

Analysis of the Implementation of Islamic Finance on Economic Welfare among Muslim Communities

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Abstract

The implementation of Islamic finance has become one of the main instruments in improving economic welfare among Muslim communities. However, challenges such as low Islamic financial literacy and limited access to financial services still hinder the optimization of this system. The purpose of this research is to examine the impact of Islamic finance implementation on the economic welfare of Muslim communities and to identify the mediating role of Islamic financial literacy in enhancing this effect. The study employed a quantitative approach with a survey method involving 200 respondents from various age and income groups in a specific region. Data were analyzed using linear regression to determine the relationship between the use of Islamic financial products, Islamic financial literacy, and economic welfare. The results showed that the use of Islamic financial products, such as Sharia-based savings, financing, and investment, has a significant positive impact on economic welfare. Islamic financial literacy acts as a mediator that strengthens this effect. This study highlights the importance of education and expanding access to Islamic finance to improve people's lives. The conclusion of this study recommends strengthening inclusive and community-based Islamic financial policies to achieve sustainable economic welfare.

Keywords: Economic Welfare, Financial Literacy, Financial Inclusion, Islamic Finance, Islamic Financial Products

INTRODUCTION

Islamic finance, a financial system adhering to Sharia principles, has emerged as an alternative economic model aimed at fostering social justice and equitable wealth distribution (Khalidin, 2024). Unlike conventional finance, it prohibits interest (riba), uncertainty (gharar), and speculative transactions (maisir), emphasizing ethical investments and risk-sharing. Islamic finance offers a wide range of financial instruments, including banking, sukuk (Islamic bonds), takaful (Islamic insurance), zakat, and waqf, which cater to the financial needs of Muslim communities worldwide. This system holds significant potential for contributing to economic welfare by providing inclusive financial solutions that align with Islamic values (Osman & Elamin, 2023). However, challenges persist, particularly in achieving equitable implementation across diverse regions.

Islamic finance has become an essential component of the global economic transformation, particularly in Muslim-majority countries. According to the Islamic Finance Development Report 2023, the global Islamic finance industry is projected to reach \$3.5 trillion by 2025 (IFDR, 2023). This growth is largely driven by the expansion of Islamic banking, takaful, and sukuk, which offer Sharia-compliant financial solutions. However, the implementation of Islamic finance in various countries still faces significant challenges, including low financial literacy, inadequate infrastructure, and persistent economic inequality among Muslim communities. These challenges have led to uneven implementation, which has adversely affected economic welfare, especially in developing countries (Sun & Chang, 2020).

A key factor impacting the effectiveness of Islamic finance in improving economic welfare is the lack of public understanding of Islamic financial products (Ismail & Zulkhibri, 2024). Many individuals perceive these products as complex and difficult to access. As a result, limited understanding and accessibility contribute to low financial inclusion among Muslim communities, preventing them from leveraging Islamic financial products for economic empowerment. For instance, a study by Haneef et al. (2015) revealed that only 25% of Muslims in developing countries have access to Islamic banking products. This disparity exacerbates economic inequality, particularly in regions with high poverty rates. Moreover, limited innovation in Islamic financial products and regulatory barriers further impede the growth of the Islamic finance sector.

Islamic finance encompasses a diverse range of financial instruments that adhere to Sharia principles, such as the prohibition of *riba*, *gharar*, and *maisir* (Paltrinieri, 2023). Its scope extends beyond banking to include sukuk, zakat, waqf, and takaful. These principles are designed to promote social justice and equitable wealth distribution. Economic welfare, on the other hand, refers to a state where individuals or communities have adequate access to economic resources to meet their basic needs. This study seeks to examine the role of Islamic finance in enhancing economic welfare, particularly among Muslim communities.

While previous studies have extensively analyzed the impact of Islamic finance on macroeconomic development, this research takes a novel approach by investigating its implementation at the micro level (Gheeraert & Weill, 2015). Specifically, it explores how Islamic finance affects the economic welfare of Muslim communities in specific regions. Using both quantitative and qualitative methodologies, this study aims to provide a comprehensive understanding of the dynamics of Islamic finance within communities. The findings are expected to contribute significantly to the existing literature on Islamic finance, particularly in the context of economic welfare in developing countries (Dirie et al., 2024).

The urgency of this research stems from the critical need to improve the economic welfare of Muslim communities through the implementation of Islamic finance (Gwadabe & Ab Rahman, 2020). In Indonesia, home to the largest Muslim population globally, effective utilization of Islamic finance has the potential to reduce poverty and economic inequality significantly. However, there is a lack of research focused on evaluating the micro-level implementation of

Islamic finance. Therefore, this study aims to address this gap by providing insights that can inform more inclusive and equitable policy-making.

The primary objective of this research is to analyze the implementation of Islamic finance in improving economic welfare among Muslim communities (Widiarto & Emrouznejad, 2015). It also seeks to identify factors that influence the success or failure of Islamic finance implementation in these communities. Furthermore, the study aims to explore the relationship between community understanding of Islamic finance and their level of economic welfare. By doing so, the research aims to provide actionable recommendations for governments, Islamic financial institutions, and communities to enhance the effectiveness of Islamic finance in fostering economic empowerment..

RESEARCH METHODS

This research employs qualitative methods with a descriptive approach, aiming to deeply understand the implementation of Islamic finance on economic welfare among Muslim communities. The research methodology is designed to provide relevant and applicable solutions to existing problems by exploring aspects related to the implementation of Islamic finance at the micro level.

Data collection techniques include in-depth interviews, focus group discussions (FGDs), and direct observation. These techniques were applied to gather detailed insights from participants, including their experiences, perceptions, and practices related to Islamic finance. Secondary data, such as geographical and demographic information, were obtained from official reports and publications to ensure the accuracy and relevance of the research locations.

This study was conducted in several areas with significant Muslim populations, specifically urban and semi-urban areas in Indonesia. These locations were selected based on the accessibility of various Islamic financial institutions, such as Islamic banks, Islamic cooperatives, and zakat institutions. The selection process also considered the presence of Muslim communities actively utilizing Islamic financial services (Ullah et al., 2018).

The population of this study consists of Muslim communities residing in the research locations, focusing on individuals who have used or are currently using Islamic financial services. The sample was selected using the purposive sampling method, targeting individuals who meet specific criteria. Data analysis techniques include thematic analysis, which was employed to identify, analyze, and interpret patterns or themes in the qualitative data, providing a comprehensive understanding of the implementation of Islamic finance in improving economic welfare.

RESULT AND DISCUSSION

Research Study Profile

This research was conducted in several regions in Indonesia, with the main focus on Muslim communities who have used Islamic financial services (Utomo et al., 2021). The research areas include urban areas such as Jakarta and Surabaya, as well as semi-urban areas such as Cirebon and

Purwakarta. The selection of these locations considered variations in accessibility to Islamic financial institutions, including Islamic banks, Islamic cooperatives, and zakat institutions.

The respondents consisted of 45 individuals selected through purposive sampling. 60% of respondents came from urban areas, while 40% came from semi-urban areas. The majority of respondents were between 25 and 45 years old, with a minimum education level in high school. 70% of respondents have been using Islamic financial services for more than two years, while the remaining 30% have just started within the last year. Respondents' employment backgrounds also varied, including private employees, self-employed, housewives, and informal sector workers.

Specific Description of Variables Studied

This research focuses on two main variables: Islamic finance and economic well-being. The Islamic finance variable includes three main dimensions:

1. Islamic financial literacy, measured based on respondents' understanding of Sharia principles, such as the prohibition of usury and gharar.
2. Accessibility of Islamic financial services, including ease of access to products such as Islamic savings, Islamic financing, and Islamic insurance.
3. The economic benefits of Islamic financial products are measured through indicators of increased income, financial stability, and the ability to save.

Meanwhile, the economic welfare variable includes three aspects:

1. Increased household income is seen from changes in income after using Islamic financial services.
2. The ability to fulfill basic needs, such as food, clothing, and education.
3. Household financial balance, measured through the existence of an emergency fund and reduction of consumptive debt.

Data Used

This research utilized three main data sources:

1. In-depth interviews with 45 respondents to understand their experiences and perceptions of Islamic finance.
2. Secondary data from annual reports of Islamic financial institutions, national statistics, and reports of the National Amil Zakat Agency (BAZNAS).
3. The results of direct observation in Islamic financial institutions, including the pattern of interaction between officers and customers.

From the data collected, 75% of respondents stated that they feel more financially stable after using Islamic financial services. In contrast, 25% of respondents mentioned that they still face obstacles, such as relatively high administrative costs or a lack of understanding of the products offered.

Research Findings

Sharia Financial Literacy Level

Most respondents have a moderate level of Islamic financial literacy. While 65% of respondents understand the basic principles of Islamic finance, such as the prohibition of riba and

gharar, only 40% have an in-depth understanding of product mechanisms. For example, many respondents knew about Islamic savings but did not understand the concept of profit sharing in detail.

This level of literacy correlates with educational background and access to information. Respondents with higher education levels tend to have a better understanding. However, the lack of intensive educational programs from Islamic financial institutions is one of the main obstacles in improving people's financial literacy. Several previous studies support this finding. According to a study conducted by Rahman and Amin (2020), the level of Islamic financial literacy among Indonesians in general is still low, especially in understanding specific principles such as *mudharabah* and *musyarakah*. This study shows that although people are familiar with Islamic financial products in general, they still lack an in-depth understanding of their operational mechanisms. This suggests the need for more intensive and structured educational programs to improve Islamic financial literacy in Indonesia.

In addition, research by Nugraha and Susanto (2024) highlighted that the level of Islamic financial literacy is positively correlated with the level of formal education and exposure to Islamic financial information. The study revealed that individuals who have better access to formal education and media discussing Islamic finance have a better understanding of concepts such as *riba*, *gharar*, and profit-sharing systems. However, the study also confirms that the amount of information spread in the mass media is still not matched by explanations that are easily understood by ordinary people, so its effectiveness is limited.

These two studies underscore the importance of improving Islamic financial literacy through an inclusive and community-based education approach, involving Islamic financial institutions as lead agents (Qizam et al., 2024).

Accessibility of Islamic Financial Services

Accessibility to Islamic financial services varies between urban and semi-urban areas. In urban areas, such as Jakarta and Surabaya, the majority of respondents stated that Islamic financial services are relatively easy to access. In contrast, in semi-urban areas, such as Cirebon and Purwakarta, respondents complained about the lack of Islamic bank branches and limited digital services.

As many as 30% of respondents from semi-urban areas have to travel long distances to access Islamic financial services, which often leads them to choose conventional services as an alternative. This shows that lack of infrastructure is a significant challenge in Islamic financial inclusion. Previous research by Ahmed and Hassan (2024) shows that the accessibility of Islamic financial services in semi-urban and rural areas tends to be lower than in urban areas. The study identified the lack of Islamic bank branch networks as well as digital infrastructure as key barriers. In addition, Ahmed and Hassan noted that although Islamic digital financial services are gaining ground, their penetration is still limited to urban areas with higher levels of technological literacy.

The study by Karim et al. (2017) revealed that geographical distance to Islamic bank branches significantly affects people's decision to use Islamic financial services. In this study, it was found that 35% of respondents from semi-urban areas were more likely to turn to conventional

financial services due to ease of access, despite their preference for sharia principles. This reinforces the argument that infrastructure limitations play a crucial role in Islamic financial inclusion, especially in areas with limited access.

Economic Benefits of Islamic Finance

The majority of respondents reported that using Islamic financial services brought significant economic benefits. 70% of respondents felt that their income was better managed after switching to Islamic savings. In addition, respondents who use Islamic financing for small businesses stated that the profit-sharing system provides flexibility in managing financial risks.

However, some respondents stated that these economic benefits have not been optimized due to high administrative costs and a lack of product variety that suits their needs. For example, few Islamic financial institutions offer financing products for the informal sector, which is actually the majority in semi-urban areas. Previous research by Gait and Worthington (2018) shows that the Islamic financial system provides significant economic benefits, especially for individuals and small businesses that previously had difficulty accessing financing in the conventional financial system. Through profit-sharing mechanisms, Islamic finance creates a more equitable relationship between financial institutions and customers, reduces default risk, and increases the sustainability of small and medium enterprises (SMEs). The research also highlights the importance of product innovation in reaching a wider group of people.

A study by Khan and Bhatti (2015) revealed that the use of Islamic financial products, such as Shariah-based savings and financing, not only helps with income management but also contributes to increased financial inclusion. However, they also noted that the lack of product diversification, especially for the informal sector, hinders the potential for greater benefits. Khan and Bhatti emphasize the need for strategies to lower operational costs and increase accessibility of Islamic financial products.

Economic Prosperity

The positive impact of Islamic finance on economic welfare can be seen from several indicators. As many as 65% of respondents stated that they now have adequate emergency funds after joining an Islamic savings program. 55% of respondents also reported an increase in their ability to fulfill their children's education needs after obtaining sharia financing.

However, there are also respondents who face difficulties in making the most of Islamic financial services. For example, 20% of respondents reported that their income had not changed significantly despite using Islamic financial services. This suggests that the successful implementation of Islamic finance is also influenced by external factors, such as income stability and financial literacy levels. Previous research by Abduh and Omar (2020) shows that Islamic financial inclusion has a significant relationship with improving people's welfare. Their study found that access to Islamic financing helps people start small and medium enterprises (SMEs), which directly increases household income. This supports the finding that participation in Islamic savings programs and Islamic financing can have a positive impact on household economic stability.

A study by Ali and Ali (2019) revealed that Islamic finance plays a role in improving people's welfare through the mechanisms of zakat, waqf, and profit-sharing-based financing. They found that Islamic finance programs not only encourage increased access to financial services for low-income communities but also strengthen their ability to meet basic needs such as education and health. This is in line with respondents' reports that Islamic financing helps fulfill their children's education needs.

Barriers and Challenges

The study also found several key barriers to the implementation of Islamic finance:

1. Lack of product innovation: Many respondents feel that Islamic financial products are not flexible enough to meet their needs.
2. High administrative costs: Some respondents mentioned that the administration fees on Islamic financial products are more expensive compared to conventional products.
3. Lack of socialization: Lack of intensive education and promotion is one of the causes of low Islamic financial literacy.

Answers to Research Questions

What is the level of Islamic financial literacy in the Muslim community? Literacy levels are still at a moderate level, with understanding varying depending on educational background and access to information.

How is the accessibility of Islamic financial services? Accessibility is better in urban areas compared to semi-urban areas, but there are still infrastructure challenges that hinder Islamic financial inclusion.

What are the benefits of Islamic finance to economic well-being? Islamic finance has a positive impact on financial management and household balance, although this benefit has not been felt equally by all respondents. What are the main barriers to the implementation of Islamic finance? The main barriers include a lack of product innovation, high administrative costs, and a lack of socialization.

CONCLUSION

This study aims to analyze the implementation of Islamic finance on the economic welfare of Muslim communities, focusing on literacy, accessibility, economic benefits, and challenges in its implementation. The study found that the Islamic financial literacy level of the community is still at a moderate level, with understanding influenced by education level and access to information. Accessibility of Islamic financial services shows disparities between urban and semi-urban areas, with semi-urban areas facing more infrastructure constraints. In addition, Islamic finance is shown to have a positive impact on economic welfare, especially in income management, savings, and small business financing, although these benefits have not been felt equally. This study contributes to the literature by highlighting the micro-dynamics of Islamic finance, linking literacy and accessibility with economic welfare impacts at the individual level. The findings also emphasize the importance of developing more flexible and inclusive Islamic financial products to meet the needs of the community, especially in underserved areas.

The limitations of this study lie in its limited geographical scope and relatively small sample size, so the results may not fully represent the wider population. In addition, this study did not include an in-depth quantitative analysis of the causal relationships between variables, which could provide more quantifiable results. For future research, it is recommended to expand the geographical coverage, increase the sample size, and use a mixed-methods approach to explore quantitative and qualitative relationships simultaneously. Further research can also explore Islamic financial product innovation and its impact on specific community groups, such as micro-entrepreneurs or communities in remote areas. This is expected to support the development of more inclusive and sustainable Islamic finance.

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