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Comparative Analysis of Business Activities of Sharia Banks and Conventional Banks: Sharia and Modern Banking Perspectives

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ABSTRACT

This article aims to explore the distinctions between Sharia Banks and Conventional Banks, along with their respective operations. Essentially, both types of banks serve as institutions that gather funds from the public in the form of savings and then redistribute these funds back to the community through loans or other means. For individuals concerned about bank interest, Sharia banking offers an alternative by implementing a profit-sharing model to calculate returns on funds, which is deemed permissible under Islamic law. The differences between Sharia Banks and Conventional Banks lie in their legal foundations: Sharia banking is governed by Islamic sharia, which is derived from the Quran, Hadith, and Ulema Fatwa (MUI), whereas conventional banks operate under the positive laws applicable in Indonesia, including civil and criminal law. These differences present unique advantages for both types of banks and their customers.

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INTRODUCTION

Banks hold a vital position in supporting a nation's economic development. Their presence significantly boosts the financial circulation within society, making banks an essential institution that exists in every country worldwide. This is due to their key role in channeling financing and providing services that facilitate money flow and distribution.

Several experts have offered definitions of banking. According to Macleod, a bank is a commercial institution that grants loans by creating credit. Meanwhile, G. M. Verryn Stuart defines a bank as a business entity that fulfills credit demands using either its own funds, funds from external sources, or by introducing new monetary instruments into circulation.

The definition of a bank is also formally outlined in Indonesian Law No. 7 of 1992 on Banking. Article 1, paragraph 1, states that a bank is a financial institution that collects funds from the public in the form of deposits and redistributes them as financing to improve the overall welfare of the people.

The emergence of Islamic banking in Indonesia was a response to the growing concern among Muslims about the conflict between conventional bank interest and the prohibition of riba (usury) in Islam. Islamic banks were introduced in the early 1990s following Government Regulation No. 72 of 1992, later refined by Law No. 10 of 1988.

One of the fundamental differences between Islamic and conventional banks lies in the relationship with clients. Islamic banks operate on a partnership model where the bank and client are investor and

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entrepreneur, respectively. In contrast, conventional banks maintain a creditor-debtor relationship. All activities in Islamic banking are carried out according to Sharia principles derived from the Qur'an, Hadith, and fatwas issued by the Indonesian Ulema Council (MUI).

The legal framework supporting Islamic banking includes Law No. 7 of 1992, Law No. 10 of 1998, and Law No. 21 of 2008 concerning Islamic Banking. These laws serve as a comprehensive legal foundation for Sharia-compliant financial practices. Additionally, Islamic banks adhere to regulations issued by Bank Indonesia (BI) or the Financial Services Authority (OJK), as well as fatwas from the National Sharia Council (DSN-MUI) (Zulhamdi, 2021).

On the other hand, conventional banks operate on a value-neutral basis. Their systems are not guided by religious principles. They function independently and are free to engage in any financial activities as long as they comply with national laws and regulations set by BI and OJK, and as long as the activities are profit-generating and legally permitted.

Given this background and explanation, the author is motivated to further explore the business operations of Islamic banks and how they differ from conventional banking practices.

LITERATURE REVIEW

A. Definition of Sharia Banks and Conventional Banks

Islamic banks are financial institutions that operate according to Islamic law (Sharia), as outlined in the Qur'an and Hadith. One of the key principles applied in Islamic banking is Mudharabah, a profit-sharing agreement where one party provides the capital while the other manages the funds. Profits are shared according to a pre-agreed ratio, reflecting a partnership rather than a debtor-creditor relationship.

According to Sudarsono (2004), as cited by Fahmi (2014), an Islamic bank is defined as a financial entity whose core function is to provide credit and payment services based on Islamic values rooted in the teachings of the Qur'an and the Hadith.

Islamic banking in Indonesia has not been long-established compared to conventional banking. One of the primary challenges faced in its early development was the general public's lack of awareness and understanding about the Islamic financial system. However, in recent years, Islamic banking has seen notable progress. A turning point came in 2003, when the Indonesian Ulema Council (MUI) issued a fatwa declaring conventional bank interest (riba) as haram, which significantly boosted the credibility and acceptance of Islamic banks among the Muslim population.

Conventional banks, on the other hand, function on a system where both fund collection and fund distribution are based on interest. They typically offer returns in the form of a fixed percentage, calculated over a specific time period—usually annually (Triandaru & Budisantoso, 2006). This interest-based system contrasts with the Sharia principle of avoiding riba, which is prohibited in Islamic finance.

Today, conventional banks still dominate the Indonesian banking landscape. This dominance is largely rooted in the country's colonial history, where the banking infrastructure was originally established under Dutch rule. As a result, many of the current banking models still reflect conventional financial practices.

B. Basic Principles and Operational System of Sharia Banking

The main principles of Islamic bank operations include justice ('adl), benefits (maslahah), and partnership (shirkah). This system is different from the conventional approach that is based on the debtor-creditor relationship. In practice, Islamic banks use various contracts such as *mudharabah*, *musyarakah*, and *ijarah* that emphasize cooperation and mutual risk (Haron & Azmi, 2019).

C. Products and Contracts in Sharia Banks

Islamic bank products are designed to reflect Islamic values and provide a halal alternative to conventional financial products. Contracts such as *murabahah* (buying and selling with margin), *wakalah* (representation), and *kafalah* (guarantee) are the basis of the offering of Islamic financial services (Dusuki & Abdullah, 2007). Product innovation also develops along with technological developments and more competitive market demands.

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D. Legal Basis and Role of DSN-MUI Fatwa in the Development of Sharia Banks

The development of Islamic banks in Indonesia is inseparable from the support of formal regulations and religious fatwas. The DSN-MUI fatwa plays an important role as a reference in determining the halal-haram of a financial product. This is in line with the legal framework regulated by the OJK and the Sharia Banking Law (Effendi, 2022). The DSN-MUI fatwa is a bridge between sharia law and the modern national financial system.

E. Fundamental Differences between Sharia Banks and Conventional Banks

The main differences between the two banks lie in their economic philosophy, profit sharing vs interest system, and approach to risk and profit. Conventional banks tend to separate between economics and morality, while Islamic banks integrate them in one complete value system (Iqbal & Mirakhor, 2011). This has an impact on the product structure, approach to customers, and the social responsibility carried out by each bank.

METHODS

This research uses a qualitative-comparative approach that aims to describe and compare the business activities of Sharia Banks and Conventional Banks from various aspects, such as principles, products, operational systems, and legal basis. This approach is suitable to be used to examine social phenomena or institutional systems in a narrative and systematic manner without manipulating variables (Moleong, 2019).

The type of data in this study is secondary data, which is obtained through library research. Data was collected from various scientific literature such as banking books, academic journals, laws and regulations (such as Law No. 7 of 1992, Law No. 10 of 1998, and Law No. 21 of 2008), as well as fatwas issued by the National Sharia Council of the Indonesian Ulema Council (DSN-MUI) (Creswell, 2014).

The analysis technique used is descriptive-comparative analysis, namely by describing the characteristics and structure of Islamic banking activities and comparing them systematically with conventional banks. The analysis process is carried out inductively, which starts from the collection of normative and theoretical data, then is compiled and concluded logically (Sugiyono, 2017).

RESULTS AND DISCUSSION

A. Functions of Sharia Banks (Funding, Financing, Service)

Basically, the function of Islamic banking can be divided into three major parts, namely:

1. Fundraising
2. Financing
3. Service.

As one of the banks in Indonesia, Sharia Bank has functions, namely:

a. Funding

The first function of an Islamic bank is to collect funds from people who have excess funds. Islamic banks collect or collect funds from the public in the form of deposits using the al-wadiah contract and in the form of investment using the al-mudharabah contract.

b. Financing

The second function of Islamic banks is to distribute funds to people in need. The public can obtain financing from Islamic banks as long as they can meet all applicable provisions and requirements. Disbursing funds is a very important activity for Islamic banks. In this case, the Islamic bank will get a return on the funds distributed. The return or income obtained by Islamic banks for the distribution of these funds depends on the contract

c. Bank Services (*Service*)

The function of Islamic banks is in addition to collecting funds and distributing funds to the community, Islamic banks provide banking services to their customers. This Islamic bank service is provided in order to meet the needs of the community in carrying out their activities. Service to customers is the third function of Islamic banks. Various types of service products that can be provided by Islamic banks include money transfer services, book transfers, securities collection and so on.

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B. Syariah Bank Contracts and Products

Variety and ivonation in Islamic bank products has become a necessity because the banking sector has an important role in the economy. Meanwhile, funding is a contract contract made by customers who lack funds with Islamic banking with a variety of products provided. In both product models, Islamic banking in this case takes a fee for the services they provide.

a. Fund Gathering

In Islamic banking, the Mudharabah contract enables capital owners to earn returns based on a profit-sharing agreement. In contrast, the Wadhiah principle does not involve profit rewards. Instead, Wadhiah is a safekeeping contract rooted in trust, where the bank holds funds or assets on behalf of the depositor without any expectation of return—though banks may, at their discretion, offer voluntary gifts (hibah).

The Wadhiah system relies on a mutual understanding between two parties—either individuals or legal entities—where one party entrusts funds or goods to another for safekeeping. The recipient must protect and return the deposit whenever the owner demands it. In this arrangement, the funds are treated as deposits, and the bank, as the custodian, may charge a service fee, depending on the terms agreed upon.

According to Bank Indonesia Regulation No. 8/29/PBI/2006, Article 1, and Law No. 10 of 1998, Article 1 Paragraph 6, a rupiah checking account allows customers to withdraw funds at any time via cheques, bilyet giro, payment instructions, or interbank transfers. This conventional product is also acknowledged in the Islamic banking system, following the issuance of DSN-MUI Fatwa No. 1/DSN-MUI/IV/2000 on current accounts (Giro). Although current accounts were formally introduced in 1998, the fatwa issued in 2000 provided the necessary Sharia-based reinforcement to ensure the product's compliance with Islamic principles.

In addition to current accounts, Islamic banks also offer Wadhiah savings products. Under Law No. 21 of 2008, Article 1 Clause 23, savings are defined as funds entrusted by customers to Islamic banks or Islamic business units based on a Wadhiah contract—or other contracts consistent with Sharia principles—offered in forms such as current accounts, savings accounts, or similar deposit instruments. Referring to the DSN-MUI fatwa on Wadhiah savings issued in 2000, such funds can be withdrawn anytime (on-call) or according to prior agreement, and no return is required unless voluntarily granted by the bank. This again demonstrates how fatwas serve as regulatory reinforcement for products that had already existed under earlier laws passed in 1998 and expanded upon in 2008.

The second key contract commonly used in Islamic banking is Mudharabah, a partnership agreement between the capital provider (shohibul maal) and the entrepreneur or fund manager (mudharib). In this arrangement, the capital provider supplies the funds, while the manager contributes expertise and effort. Profits generated from the business venture are shared based on a predetermined ratio, while any losses are borne solely by the capital provider, provided the manager has not been negligent.

Theoretically, Mudharabah is categorized into two types:

a) Mudharabah Muthlaqah (Unrestricted Partnership), and
b) Mudharabah Muqayyadah (Restricted Partnership).

In accordance with PSAK 59, Mudharabah Muthlaqah falls under the classification of Unbound Investment. In the updated Sharia Financial Accounting Standards (PSAK Syariah), it is referred to as a Temporary Syirkah Fund. From a fatwa standpoint, Mudharabah-based savings also fall under the DSN-MUI fatwa on savings issued in 2000, which strengthens the legitimacy of such products within the Islamic banking framework.

In practice, Mudharabah Muthlaqah is implemented through various banking products such as Mudharabah savings accounts, Mudharabah deposits, and other instruments operating under the same Sharia principles. These instruments are formally regulated and supported by DSN-MUI fatwas, ensuring their conformity to Islamic financial ethics.

b. Financing and Services

According to Law Number 10 of 1998, financing involves providing money or credit to another party, who is then required to repay it after a specified period, often with profit sharing or compensation. Islamic banks generally offer products and services categorized into various patterns, such as deposit, loan, profit-sharing, buying and selling, leasing, and others.

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In the financing framework of Islamic banks, principles like borrowing, profit-sharing, buying and selling, and leasing are applied, with variations in implementation across different banks. Service products are typically combined with contracts and financing products, known as multi-contracts. Murabahah, with its diverse product variations, remains the most prevalent product in Islamic banking due to its risk-minimizing nature.

However, murabahah financing is subject to specific terms and conditions as outlined in the DSN-MUI fatwa on Murabahah. Islamic banks apply murabahah products in various forms, such as purchasing goods, financing motor vehicles, houses, and even home renovations, and they can also be part of multi-service schemes.

C. DSN-MUI fatwas on Sharia Bank Products

The financial crisis that struck Indonesia in 1997–1998 triggered a sweeping transformation in the country's banking sector. Bank Indonesia (BI) responded to the systemic collapse by overhauling its policies, culminating in the issuance of Law No. 10 of 1998. This law amended Law No. 7 of 1992 and laid the foundation for formalizing and regulating the development of Islamic banking in Indonesia. It became a key legal framework for both formal and informal Islamic financial institutions (LKS).

Under this revised regulation, Sharia Commercial Banks and Conventional Banks with Sharia Units are required to adhere strictly to Islamic principles. This commitment to Sharia compliance was further strengthened through Law No. 21 of 2008 on Islamic Banking, which introduced more structured guidelines for Islamic financial practices.

In the early stages of Islamic banking in Indonesia, no official fatwas existed to guide financial institutions in complying with Sharia. Despite this, the establishment and endurance of Bank Muamalat Indonesia (BMI) during the financial crisis proved to be pivotal. Employing a profit-sharing system (Mudharabah), BMI demonstrated resilience while other financial institutions were collapsing. Notably, on November 1, 1997, licenses for 16 finance companies were revoked due to a severe loss of public trust, yet BMI remained operational.

To ensure proper Sharia guidance for financial institutions, the National Sharia Council (Dewan Syariah Nasional – DSN) was established in 1998 under the auspices of the Indonesian Ulema Council (MUI). As an independent body, MUI—separate from government influence—became the central fatwa authority for Islamic finance. Between 1998 and 2017, DSN-MUI issued 116 fatwas, covering both banking and non-banking Islamic financial institutions.

Fatwa issuance peaked in 2000 and 2002, with 18 fatwas released each year, marking the most active periods in DSN-MUI's history. In contrast, only one fatwa was issued in 2003. Across the 18-year span, the annual average stood at approximately 6.8 fatwas per year. In 2000, all fatwas supported Islamic banking operations, directly aligning with the legislative reforms of Law No. 10 of 1998—which had amended the earlier 1992 Banking Law—as a response to the national financial turmoil.

The following years saw a diversification in fatwa topics:

a) In 2001, fatwas addressed both Islamic banking and non-bank sectors like insurance and mutual funds.
b) By 2002, DSN-MUI covered broader topics including the capital and money markets, Hajj financing, and import/export Letters of Credit (L/C).
c) In 2004, new fatwas addressed issues such as charge card financing, multi-service financing, compensation, and Islamic bonds (sukuk) based on the Ijarah contract.
d) Additional fatwas in 2004 tackled conference funding, bill discounting, and Mudharabah restructuring.
e) By 2005, DSN-MUI expanded its scope to takaful (Islamic insurance) and further specifics for conventional insurance adaptation.
f) In 2008, the focus shifted to Islamic capital market instruments, while 2017 marked the issuance of a fatwa on electronic money (e-money).

These developments clearly illustrate the dynamic function of fatwas in addressing emerging financial issues. Fatwas do not merely reflect theoretical Islamic jurisprudence; they actively respond to and regulate

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real-world Islamic financial products—many of which were in operation before the issuance of Sharia-based rulings.

While most Sharia-compliant products today are governed by fatwas, implementation in practice often remains suboptimal. Interestingly, the high frequency of fatwa issuance in 2000 and 2002 suggests that DSN-MUI was attempting to close regulatory gaps—aligning pre-existing Islamic banking products with formal Sharia approval through retrospective rulings.

D. The Difference Between Sharia Banks and Conventional Banks

At first glance, Islamic and conventional banks look the same. In fact, most banks today have their own conventional and sharia branches. However, the two are still different As for the difference between Islamic and conventional banks, as described below:

a. Purpose of Establishment

The background and purpose of the establishment are the difference between an Islamic bank and the first conventional bank. Conventional banks have a profit orientation with free value or adhere to principles owned by the general public. Meanwhile, with Islamic banks, the purpose of their establishment is not only profit-oriented, but also the dissemination and application of sharia values. Banking financial activities are carried out not only to see the effects of the world, but also to pay attention to the aspects of the hereafter as well.

b. Implementation Principle

The next difference between Islamic and conventional banking is the application of the principles of each bank. The implementation principle between Islamic and conventional banks is clearly different. Meanwhile, conventional banks use conventional principles with reference to national and international regulations based on applicable laws. Meanwhile, the principle of Islamic banks based on Islamic law refers to the Quran and Hadith and is regulated by the fatwa of Ulama. So that all its financial activities adhere to Islamic principles.

c. Operating System

The operational system is also a comparison of Islamic banks and conventional banks. In conventional banks, the operational system enforces the application of interest rates and agreements in general based on national rules. Contracts between banks and bank customers are mostly carried out based on an agreement on the amount of interest rates. Meanwhile, Islamic banks do not apply interest in their transactions. According to Islamic law, interest is included in the category of usury. So that the operational system of Islamic banks uses a profit-sharing contract or ratio. Agreements between customers and banks are based on profit sharing and involve buying and selling activities (Subaidi, 2018).

d. Formal Agreement

The transaction process in a banking institution must have an agreement or formal agreement between the customer and the bank. The difference between Islamic banks and conventional banks is reviewed from a formal agreement, namely that conventional banks enter into agreements under national law. Unlike Islamic banks, they make contracts by paying attention to Islamic law as well. Various types of transaction contracts in Islamic banks range from profit-seeking to social services. Not only that, in implementing the agreement, there are several pillars and legal conditions that must be fulfilled to ratify the contract.

e. Activity Supervisor

The difference between Islamic and conventional banks is also reviewed from the supervisor of their activities. Although both are regulated by Law Number 10 of 1998 concerning Banking, the parties who supervise them are different. Conventional banks are supervised by the board of commissioners in their activities. Meanwhile, the supervision structure of Islamic banks consists of various institutions, including the Islamic Supervisory Board, the National Islamic Council, and the Board of Bank Commissioners.

f. Fund Management Process

Because Islamic banks apply Islamic principles, it also affects fund management policies. So that the next difference between Islamic banks and conventional banks is the fund management process. In conventional banks, fund management can be carried out in all profitable business lines under the auspices of the Law. Meanwhile, customer money in Islamic banks must be used according to Islamic rules. Islamic banks must manage customer funds in the line of business that is allowed by Islamic rules. As a result, customer money should not be invested or managed in business fields that are contrary to Islamic values, such as cigarette companies, drugs, and so on.

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g. Flower System

The most prominent difference between Islamic and conventional banking can be seen from the application of the interest system. Commercial banks use interest rates as a baseline and profit. Meanwhile, Islamic banks do not use an interest system, but a yield or ratio. Profit sharing is obtained from the sharing of profits between banks and customers.

h. Profit Sharing

Banking advantages are the difference between Islamic and conventional banks. In Islamic banks, bank profits are obtained from the results of buying and selling, renting, and partnerships with customers. But conventional banks benefit from the interest rates charged to customers.

i. Fine Management

Finally, the comparison between Islamic banks and conventional banks is the management of fines. When you are late in making payments in conventional banks, there is a fine charged to the customer. Even the amount of interest can increase, if the customer does not pay until the deadline set. Meanwhile, Islamic banks do not have a rule on the burden of fines for customers when they are late or unable to pay. Instead, the bank will conduct negotiations and mutual agreements. Although some Islamic banks set fines in certain cases, the fine money from customers is not enjoyed by the bank but is budgeted as a social fund.

CONCLUSION

Islamic banks and conventional banks differ in their business activities, particularly in the services and products they offer and the principles they follow in transactions. While both types of banks aim to benefit capital owners, the conventional banking system relies on interest, whereas Islamic banking operates on a profit-sharing model. These two systems are fundamentally different in both essence and technical execution. The core distinction lies in their underlying philosophical principles.

Islamic banks consistently apply a profit-sharing approach and do not engage in interest-based transactions, unlike conventional banks, which focus on interest and do not utilize profit-sharing. Operationally, Islamic banks accept customer funds as deposits or investments, whereas conventional banks primarily handle deposits with the intent of earning interest. Additionally, Islamic banks have the responsibility to issue and manage zakat, a duty not shared by conventional banks.

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