

Islamic Financial System Maturity in the Digital Age: A Comparative Institutional Analysis of Indonesia and South Korea

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Abstract

Digital transformation has altered the structure and governance of financial systems, including Islamic finance, where institutional capacity and Sharia governance determine system sustainability. Existing studies emphasize that Islamic financial system maturity should be assessed beyond quantitative indicators by incorporating regulatory coherence, institutional effectiveness, and governance readiness in the digital era. This study aims to analyze the maturity of Islamic financial systems in Indonesia and South Korea from a comparative institutional perspective. Using a qualitative literature review method, this study positions the Islamic financial system at the country level as the unit of analysis and compares both countries across regulatory frameworks, institutional structures, and Sharia governance arrangements. Indonesia represents a Muslim-majority country with expanding Islamic finance activities, while South Korea offers insight into Islamic finance development within a non-Muslim-majority institutional context. The findings suggest that Indonesia demonstrates strong market potential but faces challenges related to regulatory integration, whereas South Korea exhibits a more selective and institution-driven approach to Sharia-compliant finance. These differences indicate that Islamic financial system maturity is shaped by institutional design and regulatory context rather than market size alone. This study concludes that an institutional perspective provides a more comprehensive framework for understanding Islamic financial system maturity in the digital age.

Keywords: Islamic Financial System, System Maturity, Institutional Framework, Sharia Governance, Digital Era, Indonesia, South Korea.

Introduction

The rapid advancement of digitalization has fundamentally reshaped financial systems across the globe, influencing not only how financial services are delivered but also how financial systems are regulated, governed, and sustained. This transformation extends to Islamic finance, which operates under specific Sharia principles requiring financial activities to adhere to ethical norms, risk-sharing arrangements, and prohibitions against *riba*, *gharar*, and *maysir*. In the digital age, the development of Islamic finance is therefore not merely a matter of technological adoption, but a systemic process that depends on institutional readiness, regulatory coherence, and effective Sharia governance. Previous studies in financial system literature emphasize that sustainable financial system development is closely linked to institutional quality and governance capacity rather than market expansion alone (Beck et al., 2007; Gomber et al., 2018).

Within Islamic finance research, system advancement has traditionally been assessed using quantitative indicators such as asset growth, market share, and the number of Islamic financial institutions. While these indicators reflect industry scale, they offer limited insight into the maturity of Islamic financial systems in managing digital transformation and maintaining Sharia compliance. Scholars argue that financial system maturity in the digital era should be understood through a broader institutional perspective that incorporates regulatory frameworks, supervisory effectiveness, and governance structures (Arner et al., 2017; Claessens et al., 2018). In the context of Islamic finance, this perspective is particularly relevant, as digital innovation introduces new regulatory and governance challenges that must be addressed without compromising Sharia principles. Hasan et al. (2020) highlight that transparency, accountability, and governance effectiveness are essential components in ensuring that Islamic financial systems remain resilient and

legitimate amid technological change.

Indonesia represents a prominent case of Islamic finance development within a Muslim-majority country, characterized by substantial market potential and increasing public demand for Sharia-compliant financial services. However, existing literature suggests that Indonesia's Islamic financial system continues to face challenges related to regulatory integration and institutional coordination, reflecting an evolving stage of system maturity. In contrast, South Korea offers a distinctive institutional context as a non-Muslim-majority country with an advanced digital financial infrastructure, where Islamic finance has developed selectively within broader regulatory and economic objectives. Studies on digital finance indicate that financial innovation in such contexts is strongly shaped by institutional pragmatism and regulatory alignment rather than religious demand alone (Arner et al., 2017; Gomber et al., 2018). The contrasting experiences of Indonesia and South Korea therefore provide a valuable comparative setting for examining how Islamic financial system maturity is shaped by differing institutional and regulatory environments.

Despite the growing body of literature on Islamic finance and digital financial systems, comparative studies that examine Islamic financial system maturity across fundamentally different socio-religious and institutional contexts remain limited. Most existing research focuses on comparisons among Muslim-majority countries, leaving a gap in understanding how Islamic finance evolves within non-Muslim-majority systems. Addressing this gap, this study aims to analyze Islamic financial system maturity in Indonesia and South Korea through a comparative institutional approach. By focusing on regulatory frameworks, institutional structures, and Sharia governance in the digital age, this study seeks to contribute to a more comprehensive and context-sensitive understanding of Islamic financial system development beyond conventional quantitative assessments.

Literature Review and Conceptual Framework

Islamic financial systems are an integral component of the broader Islamic economic framework, designed to facilitate financial intermediation while adhering to Sharia principles that emphasize ethical conduct, risk sharing, transparency, and social justice. Unlike conventional financial systems, Islamic financial systems operate under normative constraints that prohibit *riba*, *gharar*, and *maysir*, thereby requiring a governance structure that ensures both financial stability and Sharia compliance. Prior literature emphasizes that Islamic finance should not be understood merely as an alternative set of financial products, but as a comprehensive system encompassing regulatory frameworks, institutional arrangements, supervisory mechanisms, and Sharia governance structures (Hasan et al., 2020; Razak et al., 2020). Consequently, the development and sustainability of Islamic financial systems are closely linked to institutional quality and governance effectiveness, aligning with broader financial system theories that associate system advancement with regulatory coherence and institutional capacity rather than market size alone (Beck et al., 2007).

In the context of financial system development, the concept of system maturity has been widely discussed as a reflection of a system's ability to operate efficiently, remain stable, and adapt to structural change. Financial system maturity is commonly associated with well-established regulatory frameworks, effective supervisory institutions, and the capacity to manage innovation without generating systemic risk (Claessens et al., 2018). Digitalization intensifies this requirement, as technological innovation reshapes financial intermediation, alters risk profiles, and challenges existing regulatory boundaries. Arner et al. (2017) argue that digital finance and fintech developments necessitate a reconceptualization of financial regulation,

emphasizing adaptive regulatory approaches and stronger institutional coordination. Within Islamic finance, this challenge is compounded by the need to integrate technological innovation with Sharia governance, making institutional readiness a central determinant of system maturity. Thus, Islamic financial system maturity in the digital age should be understood as the capacity of a system to integrate digital innovation within a coherent regulatory and institutional framework while maintaining Sharia legitimacy.

Existing literature on Islamic finance development has predominantly relied on quantitative indicators such as asset growth, market penetration, and the number of Islamic financial institutions. While these measures provide insight into industry expansion, several scholars highlight their limitations in capturing structural and governance-related dimensions of system development (Hasan et al., 2020; Alshater et al., 2022). Alshater et al. (2022) emphasize that challenges in Islamic finance development often stem from weak regulatory frameworks, limited institutional coordination, and insufficient governance capacity rather than technological constraints. This observation aligns with digital finance literature suggesting that financial innovation is not a neutral or autonomous process, but one that is deeply shaped by institutional environments and regulatory design (Gomber et al., 2018). Therefore, assessing Islamic financial systems through an institutional lens allows for a more comprehensive understanding of how governance quality, regulatory clarity, and supervisory effectiveness influence system outcomes in the digital era.

Sharia governance constitutes a distinguishing feature of Islamic financial systems and plays a critical role in determining system legitimacy and sustainability. Sharia governance frameworks involve formal institutions, such as Sharia supervisory boards and national Sharia authorities, as well as regulatory mechanisms that ensure

compliance across financial activities. Studies indicate that strong and centralized Sharia governance contributes to regulatory certainty, public trust, and system stability, whereas fragmented or weak Sharia oversight may hinder innovation and undermine confidence in Islamic finance (Razak et al., 2020; Hasan et al., 2020). In the digital age, Sharia governance faces additional complexity as new financial technologies introduce novel contractual forms and operational models that require continuous interpretation and supervision. As such, the effectiveness of Sharia governance must be evaluated alongside broader regulatory and institutional structures when assessing Islamic financial system maturity.

Comparative studies in Islamic finance highlight significant cross-country variation in system development, largely attributable to differences in regulatory frameworks and institutional arrangements rather than religious demographics alone. Research comparing Islamic finance across jurisdictions demonstrates that countries with integrated legal frameworks and clear institutional mandates tend to exhibit more stable and mature Islamic financial systems (Claessens et al., 2018). However, most comparative analyses focus on Muslim-majority countries with relatively similar socio-religious contexts, limiting their ability to explain how Islamic finance develops within fundamentally different institutional environments. The inclusion of non-Muslim-majority countries, such as South Korea, provides a valuable extension to existing literature by illustrating how Islamic finance can emerge and operate within regulatory systems primarily designed for conventional finance. Digital finance literature suggests that in such contexts, Islamic finance development is driven by institutional pragmatism, regulatory flexibility, and alignment with broader financial system objectives rather than religious demand alone (Arner et al., 2017; Gomber et al., 2018).

Based on the reviewed literature, this study adopts a conceptual framework that positions Islamic financial system

maturity as an institutional construct shaped by three interrelated dimensions: regulatory framework, institutional structure, and Sharia governance in the digital environment. Regulatory framework refers to the extent to which laws and regulations provide clarity, consistency, and adaptability for Sharia-compliant financial activities. Institutional structure encompasses the roles and coordination of financial authorities, supervisory bodies, and supporting institutions within the Islamic finance ecosystem. Sharia governance reflects the mechanisms through which Sharia compliance is interpreted, enforced, and integrated into financial system oversight. Digitalization is treated as a contextual force that interacts with these dimensions, intensifying the need for institutional coordination and regulatory adaptability. Rather than positioning technology as a primary driver, this framework emphasizes that the maturity of Islamic financial systems in the digital age is determined by their capacity to manage innovation within coherent institutional and governance arrangements. This conceptualization provides a basis for comparative analysis between Indonesia and South Korea, enabling a context-sensitive assessment of Islamic financial system maturity beyond conventional quantitative indicators.

Research Methodology

This study employs a qualitative research approach using a literature review method to analyze Islamic financial system maturity in Indonesia and South Korea from an institutional perspective. A qualitative approach is considered appropriate because the objective of this study is not to test causal relationships or produce statistical generalizations, but to develop a conceptual and systemic understanding of how Islamic financial systems evolve in the digital age. Islamic financial system maturity is treated as an institutional and governance-related construct at the country level, encompassing regulatory frameworks, institutional structures, and Sharia

governance arrangements. As such, it cannot be adequately captured through quantitative indicators alone, making qualitative analysis particularly relevant for this research (Beck et al., 2007; Hasan et al., 2020).

The literature review method is adopted to synthesize existing academic and policy-oriented studies on Islamic finance, financial system development, and digital finance. Prior research emphasizes that discussions on Islamic financial system development and Sharia governance predominantly evolve through conceptual, regulatory, and institutional analyses rather than purely empirical measurement (Alshater et al., 2022). Accordingly, this study relies on secondary data obtained from peer-reviewed international journals, scholarly books, and policy documents related to Islamic finance regulation, digital financial systems, and institutional governance. The selection of literature follows a purposive approach, prioritizing sources that are academically credible, theoretically relevant, and aligned with the study's conceptual framework. Key references include studies addressing financial system maturity, institutional quality, digital finance regulation, and Sharia governance across different jurisdictions.

The unit of analysis in this study is the Islamic financial system at the country level. Indonesia and South Korea are selected as comparative cases due to their contrasting institutional and socio-religious contexts. Indonesia represents a Muslim-majority country with an expanding Islamic finance sector embedded within a developing regulatory environment, while South Korea represents a non-Muslim-majority country with an advanced digital financial infrastructure where Islamic finance operates selectively within broader financial system objectives. This comparative design enables the examination of how differing regulatory frameworks and institutional arrangements shape Islamic financial system maturity beyond religious demographics. The comparative analysis focuses on three main

dimensions derived from the conceptual framework: regulatory framework, institutional structure, and Sharia governance in the digital environment.

Data analysis is conducted through qualitative content analysis, which involves systematic interpretation of selected literature to identify recurring concepts, themes, and patterns related to Islamic financial system maturity. The analysis examines how regulatory clarity, institutional coordination, and Sharia governance mechanisms are discussed and implemented within each country's financial system context. Cross-country comparison is performed at a conceptual level by contrasting institutional characteristics rather than numerical indicators, allowing for a context-sensitive interpretation of similarities and differences between Indonesia and South Korea. This approach aligns with digital finance literature emphasizing that financial system development reflects institutional readiness and governance capacity rather than technological adoption alone (Arner et al., 2017; Gomber et al., 2018).

To enhance analytical rigor, the study employs a structured analytical framework based on predefined dimensions derived from the literature review. This framework guides data interpretation and minimizes subjective bias by ensuring consistency across sources and cases. Nevertheless, this study is subject to certain limitations. The reliance on secondary data and qualitative interpretation means that the findings are inferential and conceptual rather than empirically measurable. The study does not attempt to construct a quantitative index of Islamic financial system maturity, but instead aims to provide a theoretically grounded and contextually rich assessment of institutional dynamics. These limitations also present opportunities for future research to extend the framework through empirical testing or mixed-method approaches across a broader set of countries.

Results and Discussion

The comparative analysis indicates that Islamic financial system maturity in Indonesia and South Korea is primarily shaped by the configuration and effectiveness of financial authorities, regulatory mandates, and institutional coordination mechanisms rather than market size or religious composition alone. In Indonesia, the Islamic financial system operates within a multi-authority regulatory environment involving the Financial Services Authority (Otoritas Jasa Keuangan/OJK), Bank Indonesia (BI), and the National Sharia Council– Indonesian Ulema Council (DSN-MUI). This institutional arrangement reflects a strong normative commitment to Islamic finance development, supported by dedicated regulations, supervisory frameworks, and national strategies for Islamic economic growth. However, the literature suggests that such institutional plurality also increases the complexity of regulatory coordination, particularly in managing cross-sectoral digital financial activities that intersect banking, fintech, and capital markets.

From a regulatory perspective, OJK plays a central role in supervising Islamic banking, Islamic non-bank financial institutions, and Sharia-compliant fintech, while Bank Indonesia is responsible for monetary policy and payment system stability, including the development of digital payment infrastructure. The presence of DSN-MUI as the authoritative body issuing Sharia rulings adds an additional governance layer that enhances Sharia legitimacy but also requires continuous coordination with financial regulators. In the digital era, this multi-layered governance structure presents both strengths and challenges. On one hand, it ensures strong Sharia oversight and public trust; on the other, it may slow regulatory responsiveness to rapid technological innovation if coordination mechanisms are not sufficiently adaptive. These findings are consistent with financial regulation literature emphasizing that regulatory fragmentation can constrain innovation when institutional coordination

mechanisms are weak (Arner et al., 2017).

In contrast, South Korea's financial regulatory architecture is characterized by a more centralized and streamlined institutional structure. Financial regulation and supervision are primarily conducted by the Financial Services Commission (FSC) and the Financial Supervisory Service (FSS), which oversee the entire financial system, including banking, capital markets, and digital finance. Islamic finance activities in South Korea are not governed by a dedicated Sharia regulatory framework but are accommodated within existing conventional financial regulations, particularly in areas such as sukuk issuance, Islamic investment products, and cross-border financial services. This approach reflects a pragmatic regulatory orientation that prioritizes financial stability, investor protection, and digital innovation over the formal institutionalization of Islamic finance.

The findings suggest that South Korea's centralized regulatory model enhances regulatory coherence and facilitates rapid adaptation to digital financial developments. The FSC's proactive stance on fintech regulation and regulatory sandbox initiatives allows new financial products, including Sharia-compliant instruments, to be tested within a controlled regulatory environment. Although Sharia governance in South Korea is not institutionalized at the national level, Islamic financial activities rely on private Sharia advisory arrangements and international standards, enabling flexibility while maintaining functional compliance. This contrasts with Indonesia's formalized Sharia governance model, highlighting that institutional maturity can manifest through different governance configurations depending on national context.

Institutional structure further differentiates the maturity trajectories of the two countries. Indonesia's Islamic financial ecosystem includes a wide range of specialized institutions, such as full-fledged Islamic banks, Sharia business units, Islamic capital market instruments, and

national Sharia governance bodies. This institutional depth supports long-term system development but also requires strong inter-agency coordination, particularly in the digital finance domain where boundaries between financial sectors are increasingly blurred. South Korea, by comparison, operates with fewer specialized Islamic finance institutions, resulting in a leaner institutional structure that enables faster policy alignment and regulatory implementation, albeit with limited Islamic finance market penetration.

Overall, the enriched findings reinforce the argument that Islamic financial system maturity in the digital age is fundamentally institutional in nature. Indonesia demonstrates strong normative legitimacy and institutional depth supported by OJK, BI, and DSN-MUI, yet continues to face challenges related to regulatory integration and digital adaptability. South Korea, supported by the centralized authority of the FSC and FSS, exhibits a form of institutional maturity characterized by regulatory coherence and digital readiness, despite the limited scale of Islamic finance activities. These contrasting models illustrate that effective financial authorities, regulatory clarity, and institutional coordination are decisive factors in shaping Islamic financial system maturity, offering important insights for policymakers and regulators seeking to strengthen Islamic finance within diverse financial system environments.

Conclusion and Recommendations

This study analyzes Islamic financial system maturity in Indonesia and South Korea through a comparative institutional lens, emphasizing the interaction between regulatory frameworks, institutional structures, and Sharia governance in the digital age. The findings confirm that Islamic financial system maturity is not solely determined by the scale of the Islamic finance industry or the religious composition of the population, but is fundamentally shaped by the effectiveness of financial authorities, the coherence of regulatory design, and the capacity of

governance institutions to adapt to digital transformation. Indonesia demonstrates a relatively advanced Islamic finance ecosystem with strong normative legitimacy, supported by specialized regulatory and Sharia institutions such as the Financial Services Authority (OJK), Bank Indonesia, and the National Sharia Council (DSN-MUI). Nevertheless, the study finds that institutional complexity and fragmented regulatory responsibilities continue to pose challenges, particularly in integrating digital financial innovation into Sharia-compliant frameworks. These challenges indicate that Indonesia's Islamic financial system has reached an intermediate stage of maturity, where institutional depth exists but requires stronger coordination and adaptive governance to fully support digital transformation.

In contrast, South Korea represents a distinct and non-conventional pathway of Islamic finance development. Operating within a non-Muslim-majority context, Islamic finance in South Korea is embedded within a centralized and technologically advanced regulatory system overseen by the Financial Services Commission and the Financial Supervisory Service. Although Islamic financial activities remain limited in scale and scope, the regulatory environment demonstrates high levels of coherence, institutional clarity, and digital readiness. The absence of a formalized national Sharia governance framework constrains the expansion and institutionalization of Islamic finance, yet the system benefits from regulatory pragmatism and streamlined decision-making processes. This comparison illustrates that institutional maturity in Islamic finance can manifest not only through comprehensive system development, as in Indonesia, but also through selective integration within a robust conventional financial framework, as observed in South Korea.

The comparative results underscore that Islamic financial system maturity in the digital age is inherently multidimensional and context-specific.

Indonesia's formalized Sharia governance structure enhances public trust and regulatory legitimacy, but also necessitates continuous institutional alignment to avoid regulatory overlap and delays in responding to digital innovation. South Korea's centralized regulatory model facilitates faster adaptation to fintech and digital finance developments, yet limits the normative and institutional depth of Islamic finance due to the absence of dedicated Sharia oversight. These contrasting institutional configurations demonstrate that system maturity should be assessed based on governance capacity, regulatory adaptability, and institutional coherence rather than quantitative growth indicators alone. The findings therefore support the study's conceptual framework, which positions institutional quality and governance effectiveness as core determinants of Islamic financial system maturity.

From a policy perspective, the findings offer several important implications. For Indonesia, strengthening inter-agency coordination among OJK, Bank Indonesia, and Sharia governance institutions is essential to enhance regulatory efficiency and digital responsiveness. Policymakers should prioritize the development of integrated regulatory frameworks that align Islamic banking, Islamic capital markets, and Sharia-compliant fintech under a coherent supervisory approach. Enhancing the capacity of Sharia governance institutions to engage proactively with digital innovation—through regulatory dialogue, adaptive fatwa issuance, and collaboration with financial technology stakeholders—would further support sustainable system development. Additionally, regulatory sandbox initiatives tailored to Sharia-compliant financial innovation could serve as a mechanism to balance experimentation with risk management.

For South Korea, policymakers may consider adopting a more structured approach to Islamic finance governance without compromising regulatory pragmatism. Establishing clearer regulatory guidelines for Sharia-compliant financial instruments, particularly in areas such as sukuk issuance, Islamic investment funds, and cross-border financial services, could enhance market clarity and investor confidence. While a fully centralized Sharia governance framework may not be necessary, institutional recognition of Sharia advisory mechanisms aligned with international standards could facilitate deeper engagement with global Islamic financial markets. Such measures would allow South Korea to leverage its advanced digital financial infrastructure while expanding its role within the global Islamic finance ecosystem.

Academically, this study contributes to the Islamic finance literature by advancing an institutional framework for assessing Islamic financial system maturity in the digital age and extending comparative analysis beyond Muslim-majority countries. By incorporating a non-Muslim-majority context, the study highlights alternative institutional pathways of Islamic finance development and challenges conventional assumptions regarding the determinants of system maturity. However, the study is subject to limitations due to its reliance on qualitative secondary data and conceptual analysis. Future research may extend this framework through empirical validation, mixed-method approaches, or broader cross-country comparisons involving different regulatory and institutional settings. Such extensions would further enhance understanding of how Islamic financial systems evolve amid ongoing digital transformation and institutional change.



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