

# ISLAMIC BANKING; THE SOLUTION FOR THE FAILING CONVENTIONAL BANKING

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IHH İNSANİ VE SOSYAL ARAŞTIRMALAR MERKEZİ  
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Referans için: Issah, Abdulbasit Baba, "Islamic Banking; The Solution For The Failing Conventional Banking",  Analysis  
INSAMER, 27.03.2019.

Economy is one vital pillar on which every civilization, state, and country depend upon. The Conventional banking system has been the banking model and transaction tool used for decades; this system depends solely on capitalism where the profits and benefits are centered on certain groups.

The capitalist economic system is deteriorating and has not been able to withstand the test of time; the global financial system is unstable and collapsing due to the capitalistic economic ideology across the world.

The world had witnessed how Europe was hit with a debt crisis since 2008 when many of European countries experienced the collapse of financial institutions, not to mention the skyrocketed government debt which led to the collapse of Iceland's banking systems and other problems faced by Portugal, Italy, Ireland, Greece, and Spain in 2009.

According to Investopedia, the European Sovereign Debt Crisis had led to a loss of confidence in European businesses and economies. The website stated a number of factors that worsen the crisis in Europe. Greece's massive debt and the Brexit movement in the UK clearly threatened the European economy. And the situation was only made worse by the total breakdown of one of the biggest economy of Europe, Italy. This phenomenon triggered social unrest in most of the European countries, where unemployment alone has risen to 21% particularly in Greece. The source also added that the on-going economic and banking crisis would have a long-term effect on the European overall economy.

The African continent also had its share in facing the global conventional banking crisis; between the year 2015 and 2018 the continent experienced financial catastrophe. In Ghana



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for example, eight indigenous banks collapsed (UT bank, Capital bank, Uni Bank Ghana limited etc.) this year; in Tanzania six banks went down (Efatha Bank Ltd., Covenant bank Women, Twiga Bancorp etc.); while Nigeria, Uganda, Mozambique, Kenya, and other African countries went through similar crisis.

## Causes of these crises

The causes of the conventional banking system failure can be looked at from the following aspects:

*Capitalistic Economic Ideology:* Capitalism as the ideology of conventional banking system has from the beginning served as a vulnerable foundation, in which strong and reliable transactions cannot be built upon. A financial institution should aim to aiding the community and nations at large but in reality the current financial institutions' products and transaction models pose as a threat to communities and countries. This is because this model is established to profit and benefit the rich and the elites.

Bank loans have shifted their function from helping people such as young entrepreneurs to have a strong business foundation. Today, financial institutions would not provide a loan without a valuable collateral, where in most cases is an impossible prerequisite for loan seekers. And to make matters worse, the collateral is the added interest on the loans set by the financial institutions for certain period. These interests sometimes exceed the loan acquired by a customer within a short period and the financial institutions would claim the collateral if the loans are not settled on time.

Here it is clear that the benefits and profits are centered only on the banks and not the customers. And again when it comes to investment it is obvious that the banks benefit from these investments far more than the customers and investors. All these products in the conventional banking system and other products and transactions constitute in the collapsing of the capitalist ideological banks across the globe.

*Mismanagement:* Banking mismanagement is also responsible in pulling down the conventional banking systems. Mismanagement of resources and authorities has evidently led to the collapse of conventional banks, especially in the African continent. People are being employed in financial institutions not because of their credentials in the area of finance and economy but rather due to favoritism, nepotism, and tribal affiliations and relations. Consequently, many banks in the African continent are filled with unqualified employees and the result of this error is clearly shown. And then corruption is also rampant due to abuse of the authorities in these institutions.

## Islamic Banking's Potentials

The ongoing banking crisis in the world today would prove that the Islamic model of banking is the viable alternative that can rescue conventional banking from disaster. Unlike the capitalistic model of banking, the Islamic banking system focuses on the entire stakeholders involved in monetary transactions, the individuals (customers and depositors), the communities and the financial institutions. In order to improve the economy and public welfare, these elements should all benefit from their transactions.

The Islamic model of banking and transactions can help the economy from crisis and disaster in the following areas:

*Absence of Interest:* the beauty and outstanding aspect of the Islamic economic system is the absence of interest throughout its entire monetary transactions and products. From here alone we can see that the products in Islamic finance focuses on the benefits of all stakeholders involved and not only the financial institution as it is in conventional banks. From here it is safe to say that the Islamic banking system does pay attention about public welfare.

Any form of interest is prohibited in Islamic financial transactions to enable the poor to gain benefits, which in the long run would raise the status of society economically and minimize financial-related crimes. A non-interest loan in

## Any form of interest is prohibited in Islamic financial transactions.

Islamic economic system enables the customers and the needy to benefit from the loans and repay it at the given time without any fear of added interest. This form of loan could support struggling entrepreneurs and not the other way round.

The concept of collateral is available in Islamic financial transactions especially in loans but what differs from the conventional system is that the Islamic financial institutions may extend the loan payment deadline without burdening the customer with interest or a raise of payment. This system helps the customer to work harder with full concentration because there is no interest or rise in payment of the loan.

*Risk Sharing through Mudaraba:* One of the weaknesses of the conventional banking system is in the area of risk management and this happens as a result of the greed-driven centered benefits of few. This greed has led to the collapse of many financial institutions across the globe. However, if there is a loss in a transaction or investment it is the bank that has to retrieve these monies to the owners and most of the time financial institutions go down due to these types of crises.

The Islamic banking system comes with a product called Mudaraba (partnership) where it involves an investor (customer) and business aspect (financial institute) to commit in it. In this contract both profit and loss are shared between the two parties instead of being centered on one party. This can serve as today's best investing model which can replace many products in conventional banking and avoid unbearable risks and collapse as the world is experiencing today.

### Future of Islamic Banking

The Islamic finance sector is booming, not only in the GCC region but also in Europe and the West,

as we can see how London is now a leading hub of Islamic banking in Europe. Islamic banking has reached new levels of maturity in the past fifty years.

According to Euronews, Islamic banking is forecasted to be worth 3 trillion dollars by 2021 with Malaysia, Saudi Arabia and the UAE currently leading the market.

The 2017 Islamic Finance Development Report stated, "It is expected that on average the growth rates of Islamic Finance sector will be 9.5% per year, which significantly exceeds the growth rate of the conventional banking institutions in the key region of the world."

In 35 countries, Muslims constitute as the majority of the population, and in 28 countries Islam is the states' religion, these countries include Egypt, Saudi Arabia, Morocco, Kuwait, Iran, Iraq, and Pakistan amongst others. The Islamic banking potential for Muslims alone is already significant. Religious aspects clearly could develop the system. Besides, the risks in Islamic financial sector is lower compared to the conventional model, and we can now witness that the conventional banking is adopting several products of the Islamic finance system and not the other way round.

### Conclusion

The conventional banking system, which has been the model of financial transactions for decades, is currently in crisis and deteriorating alongside its declining status in the major regions of the world. Conventional banking could not stand the test of time while, on the other hand, Islamic finance has been growing for the past fifty years and innovational ways of banking and new products have been introduced throughout these years.

**The conventional banking system, (...) is currently in crisis and deteriorating alongside its declining status.**



Islamic banking is growing both in the GCC region and the Western countries. It has more risk management tools than conventional banking and it is considered by the IMF as a

means to better the economy of major world regions. Islamic finance is capable of replacing the conventional banking model and it has proven its viability and it is still growing.