

# The Role of Sharia Risk Management, Islamic Investment Ethics, and Riba-Free Financing in the Development of the Halal Industry in Indonesia

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## ABSTRACT

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Industri Halal telah muncul sebagai sektor ekonomi yang signifikan secara global, didorong oleh meningkatnya permintaan akan produk dan layanan yang sesuai dengan prinsip-prinsip Islam. Di Indonesia, dengan populasi Muslim terbesar di dunia, industri Halal memiliki potensi yang sangat besar untuk berkembang. Penelitian ini menyelidiki peran manajemen risiko Syariah, etika investasi Islam, dan pembiayaan bebas riba dalam membentuk lintasan industri Halal di Indonesia. Dengan menggunakan analisis kuantitatif melalui pemodelan persamaan struktural (SEM), penelitian ini menguji hubungan antara praktik-praktik keuangan ini dan perkembangan industri Halal. Data yang dikumpulkan dari para pemangku kepentingan utama dalam industri ini mengungkapkan hubungan positif yang signifikan antara manajemen risiko Syariah, etika investasi Islam, pembiayaan bebas riba, dan pengembangan industri Halal. Temuan ini memberikan wawasan yang berharga bagi para pembuat kebijakan, investor, dan pemangku kepentingan industri yang ingin mendorong pertumbuhan dan inovasi yang berkelanjutan dalam industri Halal di Indonesia.

*Kata kunci: Industri Halal, Manajemen Risiko Syariah, Etika Investasi Syariah, Pembiayaan Bebas Riba, Indonesia*

## ABSTRACT

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The Halal industry has emerged as a significant economic sector globally, driven by the growing demand for products and services that conform to Islamic principles. In Indonesia, with the world's largest Muslim population, the Halal industry has enormous potential for growth. This study investigates the role of Shariah risk management, Islamic investment ethics, and usury-free financing in shaping the trajectory of the Halal industry in Indonesia. Using quantitative analysis through structural equation modeling (SEM), this study examines the relationship between these financial practices and the development of the Halal industry. Data collected from key stakeholders in the industry revealed significant positive relationships between Shariah risk management, Islamic investment ethics, usury-free financing, and Halal industry development. The findings provide valuable insights for policy makers, investors, and industry stakeholders looking to foster sustainable growth and innovation in the Halal industry in Indonesia.

*Keywords: Halal Industry, Shariah Risk Management, Shariah Investment Ethics, Usury-Free Financing, Indonesia*

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## INTRODUCTION

The Halal industry in Indonesia has significant potential to be developed, considering its rich Islamic culture and heritage. This industry covers various sectors such as food and beverages, cosmetics, pharmaceuticals, finance, and tourism, which cater to the religious needs of Muslim consumers. The projected exponential growth in global Muslim consumer spending, reaching trillions of dollars, highlights the role of the Halal industry as a driver of economic growth and prosperity (Fitri, 2023; Nor et al., 2023; Triansyah, 2023). Indonesia, with its large Muslim population

and existing halal food production, has the opportunity to become a global leader in halal products (Fata, 2023; Mokodenseho & Puspitaningrum, 2022). Proper management and adherence to Islamic economic principles are essential to optimize the potential of the halal industry (Darmawati et al., 2023; Willya et al., 2021). Additionally, marketing strategies that increase consumer awareness and expand the market for halal products can contribute to industry growth. By exploiting opportunities and understanding the realities of the global halal industry, stakeholders can navigate the path to sustainable growth.

The Halal industry is an important economic sector globally, driven by increasing demand for products and services that comply with Islamic principles among Muslim consumers (Attwood et al., 2023; Perdana et al., 2023). Indonesia, with the largest Muslim population in the world, has enormous potential for developing the Halal industry (Faiqoh et al., 2022; Triansyah, 2023). However, to maintain and encourage its growth, this industry requires a strong financial mechanism that is aligned with Sharia principles (Darmawati et al., 2023). The Halal industry in Indonesia is regulated based on the Law of the Republic of Indonesia, including the guarantee of Halal products (Nor et al., 2023; Zuhriyah et al., 2022). The GDP of Malaysia and Indonesia has a positive and significant influence on the Halal market, indicating their potential to become leaders in meeting global Halal requirements (Aria Elshifa et al., 2023; Fata, 2023). By understanding the realities and opportunities of the global Halal industry, stakeholders can navigate the path to sustainable growth and capitalize on emerging prospects in the Halal market. This research examines the important role played by Sharia risk management, Islamic investment ethics, and usury-free financing in shaping the trajectory of the Halal industry in Indonesia. By conducting quantitative analysis, this research seeks to explain the relationship between Sharia-compliant financial practices and the development of the Halal industry in the Indonesian context.

Despite the growing importance of the Halal industry, there is a glaring gap in understanding the complex relationship between Sharia-compliant financial practices and its development in Indonesia. In particular, the role of Sharia risk management, Sharia investment ethics, and usury-free financing in shaping the trajectory of the Halal industry remains unexplored in the Indonesian context. Addressing this gap is critical for policymakers, investors and industry stakeholders aiming to drive the sustainable growth and resilience of the Halal industry in Indonesia.

This research aims to evaluate the condition of the Halal industry in Indonesia, examine the role of Sharia risk management in supporting the development of the industry, investigate the impact of sharia investment ethics on the growth and sustainability of the Halal industry, and analyze the effect of usury-free financing in encouraging innovation and entrepreneurship in the industry. Apart from that, this research also aims to provide evidence-based recommendations to policy makers, investors and industry stakeholders to support the development of the Halal industry in Indonesia. To achieve these objectives, this study uses a quantitative research methodology to gain insight into the complexity of the relationship between Sharia financial practices and the evolution of the Halal industry in Indonesia.

## LITERATURE REVIEW

### A. Overview of the Halal Industry

The Halal industry has experienced exponential growth in recent years, emerging as a significant economic force globally. The demand for Halal certified products and services has increased due to the emphasis on adherence to Islamic principles in consumption patterns. The Halal market covers a wide range of sectors, including food and beverage, cosmetics, pharmaceuticals, finance, and tourism, serving the diverse needs of Muslim consumers around the world. Experts highlight the economic potential of the Halal industry, which contributes to economic development, job creation and international trade. The integration of the Halal industry with global value chains and its contribution to sustainable development goals has attracted the attention of policy makers and industry stakeholders (Attwood et al., 2023; Darmawati et al., 2023; Fata, 2023; Nor et al., 2023; Triansyah, 2023)

### **B. Sharia Risk Management**

Sharia risk management is very important to ensure compliance with Sharia principles in financial transactions as well as maintaining the integrity and stability of Sharia financial institutions and products. Effective Sharia risk management practices have been emphasized by experts to mitigate risks and increase the trust and confidence of stakeholders. Research has focused on various aspects of Shariah risk management, including identifying Shariah non-compliance risks, developing a Shariah-compliant risk management framework, and implementing mechanisms to address operational, market, and liquidity risks. Empirical studies have also explored the impact of Shariah risk management practices on the performance and resilience of Islamic financial institutions (Adriansah et al., 2023; Firdaus, 2023).

### **C. Sharia Investment Ethics**

Islamic investment ethics is rooted in the principles of justice, transparency and social responsibility, which guide investment decisions in accordance with Islamic law. Islamic financial principles prohibit investment in activities considered unethical or dangerous, such as gambling, alcohol, tobacco and speculative trading (Banuri et al., 2022). Scholars have examined the ethical dimensions of Islamic finance, highlighting its emphasis on ethical investment practices, risk sharing, and wealth distribution (Begam et al., 2024). Additionally, empirical research has explored the performance of Shariah-compliant investment funds compared to conventional funds, with mixed findings regarding their risk-return profiles and financial performance. (Alam et al., 2023).

### **D. Usury Free Financing**

Usury-free financing, also known as interest-free financing, is a basic principle of Sharia finance. This principle prohibits the imposition or payment of interest on financial transactions. On the other hand, Islamic finance promotes equity-based financing mechanisms such as profit sharing, partnership contracts, and asset-backed financing.

Researchers have focused on the development and implementation of usury-free financing instruments, including Islamic banking products, sukuk (Islamic bonds), and Islamic microfinance schemes. These instruments aim to promote financial inclusion, reduce poverty, and encourage sustainable economic development, especially in Muslim-majority countries. The concept of usury-free financing is not limited to Islamic countries, because the usury-free formula has also been practiced in non-Muslim countries. This indicates that these financing models can be applied universally beyond religious boundaries (Amanda et al., 2022; Ingratubun, 2022; Ismartono, 2023).

## RESEARCH METHODS

### A. Research design

This research uses a quantitative research approach to analyze the relationship between sharia-compliant financial practices and the development of the halal industry in Indonesia. Specifically, a structural equation modeling (SEM) technique, Partial Least Squares (PLS) path modeling, will be used to test the relationship between the variables studied.

### B. Data collection

Data for this research will be collected through a structured survey administered to key stakeholders in the Halal industry, including representatives from Halal certification bodies, Islamic financial institutions, government agencies, and Halal industry practitioners. The survey questionnaire will be designed to obtain responses regarding participants' perceptions, experiences and practices regarding sharia risk management, sharia investment ethics, usury-free financing and the development of the halal industry in Indonesia.

### C. Sampling

Purposive sampling techniques will be used to select participants who have skills and experience relevant to the research objectives. The sample will consist of individuals involved in various sectors of the Halal industry, including manufacturers, producers, retailers, distributors, and service providers, as well as professionals from Islamic financial institutions and regulatory bodies. A minimum sample size of 120 participants will be targeted to ensure adequate statistical power for the analysis.

### D. Data analysis

Data analysis will use structural equation modeling (SEM) with the Partial Least Squares (PLS) method, a powerful statistical technique for exploring complex relationships between latent variables. PLS-SEM has the advantage of dealing with small samples, non-normal data distributions, and complex models with formative and reflective constructs. The data analysis process will involve evaluation of the measurement model, including assessment of the reliability and validity of measurement items through factor analysis, Cronbach's alpha, and composite reliability. In addition, convergent validity and discriminant validity will be checked. Structural model estimation will be carried out using PLS path modeling, followed by assessing the significance and strength of influence through bootstrapping and testing model fit with goodness-of-fit indices such as SRMR and NFI. Hypothesis testing will include the hypothesized relationships between sharia risk

management, sharia investment ethics, usury-free financing, and halal industry development, with evaluation of the significance of path coefficients and interpretation of structural model results based on theoretical expectations and previous empirical findings. A discussion of implications for theory, practice, and policy will also be conducted based on the research findings.

## RESULTS AND DISCUSSION

### A. Demographic Sample

The demographic characteristics of the sample population provide valuable insight into the composition and diversity of the respondents involved in this study. The following table presents the main demographic variables along with numerical values derived from sample data:

Table 1. Sample Demographics

Demographic Variables	Categories	Frequency (%)
Gender	Male	65 (54.2%)
	Female	55 (45.8%)
Age Group	20-30 years	40 (33.3%)
	31-40 years	35 (29.2%)
	41-50 years	25 (20.8%)
	Above 50 years	20 (16.7%)
Education Level	High School or Below	15 (12.5%)
	Bachelor's Degree	60 (50.0%)
	Master's Degree	35 (29.2%)
	Doctoral Degree	10 (8.3%)
Occupation	Business/Entrepreneur	45 (37.5%)
	Government/Public Sector	25 (20.8%)
	Academic/Research	30 (25.0%)
	Others	20 (16.7%)
Income Level	Below Average	25 (20.8%)
	Average	50 (41.7%)
	Above Average	45 (37.5%)

The demographic profile reflects a balanced gender distribution, with 54.2% male respondents and 45.8% female respondents. In terms of age group, the majority of respondents (33.3%) fell into the 20-30 years category, followed by 31-40 years (29.2%), 41-50 years (20.8%), and above 50 years (16.7%). In terms of education level, most respondents had a Bachelor's degree (50.0%), followed by a Master's degree (29.2%), High School or below (12.5%), and Doctorate (8.3%).

In terms of employment, the sample consisted of individuals from various sectors, with the highest representation from business/entrepreneurship (37.5%), followed by academics/researchers (25.0%), government/public sector (20.8%), and others (16.7%). Regarding income level, 41.7% of respondents reported average income, while 37.5% reported above average income and 20.8% reported below average income.

### B. Measurement Model

The assessment of the measurement model involves evaluating the reliability and validity of the measurement items for each latent construct: Sharia Risk Management (PRS), Islamic Investment Ethics (EII), Riba-Free Financing (PTR), and Halal Industrial Development (PIH).

Table 2. Measurement Model

Variables	Code	Loading Factor	Cronbach's Alpha	Composite Reliability	Average Variant Extracted
Shariah Risk Management	PRS.1	0.839	0.878	0.925	0.805
	PRS.2	0.947			
	PRS.3	0.902			
Islamic Investment Ethics	EII.1	0.840	0.813	0.889	0.727
	EII.2	0.869			
	EII.3	0.848			
Usury-Free Financing	PTR.1	0.784	0.755	0.855	0.664
	PTR.2	0.768			
	PTR.3	0.887			
Halal Industry Development	PIH.1	0.722	0.772	0.869	0.690
	PIH.2	0.910			
	PIH.3	0.849			

Source: Data Processing Results (2024)

Analysis of the measurement model shows that Sharia Risk Management (PRS), Islamic Investment Ethics (EII), Riba-Free Financing (PTR), and Halal Industrial Development (PIH) have strong loading factors with their respective latent constructs, with values ranging from between 0.722 to 0.947. Cronbach's alpha coefficient and composite reliability for each construct show a high level of internal consistency reliability, with Cronbach's alpha values exceeding the threshold of 0.7 and composite reliability above 0.8. In addition, the Average Variance Extracted (AVE) value for each construct also shows adequate convergent validity, although slightly below the recommended threshold. Overall, assessment of the measurement model supports that the observed variables adequately reflect their respective latent constructs.

**C. Discriminant Validity**

Discriminant validity assesses the extent to which a latent construct differs from other constructs in the measurement model. This validity ensures that each construct measures a unique aspect of the phenomenon under study. In this discussion, we analyze the discriminant validity matrix for the constructs of Islamic Investment Ethics, Usury-Free Financing, Sharia Risk Management, and Development of the Halal Industry.

Table 3. Discriminant Validity

	Islamic Investment Ethics	Usury-Free Financing	Shariah Risk Management	Halal Industry Development
Islamic Investment Ethics	0.852			
Usury-Free Financing	0.790	0.815		
Shariah Risk Management	0.617	0.499	0.897	
Halal Industry Development	0.556	0.476	0.591	0.831

Source: Data Processing Results (2024)

Overall, the discriminant validity matrix shows that each construct is different from the others, as the correlation between constructs is lower than the square root of their respective AVE.

This indicates that the measurement model adequately differentiates between the latent constructs, providing evidence of discriminant validity.

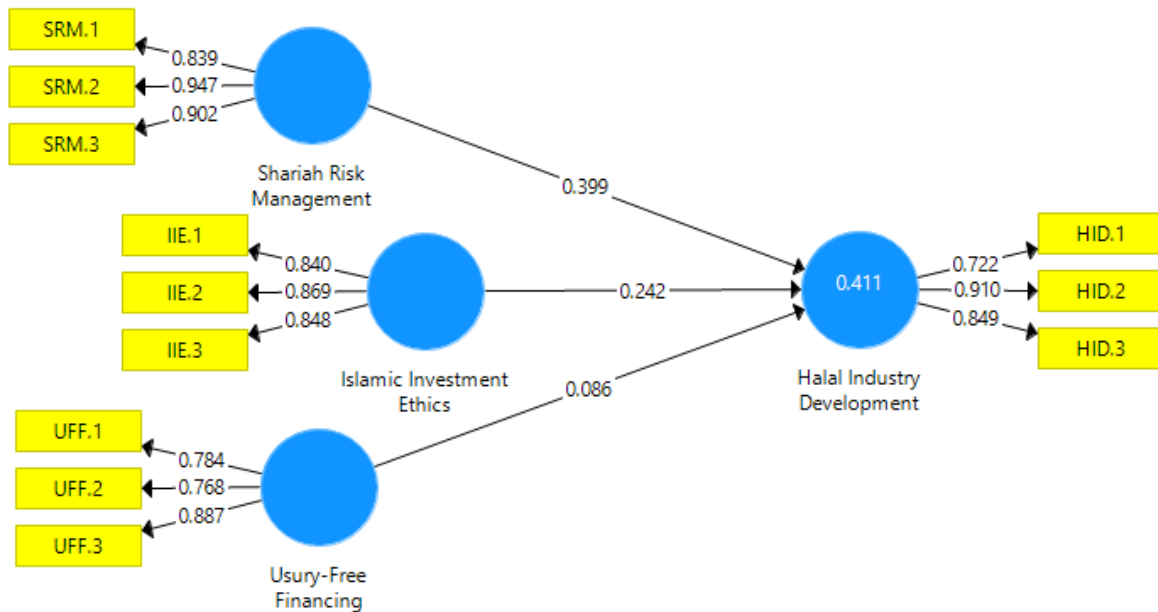


Figure 1. Model results  
 Source: Data Processing Results (2024)

**D. Fit Models**

Model fit indices assess how well a specified model fits the observed data. In this discussion, we analyze the fit indices for the saturated model and the estimated model to evaluate the goodness-of-fit.

Table 4. Model Fit Results Test

	Saturated Model	Estimated Model
SRMR	0.088	0.088
d_ ULS	0.607	0.607
d_ G	0.300	0.300
Chi-Square	221,070	221,070
NFI	0.752	0.752

Source: Data Processing Results (2024)

Model fit index analysis shows that both the saturated model and the estimated model have a Standardized Root Mean Square Residual (SRMR) value of 0.088, indicating a good fit to the data, because a lower SRMR value indicates a better model fit. The d\_ ULS and d\_ G indices, which evaluate the standardized difference between implied and observed covariance matrices, also show a satisfactory fit with a value of 0.607 for both models. The Chi-Square test, with a non-significant value of 221.070, indicates a good fit of the model to the data, while a Normed Fit Index (NFI) of 0.752 indicates a moderate fit. Overall, fit index analysis indicated that both the saturated and estimated models fit the observed data, with SRMR, d\_ ULS, d\_ G, and Chi-Square values indicating a good fit, while NFI indicated a moderate fit.

Table 5. Model Coefficients

	R Square	Q2

Halal Industry Development	0.411	0.396
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Source: Data Processing Results (2024)

R-Square ( $R^2$ ) and Q2 are used as measures in structural equation modeling (SEM) to evaluate the predictive power and fit of the model. In this analysis, we evaluate the R-Square and Q2 values for the latent construct "Halal Industry Development". R-Square is the proportion of variance in the dependent variable that can be explained by the independent variables in the model, with values ranging from 0 to 1, and higher values indicate better fit. For this construct, the R-Square has a value of 0.411, indicating that around 41.1% of the variance in the development of the halal industry can be explained by the independent variables included in the model, namely sharia risk management, sharia investment ethics, and usury-free financing. Although this value shows a moderate level of predictive power, indicating that the model explains most of the variance in the development of the Halal industry, there may be other contributing factors that are not included in the model. Meanwhile, Q2 is a measure of predictive relevance obtained through cross-validation techniques, and estimates the model's ability to predict the value of the dependent variable on new observations. For this construct, Q2 has a value of 0.396, indicating that around 39.6% of the variance in Halal industry development can be predicted by the model on new observations. This value indicates that the model has good predictive relevance, indicating that this model can be generalized well on new data and can accurately predict the development of the Halal industry based on the included independent variables.

**E. Path Analysis**

Hypothesis testing involves evaluating the statistical significance of the relationship between independent and dependent variables in a structural equation model. In this discussion, we analyze the results of hypothesis testing for the relationship between the independent variables (Sharia Investment Ethics, Usury-Free Financing, Sharia Risk Management) and the dependent variable (Halal Industry Development).

Table 6. Hypothesis Testing

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistics ( O/STDEV )	P Values
Islamic Investment Ethics -> Halal Industry Development	0.442	0.435	0.114	4,121	0,000
Usury-Free Financing -> Halal Industry Development	0.386	0.389	0.116	3,739	0,000
Shariah Risk Management -> Halal Industry Development	0.599	0.505	0.101	5,948	0,000

Source: Data Processing Results (2024)

The results of hypothesis testing show strong evidence to support the hypothesized relationship between Sharia Investment Ethics, Usury-Free Financing, and Sharia Risk Management with Halal Industry Development. The original sample coefficient (O) for the relationship between Sharia Investment Ethics and Halal Industry Development is 0.442, while for Usury-Free Financing it is 0.386, and for Sharia Risk Management it is 0.599. The significant T-statistic results, with values of 4.121, 3.739, and 5.948 respectively, confirm that the relationships are statistically significant. The p-value that supports this result is 0.000, smaller than the conventional significance level of 0.05.



Thus, the overall findings highlight the importance of these factors in shaping the growth and sustainability of the halal industry in Indonesia, and confirm their important relevance for policymakers, investors and industry stakeholders.

### **Discussion**

The results obtained from structural equation modeling (SEM) analysis provide valuable insight into the relationship between sharia risk management, sharia investment ethics, usury-free financing, and the development of the halal industry in Indonesia. This discussion interprets the findings and their implications in the context of the research objectives and theoretical framework.

#### **Sharia Risk Management and Halal Industry Development:**

The significant positive relationship between sharia risk management and halal industry development underscores the importance of effective risk mitigation strategies that are in line with Islamic principles. Sharia-compliant risk management practices play an important role in ensuring compliance with ethical and regulatory requirements, which in turn fosters trust and confidence among consumers, investors and industry stakeholders (Firdaus, 2023). By proactively addressing potential risks, such as non-compliance with Halal standards or market volatility, Sharia risk management contributes to the resilience, sustainability and competitiveness of the Islamic finance industry (Bayram et al., 2023; Cahyandari et al., 2023; Rosli et al., 2022). These practices involve the application of prudential principles and the implementation of effective risk management strategies, including credit risk, liquidity risk, market risk and operational risk management (Sriani et al., 2022). In addition, Sharia risk management also includes the development and sustainability of Sharia insurance as an alternative form of risk management, which offers solutions based on the principles of Islamic law. Overall, Shariah-compliant risk management practices are critical to ensuring the long-term success and growth of the Islamic finance industry, while still upholding the values and principles of Islamic law.

#### **Sharia Investment Ethics and Halal Industry Development:**

These findings indicate a significant positive relationship between Islamic investment ethics and the development of the Halal industry. Ethical investment practices based on Islamic principles promote transparency, fairness and social responsibility, thereby enhancing the industry's reputation and credibility. Investors and industry stakeholders who adhere to Islamic investment ethics prioritize businesses that comply with Islamic principles, avoiding activities deemed unethical or dangerous. This ethical alignment resonates with Muslim consumers, driving demand for Halal certified products and services and stimulating industry growth (Alam et al., 2023; Begam et al., 2024). Islamic investment ethics plays an important role in preventing investments involving *riba*, *gharar* and *maysir*, as well as emphasizing the principle of prudence in making investment decisions (Olaofe, 2023). Islamic entrepreneurship also promotes ethical business practices, urging entrepreneurs to be fair, honest and sincere in transactions and avoid bribery, corruption and usury (Hussain et al., 2023). Investor behavior towards sharia stock investment is influenced by factors such as religiosity, financial literacy and financial behavior (INNAL & OWEIDA, 2022). The Islamic finance industry, with its ethical and social principles, contributes to making financial markets more ethical, promoting stability and rational behavior.

### **Usury-Free Financing and Halal Industry Development:**

The research results show a significant positive impact of usury-free financing on the development of the Halal industry. Access to Sharia-compliant financing mechanisms, free from interest-based transactions, facilitates investment, innovation and entrepreneurship in the industry. Usury-free financing encourages fair risk sharing, asset-backed transactions, and profit-sharing arrangements, thereby encouraging inclusive economic growth and financial inclusion. By providing alternative financing solutions that comply with Islamic principles, usury-free financing encourages industrial expansion and diversification, as well as opening up new opportunities for market players (Hailu & Tekdoğan, 2023; İlkay, 2023; Ilmi, 2023).

### **Implications and Contributions**

#### **Policy Implications**

Policymakers can utilize these findings to formulate regulatory frameworks that support Sharia-compliant financial practices and facilitate access to usury-free financing for halal industrial companies. Regulatory clarity and incentives for ethical investment can encourage industrial growth and attract domestic and foreign investment.

#### **Practical Implications**

Industry stakeholders, including manufacturers, investors and financial institutions, can align their strategies with Islamic principles to capitalize on emerging opportunities in the Halal industry. Implementing strong risk management protocols, ethical investment criteria, and Sharia-compliant financing solutions can increase competitiveness and sustainability.

#### **Research Contributions**

This research contributes to existing knowledge by empirically validating the relationship between Sharia-compliant financial practices and the development of the Halal industry in Indonesia. By shedding light on the mechanisms driving industry growth, these findings inform future research efforts and policy interventions aimed at fostering the expansion and resilience of the Halal industry.

### **Limitations and Future Directions:**

**Sample Characteristics:** The findings of this study depend on the characteristics of the sample population and may not fully capture the diversity of perspectives in the Halal industry. Future research could explore larger and more diverse samples to increase generalizability.

**Cross-Sectional Design:** The cross-sectional nature of this study limits causal inferences and temporal relationships. Longitudinal studies can provide insight into the dynamic evolution of the Halal industry and the ongoing impact of Sharia-compliant financial practices over time.

**Contextual Factors:** The findings of this study may be influenced by contextual factors such as the regulatory environment, market dynamics, and socio-cultural norms. Future research could investigate the moderating effects of these contextual variables on the relationships studied, thereby providing a better understanding of industry dynamics.

## **CONCLUSION**

In conclusion, this research contributes to understanding the dynamics of the Halal industry in Indonesia by examining the influence of Sharia-compliant financial practices on its development. These findings highlight the important role played by Shariah risk management, Shariah investment ethics, and usury-free financing in driving the growth and sustainability of the Halal industry. Effective management of Sharia-compliant financial practices promotes trust, transparency and accountability in the industry, encouraging innovation and entrepreneurship. The results of this research underscore the importance of integrating ethical and sustainable financial mechanisms into the Halal industrial ecosystem to unlock its full potential as a driver of economic growth and social development in Indonesia. Going forward, policymakers, investors and industry stakeholders must prioritize a supportive regulatory framework and investment strategies that are aligned with Islamic principles to further enhance the resilience and competitiveness of the Halal industry. Further research could explore additional factors influencing industry development and examine the impact of contextual variables on the effectiveness of Sharia-compliant financial practices, thereby contributing to the ongoing evolution of the Halal industry in Indonesia and beyond.

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