

## A COMPARATIVE ANALYSIS OF OPERATIONAL PRINCIPLES IN ISLAMIC AND CONVENTIONAL BANKING



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### ABSTRACT

*This article aims to explore & compare the operational principles of Islamic Banking (IB) & Conventional Banking (CB) to enhance awareness & deepen understanding of IB, with the further goal of establishing a foundation for the development of joint IB & CB products in Latvia. The study investigates a comparative analysis of IB & CB operational principles is conducted through a systematic literature review highlighting key similarities & differences. Data was sourced from various electronic databases, with no restrictions on selecting papers based on the authors' religious backgrounds or countries of origin. The results show four key areas of similarity between IB & CB: both are financial institutions, operate globally adhere to principles of corporate social responsibility, & are regulated by central banks. However, nine significant differences were observed concerning: the use of interest in capital allocation, profit & loss sharing mechanisms, regulatory frameworks, the influence of religious principles, conditions for current & savings accounts, investment opportunities & types, financing & insurance practices, security requirements, and late payment charges of funding. These findings help to understand the operational principles distinguishing IB from CB. This knowledge is valuable to researchers and potential clients of IB & CB to enhance their awareness & motivation to explore IB & CB products & services, and it enable them to make informed & flexible choices between the two banking systems based on their current needs interests, & goals. The study also explores pathways for collaboration between the banking systems proposing a customer-centric banking philosophy.*

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### INTRODUCTION

The global financial sector serves as the backbone of economic development, with banking systems playing a pivotal role in facilitating growth. While conventional banking (CB) dominates the financial landscape, Islamic banking (IB) has emerged as a distinctive system catering to both Muslim and non-Muslim populations through its Shariah-compliant principles (Siddiqi, 2006). Operating in over 80 countries, IB has gained traction in dual-banking systems, particularly in Malaysia, Indonesia, and GCC nations, where Islamic windows in CB bridge the gap between the two systems (Aysan et al., 2018; Hamedian, 2013).

IB's operational framework fundamentally diverges from CB, most notably through its prohibition of *riba* (interest) and emphasis on profit-and-loss sharing (PLS) models (Abdelsalam et al., 2014; Aris et al., 2013). Additional distinctions include Shariah-based governance (Dusuki & Abdullah, 2007), unique savings and investment products (Hanif, 2014), and differentiated regulatory oversight (Ariss, 2010). These principles not only align with ethical finance but also contribute to IB's resilience during financial crises, as evidenced by lower exposure to speculative risks (Beck et al., 2013).

Despite its niche market share, IB's appeal extends beyond religious compliance, attracting customers through innovative products like Sukuk (Islamic bonds) and Musharakah-based financing (Musa et al., 2020). However, limited awareness of IB's operational mechanisms persists, particularly in non-Muslim-majority regions. This study addresses this gap by systematically analyzing IB and CB's operational principles, products, and performance through a literature review. The findings aim to enhance stakeholder understanding, inform policy discussions on financial integration, and guide

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customers in making informed banking choices. The paper is structured as follows: Section 2 reviews extant literature; Section 3 outlines the methodology; Section 4 presents results and discussion; and Section 5 concludes with implications for researchers, practitioners, and regulators.

## LITERATURE REVIEW

IB aims to attract both Muslim & non-Muslim customers by offering high-quality products & services that differ from those provided by CB. Various methods are used in practice to compare the differences & similarities between IB & CB. The key similarities are outlined below.

### Similarities of IB & CB

#### *Both Operate as Financial Institutions*

IB & CB are comparable in their role of supporting economic growth by providing financial services such as credit facilities for business operations, mortgages, and securities. Both aim to achieve their shared ultimate objective of profitability (Aggarwal & Yousef, 2000; Johnes et al., 2014; Lewis & Algaoud, 2001; Ganouati & Essid, 2017).

#### *Both Operate Globally & Enjoy Widespread Popularity*

IB is emerging in Western economies, a new and evolving phenomenon that was not previously observed. This trend is driven by the increasing demand for Shariah-compliant goods & services (Ledhem & Mekidiche, 2020). Therefore, central banks are working to develop IB windows within CB (Abedifar et al., 2013; Carruthers, 2008; Chiu et al., 2005; Odeduntan et al., 2016). IB products & services are not limited to Muslim-majority nations. While IB caters to the needs of both Muslim and non-Muslim countries, it is increasingly seen as a competitor to CB (Bitar et al., 2017; Hanif, 2014; Khan et al., 2015; Wouters, 2007).

Both CB & IB are open to all shareholders. IB offers products and services not only to Muslim clients but also to individuals from diverse cultural backgrounds. The UK is working to establish London as a global hub for Islamic Banking. As part of their diversification efforts, an increasing number of foreign banks are entering the IB market (Ariss, 2010; Doumpou et al., 2017).

#### *Operating Based On the Principles of Corporate Social Responsibility (CSR)*

Branco & Rodrigues assert that corporate social responsibility (CSR) encompasses social & environmental policies aimed at strengthening relationships with customers. Customers expect CSR from their banks, as it fosters social standards & ethical values, prioritizing them over profit (Beck et al., 2013; Branco & Rodrigues, 2007). Banks avoid funding businesses that violate human rights or contribute to environmental harm (Ullah & Jamali, 2010).

It has been demonstrated that both IB & CB have much to offer in terms of corporate social responsibility (CSR). Islamic financial instruments, such as obligatory charity (zakat), voluntary charity (sadaqat), and perpetual endowment (waqf), have historically been used to finance social initiatives and support those in need. These instruments play a significant role in the creation of public amenities and services, facilitating government efforts to raise funds for public expenditures. They are believed to have a profoundly positive impact on a country's moral, social, and economic well-being (Rahim Abdul Rahman, 2010).

As noted by El-Gamal, IB is rooted in the core values of Islam, which emphasize fairness, equality, social justice, and a strong commitment to safeguarding the well-being of future generations through environmental protection and the responsible management of the earth's valuable natural resources (El-Gamal, 2008).

A global demand for CB to adopt corporate social responsibility (CSR) practices has emerged. CB supports educational, cultural, environmental, and health-related initiatives to promote CSR (Polychronidou et al., 2014). By offering sustainable financial products & services & implementing social & ecological initiatives, CB plays a crucial role in supporting sustainability (Kumar & Prakash, 2019).

#### *The Regulations Set By Central Banks Govern Both Islamic Banking (IB) & Conventional Banking (CB)*

Both CB & IB operate by central bank regulations. These regulatory frameworks ensure financial stability, efficient risk management, & legal compliance of both types of institutions. Additionally, IB is governed by Shariah law, which mandates adherence to specific Islamic principles, such as prohibiting the charging of interest (riba) and promoting profit-sharing arrangements (Central Bank of Malaysia, 2020). A summary of the similarities between IB & CB is provided in Table 1.

Table 1. Similarities of Islamic & Conventional Banking

No.	Domain	IB		CB	
		Sources	Common aspects	Sources	
1	Both are financial institutions	Aggarwal & Yousef, 2000; Lewis & Algaoud, 2001; Ganouati & Essid, 2017	Both IB & CB provide financing services	Aggarwal & Yousef, 2000; Johnes et al., 2014;	
2	Operating & having high popularity worldwide	Carruthers, 2008; Chiu et al., 2005; Abedifar et al., 2013; Khan et al., 2015; Bitar et al., 2017; Ariss, 2010; Doumpou et al., 2017;	Both IB & CB operate worldwide in Muslim & Non-Muslim countries.	Odeduntan et al., 2016; Hanif, 2014; Wouters, 2007; Ledhem & Mekidiche, 2020	
3	Operating based on	Beck et al., 2013; Ullah &	Both IB & CB participate in	Branco & Rodrigues, 2007; El-Gamal, 2008;	

	principles of CSR	Jamali, 2010; Rahim Addul Rahman, 2010;	social well-being activities & provide CSR to customers.	Polychronidou et al., 2014; Kumar & Prakash, 2019
4	The regulations of central banks govern both.	Central Bank of Malaysia, 2020;	Both IB & CB operate under the regulations established by central banks.	Central Bank of Malaysia, 2020

Thus, despite originating from different backgrounds with distinct philosophies, both IB & CB aim to serve the interests of their clients, promote social well-being, support charity, and advance human values.

## Key Differences between IB & CB

### *Interest in Capital Usage*

IB differs from CB in its approach to interest. Based on the principles of Islam, which forbids interest (Riba), IB operates as an interest-free banking system (Oladimeji et al., 2015; Salman & Nawaz, 2018; Worthington & Gait, 2007). In IB operations, Shariah law prohibits the payment or acceptance of interest fees (Al-Augby et al., 2015; Beck et al., 2013; Musa & Musová, 2010). Interest-based transactions are prohibited in IB because interest payments are viewed as exploiting the poor for the benefit of the wealthy. IB operates as a trade-oriented institution, making decisions based on equity rather than interest. Under Shariah law, IB forbids charging interest on loans for both business and personal purposes (Abdelsalam et al., 2014; Sobol, 2015).

CB, on the other hand, is based on interest, with charging interest on loans being a core principle of its operations (Asni, 2021; Hanif, 2014; Salman & Nawaz, 2018;). Interest serves as the primary source of income & funding for CB, as it operates according to the principles of capitalism & charges interest on transactions (Hanif, 2014; Jubilee et al., 2021;). In the context of savings accounts, a return is guaranteed through a fixed interest rate specified in the deposit certificate (Mohanty & Saini, 2014). In CB, the investor is repaid in the form of interest, with a fixed interest rate. The beneficiary is held accountable for any risks associated with financing activities (Odeduntan et al., 2016).

### *Profit & Loss Sharing*

Various researchers have highlighted that IB & CB are fundamentally different. IB operates on a PLS model as an alternative to interest, whereas CB lenders transfer risk to borrowers. This distinction grants IB depositors some ownership rights in IB products and services and introduces the concept of partnership (Abdelsalam et al., 2014; Aris et al., 2013; Bitar et al., 2020; Hasan & Dridi, 2011; Lassoued, 2018). IB bases its operations on PLS. Since profit and loss fluctuate, IB does not have control over them. The objectives of IB are to maximize profit, share risk by Shariah laws & regulations, & promote wealth distribution (Kaleem & Isa, 2003; Rashid, 2007). Investment accounts in IB are operated solely under the PLS model, which provides no guarantees for capital or pre-fixed returns (Odeduntan et al., 2016).

The primary goal of CB is to maximize profit, without the use of PLS in partnership with customers (Aris et al., 2013; Odeduntan et al., 2016; Mohanty & Saini, 2014). CB receives a fixed amount of interest from the borrower & pays a fixed amount of interest to depositors (Rashid, 2007). CB offers loans exclusively to its customers, with the loan agreement carrying the sole risk of borrower default. CB does not assume any financial risks, instead leaving them to the borrowers (Hasan & Dridi, 2011; Hanif, 2014; Bitar et al., 2020).

### *Regulatory Bodies*

A robust legal framework is essential for the safe and secure development of IB. Since IB operates across different countries with varying legal environments, which reflect diverse legal traditions & differing interpretations of Shariah as a source of law, various jurisdictions have adopted different approaches to developing the legal framework that supports IB operations (Song & Oosthuizen, 2014). IB is governed by the Shariah Supervisory Board, composed of Islamic scholars, and is considered the cornerstone of IB operations. Additionally, the country's central bank plays a key role by implementing new laws in jurisdictions where both CB & IB operate (Salman & Nawaz, 2018; Kazmi, 2001; Ariss, 2010). IB must implement and uphold Shariah governance to maintain the trust of all stakeholders. Shariah laws govern every aspect of a Muslim's religious practices and economic activities (Farook & Farooq, 2011; Hasan & Dridi, 2011).

Technical Committees & the Accounting & Auditing Organization for Islamic Financial Institutions (AAOIFI) play crucial roles. Shariah Committees ensure that the operations of financial institutions comply with Islamic law by providing oversight & guidance. Additionally, AAOIFI sets standards for the governance, auditing, & accounting practices of Islamic financial institutions (AAOIFI, 2021).

Regulatory bodies overseeing CB vary by country (Anginer et al., 2019). To ensure adherence to Shariah principles in IB, Shariah Committees are established. Meanwhile, the central bank serves as the regulatory body for CB, overseeing its operations in various countries (Salman & Nawaz, 2018). CB adheres to commercial rules & regulations governing banking activities (Ahmad & Hassan, 2007).

### *Impact of Religion on Banking Principles*

IB principles are derived from the Holy Quran (the words of Allah) & the Sunnah (the actions of the Prophet Muhammad) (Akmansyah, 2015). IB was established based on Islamic principles, & its operations must fully comply with Shariah law (Asni, 2021; Hanif, 2014). The Quran contains several verses related to interest, revealed at different times. The system of IB is grounded in high moral values, & it is prohibited to invest in areas forbidden in Islam, such as alcohol, speculation, interest, illegal activities, human trafficking, & gambling (Odeduntan et al., 2016).

In contrast, the financial activities conducted by CB are not influenced by religious principles (Munro, 2012). However, CB makes financial decisions to support sustainable & responsible businesses, inspire & empower young people, & promote economic equality, green investments, & education (Haddad, 2023; Kazmi, 2001; Munro, 2012; Ofurum & Chinyere, 2007). Thus, CB was established based on commercial principles (Hanif, 2014;)

### ***Conditions for Current & Savings Accounts***

Under the current account principle, the IB receives the deposit, with the depositor granting permission for the IB to use the funds in ways that comply with Shariah law, assuming the risk. If the depositor requests the return of the principal amount, IB is required to refund it. Unlike CB, IB does not charge fees for maintaining a current account. For savings accounts, depositors allow the IB to invest the funds in Shariah-compliant businesses. Profits are shared between the depositors and the IB based on a pre-agreed ratio, while losses are shared in proportion to the amount invested (Demirgüç-Kunt et al., 2014; Kaleem & Isa, 2003; Qaed & Qaed, 2014). IB accepts deposits from customers in current accounts for safekeeping & in savings accounts for investment through "Musharakah" (partnership among investors) & "Mudarabah" (partnership between the investor & the bank), where both risk & reward are shared with customers (Chong & Liu, 2009; Hanif, 2014). IB does not charge interest (Riba) on interbank deposits, nor does it receive or pay predetermined interest to borrowers & depositors in the case of current & savings accounts (Rahman, 2007; Santos, 2000).

CB primarily offers two types of accounts: current & savings accounts. Additionally, in some countries (such as India, Hungary, Georgia, Uzbekistan, Zimbabwe, etc.), a third type, the fixed deposit account, is available. A fixed deposit is a term deposit that provides a fixed interest rate upon maturity and typically offers a higher interest rate compared to a regular savings account (Ismail, 2020). CB creates money by receiving deposits from depositors under the terms of savings accounts at a low interest rate & then lending those funds to borrowers at a higher interest rate (Santos, 2000; Rahman, 2007). In CB, interest is predetermined & fixed for current & savings accounts (Hanif, 2014). CB operates under the lender-borrower model, where interest is viewed as the cost of capital (Mohanty & Saini, 2014).

### ***Opportunities & Types of Investments Products & Services (Equity-Based Financing)***

IB investments are based on risk-sharing between the capital provider (the investor) and the fund user (the entrepreneur). "Mudarabah" (profit & loss sharing) is an equity-based PLS contract in which investment is provided by one party, known as the "rabb-ul-mal" (financier). In contrast, the other party, the "Mudarib" (entrepreneur), is solely responsible for managing the business. The financier provides oversight, with the IB conducting audits through the technical & Shariah committees to monitor the business's progress. In the event of losses, the financier bears the financial loss, while the entrepreneur only loses their time and effort, unless the loss results from the entrepreneur's negligence or misconduct. Profits are shared according to a pre-agreed ratio, which may be, for example, 70% (investor) to 30% (entrepreneur) or 80% (investor) to 20% (entrepreneur) (Demirgüç-Kunt et al., 2014; Gunpath, 2014; Yurista & Ardi, 2020).

Musharaka is a partnership arrangement used in Islamic finance, where two or more parties contribute capital to a business venture & share the profits based on a pre-agreed ratio. It is a profit-sharing, equity-based contract (Ben Amar & El Alaoui, 2023; Lewis & Algaoud, 2001). "Musharakah" (partnership) is the most sought-after type of investment in Islamic finance. It satisfies all essential Shariah requirements, including the prohibition of interest, the presence of PLS, & the direct connection of investments to underlying asset-based transactions (Gunpath, 2014).

Investments in IB involve various risks, including price fluctuations, technological challenges, transportation issues, security concerns, & foreign exchange volatility, in addition to credit risk. Unlike CB, IB cannot invest in government securities, short-term loans, bonds, or money market instruments due to the prohibition of interest-based transactions (Hanif, 2014). In the IB, investors can allocate their investment to a specified type of portfolio according to their preferences (Mohanty & Saini, 2014). If a Muslim investor places funds in a firm that engages in activities prohibited by Shariah laws, they must promptly withdraw their investment. Investment behavior in IB is governed by four fundamental principles: the prohibition of interest (Riba), avoidance of speculative activities, adherence to Islamic tax (Zakat), and the prohibition of producing or supporting goods and services that conflict with Islamic values (Haram) (Duran & Garcia-Lopez, 2012; Ullah & Jamali, 2010).

CB offers a wide range of investment options, including government securities, short-term loans, bonds from leasing companies, share investments, and more (Hanif, 2014). In CB, the investment portfolio is determined by the bank's internal policies, with no involvement or decision-making participation from depositors (Mohanty & Saini, 2014). "In CB, investors are assured a fixed rate of return in the form of interest (Hasan & Dridi, 2011). CB provides brokerage services, enabling customers to buy and sell stocks and bonds in the stock market. These investments offer opportunities for capital appreciation & income through dividends or interest payments but come with risks, including market volatility & credit exposure (Beck et al., 2013).

### ***Opportunities & Types of Financing Products & Services (Debt-Based Financing)***

The first Islamic mortgages in Europe were introduced in 1988 by Al Baraka Bank, catering to Gulf Arabs for properties in London. These mortgages were structured using an Ijarah (rental) contract. Under the Murabaha (cost-plus-profit margin) investment contract, IB purchases an asset requested by customer & resells it to the individual or entrepreneur on a fixed price, which include a disclosed profit margin. This transparency in disclosing costs & profits is a key distinction from CB, where such details are not typically disclosed (Chelhi et al., 2017; Lee & Ullah, 2007).

IB entered two contracts in Murabaha transactions. The first contract involves purchasing goods, specifying the initial price, while the second contract involves selling the goods to the customer, explicitly stating the cost and profit



margin. IB assumes all risks of loss or damage to the asset if ownership remains with the bank. Ownership is only transferred to the customer once all payments are completed. Additionally, at the time of the sale agreement, the goods must be physically present; selling non-existent goods is strictly prohibited under Shariah principles (Hanif, 2014; Tayyebi, 2009).

"Ijarah" (lease financing) is a financing product offered by IB. IB exclusively permits operating leases, as Shariah law prohibits capital leases. Under Islamic lease agreements, profit is earned through charging rent rather than interest, which is forbidden. In an Ijarah arrangement, IB retains ownership of the asset while leasing it to the customer. Alternatively, the IB may sublease a tangible asset to the client after leasing it from a third party. Customers can lease various tangible assets, such as property, vehicles, or other tangible items, under an Ijarah agreement, adhering to Shariah-compliant principles (Ali, 2004; Boumediene, 2011; Rafay et al., 2017).

"Bai Salam" & "Istisna" are forward-selling & financing agreements, respectively, between IB & their customers. While both contracts share similarities, Bai Salam (advance payment for purchase) is specifically designed for agricultural products, whereas Istisna (advance payment for manufacturing) is tailored for construction projects. Under a Bai Salam contract, the seller receives full payment upfront at the time of the agreement. The quality and specifications of the product being purchased must be clearly defined, leaving no ambiguity that could lead to disputes. In contrast, an Istisna contract requires the price and specifications of the product to be mutually agreed upon by the manufacturer and the buyer. Additionally, the manufacturer is responsible for procuring the materials needed for production, ensuring the agreed-upon deliverables are met (Ali, 2004; Hanif, 2014; McMillen, 2012).

CB's mode of financing for its customers is based on interest-bearing loans and bonds. In contrast, these categories do not apply to IB, which adheres to Shariah principles and utilizes profit-sharing, leasing, and equity-based instruments instead (Hanif, 2014)—CB deals in both operating and capital leases. Under a capital lease contract, the ownership of the asset remains with CB until all lease payments have been made, at which point it is transferred to the company or individual. In contrast, operating leases grant the lessee the right to use an asset without transferring ownership (Chhapra et al., 2018; Rafay et al., 2017). CB issues credit cards to customers, enabling them to make purchases on credit & repay the balance over time. Additionally, CB offers wealth management services, including financial planning, investment management, & estate planning (Valls Martínez et al., 2020).

#### ***Opportunities & Types of Insurance Products & Services (Socially Driven Tools)***

The "Takaful" contract is a form of Islamic insurance where members pool their funds to protect each other against loss or injury, with mutual risk shared among participants. "Takaful" emphasizes cooperation & mutual support. It covers various types of insurance, including health, life, & other forms of protection (Anwar, 2008; Stagg-Macey, 2007; Tolefat, 2006; Zainordin et al., 2018). Profit generation is not the primary goal of "Takaful" (insurance). Instead, its primary purpose is to provide equity and support to all participants during times of difficulty (Maysami & Kwon, 1999). "Takaful" insurance has gained popularity not only as an innovative financial instrument but also for religious reasons. These insurance contracts provide solidarity in times of personal tragedy, business loss, or property damage. The Islamic insurance model is grounded in the core principles of cooperation & solidarity, as outlined in the Holy Quran (Ferguson, 2008). Every "Takaful" (insurance) policyholder has the right to understand how their money is being spent & must be assured that neither returns nor funds paid out in claim settlements are derived from illegal means, such as investments in companies that produce non-halal products (Arbouna, 2000).

"Qard al-Hasan" (benevolent loan) is an interest-free, and in some countries, collateral-free loan designed to assist individuals and students in need of financial support. Each country has its own loan regulation procedures. Since the borrower is only required to repay the principal amount, this loan does not provide any financial benefit to the IB (Aderemi & Ishak, 2023; Al-Mubarak & Osmani, 2010; Ghannadian & Goswami, 2004).

The primary goal of conventional insurance is to minimize the risk of one party, the insured, by transferring specific risks to another party, the insurer. It operates on the principle of compensating for losses in exchange for a premium paid by the insured (Anwar, 2008). Conventional insurance does not follow religious tenets, and policyholders are not informed about how their premiums are utilized. Additionally, the insured loses their premiums if the policy is terminated (Arbouna, 2000; Maysami & Kwon, 1999; Willis, 2007).

#### ***Security Requirements for Financing & Additional Late Payment Charges***

In IB, collateral is required for non-PLS products. However, for PLS products, collateral is only needed in exceptional cases to prevent willful default by the borrower. The regulations regarding collateral may vary by country (Mohanty & Saini, 2014). IB does not plan to charge defaulters additional fees. However, in the case of late payments, IB charges a late payment fee to encourage clients to meet payment deadlines.

In CB, collateral plays a crucial role in the credit mechanism as it helps determine a borrower's eligibility (Mohanty & Saini, 2014). CB lends to individuals & firms that can provide the necessary collateral & have sufficient internal savings to service the debt (Chhapra et al., 2018). In regular business, CB does not waive overdue payment charges, as charging interest generates additional financial benefits for the bank (Ahmad & Hassan, 2007). CB charges additional interest when customers fail to make their installment payments within the specified period (Asni, 2021).

The finalization of the analysis of differences between IB & CB is shown in Table 2.

Table 2. Differences between Islamic vs. Conventional banking

No.	Domains	Islamic banking		Conventional banking	
		Sources	Specific aspects	Specific aspects	Sources
1	Interest on capital usage	Salman & Nawaz, 2018; Oladimeji et al., 2015; Worthington & Gait, 2007; Al-Augby et al., 2015; Beck et al., 2013; Musa & Musová, 2010; Abdelsalam et al., 2014; Sobol, 2015	IB does not charge interest on operations, loans, and financial transactions.	CB charges interest on loans, transactions, and investments.	Asni, 2021; Salman & Nawaz, 2018; Jubilee et al., 2021; Hanif, 2014; Odeduntan et al., 2016; Mohanty & Saini, 2014;
2	PLS	Lassoued, 2018; Hasan & Dridi, 2011; Bitar et al., 2020; Aris et al., 2013; Abdelsalam et al., 2014; Rashid, 2007; Kaleem & Isa, 2003; Odeduntan et al., 2016;	IB finance, trading, and investments are based on PLS.	CB receives & pays fixed interest on the loan.	Aris et al., 2013; Rashid, 2007; Hasan & Dridi, 2011; Hanif, 2014; Bitar et al., 2020; Odeduntan et al., 2016; Mohanty & Saini, 2014
3	Regulatory bodies	Song & Oosthuizen, 2014; Salman & Nawaz, 2018; Kazmi, 2001; Ariss, 2010; Farook & Farooq, 2011; Hasan & Dridi, 2011	The Central Bank, Shariah committees, and organizations like AAOIFI regulate IB.	The central bank governs the CB.	Salman & Nawaz, 2018; Ahmad & Hassan, 2007; Anginer et al., 2019
4	Impact of religion on banking principles	Akmansyah, 2015; Dusuki & Abdullah, 2007; Hanif, 2014; Odeduntan et al., 2016; Kazmi, 2001; Asni, 2021	IB aspects, operations, and investments are based on the religion of Islam.	CB was established under commercial principles.	Munro, 2012; Haddad, 2023; Hanif, 2014; Kazmi, 2001; Ofurum & Chinyere, 2007
5	Conditions for Current & Savings Accounts	Hanif, 2014; Qaed & Qaed, 2014; Kaleem & Isa, 2003; Santos, 2000; Rahman, 2007; Chong & Liu, 2009	IB does not offer interest on interbank deposits, current accounts, or savings accounts.	Interest is predetermined & fixed in the CB on current & savings accounts.	Ismail, 2020; Santos, 2000; Rahman, 2007; Hanif, 2014; Mohanty & Saini, 2014
6	Opportunities & types of investment products & services	Gunpath, 2014; Ben Amar & El Alaoui, 2023; Lewis & Algaoud, 2001	Musharaka is an investment contract where parties share control and profits/losses at a pre-agreed ratio.	In CB, the investor is guaranteed a fixed rate of return.	Hasan & Dridi, 2011; Beck et al., 2013
		Hanif, 2014; Mohanty & Saini, 2014; Ullah & Jamali, 2010; Yurista & Ardi, 2020	Modaraba is a contract where one party provides finance & the other expertise; the financier supervises & bears losses, while the entrepreneur loses only time unless negligent.	CB has a variety of options regarding investments, including government securities, short-term loans, leasing companies' bonds, share investments, & so on.	Hanif, 2014; Mohanty & Saini, 2014
7	Opportunities & types of Financing products & services	Ali, 2004; Rafay et al., 2017; Ghannadian & Goswami 2004; Al-Mubarak & Osmani, 2010; Boumediene, 2011; Aderemi & Ishak, 2023	Ijara financing contracts of IB are interest-free, and according to Shariah laws.	CB has only one type of financing, which is a loan, and charges interest on loans.	Hanif, 2014; Valls Martínez et al., 2020
		Hanif, 2014; Tayyebi, 2009; Chelhi et al., 2017; Duran & Garcia-Lopez, 2012; Lee & Ullah, 2007	In Murabaha, IB buys & resells assets at a profit, bearing all risks until completion.	CB provides diverse investments, but depositors cannot influence investment decisions.	Hanif, 2014; Mohanty & Saini, 2014
		Ali, 2004; Hanif, 2014; McMillen, 2012	Bai Salam & Istisna contracts involve receiving payment in advance & delivering the product later.	CB deals in both types of leases: operating & capital leases	Rafay et al., 2017; Chhapra et al., 2018

8	Opportunities & Types of Insurance Products & Services	Zainordin et al., 2018; Maysami & Kwon, 1999; Anwar, 2008; Stagge-Macey, 2007; Ferguson, 2008; Tolefat, 2006; Arbouna, 2000	Islamic Takaful shares risk among participants, and Qard al-Hasan contracts are interest-free and collateral-free.	Conventional insurance minimizes risk, compensates losses, and ensures premiums upon policy termination.	Maysami & Kwon, 1999; Anwar, 2008; Willis, 2007; Arbouna, 2000
9	Security Requirements & Late Payment Charges	Al-Mubarak & Osmani, 2010; Mohanty & Saini, 2014	IB products are collateral-free, but late payment fees are charged to discipline clients.	CB requires collateral for loans & does not waive late payment charges.	Al-Mubarak & Osmani, 2010; Chhapra et al., 2018; Ahmad & Hassan, 2007; Asni, 2021

The goal of this paper is to inform scholars of the banking sector and the public about the key differences between IB and CB. This will help researchers & potential clients understand which products & services to use in different scenarios, & how to determine which banking system is most suitable for their specific needs. A detailed overview of these differences is provided in Table 2, as outlined in this chapter.

## MATERIALS AND METHODS

This study employs a qualitative systematic literature review (SLR) to analyze research papers on IB & CB. The goal is to highlight and organize their commonalities and differences for comparative analysis. SLR is a structured process involving the identification, selection, collection, and critical evaluation of data from all relevant previous literature included in the review, ensuring comprehensive and reliable outcomes from the analysis (Higgins et al., 2011). The advantages of adopting an SLR lie in its ability to enhance the transparency of the article search process, clearly define research objectives & minimize bias in the research (Shaffril et al., 2018).

### Resources

This study utilized journal articles and conference papers sourced from databases such as Web of Science, Scopus, and the research-supporting platform Google Scholar. These sources were chosen for their extensive coverage and the large volume of relevant articles and papers they provide (Haddaway et al., 2015). The systematic review was conducted in three stages: identification, screening, and eligibility. Initially, articles and papers were identified based on specific keywords. Next, the selection was justified using two predefined criteria. Finally, non-relevant sources were excluded to ensure the quality and relevance of the review (Okoli, 2015; Patino & Ferreira, 2018).

### Systematic Review Process

The first stage involved searching for studies using relevant keywords such as 'IB,' 'CB,' 'similarities,' 'differences,' 'specific aspects,' and 'operational principles,' with a focus on titles and abstracts. This process resulted in the retrieval of 114 articles & papers.

The second stage involved a screening process guided by the two selection criteria proposed by Kitchenham & Brereton to ensure a justified selection of sources (Kitchenham & Brereton, 2013). The first criterion was the type of document and the reliability of its source. The second criterion was the language of the sources; to avoid confusion and translation difficulties, this study included only sources written in English. After a thorough screening, 15 sources were excluded, leaving 99 sources for the whole review process. Nine publications were further excluded because they were published before the year 2000. Following the inclusion & exclusion approach, two additional publications were removed as they did not align with the objectives of this paper.

## RESULTS & DISCUSSIONS

To further assist researchers, a thematic analysis of the similarities and differences between IB and CB is conducted, categorizing them by source, as presented in Chapter 2, Table 3.

Table 3. Thematic analysis of similarities & differences between IB & CB based on publications in 2000-2023

No.	Authors	S1	S2	S3	S4	D1	D2	D3	D4	D5	D6	D7	D8	D9
1	Aggarwal & Yousef (2000)	✓												
2	Lewis & Algaoud (2001)	✓									✓			
3	Ganouati & Essid (2017)	✓												
4	Johnes et al. (2014)	✓												
5	Carruthers (2008)		✓											
6	Chiu et al. (2005)		✓											
7	Abedifar et al. (2013)		✓											
8	Bitar et al. (2017)		✓											
9	Ledhem & Mekidiche (2020)		✓											

10	Ariss (2010)	✓			✓				
11	Doumpos et al. (2017)	✓							
12	Odeduntan et al. (2016)	✓		✓	✓		✓		
13	Asni (2021)			✓			✓		✓
14	Jubilee et al. (2021)			✓					
15	Worthington & Gait (2007)			✓					
16	Al-Augby et al. (2015)			✓					
17	Sobol (2015)			✓					
18	Khan et al. (2015)	✓							
19	Hanif (2014)	✓		✓	✓		✓	✓	✓
20	Wouters (2007)	✓							
21	Rahim Addul Rahman (2010)	✓							
22	Branco & Rodrigues (2007)	✓							
23	Ullah & Jamali (2010)	✓						✓	
24	El-Gamal (2008)	✓							
25	Polychronidou et al. (2014)	✓							
26	Kumar & Prakash (2019)	✓							
27	Salman & Nawaz (2018)			✓		✓			
28	Oladimeji et al. (2015)			✓					
29	Beck et al. (2013)	✓		✓				✓	
30	Musa & Musová (2010)			✓					
31	Abdelsalam et al. (2014)			✓	✓				
32	Lassoued (2018)				✓				
33	Mohanty & Saini (2014)			✓	✓		✓	✓	✓
34	Hasan & Dridi (2011)				✓	✓		✓	
35	Bitar et al. (2020)				✓				
36	Aris et al. (2013)				✓				
37	Rashid (2007)				✓				
38	Kaleem & Isa (2003)				✓		✓		
39	Kazmi (2001)					✓	✓		
40	Song & Oosthuizen (2014)					✓			
41	Anginer et al. (2019)					✓			
42	Farook & Farooq (2011)					✓			
43	Ahmad & Hassan (2007)					✓			✓
44	Akmansyah (2015)						✓		
45	Dusuki & Abdullah (2007)						✓		
46	Munro (2012)						✓		
47	Haddad (2023)						✓		
48	Ofurum & Chinyere (2007)						✓		
49	Chong & Liu (2009)							✓	
50	Qaed & Qaed (2014)							✓	
51	Santos (2000)							✓	
52	Rahman (2007)							✓	
53	Ismail (2020)							✓	
54	Tayyebi (2009)							✓	✓
55	Yurista & Ardi (2020)							✓	
56	Ben Amar & El Alaoui (2023)							✓	
57	Gunpath (2014)							✓	
58	Chelhi et al. (2017)								✓
59	Duran & Garcia-Lopez (2012)								✓
60	Lee & Ullah (2007)								✓
61	Boumediene (2011)								✓



62	Aderemi & Ishak (2023)	✓	
63	Ali (2004)	✓	
64	Rafay et al. (2017)	✓	
65	Ghannadian & Goswami 2004	✓	
66	Al-Mubarak & Osmani (2010)	✓	✓
67	McMillen (2012)	✓	
68	Valls Martínez et al. (2020)	✓	
69	Chhapra et al. (2018)		✓ ✓
70	Zainordin et al. (2018)	✓	
71	Maysami & Kwon (1999)	✓	
72	Arbouna (2000)	✓	
73	Anwar (2008)	✓	
74	Stagg-Macey (2007)	✓	
75	Ferguson (2008)	✓	
76	Tolefat (2006)	✓	
77	Willis (2007)	✓	✓
78	Central Bank of Malaysia (2020)	✓	

The publication period from 2000 to 2023, as shown in Table 3, was selected because it marks the beginning of the most active expansion of IBs, not only in the Asian region but also globally. During this period, interest in capital usage and PLS emerged as the most emphasized differences. The results further highlight that the opportunities and types of investment, financing, insurance products, and services offered by IB are distinct from those provided by CB. Additionally, regulatory bodies, the influence of religion on banking principles, conditions for current & savings accounts, security requirements, and late payment charges were identified as significant points of divergence between IB & CB.

However, the frequency with which these similarities and differences are discussed varies across sources (Table 4). This variation reflects the different emphases authors place on these characteristics, focusing on aspects they consider more critical or aligning with their research interests.

Table 4. Frequencies of the listed similarities and differences between IB and CB based on the literature review

Coding	The meaning of similarities & differences	Frequencies
S1	Both are financial institutions	4
S2	Both banking systems operate worldwide	11
S3	Both operate based on principles of CSR	7
S4	Both are governed by the regulations of central banks	
D1	Interest on Capital usage	13
D2	Profit & Loss sharing	10
D3	Opportunities & types of Investment	8
D4	Impact of Religion on Banking Principles	9
D5	Conditions for Current & Savings Accounts	8
D6	Opportunities & Types of Financing	10
D7	Regulatory bodies	15
D8	Opportunities & Types of Insurance	9
D9	Security Requirements & Late Payment Charges	5

The table above summarizes the results of the comparative analysis of various aspects of IB & CB. It reveals that similarities between IB & CB are mentioned in fewer sources compared to the differences between these banking systems. However, this does not imply that the aspects analysed in more sources carry greater significance than those with fewer mentions. All the similarities & differences represent the objective realities historically & culturally embedded in IB & CB. The varying frequencies reflect the differing levels of emphasis scholars have placed on these aspects in their research.

## CONCLUSIONS

This paper aims to explore and compare the operational principles of Islamic banking (IB) and conventional banking (CB) to enhance awareness and deepen understanding of IB, with the broader objective of laying a foundation for the development of joint IB-CB products in Latvia. The study identified four key similarities: both systems operate globally, enjoy widespread popularity, follow the principles of Corporate Social Responsibility (CSR), and are supported by their respective central banks. However, several critical differences emerged, particularly regarding the use of interest, approaches to profit and loss sharing, regulatory frameworks, the role of religion, the structure of current and savings accounts, investment options, financing methods, insurance offerings, collateral requirements, and late payment penalties.

These findings offer valuable insights for researchers, practitioners, and potential clients, supporting more informed decision-making when choosing between IB and CB. Although IB is still in an early stage of development compared to the well-established CB system, it demonstrates strong potential both to compete with and complement CB. Nevertheless, IB faces notable challenges, including limited public awareness, insufficiently trained staff, the lack of a dedicated Islamic legal framework, limited governmental and central bank support, and a shortage of qualified Shariah experts. These barriers significantly impede the growth and integration of IB.

To overcome these obstacles, stakeholders in the IB ecosystem must identify, understand, and address these challenges through targeted strategies, supportive policies, and institutional capacity-building. Addressing these issues is essential for ensuring the sustainable development and long-term success of Islamic banking.

One promising pathway lies in strategic collaboration between IB and CB. Such partnerships can result in the creation of innovative hybrid financial products that address unmet market needs, promote economic diversification, and support societal development. Leveraging the strengths of both systems can enable them to serve a broader and more diverse client base, including small and medium-sized enterprises (SMEs), green investors, and students seeking higher education financing. To this end, our research proposes three collaborative product concepts: (1) a joint SME financing scheme that combines CB loans with Sharia-compliant IB instruments to improve financial accessibility and risk-sharing; (2) a sustainable finance solution integrating green bonds and sukuk to fund renewable energy and infrastructure projects; and (3) an education co-funding model that offers a combination of interest-free Islamic loans, conventional loans or grants, and income-sharing agreements to expand access to higher education.

These concepts were presented to experts from Skandinaviska Enskilda Banken AB Riga in February 2025, receiving positive initial feedback. While detailed descriptions and assessments of these proposed products will be presented in a forthcoming publication following expert review, this paper introduces them as strategic recommendations grounded in the comparative analysis of IB and CB operational principles.

In conclusion, collaborative efforts between Islamic and conventional banking institutions offer a unique opportunity to develop inclusive, ethical, and sustainable financial solutions. By merging the moral foundations of Islamic finance with the global reach and infrastructure of conventional banking, these joint products can fill market gaps, enhance financial inclusion, and contribute to broader social and economic progress. Such initiatives stand to benefit clients, financial institutions, and society as a whole.

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