DANADYAKSA
POST MODERN ECONOMY JOURNAL

Vol. 2 No. 2, (2025), 154 – 166 e-ISSN: 3025-8545

The Role of Islamic Financial Institutions: Maintaining Market Integration and Preventing Distortion

Tetty Handayani Siregar[1]
Universitas Islam Negeri Sumatera Utara, Medan, Indonesia
tetty.handayanisrg@gmail.com

Isnaini Harahap[2]
Universitas Islam Negeri Sumatera Utara, Medan, Indonesia
isnainiharahap@uinsu.ac.id

Muhammad Ridwan[3]
Universitas Islam Negeri Sumatera Utara, Medan, Indonesia
muhammadridwan@uinsu.ac.id

Abstract

This study analyzes how Islamic financial institutions can encourage inclusive economic growth, reduce social inequality, and create added value for all stakeholders. In this study, researchers used a descriptive qualitative method. The data source used library research, drawing from various scholarly materials such as books, peer-reviewed journals, and official reports. These sources were carefully selected based on their relevance and credibility, and the data was analyzed through thematic analysis to identify key insights and patterns. The results of the study showed that price distortions were caused by several factors including cartels and trader associations, which manipulate supply and pricing; *ikhtikar* (hoarding of goods to drive up prices); *talaqqi ruqban* (intercepting rural sellers before they reach the market to buy goods at unfair prices); *tadlis* (concealment of product defects); *taghrir* (misleading information to deceive buyers); and bay *najasy* (artificial price inflation through false bidding). Islamic financial institutions have a strategic role in preventing market distortions caused by *usury* practices by offering Sharia-compliant financial products that emphasize profit-and-loss sharing, ethical investment, and risk-sharing. Empirical evidence from studies on Islamic finance shows that these mechanisms contribute to price stability and more equitable wealth distribution. Islamic financial institutions can encourage sustainable economic growth without harming any party by implementing a fair and transparent profit-sharing system. However, to achieve this goal, government support is needed in the form of conducive regulations and comprehensive public education campaigns. These campaigns should focus on raising awareness about the principles and benefits of Islamic financial practices, promoting ethical market behavior, and providing training programs for market participants to ensure proper implementation of Shariah-compliant transactions.

Keywords: Islamic Financial Institutions, Market Integrity, Market Distortion

Vol. 2 No. 2, (2025), 154 – 166 **e-ISSN: 3025-8545**

INTRODUCTION

In recent decades, Islamic financial institutions have experienced significant growth throughout the world, including in Indonesia. Despite this growth, there remains a crucial need to explore the specific role of these institutions in maintaining market integration and preventing market distortions. Understanding this role is essential as it directly impacts the stability, fairness, and ethical foundation of financial markets, particularly in economies where Islamic finance is rapidly expanding. This development is driven by increasing public awareness of the importance of a financial system that is in accordance with Islamic principles and increasing trust in the stability and sustainability of the Islamic financial system. In addition, support from regulators and the government through policies that encourage the growth of the Islamic financial industry has also contributed to the expansion of this sector (Poesoro, 2007).

Islamic financial institutions play a strategic role in the Islamic economic system, not only as providers of financial services but also as guardians of ethics and morality in economic activities. This role is evident in their commitment to promoting ethical investment, avoiding speculative and interest-based transactions, and ensuring that financial products align with Islamic legal principles. For instance, institutions like Bank Syariah Indonesia have implemented profit-and-loss sharing models and asset-backed financing, which reduce the likelihood of market manipulation and foster a more equitable economic environment. One of the fundamental principles in Islamic economics is the concept of *hisbah*, which aims to ensure fairness and integrity in market activities. *Hisbah* functions as a supervisory mechanism for trade practices and economic transactions to prevent monopoly, fraud, exploitation, and other forms of injustice. With this principle, it is hoped that the market can operate transparently, fairly, and oriented towards the welfare of society (Desi Nurmaida, 2017).

Islamic finance has several advantages compared to the conventional financial system. One of them is the application of asset-based financing, which means that every financial transaction must be supported by real assets. This aims to avoid speculation and transactions that are *gharar* (uncertainty) and riba (interest), which can cause economic instability. In addition, Islamic financial institutions encourage diversification of investment portfolios to

Vol. 2 No. 2, (2025), 154 – 166 e-ISSN: 3025-8545

reduce systemic risk and implement risk management in accordance with Islamic principles, so that they are more resilient to economic shocks than conventional financial systems that are often vulnerable to market volatility (Pasaribu & Widjaja, 2022).

However, despite their positive contribution to economic stability and market integrity, Islamic financial institutions still face various challenges in their implementation. Among these, the most critical and often understudied issues include ensuring full Sharia compliance amidst dynamic market conditions, developing innovative financial products without compromising Islamic principles, and establishing effective risk management strategies in volatile economic environments. These challenges highlight the need for a deeper exploration of how Islamic financial institutions can balance ethical adherence with market competitiveness. One of the main challenges is compliance with Islamic principles in various dynamic market conditions. Several studies have shown that in practice, some Islamic financial institutions face difficulties in ensuring full compliance with Islamic rules, especially in terms of product innovation and financial services. Another challenge is risk management in unstable market conditions, where Islamic financial institutions must be able to adjust their business strategies without violating Islamic principles (Della Irona & Triyani, 2022).

In addition, regulation and supervision of Islamic financial institutions are also important factors that influence the effectiveness of their role in maintaining market integrity. Regulations that are still developing and not yet fully standardized in various countries, including Indonesia, are obstacles to creating a more efficient and competitive Islamic financial environment. Therefore, more structured and systematic policies are needed to strengthen governance and ensure that Islamic financial institutions can truly contribute to preventing market distortions and creating a fairer and more sustainable financial system. Several previous studies have examined the role of Islamic financial institutions in maintaining market integrity and preventing economic distortions (Bayuni & Srisusilawati, 2018).

For example, research conducted by (Ummah, Nuryartono, & Anggraeni, 2015) highlighted how an Islamic financial system based on the principles of justice and profit

Vol. 2 No. 2, (2025), 154 – 166 **e-ISSN: 3025-8545**

sharing can reduce economic instability that often occurs in the conventional financial system. Another study by (Fauzan Fahmi Hasibuan, and Andri Soemitra, 2023) showed that Islamic financial institutions have the potential to create financial stability through asset-based financing mechanisms and avoidance of usury and *gharar*. In addition, research by (Aulia, R., & Latief, 2020) found that the implementation of the *hisbah* principle in market supervision can prevent monopolistic practices and injustice in trade, thereby creating a fairer and more sustainable economic ecosystem. However, several studies such as those conducted by (Nurwani, 2016) also revealed the main challenges faced by Islamic financial institutions, namely in terms of Sharia compliance and risk management, especially in unstable market conditions. Therefore, this study seeks to complement previous findings with a more in-depth analysis of the effectiveness of the role of Islamic financial institutions in maintaining market integrity and overcoming the challenges they face.

Based on this background, this study aims to fill the gap in the study of the role of Islamic financial institutions in maintaining market integrity and preventing distortion. Specifically, while previous studies have discussed the general benefits and challenges of Islamic finance, there remains insufficient exploration of how these institutions balance Sharia compliance with market adaptability and innovation. Moreover, the extent to which regulatory frameworks and risk management practices affect their effectiveness in preventing economic distortions has not been adequately addressed. This study seeks to answer these critical questions and provide a more nuanced understanding of their role in fostering a stable and ethical financial system. This study will analyze various factors that influence the effectiveness of Islamic financial institutions in carrying out their functions, including aspects of Sharia compliance, risk management, regulation, and economic policy. Thus, the results of this study are expected to provide significant contributions to the development of more effective, sustainable, and Islamic financial policies and practices.

Vol. 2 No. 2, (2025), 154 – 166 e-ISSN: 3025-8545

REVIEW OF LITERATURE

Islamic Financial Institutions (IFIs) play a crucial role in the global financial system by adhering to Sharia principles, which emphasize ethical finance, risk-sharing, and the prohibition of interest (riba). Unlike conventional financial institutions, IFIs operate based on profit-and-loss sharing models, thereby fostering financial stability and economic justice (Ariance, 2022). Despite these strengths, the existing literature often overlooks the practical challenges IFIs face in balancing Shariah compliance with market adaptability and innovation.

Table 1
Key Challenges and Opportunities in Islamic Financial Institutions

Challenge/Opportunity	Description	Impact on Market Integration & Distortion Prevention
Sharia Compliance	Ensuring adherence to Islamic principles amidst evolving market dynamics	Enhances ethical standards and reduces exploitation
Innovative Product Development	Creating financial products that align with Islamic laws and meet modern economic needs	Increases market competitiveness and ethical diversity
Risk Management	Developing robust strategies to handle economic volatility without violating Islamic rules	Reduces systemic risk and market instability
Regulatory Framework	Establishing standardized and effective governance across different markets	Promotes consistency and transparency in financial practices
Market Supervision (*Hisbah*)	Implementing mechanisms to prevent fraud, monopoly, and market manipulation	Ensures fairness and market integrity

Market integration refers to the extent to which different financial markets are interconnected, ensuring efficient capital allocation and price stability. IFIs contribute to market integration through risk-sharing mechanisms, where Islamic finance promotes equity-based financing, such as *mudarabah* (profit-sharing) and *musharakah* (joint venture). These financing models align the interests of financial institutions and entrepreneurs, reducing systemic risks. Asset-backed transactions further ensure that all financial dealings are supported by tangible assets or services, minimizing speculation and enhancing market

Vol. 2 No. 2, (2025), 154 – 166 e-ISSN: 3025-8545

stability. The growing adoption of Islamic financial products across various regions has facilitated cross-border investments, strengthening market integration among Muslim and non-Muslim countries (Soemitra, 2014). However, the literature often fails to critically assess the regulatory disparities and operational challenges IFIs face in different jurisdictions, which can impede effective market integration.

Market distortions arise due to information asymmetry, excessive speculation, and financial bubbles. IFIs play a significant role in preventing these distortions by eliminating interest-based transactions and uncertainty (*gharar*), thereby reducing financial instability and speculative bubbles. The emphasis on contractual transparency and ethical investments ensures fair market practices, while socially responsible investments (SRI) promote funding in halal industries that contribute to sustainable economic development (Poesoro, 2007). Despite these contributions, the literature lacks empirical studies evaluating the real-world effectiveness of these measures in diverse economic contexts.

Regulatory frameworks supporting IFIs are established by bodies such as the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the Islamic Financial Services Board (IFSB). Governments and central banks also play a vital role in integrating Islamic finance within national and global financial systems (Sinaga, 2004). Nevertheless, regulatory inconsistencies and the absence of standardized Shariah compliance protocols across different countries pose significant challenges. Further research is needed to explore how these regulatory frameworks can be harmonized to support the global expansion and operational efficiency of IFIs.

RESEARCH METHOD

This study employs a qualitative approach aimed at understanding the phenomenon in depth by emphasizing the context and meaning embedded in the data. The selection of this approach is based on its ability to explore complex social and economic dynamics, particularly those related to the role of Islamic financial institutions (IFIs) in maintaining market integration and preventing distortion. A qualitative approach allows for a more

Vol. 2 No. 2, (2025), 154 – 166 e-ISSN: 3025-8545

nuanced interpretation of the ethical, regulatory, and economic principles underpinning Islamic finance, which cannot always be adequately captured through quantitative methods.

The research method adopted is a systematic literature review, designed to gather, synthesize, and critically evaluate existing knowledge on the research topic. This method was chosen because it enables the identification of key themes, debates, and gaps within the body of literature on IFIs and their role in ensuring market stability. To ensure a comprehensive analysis, the study draws from a wide range of secondary data sources, including peer-reviewed journal articles, scholarly books, and official reports published by recognized regulatory bodies. The selection of these sources follows specific criteria, including relevance to the research questions, publication within the last two decades to ensure up-to-date perspectives, and the credibility of the publication outlet.

The data analysis in this study employs a thematic analysis approach, which involves identifying, analyzing, and reporting patterns (themes) within the literature. This method provides a structured framework to categorize and interpret data, ensuring that the study captures diverse perspectives and theoretical insights. In addition, triangulation is used to enhance the validity and reliability of the findings by cross-referencing information from multiple sources and different types of publications. By integrating varied viewpoints and corroborating evidence, the study minimizes the risk of bias and strengthens the robustness of its conclusions.

To ensure methodological rigor, the study also addresses potential biases in source selection and data interpretation. Efforts were made to include literature representing different geographical contexts and institutional perspectives to avoid a narrow or one-sided analysis. Furthermore, ethical considerations were observed by properly citing all sources and acknowledging the contributions of previous researchers, thereby upholding the principles of academic integrity.

Through this systematic and transparent approach, the study aims to provide a comprehensive and reliable analysis of the role of IFIs in promoting market integration and

Vol. 2 No. 2, (2025), 154 – 166 **e-ISSN: 3025-8545**

preventing economic distortions, contributing meaningful insights to both academic discourse and policy development.

RESULTS AND DISCUSSION

The results of this study indicate that price distortion in the market occurs due to various factors that prevent the market mechanism from running fairly and efficiently. These distortions arise from practices that undermine market integrity and create imbalances between demand and supply, ultimately harming consumers and obstructing healthy competition. Among the most prominent factors contributing to price distortion are cartel practices, hoarding of goods (*ikhtikar*), manipulative middlemen (*talaqqi ruqban*), fraud in product quality (*tadlis*), transactional uncertainty (*taghrir*), and speculative pricing through false offers (*bay najasy*). These practices not only disturb market equilibrium but also erode trust and fairness in economic activities.

Table 2
Price Distortion

Factors of Price Distortion	Description	Impact on Market
Cartel Practices	Collusion among producers/traders to control price and supply for mutual benefit	Artificial price settings, limited consumer choice, market inefficiency
Hoarding of Goods (*Ikhtikar*)	Withholding large quantities of goods creates artificial scarcity	Price surges, market volatility, and social welfare harm
Manipulative Middlemen (*Talaqqi Ruqban*)	Intercepting rural traders to purchase goods at unfairly low prices	Distorted pricing structures, economic injustice
Fraud in Product Quality (*Tadlis*)	Concealing defects or misrepresenting product characteristics	Market inefficiency, consumer dissatisfaction
Transactional Uncertainty (*Taghrir*)	Ambiguous terms or unclear ownership of goods	Disputes, unstable market environment
Speculative Pricing (*Bay Najasy*)	False offers create an illusion of increased demand	Artificially inflated prices, market manipulation

Cartel practices occur when groups of producers or traders conspire to control the price and supply of goods for mutual benefit. This collusion leads to artificial price settings

Vol. 2 No. 2, (2025), 154 – 166 e-ISSN: 3025-8545

that do not reflect genuine market conditions, stifling competition and limiting consumer choices. In various markets, there is empirical evidence showing how cartel behavior inflates prices and reduces product availability, ultimately driving market inefficiency (Smith, 2022).

The practice of hoarding goods (*ikhtikar*) exacerbates market volatility by creating artificial scarcity. When large quantities of essential goods are withheld from circulation, prices surge disproportionately, creating hardship for consumers and distorting natural market dynamics. In the context of Islamic economics, this practice is strictly prohibited due to its exploitative nature and its detrimental impact on social welfare (Ahmed & Khan, 2021).

Manipulative middlemen (*talaqqi ruqban*) contribute to price distortion by intercepting rural traders before they reach urban markets, purchasing goods at unfairly low prices due to information asymmetry. This exploitation of uninformed sellers results in distorted pricing structures and economic injustice, as rural producers fail to receive fair market value for their goods (Rahman et al., 2020).

Fraud in product quality (*tadlis*) undermines consumer trust and market transparency. By concealing defects or misrepresenting product characteristics, sellers deceive buyers, leading to dissatisfaction and market inefficiency. This deceptive practice not only damages individual transactions but also discourages fair competition and ethical business conduct (Ali, 2019).

Table 3
Islamic Financial Instruments

Islamic Financial Instruments	Description	Role in Market Stability
Mudharabah	Profit-and-loss sharing partnership	Aligns financial outcomes with business performance reduces speculative behavior
Musyarakah	Joint venture with shared capital and profits	Promotes risk-sharing and fair business practices
Istishna	Custom manufacturing with flexible payment terms	Supports real-sector projects, reduces market volatility
Ijarah	Leasing agreement for asset utilization	Provides financing without interest, fostering market stability

Vol. 2 No. 2, (2025), 154 – 166 **e-ISSN: 3025-8545**

The role of Islamic financial institutions (IFIs) in mitigating these distortions is significant. By adhering to principles of fairness, transparency, and ethical conduct, IFIs foster a more stable and equitable market environment. The implementation of profit-and-loss sharing models, such as *mudharabah* and *musyarakah*, aligns financial outcomes with actual business performance, promoting risk-sharing and discouraging speculative behavior (Hassan et al., 2023).

Sharia supervision through the Sharia Supervisory Board (DPS) and regular Sharia audits ensure that IFIs maintain compliance with Islamic principles, enhancing market transparency and operational integrity. However, challenges remain, including limited public awareness of Islamic financial mechanisms and varying interpretations of Islamic jurisprudence, which lead to inconsistent application of financial products (Yusuf, 2021).

Empirical data suggests that IFIs with robust and innovative risk management frameworks are better equipped to navigate economic shocks compared to those reliant on traditional models. The adoption of flexible contracts like *istishna* and *ijarah* for long-term financing and real-sector projects demonstrates IFIs' adaptability in balancing compliance and competitiveness (Alam et al., 2024).

To enhance IFIs' effectiveness in maintaining market integrity, several strategic measures are recommended. Expanding public education on sharia finance will increase awareness and adoption of ethical financial services. Strengthening regulatory frameworks and standardization will create a more competitive and reliable financial system. Continued product innovation aligned with market needs and Islamic principles will foster growth and inclusivity. Developing advanced risk management strategies will ensure resilience amid economic fluctuations. Finally, enhancing transparency and supervisory functions through strengthened DPS roles and comprehensive Sharia audits will uphold market integrity and trust.

The findings of this study underscore the strategic importance of IFIs in fostering an equitable economic system. By prioritizing fairness, transparency, and balance, IFIs mitigate market distortions and promote financial stability. Their emphasis on real-asset-based

Vol. 2 No. 2, (2025), 154 – 166 **e-ISSN: 3025-8545**

transactions reduces speculative risks and economic bubbles associated with debt-driven systems. Through robust supervision and adherence to sharia principles, IFIs play a pivotal role in safeguarding market integrity and advancing social welfare.

CONCLUSION

This study explores the strategic role of Islamic financial institutions (IFIs) in fostering inclusive economic growth, reducing social inequality, and ensuring market integrity by preventing economic distortions. Using a descriptive qualitative method through systematic literature review and thematic analysis, the study draws from scholarly books, peer-reviewed journals, and official reports. The findings reveal that market distortions arise due to practices like cartels, hoarding (*ikhtikar*), manipulative middlemen (*talaqqi ruqban*), misrepresentation (*tadlis*), misinformation (*taghrir*), and speculative pricing (*bay najasy*). These distortions disrupt market equilibrium, leading to inefficiency and economic injustice.

Islamic financial institutions address these issues by offering Shariah-compliant financial products that emphasize ethical investment, profit-and-loss sharing, and risk-sharing mechanisms. By promoting asset-backed financing and avoiding speculative transactions, IFIs enhance market stability and foster fair economic practices. Furthermore, the principle of hisbah serves as a supervisory mechanism ensuring fairness and ethical standards in market activities. Empirical evidence supports that Islamic finance's unique models contribute to equitable wealth distribution and mitigate market manipulation.

However, IFIs face significant challenges, including ensuring full Shariah compliance amid evolving market dynamics, innovating financial products without compromising Islamic principles, and developing effective risk management strategies. Regulatory inconsistencies and the lack of standardized Sharia protocols across different countries further complicate their implementation.

To optimize their role in maintaining market integrity, government support through conducive regulations and public education campaigns is crucial. These efforts should focus on raising awareness of Islamic financial principles, promoting ethical market behavior, and

Vol. 2 No. 2, (2025), 154 – 166 **e-ISSN: 3025-8545**

providing training programs for market participants. Ultimately, the study underscores the importance of strengthening governance and harmonizing regulatory frameworks to ensure the sustainable and effective contribution of Islamic financial institutions to global financial stability and social welfare.

REFERENCES

Abdulghani, N. A. (2024). Sustainable Development and The Role of Islamic and Social Banks. *Majapahit Journal of Islamic Finance and Management*, *4*(2), 134 –. https://doi.org/10.31538/mjifm.v4i2.326

Alam, N., Gupta, L., & Shanmugam, B. (2024). *Islamic Finance: Balancing Compliance and Competitiveness*. Kuala Lumpur: Islamic Finance Publishing.

Ariance, L. T. (2022). *Reaksi Pasar Modal Terhadap Peristiwa Pergantian Presiden Republik Indonesia 23 Juli 2001: Kajian Terhadap Return Saham LQ-45 di PT. Bursa Efek Jakarta*. Semarang: Simposium Nasional.

Aulia, R., & Latief, A. (2020). Pengaruh Inflasi dan BI Rate terhadap Indeks Saham Syariah Indonesia (ISSI). *Borneo Student Research*, *1*(3), 2140–2150.

Bayuni, E. M., & Srisusilawati, P. (2018). Kontribusi Instrumen Moneter Syariah Terhadap Pengendalian Inflasi Di Indonesia. *Amwaluna: Jurnal Ekonomi Dan Keuangan Syariah*, *2*(1), 18–38. https://doi.org/10.29313/amwaluna.v2i1.3314

Della Irona, V., & Triyani, M. (2022). Faktor-faktor yang mempengaruhi perilaku konsumen: kualitas produk, harga dan promosi (literature review smm). *Jurnal Ilmu Multidisplin*, *1*(1), 174–185. https://doi.org/10.38035/jim.v1i1.26

Desi Nurmaida. (2017). *Pengaruh Inflasi, Transaksi Pasar Uang Antar Bank Syariah (PUAS) Dan Investasi Syariah Terhadap Imbal Hasil Sertifikat Bank Indonesia Syariah (SBIS) Desi Nurmaida*.

Fathoni, C., & Jairin, J. (2022). Principles of Performance and Financial Management between Islamic Banks and Conventional Banks. *Majapahit Journal of Islamic Finance and Management*, *1*(2), 164–178. https://doi.org/10.31538/mjifm.v1i2.12

Fauzan Fahmi Hasibuan, Andri Soemitra, R. D. H. (2023). Pengaruh Inflasi, Nilai Tukar, Harga Minyak Dunia Dan Harga Emas Dunia Terhadap Indeks Saham Syariah Indonesia. *Jurnal Manajemen Akuntansi (JUMSI)*, *3*(1), 707–717.

Margona. (2010). *Metodelogi Penelitian Pendidikan*. Jakarta: Rineka Cipta.

Muhajirin, M. P. (2017). *Pendekatan Praktis: Metode Penelitian Kualitatif Dan Kuantitatif*. Yogyakarta: Idea Press.

Nurwani. (2016). Analisis Pengaruh Inflasi, Nilai Tukar Rupiah, dan Suku Bunga SBI terhadap Pergerakan Indeks Harga Saham Gabungan di Bursa Efek Indonesia. *Jurnal*

Vol. 2 No. 2, (2025), 154 – 166 **e-ISSN: 3025-8545**

Ekonomi dan Studi Pembangunan, *16*(2), 1–13.

Pasaribu, M., & Widjaja, A. (2022). *Artificial Intelligence: Perspektif Manajemen Strategis*. Kepustakaan Populer Gramedia.

Poesoro, A. (2007). *Pasar Tradisional di Era Persaingan Global*. Jakarta: SMERU Research Institute.

Ramdhan, M. (2021). *Metode penelitian*. Medan: Cipta Media Nusantara.

Sinaga, P. (2004). *Makalah Pasar Modern VS Pasar Tradisional. Kementerian Koperasi dan UKM*. Jakarta.

Soemitra, A. (2014). *Masa Depan Pasar Modal Syariah*. Jakarta: Kencana.

Toha, M., & Manaku, A. A. C. (2020). Perkembangan Dan Problematika Pasar Modal Syariah Di Indonesia. *Al-tsaman: Jurnal Ekonomi dan Keuangan Islam*, *2*(1), 135-144. Retrieved from https://ejournal.uas.ac.id/index.php/Al-tsaman/article/view/312

Ummah, B. B., Nuryartono, N., & Anggraeni, L. (2015). Analisis Inklusi Keuangan dan Pemerataan Pendapatan di Indonesia. *Jurnal Ekonomi Dan Kebijakan Pembangunan*, *4*(1), 1–27.