

COMPARATIVE EFFICIENCY ANALYSIS OF ISLAMIC AND CONVENTIONAL BANKS IN EMERGING MARKETS

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Abstract

This thesis provides data about a comparative assessment of the efficiency of Islamic and conventional banks in today's emerging markets. The paper highlights the way different business models shape efficiency rates of banks, using financial methods, such as conceptual analysis of operational structures, financial performance metrics, and risk-adjusted indicators. While Islamic banks show superior stability and resilience thanks to asset-backed financing and limitations on speculative activities, conventional banks set apart in cost-efficiency and profit generation because of wide financial tools and lower compliance costs. The findings suggest that both models provide complementary strengths important for emerging market financial systems.

Key words: *Islamic banking, conventional banking, banking efficiency, emerging markets, operational efficiency, financial performance, risk-adjusted efficiency, Shariah compliance.*

Over recent years, emerging markets have experienced noticeable growth in Islamic banking, driven by demographic changes, increased financial inclusions, and growing demand for Shariah-compliant financial products and services. The fact that Islamic and conventional banks coexist in the same regulatory and competitive environment makes the assessment of their comparative efficiency a vital topic for economists, policymakers, and researchers. This is because, efficiency is important for profitability, sustainability, and long-term continuation of banks to economic development.

Islamic banks are controlled by Shariah principles that prohibit interest, speculative activities, and excessive uncertainty. Instead, they utilize profit-and-loss sharing mechanisms and asset-backed financing. By contrast, conventional banks have access to different kinds of financial products and markets. The purpose of this paper is to compare the efficiency of two models in emerging markets by examining three indicators: operational efficiency, financial performance, and risk-adjusted stability to

identify how these models affect efficiency outcomes in developing financial systems.

Operational Efficiency in Islamic and Conventional Banks. Operation efficiency is about the capacity of banks to minimize cost whilst maximizing service delivery and output. In emergin markets, conventional banks usually hav higher operational efficiency owing to their infrastructures, standardized processes, and most importantly, the absence of Shariah requirements. Islamic banks, on the other hand, face higher compliance and administrative costs since every product must be checkef for Shariah compliance and observed throughout its lifecycle. Murabaha, ijara, and mudabara are considered complex contracts that require due diligence and more documentation, resulting the cost-to-income ratio to be higher for Islamic banks, especially in today’s growing econmy.

However, advancements in digital banking and regulatory support are helping Islamic banks close the efficiency gap. In Asian countries such as Malaysia, the UAE and Saudi Arabia, where Islamic banking is more common, operational efficiency rates are coming in close proximity to those of conventional banks, which means that technological innovations and institutional maturity play key roles in analyzing comparative efficiency.

Financial Performance Efficiency in Islamic and Conventional Banks. Financial performance efficiency is calculated using the inidicators such as Return on Assets (ROA), Return on Equity (ROE), and Net Financing Margin (NFM), which provide insight into cost-effectiveness and profitability. Due to wider revenue streams and the ability to use interes-based lending and derivatives, these metrics are usually higher in conventional banks compared to Islamic banks. The reason is that Islamic banks rely on partnertship-based and trade-based financing, which generated more stable, but sometimes lower incomes. Their asset portfolios are usually more concentrated, with a huge portion allocated to low-risk, fixed income–like instruments such as Murabaha, which limits overall profitabilitiy in Islamic banks. But, in markets, where the demand for Shariah-compliant finance is high, Islamic banks have generated profits comparable to or sometimes even surpassing their conventional counterparts. Take the Gulf region as an example, Islamic banks benefit from supportive regulation and strong liquidity positions, allowing them to maintain competitive returns. Therefore, market contex and consumer preferences are essantion to improve profitability efficiency levels.

Risk-Adjusted Efficiency and Stability in Islamic and Conventional Banks.

In contrast to conventional counterparts, Islamic banks always illustrate higher risk-adjusted efficiency, specifically during economic crisis. This could be because, the restriction of speculative activities and interest-based trading decreases exposure to volatile financial markets. Furthermore, that transactions are connected to real economic activities to promote stability is ensured by asset-based financing. According to empirical studies, during the 2008 global financial crisis and the COVID-19 pandemic, Islamic banks recorded lower non-performing financing (NPF) ratios, maintained stronger capital positions, and demonstrated faster recovery compared to conventional banks, because the use of profit-and-loss sharing structures distributed risks more equally between banks and their customers. Meanwhile, Conventional banks are more profitable as they face higher sensitivity to market risk, interest rate cycles, and liquidity pressures. Their involvement in derivatives, interbank lending, and securities trading exposes them to systemic shocks more directly.

In conclusion, the comparative efficiency of Islamic and conventional banks in emerging markets is acknowledged as multifaceted. Conventional banks typically succeed in higher profit and operational efficiency thanks to their streamlined processes and lower compliance burdens. Islamic banks, however, excel in risk-adjusted performance, stability, and financial resilience, particularly during economic downturns. The findings show that neither model is greatly efficient, yet each possesses efficiency strengths shaped by its important principles and market environment. Policymakers in emerging markets ought to design various regulatory frameworks that support the complementary roles of both banking models. A dual banking environment can enhance financial inclusion, competitiveness, and stability across the financial sector in today's economy.

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