

ISLAMIC BANKING AND SUKUK AS ALTERNATIVE FINANCING SOURCES IN DEVELOPMENT

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ABSTRACT

Islamic banking and sukuk, in the context of modern economic development, serve not only as financial instruments but also as vehicles to propagate ethical values and justice in society. In responding to the demands of the times, Islamic banking and sukuk have evolved into key players shaping the direction of global financial and economic development. The aim of this research is to analyze the crucial role of Islamic banking and sukuk as alternative financing sources in development. This research method utilizes literature review and employs descriptive analysis. The results show that Islamic banking in Indonesia plays a crucial role in supporting development financing, providing alternatives for individuals and the government interested in engaging in economic activities in line with Sharia principles. The financing provided by Islamic banking includes various types, such as murabahah financing (sale and purchase with fixed profit), mudarabah (investment cooperation), and musyarakah (ownership cooperation). Sukuk, as a Sharia financing instrument, has become the primary choice of the Indonesian government to support development projects. By issuing sukuk, the government can access substantial funds from the financial market, both at the national and international levels. Sukuk in Indonesia is often used to finance large-scale infrastructure projects such as toll roads, ports, and energy projects.

Keywords: Islamic Banking; Sukuk; Development.

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INTRODUCTION

In this era of globalization, the financial sector plays a crucial role in supporting the development of a country (Ahmed, 2019). The rapid economic growth demands innovative financial instruments that adhere to the principles of the prevailing economics. In this context, Islamic banking and sukuk have emerged as effective solutions to provide alternative sources of financing in development.

In this challenging journey through time, the financial sector becomes a vital axis in supporting the development of a country (Billah, 2019). The increasing complexity of the economy and global competition triggers the need for financial instruments that are not only innovative but also adhere to the principles of just economics. In this context, Islamic banking and sukuk have emerged as effective solutions to provide alternative and sustainable sources of financing based on the moral and ethical principles of Islam.

Since its inception, Islamic banking has transformed the face of the financial sector by providing alternatives that align with Islamic values (Hassan, 2018). As guardians of justice and balance, Islamic banking not only meets the needs of the Muslim community but also becomes an attractive choice for those seeking a more inclusive financial system. By rejecting usury and speculation, Islamic banking establishes a solid foundation to support sustainable development.

In addition, other Islamic financial instruments, especially sukuk, also serve as alternative financing based on assets (Iqbal, 2020). Sukuk combines principles of debt and equity, creating sustainable financial solutions in line with Islamic values. With its unique characteristics, sukuk becomes an attractive choice for governments and companies seeking financing in accordance with Sharia principles.

Islamic banking and sukuk, in the context of modern economic development,

serve not only as financial instruments but also as vehicles for spreading ethical values and justice in a society (Khan, 2021). In responding to the demands of the times, Islamic banking and sukuk have evolved into key players shaping the direction of global financial and economic development. The significance of Islamic banking and sukuk lies in their ability to create sustainable positive impacts. Justice, balance, and financial inclusion form the foundation that sets them apart from conventional financial systems. In line with the vision of sustainable development, Islamic banking and sukuk have the potential to be leaders in achieving sustainable development goals.

In this research, we will further explore the crucial role of Islamic banking and sukuk as alternative sources of financing in development. Subsequently, we will discuss the concept of Islamic banking, its advantages in supporting economic development, and the strategic role of sukuk in financing development projects.

MATERIALS AND METHODS

Islamic Banking: Concepts and Principles

Islamic banking is based on the principles of Islamic economics, which prohibit usury (interest) and speculation. Sharia-compliant banks provide various financial products and services in accordance with Islamic law, such as *mudarabah*, *musharakah*, and *wakalah*. The existence of Islamic banking not only meets the needs of the Muslim community but also offers a sustainable and inclusive alternative. Islamic banking, as an innovation born from Islamic values, has a deep conceptual framework and fundamental principles. The main concept of Islamic banking lies in compliance with and the application of Sharia principles, which include the prohibition of usury (interest), speculation, and investment in

sectors deemed unethical according to Islamic teachings (Ahmed, 2019).

In practice, Islamic banking provides various financial products and services in accordance with Islamic law. For example, the *mudharabah* concept illustrates a form of collaboration between the bank and the customer, where profits and risks are shared according to the initial agreement. Meanwhile, *musharakah* represents a form of business cooperation involving capital contributions and the sharing of profits or losses. The main principle of Islamic banking is to uphold justice and balance in the distribution of wealth. This principle responds to criticisms of the conventional financial system, which is perceived as unfair and tends to widen social inequalities. By eliminating usury and promoting economic sustainability, Islamic banking not only provides economic value but also establishes an ethical foundation (Chapra, 2001).

Islamic economic thinkers have provided a philosophical foundation and principles underlying the concept of Islamic banking. One influential thinker in this field is Muhammad Nejatullah Siddiqi, who contributed significant ideas through his works. Siddiqi emphasizes that Islamic banking is not just a financial institution but an economic system that embraces Islamic values. The fundamental concept of Islamic banking is to create a fair, transparent, and sustainable system (Siddiqi, 2006). In his book "Islamic Banking and Finance in Theory and Practice," he states that Islamic banking is not merely a tool to fulfill financial needs but also an instrument to achieve the moral and ethical goals of Islam. Islamic banking is not just a financial institution; it is a system rooted in Islamic morals and ethics. Its success is measured not only by profitability but also by its positive impact on society and the environment.

One of the main principles advocated by Siddiqi is the elimination of *riba* (interest). He emphasizes that *riba* creates injustice in wealth distribution and can

lead to exploitation (Siddiqi, 2006). In his perspective, Islamic banking offers a solution by providing financial mechanisms that replace the conventional interest-based system, such as *mudharabah* and *musharakah*, promoting the principle of justice in profit and loss sharing. He also highlights the importance of ethical aspects in Islamic banking. He views that moral and ethical aspects in financial transactions are the key to the success of Islamic banking. Principles such as honesty, justice, and social responsibility become integral elements in every decision and operation of Islamic banking.

Another influential thinker in Islamic economics is Yusuf al-Qardhawi. Islamic banking is a manifestation of Islam's holistic vision of life, encompassing economic and financial aspects. In his view, the principles of Islamic banking not only comply with Islamic law but also reflect the moral values emphasized by religion (Al-Qardhawi, 2002). The principles of legal compliance and ethics also form a strong foundation for Islamic banking. In this context, he emphasizes that Islamic banking is not just about adhering to the law but also about acting with honesty, justice, and social responsibility.

By basing the concept of Islamic banking on Islamic economic thought, both Siddiqi and al-Qardhawi demonstrate that Islamic banking is not just a financial alternative but also an effort to build an economy in accordance with the principles of justice and balance, in line with the teachings of Islam. In addition to Muhammad Nejatullah Siddiqi and Yusuf al-Qardhawi, another thinker in the field of Islamic economics who has made valuable contributions is M. Umer Chapra. In his thoughts, Chapra emphasizes the need to build an economic system that prioritizes social justice and equitable distribution. According to Chapra, Islamic banking must create an economic environment that benefits not only a small segment of society but the entire population. Islamic financial principles such as *zakat*, charity, and

distributive justice are at the core of Chapra's vision for achieving financial inclusion and economic sustainability also highlights the importance of ethics in financial transactions. In his book "The Future of Economics: An Islamic Perspective," he emphasizes the need to ensure that every financial transaction not only complies with Islamic law but also has a positive impact on society and the environment (Chapra, 2001).

The collective thoughts of thinkers such as Siddiqi, al-Qardhawi, and Chapra emphasize that Islamic banking should go beyond mere conformity to Islamic principles; it should become an agent of positive social and economic change. By prioritizing justice, ethics, and financial inclusion, Islamic banking becomes an instrument to realize the vision of justice and balance desired by Islamic economics. The concepts and principles of Islamic banking form a strong foundation for bringing about positive changes in the financial sector, making it not only a choice for Muslims but also a relevant model for a more just and sustainable global financial system.

In conclusion, the thoughts of these Islamic economists provide a strong foundation for the concepts and principles of Islamic banking. By exploring their perspectives, we can better understand how Islamic banking not only creates a financial system in accordance with Islamic teachings but also serves as a solution to global economic challenges by embracing values of justice, ethics, and inclusion.

Sukuk as an Asset-Based Financing Instrument

Sukuk, as an asset-based financial instrument, has emerged as an innovative solution in the world of Islamic finance. The term "Sukuk," derived from the Arabic language meaning "certificates" or "proof," has become a financial instrument that brings a unique touch to the Islamic finance world (Ali, 2011). Sukuk is a financial instrument that adheres to the principles of Islamic Sharia. The basic concept of Sukuk

encompasses several key elements that distinguish it from conventional financial instruments.

Sukuk must comply with Islamic Sharia law. This means that the investments and activities underlying Sukuk must be free from elements prohibited by Sharia, such as usury (interest), excessive speculation (maysir), and activities that violate the principles of justice. Sukuk represents ownership of a portion of specific physical assets or projects. Sukuk holders have rights to the income or benefits from these assets. In this context, Sukuk does not represent debt like conventional bonds but rather ownership. Sukuk are often issued to fund specific projects or as part of a business association (joint venture).

Sukuk holders participate in the profits and losses of the underlying project or business. Sukuk holders are entitled to a portion of the income and profits generated from the underlying project or asset. Profits are typically provided in the form of periodic payments to Sukuk holders. Sukuk holders also share the responsibilities and risks associated with the asset or project. If the project fails or incurs losses, Sukuk holders may bear a portion of those losses (Radzi, 2021). The principles of transparency and disclosure are crucial in Sukuk issuance. Sukuk issuers must provide sufficient information to Sukuk holders about the underlying assets or projects, including the associated risks.

Sukuk trading must also adhere to Sharia principles in the buying and selling process. Some Sukuk structures involve mechanisms that ensure continuous compliance with these principles. Sukuk has become a popular instrument in the Islamic financial market, allowing companies and governments to raise funds while adhering to Sharia principles. The structures and characteristics of Sukuk can vary, including Mudarabah Sukuk, Musharakah Sukuk, and Ijarah Sukuk, each with its own distinctive features.

As an asset-based financing instrument, sukuk offers an innovative solution that combines Sharia principles with the financing needs of development projects. Mohammad Ma'sum Billah (2019), an Islamic economist, in his book "Islamic Financial Products: Principles, Instruments, and Structures," describes sukuk as a tool capable of bridging the gap between financing needs and real assets, making it a reliable financing mechanism to support infrastructure and economic projects.

One of the main advantages of sukuk is its asset-based approach. Sukuk is not just a debt instrument but represents ownership in real assets or business projects. Rahail Ali (2011) in his book "Sukuk and Islamic Capital Markets: a Practical Guide" emphasizes that sukuk transforms the traditional debt paradigm by giving sukuk holders ownership rights in the financed assets and projects. Sukuk differs from conventional bonds in terms of structure and principles. While bonds are debt instruments that confer a claim to interest payments, sukuk represent ownership of real assets or business projects. This concept aligns with Sharia principles that prohibit interest or speculation.

The main advantage of sukuk lies in the asset-based structure that can support the financing of development projects. For example, sukuk can be used to finance infrastructure such as roads, bridges, or healthcare facilities. The issuance of sukuk involves joint ownership of these assets, allowing sukuk holders to claim a share of the income generated by the financed assets or projects.

Research Method

The research procedure for this study employs a qualitative descriptive approach, which aims to delve into various concepts discovered during the research. This is achieved through the use of techniques such as content analysis and library research. Library research involves collecting literature through the utilization

of library sources (Sugiyono, 2014). Content analysis is a research technique employed to examine the entirety of a text. In other words, it is a research method that seeks to understand both the manifest and latent arguments of the author. Meanwhile, library research in this study generally utilizes types and sources of secondary data obtained from research findings, books, and reference articles discussing topics related to the research theme.

Research Framework

Research framework is a structured plan or approach used to guide the collection, analysis, and interpretation of data in a research study. It provides a systematic way to understand and solve research problems by defining the key components, concepts, theories, and relationships involved in the study. A well-developed research framework helps in organizing research efforts, ensuring coherence, and enhancing the validity and reliability of the study.

This research framework provides a structured approach to explore how Islamic banking and sukuk contribute as alternative financing sources in development contexts, incorporating theoretical foundations, empirical evidence, and practical applications adjusted to the emphasis and depth of each section based on specific research focus and scope.

RESULTS AND DISCUSSION

The Advantages of Islamic Banking in Development

Islamic banking, rooted in its Islamic values, presents several advantages that serve as a key foundation in supporting sustainable economic and social development. When discussing the advantages of Islamic banking, inspiration can be drawn from the works of thinkers such as Muhammad Nejatullah Siddiqi. In his book titled "Islamic Banking and Finance in Theory and Practice," Siddiqi (2006) highlights the excellence of Islamic

banking in creating economic justice. One of the main principles of Islamic banking is the prohibition of *riba* (interest) that can create injustice in wealth distribution. By emphasizing the principle of justice in financial transactions, Islamic banking opens the door to broader economic inclusion and more equitable profit distribution.

The excellence of Islamic banking is also found in the balance maintained between profit and risk. Cooperative concepts such as *mudarabah* and *musharakah* create a symbiotic relationship between the bank and customers, where profits and risks are shared proportionally according to the initial agreement. This approach not only avoids the exploitative aspects of conventional financial systems but also fosters a healthier balance in financial relationships.

Furthermore, Islamic banking emphasizes ethical values in every transaction. According to Yusuf al-Qardhawi, it is not just about adhering to the law, but also about acting with honesty, justice, and social responsibility. These principles are not merely cosmetic views but create a solid foundation for sustainable business and investment.

In addition, Islamic banking plays a crucial role in financial inclusion. By leveraging the principles of Islamic finance, Islamic banking can encompass segments of society that were previously marginalized by conventional financial systems. In his book "Introduction to Islamic Finance," Mufti Muhammad Taqi Usmani (2005) emphasizes that financial inclusion is an integral part of Islamic financial principles that demand profit distribution and access to financial services for all layers of society. In line with this thinking, Islamic banking serves not only as a financial instrument but also as a tool for social and economic transformation. Through these advantages, Islamic banking can play a significant role in creating

inclusive, sustainable development in accordance with Islamic ethical values.

The excellence of Islamic banking in development is also reflected in its contribution to environmental sustainability. Sharia principles teach sustainability and social responsibility. In their book "Islamic Finance: Principles and Practice," Hans Visser and Herschel Visser (2010) state that Islamic banking not only considers sustainability in financial aspects but also in ecological and social contexts. Islamic banking pays special attention to investments that have a positive impact on society and the environment. The principle of sustainability is reflected in financing projects that support renewable energy, sustainable agriculture, and other initiatives that promote environmental sustainability.

The excellence of Islamic banking is not only limited to the local level but can also play a significant role on a global scale. In his book "Islamic Finance: Ethics, Concepts, Practice," Usman Hayat (2014) states that Islamic banking can serve as a model for global financial institutions by demonstrating that financial success can be achieved without sacrificing ethical values and justice. In the context of financial inclusion, the superiority of Islamic banking is also reflected in its ability to reach groups of people who may not meet conventional criteria for financing. By focusing on principles of justice and sustainability, Islamic banking opens doors for small and medium-sized entrepreneurs as well as less privileged communities to access financial services.

The excellence of Islamic banking in development is a narrative that encompasses economic, social, and environmental dimensions. By integrating ethical principles, financial inclusion, and sustainability, Islamic banking is able to shape a new paradigm in the global financial world, offering solutions that are not only financially sustainable but also in line with human and environmental values (Khan, 2010). Islamic banking emphasizes

the concepts of justice and balance in wealth distribution. These principles support sustainable and inclusive development. Islamic banking prioritizes adherence to Islamic law and ethics, creating a more stable and just financial environment. By adhering to Islamic financial principles, Islamic banking can encompass segments of society that were previously marginalized by conventional financial systems (Ramdhony, 2013).

Islamic banking in Indonesia plays a crucial role in supporting development financing, providing an alternative for individuals and the government who wish to engage in economic activities in accordance with Sharia principles. Bank Syariah Mandiri, Bank Muamalat Indonesia, and Bank Negara Indonesia Syariah are some of the leading Islamic financial institutions that contribute by offering financing products compliant with Islamic law. The financing provided by Islamic banks encompasses various types, such as murabahah financing (buying and selling with a fixed profit), mudarabah (investment cooperation), and musyarakah (co-ownership cooperation). Through these products, Islamic banking helps support development projects in various sectors, including infrastructure, housing, and micro, small, and medium-sized enterprises (MSMEs). The strategic role of Islamic banking can also be seen in its efforts to empower the community's economy through microfinance and sustainable projects. This approach supports financial inclusion and contributes to creating positive impacts at the local level.

The Role of Sukuk In Infrastructure And Development Projects

In the context of economic development, sukuk plays a crucial role in diversifying sources of financing. Diverse sources of financing are key to managing risks and creating economic stability. Smaoui (2020) explains that sukuk can assist countries or companies in raising funds in a manner consistent with Sharia

principles, making it an attractive option for investors seeking sustainable investments. It is important to note that sukuk also contribute to the liquidity of the Islamic financial market. By creating tradable investment instruments, sukuk enhance market activity and provide flexibility for investors to buy or sell assets in the secondary market.

Sukuk is issued based on Law Number 19 of 2008 and the Fatwa of DSN-MUI (an institution that serves as a supervisor of Sharia finance to ensure compliance with Sharia principles). According to the law, sukuk aims to finance the state budget (APBN), including funding for other projects. The issuance of sukuk requires the presence of owned-assets, or in simpler terms, fixed assets such as government-owned land and buildings in the development of government projects. In issuing sukuk, the government employs a Special Purpose Vehicle (SPV) also known as the Sharia Securities Issuer Company (PP SBSN), which legally acts as the issuer and trustee. The role of PP SBSN is crucial in facilitating special transactions to comply with Sharia principles and to streamline the sukuk transaction process (Iskandar, 2014).

Infrastructure and development projects require significant financing to support the economic growth of a country. Sukuk, as a rapidly growing Islamic financial instrument, has played a crucial role in providing funds for infrastructure and development projects. Sukuk offers a sustainable financing alternative for development projects. In the sukuk structure, funds are raised from investors who purchase sukuk certificates, and development projects are financed through sukuk issuance. This creates a reliable long-term source of financing. Ahmed (2019) asserts that sukuk has significant potential as a sustainable financing instrument for infrastructure projects. The sukuk structure provides clarity on the use of funds, builds investor confidence, and offers long-term funding.

Sukuk can also enable community participation in financing development projects. Through sukuk issuance, the community can invest in projects deemed crucial for economic growth and public welfare (Ghafoor, 2018). Iqbal (2020) explains that sukuk can serve as a tool for community participation in economic development. The community can contribute to infrastructure projects that have a positive impact on daily life. The issuance of sukuk for development projects can also support financial innovation. The flexible structure of sukuk allows for creativity in financing design, including the use of blockchain technology to enhance transparency and efficiency. The use of blockchain technology in sukuk issuance can improve transparency and accountability, paving the way for financial innovations that support development projects (Khan, 2021).

Sukuk has also proven to be more resilient to financial crises compared to conventional financial instruments. The characteristics of sukuk, which are based on real assets, can provide additional security for investors, ensuring that development projects can still be financed even in challenging economic situations. Sukuk has demonstrated greater resilience to economic shocks. Investing in sukuk provides a higher level of security, reducing the uncertainty risk in financing development projects (Hassan, 2018). Sukuk plays a key role in providing a source of financing for infrastructure and development projects. By offering sustainable financing alternatives, involving community participation, supporting financial innovation, and providing resilience to financial crises, sukuk can be a vital instrument in fostering economic growth and sustainable development (Madani, 2020).

If viewed historically, the development of sukuk in Indonesia has consistently recorded annual increases from 2018 to 2022. This applies to both the cumulative amount of issuances and the

cumulative amount of outstanding sukuk. This trend has driven the increase in the cumulative value of sukuk issuances and the outstanding value of sukuk in the capital market. The Financial Services Authority (OJK) notes that the outstanding value of Indonesian corporate sukuk reached Rp. 47.66 trillion in June 2023. This amount is higher by 8.29% compared to the previous month, which was Rp. 44.01 trillion. When compared to June 2022, the value has also increased by 26.12%, reaching Rp. 47.66 trillion from Rp. 37.79 trillion. The increase in the outstanding value is in line with the growing number of outstanding sukuk in the capital market. Recorded in June 2023, the number of outstanding sukuk reached 238. This figure is higher by 6.25% compared to the position in May 2023, which was 224 sukuk. When compared to June 2022, which had 200 sukuk, the number has increased by 19%.

As known, sukuk is a Sharia-compliant security in the form of certificates or ownership evidence that holds equal value and represents an undivided share (*syuyu'/undivided share*) in the underlying assets (Mohammed, 2015). The outstanding value of sukuk is the total amount of sukuk still circulating in the capital market. The increase or decrease in sukuk value can occur due to matured sukuk or the addition of new sukuk series. On the other hand, the cumulative number of sukuk issuances in June 2023 reached 428. This number is higher by 3.38% compared to May 2023, which was 414 sukuk, and grew by 19.89% from June 2022, which was 357 sukuk. Meanwhile, the cumulative value of sukuk issuances as of June 2023 reached Rp92.3 trillion, increasing by 4.12% from May 2023, which was Rp88.65 trillion. This figure is also higher by 26.30% compared to the position in June 2022, which was Rp73.08 trillion.

Sukuk, as a Sharia-compliant financing instrument, has become the primary choice of the Indonesian

government to support development projects. By issuing sukuk, the government can access substantial funds from the financial markets, both at the national and international levels. In Indonesia, sukuk is often used to finance large-scale infrastructure projects such as toll roads, ports, and energy projects. The success of sukuk as a development financing tool also indicates investors' interest in Sharia-compliant financial instruments. Investing in sukuk provides an opportunity for investors to support infrastructure development while adhering to Sharia principles. In an effort to enhance transparency and investor confidence, the Indonesian government has consistently committed to improving regulations and Sharia sukuk standards. This is aimed at making sukuk a more attractive financing instrument for stakeholders and accelerating economic development in Indonesia.

CONCLUSION AND IMPLICATION

Islamic banking in Indonesia plays a crucial role in supporting development financing, providing alternatives for individuals and the government who want to engage in economic activities in line with Sharia principles. The financing offered by Islamic banks includes various types, such as murabahah financing (buying and selling with fixed profit), mudarabah (investment cooperation), and musyarakah (co-ownership cooperation). Through these products, Islamic banks help support development projects in various sectors, including infrastructure, housing, and micro, small, and medium-sized enterprises (MSMEs). The strategic role of Islamic banking can also be seen in its efforts to empower the community's economy through microfinance and sustainable projects. This approach supports financial inclusion and helps create positive impacts at the local level.

Sukuk is not directly part of Islamic banking but is a Sharia-compliant financial

instrument commonly used by various entities, including companies, governments, and Islamic financial institutions, to obtain financing. In the context of Sharia financing, sukuk is similar to conventional bonds but is designed to comply with Sharia principles. In sukuk, investors receive income generated by the assets or projects funded by the sukuk, rather than a fixed interest as in conventional bonds. The structure of sukuk can vary and may involve concepts such as mudarabah (investment cooperation), musharakah (co-ownership cooperation), and others. Although sukuk itself is not a banking product, Islamic banks are often involved in the management and distribution of sukuk. They may play a role as underwriters or provide advisory and management services for projects funded by sukuk.

Sukuk, as a Sharia-compliant financing instrument, has become the primary choice of the Indonesian government to support development projects. By issuing sukuk, the government can access substantial funds from the financial markets, both at the national and international levels. In Indonesia, sukuk is often used to finance large-scale infrastructure projects such as toll roads, ports, and energy projects. The success of sukuk as a development financing tool also indicates investors' interest in Sharia-compliant financial instruments. Investing in sukuk provides an opportunity for investors to support infrastructure development while adhering to Sharia principles. In an effort to enhance transparency and investor confidence, the Indonesian government has consistently committed to improving regulations and Sharia sukuk standards. This is aimed at making sukuk a more attractive financing instrument for stakeholders and accelerating economic development in Indonesia.

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