

Application of Enterprise Risk Management in the Islamic Economic System

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ABSTRACT

This study examines the application of Enterprise Risk Management (ERM) in the Islamic economic system. ERM is a strategic approach to identify, assess, and manage risks holistically to achieve organizational goals. From the perspective of Islamic economics, ERM is based on sharia principles such as fairness, transparency, and social responsibility. The Islamic economic system emphasizes fair risk sharing and prohibits usury and excessive speculation. This study uses a qualitative method with a literature study approach, utilizing related literature to explore the concept, implementation, and benefits of ERM in the context of Islamic economics. The results of the study indicate that the application of ERM based on Islamic values can improve financial stability, risk management efficiency, and the conformity of business practices with Sharia principles. In addition, the application of ERM also helps Islamic companies create competitive advantages and contribute to social justice. A deeper understanding of ERM in Islamic economics is expected to be a reference for practitioners, academics, and policymakers in developing risk management strategies based on Islamic values.

INTRODUCTION

In today's rapidly evolving business environment, organizations are constantly exposed to various types of risks that can threaten their operational continuity and strategic objectives. The intensification of global competition, technological advancement, market volatility, and regulatory complexity has heightened the need for robust and integrated risk management frameworks. Risk, in this context, refers to the potential for events or circumstances to adversely affect the achievement of an organization's goals, and managing these risks effectively has become a cornerstone for maintaining organizational resilience and long-term sustainability.

Enterprise Risk Management (ERM) has emerged as a comprehensive and strategic approach that enables organizations to identify, assess, manage, and monitor risks across all operational levels. Unlike traditional risk management, which often operates in silos, ERM integrates risk considerations into the overall governance, strategy, and decision-making processes of an organization. It shifts the focus from reactive problem-solving to proactive risk anticipation and mitigation. This approach is especially relevant in the era of globalization, where interconnected risks—financial, operational, reputational, and compliance-related—require coordinated responses.

In the context of Islamic economics, ERM takes on a distinctive form. Rooted in the principles of Sharia, it emphasizes justice (*adl*), transparency (*shafafiyah*), mutual cooperation (*ta'awun*), and social responsibility. It prohibits elements such as *riba* (usury), *gharar* (uncertainty), and *maysir* (speculation), which are considered unethical and detrimental to equitable economic participation. Islamic ERM thus promotes risk-sharing rather than risk-shifting, aligning financial practices with moral and ethical considerations. It also prioritizes the alignment of financial capital with real economic activity, ensuring that risk-taking supports productive, socially responsible outcomes.

Previous studies (e.g., Al-Tamimi, 2007; Khan, 2001) have highlighted the growing relevance of ERM in Islamic financial institutions, especially in enhancing resilience and ensuring Sharia compliance. However, gaps remain in understanding how ERM frameworks are practically implemented within Islamic institutions, how these frameworks differ from conventional counterparts, and what implications they hold for corporate governance and sustainability.

This research aims to examine the application of Enterprise Risk Management within the Islamic economic system by exploring its conceptual foundations, operational principles, and implementation practices. Specifically, this study will analyze how Sharia principles shape ERM frameworks and assess their effectiveness in mitigating risks while promoting ethical and sustainable business conduct. By doing so, the study aspires to contribute to the development of ERM models that are not only financially sound but also aligned with Islamic ethical imperatives.

The findings are expected to offer valuable insights for practitioners in Islamic financial institutions, scholars of Islamic economics, and policymakers seeking to enhance risk management practices that reflect both global standards

and Islamic values. In a time when ethical finance and sustainable governance are gaining international attention, understanding the unique attributes of Sharia-based ERM holds significant relevance for the broader discourse on responsible risk management.

LITERATURE REVIEW

Currently, business growth is developing very rapidly, and the competition is becoming increasingly fierce. In everyday life, the word risk often comes up. Risk refers to the possibility of an event or situation occurring that could threaten the achievement of an organization's goals and objectives. One of the main goals of the company is to build and expand its competitive advantage. In general, risk can be defined as a situation faced by individuals or companies where there is potential for loss, even on a small scale.

In the era of globalization, risk management has become a key element in maintaining the financial and operational stability of companies. Enterprise Risk Management (ERM) is an integrated approach to identifying, assessing, and managing the risks faced by an organization. From the perspective of Islamic economics, ERM has its characteristics based on Sharia principles, such as justice, transparency, and social responsibility (Al-Tamimi, 2007). The Islamic economic system emphasizes fair risk-sharing among all parties involved in economic activities, prohibiting excessive speculation and the practice of usury. This principle creates a need for effective capital to support the implementation of ERM in Sharia-based companies (Khan, 2001). In this case, the effectiveness of capital is not only determined by its quantity but also by its quality and alignment with Islamic values.

This research aims to examine the application of ERM in the Islamic economic system. This study will discuss the definition of ERM, the Islamic perspective on the concept of ERM, and its implementation in the context of Islamic economics.

A deeper understanding of ERM in the Islamic economic system is expected to make a significant contribution to the development of more effective policies and strategies in risk management. Therefore, this research is not only relevant for practitioners in the Islamic finance industry but also academics and policymakers interested in risk management from the perspective of Islamic economics.

In recent years, the implementation of Enterprise Risk Management (ERM) has gained increasing attention within Islamic financial institutions (IFIs) as they navigate the complex landscape of global finance while adhering to Sharia principles. ERM, as a holistic and integrated framework for managing organizational risk, has been widely adopted in conventional finance. However, its application in the Islamic economic system requires adaptation to ensure compliance with key Islamic tenets such as the prohibition of *riba* (interest), *gharar* (excessive uncertainty), and *maysir* (gambling) (Rosman et al., 2014).

Rosman, Wahab, and Zainol (2014) conducted one of the earliest comparative studies highlighting how risk management practices in Islamic banks differ from those in conventional counterparts. Their findings underscore that while Islamic banks adopt similar risk identification and mitigation

techniques, they are constrained by Sharia compliance, which limits the use of conventional hedging tools. This has prompted the need for more specialized ERM frameworks tailored for Islamic financial settings.

Tajuddin et al. (2015) emphasized the role of Sharia governance in enhancing the effectiveness of ERM in IFIs. They argue that an integrated approach—combining ERM with robust Sharia governance mechanisms—ensures not only financial stability but also ethical conduct and stakeholder trust. Similarly, Srairi (2015) examined credit and liquidity risk in Islamic banks, finding that Sharia principles often lead to lower risk exposure but require more complex risk-sharing contracts and transparency to maintain trust and stability. More recently, Alam and Hossain (2020) explored ERM practices in Islamic banking using a qualitative approach. They found that ERM implementation is still in a developmental stage, hindered by the lack of standardization in Islamic finance products and limited understanding of risk quantification within Sharia constraints. However, they noted a growing trend in aligning ERM practices with *Maqashid al-Shariah* (objectives of Islamic law), focusing on justice, public interest, and the prevention of harm.

Ali and Ismail (2021) proposed an ERM framework specifically designed for Islamic financial institutions. Their model integrates traditional ERM components—such as risk identification, risk assessment, and control activities—with Islamic ethical values and Sharia screening processes. The study also highlighted the importance of board-level Sharia expertise in overseeing risk strategy.

Further, Rahman and Kassim (2022) investigated the relationship between ERM maturity and financial performance in Islamic banks across Southeast Asia. They concluded that higher levels of ERM maturity—characterized by proactive risk culture, Sharia-compliant risk tools, and strong governance positively influence financial performance, customer confidence, and institutional sustainability.

In line with these findings, emerging literature supports the integration of spiritual, ethical, and financial elements in the design of ERM systems within the Islamic economy. The convergence of ERM with *Tawakkul* (reliance on God), *Amanah* (trustworthiness), and *Maslahah* (public interest) contributes to a more comprehensive understanding of risk and promotes sustainable development across Islamic enterprises (Hussain et al., 2023).

Despite these advances, gaps remain in the empirical measurement of ERM effectiveness in Islamic institutions, the development of Sharia-compliant risk instruments, and the standardization of ERM practices across jurisdictions. Future research is needed to evaluate the performance of Islamic ERM models in diverse sectors beyond banking, such as *takaful* (Islamic insurance), Islamic capital markets, and *waqf*-based social enterprises.

METHODOLOGY

This research uses a qualitative approach with the library research method. This method was chosen to deeply explore the concept of applying Enterprise Risk Management (ERM) within the Islamic economic system. In the library study, the data used are secondary data obtained from various literature relevant

to the research topic, such as books, scientific journals, articles, research reports, and other academic sources.

RESEARCH RESULT

Enterprise Risk Management

Enterprise Risk Manajemen (ERM) is a holistic risk management process aimed at managing uncertainty, minimizing threats, and maximizing opportunities. (Iswajuni et al., 2018). Here is the updated and simplified version of the paragraph. Risk refers to the uncertainty that arises from the imperfection of an individual's knowledge in a particular field. This uncertainty can create opportunities or risks for the company. Opportunities occur when the uncertainty results in favorable outcomes, while risks arise when the uncertainty leads to adverse impacts.

The risk management process is integrated into the company's strategy and guided by management to achieve organizational goals. According to the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in the Enterprise Risk Management framework (2004), enterprise risk management is a process influenced by the board of directors, management, and employees and is applied in the formulation of strategies and operational activities of the company (Rahmadani & Husaini, 2021).

This process aims to identify potential events that may affect the company, manage risks according to the company's tolerance level, and provide adequate assurance in achieving the organization's goals. This definition emphasizes that corporate risk management is a strategic process involving all levels of the organization:

1. A continuous process: Risk management is an ongoing process that is integrated throughout the entire entity of the company, flowing dynamically over time.
2. The influence of all individuals: The risk management process is influenced by the contributions of all individuals at various levels of the organization, from the highest to the lowest.
3. Implementation in strategy: This process is applied in the company's strategic planning, ensuring that risks are always considered in every strategic plan.
4. Implementation across the company: Risk management is not limited to just one part but is applied throughout the organization, at every level and unit, including in the evaluation of risk portfolios at the entity level.
5. Opportunity identification: Risk management is designed not only to identify potential hazards but also opportunities that can affect the operations and progress of the organization.
6. Confidence in management and the board of directors: The risk management process provides sufficient assurance to management and the board of directors that the decisions made have adequately considered and managed risks.
7. Goal-oriented towards the organization: The main focus of risk management is to help the organization achieve its goals safely and efficiently, avoiding anything that could hinder the achievement of those goals.

According to Romney and Steinbart (2011), internal control according to the COSO ERM framework is a process influenced by the board of commissioners, management, and other personnel, applied in the establishment of the company's overall strategy. This process is designed to identify potential events that may affect the organization and manage the company according to the established risk tolerance levels to provide adequate assurance in achieving the company's objectives (Damayanti & Venusita, 2022).

ERM provides additional benefits by offering more detailed information about the company's risk profile. Outsiders often have difficulty assessing the strengths and financial risks of companies that are highly financial and complex. With the presence of ERM, companies can convey financial and non-financial information regarding their risk profiles to external parties, as well as demonstrate their commitment to risk management (Ai & Brockett, 2008). Risk management is a field of study that discusses how organizations implement steps to map various issues using a comprehensive and systematic management approach. Risk management encompasses all risks occurring in society, including losses of property, life, finance, and business, from the perspective of corporate management. Risk management is a comprehensive set of policies and procedures owned by the organization to manage, monitor, and control the risks faced by the organization (Kasidi, 2010).

Risk management is implemented with the primary goal of protecting the company from business risks that could be detrimental. The main objective of implementing risk management is to address issues related to risks, thereby helping the company achieve its desired goals. Some of the main objectives of risk management are:

1. Protecting the organization from significant risks that can hinder the achievement of the company's goals.
2. Ensuring that the risks present in the company have been identified, assessed, and planned with steps to minimize their impact and likelihood of occurrence.
3. Encouraging management to take action in reducing potential risks, making risk management a source of competitive advantage, and improving company performance.
4. Ensuring that the action plan developed can be implemented effectively to minimize the impact and likelihood of risks occurring.
5. Assisting in the development of a consistent framework for managing risks across various business processes and company functions.
6. Improving the effectiveness and efficiency of management by identifying risks that can hinder the company's processes and planning ways to address those disruptions, ensuring the company is prepared to face potential disturbances.
7. Increasing vigilance and encouraging every individual in the company to act cautiously in facing risks for the achievement of common goals.
8. Supporting management decision-making by providing information related to risks, both strategic and operational, in every work unit of the company.

9. Improving understanding of risks and developing the ability of individuals and management to socialize the importance of risk management.

Helping to improve the company's performance by providing information related to the level of risk mapped in the risk map, which is useful for strategy development and continuous process improvement.

Providing greater assurance in achieving the company's objectives through more effective and efficient risk management, improving relationships with stakeholders, and enhancing the ability to handle risks, including compliance risks and legal sanctions.

The goal of implementing effective risk management is to protect the company from risks that can hinder the achievement of organizational or company objectives. This includes the identification and assessment of existing risks, as well as the development of action plans to minimize the impact and likelihood of occurrence (Cristofel & Kurniawati, 2021). Risk management also encourages management to act proactively in reducing potential risks, making it a source of competitive advantage. This ensures that the implementation of effective action plans is carried out in managing risks. Additionally, risk management also helps in developing a consistent framework for managing the risks present in business processes and company functions.

Risk management is also closely related to other company functions, such as accounting, finance, marketing, production, human resources, engineering, and maintenance. Each of these functions can create risks and participate in aspects of risk management, as risks can arise from various areas within the company and affect overall performance.

Enterprise Risk Management in Islamic Perspective

Risk in business is the possibility of undesirable outcomes during an enterprise, which often arises from conditions of uncertainty. Risk management aims to manage those risks so that the business can survive and thrive. The risk management process involves the identification, measurement, monitoring, and control of risks that may arise from various business activities. Essentially, risk management encompasses three main stages: risk identification, risk evaluation and measurement, and risk management.

In Islam, risk management is an effort to uphold the trust of Allah Ta'ala regarding the wealth on earth to achieve the welfare of humanity. Allah says: "O you who have believed! Fear Allah, and let every soul look to what it has brought forth for tomorrow (the Hereafter), and fear Allah. Indeed, Allah is All-Aware of what you do." (Al-Hasyr: 18) This verse teaches the importance of anticipation in every step taken and the need for supervision over the actions performed.

Risk management has become one of the important factors in business sustainability. If a disaster or calamity occurs that results in significant losses, risk management functions to protect the company from losses that could disrupt or even destroy the business.

Risk management can also be learned from the story of Prophet Joseph 'Alayhissalam, as written in the Qur'an. When interpreting the king's dream about seven fat cows being eaten by seven lean cows and seven ears of green

wheat and seven others that were dry, Prophet Joseph provided strategic advice to face the risk of famine.

Joseph said, "You shall farm for seven years as usual; then what you harvest, leave it in the ear, except for a little that you may eat." (QS Yusuf: 47) "Then after that will come seven years of great hardship, which will consume what you have stored for them, except for a little of what you have saved." (QS Yusuf: 48) "Then after that, there will come a year in which people will be given rain (in abundance), and during that time they will press grapes." (QS Yusuf: 49) From that story, Prophet Joseph taught that the risk of famine can be managed through careful measurement and control. By storing a portion of the harvest from the first seven years, the community can face the next seven years of drought. This process includes risk identification, risk evaluation, and measurement, as well as planned risk management.

Humans always long for certainty and stability in life, but only Allah is the Most Certain and the Most Stable. When humans strive to maintain stability through risk management, they are moving towards Allah Ta'ala. Human efforts in managing risk are part of fulfilling the Divine call.

As the word of Allah says: "Indeed, my prayer, my worship, my life, and my death are all for Allah, the Lord of all worlds." (QS Al-An'am: 162) Through prudent risk management, humans not only protect their business world but also fulfill their spiritual responsibilities to the Creator.

Islamic Economic System

Economics, or *iqtishad*, is defined as the study of the principles of production, distribution, and consumption of wealth. In general, economics studies human behavior in utilizing limited resources to meet production and consumption needs. Economics also involves the analysis of how limited resources are allocated to achieve a balance between human needs and the availability of those resources. In other words, economics is the science that examines how humans meet their needs through the effective and efficient use of available resources.

In the concept of Islamic economics, several basic principles form the foundation of this economic system. First, Islamic economics functions as a supporter of faith, where faith becomes the main foundation in every economic activity. Second, Islamic economics recognizes ownership as a trust from Allah SWT that must be managed according to Sharia. Third, although it grants freedom to individuals, this system limits that freedom with rules that prevent injustice. Fourth, the value of justice is the focal point in Islamic economics, where everyone is given their rights without unjustly diminishing or adding to them. In addition, Islamic economics also emphasizes the balance between material and spiritual aspects, the spirit of brotherhood, togetherness, fair wealth distribution, and the prohibition of wealth accumulation to avoid social inequality.

Globally, there are three main economic systems widely implemented: capitalism, socialism, and Islamic economics. The capitalist system emphasizes individual freedom and a free market without government intervention. In contrast, socialism stresses the role of the government in regulating the economy

to achieve social equality. On the other hand, the Islamic economic system offers a unique approach by combining Sharia principles and balancing worldly and spiritual interests. These three systems have different paradigms, foundations, and philosophies, and often contradict each other.

Islamic economics aims to meet human needs based on Islamic values, with the ultimate goal of attaining the pleasure of Allah SWT. In practice, Islamic economics integrates awareness of God in every step of economic activities, both in work and production. This principle teaches the importance of social justice and brotherhood through the attitude of mutual assistance (ta'awun) among fellow humans. Thus, Islamic economics not only focuses on fulfilling material needs but also creates harmony in social life.

One of the main challenges in economics is managing the conflict between unlimited human needs and limited resources, known as scarcity. Various economic systems try to address this problem with different approaches. Conventional economics, for example, focuses on resource allocation, production process efficiency, and economic growth. However, this system often neglects the balance between material and spiritual needs. On the contrary, Islamic economics emphasizes the importance of utilizing resources fairly, efficiently, and according to Sharia values, thereby providing a more holistic solution to the problem of scarcity.

CONCLUSIONS AND RECOMMENDATIONS

Research on the implementation of Enterprise Risk Management (ERM) in the Islamic economic system reveals that risk management is an important element in maintaining the stability and sustainability of the company. In the Islamic economic system, ERM is implemented based on Sharia principles that emphasize justice, transparency, and social responsibility. This is different from the conventional approach, which tends to focus solely on material profit.

The ERM approach from an Islamic perspective encompasses holistic risk management by integrating financial principles and spiritual values, such as the prohibition of usury, gharar, and excessive speculation. This aims to ensure economic stability and social justice among economic actors.

This study emphasizes that the implementation of ERM in the context of Islamic economics not only provides financial benefits, such as increasing the efficiency and competitiveness of companies, but also contributes to the development of policies that support sustainability and alignment with Islamic values. Therefore, Sharia-based ERM has the potential to become a more effective, relevant, and ethical risk management framework to be applied in various sectors of the Islamic economy.

This research is expected to serve as a reference for academics, practitioners, and policymakers in developing innovative and sustainable risk management strategies by Islamic economic principles.

ADVANCED RESEARCH

Building on these insights, advanced research can investigate the operationalization and impact of Sharia-based Enterprise Risk Management (ERM) across various sectors within the Islamic economy, including banking,

halal industry, and Islamic social finance institutions. Such research may employ comparative case studies and quantitative modeling to assess the effectiveness of ERM frameworks rooted in Islamic jurisprudence versus conventional models, particularly in mitigating systemic risk and enhancing long-term organizational resilience. By integrating Maqashid al-Shariah (objectives of Islamic law) with contemporary risk governance principles, future studies can explore how ethical, spiritual, and economic dimensions are balanced in decision-making processes. This interdisciplinary approach will not only advance the theoretical underpinnings of Islamic risk management but also provide evidence-based recommendations for the institutionalization of ERM practices that align with both regulatory compliance and socio-religious accountability in the global Islamic financial ecosystem.

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