

Islamic Investment and Capital Market: Analysis of Developments and Challenges in the Modern Era

Intan Amelia Damayanti¹✉

¹ UIN Prof. K.H. Saifuddin Zuhri; Purwokerto, Central Java, Indonesia

✉ email: intanamel793@gmail.com

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ABSTRACT

The Islamic capital market has experienced significant growth in recent decades as an investment alternative compliant with Islamic principles. This development demonstrates that the Islamic financial system is not only an option for Muslims but is also beginning to attract the attention of global investors seeking more ethical and sustainable investment instruments. This article comprehensively analyzes the development of Islamic investment and capital markets, identifying their underlying principles and evaluating the challenges and opportunities faced in the context of the modern global economy. Using a descriptive-analytical approach, this study demonstrates that the Islamic capital market not only provides a halal investment alternative for Muslims but also offers stability and sustainability that can attract investors from diverse backgrounds. The unique characteristics of the Islamic capital market, which avoids *riba* (usury), *gharar* (gharar), and *maysir* (risk of gambling), create a strong foundation for more stable and sustainable long-term investment. These principles not only ensure compliance with Islamic teachings but also encourage more transparent and responsible business practices. However, challenges such as global standardization, investor literacy, and product innovation still need to be addressed to maximize the potential of the Islamic capital market. Global standardization is crucial given that differences in sharia interpretations across countries can hinder cross-border market growth. Furthermore, the low level of investor literacy regarding sharia products requires ongoing educational efforts. Product innovation is also necessary to meet the increasingly diverse and dynamic needs of investors. By addressing these challenges, the Sharia capital market has significant potential to continue growing and make a significant contribution to the stability of the global financial system.

Keywords: *Sharia Capital Market; Halal Investment; Sharia Principles; Islamic Economics; Sharia Stocks.*

INTRODUCTION

The Islamic capital market is a crucial component of the Islamic economic system and has shown significant progress in recent decades (Choiri & Mustofa, 2024). Serving as an alternative to conventional capital markets, this market provides investment instruments that align with Sharia principles, such as the prohibition of *riba* (interest), *gharar* (excessive uncertainty), and *maysir* (gambling). The global development of the Islamic capital market reflects the growing awareness of Muslims regarding the importance of investing in accordance with religious

values and illustrates the sector's significant economic potential (Khoiruddin & Syahpawi, 2024). Indonesia, as the country with the largest Muslim population in the world, holds a strategic position to promote the advancement of the Islamic capital market, both regionally and internationally. This article aims to analyze the development of Islamic investment and capital markets, identify their underlying principles, and evaluate the challenges and opportunities faced in the modern economic context.

The Islamic capital market is a securities trading system that operates in accordance with Islamic principles (Kholisatun et al., 2024). This system plays a role in collecting funds from the public for allocation into halal and beneficial economic activities. Unlike conventional capital markets, which focus on maximizing profits, Islamic capital markets emphasize a balance between material gain and spiritual values (Lestari & Kurniawati, 2023).

The characteristics of Islamic capital markets include a high level of transparency, fairness in every transaction, and a focus on developing the real sector (Sukawati et al., 2023). The primary objective of investing in Islamic capital markets is not simply to achieve economic profit, but also to contribute to social welfare and environmental preservation, in line with the primary objective of Sharia (maqasid sharia), which prioritizes the common good (Melisa, Seri Wahhyuni, Trisna Eka Sari, 2024).

Islamic capital markets are founded on three key principles that distinguish them from conventional systems. First, the prohibition of *riba* (usury), which is at the heart of Islamic economic teachings. *Riba* refers not only to interest in the general sense but also includes any form of additional profit obtained without fair exchange or equal risk. Second, the prohibition of *gharar*, which is excessive ambiguity or uncertainty in transactions that could harm one of the parties. Every transaction in Islamic capital markets must be based on transparent and complete information to prevent losses due to lack of understanding or misuse of information. Third, the prohibition of *maysir* (trading, or speculative practices similar to gambling) requires that transactions not rely solely on luck without any real effort or skill. Every transaction in the Islamic capital market must be based on contracts that comply with Islamic sharia principles, such as *musyarakah* (partnership), *mudharabah* (profit sharing), *ijarah* (rent), *istishna* (leasing), and *salam* (salam) (Karamillah, 2022).

Currently, the global Islamic capital market has grown rapidly, with total assets exceeding \$3 trillion, recording average annual growth of 10 to 15 percent. (Joudar et al., 2023) Sukuk instruments dominate the market, with outstanding values exceeding \$600 billion. Malaysia, Indonesia, Saudi Arabia, and the United Arab Emirates play key roles in the global sukuk market. Indonesia occupies a crucial position in the development of the global Islamic capital market. As the world's most populous Muslim country, Indonesia has vast domestic market potential. (Sari et al., 2022) Consistent economic growth and political stability make Indonesia an attractive investment destination for international Islamic investors (Sakinah et al., 2022).

The Financial Services Authority (OJK)'s strong commitment to advancing the sharia capital market is reflected in the various regulations it has issued. The 2015-2019 Indonesian sharia capital market roadmap, which was later extended to 2024, demonstrates the government's commitment to realizing its long-term vision of making Indonesia a global center for sharia capital markets. Despite its promising

prospects, the sharia capital market still faces several challenges (Toha et al., 2020). One major obstacle is the low level of sharia financial literacy among the public. Limited infrastructure and a shortage of skilled professionals in this field also contribute to obstacles. Disparities in standards and regulations across countries also pose challenges in implementing cross-border transactions (Bahari & Zaman, 2023). Nevertheless, the growth opportunities for the sharia capital market are substantial. The growing global Muslim population and growing awareness of Sharia investments are creating increasing demand. The increasingly popular trend of sustainable finance and ESG (Environmental, Social, and Governance) investing aligns with sharia principles. The development of financial technology (fintech) has also opened up new opportunities for innovation in the Islamic capital market (Lailatul Qomariyyah et al., 2024).

A comprehensive understanding of the Islamic capital market is crucial not only for Muslim investors but also for the development of a more inclusive and sustainable financial system. With a strong foundation and growing momentum, the Islamic capital market has the potential to become a viable and even superior alternative to the conventional financial system.

Literature Review

Basic Concepts of the Islamic Capital Market

The Islamic capital market is a capital market system run based on Islamic sharia principles. It is fundamentally no different from conventional capital markets in terms of its function and operational mechanisms. However, it has specific limitations that must be met to align with Islamic law (JAMILAH & BASYARUDIN, 2023). The basic principles that underpin the Islamic capital market include the prohibition of *riba* (interest), which means that all transactions involving fixed interest are prohibited, thus prohibiting investment in conventional bonds that pay fixed interest. (Noor Iffatin Nadhifah & Siti Imaniatul Muflihatin, 2024) Furthermore, there is a prohibition on *gharar* (excessive uncertainty), which prohibits transactions containing elements of excessive uncertainty or speculation that could harm one of the parties, including certain speculative derivative transactions. The principle of prohibition on *maysir* (gambling) is also applied to prohibit all forms of transactions that are similar to gambling or involve pure chance (Ista et al., 2024). Equally important is the application of the principles of justice and transparency, where all transactions must be conducted fairly and transparently, with complete and accurate information available to all parties involved.

Sharia Investment Instruments

The Sharia capital market offers a variety of investment instruments that have been adapted to Sharia principles to meet the needs of Muslim investors. Sharia stocks are one of the main instruments, consisting of shares in companies whose business activities do not conflict with Sharia principles and meet certain financial ratios established by the relevant authorities (Sabila et al., 2024). Sukuk, or Sharia bonds, offer an alternative investment in the form of investment certificates issued in accordance with Sharia principles as evidence of proportional ownership of

certain tangible assets (Afifi, 2024). Sharia mutual funds serve as a vehicle for collecting funds from investors for subsequent investment in a portfolio of Sharia securities selected in accordance with Islamic principles. Sharia Exchange Traded Funds (ETFs) are also available as mutual funds in the form of collective investment contracts whose units can be traded on stock exchanges, providing greater flexibility and liquidity for investors.

Screening and Cleansing Process

To ensure investment compliance with Sharia principles, a systematic and rigorous screening and cleansing process is implemented (Md. Hashim et al., 2017). The screening process includes two main stages, namely qualitative selection, which is carried out based on the type of the company's business to ensure that there are no activities that conflict with sharia principles, as well as quantitative selection which is carried out based on certain financial ratios that have been set to measure the level of company involvement in non-sharia activities (Alnamlah et al., 2022). Meanwhile, cleansing is the process of cleaning up income derived from activities that are not in accordance with sharia principles, where investors are required to separate and donate a portion of profits obtained from non-halal sources as a form of moral and spiritual responsibility in investing in accordance with Islamic teachings (Saidatolakma Mohd Yunus et al., 2017).

METHOD

This research uses a descriptive-analytical approach, collecting secondary data from various reliable sources, including capital market authority reports, academic publications, and industry statistics. The analysis was conducted qualitatively to understand the development, challenges, and opportunities of the Islamic capital market. The data used include statistics on the development of the global and Indonesian Islamic capital markets, applicable regulations, and Islamic investment trends in recent years. The analysis period covers developments from 2010 to 2025 to provide a comprehensive overview of the evolution of the Islamic capital market. This period can be divided into three main phases: a) 2010–2014: the initial stage of strengthening Islamic regulations and instruments; b) 2015–2019: implementation of the first phase of the Indonesian Islamic Capital Market Roadmap, growth in the number of Islamic stocks, and the development of Islamic sukuk and mutual fund products; and c) 2020–2024: accelerated digitalization, increasing number of Islamic retail investors, ESG and sustainable finance trends, and the impact of the COVID-19 pandemic on Islamic investment dynamics.

Concrete evidence to support these results is a) the 2010-2014 period, including 2011: OJK officially issued the first Sharia Securities List (DES). The number of sharia stocks in Indonesia was around 200 stocks in 2011. 2013: OJK released the 2015–2019 Indonesian Sharia Capital Market Roadmap as a strategic development plan. The total value of outstanding sharia sovereign sukuk increased, with outstanding reaching more than IDR 200 trillion in 2014; b) the 2015-2019 period, including the ongoing Phase I

Roadmap. The number of sharia stocks jumped to 370 stocks in 2019. Sharia Mutual Funds grew from 75 products (2015) to more than 250 products in 2019. The capitalization of sharia stocks in the Indonesian Sharia Stock Index (ISSI) reached more than IDR 3,000 trillion at the end of 2019; & c) 2020-2024 period, covering 2020: The COVID-19 pandemic lowered global indices, but Islamic stocks were relatively stable. The number of Islamic investors increased rapidly: from 92,000 Islamic SIDs (2019) to more than 190,000 SIDs (2021), and 500,000+ SIDs in 2023. Outstanding sovereign sukuk reached IDR 1,300 trillion (2023). By 2024, the number of Islamic stocks on the Islamic Securities List will exceed 500, accounting for more than 60% of the IDX capitalization. The Global: Islamic Finance Development Report 2023 recorded total Islamic financial assets reaching USD 3.7 trillion, with an average annual growth of 10–15%.

FINDINGS AND DISCUSSION

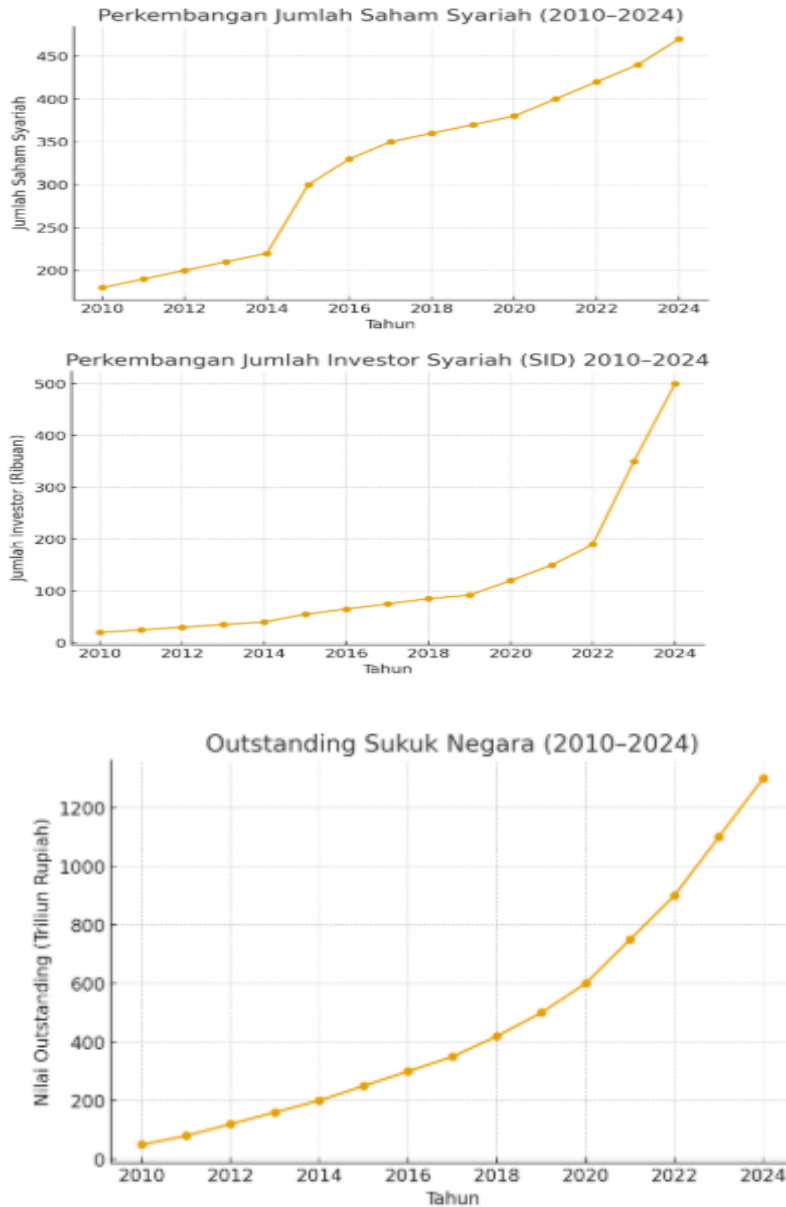
Development of the Global Islamic Capital Market

The global Islamic capital market has experienced impressive growth over the past two decades, reflecting growing investor interest in investment instruments that align with Islamic principles. According to the Islamic Finance Development Report, total global Islamic financial assets will reach more than \$3.7 trillion by 2023, with the Islamic capital market contributing approximately 15-20% of this total. This impressive growth is driven by several key interrelated factors. First, increasing religious awareness among Muslim investors, who increasingly recognize the importance of investing in accordance with their religious principles. Second, stronger regulatory support from various countries that have developed comprehensive regulatory frameworks to support the growth of the Islamic capital market. Third, continuous product innovation in the development of increasingly diverse and attractive Islamic investment products for investors. Fourth, the competitive performance of Islamic investments, which has proven to be able to compete with conventional investments in the long term.

Development of the Indonesian Islamic Capital Market

Indonesia is one of the largest Islamic capital markets in the world and has shown significant growth since its inception. The Indonesia Stock Exchange (IDX) has been developing a sharia-compliant stock index and various sharia-compliant investment products since 2000, marking the beginning of a new era of sharia-compliant investment in Indonesia. Significant progress has been achieved, including a dramatic increase in the number of sharia-compliant stocks, from 173 in 2007 to over 400 by 2025. Indonesia's sharia-compliant stock market capitalization has also experienced impressive growth, averaging 15-20% annually, reflecting growing investor confidence. Product diversification has also become a key focus, with the development of sukuk, sharia-compliant mutual funds, and sharia-compliant ETFs, increasingly diverse to meet the needs of diverse investors. Furthermore, increased investor participation is a key indicator, with the number of sharia-compliant capital market investors experiencing a

significant increase, particularly among retail investors who are increasingly aware of the importance of sharia-compliant investments.



The number of sharia stocks (2010–2024) → increased consistently from around 180 stocks to more than 470. The number of sharia investors (SID) → increased sharply, especially post-2020, to more than 500 thousand SID in 2024. Outstanding government sukuk → increased significantly from around IDR 50 trillion (2010) to IDR 1,300 trillion (2024).

Advantages of the Sharia Capital Market

The Sharia capital market has several advantages that make it attractive to investors, both from a financial perspective and in terms of its values. The primary advantage lies in its ethical and moral principles, where investments are made in sectors that do not conflict with Islamic values, such as avoiding the alcohol, gambling, and cigarette industries, thus providing peace of mind for Muslim investors. Long-term

stability is a second advantage, as Sharia principles, which discourage excessive speculation, tend to create greater market stability compared to conventional markets. Portfolio diversification is also a significant added value, offering a diversification alternative for investors seeking to align investments with religious values without sacrificing potential returns. Higher transparency and accountability are other advantages, as Sharia principles encourage greater transparency and accountability in investment management, providing greater investor confidence. Finally, fair risk sharing through a profit-sharing system in Sharia investments encourages a more equitable risk distribution between investors and issuers, creating a more harmonious and sustainable relationship within the investment ecosystem.

Challenges in Sharia Capital Market Development

Despite positive growth, the Sharia capital market still faces several challenges that need to be addressed. Global standardization is a major obstacle, as differences in interpretations of Sharia principles across countries can hamper the development of the global Sharia capital market. Another challenge relates to investor literacy, where investors' understanding of Sharia investment products and principles still needs to be significantly improved. Product limitations also pose a barrier, as the variety of Sharia investment products remains limited compared to the wider variety of conventional products. Market liquidity is a particular issue, with some Sharia instruments still facing liquidity issues that can impact overall investment performance. From a regulatory perspective, more comprehensive regulations and effective supervision are still needed to ensure compliance with Sharia principles. Furthermore, the limited human resources who understand both Sharia principles and capital market mechanisms also pose a challenge that must be addressed.

Development Opportunities

On the other hand, there are several significant opportunities for the development of the Sharia capital market that can be exploited. The growing global Muslim population presents a huge and promising market potential. Digitalization and the development of financial technology can facilitate investor access to the Islamic capital market, thereby increasing public participation in Islamic investment. International cooperation also opens opportunities for standardization and integration of Islamic capital markets across countries. Product innovation is key to developing more innovative and attractive Islamic investment products for investors. Government support committed to developing the Islamic economy can be a key driver of future Islamic capital market growth.

CONCLUSION

Based The Islamic capital market has shown significant growth and has become an attractive investment alternative for investors seeking alignment with religious values. The Sharia principles underlying the Islamic capital market, such as the prohibition of *riba* (usury), *gharar* (gharar), and *maysir* (gambling), not only provide moral guidance but also foster stability and sustainability in investments. This provides confidence to

both Muslim and non-Muslim investors who prioritize ethical aspects in their investments.

The development of the global and Indonesian Islamic capital markets shows significant potential, but still faces various challenges such as standardization, investor literacy, and product limitations. In Indonesia, the Islamic stock index continues to experience increasing market capitalization, while globally, countries such as Malaysia and the Middle East are pioneers in the development of Islamic financial instruments. However, the gap in public understanding of Islamic products and differences in standards between countries remain major obstacles that need to be addressed.

To optimize the potential of the Islamic capital market, comprehensive efforts are needed to develop regulations, increase literacy, innovate products, and strengthen infrastructure. The government and financial authorities need to create a clear and consistent regulatory framework, while financial institutions must actively educate the public about the advantages and mechanisms of sharia-compliant investments. The development of innovative products such as sukuk, sharia-compliant mutual funds, and sharia-compliant derivative instruments is also key to expanding investment options.

Going forward, the sharia-compliant capital market has significant potential for growth as investors become more aware of ethical and sustainable investments. The global trend toward Environmental, Social, and Governance (ESG) investing aligns with sharia principles, which emphasize sustainability and social responsibility. With appropriate regulatory support and continued innovation, the sharia-compliant capital market can become a crucial component of a more inclusive and sustainable global financial system, making a significant contribution to equitable economic development. Further research is needed to analyze the long-term impact of sharia-compliant capital market growth on global financial system stability, as well as the development of more sophisticated sharia-compliant investment models to meet the needs of modern investors. Empirical studies on the long-term performance of sharia-compliant portfolios, systemic risk analysis, and the development of a sharia-compliant performance measurement framework will provide essential foundations for future sustainable growth.

Implications and Suggestions

The development of Islamic capital markets has important implications for modern financial theory. The success of Islamic capital markets demonstrates that a financial system based on ethical and moral principles can operate efficiently and profitably. This supports the argument that Sharia principles can be a viable alternative in the global financial system, while also contributing to the theoretical understanding of market mechanisms that are oriented not only toward profit maximization but also consider aspects of social justice and economic sustainability.

From a practical perspective, the growth of Islamic capital markets provides a wider range of investment options for investors seeking portfolios aligned with ethical and moral values. It also encourages companies to adopt more ethical and sustainable business practices to qualify for Sharia-compliant investments. Another practical impact

is the creation of a more inclusive financial ecosystem, where investors from diverse backgrounds can participate without violating their core beliefs, as well as encouraging greater transparency and accountability in corporate practices.

Based on the analysis, several strategic recommendations can be put forward to optimize the development of Islamic capital markets. First, the development of comprehensive regulations and harmonization of international Sharia standards are urgently needed to create legal certainty and enhance investor confidence. Second, increasing literacy through extensive education and outreach programs is necessary to enhance investor understanding of sharia-compliant investments and their benefits. Third, more diverse and innovative sharia-compliant investment products need to be developed to attract a broader investor segment. Fourth, strengthening a more robust and integrated sharia-compliant capital market infrastructure will support operational efficiency and improved access. Fifth, developing human resources who understand sharia principles and capital market mechanisms is key to long-term success. Finally, regional cooperation needs to be developed to create an integrated sharia-compliant capital market and strengthen its competitive position globally.

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