



# Institutional Development of the Islamic Capital Market in Indonesia: Concepts, Instruments, and Regulatory Challenges

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## Abstract

The Islamic capital market constitutes an essential component of the Islamic financial system, designed to provide investment mechanisms that comply with Sharia principles, particularly the prohibition of riba, gharar, and maisir. This study aims to examine the concept, institutional structure, instruments, economic functions, as well as the challenges and development strategies of the Islamic capital market in Indonesia. The research employs a qualitative descriptive approach with conceptual and normative analysis, based on a literature review of regulatory frameworks, fatwas issued by the National Sharia Council of Indonesia, and relevant academic and institutional publications. The findings indicate that the Islamic capital market in Indonesia has established a relatively sound conceptual and regulatory foundation through the integration of national capital market law and Sharia governance. The main instruments include Sharia-compliant equities, sukuk, and Islamic mutual funds, with the Jakarta Islamic Index serving as a benchmark for Sharia-based equity performance. Nevertheless, the development of the Islamic capital market remains constrained by limited investor literacy, shallow market depth, and the absence of a dedicated Islamic capital market law. This study highlights the need for strengthening the regulatory framework, expanding product innovation, and enhancing market literacy to maximize the contribution of the Islamic capital market to sustainable national economic development.

*Pasar modal syariah merupakan bagian penting dari sistem keuangan Islam yang bertujuan menyediakan mekanisme investasi yang sesuai dengan prinsip syariah, khususnya larangan riba, gharar, dan maisir. Penelitian ini bertujuan untuk mengkaji konsep, struktur kelembagaan, instrumen, fungsi ekonomi, serta kendala dan strategi pengembangan pasar modal syariah di Indonesia. Metode penelitian yang digunakan adalah pendekatan kualitatif deskriptif dengan analisis konseptual dan normatif, berbasis studi literatur terhadap regulasi, fatwa Dewan Syariah Nasional–Majelis Ulama Indonesia, serta publikasi akademik dan laporan institusional terkait pasar modal syariah. Hasil penelitian menunjukkan bahwa pasar modal syariah di Indonesia telah memiliki landasan konseptual dan regulasi yang relatif memadai melalui integrasi hukum nasional dan prinsip syariah. Instrumen utama yang berkembang meliputi saham syariah, sukuk, dan reksa dana syariah, dengan Jakarta Islamic Index berperan sebagai tolok ukur kinerja saham syariah. Namun demikian, pengembangan pasar modal syariah masih menghadapi berbagai kendala, antara lain keterbatasan literasi investor, rendahnya*



*kedalaman pasar, dan belum adanya undang-undang khusus pasar modal syariah. Penelitian ini menekankan perlunya penguatan kerangka regulasi, pengembangan produk, dan peningkatan literasi untuk mengoptimalkan kontribusi pasar modal syariah terhadap pembangunan ekonomi nasional yang berkelanjutan.*

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## **A. INTRODUCTION**

The development of the Islamic capital market in Indonesia represents a significant transformation within the national financial system. Its emergence is closely linked to Indonesia's demographic structure as the country with the largest Muslim population globally, which generates substantial demand for financial instruments aligned with Islamic principles. As awareness of Sharia-compliant finance increases, the need for investment mechanisms that integrate ethical considerations, legal compliance, and economic efficiency has become increasingly prominent (Ahmed, 2019).

Despite the rapid growth of the conventional capital market, a segment of Muslim investors with surplus funds has historically demonstrated reluctance to participate in conventional financial markets (Bashir et al., 1993). This hesitation is primarily associated with concerns regarding practices perceived as inconsistent with Sharia principles, including excessive speculation, interest-based transactions, high uncertainty, and market manipulation. Consequently, a considerable pool of potential investment capital has remained underutilized in supporting productive economic activities (Sholehuddin et al., 2026).

From a theoretical perspective, the capital market is designed to function as a financial intermediary that channels funds from surplus units to deficit units, particularly corporations seeking capital for business expansion (Rana et al., 2025). Through this intermediation process, capital markets are expected to contribute to long-term economic growth, employment creation, and increased productive capacity. However, empirical observations indicate that market activities are often dominated by short-term trading behavior aimed at capital gains, which may weaken the capital market's fundamental role in financing the real sector (Noor, 2025).

The Islamic capital market was introduced to address these structural limitations while adhering to Sharia principles. Unlike conventional investment frameworks that primarily emphasize return maximization, Islamic finance incorporates ethical and procedural dimensions into investment decisions (Elamin,

2023). Compliance with Sharia principles requires that both the instruments and transaction processes avoid prohibited elements such as *riba* (interest), *gharar* (excessive uncertainty), *maisir* (gambling), insider trading, margin trading, price manipulation, and speculative practices detached from real economic activities. As a result, the Islamic capital market seeks to promote investment activities that are transparent, equitable, and socially beneficial (Amrullah & Aini, 2024).

Although the Islamic capital market in Indonesia has demonstrated substantial growth potential, its development remains constrained by several challenges, including limited market depth, low investor literacy, regulatory complexities, and restricted product innovation (Alwi et al., 2021). These constraints highlight the importance of systematic academic inquiry to better understand the conceptual foundation and operational dynamics of the Islamic capital market, as well as to identify effective strategies for its sustainable development (Nawaz et al., 2024).

Accordingly, this study aims to examine the concept of the Islamic capital market, its institutional structure, underlying objectives, defining characteristics, and the key challenges and strategic approaches relevant to its development in Indonesia. By providing a comprehensive analysis, this paper seeks to contribute to the literature on Islamic finance and to offer insights for policymakers, regulators, and market participants concerned with strengthening Sharia-compliant capital market practices.

## **B. RESEARCH METHODOLOGY**

### **1. Research Design**

This study adopts a qualitative descriptive research design with a conceptual and normative analytical approach. The research focuses on examining the Islamic capital market by integrating regulatory analysis, theoretical frameworks of Islamic finance, and empirical insights from existing literature. This design is appropriate for exploring institutional structures, guiding principles, and development challenges of Sharia-compliant capital markets, particularly within the Indonesian context.

### **2. Data Sources**

The study relies exclusively on secondary data obtained from authoritative and credible sources. These include:

- a. Academic publications such as peer-reviewed journal articles, books, and conference proceedings related to Islamic finance and capital markets.

- b. Regulatory and policy documents issued by relevant institutions, including the Financial Services Authority (Otoritas Jasa Keuangan), the Indonesia Stock Exchange, the National Sharia Council of the Indonesian Council of Ulama (DSN-MUI), and international standard-setting bodies such as the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the Islamic Financial Services Board (IFSB).
- c. Statistical reports and market publications related to the performance and development of Islamic capital market instruments in Indonesia.

These data sources provide a comprehensive basis for understanding both the theoretical and institutional dimensions of the Islamic capital market.

### **3. Data Collection Technique**

Data were collected through a systematic literature review. Relevant publications were identified using academic databases such as Scopus, Web of Science, and Google Scholar, employing keywords including “Islamic capital market,” “Sharia-compliant securities,” “Islamic finance,” and “capital market development.” Inclusion criteria focused on publications that discuss conceptual foundations, regulatory frameworks, and practical implementation of Islamic capital markets, while excluding non-academic opinion pieces and non-peer-reviewed sources unless they constituted official regulatory documents.

### **4. Data Analysis Method**

The collected data were analyzed using qualitative content analysis. This method involves categorizing and interpreting textual data to identify recurring themes, conceptual patterns, and regulatory principles related to the Islamic capital market. The analysis was conducted in several stages: (1) classification of literature based on thematic relevance, (2) identification of key concepts and institutional features, (3) comparison between Islamic and conventional capital market practices, and (4) synthesis of findings to formulate insights regarding challenges and development strategies. To enhance analytical rigor, the study applies a comparative framework that contrasts Sharia-compliant principles with conventional capital market mechanisms, allowing for a clearer identification of distinctive characteristics and structural constraints.

## **5. Research Scope and Limitations**

The scope of this study is limited to the Islamic capital market in Indonesia, with particular emphasis on its conceptual foundation, institutional structure, and regulatory environment. While international references are incorporated for comparative and contextual purposes, the analysis does not extend to empirical testing or cross-country quantitative comparison. Consequently, the findings are primarily descriptive and exploratory in nature, serving as a basis for future empirical research.

### **C. RESULTS AND DISCUSSION**

#### **Results**

##### **1. Conceptual Foundation of the Islamic Capital Market in Indonesia**

The findings indicate that the Islamic capital market in Indonesia is conceptually defined as a capital market system in which all instruments, mechanisms, and operational processes comply with Sharia principles. Based on national legal definitions and Sharia regulations, Islamic capital market activities encompass the issuance and trading of Sharia-compliant securities, institutional intermediaries, and professional services that operate within Islamic legal and ethical boundaries.

The core conceptual distinction identified in the data lies in the prohibition of *riba*, *gharar*, and *maisir*, which fundamentally differentiates Islamic capital market practices from conventional capital market mechanisms (Sulhan et al., 2025). Investment activities are required to be linked to real economic activities and structured through permissible contracts such as *musyarakah*, *mudharabah*, *murabahah*, and *ijarah*. This conceptual framework positions the Islamic capital market not merely as a financial marketplace but as an extension of Islamic *muamalah* principles in the modern financial system (Al-Oqool et al., 2014).

##### **2. Institutional and Regulatory Structure**

The results show that the institutional development of the Islamic capital market in Indonesia is supported by a dual regulatory framework. On one side, national capital market regulations, particularly Law No. 8 of 1995, provide the legal foundation for securities issuance and trading. On the other side, Sharia compliance is ensured through fatwas issued by the National Sharia Council of the Indonesian Council of Ulama (DSN-MUI).

Six major DSN-MUI fatwas were identified as the primary normative references governing Islamic capital market operations, covering Sharia-compliant shares, *sukuk*,

Islamic mutual funds, and general guidelines for Sharia application in capital markets. The collaboration between regulatory authorities and Sharia institutions, formalized since 2003, represents a key structural element enabling the operationalization of Islamic capital market principles within Indonesia's existing legal system.

### **3. Development and Market Instruments**

The findings reveal that Islamic capital market products in Indonesia primarily consist of Sharia-compliant shares, sukuk, and Islamic mutual funds. Sharia shares are identified through sectoral screening and financial ratio thresholds to ensure that issuer activities do not involve prohibited elements. Sukuk instruments are structured as ownership-based securities backed by underlying assets or projects, distinguishing them from conventional debt instruments (Addury, 2018). Islamic mutual funds function as collective investment schemes managed under Sharia principles, offering diversification opportunities for retail investors with limited capital and expertise (Sukmana, 2020).

In addition, the Jakarta Islamic Index (JII) plays a significant role as a benchmark for Sharia-compliant equity performance. The index selection process applies both Sharia screening and financial performance criteria, ensuring that listed stocks maintain compliance and market liquidity. The periodic review of index components reflects an ongoing effort to eliminate speculative and non-compliant securities.

### **4. Functional Role in Economic Development**

The results indicate that the Islamic capital market serves multiple economic functions beyond financial intermediation. These include mobilizing surplus funds, facilitating corporate financing for business expansion, and promoting risk-sharing investment structures (Anwer, 2019). By linking investment returns to business performance, the Islamic capital market reduces dependence on interest-based income and encourages productive economic activities.

Furthermore, the Islamic capital market framework emphasizes transparency, accountability, and fairness, which are intended to reduce speculative behavior and short-term price manipulation (Hasnat et al., 2025). This structural orientation supports long-term investment horizons and aligns financial activities with broader socio-economic objectives, including employment creation and equitable wealth distribution.

## **5. Constraints in Islamic Capital Market Development**

Despite its potential, the results identify several persistent constraints hindering the development of the Islamic capital market in Indonesia. These include limited investor awareness and understanding of Sharia-compliant instruments, insufficient dissemination of market information, and the absence of a dedicated Islamic capital market law. The reliance on regulatory adaptations rather than a standalone legal framework has resulted in perceived uncertainty among market participants (Hoque & Liu, 2021).

Additional constraints include limited product diversity, especially within Islamic mutual fund portfolios, and institutional challenges related to supervision and enforcement. These limitations contribute to lower participation rates compared to conventional capital markets and reduce overall market depth.

## **6. Strategic Directions for Development**

The analysis highlights three primary strategic directions for strengthening the Islamic capital market: institutional building, regulatory framework enhancement, and product development (Prakoso et al., 2023). Institutional strengthening involves improving coordination between regulators, Sharia authorities, and market participants. Regulatory development requires harmonizing Sharia standards with international capital market principles while maintaining compliance with Islamic jurisprudence.

Product development strategies focus on expanding the range of Sharia-compliant securities and improving market incentives to attract issuers and investors (Ali et al., 2020). Academic engagement and practitioner involvement are also identified as critical components for increasing literacy, credibility, and sustainable growth of the Islamic capital market in Indonesia.

## **Discussion**

The findings of this study confirm that the Islamic capital market in Indonesia is not merely a parallel financial system but represents an institutional response to structural and ethical limitations observed in conventional capital markets. The conceptual emphasis on Sharia compliance, particularly the prohibition of *riba*, *gharar*, and *maisir*, aligns with prior literature that positions Islamic finance as an ethical alternative rather than a purely profit-maximizing framework. This reinforces the view

that Islamic capital markets seek to integrate financial efficiency with moral accountability and socio-economic responsibility (Supriani et al., 2025).

The dual regulatory structure identified in the results reflects a pragmatic adaptation of Islamic financial principles within a secular legal framework. The coexistence of national capital market regulations and DSN-MUI fatwas demonstrates that Sharia compliance in Indonesia operates through normative supplementation rather than legal substitution. This finding supports earlier studies suggesting that Islamic financial systems can function effectively within conventional legal environments, provided that Sharia governance mechanisms are institutionally recognized and operationally enforced (Alsaadi, 2024).

However, the absence of a dedicated Islamic capital market law remains a critical issue. While regulatory flexibility has facilitated early-stage development, reliance on fragmented legal instruments may constrain long-term growth and investor confidence (Ahmad Alserhan, 2010). This finding is consistent with comparative evidence from jurisdictions such as Malaysia, where comprehensive legal frameworks have contributed to deeper market penetration and stronger institutional legitimacy. The Indonesian case thus highlights a trade-off between regulatory adaptability and legal certainty in Islamic capital market development.

The dominance of Sharia-compliant equities, sukuk, and Islamic mutual funds indicates a relatively narrow product base, which limits market depth and diversification opportunities. Although the Jakarta Islamic Index plays a vital role in enhancing transparency and investor confidence, its function remains largely benchmark-oriented. This suggests that Islamic capital market development in Indonesia is still concentrated on screening conventional instruments rather than fostering innovation in genuinely risk-sharing financial products. Such a pattern may partially explain the lower participation rates compared to conventional markets (Prakoso et al., 2023).

From a functional perspective, the Islamic capital market's emphasis on asset-backed financing and profit-and-loss sharing mechanisms reflects its alignment with real sector activities. This supports theoretical arguments that Islamic finance can mitigate excessive speculation and financial instability by anchoring financial transactions to productive economic activities. Nevertheless, the persistence of speculative behavior in broader market practices indicates that Sharia compliance

alone is insufficient without effective supervision, enforcement, and investor education.

The constraints identified in this study underscore the importance of human capital and institutional literacy in Islamic capital market development. Limited awareness among investors and practitioners not only restricts demand but also weakens market credibility. This finding resonates with prior research emphasizing that regulatory reforms must be complemented by educational initiatives and academic engagement to ensure sustainable growth.

Strategically, the results suggest that future development should prioritize integrated institutional building, harmonized regulatory frameworks, and product innovation. Aligning Sharia standards with international capital market principles, while maintaining jurisprudential integrity, is essential to enhance competitiveness without compromising religious legitimacy. In this context, the Islamic capital market should be viewed not solely as a niche religious market but as a component of a broader ethical finance ecosystem capable of contributing to inclusive and sustainable economic development.

Overall, the discussion indicates that the Islamic capital market in Indonesia has established a solid normative and institutional foundation, yet its transformative potential remains underutilized. Addressing regulatory fragmentation, expanding product diversity, and strengthening market literacy are critical steps toward realizing its full economic and social contributions.

#### **D. CONCLUSION**

The Islamic capital market plays an increasingly important role in the era of globalization, particularly in Indonesia, where the majority of the population adheres to Islam. Its relevance lies not only in demographic considerations but also in its ability to offer an investment framework grounded in ethical principles, legal certainty, and equitable economic participation. By eliminating interest-based mechanisms and prohibiting elements such as *riba*, *maisir*, and *gharar*, the Islamic capital market provides an alternative that addresses long-standing concerns among Muslim investors regarding participation in conventional capital markets.

The implementation of Sharia principles within the capital market framework is further supported by Indonesia's national legal system, which generally aligns with Islamic contractual principles in areas such as fairness, transparency, and legal

accountability. With the exception of transactions involving interest and prohibited goods, national capital market regulations do not inherently conflict with Sharia norms. This compatibility creates a favorable institutional environment for the development of Sharia-compliant capital market instruments.

Nevertheless, the effective expansion of the Islamic capital market requires clear and specific regulatory arrangements. Differences in terminology and conceptual frameworks between Islamic jurisprudence and national legal traditions necessitate explicit Sharia certification to enhance investor confidence. In this regard, the role of regulatory authorities, particularly through coordination between capital market regulators and the National Sharia Council, is crucial in ensuring the credibility, standardization, and governance of Sharia-based securities.

Ultimately, the strengthening of the Islamic capital market has broader economic implications. Beyond serving religious compliance, it contributes to national economic development by mobilizing idle funds, supporting productive investment, and fostering inclusive growth. Therefore, the continued development of Sharia-compliant capital market products, supported by coherent regulation and institutional collaboration, is essential to maximize the Islamic capital market's contribution to sustainable economic growth in Indonesia.

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