



# The Urgency of the Existence of Islamic Banking (Comparative Study with Conventional Banking)

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## Abstract

*Banking has an important role in the development of a country's economy. Banking is a business entity that provides services in the payment traffic and circulation of money in the world. Islamic bank is a bank that conducts business activities based on Islamic principles, namely the rules of the agreement based on Islamic law between banks and other parties to finance business activities and / or deposit funds and other activities. The method used in this research is the normative method, namely legal research which is carried out by examining library materials or secondary data using a statutory approach, a conceptual approach and a comparative approach. The sources of data obtained are secondary data sources that come from literature studies by reviewing, analyzing and processing literature, laws and regulations, journals, articles, and writings related to Islamic banks and conventional banks. The results show that there is an urgency for the existence of Islamic and conventional banking in Indonesia in accordance with the interests of society.*

**Keywords :** *Islamic banking, Conventional banking, Comparative study*

## 1. Introduction

Banking has an important role in the development of a country's economy. Banking in general can move the wheels of the economy. Banking is a business entity that provides financing and services in payment traffic and money circulation in the world. Law Number 14 of 1967 concerning Banking Principles explains that a bank is a financial institution where the main business is providing services and credit in the traffic of money circulation and payments, while a financial institution is an entity whose activities are in the financial sector, namely channeling and withdrawing money from / to the community. Act Number 7 of 1992 concerning Banking provides that a bank is a business entity whose activities are to channel funds to the public and collect funds from the public in the form of savings in order to improve the people's standard of living. In this law, there is no definition of a financial institution as stated in Law Number 14 of 1967

Sharia bank is a bank that conducts business activities based on sharia principles, namely the rules of the agreement based on Islamic law between banks and other parties to finance business activities and / or deposit funds and other

activities.<sup>1</sup>Islamic banks consist of Sharia Rural Banks and Sharia Commercial Banks. In essence, Islamic banks are different from conventional banks. The main difference is seen in the operating bases used by both Islamic banks and conventional banks. If an Islamic bank operates on a profit-sharing basis and is added by buying and selling and renting, it is different from conventional banks which operate on an interest basis.

Islamic banking in Indonesia itself began to develop on May 1, 1992, namely since the establishment of Bank Muamalat Indonesia (BMI).<sup>2</sup>Islamic banks are considered capable of meeting the needs of people who need banking services in accordance with the principles of sharia based on their Islamic religion. Currently, the existence of Islamic banking in Indonesia is increasing since the existence of Law Number 21 of 2008 concerning Islamic Banking which provides a clearer operational basis for Islamic banks. Broadly speaking, economic development activities cannot be separated from the banking sector, both Islamic banking and conventional banking, because banks play an important role in the growth of economic stability. If banks are unable to carry out their proper functions, this will have an impact on economic growth which in turn can hinder Indonesia's national development in particular.

## **2. Research methods**

### **2.1. Types of research**

This research adopts a type of normative legal research which can be interpreted as legal research conducted by examining secondary data or library materials. Normative legal research is also called doctrinal legal research which can be interpreted as library research because this research is aimed at written regulations so that this research is closely related to literature because it will require secondary data.

### **2.2. Research Approach**

In accordance with the type of research, namely normative legal research, the approach method used in this study is the statutory approach, the conceptual approach and the comparative approach. The statutory approach is carried out by reviewing all laws and regulations regarding a legal issue, in this case concerning Islamic banking and conventional banking. The conceptual approach is carried out by linking a legal issue which in this case is about Islamic banks and conventional banks with the underlying concepts. Then the last one is the comparative approach which is carried out by comparing the two legal issues, namely comparing between Islamic banks and conventional banks.

### **2.3. Data source**

Sources of data obtained in this study are secondary data, where the main activity carried out is literature study. Secondary data is data obtained from literature studies by reviewing, analyzing and processing literature, laws and regulations, journals, articles, and writings related to Islamic banks and conventional banks.

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<sup>1</sup> Ascarya and Diana Yumanita, "Islamic Bank (Overview)", (Jakarta: Center for Education and Central Banking Studies (PPSK), 2005, p. 1

<sup>2</sup> Sri Muliawati, Thesis: "Determinants of the Profitability of Islamic Banks in Indonesia", (Semarang: UNNES, 2015), p. 1

## 2.4. Data analysis

The data analysis technique used is descriptive qualitative data analysis technique. The data analysis technique is descriptive qualitative, namely the method of data analysis by grouping and selecting data obtained from literature studies, namely searching for information through books, scientific journals, literature, scientific essays, scientific papers and other sources either in written form or in the form of non-written, such as digital formats that are relevant and related to the object being studied, namely regarding Islamic banks and conventional banks.

## 3. Discussion

### 3.1 The Urgency of the Existence of Sharia Banks in Indonesia

#### a. Prospects for the Development of Sharia Banks in Indonesia

Sharia banks are banks that carry out business activities based on sharia principles, especially those that are free from interest (usury) to collect funds from the public in the form of deposits and channel them to the public in the form of credit or other purposes to support the implementation of national development in order to increase the distribution of welfare the Indonesian people in particular. A narrower concept regarding Islamic banks, namely interest-free banks, which indicates that Islamic banks, both in terms of their instruments and / or operations, are free of interest (usury). Islamic banking in the legislation in Indonesia is contained in Law Number 21 of 2008 concerning Sharia Banks which provides confidence to people who are still doubting the operations of Islamic banks. Law Number 21 of 2008 contains provisions concerning the implementation of sharia, types of business, distribution of funds, business feasibility and prohibitions for Islamic banks and Sharia Business Units (UUS). Law Number 21 of 2008 specifically discusses Islamic banking as a government effort to strengthen the contribution of Islamic financial institutions in strengthening national development.

Islamic banks have two main functions in the banking sector especially in Indonesia, namely as a social body and as a business entity. As a business entity, Islamic banks act as investors, investment managers and service providers. As investors, Islamic banks transfer funds through investment activities with the basic principles of Islamic banks, namely profit sharing, buying and selling and leasing. As investment managers, Islamic banks also source funds from their customers on the principle of deposit, profit sharing and leasing. Islamic banks provide financial services, non-financial services as well as agency services carried out on the principle of bank guarantees, debt transfer, mandating, pawning and benevolence loans used for bailout funds. Islamic banks are banks that use a profit sharing system rather than an interest system as the basis for the operation of the operating system both in mobilizing funds and distributing funds (financing). In addition to profit sharing, Islamic banks also use the principle of non-profit sharing and mobilization of funds. Broadly speaking, the business activities of Islamic banks are divided into channeling funds, raising funds, providing services and social activities. In fact, the Islamic banking financial industry is experiencing a faster development in Indonesia when compared to other countries. In general, the customers of Islamic banks in

Indonesia are not that big. If we look at BI's Islamic banking statistics, as of April 2013 the total assets of Islamic banking have reached 207,800 trillion rupiah.<sup>3</sup> The pioneer of the establishment of a bank based on Islamic law in Indonesia starting in 1991 was the Muamalat bank. Bank Muamalat is an example for other Islamic banks that have already implemented this system in the midst of the proliferation of conventional banks. In 1998, there was a monetary crisis in Indonesia which led to the sinking of conventional banks due to failure in the interest system. However, this does not apply to Islamic banks so that they can still show their existence and be able to survive. Then not only that, in 2008 there was a global crisis that hit the world but this still did not apply to the development of conventional banks. The condition of Islamic banking remains stable and provides many advantages, such as benefits, convenience, and security for both securities holders, borrowers and depositors of funds as well as shareholders in Islamic banking. This shows that Islamic banks are able to adapt in any condition. Islamic banks have different institutions from conventional banks. Islamic banks consist of Islamic commercial banks, Islamic people's credit banks and Islamic business units. Outside the bank there are Bank Indonesia, the sharia supervisory board, the national sharia board and the national sharia arbitration body.

#### **1) Sharia Commercial Bank**

Sharia commercial banks are business entities equivalent to conventional commercial banks with the legal form of PT, cooperatives or regional companies. Islamic commercial banks in carrying out their activities provide services in the form of payment traffic based on sharia principles. Islamic commercial banks operate as non-foreign exchange banks and foreign exchange banks such as conventional commercial banks.

#### **2) Sharia Rural Bank**

Sharia rural credit banks are business entities whose activities do not provide payment services and are carried out according to sharia principles. The activities of Islamic rural banks are narrower than those of Islamic commercial banks because Islamic rural credit banks are prohibited from accepting insurance, current accounts and foreign exchange activities. Sharia people's credit banks are banks that are equivalent to conventional people's credit banks, where the legal form is PT, cooperative or regional company. The business activities of rural credit banks are:

- a) Give credit.
- b) Provide financing and placement of funds based on sharia principles in accordance with the provisions made by Bank Indonesia.
- c) Collecting funds from activities carried out by the community in the form of savings in the form of savings, time deposits and others.

#### **3) Sharia Business Unit**

Sharia Business Unit (UUS) is a unit that functions as the main office of an office carrying out business activities based on sharia principles, which is a

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<sup>3</sup> Yayan Alfian Nugraha, "Bank Syari'ah (Weaknesses and Strengths)" (Attack: Indonesian Banking and Accounting Academy), Revenue Scientific Journal, Vol 1, No 1, 2015

work unit of the head office of a Conventional Commercial Bank. Sharia business units are tasked with:

- a) Manage and supervise the activities of sharia branch offices.
- b) Collecting funds in the form of savings, in the form of demand deposits and other forms that do not conflict with sharia principles.
- c) Collecting funds in the form of investments in the form of savings, deposits, and other forms that are not against sharia principles.

## **b. Strengths and Weaknesses of Islamic Banks**

### **1) Advantages**

- a) Support from the government, especially from the banking authority (Bank Indonesia) for the development of Islamic banks, can be seen in a number of applicable regulations in Indonesia such as Law Number 7 of 1992 and Government Regulation Number 72 of 1992 concerning banks based on the principle of profit sharing which is an opportunity. establishment of a bank with a profit sharing system and other laws and regulations.
- b) The majority of indigenous Indonesians are Muslims. Seeing a situation like this makes a more potential market prospect. The presence of Islamic banks is eagerly awaited by the Indonesian people in general.
- c) The concept inherent in Islamic banks is in accordance with development needs.<sup>4</sup>
- d) Islamic banks use a profit sharing system which is inversely proportional to the interest system which aims to improve the welfare of many people, not to get the maximum profit.

### **2) Weakness**

- a) The low level of public understanding of the products and benefits of Islamic banking.
- b) The Islamic banking service network is still limited because it has not reached all the central economic services in Indonesia.
- c) In general, the success of the profit-sharing system implemented by Islamic banking depends on the honesty of the customer and is very vulnerable to good-faith customers.
- d) Requires accuracy in calculating the profit sharing system when compared to conventional banks that use the interest system.

## **3.2 The Urgency of Conventional Banks in Indonesia**

### **a. Prospects for Conventional Bank Development in Indonesia**

When discussing the principles and mechanisms of conventional banks, these cannot be separated by their duties and functions, namely as an intermediary institution between debtors and creditors in terms of withdrawing and channeling funds from the public using the interest mechanism. In carrying out its operations as an intermediary institution, its main activity is to provide services in the circulation of money and payments, banking products and services as well as providing credit. As stipulated in Law Number 7 of 1992, in Indonesia there are two types of banks with different types of business, namely:

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<sup>4</sup> Antono, Muhammad Syafi'i, *Islamic Bank Jakarta: Gema Insani*, 2001

**1) commercial banks**

Based on Law Number 7 of 1992, commercial bank businesses include:

- a) Give credit.
- b) Collecting funds from the public in the form of demand deposits, certificates of deposit, time deposits, savings and other forms.
- c) Lending funds and placing by letter.
- d) Transferring funds both for the benefit of customers and for their own interests.

**2) rural banks**

Law Number 7 of 1992 describes the people's credit bank business, namely:

- a) Give credit.
- b) Raising funds from the public in the form of deposits in the form of savings, time deposits and other forms.
- c) Placing funds in the form of Bank Indonesia Certificates, certificates of deposit, time deposits and savings with other banks.

**b. Strengths and Weaknesses of Conventional Banks**

**1) Advantages**

- a) Conventional banks tend to be more diverse. Conventional banks tend to be more creative in creating products with proven and experienced methods. For example, conventional banks apply an interest system when customers make savings or borrow transactions.
- b) Conventional banks tend to know the game of the banking market and look for new gaps in pursuing its expansion.
- c) In general, customers are more familiar with the interest system applied to conventional banks. Conventional banks are easier to get venture capital.
- d) Conventional banks receive support from the government in the form of laws and regulations and more established government policies so that they can move more confidently.
- e) Conventional banks developed first in Indonesia so that the interest system was introduced to the Indonesian public first.

**2) Weakness**

- a) Conventional banks use an interest system which is prohibited in Islam because it is considered usury.
- b) In general, the flowers that are applied are sometimes so large. This can make customers think twice about opening an account or savings at a conventional bank.
- c) The rise of fraudulent practices such as fictitious transactions and banks within the bank.
- d) The rise in non-performing loans is due to the accumulation of credit in certain circles and the procedure for providing credit tends to be disobeyed.
- e) The rampant practice of calculating and too ambitious speculation.

### 3.3 Comparison of Sharia Banking with Conventional Banking

#### a. Equation

In general, the similarities between Islamic banks and conventional banks can be seen in the following aspects:

- a) Money acceptance techniques.
- b) Transfer mechanism.
- c) Computer technology used.

#### b. Difference

In general, the differences between Islamic banks and conventional banks can be seen in the following table:

**Table 1**

Difference between Islamic Bank and Conventional Bank

No.	Difference Orientation	Islamic Bank	Conventional Bank
1	Basic principles	Anti-usury and anti-maysir	Not anti-usury and anti-maysir
2	Orientation	Public interest	Personal interests
3	Shape	Islamic socio-economic goals, profit	Advantage
4	Bank Functions and Activities	Intermediation, Investment Manager, Investor, Social and Financial Services	Intermediation and Financial Services
5	Service Priorities	<ul style="list-style-type: none"> <li>- Islamic sharia principles</li> <li>- Money as a medium of exchange is not a commodity</li> <li>- Profit sharing, buying and selling and leasing systems</li> </ul>	<ul style="list-style-type: none"> <li>- Materialist principles</li> <li>- Money as a commodity</li> <li>- Flower system</li> </ul>
6	Loans granted	Limited	Money market and central bank
7	Customer Relations	Be more careful because of participation in risk	<i>Creditworthiness and Collateral</i>
8	Sources of Short-Term Liquidity	As a business partner	Limited to debtors
9	Dispute Resolution Institution	Commercial and Noncommercial, oriented to non-profit and profit	Commercial and Noncommercial, oriented for profit

Source: Yumanita, D., (2005). Sharia Bank: Overview. (Jakarta: Bank Indonesia Center for Education and Central Banking Studies).

#### **4. Conclusion**

From the description that has been presented, it can be concluded that both Islamic banks and conventional banks have an urgency for their existence in accordance with the goals and interests of their customers. Based on the principle of operationalization of existing transactions in Islamic banks and conventional banks, it can be concluded that although they have similarities between providing benefits to fund owners, the profit sharing system and the interest system have differences according to their respective urgencies. In essence, the profit sharing system, which is an instrument of Islamic banks, and the interest system, which is an instrument of conventional banks, are two different things, both from a technical point of view and in essence.

The most basic difference can be seen in the philosophy adopted by the two. Islamic banks do not implement the interest system because it is considered usury, Islamic banks use a profit-sharing system plus buying and selling and leasing. Islamic banks do not use interest as a tool to gain profit. Therefore, Islamic banks have a function to invest public funds according to Islamic recommendations in a productive and effective manner and develop these savings. Of course this is inversely proportional to conventional banks which adopt an interest system where one of the objectives is to seek maximum profit. In terms of responsibility, Islamic banks are obliged to issue zakat and manage it, whereas this does not exist in conventional banks. Then the difference can be seen in the second operational system, the funds entrusted to Islamic banks are in the form of investments or deposits. This is also inversely proportional to conventional banks that use deposits for the purpose of generating money. Between Islamic banks and conventional banks have similarities in terms of transfer mechanisms, technology used, technical acceptance of money and general terms of obtaining financing. The most basic difference is regarding the system for getting a profit / profit. Between Islamic banks and conventional banks have similarities in terms of transfer mechanisms, technology used, technical acceptance of money and general terms of obtaining financing. The most basic difference is regarding the system for obtaining a profit / profit. Between Islamic banks and conventional banks have similarities in terms of transfer mechanisms, technology used, technical acceptance of money and general terms of obtaining financing. The most basic difference is regarding the system for getting a profit / profit.

Basically, Islamic banks have enormous potential to develop, especially in Indonesia. Islamic banks are very suitable to encourage the progress of the Indonesian economy from an asset perspective. However, when viewed in terms of service quality, Islamic banks must catch up with conventional banks that have already been established. Then to produce professional competition between the two, a special sharia banking regulation, namely Law Number 21 of 2008, makes Islamic banking able to carry out its duties without having to refer to conventional banking regulations.



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