



A LITERATURE REVIEW: COMPARING APPROACHES OF ISLAMIC FINANCE AND CONVENTIONAL FINANCE IN THE EPISTEMOLOGY OF SHARIA ECONOMY

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Abstract

The foundational principles of Islamic finance, rooted in the Qur'an's prohibitions against riba, fundamentally distinguish it from conventional finance. This prohibition, coupled with the historical roots and philosophical underpinnings of Islamic finance, shapes its unique approach to investment and risk management. By avoiding interest-based activities and advocating for ethical and socially responsible investing, Islamic finance offers a distinct model that emphasizes justice, equity, and societal welfare. Despite facing similar risks as conventional banks, Islamic finance's emphasis on holistic risk-sharing and its consideration of social, environmental, and religious factors in accounting practices demonstrate its commitment to a more inclusive and responsible financial system. In summary, the contrasting approaches of Islamic finance and conventional finance underscore the importance of ethical considerations and social responsibility in shaping financial systems that promote equity and justice for society as a whole.

Keywords: *Islamic, Konvensional, Finance*



Abstrak

Prinsip-prinsip dasar keuangan Islam, yang berakar pada larangan Al-Qur'an terhadap riba, pada dasarnya membedakannya dari keuangan konvensional. Larangan ini, menjadi dasar-dasar filosofis keuangan Islam, membentuk pendekatan secara khusus terhadap investasi dan manajemen risiko. Dengan menghindari keuangan berbasis bunga dan menganjurkan investasi yang tepat dan bertanggung jawab secara sosial. Keuangan Islam menawarkan model berbeda yang menekankan keadilan, kesetaraan, dan kesejahteraan masyarakat. Meskipun menghadapi risiko yang sama seperti bank konvensional, penekanan keuangan syariah pada pembagian risiko holistik dan pertimbangan faktor sosial, lingkungan, dan agama dalam praktik perhitungan keuangan menunjukkan komitmennya terhadap sistem keuangan yang lebih inklusif dan bertanggung jawab. Dengan demikian, pendekatan yang kontras antara keuangan Islam dan keuangan konvensional menggarisbawahi pentingnya pertimbangan etis dan tanggung jawab sosial dalam membentuk sistem keuangan yang mendukung kesetaraan dan keadilan untuk masyarakat secara keseluruhan.

Kata kunci: Syariah, Konvensional, Keuangan



A. INTRODUCTION

In the era of globalization transformation, the economy is constantly developing. Islamic finance has become a major concern in the discussion of Islamic economics. The concept of Islamic finance not only involves practical aspects, but also has depth in the Islamic epistemological dimension that underlies its entire financial system. One of the driving factors is the increasing public awareness of the importance of Islamic principles in everyday life, including in the field of finance.

The history of Islam has provided a philosophical and methodological foundation for the development of a financial system in accordance with the principles of Shariah. Traditional approaches in Islamic finance tend to be based on textual interpretations of the Quran and Hadith, as well as the works of classical scholars outlining financial laws in Islam. The emergence of modern Islamic finance organizations was influenced by the demonstration of contracts and cultural resurgence, particularly in countries aspiring for Muslim cultural revival post-colonization (Mujiatun, 2022). Islamic finance is distinct from conventional finance due to its adherence to Sharia principles, ensuring transactions are free from unlawful practices like usury and following fiqh mu'amalah regulations (Biancone & Secinaro, 2022). The sector's growth is driven not only by religious beliefs but also by practical interests in enhancing the economy (Shahid, 2022).

The financial system based on Islamic principles derived from the Qur'an and the Sunnah, emphasizing justice, equity, and ethical practices. It prohibits interest-bearing debt instruments and promotes risk-sharing mechanisms like sukuk instead of conventional bonds (Biancone & Secinaro, 2022). The system has gained global popularity, attracting not only Muslims but also non-Muslims due to its universal and ethical foundations (al Amin et al., 2022). Islamic finance operates within a regulatory framework that combines Sharia law and local regulations, with countries like the United States and Canada establishing supportive environments for its practice (Hassan et al., 2022). The industry's growth is evident in the development of Islamic banking



systems, which cater to the financial needs of Muslim populations while upholding societal interests through just and equitable practices [4].

Islamic finance differs from conventional finance primarily in its principles and practices. Islamic finance is guided by Sharia rules, emphasizing justice, equity, and ethical frameworks in financial operations (Ikay, 2023). It prohibits interest-based financial activities and promotes risk-sharing, socially responsible investing, and value creation through partnership-style financing [2]. The Islamic financial system has historical roots dating back to early Islam, with a focus on faith, morality, and substance over form [3]. Islamic finance contributes to financial inclusion by offering unique financial products, enhancing access to capital for small businesses, and promoting financial stability through risk-sharing and leverage avoidance [4].

The aim of Islamic finance to alleviate poverty by diversifying finance and providing funding for various sectors, benefiting both Muslims and non-Muslims (Mujiatun, 2022). In contrast, conventional finance relies on interest-based models, which Islamic finance strictly prohibits, leading to a more ethical and morally guided approach in Islamic banking (Farooqui, 2022). The IMF's interest-based policies conflict with Islamic finance principles, causing challenges for Muslim countries and highlighting the fundamental differences between the two systems. Despite similarities in economic outcomes with conventional finance, Islamic finance aims to differentiate itself by developing innovative products and addressing investor concerns about system authenticity.

Based on the analysis that has been described, the researcher will conduct a study with the title *Comparing Approaches of Islamic Finance And Conventional Finance*. The purpose of this study is to investigate the differences in approaches between Islamic finance and conventional finance through an in-depth literature review.

B. METHOD

This research uses a type of qualitative research with a literature study method known as literature review. Literature review is a literature analysis of a research topic that aims to inform readers about the results of other research related to current research, link research with existing literature, and fill gaps in previous research (Creswell & Poth, 2016).



Data collection techniques using literature studies are a way of collecting data or other sources related to research topics that can be obtained from various sources in the form of journals, books, and other studies. In this study, literature was obtained which includes international and national journals. Data analysis techniques are carried out from various data that have been obtained using descriptive analysis methods by presenting facts then analyzed and described and providing sufficient understanding and explanation.

C. RESULTS AND DISCUSSION

Based on the results of research conducted using the literature study method, namely by collecting references, and processing materials that are relevant to the problem or case raised. The following are the results of a review of several article sources used in this study.

Table 1. Comparing Approaches of Islamic Finance And Conventional Finance

| No | Researcher | Title | Result |
|----|--------------------------|---|---|
| 1. | (Ikay, 2023) | Islamic Finance: Fit for Purpose or Mere Replication? | Islamic finance differs by emphasizing substance over form, prohibiting riba, promoting risk-sharing, and avoiding leverage. It aims to develop innovative products while meeting Islamic requirements. |
| 2. | (Abi Anwar et al., 2022) | Risk management in islamic financial technology | Islamic finance differs by adhering to Sharia principles, emphasizing ethical investments. Risk management in Islamic fintech focuses on technology risks due to digital platforms, requiring tailored strategies aligned with business objectives. |
| 3. | (Alandejani, 2022) | An Overview of Efficiency and Profitability in Islamic Banking: | Islamic finance differs by Sharia principles, and emphasizing risk-sharing in investments. Both Islamic and conventional banks use similar A performance measurement techniques, with |



| | | |
|---------------------|---|---|
| | Comparative Study between Islamic Banking and Conventional Banking | Islamic banks focusing on socio-economic development rather than profit maximization. |
| 4. (Mujiatun, 2022) | Analysis of the Modern Era's Financial and Islamic Economic Importance | Islamic finance originates from the Al-Quran and Sunnah, remaining unchanged for centuries. It is gaining popularity among non-Muslims, positively impacting the economy and changing mindsets towards Islam. |
| 5. (Mordini, 2018) | Numerical Comparison of Risk Distribution in Conventional and Islamic Instruments in Project Finance | Islamic finance emphasizes risk-sharing over risk-trading, contrasting conventional finance. The study numerically compares risk distribution in project finance, showing how Islamic instruments redistribute risk-return profiles among parties. |
| 6. (Baber, 2018) | How crisis-proof is Islamic finance? : A comparative study of Islamic finance and conventional finance during and post financial crisis | Islamic finance differs by adhering to Sharia principles, prohibiting interest and unethical investments. It emphasizes profit-sharing and asset-backing, promoting risk-sharing and ethical investment practices compared to conventional finance. |

Based on the results of the analysis of articles Islamic Finance and Conventional Finance from several researchers in the table above shows that Islamic finance and conventional finance differ in their approaches. Islamic finance aligns with Socially Responsible Investing (SRI) by considering ethical, moral, and social aspects in transactions. It emphasizes creating social value



alongside financial returns, contrasting with conventional finance's focus solely on risk and return. Islamic banks rely more on equity than external finance, unlike conventional banks (Arslan-Ayaydin et al., 2016). Additionally, the performance of Islamic equities is favorable for faith-based investors in both short and long terms, but conventional equities become more desirable for long-term investors when included in the asset menu (Zarqa, 2019). Islamic economics advocates for continued engagement with conventional economics, emphasizing nuanced views on self-interest and the salvage of beneficial aspects (Umar, 2017). This highlights the nuanced and socially responsible approach of Islamic finance compared to conventional finance.

The Qur'an's prohibitions against riba in the Quran and its historical roots to understand what the purpose of these restrictions is by looking at Islamic finance philosophy and criticised various contract types which have been used to circumvent the prohibition of riba through hilah. Islamic finance differs from conventional finance in investment strategies by focusing on ethical and socially responsible investing, risk-sharing, and avoiding interest-based activities (Zubair, 2023). It is emphasize risk-sharing over conventional finance's interest-based system. It suggests developing an original "profit theory" to reflect Islamic finance's unique and alternative nature.

Islamic finance operate based on Sharia principles, emphasizing justice and equity for society as a whole. In terms of risk management, Islamic finance face similar risks as conventional banks but with added complexity, requiring unique risk measurement and mitigation strategies compliant with Shariah principles (Shahid, 2022). Islamic banking business involves risks such as market, liquidity, credit, legality, reputation, compliance, operational, and strategic risks, with a need for professional regulation of interest rates to safeguard the Islamic banking system. Islamic finance also prioritizes social, environmental, and religious performance in its accounting practices, contrasting with the profit-centric focus of conventional accounting.

Studies comparing the two show differences in performance metrics during the Covid-19 pandemic, with Islamic finance excelling in Capital Adequacy Ratio and Financing to Deposit Ratio, while conventional finance outperform in Return on Asset, Return on Equity, and Operating Costs. Additionally, Islamic finance is highlighted for its ethical foundations and



holistic approach, considering social, environmental, and religious aspects which impacts risk-sharing with customers (Safarda et al., 2023).

Islamic finance and conventional finance exhibit distinct approaches. Islamic finance emphasizes ethical and social considerations alongside financial performance, as seen in its focus on risk-sharing and socially responsible investing. In contrast, conventional finance is critiqued for its lack of ethical grounding and sole pursuit of profit, leading to issues like inequalities.

D. CONCLUSION

The comparison between Islamic finance and conventional finance reveals profound disparities in their underlying principles and operational frameworks. Islamic finance, characterized by its adherence to Sharia principles and emphasis on ethical, moral, and social considerations, aligns with Socially Responsible Investing (SRI) by prioritizing the creation of social value alongside financial returns. This stands in stark contrast to conventional finance, which predominantly focuses on maximizing profits without necessarily considering broader societal impacts.

Moreover, Islamic finance's reliance on equity-based financing and risk-sharing mechanisms underscores its commitment to justice and fairness, challenging the conventional interest-based system prevalent in conventional finance. The nuanced and socially responsible approach of Islamic finance, as highlighted in its investment strategies and risk management practices, serves as a compelling alternative that prioritizes ethical considerations and societal well-being.



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