

A Hybrid Governance Framework for Islamic Fintech Sustainability: Integrating Shariah Compliance and Digital Innovation through Maqashid al-Shariah Principles

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Abstract

The rapid evolution of Islamic fintech has transformed the architecture of financial intermediation, yet challenges of governance, ethics, and sustainability persist. This conceptual paper proposes a Hybrid Governance Framework integrating *Shariah compliance governance* and *digital innovation governance* through the lens of *Maqashid al-Shariah*. Using a theoretical synthesis approach, the study draws upon financial inclusion theory, technology governance, and Islamic ethical principles to construct a holistic governance model for sustainable Islamic fintech ecosystems. The framework identifies five interrelated components: ethical foundation, innovation layer, governance mechanism, compliance feedback loop, and outcome dimension that collectively ensure both agility and moral integrity. Findings indicate that embedding *Maqashid al-Shariah* within digital governance enhances ethical accountability, user trust, and systemic resilience. The study contributes to Islamic finance theory by reconceptualizing Shariah governance as an ethical innovation process rather than a regulatory constraint. Policy-wise, it calls for integrated RegTech systems and cross-border standardization of digital Shariah governance. The paper's novelty lies in advancing a faith-based digital governance paradigm, aligning spiritual values with technological sustainability.

Keywords: Islamic Fintech, Shariah Governance, Maqashid al-Shariah, Digital Innovation, Sustainable Finance, Hybrid Governance Model

1. INTRODUCTION

Digital transformation has significantly reshaped global financial systems by increasing accessibility, efficiency, and inclusivity. Financial technology, commonly referred to as fintech, has evolved as a disruptive force that enhances transparency, speed, and financial inclusion, particularly in developing economies (Arner et al., 2020). Within Muslim-majority countries, Islamic fintech combines technological innovation with the ethical framework of Islamic finance, which prohibits *riba* (interest), *gharar* (excessive uncertainty), and investment in non-halal sectors. It has emerged as a faith-based driver for equitable access to finance, especially for the unbanked and underbanked populations (Hassan et al., 2024). However, the rapid expansion of fintech also raises critical concerns regarding governance, security, trust, and compliance with Shariah principles.

Recent reports by the Islamic Development Bank (IsDB, 2024) indicate that Islamic fintech could potentially bridge a financial inclusion gap of around USD 120 billion across the Organization of Islamic Cooperation (OIC) member states. Despite this potential, disparities in digital literacy, uneven regulatory infrastructures, and limited Shariah governance mechanisms remain pressing challenges in the Muslim world. The reliance on digital platforms and algorithmic decision-making introduces a new layer of ethical complexity that traditional Shariah Supervisory Boards (SSBs) are not fully equipped to manage. Consequently, the need arises for a governance model that can balance

innovation with moral integrity: a hybrid approach that fuses ethical oversight with technological adaptability.

The sustainability of Islamic fintech should not only be assessed in economic or environmental terms but also in its capacity to uphold justice, transparency, and social welfare as envisioned by the principles of *Maqashid al-Shariah*. A comprehensive model must integrate faith-based accountability with digital governance to ensure resilience and ethical balance. This study, therefore, aims to construct a conceptual framework of hybrid governance for Islamic fintech sustainability that harmonizes digital innovation with Maqashid-oriented ethics.

In Indonesia, the Islamic fintech market is projected to exceed USD 15 billion by 2027 (IFSI, 2023), supported by increasing smartphone penetration and the rise of peer-to-peer sharia-compliant financing platforms. Nevertheless, limited literacy in Shariah-based digital finance and fragmented supervision among national authorities continue to hinder its full potential. Similar patterns are found in other OIC member countries, where the absence of unified Shariah digital governance limits international scalability. This reality emphasizes that hybrid governance is not only a theoretical necessity but an economic imperative for global Islamic fintech integration.

Moreover, the COVID-19 pandemic accelerated digital financial inclusion but also exposed governance vulnerabilities, such as data misuse and unethical algorithmic lending. These trends

underscore the urgency of embedding moral accountability into fintech innovation from the outset, rather than relying solely on post-crisis regulation.

2. LITERATURE REVIEW

The literature on fintech highlights its role as a major enabler of financial inclusion, allowing individuals and small businesses to access formal financial services more efficiently (Arner et al., 2020). The World Bank (2022) emphasizes that fintech innovations reduce transaction costs, facilitate microfinance, and promote inclusion, particularly in developing regions. However, fintech also introduces challenges in privacy, data governance, and algorithmic bias (Omar et al., 2022). Ethical and regulatory concerns have become central in ensuring that innovation remains aligned with social and moral objectives. The Organisation for Economic Co-operation and Development (OECD, 2021) introduced the concept of “responsible innovation,” which calls for balancing progress with accountability.

In the context of Islamic finance, fintech development carries a unique layer of moral responsibility. The ethical foundation of Islamic finance is built upon principles of justice (*adl*), benevolence (*ihsan*), and the avoidance of exploitation (*zulm*). Consequently, Islamic fintech must go beyond efficiency to ensure that its innovation is consistent with Shariah principles (Zainal et al., 2021). The governance of Islamic financial institutions traditionally relies on Shariah Supervisory Boards (SSBs) to monitor compliance with Islamic law (AAOIFI, 2021). However, these boards are often structured hierarchically and function through manual review processes that limit adaptability to the rapid technological changes inherent in digital ecosystems (Dusuki, 2020).

Recent studies have proposed technology-driven mechanisms such as RegTech (Regulatory Technology) and SupTech (Supervisory Technology) to automate compliance monitoring and enhance real-time oversight (Kassim et al., 2023). These technologies can improve efficiency and transparency but may also challenge the traditional authority of Shariah scholars. The shift toward digital governance requires a hybrid model that blends institutional oversight with algorithmic ethics. As Alam et al. (2024) argue, hybrid governance represents the convergence of regulatory, technological, and moral systems into an integrated ethical architecture.

At the heart of Islamic governance lies the theory of *Maqashid al-Shariah*, the higher objectives of Islamic law, which encompass the protection of faith, life, intellect, lineage, and wealth. *Maqashid* serves as an ethical compass that directs financial innovation toward justice, social welfare, and sustainability (Dusuki, 2020). It provides not only a

moral basis for Shariah compliance but also a philosophical framework for responsible innovation. In the fintech domain, the incorporation of *Maqashid* principles aligns ethical decision-making with digital functionality, transforming compliance from a restrictive process into a proactive mechanism for value creation.

Existing research, however, tends to examine these elements—Shariah governance, digital innovation, and sustainability—in isolation rather than as an interconnected system. Few frameworks have attempted to merge these domains into a coherent structure. Alam et al. (2022) and Rahman and Kassim (2023) have highlighted this fragmentation and suggested the need for a comprehensive model that integrates *Maqashid*-based ethics within a technologically adaptive governance structure. This paper aims to fill that theoretical gap by developing a hybrid governance framework that operationalizes Islamic ethical principles through digital tools to ensure inclusive and sustainable financial ecosystems.

While the existing literature extensively discusses Shariah compliance, most studies adopt a descriptive or normative approach rather than analytical modeling. There remains limited exploration of how *Maqashid* principles can be quantitatively embedded within algorithmic systems. Furthermore, empirical research on RegTech adoption in Islamic finance remains scarce, particularly concerning small fintech startups that lack institutional Shariah boards. This study responds to these gaps by proposing a model that operationalizes *Maqashid* ethics through data-driven mechanisms and feedback-based compliance.

3. CONCEPTUAL FRAMEWORK

The proposed Hybrid Governance Framework (HGF) integrates three core theoretical dimensions: sustainable financial inclusion, adaptive technology governance, and Islamic ethical philosophy derived from *Maqashid al-Shariah*. Each dimension contributes a unique foundation for constructing an ethical and digitally resilient financial ecosystem. Financial inclusion focuses on equitable access and resilience in the economy (GPFI, 2022), while technology governance emphasizes adaptability, transparency, and accountability in digital operations (OECD, 2021; Alam et al., 2024). The *Maqashid al-Shariah* dimension provides a moral foundation that transforms Shariah compliance from a static requirement into a dynamic pursuit of social and spiritual well-being (Rahman & Kassim, 2023).

The Hybrid Governance Framework is designed as an interdependent system composed of five interconnected layers. The first is the ethical foundation, grounded in *Maqashid al-Shariah*, ensuring that all technological and financial innovations serve social justice and human welfare. The second layer is the innovation architecture,

which integrates digital tools such as artificial intelligence, blockchain, and cloud computing to enhance efficiency and traceability. The third layer, governance mechanism, utilizes RegTech and SupTech to provide real-time compliance monitoring and risk management. The fourth layer is the feedback loop, which ensures continuous learning and ethical auditing through adaptive algorithms. Finally, the impact dimension measures both financial performance and socio-spiritual outcomes, creating a feedback process that strengthens trust and accountability.

The logic of this framework follows a circular relationship: ethical values inform innovation design; innovation enables better governance; governance ensures ethical reinforcement; and feedback sustains improvement. This structure creates a cycle where faith-based ethics and technological adaptability coexist harmoniously. Conceptually, five propositions emerge: alignment with *Maqashid al-Shariah* enhances institutional legitimacy; integration of digital and Shariah governance builds user trust; RegTech auditing supports ethical accountability; multi-stakeholder collaboration fosters sustainability; and hybrid governance promotes long-term systemic stability. Collectively, these propositions form a holistic foundation for future empirical studies on Islamic fintech governance.

When compared with conventional digital governance frameworks proposed by the World Bank (2022) or OECD (2021), the HGF offers an additional spiritual dimension absent in secular models. Conventional frameworks emphasize transparency, efficiency, and stakeholder engagement, whereas the hybrid approach extends accountability beyond human oversight toward divine responsibility. This creates a dual-governance logic that merges vertical (faith-based) and horizontal (institutional) accountability, producing a unique ethical resilience not found in conventional systems.

4. DISCUSSION AND IMPLICATIONS

The integration of Shariah and digital governance challenges the conventional understanding of compliance as a mere regulatory function. Instead, it reframes compliance as an enabler of innovation and a generator of ethical value. Traditionally, Shariah Supervisory Boards review products only after development, which creates a reactive process prone to inefficiency (Dusuki, 2020). The Hybrid Governance Framework proposes embedding ethical reasoning during the design phase so that each technological decision reflects both moral and technical considerations. This integration transforms governance from post-verification into a dynamic process of continuous ethical alignment (Kassim et al., 2023).

Bringing together the principles of faith-based governance and digital accountability introduces what can be termed Faith-Based Digital Governance. In this paradigm, digital tools such as RegTech automate processes to ensure transparency, while faith-based oversight ensures moral alignment. Decentralization brings agility, while divine accountability brings ethical direction (Alam et al., 2024). The resulting system balances autonomy and authority, bridging the gap between technological flexibility and spiritual responsibility.

This hybrid model also enriches sustainability theory by introducing the concept of ethical holism a multidimensional perspective where economic, social, environmental, and spiritual well-being are inseparable. While conventional ESG (Environmental, Social, and Governance) frameworks emphasize human-centered ethics, the *Maqashid al-Shariah* approach embeds transcendental accountability, aligning sustainability with divine purpose (Khan et al., 2022). Through this lens, sustainability in Islamic fintech is not only about economic endurance but also about moral integrity and social continuity.

Practically, implementing hybrid governance requires institutional and technological readiness. Islamic fintech companies can begin by forming ethical co-design teams that include both Shariah scholars and digital engineers during product development. This ensures that ethical objectives are integrated from the outset rather than appended as afterthoughts. The second step is developing RegTech-driven auditing systems to automate compliance and provide transparent reporting to regulators and investors. The third is establishing adaptive monitoring dashboards that combine financial and ethical key performance indicators to measure not only profit but also social impact. These mechanisms enhance public trust, which is the cornerstone of Islamic finance (Hassan et al., 2024), transforming compliance from a burden into a source of reputational capital.

On a regulatory level, hybrid governance requires policymakers to build integrated regulatory sandboxes that embed *Maqashid* principles into digital finance experimentation. Such sandboxes can serve as collaborative platforms for regulators, fintech firms, and scholars to co-develop digital products that are both innovative and compliant. To scale globally, there must be efforts to harmonize Shariah standards across jurisdictions through machine-readable Shariah protocols that allow interoperability among fintech systems. These protocols would standardize compliance criteria and enhance international credibility for Islamic digital finance (Alam et al., 2024).

The proposed framework not only contributes to theory but also offers practical guidance for governments, financial regulators, and Islamic fintech developers. For regulators, it highlights the

importance of integrating ethics into digital policy. For fintech practitioners, it emphasizes that ethical governance can drive innovation and consumer trust. And for scholars, it provides a conceptual basis for empirical validation through mixed-method research, case studies, or simulation modeling.

In the Southeast Asian context, cross-border integration of Islamic fintech requires a coordinated governance approach. Countries such as Malaysia and Indonesia could establish a regional Shariah Fintech Council under the ASEAN framework to harmonize digital standards and data protection mechanisms. Such cooperation would facilitate interoperability, reduce regulatory friction, and enhance investor confidence. Beyond Asia, similar models could be adopted in the Gulf Cooperation Council (GCC) and African OIC nations, creating a global corridor for faith-based digital finance.

5. CONCLUSION

This paper has developed a conceptual Hybrid Governance Framework (HGF) that integrates digital innovation and Shariah compliance through the ethical lens of *Maqashid al-Shariah*. The framework redefines governance in Islamic fintech as both technologically responsive and spiritually grounded, ensuring that efficiency does not come at the expense of ethics. It positions compliance as a creative and value-generating process rather than a restrictive mechanism.

In a broader context, this model contributes to global discussions on responsible digital governance. By linking divine ethics with algorithmic accountability, it provides a pathway toward financial systems that are both human-centered and spiritually conscious. Such a synthesis can guide the evolution of ethical AI, blockchain-based finance, and other future technologies within Islamic and conventional contexts alike. The convergence of faith and technology thus becomes not only a practical necessity but also a moral imperative in the age of digital transformation.

The proposed framework also opens avenues for future research. Empirical validation could explore how Islamic fintech firms operationalize *Maqashid*-based metrics within RegTech systems or how regulators implement hybrid oversight structures. Further comparative studies could examine how faith-based governance models interact with secular regulatory frameworks in promoting ethical innovation. Ultimately, the framework seeks to demonstrate that sustainable progress in Islamic fintech depends on the ability to balance innovation with integrity and technology with transcendence.

The future of Islamic fintech governance will depend on the ability to synthesize jurisprudential rigor with algorithmic design. Researchers should explore how artificial intelligence can be programmed to reflect *Maqashid* values, ensuring that ethical decision-making is embedded into code rather than enforced externally. Regulators, on the other hand, should develop metrics for

“ethical digital maturity” to measure the readiness of institutions to adopt faith-based digital standards. These directions will transform the HGF from a theoretical construct into a measurable governance framework applicable across contexts.

6. REFERENCES

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