

Islamic Banking Scenario of Bangladesh

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Abstract

With an aim to explore the current Islamic banking scenario of Bangladesh, this study examines the key concepts of Islamic banking and its history in the world and in Bangladesh as well. This secondary data based research meets its objectives of reviewing relevant concepts, history and current performance of the Islamic banks of Bangladesh through both qualitative and quantitative approaches. From the establishment of first Islamic bank in 1983, this country has currently eight Islamic banks. Except one individual bank (ICBIBL), most of the Islamic banks show remarkable growth in their profitability in the last decade. One reason behind this consistent negative figure in profitability of this bank is the frequent change of ownership. But overall significant contribution of the Islamic banks in the banking industry is visible from the research. This paper provides up-to-date scenario of the Islamic banking in Bangladesh.

Keywords: Islamic Banking, Riba, Performance, Banking Industry

JEL-classification: E44 G10 G21

1. Introduction

Islamic banking and finance is a creation of modern age. Capitalism argues, capital- one of the key factors of production, deserves fixed return whereas the entrepreneurs have to bear all the risks. The conflict of opinions with the Islamic values starts from this very basic point. As the conventional banking systems follow the philosophy of capitalism and interest which is forbidden according to Islamic Shariah, the Muslims made the first move toward the Islamic financial system was observed in the second half of 20th century when the Muslim world got liberation from colonial powers (Hanif, 2011). Conference of Foreign Ministers of Muslim countries (1973) can be marked as a landmark of the growth and popularity of Islamic Financial Institutions (IFIs). Soon after this conference, Bangladesh signed the Charter of Islamic Development Bank n August 1974. Analyzing the demand and feasibility of Islamic banking, Islami Bank Bangladesh Limited, the first Islamic bank of Bangladesh was established in March 1983³. Currently eight Shariah based Islamic banks are operating in Bangladesh with their significant contributions to the banking industry and to the financial system of the country as well.

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³ Source: Islami Bank Bangladesh Limited official website, February 4, 2014

2. Objectives

The key objectives of the study are:

- To review the distinctive concepts of Islamic banking
- To analyze the history of Islamic banking
- To evaluate the current practice and performances of the Islamic banks of Bangladesh

3. Methodology

This is a secondary data based report. Information has been collected from various secondary sources like journal articles, annual reports of different banks, books and different websites. All the existing Islamic banks of Bangladesh are included in this study. The first two objectives of the research are subject to be achieved through the secondary data review and the qualitative discussion. Current Islamic banking practices and the performances of different Islamic banks are measured and analyzed from the financial statements of the banks and information from different relevant websites. Statistical analysis tool SPSS and MS Excel had been used for analysis and graphical presentations.

4. Review of Literature

A significant level of development had been observed in Islamic banking research since the last decade. The western analysts and economists demonstrated their emphasis on the interest-free business transactions. These western economists discovered the connection between the interest rates and some key macroeconomic instabilities like- unemployment, inflation or negative growth (Bernante and Gertler, 1990; Fisher, 1933; Greenwald and Stiglitz, 1988; Hayek, 1933 & 1939; Minsky, 1977; Smith, 1904; Wicksell, 1935). In different parts of the world, Islamic banking researches had been mostly conducted by Muslims and a small portion by the non-Muslims. The works of Erol and El-Bdour (1989) and Erol et al (1990) revealed three key selection criteria for Islamic banks: fast and efficient services, reputation and confidentiality. According to their findings, religious motivation was not a prime criterion. On the contrary, Metawa and Almosawi (1998) and Naser et al (1999) found loyalty to Islamic belief the primary criterion for selecting Islamic banks in countries like Bahrain and Jordan. Similarly, some other scholars discovered same findings in their studies in Indonesia, Kuwait and Malaysia (Kader 1993 & 1995; Osman et al, 2009; Othman and Owen, 2001 & 2002; Wakhid and Efrita, 2007). A study on a large number of respondents by Dusuki and Abdullah (2006) discovered that Islamic bankers should not only rely on promoting the Islamic factors but also the necessary service quality. The three most important factors found in their study were competence, friendliness and customer service quality.

Hanif & Iqbal (2010) categorized Islamic modes of financing objectively in two heads; Sharia compliant and Sharia based. Later, Hanif (2011) discussed these terms used for modes of financing briefly. He explained Sharia compliant products as the modes of financing where return of financier is predetermined and fixed but within Sharia constraints. The tools which are relatively harmonizing the operations of Islamic financial system with conventional banking includes Murabaha (cost plus profit sale), Ijara (a rental arrangement), Bai Salam (spot payment for future delivery), Bai Muajjal (sale on deferred payment), Istasna (order to manufacture) and Diminishing Musharaka (house financing) are all Sharia compliant products. Sharia based transactions means the financing modes adopted by IFIs on profit and loss sharing basis including Musharaka (partnership in capital) and Mudaraba (partnership of capital and skill). Under Sharia based modes of financing returns of financier are not fixed in advance rather it depends upon the outcome of the project. However loss is to be shared according to capital contribution. Following the rule of substance over form one can conclude that the major difference between conventional and Islamic financing is Sharia based modes of financing.

Mahal & Rahman (2013) made a comparative analysis between conventional and Islamic banks of Bangladesh. They discussed the distinctions of product or service and the distinctions in terms of business efficiency between Islamic Banks and Conventional Banks. Their key findings on the product or service differences are about the principles of business, variation in goals, variations in deposit etc. The conventional banks of Bangladesh deal with man-made principles or principles provided by Bangladesh Bank. But Islamic banks follow Shariah based principles under the supervision of BB. Conventional banks currently focusing on the CSR activities but Islamic banks are focusing on the IT development though they also consider the CSR issues. Conventional deposit schemes are like the fixed deposit, savings or short notice deposit and current deposit. The Islamic banks offer through Al-Wadeeah principle and Mudaraba principle. These researchers also discussed the distinctions in terms of business efficiency. Profitability of conventional banks depends on loans and investments both; whereas Islamic banks depends on only investments sectors. Conventional banks have to maintain more SLR (19%) than the Islamic banks (10.5%). Islamic banks do not collect deposits through conventional methods rather on the basis of profit & loss sharing notion.

5. Banking Industry of Bangladesh

After the independence, banking industry in Bangladesh started its journey with 6 nationalized commercialized banks, 2 State owned specialized banks and 3 Foreign Banks. In the 1980's banking industry achieved significant expansion with the entrance of private banks. Of the 56 scheduled banks⁴ currently operating in Bangladesh, 8 are Islamic Shariah based banks (IBs).

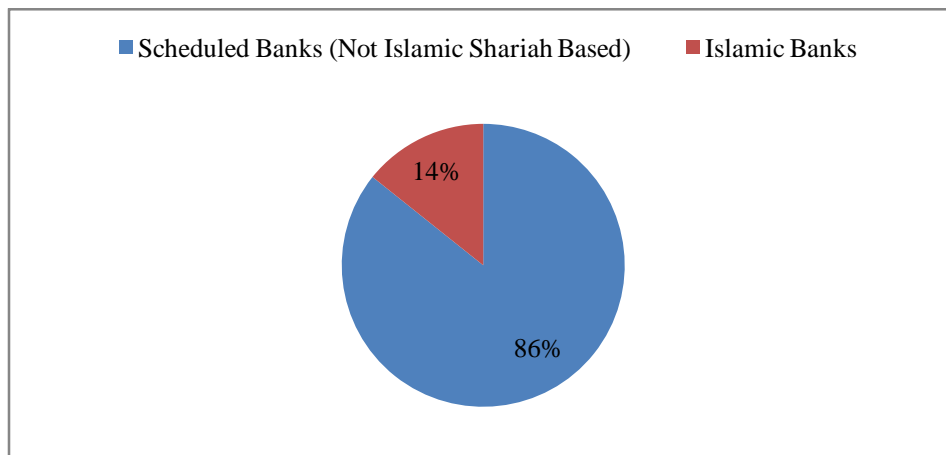


Figure 1: Portion of Islamic Banks in the Industry

The 56 scheduled banks include 39 Private Commercial Banks (PCBs), 4 State Owned Commercial Banks (SOCBs), 4 Specialized Banks (SDBs) and 9 Foreign Commercial Banks (FCBs). These banks operate under full control and supervision of Bangladesh Bank which is empowered to do so through Bangladesh Bank Order, 1972 and Bank Company Act, 1991. As mentioned earlier, Islami Bank Bangladesh Limited is the first Islamic bank in the country and the last inclusion in the list of Islamic banks is the Union Bank Limited, which was incorporated recently (2013). Establishment of Islamic banks in Bangladesh had been portrayed here along with their year of Incorporation, listing status in stock market and year of listing.

⁴ Source: Bangladesh Bank (Central Bank of Bangladesh) website, February 10, 2014

Table 1: Islamic Banks' Year of Incorporation and Listing⁵

SL	Name of Bank	Year of Incorporation	Listing Status	Year of Listing
1	Islami Bank Bangladesh Limited (IBBL)	1983	Listed	1985
2	ICB Islamic Bank Limited (ICBIBL)	1987	Listed	1990
3	Al-Arafah Islami Bank Limited (AAIBL)	1995	Listed	1998
4	Social Islami Bank Limited (SIBL)	1995	Listed	2000
5	Export Import Bank of Bangladesh Limited (EXIM)	1999	Listed	2004
6	First Security Islami Bank Ltd. (FSIB)	1999	Listed	2008
7	Shahjalal Islami Bank Limited (SJIBL)	2001	Listed	2007
8	Union Bank Limited (UBL)	2013	-----	-----

6. Current Performance

Other than Union Bank Limited (as not yet enlisted in the stock market), all the seven banks have their offered shares in the capital market. Net profit (after tax) of these seven banks for the last 10 years had been presented here.

Table 2: Net profit (Researchers' own calculation)

Year	Net Profit after Tax (in million BDT)							Total (Islamic Banks)	Average (Islamic Banks)
	IBBL	ICB	AAIBL	SIBL	EXIM	FSIB	SJIBL		
2003	375.41	(393.39)	127.06	193.68	254.79	55.85	N/A	613.40	87.63
2004	1,013.65	(249.80)	154.76	83.86	381.80	101.49	(472.57)	1,013.19	144.74
2005	1,125.82	(572.73)	262.90	13.94	555.34	9.89	255.59	1,650.75	235.82
2006	1,400.59	(4,308.30)	470.02	57.63	650.29	(117.22)	463.22	(1,383.77)	(197.68)
2007	1,427.36	610.88	347.31	150.04	930.84	30.63	646.99	4,144.05	592.01
2008	2,674.80	(776.74)	668.24	202.07	1,096.63	104.28	817.71	4,786.99	683.86
2009	3,403.55	(2,062.21)	858.99	431.52	1,682.99	326.84	1,070.57	5,712.25	816.04
2010	4,485.48	(1,358.24)	1,816.14	640.10	3,458.02	548.60	2,072.34	11,662.44	1,666.06
2011	4,624.59	(1,796.15)	1,992.87	1,032.46	2,017.72	579.94	1,168.65	9,620.08	1,374.30
2012	5,616.75	(1,061.04)	1,694.14	1,465.22	2,083.08	762.29	1,744.45	12,304.89	1,757.84

Here, we see that except the ICB, most of the Islamic banks shows remarkable increase in their profitability. Islami Bank Bangladesh Limited, the first Islamic bank of Bangladesh is leading in term of net profit since the last decade. On the other hand, ICB Islamic Bank Limited shows net loss in almost all the years of the last ten years. This one is an exception. One reason behind this consistent negative figure in profitability is the change of ownership. Among the recent periods, once it showed net profit is in the year 2007. The other banks show more or less gradual increase in their profitability or portray the upward trend in financial performance. Union Bank Limited, which is the latest incorporation, hasn't published any official financial statements yet.

⁵ Source: Banglaesh Bank (2014), Dhaka Stock Exchange (2014) and Annual Reports of concern banks.

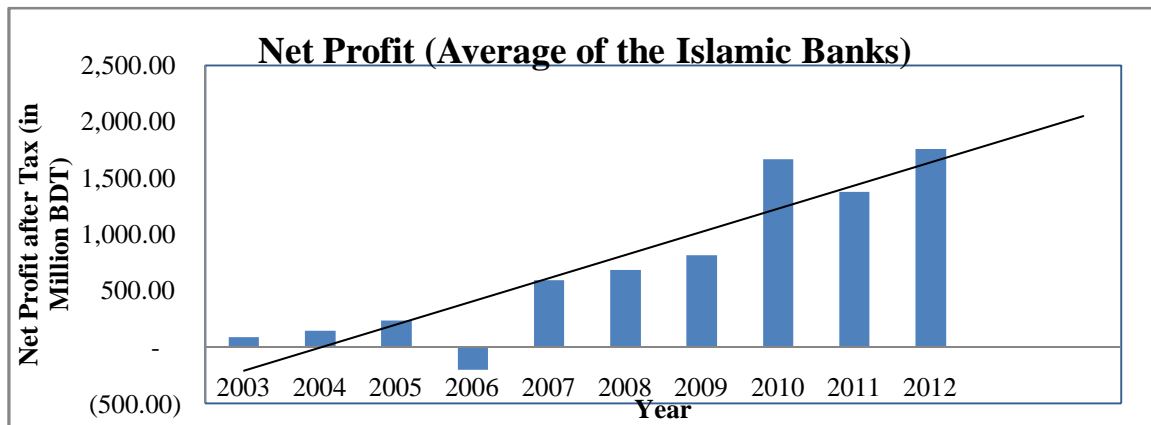


Figure 2: Profitability trend of the Islamic Banks of Bangladesh

On an average, Islamic banking industry presented promising performance over the last few years. But we can see that in the year 2006, the industry average is showing a negative figure especially for the large volume of loss by ICB in that particular year.

Now, the contribution of these average net profits to the banking industry of Bangladesh can be analyzed through measuring their relationship. Here, ROA in the overall banking industry for the last nine years had been considered for the analysis.

Table 3: Average NPAT of Islamic Banks and ROA⁶ in the Banking Industry

Year	Average NPAT of Islamic Banks (in Billion BDT)	ROA (Industry)
2004	1.45	0.7
2005	2.36	0.6
2006	-1.98	0.8
2007	5.92	0.9
2008	6.84	1.2
2009	8.16	1.4
2010	16.66	1.8
2011	13.74	1.5
2012	17.58	0.6

To illustrate the contribution of Islamic banks profitability in the overall industry, a regression analysis had been conducted considering the NPAT of the Islamic banks as independent variable and the ROA of the industry as the dependent variable. The findings of this analysis are presented here.

Model Summary^b

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.512 ^a	.262	.156	.40068

a. Predictors: (Constant), Net profit generated by the Islamic Banks

b. Dependent Variable: ROA of the banking industry

⁶ Source: Bangladesh Bank, February 10, 2014

Coefficients^a

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	.801	.210		3.820	.007
Net profit generated by the Islamic Banks	.000	.000	.512	1.575	.159

a. Dependent Variable: ROA of the banking industry

Here, we find that there is moderate relationship between these two variables and one unit change in the independent variable will cause 0.512 unit change in the dependent variable. Value of R Square (.262) indicates that the model is not much capable of explaining the relationship. Still it is visible from the profit figures of these Islamic banks that they have contributions in the banking industry of Bangladesh.

7. Conclusion

A major and influential part of the banking sector as well as the financial sector of Bangladesh is the Islamic banking. Most of the Islamic banks are performing well except the unexpected negative profitability of the ICB Islamic Bank of Bangladesh. This study identified the frequent change in the ownership is the main reason for the struggling situation of this bank. So, this negative contribution brings back the overall profitability of the Islamic banks of Bangladesh. The Islamic bankers consider that the Profit Loss Sharing (PLS) principle symbolize the financial advantages for the banks and offers benefits for the economy by causing lower interest stimulated instability. The most effective factor making Islamic banking attractive to customers is loyalty to the rules of Shariah. Convenience of opening accounts or the quality of the services offered does not have much impact on the consumer's decision of choosing an Islamic banking system, but for the Shariah based activities of the Islamic banks, their reliable commitment to the customer also their well behave encourage the Muslim to be attracted by the Islamic banks.

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