Institutional Capacity and the Contemporary Paradox of Islamic Finance: From Shariah Principles to Credible and Operational Ecosystems

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Abstract

This paper argues that the contemporary paradox of Islamic finance is not primarily a doctrinal failure, nor the result of insufficient demand, but rather the consequence of uneven institutional capacity across jurisdictions. Despite strong normative appeal, sustained sectoral growth, and the expansion of Islamic finance across more than 140 countries, the industry remains unevenly institutionalized, geographically concentrated, and operationally fragmented. To explain this gap, the paper develops an institutional capacity framework structured around three dimensions: normative coherence, institutional credibility, and operational capacity. It shows that Islamic finance requires not only *Shariah*-compliant products, but also harmonized and intelligible standards, credible governance mechanisms, transparent *Shariah* supervision, effective audit structures, professional expertise, market infrastructure, and deep ecosystems. By applying this framework to current debates on standardization, *Shariah* governance, perceived authenticity, market depth, and ecosystem development, the paper suggests that the future of Islamic finance depends on its ability to transform *Shariah* principles into coherent standards, credible institutions, and operationally robust markets.

Keywords: Islamic finance; institutional capacity; Shariah governance; Shariah boards; institutional credibility; operational capacity; normative coherence.

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Introduction

Since the establishment of Dubai Islamic Bank in 1975, Islamic finance has undergone spectacular development. In 2024, the Islamic finance ecosystem extended across 140 countries and dependencies, while a financial presence—through Islamic financial institutions or Islamic capital markets—was recorded in 98 countries. Global Islamic finance assets reached USD 5.98 trillion, representing a 21% increase compared with the previous year. Moreover, global Islamic finance assets are projected to reach approximately USD 9.72 trillion by 2029 [1].

One of the main explanations for the growth of Islamic finance lies in the ethical principles of Islam, such as the strict prohibition of usurious interest (*riba*), excessive uncertainty (*gharar*), and speculation (*maysir*). The strict observance of Islamic legal and ethical rules appears necessary in order to provide the Muslim community with an alternative aligned with Islamic values.

Indeed, several previous studies have shown that religious identity is among the factors that most strongly influence individual behavior (Kamaruddin et al., 2021; Eid and El-Gohary, 2015; Zamani-Farahani and Musa, 2012). More specifically, attachment to Islamic values is reflected in Muslims' relationship to consumption patterns (Zafar and Abu-Hussin, 2025; Rehman and Shahbaz Shabbir, 2010), and more broadly, Muslim spirituality appears to be one of the most significant factors influencing the behavior of Muslim people (Ubale and Abdullah, 2015). The available evidence therefore suggests that attachment to Islamic economic principles is not limited to abstract normative adherence. In jurisdictions where compliant products are effectively available, Muslim consumers tend to prefer them over conventional alternatives.

Yet this favorable dynamic should not obscure the structural limits of the sector's institutionalization. Despite the spectacular increase in the total value of assets, Islamic finance remains a minority component of the global financial system: according to the *ICD–LSEG Islamic Finance Development Report 2025*, Islamic banking still accounted for only 2.3% of global banking assets in 2024. Similarly, the sector's development remains highly geographically concentrated, with the three largest markets–Iran, Saudi Arabia, and Malaysia–alone accounting for approximately 72% of global Islamic finance assets. Finally, numerous specialized reports reveal highly heterogeneous levels of integration across jurisdictions, despite the existence of several advanced hubs such as Malaysia, Saudi Arabia, and the United Arab Emirates.

Thus, beyond the idea of a mere lack of demand for Islamic financial products, as some studies have suggested, the central paradox of Islamic finance lies in the persistent gap between three simultaneous dynamics: genuine individual adherence to Islamic economic principles, sustained sectoral growth, and an institutionalization that remains concentrated, uneven, and marginal at the scale of the global financial system. Accordingly, the central question is not simply why Muslims would or would not use Islamic financial products, but why genuine normative adherence and sustained sectoral growth have not yet translated into a more homogeneous, deeper, and more systemic form of institutional integration.

[1] Islamic Corporation for the Development of the Private Sector (ICD) and London Stock Exchange Group (LSEG), Islamic Finance Development Report, 2025.

In light of the existing literature and available data, the article first examines the paradox between strong normative adherence, sustained sectoral growth, and limited institutionalization, before introducing institutional capacity as the analytical framework through which this gap can be understood. It then diagnoses the main institutional capacity gaps affecting Islamic finance and discusses their implications for standard-setters and Islamic financial institutions.

I – The Islamic Finance Paradox

I.1 – Strong Adherence to Standards

Islamic finance is a relatively recent concept, referring to a practice of finance rooted in and compliant with the major principles of Islamic law (*Shariah*). Its objective is to provide Muslims with an ethical alternative aligned with their religious values, without excluding other communities, insofar as it also presents itself as a systemic proposition grounded in universal values of justice and equity. Indeed, as Kahf (2010) recalls, the deeper purpose of Islamic finance is to serve an objective of social justice and equitable resource-sharing, rather than merely reproducing conventional banking mechanisms primarily centered on capital accumulation and profitability as ends in themselves.

In this regard, several ethical principles constitute the foundations of Islamic finance, derived from the sacred texts of the *Qur'an* and the Prophetic tradition (*Sunnah*). These include the strict prohibition of usurious interest (*riba*), excessive uncertainty in transactions (*gharar*), speculation (*maysir*), and unlawful sectors such as alcohol or prostitution, while encouraging risk-sharing, transparency, and ethical investment (Chapra, 2016; Siddiqi, 1983).

Strict adherence to these major principles constitutes a fundamental source of credibility within the Muslim world, insofar as most practicing Muslims consider Islam to be their primary normative framework (Zein et al., 2022; Al Smadi et al., 2021). The work of Mutanda and Nomlala (2025) shows that, at the European level, when Muslim consumers are given the choice between Islamic finance tools–particularly *riba*-free services–and conventional tools, they tend to choose *Shariah*-compliant instruments. This also aligns with other works showing that the growing opening of Islamic bank accounts is supported by Muslims' positive perception of Islamic banking, such as those of Latif (2021) in the Philippines and Kannaiah, Masvood and Choudary (2017) in India. Saiti, Ardo and Yumusak (2022) even show that normative coherence and the values promoted by Islamic banks explain the growing number of account openings by non-Muslims in Nigeria. In India, Islamic financial solutions are particularly popular among precarious Muslim populations, who view these alternatives as instruments of financial and social inclusion for the poor (Siddiqui, Naushad and Farooque, 2021). Loo (2010) adds a generational perspective, showing that in Malaysia, members of Generation X are more willing to engage with Islamic banks than baby boomers, suggesting heightened awareness of the problems associated with conventional finance and a stronger willingness to adhere to religious values. Overall, the existing literature indicates that Muslims' attitudes toward the Islamic financial system are broadly favorable.

This finding appears to reinforce the conclusions drawn in our master's thesis, *Islamic Economics*

against Capitalism's Setbacks (2025) [2]. According to the ideological-perceptual analysis:

> Islamic economics holds strong ideological appeal, particularly in Muslim-majority contexts. The ethical and redistributive aspects of the system are often praised and there is significant symbolic alignment with Islamic values. (Ben Tahar, 2025, pp. 53–54)

Furthermore:

> Cross-generational and cross-regional surveys highlighted growing interest in Islamic economic ethics, particularly among younger cohorts and in urban contexts. Spiritual intelligence, religiosity, and social environments all emerged as mediators of trust and identification with Islamic economic models. (Ben Tahar, 2025, pp. 57–58)

I.2 – Spectacular Growth of the Sector

The growing appeal of Islamic finance services can also be explained by the sector's spectacular development in recent years. According to the *ICD–LSEG Islamic Finance Development Report 2025*, the total value of Islamic finance assets rose from USD 1.0 trillion in 2010 to USD 5.98 trillion in 2024, with projected growth to approximately USD 9.7 trillion by 2029. Moreover, the annual growth rate of Islamic finance assets worldwide reached 21% in 2024, a historic level supported by a broad number of Islamic financial institutions. Most Islamic finance assets are concentrated in Islamic banking, followed by *sukuk*, and then Islamic funds, reflecting a certain degree of product diversification.

From a more institutional perspective, several major trends can be identified within the global Islamic finance ecosystem. First, in terms of governance, by 2024, nearly 57 countries worldwide had adopted at least one form of legislation governing Islamic finance, while 23 had established a centralised *Shariah* committee composed of scholars actively involved in the representation of *Shariah* boards.

With regard to sustainability, the value of Environmental, social, and governance (ESG) [3] *sukuk* was estimated at approximately USD 61.5 billion in 2024, while ESG Islamic funds amounted to USD 9.7 billion. This reflects clear progress compared with previous years, although these figures remain relatively marginal when measured against the total value of Islamic finance assets. By contrast, nearly 50 countries had adopted sustainability guidelines, revealing a concrete form of institutional recognition. In terms of practical engagement, the multiplication of conferences, publications, and training institutions also testifies to the growing institutionalization of the intellectual ecosystem surrounding Islamic finance.

As for the leading countries in the Islamic finance sector, two interpretative frameworks may

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[2] Ben Tahar, Y., *Islamic Economic's against Capitalism's Setbacks*, Master's thesis, ESCP Business School, Paris, 2025; also available in the School's digital library and published online by the author.

[3] Environmental, social, and governance (ESG) is an acronym used to refer to sustainable investment practices that take into account environmental and social issues and corporate governance.

be adopted. In terms of total Islamic finance assets, Iran ranks first, with USD 2.249 trillion in assets, followed by Saudi Arabia with USD 1.316 trillion, Malaysia with USD 761 billion, the United Arab Emirates with USD 460 billion, and Kuwait with USD 198 billion.

However, a more refined and more relevant reading for the purpose of this research is to refer to the Islamic Finance Development Indicator (IFDI). According to the *ICD–LSEG report*:

> The composite indicator is composed of five key areas driving development of the Islamic finance industry: Financial Performance; Governance; Sustainability; Awareness; and Knowledge. These areas reflect the core elements of the industry and are aligned with contemporary priorities such as regulatory frameworks, sustainability, and public engagement. Each plays a fundamental role in shaping the industry's evolution as a globally recognized financial system. (ICD & LSEG, 2025, p. 13)

The maximum attainable score, obtained by aggregating the various metrics, is 200, indicating full institutionalization and integration of Islamic finance within a country, while the lowest score is 0. According to this framework, the leading countries are Malaysia (135), Saudi Arabia (114), the United Arab Emirates (92), Indonesia (75), and Pakistan (72), respectively. This is particularly significant insofar as institutionalization cannot be understood as resting exclusively on financial production and concentration, but rather on a broader set of economic, social, scientific, and political dynamics.

Finally, geographical dispersion is also a key trend revealing the global reach of Islamic finance. Nearly 39% of Islamic finance assets originate from Gulf Cooperation Council (GCC) countries and another 39% from other countries in the Middle East and North Africa (MENA) region, while the remainder comes primarily from Southeast Asia and, to a lesser extent, Europe, where integration remains limited but is progressing, particularly in the United Kingdom. Regarding countries outside the Organization of Islamic Cooperation (OIC), the report notes:

> Non-OIC countries are also becoming important players in Islamic finance, particularly in emerging asset classes such as Islamic funds. Key financial hubs include the UK, Luxembourg, Singapore and South Africa. As of 2024, 84 non-OIC countries have either expressed interest in or are actively operating in the Islamic finance space. (...) There are now more than 1,000 Islamic financial institutions serving non-OIC markets. (ICD & LSEG, 2025, p. 35)

Similarly, with regard to clientele, the report states:

> Several Islamic financial institutions in non-OIC countries report a growing share of non-Muslim clients, attracted by the industry's emphasis on universal ethical principles, transparency, exclusion of unethical industries, and support for real economic activities. These values align closely with ESG investing, making Islamic finance appealing to agnostic and values-driven investors. (ICD & LSEG, 2025, p. 36)

I.3 – Institutionalization Remains Limited

Despite theoretical foundations that carry a universal scope through the values and objectives they promote, Islamic finance still struggles to reach regions that have little or no historical, cultural, or traditional attachment to Islam. This is not because the underlying values advanced by the Islamic financial model lack appeal, since research and empirical studies have shown for several years a growing interest in more ethical and just financial practices. Rather, the institutionalization of the Islamic finance sector remains limited. In this sense, the central paradox of Islamic finance stems from the gap between a level of sectoral development that is significant enough for it no longer to be considered marginal, yet insufficiently institutionalized for it to become systemic.

First, it should be recalled that the share of Islamic finance within the global financial sector remains very small:

> Despite reaching nearly US$6.0 trillion in assets, however, Islamic finance remains a small segment of the world's financial market, with Islamic banking accounting for just 2.3% of global banking assets as of 2024. (ICD & LSEG, 2025, p. 31)

Second, the Islamic financial sector remains highly geographically concentrated, as the *ICD–LSEG report* again emphasizes:

> Despite the industry's presence in 98 countries, it remains centered mostly on Muslim-majority countries, whether through Islamic financial institutions or Islamic capital markets. The three largest markets – Iran, Saudi Arabia and Malaysia– collectively account for US$4.3 trillion, or 72% of global Islamic finance assets. Regionally, the GCC and the rest of MENA each hold US$2.34 trillion in assets, while Southeast Asia is nearing the US$1 trillion mark. OIC countries represent 98% of the industry's total assets. (ICD & LSEG, 2025, p. 30)

Moreover, jurisdictional disparities further complicate harmonized institutionalization on a large scale. Islamic finance, as a discipline underlying Islamic economics, is, like any legal subject in Islam, subject to interpretive divergences between legal schools (*madhahib*). This is all the more significant given that the sector is evolving rapidly and is highly sensitive to technological innovations, leading to the increasing emergence of new legal questions (*nawazil*) that require an intense and complex interpretive effort (*ijtihad*) from Muslim scholars and domain experts in order to determine whether new products and methods comply with Islamic ethics. According to Alharbi (2025), although institutions such as the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) [4] and the Islamic Financial Service Board (IFSB) [5] have made considerable progress in defining international standards and criteria for *Shariah* compliance, harmonization and large-scale adoption remain structural challenges.

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[4] The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) is a leading international non-profit organization founded in 1991 and based in Bahrain, that develops standards for accounting, auditing, governance, ethics, and *Shariah*, which are used by Islamic financial institutions in more than 45 countries.

[5] The Islamic Financial Services Board (IFSB) is an international standard-setting organization founded

He further shows that most Islamic banks operate within an institutional framework designed for conventional finance, creating compliance frictions that tend to slow innovation, generate competitive disadvantages, and produce operational complexities.

Overall, these findings suggest that the main obstacles no longer relate exclusively to legal compliance, the existence of demand, or even the availability of a diversified supply. Rather, they increasingly concern a lack of institutional capacity to transform this demand into a stable, coordinated, and sustainable ecosystem.

II – Methodological Framework: Institutional Capacity

II.1 – Defining Institutional Capacity

In this research, we propose to mobilize the concept of institutional capacity, understood as the ability of a political, economic, or social system to transform widely shared normative principles into effective institutions that are sufficiently credible to produce durable collective action. Effective institutions include governance structures, organizations, legal arrangements, technical standards, and implementation mechanisms. This definition constitutes an analytical proposition that may be further developed in subsequent research.

The concept of institutional capacity is already used in the literature on public policy and international organizations, particularly to designate the ability of public institutions to implement the mandates assigned to them. Kim et al. (2026), for instance, define institutional capacity as the ability of a public institution to implement the policies or projects falling within its mandate, while distinguishing between organizational and governance dimensions. Similarly, Poisson and Kools (2024) mobilize this concept for IIEP-UNESCO and the OECD in an applied perspective, in order to assess the capacity of ministries of education to use data and evidence in the formulation and implementation of education policies.

The present article is situated within this field while introducing an analytical shift. It is not concerned solely with the capacity of an organization to execute an already defined mission, but with the more fundamental capacity of an ecosystem to transform a shared normative framework into effective institutions. Institutional capacity is therefore understood here in an expanded sense: it includes the organizational and operational dimensions already identified in the literature, but connects them to two more upstream dimensions, namely normative coherence and institutional credibility.

This concept thus becomes essential for understanding the points of rupture between the different layers through which a norm becomes embodied in an institution.

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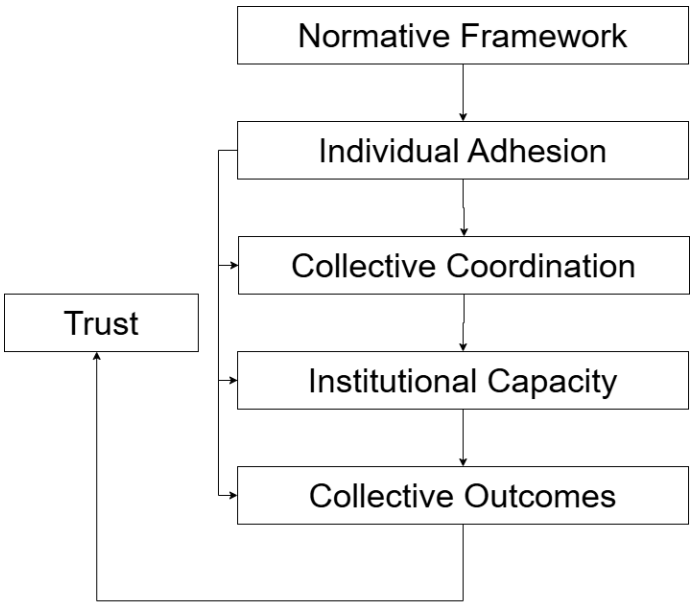
in 2003 and based in Kuala Lumpur, Malaysia, that promotes the soundness and stability of Islamic banking. Its main role is to issue global prudential standards and guiding principles for capital adequacy, corporate governance, risk management, and transparency.

II.2 – From Normative Adherence to Institutional Capacity

The model proposed below describes a process of institutional transformation through five analytically distinct but interdependent layers. These layers should not be understood as the mechanical stages of a linear causal sequence. Rather, they identify different levels through which a normative framework may become translated into collective practices, effective institutions, and eventually collective outcomes. Reinforcement effects, blockages, mismatches, and feedback loops may emerge between each of these levels.

A norm may therefore be widely recognized without being deeply internalized; it may be individually internalized without generating effective collective coordination; coordinated practices may emerge without being supported by sufficiently credible institutions; and formally established institutions may fail to produce the collective outcomes initially expected from them. The possibility of such ruptures is precisely what makes institutional capacity analytically relevant.

Figure 1: The Institutional Capacity Framework: From Shared Norms to Collective Outcomes



Source: Author's own elaboration.

The five layers of the model are as follows:

- **Normative Framework:** The set of principles, values, prescriptions, and prohibitions that define what is considered legitimate, desirable, or unacceptable within a given social order. Such a framework may be religious, ethical, legal, political, or cultural. It provides actors with common reference points through which behaviors and practices may be evaluated. However, a normative framework does not operate only as an abstract set of principles: it also requires interpretation, clarification, and translation into concrete contexts by authorities recognized as sufficiently competent and legitimate.

- **Individual Adherence:** The extent to which the normative framework is internalized by individuals and begins to shape their preferences, beliefs, attitudes, and choices. Such adherence may emerge through socialization, education, personal experience, community belonging, moral conviction, or perceived self-interest. It may also vary considerably in intensity and motivation across individuals. This layer therefore distinguishes the mere existence of a norm from its effective influence on individual behavior.
- **Collective Coordination:** Individual adherence becomes socially effective when actors are able to coordinate their behavior around shared practices and reciprocal expectations. This requires sufficiently aligned incentives, common reference points, information, reputation mechanisms, and expectations that other actors will also conform to the relevant rules. Collective coordination therefore represents the transformation of dispersed individual adherence into repeated and mutually intelligible social practices, including exchanges, contracts, investments, or consumption patterns.
- **Institutional Capacity:** The ability of an institutional ecosystem to support, organize, regulate, and stabilize these collective practices. At this level, the norm becomes embodied in effective institutions through clear rules, governance structures, competent authorities, legal arrangements, infrastructures, technical standards, supervision procedures, and conflict-resolution mechanisms. Institutional capacity therefore refers not merely to the existence of formal organizations, but to the ability of the broader ecosystem to generate predictability, credibility, and continuity over time.
- **Collective Outcomes:** The aggregate economic, social, political, legal, or symbolic effects produced by the institutionalization of the norm. These may include financial stability, economic inclusion, social justice, reduced uncertainty, greater collective welfare, sustainable development, or other forms of public value. Collective outcomes should not be treated as the terminal point of the model: they feed back into previous layers. Outcomes perceived as consistent with the original normative promise may reinforce adherence, trust, and institutional legitimacy, whereas disappointing or contradictory outcomes may weaken them.

Trust plays a cross-cutting role within the model rather than constituting an additional layer. It facilitates adherence, reduces the costs of collective coordination, reinforces institutional credibility, and affects the way collective outcomes are interpreted. At the same time, trust is itself produced by institutional performance. Institutions perceived as transparent, predictable, competent, and faithful to their stated principles are more likely to generate trust, whereas incoherent, opaque, or ineffective institutions may progressively undermine it. The framework should therefore be understood as partly circular: institutional performance can reinforce the normative and behavioral foundations from which institutions initially emerged, but it can also weaken them.

The model consequently implies several propositions:

- A shared normative framework does not automatically generate robust institutions.
- Formal institutions may exist while remaining weak if they lack sufficient adherence, effective coordination, credibility, or implementation capacity.

- Institutional breakdowns may occur at any layer of the process, including the definition of the norm, its internalization, collective coordination, institutional organization, or the production of collective outcomes.
- Diagnosis and institutional action should therefore identify the weakest link within the process rather than assume that the same intervention will be effective in every context.
- Institutional capacity must consequently be assessed in a systemic, multi-level, and context-dependent manner.

The case of Islamic finance provides a direct illustration of this five-layer process:

- **Normative Framework:** The prohibition of *riba*, *gharar*, *maysir*, and illicit activities, together with principles such as justice (*'adl*), risk-sharing, transparency, and ethical economic conduct. These principles derive from *Shariah* and constitute the underlying normative framework of Islamic finance.
- **Individual Adherence:** The willingness of Muslim individuals to favour *Shariah*-compliant financial practices and products because of religious conviction, ethical preferences, or the search for religious legitimacy.
- **Collective Coordination:** The transformation of these individual preferences into organized demand, repeated transactions, specific contractual practices, and specialized markets for *Shariah*-compliant financial services.
- **Institutional Capacity:** The ability of the ecosystem to structure and sustain these practices through Islamic financial institutions, regulators, *Shariah* governance mechanisms, standard-setting organizations such as AAOIFI and the IFSB, audit structures, legal arrangements, payment infrastructures, professional expertise, and sufficiently developed financial markets.
- **Collective Outcomes:** The broader effects generated by this institutionalization, including financial inclusion, market development, infrastructure financing through *sukuk*, greater alignment between financial practices and Islamic ethical principles, but also weaker outcomes where institutional credibility, normative coordination, or market depth remain insufficient.

The five-layer model therefore describes how a normative framework becomes institutionally embedded, whereas the three dimensions developed in the following section–normative coherence, institutional credibility, and operational capacity–provide a diagnostic framework for assessing how robust that institutionalization actually is. The layers identify where institutionalization may break down; the dimensions help explain why.

II.3 – The Three Dimensions of Institutional Capacity

The three dimensions of institutional capacity are not additional stages in the five-layer process. They are cross-cutting diagnostic criteria used to assess whether the institutionalization of a norm is coherent, credible, and operationally robust.

- **Normative Coherence** concerns the clarity, intelligibility, internal consistency, and practical applicability of the rules through which the initial normative framework is translated into institutional standards. It also concerns the capacity of recognized authorities to interpret, coordinate, and revise these rules when new situations arise.
- **Institutional Credibility** concerns the extent to which actors consider institutions legitimate, trustworthy, transparent, and faithful to their stated principles. It depends on governance, accountability, effective supervision, enforcement, and the perceived consistency between formal commitments and actual practices.
- **Operational Capacity** concerns the resources, skills, organizations, infrastructures, procedures, and coordination mechanisms required to implement rules, sustain practices, adapt to change, and produce collective outcomes at scale.

These dimensions are analytically distinct but mutually reinforcing. Normative coherence without credibility may produce formally clear but weakly legitimate rules; credibility without operational capacity may generate trust without effective implementation; and operational capacity without normative coherence may scale practices whose relationship to the original normative framework remains contested. The table below summarizes the three dimensions used in Part III to diagnose the case of Islamic finance.

Table 1: Institutional Capacity as a Diagnostic Framework

Dimension	Core question	Institutional function	Main risk when weak
Normative coherence	Do actors know which rules govern the institution, and do they recognise them as authoritative?	Provides intelligible, stable, and legitimate standards for coordination	Fragmentation of standards, legal uncertainty, higher coordination costs
Institutional credibility	Do actors believe that institutions will apply these rules faithfully, transparently, and predictably?	Generates trust, legitimacy, and durable adoption	Doubts over Shariah compliance, weak trust, limited adoption
Operational capacity	Are institutions able to implement and sustain what they promise?	Converts norms and trust into effective products, services, markets, and outcomes	Shallow markets, limited accessibility, weak infrastructure, poor scalability

Source: Author's own elaboration.

III – Diagnosing the Institutional Capacity Gap

In light of the analytical framework established above, the paradox of Islamic finance can now be reformulated as a differentiated deficit of institutional capacity. The point is not to claim that the industry lacks institutions, nor that its development is marginal in itself, but rather to understand why this institutionalization remains uneven, concentrated, and partially incomplete. This diagnosis can be conducted through the three constitutive dimensions of institutional capacity: normative coherence, institutional credibility, and operational capacity.

III.1 – Normative Coherence Gap: Legal Pluralism, Harmonization and Standard-Setting

The first axis of the diagnosis concerns normative coherence. In the framework proposed above, the relevant question is twofold: do actors know which rules govern Islamic finance, and do they recognize these rules as sufficiently authoritative to guide their decisions? In the case of Islamic finance, this question is particularly important because the industry is rooted in Islamic jurisprudence related to socio-economic transactions (*mu'amalat*), a field in which legal reasoning (*ijtihad*) and legal pluralism (*ikhtilaf*) have historically played a central role.

This plurality should not be understood as a weakness in itself. Islamic jurisprudence has long recognized the existence and legitimacy of *ikhtilaf*, especially in matters involving changing social realities and new practical cases (*nawazil*). Since *mu'amalat* deal with evolving economic and social interactions, they naturally require frequent recourse to analogical reasoning (*qiyas*), consideration of custom (*'urf)*, public interest (*maṣlaḥah*), and *ijtihad* [6]. The contemporary challenge for Islamic finance is therefore not to abolish juristic disagreement, but to determine how legitimate disagreement can be institutionally coordinated through recognized authorities, transparent methodologies, and reviewable standards [7].

This issue becomes particularly significant in a financial industry where legal uncertainty has direct operational consequences. A juristic opinion (*fatwa*) may clarify the permissibility of a product, contract, or transaction, but it does not necessarily establish a universally binding rule for the entire industry. As a result, Islamic financial institutions may face situations in which different *Shariah* boards approve or reject similar products, sometimes within the same jurisdiction. Thus, the central institutional question is not whether plurality should exist, but how it should be organized: which authorities are competent to interpret *Shariah* standards [8],

[6] On the distinction between certain (*qat'i*) and conjectural (*zanni*) rulings in *Shariah*, and on the human and interpretive nature of fiqh, see for instance 'Abd Allah al-Maliki, *Siyādat al-Umma qabla taṭbīq ash-Sharīᶜa*, pp. 65–67 (French translation). Al-Maliki emphasizes that revelation is stable whereas reality is changing, and that the Muslim jurist mediates between foundational sources and practical cases through interpretive tools such as *istinbat*, *qiyas*, *'urf*, *maslahah* and *istihsan.*

[7] This tension between normative unity and legal plurality is not new. A famous report (see Ibn Sa'd, *Kitab al-Ṭabaqat al-Kabīr*) relates that the Abbasid caliph Abu Ja'far al-Manṣur considered imposing Malik ibn Anas's *Muwaṭṭa'* as a single legal reference across the major cities of Islam, which Imam Malik reportedly refused in the name of the diversity of already established legal traditions across regions.

[8] The classical question of the *ḥakim* (i.e. the authority empowered to settle certain disagreements in the public interest) may today be reconsidered in light of contemporary structures of financial governance, public

how disagreements should be documented and revised, and through which mechanisms actors can identify the applicable rules in a given market.

This difficulty appears clearly in contemporary debates on the standardization of Islamic finance. In the 2022 Standing Committee for Economic and Commercial Cooperation (COMCEC)[9] report, Aysan et al. usefully distinguish harmonization, understood as the minimization of existing differences, from standardization, which aims at eliminating such differences. This distinction is essential: the objective is not necessarily to impose a single legal interpretation on the entire industry, but to make divergences sufficiently intelligible, coordinated, and operational so that they do not become an obstacle to collective action. The same report emphasizes that the lack of standardization is widely perceived as one of the main challenges facing the industry, since divergent interpretations of *Shariah* may lead to situations where the same product is approved by one institution and rejected by another. Such inconsistency affects the perception of Islamic financial institutions and calls for clarification not only in *Shariah* rulings, but also in auditing, reporting, legal documentation, governance, and dispute resolution.

The case of bitcoin and, more broadly, crypto-assets illustrates this problem particularly well. As a financial and technological innovation, bitcoin raises new questions regarding its legal classification, its possible status as money or an asset, its volatility, its speculative use, its possible lack of intrinsic value, but also its potential benefits in terms of transparency, security, financial inclusion, and disintermediation. Qurtubi, Sugianto and Kelibia (2024) identify three main positions in the recent literature: a permissive view, which considers bitcoin lawful under certain conditions, particularly when used for lawful and non-speculative transactions; a prohibitive view, which considers it unlawful because of *gharar*, *maysir*, volatility, and risks of illicit use; and a conditional view, which makes permissibility dependent on a clear regulatory framework, transparency safeguards, and appropriate supervisory mechanisms.

This case reveals the precise nature of the normative coherence gap. Actors do not necessarily lack general principles; rather, they often lack institutional procedures capable of translating these principles into new technological contexts. The question is therefore not merely whether bitcoin is lawful or unlawful in itself, but which authorities are competent to decide, according to which methodology, with which technical expertise, within which regulatory framework, and with what capacity for revision as uses and risks evolve. In this regard, the debate on crypto-assets shows that normative coherence requires less the absolute uniformization of opinions than the establishment of collective processes for arbitration, documentation, and revision.

For this reason, the institutional recommendations formulated in the COMCEC report are particularly significant. Aysan et al. (2022) show that respondents tend to favour harmonization

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regulation, and standard-setting. For a discussion of this issue in contemporary Islamic political law, see ʻAbd Allah al-Maliki, *Siyādat al-Umma qabla taṭbīq ash-Sharīᶜa*, pp. 71–75 (French translation).

[9] The Standing Committee for Economic and Commercial Cooperation (COMCEC) is one of the main committees of the OIC. Established in 1981, it serves as a multilateral economic and commercial cooperation forum in the Islamic world. The committee convenes annually in Istanbul under the Chairmanship of the President of the Republic of Turkey.

rather than the full standardization of all Islamic finance *fatwas*, while overwhelmingly considering international collaboration necessary to address the sector's legal and regulatory issues. A large majority also considers that appropriate harmonization of *Shariah* decisions would reduce *fatwa* shopping. This confirms that a balance must be found between legal plurality, contextual adaptation, and institutional coordination.

From this perspective, standard-setting institutions such as AAOIFI, the IFSB, and the International Islamic Financial Market (IIFM) [10]—a global standard-setting body of the Islamic Financial Services Industry (IFSI)—may be understood as attempts to transform legal pluralism into institutional capacity. The COMCEC report recommends, among other measures, the development of a strategic plan for standardization and harmonization, the establishment of a centralised *Shariah* governance framework, the periodic review of standards, the strengthening of legal, regulatory, and prudential frameworks, and deeper coordination between national regulators and international standard-setting bodies.

Finally, normative coherence should not be treated only as a theoretical or legal issue; it has direct consequences for the credibility and stability of the sector. Sori (2025) shows that *Shariah* non-compliance risk may lead to legal or regulatory sanctions, financial losses, reputational damage, and loss of public confidence towards Institutions offering Islamic Financial Services (IIFS). He recalls that the IFSB defines this risk as:

> The risk that arises from IIFSs' failure to comply with the *Shariah* rules and principles determined by the *Shariah* Board of the IIFS or the relevant body in the jurisdiction in which the IIFS operate [11].

AAOIFI, for its part, defines it as:

> The risk that arises when an Islamic Financial Institution (IFI) fails to adhere to *Shariah* principles and rules. This risk is a subset of operational risks and, in certain circumstances, may lead to legal, financial, or reputational consequences [12].

Thus, the normative coherence gap in Islamic finance does not stem from the existence of *ikhtilaf* as such. It stems rather from the contemporary difficulty of transforming a plurality of legitimate opinions into a framework that is sufficiently intelligible, recognized, harmonized, and reviewable to support common financial practices. The challenge is therefore not to abolish disagreement, but to institutionalize it: that is, to create mechanisms allowing actors to know which rules apply, who has authority to interpret them, how decisions are revised, and how they can be coordinated at the local, regional, and international levels. Only under these conditions can normative plurality cease to be a source of uncertainty and become an institutional resource.

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[10] The International Islamic Financial Market (IIFM) focuses on standardization of *Shariah*-compliant financial contracts and product templates. It was established in Bahrain in 2002 under Royal Decree No (23) as a neutral and non-profit international Islamic infrastructure institution.

[11] IFSB 5, 2005, p. 26.

[12] AAOIFI's Governance Standard No. 9, p. 8.

III.2 – Institutional Credibility Gap: Trust, Governance and Perceived Authenticity

Following the issue of normative coherence, the second dimension of the institutional capacity gap concerns institutional credibility. Actors may adhere to a norm that they perceive as coherent and authoritative without necessarily regarding the institutions claiming to embody that norm as credible. In Islamic finance, this credibility gap is particularly important because the adoption of Islamic financial products does not depend solely on formal *Shariah* compliance, but also on whether such compliance is perceived as sincere, transparent, verifiable, and institutionally reliable.

The first difficulty lies in the distinction between declared compliance and perceived compliance. An Islamic financial institution may formally present itself as *Shariah*-compliant, possess a supervisory committee, follow specific *fatwas*, or operate within a national regulatory framework, without necessarily being perceived as fully credible by users. Mohamad and Sulong (2025) show that *Shariah* non-compliance risk is not merely a technical issue, but a governance problem capable of weakening institutional credibility and stakeholder trust. Similarly, Suaidi (2025), in the Indonesian case, emphasizes that the existence of regulations, *fatwas*, and supervisory bodies does not automatically ensure effective compliance when problems of regulatory harmonization, competence, independence of supervisory bodies, and Islamic financial literacy remain unresolved.

This distinction is decisive because the adoption of Islamic financial instruments depends heavily on how actors perceive their actual compliance. Shah et al. (2023) show that perceived *Shariah* compliance, knowledge of the Islamic financial system, religious preferences, and loyalty positively influence the intention to adopt Islamic finance, particularly through the mediation of attitudes toward Islamic finance. In the same vein, Hidayatullah (2026) shows that some Islamic fintech platforms may be perceived as reproducing mechanisms close to conventional lending–fixed-interest-like returns, unclear contractual structures, opaque fees–despite their *Shariah*-compliant claims. His quantitative study indicates that *Shariah* compliance, transparency, and trust jointly explain a significant share of users' perceptions, with *Shariah* compliance appearing as the dominant determinant. Institutional credibility therefore depends not only on proclaimed compliance, but on the capacity of institutions to make such compliance intelligible, verifiable, and most importantly, convincing in the eyes of actors.

A second credibility issue concerns the role of *Shariah* boards. These boards are not merely symbolic bodies; they are one of the key institutional sites where *Shariah* norms are transformed into organizational decisions. Wardhany and Arshad (2012) recall that *Shariah* boards are involved in issuing *fatwas*, supervision (*raqabah*), review (*mutaba'ah*), audit, and annual certification of compliance, making them central organs of Islamic governance within financial institutions [13]. From this perspective, their credibility depends less on their formal existence

[13] The terms *raqabah* and *mutaba'ah* refer respectively to *Shariah* supervision and *Shariah* review/follow-up mechanisms, through which *Shariah* boards monitor the compliance of products, contracts, and institutional practices.

than on the effective balance between their responsibility and authority: a board tasked with guaranteeing compliance without possessing real authority over products, contracts, or internal procedures can only provide limited assurance. This requirement is supported by Sueb et al. (2022), who show that the characteristics of *Shariah* supervisory boards–size, expertise, education, reputation, and cross-membership–significantly influence the performance of Islamic banks, confirming that the quality of *Shariah* supervision has concrete institutional effects.

However, the literature also shows that *Shariah* boards may become a source of fragility when they lack transparency, independence, or technical competence. Haridan, Hassan and Karbhari (2018) argue that, in the Malaysian case, the establishment of a *Shariah* governance framework has improved the credibility of religious assurance, but that compliance review may remain insufficient when *Shariah* boards depend excessively on internal bank officers, lack technical knowledge in banking and finance, or perform a role that is more ceremonial than genuinely vigilant. This critique is decisive for the present framework: trust does not automatically result from the mere presence of a *Shariah* board; it depends on the perception that this board is truly independent, competent, transparent, and able to monitor the institution it certifies. Kachkar and Yilmaz (2022) further add that, although *Shariah* supervisory boards display relatively acceptable diversity in terms of education and nationality, they still suffer from a significant lack of gender and age diversity, while regulatory diversity requirements remain almost non-existent. Institutional credibility therefore requires not only certified compliance, but also visible, independent, competent, and accountable *Shariah* governance.

Beyond the specific role of *Shariah* boards, institutional credibility also depends on the broader governance architecture of Islamic financial institutions. Saidi (2008) recalls that corporate governance aims to organize the direction, administration, and control of organizations through mechanisms of audit, transparency, disclosure, and accountability. In the case of Islamic financial institutions, this requirement is reinforced by an additional layer of governance, since their operations must satisfy not only conventional standards of sound management, but also *Shariah* principles and the expectations of the Muslim community. He thus emphasizes that IFSB and AAOIFI standards seek precisely to articulate international governance codes with the specificities of Islamic financial institutions, particularly in relation to reporting, protection of investment account holders, mechanisms for obtaining and applying *Shariah* opinions, and public disclosure of compliance decisions. This requirement is confirmed by Shafii and Salleh (2010), who show that *Shariah* compliance often remains largely self-declared by institutions, without sufficient independent external corroboration. According to them, the absence of external *Shariah* audit and deep internal control of *Shariah* systems limits accountability, transparency, and stakeholders' ability to assess *Shariah* non-compliance risk. In this regard, governance therefore appears not as a simple peripheral issue, but rather as a central mechanism of credibility, which transforms proclaimed compliance into controlled and institutionally verifiable compliance.

A third factor weakening institutional credibility lies in the recurrent suspicion that some Islamic finance products merely reproduce conventional financial instruments under a legally adjusted form. This critique is not external to the field of Islamic finance. Usmani (1998) himself recalls that the ideal modes of financing in *Shariah* are *musharakah* and *muḍarabah*, whereas *murabaḥah* is not originally a mode of financing, but a mechanism tolerated under

specific conditions when profit-and-loss sharing instruments are not practicable. He insists that *murabaḥah* does not become lawful through the mere terminological substitution of "interest" with "profit" or "mark-up", but only through the effective fulfilment of substantive legal conditions distinguishing a real sale from an interest-bearing loan. Usmani also recognizes that *murabaḥah* and *ijarah* may be criticized insofar as their economic outcome may sometimes resemble interest-based financing, which is why they should not be considered ideal modes and should only be used in cases of need, with strict respect for *Shariah* conditions. This tension is reinforced when Islamic profits are indexed to conventional benchmarks such as the London Inter-Bank Offered Rate (LIBOR): Usmani admits that this practice does not necessarily render the transaction unlawful if the conditions of *murabaḥah* are fulfilled, but nevertheless considers it undesirable because it gives the appearance of interest-based financing and does not advance the distributive philosophy of Islamic economics. In the same spirit, Siddiqi (2006) criticizes the tendency of the industry to design *Shariah*-compliant substitutes for conventional instruments already familiar to the market, thereby risking reducing Islamic finance to contractual engineering and replication rather than a genuine institutional alternative. The issue is therefore not merely legal, but institutional, insofar as the more Islamic products appear as functional equivalents of conventional products, the more the institutions offering them risk being perceived as nominally compliant but insufficiently faithful to the spirit and objectives of Islamic finance.

A fourth factor of institutional credibility concerns the practical conditions of access to Islamic financial products. Even when *Shariah* compliance is accepted, effective adoption also depends on price, availability, service quality, and user experience. In the British case, Omar Shaikh, Advisory Board Member and Director of the Islamic Finance Council UK (UKIFC) [14], distinguishes awareness (i.e. the fact of knowing that Islamic finance exists) from acceptance (i.e. the fact of being effectively willing to use it) [15]. According to him, acceptance is often shaped more by perceptions of pricing, accessibility, and service quality than by *Shariah* compliance alone. He also emphasizes that awareness campaigns have limited impact if products are not actually available because consumers cannot be educated about Islamic car finance if no institution offers such a product. In markets where Islamic finance penetration remains below 15%, the absence of a credible and usable ecosystem significantly limits adoption, whereas markets reaching 30-50% penetration generally benefit from broader product availability and deeper consumer familiarity (ICD & LSEG, 2025). This idea is consistent with Shinkafi, Yahaya and Sani (2019), who recall that financial exclusion is not limited to the absence of institutions, but also includes access-exclusion, condition-exclusion, price-exclusion, marketing-exclusion, and self-exclusion. The same authors identify technology, financial literacy, infrastructure, microfinance, public awareness, and regulatory commitment as essential levers of Islamic financial inclusion. Finally, Hardana et al. (2023) empirically show that attitudes toward Islamic banking are positively associated with customer satisfaction and service quality, while satisfaction positively influences trust, and trust affects customer

[14] The Islamic Finance Council UK (UKIFC) is a non-profit and advisory organization established in 2005 focused on promoting and enhancing the global Islamic and ethical finance industry.

[15] Omar Shaikh's remarks are drawn from the UKIFC executive insight interview published in the *ICD–LSEG Islamic Finance Development Report 2025*.

loyalty. These results confirm that institutional credibility is not merely a matter of abstract religious certification: indeed, an Islamic financial institution becomes credible insofar as it offers accessible, competitive, understandable, and qualitatively comparable–or superior –services to conventional alternatives.

These different elements allow the question of trust to be reformulated. Institutional trust should not be understood as an abstract, purely cultural, or psychological prerequisite, but as a property progressively produced by institutions capable of demonstrating competence, integrity, and fidelity to the principles they claim to uphold. North (1990) shows that institutions reduce uncertainty by stabilizing actors' expectations; from this perspective, an institution inspires trust when it makes behavior predictable, commitments credible, and rules effectively applicable. Before him, Arrow (1974) had already emphasized that trust is a fundamental element of economic life, insofar as it reduces coordination costs and makes possible transactions that would otherwise be too costly or too risky.

Accordingly, the institutional credibility gap in Islamic finance cannot be reduced to a problem of image or communication. It refers more fundamentally to the capacity of institutions to make their compliance visible, their procedures transparent, their governance verifiable, their products accessible, and their performance durable. An Islamic financial institution becomes credible when it succeeds in converting declared compliance into effective trust. Conversely, it becomes fragile when the gap between normative promise, actual governance, and user experience generates doubt. Thus, after normative coherence, institutional credibility appears as the second dimension of institutional capacity: it transforms a recognized norm into a trustworthy institution. Yet credibility itself remains insufficient if the institution does not subsequently possess the operational means required to fulfill its promises.

III.3 – Operational Capacity Gap: Ecosystems, Infrastructure and Market Depth

The third dimension of the institutional capacity gap concerns operational capacity. Once adherence to the norm has been established and institutional credibility has been partially acquired, institutions must still be effectively capable of implementing and sustaining what they promise. A credible norm and real demand do not automatically produce an institutionalized market if the necessary infrastructures, skills, and coordination mechanisms are lacking. This is precisely what is revealed by the contrast between the global growth of Islamic finance and the highly uneven distribution of its institutional depth. The *ICD–LSEG Islamic Finance Development Report 2025* emphasizes that the IFDI does not measure only assets or financial performance, but provides a broader assessment of the industry through financial performance, governance, sustainability, knowledge, and awareness. This framework reveals considerable disparities: Malaysia reaches an IFDI score of 135, Saudi Arabia 114, and the United Arab Emirates 92, while the global average remains only 11. In other words, the issue is not merely whether Islamic financial products exist, but whether a country is able to build a complete ecosystem in which such products are accessible, liquid, competitive, supervised, understood, and continuously renewed.

Malaysia constitutes the most advanced example of integrated operational capacity. The *ICD–*

LSEG report notes that, since the 1980s, the country has developed a dual financial system in which Islamic finance operates alongside conventional finance, supported by resilient institutions, a wide range of instruments, and a comprehensive enabling infrastructure. This integration is reflected empirically in a high level of penetration: in 2024, Islamic finance accounted for more than 46% of total financing in Malaysia, the takaful sector for nearly 24% of industry premiums, and the country for 36% of outstanding global *sukuk*. This result cannot be explained by religious demand alone, but by cumulative institutional efforts combining digitalisation, Islamic digital banks, financial innovation, professional training, standards, *Shariah* forums, specialized institutions, and international coordination. The report mentions the International Center for Education in Islamic Finance (INCEIF) University [16], the Islamic Banking & Finance Institute Malaysia (IBFIM) [17], the Chartered Institute of Islamic Finance Professionals (CIIF) [18], the Association of *Shariah* Advisors in Islamic Finance Malaysia (ASAS) [19], and the Centralised *Shariah* Advisory Forum (CSAF) [20] as components of this architecture of talent development and mutual recognition. Malaysia therefore shows that operational capacity is a multisectoral ecosystem property, emerging from the articulation between regulators, banks, capital markets, educational institutions, standards, digital infrastructures, and coordination mechanisms.

By contrast, other jurisdictions illustrate more partial forms of operational capacity. The United Kingdom, for instance, plays an important role as a non-Muslim hub. Indeed, London remains a key listing venue for US dollar-denominated *sukuk*, the London Metal Exchange (LME) remains central to certain commodity *murabaha* liquidity management solutions, and British Islamic fintechs contribute to both domestic and international innovation. However, Omar Shaikh [21] emphasizes that adoption does not depend only on awareness, but also on acceptance, which is itself shaped by pricing, accessibility, and service quality. In markets where Islamic finance penetration remains below 15%, the absence of available and usable products limits the impact of awareness campaigns. Indonesia, for its part, illustrates strong operational capacity in specific segments, particularly sovereign and retail *sukuk*: since 2008, it has issued approximately USD 223.8 billion in sovereign *sukuk* and aims for *sukuk* to account for 25-30% of government securities issued, while retail *sukuk* have attracted more than 400,000 individual investors and promoted financial inclusion through digital distribution. Ethiopia, finally, represents an emerging case: potential demand exists, but the *ICD–LSEG report*

[16] The INCEIF University was set up by Bank Negara Malaysia in 2005, contributing to develop human capital and knowledge leadership for the global Islamic finance industry.

[17] IBFIM is a lifelong learning institution based in Kuala Lumpur, Malaysia, which specializes in industry technical certifications designed to ensure attainment of technical proficiency levels to fulfill jobs requirement and support professionalization of the Islamic finance industry.

[18] The CIIF was established in 2015 in Kuala Lumpur, Malaysia, as a professional body dedicated to Islamic Finance. Its main purpose is to elevate standards of professionalism and ethical behaviour amongst the professionals serving the industry and its stakeholders.

[19] The ASAS was established in 2011 in Malaysia to promote and maintain a high level of professionalism with standards of competence and conduct of the *Shariah* advisory services for Islamic finance.

[20] The CSAF is an international networking platform established in 2018, at the initative of Bank Negara Malaysia, that gathers central *Shariah* authorities across the globe. Its purpose is to strengthen global connectivity and foster mutual respect on *Shariah* views across jurisdictions.

[21] Omar Shaikh's remarks are drawn from the UKIFC executive insight interview published in the *ICD–LSEG Islamic Finance Development Report 2025*.

emphasizes the need to build a unified national policy, an adapted legal and tax framework, credible *Shariah* governance, anchoring products such as retail *sukuk*, and financial education campaigns.

The IFSB 2025 report confirms this reading through the issue of market depth [22]. Despite robust growth, the industry remains structurally concentrated in Islamic banking and in certain regions, which highlights the need to develop non-bank segments and emerging markets. In particular, the IFSB observes that *sukuk* markets remain vulnerable because of complex contractual structures, lack of standardization, weak secondary market liquidity, a concentrated investor base, the absence of regular local-currency sovereign benchmarks, and still insufficient market infrastructure. These operational weaknesses have concrete effects, as they limit price discovery, increase transaction costs, reduce the liquidity management flexibility of Islamic banks, and constrain the sector's capacity to function as a systemic instrument of financing and stability. The work of Brown, Hassan, and Skully (2007) on the operational efficiency of Islamic banks already pointed in this direction: banking performance depends not only on product compliance, but also on the efficient use of resources, technologies, and intermediation processes.

Thus, the operational gap explains why Islamic finance may continue to grow while remaining institutionally uneven. In advanced jurisdictions, the existence of a dense ecosystem allows the norm to be transformed into a deep market, where products are available, professionals are trained, regulators are involved, infrastructures are present, and investors are sufficiently numerous to support liquidity. In less advanced jurisdictions, by contrast, Islamic finance is often constrained by rare, expensive, or insufficiently diversified offerings, stronger conventional competition, complex procedures, weak digitalisation, a shortage of specialized professionals, or incomplete regulatory infrastructure. The Algerian case illustrates this type of constraint: Rahmani (2025) identifies regulatory rigidity, competition from conventional banks, procedural complexity, and the weakness of certain infrastructures as obstacles to the full institutional valorization of Islamic finance.

Operational capacity therefore constitutes the third dimension of institutional capacity: it transforms a credible institution into an effective institution. Without it, Islamic finance may remain a normative promise, a niche market, or a partial offering. With it, however, it becomes an ecosystem capable of producing inclusion, liquidity, innovation, stability, and development. The institutional capacity gap thus appears as a systemic phenomenon: weak normative coherence undermines credibility; weak credibility limits adoption; weak operational capacity prevents scaling. It is this interaction between the three dimensions that must now be synthesised before considering the broader implications of the analysis for standard-setters and Islamic financial institutions.

[22] Market depth is understood here as the existence of liquid, diversified, regularly issued, and sufficiently traded instruments, supported by benchmarks, infrastructure, investor diversity, and secondary-market activity.

III.4 – Synthesis: Uneven Institutional Capacity, Not Doctrinal Failure

The preceding analysis allows the paradox of Islamic finance to be reformulated through the framework of institutional capacity. The limits observed do not stem from a doctrinal rejection of Islamic economic principles, nor from a general absence of demand, nor even from an absolute lack of institutions. Rather, they reflect a differentiated process of institutionalization, in which the most advanced jurisdictions are those that succeed in articulating normative coherence, institutional credibility, and operational capacity.

This framework shows that the three dimensions should not be understood separately. Weak normative coherence may undermine institutional credibility; fragile credibility may limit adoption; insufficient operational capacity may prevent an otherwise legitimate institution from producing durable outcomes. Conversely, the most advanced cases, such as Malaysia, show that robust institutional capacity rests on the progressive accumulation of institutions, instruments, competencies, standards, training systems, and market infrastructures.

Table 2: Diagnosing the Institutional Capacity Gap in Islamic Finance

Dimension of Institutional Capacity	Guiding Question	Observed Deficit in Islamic Finance	Concrete Manifestations	Institutional Effect	Possible Way Forward
Normative Coherence	Do actors know which rules govern the institution, and do they recognize them as authoritative?	Fragmentation of standards, interpretive divergences, plurality of Shariah methodologies that remain difficult to read	Differences between legal opinions, partial adoption of AAOIFI/IFSB standards, fatwa arbitrage, uncertainty regarding certain products or innovations such as crypto-assets	Legal uncertainty, coordination costs, difficulty in building common and comparable markets	Harmonization without absolute uniformization; methodological clarification; partial centralization of rulings; better documentation of Shariah decisions
Institutional Credibility	Do actors believe the institution will apply these rules faithfully, fairly, and predictably?	Gap between declared compliance and perceived compliance; doubts about the independence, transparency, and sincerity of institutions	Suspicion of 'halal replication' of conventional products, sometimes opaque role of Sharia boards, lack of external Shariah audit, perception of products as expensive, complex, or insufficiently accessible	Distrust, limited adoption, perception of merely nominal rather than substantive compliance	Stronger governance, greater transparency of Sharia boards, independent audit, improved disclosure, better user experience and service quality
Operational Capacity	Is the institution effectively able to implement and sustain what it promises?	Insufficiently diversified supply, limited infrastructure, shortage of specialized professionals, shallow markets	Weak retail presence in some countries, limits of fintechs without sufficient capital, lack of sukuk benchmarks, weak secondary liquidity, geographic concentration of assets	Shallow markets, limited diffusion, weak scalability, dependence on a few advanced jurisdictions	Development of complete ecosystems: banks, regulators, human capital, training, fintech, sukuk markets, liquidity instruments, legal and fiscal infrastructures

Source: Author's own elaboration.

Ultimately, the case of Islamic finance does not reveal the failure of a norm, but rather the difficulty of its institutional translation. A norm may be known, desired, and even partially embodied in financial products without immediately producing a deep, credible, and generalizable system. The central diagnosis is therefore one of uneven institutional

capacity: where the three dimensions mutually reinforce one another, Islamic finance becomes an ecosystem; where one of them is lacking, it remains a partial offering, a niche market, or an unfinished promise.

IV – Implications for Standard-Setters and Islamic Finance Institutions

The preceding diagnosis suggests that the future development of Islamic finance depends less on the mere multiplication of *Shariah*-compliant products than on the consolidation of institutional capacity. In practical terms, this means strengthening the mechanisms through which *Shariah* principles are translated into coherent standards, credible governance structures, and operationally deep ecosystems. This section outlines several implications for standard-setters, regulators, Islamic financial institutions, and ecosystem-building organizations.

First, Islamic finance requires harmonization without excessive uniformization. The objective should not be to eliminate all *ikhtilaf*, which remains both legitimate and necessary, but to make such disagreements intelligible, documented, and operationally manageable. A more harmonized framework would reduce uncertainty, limit *fatwa* shopping, and facilitate cross-border comparability, while preserving the flexibility required by different legal schools, jurisdictions, and market contexts.

Second, there is a need for better documentation of *Shariah* methodologies. Beyond the final ruling on a product or transaction, institutions should make clearer the reasoning, assumptions, sources, and conditions underlying *Shariah* decisions. This does not necessarily require disclosing every internal deliberation, but it does imply greater methodological transparency. Such documentation would help users, regulators, scholars, and market participants understand why a given product is considered compliant, under what conditions, and whether the ruling remains valid if the economic substance of the product changes.

Third, the transparency and authority of *Shariah* boards should be strengthened. Their credibility depends not only on their formal existence, but on their independence, competence, access to information, and effective authority over products, contracts, and internal procedures. Islamic financial institutions should therefore ensure that *Shariah* boards are not reduced to symbolic or ceremonial bodies, but are integrated into the governance process in a way that allows them to monitor and challenge institutional practices when necessary.

Fourth, the development of external *Shariah* audit should be encouraged. Since *Shariah* compliance often remains largely self-declared, independent review mechanisms can play a major role in transforming proclaimed compliance into verifiable compliance. External *Shariah* audit would strengthen accountability, improve public trust, and reduce the gap between declared conformity and perceived authenticity. This is particularly important in sectors where products are complex, hybrid, or close in economic effect to conventional instruments.

Fifth, stronger articulation is needed between international standards and national regulatory frameworks. AAOIFI, the IFSB, IIFM, national regulators, central banks, and *Shariah* governance authorities each play different but complementary roles. Yet, the institutional

challenge is to avoid both excessive fragmentation and purely symbolic adoption of international standards. Therefore, a more effective architecture would clarify how international standards are incorporated into national law, supervisory practices, dispute-resolution mechanisms, and prudential regulation.

Sixth, Islamic finance requires sustained investment in professional training and human capital. Operational capacity depends on the availability of professionals who understand not only *Shariah* principles, but also financial engineering, risk management, regulation, auditing, fintech, capital markets, and user experience. The development of specialized training institutions, professional certifications, and cross-disciplinary programs is therefore essential for transforming Islamic finance from a compliance-based offering into a mature and innovative ecosystem.

Seventh, the industry would benefit from institutional capacity indicators allowing jurisdictions to be compared not only in terms of assets, but also in terms of ecosystem depth. Such indicators could assess normative coherence, *Shariah* governance quality, regulatory integration, audit mechanisms, product diversity, human capital, market liquidity, digital infrastructure, financial inclusion, and consumer trust. The objective would not be to create a purely quantitative ranking, but to provide a diagnostic tool capable of identifying where each jurisdiction's institutional capacity is strong, partial, or fragile.

Finally, the development of Islamic finance should focus on complete ecosystems rather than isolated compliant products. A product may be formally *Shariah*-compliant and yet remain ineffective if it is unavailable, expensive, poorly understood, illiquid, weakly regulated, or unsupported by market infrastructure. The most advanced jurisdictions show that Islamic finance becomes institutionally robust when banks, regulators, capital markets, fintechs, training institutions, *Shariah* scholars, auditors, investors, and consumers are connected within a coherent ecosystem. The strategic objective should therefore be to build markets in which Islamic finance is not only compliant, but accessible, credible, competitive, liquid, and capable of supporting broader economic development.

Taken together, these implications point toward a shift in emphasis: from product-level compliance to ecosystem-level institutional capacity. The central task for the next stage of Islamic finance is not simply to prove that particular products can be made *Shariah*-compliant, but to ensure that the industry as a whole can generate trust, coordination, scalability, and durable public value.

Limits

The analysis presented in this article should be understood as a conceptual and diagnostic contribution rather than as an exhaustive cross-country comparison. The jurisdictions discussed throughout the paper were selected purposively for their analytical relevance and for the contrasting configurations they illustrate, ranging from relatively integrated ecosystems, such as Malaysia, to non-Muslim financial hubs, sector-specific developments, emerging markets, and more constrained institutional environments. These cases are therefore illustrative rather than statistically representative. Their selection, as well as differences in data availability across jurisdictions, may influence the patterns identified and does not exclude the possibility

that other institutional configurations would reveal different interactions between normative coherence, institutional credibility, and operational capacity.

A second limitation concerns the empirical status of the institutional capacity framework itself. The three dimensions proposed in this article are derived from the existing literature and applied to secondary academic and institutional evidence, but they have not yet been operationalized through standardized cross-country indicators or subjected to systematic causal testing. The analysis therefore does not claim that institutional capacity constitutes the sole determinant of Islamic finance development, nor that doctrinal, political, macroeconomic, legal, or historical factors are irrelevant. Rather, it identifies institutional capacity as a potentially important explanatory framework whose comparative validity and causal mechanisms should be tested in future research through broader cross-country analysis, longitudinal evidence, and more systematic measurement of its three dimensions.

Conclusion

Islamic finance does not primarily suffer from a doctrinal failure or from a lack of demand. Its contemporary paradox lies rather in the uneven distribution of institutional capacity across jurisdictions. While the industry has achieved substantial growth and benefits from a real normative appeal, its ability to become both a credible and widely accessible system depends on the interaction between three dimensions: normative coherence, institutional credibility, and operational capacity.

The future development of Islamic finance therefore depends on its ability to transform *Shariah* principles into coherent standards, credible institutions, and operationally deep ecosystems. Where this translation succeeds, Islamic finance can move beyond niche compliance and become a genuine institutional alternative capable of producing trust, inclusion, liquidity, innovation, and development. Where it fails, the industry risks remaining fragmented, partially credible, and unevenly institutionalized despite its continued growth.

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