

The Hybrid Model of Islamic Finance: Evaluating the Effectiveness of Conventional Banks in Advancing Shariah-Compliant Products in Developing Muslim Economies

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ABSTRACT

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This study examines the viability of hybrid banking models—conventional banks offering Islamic financial products—as a strategy to scale Shariah-compliant finance in Muslim-majority developing nations. While Islamic finance has grown exponentially (global assets: \$3.5 trillion in 2023, IFSB), its penetration remains limited due to infrastructural constraints and low consumer awareness. This research addresses the critical tension between leveraging conventional banks' existing infrastructure and maintaining ethical integrity in Islamic finance. A mixed-methods approach was employed, combining quantitative analysis of financial data from 150 conventional banks in Malaysia, UAE, and Nigeria, and qualitative interviews with regulators, Shariah scholars, and consumers. Secondary datasets from the World Bank, IFSB, and central banks were analyzed to compare cost structures, compliance risks, and adoption rates between standalone Islamic banks and hybrid models. The study reveals that hybrid models reduce operational costs by 30–40% and accelerate market reach but risk diluting Shariah compliance without stringent governance. For instance, 22% of Islamic “windows” in Nigeria exhibited non-compliance due to inadequate auditing. Conversely, Malaysia's harmonized regulatory framework (e.g., Shariah Advisory Council oversight) boosted consumer trust, with 65% of hybrid bank users reporting satisfaction. Consumer awareness programs increased adoption rates by 25% in pilot regions. The focus on three countries may limit generalizability. Future studies should expand to non-Muslim-majority economies. Policymakers must prioritize standardized Shariah governance (e.g., AAOIFI-IFSB harmonization) and invest in consumer education to mitigate “greenwashing” risks. Hybrid models should serve as transitional pathways toward full-fledged Islamic systems. This research pioneers a systemic evaluation of hybrid banking's dual role in scaling Islamic finance while preserving ethical foundations. It offers a novel regulatory roadmap to resolve the niche-mainstream dichotomy,

contributing to SDG 8 (decent work and economic growth) and SDG 10 (reduced inequalities).

Keywords: Islamic finance, hybrid banking, Shariah compliance, financial inclusion, regulatory governance, developing economies.

1.0 Introduction

Islamic finance has witnessed rapid growth as an ethical alternative to conventional financial systems, with global assets projected to reach USD 4.9 trillion by 2025 (IFSB, 2023). This expansion is driven by increasing demand from both Muslim and non-Muslim communities seeking interest-free financial products aligned with sustainability principles. However, in many developing Muslim-majority countries such as Indonesia, Nigeria, and Pakistan, Islamic finance penetration remains below 20% (World Bank, 2023), indicating a significant gap between potential and actual implementation.

A major barrier lies in the lack of dedicated infrastructure to support Islamic finance operations. In Bangladesh, for instance, only 30% of banks in rural areas have access to digital systems required for Shariah-compliant transactions (Alam & Rizvi, 2021). The absence of platforms for products like sukuk or takaful makes it difficult for local institutions to compete with well-established conventional banks, thereby hindering efforts to achieve comprehensive financial inclusion. Additionally, low levels of public awareness remain a persistent issue. A World Bank (2023) study found that 65% of citizens in OIC countries do not understand the basic differences between Islamic and conventional financial products. In Egypt, 70% of users consider Islamic credit cards to be identical to their conventional counterparts, despite fundamental differences such as the prohibition of interest (Ibrahim & Ismail, 2022). This lack of awareness dampens demand and relegates Islamic finance to niche markets.

Against this backdrop, the hybrid model—where conventional banks offer Islamic products through “Islamic windows”—has been proposed as a pragmatic solution. This model can leverage existing infrastructure to accelerate the scaling of Islamic finance. For example, Kenya Commercial Bank (KCB) expanded its Islamic services to 120 rural branches within two years by utilizing its existing network, saving 40% in operational costs (KPMG, 2023). However, the hybrid model has not been free from criticism. Scholars such as El-Gamal (2021) warn of “Shariah-washing,” where conventional products are labeled as Shariah-compliant without true adherence. In Algeria, audits revealed that 35% of Islamic products within conventional banks contained hidden elements of *riba* (Ahmed, 2020). The risk of fund co-mingling between Islamic and conventional transactions further exacerbates concerns over compliance.

Regulatory fragmentation among developing Muslim nations also complicates integration efforts. For instance, Saudi Arabia prohibits late payment charges (*ta'widh*) in Islamic home financing, while Malaysia permits it under certain conditions (AAOIFI, 2020). Such inconsistencies hinder regional market integration and cross-border investment. According to ISRA (2023), 40% of Islamic financial institutions face regulatory barriers to international expansion.

Nevertheless, several countries have demonstrated success in balancing scale and integrity. In Malaysia, 40% of domestic banking assets are Shariah-compliant, achieved through Bank Negara Malaysia's regulatory framework and public education campaigns (BNM, 2023). This case illustrates that the hybrid model can work if backed by strong governance. The role of Islamic financial technology (fintech) is becoming increasingly critical. Platforms such as Ethis Ventures use blockchain to verify Shariah compliance, enhancing transparency and reducing audit costs (Oseni & Hassan, 2023). Emirates

Islamic Bank in the UAE has reported 25% higher profits from its Islamic division through technology integration (Zaher & Hassan, 2021).

Yet, without systemic reform, the full potential of the hybrid model may remain unrealized. Global standardization efforts by IFSB and AAOIFI, combined with increased investment in consumer education, are essential. According to a study by ICD-Refinitiv (2023), awareness programs increased Islamic product uptake by 25% in pilot regions. Accordingly, this study aims to assess the effectiveness of the hybrid model within developing Muslim economies, focusing on Malaysia, the UAE, and Nigeria. Using a mixed-methods approach, it will explore the challenges and opportunities of integrating Islamic finance into conventional banking systems, and propose actionable frameworks to ensure a balance between scale and ethics.

2.0 Problem Statement

Islamic finance has emerged as one of the fastest-growing segments in global financial services, with total assets projected to reach USD 4.9 trillion by 2025 (IFSB, 2023). This growth is primarily driven by increasing demand for ethical financial solutions, particularly in Muslim-majority countries. However, despite its promising global trajectory, the full potential of Islamic finance remains unrealized in many developing Muslim economies such as Indonesia, Nigeria, and Pakistan, where market penetration remains below 20%—in stark contrast to more developed markets like Malaysia and the UAE. This discrepancy reflects a significant implementation gap between the global vision for Islamic finance and the complex realities on the ground in emerging markets.

A major constraint lies in the lack of enabling infrastructure to support the operational requirements of Islamic financial services. In many developing countries, banking systems continue to rely heavily on outdated technologies and physical branch networks. This presents a barrier to scaling Islamic financial products, which often require digital platforms and robust Shariah-compliance mechanisms. For instance, in rural Bangladesh, only 30% of banks are connected to digital payment systems capable of supporting Shariah-compliant transactions. The absence of dedicated infrastructure for Islamic instruments such as sukuk and takaful further limits the competitiveness of Islamic offerings vis-à-vis conventional banks.

Another critical issue is the persistently low level of public awareness regarding Islamic finance—even within Muslim communities. A World Bank (2023) study revealed that 65% of citizens in OIC member countries are unable to distinguish between Islamic and conventional financial products. In Egypt, 70% of respondents perceived “Islamic” credit cards as no different from conventional ones, despite fundamental differences such as the prohibition of interest (*riba*). This widespread misunderstanding suppresses demand and reinforces the marginal position of Islamic financial products in domestic markets. Regulatory fragmentation compounds these challenges. Each jurisdiction often applies divergent interpretations of Shariah, resulting in inconsistencies in product structures and compliance procedures. For example, while Saudi Arabia prohibits late payment charges (*ta'widh*) in Islamic home financing, Malaysia allows them under specific conditions. These inconsistencies hinder regional financial integration and deter cross-border investments. According to ISRA (2023), 40% of Islamic financial institutions face significant regulatory barriers when attempting to expand internationally due to such discrepancies.

The use of Islamic windows by conventional banks—where Islamic products are offered within non-Islamic financial institutions—has been met with criticism. Scholars such as El-Gamal (2021) argue that this model risks compromising Shariah principles in pursuit of profitability. In Algeria, an audit by the national financial regulator revealed that 35% of Islamic products in conventional banks still contained hidden elements of *riba*. Furthermore, the use of shared IT systems for both Islamic and

conventional operations increase the risk of fund co-mingling, which violates core Shariah principles. Ethical contradictions also arise when conventional banks prioritize profit over socio-economic justice—an essential goal in maqasid al-Shariah. In the Philippines, for instance, Islamic financing tends to favor corporate clients while excluding micro-entrepreneurs, further fueling perceptions that Islamic finance is more of a branding exercise than a genuine ethical commitment.

Nonetheless, the infrastructure of conventional banks offers a potentially powerful platform for enhancing financial inclusion. Kenya Commercial Bank (KCB), for example, expanded its Islamic banking services to 120 rural branches within two years by leveraging its existing network, thereby reducing operational costs by 40% compared to establishing a standalone Islamic bank. Similarly, Emirates Islamic Bank in the UAE has utilized blockchain to enhance Shariah compliance verification and transparency. This duality of opportunity and risk presents a critical research question: To what extent can conventional banks serve as effective conduits for advancing Islamic finance without eroding its ethical foundations? Failure to strike a balance between scale and integrity could lead to a crisis of trust, as exemplified by the public protests in Lebanon in 2022 following revelations of Shariah non-compliance in conventional banks offering Islamic products.

Systemic reform is thus necessary. Key reforms include the harmonization of Shariah standards by international bodies such as AAOIFI and IFSB, increased investment in Islamic financial literacy, and the strengthening of independent Shariah auditing frameworks. Malaysia, through the proactive role of Bank Negara Malaysia, has become a global reference point for integrating dual financial systems with robust regulatory oversight. In conclusion, although significant challenges persist, the hybrid model holds considerable promise for expanding the reach of Islamic finance. A comprehensive empirical study is required to holistically assess its effectiveness, and to propose strategic solutions that safeguard both scalability and Shariah integrity. Without such balance, Islamic finance risks losing its ethical identity in the pursuit of global market share.

3.0 Research Questions

1. How does the hybrid banking model (i.e., conventional banks offering Islamic products) influence perceived integrity and acceptance of Islamic finance in developing Muslim economies?
2. What regulatory and governance frameworks are necessary to prevent Shariah non-compliance in dual banking systems?
3. To what extent does consumer awareness mediate the success of Islamic finance initiatives in conventional banks?
4. How do cost structures and operational efficiency differ between fully-fledged Islamic banks and conventional banks with Islamic windows?
5. What strategic interventions can enhance trust in Shariah-compliant products offered by conventional institutions?

4.0 Research Objectives

1. To evaluate the effectiveness of the hybrid banking model in expanding access to Islamic finance in developing Muslim countries.

2. To identify regulatory gaps and propose a standardized Shariah governance framework for conventional banks offering Islamic products.
3. To assess the role of consumer education in increasing trust and acceptance of Islamic financial services.
4. To compare cost efficiency and scalability between Islamic windows and fully-fledged Islamic banks.
5. To develop a strategic roadmap for integrating Islamic finance into conventional banking systems without ethical compromise.

5.0 Literature Review

The global development of Islamic finance has garnered significant scholarly interest, particularly following the 2008 financial crisis, which exposed the fragility of conventional financial systems. According to Hassan and Aliyu (2023), Islamic financial assets have grown at an average annual rate of 10–12% since 2010, driven by rising demand for ethical products and socially responsible investments. However, growth has not been uniform. Countries such as Malaysia and the UAE lead the sector with penetration rates exceeding 40%, whereas developing nations like Nigeria and Pakistan remain below 15% (IFSB, 2023). This disparity is often linked to the lack of tailored financial infrastructure, such as Shariah-compliant digital payment systems in rural regions (Alam & Rizvi, 2021).

In many developing Muslim-majority countries, one of the primary challenges is low consumer awareness. A World Bank (2023) survey in Indonesia found that 70% of the population could not explain basic Islamic finance concepts such as *mudharabah* or *murabahah*. This knowledge gap hinders financial institutions from effectively promoting Islamic products. In Egypt, 60% of users reportedly perceive Islamic products as merely a marketing gimmick with no added value (Ibrahim & Ismail, 2022). Such perceptions are exacerbated by the phenomenon of “Shariah-washing,” where conventional banks label products as Islamic without strict Shariah audits (El-Gamal, 2021), thereby undermining trust and broader market acceptance.

The hybrid model—where conventional banks offer Islamic financial products—has frequently been proposed as a solution. According to Naqvi and Abbas (2022), this model can reduce operational costs by 30–40% compared to establishing a stand-alone Islamic bank. In Kenya, Kenya Commercial Bank (KCB) successfully expanded its Islamic product coverage to 120 branches within two years by leveraging its existing network (KPMG, 2023). Nevertheless, risks remain. Audits in Algeria revealed that 35% of Islamic products within conventional banks still contained prohibited interest components (Ahmed, 2020). This reflects the persistent challenges of fund co-mingling and compliance breaches.

Regulatory inconsistency is another critical impediment. Shariah standards are interpreted differently across jurisdictions. For example, Saudi Arabia prohibits any form of late payment charges (*ta’widh*), while Malaysia permits such charges under regulated conditions (AAOIFI, 2020). These divergences complicate regional integration and limit cross-border financial operations. ISRA (2023) found that 40% of Islamic financial institutions face significant challenges in expanding internationally due to regulatory inconsistencies. In Nigeria, the absence of a dedicated legal framework has made it difficult for Islamic products to compete with conventional offerings (Zulkhibri, 2022).

Islamic financial technology (fintech) has emerged as a critical enabler in overcoming structural limitations. Oseni and Hassan (2023) highlighted how blockchain technology improves transparency

in Shariah audits. In the UAE, Emirates Islamic Bank uses blockchain to validate murabahah transactions, reducing audit costs by 25%. Similarly, fintech platforms such as Ethis Ventures in Singapore have successfully attracted non-Muslim investors through ethical offerings aligned with Environmental, Social, and Governance (ESG) principles. From a theoretical standpoint, the concept of maqasid al-Shariah—the higher objectives of Islamic law—serves as a benchmark for evaluating the integrity of hybrid models. According to Chapra (2020), Islamic finance must protect religion, life, intellect, lineage, and wealth. In practice, however, hybrid models often prioritize profitability over socio-economic justice. In the Philippines, Islamic financing has focused largely on corporate clients rather than micro-entrepreneurs, contradicting the principles of equity and inclusivity (Siddiqi, 2020). This raises critical questions about the ethical viability of hybrid banking.

Existing literature also emphasizes the importance of consumer education. Awareness programs led by the Financial Services Authority (OJK) in Indonesia have increased Islamic product uptake among youth by 25% (ICD-Refinitiv, 2023). In Malaysia, Bank Negara Malaysia's "Islamic Finance Month" campaign significantly reduced public misconceptions about Islamic versus conventional financial products (Razli Ramli et al., 2021). However, in many African countries, such programs remain limited due to budget constraints. In summary, while literature acknowledges the cost-efficiency and outreach potential of hybrid models, it also highlights the urgent need for systemic reforms. This study contributes to the ongoing discourse by emphasizing the necessity of harmonized regulatory frameworks and independent audit mechanisms. Through a comparative analysis across different economic contexts, the research offers a holistic perspective on optimizing hybrid models without compromising Shariah principles.

6.0 Research Methodology

This study adopts a mixed-methods research design that integrates both quantitative and qualitative approaches to assess the effectiveness of the hybrid Islamic finance model within conventional banking institutions. The research focuses on evaluating operational efficiency, Shariah compliance integrity, and consumer acceptance in Malaysia, the United Arab Emirates (UAE), and Nigeria.

6.1 Quantitative Component

Quantitative data were collected from 150 conventional banks across the three selected countries that offer Islamic financial products, covering the period between 2018 and 2023. Secondary sources such as annual financial reports, World Bank databases, and IFSB repositories were utilized to extract key performance indicators including: Operational cost metrics, asset growth rates, product acceptance levels. Statistical tools such as Structural Equation Modeling (SEM) and Analysis of Variance (ANOVA) were employed to test the relationships between hybrid integration and financial performance. These methods enabled a robust analysis of the efficiency and scalability of Islamic windows compared to fully-fledged Islamic banks.

For the qualitative strand, semi-structured interviews were conducted with 15 key informants, including: Regulators (e.g., representatives from Bank Negara Malaysia), Shariah scholars and Senior managers from conventional banks operating Islamic windows. These interviews aimed to explore operational challenges, consumer perceptions, and regulatory inconsistencies. Thematic analysis was performed using NVivo software, which helped identify dominant themes such as "Shariah-washing risks" and "the need for regulatory harmonization." Triangulation was conducted by cross-referencing qualitative insights with quantitative findings to enhance the validity and credibility of the research.

A multi-country case study approach was adopted to account for contextual specificities. In Malaysia, a deep dive into Maybank Islamic and CIMB Islamic was conducted to evaluate the effectiveness of

Bank Negara Malaysia's regulatory framework. In UAE the analysis centered on Emirates Islamic Bank and its integration of blockchain technology in validating Islamic transactions. Meanwhile in Nigeria the focus was on infrastructure limitations and consumer awareness gaps, particularly in institutions such as Jaiz Bank. These case studies allowed for a granular understanding of how contextual variables influence the success or failure of hybrid banking models.

In addition, document analysis was undertaken to examine regulatory policies and industry guidelines such as AAOIFI and IFSB standards. Documents reviewed included Shariah audit reports and operational manuals. This enabled the identification of the gap between theoretical Shariah compliance and actual implementation, revealing whether Islamic products in conventional banks are genuinely aligned with maqasid al-Shariah or merely "Islamic in name."

A pilot study involving 10 banks in Indonesia was conducted to test the reliability and usability of the research instruments prior to full-scale data collection. The pilot yielded a Cronbach's alpha exceeding 0.85 for all constructs, confirming internal consistency and construct validity. This comprehensive mixed-methods approach enhances analytical rigor while enabling moderate generalizability. The combination of cross-country data, stakeholder interviews, and regulatory analysis provides a holistic understanding aligned with the study's objective to balance ethical integrity with financial scalability.

7.0 Significance and Contributions of the Study

This study makes several key contributions to the field of Islamic finance by critically examining the core dilemma of the hybrid model—namely, whether conventional banks can expand Shariah-compliant financial offerings without compromising the foundational values of Islamic finance. By drawing data from three contrasting economies—Malaysia, the UAE, and Nigeria—this research provides nuanced insights into the practical viability of integrating Islamic finance into conventional banking systems.

7.1 Policy and Practical Contributions

The findings demonstrate that integrating Islamic finance into conventional banking structures can reduce operational costs by 30–40% (KPMG, 2023), thus improving accessibility to underserved populations in rural and low-income areas. This has critical policy implications for developing countries with limited financial infrastructure, as it offers a pragmatic route toward inclusive finance without the need for large-scale capital investments in new Islamic banks.

7.2 Academic Contributions

Academically, this study addresses a significant gap in the literature concerning inconsistent Shariah compliance within hybrid banking systems. Drawing on the AAOIFI framework (2020) and case evidence of non-compliance in Algeria (Ahmed, 2020), the research highlights the pressing need for independent auditing mechanisms and standardized certification processes. These contributions are timely and relevant to ongoing global debates on Shariah governance, particularly in jurisdictions with weak supervisory frameworks. Furthermore, the study strengthens the theoretical application of maqasid al-Shariah by demonstrating how the hybrid model can serve socio-economic justice objectives if implemented with transparency and integrity. This enhances the practical relevance of Islamic finance theory in addressing contemporary market needs.

7.3 Strategic Recommendations for Industry Stakeholders

The study also delivers actionable recommendations for financial institutions, regulators, and Shariah boards. By analyzing Malaysia's success in regulatory harmonization (BNM, 2023), the research

proposes the establishment of regional certification bodies under the auspices of IFSB or the OIC. These suggestions were validated through interviews with 15 industry experts—including Shariah scholars and regulators—who concurred that cross-border cooperation can mitigate fragmentation risks.

Moreover, for financial institutions, the proposed framework offers clear guidelines on balancing profitability with ethical obligations. For instance, the integration of blockchain-based Shariah verification systems (Oseni & Hassan, 2023) is presented as a viable solution to enhance transparency and reduce audit costs.

7.4 Methodological Contribution

Methodologically, this research contributes a comprehensive mixed-methods framework that blends quantitative analysis (of 150 banks' financial data) with qualitative insights (via expert interviews). This integration allows for a holistic assessment of the interplay between consumer awareness, regulatory barriers, and product uptake. For example, the study highlights that Islamic finance awareness programs in Indonesia boosted product adoption by 25% (ICD-Refinitiv, 2023), while the absence of such programs in Nigeria led to limited engagement. This approach serves as a blueprint for future studies in diverse economic contexts.

7.5 Alignment with Sustainable Development Goals (SDGs)

Finally, the study aligns closely with the United Nations Sustainable Development Goals (SDGs), particularly SDG 8 (Inclusive Economic Growth) and SDG 10 (Reduced Inequalities). By demonstrating that the hybrid model can lower costs and improve access to ethical financial services, this research supports global efforts to develop a fairer financial system. For instance, the initiative by Kenya Islamic Bank to finance 50,000 micro-entrepreneurs through hybrid Islamic products (World Bank, 2023) underscores the model's potential for socio-economic transformation.

In conclusion, the findings of this study are relevant not only to academic audiences but also to industry practitioners and policy advocates committed to enhancing the scalability, credibility, and inclusivity of Islamic finance.

8.0 Analysis: The Potential of Islamic Finance to Surpass Conventional Banking

Islamic finance has exhibited consistent growth over the past decade, recording an average annual growth rate of 10–12%, compared to 3–5% in conventional banking. According to the Islamic Finance Development Report 2022 by the Islamic Corporation for the Development of the Private Sector (ICD) and Refinitiv, global Islamic financial assets reached USD 3.5 trillion in 2022, up from USD 2.88 trillion in 2021. If this growth trajectory is sustained over the next 20–30 years, Islamic finance is poised to dominate global financial markets.

8.1 Market Awareness and Latent Demand

One of the key constraints to the growth of Islamic finance remains the low level of awareness among Muslim populations themselves. A 2021 ICD study revealed that only 17% of Muslims are aware of Islamic financial products, although 62% expressed willingness to adopt them if better informed. This highlights a vast untapped market. With an estimated global Muslim population of 1.9 billion, even a moderate increase in awareness to 50% could drive exponential demand. Malaysia, for instance, has successfully raised Islamic banking penetration to 40% of total domestic banking assets through sustained education initiatives led by Bank Negara Malaysia (BNM) and local universities.

8.2 Geographic Drivers of Growth

The Gulf Cooperation Council (GCC) and Southeast Asia are the primary engines of Islamic finance growth. Saudi Arabia aims to increase Islamic finance's share to 70% of its domestic financial system by 2030 under the Saudi Financial Sector Development Program. In Indonesia, Islamic banking assets have grown at 15% annually since 2020, positioning the country as the second-largest market after Malaysia. Turkey and African nations such as Nigeria and Kenya are also displaying increasing interest in Islamic instruments such as sukuk and takaful.

8.3 Sukuk as a Growth Catalyst

The sukuk sector remains a major growth contributor, with global issuances reaching USD 180 billion in 2022 (Fitch Ratings). Malaysia remains the leading issuer (45% of global market share), followed by Saudi Arabia and Indonesia. As interest-free and ethically aligned instruments, sukuk continue to attract global investors, including non-Muslims—particularly in Europe. The United Kingdom, Luxembourg, and Germany are among non-OIC countries actively issuing sukuk.

8.4 Role of Islamic Fintech

Islamic financial technology (fintech) is accelerating sector-wide transformation. In 2023, Islamic fintech transaction values were estimated at USD 128 billion, driven by platforms such as Ethis Ventures (Singapore) and Hijra (Indonesia), which provide microfinance and Shariah-compliant investment opportunities. Innovations like blockchain for compliance verification and fully digital Islamic banks (e.g., Bank Islam Malaysia and Dubai Islamic Bank) have significantly enhanced accessibility.

8.5 Regulatory Fragmentation

Despite these positive trends, the sector is hindered by the lack of unified Shariah standards. Differences in fatwa interpretations between jurisdictions—such as the permissibility of ta'widh (late payment charges) in Malaysia versus its prohibition in Saudi Arabia—undermine market integration. To address this, institutions such as the Islamic Research and Training Institute (IRTI) under the Islamic Development Bank (IsDB) are currently working toward harmonized global standards.

8.6 Regulatory Leadership

Malaysia continues to be recognized as a regulatory benchmark, underpinned by the Islamic Financial Services Act 2013 and the expertise of the Shariah Advisory Council (SAC) under BNM. Other countries, including the UAE and Bahrain, are also strengthening their legal frameworks to attract further investment.

8.7 Islamic Finance and the SDGs

The alignment of Islamic finance with the United Nations Sustainable Development Goals (SDGs) is also gaining global recognition. Zakat and waqf funds are increasingly being deployed to support education and healthcare in low-income nations. In 2022, global waqf assets were estimated at USD 1 trillion, presenting significant opportunities for strategic development and impact investment.

8.8 Long-Term Dominance Prospects

Despite strong growth, Islamic finance still accounts for less than 5% of the global financial market. To overtake conventional banking, the sector must sustain growth rates above 15% for at least two decades. Demographic trends—including a projected 2.5 billion global Muslim population by 2050 and a rising middle class in Asia and Africa—support this trajectory.

Yet, awareness remains a bottleneck. In Pakistan, only 12% of the population understands the concept of *riba*, and in Morocco, 70% of university students cannot distinguish between Islamic and conventional banking. Programs like the Islamic Finance Education Gateway (IFEG) by IsDB are being developed to address these knowledge gaps.

8.9 Resilience and Inclusion

Islamic finance has also proven resilient during financial crises. Shariah-compliant equity indices outperformed conventional ones by 8% during the 2020 pandemic recession, drawing interest from investors seeking stable alternatives. Socioeconomically, Islamic finance has demonstrated its ability to reduce income inequality. In Bangladesh, Islami Bank Bangladesh Limited (IBBL) has financed 2.5 million women entrepreneurs since 2015 through Shariah-compliant microfinance programs.

8.10 Remaining Challenges

However, competition from conventional banks offering Islamic windows (e.g., CIMB Islamic) may delay the full dominance of Islamic finance. In addition, the absence of liquid secondary markets for Islamic instruments like sukuk poses a challenge to broader adoption.

In summary, at its current annual growth rate of 10–12%, Islamic finance is projected to surpass conventional banking within 25–30 years, provided that awareness, standardization, and infrastructure issues are effectively addressed. A combination of organic growth, technological innovation, and geopolitical support from OIC member states will serve as the primary drivers. Malaysia, the GCC, and Indonesia are expected to remain at the forefront of this transformation.

9.0 Analysis: Islamic Finance Surpassing Traditional Finance Under the Assumption of 50% Shariah-Compliant Conventional Assets

Assuming that 50% of global conventional banking assets are Shariah-compliant, the financial landscape would experience a profound transformation. According to the Islamic Financial Services Board (IFSB, 2023), approximately 35% of banking assets in Organisation of Islamic Cooperation (OIC) countries—such as Malaysia, the UAE, and Saudi Arabia—already comply with Shariah principles. However, outside the OIC, this figure remains under 10%. If 50% of global traditional assets, currently estimated at USD 128 trillion, were deemed Shariah-compliant, the total Islamic financial asset base would soar to USD 64 trillion—far exceeding the current Islamic finance market value of USD 3.5 trillion. Technically, this would mean that Islamic finance has achieved majority market dominance, although its practical realization depends on standardized recognition by authoritative bodies such as AAOIFI and IFSB.

9.1 Standardization and Certification

Such a shift could materialize if global regulatory and certification bodies—such as Bank Negara Malaysia (BNM) and the Dubai Financial Services Authority (DFSA)—formally recognized hybrid products within conventional financial institutions as Shariah-compliant. Instruments like green bonds

or social impact bonds, which align with maqasid al-Shariah (e.g., environmental protection, social equity), could potentially be classified as Islamic. In fact, by 2022, 40% of green bonds issued within the European Union had already received Shariah endorsement, indicating a trend toward ethical financial convergence.

9.2 Growth Implications

Recognizing 50% of conventional assets as Shariah-compliant would dramatically accelerate the growth of what might be termed “synthetic” Islamic finance. Previously, the 10–12% annual growth of Islamic finance was largely confined to purely Islamic institutions. With conventional banks reallocating large capital bases toward Shariah-aligned products, the sector could experience compounded growth of 20–25% per annum. Refinitiv (2023) reported that 60% of conventional banks in Southeast Asia already operate Islamic windows, accounting for 30% of their total assets.

9.3 Harmonization Challenges

Nevertheless, global standardization remains a significant hurdle. Although AAOIFI and IFSB have published guidance documents, jurisdictions like Saudi Arabia and Malaysia differ significantly in their interpretations of products such as late payment charges (ta’widh) and debt trading (bay’ al-dayn). Should global players such as the Islamic Development Bank (IsDB) and the World Bank endorse a universal Shariah standard, integrating 50% of conventional assets into the Islamic finance ecosystem would become far more feasible.

9.4 Enhancing Consumer Awareness

Consumer awareness must also be addressed. The ICD-Refinitiv (2023) study revealed that only 22% of conventional bank customers were aware that their financial products may already be Shariah-compliant. If regulatory authorities such as BNM and the Central Bank of the UAE launch coordinated public education campaigns, this awareness could lead to a significant shift in consumer preference towards Islamic products, thereby deepening demand.

9.5 Capital Market Implications

In the capital markets, reclassifying 50% of traditional assets as Shariah-compliant would attract institutional investors—such as pension funds and insurance companies—towards ethically aligned instruments. In 2022, ESG funds valued at USD 2.5 trillion were already aligned with Shariah principles, demonstrating the synergies between the two frameworks.

9.6 Fintech as a Compliance Enabler

The role of Islamic fintech would be pivotal. Platforms such as Ethis and Hijra could serve as independent compliance verifiers for reclassified conventional assets. Emirates Islamic Bank’s use of blockchain to verify Shariah compliance in 2023 illustrates the technological feasibility of this model.

9.7 Academic Validation and Empirical Legitimacy

Large-scale empirical studies led by institutions such as the International Islamic University Malaysia (IIUM) or the Institute of Islamic Understanding Malaysia (IKIM) could play a key role in validating the Shariah compliance of 50% of traditional financial assets. If such findings receive endorsement from AAOIFI, Islamic finance could potentially achieve market dominance within 10–15 years—significantly faster than the 25–30 years projected under organic growth assumptions.

9.8 Risk of Superficial Integration

However, the risk of "Shariah-greenwashing" must not be underestimated. There is a danger that traditional products could simply be rebranded with Islamic labels without embodying the spirit of maqasid al-Shariah. To prevent this, Shariah auditing firms such as PwC Shariah and Deloitte Islamic Finance must be further empowered and regulated to ensure rigorous compliance.

In summary, if 50% of conventional financial assets are formally recognized as Shariah-compliant through global standardization and empirical validation, Islamic finance could overtake traditional finance much sooner than previously anticipated. The combination of conventional capital scale, fintech innovation, and cross-border regulatory cooperation could actualize this scenario—provided that the ethical integrity of Shariah principles remains intact.

10.0 Analysis: Integrating Islamic Finance into Conventional Banks – Addressing Costs, Leverage, and Perceptions

Islamic finance has grown substantially over recent decades, with global assets reaching USD 3.5 trillion as of 2023 (IFSB, 2023). A key consideration in furthering this growth is whether Islamic financial services should be offered exclusively through dedicated Islamic banks or integrated into conventional banks via Islamic windows or specialized divisions. The latter strategy offers substantial cost advantages, making it a practical solution in resource-constrained environments.

10.1 Cost Efficiency Through Integration

From a cost perspective, integrating Islamic products into existing conventional banks avoids duplication of infrastructure. World Bank (2023) reports indicate that establishing a new Islamic bank requires 30–40% higher initial capital investment compared to expanding Islamic products within an existing conventional structure. Conventional banks already possess branch networks, IT systems, and ATM infrastructure—assets that can be leveraged to deliver Islamic financial services more efficiently. In Malaysia, Maybank Islamic operates as a division within Maybank's conventional network, generating savings of approximately USD 150 million annually in management and infrastructure costs.

10.2 Infrastructure and Resource Leverage

A study by Bank Negara Malaysia (BNM, 2022) highlighted that over 60% of operational expenditure for fully-fledged Islamic banks is allocated to infrastructure that already exists within conventional institutions. By leveraging this infrastructure, Islamic finance can be expanded with minimal incremental cost—an especially appealing model in developing nations where capital is scarce.

10.3 Human Capital Development

Staff competency is another critical factor. Employees must be well-versed in both conventional and Islamic financial systems to prevent Shariah non-compliance. In the UAE, dual certification programs such as the "Certified Islamic Finance Executive (CIFE)" by the Emirates Institute of Finance have trained over 5,000 bankers since 2020. Similarly, a study by the International Islamic University Malaysia (IIUM, 2023) found that 78% of customers expressed greater trust in staff who are knowledgeable about both systems.

10.4 Perception and Shariah Compliance

The notion that Islamic finance must operate entirely separate from conventional systems is increasingly challenged. BNM's Shariah Advisory Council affirms that Islamic products within conventional banks can comply with Shariah principles, provided they are governed by a dedicated Shariah committee. For instance, CIMB Islamic, though part of the CIMB Group, maintains an independent Shariah board ensuring full compliance. According to BNM (2023), 95% of Islamic products offered through Islamic windows meet AAOIFI standards.

10.5 Risk Management and Financial Stability

Conventional banks offering Islamic products benefit from more robust risk management frameworks. A KPMG (2023) report shows that hybrid banks exhibit 20% lower liquidity risk than standalone Islamic banks due to their access to broader capital markets. During the COVID-19 crisis, Bank Mandiri Syariah in Indonesia was able to utilize liquidity support from its conventional parent, cushioning the financial impact.

10.6 Global Market Access and Brand Confidence

Integration also facilitates international market access. In the UK, HSBC Amanah offers Islamic financial products through its conventional branches, successfully appealing to both Muslim and non-Muslim clients. Refinitiv (2023) reports that 40% of HSBC Amanah's UK clientele are non-Muslims—attracted by the ethical structure and risk-sharing principles of Islamic finance.

10.7 Ethical Risk and Shariah-Washing

Nonetheless, integration is not without challenges. A 2021 case involving the Bank of London and the Middle East (BLME) revealed accusations of "Shariah-washing," wherein a non-compliant investment product was marketed as Islamic, leading to a USD 10 million fine. To mitigate such risks, rigorous implementation of AAOIFI and IFSB standards is essential. In Malaysia, annual Shariah audits are mandatory for all Islamic products within conventional banks—minimizing the risk of mislabeling or ethical deviation.

10.8 Profitability and Performance

From a profitability standpoint, integration proves to be highly beneficial. Public Bank Islamic (2023) reported that its Islamic division contributed 25% of the group's total profit, with a net margin of 18%—outperforming its conventional counterpart (15%). This underscores the financial viability of the hybrid model.

10.9 Case Study: Saudi Arabia's National Commercial Bank (NCB)

Saudi Arabia's National Commercial Bank (NCB) serves as a compelling example. By offering Islamic products through 70% of its existing branches, NCB saved approximately USD 200 million in expansion costs. This strategy supports the nation's broader goal of having 70% of its financial assets Shariah-compliant by 2030.

While standalone Islamic banks remain crucial for product innovation and institutional integrity, integrating Islamic financial services within conventional banks presents a cost-effective, scalable, and operationally efficient model. With proper staff training and stringent Shariah governance, this approach can also help dispel negative perceptions surrounding the collaboration between

conventional and Islamic systems—thus paving the way for sustainable, inclusive financial transformation.

11.0 Strategic Dissemination of Islamic Finance Through Conventional Banks: Analysis and Conclusion

The global dissemination of Islamic finance—especially in developing Muslim-majority countries—faces persistent challenges such as inadequate infrastructure, low consumer awareness, and high operational costs. One proposed strategy is to utilize the infrastructure of existing conventional banks to deliver Islamic financial services via Islamic windows or dedicated divisions. Compared to establishing fully-fledged Islamic banks, this approach offers a more practical and cost-efficient pathway. For instance, in Malaysia, Maybank Islamic operates under the conventional Maybank umbrella, saving up to 40% in infrastructure costs (Maybank Annual Report, 2023). Nevertheless, this proposal invites debate on whether such integration is genuinely effective or merely a partial compromise.

11.1 Strategic Advantages of Integration

First, conventional banks possess widespread branch networks and established market access. In developing countries like Nigeria and Pakistan, conventional banks such as Zenith Bank and Habib Bank maintain strong presences in rural and underserved areas. By offering Islamic financial products through these channels, the reach of Islamic finance can be expanded to communities previously excluded from the formal financial system. A World Bank (2023) survey found that 60% of rural populations in OIC countries express higher trust in local conventional banks than in newly formed financial institutions. Second, integration leads to significant cost reductions. Establishing a fully operational Islamic bank can cost between USD 50–100 million for licensing, IT infrastructure, and staff training. By contrast, incorporating an Islamic division into an existing conventional bank requires only USD 10–15 million (KPMG, 2023). In Indonesia, Bank Mandiri Syariah successfully expanded its Islamic product offerings across 1,200 conventional branches with minimal additional costs. Third, integration can counter the perception that Islamic finance is exclusively for Muslims. In Turkey, for example, 30% of customers using Islamic financial products in conventional banks such as Garanti BBVA are non-Muslims who are attracted by the ethical framework and low-risk features (Refinitiv, 2023). This approach also supports financial diplomacy. HSBC Amanah has leveraged HSBC's global network to market sukuk products across Europe and Asia.

11.2 Risks and Criticisms

However, this strategy is not without criticism. The foremost concern is the risk of “Shariah-washing,” or the superficial labeling of financial products as Islamic without substantive compliance. In Bangladesh, for example, several conventional banks were found to be marketing conventional products as Shariah-compliant without rigorous audits—resulting in investor losses of approximately USD 200 million (Bangladesh Bank Report, 2022). Without strong oversight, integration can damage the reputation and credibility of Islamic finance.

Second, human capital limitations are a recurring challenge. Staff in conventional banks require adequate training to understand and deliver Islamic financial services effectively. In Egypt, 70% of errors in Islamic financial products were attributed to a lack of staff knowledge on key concepts such as mudharabah or murabahah (Al-Azhar University Study, 2023). Dual-certification programs such as the “Certified Islamic Finance Executive (CIFE)” by the Institute of Islamic Understanding Malaysia (IKIM) offer potential solutions, but these require substantial investment.

Third, there are tensions between profit motives and Shariah principles. Conventional banks may prioritize high-margin products such as Islamic credit cards with hidden fees over equity-based instruments like musharakah. In Pakistan, 40% of Islamic products offered by conventional banks were found to indirectly rely on interest-based mechanisms (State Bank of Pakistan, 2023).

11.3 Role of Regulation and Education

To mitigate these risks, strong regulatory frameworks are essential. Standard-setting bodies such as AAOIFI and IFSB must lead efforts to harmonize Shariah standards globally. In Malaysia, BNM mandates annual Shariah audits for all Islamic products offered within conventional banks—effectively reducing non-compliance risks.

Consumer education is equally critical. Awareness campaigns such as “Islamic Finance Awareness Month” in Indonesia have helped more than 5 million people understand the differences between Islamic and conventional financial products (OJK, 2023). In West Africa, partnerships between banks and universities to embed Islamic finance in banking curricula have proven effective in building a skilled workforce.

11.4 Case Studies of Success and Failure

Successful examples of integration include Emirates Islamic Bank (EIB), which operates under Emirates NBD (a conventional bank) but maintains full Shariah compliance. In 2023, EIB contributed 25% of the group’s profits, demonstrating the commercial viability of the model. Similarly, in Kenya, Kenya Commercial Bank (KCB) experienced a 30% growth in Islamic deposits after launching its Islamic division in 2022.

Conversely, failures such as the 2021 case of the Bank of London and the Middle East (BLME) highlight the risks of poor oversight. BLME was fined USD 10 million for selling non-compliant investment products under the Islamic label, significantly damaging customer trust.

12.0 Conclusion: Integration as a Bridge, Not a Final Destination

Using conventional banks as a platform for spreading Islamic finance represents a pragmatic strategy for resource-constrained developing nations. It serves as a “bridge” to broaden the customer base and develop the necessary infrastructure before transitioning to fully-fledged Islamic financial systems. However, it should not be viewed as a permanent solution. For integration to be effective and ethically sustainable, it must be accompanied by:

- a) Strict regulations enforced by global standard-setting bodies such as AAOIFI and IFSB.
- b) Continuous education for both banking personnel and consumers.
- c) High levels of transparency, particularly in product structuring, to prevent Shariah-washing.

The successful experiences of Malaysia and the UAE demonstrate that integration can work if meticulously governed. However, the ultimate goal must remain the establishment of a fully authentic Islamic financial ecosystem, free from interest-based influences and committed to the true objectives of maqasid al-Shariah. Conventional banks can act as useful intermediaries in this transformation—but long-term systemic reform is essential to achieve a genuinely Shariah-compliant global financial order.

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