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Governance Transformation in Indonesia's Banking Sector: Regulatory Pressures and Institutional Dynamics in the Conversion of Bank Riau Kepri to Islamic Banking

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Abstract. *This study investigates the governance transformation underpinning the conversion of Bank Riau Kepri (BRK) into Bank Riau Kepri Syariah (BRK Syariah), focusing on the interplay between regulatory pressure, institutional dynamics, and strategic intent. Using a qualitative case study design, the analysis reveals that the conversion was driven by a combination of internal aspirations for regional economic leadership and external pressures, including regulatory encouragement and alignment with national Islamic finance roadmaps. While institutional support and political endorsement facilitated the conversion, challenges remain in harmonizing Sharia principles with operational realities, including staff capacity, legacy systems, and market adaptation. The study contributes to the growing discourse on conventional-to-Islamic bank conversion by highlighting how regulatory ecosystems, institutional inertia, and governance reform intersect in shaping the trajectory of Islamic banking transformation in Indonesia.*

Keywords: *Islamic banking transformation; governance reform; regulatory pressure; institutional adaptation; conventional-to-Islamic conversion; Bank Riau Kepri*

Abstrak. *Studi ini menelaah transformasi tata kelola yang mendasari proses konversi Bank Riau Kepri (BRK) menjadi Bank Riau Kepri Syariah (BRK Syariah), dengan menyoroti interaksi antara tekanan regulasi, dinamika kelembagaan, dan strategi institusional. Melalui pendekatan studi kasus kualitatif, temuan penelitian menunjukkan bahwa proses konversi dipicu oleh aspirasi internal untuk menjadi pemimpin ekonomi regional serta dorongan eksternal berupa dukungan regulatif dan sinkronisasi dengan peta jalan keuangan syariah nasional. Meskipun konversi difasilitasi oleh dukungan kelembagaan dan legitimasi politik, tantangan tetap muncul dalam menyelaraskan prinsip-prinsip syariah dengan praktik operasional, termasuk kapasitas SDM, sistem warisan, dan adaptasi pasar. Studi ini memperkaya wacana tentang konversi bank konvensional menjadi bank syariah dengan menyoroti bagaimana ekosistem regulatif, inersia kelembagaan, dan reformasi tata kelola membentuk arah transformasi perbankan syariah di Indonesia.*

Kata kunci: *transformasi perbankan syariah; reformasi tata kelola; tekanan regulasi; adaptasi kelembagaan; konversi bank; Bank Riau Kepri*

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Introduction

The transition of conventional banks to Islamic banks has become an increasingly observed phenomenon in Indonesia, influenced by the growing demand for sharia-compliant financial products and the development of regulatory frameworks intended to support this process. Several Bank Pembangunan Daerah (BPD or Regional Development Bank) in Indonesia, including Bank Aceh and Bank NTB, have undergone transitions from conventional to Islamic banking, which have been addressed in both policy and academic contexts.

However, Bank Riau Kepri Syariah (BRK Syariah) offers a more recent example situated within a novel regulatory environment that presents new challenges and opportunities for governance transformation. This case is particularly relevant for exploring how emerging regulatory pressures may influence institutional adaptations during bank conversion processes, given its occurrence under a newly introduced regulatory regime that significantly impacts the governance of Islamic banking in Indonesia. Although earlier conversion cases have received scholarly attention, recent cases such as BRK Syariah remain underexplored, especially in the context of evolving regulatory mandates such as the spin-off requirement for Islamic business units. Therefore, this study seeks to fill this gap by examining BRK Syariah's experience as an actual and unique case of institutional change within a shifting regulatory landscape.

In Indonesia, BPDs are established with a primary mandate to support and stimulate local economic development. Their strategic objectives typically include increasing regional income, enhancing the quality and accessibility of public services, and fostering inclusive and sustainable local economic growth. In fulfilling these goals, BPDs are expected to function not merely as profit-driven financial institutions but also as instruments of regional policy that align closely with the development agendas of local governments. This dual role, developmental and financial, renders the transformation of BPDs into Islamic banks particularly complex and institutionally significant.

Within this institutional framework, several BPDs have transitioned into full-fledged Islamic banks, with Bank Aceh and Bank NTB being among the earlier examples. Bank Riau Kepri Syariah (BRK Syariah) represents a more recent case of such a transformation. Like its predecessors, BRK's conversion was motivated in part by regional strategic considerations. However, its transition was also significantly shaped by national regulatory pressures. Prior to becoming a fully sharia-compliant bank, BRK operated a sharia business unit, and its spin-off was prompted by the broader regulatory mandate requiring the separation of

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sharia business units from their conventional parent banks. While prior research has examined earlier conversions such as those of Bank Aceh and Bank NTB, limited attention has been paid to how newly converted Islamic banks respond to governance reforms under emerging regulatory frameworks.

The conversion of conventional banks to Islamic banks has been the subject of growing scholarly attention, reflecting both practical expansion and theoretical debates. Al-Harbi (2020), in his analysis of five GCC banks, found that while conversion significantly improved financial size indicators such as assets, deposits, equity, and net income, it did not necessarily translate into better profitability, efficiency, or risk management, largely due to limitations in managerial capacity to adapt to the new operational paradigm. Similarly, Shafii et al. (2016) highlighted that the success of conversion is often constrained by the absence of a comprehensive regulatory and operational framework, including gaps in sharia compliance, product readiness, human resources, and legal alignment. They stressed the need for gradual conversion and capacity building, especially through AAOIFI standards and tailored training.

Complementing these insights, Suzuki et al. (2020) examined the Bangladeshi context. They identified regulatory incentives, such as lower reserve requirements, as initial drivers of conversion. Yet, they cautioned that overly protective frameworks might discourage genuine risk-taking and hinder the growth of participatory Islamic finance. Collectively, these studies highlight that conversion is not merely a formal rebranding, but a significant structural change necessitating the harmonization of regulatory frameworks, internal capacities, and innovative financial mechanisms. These international perspectives provide a comparative framework to assess the dynamics of bank conversion in Indonesia, particularly in understanding how regulatory pressures, institutional capacity, and governance reforms intersect in shaping the trajectory of newly converted Islamic banks such as BRK Syariah.

Furthermore, BRK Syariah's governance transformation occurred alongside the implementation of a new regulatory framework: Financial Services Authority (OJK) Regulation No. 2 of 2024. This regulation redefines the role and responsibilities of the Sharia Supervisory Board (SSB) and places a stronger emphasis on establishing robust and effective sharia governance mechanisms. These regulatory changes represent a new phase in the development of Islamic banking supervision in Indonesia. Yet, little is known about how these regulations are being implemented in practice, especially by banks undergoing conversion during the early stages of this regulatory transition. This research seeks to explore how BRK Syariah is responding to and implementing the new regulatory framework, with particular attention to

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how these pressures shape its governance structures and decision-making processes. Understanding these processes is essential for evaluating the broader implications of regulatory reforms on the governance of Islamic financial institutions in Indonesia.

The objectives of this study include: first, to explore the specific motivations and challenges influencing BRK Syariah's transition; and second, to analyze how regulatory pressures and institutional adaptations shape the bank's governance practices. By focusing on a more recent and less-examined conversion case, this study aims to contribute additional empirical evidence to the discourse on Islamic banking transformation and governance in Indonesia, particularly in the context of implementing the latest OJK governance framework.

Challenges and Growth of Islamic Banking

Islamic banking is based on principles of sharia law, which prohibits interest (*ribā*) and mandates the use of profit-and-loss sharing (PLS) mechanisms, primarily through the concepts of *muḍārabah* (profit-sharing) and *mushārakah* (joint venture). The fundamental difference between Islamic banks and conventional banks lies in the application of the principle of profit sharing distribution for investment fund owners (customers) (Khairunisa & Megawati, 2024). Under the PLS paradigm, borrowers share profits and losses with banks, which in turn share these outcomes with depositors. This is in contrast to conventional banking, where interest is charged on loans and paid on deposits. Proponents of Islamic banking argue that this system enhances resilience to external shocks and promotes economic growth, as the risk-sharing feature allows for long-term financing of high-risk projects (Chong & Liu, 2009).

However, in practice, the Islamic banking system often deviates from the original PLS model. For example, in Malaysia, the adoption of PLS financing on the asset side has been notably low; only 0.5% of Islamic bank financing is based on *muḍārabah* and *mushārakah*. The majority of Islamic banking in the country still relies on non-PLS modes of financing, which, although permissible under sharia law, do not fully reflect the spirit of the prohibition of usury (Chong & Liu, 2009). On the liability side, *muḍārabah* deposits account for a more significant share (70%), but the overall structure of Islamic banking still reflects conventional banking practices (Chong & Liu, 2009). It is important to note, however, that this study was conducted some time ago, and therefore, the conditions and practices of Islamic banking may have evolved since then.

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Beyond operational and regulatory considerations, critical scholarship has questioned the deeper conceptual meanings and practices of sharia compliance in Islamic banking. In the review of Islam and Mammon, Abboud (2007) notes that Kuran critiques the mainstream implementation of Islamic finance for prioritizing legalistic and contractual conformity over substantive ethical objectives, leading to a formalistic adherence that obscures the justice principles central to sharia. Similarly, Wael Hallaq (2009) critiques the modern sharia industry as being embedded within state bureaucracies that reinterpret Islamic law through modern institutional frameworks, often detached from its ethical and spiritual roots. These perspectives suggest that Islamic banking's development may reflect institutional pressures for conformity and legitimacy rather than genuine transformation of financial ethics.

The integration of Islamic and conventional banking systems has led to what is known as "dual banking economies," where both systems coexist, often in competition. This duality can lead to a situation where each type of bank competes not only with the other type of bank but also with other banks within their segment (Abedifar et al., 2016). As the Islamic banking sector grows, questions arise regarding the stability of banks in dual banking economies, especially given the increased competition and regulatory challenges (Azmi et al., 2019).

Indonesia, the largest Muslim-majority country, has seen growth in its Islamic banking sector, despite it making up a smaller share of the overall banking assets. In 2023, the market share of Islamic banking increased to 7.44%, a rise from 7.09% in 2022 (Financial Authority Services, 2023). Institutional theory helps explain the formation of Islamic banks in Indonesia, as organizations tend to adopt practices that are seen as legitimate or required by society, even when these practices deviate from pure efficiency-based motives. Coercive, mimetic, and normative isomorphism are three key processes that influence the formation of these banks, with coercive isomorphism stemming from external pressures such as regulatory demands, and mimetic isomorphism emerging from efforts to reduce uncertainty by mimicking successful practices (Fitrah, 2017).

Several banks in Indonesia were established or converted into Islamic banks through various mechanisms, including acquisitions, spin-offs, and conversions (Fitrah, 2017). These mechanisms reflect the dynamic nature of the Islamic banking sector in Indonesia and the role of regulatory policies in shaping its development. Despite these developments, the reality of Islamic banking, particularly in dual banking systems, often deviates from its original theoretical framework. As noted, the Islamic banking system today tends to adopt practices similar to conventional banking, particularly in terms of financing contracts.

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The concept of Islamic banking is often understood and implemented through contractual frameworks that resemble conventional credit systems, leading to criticisms regarding adherence to sharia principles in its current form (Attoyibah et al., 2022). This highlights the ongoing challenges in aligning Islamic banking practices with the core tenets of sharia law, particularly in banking markets where conventional banking practices dominate. Thus, while Islamic banking has experienced growth and success in many countries, including Indonesia, its practice often differs from its theoretical foundation, raising important questions about its future trajectory and the extent to which it can fulfill its original economic and ethical objectives.

The conversion of conventional banks to Islamic banks is a growing phenomenon, particularly in regions with a strong Islamic presence. The shift from conventional to Islamic banking is based on the principles of sharia law, which prohibits interest (*ribā*) and mandates profit-and-loss sharing mechanisms such as *muḍārabah* (profit-sharing) and *mushārakah* (joint venture). This system contrasts with conventional banking, where interest is the fundamental basis of operations (Chong & Liu, 2009). The key drivers for Islamic banking include the ethical foundations of the system, promoting fairness, transparency, and social justice, which have increasingly attracted both Muslim and non-Muslim customers (Afif et al., 2022).

Islamic banking in dual banking economies often mirrors conventional banking practices. Despite the ideal of profit-and-loss sharing (PLS) in theory, the actual application often deviates, with banks using non-PLS financing instruments, especially in countries like Malaysia, where the use of *muḍārabah* and *mushārakah* financing remains low (Chong & Liu, 2009). Similarly, Indonesia's Islamic banking sector, though growing, has been influenced by regulatory pressures and the need for competitive positioning within a dual banking system (Fitrah, 2017).

The establishment and conversion of Islamic banks in Indonesia, as seen in Aceh, have been motivated by strong political will and regional autonomy, allowing the implementation of sharia-compliant financial systems through *qanun* (regional regulations) (Hakim et al., 2023). For example, Aceh's provincial regulations have mandated the conversion of all financial institutions to sharia-compliant institutions, impacting the risk structure and potential for bankruptcy in the banking sector (Hakim et al., 2023). These conversions are governed by comprehensive regulatory frameworks, requiring adherence to both sharia principles and conventional banking regulations, which pose challenges in terms of governance and risk management (Mainata et al., 2024).

The conversion of conventional banks to Islamic banks often involves significant changes in financial practices, including the introduction of sharia-compliant contracts like *murābaḥah* (cost-plus financing) to replace interest-based loans. These changes require adherence to fatwas issued by relevant sharia boards, such as the Indonesian National Sharia Council – Indonesian Ulama Council (Dewan Syariah Nasional or DSN-MUI) (Hakim et al., 2023). A major impact of this conversion is the risk associated with the operational shift, which alters both the risk profile of the bank and the types of financial products offered to customers. The impact on the bank's risk profile can be substantial, particularly concerning asset risks and bank credibility (Mainata et al., 2024). The conversion process also requires significant adjustments in governance structures, management practices, and human resource deployment to align with the new sharia-compliant framework.

In terms of customer loyalty, Islamic banks have demonstrated the ability to attract not only Muslim customers but also non-Muslim ones. Studies such as those by Afif et al. (2022) suggest that brand image and brand loyalty are positively impacted by the customers' experience with Islamic banks. Even non-Muslim customers, whose religious principles differ from those of the bank, have shown loyalty to Islamic banks, driven by the perception that these banks offer ethical and socially responsible financial services. The concept of self-congruity, where customers perceive their values and identity aligning with the values of the Islamic bank, also significantly influences brand loyalty (Afif et al., 2022).

The financial performance of converted Islamic banks, such as Bank NTB Syariah, has shown mixed results. On the one hand, the bank's financial position improved following its conversion to an Islamic Commercial Bank (BUS), with increases in the Loan-to-Equity Ratio (LER) and Debt-to-Assets Ratio (DAR), indicating growth and higher capital requirements. However, this conversion also brought about significant operational costs, including the need for new staff, infrastructure, and risk management systems, which affected profitability, as reflected in the increase in the BOPO ratio (Mainata et al., 2024).

The conversion process, both at a regional level in Indonesia and at an international level, is guided by standards from organizations like the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), which provide comprehensive guidelines on sharia compliance (Hakim et al., 2023). However, challenges remain, particularly in ensuring full adherence to Sharia principles in post-conversion operations. There are concerns about the persistence of interest-based transactions under the guise of sharia-compliant contracts, which undermine the ethical foundation of Islamic banking (Hakim et al., 2023).

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These observations align with broader critiques from scholars such as Timur Kuran (2004), who points out that many Islamic financial products are economically indistinct from conventional instruments and are primarily designed to create the appearance of compliance rather than achieving substantive ethical transformation. Similarly, Wael Hallaq (2009) warns that the modern state's bureaucratic and technocratic approach to sharia reconfigures it into a legalistic structure, often estranged from its classical moral and epistemological foundations. These critiques highlight the tension between regulatory formalism and the deeper ethical aspirations of sharia, suggesting that conversion processes may replicate institutional forms without necessarily fulfilling the values that underpin Islamic finance.

In conclusion, the conversion of conventional banks to Islamic banks is a complex process that involves significant regulatory, operational, and financial changes. While this transition offers the potential for enhanced ethical banking practices and customer loyalty, it also presents challenges in terms of compliance, governance, and financial performance. As Islamic banking continues to grow, particularly in dual banking systems, its success will depend on the ability of institutions to fully integrate Sharia principles into their operations, ensuring both ethical and financial sustainability.

Methods

This study employs a qualitative approach using the case study method, a research strategy particularly suitable for exploring complex phenomena within their real-life contexts. Data were collected through in-depth interviews with members of the Sharia Supervisory Board, the management of BRK Syariah, as well as experienced sharia experts and auditors. Additionally, a document analysis of the 2023 GCG implementation report was conducted to gain a comprehensive understanding.

A qualitative case study is defined as an empirical investigation using context-rich data from a bounded real-world environment to examine a focused phenomenon (Barratt et al., 2011). This method is particularly relevant for addressing the research objectives of this study, as it enables a deep exploration of institutional changes and their implications for governance practices. The purpose of a case study is to build and extend theory and to explore better and understand contemporary issues or phenomena that arise within real-world contexts (Barratt et al., 2011).

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A case study may involve individuals, groups, institutions, or large-scale communities, which can serve as either single or multiple cases (Gillham, 2000). This research uses a single case study approach because it allows for an in-depth investigation of specific research questions. These questions may initially be loosely defined, but the method facilitates the collection and synthesis of various types of evidence within the case context. These pieces of evidence are then analyzed to provide the best possible answers to the research questions (Gillham, 2000). A single case study was chosen for this research to thoroughly examine the transformation process of BRK Syariah and its implications, as this case presents unique insights into institutional change within Islamic banking.

A fundamental characteristic of a case study is that the research does not necessarily begin with a pre-existing theory. Instead, the researcher immerses themselves in the context to collect data and understand the phenomenon. This flexibility is essential when the most appropriate theoretical framework is not immediately evident (Gillham, 2000). While actual data may be specific to the particular individuals, groups, or institutions under study, the theoretical insights derived from these findings may be generalized to other contexts or used to understand similar phenomena in different settings (Gillham, 2000). However, the focus remains on evidence rather than theory, ensuring that data is not forced to fit a theoretical framework (Gillham, 2000).

Qualitative case studies can also employ a deductive approach, where the study confirms or falsifies a theory's applicability by meeting specific requirements proposed by Johnston et al. (1999) (Barratt et al., 2011). These requirements include beginning with an existing theory to develop research hypotheses, following a systematic and logical research design, and applying evaluation criteria to assess potential biases and ensure methodological rigor. Consequently, case studies should not be viewed as "sampling units" in inferential statistics but as "individual studies" used to confirm or falsify a theory (Barratt et al., 2011). The lack of generalizability to a broader sample population is not a primary concern; instead, the emphasis lies on the contextual data that contributes to confirming or falsifying a theory (Barratt et al., 2011).

This study employed a single case study using an inductive approach, as it is better suited for capturing contextual data and enhancing the reliability of the findings. By adopting an inductive approach, the study focuses on deriving insights directly from the data, ensuring that findings remain grounded in the specific context of Bank Kepri Syariah.

Interviews were conducted using a semi-structured format. The researcher prepared a set of guiding questions in advance but allowed flexibility to explore

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emerging themes during the interviews. Initially, two key informants were selected using purposive sampling, targeting members of the Sharia Supervisory Board. However, during the data collection process, the scope expanded organically. One informant from the compliance unit participated and later referred a colleague who had been directly involved in the bank's conversion process. In total, four informants contributed to the study, each offering diverse insights into the governance transformation.

To enhance transparency and methodological clarity, the interview transcripts were analyzed through a thematic categorization process. Although no formal coding tables or software were used, the researchers manually reviewed and organized the data based on their relevance to the study's two main research objectives. Specifically, the analysis focused on identifying statements related to: (1) the motivations and challenges underlying BRK Syariah's transition, and (2) the influence of regulatory pressures and institutional adaptation on the bank's governance practices. This process was iterative and reflexive; rather than applying a rigid coding framework from the outset, the researcher allowed key themes to emerge progressively from the data. As the data were reviewed, segments that were particularly rich or insightful were aligned with the evolving focus of each research question. Selected quotations are included to support major points, ensuring that the findings are firmly grounded in the voices of the participants.

Case study researchers must remain open-minded, continuously gather data, and postpone final analysis until the dataset is sufficiently comprehensive, while still maintaining ongoing engagement with the data thereafter. Regular and systematic review and summarization are essential to manage the complexity of the material effectively. Without careful organization and documentation, case study research can easily lose structure and coherence (Gillham, 2000).

Results and Discussion

Motivations and Conversion Processes from Conventional to Islamic Banks

The conversion of conventional banks to Islamic banks is driven by various motivations, primarily the desire to adhere to Islamic principles. Studies indicate that nearly 60% of conventional banks worldwide have undergone conversion to comply with these principles (Shafii et al., 2016). Other factors include trust in religion, the provision of Islamic financial products, increased profitability, and efforts to retain existing customers and attract new ones (Shafii et al., 2016). This trend is common in countries with a majority Muslim population. Customers who prioritize adherence to Islamic principles, even at a higher cost, are identified as engaging in sharia arbitrage, reflecting their loyalty to products aligned with Islamic principles (Azmi et al., 2024).

Before complete conversion, many banks begin with a hybrid or dual-window model, offering both conventional and Islamic products. This system allows banks to experiment with the Islamic market while retaining their conventional customer base. In Indonesia, Islamic Business Units (Unit Usaha Syariah or UUS) represent a gradual step towards full Islamic compliance. This transformation requires a convergent approach, making incremental changes, such as introducing Islamic products before altering the entire operation. This approach aims to minimize resistance and disruptions within the organization. Regulations that provide 15 years for UUS to separate from its parent bank are designed to facilitate a smoother and more planned transformation. Additionally, the spin-off policy aims to expand the Islamic banking industry. Previous studies suggest that a substantial market share is the best way to achieve financial stability, meaning that larger banks can reduce risks and contribute to financial system stability (Mainata et al., 2024).

Bank Riau Kepri (BRK) is an example of the transformation from a conventional to an Islamic bank influenced by spin-off policies. The spin-off policy is a key feature of Islamic banking regulation in Indonesia. This process reflects the regulator's efforts to encourage the full implementation of Islamic principles by creating independent Islamic entities. However, research indicates that spin-offs often do not occur as scheduled, primarily because achieving Islamic Business Unit assets equal to 50% of the parent bank's total assets is a significant challenge. As a result, most spin-offs take place only after the 15-year deadline mandated by law has passed (Yusuf et al., 2023). In the case of BRK Syariah, there was a proposal to establish the IBU of Bank Riau Kepri as a specialized Islamic bank for the Riau Islands Province (Kepri), which at the time did not have a regional bank. However, this option was difficult to pursue because the Regional Government of the Riau Islands would need to provide additional capital of one trillion rupiahs.

BRK Syariah successfully completed its conversion in 2022, following the successful transformation of other regional development banks, such as Bank Aceh (2016) and Bank NTB (2018). The transformation of regional development banks into sharia-compliant institutions in Indonesia has taken various forms, often influenced by unique socio-political and cultural contexts. One of the earliest and most prominent examples is Bank Aceh, which completed its

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conversion in 2016. As a province with special autonomy, Aceh implements Islam as the normative foundation for its governance and legal systems. In 2018, the provincial government issued Qanun No. 11 of 2018 on Islamic Financial Institutions (Lembaga Keuangan Syariah, or LKS), mandating that all financial institutions operating in Aceh must comply with sharia principles. This regulation effectively created an exclusive Islamic financial ecosystem within the province. While the policy demonstrates a strong political commitment to Islamic finance, it has also been viewed by some observers as marginalizing conventional (non-sharia) financial institutions, raising debates over inclusivity in financial access (Zada, 2023).

Similarly, the transformation of Bank NTB into a sharia-compliant bank took place within a distinctive religious and cultural context. The province was, at the time, led by TGH Muhammad Zainul Majdi, a governor who was also a Hafiz of the Qur'an. His leadership symbolized and reinforced the province's strong Islamic identity, which resonated with the majority of the population, particularly in the banking sector. Although no specific academic sources directly attribute the conversion policy to the governor's religious authority, it is a matter of public record that he served for two consecutive terms (a total of ten years), and the conversion was finalized during his final term. The plan to transform Bank NTB had reportedly been initiated as early as 2014. It was formally enacted on 13 September 2018, through the issuance of Regional Regulation (Perda) No. 8 of 2018 concerning the conversion of Bank NTB into Bank NTB Syariah (Teland, 2020).

While the cases of Aceh and NTB offer valuable comparative insights, the present study does not aim to conduct an in-depth institutional or political analysis of either case. Instead, they are discussed to illustrate the diversity of regional motivations and regulatory environments that have shaped sharia conversion in Indonesia. In the case of Aceh, the conversion was legally enforced through a provincial regulation under its special autonomy status. In NTB, the decision was shaped by local cultural-religious identity and political leadership. However, further research is needed to determine the extent to which personal piety or religious symbolism influenced policy outcomes.

This paper, however, focuses specifically on the case of BRK Syariah in Riau, where neither special autonomy nor religious leadership directly shaped the conversion. Instead, the motivations appear to be driven by institutional readiness, regulatory compliance with the spin-off mandate, and cultural proximity to Islamic finance norms. Riau, as a culturally Malay region closely linked to Islam and geographically adjacent to Malaysia, a global leader in Islamic banking and finance, provides a conducive context for such transformation. Therefore, while regulatory pressure remains the primary driver, the decision to convert also aligns with local cultural and religious sensibilities.

The conversion process of Bank Riau Kepri (BRK) to BRK Syariah involved obtaining approval from all customers or making an announcement through the website. However, because not all customers could be reached directly, Bank BRK disseminated information through national and local media. If no complaints were received from customers, it was assumed that they agreed to transition to BRK Syariah. This process is known as negative confirmation. Technically, the requirements and procedures for separating the Islamic business unit are regulated under Regulation No. 59/POJK.03/2020. However, the main challenge in the conversion process is cultural transformation due to the fundamental differences between the business models of conventional and Islamic banks. Conventional banks operate based on an interest system, which in Islam is categorized as riba and prohibited. In contrast, Islamic banks apply Islamic principles by avoiding interest and using profit-sharing schemes or asset-based transactions.

To enhance employees' understanding and ensure sufficient knowledge of Islamic banking operations and products, BRK Syariah implemented a mandatory training program as part of its institutional transformation. Given that most employees previously worked in a conventional banking environment, the training was designed to equip staff with the necessary competencies in line with sharia principles. The program emphasized accountability through a strict evaluation mechanism. One employee explained: "We have to attend training frequently, and only if we pass with a score above 85% can we proceed. If below 85%, we must retake the training" (BRK Syariah employee, personal communication, 26 October 2024). This structured approach reflects the bank's commitment to ensuring that all personnel possess a baseline understanding of Islamic financial operations before engaging in their roles under the new system.

This shift in business models presents a significant challenge during the conversion process, particularly regarding employee readiness. For example, at Bank Syariah Mandiri (prior to its merger into Bank Syariah Indonesia), many employees lacked a solid foundation in Islamic economics and finance. Instead, they had only informal education focused on general management (Shafii et al., 2016). A similar situation was observed during the conversion of BRK Syariah. According to a Sharia Supervisor, errors in contract documentation—especially in the application of sharia-compliant *akad*—continued to occur after the conversion. These errors were attributed not to a lack of training, but to persistent habits formed during years of working in a conventional banking environment. As the supervisor explained, "They are used to the old system; we still find small mistakes in documentation" (Sharia Supervisor, personal communication, 11 November 2024). This suggests that while training is essential, it must be complemented by sufficient time for internalization and continuous support to shift deeply embedded work practices.

The findings reinforce previous research suggesting that the most challenging aspect of sharia conversion lies not in structural changes, but in the behavioral and cultural transformation required at the operational level (Shafii et al., 2016). Organizational cultural change tends to progress more slowly than changes driven by political or regulatory decisions. In the case of BRK Syariah, several symbolic cultural shifts occurred promptly due to leadership policies, such as the broadcasting of the call to prayer (*adhān*) within the workplace. Within institutional change theory, symbolic adjustments are often easier to introduce and more readily accepted than more profound normative shifts (Greenwood & Hinings, 1996). This observation is supported by a statement from one of the staff interviewed:

> *"It feels more Islamic now, especially in the clothing. In the morning, we must read a longer prayer than usual... when the prayer time comes, the adzan sounds, and we must pray, with one person remaining. Before the conversion (when it was conventional), there was no adhān in the office, but now it must be played (BRK Syariah employee, personal communication, 26 October 2024)".*

While such visible changes signal the bank's commitment to an Islamic identity, they also invite reflection on inclusivity. Although no interviewees expressed discomfort—and most BRK Syariah employees and clients are Muslim—it remains important to ensure that visible religious practices in the workplace do not inadvertently alienate non-Muslim employees, especially if the bank expands into more religiously diverse regions.

One of the key motivations for BRK's conversion into a fully sharia-compliant bank was the implementation of the spin-off policy. This policy reflects the philosophy of pure Islamic banking, where Islamic banks are expected to operate independently from their conventional counterparts. Normatively, this principle aligns with the foundational objectives of Islamic finance, aiming to ensure a clear separation of contracts, operations, and governance structures. Although several studies suggest that spin-offs do not always lead to improvements in market structure, performance, efficiency, or financial ratios, the approach is still widely regarded as ideal for safeguarding sharia compliance.

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In the case of BRK Syariah, the spin-off was not merely a response to regulatory mandates, but also a strategic decision to eliminate the complexities associated with dual banking systems and to strengthen public confidence in the bank's Islamic identity. Stakeholders perceived the separation from its conventional parent not only as a legal requirement, but as an institutional commitment to a coherent and consistent sharia-based banking model. Thus, the spin-off functioned both as a compliance mechanism and a catalyst for more profound organizational transformation.

The conversion process at BRK Syariah illustrates how regulatory pressure intersects with local socio-cultural identity and political feasibility. According to OJK Regulation No. 15/POJK.03/2020, Islamic banking units (Unit Usaha Syariah or UUS) must be spun off into independent Islamic banks once they reach 50% of their parent bank's total assets or by June 2023, whichever comes first. In BRK's case, however, the UUS did not meet the required capital threshold to spin off into a standalone Islamic bank. An alternative proposal to transfer the UUS into a new Islamic bank for the Riau Islands province (Kepri) was also unfeasible due to Kepri's lack of financial capacity. Faced with this regulatory pressure and limited structural options, full conversion of BRK into a sharia-compliant bank emerged as the most viable path.

This decision was further supported by cultural and political narratives. As a Malay-majority region with strong Islamic values, there was a local perception that a sharia-compliant bank would better reflect the identity and aspirations of the community. Local societal groups had previously advocated for the transformation of BRK into a full-fledged Islamic bank. Within the framework of institutional theory, this process can be interpreted as a form of coercive isomorphism, where organizations adapt in response to regulatory mandates. Simultaneously, normative pressures related to cultural-religious identity reinforced the perceived legitimacy of the conversion. Thus, the shift to BRK Syariah was not merely a strategic choice, but a convergence of regulatory constraints, cultural alignment, and institutional legitimacy.

Sharia Governance and Institutional Change in BRK Syariah's Conversion

The conversion of conventional banks to Islamic banks involves aspects of sharia compliance, adherence to formal legal requirements, supervisory mechanisms, and management functions such as financial performance and human resource management (Hakim et al., 2023). A fundamental difference between Islamic and conventional banks is the presence of a Sharia Supervisory Board (SSB) within their organizational structure. The SSB ensures that all operational activities and products offered by the bank align with sharia principles.

In the case of Bank Riau Kepri (BRK) Syariah, the bank previously operated under a dual system, with an Islamic Business Unit under its conventional banking division. Following the conversion to a full-fledged Islamic bank, the SSB, which had previously supervised the Sharia Business Unit (UUS), continued its role in BRK Syariah. Although the current SSB is not the first SSB that oversaw the UUS, it became part of the UUS and actively participated in the conversion process, closely monitoring the transformation. For instance, the number of employees in the UUS was significantly lower compared to the workforce after the transformation into an Islamic commercial bank.

One significant contribution of the SSB during the conversion was the issuance of 24 sharia opinions, revising previous Standard Operating Procedures (SOPs) to align with sharia principles. These SOPs were approved by the SSB representing the National Sharia Board of the Indonesian Ulema Council (DSN-MUI), which serves as the highest authority in sharia financial compliance in Indonesia. The issuance of these opinions played a pivotal role in standardizing operational procedures, ensuring that each financial product and service offered by the bank met established Islamic legal criteria.

In addition, the SSB conducted compliance audits (random audits) to monitor and evaluate the actual implementation of sharia principles at the operational level. Initially, these audits were conducted randomly across different branches; however, over time, the strategy evolved to target branches that had not yet been audited or those identified by management as needing attention. These audits were designed not only to identify non-compliance but also to guide continuous improvement. Findings from these audits were systematically communicated to relevant branch managers and directors, who were then expected to address any deviations or inconsistencies through corrective action. This mechanism ensured a dynamic feedback loop between sharia governance and operational practice.

BRK Syariah is adapting to the provisions of Financial Services Authority Regulation No. 2 of 2024, which governs sharia governance for Islamic Commercial Banks and Islamic Business Units. This regulation introduces detailed requirements, including a minimum of three SSB members or up to 50% of the number of directors. Currently, BRK Syariah has two SSB members, necessitating adjustments to meet this requirement. Financial Services Authority

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Regulation No. 2 of 2024 also strengthens the role and position of the SSB, recognizing them as 'primary parties' in the bank's structure. These enhancements include restrictions on multiple roles: SSB members may not concurrently serve as directors, commissioners, or executive officers in other financial institutions. They may only hold positions in one other Islamic commercial bank or Islamic Business Unit and up to two additional financial institutions. Furthermore, SSB members are limited to one non-financial institution role and are prohibited from holding public office.

These changes mark a departure from previous rules, which allowed public officials, such as vice presidents, to serve as SSB members in multiple financial institutions. The updated regulations reflect a growing emphasis on integrity, independence, and professionalization in sharia governance. This emphasis reflects a broader pattern of institutional change, where evolving regulatory expectations reshape not only organizational structures but also the normative commitments of financial institutions. If institutions are the "foundation of social life" (Campbell, 2004), such reforms are not merely technical—they are indicative of deeper transformations in how Islamic banking is embedded within society.

The regulation also specifies mechanisms for the dismissal of SSB members, requiring approval from the Financial Services Authority to ensure governance stability and reduce the risks of political intervention, particularly in regional government-owned banks like BRK Syariah in this case. Additionally, Financial Services Authority Regulation No. 2 of 2024 mandates that directors implement SSB recommendations, emphasizing their integration into operational decision-making. SSB remuneration must reflect the complexity of tasks, risk levels, and proportionality compared to the Board of Commissioners.

The transformation journey of BRK Syariah highlights regulatory pressure as a significant factor shaping institutional practices and outcomes. The role of the SSB extends beyond compliance, actively influencing strategic decisions. For example, BRK Syariah's compliance division, supervised by the Director of Compliance & Risk Management, ensures that all operations adhere to sharia principles. Before launching a product, compliance reviews include sharia compliance audits and SSB opinions, ensuring alignment with DSN-MUI fatwas.

The 2023 BRK Syariah governance report indicated that all members of the Sharia Supervisory Board (SSB) did not concurrently serve in other Islamic banks. However, one member simultaneously held SSB positions in a Sharia Business Unit (UUS) and a foundation. While this arrangement remained in compliance with

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the prevailing regulations at the time, newly issued regulations by the supervisory authority have introduced more stringent requirements. These new provisions particularly concern the minimum number of SSB members and impose tighter restrictions on multiple board memberships. Studies on Islamic banks in the GCC and Southeast Asia show that over 82% of sharia scholars serve on more than two supervisory boards, enhancing their networks and reputation while contributing positively to financial performance. If institutions are the "foundation of social life" (Campbell, 2004), institutional change becomes a driving force for societal transformation.

Beyond limiting multiple appointments, the new regulations also emphasize the institutional strengthening of SSBs through an increase in both their number and professional competence. This aligns with the findings of Farag et al. (2018), who demonstrated that a larger SSB can significantly enhance the financial performance of Islamic banks.

Larger SSBs are seen as better equipped to manage the complexity of banking operations, reinforce supervisory functions, and expedite the certification of new Sharia-compliant financial products, such as Islamic microfinance and Sharia-compliant derivatives. The study also supports the monitoring hypothesis, which posits that the benefits of enhanced supervision, such as improved sharia compliance, better risk management, and increased investor confidence, outweigh the associated costs.

Although expanding the number of SSB members entails additional costs, such as honoraria and training, these costs are considered offset by the advantages of more effective supervision. Currently, BRK Syariah has not yet fully met the minimum membership requirement stipulated by the new regulation. This indicates that, although BRK had complied with previous standards, full implementation of the updated regulatory framework still requires institutional adjustments.

At the same time, earlier studies have suggested that multiple appointments held by SSB members can have beneficial effects, including enhanced scholarly reputation and credibility, the expansion of professional networks, and the diffusion of best governance practices across institutions. These factors may ultimately contribute positively to the financial performance of Islamic banks. Nonetheless, the restrictions on multiple appointments introduced in the latest regulatory reforms are broadly viewed as a necessary step to strengthen supervisory independence and improve overall sharia governance quality in the Islamic financial sector.

BRK Syariah's conversion underscores the interplay between regulatory frameworks, governance practices, and operational outcomes. Financial Services Authority Regulation No. 2 of 2024's requirements reflect an evolutionary tightening of standards to address vulnerabilities and strengthen trust in the Islamic banking sector. For instance, the regulation's focus on SSB competency, such as mandatory risk management certification equivalent to level 6, enhances their ability to oversee complex financial operations. However, the transformation also introduces challenges. For instance, while SSB reforms strengthen governance, they may also create new obstacles, such as an increased workload for SSB members and a smaller talent pool due to stricter requirements.

BRK Syariah's experience demonstrates that institutional change is not merely symbolic but requires tangible adjustments in governance structures and practices. The bank's preparation to comply with Financial Services Authority Regulation No. 2 of 2024 highlights the dynamic relationship between regulatory pressures and institutional adaptation. As Tang (2011) noted, understanding institutional change is essential to comprehending the broader evolution of social systems. In the case of BRK Syariah, this evolution is visible in how formal governance mechanisms, such as SSB membership requirements and compliance procedures, are increasingly shaped by regulatory interventions that carry broader normative implications. BRK Syariah's transformation serves as a case study of how regulatory interventions drive changes that align institutional practices with societal expectations.

Conclusions

The transformation of Bank Riau Kepri into an Islamic commercial bank underscores the pivotal role of regulatory pressures and institutional adaptations in facilitating such transitions. This case study illustrates how aligning governance structures and operational practices with Islamic principles is critical to navigating the complexities of conversion and ensuring compliance with Sharia requirements. By addressing both external regulatory demands and internal organizational adjustments, the case highlights the broader challenges and opportunities in meeting societal expectations for ethical and Sharia-compliant financial practices.

The findings of this study highlight the necessity of robust regulatory support and institutional alignment in addressing the challenges associated with implementing Sharia principles in daily banking operations. Financial institutions considering similar transitions may benefit from exploring strategies that integrate

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regulatory requirements with societal expectations for ethical banking. Furthermore, the experience of Bank Riau Kepri provides valuable insights into the interplay between external pressures and internal adaptations in the context of Indonesia's evolving Islamic banking sector.

This study contributes to the literature on Islamic banking governance by illustrating the dynamic interaction between regulatory frameworks and organizational change. It emphasizes how regulatory pressures can facilitate the shift to Islamic banking while shaping governance structures to align with Sharia principles. Such transformations reflect society's increasing demand for financial institutions that uphold Islamic values.

Future research could explore the long-term impacts of similar conversions on financial performance, customer satisfaction, and industry competitiveness. Comparative analyses across different regions or banking models could further enrich understanding of the mechanisms driving successful transitions to Islamic banking. By building on the insights provided in this study, scholars and practitioners can advance the development of more effective strategies for facilitating the growth of Islamic finance globally.

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