

Islamic Bank Strategy in Facing Competition in The Era of Digitalization

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ABSTRACT

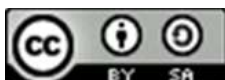
Digital transformation has brought significant changes to the global banking industry, including for Islamic banks in Indonesia. This study aims to examine the strategies implemented by Islamic banks in responding to the increasingly intense competition in the digitalization era. The method used is qualitative research with a case study approach, involving in-depth interviews with managers and practitioners of Islamic banking. The findings indicate that Islamic banks adopt several key strategies, such as the digitalization of banking services, integration of Sharia principles into digital platforms, strengthening of technological infrastructure, and enhancement of human resource capacity. In addition, collaboration with fintech companies, customer education, and the development of products tailored to the needs of the younger generation are vital components of digital adaptation efforts. Despite facing infrastructure limitations and regulatory challenges, Islamic banks demonstrate potential for growth and competitiveness through innovative strategic approaches grounded in Sharia values. This study contributes to the development of relevant business strategies for Islamic banks in the digital transformation era and may serve as a reference for policymakers and stakeholders in the Islamic finance industry.

Keywords: Islamic Bank, Digital Strategy, Digital Transformation, Competition, Fintech

INTRODUCTION

The global financial industry is currently undergoing massive transformation due to digitalization. Technological innovations have changed how financial institutions operate and deliver services to customers. This development is marked by the emergence of digital banking technologies, the use of artificial intelligence (AI), big data analytics, and the integration of services through mobile and internet banking. Digital-based financial services enable faster, more efficient, and personalized transactions, positioning technology as the cornerstone of competitiveness in the banking sector. The emergence of financial technology (fintech) companies has further accelerated this shift, offering practical and app-based financial solutions. Fintech's agility in responding to public needs especially those of digitally-savvy younger generations has pushed both conventional and Islamic banks to adapt. The COVID-19 pandemic also served as a major catalyst for digitalization, as physical restrictions forced financial institutions to migrate almost all activities to digital platforms.

Islamic banks, as part of the national banking industry, have also been impacted by the wave of digitalization. On one hand, digitalization presents a great opportunity for Islamic banks to improve operational efficiency, expand service accessibility, and reach the unbanked population. On the other hand, Islamic banks face unique challenges in integrating Sharia principles into digital systems while maintaining strict compliance with Islamic law (Sharia compliance).



Digitalization requires Islamic banks to balance technological innovation with *muamalah* principles, including contractual transparency, prohibition of *riba* (usury), and equitable risk-sharing. If implemented correctly, technology can serve as a strategic tool to promote Islamic financial inclusion and enhance the competitiveness of Islamic banks amid growing competition. In this competitive landscape, Islamic banks do not only compete with fellow Sharia-compliant institutions but also face pressure from conventional banks that typically have greater resources and faster digitalization capabilities. Conventional banks are generally more aggressive in developing digital products and expanding through fintech platforms. Some have even acquired or partnered with tech companies to accelerate their digital transformation.

Meanwhile, non-bank fintechs operate with flexible business models, offering intuitive and user-friendly loan, payment, and investment services. This situation places Islamic banks in a challenging position, requiring competitive strategies that rely not only on Sharia compliance but also on technological efficiency and innovation. To survive and grow in the digital era, Islamic banks must design adaptive and innovative strategies. These strategies should consider changing industry landscapes, regulatory demands, and evolving customer needs. Digital innovations such as Sharia-based mobile banking, digital onboarding processes for easier online account opening, and the implementation of smart branch technology are essential steps to attract Millennials and Gen Z customers, who are highly dependent on technology.

Technology-based strategies are not only meant to increase efficiency but also to retain customer loyalty, especially from those increasingly critical of service quality. Without solid and measurable strategies, Islamic banks risk falling behind more responsive competitors. Technological advancements have changed the consumption patterns of banking services. Customers now expect services that are fast, easily accessible, secure, and available anytime and anywhere. These preferences demand that Islamic banks simplify their processes, remove administrative barriers, and offer user-friendly digital platforms.

Challenges arise when customer expectations are not fully matched by the readiness of Islamic banks' digital infrastructure and systems. This gap may lead customers to shift to banks or financial service providers that offer more convenience and speed. Not all Islamic banks have the same technological capacity. Some institutions still face limitations in digital infrastructure, human resource development, and budget availability for innovation. This creates a gap between the vision of digital transformation and its implementation. Furthermore, the regulatory framework for digitalization in the Islamic context is still evolving and presents additional challenges. Another crucial issue is the readiness of human resources to understand technology and the ability of management to design digital strategies that align with Sharia values. Therefore, Islamic banks must strengthen their internal capabilities to undergo sustainable transformation.

Although the digitalization of Islamic banks has become an important topic in academic and practical discussions, there is still a limited number of in-depth studies exploring the internal strategies adopted by Islamic banks to face digital era challenges. Existing studies are generally quantitative in nature and do not delve into strategic decision-making dynamics, implementation challenges, and how Sharia values are upheld in the innovation process. Therefore, this study is important as it provides empirical insight through a qualitative approach, which can deeply explore the experiences, strategies, and perspectives of stakeholders in the Islamic banking industry.

METHODS

This research employs a qualitative approach to gain a deeper understanding of the strategies used by Islamic banks in addressing challenges and seizing opportunities in the digitalization era. A qualitative approach is deemed most appropriate, as this study aims to explore in detail the policies, perspectives, and strategic actions taken by actors in the Islamic banking industry, rather than statistically testing hypotheses.

This method enables the researcher to capture the complex dynamics behind decision-making processes and the implementation of digital strategies, which are not always quantifiable. In this context, the researcher seeks to understand social realities from the perspective of key informants directly involved in strategy development within Islamic banks, including bank leaders, digital banking managers, and where necessary regulators or supervisory authorities.

Data collection was carried out through semi-structured in-depth interviews, allowing informants to openly express their thoughts and experiences. In addition, the researcher also used documentation from annual reports, corporate digital strategies, and relevant publications or press releases to complement the primary data. To select informants, purposive sampling was used where respondents were deliberately chosen based on certain criteria such as position, experience, and direct involvement in the digital strategies of Islamic banks. The number of informants was determined until data saturation was reached, meaning no new relevant information emerged from additional interviews.

Data analysis was conducted using thematic analysis, which involves coding, categorization, and identification of key themes from the interview and document data. The researcher repeatedly read the data to identify patterns, key statements, and relationships among concepts relevant to Islamic bank digital strategies. To ensure data validity, source and method triangulation techniques were applied, as well as member checking to confirm interview results with informants and ensure accurate interpretations. With this approach, the study is expected to make a significant contribution to understanding the strategic practices of Islamic banks amid the ongoing digital transformation.

RESULTS AND DISCUSSION

To gain a more comprehensive understanding of the digital strategies implemented by Islamic banks, this study presents the findings derived from in-depth interviews analyzed through thematic analysis. The following table summarizes the key strategies identified, including their implementation methods, challenges encountered, and their impact on the performance and competitiveness of Islamic banks in the digital era. This data presentation aims to provide a systematic overview of the adaptive approaches undertaken by Islamic banks in responding to the dynamic process of digital transformation.

Table 1. Strategic Themes Identified from In-Depth Interviews

Main Theme	Subtheme	Illustrative Quote
Digital Service Innovation	Mobile Banking Development	"We are focusing on optimizing our sharia mobile app to serve younger customers."
	Online Account Opening	"Digital onboarding simplifies access, especially for customers in remote areas."
Sharia Compliance in Technology	Smart Contract-Based Akad	"We ensure every transaction is recorded under a clear sharia contract."
	Sharia Audit Integration	"Our IT system is embedded with automatic sharia screening tools."

Human Resource Capacity	Digital Talent Recruitment	"We are hiring IT experts with an understanding of Islamic finance."
	Internal Upskilling Programs	"We conduct regular training to align tech knowledge with sharia principles."
Strategic Collaboration	Partnership with Fintech	"Collaborating with fintech allows us to expand services without building from zero."
	API-Based Integration	"We integrate APIs to connect our services to fintech ecosystems."

Source : Author's Analysis 2025

The table presents key strategic themes and initiatives undertaken by Islamic banks in the digital era, categorized into four main themes: Digital Service Innovation, Sharia Compliance in Technology, Human Resource Capacity, and Strategic Collaboration. Under digital innovation, banks are developing mobile banking and online onboarding to attract younger users and enhance accessibility for remote customers. In ensuring Sharia compliance, they implement smart contract-based *akad* and integrate automatic sharia screening tools in IT systems. On the human resource front, banks focus on recruiting digital talent familiar with Islamic finance and conduct internal upskilling programs to align technological capability with religious values. Lastly, strategic collaboration involves partnerships with fintech firms and API-based integration, enabling Islamic banks to expand their digital services efficiently within the broader fintech ecosystem. This comprehensive strategy reflects a balanced approach to modernization while preserving the core values of Islamic banking.



Fig. 1. Mind map illustrating the structured and comprehensive digitalization strategy of Islamic banks in response to digital era challenges and opportunities.

The image presents a mind map illustrating the digitalization strategy model of Islamic banks in facing competition in the digital era. At the center of the diagram is the core focus: digitalization strategy, which branches into seven key elements digitalization of products and services, integration of Sharia principles, enhancement of technological infrastructure, strengthening of digital human resources capacity, market segmentation and customer education, strategic collaboration with fintech, and response to regulation and government support. Each element is interconnected, forming a comprehensive digital transformation ecosystem. The mind map emphasizes that the success of digitalization in Islamic banks is not solely dependent on technology, but also on the incorporation of Sharia values, internal readiness, and consistent external support.

Digital Service Innovation

The interviews highlight that digital service innovation is a central strategy. Bank syariah prioritizes mobile banking and digital onboarding as tools to increase market reach, especially among tech-savvy youth and underserved rural communities. These innovations are perceived not only as conveniences but as competitive necessities in the digital era.

Sharia Compliance in Technology

Maintaining sharia integrity within digital systems is a unique and critical challenge for Islamic banks. Respondents emphasize the implementation of smart contracts and automated sharia audits. These tools help ensure that all digital transactions align with Islamic law while enhancing transparency and trustworthiness.

Human Resource Capacity

Bank syariah recognizes that human capital is a core enabler of digital transformation. They address this by recruiting professionals who possess both IT and Islamic finance expertise. Additionally, regular internal training helps to close the knowledge gap between digital skills and sharia compliance requirements.

Strategic Collaboration

To accelerate innovation and reduce development costs, bank syariah engages in strategic collaborations with fintech companies. By using APIs and open banking models, they can deliver more agile and diverse financial products while still maintaining control over the core principles of sharia compliance.

Product and Service Digitalization Strategy

Digital transformation in Islamic banking services is not limited to launching applications, but also includes the digitalization of internal processes, such as automated financing submissions, digital risk management, and the integration of more adaptive customer relationship management (CRM) systems. Some Islamic banks have also begun developing AI-based chatbot features for customer service, although still in the early stages. This reflects the banks' commitment to sustainably and responsively catching up with market demands.

Integration of Sharia Values into Digital Services

The uniqueness of Islamic banks lies in integrating religious values into digital systems, which serves as a selling point but also poses challenges due to the absence of standardized Sharia-compliant technology. For example, in developing financing applications, banks must ensure that the contracts (akad) used are technically implemented correctly, not just administratively. In this regard, blockchain technology is also being considered as an alternative for transparency and permanent contract recording.

Enhancement of Technological Infrastructure

In addition to core system upgrades, several Islamic banks have started to utilize cloud technology for efficiency and scalability, as well as data analytics to understand customer behavior and create more personalized offerings. However, such investments require support from top management and shareholders, who are often skeptical of short-term returns on digital transformation investments. Some banks have even adopted a phased implementation approach to minimize risks.

Strengthening Digital Human Resource Capacity

Human resource development is not only focused on technical training but also cross-functional understanding between Sharia principles and digital technology. Some Islamic banks have formed cross-departmental teams consisting of IT experts, Sharia law experts, and financial practitioners to develop product innovations. Moreover,

collaborations with universities and tech business incubators have begun to prepare young digital talents who understand Sharia principles.

Market Segmentation and Customer Education

Segmentation also targets MSMEs and Islamic boarding school communities, which have great potential yet remain underserved. Islamic banks are developing dedicated platforms for Sharia-based MSMEs that combine microfinancing, financial education, and digital business partner networks. For the youth segment, digital campaigns are conducted via social media with relevant narratives and interactive content such as podcasts, short videos, and webinars on modern Islamic finance.

Strategic Collaboration and Digital Ecosystem Development

Collaborations are not limited to fintech but also extend to tech startups, e-commerce platforms, digital zakat and waqf platforms, and Sharia-based e-wallets. This collaborative model encourages the creation of an integrated Sharia-compliant digital financial ecosystem. Some Islamic banks have also joined the OJK regulatory sandbox to test new digital products that currently lack clear legal frameworks, as part of an agile and innovative approach.

Response to Regulations and Government Support

There is an ongoing demand from informants for regulations that support Sharia digital innovation. Beyond legal clarity, they also hope for incentives such as tax exemptions on technology investments, subsidies for employee digital training, and easier access to capital for developing digital infrastructure. Several banks have responded positively to initiatives by OJK and Bank Indonesia in promoting digitalization in the Islamic financial sector through the Sharia Economic Movement program and the national Islamic banking digital roadmap.

Evaluation of Strategy Effectiveness

Evaluation is conducted not only through quantitative indicators such as digital account growth, but also through surveys on digital customer satisfaction, system security, and organizational readiness for change. Some banks have developed digitalization dashboards to monitor achievements and challenges in implementing digital strategies. These findings indicate a paradigm shift among Islamic bank management from a conventional approach to one that is more data-driven and innovation-oriented.

CONCLUSIONS

This study concludes that Islamic banks in Indonesia are in a challenging yet strategic position in facing the era of digitalization. Amid the accelerating digital transformation of the financial sector, Islamic banks are striving to respond to competition through the digitalization of products and services, the integration of Sharia principles into digital platforms, and the enhancement of infrastructure and human resource capacity. Despite facing technological limitations and a digital divide, some Islamic banks have shown progress through collaborations with fintech companies and the development of application-based services. Adaptive strategies that focus on customer education, youth market segmentation, and responsiveness to regulations are key to maintaining relevance and expanding Sharia financial inclusion. Thus, the success of Islamic banks in the digital era is not solely determined by technological sophistication, but also by their commitment to uphold Sharia values and their ability to build holistic, sustainable, and innovative strategies.

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