




## Analysis of Hedging Strategies for Optimal Risk Management in Islamic Banking

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### ABSTRACT

This study aims to analyze the implementation of hedging strategies as an optimal risk management approach in Islamic banking institutions in Indonesia. Facing global economic volatility and currency fluctuations, Islamic banks are required to adopt risk management policies that are not only financially effective but also compliant with Sharia principles. This research employs a qualitative approach using library research methods by reviewing academic literature, DSN-MUI fatwas. The findings reveal that internal factors such as liquidity, leverage, firm size, and financial condition significantly influence the decision to apply hedging within Islamic banks. Meanwhile, external factors—including government policies, regulatory changes, and global market dynamics—further reinforce the necessity of risk management strategies grounded in justice and sustainability. The implementation of Sharia-based hedging is proven to enhance financial stability, strengthen public trust, and improve the competitiveness of the Islamic financial industry at both national and international levels. This study contributes theoretically and practically to the development of innovative, ethical, and sustainable Sharia-compliant financial instruments

**Keywords:** Sharia Hedging, Risk Management, Al-Tahawwuth Al-Islami

### ARTICLE INFO

*Article history:*

Received  
September 7, 2025  
Revised  
September 08,  
2025  
Accepted  
September 30,  
2025

Journal Homepage

<https://ojs.staialfurqan.ac.id/IJoASER/>

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## INTRODUCTION

Entering 2025, the development of Islamic banking in Indonesia is projected to continue showing a positive trend. This growth is driven by increasing Sharia-based financing, public awareness of Islamic financial literacy, and a strengthening of the national halal economic ecosystem. As a strategy to protect against financial risks, Islamic banking institutions are expected to utilize Islamic financial instruments such as sukuk and develop various innovative products that comply with Sharia principles. This step will not only strengthen the Islamic financial system but also help Islamic banks effectively manage market risks and exchange rate fluctuations, in line with supervisory policies aimed at increasing the competitiveness of the Islamic banking sector.

Furthermore, Islamic banking performance is predicted to surpass that of the conventional banking sector thanks to increased financing disbursement and optimization of third-party fundraising. The active role of Islamic banks in supporting the halal industry supply chain is also strengthening, in line with the rapid growth of the halal sector in various sectors, from food and cosmetics to tourism. With a financial structure based on the principles of fairness and sustainability, Islamic banks are expected to maintain stable performance and resilience to global economic pressures, while also becoming a key driver of inclusive and sustainable national economic growth (Rizvi et al. 2020).

Progressive government and Financial Services Authority (OJK) policies, such as the development of a roadmap for Islamic banking development and the planned separation of Islamic Business Units (UUS) from conventional parent companies, are strategic steps in strengthening the national Islamic banking ecosystem. This policy support is expected to accelerate the growth of the Islamic banking industry through institutional strengthening, increased competitiveness, and the implementation of prudential principles aligned with Islamic values. Facing global economic uncertainty, Islamic banks need to implement risk mitigation strategies in accordance with Islamic principles to remain adaptive to the ever-changing dynamics of the international economy (Sholikhah and Nurwahidin 2025).

Furthermore, Islamic banks are expected to be able to offer more competitive, innovative financing and investment products that meet the needs of the modern market. Utilizing Islamic financial instruments such as sukuk, issued by both the government and corporations, can be an effective alternative for managing market risk and maintaining the stability of the Islamic financial sector. For example, Bank Syariah Indonesia (BSI) sees strengthening the halal industry as a strategic opportunity to expand its market share and support national and global economic growth. Considering fluctuations in the Rupiah exchange rate, which are influenced by global economic conditions, Islamic banks are also required to have an effective currency risk management strategy through the use of Islamic financial instruments that comply with Islamic sharia principles (Mahadewi 2024).

According to previous research (OJK, 2023), in recent years the Islamic banking industry in Indonesia has experienced quite rapid growth along with increasing public awareness of the Islamic-based financial system. Total Islamic banking assets increased from IDR 535.82 trillion in 2020 to IDR 761.88 trillion by the end of 2023, with market share increasing from 6.51% to 7.15% during the same period. Despite this positive trend, the sector still faces various structural challenges, such as the need to strengthen capital, improve operational efficiency, and expand the reach of Islamic financial services to underserved areas (Yanti et al. 2024).

Meanwhile, another study by Ira Maelani Azizah and colleagues (2025) showed that factors such as leverage, liquidity, and firm size influence hedging decisions. In a financial context, leverage reflects a company's ability to meet short-term and long-term financial obligations and indicates the extent to which the company is financed by debt. This ratio is typically measured by the Debt-to-Equity Ratio (DER). The research results This study confirms that hedging decisions are not only influenced by the level of leverage, but also by the size and liquidity of the company, which play a role in determining the effectiveness of financial risk management (Fajri et al. 2023).

Research conducted by (Bakar et al. 2023) examines how company management assesses and responds to external risks such as currency exchange rate fluctuations and global economic instability. The results show that in uncertain economic conditions, companies tend to adopt a more cautious approach by using hedging instruments to maintain asset stability and mitigate potential losses. External factors such as changes in government policy, financial regulations, and international market volatility significantly influence management strategies in identifying and controlling risks. These findings confirm that companies with a high level of risk awareness and a deep understanding of risk management mechanisms tend to be more proactive in implementing strategies to protect against potential financial losses.

Consistent with previous research, various studies have shown that internal financial factors such as leverage, liquidity, and company size play a significant role in determining risk management policies. Implementing a proportionate hedging strategy can help companies with stable financial conditions more effectively identify and manage risks. Conversely, companies with high leverage or low liquidity tend to be more conservative in making risk-related decisions. In the context of Islamic banking, hedging decisions are influenced not only by financial conditions but also by the level of

compliance with Sharia principles. This compliance ensures that all risk management policies remain in line with Islamic values, including the prohibition against usury and excessive speculative activity (Tama Putra Saratian, Rokhmatul Aysa, and Sudiana 2024).

This study focuses on the implementation of hedging in risk management in Islamic banks, with compliance with Islamic principles as a variable that can strengthen or limit the relationship between these financial factors. Unlike previous studies that only highlighted the influence of financial factors on hedging decisions or risk management in general, this study presents a new perspective on the role of Islamic principles in creating a balance between risk management needs and compliance with Islamic values. Therefore, the purpose of this study is to provide a deeper understanding of how the implementation of hedging in risk management based on Islamic principles can serve as a guideline in regulating the relationship between financial factors and risk management decisions, particularly in the context of implementing hedging strategies in Islamic banking.

## **METHOD**

This research uses a qualitative approach with a library research method. This approach is carried out through the collection and review of various literature relevant to the research problem. The library study aims to obtain a strong theoretical foundation by examining academic sources such as books, scientific journals, research reports, and other references related to the topic Risk management and hedging strategies in Islamic banking. In this article, the author examines various theories and empirical findings that support the analysis of the implementation of hedging strategies in accordance with Islamic principles as an effort to create an optimal and sustainable risk management system.

## **RESULT AND DISCUSSION**

### **Implementation of Hedging in Risk Management in Islamic Banks**

A company's financial condition plays a crucial role in determining the direction of its policies and the effectiveness of its risk management implementation. Factors such as the ability to obtain funding, profitability, and capital adequacy are key indicators in assessing a company's ability to identify, evaluate, and control the risks it faces. The stronger a company's financial condition, the greater its capacity to bear risks and develop effective mitigation strategies to minimize potential future losses (Firdaus 2023).

In the context of Islamic banking, the implementation of internal control systems and risk management is not only measured by material or financial aspects, but must also align with Sharia principles, which are based on divine values as stated in the Quran and Sunnah. These principles include justice, public welfare, the prohibition of usury (riba), the obligation of zakat (zakat), the prohibition of gambling (maysir), information transparency, and the understanding that money serves as a medium of exchange, not a commodity for speculation (Hidayati and Hidayatullah 2021).

From a micro perspective, the Sharia values that underpin operations include shiddiq (honesty), amanah (responsibility), fathanah (intelligence), and tabligh (the ability to convey the truth). Success, from a Sharia banking perspective, is measured not only by worldly gains but also by spiritual attainment oriented toward long-term well-being. Therefore, every operational activity and risk management decision must consider the sanctity of funding sources, the validity of business processes, and the resulting benefits to the wider community. Consistent and consistent implementation of Sharia principles is the primary foundation for maintaining the integrity and sustainability of risk management practices in Sharia financial institutions (Minaryanti et al. 2024).

The implementation of risk management policies should be the primary foundation for developing a bank's risk profile, which is outlined in an official document and updated periodically in line with operational dynamics and changing market

conditions. The risk assessment process encompasses two approaches: risks that can be measured quantitatively through numerical data and calculations, and qualitative risks that cannot be directly measured but have a significant impact on the institution's stability. In this process, banks need to consider the balance between the costs and benefits of each risk mitigation decision. Furthermore, Islamic financial institutions must determine whether to accept, avoid, or limit certain risks based on a predetermined risk tolerance level (Sardar and Iqbal 2023).

Risk assessment covers various types of potential threats faced by banks, both individual and aggregate, such as credit, market, liquidity, operational risks, legal, reputational, strategic, and compliance. If uncontrolled risks are identified, whether old or newly emerging, the internal control system must be reviewed to ensure its effectiveness in maintaining the stability and integrity of the institution. Therefore, a comprehensive risk management policy is a crucial tool in building healthy, transparent, and sustainable governance in Islamic banking (Al Rahahleh, Ishaq Bhatti, and Najuna Mismam 2019).

### **The Relationship between Shariah Compliance and Factors Affecting Hedging Decisions**

Hedging is a financial strategy used to manage and mitigate risks in transactions and investments, particularly those related to fluctuations in foreign exchange rates. In the context of Islamic economics, hedging serves as a preventative measure to minimize potential losses due to volatile exchange rate fluctuations, while maintaining compliance with Islamic principles. Therefore, the decision to hedge in Islamic banking is influenced not only by internal financial factors such as leverage, liquidity, and institutional size, but also by the level of compliance with Islamic law, which prohibits *riba* (usury), *gharar* (excessive uncertainty), and *maysir* (speculation). By maintaining a balance between economic efficiency and sharia compliance, hedging strategies can be implemented as an ethical and sustainable risk protection instrument (Hernawaty, Nurhayati, and Harahap 2025).

Hedging transactions from an Islamic perspective, as stipulated in the Fatwa of the National Sharia Council of the Indonesian Ulema Council (DSN-MUI), are mechanisms used to mitigate or anticipate risks arising from currency exchange rate fluctuations. Its implementation is based on the principle of prudence and compliance with Sharia law. In practice, Sharia hedging is conducted through a forward agreement, an agreement between two parties to conduct a foreign exchange transaction (foreign exchange spot) for a specific amount at a pre-agreed time in the future, using a pre-agreed exchange rate or exchange rate calculation method. Although this mechanism has been approved by Sharia, several Islamic economists still have different views regarding the form and limitations of the implementation of Al-Tahawwuth Al-Islami or Sharia hedging, especially in terms of its compliance with the principles of justice and the prohibition of speculation (Judijanto et al. 2025).

Compliance with Sharia principles plays a central role in determining how financial factors influence hedging decisions in financial institutions and companies operating under the Islamic financial system. In the context of Islamic finance, all economic activities must comply with provisions prohibiting *riba* (interest), *gharar* (excessive uncertainty), and *maysir* (speculation or gambling). Therefore, the decision to implement a hedging strategy is based not only on considerations of efficiency or financial gain, but also on the extent to which the institution is able to maintain integrity and compliance with Sharia principles. Therefore, hedging in Islamic finance is not merely a means of protecting against risk but also a form of implementing moral values and business ethics in accordance with Islamic teachings (Haikal, Efendi, and Ramly 2023).

Liquidity factors have a different impact on companies operating under Sharia principles compared to conventional companies. In conventional systems, high levels of liquidity generally strengthen a company's ability to engage in hedging activities, as

adequate funds enable the company to cover transaction costs and market risks. However, in Islamic companies, the results of research conducted by Baroroh and Hasanah (2023) show a negative relationship between the level of liquidity and the decision to hedge.

This situation is caused by the tendency of Islamic companies with high liquidity to refrain from intensively using Islamic derivative instruments. This occurs due to the limited choice of Islamic financial instruments that comply with Islamic principles, as well as the high costs of compliance with applicable Islamic regulations and provisions. Therefore, although liquidity reflects a company's financial strength, in the context of Islamic finance, high liquidity levels do not necessarily encourage increased hedging activity. Instead, they can indicate that the company prioritizes prudence and adherence to Islamic values in managing financial risk (Tuti Yulianingsih and Hexana Sri Lastanti 2024).

## **Internal Factors Influencing Hedging Policy**

### **1.1. Financial Distress**

Financial distress reflects a company's declining ability to meet its short-term and long-term obligations. Companies experiencing financial distress tend to be more cautious in making decisions that involve additional risks, including implementing hedging strategies. In such situations, management's primary focus typically shifts to maintaining liquidity and cash flow stability rather than speculative activities or high-risk investments. Financial pressure can also reduce a company's capacity to finance hedging activities due to limited funds and high transaction costs. Consequently, companies in financial distress tend to reduce their exposure to risk by reducing derivatives trading or forward contracts, and preferring conservative risk management strategies. In the context of Islamic finance, this decision is also driven by the prudential principle and the need to avoid excessive uncertainty (gharar) and speculation (maysir). Therefore, hedging policies must remain aligned with Islamic values, which emphasize balance and sustainability (Maimun and Tzahira 2022).

### **1.2. Leverage (Debt to Equity Ratio)**

Leverage is an important indicator that describes the extent to which a company uses borrowed funds to finance its operational and investment activities. Companies with high levels of leverage generally have greater risk exposure to fluctuations in exchange rates and interest rates, making the need for hedging even more relevant. However, excessive leverage can also increase cash flow pressure and restrict management's latitude in making risk mitigation decisions (Anggyantari and Purbawangsa 2020).

In the context of sharia-compliant companies, the effects of leverage have different characteristics than those of conventional companies. The Islamic financial system prohibits The practice of usury and emphasizes real asset-based financing and profit-sharing principles. Therefore, the capital structure of Islamic companies tends to be healthier due to the relatively low proportion of interest-bearing debt. Consequently, the need for hedging in Islamic companies depends not only on the level of leverage but also on the level of compliance with Islamic principles and the form of financing used. Hedging is not undertaken to profit from exchange rate fluctuations, but rather as a protective measure in accordance with Islamic principles (Satria, Nofiansyah, and Rizvi 2022).

### **1.3 Company Liquidity**

Liquidity reflects a company's ability to meet its short-term obligations using its current assets. Generally, companies with high liquidity have greater financial flexibility to engage in hedging activities because they have sufficient cash reserves to cover transaction costs and risk margins. However, in the context of Islamic companies, the relationship between liquidity and hedging policies shows a different direction (Pratomo, Nuramalia Hasanah, and Diah Armeliza 2023).

Research by Baroroh and Hasanah (2023) found a negative relationship between liquidity levels and the propensity to hedge in Islamic companies. This occurs because companies with high liquidity tend not to require Islamic derivative instruments to manage risk, given that they already have strong financial buffers. Furthermore, the limited availability of Islamic financial instruments and high compliance costs lead companies to prefer simple and straightforward risk management strategies, such as asset diversification and Islamic-compliant cash management. Therefore, the higher the liquidity level of an Islamic company, the lower its propensity to use formal hedging mechanisms.

#### 1.4 Firm Size

Company size is a significant factor influencing the decision to implement a hedging policy. Larger companies generally have broader resources, better risk analysis capabilities, and access to a variety of financial instruments and information technology that support hedging strategies. In addition, large operational scales also cause exposure to market risks to become more complex, so the need for risk protection through hedging becomes increasingly important (Savitri et al. 2024).

Conversely, small companies often face limited capital and access to derivative instruments, thus relying more on non-financial strategies to manage risk, such as contract price negotiations or business diversification. In the Islamic financial system, company size is measured not only by the size of assets or revenue, but also by the extent to which the entity is able to consistently apply Sharia principles in all its activities. Large-scale Islamic companies typically have more established Sharia compliance systems and dedicated risk management units that ensure every transaction complies with Islamic law. Therefore, company size influences not only its financial capacity for hedging but also the maturity of its governance and Sharia compliance (Marlina et al. 2020).

### **External Factors Influencing Hedging Policy**

#### 1.1 Exchange Rate Fluctuations

Exchange rate fluctuations are a key external factor influencing a company's decision to hedge. Sharp changes in exchange rates can pose significant risks for companies with foreign currency exposure, particularly Islamic financial institutions conducting cross-border transactions. Exchange Rate Fluctuations Exchange rate volatility can reduce the value of assets or increase a company's liabilities if not properly anticipated. Therefore, hedging strategies are a crucial tool for maintaining financial stability and protecting profit margins.

In the context of Sharia, hedging against exchange rate risk must be carried out while adhering to Islamic principles prohibiting usury (riba), gharar (gharar), and maysir (gambling). One way to implement this is through Sharia-compliant forward agreements, as stipulated in the Fatwa of the National Sharia Council of the Indonesian Ulema Council (DSN-MUI). In the context of Sharia, hedging against exchange rate risk must be carried out while adhering to Islamic principles prohibiting usury (riba), gharar (gharar), and maysir (gambling). One way to implement this is through Sharia-compliant forward agreements, as stipulated in the Fatwa of the National Sharia Council of the Indonesian Ulema Council (DSN-MUI). Number 96/DSN-MUI/IV/2015 concerning sharia hedging transactions (al-tahawwuth al-islami). Through this instrument, Islamic banks can mitigate exchange rate risk while maintaining compliance with Islamic law, ensuring that the hedging function is not used for speculative purposes but rather as a legitimate and ethical hedging mechanism (Musadad et al. 2025).

#### 1.2 Changes in Government Regulations and Policies

Government policies and financial authority regulations have a major influence on the implementation of hedging strategies, both in terms of scope and implementation mechanisms. In the Indonesian context, the Financial Services Authority (OJK) and Bank Indonesia play a strategic role in regulating risk governance and financial system stability,

including policies related to Sharia-compliant derivative transactions. Policy changes, such as financial instrument restrictions or Sharia-compliant requirements, can impact the flexibility of financial institutions in conducting hedging activities (Azhari 2025).

Furthermore, the DSN-MUI fatwa serves as a normative guideline that ensures all hedging activities are conducted in accordance with Sharia principles. Compliance with these provisions can be both a limiting factor and a driving force for Sharia financial institutions to develop innovative halal derivative products. For example, the implementation of Islamic forward contracts or Sharia cross-currency swaps developed using spot and wa'ad (unilateral promise) mechanisms. With clear regulatory support and legal certainty, Sharia hedging practices can be more optimal and transparent, and increase public trust in the Islamic financial system (Fikri et al. 2024).

1.3 Global Market Turmoil Global economic uncertainty and international market volatility are external factors that financial institutions, including Islamic banks, cannot avoid. Factors such as economic crises, commodity price fluctuations, geopolitical conflicts, and changes in monetary policy in developed countries can have a domino effect on domestic market stability. In such conditions, hedging strategies play an important role as a mitigation measure to maintain the stability of the company's asset value and cash flow (Hasan, Hassan, and Alhomaidi 2023).

Islamic banks face a dual challenge: maintaining financial stability while ensuring all their activities remain compliant with Sharia law. Therefore, in addressing global risks, Islamic financial institutions typically prioritize real transaction-based hedging instruments, such as murabahah-based hedging or wa'ad-based hedging, eliminating the element of speculation. This approach not only strengthens resilience to global market fluctuations but also emphasizes the ethical and sustainable character of the Islamic financial system. Therefore, implementing hedging policies that adapt to global market dynamics will support economic stability and enhance the competitiveness of the Islamic financial industry on the international stage.

### **Sharia Compliance and Implementation of Al-Tahawwuth Al-Islami**

Compliance with Sharia principles is the primary foundation for implementing risk management in Islamic banking, including hedging strategies. Every financial activity must align with the values of justice and the public interest, while avoiding elements of usury (riba), gharar (excessive uncertainty), and maysir (speculation). Therefore, hedging in Islamic financial institutions should be conducted for risk prevention purposes, not speculative profit (Hernawaty et al. 2025).

The concept of Al-Tahawwuth Al-Islami aims to minimize the negative impact of fluctuations in exchange rates or commodity prices without violating sharia provisions. Based on DSN-MUI Fatwa No. 96/DSN-MUI/IV/2014, sharia hedging transactions are only permitted if based on real needs (real exposure). One form is a forward agreement based on the wa'ad contract, namely a unilateral promise between two parties to conduct a foreign exchange transaction at a certain time at an agreed exchange rate, without binding either party speculatively (Hernawaty et al. 2025).

The Sharia Supervisory Board (SSB) has an important role in ensuring that every hedging transaction complies with Islamic principles through regular audits and supervision. Sharia compliance not only ensures legal legitimacy but also strengthens the stability, trust, and integrity of Islamic financial institutions. By consistently implementing Islamic principle (Al-Tahawwuth Al-Islami), Islamic banks can maintain a balance between financial protection and spiritual compliance, in line with the objectives of the maqyyid al-syar'ah (protection of wealth) and the public good (maslahah).

## CONCLUSION

This study confirms that hedging strategies play a crucial role in maintaining financial stability and the operational sustainability of Islamic banking amidst global economic dynamics. The implementation of hedging in accordance with Sharia principles serves not only as a risk protection tool but also as an effort to strengthen fair and transparent financial governance. Internal factors such as liquidity, leverage, company size, and financial condition, as well as external factors such as exchange rate fluctuations, government policies, and global market volatility, have been shown to influence the decisions and effectiveness of the hedging strategies implemented.

Going forward, Islamic banks need to develop innovative hedging instruments that comply with the DSN-MUI fatwas and strengthen their risk management capacity to compete globally without abandoning sharia values. Optimizing hedging based on Islamic principles is expected to increase the resilience of the Islamic financial industry to economic uncertainty and at the same time strengthen its contribution to national economic growth.

## SUGGESTION

Future research is recommended to expand the scope of analysis by including more macroeconomic variables, such as inflation, the Islamic benchmark interest rate, and exchange rate stability, which can influence the effectiveness of hedging strategies in the Islamic banking sector. Furthermore, future research should explore financial technology-based hedging models (Islamic fintech) that have the potential to increase efficiency and compliance with Islamic principles. For practitioners and regulators, strengthening the regulatory and supervisory framework is crucial to ensure that hedging practices in Islamic financial institutions are implemented more transparently, accountably, and in accordance with the values of the maqāyid al-syarī'ah

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