e-ISSN: xxxx-xxxx/Vol.1 No.1 (2024)

TRANSFORMATION OF ISLAMIC BANK IN INDONESIA: OPPORTUNITIES AND CHALLENGES IN FACING THE DIGITAL ERA

Muhamad Rizki Agustian[1)], Nisa Rahma Fadila[2)],
[1,2)]Islamic Economics Study Program, Universitas Terbuka, Indonesia
Corresponding author: rizkiagustian306@gmail.com

Abstract

Islamic banking in Indonesia has undergone continuous transformation, starting from the idea of establishing Islamic banking in the 1960s, the founding of Bank Muamalat Indonesia as the first Islamic bank in the 1990s, and continues to grow rapidly, especially in the digital era, which also presents both opportunities and challenges faced by Islamic banking in the digital era. The research method used is descriptive qualitative with a literature review approach. The findings of this study show several opportunities to Islamic banking in Indonesia, including the development of products that meet societal needs, the use of digital technology to facilitate services, and the development of human resources, which also presents challenges for Islamic banks. Furthermore, the challenges currently faced by Islamic banking include integrating technology with sharia prinsiples, competition with conventional financial institutions, cyber security, and the low financial literacy of the public. Therefore, Islamic banks must continue to innovate and develop in order to maintain their relevance in the face of tight market competition.

Keywords: Islamic Bank, Financial Literacy, Technology Integration, Transformation

Introduction

In recent decades, the rapid development of technology has permeated various aspects of human life. This Industry 4.0 era is characterized by the utilization of digital technology as a tool for industry players to develop their businesses (Abubakar & Handayani, 2022). The advancement of digital technology in Indonesia has disrupted societal structures (Suganda et al., 2023), including the banking sector. The changes occurring today impact not only conventional banking but also Islamic banking, which must maintain its adherence to Sharia principles while adapting to the evolving times. The current digital era represents a new paradigm that brings significant changes, creating both opportunities and challenges, particularly for Islamic banking, to sustain its relevance.

The development of the Islamic banking industry in Indonesia historically began in the 1980s, discussed in greater detail during the fourth National Conference of the Indonesian Ulama Council (MUI) in Jakarta. This conference resulted in the establishment of Bank Muamalat Indonesia, the first Islamic bank in Indonesia (BSI, 2023). Unlike conventional banks, Islamic banking has unique characteristics, as all its business activities operate based on the principles of fairness, profit-sharing, and avoiding transactions containing elements of Maghrib (Maisyir, Gharar, and Riba) (Khatimah, 2022).

With the growing needs of society, as evidenced by the continuous increase in assets and financing in Islamic banking and the rising number of customers, this indicates that people are increasingly aware of the values and benefits offered by Islamic banking (Wahyudi et al., 2024).

Currently, digitalization in the Islamic banking sector is not merely a response to the dynamic needs of society and market competition with conventional banking. It also emphasizes how Islamic banking integrates digital technology with Sharia values in its operations (Haerunnisa & Sugitanata, 2024). The emergence of Fintech (Financial Technology) products as an innovation to support financial inclusion (Latifah & Abdullah, 2022), which has begun to penetrate Islamic banking, is transforming how people access and utilize banking services in a more effective and efficient manner (Sudarmanto et al., 2024). However, the presence of Fintech requires stricter risk management, particularly concerning data security, customer protection, and operational integrity. Thus, the challenges faced by Islamic banking in the digital era extend beyond technical aspects, including how Islamic banking adapts digitally while maintaining its principles and complying with existing regulations.

In this digital era, Islamic banking demonstrates significant opportunities, marked by its ongoing growth. In 2023, the Islamic banking sector grew by 15.63% to reach IDR 802 trillion. In 2022, Islamic banking financing increased by 19.00%, reaching IDR 470 trillion. This significant growth was also reflected in the increase in the number of Islamic banking customers, which rose by 12.72% to 31.89 million customers (Wahyudi et al., 2024). This development is supported by Indonesia's large Muslim population, which continues to drive the demand for Islamic banking.

Currently, the world is entering the digital era, where digitalization has permeated almost every aspect of human life. On April 4, 2018, Indonesian President Joko Widodo launched Making Indonesia 4.0, a roadmap and strategy to address the global digital age. This initiative focuses on five key technologies: the Internet of Things (IoT), Artificial Intelligence (AI), Human-Machine Interface, robotics and sensor technologies, and 3D Printing (Sundari et al., 2019). The digital era has brought significant changes in how people perceive and manage various aspects of life, including financial systems (Qothrunnada et al., 2023). Several studies have explored how Islamic banking in Indonesia navigates the opportunities and challenges of the digital era. These studies serve as references for this research. Suganda et al. (2023), employing a descriptive qualitative method, analyzed the opportunities and challenges Islamic banking faces in the digital age. Their findings reveal that Inovasi Keuangan Digital (IKD) has driven rapid growth in the financial services sector annually. Furthermore, in the digital era, the most significant opportunities for Islamic banking lie in product promotion and public engagement (Suganda et al., 2023). Similarly, Zia Ulhaq and Rasyad Al Fajar (2022) analyzed the opportunities and challenges of Islamic banking in the digital age using a descriptive qualitative approach. Their study found that Islamic banking is well-positioned to meet societal needs by offering ease and technologically advanced services. However, success in this area requires product innovation aligned with public needs to deliver broader benefits (Zia Ulhaq & Rasyad Al Fajar, 2022). Ash-shiddiqy (2023) highlighted in their research that Islamic banks, as institutions implementing Inovasi Keuangan Digital (IKD), have substantial opportunities in Indonesia, particularly given the country's large Muslim population. However, a significant challenge remains the lack of skilled human resources in this sector (Ash-shiddiqy, 2023).

Despite the opportunities, Islamic banking faces various challenges in the current digital era. Previous studies indicate that Islamic banking often encounters inadequate information technology infrastructure and a lack of skilled human resources in digitalization, hindering the development and delivery of innovative banking products (Qothrunnada et al., 2023). Additionally, Islamic banking faces unique challenges in adopting digitalization, including ensuring that products maintain Sharia compliance and addressing societal acceptance of technological potential (Sudarmanto et al., 2024). Given this context, it is crucial to analyze how Islamic banking can capitalize on its opportunities while addressing its challenges in this digital era.

The purpose of this study is to analyze the opportunities and challenges faced by Islamic banking in Indonesia in navigating the digital era. Additionally, this study aims to identify the approaches adopted by Islamic banks to address the increasingly intense competition brought about by the advancement of the digital era. Furthermore, this research will discuss the transformation of Islamic banking from a historical perspective, from its inception to the present day.

Methods

This study employs a qualitative approach to examine the transformation of Islamic banking in Indonesia and analyze its opportunities and challenges in facing the digital era. The method used is a literature review, involving the collection and analysis of various literatures, records, reports, books, journals, and other relevant scientific sources (Sudarmanto et al., 2024). The data for this study includes literature reviews, utilizing national and international scientific journals related to the research topic. The analytical method applied is descriptive research, which aims to describe, explain, and validate the transformation of Islamic banking in Indonesia as it confronts various opportunities and challenges in the current digital era (Muhammad Ramdhan, 2021).

Results and Discussions

Islamic banking as it exists today has undergone a long journey. The idea of establishing Islamic banking in Indonesia actually emerged as early as the 1960s when the Majlis Tarjih Muhammadiyah held a session in Sidoarjo, East Java, to discuss the legal status of bank interest. This issue was further explored in the 1970s during a session in Wiradesa, Pekalongan, addressing the Islamic economic system, particularly banking institutions based on Islamic principles.

In the 1980s, during the Lajnah Ba'shul Masa'il session in Lampung, the Nahdlatul Ulama (NU) organization proposed several ideas about implementing Sharia-based systems in the economic sector and establishing Islamic banks. Then, in 1983, the government introduced deregulation with the June 1, 1983 policy, which allowed banking institutions to independently set their deposit and lending interest rates.

However, this opportunity was not utilized by the Muslim community to establish Islamic banking, as the policy did not include provisions for establishing new banks (Sup & Hartanto, 2020).

The idea of establishing Islamic banking resurfaced in 1988 when the government introduced the October Policy Package (PAKTO 1988), which outlined banking liberalization policies. PAKTO 1988 included four main points: *first* Simplifying the requirements for opening financial institutions, including banks and non-bank institutions, along with their branches. *Second* Allowing the establishment of new private banks with a minimum paid-up capital of IDR 10 billion, as well as enabling the establishment of Bank Perkreditan Rakyat (BPR) with a minimum capital of IDR 50 million. Thirnd Encouraging banks to offer various attractive savings products to customers. And the *fourth* Permitting the establishment of joint-venture banks (Sup & Hartanto, 2020). The issuance of PAKTO 1988 provided a breath of fresh air for Muslim scholars in Indonesia. This prompted the Majelis Ulama Indonesia (MUI) to hold a workshop on interest and banking on August 19-22, 1990, in Cisarua, Bogor, West Java. Based on the recommendations from the workshop, the issue was further discussed at the Fourth National Conference (Munas IV) of MUI held in Jakarta on August 22-25, 1990. The conference resulted in a mandate to form a working group for establishing an Islamic bank in Indonesia. Finally, on November 1, 1991, the deed of establishment for the first Islamic bank in Indonesia, PT Bank Muamalat Indonesia (BMI), was signed. On May 1, 1992, Bank Muamalat Indonesia officially commenced operations with an initial capital of IDR 106,126,382,000. The operations of Bank Muamalat Indonesia were based on Law No. 7 of 1992, which included a provision mentioning "banks with a profit-sharing system," although the law did not explicitly detail the legal basis for Sharia or the types of businesses compatible with Sharia principles (Zia Ulhaq & Rasyad Al Fajar, 2022).

The development of Islamic banking in Indonesia has also been accompanied by legal frameworks that support its existence. For example, in 1998, the People's Representative Council (DPR) amended Law No. 7 of 1992 into Law No. 1 of 1998, which stated that the banking system in Indonesia consists of two types: conventional banking and Islamic banking. Furthermore, legal frameworks were also created to support the growth of the Islamic financial market, such as Law No. 21 of 2008 on Islamic Banking, Law No. 19 of 2008 on Sukuk, and Law No. 42 of 2009, which is the third amendment to Law No. 8 of 1983 on VAT for Goods and Services. Specifically, Law No. 21 of 2008 provides legal protection for Islamic banking and supports its continued growth (Zia Ulhaq & Rasyad Al Fajar, 2022).

Islamic banking continues to show its progress. According to data published by the Central Statistics Agency (BPS), in June 2024, the Islamic banking industry had total assets of IDR 874,089 billion, comprising 14 Islamic Commercial Banks (BUS) and 19 Sharia Business Units (Badan Pusat Statistik, 2024).

Since the establishment of the first Islamic bank in Indonesia, Bank Muamalat Indonesia, the Islamic banking industry has continued to grow rapidly. This is driven by the Indonesian community's need for banking products that align with Islamic principles. In the current digital era, Islamic banking is entering a new phase marked by the digitalization of banking services. This transformation also applies to Islamic banking. Islamic banking has now become part of a new business model known as Digital Financial Innovation (IKD), where this model combines financial services with a broader digital ecosystem (Ash-shiddiqy, 2023). Today, Islamic banking is required to continuously innovate, keeping pace with digital developments, including the products offered, to compete with conventional banking and provide effective and efficient services.

The adoption of digital technology by Islamic banking includes mobile banking, as well as the application of blockchain and artificial intelligence (AI) to enhance efficiency and security in customer transactions. The use of mobile banking makes it easier and more convenient for customers to carry out various financial transactions such as sending money, paying zakat, and managing daily payments and finances. Additionally, mobile banking extends banking access to areas that were previously difficult to reach. On the other hand, the adoption of blockchain technology improves transaction transparency and security, as each transaction record cannot be altered, ensuring honesty and fairness in accordance with Sharia principles. Furthermore, the use of AI and machine learning helps Islamic banking perform deeper customer data analysis, allowing the bank to offer personalized and relevant products and services that meet customer needs. In addition to adopting digital technology to enhance services and operational efficiency, Islamic banking also needs to innovate both in financing products and investments. Innovations in Islamic banking products designed to support inclusive and sustainable finance include digital sukuk products, Sharia peer-to-peer (P2P) financing, and robo-advisors for Sharia investments (Haerunnisa & Sugitanata, 2024).

Several products have emerged as a result of integrating digital technology into Islamic banking, with Financial Technology (Fintech) standing out as one of the most notable outcomes of digital advancements. Islamic banks have the potential to collaborate with fintech companies to unlock new opportunities and foster innovation in Islamic finance. By leveraging technology, they can enhance the efficiency and convenience of payment transactions while remaining compliant with Sharia principles (Sudarmanto et al., 2024).

As it continues to grow and innovate, Islamic banking has now entered an era marked by both opportunities and challenges. This is especially true amidst the rapid advancements in digital technology, which demand ongoing transformation to ensure Islamic banking remains relevant and competitive. The shifts within the Islamic banking sector have fundamentally changed how people interact with financial systems. While these changes present promising opportunities, they also bring increasingly complex challenges that the industry must address.

A literature review conducted by the author identifies several opportunities for Islamic banking in the current digital era, including the following:

1. Development of Products Relevant to Community Needs
   The demand for financial services today extends beyond compliance with Sharia principles to include ease of access and affordability. Islamic banking must evolve to provide services that are both convenient and relevant to modern life. Start-ups, through financial technology (fintech), have taken on a significant role in financing, which is traditionally the main function of financial institutions (Tazkiyyaturrohmah, 2020). Product development can address current needs, such as online financing for housing or vehicles, digital Sharia-compliant investment products, or banking services that support small and medium enterprises (SMEs). This way, product innovation can directly meet the needs of society while ensuring Islamic banking remains relevant.
2. Untilizing Digital Technology to Enhance Services
   Technological advancements in the banking industry, such as mobile banking, internet banking, AI, blockchain, and other digital products, enable Islamic banks to deliver faster and more optimized services to customers. Beyond product technology, the ease of obtaining information in the digital age presents a significant opportunity for Islamic banking. Through various digital platforms, Islamic banks can promote and socialize their products while gaining insights into customer preferences. The accessibility of information about Sharia-compliant banking products to the wider community creates a valuable opportunity for banks to market their offerings effectively (Ash-shiddiqy, 2023).
3. Human Resource Development
   Indonesia, with its large population and majority Muslim demographic, offers significant opportunities for Islamic banking, both in terms of trust and internet penetration (Suganda et al., 2023). According to Harisman, Director of Sharia Banking at Bank Indonesia, the Islamic banking industry will require around 10,000 human resources in the next 4–5 years. BI data even suggests a higher demand of approximately 14,000 professionals (Zia Ulhaq & Rasyad Al Fajar, 2022). While this is a promising opportunity, it also poses challenges, particularly as more universities establish Islamic Economics programs to support workforce quality improvement. Recruitment in Islamic banking today requires not only mastery of Sharia principles but also expertise in communication, marketing, and technology (Tazkiyyaturrohmah, 2020) to ensure the best service for customers.

Islamic banking, despite its various opportunities, faces numerous challenges, particularly in the digital era. These challenges include:

1. Integration of Technology with Sharia Principles
   The Islamic financial industry must not only innovate its products but also ensure that these products align with Sharia principles in their implementation, avoiding elements such as maysir (gambling), gharar (excessive uncertainty), and riba (usury), while emphasizing profit-sharing systems. This presents a complex challenge as Islamic banks must develop advanced, user-friendly IT systems while adhering to Islamic legal provisions (Haerunnisa & Sugitanata, 2024).
2. Competition with Comventional Financial Institutions
   The Islamic financial industry must contend with intense competition from conventional financial institutions, which are well-established and have widespread infrastructure and advanced digital adoption in Indonesia. To remain competitive, Islamic banks need to create value-added services that attract customers while staying true to Islamic values (Haerunnisa & Sugitanata, 2024). This is crucial for maintaining their market presence and competing effectively with conventional counterparts.
3. Cybersecurity
   As the Islamic financial industry evolves, cybersecurity becomes a significant concern. In 2018, a global data breach affecting ATMs in 64 countries, including 13 private banks in Indonesia, underscored the vulnerability of banking systems. Such incidents highlight the critical need for robust cybersecurity measures. According to Article 2, Clause 2 of OJK Regulation No. 12/POJK.03/2028,

banks offering electronic or digital banking services must implement risk management, adhere to prudential principles, and comply with the regulation. Islamic banks must collaborate with market players to develop decision-making processes for detecting and addressing potential issues. Establishing a strong risk management framework, including consumer protection measures, is essential for earning public trust and enhancing the bank's reputation (Ash-shiddiqy, 2023).

4. Limited Financial Literacy among the public
   Public understanding of Islamic finance remains a significant obstacle for the industry. While digital advancements in the financial sector have improved financial inclusion, literacy regarding Islamic finance remains low. Many people perceive little difference between Islamic and conventional banking, which hampers the growth of Islamic financial institutions. To address this challenge, Islamic banks must intensify their efforts to educate the public through digital education campaigns. These initiatives aim to increase awareness of Sharia principles and highlight the advantages of Islamic banking over conventional systems (Suganda et al., 2023).

The various opportunities and complex challenges faced by Islamic banking in the digital era require a holistic approach (Haerunnisa & Sugitanata, 2024). By leveraging existing opportunities, integrating technology with products that align with Sharia principles, enhancing cybersecurity, addressing market competition, educating the public, and collaborating with fintech companies, Islamic banking must continually adapt and innovate. These efforts are essential to maintaining its existence and relevance, enabling it to compete effectively in the global market.

Conclusion

Islamic banking in Indonesia has shown rapid development since its initial concept emerged in the 1960s, leading to the establishment of Bank Muamalat Indonesia as the first Islamic bank in the 1990s. Over time, the growth of Islamic banking in Indonesia has been supported by clear regulations, such as Law No. 21 of 2008, which governs Islamic banking. In today's digital era, Islamic banking is entering a new business phase that integrates financial services with the digital ecosystem. Key digital products adopted by Islamic banks include mobile banking, blockchain, and artificial intelligence (AI), which aim to enhance transaction efficiency and security while meeting the evolving needs of society.

However, alongside its rapid growth, Islamic banking faces various opportunities and challenges. Opportunities include developing products that align with market needs, leveraging digital technology to simplify services, and investing in human resource development, which simultaneously poses challenges for the industry. On the other hand, challenges include integrating technology with Sharia principles, competing with conventional financial institutions, addressing cybersecurity issues, and overcoming the limited financial literacy among the public.

Given these opportunities and challenges, Islamic banking in Indonesia must continuously innovate to remain competitive and meet societal needs. This can be achieved through several strategies, such as strengthening the development of products that align with market demands, enhancing financial literacy through more extensive education campaigns, and prioritizing data and transaction security. By implementing these steps, Islamic banking can continue to grow and innovate, ensuring its relevance in an increasingly competitive global market.

References

Abubakar, L., & Handayani, T. (2022). Penguatan Regulasi: Upaya Percepatan Transformasi Digital Perbankan Di Era Ekonomi Digital. Masalah-Masalah Hukum, 51(3), 259–270. https://doi.org/10.14710/mmh.51.3.2022.259-270

Ash-shiddiqy, M. (2023). Analisis Peluang dan Tantangan Perbankan Syariah di Era Digital. JASIE - Journal of Aswaja and Islamic Economics, 02(01), 9–16.

Badan Pusat Statistik. (2024). Juni 2024. Kma - Klinik Management Aktuell, 29(04), 4–5. https://doi.org/10.1055/s-0044-1787612

Bank Syariah Indonesia. (2023). Sejarah dan Perkembangan Bank Syariah di Indonesia. https://www.bankbsi.co.id/news-update/edukasi/sejarah-dan-perkembangan-bank-syariah-di-indonesia

Dr. Muhammad Ramdhan, S.Pd., M. M. (2021). Metode Penelitian (A. A. Effendy (ed.)). Cipta Media Nusantara. https://books.google.co.id/books?id=Ntw_EAAAQBAJ&lpg=PR1&ots=f3oE8PTwbB&dq=metode penelitian&lr&hl=id&pg=PR1#v=onepage&q=metode penelitian&f=false

Drs. Ismail, MBA., A. (2016). Perbankan Syariah (4th ed.). PRENADAMEDIA GRUP. https://books.google.co.id/books?id=X9xDDwAAQBAJ&lpg=PR5&ots=qA4_JDbAzi&dq=perbankan syariah&lr&hl=id&pg=PA22#v=onepage&q&f=false

Haerunnisa, & Sugitanata, A. (2024). Ekspolari Teori Distrupsi Digital Clayton Christenses dan Maqashid Syariah Terhadap Inovasi Perbankan Syariah di Era Digital. 03(01), 37–51.

Khatimah, U. (2022). Distribusi Hasil Usaha Menurut Sistem Perbankan Syariah Perspektif Manajemen Keuangan Syariah. 1–82. https://repository.iainpare.ac.id/id/eprint/3414/

Latifah, E., & Abdullah, R. (2022). Financial Technology (Fintech) Pada Perbankan Syariah: Aplikatif Dan Peran. JIAR : Journal Of International Accounting Research, 1(02), 99–115. https://doi.org/10.62668/jiar.v1i02.1130

Qothrunnada, N. A., Iswanto, J., Fitrotus, D., Hendrarti, B. G., & Subekan, S. (2023). Transformasi Digital Lembaga Keuangan Syariah: Peluang dan Implementasinya di Era Industri 4.0. Indonesian Journal of Humanities and Social Sciences, 4(3), 741–756. https://ejournal.iai-tribakti.ac.id/index.php/IJHSS

Sudarmanto, E., Yuliana, I., Wahyuni, N., Yusuf, S. R., & Zaki, A. (2024). Transformasi Digital dalam Keuangan Islam: Peluang dan Tantangan. Jurnal Ilmiah Ekonomi Islam, 10(1), 645. https://doi.org/10.29040/jiei.v10i1.11628

Suganda, R., Mujib, A., Ag, M., Syari, F., Islam, U., & Sunan, N. (2023). Analisis Terhadap Peluang Dan Tantangan Perbankan Syariah Pada Era Digital. JIEI: Jurnal Ilmiah Ekonomi Islam, 9(01), 677–683.

Sundari, C., Fajariah, M., Suryo, D., & Abdullah, F. (2019). Fenomena Digital 4.0. Jurnal Dimensi DKV Seni Rupa Dan Desain, 8(1), 47–58.

Sup, D. F. A., & Hartanto, S. (2020). Sejarah Perbankan Syariah (Dari Konseptual Hingga Institusional). Journal of Islamic Banking, I(Desember), 1–23.

Tazkiyyaturrohmah, R. (2020). PELUANG DAN TANTANGAN BANK SYARIAH DI ERA INDUSTRI 4.0 Institut Agama Islam Riyadlotul Mujahidin Ponorogo Endang Sriani Institut Agama Islam Negeri Salatiga Email : endangsriani@iainsalatiga.ac.id. Researchgate.Net, February 2020. www.researchgate.net/publication/364816360

Wahyudi, I., Qizam, I., Amelia, E., & Yama, I. (2024). Potensi Bisnis Perbankan Syariah Indonesia Tahun 2024: Peluang Dan Tantangan. Jurnal Lentera Bisnis, 13(1), 11. https://doi.org/10.34127/jrlab.v13i1.945

Zia Ulhaq, M., & Rasyad Al Fajar, M. (2022). Peluang Dan Tantangan Bank Syariah Di Era Digital. Jurnal Ekonomi Syariah, 5(1), 49–61. http://ejournal.iaimbima.ac.id/index.php/jesa