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Risk Management in Islamic Banking: A Comparative Study of Islamic vs Conventional Banking Systems

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Abstrak -

This article aims to determine the differences in risk management between Islamic banking and conventional banking and the importance of risk management in the company. The article was created using a qualitative method by obtaining sources from literature studies in the form of books, journals, websites, and other supporting sources related to the article. In risk management, both banks have differences, namely in the risks applied, in conventional banking, namely Credit Risk, Market Risk, Liquidity Risk, Operational Risk, Legal Risk, Strategic Risk, Compliance Risk, Reputation Risk which are different in Islamic banking risk management, there are additional Return Risk and Investment Risk (equity investment risk). In the practice of Islamic banking risk management based on sharia principles by ensuring that all transactions and operations are in accordance with sharia such as the prohibition of usury, gharar, and maysir and using contracts in every transaction. While in conventional banking, the focus is on maintaining the bank's financial health by minimizing losses due to bad debts and interest rate fluctuations.

Keywords:

Financial Institutions, Islamic Banking, Risk Management

Introduction

Banking is a financial institution that currently has the most promising prospects among other financial institutions. Banking is a financial institution that is needed by the community to support financial transactions ranging from savings, loans, insurance, etc. With this, banking becomes a financial institution that is very much needed by the community. In addition, banking can support the implementation of national development and improve the standard of living of the community. The rapid development of the era has made banking in Indonesia continue to develop and improve the banking system starting from the products and services offered to the control carried out by banking institutions. In the banking system in Indonesia there are 2 systems, namely the conventional banking system and the sharia banking system.

The development of banking has received a good response from the community, making banking institutions a much-needed financial institution. In meeting the needs of the community, banking institutions make it easy to access banking, such as easy and fast access via mobile. Most banks in Indonesia have their own mobile banking applications that allow people to access anywhere without having to go to a particular bank. Until now, according to BPS data, in 2024 there were 1,680 banking institutions in Indonesia consisting of Conventional Commercial Banks, 13 Sharia Commercial Banks, 1,402 Conventional BPRs, and 173 Sharia BPRs. From the data above, Islamic banking is still very small in number compared to conventional banking even though the majority of the population is Muslim in Indonesia. Even with a small number, Islamic banking continues to develop and innovate which can increase the productivity of Islamic banking. In increasing banking productivity, control is also needed to minimize the risks that will occur. This is done so that if something happens outside of predictions, it can be prevented or minimized. The importance of risk management for companies, especially banks that have very high risks in their company operations, especially Islamic banking.

In order to deal with risks effectively, companies must first understand the types of risks that exist. After knowing the risks, the next step is to measure the level of loss and the probability of occurrence. Based on the results of this assessment, the company can develop a strategic plan to reduce the negative impact of the risk or even prevent it altogether (Sholahuddin. M., 2004). Islamic banking has such a big risk with the products and services it has. With the implementation of good risk management, companies can anticipate the risks that occur. And in this article will discuss risk management in Islamic banking with conventional banking by analyzing the risk management implemented by each bank to find out which sector is better in risk management.

Literature review

Definition of Banking

According to Law Number 10 of 1998 concerning Banking, a Bank is defined as a business entity that collects funds from the public in the form of savings and distributes them to the public in the form of credit and/or other forms in order to improve the standard of living of the community. Banking earns income by circulating customer funds by offering loan services and the like. The purpose of banking is to support the implementation of national development, by increasing Equality, Economic Growth, National Stability, and People's Welfare.

In banking there are 2 systems owned, namely the Islamic banking system and the conventional banking system, each of which has different regulations. There is a difference in the Islamic banking system and the conventional banking system, namely that Islamic banking does not apply an interest system but wages or administrative fees while conventional banking applies an interest system.

Risk Management

Risk management is an effort to manage risk through the process of identification, analysis, assessment, control, and efforts to avoid, minimize, or even eliminate unacceptable risks. Risk management is carried out to protect the company, improve company performance, position work management to be proactive, etc. A company with good performance will also have good risk management. The importance of risk management for a company can be a benchmark for assessment by investors that impacts the company's operations. However, in banking risk management there are differences in conventional banking and Islamic banking risk management. In conventional banking, namely Credit risk, Market risk, Liquidity risk, Operational risk, Legal risk, Strategic risk, Compliance risk, Reputation risk. While in Islamic banking risk management there are additions, namely Return Risk and Investment Risk (equity investment risk).

Methodology

This article is written using a qualitative research method. Which method is carried out by analyzing a phenomenon in depth to obtain results that are in accordance with what is being studied. This article is made with a literature review obtained from journals, books, websites, or other supporting sources. To obtain the appropriate article results, a comparison will be made between the risk management of Islamic banking and conventional banking.

Results and Discussion

Every entity certainly has its own risks, both from company operations, finances, etc. It is important for companies to avoid risks that occur in their company operations, namely with risk management. Banking companies are among the companies that have major risks, therefore banking must have adequate risk management. Banking risk management is a series of activities to identify, analyze, and manage risks that can threaten the continuity of a bank's business. With risk management, banks proactively try to prevent losses that may occur as a result of their business activities. The goal is to control risks that can disrupt financial performance and stability and to deal with uncertainties and threats that may arise.

In banking risk management there are differences between conventional banking risk management and Islamic banking. From the risk management, both have differences, namely in the risks applied, in conventional banking, namely Credit Risk, Market Risk, Liquidity Risk, Operational Risk, Legal Risk, Strategic Risk, Compliance Risk, Reputation Risk which are different in Islamic banking risk management, there are additions, namely Return Risk and Investment Risk (equity investment risk). In the practice of Islamic banking risk management based on Islamic principles by ensuring that all transactions and operations are in accordance with Islamic law such as the prohibition of usury, gharar, and maysir and using contracts in every transaction. While in conventional banking, the focus is on maintaining the bank's financial health by minimizing losses due to bad debts and interest rate fluctuations.

Risk management practices on several risks in Islamic banking are inherent in the products and services owned, such as: Murabahah Financing, the risks that occur are the same as interest-based financing but must be adjusted to the fiqh that regulates it, in this financing, namely by not being charged any fees if there is a delay in payment and the absence of a commitment to make customers pay their dues as they please which results in bank losses (Siti Nor Amira et al., 2014) . Salam financing, there are 2 risks taken, namely arising from failure to supply goods that do not comply with the contract, with the risk that occurs the supplier must still confirm and the risk of late payment for customers (Alrukhayyes et al., 2014) . From the risks that exist in Islamic banking, risk management is very important to be carried out so that the risks that occur can be managed properly with systematic processes, namely risk identification, risk measurement, risk mitigation, monitoring and evaluation. Risk management will bring its own assessment if there is a risk in the company and how the company controls it. In banking products or operations that are not in accordance with sharia principles will disrupt the bank's reputation and reduce customer trust. In dealing with the risk of the company's reputation, it will be assessed to maintain the company's reputation, reputation risk control must also be carried out.

The obligation for Islamic banks to have risk management is regulated in Article 38 (1) of the UUS Law and Islamic banks are required to implement risk management which includes the concept of knowing the customer and consumer protection with the concept of prudence in carrying out commercial activities as explained in Article 35 of Law No. 21 of 2008. Meanwhile, general bank risk management is stated in OJK Regulation 18/POJK.03/2016 concerning the implementation of general bank risk management.

Conclusion

Risk management is important for companies to avoid risks that will occur and not disrupt company operations. Banking risk management involves the process of identifying, analyzing, and managing risks that can threaten business continuity , with the aim of maintaining financial stability and facing uncertainty. The main difference in risk management of Islamic banking with conventional banking is in the principles used, Islamic banking applies sharia principles by ensuring all transactions and operations and using contracts in every transaction. While conventional banking focuses on maintaining the financial health of the bank with general rules such as using interest rates.

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