.29 million electronic money transactions with a transaction value of more than IDR 35.1 trillion, up 59 percent year-on-year. Meanwhile, the number of fintech lending companies currently licensed by OJK is 102 companies, both sharia-based and conventional (OJK, 2022).

Islamic fintech is an inevitable part of the development of information and communication technology innovations utilized in the financial services sector. Islamic fintech has become something that cannot be separated from the Islamic finance industry itself (Hui et al., 2019). It is estimated that the global Islamic fintech market size in 2021 is USD 79 billion and is projected to grow by 18 percent per year to USD 179 billion by 2026 (Dinar Standard, 2022). Indonesia alone is reported to lead the number of Islamic fintechs, with 61 fintechs or 20 percent of the total number of 375 global Islamic fintechs, with a market value of USD 4.2 billion (Mahomed, 2022).

The development of Islamic fintech shows great potential in supporting the digital economy in Indonesia. Fintech plays a very important role in the modern Islamic economic and financial ecosystem, be it in the banking sector, capital market, or non-bank financial industry (Miskam et al., 2019). Islamic fintech is even considered to have supported financial inclusion by financing underdeveloped sectors such as agriculture and MSMEs, and has encouraged SDGs in eradicating poverty, hunger, and reducing inequality (Hudaefi, 2020). This shows the significant role that Islamic fintech has, not only in the sustainability of the Islamic economic industry but also in the benefit of society in general.

Competitive Advantage Analysis of Indonesia's Digital Economy

Potter (2008) developed an analytical model to measure the competitive ability of a company in which there are four condition factors that determine the level of competitiveness, namely: factor conditions; demand conditions; firm strategy, structure, and rivalry; and related and supporting industries. In addition, there are two supporting factors, namely the role of government and opportunities (change). These factors synergize with each other and produce an analysis that can determine the competitive advantage of an industry. The more complete the presence of these factors, the greater the competitive advantage. After being adjusted to the country level, the following is a description of the Potter model analysis of the competitive advantage of Indonesia's digital economy:

1. Factor conditions

This factor discusses the natural factors that exist in a country to support the industry. Speaking of the condition of Indonesian society, reports have shown that Indonesians are quick to absorb new technological developments, especially those related to the digital economy. Based on the McKinsey report (2019), Indonesia ranks first as the country that recorded the fastest growth in adopting the digital economy. This can indirectly indicate that the presence of the domestic digital industry will be easily accepted in Indonesia. This will certainly be an advantage in the digital economy competition if the opportunity can be captured well.

In addition, Indonesia has natural resource factors such as nickel and other mining commodities that can be used as raw materials for making hardware for electronic goods (Dutu, 2015). If Indonesia is able to manage it well, it will place itself in an important position in the global digital economy supply chain.

2. Demand conditions

This illustrates the demand for goods and services in a country. Indonesia is one of the countries with the largest population in the world. With a large number of young people and the middle-class category, this will encourage the potential for demand to consume products in the digital economy sector (Cakranegara, 2020). The survey results of the Indonesian Internet Service Providers Association (APJII, 2022) reported that the internet penetration rate in Indonesia in 2021 was 77.02 percent, up 3.32 percent from the previous period. The internet is undeniably one of the main characteristics of the digital economy. The large number of internet users in Indonesia (around 210 million people) is a huge market potential to encourage the development of the digital economy.

3. Firms Strategy, Structure and Rivalry

This factor speaks to the state of the industry and the state of competition in a country. Utting (2005) explains that due to the different characteristics of the digital world, monopoly regulations for start-up companies are not enforced as in other fields. Likewise in Indonesia, although there are large digital technology companies that dominate the market such as Gojek or Tokopedia, there is no prohibition for new companies to enter and compete in the market. Any start-up company can enter the market without any significant difficulties in terms of regulation. This makes Indonesia a competitive and healthy market for development and innovation in the digital economy.

4. Related and Supporting Industries

This relates to the factors that can support the industry to grow in a country. Speaking of this, the support factor from the education sector is very important. In this case, support from educational institutions that produce a workforce that is ready to enter the digital economy industry. In Indonesia alone, there are thousands of universities, both private and public, and majors in the field of ICT are one of the majors offered. Not to mention the ready-made workforce born from vocational high schools in the field of ICT. According to Oosterbek et al. (2010), this could mean two things: the number of young people who start working and the number of young people who are interested in working in start-up companies.

5. Government Role

In addition to the four factors mentioned above, the role of the government also has an important and strategic position. Support from the policy sector will greatly affect the development of the digital economy sector. The Indonesian government itself has and will continue to do several things in order to build and support the digital economy. These include drafting regulations regarding guarantees of protection and security in electronic information and transactions (Law No. 19 of 2016), launching an Electronic-Based Government System (SPBE), the 100 Smart City Movement, the Let's Go Online Movement, Making Indonesia 4.0, etc. (Asnawi, 2022). Although of course, there are still many shortcomings in its implementation. Personal data security and digital crime are still issues that are troubling the public.

From the description above, it can be said that Indonesia has great potential to become one of the advanced countries in the digital economy sector. This optimistic view is also shared by Minniti (2008). From Potter's analysis model, factors that can support Indonesia in gaining a competitive advantage in the digital economy sector can be identified. This model is certainly a good start to build a digital economy in order to achieve public welfare.

The Role of Sharia Fintech in Supporting Indonesia's Digital Economy Competitive Advantage

Islamic fintech plays a significant role in supporting the competitive advantage of Indonesia's digital economy, especially in meeting the needs of people who want financial services that comply with sharia principles. The presence of Islamic fintech not only offers innovative financial solutions, but also builds the trust and loyalty of Muslim consumers who make up the majority in Indonesia. By applying strict sharia compliance parameters, sharia fintech can ensure that all products and services offered are in accordance with Islamic values, which in turn increases market attractiveness and creates a sustainable competitive advantage.

1. Factor Conditions

Islamic fintech capitalizes on the growing digital infrastructure in Indonesia, along with the high rate of technology adoption by the public. For example, the large number of internet users in Indonesia is a great potential for Islamic fintech to reach out to the wider community. In addition, human resources who master technology and understand sharia principles are increasingly emerging, especially from universities that offer study programs related to Islamic economics and information technology.

2. Demand Conditions

In terms of demand, Islamic fintech is able to address the market's need for halal and shariah-compliant financial products. With a large Muslim population, the demand for Islamic financial services is expected to continue to rise, and Islamic fintech is well positioned to fulfill this need. This will contribute to strengthening Indonesia's digital economy by creating a more inclusive and diverse market.

3. Firm Strategy, Structure, and Rivalry

The Islamic fintech industry in Indonesia shows healthy competitive dynamics, with many start-ups continuing to innovate and compete to provide better financial solutions. Supportive government policies and a competitive business environment allow Islamic fintech to grow rapidly, while maintaining compliance with sharia principles.

4. Related and Supporting Industries

Islamic fintech is also supported by various related industries, such as the Islamic banking sector, information technology, and educational institutions that continue to produce experts in the field of Islamic economics and technology. The synergy between the Islamic fintech industry and other supporting industries creates a strong ecosystem, which is able to increase the competitiveness of Indonesia's digital economy in the global arena.

5. Government Role

The Indonesian government has taken various steps to support the development of Islamic fintech, including the development of regulations that ensure compliance with sharia principles and the security of digital transactions. These policies not only protect consumers, but also encourage innovation in the Islamic fintech sector. Effective implementation of these regulations will help Islamic fintech play a bigger role in the digital economy, while increasing public trust in digital financial services.

As such, Islamic fintech, with support from the implementation of sharia compliance parameters, can contribute significantly to enhancing the competitive advantage of Indonesia's digital economy. Continued development in this sector is expected to bring Indonesia to become one of the leaders in the global digital economy, while maintaining the sharia principles that are an important foundation for its society.

The Urgency of Establishing Fintech Shariah Compliance Parameters

Basically, fintech fiqh falls into the category of muamalah, so in general the rule "al ashlu fi al mua'malati al ibahatu illa an yadulla dalilun ala tahrimiha" applies. This indicates that sharia opens the door to innovation in fintech practices as long as there is no text that prohibits or violates sharia values. So when this will be applied in daily life, MUI sees that people need an explanation of the provisions and legal limits related to fintech services based on sharia principles. MUI itself has issued a fatwa on fintech through Fatwa DSN MUI No. 117/DSN-MUI/II/2018 on Financing Services Based on Information Technology Based on Sharia Principles. As part of a relatively new financial service, the existence of this fatwa can at least be a guideline for the Muslim community and feel calmer in adopting sharia fintech.

In every provision of Sharia, there is actually a maqasid (purpose) which is the intention of Allah in laying down the Sharia. In this case Al-Shatibi (2014) states:

"...that the formulation of the laws is for securing the interests of the servants (human beings) in both the here and the Hereafter."

Then the human interest is organized by preserving five things that become the goal or basic needs (daruriyya) - namely religion, life, offspring, wealth / property and reason - where every state is obliged to protect it (Al-Shatibi, 2014). These sharia provisions are then known in the Islamic financial industry as sharia compliance. So the provisions on shariah compliance are actually there for the benefit of humans themselves, in order to protect their rights. It is well known that the fintech industry is prone to the risk of fraud and cybersecurity. Thus, the existence of sharia compliance provisions ideally keeps fintech developing in accordance with sharia provisions, not just 'for sharia' itself, but also for the benefit of stakeholders as humans involved in it.

Further on the issue of sharia compliance parameters, Laldin & Djafri (2019) explain:

"...to ensure the protection of the sanctity and validity of the contract, authorities and regulators are

required to develop Shariah standards that would explicitly spell out the requirements of Shariah that are fundamental to fintech operations and practices. The aims of these standards are to foster transparency, consistency and mutuality in the application of fintech by Islamic financial institutions."

Therefore, it is important for authorities such as OJK and BI to collaborate with MUI or other Islamic economists in establishing clear and standardized standards regarding sharia compliance criteria. In the end, sharia compliance will benefit all parties. Not only consumers will be protected, but with shariah compliance, fintech managers will at least gain the trust of consumers which can ultimately have an impact on profitability. Thus, sharia compliance will broadly support the running of the digital economy sector.

Conclusion

The development of sharia fintech in Indonesia shows significant potential in supporting the competitive advantage of the national digital economy. By continuously improving the implementation of sharia compliance parameters, Islamic fintech can become a more inclusive and sustainable alternative to conventional financial services. This paper makes an important contribution to practice and policy by emphasizing the need to strengthen regulation and supervision to ensure that all Islamic fintech services comply with sharia principles, as well as encourage innovation in line with Islamic values. For future research, it is recommended to conduct more in-depth studies on the specific impact of various Islamic fintech business models on financial inclusion and economic stability, as well as further explore the role of recent technological innovations such as blockchain and artificial intelligence in improving efficiency and transparency in Islamic fintech. In addition, further research is needed to identify the challenges and opportunities in expanding the reach of Islamic fintech to broader segments of society, including in rural areas and underserved communities.

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