



The Role of Islamic Banks in Promoting Financial Inclusion: Challenges and Opportunities

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Abstract:

This paper examines the multifaceted role of Islamic banks in promoting equitable financial inclusion, focusing especially on both the difficulties and prospects they encounter in supplying monetary services to underserved communities. Islamic banks, adhering to equitable Shariah principles, offer an alternative to conventional banking systems by proffering interest-free wares and emphasizing social justice, balance, and shared risk. The paper explores how Islamic banks can contribute to inclusive financing by leveraging such principled financial products as profit-and-loss participation arrangements, microcredit, and interest-free loans, notably in regions where significant portions of the population lack access to banking. Despite holding potential, Islamic banks face various impediments, including low financial health, inadequate substructure, and inconsistent regulatory systems. However, emerging opportunities like the integration of innovative technologies and utilization of Islamic social investment tools may help Islamic banks to better serve more people.

Keywords: Islamic banking, financial inclusion, Shariah-compliant finance, poverty alleviation, microfinance, fintech, zakat, waqf, social justice, equity.

JEL Classification Codes : Z12, O16, G23.





دور البنوك الإسلامية في تعزيز الشمول المالي: التحديات والفرص

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ملخص:

تتناول هذه الورقة البحثية الدور المتعدد الأبعاد الذي تلعبه البنوك الإسلامية في تعزيز الشمول المالي العادل، مع التركيز بشكل خاص على التحديات والفرص التي تواجهها في تقديم الخدمات المالية للفئات المحرومة. تلتزم البنوك الإسلامية بمبادئ الشريعة العادلة، وتقدم بدليلاً للنظام المصرفي التقليدي من خلال توفير منتجات خالية من الفوائد والتركيز على العدالة الاجتماعية، والتوازن، وتقاسم المخاطر. وتستعرض الورقة كيف يمكن للبنوك الإسلامية أن تُسهم في التمويل الشامل من خلال الاستفادة من منتجات مالية مبدئية مثل صيغ المشاركة في الربح والخسارة، والتمويل الصغير، والقروض الحسنة، خصوصاً في المناطق التي تعاني فيها نسبة كبيرة من السكان من غياب الخدمات المصرفية. ورغم ما تحمله من إمكانات، تواجه البنوك الإسلامية عدداً من العراقيل، من بينها ضعف الصحة المالية، وغياب البنية التحتية الكافية، وعدم اتساق الأنظمة التنظيمية. ومع ذلك، فإن الفرص الناشئة مثل دمج التقنيات المبتكرة واستخدام أدوات الاستثمار الاجتماعي الإسلامي قد تساعدها على خدمة عدد أكبر من الناس بشكل أكثر فعالية.

الكلمات المفتاحية: الصيرفة الإسلامية، الشمول المالي، التمويل المتتوافق مع الشريعة، التخفيف من الفقر، التمويل الصغير، التكنولوجيا المالية، الزكاة، الوقف، العدالة الاجتماعية، الإنفاق.

تصنيف JEL: Z12, O16, G23.



1. Background:

Financial inclusion constitutes a paramount global development objective, striving to furnish individuals, especially those hailing from underserved and marginalized demographics, with access to formal financial services. The significance of financial inclusion resides in its capacity to alleviate poverty and inequality while fostering economic advancement by equipping individuals and enterprises with the necessary tools to participate in the formal economy. Nevertheless, in spite of concerted international initiatives aimed at enhancing access to financial services, a considerable segment of the global populace continues to be marginalized from formal financial systems. This exclusion frequently stems from factors such as exorbitant transaction costs, geographical isolation, insufficient financial literacy, and a prevailing mistrust towards conventional financial institutions.

In numerous Muslim-majority nations, financial exclusion is further intensified by religious impediments, as conventional banking systems operate on an interest-based framework (riba), which is deemed impermissible under Islamic jurisprudence. Islamic banking, which functions in adherence to Shariah principles, offers an alternative that not only circumvents interest-based transactions but also underscores equity, risk-sharing, and social justice. Islamic financial institutions proffer a variety of financial products including microfinance, profit-and-loss sharing arrangements, and interest-free loans, all designed to cater to the needs of populations that are financially excluded. These offerings are congruent with the overarching objectives of financial inclusion by rendering accessible, ethical, and non-exploitative financial services.

Islamic banking has garnered notable attention as a plausible remedy for enhancing financial inclusion, particularly within developing economies where access to banking services is severely constrained. However, notwithstanding its prospective benefits, the efficacy of Islamic banking in furthering financial inclusion is obstructed by an array of challenges. These challenges encompass low levels of financial literacy among potential clientele, deficient banking infrastructure, and inconsistent regulatory frameworks across various jurisdictions. Furthermore, while Islamic banking institutions are experiencing growth, they confront obstacles in diversifying their product offerings to adequately address the multifaceted needs of financially excluded populations.

This study aspires to investigate the role of Islamic banks in advancing financial inclusion, scrutinize the challenges they encounter, and discern the opportunities available to broaden their reach and effect. By conducting an analysis of the extant literature pertaining to Islamic banking and financial inclusion, the study aims to furnish a comprehensive understanding of the factors that impact the efficacy of Islamic banking in achieving financial inclusion and its potential contribution to economic development.

2. Introduction:

Financial inclusion has emerged as a pivotal element of global development, as it significantly facilitates poverty alleviation, the reduction of inequality, and economic empowerment. Nonetheless, in spite of concerted international initiatives to extend formal financial system access to underserved demographic groups, a considerable portion of the population remains marginalized. This phenomenon of financial exclusion is particularly salient in developing nations and rural locales, where individuals encounter obstacles such as constrained access to banking services, elevated transaction costs, and insufficient financial literacy. Furthermore, in countries with a predominant Muslim population, a substantial segment of the populace abstains from engaging with conventional financial systems due to religious constraints on interest-based transactions, thereby exacerbating financial exclusion.

Islamic banking, characterized by its focus on Shariah-compliant financial offerings, presents a viable alternative to traditional financial systems. These offerings eschew interest (Riba), encourage risk-sharing, and emphasize ethical investment methodologies. Despite the increasing acceptance of Islamic banking, challenges persist in the comprehensive integration of these systems into the wider financial inclusion framework. The efficacy of Islamic banks in mitigating financial exclusion, particularly for economically disadvantaged individuals and small enterprises, remains inadequately examined. Moreover, while Islamic banks provide ethical and inclusive financial products, impediments such as limited financial literacy, insufficient infrastructure, and regulatory inconsistencies hinder their endeavors to reach marginalized populations.

This study seeks to address these deficiencies by investigating the role of Islamic banks in fostering financial inclusion, the obstacles they encounter, and the prospects they offer for enhancing access to financial services in underserved regions.

2.1. Method of Analysis Adopted:

This study employs a qualitative and descriptive analysis methodology, synthesizing the extant literature on Islamic banking and financial inclusion. The focus encompasses theoretical frameworks and empirical evidence from prior research. A critical review of scholarly articles, reports, and case studies will be undertaken to assess the role of Islamic banks in fostering financial inclusion, particularly in developing economies. The study will also evaluate the effects of digital financial services, such as fintech, on the capacity of Islamic banking to enhance its outreach.

Furthermore, the research will investigate the obstacles encountered by Islamic banks in delivering accessible financial services, taking into account regulatory frameworks, financial literacy, and infrastructure. The analysis will underscore exemplary practices, success narratives, and potential approaches to surmounting these challenges, utilizing case studies from regions with varying degrees of success in integrating Islamic banking into their financial systems.

2.2. Hypotheses Embraced as:

These are the hypotheses that will steer this study, given the available information and prevailing research developments:

H1: Offering Shariahcompliant financial products that match the requirements of underserved populations, especially in Muslimmajority countries, Islamic banks have a lot of potential to help financial inclusion.

H2: For Islamic banks trying to advance financial inclusion, primary difficulties are low financial literacy, poor infrastructure, and different legal systems between nations.

H3: Integration of Islamic banking with digital banking solutions and fintech can improve financial access, lower infrastructure hurdles, and stimulate more general financial inclusion.

H4: Modern banking systems can use Islamic social finance tools like zakat, waqf, and qardh alhasan to effectively integrate into modern banking systems so as to create sustainable funding sources for financial inclusion initiatives.

2.3.Objectives of the Article:

The first goals of this post are:

1. By providing Shariahcompliant financial goods that support the tenets of social justice, risksharing, and equity, Islamic banks help to investigate their role in expanding financial inclusion.
2. To investigate the obstacles Islamic businesses confront in becoming completely inclusive in financial terms, especially in overcoming barriers linked to financial literacy, infrastructure, and regulatory variances.
3. Focusing on the possibilities presented by fintech, digital finance, and tools of Islamic social finance such as zakat and waqf will let you evaluate the prospects for development in Islamic financial inclusion.
4. Emphasizing the incorporation of modern technologies, improved regulatory structures, and increased financial literacy, propose suggestions for Islamic banks to surmount obstacles and maximize their influence in advancing financial inclusion.
5. To assess how Islamic banking affects economic development in areas with little financial inclusion, with a particular focus on poverty alleviation, wealth distribution, and the empowerment of disadvantaged groups.

3.The concept of Islamic Banks and Financial Inclusion:

Islamic banks play a crucial role in promoting financial inclusion, particularly in regions where large segments of the population remain unbanked or underserved by conventional financial systems. In developing economies, low-income communities, rural populations, and small businesses often struggle to access necessary financial services. Islamic banking, with its Shariah-compliant products, offers a solution by providing ethical, interest-free, and socially responsible financial services grounded in principles of fairness, risk-sharing, and social justice. Through instruments like microfinance, profit-sharing investments, and interest-free loans, Islamic banks can address the needs of excluded populations, improving financial access for individuals and businesses in underserved areas. The social justice values inherent in Islamic

banking also align with broader goals of addressing systemic inequalities, thus furthering the aim of financial inclusion.

3.1. The definitions of Islamic Banks and Financial Inclusion:

Islamic banks operate according to Shariah principles, offering interest-free, ethical financial products such as profit-sharing and joint venture models. Financial inclusion, on the other hand, aims to provide underserved populations with access to essential financial services like savings, loans, and insurance. The intersection of these two concepts enables Islamic banks to bridge financial gaps, fostering economic equity and promoting access for marginalized communities.

3.2. The definitions of Islamic Banks:

1. Islamic Banks as Shariah-Compliant Financial Institutions: Islamic banks are financial institutions that adhere to Shariah law, which prohibits interest (Riba) and other activities like gambling (maysir) and uncertainty (gharar). They offer financial products based on ethical principles, ensuring fairness and risk-sharing between clients and banks(Puspita & Kassim, 2024, p. 6).
2. Islamic Banks as Providers of Socially Responsible Finance: Islamic banks provide financial services that promote social justice and economic development through instruments such as profit-sharing (Mudarabah) and joint ventures (Musharakah). These instruments ensure that wealth is distributed equitably and contribute to the well-being of society by focusing on investment in beneficial sectors like healthcare, education, and infrastructure(Raza et al., 2024, p. 73).

3.3. The definitions of Financial Inclusion:

1. Financial Inclusion as Access to Formal Financial Services: Financial inclusion refers to the process of ensuring that individuals, especially those from low-income or underserved communities, have access to affordable and appropriate financial services, including savings accounts, loans, payments, and insurance, which meet their economic needs(Puspita & Kassim, 2024, p. 2).
2. Financial Inclusion as Enabling Participation in the Economy: Financial inclusion is the ability for all individuals, particularly marginalized groups, to participate in the formal financial system. It provides access to the tools necessary for economic empowerment, including credit, savings, and insurance, which can help improve their standard of living and contribute to broader economic growth(Syahrul Hidayat et al., 2023, p. 5303).
3. Financial Inclusion as Reducing Barriers to Financial Access: Financial inclusion is defined as the removal of both price and non-price barriers to accessing formal financial services. It aims to provide equitable opportunities for all people to use banking services, regardless of their income, geographic location, or social status, thus promoting social equity and economic development(Putri Ghina Marla et al., 2024, p. 88).

3.4. The roles of Islamic Banks and Financial Inclusion:

Islamic banks play a crucial role in promoting financial inclusion, particularly in regions with underserved populations, by offering Shariah-compliant financial products. These banks focus on ethical principles like risk-sharing, fairness, and social justice, providing interest-free loans, profit-sharing, and microfinance to address financial exclusion. Additionally, Islamic banks support social justice through tools like zakat and waqf, contributing to equitable access to financial services and overall economic development.

3.4. The roles of Islamic Banks:

1. Islamic banks play a multifaceted role in fostering financial inclusion, economic development, and social equity, primarily through their adherence to Shariah principles. One of the key roles of Islamic banks is to provide financial products that are aligned with Islamic values, specifically prohibiting interest (Riba) and promoting ethical investments. This unique approach attracts individuals and businesses that are unable or unwilling to engage with conventional banks due to religious constraints. By offering products like Mudarabah (profit-sharing) and Musharakah (joint venture), Islamic banks promote mutual risk-sharing and benefit, ensuring that both parties are equally invested in the success of the venture, which contrasts with the interest-based model of conventional banks(Raza et al., 2024, p. 73).
2. Another critical role Islamic banks play is supporting financial inclusion by providing access to finance for underserved populations, particularly in rural and low-income areas. Through products such as microfinance, Islamic banks enable individuals and small businesses that are typically excluded from traditional banking services to gain access to capital. These products allow borrowers to engage in economic activities, such as starting small businesses or investing in education and healthcare, which may otherwise be inaccessible due to the high interest rates and restrictive conditions imposed by conventional banks(Puspita & Kassim, 2024, p. 6).
3. Islamic banks also encourage entrepreneurship by providing Shariah-compliant finance to small and medium-sized enterprises (SMEs). Many SMEs face challenges in accessing traditional loans due to their high risk and lack of collateral. Islamic banks, however, use risk-sharing models that allow businesses to access funding without the burden of high interest payments, fostering a more sustainable approach to entrepreneurship. By supporting SMEs, Islamic banks contribute to local economic growth, job creation, and poverty reduction(Syahrul Hidayat et al., 2023, p. 5303).
4. Furthermore, ethical investment is another significant role played by Islamic banks. They invest in sectors such as education, healthcare, and infrastructure, which directly contribute to improving the quality of life for individuals in marginalized communities. The prohibition of investments in industries like alcohol, gambling, and tobacco ensures that Islamic banks align their financial

activities with broader societal goals, focusing on sustainable and socially responsible economic growth(Puspita & Kassim, 2024, p. 8).

In summary, the roles of Islamic banks extend beyond providing financial products—they are essential players in promoting financial inclusion, fostering economic development, supporting social welfare, and advancing ethical finance. By embracing Shariah-compliant principles, Islamic banks provide access to finance for underserved populations, alleviate poverty, and contribute to sustainable economic growth and social equity.

3.5.The roles Of Financial Inclusion:

1. Financial inclusion plays a critical role in fostering economic growth, reducing poverty, and promoting social equity. At its core, financial inclusion is about ensuring that individuals, especially those from marginalized communities, have access to affordable and appropriate financial products and services. These services include savings accounts, credit, insurance, and payment systems, which are necessary for individuals and businesses to participate fully in the economy. By offering these tools, financial inclusion helps empower individuals to manage their economic risks, invest in their future, and contribute to the broader economy(Puspita & Kassim, 2024, p. 2).
2. One of the primary roles of financial inclusion is to reduce poverty and inequality by providing underprivileged individuals and small businesses with access to credit and other financial products. In many developing countries, people living in poverty often have limited or no access to formal financial services, which restricts their ability to save, invest, or start businesses. Financial inclusion ensures that these populations can access the tools they need to improve their financial situation, such as affordable loans for education or starting a small business. By improving access to finance, financial inclusion enables individuals to break out of the cycle of poverty and build a better future for themselves and their families(Syahrul Hidayat et al., 2023, p. 5303).
3. Another important role of financial inclusion is its ability to support small and medium-sized enterprises (SMEs), which are often the backbone of developing economies. SMEs typically face challenges in accessing traditional financing due to their size, lack of collateral, and higher perceived risk. Financial inclusion ensures that these businesses can access the capital they need to expand, innovate, and create jobs, thereby contributing to overall economic growth. By facilitating access to credit, savings, and insurance, financial inclusion helps SMEs thrive and become more resilient to economic shocks(Putri Ghina Marla et al., 2024, p. 89).
4. In addition to its economic benefits, financial inclusion promotes social stability by integrating previously excluded populations into the formal financial system. This integration helps individuals and businesses engage in secure and efficient transactions, reducing reliance on informal financial mechanisms that are often

exploitative and less reliable. By offering secure payment systems and savings accounts, financial inclusion helps build trust in the financial system, reduces financial risks, and encourages savings and investments(Puspita & Kassim, 2024, p. 8).

5. Lastly, financial inclusion also has a significant role in economic development by stimulating investment in infrastructure, education, and healthcare. As more individuals and businesses gain access to financial services, they can invest in projects that improve the quality of life and contribute to sustainable development. Moreover, financial inclusion supports the development of digital finance and mobile banking, which can further enhance access to financial services, particularly in remote and rural areas where traditional banking infrastructure is lacking(Syahrul Hidayat et al., 2023, p. 5309).

4.The relationship between Islamic Banks and Financial Inclusion:

The relationship between Islamic banks and financial inclusion is grounded in Shariah principles, which prioritize equity, risk-sharing, and social welfare(Raza et al., 2024, p. 73). This integration ensures that financial inclusion not only promotes access to services but also fosters social justice and economic empowerment for marginalized communities(Puspita & Kassim, 2024, p. 6).

Aspect	Islamic Banks	Financial Inclusion	Relationship
Core Principles	Operate according to Shariah law, avoiding interest (Riba), and emphasizing ethical investments	Providing accessible financial products and services to all individuals, especially the underserved	Islamic banks promote financial inclusion by offering Shariah-compliant financial products, ensuring accessibility for those excluded from conventional systems.
Financial Products	Profit-sharing models (Mudarabah, Musharakah), interest-free loans (Murabaha), and microfinance	Savings accounts, loans, insurance, and payment systems for underserved populations	Islamic banks offer products that are more accessible to underserved groups, especially in

			regions where interest-based banking is avoided.
Target Audience	Focus on marginalized populations, low-income households, SMEs, and women	Low-income individuals, SMEs, rural populations, and women	Islamic banks' products are designed to cater specifically to those who are excluded from conventional banking due to religious or economic barriers.
Social Finance Tools	Zakat (charity), waqf (endowments), and qardh al-hassan (benevolent loans) for wealth redistribution and social welfare	Providing a safety net for underserved populations through affordable loans and access to savings, credit, and insurance	Islamic banks incorporate social finance tools into their offerings, ensuring that financial inclusion goes hand in hand with social welfare and wealth redistribution.
Ethical Investments	Investments in socially responsible sectors like healthcare, education, and infrastructure	Promoting investments in projects that foster economic and social well-being	Islamic banks' focus on ethical investments ensures that financial inclusion also contributes to societal welfare and sustainable development.
Entrepreneurship	Risk-sharing products	Providing financial	Islamic banks

and Economic Empowerment	like Mudarabah and Musharakah to support small businesses and entrepreneurship	services like loans and savings to small businesses and entrepreneurs, fostering economic growth	support SMEs and entrepreneurs by offering financing mechanisms that foster business growth without relying on interest, promoting sustainable development.
Poverty Alleviation	Microfinance products that provide capital to low-income individuals and underserved businesses	Access to affordable credit and savings tools, directly addressing poverty by enabling economic participation	Through microfinance and other Shariah-compliant products, Islamic banks contribute directly to poverty alleviation by empowering underserved communities.
Access to Capital			Islamic banks provide alternative means of accessing capital that do not rely on interest, facilitating the inclusion of individuals and businesses in the formal

			economy.
Infrastructure Support	Branches, ATMs, mobile banking services, and digital platforms expanding to rural areas	Offering financial services in underserved areas via physical or digital platforms	The expansion of Islamic banking infrastructure, both physical and digital, helps extend financial services to remote and underserved populations.

Source: Prepared by the researcher.

5.Challenges and Opportunities, case study of Algeria:

The integration of Islamic banking into Algeria's financial system presents both challenges and opportunities in advancing financial inclusion. Despite facing regulatory hurdles and limited financial literacy, Islamic banks in Algeria have made significant strides in offering Shariah-compliant products that cater to underserved populations. The country's efforts to adopt digital banking and financial technologies provide promising opportunities to overcome geographical and infrastructural barriers(Kanwal et al., 2023; Siregar & Nasution, 2022). However, for Islamic banking to fully unlock its potential in promoting financial inclusion, further investment in education, regulation, and technology is required(Jan et al., 2023, p. 293).

5.1.The Role of Islamic Banks in Promoting Financial Inclusion:

Islamic banks, rooted in Shariah principles, provide a unique alternative to conventional banking by offering ethical financial services that promote inclusivity and economic empowerment. Their role in advancing financial inclusion, particularly for underserved and low-income populations, has garnered significant attention in both Muslim-majority and developing countries(Siregar & Nasution, 2022, p. 124).

Islamic banks are pivotal in addressing the financial exclusion that many low-income individuals face, especially in developing nations. These institutions offer financial services tailored to the needs of people who are unable to participate in conventional banking systems due to religious reasons. In particular, Islamic microfinance has emerged as an effective tool for empowering small-scale entrepreneurs and helping them access capital without incurring interest, which is forbidden in Islam. Islamic microfinance institutions provide interest-free loans or equity financing, enabling entrepreneurs in rural and underserved areas to develop their businesses, thereby contributing to local economies(Nengsих, 2015, p. 228). By leveraging Shariah-compliant financial instruments, Islamic banks foster an inclusive

financial ecosystem that supports entrepreneurship, poverty reduction, and social stability.

Moreover, the focus of Islamic banks on profit-sharing and risk-sharing mechanisms rather than interest-based transactions enhances the financial inclusion of marginalized groups. The mudarabah and musharakah contracts are examples of such structures that allow individuals without collateral to access financing. These structures create opportunities for low-income individuals and small businesses to share in the profits of their ventures, ensuring a more equitable distribution of wealth(Ahmed Hassan, 2024, p. 4057). In addition, Islamic banks' adherence to the principles of fairness and transparency helps build trust among their customers, especially those who have been previously excluded from conventional financial systems due to concerns about interest and exploitation. This level of trust is essential for promoting financial inclusion, as it encourages participation from populations that would otherwise remain hesitant to engage with financial institutions.

However, the reach of Islamic banks in promoting financial inclusion is still constrained by several challenges. One of the most significant obstacles is the limited understanding of Islamic finance products among the general public, especially in rural or underserved areas. Low financial literacy is a major barrier to the effective use of Islamic banking services, as many potential clients are not familiar with concepts such as profit-sharing or asset-backed financing(Ab. Aziz et al., 2023, p. 295). Additionally, regulatory frameworks in many countries do not fully support the growth of Islamic banking, leading to legal and compliance challenges. Without a robust legal framework that explicitly accommodates Islamic financial products, the expansion of Islamic banking remains hindered, particularly in non-Muslim-majority countries(Ahmed Hassan, 2024, p. 48). These barriers need to be addressed through increased public awareness, regulatory reforms, and investment in financial education to allow Islamic banking to reach its full potential in promoting financial inclusion.

5.2.Challenges in Islamic Banking for Financial Inclusion:

While Islamic banks offer numerous opportunities for promoting financial inclusion, they also face several challenges that limit their broader impact. One major challenge is the regulatory and legal framework in many countries, which is often not conducive to the growth of Islamic banking. In non-Muslim-majority countries, Islamic banks may struggle to navigate the existing financial regulations, which are predominantly designed for conventional banks. For example, the absence of clear and supportive legal frameworks for Islamic financial products often results in operational inefficiencies and delays in the implementation of Shariah-compliant financial services(Siregar & Nasution, 2022, p. 127). Furthermore, in many Muslim-majority countries, the legal system may not fully support Islamic finance, which restricts the scope of Shariah-compliant banking services available to the public.

In addition to regulatory challenges, Islamic banks face issues related to market penetration and the lack of financial literacy. Although the demand for Islamic

banking is growing, especially in countries with large Muslim populations, many potential customers still have limited understanding of the products offered. Islamic finance is a complex system, and products like sukuk (Islamic bonds), mudarabah, and musharakah require a level of financial literacy that many low-income or rural populations lack(Jan et al., 2023, p. 297). As a result, many individuals remain hesitant to adopt these products, limiting the ability of Islamic banks to reach all segments of society. In order to overcome these barriers, financial institutions must invest in education and awareness campaigns to ensure that consumers understand the benefits and principles of Islamic finance.

5.3. Opportunities for Islamic Banks in Promoting Financial Inclusion:

Despite the challenges, Islamic banks have significant opportunities to enhance financial inclusion, especially through technological innovation and strategic partnerships. The rise of financial technologies (fintech) offers Islamic banks a unique opportunity to expand their reach to underserved populations. Digital banking and mobile financial services, in particular, have the potential to break down geographical barriers, allowing Islamic banks to serve remote and rural areas where traditional banking infrastructure is limited. For instance, Islamic fintech platforms can facilitate microfinance and crowdfunding initiatives that cater specifically to low-income individuals and small businesses. By adopting digital solutions that align with Shariah principles, Islamic banks can provide faster, more accessible financial services to individuals who may not have access to brick-and-mortar banks(Kanwal et al., 2023, p. 4057). These innovations can enable Islamic banks to effectively promote financial inclusion and improve the economic stability of marginalized communities.

Additionally, Islamic banks can leverage product innovation to enhance financial inclusion. By developing new products that cater to the specific needs of low-income populations, Islamic banks can expand their market base and empower individuals who are often excluded from conventional financial systems. For example, the introduction of digital waqf (charitable endowment) platforms allows for greater community involvement in financing social development projects, which directly contributes to the welfare of underserved populations(Ainun Nufus et al., 2024, p. 122). Moreover, Islamic microfinance products, such as qard al-hasan (interest-free loans), offer individuals the opportunity to access capital for small-scale projects without the burden of interest. These financial products align with Islamic values of social justice and equity, providing a foundation for more inclusive economic participation.

Through these innovations and strategic approaches, Islamic banks have the potential to play a transformative role in promoting financial inclusion and driving sustainable economic growth, especially in developing countries where traditional banking systems are less effective in addressing the needs of the population(Ahmed Hassan, 2024, p. 49).

5.4. The Role of Islamic Banks in Financial Inclusion in Algeria:

Algeria has made significant progress in integrating Islamic banking into its financial system, which has had a positive impact on promoting financial inclusion in the country. The introduction of Islamic banks in Algeria occurred after the enactment of the 2010 law that allowed Islamic banking products to be offered alongside conventional banking services. Islamic banks in Algeria aim to serve both Muslim and non-Muslim populations, offering interest-free financial services that align with Shariah principles. This inclusionary approach provides an alternative to traditional interest-based banking, particularly appealing to the underserved and financially excluded segments of society.

The development of Islamic banking in Algeria has been marked by gradual growth, with the market share of Islamic banks currently estimated to be between 10 and 12% of the total banking sector. Despite this growth, a significant portion of the population, especially in rural and remote areas, still faces barriers to accessing financial services. The limited presence of banking infrastructure and the low level of financial literacy among the general population contribute to the persistent financial exclusion in these areas. Furthermore, while the government has supported the growth of Islamic banking, there are still regulatory challenges, particularly related to the harmonization of Islamic finance laws with the existing financial system(Siregar & Nasution, 2022, p. 125).

Islamic banks in Algeria have also begun to explore digital banking solutions to reach the underserved populations. Through mobile banking platforms, Islamic banks aim to increase their outreach to rural and remote communities. The use of technology has proven to be an essential tool for enhancing financial inclusion by providing easy access to banking services such as savings, microfinance, and insurance(Jan et al., 2023, p. 293). These innovations align with Algeria's growing interest in adopting financial technologies (fintech), offering greater convenience and accessibility to individuals who previously had limited access to financial institutions.

Despite the challenges, the case of Algeria demonstrates the potential of Islamic banks to address financial exclusion by providing Shariah-compliant financial products that meet the needs of a wide range of customers, including the unbanked and those excluded from conventional financial services. However, for the country to fully harness the benefits of Islamic banking in promoting financial inclusion, it will be necessary to continue developing regulatory frameworks, improving financial literacy, and investing in digital infrastructure(Ahmed Hassan, 2024, p. 48).

6. Conclusion:

In conclusion, Islamic banks have shown significant potential in promoting financial inclusion, particularly in Muslim-majority countries like Algeria, where a large portion of the population remains excluded from conventional financial systems due to religious prohibitions against interest. Islamic banks, through products such as microfinance, profit-sharing schemes, and digital innovations, have made strides in addressing the financial needs of underserved and unbanked populations(Jan et al.,

2023; Siregar & Nasution, 2022). Their unique approach to financial services—rooted in ethical and Shariah-compliant principles—has provided a viable alternative to interest-based banking, offering a more inclusive and equitable financial environment for those excluded from traditional banking systems.

However, the successful expansion of Islamic banking in fostering financial inclusion requires overcoming several challenges, including regulatory barriers, low financial literacy, and limited infrastructure, especially in rural and remote areas. As observed in Algeria, while the market share of Islamic banks has grown, their reach is still constrained by these persistent obstacles(Ahmed Hassan, 2024, p. 48). Despite these challenges, the growing adoption of digital banking solutions and fintech platforms presents a promising opportunity to bridge these gaps. Digital tools, such as mobile banking and waqf platforms, are particularly effective in extending Islamic financial services to underserved regions, enhancing access and participation in the financial system(Ainun Nufus et al., 2024; Kanwal et al., 2023).

The findings suggest that while Islamic banks have contributed significantly to financial inclusion, their potential is yet to be fully realized. For Islamic banks to play a transformative role in promoting financial inclusion, further efforts are needed in expanding digital infrastructure, improving financial literacy, and reforming regulatory frameworks. By addressing these areas, Islamic banking can foster a more inclusive financial system that not only meets the needs of Muslim populations but also offers ethical and sustainable financial solutions that can benefit broader society.

7. References:

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