

# Growth of Islamic Banking in Bangladesh

## Recent Trends in the Global Context

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### Introduction

Events of the last few years have forcefully shown the Muslim world's resentment of the West's power, influence and encroachment on its way of life. That power is nowhere more evident than in the finance arena, where Western banks and financial markets dominate but contradict strikingly with traditional Islamic beliefs. Over the past 25 years, however, a non-violent challenge to that dominance has been building.

The change has come from a caravan of Islamic financial institutions and Islamic subsidiaries of major international banks that have steadily expanded their operations. Islamic banking has gone from almost nothing to an industry with assets of hundreds of billions of dollars and half of the consumer market and 10% of the assets under management in countries such as Malaysia. Yet, it has not yet emerged as a truly revolutionary force in the financial world. Whether it can make that leap is a crucial question for every Islamic banker. An attempt has therefore been made in this paper to make an overview on the growth of Islamic banking in Bangladesh.

Ulema of all school of thought, except minor exceptions, hold the view that *riba* includes all forms of interest including bank interest. This would seem to rule out traditional banking practices. But Muslims would still like to save money, keep up with inflation, invest in ways that will offer a steady return and meet other financial needs. In addition, Muslims would also like the companies they own

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to expand, build new plants and accommodate working capital needs. These contradictory demands of religious belief and economic necessity have provided the impetus to the origin and growth of Islamic banking.

### **Replacing Interest with Profits**

Islamic jurists had previously concluded that if financing entities takes possession of an item and thereby accept some of the risk, they might be entitled to a profit similar in amount to an interest payment. In doing so, they are not lending money to the customer but buying a commodity themselves and reselling it. Further, they may package a bundle of such contracts and sell them to investors, as is commonly done today with mortgages. This meant creating contracts and documentation and dealing with different taxation and customs authorities in cross-border transactions. These were complex and time-consuming challenges, but ultimately the efforts paid off. By 1987, the product had \$3 billion outstanding owned by some 50 major corporations around the world. This way had a great attraction for trading companies because it allowed them to build inventory but not increase bank borrowings on their balance sheet.

Over time, however, many types of Islam-friendly financial products were created to cater to needs such as corporate borrowing, mortgage financing and long-term investment. Though specific numbers are hard to come by, the Islamic finance industry is said to have some \$200 billion to \$250 billion in assets under management; the Economist Intelligence Unit reckons that it is growing an annual rate of 10% to 15%. Today some 150 dedicated Islamic banks exist around the world. Almost all these banks are based in Islamic countries, but they also have subsidiaries in countries with Muslim communities, including the U.S., U.K. and France.

There is now a Dow Jones Islamic Index--which includes companies that do not produce alcohol, tobacco products or other items forbidden by Islam and have a very low level of debt or earnings from interest--and dozens of Islamic mutual funds.

Malaysia, the leader in Islamic finance, issued almost \$4 billion in Islamic bonds in 2003. Companies such as the Swiss food giant Nestle placed a \$184 million seven-year Islamic bond last year.

While the growth of Islamic finance has been impressive, expert observers as well as practitioners are frustrated for a variety of reasons. They are worried about applying appropriate capital and regulatory structures to the industry. While the traditional banking system is guided by the Basel core principles, which outlines the minimum requirements for the supervisory regime, these principles need to be reviewed from the perspective of Islamic banking and its products and services. It is not as straightforward as a debtor-creditor relationship in traditional banking but also needs to include other inherent risks arising from the investor-entrepreneur relationship that is inherent in Islamic banking.

Another challenge that confronts Islamic banking is the enormous variation across countries and among Islamic banks, which offers opportunities to unscrupulous operators as well as perfectly normal, if less religiously motivated, Western firms. Citigroup, the U.S. financial behemoth, handled the Nestle bond issue. HSBC offers a popular Islamic car loan program. Neither institution is Islamic, and money being fungible, questions are sometimes raised about how these institutions might be co-mingling funds, or how much risk they are really assuming in funding activities such as buying cars. Both institutions have appointed Islamic clerics to approve their transactions.

Since there is no institutional Islamic church and Muslims are spread across geographic borders, a lot of variation exists among Islamic banks' products and the way they are legally constituted. The market is segmented by the level of religious conservatism. Several groups, including the Islamic Financial Services Board, an organization of representatives of seven central banks organized by Malaysia, are trying to construct uniform standards.

## **Analysis of Trends of Islami Bank Branch Expansion and Resource Mobilization in Bangladesh**

Table -1 shows year-wise number of Islamic banks and branches in Bangladesh. It is evident that 21 years ago, a bank namely Islami Bank Bangladesh Limited with 3 branches started Islamic banking business, for the first time, in Bangladesh in the year 1983. After 4 years' operational success, when its branch number stood at 18, another Islamic bank namely Al-Baraka Bank Ltd. was established in 1987. Since then, the number of these two banks' branches has been increasing and under this encouraging situation, two more Islamic banks namely Al Arafah Islamic Bank Ltd. and Social Investment Bank Ltd. were established in the year 1995. The number of branches of all these 4 banks was increasing and when it stood at 172 in the year 1998 i.e., just after 3 years, a Traditional bank namely Prime Bank Ltd. opened an Islamic branch in Dhaka. It indicates that 15 years successful operations of Islamic banks has attracted a Traditional bank to open its Islamic banking branch for the first time in Bangladesh. It has provided a new dimension and set a new example of dual banking system in the country. Thus in the year 2000, the number of Islamic bank branches stood at 194 from 172 in the year 1998 which shows 12% growth only in two years.

This growth of domestic private Islamic banks attracted a foreign Islamic bank namely Shamil Bank Bahrain, to open its branch in Bangladesh in the year 2000 and a local Islamic bank namely Shahjalal Bank Ltd. was established in the following year. When the country is experienced in Islamic banking with 5 domestic and one foreign Islamic banks with their 225 branches in the year 2002, 7 new domestic Traditional banks namely i. The Dhaka Bank Ltd. ii. The South-East Bank Ltd. iii. Premier Bank Ltd. iv. The City Bank Ltd. and Jamuna Bank Limited opened 9 Islamic bank branches in the year 2003. Prime Bank Ltd. also opened second Islamic bank branch in the same year. So total number of Islamic bank branches of Traditional banks stood at 15 in the year 2003 only, which indicates potential promises of this banking system for future growth.

Therefore, the number of branches of 6 Islamic banks stood 242 and number of Islamic branches of 6 Traditional banks stood 10 i.e, altogether  $252 = (242 + 10)$  Islamic bank branches were opened in the country up to the year 2003. This growth of Islamic banking has witnessed a total change of a Traditional bank namely EXIM Bank Ltd. After long 4 years' banking operation as a Traditional bank, EXIM Bank has totally been changed into Islamic banking system with its 16 branches. In the year 2004, the total number of Islamic banks stood at 7 and the total number of Islamic bank branches stood at  $268 = (258 + 10)$  in Bangladesh.

Regarding mobilization of savings by Islamic and Traditional banks in Bangladesh during 1998 to 2002, Table-2 shows that total savings of Traditional banks under study are Tk. 55,233 million, Tk. 62,692 million, Tk. 69,820 million, Tk. 78,581 million and Tk. 90,204 million against the year 1998, 1999, 2000, 2001 and 2002, respectively. On the other hand, total savings of Islamic banks, under study, are Tk. 34,447 million, Tk. 44,777 million, Tk. 52,018 million, Tk. 71,258 million and Tk. 93,602 millions against those years, respectively. It has been observed that year-wise amounts of total savings of Traditional banks are higher than those amounts of Islamic banks up to the year 2001. Total savings of Islamic banks exceeded the total savings of Traditional banks by an amount of Tk. 3398 million in the year 2002. It has been observed from Chart-I, given below, that savings mobilizations of Islamic banks have shown higher trend than Traditional banks.

Again, the differential amounts of savings mobilization between Traditional banks and Islamic banks are • Tk. 20,786 million, Tk. 17,917 million, Tk. 17,820 million, Tk. 7,323 million and Tk. (3398) million during the period under study. It shows a diminishing trend, which has been shown in Chart -1. It indicates that Islamic banks not only reduced savings mobilization gaps with Traditional banks but also exceeded in the year 2002. It follows, therefore, the promises of Islamic banks have become stronger than Traditional banks in terms of savings mobilization in Bangladesh.

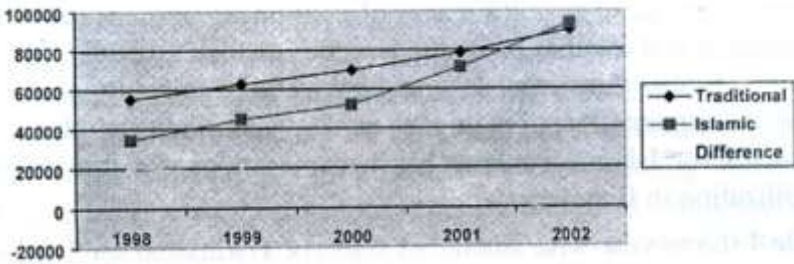


Chart -1: Trend of Savings Mobilization of Traditional and Islamic Banks (1998-2002)

Table-3 shows year-wise total amount of investment of Traditional and Islamic banks under study. It is evident that the amounts of investment of Traditional banks are Taka 45,215 million, Tk. 48,479 million, Tk. 57,436 million, Tk. 64,845 million and Tk. 74,543 million in the year 1998, 1999, 2000, 2001 and 2002, respectively. On the other hand, the amount of investment of Islamic banks is Tk. 22,836 million, Tk. 33,217 million Tk. 43,447 million, Tk. 54,328 million and Tk. 70,778 million in those years, respectively. The comparison of figures shows that year-wise amount of investment of Traditional banks is higher than those of Islamic banks, which can easily be understood from Chart-2, although the growth trend of investment of Islamic banks is higher than Traditional banks.

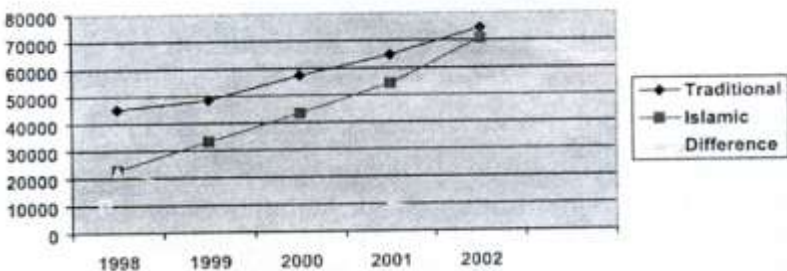


Chart 2: Trend of Investment Mobilization of Traditional and Islamic Banks (1998-2002)

It has been observed that year-wise differences of amounts of investment between Traditional banks and Islamic banks, under the study period, are Tk. 22,379 million, Tk. 15,266 million, Tk. 13,989 million, Tk. 10,517 million and Tk. 3,765 million. It shows a

downward trend of the differences of investment amounts between Traditional and Islamic banks under study, which is evident from Chart-2. It also shows that Islamic banks comparatively mobilized more investments than Traditional banks which indicates that the promises for Islamic banking has become strong for investment mobilization in Bangladesh.

Table 4 shows year-wise amount of assets of Traditional and Islamic banks, under study, for the period of 1998-2002. It is observed that total assets of 4 Traditional banks are Tk. 79,098 million, Tk. 90,184 million, Tk. 10,9231 million, Tk. 1,20,487 million and Tk. 1,29,314 million against the year 1998,1999,2000,2001 and 2002, respectively. On the other hand, total assets of Islamic banks are Tk. 41,766 million, Tk. 54,942 million, Tk. 65,946 million, Tk. 84,820 million and Tk. 1, 05,558 million in the year 1998, 1999, 2000, 2001 and 2002, respectively. It is observed that the amounts of assets of traditional banks are higher than those amounts of Islamic banks. But the trend of total asset growth is

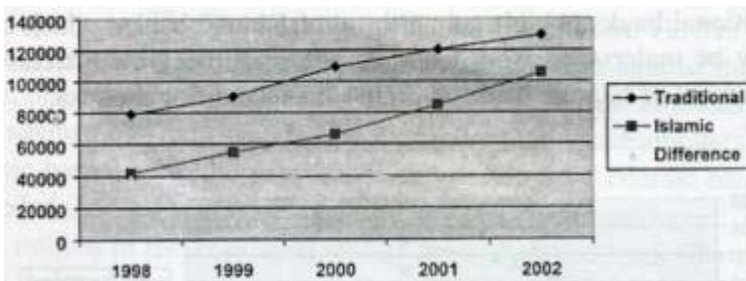


Chart 3: Trend of Assets of Traditional and Islamic Banks (/998-2002)

in favor of Islamic in favor of Islamic banks, which can be seen from Chart -3. The difference of amount of asset between Traditional and Islamic banks are Tk. 37,332 million, Tk. 35,242 million, Tk. 43,285 million, Tk. 35,667 million and Tk. 23,756 million against the year 1998, 1999, 2000, 2001 and 2002, respectively. It shows a downward trend of asset difference between Traditional and Islamic banks under study, which can be seen in the Chart-3. It indicates, therefore, Islamic banks are growing well in Bangladesh.

It follows, therefore, the growth of Islamic banking in terms of branch expansion was observed not only in Islamic banking companies but also in Traditional banking companies. Moreover, Islamic banking is growing well in terms of resource mobilization. These indicate that the premises of Islamic banking system in Bangladesh have become stronger, although Islamic-banking system is working side by side with Traditional banking system. It is an encouraging experience indicating a promising banking system.

### **Summary and Conclusions**

The prohibition of *rib a* (fixed interest) makes Islamic banking different from Traditional banking. Of course, the investments of an Islamic bank must be channeled to the Islamic Shariah approved sectors. The phenomenal growth of Islamic banks has attracted the attention of bankers, business community and bank customers.

Islamic banks in Bangladesh have become, to an extent, successful in the field of savings and investment mobilization. As a result, the growth of Islamic banking in terms of branch expansion was evident not only in Islamic banking companies but also in Traditional banking companies. Moreover, Islamic banking is growing well in terms of resource mobilization. These indicate that premises of Islamic banking system in Bangladesh have become stronger, although Islamic-banking system is working side by side with Traditional banking system. It is an encouraging experience indicating promising banking system.

Islamic banks are involved in the heroic role of eliminating *riba* from financial dealings in Muslim countries against a backdrop of regulation in the area of taxation, legal framework, and weak moral fabrics of society. It is expected, therefore, the banking system of the country will forward towards Islamic banking system in future. In order to remove misconception about Islamic banking, if any, from the minds of bankers and customers, there is no alternative to publicity, research and training of Islamic banking practices. Research should focus on the development of financial products that conform to Islamic Sharia, and training should be given to bankers, potential researchers and bank customers.



**Table-1: Year-wise No. of Islamic Banks and Branches in Bangladesh**

Year	No. of Islamic Bank	No of Branches of Islamic Banks	No of Branches of Traditional Banks
1983	1	3	
1984		7	
1985		13	
1986		18	
1987	2	24	
1988		37	
1989		54	
1990		71	
1991		84	
1992		97	
1993		103	
1994		111	
1995	4	123	4
1996		137	
1997		152	
1998		172	
1999		185	
2000	5	195	
2001	6	208	1
2002		225	3
2003		242	7
2004	7	258	15

Source : Annexure I & II

**Table-2 : Savings Mobilization of Conventional and Islamic Banks (1998-2002)**

Year	Savings of Conventional Banks				Total (A)	Savings of Islamic Banks (B)				Total (B)	Difference (A-B)=C
	NBL	BPC	ABBL	CBL		IBBL	IBDL	ADAFAH	ORIENTAL		
1998	17365	15642	11716	38530	55213	30385	2029	4528	7507	34447	20766
1999	20219	16264	13625	12544	62652	29500	3900	4543	8834	44377	17977
2000	23071	16426	16597	13696	69820	32112	4883	7308	10716	52818	17020
2001	24897	17090	19410	17184	78581	41547	30560	7679	14265	71251	7323
2002	26276	18720	25525	16638	90304	55662	15141	7163	15836	81602	1100

Source : Ministry of Finance, Government of Bangladesh, *Resume of Banks and Financial Institutions*, Different Issues.

Table-3 : Investment Mobilization of Conventional and Islamic Banks (1998-2002)

Year	Amounts in million Taka										
	Investment of Traditional Banks (A)				Total (A)	Investment of Islamic Banks (B)				Total (B)	Difference (A-B)+C
	NBL	IFC	ABDL	CBL		IBBL	SIBL	ARAFAJI	ORIENTAL		
1998	11682	15488	10316	7729	45215	13436	1174	2260	9966	72636	22779
1999	13235	16126	10769	8369	48479	29585	2192	3794	6666	33237	15262
2000	18555	16234	12682	9965	57436	27437	3522	3728	8260	43447	13889
2001	30201	17653	14862	12729	64845	35238	5499	3875	9716	54328	10117
2002	21678	19560	19477	13885	74943	46280	7504	5289	11504	59778	1763

Source: *Ibid.*

Table-4: Assets of Traditional and Islamic Banks (1998-2002)

Year	Amounts in million Taka										
	Assets of Conventional Banks (A)				Total (A)	Assets of Islamic Banks				Total (B)	Difference (A-B)+C
	NBL	IFC	ABDL	CBL		IBBL	SIBL	ARAFAJI	ORIENTAL		
1998	33618	38120	14067	13283	79089	23443	2667	6771	8855	41766	37322
1999	36503	38742	19704	15735	90884	31315	4753	8556	10318	54942	35242
2000	47148	39334	25168	17991	109231	39366	6688	8589	11303	65946	43283
2001	69752	25637	25152	20776	120467	49459	11300	9264	14788	84820	35647
2002	45719	27333	31919	24343	129314	65081	18224	8710	15494	105558	23756

Source: *Ibid.*

## Annex I: Year-wise Opening of branches by the Islamic banks of Bangladesh

Year	IBBL	Br.	Oriental	Br.	Arafa	Br.	SIBL	Br.	Shahjalal	Br.	Shamul	Br.	EXIM	Br.	Total
1983	1	3													3
1984		4													4
1985		6													6
1986		5													5
1987		3	1	3											7
1988		6		7											13
1989		13		8											21
1990		9		4											13
1991		12		1											13
1992		10		3											13
1993		5		1											6
1994		7		1											8
1995		7	4	1	5	1	1								16
1996		5	1		5		4								15
1997		5	0		10		0								15
1998		5	0		10		5								17
1999		8	1		5		2								16
2000		6	0		0		2			1	1				10
2001		5	0		5		1	1		2	0				9
2002		7	0		0		4			6	0				17
2003			0		2		3			2	0				5
2004										0	1	1	1	1	4

Year Source: IBBL, Annual Reports, *Different issues.*

## Annex II : Year-wise Opening of Islamic bank branches by the Traditional banks of Bangladesh

Year	Prime	Br.	Dhaka	Br.	South-East	Br.	Prenter	Br.	City	Br.	Jamuna	Br.	Total Branch
1998	1	1											2
1999													
2000													
2001													
2002													
2003		1		1	3		1		1		1	1	8
Total	1	2	1	1	3	1	1	1	1	1	1	1	10

Source: *Ibid.*

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