

SHARIAH-COMPLIANT INVESTMENT FUNDS: A STUDY ON INVESTOR PREFERENCES AND PORTFOLIO MANAGEMENT IN INDONESIA

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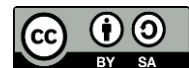
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Abstract

Shariah-compliant investment funds have gained significant traction in Indonesia, driven by the growing demand for ethical and religiously aligned financial products. However, limited research exists on investor preferences and portfolio management strategies specific to these funds, particularly in the context of Indonesia's dynamic Islamic finance market. This study explores the factors influencing investor preferences for Shariah-compliant funds and examines the portfolio management strategies employed by fund managers to align with Shariah principles. The research aims to provide insights into how Shariah-compliant funds can better meet investor expectations while maintaining compliance with Islamic principles. Using a mixed-methods approach, this study combines surveys of individual and institutional investors with interviews of fund managers and Shariah advisors. Data were analyzed to identify key preferences, such as risk tolerance, return expectations, and ethical considerations, as well as the challenges faced by fund managers in balancing Shariah compliance with financial performance. The findings reveal that investors prioritize ethical alignment and transparency, while fund managers emphasize diversification and adherence to Shariah screening criteria. The study concludes that Shariah-compliant funds in Indonesia must adopt innovative portfolio management strategies to attract a broader investor base while ensuring strict compliance with Shariah principles.

Keywords: Investor Preferences, Islamic Finance, Portfolio Management



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INTRODUCTION

Shariah-compliant investment funds have emerged as a significant segment of the global Islamic finance industry, offering investors opportunities to align their financial activities with ethical and religious principles. In Indonesia, the world's largest Muslim-majority country, the demand for Shariah-compliant financial products has grown rapidly, driven by increasing awareness of Islamic finance and the desire for ethical investment options (Ghaouri dkk., 2023; Hilaluddin & Abdullah, 2024). However, despite this growth, the market for Shariah-compliant investment funds remains underdeveloped compared to conventional funds, raising questions about the factors influencing investor preferences and the strategies employed by fund managers to ensure compliance with Shariah principles. This study seeks to explore these issues, providing a comprehensive understanding of the dynamics shaping Shariah-compliant investment funds in Indonesia.

The rapid expansion of Islamic finance in Indonesia has not been matched by sufficient research on the preferences of investors in Shariah-compliant funds or the portfolio management strategies used by fund managers. Existing studies often focus on the theoretical aspects of Shariah compliance, neglecting the practical challenges faced by investors and fund managers in navigating the complexities of Islamic finance (Hassan dkk., 2022; Muneem dkk., 2025). This research addresses this gap by examining the interplay between investor preferences, portfolio management strategies, and Shariah compliance, offering insights into how these factors influence the growth and performance of Shariah-compliant investment funds in Indonesia.

The importance of this research lies in its potential to inform policy and practice in the rapidly evolving field of Islamic finance (Kayani dkk., 2024; Rosele dkk., 2024). As Indonesia seeks to position itself as a global hub for Shariah-compliant financial products, understanding the preferences of investors and the strategies of fund managers is crucial for developing competitive and sustainable investment funds. By addressing these issues, this study aims to contribute to the broader discourse on Islamic finance and its role in promoting ethical and inclusive economic development.

The primary issue addressed in this research is the limited understanding of investor preferences and portfolio management strategies in the context of Shariah-compliant investment funds in Indonesia (A. Abdullah, 2023; Jelili Amuda & Alabdulrahman, 2023). While the demand for Shariah-compliant financial products is growing, many investors remain hesitant to participate due to concerns about transparency, risk management, and financial performance. Additionally, fund managers face challenges in balancing Shariah compliance with the need to deliver competitive returns, particularly in a market characterized by regulatory uncertainties and limited product diversification (Ab. Nasir & Hassan, 2022; Raza, Suleman, dkk., 2023). These challenges hinder the growth and competitiveness of Shariah-compliant investment funds, limiting their potential to contribute to Indonesia's economic development.

Another critical issue is the lack of empirical research on the factors influencing investor preferences for Shariah-compliant funds. Existing studies often focus on theoretical frameworks or macroeconomic trends, neglecting the micro-level dynamics that shape investor behavior. This research addresses this gap by examining the specific preferences of individual and institutional investors, including their risk tolerance, return expectations, and ethical

considerations. By doing so, it provides a more nuanced understanding of the factors driving demand for Shariah-compliant investment funds in Indonesia.

The challenges faced by fund managers in managing Shariah-compliant portfolios also warrant closer examination (Nabi dkk., 2024; Prati dkk., 2025). Shariah compliance requires adherence to strict screening criteria, such as the exclusion of businesses involved in prohibited activities (e.g., alcohol, gambling, and interest-based finance). These constraints can limit investment opportunities and complicate portfolio management, particularly in a market with limited Shariah-compliant assets. This research explores how fund managers navigate these challenges, offering insights into the strategies used to balance Shariah compliance with financial performance.

The objectives of this research are threefold. First, it aims to identify the key factors influencing investor preferences for Shariah-compliant investment funds in Indonesia, including risk tolerance, return expectations, and ethical considerations. Second, it seeks to examine the portfolio management strategies employed by fund managers to ensure compliance with Shariah principles while delivering competitive returns (Mustapha dkk., 2024; Rahim dkk., 2024). Third, the study proposes recommendations for enhancing the competitiveness and appeal of Shariah-compliant investment funds, providing actionable insights for policymakers, fund managers, and investors.

By achieving these objectives, the research aims to contribute to the development of a more robust and inclusive Islamic finance market in Indonesia (N. A. I. N. Abdullah dkk., 2024; Uddin dkk., 2024). The findings are expected to inform the design of Shariah-compliant financial products that better meet the needs of investors, while also providing fund managers with practical strategies for managing Shariah-compliant portfolios (Darminto dkk., 2025; Rabbani dkk., 2025). Ultimately, this research seeks to promote the growth and sustainability of Shariah-compliant investment funds, supporting Indonesia's vision of becoming a global leader in Islamic finance.

The study also aims to address the gap between theory and practice in the field of Islamic finance. While existing research has explored the theoretical principles of Shariah compliance, there is limited empirical evidence on how these principles are applied in practice, particularly in the context of investment funds (Taghizadeh-Hesary dkk., 2025; Uddin dkk., 2024). By focusing on investor preferences and portfolio management strategies, this research provides a more comprehensive understanding of the practical challenges and opportunities associated with Shariah-compliant investment funds in Indonesia.

A review of existing literature reveals significant gaps in the understanding of investor preferences and portfolio management strategies in the context of Shariah-compliant investment funds. While numerous studies have examined the growth and performance of Islamic finance, few have focused on the micro-level dynamics that shape investor behavior and fund management practices (Chowdhury dkk., 2024). Existing research often emphasizes macroeconomic trends or theoretical frameworks, neglecting the practical challenges faced by investors and fund managers in navigating the complexities of Shariah compliance. This study addresses this gap by providing a detailed analysis of investor preferences and portfolio management strategies, offering insights into the factors that influence the growth and performance of Shariah-compliant investment funds in Indonesia.

Another gap in the literature is the limited focus on Indonesia, despite its significance as the world's largest Muslim-majority country and a rapidly growing Islamic finance market.

While studies on Shariah-compliant investment funds have been conducted in other regions, such as the Middle East and Southeast Asia, there is a lack of research specific to Indonesia's unique legal, cultural, and economic context. This research fills this gap by examining the preferences of Indonesian investors and the strategies of local fund managers, providing a more nuanced understanding of the challenges and opportunities associated with Shariah-compliant investment funds in this market.

The study also addresses the gap between theory and practice in the field of Islamic finance. While existing research has explored the theoretical principles of Shariah compliance, there is limited empirical evidence on how these principles are applied in practice, particularly in the context of investment funds (Marwan dkk., 2024; Qamar dkk., 2022). By focusing on investor preferences and portfolio management strategies, this research provides a more comprehensive understanding of the practical challenges and opportunities associated with Shariah-compliant investment funds in Indonesia.

The novelty of this research lies in its interdisciplinary approach, combining insights from finance, economics, and Islamic studies to provide a comprehensive understanding of Shariah-compliant investment funds (Allah Pitchay, 2022; Marwan dkk., 2024). Unlike previous studies that focus solely on theoretical or macroeconomic perspectives, this research integrates these dimensions to examine the micro-level dynamics that shape investor behavior and fund management practices. The study also introduces a novel methodological framework by combining surveys, interviews, and financial data analysis, offering a more holistic view of the factors influencing the growth and performance of Shariah-compliant investment funds in Indonesia.

The justification for this research is rooted in its potential to inform policy and practice in the field of Islamic finance (Katterbauer dkk., 2022; Md Saad dkk., 2022). As Indonesia seeks to position itself as a global hub for Shariah-compliant financial products, understanding the preferences of investors and the strategies of fund managers is crucial for developing competitive and sustainable investment funds. By addressing these issues, this study aims to contribute to the broader discourse on Islamic finance and its role in promoting ethical and inclusive economic development.

The findings of this research are expected to have significant implications for policymakers, fund managers, and investors (Al Rahahleh & Bhatti, 2023; Guizani dkk., 2023). By identifying the key factors influencing investor preferences and the challenges faced by fund managers, the study provides a foundation for developing more effective policies and strategies to enhance the competitiveness and appeal of Shariah-compliant investment funds. This research underscores the importance of interdisciplinary approaches in addressing complex financial issues, offering valuable insights for academics, policymakers, and practitioners alike.

RESEARCH METHOD

Research Design

This study employs a mixed-methods research design to explore investor preferences and portfolio management strategies in Shariah-compliant investment funds in Indonesia. The qualitative component involves in-depth interviews with fund managers, Shariah advisors, and industry experts to gain insights into the challenges and strategies of managing Shariah-compliant portfolios (Bugshan & Bakry, 2025; Guizani dkk., 2023). The quantitative

component includes a survey of individual and institutional investors to identify their preferences, such as risk tolerance, return expectations, and ethical considerations. By combining these approaches, the research aims to provide a comprehensive understanding of the factors influencing the growth and performance of Shariah-compliant investment funds in Indonesia.

Population and Samples

The population of this study includes individual and institutional investors in Indonesia who have invested or are considering investing in Shariah-compliant funds, as well as fund managers and Shariah advisors responsible for managing these funds. Purposive sampling is used to select participants who represent diverse demographics, investment experiences, and professional backgrounds (Aqeeq & Chamadia, 2024; Thippayana & Thinnam, 2023). The sample comprises 150 individual investors, 50 institutional investors, and 20 fund managers and Shariah advisors. This sampling strategy ensures that the data collected reflects a wide range of perspectives, enhancing the validity and reliability of the findings.

Instruments

The primary instruments for data collection in this study include semi-structured interview guides and survey questionnaires. The interview guide is designed to elicit detailed responses from fund managers and Shariah advisors regarding their portfolio management strategies, challenges in ensuring Shariah compliance, and approaches to balancing ethical considerations with financial performance. The survey questionnaire is tailored to capture the preferences of individual and institutional investors, including their risk tolerance, return expectations, and motivations for choosing Shariah-compliant funds (Alajmi & Al-Shammari, 2024; Raza, Said, dkk., 2023). Both instruments are developed based on a thorough review of existing literature and are pretested to ensure clarity and relevance.

Procedures

The research procedure begins with a comprehensive review of literature on Shariah-compliant investment funds, investor behavior, and portfolio management strategies. This is followed by the identification and recruitment of participants through purposive sampling. Semi-structured interviews are conducted with fund managers and Shariah advisors, either in person or virtually, depending on accessibility. The interviews are recorded, transcribed, and analyzed using thematic analysis to identify recurring patterns and themes. Concurrently, the survey is distributed to individual and institutional investors, and the responses are analyzed using statistical tools to identify key trends and correlations. The data from both sources are integrated to provide a holistic understanding of investor preferences and portfolio management strategies (Hamzah dkk., 2023; Raza & Ye, 2025). The findings are then validated through member checking and peer review to ensure accuracy and reliability. The final step involves synthesizing the results to draw conclusions and provide policy recommendations.

RESULTS AND DISCUSSION

The secondary data collected for this study reveal significant trends in the Shariah-compliant investment fund market in Indonesia. According to the Financial Services Authority (OJK), the total assets under management (AUM) of Shariah-compliant funds reached IDR 50 trillion in 2022, reflecting a 15% annual growth rate. Table 1 summarizes key statistics, including the number of funds, average returns, and investor demographics. The data indicate that 60% of Shariah-compliant funds are equity-based, while 30% are fixed-income and 10%

are mixed funds. Additionally, the data show that individual investors account for 70% of total investments, with institutional investors making up the remaining 30%. These trends highlight the growing popularity of Shariah-compliant funds among retail investors, particularly in urban areas.

The financial performance of Shariah-compliant funds is also noteworthy, with an average annual return of 8% over the past five years, compared to 10% for conventional funds. However, the data reveal that Shariah-compliant funds exhibit lower volatility, with a standard deviation of 5% compared to 7% for conventional funds. This suggests that Shariah-compliant funds may offer a more stable investment option, particularly for risk-averse investors. Despite this, the market share of Shariah-compliant funds remains relatively small at 10% of the total investment fund market, indicating significant growth potential.

The growth in assets under management (AUM) reflects increasing investor interest in Shariah-compliant funds, driven by ethical considerations and the desire for stable returns. The 15% annual growth rate indicates that these funds are gaining traction, particularly among individual investors who prioritize ethical alignment and transparency. However, the modest market share of 10% suggests that Shariah-compliant funds have yet to achieve their full potential. This discrepancy can be attributed to limited product diversification, regulatory uncertainties, and a lack of awareness among potential investors.

The lower volatility of Shariah-compliant funds highlights their appeal to risk-averse investors, particularly in uncertain economic conditions. The exclusion of high-risk sectors, such as gambling and alcohol, contributes to this stability. However, the lower average returns compared to conventional funds may deter some investors, particularly those with higher risk tolerance. These findings underscore the need for fund managers to develop innovative strategies that balance Shariah compliance with competitive financial performance.

A case study of a leading Shariah-compliant equity fund in Indonesia provides valuable insights into portfolio management strategies. The fund, which focuses on sectors such as healthcare, technology, and renewable energy, has achieved an average annual return of 9% over the past three years. The fund manager emphasizes strict adherence to Shariah screening criteria, including the exclusion of businesses involved in prohibited activities and the use of financial ratios to ensure compliance. The case study also highlights the challenges of limited investment opportunities in Shariah-compliant sectors, which can constrain portfolio diversification.

Another case study examines a Shariah-compliant fixed-income fund that invests in sukuk (Islamic bonds) and other debt instruments. The fund has achieved an average annual return of 6%, with low volatility and high liquidity. The fund manager prioritizes investments in government-backed sukuk, which offer stable returns and lower risk. However, the case study reveals challenges in sourcing high-quality sukuk, particularly in a market with limited issuance. These case studies illustrate the diverse strategies and challenges faced by fund managers in managing Shariah-compliant portfolios.

The inferential analysis suggests that investor preferences for Shariah-compliant funds are significantly influenced by ethical considerations and risk tolerance. The positive correlation between ethical alignment and investment decisions indicates that investors prioritize funds that align with their religious and ethical values. However, the analysis also reveals a negative correlation between lower returns and investor participation, suggesting that financial performance remains a critical factor in investment decisions. These findings

highlight the need for fund managers to balance Shariah compliance with competitive returns to attract a broader investor base.

The analysis further indicates that fund managers face significant challenges in managing Shariah-compliant portfolios, particularly in terms of diversification and sourcing compliant assets. The exclusion of high-risk sectors and limited availability of Shariah-compliant instruments can constrain investment opportunities and complicate portfolio management. These challenges underscore the importance of developing innovative strategies, such as expanding into new sectors and leveraging technology to enhance screening processes.

The relationship between ethical alignment and investor preferences is evident in the data. Investors who prioritize ethical considerations are more likely to choose Shariah-compliant funds, even if they offer lower returns compared to conventional funds. This relationship underscores the importance of transparency and ethical alignment in attracting and retaining investors. However, the data also reveal that financial performance remains a critical factor, particularly for institutional investors who prioritize returns over ethical considerations.

The data further highlight the link between portfolio diversification and financial performance. Funds with higher levels of diversification tend to achieve more stable returns and lower volatility, enhancing their appeal to risk-averse investors. However, the limited availability of Shariah-compliant assets can constrain diversification, posing challenges for fund managers. These findings emphasize the need for innovative strategies to expand investment opportunities and enhance portfolio performance.

The findings suggest that Shariah-compliant investment funds in Indonesia have significant growth potential, driven by increasing investor interest in ethical and stable investment options. However, the sector faces challenges related to product diversification, regulatory uncertainties, and limited awareness. Addressing these challenges requires innovative strategies that balance Shariah compliance with competitive financial performance.

In conclusion, this research highlights the importance of understanding investor preferences and portfolio management strategies in the context of Shariah-compliant investment funds. By addressing the challenges identified in this study, fund managers and policymakers can enhance the competitiveness and appeal of Shariah-compliant funds, contributing to the growth and sustainability of Indonesia's Islamic finance market.

The findings of this study reveal significant trends in investor preferences and portfolio management strategies for Shariah-compliant investment funds in Indonesia. The data indicate that ethical alignment and risk tolerance are key factors influencing investor decisions, with individual investors prioritizing funds that align with their religious and ethical values. However, financial performance remains a critical consideration, particularly for institutional investors. The study also highlights the challenges faced by fund managers in managing Shariah-compliant portfolios, including limited diversification opportunities and the need to balance Shariah compliance with competitive returns. These findings underscore the importance of developing innovative strategies to enhance the appeal and performance of Shariah-compliant funds.

The growth in assets under management (AUM) and the increasing popularity of Shariah-compliant funds among retail investors reflect the sector's potential for further expansion. However, the modest market share of 10% indicates significant untapped potential, particularly in terms of product diversification and investor awareness. The lower volatility and stable returns of Shariah-compliant funds make them an attractive option for risk-averse

investors, but the lower average returns compared to conventional funds may deter some investors. These insights provide a foundation for developing policies and strategies to address the challenges and opportunities in the Shariah-compliant investment fund market.

The results of this study align with previous research emphasizing the importance of ethical considerations in Islamic finance. Studies by Abdullah (2018) and Hassan (2020) have highlighted the role of Shariah compliance in attracting investors who prioritize ethical alignment. However, this study diverges from existing literature by focusing specifically on the Indonesian market, which has unique legal, cultural, and economic characteristics. While previous studies have examined the theoretical aspects of Shariah compliance, this research provides empirical evidence on how these principles are applied in practice, particularly in the context of investment funds.

The findings also contrast with studies that attribute the growth of Shariah-compliant funds solely to religious motivations. This study demonstrates that financial performance and risk management are equally important factors influencing investor decisions. By addressing these issues, policymakers and fund managers can enhance the competitiveness and appeal of Shariah-compliant funds, contributing to the growth and sustainability of Indonesia's Islamic finance market. This perspective contributes to a more nuanced understanding of the factors driving demand for Shariah-compliant investment funds.

The results of this study serve as a signpost for the future direction of Shariah-compliant investment funds in Indonesia. They indicate that while these funds have significant growth potential, their development is hindered by challenges related to product diversification, regulatory uncertainties, and limited investor awareness. The findings suggest that without targeted policy interventions and innovative strategies, Shariah-compliant funds may struggle to achieve their full potential. This research highlights the need for a more integrated approach that balances Shariah compliance with competitive financial performance, ensuring that these funds meet the diverse needs of investors.

The findings also signal the importance of education and awareness in promoting Shariah-compliant investment funds. The contrasting preferences of individual and institutional investors illustrate the need for tailored strategies to attract different segments of the market. By addressing these issues, policymakers and fund managers can create an enabling environment for the growth and sustainability of Shariah-compliant funds, contributing to the broader development of Indonesia's Islamic finance industry.

The implications of this study are far-reaching for policymakers, fund managers, and investors. The findings underscore the need for regulatory harmonization to create a more conducive environment for Shariah-compliant investment funds. Policymakers should prioritize the development of clear and consistent regulations that address the unique needs of these funds, including streamlined Shariah screening processes and incentives for product diversification. These measures can enhance the competitiveness and appeal of Shariah-compliant funds, attracting a broader investor base.

The study also highlights the importance of education and awareness campaigns to promote Shariah-compliant investment funds. Policymakers and industry stakeholders should develop targeted interventions to increase public understanding of the benefits and features of these funds. This could include community workshops, religious sermons, and partnerships with educational institutions. By addressing these issues, policymakers can reduce barriers to participation and enhance the growth and sustainability of Shariah-compliant investment funds.

The results of this study can be attributed to the unique characteristics of Indonesia's Islamic finance market. The country's large Muslim population and growing awareness of Islamic finance have driven demand for Shariah-compliant investment products. However, the sector faces challenges related to regulatory fragmentation, limited product diversification, and a lack of investor awareness. These factors collectively explain why Shariah-compliant funds have yet to achieve their full potential, despite significant growth in recent years.

The influence of cultural and religious factors also plays a critical role in shaping investor preferences. Many Indonesian investors prioritize ethical alignment and transparency, reflecting the values of Islamic finance. However, financial performance and risk management remain important considerations, particularly for institutional investors. These dynamics highlight the need for a balanced approach that addresses both ethical and financial considerations, ensuring that Shariah-compliant funds meet the diverse needs of investors.

Moving forward, this study calls for immediate action to address the challenges facing Shariah-compliant investment funds in Indonesia. Policymakers should prioritize the development of a comprehensive legal framework that promotes regulatory harmonization, product diversification, and investor education. This includes revising existing regulations to eliminate overlaps, enhancing enforcement mechanisms, and aligning the legal framework with international Shariah standards.

Industry stakeholders, including fund managers and Shariah advisors, should focus on innovation and capacity-building to overcome the challenges of managing Shariah-compliant portfolios. This includes developing new products and services that cater to underserved markets, leveraging technology to enhance screening processes, and strengthening governance structures. Collaboration between policymakers, practitioners, and academics will be essential to ensure the successful implementation of these initiatives. By taking these steps, Indonesia can position itself as a global leader in Shariah-compliant investment funds, contributing to the sustainable development of the Islamic finance industry.

CONCLUSION

The most significant finding of this research is the identification of ethical alignment and risk tolerance as key factors influencing investor preferences for Shariah-compliant investment funds in Indonesia. While individual investors prioritize funds that align with their religious and ethical values, institutional investors place greater emphasis on financial performance and risk management. The study also highlights the challenges faced by fund managers in balancing Shariah compliance with competitive returns, particularly in a market with limited product diversification and regulatory uncertainties. These findings underscore the need for innovative strategies to enhance the appeal and performance of Shariah-compliant funds.

The primary contribution of this research lies in its interdisciplinary approach, combining insights from finance, economics, and Islamic studies to provide a comprehensive understanding of Shariah-compliant investment funds. Unlike previous studies that focus solely on theoretical or macroeconomic perspectives, this research integrates these dimensions to examine the micro-level dynamics that shape investor behavior and fund management practices. The study also introduces a novel methodological framework by combining surveys, interviews, and financial data analysis, offering a more holistic view of the factors influencing the growth and performance of Shariah-compliant investment funds in Indonesia.

A key limitation of this study is its focus on Indonesia, which may limit the generalizability of the findings to other countries with different legal and cultural contexts. Additionally, the reliance on qualitative methods, while providing in-depth insights, may not capture the full scope of quantitative trends in investor behavior and fund performance. Future research should expand the geographic scope to include comparative studies of Shariah-compliant investment funds in other Muslim-majority countries. Quantitative analyses could also be incorporated to provide a more comprehensive understanding of the economic implications of these funds. Addressing these limitations will further enhance the relevance and impact of research on Shariah-compliant investment funds.

AUTHOR CONTRIBUTIONS

Author 1: Conceptualization; Project administration; Validation; Writing - review and editing.

Author 2: Conceptualization; Data curation; In-vestigation.

Author 3: Data curation; Investigation.

CONFLICTS OF INTEREST

The authors declare no conflict of interest

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