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SPECIALTY OF FINANCING IN ISLAMIC BANKING

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INTRODUCTION

The emergence and expansion of Islamic banking represent a significant development in the global financial landscape, particularly in response to increasing demands for ethical and interest-free financial alternatives. Rooted in the principles of Shari'ah (Islamic law), Islamic banking offers a unique financial model that diverges fundamentally from conventional Western banking systems. Central to this model are the prohibitions of *riba* (interest), *gharar* (excessive uncertainty), and *maysir* (speculation), as well as a commitment to profit-and-loss sharing, asset-backed financing, and socially responsible investment practices.

In recent decades, Islamic finance has evolved from a niche concept into a sophisticated, multi-trillion-dollar industry. Its growth has been driven not only by the increasing size and affluence of Muslim populations worldwide but also by the global search for financial systems that prioritize transparency, fairness, and real economic value. Islamic financial institutions now operate in both Muslim-majority and non-Muslim countries, reflecting the system's adaptability and broader appeal beyond its religious origins.

Despite its growing prominence, Islamic banking remains widely misunderstood, especially in non-Muslim contexts. It is often perceived narrowly as a religious or cultural alternative to conventional finance, rather than as a comprehensive, principle-based financial system. This thesis seeks to address such misconceptions by examining the foundational concepts, operational structures, and financial instruments that define Islamic banking. Particular emphasis is placed on the comparison between Islamic and conventional banking models, with a focus on how Islamic finance maintains compliance with Shari'ah while offering competitive and functional financial services.

The objective of this research is to analyze the underlying legal, ethical, and economic dimensions of Islamic banking and to assess its relevance and application in contemporary global finance. By exploring key instruments such as *Murabaha*, *Ijara*, *Musharakah*, and *Mudaraba*, as well as the broader regulatory and institutional frameworks supporting Islamic finance, this study aims to provide a comprehensive understanding of the system. Ultimately, this thesis aspires to contribute to the academic discourse on alternative banking models and to demonstrate the

potential of Islamic finance as a sustainable, inclusive, and ethically grounded component of the global financial system.

1. HISTORICAL DEVELOPMENT OF ISLAMIC BANKING

The origins of Islamic banking can be traced back to the medieval period (around the 13th century), when trade and business transactions in the Muslim world were conducted based on profit-and-loss sharing principles. During this era, Islamic financial practices were deeply rooted in Shariah law, ensuring that all commercial activities adhered to ethical and religious guidelines. Merchants and businesspeople at the time engaged in trade financing without involving interest (riba), instead relying on risk-sharing mechanisms that promoted fair and equitable transactions.

A significant influence on early Islamic financial practices came from the trading relationship between the Arabs of the Ottoman Empire and the Spanish merchants. The Spanish, having been influenced by centuries of interaction with the Muslim world, had developed a non-interest-based financial system that aligned with Islamic principles. This system was extensively used for financing trade and business affairs, allowing economic exchanges to flourish between these regions.

However, the landscape of financial systems in the Islamic world underwent a major shift with European colonial expansion. As European trading companies began to take an interest in the Middle East and Asia in pursuit of trade and resources, they introduced their own financial institutions in these regions. Unlike the Islamic banking practices that were based on Shariah compliance, these newly established banks followed traditional European interest-bearing financial models. Consequently, European financial institutions began to dominate the banking sector in many Muslim-majority regions, gradually expanding their influence beyond Europe.

At the time, many Islamic countries operated their own local banks, but these institutions were relatively small in scale and lacked the financial resources to compete with the well-established European banking networks. As a result, businesses and individuals in these regions were often forced to rely on European banks, despite the fact that charging or paying interest was fundamentally against Islamic principles. The capital gap between local Islamic banks and

European financial institutions was significant, limiting the ability of Islamic banks to provide comprehensive financial services. Consequently, the primary function of local banks in Muslim-majority regions was often restricted to simple money transfers, while other financial transactions—such as borrowing and depositing—were limited due to the reluctance of the Muslim population to engage with interest-based banking systems.

As economic globalization accelerated in the 20th century, avoiding interest-based banking systems became increasingly difficult. The expansion of global trade and investment meant that financial institutions following the Western banking model dominated the global economy. However, despite this dominance, many Muslim scholars, economists, and financial experts began to explore the possibility of reviving an Islamic banking model that would align with Shariah law while remaining competitive in the modern financial landscape.

A significant milestone in the development of modern Islamic banking was the establishment of the Mit Ghamr Savings Project in Egypt during the 1960s. This initiative is widely recognized as the first modern financial institution to operate on Islamic banking principles. The Mit Ghamr project successfully implemented profit-and-loss sharing mechanisms while avoiding interest-based transactions. Its success demonstrated that Islamic banking could function as a viable and sustainable alternative to conventional financial models.

Following this success, Islamic banking continued to evolve. In 1971, the Mit Ghamr Savings Project merged with the Nasser Social Bank, marking an important step toward institutionalizing Islamic finance. This was followed by a major breakthrough in 1975, when the first intergovernmental Islamic bank was established, providing a structured and formalized approach to Shariah-compliant financial services. In the same year, the Dubai Islamic Bank (DIB) was founded, making history as the first privately owned, interest-free Islamic bank.

The rapid success of the Dubai Islamic Bank set a precedent for other financial institutions, leading to the establishment of numerous Shariah-compliant banks across the Muslim world. Today, more than fifty Islamic financial institutions operate globally, with a majority of them located in Muslim-majority countries. However, the influence of Islamic banking has extended beyond these regions, reaching non-Muslim nations and becoming an integral part of the global financial system.

In recent decades, Islamic banking has experienced unprecedented growth, solidifying its position as one of the most significant financial systems worldwide. The total assets managed by Islamic financial institutions have expanded dramatically, exceeding \$3 trillion USD in 2021. This remarkable growth has been driven by several key factors.

Islamic banking principles focus on risk-sharing and specific ethical frameworks, which appeal to a segment of consumers, both Muslim and non-Muslim, looking for alternatives to mainstream financial systems. Many governments in Muslim-majority countries have actively supported the development of Islamic banking institutions, ensuring that regulatory frameworks align with Shariah compliance. Additionally, international financial organizations such as the Islamic Development Bank (IDB) have played a pivotal role in fostering the sector's expansion.

Unlike its early days, modern Islamic banking now offers a wide range of financial instruments that cater to both individuals and businesses. The development of Shariah-compliant financing methods, such as Ijara (leasing), Murabaha (cost-plus financing), and Musharaka (partnership-based investment), has strengthened the industry's ability to compete with conventional banking systems.

While Islamic banking remains dominant in countries such as Saudi Arabia, the United Arab Emirates, Malaysia, and Indonesia, it has also gained substantial traction in non-Muslim-majority regions, including Europe, Africa, and Southeast Asia. Cities such as London, Luxembourg, and Frankfurt have established themselves as key centers for Islamic finance in Europe, offering a range of Shariah-compliant investment products.

The rise of Islamic bonds (sukuk) has played a critical role in integrating Islamic banking into global financial markets. Countries such as the United Kingdom, Germany, and Hong Kong have issued sovereign sukuks, demonstrating the increasing acceptance of Islamic financial instruments in mainstream banking.

The evolution of Islamic banking from its medieval roots to a globally recognized financial system highlights its resilience and adaptability. What began as a traditional system of profit-and-loss sharing has now expanded into a sophisticated multi-trillion-dollar industry, offering a competitive alternative to conventional banking.

Despite challenges in competing with interest-based financial institutions, Islamic banking has demonstrated consistent growth and global relevance. The continued expansion of Islamic banking into new markets, along with increasing regulatory support and product innovation, suggests that the system will remain an influential force in the financial world for years to come.

As Islamic finance continues to evolve, it is expected to play an even greater role in shaping the future of ethical and sustainable banking, making it a valuable component of the global financial landscape.

2. CORE PRINCIPLES OF ISLAMIC BANKING

The Islamic banking system represents a distinct financial model that diverges significantly from the conventional Western banking system. Rooted in Islamic principles, this system ensures that all transactions adhere to ethical and religious guidelines as prescribed in the Qur'an. The primary objective of Islamic banking is to promote financial transactions that are free from exploitative practices, emphasize economic justice, and ensure transparency in all dealings. Unlike conventional banking, which is largely driven by interest-based lending and profit maximization, Islamic banking operates under a framework that prohibits unjust financial gains and mandates risk-sharing between parties.

One of the key prohibitions in Islamic finance is *Gharar*, which refers to excessive uncertainty, speculation, or ambiguity in contractual agreements. Transactions that involve unclear terms, high levels of risk, or speculative elements are strictly forbidden, as they can lead to economic instability and potential exploitation. Consequently, financial activities such as gambling, derivative trading, and speculative investments are not permitted within the Islamic banking system.

In addition to avoiding uncertainty, Islamic banking follows strict ethical investment guidelines. Financial institutions must refrain from investing in industries or businesses that are considered *haram* (forbidden) under Islamic law. This includes sectors related to alcohol, pork, gambling, explicit media, and any other activities deemed unethical. As a result, Islamic financial institutions ensure that their investments contribute to morally responsible economic activities that align with Islamic values.

A defining feature of Islamic finance is its emphasis on asset-backed transactions. Islamic banks utilize asset-backed transactions as part of their operational model, differing from the interest-based approach used in conventional banking. This ensures that financial institutions do not earn income without assuming some level of risk, thus reinforcing the principle of profit-and-loss sharing.

A fundamental distinction between Islamic and conventional banking is the prohibition of *riba*, or interest. Islamic law explicitly forbids profiting from interest-based transactions, as they are seen as exploitative and unjust. According to the principles of Shariah, lending money should

not generate any financial return beyond the original amount borrowed, as this creates an imbalance in financial relationships. Instead, profits should be derived from legitimate trade, investment, or business activities in which both parties share risks and rewards.

Closely related to the prohibition of *riba* is the concept of risk-sharing. In conventional banking, financial institutions extend loans to borrowers while transferring all financial risk onto them. The bank secures its profit through interest payments, regardless of the borrower's financial circumstances or external market conditions. Islamic banking, however, requires financial institutions to assume a share of the risk alongside their clients. This ensures that banks do not earn profits unfairly but instead participate in transactions where both gains and losses are equitably distributed.

Given these strict principles, one might assume that obtaining a mortgage in an Islamic banking system is entirely forbidden. While this assumption is technically correct, the reality is more complex. Traditional mortgage structures, as seen in Western financial systems, do not comply with Islamic banking principles for several reasons.

Firstly, a conventional mortgage does not qualify as an asset-backed transaction in the way Islamic finance requires. Although mortgages involve collateral, this collateral primarily serves as a security measure for the lender rather than as a basis for shared risk. In a conventional mortgage, if the borrower defaults on payments, the bank has the right to seize and sell the property, ensuring that the lender does not suffer financial loss. This structure places the burden of risk entirely on the borrower, violating the fundamental Islamic principle that financial risk should be shared between both parties.

Secondly, a mortgage inherently involves interest payments, which are strictly prohibited under Islamic law. In a conventional mortgage, banks charge interest on loans, meaning that borrowers repay an amount that is significantly higher than the original sum borrowed. Since Islamic banking forbids earning profits through interest, traditional mortgage structures are incompatible with Shariah-compliant financial systems.

Despite these prohibitions, Islamic banking has developed alternative financial models that align with Islamic principles while allowing individuals to engage in homeownership and long-term investments. These alternatives emphasize risk-sharing, ethical financing, and transparency,

ensuring that financial institutions and clients enter agreements that comply with Shariah law. Rather than earning profits through interest, Islamic banks structure their financing mechanisms around asset ownership, trade, and leasing arrangements that facilitate financial transactions while adhering to religious guidelines.

By maintaining a strong commitment to Shariah-compliant financing, Islamic banking has developed as a different model of finance that operates alongside conventional systems. It not only provides ethical and equitable financial solutions for the global Muslim population but also demonstrates the feasibility of a banking system that prioritizes fairness, transparency, and risk-sharing. As Islamic banking expands globally, its principles offer insights into sustainable and responsible financial practices that could reshape the broader financial landscape.



1. Figure Principles of Islamic Banking - Belouafi, Ahmed & Belabes, Abderrazak. (2011). Islamic Finance and the Regulatory Challenge: The European Case. 10.1057/9780230361133_7.

During the interview, it was mentioned that Islamic banking is based on Sharia principles, which form the foundation of Islamic finance as a whole. Key principles include the prohibition of interest (riba), the avoidance of excessive uncertainty (gharar), and the restriction of speculative risk-taking. Instead of relying on interest-based or speculative transactions, Islamic finance emphasizes risk-sharing, where profits and losses are distributed fairly among all parties involved. Other important principles include materiality—ensuring that transactions are backed by tangible assets—and justice, which promotes fairness and ethical conduct in all financial dealings.

While Islamic banks offer financial products that resemble those of conventional banks, the underlying structure and delivery of these products are guided by Sharia principles. These principles are derived from core Islamic sources, primarily the Quran and the teachings of the Prophet Muhammad (Hadith). This connection ensures that Islamic banking remains aligned with the ethical and legal framework of Islam.

During the interview an important aspect mentioned was that there are various options available in Islamic banking, and the choice largely depends on the financial goals of the customer. For individuals who simply want to deposit money for daily use, opening a custodial account is a suitable option. However, for those interested in investing their money, the choice of financial instruments will depend on the specific investment objectives.

Among the commonly used contracts in Islamic banking are *mudarabah* and *musharakah*. These were specifically mentioned as key instruments, along with *ijarah*, which is also widely applied. Other contracts, such as those related to fabrication or manufacturing agreements, are also connected to these core financial instruments.

When comparing *mudarabah* and *musharakah*, there is no one-size-fits-all solution. The choice between them depends on the customer's preferences and risk tolerance. In a *mudarabah* contract, the customer provides capital while the entrepreneur contributes effort and management. If the business is successful, profits are shared. If it fails, the customer bears the financial loss, while the entrepreneur loses their effort or business stake.

In contrast, *musharakah* is a partnership where both the bank and the customer invest in a project. Profits or losses are shared in proportion to each party's ownership stake. This continues until the financing is repaid or the project reaches completion. In this model, both parties are exposed to risk and reward.

Ultimately, there is no definitive preference for one contract over another; the choice depends on what the customer wants to achieve financially. It is primarily a matter of individual risk preference.

Islamic finance is built around defined principles, which influence how sustainability is approached in its financial model. One of its core strengths lies in its close connection to the real

economy. Transactions are tied to tangible assets and real business activities, which means that financial risk is directly related to actual economic performance.

Unlike conventional financial markets—where investments can be heavily influenced by speculation, sentiment, or even rumors—Islamic finance requires a direct link to real economic output. This connection helps ensure that financial activities reflect genuine business risks and outcomes, rather than being driven solely by market volatility or abstract financial instruments. As a result, the system promotes greater long-term sustainability.

Islamic finance is often regarded as highly sustainable due to its foundation in well-defined, principle-based frameworks. A key strength of the system is its strong linkage to the real economy. Financial transactions must be backed by tangible assets and real economic activities, ensuring that the associated risks correspond to actual business performance.

In contrast to conventional financial markets—where investment decisions are frequently influenced by speculation, market sentiment, or external rumors—Islamic finance requires financial transactions to be linked to tangible assets, avoiding the use of purely speculative financial instruments. By emphasizing asset-backing, Islamic finance operates differently from models that include a wider range of financial instruments, including speculative ones, thereby contributing to long-term financial stability and sustainability.

3. ISLAMIC VS CONVENTIONAL BANKING

One of the most defining and foundational distinctions between Islamic and conventional banking systems pertains to the treatment and conceptualization of interest, referred to in Islamic jurisprudence as *riba*. Within the framework of Islamic finance, the charging or paying of interest is categorically prohibited, as it is considered not only exploitative in nature but also morally and socially unjust. This prohibition is derived from explicit injunctions in the Qur'an, which condemn *riba* as a practice that leads to economic inequality and unjust enrichment at the expense of others. As such, Islamic financial institutions are not permitted to engage in interest-based transactions under any circumstances.

In place of interest-based earnings, Islamic banks operate through a series of Shariah-compliant financial contracts that are grounded in real economic activity and mutual benefit. Prominent among these are *Murabaha* (a cost-plus financing arrangement), *Mudarabah* (a profit-sharing partnership), and *Ijarah* (a leasing contract). These instruments allow Islamic banks to earn legitimate profits by participating in trade, asset-based transactions, or joint ventures, thereby avoiding the ethical concerns associated with interest. Each of these contracts is designed to promote transparency, fairness, and equitable returns, aligning financial objectives with ethical considerations.

By contrast, conventional banks are fundamentally structured around the mechanism of interest, which serves as the primary source of income. In a conventional financial model, interest is charged on loans extended to individuals, businesses, and governments, and a corresponding rate of interest is paid on deposits made by customers. The difference—or "spread"—between the interest charged and interest paid constitutes a major portion of a bank's profit. This reliance on a predetermined, fixed return irrespective of economic outcomes stands in clear opposition to the Islamic financial model, which seeks to link financial gains to productive, risk-bearing activity.

Another essential divergence between the two systems is the approach to risk. Islamic banking places a strong emphasis on the principle of risk-sharing, reflecting a broader Islamic ethical commitment to justice, mutual cooperation, and economic fairness. In contracts such as *Musharakah* (a joint partnership) and *Mudarabah*, profits and losses are distributed between the bank and the client based on pre-agreed ratios. This structure incentivizes all parties involved to act prudently and collaboratively, fostering an environment of shared responsibility and

entrepreneurial accountability. In this way, Islamic finance is structured to focus on real economic activity, and its framework discourages certain speculative practices.

In sharp contrast, the conventional banking model predominantly operates on the basis of risk transfer. Once a loan is issued, the responsibility for repayment—with interest—rests entirely on the borrower, irrespective of the financial viability or success of the project for which the loan was taken. This one-sided risk allocation tends to protect the bank from loss, while placing the full burden of potential failure on the borrower. From an Islamic legal and ethical standpoint, such an arrangement is deemed inconsistent with the principles of fairness and distributive justice, as it often leads to economic hardship, particularly in times of financial distress or market downturns.

Furthermore, Islamic finance mandates that every financial transaction must be tied to a tangible asset or real economic activity. This requirement ensures that money is not treated as a commodity in itself, but rather as a means of facilitating legitimate trade and investment. The use of instruments such as *Ijarah* and *Istisna* (contracts for the manufacture or construction of goods) exemplifies this asset-based approach, which seeks to ensure that all financial dealings are firmly anchored in the actual production and exchange of goods and services. The framework seeks to limit speculation (*gharar*) and attempts to avoid financial bubbles, aiming for a stable transaction environment.

Conversely, conventional banks are not constrained by any such requirement to link lending activities to physical assets. Credit is often extended purely on the basis of a client's creditworthiness, and financial instruments—such as derivatives, futures, and options—are widely used, even when they are not connected to any tangible underlying assets. While these tools may enhance liquidity and allow for sophisticated financial engineering, they also introduce significant systemic risk, particularly when used for speculative purposes. Islamic finance views this as a deviation from the purpose of finance, which should serve the real economy and promote societal welfare.

Ethical and moral considerations also play a central role in the operation of Islamic banks. Islamic finance is not merely a financial system, but part of a broader ethical framework that aims to ensure socio-economic justice and the well-being of the community (*maslahah*). As a result,

Islamic financial institutions are prohibited from investing in industries and activities that are considered harmful or morally objectionable, including alcohol, gambling, tobacco, explicit media, and pork production. To ensure compliance with these principles, every Islamic bank is required to have a Shariah Supervisory Board (SSB), composed of scholars with expertise in Islamic law and finance. These boards are responsible for vetting financial products, issuing rulings (fatwas), and overseeing the bank's operations to ensure alignment with Shariah principles.

Conventional banks, by comparison, do not adhere to religious or ethical investment constraints unless these are imposed by regulatory authorities or voluntarily adopted under corporate social responsibility initiatives. Profit maximization remains the primary objective, and financial decisions are typically driven by market considerations, shareholder expectations, and legal compliance, without reference to moral or spiritual values.

A hallmark feature of Islamic banking is its reliance on equitable profit and loss sharing. This concept forms the foundation of several key financial instruments and reflects the broader Islamic ideal of justice in economic transactions. Profit-sharing contracts in Islamic finance are designed to involve both parties in the outcome of the transaction, sharing responsibilities and risks. Additionally, they promote a more sustainable financial system by encouraging the careful evaluation of investments and the avoidance of unsound or overly risky ventures.

In contrast, conventional financial systems often prioritize security and predictability of returns, offering fixed-income products such as bonds and interest-bearing loans that guarantee profits to lenders regardless of the performance of the underlying investment. While this may offer stability to investors, it can also lead to borrower over-indebtedness and systemic vulnerability, especially in times of economic crisis when income streams are disrupted but debt obligations remain fixed.

In terms of governance and regulatory oversight, Islamic banks are subject to an additional layer of supervision to ensure Shariah compliance. Each institution is guided by a Shariah board that plays an integral role in the development, approval, and monitoring of financial products and services. This body ensures that all transactions conform not only to national regulatory frameworks but also to Islamic legal principles. This dual compliance structure, while complex,

reflects the unique identity of Islamic finance and its commitment to operating within both secular and religious boundaries.

On the other hand, conventional banks are regulated solely by national or international financial authorities, such as central banks, securities commissions, or international regulatory bodies like the Basel Committee. These organizations establish rules on issues such as capital adequacy, liquidity, risk management, and consumer protection, but do not incorporate religious or ethical considerations into their oversight.

In conclusion, Islamic and conventional banking represent two distinct paradigms of financial thought and practice. The former is characterized by its prohibition of interest, emphasis on risk-sharing, insistence on asset-backed transactions, and adherence to ethical investment principles rooted in Islamic law. The latter prioritizes interest-based lending, risk transfer, and market-driven investment strategies, often without ethical constraints. As global interest in ethical and sustainable finance grows, the Islamic model offers a compelling alternative that integrates moral values with financial discipline. This comparative analysis illustrates not only the operational differences between the two systems but also the broader philosophical divide that continues to shape the future of global finance.

The interview offered relevant commentary on this point. It was suggested that there is no clear distinction between one system being better or worse; rather, each has its own specific applications and areas of relevance. In conventional finance, individuals have the flexibility to invest or take loans without necessarily specifying the purpose or how the funds will be used. This flexibility can lead to greater opportunities, but also higher exposure to risk and speculation.

Islamic finance, on the other hand, tends to offer more stability and safety. One of its key advantages lies in its adherence to principles like asset-backing and materiality. These principles prohibit speculative practices such as margin trading and investments in financial derivatives, which are often criticized for being disconnected from real economic activity. For example, trading in derivatives is likened to "buying fish in the sea" - investing in something that doesn't tangibly exist yet.

By requiring that transactions be backed by real, tangible assets, Islamic finance limits speculative behavior and promotes a more grounded approach to economic activity. This can

contribute to greater overall stability in both business and the broader economy. Nevertheless, both Islamic and conventional systems have their own unique roles and are suited to different financial needs and contexts.

Numerous studies and articles have explored the comparison between Islamic finance and conventional finance, particularly in terms of profitability. Some studies have analyzed profitability trends in Islamic banks and noted instances of financial consistency during certain economic periods.

During periods of financial crisis—such as the global mortgage crisis or the COVID-19 pandemic—conventional banks often experienced significant declines in performance and profitability. In some cases, Islamic banks showed less fluctuation in performance during financially turbulent periods. This suggests that the underlying principles of Islamic finance may contribute to greater resilience in times of economic uncertainty.

4. DEMOGRAPHICS AND MARKET REACH

The Muslim community, like many other large religious and cultural groups, is spread across the world, residing in various regions with diverse economic, political, and social landscapes. Currently, the global Muslim population is estimated to exceed two billion people, making up approximately one-fourth of the world's total population. This significant demographic presence underscores the importance of Islamic banking and finance, as Shariah-compliant financial services play a crucial role in meeting the economic needs of the Muslim community. The prevalence and development of Islamic financial institutions vary by country, largely depending on the size and influence of the Muslim population within each nation. Interestingly, despite common misconceptions, not all of the countries with the largest Muslim populations are located in the Middle East.

The country with the largest Muslim population is Indonesia, home to approximately 242.7 million Muslims, who constitute 88.25% of the nation's total population. This makes Indonesia not only the most populous Muslim-majority country but also a significant hub for Islamic financial institutions. Following closely behind is Pakistan, with an estimated 240.76 million Muslims, accounting for 96.46% of its total population. Together, Indonesia and Pakistan collectively account for nearly 25% of the world's Muslim population, highlighting their pivotal roles in the global Islamic economy.

India holds the third-largest Muslim population, which may be surprising given that the majority of its inhabitants adhere to Hinduism. However, due to India's vast overall population—approaching 1.5 billion people—its Muslim community numbers an estimated 200 million individuals. This makes India a key player in global Islamic finance, despite the fact that it is not officially a Muslim-majority country.

Next on the list is Bangladesh, where approximately 150.8 million Muslims make up the overwhelming majority of the population. Like its neighboring countries, Bangladesh has seen a growing interest in Islamic banking and financial services.

Perhaps unexpectedly, the fifth-largest Muslim population is found in Nigeria, an African nation where Islam is followed by nearly half of the total population. Currently, 97 million

Nigerians identify as Muslim, making Nigeria a critical country for the expansion of Islamic finance on the African continent.

In addition to Nigeria, which has been a focal point for the development of Islamic finance in Africa, Egypt also represents a key player in the region. Egypt is often regarded as the historical birthplace of Islamic banking, with institutions such as the Mit Ghamr Savings Bank, established in the 1960s, serving as early prototypes of modern Islamic financial systems. The country possesses a substantial Muslim population, estimated at approximately 90 million individuals. This figure constitutes nearly 95 % of Egypt's total population, thereby underscoring the significant potential for Islamic banking and finance within the nation. The demographic composition not only reflects strong cultural and religious alignment with Sharia-compliant financial practices but also positions Egypt as a strategically important market for the continued growth and expansion of Islamic financial services across the African continent.

Within Europe, the country with the largest Muslim population—excluding Turkey and Russia (Turkey due to its overwhelmingly Muslim demographic, with over 98 % of its population adhering to Islam, and Russia because of its complex geographical and cultural position)—is France. France is home to approximately 6.7 million Muslims, constituting around 10% of its total population. Other European countries with substantial Muslim communities include Germany, where approximately 4.6 million Muslims reside, accounting for about 5.5% of the total population; the United Kingdom, with a Muslim population of roughly 3.87 million, representing around 5.7%; and Italy, where an estimated 2.99 million Muslims comprise approximately 5% of the national population. As immigration patterns and birth rates continue to shape Europe's demographic landscape, projections suggest that these figures are likely to rise in the coming decades. In response to this growing demand, financial institutions across the continent are increasingly exploring and adopting Shariah-compliant financial products and services, thereby integrating Islamic finance into the broader European economic framework.

In contrast to Europe and Asia, the United States of America has a comparatively smaller Muslim population. Approximately 3.45 million Muslims currently reside in the U.S., constituting about 1% of the country's total population, which stands at approximately 327.8 million people. Several factors contribute to the relatively modest size of the Muslim population in the United States. One potential explanation is the historical and ongoing geopolitical and

economic tensions between the U.S. and key Muslim-majority regions, particularly in the Middle East, due in part to competition over oil and other strategic interests. However, despite these complexities, projections suggest that the Muslim population in the U.S. is likely to grow steadily in the coming years. Additionally, the United States represents an increasingly attractive market for Islamic financial products and services, as Muslim entrepreneurs and businesses seek opportunities to expand within the country's diverse and dynamic economic landscape.

Beyond the U.S.A., other regions such as Australia, Canada, and parts of South America also feature notable and growing Muslim populations that contribute to the global demand for Islamic financial services.

In Australia, Islam is the second-fastest-growing religion, with approximately 813,000 Muslims, making up around 3.2% of the country's total population. Canada similarly has a significant and expanding Muslim community, with an estimated 1.8 million individuals, representing about 4.9% of the national population.

While South America has a relatively small proportion of Muslims—less than 0.5% of the continent's total population—it is nonetheless home to an estimated 1.6 million Muslims. The largest concentrations are found in Argentina, with approximately 995,000 Muslims, and Brazil, with around 204,000, alongside smaller communities in countries such as Venezuela, Colombia, and Chile.

These demographic trends illustrate that interest in Islamic finance is not confined to traditionally Muslim-majority regions. As Muslim populations grow in diverse global contexts, there is a corresponding increase in the demand for Shariah-compliant financial products and services. Financial institutions in these regions are beginning to recognize this opportunity, positioning Islamic finance as a meaningful component of broader financial inclusion and market diversification strategies.

The global distribution of the Muslim population plays a critical role in shaping the development and expansion of Islamic banking and finance. As Islamic financial institutions continue to grow in response to the increasing demand for Shariah-compliant products, countries with significant Muslim populations—whether in Asia, Africa, Europe, or North America, or any other region—will likely experience greater integration of Islamic financial principles within

their economic systems. Furthermore, as globalization and migration patterns continue to influence demographic shifts, Islamic finance is poised to expand beyond traditional Muslim-majority countries, creating new opportunities for ethical and interest-free financial solutions worldwide.

The participant expressed interest in the stability and growing size of the Islamic finance sector, noting that it warrants more attention and deeper understanding. One particularly interesting aspect of Islamic finance is the concept of Qard Hassan—a benevolent loan. With this type of loan, an individual can borrow a sum, such as \$1,000, and repay the same amount without any interest. While there are specific conditions attached, the essence of this loan is that it is designed not to generate profit but to assist individuals who may be in need. For example, a student who lacks sufficient funds to cover their studies can receive a Qard Hassan loan to support their education, with no interest or profit involved. This reflects the broader philosophy of Islamic banking, which emphasizes helping individuals build their lives and futures, rather than focusing solely on profit.

Another important feature of Islamic finance mentioned was the Islamic insurance system, which operates differently from conventional insurance. In Islamic insurance, customers are treated as partners, and the system is based on the concept of Takaful—a cooperative model where participants share risk. This approach contrasts with traditional insurance models, where the insurer assumes the risk for a fee. The participant found these two aspects—Qard Hassan loans and the Takaful insurance system—particularly noteworthy and important components of Islamic finance.

5. ISLAMIC FINANCIAL INSTRUMENTS

5.1. Murabaha (cost + markup)

Murabaha is one of the most widely utilized financing methods in Islamic banking, primarily due to its transparency, straightforward structure, and compliance with Shari'ah principles. The Murabaha contract serves as an alternative to conventional debt or mortgage agreements, which typically involve interest payments based on the borrowed principal. However, Islamic law strictly prohibits the charging or payment of interest (riba) in any form, necessitating financial arrangements that adhere to Islamic principles while still allowing banks to generate revenue and sustain their operations.

In essence, the Murabaha contract operates in a manner akin to traditional debt agreements but with key distinctions that ensure its compliance with Islamic jurisprudence. One of the fundamental requirements of a Murabaha contract is that the bank must assume ownership of the asset being financed before it can be sold to the customer. This stipulation differentiates Murabaha from conventional loan structures in which financial institutions extend credit without direct involvement in the underlying asset. To maintain Shari'ah compliance, the execution of Murabaha must adhere strictly to Islamic legal guidelines to prevent any element of riba, uncertainty (gharar), or unjust enrichment.

In contrast to Western mortgage and debt financing systems, Murabaha does not incorporate interest payments as a means of generating profit. In a conventional mortgage agreement, the bank and the borrower typically agree on several key terms, including the principal loan amount, repayment period, interest rate (which may be fixed or variable), and the overall structure of the mortgage. Under this arrangement, ownership of the property transfers immediately to the buyer, meaning that the bank never possesses legal ownership of the asset and therefore does not bear the associated risks. This conventional model is largely incompatible with Islamic finance principles, as it involves riba and does not require the lender to assume ownership or risk related to the financed asset.

Given that Islamic banks operate within a profit-oriented framework, Murabaha must incorporate a legitimate mechanism for generating revenue while remaining compliant with Islamic law. This is achieved by structuring the transaction in a way that ensures the financial

institution assumes ownership of the asset before selling it to the customer at a marked-up price. The bank's profit, therefore, is derived from this markup rather than from interest payments, making the transaction permissible under Shari'ah.

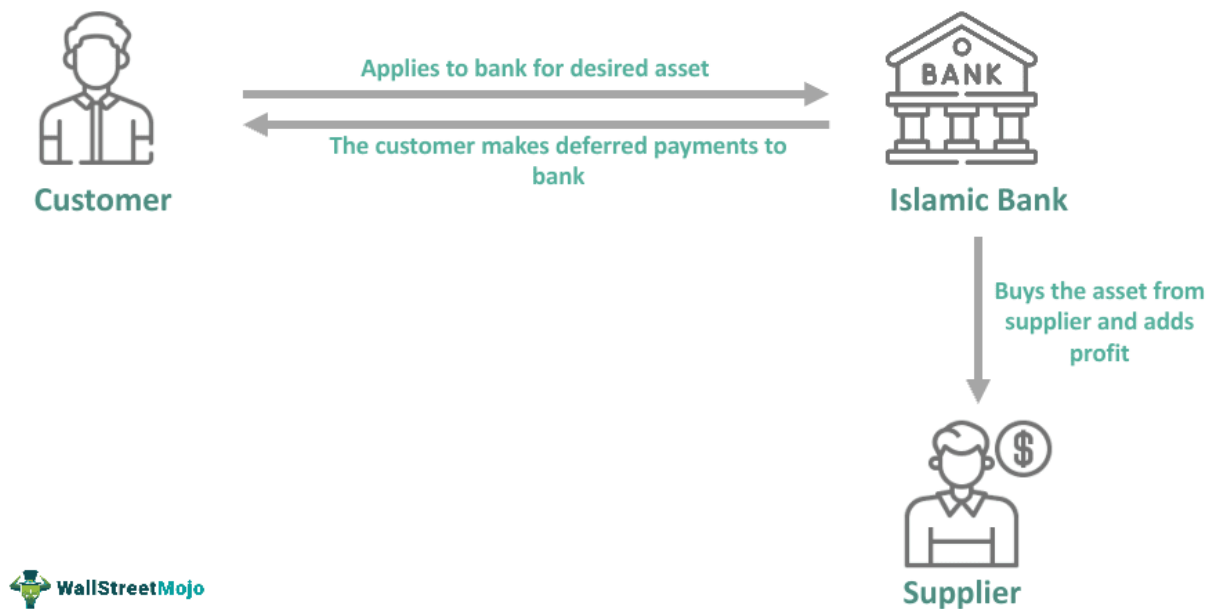
The process of initiating a Murabaha transaction begins when a customer approaches the bank with the intent to finance the purchase of a specific asset. To facilitate the transaction, the bank requires the customer to enter into an agency agreement, which designates the customer as an agent of the financial institution. This arrangement allows the customer to select the desired asset on behalf of the bank, ensuring that the asset meets their specific needs and preferences. Without this step, there would be a risk of the customer rejecting the asset if it were chosen directly by the bank, thereby complicating the transaction.

By acting as an agent, the customer assumes responsibility for selecting the asset and identifying a suitable seller. This structure effectively shifts the risk of non-delivery or dissatisfaction with the asset to the customer, as they are directly involved in the procurement process. Once the asset has been identified, the bank purchases it in its own name, thereby taking legal ownership and assuming the associated risks. Subsequently, the bank sells the asset to the customer at an agreed-upon price, which includes a profit margin. The customer then repays the bank in installments or through a deferred payment structure.

The key distinguishing feature of Murabaha is that the profit margin serves as an alternative to conventional interest, enabling Islamic banks to generate income in a manner that aligns with Shari'ah. The transfer of ownership to the customer occurs once the sales contract has been finalized, with both parties agreeing to the stipulated price and terms. It is crucial to note that once the contract has been executed, modifications to its terms are strictly prohibited under Islamic law, as any alterations could render the contract void.

Murabaha, therefore, represents a structured, risk-sharing financial arrangement that aligns with Islamic ethical and legal principles. By ensuring that the bank assumes ownership and risk before reselling the asset, this financing method provides a viable alternative to conventional interest-based lending, enabling financial institutions to operate within the framework of Islamic finance while meeting the needs of customers seeking Shari'ah-compliant financial solutions.

What Is Murabaha?



2. Figure How Murabaha works? - <https://www.wallstreetmojo.com/murabaha/>

5.2. Ijara (leasing)

Ijara, an essential concept in Islamic finance, is functionally analogous to the leasing arrangements commonly found in Western financial systems. While the fundamental structure of Ijara bears resemblance to conventional leasing practices, there are notable distinctions, particularly in terms of the underlying principles and objectives. In conventional financial systems, leasing is typically employed as a mechanism for renting or acquiring assets, whereas in Islamic banking, Ijara serves as a Shariah-compliant mode of financing, ensuring adherence to Islamic ethical and legal standards.

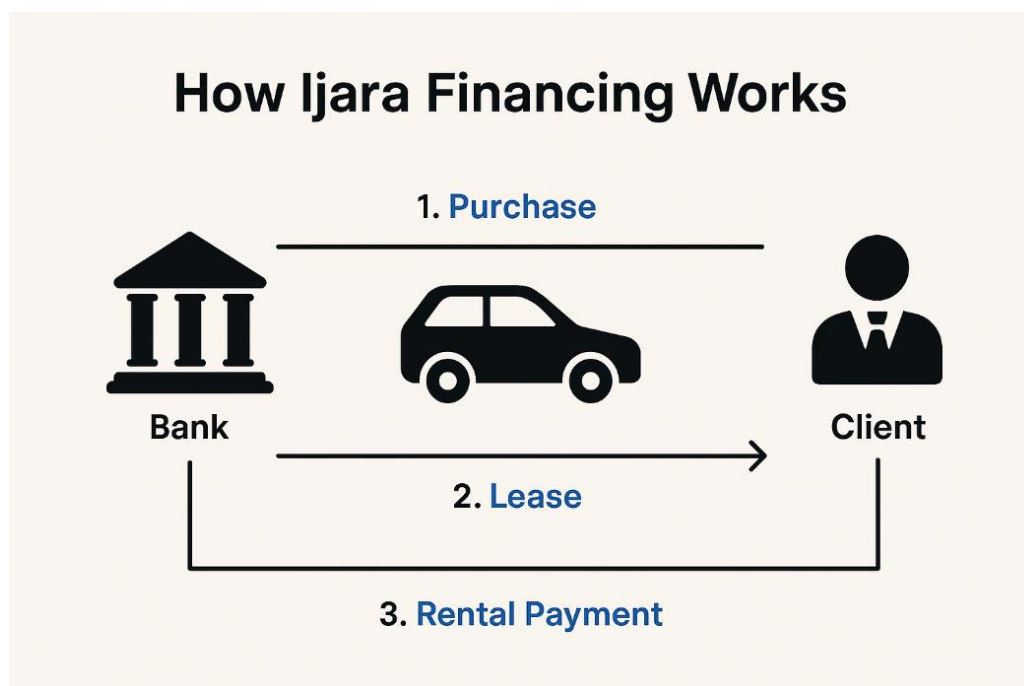
Leasing, in its general form, is a contractual agreement in which the lessor (seller or financial institution) permits the lessee (buyer) to utilize a specific asset for an agreed-upon period in exchange for periodic payments. This contractual arrangement is frequently applied to high-value assets such as vehicles, real estate, and machinery. When leasing a car, for example, the terms of the contract typically stipulate several key elements, including the duration of the lease, the monthly installment payments required from the lessee, and the residual value of the asset at the end of the lease term. Upon expiration of the contract, the lessee is given the option to purchase the asset by paying the pre-agreed residual value in a lump sum. If the lessee chooses not to acquire ownership of the asset, the lessor retains possession and may determine its future use, whether by leasing it to another party or disposing of it through other means.

Ijara, as practiced within Islamic finance, shares these fundamental characteristics but is structured to comply with Islamic principles prohibiting interest (riba) and ensuring ethical financial transactions. In this context, Ijara closely resembles Murabaha, another Islamic financing method, in terms of procedural execution. Under an Ijara arrangement, the customer and the Islamic financial institution enter into an agency contract, wherein the customer (acting as an agent) selects the asset they wish to lease. Subsequently, the bank or financial institution formally acquires ownership of the asset in its own name. Once ownership is secured, the bank and the customer enter into a leasing contract, outlining key details such as the agreed monthly installment payments, the final purchase price (if applicable), and the duration of the lease agreement.

Throughout the lease period, the Islamic financial institution retains legal ownership of the asset and assumes all associated risks, including maintenance and potential depreciation, unless

otherwise stipulated in the contract. At the end of the lease term, the lessee may acquire the asset by completing the final payment, thereby transferring ownership. A critical aspect of Ijara, as well as Murabaha, is the strict prohibition of any modifications to the terms of the contract once it has been signed. Any attempt to alter the agreed-upon terms renders the contract void and necessitates its immediate termination. This strict adherence to contractual integrity ensures compliance with Shariah principles, promoting ethical and transparent financial transactions in Islamic banking.

Overall, Ijara serves as a crucial financial instrument in Islamic banking, offering a Shariah-compliant alternative to conventional leasing while upholding principles of fairness, risk-sharing, and ethical financial conduct. By ensuring that all contractual obligations are fulfilled in accordance with Islamic law, Ijara contributes to the development of a financial system that aligns with Islamic ethical and legal principles, providing viable financing solutions without engaging in interest-based transactions.



3. Figure How Ijara works? - Made by the Author

5.3. Musharakah (co-ownership)

Musharakah is a fundamental concept in Islamic finance that exemplifies the relevance and applicability of Islamic banking principles in contemporary financial systems. This financing arrangement is particularly well-suited to the United States, where it provides both security and transparency to the involved parties. In recent years, an increasing number of individuals in the U.S. have opted for Musharakah-based mortgage financing as a Shariah-compliant alternative to conventional mortgage loans.

To understand how Musharakah mortgages function, it is useful to first examine the structure of a traditional mortgage. In a conventional mortgage arrangement, a prospective homebuyer selects a property and approaches a financial institution to obtain a loan. The bank evaluates the applicant based on several criteria, including income level—often assessed in relation to the amount being borrowed—and the availability of collateral, which in most cases is the property itself. Once the applicant satisfies the lender's requirements, the terms of the mortgage agreement are established and formalized through a contractual arrangement. Following the execution of the contract, the borrower takes immediate ownership of the property while simultaneously assuming the obligation to repay the loan in installments over an agreed-upon period.

In contrast, Musharakah-based mortgage financing operates under a partnership model in which both the buyer and the financial institution jointly acquire ownership of the property. Each party contributes a specified portion of the purchase price, thereby determining their respective shares of ownership. Over time, the buyer gradually purchases the bank's share of the property, increasing their ownership stake while decreasing the bank's involvement.

For instance, consider a scenario in which an individual (A) wishes to purchase a house valued at \$100,000 but possesses only \$25,000 in personal savings. In a Musharakah agreement, the individual approaches an Islamic financial institution (B) to co-purchase the property. If the bank agrees to contribute the remaining \$75,000, then the initial ownership distribution will be 25% for A and 75% for B. The parties then determine the monthly payments, the period within which A will acquire full ownership, and other relevant contractual terms. Under this arrangement, both parties share profits and risks, in accordance with Islamic financial principles. Furthermore, because the bank retains a significant ownership stake at the outset, it has a vested

interest in ensuring the property is well-maintained and secured, which ultimately benefits the buyer as well.

As time progresses, the ownership structure shifts as the buyer gradually acquires the bank's share through scheduled payments. Unlike conventional mortgages, where the lender earns interest on the loan, the bank in a Musharakah arrangement profits through its shared ownership and the agreed-upon financial terms. This model aligns with Islamic principles by avoiding interest (riba) and emphasizing risk-sharing, mutual benefit, and ethical financial practices.

Musharakah not only serves as a viable alternative to traditional mortgage financing but also reflects the broader principles of Islamic banking, which emphasize fairness, transparency, and shared responsibility. By integrating Shariah-compliant financial solutions into modern banking systems, Musharakah demonstrates the practical and ethical advantages of Islamic finance, making it an increasingly attractive option for individuals seeking interest-free homeownership solutions.

5.4. Mudaraba (finance + labor)

Mudaraba is a distinctive financial arrangement that mirrors the principles of Musharakah, characterized by a collaborative engagement between the parties involved. This financing method is particularly beneficial in circumstances where one participant possesses the requisite financial resources but lacks the operational expertise to initiate and run a business, while the other possesses the necessary skills but does not have adequate capital to establish the venture independently. Such a scenario underscores the utility of Mudaraba as an ideal solution to bridge the gap between financial provision and operational capacity.

In this arrangement, the party endowed with monetary resources enters into an agreement with the individual who possesses the operational acumen to manage the business venture. The financial provider commits to supplying the necessary capital required to launch the enterprise, while the skilled individual assumes the responsibility of its day-to-day operations. Subsequently, the two parties engage in negotiations to determine their respective shares of any profits (or losses) generated by the business. The allocation of profit-sharing may be influenced by several factors, including the level of risk assumed by each party. For example, in scenarios where the

financial contributor bears the full burden of potential financial losses - particularly in the event of business failure—the investor may seek a proportionately larger share of the profits compared to the operational partner. Conversely, if the business involves inherent risks that could jeopardize the safety and well-being of the labor provider, this individual may negotiate for a larger percentage of the profits in recognition of the heightened danger associated with their role.

It is essential that both parties finalize these terms prior to commencing business operations, thereby ensuring mutual understanding and clarity regarding their respective commitments and expectations.

To illustrate this concept further, consider the following example: Investor A identifies a lucrative opportunity to invest in a car mechanic workshop, motivated by the observation that there are no such establishments within the local vicinity, thereby creating a demand for automobile maintenance services. Recognizing a potential mechanic who possesses the necessary skills to operate the workshop but faces employment saturation at existing local garages, Investor A conceptualizes the establishment of a new business. After careful assessment, they conclude that an estimated capital of approximately \$100,000 is requisite to secure a suitable garage space equipped with essential tools and machinery for effective vehicle repair, as well as to maintain a cash flow for procuring necessary parts initially.

Given the significant capital requirement, both parties arrive at the conclusion that the associated risks necessitate an equitable distribution of profits that reflects their contributions. Consequently, they agree upon a profit-sharing ratio of 70% for the investor and 30% for the operational partner. This arrangement ensures that both parties attain a fair compensation commensurate with their investment of resources and expertise, thus establishing a foundation for a potentially successful business venture.

5.5. Sukuk (bonds)

Sukuk, commonly referred to as Islamic bonds, represent a distinctive form of investment designed for individuals seeking Shari'ah-compliant financial instruments. Unlike conventional bonds, which are based on interest-bearing debt obligations, Sukuk adhere to Islamic financial principles that prohibit *riba* (interest) and emphasize ethical investment. As a result, Sukuk

provide investors with an alternative means of participating in financial markets while ensuring compliance with Islamic law.

Similar to other Islamic financing instruments, Sukuk are asset-backed securities. This means that the proceeds from Sukuk issuance are directly linked to tangible, identifiable assets, which can be used for financing business operations, infrastructure development, or corporate expansion. For instance, a company seeking funds for the construction of a new facility may issue Sukuk to raise the necessary capital. Rather than creating a conventional debt obligation, Sukuk grant investors ownership rights in the underlying assets.

One of the defining characteristics of Sukuk is that investors do not hold a claim to future debt repayments, as is the case with traditional bonds. Instead, investors are issued certificates that represent proportional ownership in the asset to which the Sukuk is linked. Consequently, Sukuk can only be structured around identifiable assets—assets whose market value can be objectively determined at a specific point in time. Upon maturity, Sukuk holders are repaid the principal investment amount at par value. However, unlike conventional bonds, which are priced based on the creditworthiness of the issuer, Sukuk valuation is directly tied to the market value of the underlying asset at the time of redemption. Additionally, investors receive a share of the profits generated by the asset during their holding period, rather than earning fixed interest payments.

The key distinctions between Sukuk and conventional bonds can be summarized as follows:

Asset-backed vs. Debt-based – Sukuk are backed by tangible assets, while conventional bonds represent a debt obligation of the issuer.

Return on Investment – In conventional bonds, returns are based on pre-agreed interest rates, whereas Sukuk returns fluctuate based on the performance and appreciation of the underlying asset.

Valuation Basis – The value of a bond is determined by the issuer's credit rating and market interest rates, while the value of Sukuk is based on the market valuation of the asset to which it is tied.

Despite these differences, Sukuk and conventional bonds share certain similarities. Both instruments provide investors with a stream of periodic payments, making them attractive for those seeking regular returns. Additionally, both Sukuk and bonds are generally considered less risky than equities, making them appealing to investors with a lower risk tolerance.

Sukuk offer a valuable investment opportunity for individuals who seek financial products that comply with Islamic principles while still generating competitive returns. Sukuk offer a financial mechanism aligned with Islamic principles, serving as an alternative to traditional interest-based bonds, contributing to the growth of Islamic capital markets while ensuring financial stability and sustainability.

5.6. Salam (finance before delivery)

Salam (also known as Bay‘ al-Salam) is a forward sale contract that represents one of the classical financing instruments in Islamic commercial jurisprudence. Rooted in the principles of the Shariah, Salam was historically developed to facilitate the needs of agricultural producers by providing them with working capital prior to the harvesting of crops. It remains a fundamental contract in modern Islamic finance, particularly within sectors that require pre-delivery payment structures, such as agriculture, manufacturing, and trade finance.

Under a Salam contract, the buyer agrees to pay the full purchase price of a specified good in advance, at the time of contract initiation, while the seller commits to deliver the good at a future specified date. The asset in question must be clearly defined in terms of quantity, quality, and delivery date, and must be a fungible, standardized item that can be precisely described. Importantly, the good sold under a Salam contract cannot be a specific or unique item (e.g., a particular car or house), and it must not yet exist at the time of sale.

Salam is an exception to the general rule in Islamic law that prohibits the sale of non-existent goods, which is normally classified under Bay‘ al-Ma‘dum and considered invalid due to the prohibition of gharar (excessive uncertainty). However, classical jurists permitted Salam on the grounds of public interest (maslahah), particularly due to its benefits to farmers and small producers who lack upfront capital but require financing to continue production. This rationale continues to justify its application in contemporary Islamic finance.

Modern Islamic banking institutions use Salam as a tool for Shariah-compliant short-term financing, often in combination with other contracts (such as parallel Salam) to manage operational risks and ensure liquidity. In a parallel Salam, the Islamic bank enters into a second Salam contract with a third party to whom it sells the goods it will receive from the original seller, thereby mitigating inventory risk.

From a risk management perspective, Salam contracts require robust oversight due to the potential for delivery default, quality disputes, or market price fluctuations. As such, Islamic banks engaging in Salam financing typically apply strict due diligence and risk-mitigation mechanisms, including detailed contract specifications, quality assurance protocols, and delivery guarantees.

In sum, Salam financing provides a Shariah-compliant alternative to conventional prepayment or working capital finance, aligning with the ethical and legal principles of Islamic commercial law. It exemplifies the adaptability of Islamic contractual structures in meeting modern financial needs while preserving the normative foundations of the Shariah.

5.7. Takaful (insurance)

Takaful, derived from the Arabic root word *kafala* (meaning "guaranteeing" or "mutual responsibility"), refers to a Shariah-compliant alternative to conventional insurance. It is a cooperative model based on the principles of mutual assistance, shared responsibility, and risk-sharing, designed to protect participants against defined losses. Takaful aligns with the ethical and legal norms of Islamic jurisprudence (*Fiqh al-Mu'amalat*) by avoiding elements prohibited under Islamic law, namely *riba* (interest), *gharar* (excessive uncertainty), and *maysir* (gambling or speculation), all of which are intrinsic to conventional insurance models.

In a Takaful scheme, participants contribute to a common pool of funds with the intention of mutually supporting one another in times of need. These contributions are considered donations (*tabarru'*) rather than payments for a commercial contract, thereby establishing a cooperative and non-profit-oriented framework. When a participant suffers a defined loss or damage, compensation is paid out of the pooled fund, subject to the conditions of the Takaful agreement. The operator—typically a Takaful company—manages the fund either on a *wakalah*

(agency) basis, charging a pre-agreed fee, or under a mudarabah (profit-sharing) model, where profits from the fund's investment activities are shared between the operator and the participants.

From a financial structuring perspective, Takaful plays a critical role in Islamic finance by offering a Shariah-compliant risk mitigation tool, thereby facilitating broader financial inclusion and stability. It is particularly important in supporting Islamic banking and investment services, where conventional insurance cannot be used due to its non-compliance with Shariah principles. Takaful products span a wide array of services, including family Takaful (akin to life insurance), general Takaful (covering health, property, auto, and liability risks), and re-Takaful (Shariah-compliant reinsurance mechanisms).

The growth of the Takaful industry has been significant over the past two decades, with increasing demand observed in both Muslim-majority countries and jurisdictions with growing interest in ethical finance. Despite its progress, the sector faces several challenges, such as regulatory standardization, operational efficiency, and limited public awareness. Additionally, investment management of Takaful funds requires careful alignment with Islamic investment principles, further complicating operational models.

To address these issues, global institutions such as the Islamic Financial Services Board (IFSB) and Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) have developed standards to enhance governance, transparency, and risk management practices in Takaful operations.

6. REASONS FOR GROWTH IN ISLAMIC BANKING

The sustained and substantial growth of the Islamic banking system over the past few decades demonstrates its increasing appeal not only in Muslim-majority countries but also in various regions across the globe. This expansion challenges the misconception that Islamic banking is solely intended for those who adhere to Islamic principles. Instead, its unique financial model—based on ethical, interest-free transactions—has attracted a diverse customer base, including non-Muslim individuals and businesses seeking alternatives to conventional banking. The question then arises: What factors contribute to the widespread adoption of Islamic banking on a global scale?

One of the primary reasons behind the success of Islamic banking is its inclusive and non-discriminatory nature. Contrary to what some may assume, Islamic banks do not restrict access to their services based on religious affiliation. While their operations are guided by Shariah principles, these institutions welcome all customers, regardless of their beliefs or cultural backgrounds. This inclusivity plays a crucial role in attracting individuals and businesses who are interested in ethical banking practices, fair financial dealings, and interest-free financial solutions. Many people who may not necessarily follow Islamic teachings still choose Islamic banking because of its emphasis on transparency, ethical investments, and risk-sharing mechanisms.

Another significant factor fueling the expansion of Islamic banking is its alignment with the financial needs of Muslim populations, particularly in regions where conventional banking systems conflict with Shariah principles. The presence of *riba* (interest) in traditional financial institutions poses a major obstacle for observant Muslims who wish to comply with Islamic teachings. Since Islamic banking operates without interest-based transactions and instead focuses on asset-backed and risk-sharing models, it provides a viable alternative for individuals who would otherwise have limited access to financial services. This demand has driven Islamic financial institutions to expand their reach, ensuring that Shariah-compliant banking services are accessible in diverse markets.

A key contributor to the rapid growth of Islamic banking is its willingness to adapt to contemporary financial needs and technological advancements. Unlike traditional perceptions of Islamic finance as a rigid or outdated system, modern Islamic banks are increasingly integrating

new financial technologies, digital banking solutions, and innovative products to remain competitive within the global banking landscape. These institutions actively seek ways to align their services with international banking standards while maintaining compliance with Islamic law.

To bridge the gap between Islamic finance and the conventional banking sector, Islamic financial institutions frequently collaborate with financial experts, regulatory bodies, and technology firms to enhance their offerings. The adoption of digital banking, mobile financial services, and online investment platforms has made Islamic banking more accessible and user-friendly, attracting tech-savvy customers who seek efficient and convenient banking experiences. This modernization has allowed Islamic banking to compete with mainstream financial institutions while maintaining its distinct ethical framework.

Additionally, as people increasingly explore alternative banking solutions, many are drawn to Islamic banking due to its emphasis on financial justice, ethical investing, and economic stability. Individuals who may not have previously considered Islamic finance are now viewing it as a credible option for meeting their financial needs—whether in securing housing, purchasing vehicles, or making long-term investments. The appeal of a financial system that promotes fairness, reduces economic exploitation, and discourages excessive speculation has resonated with a broad audience beyond the Muslim community.

As Islamic banking continues to evolve, its influence in the global financial market is expected to grow. The increasing number of Shariah-compliant financial institutions, investment funds, and international partnerships demonstrates that Islamic finance is not merely an alternative for religious reasons but also a strategically sound and sustainable financial model. With more countries recognizing the benefits of interest-free banking and ethical finance, Islamic banking is poised to expand further, offering innovative and inclusive financial solutions to diverse populations worldwide.

By embracing technological advancements, regulatory reforms, and cross-border collaborations, Islamic banking institutions are demonstrating their commitment to remaining relevant in an increasingly interconnected and digitalized world. Their ability to adapt to modern financial demands while staying true to their ethical principles ensures that they will continue to

attract customers from different backgrounds, reinforcing their role as a significant force in the global banking sector.

My interviewee said that the need for Islamic Banks and for the Islamic Financial system exists not just in Europe. The growth of the system has been above 10% every year in the last 20 years, which shows Islamic Banking takes an important part in the global economy as well, thanks to the foundations, such as materiality and risk sharing. Since every transaction must be linked to the real economy through assets, these include every transaction and every loan. These properties make Islamic Banking safer and more stable than the conventional banks. Interest in Islamic banking increased following the US mortgage crisis, with some attributing this to differences in how Islamic financial systems operate. In general, not just Europe but the whole world and the global economy needs the Islamic Financial system.

The growth of Islamic banking has been remarkable over the past few decades, with a significant presence in both Muslim-majority countries and non-Muslim regions. The table on the right provides a detailed ranking of the countries with the most Islamic banks, organized in descending order, along with the total assets these institutions manage (in billion USD). It is important to note that the asset values listed do not represent the total financial assets of these countries. Instead, they indicate the percentage share of Islamic banking assets relative to the total financial assets within the banking sector of each nation.

The ranking reveals Sudan as the leading country, where Islamic banks control 100% of the banking sector. Other major players include Saudi Arabia (74.9%), Kuwait (51%), Qatar (28.6%), and Djibouti (25%). Additionally, the United Arab Emirates, Jordan, Palestine, Oman, and Bahrain hold significant shares, ranging between 16.1% and 22.7%. These figures highlight the dominance of Islamic banking in certain regions, particularly in the Middle East and North Africa (MENA), while also demonstrating its gradual expansion into new markets.

The scale of Islamic banking's growth is further illustrated by the financial performance of the largest institutions in the sector. In 2022, the top 15 Islamic banks collectively managed nearly 770 billion USD in assets, reflecting the increasing demand for Shariah-compliant financial services. Many of these banks have expanded beyond their home countries to establish an international presence. For instance, Bank Al Baraka, one of the most prominent Islamic

financial institutions, operates in more than 15 different countries, illustrating the cross-border nature of Islamic banking.

Islamic Bank Rank 2024	Islamic Bank Rank 2023	Bank	Country	Assets (\$million)
1	1	Al Rajhi Bank	Saudi Arabia	215,504
2	3	Kuwait Finance House	Kuwait	123,682
3	5	Dubai Islamic Bank	UAE	85,563
4	7	Alinma Bank	Saudi Arabia	63,127
5	6	Maybank Islamic	Malaysia	62,502
6	10	Abu Dhabi Islamic Bank	UAE	52,496
7	8	Qatar Islamic Bank	Qatar	51,959
8	9	Masraf Al Rayan	Qatar	45,104
9	-	Ahli United Bank	Bahrain	41,900
10	11	Bank Albilad	Saudi Arabia	38,164

4. Figure Top 10 biggest Islamic banks in 2024 - <https://tabinsights.com/ab100/largest-islamic-banks>

Furthermore, data from 2021 to 2022 indicates a significant increase in the total assets of Islamic banks, with several institutions almost doubling their financial portfolios within just one year. This rapid growth is indicative of the system's increasing global appeal and its ability to compete with conventional financial institutions by offering viable, ethical alternatives that comply with Islamic principles.

While the most prominent Islamic financial institutions are based in Muslim-majority nations, the influence of Islamic banking extends well beyond these regions, particularly in Asia, Africa, and Europe.

One of the most dynamic regions for Islamic finance is the Asia-Pacific, which accounts for 25% of the total Islamic financial system. A major contributor to this is Malaysia, which has established itself as a leading hub for Islamic finance. The country plays a pivotal role in the sukuk (Islamic bond) market, with its capital, Kuala Lumpur, hosting the Islamic Financial Services Board (IFSB)—one of the world's most influential regulatory bodies for Islamic finance.

Other important Islamic banking markets in the region include Bangladesh, Brunei, and Pakistan, which together hold 15% of the total Islamic banking assets. However, an interesting

case is Indonesia, the world's most populous Muslim country, where Islamic banking has historically had a limited presence despite over 90% of the population identifying as Muslim. For many years, Indonesia's financial sector remained dominated by conventional banking systems. However, recognizing the untapped potential, Indonesian authorities have recently taken significant steps to develop a comprehensive roadmap for Islamic finance, in collaboration with Malaysian experts. These efforts led to the establishment of Bank Syariah, which quickly became one of the ten largest Islamic banks in the world.

Africa presents a compelling example of a region where Islamic finance has yet to reach its full potential but has already made substantial progress in recent decades. Islamic finance in Africa is still in its early stages, yet it has gained significant traction as more countries recognize its economic benefits.

A major milestone was achieved in March 2024, when Uganda opened its first Shariah-compliant bank, operating under the Salaam Group. The slower penetration of Islamic finance in Africa can be attributed to several factors, including limited financial literacy, vast geographic territories, and underdeveloped regulatory frameworks. The absence of strong financial infrastructure in many African nations has historically hindered the establishment of a robust Islamic banking sector. However, as regulatory bodies and governments work toward enhancing financial education and creating legal frameworks for Shariah-compliant banking, the potential for growth remains substantial.

Europe represents yet another promising region for Islamic banking, with growing demand for Shariah-compliant financial services. Following the 2008 Global Financial Crisis, many individuals and businesses sought alternatives to conventional banking due to concerns about excessive risk and unethical financial practices. Islamic banking, which emphasizes risk-sharing, ethical investment, and financial transparency, was viewed as a stable and reliable option for financial recovery.

Among European nations, London has emerged as the leading center for Islamic finance, hosting five fully licensed Islamic banks and offering over 20 different Shariah-compliant financial products. The United Kingdom has played a pivotal role in integrating Islamic banking

into the global financial system, positioning itself as a bridge between the Middle East, Asia, and Western financial markets.

Other European countries have also made significant strides in Islamic finance. For instance:

Luxembourg became the first European nation to issue sovereign sukuk (Islamic bonds), demonstrating its commitment to fostering Islamic financial markets.

Germany has taken active steps in supporting Islamic finance, issuing several sukuks and, in 2015, licensing its first full-fledged Islamic bank—KY Bank AG.

France, home to the largest Muslim population in Europe, initially showed strong interest in expanding Islamic banking. However, security concerns and political challenges following a series of terrorist attacks led to a halt in government-led Islamic finance initiatives. Despite this, several French investment banks continue to offer Shariah-compliant financial products, particularly catering to wealthy foreign investors.

The global expansion of Islamic banking underscores its growing relevance as an alternative financial system that transcends religious and cultural boundaries. While its strongest presence remains in Muslim-majority countries, the system has successfully penetrated new markets in Asia, Africa, and Europe, demonstrating its viability and appeal beyond traditional Islamic regions.

The rapid increase in total assets managed by Islamic banks, coupled with successful regulatory developments and international collaborations, signals a promising future for Shariah-compliant finance. As Islamic banking continues to modernize and adapt to global financial trends, it is expected to further integrate into the mainstream financial sector, offering an ethical and stable alternative to conventional banking worldwide.

CONCLUSION

The primary objective of this research is to explore the distinctive features of financing within the Islamic banking system and to conduct a comparative analysis with the well-established Western banking model. The study specifically focuses on the financing methods employed in Islamic banking, the structural components that define this system, the legal and religious restrictions that shape its operations, and the ways in which Islamic financial institutions manage to provide essential banking services while adhering to Shari'ah (Islamic law).

A key motivation behind this thesis is the growing prominence of Islamic banking as a viable and expanding financial system. In recent years, Islamic banking has witnessed significant global growth, progressively extending its influence beyond traditionally Muslim-majority countries. However, despite its increasing presence in international markets, there remains a widespread lack of awareness and understanding among non-users, which often leads to skepticism regarding the credibility and reliability of the Islamic financial system. This research seeks to bridge this knowledge gap by providing an in-depth analysis of Islamic banking, outlining its differences from conventional Western banking, and addressing common misconceptions. By presenting a well-rounded examination of this financial model, this study aims to challenge and dispel certain prejudices associated with the financial institutions established and operated within Islamic principles.

Furthermore, globalization and demographic shifts have facilitated increased migration and cultural integration, leading to the expansion of Muslim communities in non-Islamic countries. As financial inclusivity becomes a priority for many nations, it is becoming increasingly evident that the establishment of at least one Shari'ah-compliant financial institution within national banking frameworks will be necessary to accommodate the diverse financial needs of their populations. The growing demand for ethical finance, coupled with the rising presence of Muslim populations in various regions, underscores the importance of understanding and integrating Islamic banking into the global financial landscape.

To achieve the objectives of this research, the thesis examines and explains several fundamental financing methods utilized in Islamic banking. These financial instruments, which differentiate Islamic banking from conventional Western banking, include:

Murabaha (Cost-Plus Financing): This method is analogous to mortgage or debt contracts in conventional banking. In a Murabaha transaction, the bank purchases an asset on behalf of a client and resells it at a predetermined markup, allowing the client to make deferred payments. Importantly, interest (riba) is not charged; instead, profit is generated through the sale of tangible goods.

Ijara (Leasing): Ijara is a lease agreement in which the bank retains ownership of the asset while the client pays rental fees for its use. Unlike conventional lease agreements, Ijara contracts ensure that ownership remains with the lessor unless a separate contract for transfer of ownership is agreed upon. Unlike Western lease agreements with residual value clauses, Ijara does not impose interest-based conditions.

Musharakah (Joint Partnership): In this financing model, two or more parties contribute capital to jointly own an asset or business. As partners, all parties share profits and losses based on their respective contributions. This method differs significantly from traditional Western loans, as it fosters risk-sharing between the financier and the client rather than burdening the latter with fixed interest payments.

Mudaraba (Trust-Based Investment Partnership): This form of financing is frequently used in project investments, where one party (the financier) provides the capital, while the other party (the entrepreneur or manager) contributes expertise and labor. Profits are shared according to a pre-agreed ratio, while financial losses are borne solely by the investor unless negligence or misconduct is involved.

Sukuk (Islamic Bonds): Sukuk is an Islamic alternative to conventional bonds, used primarily for capital raising and crowd financing. Unlike interest-based bonds, Sukuk represent ownership in an underlying asset, granting investors a share of the asset's returns rather than fixed interest payments.

By analyzing these financing methods, this research provides an in-depth understanding of how Islamic banking operates within the constraints of religious guidelines while offering practical financial solutions. The findings of this study contribute to the broader discourse on ethical and interest-free banking models, emphasizing the increasing relevance of Islamic banking in today's global financial environment.

In the context of an increasingly globalized world, where geographical boundaries no longer pose significant restrictions on migration and cross-border settlement, the need for financial inclusivity has become more pronounced than ever. As individuals relocate to different regions for work, education, or personal reasons, financial institutions must evolve to accommodate diverse cultural and religious needs. Islamic banking, in particular, plays a crucial role in addressing the financial requirements of Muslim populations who remain committed to their religious beliefs and seek to manage their finances in accordance with Islamic principles.

For devout Muslims who strive to lead their lives in strict adherence to the Quran and Shari'ah law, access to financial institutions that comply with Islamic guidelines is not merely a preference but a necessity. Conventional banking systems, which are predominantly based on interest-bearing transactions (*riba*), speculative investments (*gharar*), and uncertain financial practices, are fundamentally incompatible with Islamic teachings. Consequently, the demand for Shari'ah-compliant financial services has grown significantly in both Muslim-majority and non-Muslim countries, necessitating the establishment and expansion of Islamic banking institutions worldwide.

It is my perspective that Islamic banking is not only an essential component of modern financial systems but also possesses the potential for widespread adoption beyond Muslim communities. While initially designed to cater to the specific needs of Muslims, the ethical and transparent financial principles upon which Islamic banking is built make it an appealing alternative for individuals of various religious and cultural backgrounds. The model of Islamic finance includes elements such as risk-sharing and ethical considerations, which resonate with certain financial preferences, and prioritizes transparency, sustainability, and equitable financial transactions.

As Islamic banking continues to expand, it is inevitable that awareness and understanding of its principles will increase among the broader population. The structured and well-defined nature of its financial operations, which prohibit exploitative practices and promote mutual benefit between financial institutions and their clients, serves as a testament to its viability as a modern banking model. With continuous growth and adaptation, Islamic banking is expanding in various markets, offering an alternative financial approach influenced by religious and economic principles.

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APPENDICES

DECLARATION of originality

I, the undersigned KEVIN PANAIK.....aware of my criminal responsibility,
I declare that the facts and figures contained in my dissertation correspond to reality and
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