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Islamic Law Review of Sharia Cooperative Practices in Indonesia

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ABSTRACT

This paper examines the practices of Sharia cooperatives in Indonesia through an Islamic law perspective, focusing on their adherence to Sharia principles, the effectiveness of existing legal frameworks, and the operational challenges they face. Utilizing a comprehensive literature review, the study reveals that while Sharia cooperatives aim to provide ethical financial solutions, many struggle with compliance due to inadequate understanding of Islamic finance, regulatory ambiguities, and governance issues. The findings highlight the importance of enhancing regulatory clarity, establishing robust Sharia supervisory bodies, and fostering continuous education among cooperative managers and staff. By addressing these challenges, Sharia cooperatives can better align their practices with Islamic law and contribute to the broader Islamic finance ecosystem in Indonesia.

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1. INTRODUCTION

Sharia cooperatives in Indonesia play a crucial role in providing financial services aligned with Islamic principles, offering an ethical alternative to conventional institutions. These cooperatives avoid interest (riba), uncertainty (gharar), and unethical investments, while promoting social equity and financial inclusivity. Employee competence, creativity, and motivation significantly impact performance, as shown in the Tunas Artha Mandiri Syariah Jombang cooperative [1]. Despite the strong foundation of cooperation in Indonesian society, clearer legal frameworks are needed [2], and the National Sharia Council provides guidelines to ensure compliance with Islamic law [3]. Trust and reciprocity enhance member satisfaction and sustainability in Sharia cooperatives [4]. However, to fully optimize their role, strategic improvements in regulation, public education, and product innovation are required to boost financial inclusivity and economic growth [5].

The development of Islamic cooperatives in Indonesia is closely tied to the growth of Islamic finance, supported by legal frameworks and government policies. However, Sharia cooperatives face challenges in maintaining compliance with Sharia principles due to regulatory vagueness and operational inconsistencies. Although the government has introduced laws to support Sharia cooperatives, clearer regulations, particularly in dispute resolution, are still required [2]. While policies have influenced the Islamic economy's development, a stronger legal framework is needed [6]. Operational improvements are essential for these cooperatives to benefit society [2], and enhancing employee competence, creativity, and motivation is crucial [1]. The National Committee for Islamic Financial Economics (KNEKS) plays a key role in making Islamic finance more inclusive [7], and strong governance, built on trust and reciprocity, can enhance cooperative performance [4].

Given the critical role that Sharia cooperatives play in promoting Islamic financial practices, it is essential to review their operations from an Islamic legal perspective. This paper aims to provide a comprehensive literature review of the practices of Sharia cooperatives in Indonesia. By examining existing literature, regulatory frameworks, and case studies, this study will assess the extent to which Sharia cooperatives align with Islamic law and identify areas for improvement. The primary objective of this literature review is to explore the legal and operational practices of Sharia cooperatives in Indonesia through the lens of Islamic law. It seeks to answer the following questions: To what extent do Sharia cooperatives comply with Islamic financial principles? What are the key challenges faced by these cooperatives in adhering to Sharia law? What legal and operational frameworks can be improved to ensure that Sharia cooperatives maintain their Islamic integrity while fulfilling their financial and social missions?

2. LITERATURE REVIEW

2.1 Previous Studies on Sharia Cooperatives in Indonesia

The performance and Sharia compliance of cooperatives in Indonesia have been the subject of several empirical studies, revealing both challenges and opportunities. Sharia cooperatives, such as those in West Java [8], often claim adherence to Sharia principles, yet deviations in profit-sharing models are common, largely due to issues like liquidity and risk management [1], [4]. Digital transformation, particularly through fintech, offers a promising solution to enhance compliance and operational efficiency [9], [10]. Fintech can improve transparency, record-keeping, and financial reporting, while contracts like murabahah and wakalah bil Ujrah help align operations with Sharia principles [11]. Additionally, improving Sharia competence, creativity, and motivation among employees positively influences cooperative performance, while trust and reciprocity are key factors in enhancing member satisfaction [1], [4].

2.2 Research Gaps

Despite the growing body of literature on Sharia cooperatives, several gaps remain. First, while numerous studies have explored the legal frameworks governing these cooperatives, there is limited research on how different legal interpretations of Sharia impact cooperative practices in various regions of Indonesia. Additionally, more empirical studies are needed to assess the effectiveness of Sharia governance mechanisms in cooperatives. Another area for further research is the role of technology in enhancing Sharia compliance, particularly as more cooperatives begin to adopt digital financial services.

3. METHODS

3.1 Research Design

This study utilizes a qualitative research approach with a focus on literature review analysis. The qualitative method is chosen as it allows for an in-depth examination of the legal and operational aspects of Sharia cooperatives based on existing scholarly works, legal documents, and case studies. The literature review method is particularly appropriate for this research because it synthesizes knowledge from various sources to assess how well Sharia cooperatives align with Islamic law.

The primary source of data for this study is secondary literature, which includes academic papers, books, conference proceedings, official reports, legal regulations, and fatwas related to Sharia cooperatives in Indonesia. The selection of these sources was based on the relevance and quality of the studies in addressing the research objectives. The data collection process was divided into the following steps:

3.2 Literature Search Strategy

The literature search was conducted using a variety of academic databases and search engines, including Google Scholar, JSTOR, Scopus, and Web of Science. Key search terms used included "Sharia cooperatives," "Islamic law," "Islamic finance," "Sharia compliance," "Indonesia," and "Islamic cooperative governance." The search was limited to publications written in English and Indonesian to ensure comprehensive coverage of both international and local perspectives on Sharia cooperative practices.

Table 1. Inclusion and Exclusion Criteria

Criteria	Inclusion	Exclusion
Publication Year	Studies published between 2000 and 2023.	Articles published before 2000.
Topic	Articles and books that specifically discuss Sharia cooperatives in Indonesia or Islamic cooperative practices globally, with relevance to the Indonesian context.	Publications not directly related to Islamic law or Sharia cooperatives.
Legal Principles	Research papers that address Islamic law principles and their application in Islamic finance and cooperative systems.	Publications focusing exclusively on conventional cooperatives without reference to Sharia compliance.

The primary literature sources used in this review include academic articles on the legal frameworks governing Sharia cooperatives, empirical case studies on Sharia cooperative operations in Indonesia, and fatwas issued by the National Sharia Board (DSN). Legal documents, such as Indonesia's Law No. 25 of 1992 on Cooperatives and Law No. 21 of 2008 on Sharia Banking, were also analyzed to provide a regulatory context.

3.3 Data Analysis

The literature collected was analysed using thematic analysis, a qualitative method to identify themes and patterns in the data. This process organised the data into relevant categories, such as Shariah compliance, regulatory challenges, and governance mechanisms. The first step was the identification of themes based on relevance to the research questions, which included: Shariah compliance of cooperatives in Indonesia to the principles of Islamic law, the role of the regulatory framework in the operations of Shariah cooperatives, and practical challenges in maintaining Shariah compliance, including financial sustainability and market competition.

4. RESULTS AND DISCUSSION

4.1 Sharia Compliance of Cooperatives

The analysis of the literature reveals a mixed picture regarding the Sharia compliance of cooperatives in Indonesia. The Sharia compliance of cooperatives in Indonesia presents a complex scenario, as many aim to adhere to Islamic finance principles but face challenges in implementation. While cooperatives strive to follow profit-sharing models like mudarabah and musharakah, discrepancies arise due to a lack of comprehensive understanding of Islamic finance among management teams, often resulting in practices resembling conventional banking that potentially violate Sharia principles [12], [13]. The Indonesian government has made efforts to support Sharia cooperatives through various laws, but clarity and enforcement remain problematic [12]. Many cooperatives struggle with inadequate training on Islamic finance, leading to non-compliance [12], and some operate under practices more aligned with conventional banking [12]. Stronger regulations and clearer enforcement are essential [11], [12], as government support plays a critical role in ensuring Sharia financial institutions grow and remain compliant [14]. Additionally, trust and reciprocity significantly influence member satisfaction, which in turn enhances cooperative performance [4]. This gap in knowledge leads to unintended violations, such as the imposition of fixed fees that resemble interest payments, undermining the cooperative's Sharia legitimacy.

4.2 Effectiveness of Legal Frameworks

The literature suggests that the existing legal frameworks governing Sharia cooperatives in Indonesia provide a foundational structure for their operation, but significant gaps remain. The existing legal frameworks for Sharia cooperatives in Indonesia, while foundational, have significant gaps that complicate compliance. The dual governance system involving cooperative law and Sharia banking regulations adds complexity. Laws No. 25 of 1992 and No. 21 of 2008 provide essential guidelines but do not fully address the specific needs of Sharia cooperatives. The National Sharia Board (DSN) plays a key role in issuing fatwas, yet inconsistent application causes discrepancies in compliance [3]. The coexistence of these laws creates a complex environment, often hindering compliance, as current regulations lack full integration of Sharia principles, leading to legal uncertainty [15]. Fatwa inconsistencies, like with Fatwa No. 141/DSN-MUI/VIII/2021, further complicate matters [3]. However, studies show that cooperatives such as Fitrah Insani Bandung meet compliance standards, pointing to opportunities for policy-making [16]. Trust and reciprocity are crucial for member satisfaction, suggesting a focus on building strong relationships [4]. More integrated regulations and the establishment of a Sharia Commercial Court could enhance legal certainty and support Sharia economy growth in Indonesia [15], [17]. This inconsistency in regulatory oversight raises questions about the effectiveness of the existing legal framework in ensuring comprehensive Sharia compliance across all cooperatives.

4.3 Challenges of Operational Compliance

The literature review identifies several key challenges that hinder Sharia cooperatives from fully adhering to Islamic principles. Financial sustainability is a significant challenge for Islamic cooperatives, often leading them to adopt non-compliant practices to maintain liquidity and capital. Reliance on conventional financial mechanisms, such as interest-based loans, is a common strategy, despite contradicting Islamic finance principles. This issue is exacerbated by weak governance structures, which can result in mismanagement and deviation from Shariah principles, further compounded by the absence of a dedicated Shariah supervisory board or committee, leading to inadequate audits and compliance checks [18]–[20]. Liquidity constraints push cooperatives towards non-compliant financial practices, and regulatory challenges add complexity to maintaining Shariah adherence [18], [21]. The lack of strong governance structures contributes to mismanagement, while digital transformation presents opportunities for innovation, improving access to finance and enhancing sustainability [21], [22]. Without effective oversight, cooperatives may inadvertently engage in practices that compromise their Sharia compliance, such as excessive risk-taking or insufficient profit-sharing.

4.4 Technological Adoption and Sharia Compliance

The integration of technology into Sharia cooperative operations can significantly enhance compliance with Islamic law by improving transparency, record-keeping, and profit-sharing processes. Digital financial solutions, such as fintech, offer automated transaction monitoring, reducing errors that could lead to Sharia violations. However, successful implementation requires adequate training and education for managers and staff to ensure alignment with Islamic finance principles [23], [24]. Digital solutions enhance transparency and operational efficiency, with fintech providing automated monitoring to ensure compliance [24], [25]. However, adequate training is necessary to align technology with Sharia requirements, while public knowledge of Sharia fintech must improve, as many perceive it to be similar to conventional fintech [11], [23]. Moreover, Islamic fintech must adhere to government regulations and avoid practices like riba, maysir, and gharar [25]. While technology offers significant benefits, addressing the digital divide and cybersecurity risks is essential for ensuring sustainable growth in Islamic finance without compromising Sharia compliance [24]. Therefore, continuous education and training programs are essential to empower cooperative personnel in navigating the complexities of Sharia compliance in a digital age.

4.5 Implications for Policymakers and Practitioners

The findings from this literature review highlight several important implications for policymakers, cooperative managers, and scholars in the field of Islamic finance. First, there is a pressing need for enhanced regulatory clarity regarding the operations of Sharia cooperatives. Policymakers should consider developing specific guidelines that address the unique challenges faced by these institutions, particularly in areas related to governance and Sharia compliance.

Additionally, the establishment of dedicated Sharia supervisory bodies within cooperatives could significantly enhance their operational integrity. By ensuring that cooperatives have access to knowledgeable advisors and Sharia compliance auditors, the potential for non-compliance can be mitigated.

Lastly, ongoing training and capacity-building initiatives should be prioritized to equip cooperative managers and staff with the necessary skills and knowledge to navigate the complexities of Islamic finance. By fostering a culture of continuous learning, Sharia cooperatives can better align their practices with Islamic law and contribute to the overall growth of the Islamic finance sector in Indonesia.

5. CONCLUSION

In conclusion, this study highlights the important role of Islamic cooperatives in the Islamic finance landscape in Indonesia, while underscoring the significant challenges they face in maintaining compliance with Shariah principles. The literature review suggests a complex interaction between the regulatory framework, operational practices, and understanding of Islamic finance among co-operative managers. To improve the effectiveness of Islamic cooperatives, policymakers must provide clearer regulatory guidelines that specifically address the needs of these institutions. In addition, the establishment of a dedicated Shariah supervisory body within the cooperative will be crucial to ensure compliance with Islamic law, as this body can conduct regular audits and provide ongoing guidance. Finally, ongoing education and training programs should be prioritized to equip cooperative personnel with the necessary knowledge and skills to deal with the complexities of Islamic finance. By addressing these areas, Islamic cooperatives in Indonesia can improve their operational integrity, strengthen their contribution to the economy, and better serve the community while remaining true to the principles of Islamic finance.

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