



Contents list available at: <https://journal.unesa.ac.id>
al-Uqud: Journal of Islamic Economics
Journal homepage: <https://journal.unesa.ac.id/index.php/jie>



The Evolution of Islamic Finance: Contractual Continuity, Institutional Transformation, and the Search for Sharia Substance

Jamiu Adeniyi Yusuf^{1*}, Azeem Tunde Muhammed², Ismail Aderole Ayuba³

¹Department of Economics and Social Research, National Institute for legislative and Democratic Studies, Abuja, Nigeria

²Department of religions and peace studies, Lagos State University, Ojo, Nigeria

³Department of Islamic Studies, Federal University Lokoja, Kogi State, Nigeria.

Article Info

Paper type:

Research Paper

Keywords:

Islamic finance; Sharia compliance;
Financial engineering; Sukuk; Risk-sharing; Maqasid al-Shariah

Article history:

Received: December 28, 2025

Revised: October 17, 2026

Accepted: October 20, 2026

Available online: October 25, 2026

Abstract

Islamic finance has expanded from classical trade-based mechanisms into a global financial architecture with total assets exceeding US\$3 trillion. While existing literature extensively documents its chronological progression, critical analysis regarding whether modern financial engineering preserves the economic substance of classical risk-sharing remains fragmented. This study adopts a qualitative historical-documentary and comparative thematic approach to evaluate the transformation of Islamic finance from its normative foundations to contemporary fintech innovations. We introduce a five-dimensional analytical framework, comparing Classical Foundations, Modern Forms, Continuity Mechanisms, Transformation Dynamics, and Sharia/Ethical Implications, to examine how classical contracts (Mudarabah, Musharakah, Bay' al-Salam) have evolved into modern capital market instruments (Sukuk, Takaful, trade finance). Our findings indicate that while contractual continuity remains robust at the formal compliance level, institutional transformation has led to a significant reliance on debt-like replication (Tawarruq) and benchmark pricing linked to conventional interest rates. Consequently, modern innovations often prioritize legal form over economic substance (Maqasid al-Shariah).

*Corresponding author: yusufadeniyijamiu@gmail.com

Please cite this article in APA style as:

Yusuf, J.A., Muhammed, A.T., Ayuba, I.A. (2026). The evolution of Islamic finance: Contractual continuity, institutional transformation, and the search for Sharia substance. *Al-Uqud : Journal of Islamic Economics*, 10(1), 82–97 <https://doi.org/10.26740/al-uqud.v10n1.p82-97>

Introduction

Islamic finance operates under the normative framework of Islamic commercial law (*Fiqh al-Muamalat*), which explicitly prohibits *riba* (usury/interest), *gharar* (excessive uncertainty), and *maysir* (gambling) (Ayub, 2013; Kamali, 2002). Historically rooted in equitable risk-sharing and asset-backed transactions, the modern industry has expanded exponentially across the Middle East, Southeast Asia, and Africa (Hassan & Lewis, 2007). Driven by petrodollar liquidity, sovereign capital allocation, and proactive institutional modernization, global Sharia-compliant financial assets have scaled significantly over recent decades (IFSB, 2023; Narayan & Phan, 2019).

The structural evolution of Islamic finance reflects a continuous balancing act between maintaining traditional risk-bearing principles and achieving commercial competitiveness within a global economic architecture dominated by interest-based banking systems (El-Gamal, 2006; Iqbal & Mirakhor, 2011). In response to expanding market demand, Islamic Financial Institutions (IFIs) have engineered a wide suite of retail, corporate, and capital market products designed to provide halal alternatives to conventional financing mechanisms (Ahmad & Hassan, 2007; Yusuf et al, 2025a). However, as these institutions integrate into global capital markets, an intense academic and regulatory tension emerges between preserving the ethical ethos of classical Islamic law and adapting to modern regulatory requirements such as the Basel frameworks and international liquidity management standards (El-Gamal, 2006; IFSB, 2023). Figure 1 illustrates the conceptual evolutionary pathway of Islamic finance, highlighting the transition from classical risk-sharing foundations to modern financial engineering and potential future developments in digital finance.

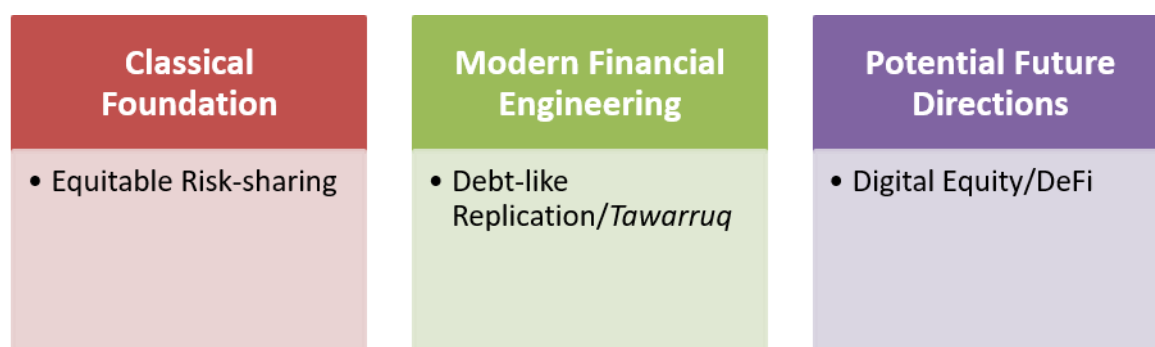


Figure 1. Conceptual Evolutionary Pathway of Islamic Finance

The existing literature extensively covers the chronological progression of Islamic banking from classical trade practices to modern institutions (Udovitch, 1970; Khan, 2010). What remains insufficiently answered is how and to what extent modern financial engineering alters the underlying economic substance of classical contracts (Farook et al., 2011; Kamali & Abdullahi, 2014). Rather than offering a descriptive overview, this paper provides a critical, thematic investigation into the mechanisms of transformation (Ayuba & Yusuf, 2021; Jobst et al., 2008). We evaluate whether modern innovations, such as tradable *sukuk*, commodity *murabahah*, and fintech applications, preserve the ethical ethos of classical risk-sharing or merely replicate conventional debt structures under Sharia-compliant legal contracts (Yusuf, 2025a; Zarrouk et al., 2016).

The central scholarly contribution of this study lies in examining the distinction between *Sharia* compliance (adherence to legal form and contractual requirements) and *Sharia* substance (the fulfillment of the broader socio-economic objectives of Islamic law, or

Maqasid al-Shariah) (Chapra, 2000; Güney, 2024). By synthesizing historical legal precedents with contemporary corporate and capital market structures, this study develops a qualitative analytical framework to examine how risk allocation and economic substance evolve as classical Islamic financial contracts undergo modern financial engineering (Jobst et al., 2008; Vogel & Hayes, 1998). Accordingly, the study moves beyond a descriptive historical account to critically assess whether contemporary Islamic financial innovations preserve the underlying ethical and economic principles of classical Islamic finance or increasingly resemble conventional debt-based financial structures (Beck, 2013; Laldin & Furqani, 2013a).

Building on this analytical perspective, the study pursues four interrelated objectives. First, it critically analyzes the normative foundations and economic objectives underlying classical Islamic financial principles. Second, it evaluates the institutional transformation of classical risk-sharing contracts into contemporary financial engineering structures. Third, it examines the tension between formal *Sharia* compliance and substantive alignment with the objectives of Islamic law (*Maqasid al-Shariah*) in modern Islamic financial products (Laldin & Furqani, 2013b). Finally, it proposes an integrated analytical framework that translates the study's findings into implications for *Sharia* governance, financial regulation, and product development. Through these objectives, the study seeks to contribute to the ongoing debate on how modern Islamic finance can reconcile commercial innovation and institutional competitiveness with its foundational ethical and socio-economic principles (Godlewski et al., 2013; Khan et al., 2021).

Literature Review

Normative Foundations and Economic Objectives of Islamic Finance

The foundational philosophy of Islamic economics rests upon the Quranic imperative permitting trade (*bay'*) while forbidding interest (*riba*) (Surah Al-Baqarah 2:275) (Chapra, 2000; Rahman, 2010). Classical juristic discourse established that financial gain must be justified by value creation, property rights, or liability exposure (*al-ghunm bi-l-ghurm*, gain accompanies risk) (Yusuf, 2025b; Kamali, 2002). Primary contracts were structured to ensure equitable distribution:

- a. *Mudarabah* (Trust Trustee Financing): The capital owner (*rab al-mal*) provides capital while the entrepreneur (*mudarib*) manages the business venture (El-Gamal, 2006). Financial losses fall on capital, while managerial effort bears the loss of labor (Iqbal & Mirakhor, 2011).
- b. *Musharakah* (Joint Venture): All partners contribute capital and share profits according to agreed ratios, while losses are strictly absorbed based on capital contribution share (Ayub, 2013; Nomran & Haron, 2020).

The primary economic objective of these normative foundations extends beyond individual transactional fairness to encompass macroeconomic balance, wealth circulation, and the absolute elimination of exploitative financial extraction (Chapra, 2000). Classical jurists such as Imam Abu Hanifa, Imam Malik, Imam Shafi'i, and Imam Ahmad ibn Hanbal formulated *Fiqh al-Muamalat* (commercial jurisprudence) to protect real market activities while prohibiting speculative constructs like *gharar* (excessive risk/uncertainty) and *maysir* (gambling) (Kamali, 2002; Vogel & Hayes, 1998). By anchoring gain directly to risk-bearing and physical asset ownership, classical Islamic law established a direct coupling between the monetary system and the real goods sector (El-Gamal, 2006; Kuran, 2011). Modern economic literature stresses that this coupling inherently mitigates systemic debt build-up and

speculative asset bubbles, offering a resilient theoretical alternative to conventional fractional-reserve interest-based models (Ayub, 2013; Muhammed & Yusuf, 2026).

Classical Risk-Sharing and Institutional Development

During the Islamic Golden Age (8th–14th centuries), institutions evolved trade mechanisms such as *sakk* (payment certificates), *hawala* (debt transfers), and *bay' al-salam* (forward sales for agricultural liquidity) to facilitate long-distance trade without interest (Hassan & Lewis, 2007; Udovitch, 1970). These structures linked financial claims directly to real physical assets, preventing speculative expansion detached from the real economy (Kuran, 2011; Obaidullah, 2005). Figure 2 summarizes the operational functions of classical Islamic financial mechanisms, including *sakk*, *hawala*, and *bay' al-salam*, in facilitating trade, remittances, and agricultural financing.

CLASSICAL RISK-BEARING ECOSYSTEM	
Mechanism	Operational Function
Sakk	Fractional asset claim facilitating trade credit
Hawala	Trust-based international remittance without interest
Bay' al-Salam	Agricultural forward funding tied to real crops

Figure 2. Classical Islamic Financial Mechanisms and Their Operational Functions

The historical development of classical institutional structures demonstrates that merchant communities operated sophisticated cross-border trade networks without relying on interest-bearing debt obligations (Hassan & Lewis, 2007; Udovitch, 1970). For instance, *bay' al-salam* provided capital-starved agricultural producers with immediate cash flow while protecting buyers through strict asset specifications and clear delivery timelines (Obaidullah, 2005). Similarly, early *sakk* issuances functioned as revenue-sharing instruments grounded in actual property rights or merchant commodity flows (Hassan & Lewis, 2007).

These historical mechanisms confirm that early Islamic commercial law did not restrict financial liquidity; rather, it channeled liquidity through real asset transactions, mutual risk-bearing, and ethical partnership models (Udovitch, 1970). Classical institutions built financial confidence upon personal reputation, trust, and shared equity exposure, creating a commercial ecosystem where wealth generation correlated directly with productive economic activity (El-Gamal, 2006; Kuran, 2011).

Transformation from Classical Contracts to Modern Financial Engineering

The 20th-century revival of Islamic banking saw the adaptation of bilaterally negotiated classical contracts into standardized commercial products (Khan & Bhatti, 2008). Modern financial engineering introduced:

- a. Debt-based Contracts (*murabahah* & *tawarruq*): Originally a cost-plus sales transaction, modern *murabahah* has been adapted into organized liquidity management tools, replacing equity-based partnerships with fixed return profiles (Ayub, 2013; El-Gamal, 2006).

- b. Securitization (*sukuk*): Classical payment certificates (*sakk*) were transformed into tradable capital market securities representing undivided shares in underlying assets or usufructs (Jobst et al., 2008).

As Islamic banks emerged in the 1970s, led by pioneering institutions such as Dubai Islamic Bank and the Islamic Development Bank, practitioners faced severe market pressure to deliver capital protection and fixed yields comparable to conventional commercial banks (Ahmad & Hassan, 2007; Zarrouk et al., 2016). Consequently, financial engineers shifted primary product focus away from genuine equity-based partnership models (*mudarabah* and *musharakah*) toward synthetic debt instruments (El-Gamal, 2006; Khan & Bhatti, 2008).

Through organized *tawarruq* (reverse commodity *murabahah*), institutions execute rapid, multi-broker commodity buy-and-sell operations to generate immediate cash liquidity for clients while creating a deferred, fixed-rate debt obligation (Yusuf & Adio, 2025). While this transformation facilitated rapid balance sheet expansion and regulatory acceptance, it fundamentally altered the functional nature of Islamic banking from direct equity partnership to intermediated, fixed-income debt creation (Khan & Bhatti, 2008; Vogel & Hayes, 1998).

Sharia Compliance versus Economic Substance: Contemporary Debate

Recent literature highlights a growing critique regarding "Sharia arbitrage", the practice of structuring products to meet legal contractual form while mimicking the cash flows and risk profiles of conventional debt (El-Gamal, 2006; Kamali & Abdullahi, 2014). Scholars argue that an over-reliance on benchmark pricing (e.g., SOFR/LIBOR) and capital-guarantee mechanisms in investment accounts dilutes the risk-sharing identity of Islamic institutions (Ayub, 2013; Chapra, 2000).

The contemporary debate centers on whether formal adherence to juristic mechanics (*Sharia* compliance) satisfies the ultimate ethical mandate of Islamic law (*Sharia* substance) (Kamali & Abdullahi, 2014). Prominent critics emphasize that modern structures frequently utilize legal devices (*hiyal*) to sidestep the core prohibition of interest (El-Gamal, 2006). For example, modern *sukuk* structures routinely incorporate purchase undertakings (*wa'ad*) from the issuer, guaranteeing to repurchase underlying assets at face value upon maturity regardless of asset performance (Jobst et al., 2008). This contractual mechanism effectively transfers asset market risk away from investors and back to the issuer, converting a theoretical equity-like asset investment into a credit-rated debt obligation (El-Gamal, 2006; Jobst et al., 2008). Furthermore, using conventional benchmark interest rates to price profit margins in *murabahah* and *ijara* contracts causes Islamic financial returns to mirror conventional borrowing costs, drawing sharp criticism from contemporary jurists and developmental economists alike (Ayub, 2013; Chapra, 2000).

Digital Transformation and the Emerging Research Gap

The arrival of Islamic fintech, decentralized finance (DeFi), and smart contracts offers potential solutions to classical intermediation challenges (Zarrouk et al., 2016). However, a gap remains in systematically conceptualizing whether digital platforms foster genuine peer-to-peer risk-sharing or simply accelerate automated debt replication (Zarrouk et al., 2016). As illustrated in Figure 3, the transformation from traditional financial intermediation to digital decentralization highlights the potential role of smart contracts, peer-to-peer risk-sharing, and transparent asset tracking in Islamic finance.

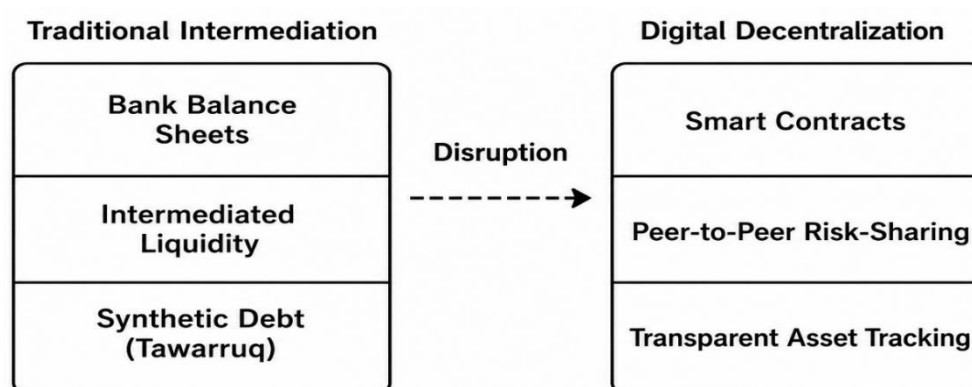


Figure 3. Fintech Transformation Matrix

The rapid integration of financial technology introduces unprecedented opportunities alongside regulatory complexities for the global Islamic financial sector (Firmansyah & Harsanto, 2022; Yusuf et al, 2024). Blockchain architecture and automated smart contracts allow developers to program contractual execution logic directly into digital tokens, ensuring that asset transfers, profit calculations, and loss distribution occur automatically without centralized manual intervention (Zarrouk et al., 2016). Equity crowdfunding platforms (e.g., Ethis) and automated investment platforms (e.g., Wahed Invest) demonstrate how technology can drastically reduce transaction and monitoring costs, enabling direct micro-investments into real commercial enterprises (Zarrouk et al., 2016). However, current empirical literature lacks rigorous frameworks to evaluate whether these digital platforms genuinely advance *Maqasid al-Shariah* or merely digitize high-cost consumer debt instruments (Kamali & Abdullahi, 2014; Zarrouk et al., 2016). Addressing this knowledge gap requires investigating how digital infrastructure can bypass legacy commercial banking balance sheets to restore true risk-bearing partnership models at scale (Zarrouk et al., 2016).

Analytical Framework: Evolution and Transformation Mechanisms

To trace the transition from historical principles to contemporary practices, Table 1 details the analytical mechanisms, structural transformations, and ethical implications across major contract categories.

Table 1. Comparative Analytical Framework of Evolution in Islamic Finance

Classical Foundation	Modern Instrument	Continuity Mechanism	Transformation Dynamic	Sharia / Ethical Implication
<i>Mudarabah / musharakah</i> (Profit-and-Loss Sharing) (Ayub, 2013; Iqbal & Mirakhor, 2011)	Islamic Investment Accounts (PSIA), Equity Crowdfunding (Zarrouk et al., 2016)	Profit-and-loss sharing (PLS) contractual structure (Ahmad & Hassan, 2007; ICD & LSEG, 2023)	Intermediated through banking balance sheets; use of Profit Equalization Reserves (PER) (Hassan & Lewis, 2007)	Shifts risk away from depositors toward bank capital protection; dilutes direct risk-sharing ethos (El-Gamal, 2006).

<i>Sakk</i> (Trade/Tax Certificate) (Hassan & Lewis, 2007; Udovitch, 1970)	Tradable Sovereign & Corporate <i>Sukuk</i> (IFSB, 2023; Jobst et al., 2008)	Fractional asset ownership or usufruct rights (<i>Manfa'ah</i>) (Jobst et al., 2008)	Securitization into capital markets; credit rating integration and purchase undertakings (Jobst et al., 2008)	Predominance of "asset-based" over "asset-backed" <i>sukuk</i> leads to conventional credit-risk profile (El-Gamal, 2006; Jobst et al., 2008).
<i>Bay' al-Salam / Murabahah</i> (Deferred Trade/Sale) (Obaidullah, 2005)	Commodity <i>Murahahah / Tawarruq</i> (Ayub, 2013)	Cost-plus margin pricing and deferred delivery sales (El-Gamal, 2006)	Automated, multi-party broker transactions for instantaneous cash liquidity (Khan & Bhatti, 2008; Ahmed, 2024)	Generates fixed debt obligations; diverges from real trade into purely synthetic liquidity generation (Ayub, 2013; El-Gamal, 2006).
<i>Kafalah Ta'awun</i> (Mutual Support/Guarantee) (Obaidullah, 2005)	Digital <i>Takaful</i> & Insurtech Platforms (Moody's Analytics, 2022; Zarrouk et al., 2016)	Mutual risk-pooling (<i>Tabarru'</i>) and cooperative assistance (Obaidullah, 2005)	Institutionalization via <i>Wakalah/Mudarabah</i> operational models & actuarial modeling (Moody's Analytics, 2022)	Balances commercial solvency with mutual cooperation; highly aligned with original ethos (Obaidullah, 2005; Hasan et al., 2020).

Source: Authors' own work

Methodology

Research Design and Approach

This study adopts a qualitative historical-documentary design, supported by comparative thematic analysis. The design is appropriate because the study examines the development of Islamic finance as a body of legal, institutional, and commercial practice rather than testing a statistical relationship between variables. The historical-documentary approach enables the discussion to connect classical Islamic commercial contracts and juristic principles with their institutional adaptation in modern banking, capital markets, social finance, and financial technology. The analysis is interpretive and conceptual: it assesses continuity and change in contractual structures and considers the implications for Sharia compliance and the broader objectives of *Maqasid al-Shariah*.

Data Sources and Document Collection

The study draws on documentary sources cited and discussed in the manuscript, including scholarly books and articles on Islamic commercial jurisprudence, Islamic banking, financial engineering, sukuk, Islamic microfinance, and fintech; institutional publications and standards; and relevant historical and conceptual works. The source base includes works by Udovitch (1970), Vogel and Hayes (1998), Chapra (2000), El-Gamal (2006), Iqbal and Mirakhor (2011), Ayub (2013), Mollah & Zaman, (2015), and institutional materials cited from the IFSB, (2023) and AAOIFI, (2023). These sources provide the historical, juristic, institutional, and contemporary perspectives needed to compare classical contracts with modern financial products. Document collection was guided by the study objectives and by the relevance of each source to the evolution of contractual forms, risk allocation, *Sharia* governance, and technological innovation. The manuscript does not claim to be an exhaustive systematic review of all publications in the field.

Document Selection Criteria

Documents were considered relevant where they addressed at least one of four areas: (i) the normative foundations of Islamic commercial law, including the prohibitions of *riba*, *gharar*, and *maysir* and the principles governing profit, loss, ownership, and risk; (ii) the historical development of trade and partnership mechanisms; (iii) the institutional design or operation of contemporary Islamic financial products, including *murabahah*, *tawarruq*, *sukuk*, *takaful*, and Islamic investment accounts; or (iv) the relationship between formal *Sharia* compliance, economic substance, *Maqasid al-Shariah*, and digital finance. Priority was given to sources that directly informed the study's research objectives or offered a clearly identifiable historical, conceptual, institutional, or regulatory contribution. Sources that did not materially inform these themes were not used in developing the analytical framework. Because this is a qualitative documentary analysis rather than a systematic evidence review, no numerical screening flow, exhaustive database search, or formal study-quality scoring is claimed.

Data Analysis Procedures

The analysis proceeded in four connected stages. First, the relevant documentary material was read in relation to the study objectives, and propositions concerning classical contracts, risk-bearing, asset ownership, institutional constraints, and *Sharia* objectives were identified. Second, the material was organised comparatively across five dimensions: classical foundations, modern forms, continuity mechanisms, transformation dynamics, and *Sharia* or ethical implications. Third, classical arrangements, including *mudarabah*, *musharakah*, *bay' al-salam*, *sakk*, and mutual-support principles were compared with contemporary forms such as Islamic investment accounts, sukuk, commodity *murabahah* and *tawarruq*, *takaful*, and fintech platforms. The comparison focused on the contractual basis of the product, the allocation of profit and loss, the relationship to underlying assets or economic activity, and the implications for risk-sharing and *Sharia* substance. Fourth, recurring patterns and tensions were synthesised into the analytical framework presented in Table 1 and examined in the critical discussion. Interpretations were checked against the cited documentary sources, and the conclusions were framed as qualitative analytical findings rather than statistical estimates or universal claims about every institution or product. This procedure links the evidence discussed in the manuscript to the recommendations on *Sharia* governance, product design, and digital finance.

Result and Discussion

Institutional Evolution: Contractual Continuity vs. Structural Shift

The analysis demonstrates that modern Islamic financial engineering maintains formal contractual continuity by embedding classical nominative contracts (*aqd*) into legal documentation (El-Gamal, 2006; Vogel & Hayes, 1998). However, the institutional environment demands standardization, capital adequacy compliance (e.g., IFSB/Basel guidelines), and liquid secondary markets (Hassan & Lewis, 2007; IFSB, 2023). This context has driven a structural shift away from equity-like *Mudarabah* and *Musharakah* towards fixed-income debt equivalents like organized *Tawarruq* (Ayub, 2013; Khan & Bhatti, 2008). Figure 4 illustrates the structural shift from classical profit-and-loss-sharing arrangements, characterized by direct business risk exposure and variable returns, toward modern intermediated banking structures that emphasize depositor capital protection and debt-like returns.

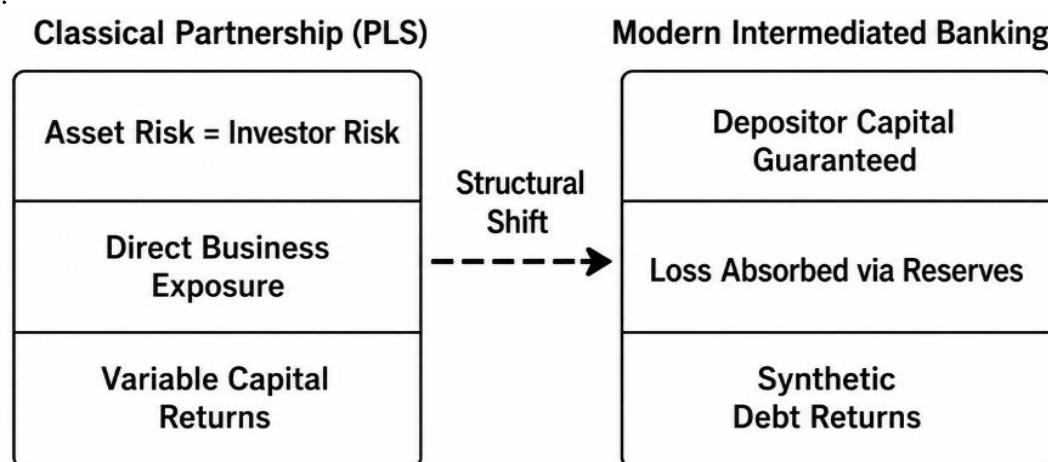


Figure 4. Structural Shift in Risk Allocation

This structural shift stems from fundamental institutional constraints embedded within the contemporary global financial landscape (El-Gamal, 2006; Iqbal & Mirakhor, 2011). Conventional central banking frameworks act as lenders of last resort primarily through interest-bearing credit facilities, forcing Islamic central banks and commercial institutions to construct Sharia-compliant liquidity mechanisms that offer predictable, risk-free returns (Ayub, 2013; IFSB, 2023). Furthermore, international regulatory frameworks like Basel III impose heavy capital charges on unhedged equity holdings, discouraging commercial Islamic banks from holding direct equity stakes in private corporate ventures (IFSB, 2023).

To navigate these regulatory capital costs while maintaining commercial viability, IFIs utilize Profit Equalization Reserves (PER) and Investment Risk Reserves (IRR) (Hassan & Lewis, 2007). These accounting mechanisms smooth profit distributions to depositors, preventing commercial displacement risk where depositors move funds to conventional banks during periods of lower investment yields (Hassan & Lewis, 2007; Khan & Bhatti, 2008). Consequently, while the underlying legal contracts reference equity partnership, the operational reality mirrors fixed-income commercial banking (El-Gamal, 2006).

From Sharia Compliance to Sharia Substance: Has Modernization Preserved the Classical Ethos?

A critical evaluation of modern practices reveals notable divergences between legal Sharia compliance (form) and economic Sharia substance (*Maqasid al-Shariah*) (Chapra, 2000; Kamali & Abdullahi, 2014):

- a. Debt-like Replication in *Sukuk*: While classical *sakk* represented direct ownership of physical assets, a majority of modern *sukuk* are structured as "asset-based" (Jobst et al., 2008). In these models, investors hold contractual rights to returns rather than direct recourse to underlying assets, functioning similarly to conventional unsecured bonds (Mahyudin & Rosman, 2022; Nuhic-Meskovic et al., 2026).
- b. Benchmark Pricing: The prevailing industry practice of pricing Islamic trade and lease contracts using conventional interest rate benchmarks (e.g., SOFR) aligns returns with conventional market rates (Ayub, 2013). While juristically permissible, it limits the economic independence of Islamic finance (Abedifar et al., 2013; IFAAS, 2022).
- c. Social Finance vs. Commercial Banking: The institutional convergence towards commercial banking profitability has historically marginalized social finance tools (Karim et al., 2008; Rahman, 2010). However, non-bank models, such as the Akhuwat Foundation's *Qard al-Hasan* (benevolent micro-loans), demonstrate that community-centered risk-sharing models can achieve high repayment rates without profit margins or interest burdens (Alshater et al., 2022).
- d. Evaluating this form-versus-substance gap shows that prioritizing legal compliance over economic intent risks undermining public trust and diminishing the ethical identity of Islamic finance (Chapra, 2000; El-Gamal, 2006). When *Sukuk* issuers incorporate binding repurchase promises at face value, they remove investor exposure to asset loss, neutralizing the core *Sharia* principle that profit justifies risk exposure (*al-ghunm bi-l-ghurm*) (Kamali & Abdullahi, 2014; ICD & LSEG, 2023).

Similarly, the widespread reliance on organized *tawarruq* to provide personal cash loans, credit card balances, and corporate refinancing creates a credit-expansion system that duplicates conventional debt accumulation without generating tangible physical assets or productive employment (Ayub, 2013; Habib, 2017). In contrast, models like the Akhuwat Foundation utilize community centers and trust networks to disburse interest-free loans (*Qard al-Hasan*), demonstrating that financial inclusion can flourish when decoupled from commercial debt creation (Karim et al., 2008; Rahman, 2010). Figure 5 illustrates the divergence between formal *Sharia* compliance and economic substance, emphasizing how legally valid contractual structures may not necessarily achieve the broader objectives of real economic value creation, equitable wealth distribution, and genuine risk-sharing.

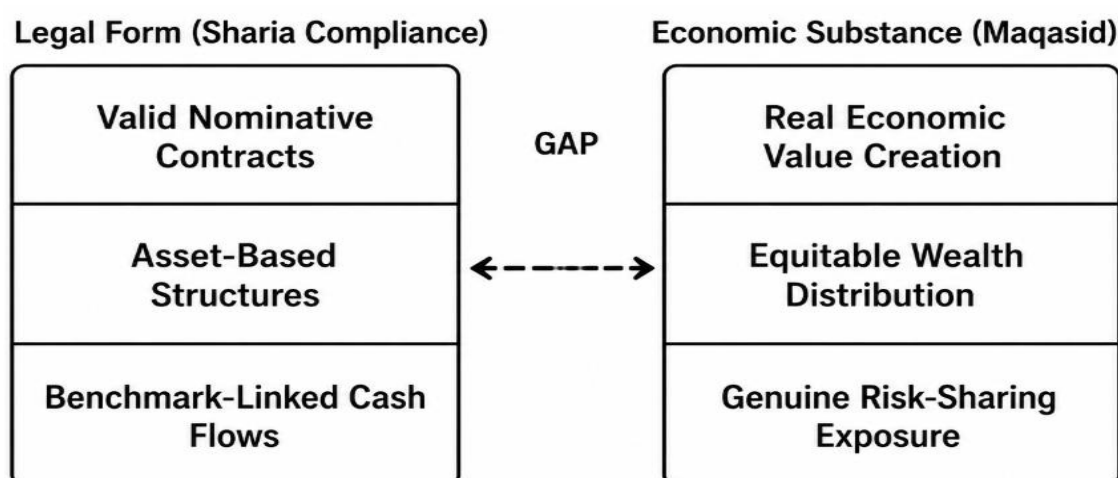


Figure 5. Form Vs Substance Divergence

Technological Frontiers: Fintech and Decentralized Risk Sharing

Digital transformation presents an opportunity to realign Islamic finance with its classical risk-sharing ethos (Zarrouk et al., 2016). Equity crowdfunding platforms (e.g., Ethis) and smart-contract-driven *Takaful* remove traditional banking intermediaries, enabling direct profit-and-loss sharing between investors and entrepreneurs (Zarrouk et al., 2016). Blockchain technology can also improve transaction transparency in asset-backed *Sukuk*, verifying asset existence and preventing double-hypothecation (Zarrouk et al., 2016).

Technological disintermediation offers a viable path to address the long-standing structural challenges of commercial Islamic banking (Zarrouk et al., 2016). By replacing centralized bank balance sheets with decentralized peer-to-peer protocols, digital platforms allow capital providers to connect directly with entrepreneurs without needing Profit Equalization Reserves or debt-replication structures (El-Gamal, 2006; Zarrouk et al., 2016). Smart contracts deployed on immutable distributed ledgers automatically verify asset ownership, enforce revenue distribution rules, and execute collateral transfers without human error or discretionary delay (Zarrouk et al., 2016; Khan & Aliyu, 2018).

Furthermore, tokenizing physical assets enables fractional ownership of real estate, agricultural yields, and infrastructure projects, allowing retail investors to participate directly in asset-backed investments (Zarrouk et al., 2016). These technological tools can restore the classical coupling of monetary wealth to real asset performance, helping realize the socio-economic principles of *Maqasid al-Shariah* within a digital global economy (Kamali & Abdullahi, 2014; Zarrouk et al., 2016).

Conclusion

This study critically examined the evolution of Islamic finance from its classical normative foundations to contemporary financial engineering and digital financial innovations. The findings indicate that although modern Islamic financial instruments generally retain elements of classical contractual structures, institutional transformation has increasingly encouraged the development of debt-like financial arrangements. In particular, the growing reliance on instruments such as *Tawarruq*, benchmark-linked pricing mechanisms, and certain *Sukuk* structures highlights the continuing tension between formal *Sharia* compliance and the broader economic objectives of Islamic finance. This tension raises important questions regarding the extent to which contemporary financial products preserve the principles of genuine risk-sharing, equitable wealth distribution, and social justice embodied in *Maqasid al-Shariah*. By integrating historical contractual foundations with contemporary institutional developments, this study contributes an analytical framework for examining the relationship between contractual continuity, financial engineering, risk allocation, and *Sharia* substance. The findings suggest that the long-term development of Islamic finance requires greater attention to the economic functions and ethical implications of financial products rather than relying exclusively on formal contractual compliance.

Nevertheless, this study has several limitations. As a qualitative historical-documentary analysis, its findings are based on the interpretation and synthesis of existing literature and institutional documents rather than direct empirical observations of financial institutions or individual financial products. Consequently, the proposed analytical framework does not establish the prevalence of particular contractual practices across the global Islamic finance industry or measure their economic and social outcomes. Future research could empirically examine the relationship between contractual structures, risk allocation, and *Sharia* substance across different institutional and regulatory contexts. Comparative studies of *Sukuk* structures, Islamic investment accounts, and emerging fintech platforms could also provide further evidence regarding whether contemporary financial innovations contribute to

genuine risk-sharing and the realization of *Maqasid al-Shariah*. Such investigations would help strengthen the empirical foundations for developing Islamic financial instruments that balance commercial competitiveness with their underlying ethical and socio-economic objectives.

Implications and Recommendations

The findings of this study provide several implications for *Sharia* governance, financial regulation, and Islamic financial product development. The analysis highlights the need to strengthen the alignment between formal *Sharia* compliance and the broader economic objectives of Islamic finance. In particular, the increasing reliance on debt-like financial structures, differences in *Sharia* governance standards across jurisdictions, and the growing adoption of financial technology present important challenges for the development of Islamic financial institutions. Addressing these challenges requires coordinated efforts among regulators, standard-setting bodies, financial institutions, and fintech developers.

Table 2 presents the relationship between the key analytical findings, their systemic implications, and the corresponding policy and industry recommendations. The proposed recommendations emphasize regulatory support for genuine risk-sharing instruments, greater harmonization of *Sharia* governance standards, improved transparency in Sukuk structures, and appropriate governance mechanisms for emerging financial technologies.

Table 2. Mapping of Research Findings, Systemic Implications, and Policy Recommendations

Research Finding	Systemic Implication	Policy / Industry Recommendation
Over-reliance on synthetic debt structures (<i>Tawarruq</i>) (Ayub, 2013)	Divergence from real economic backing and ethical risk-sharing (El-Gamal, 2006)	Central Banks & Regulators: Establish regulatory incentives (e.g., lower capital risk-weightings) for equity-based PLS instruments (IFSB, 2023).
Fragmented cross-border <i>Sharia</i> rulings (Vogel & Hayes, 1998)	Increased transaction costs and global investor uncertainty (Hassan & Lewis, 2007)	AAOIFI & IFSB: Accelerate harmonization of global <i>Sharia</i> governance standards and mutual recognition frameworks (AAOIFI, 2023).
Predominance of asset-based over asset-backed <i>sukuk</i> (Jobst et al., 2008)	Capital market exposure to legal ambiguity during defaults (IFAAS, 2022)	Capital Market Authorities: Mandate clear legal asset-transfer mechanisms for issuances labeled as sovereign or green <i>sukuk</i> (Jobst et al., 2008).
Technological disintermediation potential (Zarrouk et al., 2016)	Traditional regulatory frameworks struggle to oversee fintech platforms (Zarrouk et al., 2016)	Fintech Developers & Regulatory Sandboxes: Standardize smart-contract audits for automated, transparent <i>Sharia</i> execution (Zarrouk et al., 2016)

Source: Authors' own work

These recommendations suggest that the future development of Islamic finance should not be evaluated solely in terms of market expansion and financial innovation. Greater attention should also be given to the economic substance of financial transactions, the allocation of risks and returns, and their alignment with the objectives of *Maqasid al-Shariah*.

Nevertheless, the proposed recommendations remain conceptual and require further institutional and empirical assessment before their practical implementation.

Author's Contributions (CRediT Taxonomy)

Jamiu Adeniyi Yusuf: Conceptualization, Methodology, Formal analysis, Writing – original draft, Writing – review & editing.

Azeem Tunde Muhammed: Investigation, Data curation, Resources, Writing – original draft, Writing – review & editing.

Ismail Aderole Ayuba: Methodology, Investigation, Data curation, Formal analysis, Writing – original draft, Writing – review & editing.

All authors contributed to the literature review, critically reviewed the manuscript, and read and approved the final version for publication.

Acknowledgements

We appreciate those authors; whose works were cited in this work and as well as our reviewers for taking their quality time to review our work thereby improving the quality of the manuscript.

Declarations

Ethical considerations

This study is based exclusively on publicly available secondary sources and documentary materials. No human participants were involved; therefore, ethical approval and informed consent were not required.

Use of artificial intelligence (AI)

The authors declare that no generative artificial intelligence (AI) tools were used in the preparation, analysis, or writing of this manuscript.

Conflict of Interest

The authors declare no conflicts of interest.

Funding

This research did not receive any financial support.

References

- AAOIFI. (2023). *Shariah governance standards for Islamic financial institutions*. SS (6) Conversion of a Conventional Bank to an Islamic Bank. [Accounting and Auditing Organization for Islamic Financial Institutions](#)
- Abedifar, P., Molyneux, P., & Tarazi, A. (2013). Risk in Islamic banking. *Review of Finance*, 17(6), 2035–2096. <https://doi.org/10.1093/rof/rfs041>
- Ahmad, A. F., & Hassan, M. K. (2007). Regulation and performance of Islamic banking in Bangladesh. *Thunderbird International Business Review*, 49(2), 251-277.
- Ahmed, H. (2024). Security tokens, ecosystems and financial inclusion: Islamic perspectives. *International Journal of Islamic and Middle Eastern Finance and Management*, 17(4), 730–745. <https://doi.org/10.1108/IMEFM-04-2024-0195>

- Alshater, M. M., Saba, I., Supriani, I., & Rabbani, M. R. (2022). Fintech in Islamic finance literature: A review. *Heliyon*, 8(9), Article e10385. <https://doi.org/10.1016/j.heliyon.2022.e10385>
- Ayub, M. (2013). *Understanding Islamic finance*. John Wiley & Sons.
- Ayuba, A. I., & Yusuf, J. A. (2021). Islamic economic system: A better approach to revive the Nigerian economy. In Proceedings of the 2021 Conference on Islam in Nigeria (COIN): Managing Pandemics, Economic Crisis & Health Care Challenges in Nigeria: Islamic Perspective (Vol. 10, pp. 34–41). Islamic Welfare Foundation. https://iwf.com.ng/2021_conference_papers/materials_2021/COIN_pp%2034-41.pdf
- Beck, T., Demirgüç-Kunt, A., & Merrouche, O. (2013). Islamic vs. conventional banking: Business model, efficiency and stability. *Journal of Banking & Finance*, 37(2), 433–447. <https://doi.org/10.1016/j.jbankfin.2012.09.016>
- Chapra, M. U. (2000). *The future of economics: An Islamic perspective*. The Islamic Foundation.
- El-Gamal, M. A. (2006). *Islamic finance: Law, economics, and practice*. Cambridge University Press.
- Farook, S., Hassan, M. K., & Lanis, R. (2011). Determinants of corporate social responsibility disclosure: The case of Islamic banks. *Journal of Islamic Accounting and Business Research*, 2(2), 114–141. <https://doi.org/10.1108/17590811111170523>
- Firmansyah, E. A., & Harsanto, B. (2022). Islamic fintech research: Systematic review using mainstream databases. *ETIKONOMI*, 21(2). <https://doi.org/10.15408/etk.v21i2.24602>
- Godlewski, C. J., Turk-Ariss, R., & Weill, L. (2013). Sukuk vs. conventional bonds: A stock market perspective. *Journal of Comparative Economics*, 41(3), 745–761. <https://doi.org/10.1016/j.jce.2013.02.006>
- Güney, N. (2024). Maqāṣid al-Sharī'a in Islamic finance: A critical analysis of modern discourses. *Religions*, 15(1), Article 114. <https://doi.org/10.3390/rel15010114>
- Habib, F. (2017). Towards a robust Shariah screening criterion for stocks. In S. A. R. Rizvi and I. Saba (Eds.), *Developments in Islamic finance: Challenges and initiatives*. Palgrave Macmillan. <https://doi.org/10.1007/978-3-319-59342-5>
- Hasan, R., Hassan, M. K., & Aliyu, S. (2020). Fintech and Islamic finance: Literature review and research agenda. *International Journal of Islamic Economics and Finance*, 3(1), 75–94. <https://doi.org/10.18196/ijief.2122>
- Hassan, M. K., & Lewis, M. K. (Eds.). (2007). *Handbook of Islamic banking*. Edward Elgar Publishing.
- IFAAS. (2022, March 10). *Islamic finance industry set for continued growth in 2022 despite challenges*. Islamic Finance Advisory & Assurance Services. <https://ifaas.com/islamic-finance-industry-set-for-continued-growth-in-2022-despite-challenges.html>
- IFSB. (2023). *Islamic financial services industry stability report 2023*. <https://www.ifsb.org/>
- Iqbal, Z., & Mirakhor, A. (2011). *An introduction to Islamic finance: Theory and practice* (2nd ed.). John Wiley & Sons.
- Jobst, A. A., Kunzel, P., Mills, P. S., & Sy, A. N. R. (2008). *Islamic bond issuance: What sovereign debt managers need to know* (IMF Policy Discussion Paper No. 08/03). International Monetary Fund. <https://doi.org/10.5089/9781451946024.003>
- Kamali, M. H. (2002). *Principles of Islamic jurisprudence* (3rd ed.). Islamic Texts Society.
- Kamali, M. H., & Abdullah, A. K. (Eds.). (2014). *Islamic finance: Issues in sukuk and proposals for reform*. Kube Publishing.
- Karim, N., Tarazi, M., & Reille, X. (2008). *Islamic microfinance: An emerging market niche* (Focus Note No. 49). Consultative Group to Assist the Poor.

- Khan, A., Rizvi, S. A. R., Ali, M., & Haroon, O. (2021). A survey of Islamic finance research: Influences and influencers. *Pacific-Basin Finance Journal*, 69, Article 101437. <https://doi.org/10.1016/j.pacfin.2020.101437>
- Khan, F. (2010). How 'Islamic' is Islamic banking? *Journal of Economic Behavior & Organization*, 76(3), 805–820. <https://doi.org/10.1016/j.jebo.2010.09.015>
- Khan, M. F., & Aliyu, S. (2018). A contemporary survey of Islamic banking literature. *Journal of Financial Stability*. <https://doi.org/10.1016/j.jfs.2017.11.006>
- Khan, M. F., & Bhatti, M. I. (2008). *Developments in Islamic banking: The case of Pakistan*. Palgrave Macmillan.
- Kuran, T. (2011). *The long divergence: How Islamic law held back the Middle East*. Princeton University Press.
- Laldin, M. A., & Furqani, H. (2013a). Developing Islamic finance in the framework of maqāṣid al-Sharī'ah: Understanding the ends (maqāṣid) and the means (wasā'il). *International Journal of Islamic and Middle Eastern Finance and Management*, 6(4), 278–289. <https://doi.org/10.1108/IMEFM-05-2013-0057>
- Laldin, M. A., & Furqani, H. (2013b). The foundations of Islamic finance and the maqāṣid al-Sharī'ah requirements. *Journal of Islamic Finance*, 2(1), 31–37. <https://doi.org/10.31436/jif.v2i1.9>
- Mahyudin, W. A., & Rosman, R. (2022). Performance of Islamic banks based on maqāṣid al-Sharī'ah: A systematic review of current research. *Journal of Islamic Accounting and Business Research*, 13(4), 714–735. <https://doi.org/10.1108/JIABR-10-2020-0337>
- Mohamed H. Rashwan, Heba Ehab (2016). Comparative Efficiency Study between Islamic and Traditional Banks. *Journal of Finance and Economics*, 4(3):74-87. doi: 10.12691/jfe-4-3-2.
- Mollah, S., & Zaman, M. (2015). Shari'ah supervision, corporate governance and performance: Conventional vs. Islamic banks. *Journal of Banking & Finance*, 58, 418–435. <https://doi.org/10.1016/j.jbankfin.2015.04.030>
- Moody's Investors Service. (2022, March 8). *Islamic finance – Cross-region: Growth will remain strong in 2022, but higher crude prices will slow sukuk issuance*. Moody's. <https://www.moody's.com>
- Muhammed A.T, & Yusuf J.A. (2026). Economic peace theory and religion: How faith-based social. norms reduce transaction costs and support sustainable development. *Religion as a catalyst for Socio-Moral and Politico-Economic Change of Humanity Festschrift in Honour of Prof Kabir Olawale Paramole,1* (353–363). Lagos State University Press.
- Narayan, P. K., & Phan, D. H. B. (2019). A survey of Islamic banking and finance literature: Issues, challenges and future directions. *Pacific-Basin Finance Journal*, 53, 484–496. <https://doi.org/10.1016/j.pacfin.2017.06.006>
- Nomran NM & Haron R (2020). A systematic literature review on Sharī'ah governance mechanism and firm performance in Islamic banking. (2020). *Islamic Economic Studies*, 27(2), 91–123. <https://doi.org/10.1108/IES-06-2019-0013>
- Nuhic-Meskovic, M., Hassan, M. K., & Meskovic, A. (2026). Islamic FinTech: A systematic literature review of trends and research gaps. *Journal of Islamic Marketing*. 1–33. <https://doi.org/10.1108/JIMA-10-2025-0662>
- Obaidullah, M. (2005). *Islamic financial services*. Scientific Publishing Centre, King Abdulaziz University.
- Rahman, A. R. A. (2010). Islamic microfinance: An ethical alternative to poverty alleviation. *Humanomics*, 26(4), 284–295. <https://doi.org/10.1108/08288661011090884>
- Vogel, F. E., & Hayes, S. L. (1998). *Islamic law and finance: Religion, risk, and return*. Brill.

- Yusuf, J. A. (2025a). Islamic finance and sustainable development in Nigeria: Assessing the role of non-interest banking in poverty reduction and SME growth. *Indonesian Journal for Islamic Studies*, 3(3), 100–110. <https://doi.org/10.58723/ijfis.v3i3.536>
- Yusuf, J. A. (2025b). Sustainable housing finance through Islamic contracts: A comparative study of Murabaha vs. diminishing Musharakah models. *COMSATS Journal of Islamic Finance*, 10(1), 69–89. <https://doi.org/10.26652/cjif.10202514>
- Yusuf, J. A., Ademola, A. A., Muhammed, A. T., & Ayuba, I. A. (2025). The role of Islamic finance and green bonds in promoting sustainable development. *International Journal of Islamic Economics and Finance Research*, 8(2), 42–53. <https://doi.org/10.53840/ijiefer201>
- Yusuf, J. A., Adio, S. F., (2025). The role of Islamic microfinance in promoting economic development in Nigeria. *Review of Islamic Economics and Finance*, 8(2), 261–278. <https://doi.org/10.17509/rief.v8i2.84263>
- Yusuf, J. A., Rauf, M. O., Ayuba, I. A., & Muhammed, A. T. (2025). The impact of Islamic banking on redistribution of sustainable income. *Journal of Islamic Economics and Finance Studies*, 5(2), 352–367. <https://doi.org/10.47700/jiefes.v5i2.9194>
- Zarrouk H, Ben Jedidia K, Moualhi M (2016), "Is Islamic bank profitability driven by same forces as conventional banks?". *International Journal of Islamic and Middle Eastern Finance and Management*, 9(1),46–66 <https://doi.org/10.1108/IMEFM-12-2014-0120>