The Comparative Analysis of Risk Management Practices in Conventional and Islamic Banking in Indonesian

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Abstract. The phenomenon of banking development in Indonesia shows that the sector plays an important role in the economy, with similar risks faced by both conventional and Islamic banking, such as credit, market, liquidity and operational risks. However, due to different basic operational principles, especially the prohibition of usury in Islamic banking, these two types of banks have different risk management approaches. This study aims to compare risk management practices in conventional and Islamic banking in Indonesia, focusing on credit and liquidity risks as the main challenges. The method used is qualitative analysis through literature studies and case studies on PT Bank Negara Indonesia (Persero) Tbk and several Islamic Commercial Banks in Indonesia. The results showed that Islamic banking faces greater challenges in managing risk, especially in credit and liquidity risk, due to the profit sharing mechanism that increases risk exposure. The conclusion of the study states that Islamic banking requires a more structured risk management strategy to comply with sharia principles, while being able to maintain operational stability. The Financial Services Authority (OJK) is advised to develop more supportive regulations so that Islamic banking can address the unique risks faced by monitoring and controlling procedures arising from all bank business activities.

Keywords: Risk Management, Conventional Banking, Islamic Banking, Credit Risk, Liquidity, Sharia Principles.

Introduction

Banking has an important function as a financial intermediary that supports economic growth by channeling funds from the public to productive sectors. In Indonesia, banking is divided into two main types: conventional and sharia, with significant differences in operational principles. Conventional banks operate based on the interest system which is the main source of income, while Islamic banks are based on Islamic law, which prohibits usury (interest) and emphasizes more on real asset-based transactions and profit and loss sharing. (*profit and loss sharing*) (Rahmawati & Nisa, 2024).

These differences in operating principles lead to different approaches to risk management, even though both are exposed to credit, market, liquidity and operational risks. Conventional banking tends to address credit risk with interest rate setting and strict credit evaluation. Meanwhile, Islamic banks, with the prohibition of usury, manage credit risk through contracts such as mudharabah and musyarakah, which require banks and customers to share both profits and losses. This adds to the complexity of managing credit risk as profits and losses must be shared based on business results that cannot always be predicted (Sahla, 2018)(Hilmiatus Sahla). In addition, Islamic banks have limitations in managing liquidity risk because they cannot use interest-based instruments and must rely on alternative instruments such as sukuk and asset-based financing.

(Rahmawati & Nisa, 2024).

Otoritas Jasa Keuangan (OJK) through regulation No. 65/POJK.03/2016 regulates Islamic banking risk management, which includes supervision by the Shariah Supervisory Board, setting risk limits, and monitoring in accordance with shariah principles. These regulations provide an important basic framework

for Islamic banking, but specific challenges such as credit and liquidity risks require additional approaches that are shariah-compliant. (OJK, 2016).
This study is aimed at identifying key differences in risk management approaches between conventional and Islamic banking in Indonesia. With a focus on credit and liquidity risk as the main challenges, this research seeks to analyze the impact of these differences on the stability and sustainability of bank operations. In addition, this research will also explore how regulations from OJK support risk management practices in both types of banking and provide deeper insights for stakeholders in the banking industry to develop effective risk management strategies.

Methods

This research uses a qualitative approach with literature study and case study methods. Data was obtained from the annual reports of banks as well as official publications from the Otoritas Jasa Keuangan (OJK). The case study focuses on PT Bank Negara Indonesia (Persero) Tbk for conventional banking and several Islamic Commercial Banks in Indonesia for Islamic banking. The analysis technique used is descriptive qualitative analysis, with the aim of comparing the risk management practices applied by these two types of banking.

Result and Discussion

1. **Credit Risk**

   Conventional Banking

   Conventional banking manages credit risk through interest-based instruments, setting lending rates, and rigorous evaluation of debtor eligibility. This enables stability in low Non-Performing Loan (NPL) ratios..

   1. **Interest-Based System**
      Interest rates are set based on the risk profile of the borrower, where higher risk borrowers are charged higher interest rates. This approach allows banks to offset potential credit losses with interest income.
   2. **Evaluation and Determination of Credit Limit**
      Before granting credit, banks conduct a thorough assessment of the debtor's ability, using the 5C analysis (Character, Capacity, Capital, Collateral, Conditions). Credit limits are set to minimize exposure to excessive credit risk.
   3. **Non-Performing Loan (NPL) Monitoring**
      The NPL ratio is a key indicator of credit risk health. Conventional banks typically keep NPLs below 3%, in line with the limit set by the Financial Services Authority (OJK).

   Table 1: NPL Ratio PT Bank Negara Indonesia (2018–2022)
   (Soucre: BNI Annual Report)

Years	Total Credit (Trillion IDR)	Total NPL (Trillion IDR)	NPL Ratio (%)
2018	500	12	2.4
2019	520	13	2.5
2020	540	15	2.8
2021	550	14	2.5
2022	580	14	2.4

   Table 1 shows the NPL ratio which has been maintained below the 3% threshold for the past five years.
   BNI's stable NPL ratio demonstrates the effectiveness of credit risk management. The interest-based system gives conventional banks the flexibility to adjust their income to the level of credit risk.

   Perbankan Syariah

   Islamic banks face greater challenges in credit risk management as their operating principles prohibit the use of interest (riba). Instead, Islamic banks use profit-sharing-based contracts, such as:

   1. **Mudharabah Agreement**
      In this contract, the bank provides capital for the customer's business, while the customer is responsible for managing the business. Profits are shared based on the agreement, but losses are fully borne by the bank unless caused by the customer's negligence.

2. **Musyarakah contract**
   The bank and the customer cooperate in providing capital and managing the business. Profits and losses are shared based on the portion of each party's capital contribution.
3. **Risk of Non-Performing Financing (NPF)**
   Due to the nature of profit sharing, the Islamic bank's income is highly dependent on the success of the customer's business. This increases exposure to credit risk, especially if the customer's business suffers losses or fails**.**

Table 2: NPF Ratio in Sharia Commercial Banks in Indonesia (2020)
(Source: Statistik Perbankan Syariah OJK)

Bank	Total Financing (Trillion IDR)	Total NPF (Trillion IDR)	NPF Ratio (%)
Bank Syariah Mandiri	150	6	4.0
BNI Syariah	100	3	3.0
Bank Muamalat	70	4	5.7

A higher NPF ratio than NPL indicates greater challenges in credit risk management at Islamic banks. Credit risk management requires in-depth analysis of customer business performance, as well as adjustments to financing policies.

2. **Liquidity Risk**
   Conventional Approach
   Conventional banking has high flexibility in liquidity management because it can use interest-based instruments. These instruments include:
1. **Interbank Money Market (PUAB)**
   Banks can borrow short-term funds from other banks through PUAB, with interest rates adjusted to market conditions.
2. **Government Securities (SUN)**
   Conventional banks can buy or sell SUN as a quick liquidity instrument.

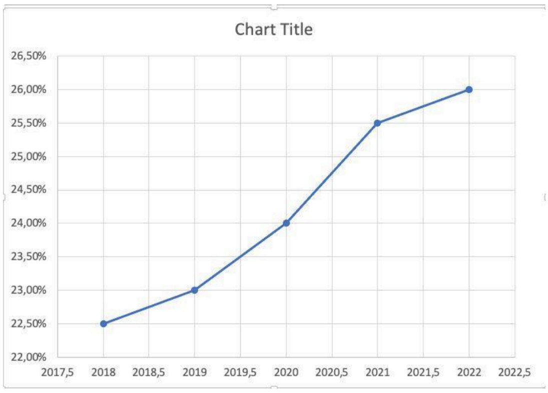

Figure 1: PT Bank Negara Indonesia's Liquidity Ratio (2018–2022
Source: BNI Annual Report

Chart Analysis:
The chart shows that BNI's liquidity ratio remains stable at over 20%, reflecting effective liquidity management by utilizing interest-based instruments.

Sharia Approach

Islamic banks cannot use interest-based instruments as they violate sharia principles. Instead, Islamic banks use alternative instruments such as:

1. **Sukuk**
   Shariah-based debt securities backed by real assets. Sukuk can be used to increase liquidity although the disposal process is slower than conventional instruments.
2. **Asset-Based Financing**
   Islamic banks utilize murabahah or wakalah contracts to meet liquidity needs..

Table 3: Average Liquidity of Sharia and Conventional Banks (2020)
(Souce: Statistik Perbankan OJK)

Bank Type	Average Liquidity (%)	First Instruments
Conventional Banks	25.6	PUAB, SUN
Sharia Bank	14.2	Sukuk, Asset Financing

Analysis Table:
The liquidity of Islamic banks is lower than conventional banks. This is due to the limited sharia-based instruments that can be used to fulfill urgent liquidity needs.

3. **Liquidity Risk Comparison**

Table 4: Liquidity Risk Management Approach Comparison

Aspects	Conventional Banking	Sharia Banking
Main Instruments	PUAB, SUN	Sukuk, Asset-Based Financing
Flexibility	High	Low
Transaction Process	Fast	Tends to be slow
Average Liquidity	25.6%	14.2%

Average Liquidity Data (2020):

- Bank Convensional: 25.6%
- Bank Sharia: 14.2%

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Comparative Analysis

a. **Flexibility**
   - Conventional Banks: Have high flexibility in managing liquidity risk thanks to access to money markets and interest-based instruments.
   - Islamic Banks: Face limitations in liquidity management as the instruments used are less flexible and less liquid.

b. **Response to Short-Term Needs**
   - Conventional Banks: Instruments such as interbank market allow conventional banks to respond to liquidity needs quickly.
   - Islamic Banks: The settlement process of asset-based transactions such as sukuk is slower, so the response to urgent needs is more hampered

c. . **Impact on Operational Stability**
   - Conventional Banks: Higher levels of liquidity provide greater stability in the face of market fluctuations.
   - Islamic Banks: Lower average liquidity makes Islamic banks more vulnerable to liquidity pressures in volatile market situations.

4. Analysis of the Role of Regulation

Regulation plays an important role in supporting the stability of the banking sector, both conventional and Islamic. In the context of risk management, the Financial Services Authority (OJK) in Indonesia issued various regulations that aim to regulate, supervise, and support the implementation of effective risk management principles in both types of banking. This regulatory role helps ensure the sustainability of bank operations in the face of credit, liquidity, market and operational risks.

a. Regulation on Conventional Banking

Regulations for conventional banking, as stipulated in POJK No. 18/POJK.03/2016, require the implementation of risk management that includes credit, liquidity and market supervision. Conventional banks have the freedom to use interest-based instruments such as the Interbank Money Market (PUAB) and Government Securities (SUN). This regulation supports flexibility in risk management as these instruments have active and liquid markets. During the COVID-19 pandemic, OJK issued POJK No. 11/POJK.03/2020, which provides countercyclical policies to maintain financial stability through credit restructuring and leniency towards Non-Performing Loan (NPL) ratios. The role of this regulation greatly supports the operational sustainability of conventional banks in the face of market fluctuations and economic crises.

b. Regulation on Islamic Banking

Islamic banking regulations are set out in POJK No. 65/POJK.03/2016, which emphasizes compliance with sharia principles in risk management. Additional supervision from the Sharia Supervisory Board (DPS) ensures that all products and activities of Islamic banks comply with Islamic law. However, the limitations of Islamic instruments such as sukuk and asset-based financing pose a challenge in meeting short-term liquidity needs. Islamic regulations are also more complex as they must combine modern risk management with Islamic financial principles, such as the prohibition of riba and speculative transactions (gharar).

c. Comparison of Regulatory Roles

Table 5: Comparison of Conventional and Islamic Banking Regulations

Aspect	Conventional Banking	Sharia Banking
Liquidity Instruments	PUAB, SUN, Conventional Bonds	Sukuk, Asset-Based Financing
Supervision	OJK	OJK and the Sharia Supervisory Board
Key Risks	Credit and Liquidity	Credit (NPF) and Liquidity (Sukuk)
Operational Flexibility	High	Low

Analysis:

Regulations in conventional banking provide high flexibility in the use of financial instruments, while regulations in Islamic banking limit instrument options to maintain Shariah compliance. This makes Islamic banks more vulnerable to liquidity pressures in volatile market conditions.

The role of regulation in conventional and sharia banking risk management is very important to maintain financial system stability.

- Conventional banks have greater flexibility in utilizing regulations to manage credit and liquidity risks.
- Islamic banks face greater challenges due to the limitations of Islamic liquidity instruments and dual supervision by OJK and the Sharia Supervisory Board.

With the support of more innovative regulations and more flexible financial instruments, Islamic banks can strengthen their position and reduce the gap with conventional banks in terms of risk management.

Conclusion

This study compares risk management in conventional and Islamic banking in Indonesia, including credit risk, liquidity risk, and the role of regulation. Differences in operational principles affect their risk management approaches. Conventional banking uses a flexible interest-based system, supported by creditworthiness analysis and supervision of Non-Performing Loan (NPL) ratios that average below 3%, reflecting high stability. In contrast, Islamic banking manages credit risk through profit-sharing-based contracts such as mudharabah and musyarakah, but this increases exposure to customer business risk, as seen from the higher Non-Performing Financing (NPF) ratio compared to NPLs. In terms of liquidity risk, conventional banking has an advantage with access to instruments such as the Interbank Money Market (PUAB) and Government Securities (SUN), which are more flexible and liquid, while Islamic banking faces challenges with limited instruments such as sukuk, which have less liquid markets and longer processing times. Regulations in conventional banking support flexibility, while Islamic banking regulations ensure compliance with sharia principles but add complexity through additional supervision by the Sharia Supervisory Board (DPS). To strengthen competitiveness, Islamic banking needs to develop more flexible liquidity instruments, strengthen the secondary sukuk market, and integrate technology for efficiency. With the support of innovative regulations, Islamic banking can overcome the challenges and enhance its stability in the Indonesian financial system.

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The author realizes that this research still has limitations. Therefore, constructive criticism and suggestions are highly expected for the improvement of this research in the future. Hopefully this research can provide benefits for the development of science, especially in the field of banking risk management in Indonesia.

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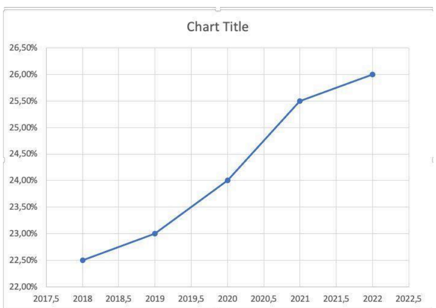
Graphs



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