

REGULATORY CHALLENGES AND PROSPECT OF ISLAMIC BANKS IN TURKEY AND INDONESIA: PROPOSE FOR SUSTAINABILITY

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Abstract: *The issues and challenges faced by Islamic banking in Indonesia and Turkey are similar and appropriate to explore. Despite having a legacy of strong Islamic law, the majority Muslim population, and the strategic location of each country, they have not been able to dominate the local market share of Islamic banks compared with conventional banks. This research aims to examine Islamic banks in terms of the distinguish regarding to the legal and regulatory progress in both countries, especially on their SWOT and propose strategies for developing and sustainability. This study is a qualitative study as the main method that takes data from various works of literature, namely books, journals, and other sources. Primary data has also been explored by conducting an in-depth interview with the experts regarding these issues. The expert interview has been conducted in Indonesia, and Turkey from 2019 to 2022. Basically, they were Bankers, Islamic Scholars, Regulators, and Academicians. Meanwhile, this research also applied a comparative approach. This research found that government support stands as the first priority from an opportunity aspect. Islamic bank in those countries also needs to be aware of the absence of separate law as the main priority of threats aspect. Another finding shows that separate law and regulation is the main strategy to enhance Islamic banks in each country. This study could serve as a reference point for the regulator in formulating appropriate policy strategies to increase the market share of Islamic banks in Malaysia, Indonesia, and Turkey. This research is also expected to be able to contribute to enriching scientific studies in an effort to popularize Islamic banking in whole Muslim countries.*

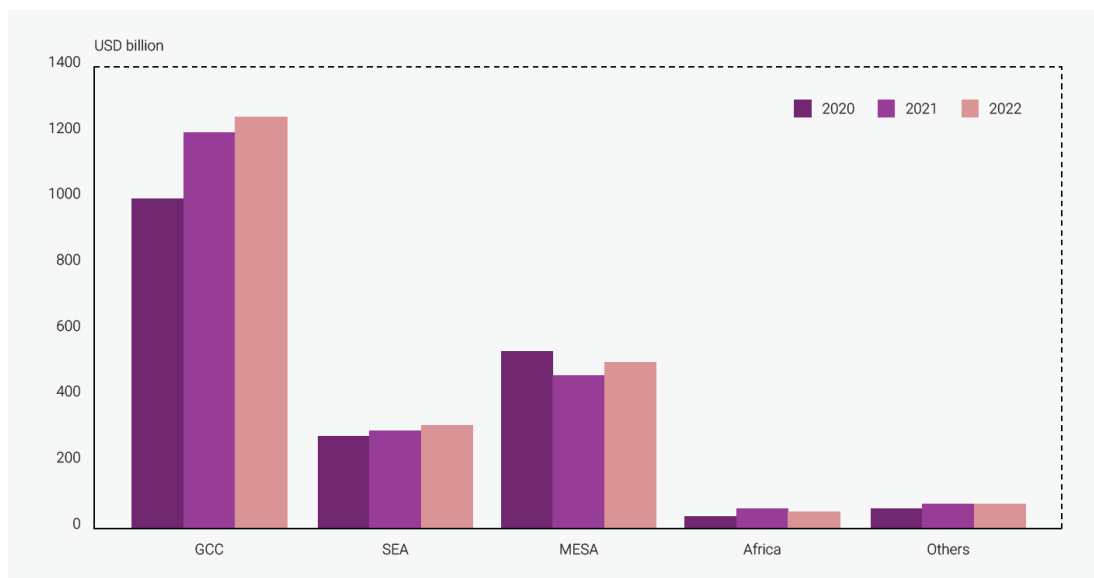
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Introduction

Islamic Financial Services Industry Stability Report 2020 (IFSB, 2020) reported that there is a presence of IB in at least 36 jurisdictions in the world. The share of IB has continued to increase in many countries and hence deepening its penetration. The increases in IB market share were experienced across 19 countries, including Gulf-Cooperation Countries (GCC), Middle East and North Africa (MENA, exclude GCC), and Asia region. In this regard, the International Monetary Fund (IMF) has highlighted the key success factors of the IB market penetration as follows: (i) the ethical principles and socially responsible business, (ii) the resilience during global financial meltdown, (iii) the increasing demand for shariah compliant instruments, (iv) the innovation of shariah compliant products, and (v) the sound regulatory framework and infrastructure (IMF, 2015).

As reported in 2019, Turkey ranked 7th in Islamic Banking asset and market share after Kuwait and Qatar, where Iran took the highest position of the chart¹. The latest data also shows that the 6 banks that are members of the participatory bank in Turkey, namely Albaraka Turk, Vakif Katilim, Ziraat Katilim, Turkiye Finans, Emlak Katilim, and Kuveyt Turk. Kuveyt Turk is reported as the largest market share, amounted for 36% per 2020, and then followed by Turkiye Finans (19%) and Albara Turk (16%).

The slowdown of global economy posts pandemic covid 19, the progress of growth Islamic banking assets can be explained by statistic data as follow. The segment in the GCC region exhibited a growth rate of 10.8% y-o-y by the end of 2022 (compared to 16.3% in 2021), The SEA region also retained its second position albeit with an assets-growth of 6.9% y-o-y at the end of 2022. (2021: 11.4%). In a rebound from the negative growth of -4.0% registered in 2021. MESA region Islamic banking assets grew by a marginal 0.1% y-o-y at the end of 2022. While the “others” region grew by 3.6%. The Africa region registered a decline of -14.8% y-o-y in 2022, compared to the 19.2% growth registered in 2021.



Graph: Regional Islamic Banking Asset 2020 – 2022

Source: The Islamic Financial Services Industry Stability Report 2023

¹ Islamic Financial Services Board. Islamic Financial Services Industry Stability Report 2020. Bank Negara Malaysia, Kuala Lumpur.

Despite experiencing stable growth and performance, unfortunately Islamic banks also experienced various obstacles and challenges. The growth of Islamic banks in Turkey and Indonesia still meet several challenges, such as lack of public awareness, lack of distribution network, lack of variety of product, lack of qualified human resource, lack of financial contract standardization, and operational environment risk².

Many studies discussed participatory banks in Turkey both qualitative and quantitative studies. Recent publication by Zulfahmi, et al (2021) studied on the issues and strategy of participatory banks in Turkey. The study proposed the separation of law and regulation is able to enhance participatory bank in Turkey³. Aysan, Dolgun, and Turhan (2013) assessed the inclusivity of participation banks in Turkey. Participation banks has a pivotal role in financial inclusion by channelling the idle capital into more productive business. This study also addresses the issue of religious sensitivity as one of the factors to be financially included⁴. Nevertheless, the proposes strategies to improve Islamic banks in Turkey and Indonesia were not properly provided.

Economic and Financial Sectors in Turkey and Indonesia

The World Bank (2018) reports that Turkey is projected to maintain its significant growth and reach nearly 5 percent in 2019. The Turkish government is likely to maintain its expansionary policies driven by the aim to sustain solid growth. However, with an inflation rate above 10 percent, the Turkish government faces a serious policy challenge in the coming years. Although Turkey's growth prospects are reasonably robust, with an expected growth to near 5% in 2019, it faces challenges in moving to the status of high-income.

An Overview of Islamic Banking and Finance Conditions

Indonesia is known for being to the world's largest Muslim population. More than 230 million Indonesians – which is about 87 percent of Indonesia's population – are categorized as Muslim. Despite that, Islamic Banking and finance in this country continues to be nascent with Indonesian Islamic finance market share reached only 9.6% in 1H20 (fitch Rating 2021).⁵

Similar with Turkey as a majority Muslim population country, The Republic of Turkey is a country, located mostly in Western Asia, and East Thrace in South-eastern Europe with sharing borders with several countries including, Greece, Iraq, Iran and Syria. Turkey is a democratic, secular, unitary, constitutional republic with a diverse cultural history.

In 2016, Turkey government's revenue was TRY 808.819 billion whereas the expenditure was TRY 867.358 billion. This resulted in the Turkish government's net lending / borrowing to become negative at TRY 58.539 billion in 2016 indicating that the government was not making enough financial resources available to increase the development of the local economy. The current account balance for Turkey in the year 2016 was negative at USD 32.602 billion. It is

²<https://www.fitchratings.com/research/banks/turkish-islamic-banks-have-small-market-share-reasonable-medium-term-prospects-20-03-2020>. Accessed 27 August 2020

³ Zulfahmi, Z., Devi, A., Asker, E., & Hassan, R. (2021). Participation Banks in Turkey: Issues and Proposes Strategies Based on SWOT Analysis. *International Journal of Islamic Economics and Finance (IJIEF)*, 4(SI), 121-152

⁴ Aysan, A. F., Dolgun, M. H., & Turhan, M. I. (2013). Assessment of the participation banks and their role in financial inclusion in Turkey. *Emerging Markets Finance and Trade*, 49(sup5), 99-111

⁵ Rusni Hassan (2022). *Islamic Banking and Finance in Indonesia*. Malaha Press, 1.

expected to decline at a CAGR of 1.59% and reach USD 35.879 by the year 2022. This negative current account balance indicates that Turkey is a net borrower from the whole world.⁶

According to the Turkish government's ambitious plans, the country is on the path to become the world's tenth largest economy by the year 2023, with a gross domestic product (GDP) of two billion US dollars, a per capita income of \$ 25,000 and export of \$ 500 billion.

In a nutshell, the remarkable growth of the IBs industry is a continuous process that largely depends on market development and competitive strategic positioning. There is still an ample room for IBs to grow particularly in potential economies with large untapped Muslim populations, especially Turkey.

The SWOT of Islamic Banks in Turkey and Indonesia

The SWOT analysis is the process of exploring the internal and external environments of an organization and extracting convenient strategies based on its strengths, weaknesses, opportunities, and threats. (Ghazinoory, Mansoureh Abdi & Azadegan-Mehr, 2011). The SWOT methodology is a strategic analysis tool that combines the study of the strengths and weaknesses of an organization, territory, project, or sector with the study of opportunities and threats in its environment. Moreover, SWOT analysis is a methodology allowing understanding and planning on how to use strengths to exploit opportunities, to recognize and repair or avoid weaknesses, and to defend against or sidestep any threats (BETTER, 2015)⁷.

The SWOT of Islamic Banks in Turkey

According to Necip C. Bagoglu in Germany Trade & Invest (GTAI) 2017, SWOT analysis of Turkey is shown in Figure 1.2:

Strengths <ul style="list-style-type: none"> • Large, dynamic internal market • Young, growing population • Attractive geographical location • Well-developed industrial base • Motivated workers 	Weaknesses <ul style="list-style-type: none"> • Internal and geopolitical instability • Inefficient education and legal system • Heavy bureaucracy • High import dependency of the industry
Opportunities <ul style="list-style-type: none"> • Regional energy rotary disc • High interest in renewable energies and energy efficiency • Massive expansion of energy and transport infrastructure • Opportunities for the local production of high-quality goods • Interest in industry 4.0 	Threats <ul style="list-style-type: none"> • Internal and geopolitical instability • Inefficient education and legal system • Heavy bureaucracy • High import dependency of the industry

Figure Error! No text of specified style in document..1 The SWOT Analysis of Turkey

Source: (GTAI, Necip C. Bagoglu, 2017)⁸

⁶<https://www.marketresearchreports.com/market-research-reports-inc/turkey-swot-analysis-market-research-report>. Accessed 5 July 2019.

⁷BETTER is The Project Acronym of Bringing Europe and Third countries closer together through renewable Energies. BETTER intends to address RES cooperation between the EU and third countries. The RES Directive allows Member States to cooperate with third countries to achieve their 2020 RES targets in a more cost-efficient way. The core objective of BETTER is to assess, through case studies, stakeholder's involvement and integrated analysis, to what extent this cooperation can help Europe achieve its RES targets in 2020 and beyond, trigger the deployment of RES electricity projects in third countries and create win-win circumstances for all involved parties.

⁸ It also can see at <http://globalsuccess-days.net/blog/-/blogs/swot-analyses-turkey>

The SWOT of Islamic Banks in Indonesia

Issues and challenges in terms of the development of Islamic banking in Indonesia can be divided into 4 aspects consisting of human resources (HR) aspects, Technical, Legal/Structural and Market/Communal aspects. Clusters by the whole is grouped into clusters of problems, solutions, and strategies.

Strengths <ul style="list-style-type: none"> • The most populated Muslim country (200 million) • Supported with the Highest Constitution Law No.21/2008 (dual banking system) • More Diverse Fatwa issued by the Ulama Council like Tawarruq • Experience of 30 years (started from 1992) 	Weaknesses <ul style="list-style-type: none"> • The market share is not significance in highly competitive market with conventional banks • Supervision of Sharia Advisor still weak in consideration to Banker's awareness • Small Variant in Funding Product as more on Profit Sharing Product (Mudharabah) • Selling more Sales Based Product in Financing Like Murabahah and Ijarah
Opportunities <ul style="list-style-type: none"> • The room to grow the market share still vast • Supported by the Government in sukuk issuance and The Minister of State-Owned Enterprise to merge State owned Islamic Bank • Support from Ulema Council on the variation of the Fatwa in Capital Market (Tawarruk) and Money Market (Bay al Inah) • Supported by the highest Law in Halal Product to be implemented in 2024 to become Halal Center 	Threats <ul style="list-style-type: none"> • Low Financial Literacy of Sharia Finance with only 17 % (OJK) • Free fight competition market with conventional bank (bottom up approach) • Relatively higher pricing product as compare to conventional especially Long Term Product • No political policy from State Owned company to use Islamic Bank Product

Figure Error! No text of specified style in document..2 The SWOT Analysis of Indonesia

Source: Authors and some references

Method

This research applied a qualitative approach. It has been conducted depth interview with experts in the Islamic finance specially in Islamic banking at three countries: Turkey and Indonesia. Basically, they are academicians, Islamic Banking officers and Regulators.

This has supported in exploring the value, meaning, beliefs, and thoughts of experts on the phenomenon under investigation (the real and current Issues and challenges faced by Islamic banks). The resume profile of the informants describes in the table below:

Table: Profile of Expert Informants

No	Name	Designation	Institution
1	Informant 1 (I_1)	Regulator/Academician	-Former Board of CBT -Marmara University - Istanbul Commers Univ.
2	Informant 2 (I_2)	Regulator	Vice Chairman of BDDK/BRSA
3	Informant 3 (I_3)	Regulator	The officer of Turkish President Finance Division
4	Informant 4 (I_4)	Practitioner	Turkiye Finans IBS
5	Informant 5 (I_5)	Practitioner	AlBaraka IBS
6	Informant 6 (I_6)	Practitioner	Kuveyt Turk IBS
7	Informant 7 (I_7)	Academician/Regulator	-Marmara University -Member of Central Shariah Advisor Board
8	Informant 8 (I_8)	Academician/Regulator	Professor at IIBF IIUM
9	Informant 9 (I_9)	Practitioner	Alami Islamic Fintech Indonesia
10	Informant 10 (I_10)	Academician	Professor at Business and Economic Faculty UIN Syarif Hidayatullah Jakarta
11	Informant 11 (I_11)	Practitioner/Regulator	Former Danamon Sharia Bank DSN-MUI Indonesia

Source: Authors

This research tried to come out with a model in aspect of regulation which is extracted through the legal practices of Islamic banking in Turkey and Indonesia. The research will examine the comparative review among those countries along the period 2019-2022.

Finally, this study will be not only limited as materials that are intended for university levels but also for the broader public level since the students of universities has responsibility to promote and implement what they have gotten from university in social life as their completing their studies or as soon as they graduated.

Result and Analysis

The presentation and analysis of the results in this section is based on the seven major issues and challenges faced by IBS, generated from the collected data not only from the literatures but also FGD (Focus Group Discussion) with experts. The following premised issues and challenges that are obtained from the literatures are confirmed to the experts. Some of them are:

1. There is a lack of regulatory institutions focusing specifically on Islamic banking constraints and legal improvements.
2. The operational efficiency of IBs is lower compared with CBs.

3. The perception of Islamic banking is very weak within the society.
4. Bankers or practitioner's shariah awareness on IBS still need to improve
5. Inadequate competitive product (majority in Murabaha)
6. Lack of Sharī'ah governance causes misperceptions
7. The lack of academic research and educational institutions to study the aforementioned problems further aggravates them.

Seven issues above are becoming the underpinning background of this study. Therefore, we were arranging interview schedule with the informants and discussing the results under this section. We have interviewed some experts to obtain important information on the issues and challenges of IBS in Turkey. Our expert who commented on this issue were academia and regulators. Academia comes from a Professor at Marmara University, Istanbul Commers University, Istanbul Sabahattin Zaim University (IZU) and others.

The Participation (Islamic) banks has been operating for 20-30 years in Turkey. Up to 2021, there are 6 Participation banks, 3 of them are state-owned companies namely Ziraat katılım bankası, vakıf katılım bankası and emlak katılım bankası, and the other 3 are private banks.

First of all, lack of awareness in term of sharia regulation and sharia roll (lack of education of practitioners/lack of qualified human resource). Although in establishment of PP in 1980s, still there is no awareness in term of sharia regulation and sharia roll regarding to IBS in Turkey. Most of the main subject for economic student in the Turkish university is conventional economic or finance. Therefore, the one who work for IBS has lack of understanding in sharia roll related to the name feature of IBS.

Secondly, IBs is supposed to be financial Exclusion not Financial Inclusion. The exclusivity of IBS to some segments might due to lack of financial literacy. There are not many Islamic bankers who also take part in marketing IBs products to the wider community. Therefore, this issue we called as lack of financial inclusion or financial awareness.

Further, product with *murabahah* contract becomes the star in IBS. According to experts, this condition actually not only happens in Turkey, but also in other countries including Indonesia. 90-95% of the IBs's funds in the pool are used in Murabahah contract. In term of government support, BDDK has put some effort to prepare. BDDK established the draft of law, even though it is not special for IBs but general law for Islamic finance in Turkey.

Accordingly, from the explanations above, issues and challenges faced by of IBS development in Turkey and Indonesia summarizes in the conceptual framework as descript in the figure below.

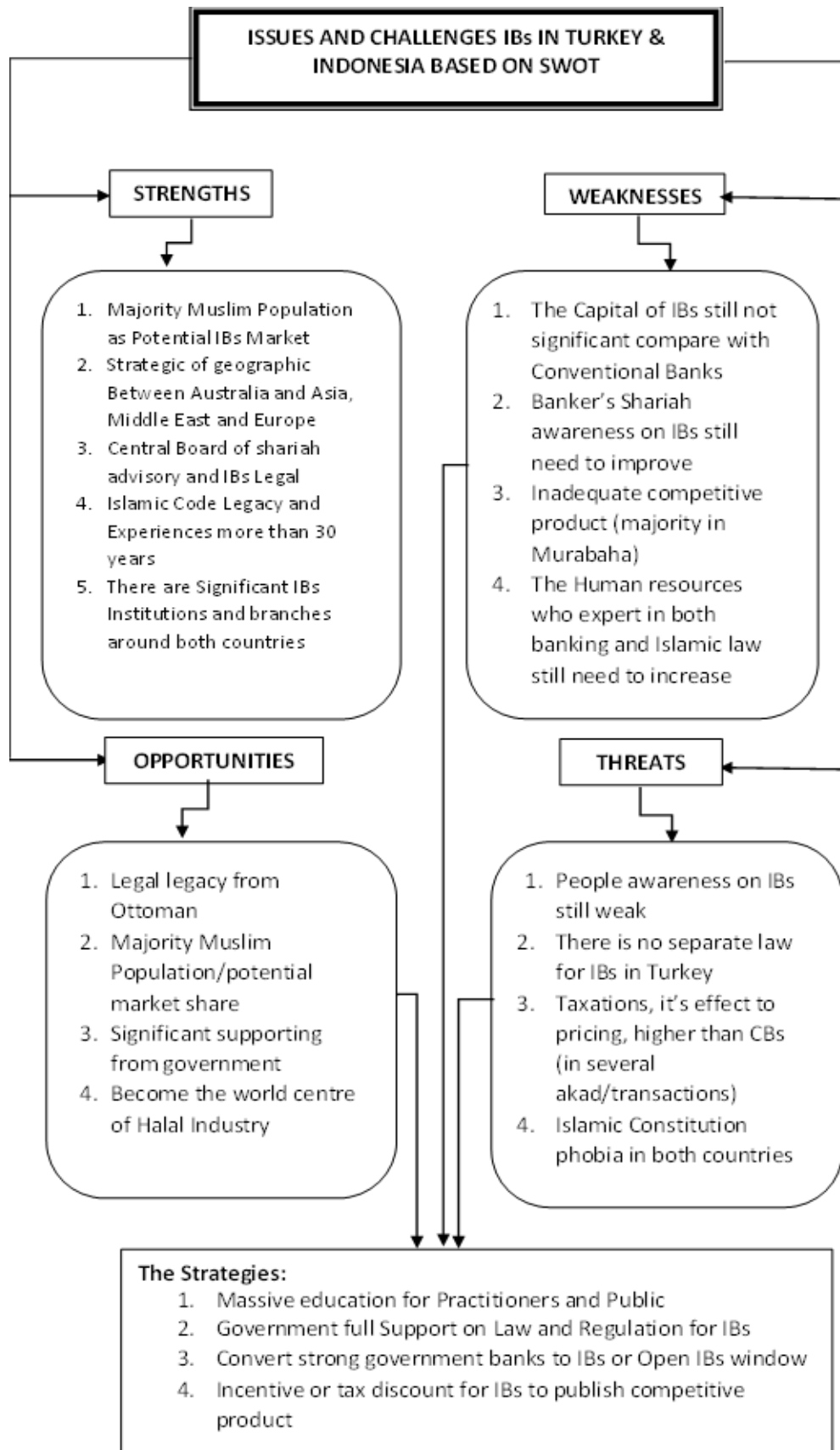


Figure: Issues and Challenges IBs in Turkey & Indonesia Framework

Source: Author (elaborated literatures and In-depth Interview)

Finally, this research extracted two general problems of IBS in both countries, problems that might come from internal (internal problems) and problems which come from external side (external) problems. Briefly, internal problems are problems that originate from internal Islamic banking institutions, while external problems are problems that come from outside the institution. Internal problems include a lack of understanding, lack of skills, and lack of sharia governance.

Conclusion

The research has deliberated the regulatory challenges, prospect and propose sustainability of Islamic Banks in Indonesia and Turkey. Overall, the research constitutes the first attempt to propose priority strategies to deal with the current issues and challenges faced by IBs in both countries. The bank institutions as general in Turkey are divided into three categories under the Turkish banking legislation, in accordance with the operations conducted by them; they are deposit banks, participation banks, and Development and Investment Banks. Among these categories, only participation bank is operating by Islamic principle. The main legislation regarding the banking industry in Turkey is the Turkish Banking Law No. 5,411 (the Banking Law), the Turkish Central Bank Law No. 1,211 (the Central Bank Law), the Turkish Capital Markets Law No. 2,499, the Law on the Protection of the Value of Turkish Currency No. 1,567, the Decree-Law on Money Landing Transactions No. 90, and the regulations promulgated under these laws.

Findings

Overall, this study ascertained the current and future analysis of Islamic banks in Turkey and Indonesia. The analysis contains four main aspects, strength, weakness, opportunity and treatment. The discussion on strategy has been provided in the analysis chapter. As the model developed, we can conclude that four important aspects can be considered as the factors to develop Islamic banks in Turkey and Indonesia, namely, strength, weakness, opportunity, and threat. Each aspect in this level consisted of 3 (three) to 4 (four) sub-elements and has been validated by the experts. The most priority under-strength cluster is the Central Board of shariah advisory board in Internal IBS, while the most priority under weakness cluster is inadequate competitive product (majority in Murabahah).

The finding also provides managerial implications for practitioners of the Islamic bank, regulators in Turkey and Indonesia, at the same time also provides a theoretical implication for a prospective researcher. As the finding implies, the Islamic banks need to adopt four meaningful strategies to enhance the Islamic bank in both countries according to its priority, namely separated law and regulation, massive education, incentive or tax discount, and strongly supported by the government.

Recommendations

Based on the current findings, the study makes the following recommendations for regulators, practitioners, scholars, and directions in future research:

1. The Public awareness of Islamic banks as one of the important Islamic financial institutions requires serious attention to achieve significant progress in the growth of Islamic banking in a region.
2. The massive education for knowledge improvement regarding educating people about Islamic financial principles and practices.
3. The optimal support from the government, IBs shareholders and public to produce strong regulations and a comfortable business environment for IBs.

4. The research focuses on the identification of issues and challenges of the legal framework of Islamic banks in Both countries.
5. Further research may explore the impact of separated law between Islamic Banks and Conventional banks.

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