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# COMPARE OF THE ISLAMIC BANKING SYSTEM AT INDONESIA AND MALAYSIA

**Lola Irma Yunda[1], Dewi Mahrani Rangkuty[2], Jumadil Saputra[3], Rusiadi[4]**
[1,2,4]Universitas Pembangunan Panca Budi, Indonesia
[3]Universiti Malaysia Terengganu, Malaysia
Email: lolairmayunda2@gmail.com[1] , dewimahrani@dosen.pancabudi.ac.id[2] , jumadil.saputra@umt.edu.my[3] , rusiadi@dosen.pancabudi.ac.id[4]

**Abstract:**

Indonesia and Malaysia play a pivotal role in propelling the advancement of Islamic banking and finance in Southeast Asia. The progress of Islamic banking and finance systems in these two nations serves as a catalyst, encouraging other countries in the region to engage in the development of the Islamic banking and finance industry. This study aims to explore and compare the Islamic banking systems in Indonesia and Malaysia. The research employs a descriptive qualitative approach through a literature review. The institutional frameworks of Islamic banking in Indonesia and Malaysia exhibit numerous similarities, particularly concerning the central bank. The central banks in both countries hold the highest authority in overseeing, guiding, and formulating policies for financial institutions, especially within the Islamic banking sector.

**Keywords:** *Indonesia, Islamic Banking, Malaysia*

## INTRODUCTION

Southeast Asia is one of the regions at the center of the world's Islamic banking and finance development. The region has enormous potential to advance Islamic banking and finance, where Malaysia has the highest assets, about 70% of the overall Islamic banking assets in the Asian region. Then Indonesia has the largest Muslim population of around 250 million, likely to become the main market for Islamic finance. The two countries are the driving axis of the development of Islamic banking and finance in the Southeast Asian region. The development of Islamic banking and finance systems in these two countries has encouraged countries in the region to also participate in developing the Islamic banking and finance industry. Countries in the Southeast Asian region that are members of The Association of southeast Asian Nations that develop Islamic banking and finance are Indonesia, Malaysia, Brunei Darussalam, Singapore, the Philippines, and Thailand (Yulita et al., 2015). The Southeast Asian region is currently a growing region that is becoming the center of the development of the sharia financial industry in the world. Indonesia and Malaysia are the two countries in the region that are the driving force for the development of the sharia financial industry in Southeast Asia (Rama, 2015).

The economic crisis that has occurred in Indonesia has had an impact on banking, so that during the crisis many people took the money they saved in the bank because they were worried that the money they had saved in the bank was lost due to the economic crisis that occurred in the 90s. This shows that the health level of a bank after a crisis needs to be maintained because a good health level can increase public confidence, especially Islamic banking after a crisis (B, 2023).

Indonesia is the country with the largest Muslim population in the world with a percentage of the Muslim population of around 83% or around 250 million people. This makes Indonesia a country that has the potential to develop an Islamic financial system. The Islamic banking system was first recognized in 1990 through a conference held by the Indonesian Muslim Scholars Association and the Indonesian Ulema Council which discussed an interest-free banking system. In Indonesia, financial institutions that harmonize their operations with sharia principles are called Islamic financial institutions. Banks that apply sharia principles are referred to as Islamic banks (Makhfud, 2019).

Malaysia is a country in the Asian region that is the fastest in developing the Islamic banking and finance industry. The development of Islamic banking and finance in Malaysia began when the government established a Hajj savings account in 1963 (Saputra, 2016). This institution was formed to invest people's Hajj savings using mudharabah, musyarakah, and ijarah contract schemes. In carrying out all its activities, this institution is supervised by the National Fatwah Committee of Malaysia, which is under Bank Negara Malaysia, this Fatwah Committee is not independent.

Indonesia and Malaysia are two countries that are in the spotlight (Rangkuty, 2021) in terms of the development of the Islamic economy, including the development of the Islamic banking industry. In its report, EY states that there are 9 countries that have the largest market share of Islamic banking assets in the world. These nine countries have an asset value capitalization of up to 93%, of which two of them are Indonesia and Malaysia. These two countries are Southeast Asian countries, while other countries are dominated by Middle Eastern countries. In its development, Islamic banking in Malaysia has always been superior to Islamic banking in Indonesia. The Islamic Finance Development Indicator (IFDI) report published by the Islamic Corporation for the Development of the Private Sector (ICD) shows that Malaysia's Islamic banking indicators are above Indonesia's Islamic banking indicators. However, when viewed from year to year, the development of Islamic banking in Indonesia looks higher than Malaysia. (Mahdi, 2021). The rapid growth of the Islamic banking industry in Malaysia is inseparable from the conducive policy environment provided by the Central Bank of Malaysia, Bank Negara Malaysia (BNM). To further accelerate the development of the Islamic banking industry and create competitive competition, BNM has licensed the opening of new Islamic BUSs both from within the country and outside the country, especially from the Middle East to operate in Malaysia (Majid, 2014).

Indonesia and Malaysia have become the mecca for the development of Islamic finance in the world. The intermediary function of Islamic banking plays a role in reviving the real sector through the receipt and distribution of funds. The existence of quality gaps and differences can be seen in terms of regulation, the number and growth of the quality of Islamic financial assets. Indonesia is supported by the Indonesian Ulema Council, the Indonesian Sharia Council and the Indonesian Sharia Supervisory Board, regulations since 1992. Malaysia adopts dual levels of supervision, namely at the macro level there is a Shariah Advisory Council (SAC) at the Central Bank of Malaysia (BNM) which functions in sharia financial fatwas, Central Banking Act (CBA) 2009, regulations since 1963 (Hartini, 2020).

The development of Islamic banks is currently more rapid and is starting to be recognized by the wider community, especially in Indonesia and Malaysia. This is because Islamic banks do not use an interest system but use a profit-sharing system that avoids usury. The development of Islamic banks in Indonesia is very positive, it is evident that many conventional banks have opened sharia branches or opened sharia-based services (Rahmawati, 2020). Banks that have opened sharia branches in Indonesia until 2012 (Neli, 2019) The development of global Islamic financial institutions is very rapid This is also stated by EY which states that there are 9 countries that have the largest Islamic banking assets in the world (Ernst & Young Global Limited, 2016). These nine countries have asset value capitalization reaching 93% of total global assets (Umar & Haryono, 2022).

Islamic banking in Indonesia and Islamic banking in Malaysia have relatively similar characteristics, both in terms of the majority Muslim community and its operational policies that adhere to the dual banking system (Hilman, 2020). Islamic banking is one of the first sectors in the implementation of Islamic economics in Indonesia and Malaysia. Where the growth of Islamic banking in Indonesia or in Malaysia is supported by various factors that support both in terms of products, services, operations and others. As an indicator used to see or determine the success of a country's Islamic banking system, improving the quality of Islamic audits is very important to do (Naqiah, 2022). Islamic banking requires a measuring tool (Rusiadi, 2016) in terms of sharia objectives (maqashid shariah) to assess the extent of the performance that has been achieved, which must be in accordance with Islamic principles in its operations, especially in terms of the objectives of the Islamic bank itself. The objectives of Islamic banks are not limited to financial aspects only but must also pay attention to other aspects such as social and environmental. Based on the Law of the Republic of Indonesia No. 21 of 2008 concerning Islamic Banking "The purpose of Islamic banks is to support the implementation of national development in order to increase justice, togetherness and equitable distribution of people's welfare" (Ramadhani & Mutia, 2016).

Islamic banks in different countries can have similarities and differences for several reasons. These differences will be reflected in the use of different contracts in the products and services offered by Islamic banks. Factors that influence these differences include: The economic system adopted by a country, the school of thought or school of thought used by the majority of people in a country, the position of Islamic banks in the law, and the chosen product development approach (Darma, 2021).

In Southeast Asia, Bank Islam Malaysia Berhad (BIMB) was the first Islamic banking to be born, namely in 1983. Meanwhile, the first Islamic banking that appeared in Indonesia was Bank Muamalat Indonesia (BMI) in 1992 (Majid, 2014). The establishment of Islamic banks comes from the source of Islamic law which is against the additional interest or usury obtained from collecting or borrowing money (Harahap et al., 2022).

The development of Islamic banks is currently more rapid and is starting to be recognized by the wider community, especially in Indonesia and Malaysia. This is because Islamic banks do not use an interest system but use a profit-sharing system that avoids usury. This study aims to determine the financial performance of Islamic banks with a comparative study of Indonesia and Malaysia which was conducted over a 3-year period, namely 2017 to 2019 (Rahmawati, 2020). The development of Islamic banks in Indonesia is very positive, it is proven that many conventional banks have opened sharia branches or opened services based on sharia. Banks that have opened sharia branches in Indonesia until 2012 (Neli, 2019) The rapid growth of the Islamic banking industry in Malaysia is inseparable from the conducive policy environment provided by the Central Bank of Malaysia, Bank Negara Malaysia (BNM). To further accelerate the development of the Islamic banking industry and create competitive competition, BNM has licensed the opening of new Islamic BUSs both from within the country and outside the country, especially from the Middle East to operate in Malaysia (Majid, 2014). Islamic banking requires a measuring tool in terms of sharia objectives (maqashid shariah) to assess the extent of the performance that has been achieved, which must be in accordance with Islamic principles in its operations, especially in terms of the objectives of the Islamic bank itself. The objectives of Islamic banks are not limited to financial aspects only but must also pay attention to other aspects such as social and environmental. Based on the Law of the Republic of Indonesia No. 21 of 2008 concerning Islamic Banking "The purpose of Islamic banks is to support the implementation of national development in order to increase justice, togetherness and equitable distribution of people's welfare" (Ramadhani & Mutia, 2016).

The growth of Islamic banking has encouraged high competitiveness between the financial services industry (Rusiadi, 2022). Islamic banking is also able to maintain its performance well so that it can compete with other banking industries, both domestic Islamic banking and Islamic banking from other countries (Widiasmara & Retnowati, 2020).

## RESEARCH METHODS

This study employs a descriptive qualitative approach using a literature review method, drawing insights from previous research findings (Kurniawan, 2014) in journals related to the topic. Additionally, data is gathered from online sources as information publications. In this descriptive qualitative study, the researcher serves as the primary instrument, employing inductive techniques to collect and analyze data, as outlined by Sugiyono (2012). The process involves combining and analyzing data to generate descriptive findings, such as narrating outcomes from interviews and observations.

## RESULTS AND DISCUSSION

The Indonesian and Malaysian Islamic banking institutional systems still have many similarities, the first in terms of the central bank. The central banks of both countries, namely Bank Indonesia and Bank Negara Malaysia, are still the highest authority in the field of supervision, guidance and policy makers in financial institutions or institutions in both countries, especially Islamic banking (Sirajuddin, 2018). The most striking difference from the institutional side of Islamic banking in Indonesia and Malaysia according to observations lies in the field of Islamic banks operating and offering Islamic banking products in the two countries. Where in Malaysia it opens the door to foreign or foreign full pledged Islamic banks to invest or offer Islamic banking products. There are several foreign Islamic banks operating in Malaysia, namely Al Rajhi Banking & Investment Corporation (Malaysia) Berhad, Kuwait Finance House (Malaysia) Berhad, OCBC Al-Amin Bank Berhad and Standard Chartered Saadiq Berhad. Meanwhile, the only foreign Islamic bank operating in Indonesia according to the author's search is MAYBANK (Malaya Bank) Syariah from Malaysia (Sirajuddin, 2018). The performance of Islamic banking in Indonesia based on the concept of Maqashid Sharia is quite good, it's just that there are several Islamic banks that do not publish several ratios included in the measurement of the shariah maqashid index. Compared to Malaysian Islamic banks, Indonesian Islamic banks are superior in the value of the goal of educating individuals (Munira et al., 2022).

Malaysia has become a Southeast Asian force in the global Islamic finance industry. Malaysia's decades of Islamic banking continues to evolve with the aim of meeting the needs of the global industry. One of the Southeast Asian countries with the fastest growing Islamic banking and finance industry is Malaysia. based on statistical information from Bank Negara Malaysia. Malaysia now has 5 international Islamic banks and more than 17 domestic Islamic banks operating there. Although 15 banks are involved in the development of Islamic banking schemes. Malaysia's significant Islamic banking market share also helps State Malaysia support the development of Islamic banks in Malaysia which is very strong in terms of legality, capitalization, resources, and development levels (Maulana Syarif Afwa & Sulistyowati, 2023).

The rapid development of banking in Malaysia (Saputra, 2017) is solely due to the responsive and accommodating government in providing a legal framework for Islamic banking operations. Islamic banking assets in Malaysia reached RM 350.8 billion (USD 116 billion), controlling 21 percent of the market share (Majid, 2014) While Indonesia, which started its Islamic banking business since 1992, its total assets have not been able to reach 3.3 percent of its market share in 2010. Whereas in Indonesia there have been 11 Islamic banks, 151 Islamic BPRs, and 23 conventional banks offering Islamic banking business, with total assets of IDR 104 trillion (USD 10.4 billion). In 2011, Islamic banking assets in Indonesia as a whole only reached 3.7 percent compared to national banking assets.

It can be seen that the average growth of Indonesia's Islamic banking assets is higher than Malaysia's, where Indonesia's Islamic banking assets growth has an average of 12.81% while Malaysia's is 11.9%. The average growth of Indonesia's Islamic banking third party funds is also 3% higher than Malaysia. Then, the average growth of Malaysia's Islamic banking financing was 12.38% while Indonesia's was lower at 9.41%. (Mahdi, 2021). Now Malaysia is listed as the country with the largest sharia financial assets in Southeast Asia and in the world. Its value in December 2014 even reached US$ 423.2 billion. In this case, Indonesia is very far behind with an asset value of only US$ 35.62 billion. The value of assets in neighboring countries is recorded 10 times the assets of the sharia financial industry in Indonesia. Therefore, as a regulator, Bank Indonesia (BI) pays serious attention and is serious in encouraging the development of sharia banking (Rusliani, 2017).

Shariah governance for shariah financial institutions in Indonesia and Malaysia is stated in laws and technical regulations respectively. The difference is that Malaysia has developed a more comprehensive framework by using a special term, 'shariah governance'. While Indonesia still uses the perspective of corporate governance for sharia financial institutions. Furthermore, Indonesia and Malaysia both use a two-level supervisory approach, namely at the macro level there is a sharia fatwa council that functions in standardizing and harmonizing sharia provisions and at the micro level there is a sharia council that supervises the implementation of the fatwa at the company level (Rama, 2015). Historical analysis of the development of Islamic banking reveals that both countries are similar, in that the political situation has significantly influenced the growth of financial institutions in general, and Islamic banking institutions in particular. The strong political support in Malaysia has provided access to the rapid development of the institution, for example, with an excellent set-up process, both in terms of regulation and management. In contrast, the lack of political support from the government in the early days of Islamic banking in Indonesia has resulted in the slow development of Islamic banking (sharia) (Triyanta, 2009). The year 2011 was a remarkable year for the growth of the financial services industry in the world. In this year the Islamic financial industry broke the USD1.357 trillion mark. Sukuk issuance grew 77% or worth USD85 billion. While the growth of global Islamic banking grew 16.04%.25 Of course this is encouraging for the global Islamic financial industry (Syukron, 2013).

The development of Islamic banking is considered to be increasingly rapid, especially in Indonesia, this is because people increasingly need banking services in social life. The establishment of Islamic Banks was pioneered by the issuance of regulations by the government through Law No. 7/1992 on banking, so that the concept of sharia-based banking was born. Furthermore, the regulation has been revoked by Law No. 10/1998 which provides substance and explicit explanations related to Islamic banking from the previous law. The policy reform is not limited to the expansion of Islamic bank offices, but also involves Islamic bank operational services (Khofifah, 2020).

Based on the 2019 Islamic Finance Development Report (IFDI) which is an index to measure the development of the Islamic finance industry and also a barometer of the health level of the global Islamic finance industry, Indonesia is in 4th place from 10th place in the previous year. Malaysia is in first place, followed by Bahrain and the United Arab Emirates. The three countries hold a 65% share of Islamic finance assets in 2018 and for the Islamic finance industry assets in Malaysia grew by 5% in 2018, while Indonesia grew by 3% from US$ 2.4 trillion in 2017 to US$ 2.5 trillion in 2018. The indicators assessed by IFDI include; quantitative growth, knowledge, governance, Corporate Social Responsibility (CSR) and public awareness (Lestari, 2020).

## CONCLUSION

The Indonesian and Malaysian Islamic banking institutional systems have many similarities, for example in terms of the central bank. The central banks of Indonesia and Malaysia, namely Bank Indonesia and Bank Negara Malaysia, are still the highest authority in the field of supervision, guidance and policy makers in financial institutions or institutions in the two countries in question, especially in the Islamic banking system. Shariah governance for shariah financial institutions in Indonesia and Malaysia is stated in laws and technical regulations respectively. The difference is that

Malaysia has developed a more comprehensive framework by using a special term, 'shariah governance'. While Indonesia still uses the perspective of corporate governance for sharia financial institutions.

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