Challenges to the Performance of Islamic Banking and Equity-Based Financing Instruments: A Literature Review

Dr. Md Din Islam Miah FCA

Independent researcher

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ABSTRACT

Mudarabah and Musharakah are equity-based and completely Riba-free financing instruments that represent the fundamental principles of Islamic finance. As risk-sharing modes of financing, they contribute to the establishment of justice, fairness, and economic balance in accordance with the objectives of Islamic Shariah.

Despite their significance, these financing instruments are rarely utilized by Islamic banks and financial institutions in Bangladesh. The primary objective of this study is to investigate the challenges hindering the adoption and performance of Mudarabah and Musharakah financing in Bangladeshi Islamic financial institutions and to propose possible solutions to overcome these challenges.

This study is based on a comprehensive review of the existing literature, including contemporary and relevant scholarly works from around the world. A qualitative research methodology has been employed to achieve the study's objectives.

The findings reveal that Islamic banks and financial institutions show limited preference for Mudarabah and Musharakah financing due to several challenges, including moral hazard, agency problems, inadequate professional knowledge and expertise, regulatory constraints, limited financial inclusion, and weaknesses in governance frameworks.

To address these challenges, the study recommends the enactment of a comprehensive Islamic banking regulatory framework, the development of skilled professionals in Islamic finance, the establishment of a central Shariah supervisory board, the implementation of independent Shariah audits with public disclosure of audit findings, the adoption of fintech solutions, and the strengthening of governance, monitoring, and compliance mechanisms.

The effective implementation of these recommendations may enhance the credibility, efficiency, and Shariah compliance of Islamic banking and promote the wider application of Mudarabah and Musharakah financing in Bangladesh.

Keywords: Mudaraba, IFIs, Islamic Banks, Riba.

INTRODUCTION

In Islamic finance, the fundamental prohibitions of riba, gharar, and maisir are critical in promoting ethical and sustainable financial practices. Riba, which refers to the charging of interest, is prohibited in Islamic finance due to its exploitative nature and potential to create economic imbalances (Ahmad, 2020). Gharar, or uncertainty, is also forbidden as it introduces an element of risk that may lead to unfair transactions (Fahmi, 2020).

Similarly, Maisir, or gambling, is prohibited as it is seen as a form of speculation that can harm society and undermine economic stability (Sulaiman, 2020). These three fundamental prohibitions are central to Islamic finance and help ensure financial transactions are conducted fairly, ethically, and socially responsibly.

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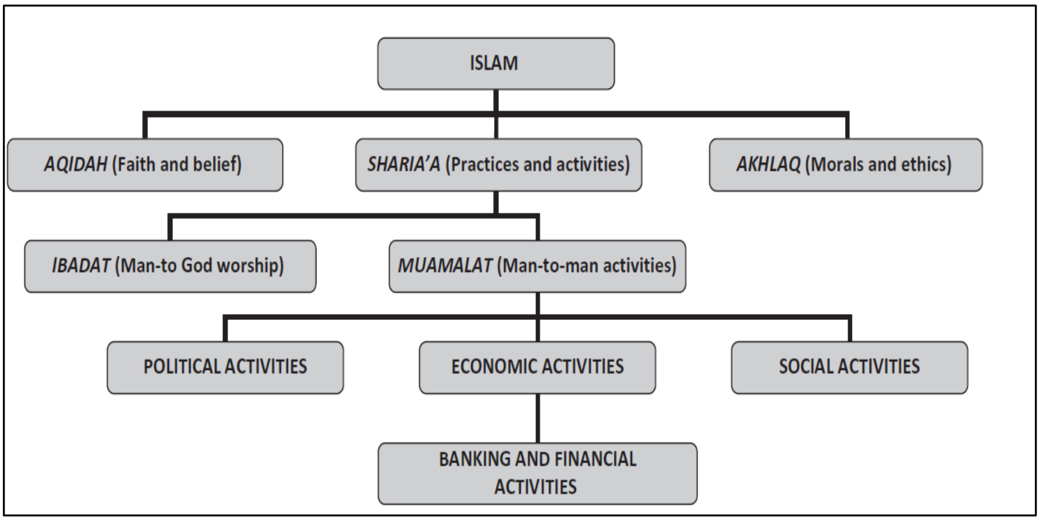

Figure 1. 1 : Islamic finance in Islam

Source: Authors' own thesis

All types of Riba are prohibited in Islam. Following are the verses of the holy Quran for prohibition of Riba Chronological.

Table 1. 1 : Chronological Revelation of Quranic Verses Relating to Riba

No. of Sura	Name of Sura	No of Ayat	Total Ayat
30	Al Rom	39	1
4	Al Nisa	160-161	2
3	Ale Imran	130-131	2
2	Al Bakarah	275-281	7
Total	**Four surah**		**12 Ayat**

Source: Authors' own thesis

Riba or Interest

As interpreted in Shariah law, Riba is an Arabic term that theoretically refers to any excess compensation of a debt over time. Nouman and Ullah (2014) describe it as an "excess", "addition", or "surplus", where the related verb implies "multiply", "increase", or "surpass what is due". In financial terms, Riba is synonymous with the concept of interest or usury, derived from the Latin word "usura", meaning the "use" of borrowed capital (Promwichit et al., 2013). Operationally, in the context of this study, Riba pertains to any form of interest or additional charge applied in financial transactions prohibited under Islamic finance. This includes evaluating and ensuring that all financial practices and instruments used by Islamic Financial Institutions in Bangladesh are free from any elements of Riba, aligning with the principles of Islamic finance that strictly forbid any form of interest or usurious practices in financial dealings.

Riba al-nasi'ah' and 'Riba al-fadl

The word "Riba" is used in the Qur'an to refer to "Riba al-nasi'ah," or delayed payment interest. In contrast, the hadith refers to "Riba al-fadl," or rising interest owing to an uneven exchange of goods and commodities (Alam et al., 2021). The kind of riba that the hadith forbids is riba al-fadl. For instance, "Gold for gold, silver for silver, wheat for wheat, barley for wheat, dates for dates, salt for salt, the like for the like, hand to hand (i.e., quick sale); (but) if the sorts vary, then sell as you may like from hand to hand (Bukhari and Muslim), (Syahri & Harjito, 2020).

Gharar and Maisir

Gharar is an Arabic term that means "uncertainty." Gharar is forbidden under Islamic Shariah and should not be included in a contract (Alshater et al., 2022). For instance, sell off items without ownership, possession, or existence since this involves ambiguity. Similarly, because both the buyer and the seller are unsure of what they are dealing with, it is impossible to sell an object of unknown quality or quantity, an unborn calf, fish in a pond, etc. (Intansari, 2020). The Arabic term for "maisir" also means "gambling" or "speculation." Islam forbids any agreement relating to maisir since it is an act of injustice and is like the Riba concept (Alshammari, Alhabshi, & Saiti, 2019). Gambling, often known as betting on the occurrence or nonoccurrence of any future event, is prohibited, and there is no reward for using money that a person may win via gambling in any way (Mahdi & Rahaman, 2020).

Debt /Equity in Islamic Finance

A debt is anything borrowed, most often money from another person, credit sale, etc. Many businesses and people utilize debt to finance significant expenditures that they would otherwise be unable to afford (Osmanovic, 2022). A debt agreement permits the borrowing party to borrow funds subject to the requirement to be repaid later (Investopedia, 2022). The most typical types of debt, including credit card debt, vehicle loans, personal loans, and mortgages, are loans, claim Juhro et al. (2020).

The word "equity" refers to the capital invested in or owned by a firm and its owner (Umar & Bashir Ahmad, 2020). A company's equity is represented on its balance sheet by the difference between its obligations and assets (Naz & Gulzar, 2022). The value of equity is calculated using the share price or a value established by valuation specialists or investors. Owners' equity, stockholders' equity, and shareholders' equity are further names for this account (Karim et al., 2022). The three guiding concepts of Islamic finance are ownership, participation, and equity. These guidelines imply that under an Islamic financial system, money may only be provided for commercial operations, productive endeavours, and physical assets (Hasan et al., 2022).

Islamic Finance in the modern world

In the modern world, financial transactions are predominantly conducted through banks and financial institutions, which play a vital role in mobilising savings, facilitating investments, and supporting economic development. These institutions provide a wide range of financial services, including deposit-taking, financing, payment systems, and risk management. As global financial activities continue to expand, there is a growing demand for ethical and socially responsible financial solutions. Islamic finance has emerged as an alternative financial system that operates in accordance with Shariah principles, emphasizing fairness, transparency, asset-backed transactions, and the prohibition of interest (riba). Through various Shariah-compliant financing modes, Islamic financial institutions contribute to economic growth while promoting justice and shared prosperity.

Table 1.2 Islamic Financial Assets of Leading countries:

Rank Country	Islamic Finance Assets (US$ Billion) 2024
Iran	1,316
Saudi Arabia	761
Malaysia	460

United Arab Emirates	198
Kuwait	192
Qatar	179
Indonesia	139
Bahrain	127
Türkiye	98
Pakistan	77
Bangladesh	63

Source: Islamic Finance Development Report 2025 (LSEG–ICD)

Islamic finance assets generally include Islamic Banking Assets (the largest component), Sukuk (Islamic bonds), Islamic Investment Funds, Takaful (Islamic insurance), Other Shariah compliant financial institutions.

Table 1.3 Countries with Dedicated Islamic Banking Laws or Formal Legal Frameworks

Country	**Law / Legal Framework**	**Year Enacted**
Malaysia	Islamic Banking Act	1983
Iran	Law for Usury-Free Banking	1983
Pakistan	Islamic banking reforms and legal framework	1984
Sudan	Full Islamic banking system	1984
Indonesia	Islamic Banking Act (Law No. 21)	2008
Kazakhstan	Law on Organization and Activities of Islamic Banks and Islamic Finance	2009
Oman	Islamic Banking Regulatory Framework	2012
Malaysia	Islamic Financial Services Act (IFSA)	2013
Tajikistan	Law on Islamic Banking Activity	2014
Morocco	Participatory Banking Framework	2014

Notable Non-Muslim Majority Countries

Country	**Majority Religion**	**Islamic Banking Law/Framework**
United Kingdom	Christian/Secular	Regulatory and tax reforms enabling Islamic banks (from 2004)

South Africa	Christian	Tax and banking reforms supporting Islamic finance
Singapore	Non-Muslim majority	Regulatory framework (2005–2008)
Hong Kong	Non-Muslim majority	Sukuk and Islamic finance legislation (2013)
Kazakhstan	Secular state	Dedicated Islamic finance law (2009)
Tajikistan	Secular state	Islamic Banking Law (2014)
Philippines	Christian majority	Islamic Banking Act (2019)
Uganda	Christian majority	Islamic banking legislation (2023)

Source: Inernet Search: World Bank, Islamic Finance Development Reports

Islamic Banking Act in Bangladesh

Bangladesh does not yet have a separate Islamic Banking Act. Islamic banks operate under the general banking regulations issued by Bangladesh Bank, supported by Islamic banking guidelines and Shariah governance instructions.

Developments of Islamic Banking in Bangladesh

Developments of Islamic Banking in Bangladesh Islamic Banking system has significant contributions in terms of deposits, investment, exports, imports, remittances mobilization and employment generation in the financial sector of Bangladesh. At the end of December 2025, Islamic banking system represents 24.38 percent share in terms of deposits in the total banking industry while it accounted for 29.10 percent share in terms of investments. The share of remittance of Islamic banking system among entire banking industry recorded 25.97 percent during the October- December quarter of 2025. Islamic Banking system has contributed 12.25 percent share in of the agricultural credit of the banking industry as of end December 2025.

Islamic banking has experienced notable global expansion, driven by its ethical principles, risksharing mechanism, and asset-backed financing framework. In Bangladesh, the sector has expanded steadily with strong support from the Government and Bangladesh Bank (BB), as well as increasing public demand for Shariah-compliant financial products and services. Islamic banking facilities are currently provided through full-fledged Islamic banks, Islamic banking branches, and Islamic banking windows of the conventional banks. Recently, structural reforms including the formation of “Sommilito Islami Bank PLC” through the consolidation of five weak Islamic banks** have been initiated to strengthen governance and stability in this sector (Bangladesh Bank, 2025).

Table 1.4 Islamic Banks, Branches and Windows in Bangladesh

SL	Full-fledged Islamic Banks	Branches (Numbers)	SL	Full-fledged Islamic Banks/Islamic Branches/Windows	Branches/Windows (Numbers)
1	Islami Bank Bangladesh PLC	400	7	Standard Bank PLC	138
2	Al-Arafah Islami Bank PLC	226	8	Union Bank PLC	114

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3	First Security Islami Bank PLC	206	9	Global Islami Bank	105
4	Social Islami Bank PLC	181	10	ICB Islamic Bank Limited	33
5	EXIM Bank PLC	155	11	Conventional Banks having Islamic Branches (17 Banks)	43
6	Shahjalal Islami Bank PLC	142	12	Conventional Banks having Islamic Windows (21 Banks)	976

Source: Bangladesh Bank, 2025

*Janata Bank PLC has obtained permission for starting Islamic Banking window from Bangladesh Bank but not yet started operation.

** EXIM Bank PLC., First Security Islami Bank PLC., Global Islami Bank PLC., Social Islami Bank PLC., Union Bank PLC

Islamic Financial tools

Equity Based tools of Islamic Finance

Mudarabah

Mudarabah is a form of partnership in Islamic finance where one party provides capital (Rab-ul-Maal), and the other provides entrepreneurial expertise (Mudarib) for a joint venture. Profits are shared according to a pre-agreed ratio, while the capital provider bears losses unless they are due to the mudarib's misconduct or negligence.

Mudarabah investment of Islamic Finance being an equity-based financing system in the economy as a contrary to Riba-based and debt-based financing system for a balanced economic and social development by improvement of knowledge, expertise, innovation, motivation of new business, risk sharing from one to all, reduction of unemployment, moral and ethical development in the society. As there is a thumb rule of Islamic financing that no one may claim any profit without taking a risk which is popularly known as Al-ghounm bi al-ghourm and the Profit and Loss Sharing or Mudarabah model was developed from this rule (Bhatti & Bhatti, 2010); Jedidia, 2020). This states that all participants must share the risks and rewards of a financial transaction. Allah (SWT) has permitted business and prohibited Riba (interest) (Al Quran 2:275) and the main characteristic of a business is the risk of losses. Mudarabah mode of transaction is regarded as the cornerstone of Islamic financial system since it advocates risk sharing and equitable distribution of risk which is considered as non-exploitative, socially productive as well as social welfare oriented (Alfarisi, 2015). The center point of difference between the Islamic Banking and Conventional Banking is Mudarabah (Murshid & Hussain, 2016).

The Mudarabah finance concepts were well known during the Prophet Mohammad (PBUH) (Sherif, 2020); (Issa, 2020a; Rahman & Riyadh, 2016; Wolf, Nabin, & Bhattacharya, 2012). The journey of Mudarabah continued up to the nineteenth century. Still, the control of the Western colonial powers divided the Islamic world into many small states. The capitalist system effectively replaced the existing financial scheme that complied with Islamic Sharia objectives (Jedidia, 2020). That is why the innovative idea of Riba-free banking against the conventional banking system was further introduced in the late 1940s by some of the Islamic scholars like Anwar Qureshi in 1946, Mahmud Ahmad in 1952, Naiem Siddiqi in 1948 and others and their proposal for the Islamic banking system was based on the original concept of Mudarabah (Profit Sharing) (Rahman & Riyadh, 2016).

The Messenger of Allah (PBUH) said: "Till one of the two partners does not commit dishonesty, I am a third partner of them." He also said, "There is a blessing in Mudarabah" (Mughal, 2012). Four Caliphs of Islam continued the Islamic finance system established by Mohammad (PBUH). Then Mudarabah (profit sharing) was practiced by Caliph Utman (R.A.), Caliph Umar (R.A.), two of his sons, Abdullah Ibn Abbas (RA) (Åström, 2011). The ancient Arabs also used the term Muqaradah, and the Roman used the term Commenda to mean MUDARABAH (profit sharing) in an early appearance in Roman law of the early Middle Age. The Commenda was an agency contract, like equity-based investment or Mudarabah (profit sharing) contract, that originated in Italy and spread from west to east up to 16^{th}century. It was a widespread business agreement between Muslims and non-Muslims worldwide (Ghayad & Hamdan, 2021). Being a risk sharing investment tool, Islamic Banks have a very limited use of this tool for financing.

Musharakah

Musharakah is a risk-sharing Islamic financing tool like Mudarabah. Under the system of Musharakah, Profit and loss are shared between the fund provider and fund manager according to their ratio of investment. It is an equity-based, completely Riba-free investment tools for Islamic Banks and financial institutions. In Musharakah the fund Manager may also invest funds along with the fund provided by the fund provider (Rab-ul-Maal). As the banks do not share loss of business of its customers, use of Musharakah investment is very few. (Chowdhury et al., 2016; Habib & Hossain, 2020; Issa, 2020a)

Whereas traditional debt-based financing system is exploitative, predatory and bears the allegation of Riba (Bougatef, Nakhli, & Mnari, 2020; Fianto, 2020; Chowdhury, Shoyeb, Akbar, & Islam, 2016; Alshater, Saba, Supriani, & Rabbani, 2022). The Mudarabah mode of financing has undergone various evolutions to fulfill the needs of fast-developing Islamic finance. Currently, they become less preferable due to allegations like moral hazard compared to debt financing instruments such as Murabaha (Alshater, Saba, Supriani, & Rabbani, 2022), however, the allegations are not unsolvable. In Murabahah financing, banks receive a fixed return from its customer, which is based on usury and debt as the customer has to pay to the bank is fixed at the beginning of the contract (Sherif, 2020; Issa, 2020a; Rahman & Riyadh, 2016; Wolf et al., 2012; Ghayad, Hamdan, & Professor, 2021).

Although, Islamic Banks increased remarkably; Conventional banks are also doing Islamic Banking operations through their branches and windows as they can accommodate debt-based products of Islamic Banking system very easily. As the banks do not share loss of business of its customers, the investment portfolio of Islamic Banking is dominated by this debt-based products, where the share of Mudaraba investment is very few (Chowdhury et al., 2016; Habib & Hossain, 2020; Issa, 2020a). But the Banks most of the fund mobilization is under the Mudarabah financing tool where its customer must take risk of losses. So, there is a common question to the stakeholders are the Islamic Banks really Islamic?

The investments made by Islamic banks in ideal Islamic modes like Mudarabah and Musharakah are still at a few levels. In view of this, the Islamic banking system should prioritize the development of proper guidelines and policies to facilitate investments under Mudaraba and Musharaka modes. (Bangladesh Bank, 2025)

Debt-based tools of Islamic Finance

Bai-Murabaha is a Shariah-compliant common Islamic financing mode in which a financial institution purchases an asset requested by a client and then sells it to the client at a disclosed cost plus an agreed profit margin. The sale price and payment terms are fixed in advance, and payment may be made immediately or on a deferred basis. Since the transaction is based on the sale of a real asset rather than the charging of interest, it complies with the principles of Islamic Shariah.

Bai-Muajjal (Deferred Payment Sale) is an Islamic financing mode in which a seller sells goods or assets to a buyer at an agreed price, with payment deferred to a future date or made in installments. The sale price, including any profit margin, is fixed and known to both parties at the time of the contract and cannot be increased due to late payment.

Hire Purchase under Shirkatul Melk (HPSM) is an Islamic financing mode based on joint ownership (Shirkatul Melk) between a financial institution and a client. Both parties jointly own an asset, and the client gradually acquires the institution's share through periodic payments while also paying rent for the portion owned by the institution. Upon completion of all payments, full ownership is transferred to the client.

Ijara is a Shariah-compliant lease contract in which the owner of an asset leases it to another party for an agreed rental payment and period. Ownership of the asset remains with the lessor, while the lessee enjoys the right to use the asset.

Bai-Salam is a Shariah-compliant forward sale contract in which the buyer pays the full purchase price in advance, while the delivery of the specified goods is deferred to a future date. The quantity, quality, price, and delivery date of the goods must be clearly defined at the time of the contract.

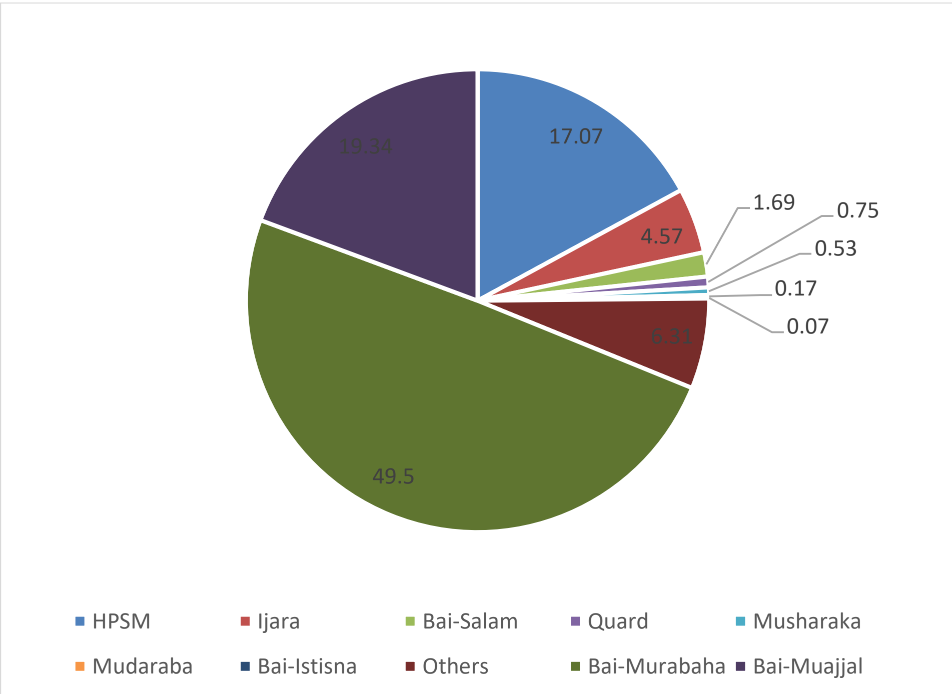
Qard (Qard Hasan) is an interest-free loan under Islamic finance in which the borrower is required to repay only the principal amount. When security or collateral is taken to safeguard repayment, the arrangement is commonly referred to as Qard with Security.

Bai-Istisna (Manufacturing Contract) is a Shariah-compliant contract whereby a buyer places an order with a manufacturer or contractor to produce, construct, or manufacture specified goods or assets according to agreed specifications, for delivery at a future date. The price may be paid in advance, in stages, or upon completion.

In Islamic Banking and finance system, IBs are much reluctant to prefer business that was done and by Rasulullah (sallahu alyhi wa sallam) himself and his shahaba (RA) due to the effect of western business system of capitalism. However, equity-based financing represents the pure Islamic banking structure and should be promoted as a priority for governing true Islamic Banking (Shaikh, Ismail, Mohd. Shafiai, Ismail, & Shahimi, 2017; Ali & Javaid, 2020).

Mode -Wise Investments

Figure 1. 2 : Mode -wise Investments



Source: Bangladesh Bank, 2025

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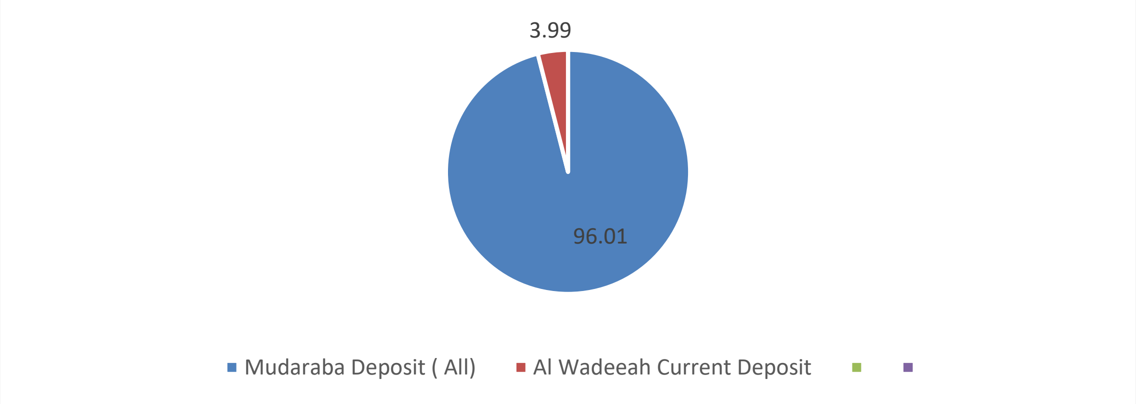
Figure 1.3 : Deposit Collection of Islamic Banks



Bangladesh Bank, 2025

Identified Factors impacting Profit-Loss Sharing Implementation

This article addresses the factors impacting performance of Islamic Banking as well as its tools Mudarabah, Musharakah financing for providing with recommendations for industry stakeholders.

Competition

Islamic finance has been facing serious competition as conventional banking (CB) are playing both role of Islamic Banking as well as conventional Banking but the main objective of IB and CB are not the same, so IB may face difficulty due to market competition in coming decades (Jedidia, 2020). Complying with the Islamic ethics and principle are the only way to avoid the competition.

Moral Hazard

It is opined that Mudarabah contracts are caused by the existence of asymmetric information, problems of adverse selection and moral hazard. Due to imperfect information that is inherent in Mudarabah (profit sharing) contracts, it has been declined as an important financing (Hiep & Binh, 2020). The research findings are, Mudarabah contracts are vulnerable to agency problems, riskier, not feasible for short-term funding, high monitoring costs, lack of transparency, asymmetric information (Ghayad et al., 2021). The researcher identified the moral hazard for asymmetric information problems and draw a solution also but also mentioned that the popular product of IB Murabaha is riskier than Mudarabah (Profit Sharing) in terms of moral hazard (Issa, 2020; Yazar Soyadı, Yazar Soyadı, & Fauzi, 2020). The researcher proved the better performance of Islamic Microfinance investment under Mudarabah in the case of the disadvantaged entrepreneurs (Herlangga, 2021; Suryani & Fathoni, 2020). As a faithful Muslim, the entrepreneur needs to work in a trustworthy manner and carry out his responsibility truthfully with the intention of obtaining Allah's blessings and not for his self-interest (Ryandono, Kusuma, & Prasetyo, 2021; Yazar Soyadı et al., 2020).

Shariah Supervisory Board

Shariah Supervisory Board (SSB) is not independent in their Shariah decision making process and activities. It is directly or indirectly influenced by the Board of directors and the management. The practices and functions of the SSB, their decision-making and other activities are influenced by the Board of directors indirectly (Alam et al., 2021). It has been argued by the Islamic scholar that IBs should return to their fundamental functions of providing innovative Shariah-based investment products and services that add value to the economy and address the true deserving current and potential customers (Dchieche & Aboulaich, 2016; Othman, Majid, & Rahman, 2017). A very vital issue of IB to evaluate the Shariah-compliance status of the Islamic banks in Bangladesh raised that all the Islamic banks under study are, more or less, violating Islamic Shariah (Alam et al., 2021). Market discipline for Islamic banks is analyzed and suggested that policy makers should consider strengthening supervisory powers and continue close monitoring for the improvement of the safety of IBs due to not having strong market discipline (Sawafta, 2021).

Murabaha

Islamic banks preferred utilizing Murabaha because IBs are concerned about their commitments for paying back depositors' money. As Mudarabah is a long-term investment tool as well as a risky instrument, there were seriously worries about a mismatch of funds of IB. Murabaha, by contrast, gives fixed returns which could be repaid to depositors without problems (Herlangga, 2021; Sawafta, 2021; Yustiardhi et al., 2020). So, IB banks technically avoid the equity-based products of investments. But it is argued that Mudarabah (profit sharing) and Musharakah (profit loss sharing) principles are the basic equity financing instruments for Islamic business contracts (Issa, 2020b; Miasary, 2020; Suryani & Fathoni, 2020). The Central banks can control economic activity for efficient allocation of resources by using Mudarabah products of Islamic finance (Alam et al., 2021; Mahdi & S. Rahaman, 2020; Sawafta, 2021).

In practice, Islamic finance often involves structuring Shariah-compliant products that appear like conventional products. According to Julia and Kassim (2020) and (HS, 2020), Islamic banks are not different from conventional banks in Malaysia. The above analysis of the challenges of IB requires urgently the implementation of the Mudarabah under the Islamic financial system. Despite some valuable recommendations in their research remains ineffective. So, it needs more study to solve the issues of Mudarabah investment development under Islamic Financial Institutions.

The researchers opined that the Mudarabah contracts are to be revived but the existing Islamic Banking may not be a fertile soil for Mudarabah to bloom unless the business relationship context between investors and entrepreneurs is developed with believed each other to recognize its real benefits. It is also noted that the Mudarabah concepts are not known to many including the entrepreneurs who are looking for capital and investors who wish to grow their savings. This knowledge deficiencies have resulted in lower trust in the true potential of the Mudarabah (Ghayad et al., 2021).

The researchers expressed concern over the mushrooming of Islamic banking operation in parallel with the conventional banking activities (Nor & Ismail, 2020; Suryani & Fathoni, 2020). Due to dual banking operation, IBs hold huge responsibility in order to maintain credibility by ensuring that all its products offered, operations, processes are in accordance with Shariah compliance issues. To protect the interests of the stakeholders risk management strategies are required and future research is recommended to establish Mudarabah investment (Mustafa, 2020). Risk refers to put oneself or someone or something in danger, failure, or loss while Islamic risk management refers to mukhatarah (risk) as the situation that involves the probability of deviation from the path or compliance requirement that leads to the expected or usual result and the likelihood of loss.

Knowledge

Another challenge of IB is the lack of educational systems in the Muslim majority countries to acquire theoretical and practical knowledge of Islamic economics and on the comparative economic system amongst Muslims for creating the knowledge-based awareness of the importance of Islamic Banking and Finance and availability of Islamic financial products and its features as alternatives to the product and services of conventional banking (Zainuldin & Lui, 2020). To overcome the situation, it needs of establishing diversified but parallel institutions as well as research centers in all the Muslim countries to ensure an adequate supply of skilled, knowledgeable and keen Muslim professionals, researchers, and specialists in the different disciplines of Islamic finance. Academic institutions need to expand the boundaries of their educational curriculum for providing proper knowledge of Islamic finance and to spread the education of Islamic economics and related laws, rules and regulations to meet the future challenges of the Islamic banking industry in all Muslim world (Sherif, 2020).

A capitalist economy is basically based on interest. Due to the effect of capitalism, Muslims elsewhere in the world has to accept and pay interest in different ways and transactions (Omer Mustafa, 2020) mostly because of a lack of knowledge of Islam. But Islam is the only way of life as directed by Allah (SWT). As per

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Islamic Shariah, Islamic virtues or principles should be the only way of life regarding all aspects of a person and not just only daily rituals such as Salat, Siam, Hajj, Zakat, etc. Society was and even tills to date much secular in nature (Alam et al., 2021)

Collateral

Just like CBs, IBs extended their financial facilities to the established business concerns and individuals. It creates the rich to be richer and the poor remains as poor and the gap become wider between the rich and the poor. For a young entrepreneur, it is virtually impossible to meet up the requirements of a bank's security demands to secure financial support to start a new business or to develop or modernize an existing one (Issa, 2020b; Julia & Kassim, 2020; Mohd Nor & Ismail, 2020).

Government Regulation

Researchers have tried to find out the growth prospects of the Islamic banking industry in Bangladesh. They identify the challenges of IBs and concluded Islamic Financial System particularly the Mudarabah investment can bring out the most efficient banking and financial system if it gets support of Islamic Banking Laws in terms of governance and direction (Ali, Javaid, & No, 2020; Mahdi & Rahaman, 2020; Uddin, 2021). Though both growth and popularity of Islamic banking in Bangladesh is remarkable, two very important modes of Islamic investment i.e., Mudarabah and Musharakah are yet to be practised. To give the Islamic banks a complete shape, there is no other alternative but to implement, practise and popularize the Mudarabah and Musharakah modes (Hossain, 2016; Sarker, 2005; Shaown, 2017). But in reality there is no Islamic banking Law in Bangladesh, Islamic Banking has to follow the law of conventional banking, policy, standards, etc.

Financial Inclusion

Financial Inclusion word is made with the combination of three words; finance, financial services, and technology (Ali et al., 2020; Mahdi & Rahaman, 2020; Uddin, 2021). Mahdi and Rahaman, (2020) defines Financial Inclusion as… "Technologically enabled financial innovations that could result in new business models, applications, processes, or products with an associated material effect on financial markets and institutions and the provision of financial services." The impact of Financial Inclusion on the banking and financial services industry is high (Kakhkharov & Bianchi, 2022; Thakor, 2020). Newer technological innovations, recent technological infrastructure development, and technology implementation across the financial and banking industry changing the way it operates and resulting in changing expectations of the customers (Mainardes, Costa, & Nossa, 2022)

Digital Banking and Financial Inclusion

Many researchers have argued that 90% of poor people are excluded from the inclusion of IB financial services and they have also recommended to reduce financial exclusion or FinTech by Islamic financial institutions leverage on technology, use equity-based modes of finance, and focus attention on Islamic microfinance, SME finance for micro and macroeconomic growth (Afkar et al., 2020; Aysan & Disli, 2019; Bidabad, Mohammadi, & Sherafati, 2019; Imronudin & Hussain, 2016; Promwichit, Shamsher & Hassan, 2013).

Islamic Banking Law and its application

Therefore, further research and improvement in this rising industry of Islamic Finance and its governance are important. Bangladesh, being 90% Muslim majority country, is yet to make a full-fledged Islamic Banking law in the country. But the Islamic Banks in the country is to follow the conventional banking laws like Bank Companies Act 1991 and other related rules and the Islamic Banks are also controlled by the guidelines issued by the central bank. Absence of long-term funds and a full-fledged Islamic Banking Law issues are to be solved to develop equity-based investment of Islamic banking (Julia & Kassim, 2020).

Central Shariah Supervisory Board

It is found that Islamic banks have a lower practice of maqasid al-Shariah. Non-disclosure of Shariah violations and compliance amount show the limitations of the annual report and create questions about the Shariah-compliance procedures (Alam et al., 2021; Julia & Kassim, 2020; Mahdi & S. Rahaman, 2020; Shaown, 2017). It is argued that most of the cases SSB are not independent and also have no power, guidelines of central banks for appoint of members of the SSB are not followed and there are knowledge gap in SSB (Alam et al., 2021; Julia & Kassim, 2020; Mahdi & S. Rahaman, 2020; Shaown, 2017).

Knowledge and Skill development

Institutions for Islamic finance, research centers for an adequate supply of skilled, knowledgeable and keen Muslim professionals, researchers, and specialists in the different disciplines of Islamic finance. Academic institutions need to expand the boundaries of their educational curriculum for providing proper knowledge of Islamic finance and to spread the education of Islamic economics and related laws, rules and regulations to meet the future challenges of the Islamic banking industry in all Muslim world (Sherif, 2020).

Good governance

It is observed that, some full-fledged Islamic banks have been facing severe liquidity crisis due to lack of some sort of irregularities and good governance. It is essential to establish in Islamic banking system, as good governance and accountability are key to navigating the current crisis and ensuring sustainable growth of this sector. (Bangladesh Bank, 2025)

Based on the literature review this article provides with the recommendations for better performance of most shariah compliance tools of Islamic financing for Islamic banks and financial institutions in Bangladesh.

Designing of collateral system for Mudarabah

Structured collateral system specially for willful negligence of Mudarabah can be introduced.

Selection and monitoring of the partner in Mudarabah

Mudarabah is a partnership agreement, and the risk of a partnership business is unlimited. So, the Selection process of partner is the most vital point to overcome the situations of moral hazard problem. Application of fintech and monitoring systems can be effective for Mudarabah failure.

METHOD

The purpose of this systematic literature review was to delve into and understand the intricacies associated with Mudarabah, Musharakah financing in Islamic banking, focusing on its challenges and the recommendations for enhancing its compliance and transparency.

A systematic search of electronic databases including Google Scholar, Research sites like Scopus, Thesis, etc. was conducted to identify relevant literature on the topic of religiosity and the adoption of Islamic banking.

Selection Criteria

Studies included in the review were limited to peer-reviewed journal articles to ensure the reliability of the sources. Articles were eligible for inclusion if they specifically discussed the challenges associated with Mudarabah, Musharakah financing in Islamic banking and presented proposals for its improvement.

Search Terms

The search was guided by a range of keywords and phrases:

"Factors affecting Mudarabah, Musharakah performance"

"Mudarabah challenges"

"Mudarabah issues"

"Recommendation for solutions of Murabaha issues"

Study Selection

From the search, more than fifty articles, websites, Bangladesh Banks Research publications on Islamic Banking, etc. were identified and chosen based on their relevance and contribution to the research topic.

Data Extraction and Synthesis

The data from the selected articles were extracted and synthesized to provide a comprehensive overview of the challenges and recommendations associated with Islamic Banking its Mudarabah, Musharakah financing.

DISCUSSION

Islamic finance has grown exponentially over the years, offering unique financial solutions rooted in ethical principles and Shariah guidelines. At the forefront of these innovative solutions is Mudarabah – an instrument promoting profit-and-loss-sharing. While its ethical underpinnings are commendable, several challenges surround its practical implementation. Through a systematic review of the literature, this discussion will further delve into the role and potential of Mudarabah, Musharakah as cornerstones in ethical Islamic banking and finance.

CONCLUSION

Mudarabah and Musharakah provide individuals and businesses with ethical and Shariah-compliant alternatives to conventional interest-based financing. As equity-based financing modes, they embody the fundamental principles of Islamic finance, emphasizing risk-sharing, justice, transparency, and mutual benefit. For stakeholders considering these financing arrangements, it is essential to understand the underlying principles of Islamic finance, ensure compliance with Shariah requirements, evaluate the credibility of financial institutions, assess financing terms and associated risks, and seek professional guidance where necessary. Such considerations can facilitate informed decision-making and enhance the effectiveness of equity-based financing arrangements.

In conclusion, the findings of this study suggest that while Mudarabah and Musharakah hold significant potential to advance the objectives of Islamic banking, their performance continues to be influenced by various institutional, regulatory, operational, and market-related challenges. Addressing these challenges through supportive regulatory frameworks, enhanced governance mechanisms, product innovation, technological advancement, and greater stakeholder awareness is essential for their sustainable growth. As global financial systems increasingly emphasize ethical, transparent, and socially responsible practices, Islamic finance, through its equity-based financing instruments, is well-positioned to contribute to a more inclusive and resilient financial landscape. By overcoming the factors affecting its performance, Islamic banking can further strengthen its role as a viable and sustainable alternative within the global financial system.

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