

## **ISLAMIC BANKING IN BANGLADESH: A CASE STUDY OF IBBL**

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*The article undertakes a case study on an Interest-Free Financial Institution in Bangladesh known as Islami Bank Bangladesh Limited (IBBL). The aim of the study was to see how Islamic banking activities differ from a conventional bank and also to see how Islamic banks may contribute to render financial services towards small and rural sector. By discussing various aspects of the IBBL, it is shown in detail how interest-free bank functions besides many established conventional banks in the country.*

*Although conventional banks are rendering financial services in Bangladesh for a long period still, the innovation of interest-free banking systems, proved its worth in the country's money market, since IBBL started rendering banking services without any interest in the nation's financial market in recent years. The article mainly consists of two sections. In the first section, an introduction of Islamic banking systems and various financing modes or techniques used by Islamic banks, are discussed. The second section includes a short history of the Islami Bank Bangladesh Limited (IBBL) along with an empirical based detailed accounts of its financial activities in the country since the introduction of this financial institution in the financial system of Bangladesh.*

### **Introduction**

The introduction of interest-free and equity-based financing by the Islamic banking system is based on the principles of Islamic economics. The aim of Islamic economics, as observed by Molla et.al. (1988), is not only the elimination of interest based transactions and the introduction of the zakah (contribution to poor) system but also the establishment of just and balanced social order free from all kinds of exploitation. The Islamic banking system is highlighted in the World Development report (1989, Box 6.3), as under;

“Islamic banks offer savers risky open-ended mutual fund certificates instead of fixed-interest deposits. (This is not unlike cooperative banks and mutual in the west, where deposits earn variable interest and double as equity.) Difficulties arise on the lending side. Arrangements to share profits and losses lead to considerable problems of monitoring and control, especially in lending to small business”.

Ahmed (1994), argues that elimination of interest does not mean zero-return on capital. Rather, Islam forbids a fixed predetermined return for a certain factor of production i.e. one party having assured return and the whole risk of an entrepreneurship to be shared by others. The author also observed that it is the capital entrepreneurship that shares both the real contribution and the real profitability. The Islamic bank follows the principle of *equity based-investment*. The Islamic banking system also proposes that resources can be contracted on the basis of venture capital and risk sharing deals. The idea of equity-based investment banking is not new to the financial market. If we look into history it may be observed that capital, as loan capital as well as venture capital played a great role in promoting industrial and economic development of various countries of the world. For example, during the 19th and 20th centuries investment banks played a great role in French tradition while in British model of banking equity-based investment was limited. Similarly in Germany equity-based investment was being practiced by commercial banks during that period. Even the banking crisis in the western world during the great depression in the 30's or the 80's proposed two-tire banking i.e. hundred percent deposit banking and the equity-based investment banking.

In the modern financial market an alternate arrangement for participation of capital and entrepreneurship started with the advent of Islamic Banking in the 70's. In a number of studies such as IMF, World Bank and IFC, the Islamic bank activities were discussed in detail. Highlighting Islamic bank's principle Khan (1986, p. 19), in the IMF staff Paper, observed as;

“Indeed it is really apparent that the Islamic model of banking based on the principle of equity participation bears a striking resemblance to proposals made in the literature on the reform of banking system in many countries. The Islamic System may well prove to be better suited to adjusting to shocks that result in banking crises and disruption on the payment mechanism of the country. In an equity-based system that exclude predetermined interest rate and does not guarantee the nominal value of deposits, shock to asset position are immediately absorbed by changes in the values of the share deposits held by the public in the banks. Therefore, the real value of assets and liabilities of banks in such a system will be equal at all points in time. In the more traditional banking system since the nominal value of deposits is fixed, such shocks can cause a diversion between real assets and liabilities. It is not clear if this would be correct and how long the process would take.”

A study by OECD of the European countries, Paris, (1983) reveals the fact that interest-free banking is a novel form of finance and they are not only trying to give interest another name but that legal instruments within the framework of Shari'ah exist which permit profitability on a different, albeit Qoranicly acceptable basis. Islamic banks belong to the class of equity-participation bank. In this regard Ahmad (1994, P. 190) in his study quoted the idea of Alba'ch as;

“They supply equity in the form of venture capital to investors whose share is their ingenuity and their labor. Secondly, they supply equity in the form of equity capital participants in the type of project, which in general has majority shareholders. They may be ideally suited to meet the need for equity capital in developing countries where the business risk is particularly high as well as in the industrialized countries where the development of new processes and new projects involves high risk and requires large amount of venture capital”

Scharf (1983, P. 94-95), in his study entitled 'Arab and Islamic Bank' conducted by Development center, Organization of Economic Cooperation and Development (OECD), highlighted the Islamic banking principles and prospect as follows;

'Islamic banking is trying to develop the relationship between finance on one hand and industry and commerce on the other. This new relationship is the basis of the Islamic economic system being set up. Though Islamic principles have yet to be put to the test in the competitive of international finance, the two system are similar in that they both strive for closer ties between financial intermediation and economic asset creation. Islamic banks could make a useful contribution to economic growth and development particularly in a situation of recession, stagflation and low-growth level because the core of their operation is oriented towards productive investment All countries both in the North and in the South, need more venture capital. Loan capital is available, particularly from industrialized countries but at high interest rates. However, even from expansion and innovation. This has acted as a brake on productivity and economic growth in the North. Thus practical and immediate cooperation possibility exists between Islamic banks and enterprises all over the world. The intermediation process remains to be fully developed'.

About the possibility of introducing an interest-free financing system through Islamic banking principle Scharf (1983) also argues that the establishment Islamic Financial System based on the principle of Shari'ah is not only feasible but also profitable.

Western countries today realize the truth that interest is an unbearable burden for the developing countries. Due to that, as observed by Ahmad (1994, p. 188), 'Canada has already waived of all the interest. Australia has made a similar move. President Mitterrand of France has officially suggested in the Group-7 meeting that at least 30-35 percent of the present interest element of the debt should be waived off'.

## Practices of Islamic Banking System By Western Bankers

Islamic banks appeared in their modern form as late as in the mid 60's and presently more than 70 Islamic banks and Insurance houses rendering interest-free services in Asia, the Middle East, the Far east, Africa and Europe (Nassief, 1989, Ahsan, 1989, Kazarian, 1991). It is reported by Gathura (1996, p.35) that, the total deposits of Islamic banks could grow to more than US \$ 100 billion by 1997. A few western banks such as, the Kleeinworte Benson, Citibank and ANZ Grindlays also started to adopt the pattern of Islamic banking in cost-plus financing, leasing and equity financing for their clients in the Middle East, Southeast Asia and a few international corporations in Europe and Latin America.

Roula (1995, p.1), in his article highlighted about activities of the Citibank in the Middle East. He observes; 'Citibank will soon become the first Western-owned banking company to open an Islamic bank in the Middle East. Like other Islamic banks, the Citibank venture in Bahrain will follow the Koran, which forbids interest but allows profit'. In USA also Islamic banking system are functioning well and several groups of bankers are practicing this system with a better result. Concerning the application of Islamic banking principles in America Ken (1994 p.1) argues as;

'Islamic banking is making inroads in America as several groups of bankers and Muslim scholars attempt to create an interest-free banking system that uses lease agreements, mutual funds, and other methods to avoid interest payments. This strategy is necessary because Islamic law prohibits Muslims from paying or earning interest.'

The introduction of Islamic banking principles by various western bankers have shown a positive results which indicates that Islamic banking systems can work effectively in both developed as well as developing nations regardless of religious boundary. Regarding the positive result of the application of Islamic banking principles by western banks Parker (1993, p28 (i) n227), observes;

'Morabaha or cost-plus financing transactions have earned Kleinwort Benson \$ 4 billion in 1992, while ANZ Grindlays earned \$400 million. The banks arrange for transactions within the limits set by the Islamic banks and get it approved by the Shariah advisors of investors or by banks engaged in the transactions'.

Heffernan (1999 p.115) in this regard argues

'A few western institutions have also entered the Islamic banking market. For example Kleinwort Benson, a London merchant bank, has a Middle East banking department and a shariah advisor. The bank and its clients engaged in profit-sharing investment activity, and syndicated loans have been arranged. Kleinwort Benson have used *murabaha* and *hijara* finance techniques'

Although the observation of the various international bodies such as, World bank, IMF, IFC OECD advocate the possibility and profitability of the equity-based and participating investment policy of the Islamic banks, yet its practical implementation needs to be observed. It is due to the fact that, the application of theoretical aspects of Islamic banking systems differs from country to country under different economic conditions and social environments. Consequently, the problem of the interest-free & equity-based financing system of the Islamic bank raises questions as to what principle an interest-free and equity based financing system follows in its operations concerning deposits and modes of lending, investment etc. In my study I tried to find answers of the question as such. The study of the problem may help readers to get an answer to the commonly asked question, "is it really possible to run a bank without profit from interests?"

## Methodology Used in This Study

Islamic banking systems is a quiet new phenomenon in the money market of Bangladesh. In order to go deep into this particular area of study and also to realize the objectives of my research, the methodological approach used in this study is of a qualitative nature. Regarding a qualitative research Merriam (1998, p. 5) observes; '*Qualitative research is an umbrella concept covering several forms of inquiry that help us understand and explain the*

*meaning of social phenomena with as little disruption of the natural setting as possible*'. Further to the above, the author with regards to a qualitative research observes that this method is often used for interchangeably naturalistic inquiry, interpretative research, field study, participant observation, inductive research, case study and ethnography. To understand problems of the Islamic banking activities a **case study** method is used in the study about which Yin (1994, p.13) argues that a case is an empirical inquiry that investigate a contemporary phenomenon within its real-life content, especially when boundaries between phenomenon and content are not clearly evident.

The main objective of using case study method is to find how an Islamic banks functions among other established conventional banks in the country. Hence, to realize the said objectives, apart from depth interview, participants' observation is also used in the study.

### **Theoretical Basis and Business Practice of Islamic Banking**

From the viewpoint of Islamic Shariah, in order to be justified islamically the banking system has to avoid interest. Consequently, financial intermediation in Islamic banking between the bank and the client takes place as a partner rather than a debtor-creditor. The financial activities of modern conventional banks are based on a creditor-debtor relationship between depositors and bank on the one hand and between the borrower and the bank on the other. Interest is regarded by conventional banks as the price of credit reflecting the opportunity cost of money. As interest is prohibited in Islam, commercial banking in an Islamic framework could not be based on the creditor-debtor relationship. The other aspect of the theoretical basis of Islamic banking is that the interest free bank is not risk free. This principle is applicable to two main factors of production, i.e. labor and capital. According to this principle, as no payment is allowed to labor, unless it is applied to work, no reward for capital should be allowed, unless it is exposed to business risk. From these two principles of the theoretical basis of Islamic banking, it may be said that Islamic financial relationships are of a participatory nature (Ahmad, 1993). Based on the theoretical background, business practices of Islamic bank, especially sources and uses of bank's funds, are characterized by the following modes or techniques.

### **Sources of Funds of Islamic Banks**

#### ***Current Accounts***

Islamic banks accept deposits from customers on current accounts as conventional banks do. This account is also known as 'Demand Deposit as the deposited amount is payable to customers on demand without any notice. As banks use current account deposits on their own risk the depositors of this type of account are not entitled to any share in the profit earned by the bank.

#### ***Savings Accounts***

Islamic banks accept saving deposits from customers under Al-Wadia and Al-Mudaraba Sharia Principles. The word Al-Wadia means '*Trusteeship*'. In this case banks act as trustee for its customers. In Saving Accounts under the Al-Wadia principle the bank is given an authorization by depositors to use the fund at the bank's own risk. This type of deposit is almost similar to a 'Current Account' or Demand Deposit' except that the bank guarantees its customer the full return of the deposited fund with any profit voluntarily. Under the Al-Mudaraba Shariah principle there are two different types of savings accounts, such as

- savings under profit and loss sharing agreement and
- savings under Investment Account.

The word 'Al-Mudaraba' originates from the word 'Mudarib' and means 'The Manager' of the fund. The bank in this case acts as a manager of customers' funds. The depositors on the other hand are known as 'Sahib-Al-Mal' meaning *the owner* of the fund. Deposits accepted on savings under the Profit and Loss sharing agreement is invested by the bank on its own risk. Customers give authorization to the bank to invest funds and share profit or loss on agreed proportions. Account holders of this type of account are required to maintain a minimum balance in the account.

Further to the above, Islamic banks accept deposits from customers under the Investment Account on a Profit and Loss Sharing basis. The saving account of such a nature in an interest-free banking system is also known as a participatory account or a Profit or Loss Sharing (PLS) account. Depositors of this type of account receive share of profit to the agreed ratio from their funds invested by the bank. The profit and loss sharing also depends on the total amount deposited and the length of period the money is held by the bank. Depositors of an Investment Account are required to give prior notice to the bank if they withdraw their invested funds under any special circumstance. In such a case no share of profit is given for the amount withdrawn.

Investment accounts are again subdivided into the following various categories.

- Joint or General Investment Account
- Limited-Period Investment Deposit
- Unlimited-Period Investment Deposit
- Specified Investment Deposit

Under the 'Joint or General Investment Account' the bank pools together investment deposits of different maturities which are not invested in any specified project but utilized for different financing operations of the bank. Depositors of this type of account receive profits at the end of the period, which is accounted and distributed on a pro rata basis. The 'Investment Deposits on Limited Period' basis indicates a type of investment, where the bank accept deposits from customers for a specified period of time. The bank refunds the money to depositors after the time is expired. The profit generated from such funds is distributed at the end of the financial year. The bank also accepts deposits from its customers under an 'Unlimited-Period Investment Deposit', where investment deposits are automatically renewable without specifying the period. Depositors of this type of account may withdraw their funds within three months notice to the bank. Profits are distributed to depositors at the end of the financial year. Some Islamic banks accept an 'Specified Investment Deposit', where the bank and the customer agrees to invest this fund to a specific project or trade. Profits accrued from this type of investment are shared by the bank and the customer. The bank in this regard, works as an agent for the customer, and may charge an agreed fee for the investment function or may share the profit at an agreed proportion.

### ***Saving Deposit as Quard E Hasan***

Apart from the above Islamic banks accept savings from customers as Quard E hasan (benevolent loan) from the customers. Depositors of this sort of savings deposits receive financial or non-financial benefits from the bank.

### **Uses of Funds of Islamic Banks**

Based on the theoretical viewpoint as discussed earlier two fundamental techniques or modes of investment advocated by the Islamic Shariah Principle is;

- Mudaraba (Capital Financing)
- Musharaka (Partnership )

### ***Mudaraba (Capital Financing)***

Capital Trust financing is a contract between at least two parties in which the bank as the investor supplies the entire capital of the business forming a relationship between the supplier of capital and the user of capital. These two parties work together and share profits and losses. Under 'Murabaha' financing the investor is known as 'Rab-Al-Mal' which means the owner of the property and the entrepreneur is called 'Mudarab', meaning the manager of capital. When the venture ends, the manager of capital i.e. the entrepreneur returns the entire capital to the bank, along with an agreed proportion of profit. If there is any loss, it is born by the bank. The main advantage with this type of partnership is that it combines the efforts of human beings and their skills with the capital, which contribute greatly towards the development activities in a society and also assists to solve unemployment problems by utilizing manpower resources in a productive way.

### ***Musharaka (Partnership)***

The word 'Musharaka' means a profit sharing joint venture, designed to limited production or commercial activities of long duration. In this case the bank and the customer contribute capital jointly. They also contribute managerial expertise and other essential services at agreed proportions. Profit or losses are shared according to the contract agreed upon. An individual partner does not become liable for the losses caused by others.

In addition to the above two financial arrangements, Islamic Banks currently in existence are also engaging in or actively considering several other financial practices usually acceptable in Islamic Law. These are:

- Murabaha (Mark-up or Cost-Plus-based Financing)
- Ijara (Leasing) and
- Qard- E- Hasan (Interest-Free Loan)

### ***Murabaha (Cost plus profit)***

The word 'Murabaha' means a cost-plus Profit contract. In this system of financing the bank agrees to purchase for a client who will then reimburse the bank in a stated time period at an agreed upon profit margin. The mark-up price that the bank and the buyer agree to is mainly based on the market price of the commodity. Thus the bank earns a profit without bearing any risk.

### ***Ijara (Leasing)***

The word 'Ijara' indicates leasing. The leasing purchase is another technique followed by Islamic banks in financing customers. This system is almost similar to the leasing activity provided in traditional banking. Leasing is a contract between the bank and the customer to use particular assets. In this case the bank is called lessor and the customer is called lessee who wants to use the assets and pays rent. Zineldin(1990, p.83), in this regard argues as, "The leasing agreement is based on profit sharing in which the bank buys the movable or immovable property and lease it to one of its client for an agreed sum by installments and for a limited period of time into a saving account held with the same bank. These installments are invested in Mudaraba investment (Venture) for the customer's account. The accumulated profit generated from the payments, and the payments themselves are invested in the bank's investment ventures over the time period of lease, contributing to eventual purchase of the leased assets." According to the Western leasing system the lessee pays specific rentals and a fixed rate of interest over a given period for the use of specific assets. But in the Islamic banking system of leasing the risk related to leasing has to be shared between the bank and the lessee, in case of any damage to the leased assets. The contract is called '*ijara-wa-iqtina*' i.e. leasing purchase, when the ownership of the assets is transferred to the clients after the completion of the leasing contract.

**Quard E Hasan (Interest free loan)**

Quard E Hasan means an interest-free loan given by the Islamic bank to the needy people in a society. The practice of dealing with this sort of investment differs from bank to bank. Quard E Hasan is normally given to needy students, small producers, farmers, entrepreneurs and economically weaker sections of the society, who are not in a position to obtain loan or any financial assistance from any other institutional sources. The main aim of this loan is to help needy people in a society in order to, make them self-sufficient and to raise their income and standards of living. (Zineldin, 1990; Khan, 1897; Kazarian, 1991, Ahmad, 1993)

**Banking Environment in Bangladesh**

Bangladesh appeared as a new nation on the world map in the year 1971. After independence financial institutions, especially banks played a vital role in re-constructing the war-torn economy of Bangladesh. As reported by BSB (P. 29, 1993), “the banking system of Bangladesh is a mixed one comprising nationalized, private and foreign commercial banks. Bangladesh Bank is the central bank of the country and is in charge of monetary policies of the Government and controls all commercial banks.” Immediately after independence the government of Bangladesh nationalized most of the banking institutions, though, within a short period, due to the failure in administering them properly, many of them were returned to their owners. The banking sector is one of the fast growing sectors of economy in Bangladesh. At present there are 34 banks working in the financial market of the country, including four Islamic banks and a number of foreign banks. The total figure of banking institutions in Bangladesh may be stated by the following Table.

**TABLE I**

**Banking institutions in Bangladesh**

	NAME OF THE BANKS	NUMBER
i	Central Bank	01
ii	Government owned commercial banks	04
iii	Locally incorporated private commercial banks	09
iv	Islamic banks	04
v	Overseas banks operating in Bangladesh	06
vi	Government -owned specialized banks	03
vii	Non-bank financial institutions	06
viii	Cooperative bank	01
	TOTAL	34

**Source: GOB 1993/1994**

During the Fiscal Year 1993-94 the banking institutions of Bangladesh transacted their business through 5,780 branches (BSB, 1994). The deposit of scheduled banks (excluding inter-bank items) amounted to TK. 309,884 million\*. The bank deposits during the year 1993-94 were increased by TK. 27,629 million, of which 12.29% was in time deposits and TK. 22,043 million or 25.50% in demand deposits. The total bank credit in the same year was TK. 240,870 million. Of this, credit to the government sector recorded a decrease of 55.05% and credit to the private sector expanded by 8.55%. (GB, 1993/94).

## **The Islamic Bank Bangladesh Limited**

Based on Islamic principles and shariah (Islamic law), with an authorized capital of TK. 500 million (12.5 million US dollars), the Islamic bank in Bangladesh, called Islami Bank Bangladesh Limited (IBBL) was incorporated on March 13, 1983 as a Public Limited Company under the companies Act of 1913. The bank started its financial activities with effect from March 30, 1983. This is one of the first interest free banks in South Asia. The opening of Islami bank brought a new era in the history of the country's financial market. The long cherished desire of many Muslims in the country was realized. The total number of branches of the bank as on December 1995 stood at 83. The bank had taken steps to spread its activities towards the rural areas of Bangladesh. With the implementation of the expansion program in the year 1997, almost all-important commercial places of the country would come under the operational activities of the bank.

In Bangladesh, which is the second largest Muslim country of the world, Islami Bank Bangladesh Limited (IBBL) started as a joint venture multinational bank with 63.92% of equity contributed by the Islamic Development Bank and financial institutions like Al-Raji Company for Currency Exchange and Commerce of Saudi Arabia, Kuwait Finance House, Jordan Islamic Bank, Islamic Investment and Exchange Corporation of Qatar, Bahrain Islamic Bank, Islamic Banking System International Holding, S.A, Dubai Islamic Bank, Kuwait Ministry of Awqaf and Islamic Affairs. Two eminent personalities of Saudi Arabia namely Fouad Abdul Hameed Al-Khateeb and Ahmed Salah Jamjoom, are also the sponsors of the Islami Bank Bangladesh Limited. (GB 1993/94).

The responsibility for management and formulation policy of the IBBL is vested in the board of directors. The board consists of 14 local and 9 foreign directors. As a rule in the Article of Association, a Bangladeshi director is to be elected as the chairman of the company. A high powered Executive Committee has been formed to assist the chairman. There are six members in this committee, nominated by the board of directors. In addition to this there is a Management Committee consisting of the most senior executives of the bank. There is also a Shariah Council comprising famous Islamic scholars, economists and bankers. This Council is responsible for supervising the day to day affairs of the Islamic bank from the viewpoint of the Islamic Shariah. (GB, 1995).

### **Objectives of Islami Banks Bangladesh Limited (IBBL):**

The main object of the Islami Bank Bangladesh Limited (IBBL) had been to offer an interest free banking system in the financial market. Apart from that, the bank started its operation in the country with a view to realizing the following objectives.

- To establish a partnership relationship with customers and to eliminate the idea of the debtor-creditor relationship of traditional banks.
- To establish welfare oriented banking system;
- To mobilize savings towards productive sectors;
- To invest on profit and risk sharing basis;
- To invest to those businesses sectors that are found legal from the religious point of view.
- To accept deposits on profit and loss sharing basis.
- To create employment opportunities by investing savings towards prospective economic sectors.
- To extend banking services towards the poor, helpless and low-income group of people in the society in order to uplift of their standard of living.
- To contribute to establishment of a society by equitable distribution of wealth
- To establish justice in trade and commerce in the country;
- To develop morals among the people and to establish the shariah in the field of trade and commerce; And;
- To render services for the economic development of the nation.
- To contribute towards establishment of an Islamic Economic System in the Country.



## **Equity Position OF IBBL**

According to the Annual Report 1994 of IBBL the total equity of the Bank as on December 31, 1994 stood at Taka 537.35 million against Taka 420.06 million as on Dec. 31, 1993. The bank achieved a good progress with regard to increase in its reserve position during the recent years. The reserve of the bank increased to Taka 340 million the year 1994 from Taka 92 million in the year 1990, registering an increase of Taka 248 million (269.59%) within the range of 5 years. It may also be noted that paid-up capital being the same each year the bank managed to increase its reserve position. From the last five years record it may also be noted that the bank on the average made more than a 30% increase in reserve position since the financial year 1990.

## **Functions of IBBL**

Islamic banks render almost similar services to their customers conventional banks do. However, differences exist in administering incentives for deposits and charging for capital investments, in so far as techniques of calculating the incentive or the cost of the capital is concerned. Like a conventional bank, the Islami bank also accepts deposits from customers and advances loans. The bank invests its funds for short as well as long term deposits. The Islami bank also acts as a custodian of its customers and performs all foreign transactions on behalf of them. The IBBL perform mainly three different types of functions

Banking services,

Investment, and

Foreign exchange services

Banking services comprise three regular types of operations related to acceptance of deposits in the different customers accounts as mentioned earlier, as well as, different transactional services to the customers, safe-keeping of personal valuables and securities, collection of bills, agency services, etc.

The bank lends its funds for the rapid growth and development of industrial sectors and the promotion of trade and commerce in the country. The bank also invests its funds in various socio-economic schemes such as, Rural Investment Scheme, Small Traders Investment Scheme, Doctors Investment Scheme, Small Transport Scheme, Small and Cottage Industry Project, Hawker's Investment Scheme, Household Durable Scheme and Low Cost Housing Scheme.

The third important function of the bank is to render services to customers regarding foreign exchange transactions plus services to its customers for import and export of different industrial, commercial, agricultural and other items.

## **Operations of IBBL**

This section of the article includes a detailed discussion of various functions of the Islami Bank Bangladesh Ltd. (IBBL), since it started its banking activities such as, acceptance of deposits and investment of funds etc. Further to that, an attempt has also been made to highlight on the overall performances of the bank, ever since it started its financial activities in the money market of Bangladesh.

## **Acceptance of Deposits**

In recent years Islami Bank Bangladesh limited had succeeded in attracting increased deposit. The deposit figure rose to Taka 10,418 million in March 1995 from Taka 144.20 million as on March 1983, registering an increase of Taka. 10,273.8 million.

**Year-wise deposit and the growth rate of deposits since 1993**

The total deposit figure of the IBBL in the year 1983 was TK: 144.20 million. Since the start of the banking services, the deposit position of the IBBL showed a favorable tendency every year.

According to data available as of December, 1994, the bank's deposit figure increased to Taka 10,226 million from Taka 8,380 million in the year 1993 registering an increase of Taka 1846 million, i.e. 22 per cent as compared to the national growth rate of 18.47 per cent in the banking sector for that year. In the year 1994 the total number of depositors rose to 339,600 from 291,000 in the preceding year registering an increase of 17 per cent. (IBBL Annual Report and GB Financial Report, 1994)

The deposit position of the IBBL as shown by Annual Reports indicate that in 1984 accumulated deposit figure rose to Taka 635.9 million from Taka 144.20 million year 1983, registering an increase in deposit of Taka 491.7 million i.e. 340% increase in growth rate of deposit within one year. But the growth rate of deposits decreased from 340% to 145% in 1985. In the year 1986 the total deposits of the bank was Tk. 2230.6 million. If we compare the rate of growth in 1986 with that of 1985 it can be observed that the deposit reduced to 42% from 145%, registering a fall of 103% in a one year period. The bank experienced a drastic fall in deposit growth in the year 1987. The total deposit received in 1987 was TK. 2419.7 and the growth rate compare to the year 1986 was 08%. It was reported by senior officials of the IBBL, that such a fall in the bank deposit in 1987 happened due to the political unrest in the country.

Since 1988 to 1994 the deposits figure and the growth percentage of the Islami Bank Bangladesh Limited is shown below by Table 2.

**TABLE 2  
DEPOSIT POSITION OF THE IBBL FROM 1983 TO 1994**

(Taka in million)

Year	Total deposit TK.	% of deposit growth	Demand Deposit TK.	6 months to 1 year TK.	1 Year to 3 years TK.	3 Years to above TK.
1983	144.20	---	134.40	-----	8.80	1.00
1984	635.90	340%	460.60	-----	138.20	37.10
1985	1563.90	145%	1208.10	-----	262.60	93.20
1986	2230.60	42%	1675.30	-----	338.30	217.00
1987	2419.70	08%	1756.64	-----	344.50	318.80
1988	2812.80	16%	2103.70	-----	409.60	299.50
1989	3455.50	22%	2553.80	-----	445.00	436.50
1990	4462.70	29%	3305.10	26.00	570.5.	561.10
1991	5671.60	27%	4155.80	151.00	617.20	747.60
1992	7150.80	26%	5027.90	196.10	910.30	1016.50
1993	8380.00	17%	5950.00	354.90	1019.00	1056.10
1994	10226.00	22%	-----	-----	-----	-----

*Source: (GB), Financial Report 1993/1994 & IBBL Annual Report, 1994*

From the above Table it may be observed that, even though the cumulative deposit figures of the Islami bank shows a tendency of gradual increase over the years still the growth rate is not fast enough.

**Composition of deposits in the year 1994:**

Two shariah principles, viz., AL-Wadia and Mudaraba are followed by the Islami bank to mobilize its deposits. The first one is almost similar to demand account or current account of conventional banks and the other implies various types of Profit Loss Sharing (PLS) Accounts. Of these accounts almost 80% to 85% of the total deposit of the Islami Bank is received under 'Mudaraba' Shariah principle. The highest profit so far paid by the bank on this type of deposit was 15%.

In the year 1994 the Annual Report showed a balance of deposits to the tune of Taka 10,226 million. An account-wise breakdown of the bank deposits is shown below by Table 3.

**TABLE 3**  
**Account-wise breakdown of the IBBL's deposit For the year 1994**  
**(Taka in million)**

Year	Deposits under various Accounts	Amount TK.	Cumulative Total TK
1994	PLS-SAVINGS (Including Hajj Savings)	4754.00 (50.00)	4754.00
1994	Current Account	2045.00	6799.00
1994	PLS-SND	257.00	7056.00
1994	PLS-TERM	3170.00	10,226.00

*Source: Annual Report of the IBBL 1994*

From the above it may be concluded that the IBBL attracted a major portion of its deposits from its customers in 1994 under the PLS-SAVINGS deposits.

**Position of Demand Deposit of the IBBL from 1983 TO 1993**

Deposit position under following the 'Mudaraba' Shariah principle or **Deposit under PLS Savings Account** since 1983 shows that the deposit figure increased to Taka 5950 million in the year 1993 from Taka 134.4 million in the year 1983, registering an increase of Taka 5815.6 million within one decade.

There was a high growth rate in Demand Deposits in the year 1983-84 which then started to reduce gradually. In 1986 the rate came down to 39% from 162% in the previous year, registering a deposit reduction of about 123%. Although the figure in 1987 shows an increase of Taka 81 million, it still grew only 5% in that year implying that the bank did not succeed in attracting much deposits in 1987. From 1988 till 1992 the average growth rate was maintained at around 23% which again fell in 1993. Further, the total deposit position grew every year in spite of the fact that, the increase in the rate of growth slowed down in the last few years.

The average percentage of Demand Deposit to the total deposit for the last ten years is around 76%. Even though, the amount of the Demand Deposit has been somehow increased since 1987, the percentage shows a reduced rate in comparison with the total deposit. It is also observed from the record that from 1988 till 1993, the growth percentage of Demand Deposit in comparison with the total deposit shows a static position being the range in between 72% to 74%.

#### ***PLS Term deposits from 1983 TO 1993***

The accounting record of the Islami Bank Bangladesh Limited shows that no deposit so far has been made by the Islami Bank for less than a 3 months to a 6 months period. Besides Demand Deposit the major sources of the bank's fund is various types of PLS Term deposits of 6 months to 1 year, 1 year to 3 years, and 3 years to the above term. The bank started receiving Term deposits under 6 months to 1-year period from 1990.

The time deposit under the 3-year-to-above term increased from Taka 1 million in 1983 to Taka 1056.1 million in 1993 registering an increase of Taka 1055.1 million within the ten years. The time deposit under the 1 to 3 years term also shows good progress with an increase of 1010.2 million in total deposit within a ten years period (1019-8.8). Within the short time of starting to accept time deposits under the 6 months to 1-year term some good progress has been achieved. The deposit under 6 months to 1 year term, in 1990 was Taka 26 million; while the figure rose to Taka 1019 million in 1993, registering an increase of 1265% within four years.

The deposits that accepted by the bank under the 6-month to 1-year term are lower than all other modes. This type constituted an average of 2.5% of the total deposits of the bank. The 'Time deposit' under the 1 to 3 years term yielded an average of 14% of total deposits. Deposits accepted by the bank under the 'Time deposit' of the 3 years to above constitute about 11% of the total deposit.

#### ***Growth rate of deposits compared to the growth rate of branches of IBBL:***

It is assumed that with the proliferation of branches a bank can spread its activities and attract an increasing number of customers both for accepting deposits and investing capital. This pattern was not found in case of the IBBL, since the record shows that in some years, in spite of a growth of a number of branches, a concomitant growth of deposits did not occur. The trend of the growth rate of deposits compared to the growth rate of branches from 1983 to 1995 is shown in figure 4.

The IBBL started its operation with only three branches in the year 1983. In 1995 the number of branches stood at 53. The growth rate of branches varied from year to year. In 1985 the number of branches opened was the highest; it decreased again in 1986. Although there was only a modest decrease of branches in 1986, there was a drastic reduction in the deposit figure. The deposit growth rate percentage from 1987 to 1989 is also low compared to the growth of branches.

#### ***Profit paid to depositors of IBBL in 1994:***

The Annual Report 1994 of IBBL shows that the bank distributed Taka 398.34 million as profit among depositors, which constitute 75% of the investment income of the concerned financial year. The rate of profit paid to the depositors is higher than the floor rate fixed by the central bank of the country. The rate of profit paid to the depositors of various types of deposit as well as the rate fixed by the central bank is shown in Table 4.

Types of Deposits	Profit rates in 1994	Floor rate fixed by the Central bank
Profit and loss sharing Deposits	6.15%	4.50%
Profit and Loss Sharing SND	2.87%	
Profit and loss Sharing Term Deposit		5.00%
06 months		
12 months	7.54%	
24 months	7.87%	
36 months	8.04%	
	8.20%	
Hajj Saving Deposit	9.20%	

***Source: IBBL Annual Report 1994***

### **Investment an Important Means of Using IBBL'S Fund:**

The Islamic Bank Bangladesh Limited invests its fund in various projects under different modes or techniques as discussed earlier. The bank shows a good progress in investing its funds, since it started its business. From the record is observed that the total investment of the bank has increased to Taka 9,766 as on March 31, 1995 from Taka 28 Million in the year 1983, registering an increase of Taka 9738 million since the bank started its financial activities in the Money Market of Bangladesh. The Annual Report of 1994 shows that investments of the bank in 1994 increased to Taka 8055.33 million from Taka 5521.35 million in 1993, registering an increase of Taka 2533.98 million, i.e. 45.89 percent as against a 6.56 percent growth rate of investment in the banking sector of the country.

Although the total investment of the bank registered an increase every year, the rate of growth fluctuated by a wide margin. The record shows that growth rate of investment from 1987 to 1989 is 28%, 17.8%, and 10.6% respectively. In the year 1990, a record of a 73.9% growth rate had been achieved, while it fell in 1991, 1992 and 1993. Further, the growth rate of investment in 1993 reduced to 7.32% from 20.57% in 1992, registering a reduction of 13% within one year.

### ***Modes of Investment of IBBL:***

Islami Bank Bangladesh Limited follows different modes or techniques while investing their funds. It has been observed from the past record that the bank invests its funds mainly under Murabaha, Musharaka, Bai-Muajjal, Hire Purchase, and Quard E Hasana mode of investments. The Mudaraba mode has not been used.

It is apparent from an analysis of the bank's mode of operations that the bank concentrates on the Murabaha mode of investment. Of the total investment, the bank invested almost 54.13% under the Murabaha mode and 18.24%

under the Bai-Muajjal mode. The Hire Purchase and the Purchase & Negotiation modes occupy the third and the fourth positions, registering 11.36% and 8.35% of the total investment respectively. The bank made its lowest investment in the Musharaka, Quard E Hasana modes which records only 3.8% and 2.99% of the total investment since 1983.

The investment policy with regard to the duration differs from one mode of investment to another. The bank makes short, medium and long-term investments under different modes; the period of investment mainly depends on the nature of business, item and income cycle. A list showing the time limit of mode-wise investment is given below in Table 5.

**TABLE 5**  
**Time Limit of the Mode-wise investment.**

<b>MODES OF INVESTMENT</b>	<b>TIME LIMIT</b>
Quard against QDR	1 month to 1 year
Murabaha	2 months to 1 year
Bai-Muajjal	3 months to 2 years
Quard-E- Hasana	1 year to 5 years
Hire-Purchase	1 year to 6 years
Musharaka	2 years to 10 years

***Source: Investment Department IBBL***

Musharaka or investment under partnership is one of the most important financing techniques of the Islami Bank Bangladesh Limited. This mode of investment where the bank and the client jointly supplies the capital is also known as the Equity Participation mode of investment. Profit is distributed according to a predetermined ratio and loss also shared according to the capital contributed ratio. The bank as well as the customer both takes part in the management and control of the entrepreneurial activities.

The Murabaha is another important mode of investment used by the Islami Bank Bangladesh Limited. In an average the bank invested more than half of its capital under this financing technique. The word 'Murabaha' means mark-up sale or sale on profit. In this mode of investment the Islami Bank purchases goods at the request of the client and sells the same to him at cost plus declared profit. The terms and conditions of Murabaha mode of financing are that there must be three parties to a Mudaraba transaction viz. The bank, the seller and the buyer. Price of the goods will have to be known to both the bank and the client.

The following are the characteristics of the Murabaha mode of financing by the IBBL.

1. In order be sure that the bank is investing in a profitable project before procurement of the goods at the request of the client, the bank studies the following points with great care: marketability products and goods; integrity of the client and expected profit.
2. No cash payment is made to the customer rather the bank itself makes purchase of goods selected by the client from respective sources i.e. producers/suppliers/whole-sellers etc. and sell the same to the client.

3. The bank takes 25% to 30% of the sale price of as security from the client. Depending upon agreement, the security may be given by cash or goods. The amount of the security is refunded or adjusted at the close of the transaction. The bank can also demand collateral securities to ensure completion of the transaction as per agreement.

4 In case a client fails to receive delivery of goods on payment of price, the bank retains the right to sell the stock at the highest available price and adjust the investment account.

5. The bank, under no circumstances is allowed to realize more than the amount of cost plus declared profit. In case any loss caused by the willful default of the client, the bank can impose and recover compensation.

6. The ownership of the goods is retained by the bank until the client pays the agreed sale price.

A similar mode of investment as Murabaha is the Bai-Muajjal mode of investment except the following:

1. The bank transfers the possession of goods to the client before payment and

2. In order to cover the sale price of the goods the bank obtains collateral securities from the client. The bank normally takes property of the Municipal area as mortgage. In case the client fails to repay the sale price, the bank realizes the amount by selling the mortgage property.

3. Under the Hire-Purchase mode the bank invests funds to sell building, transport and other valuable items to the client. The value of the hire-purchase amount is payable in installments. When the client pays back the value of the goods including rent, the ownership is transferred to him.

#### ***Mode-wise investment position of IBBL***

In the year 1984 the bank made 28.95% of its total investment under the Musharaka mode which was reduced to 3.54% in 1994. Murabaha investment on the other hand showed a record increase in 1985, when the bank made almost 71.98% of its total investment under the Murabaha mode. In 1989 the figure came down to about 49.6% registering a reduction of about 30% compared to 1985.

Investment under the 'Bai-Muajjal mode' increased in the year 1989 to 25.47% but the figure reduced to 15.62% in the year 1995 registering a fall of 9.85%. The Hire Purchase investment to total investment decreased to a minimum of 0.44% in the year 1985. The investment under this mode in comparison to the total investment increased to 13.42% in the year 1989. Since 1989 the investment under the Hire-Purchase mode showed an upward tendency.

#### ***Growth rate of different modes of investment of IBBL:***

The Musharaka mode of investment decreased from 1987 to 1989 by 14%, 29% and 23% respectively. Since 1990 there is a growth rate at 17.78% in 1991 to 66.08% in 1993. While it diminished again in 1994.

The bank did not invest much through the Murabaha mode of investment in 1987 and 1988. As shown in Figure 7, the Murabaha investment in the year 1989 decreased to TK. 1140 million from TK. 1228 million in 1988, registering a decrease of TK 88 million within one year. This indicates that the growth rate of Murabaha investment in 1989 reduced to a -7% in compare to the year 1988.

Concerning the Bai-Muajjal mode of investment the bank experienced different growth rates in different years. It reduced to 43.83% in the year 1987 from 82.57% in 1987. Once again the rate of growth in this type of investment reduced drastically in the year 1991, registering a 53.99% fall compare to 1989. It also shows an increase in 1992 and a decrease in 1993. The growth rate of Hire Purchase showed a serious fall in 1987, which records 20.21% in

comparison to 803.7% in 1986. From 1990 the growth however shows almost the same position, while it increased in 1994 to 40.01% from 22.37% in 1993.

**Sector-wise investment of IBBL:**

The sector-wise investment position seen in Table 5 indicates that the bank invested a major portion of their funds in the commercial sector. In the year 1994 the bank invested about Taka 5,002 million in this sector, which is 64.59% of their total investment in the same year. From 1990 to 1994 the total investment in the commercial sector increased by Taka 3,551 million. The percentage of investment in the industrial sector did not show any remarkable progress; rather it diminished gradually since 1990. Record shows that the percentage of investment in this sector is reduced to 9.35% in the year 1994 from 28.16% in 1993, registering a reduction of almost 18% in one year. Sector-wise investment in 1993 and 1994 is shown by Table 6.

**TABLE 6**  
**Sector-wise investment of the IBBL from 1993 to 1994**

SECTORS	INVESTMENT IN 1993 (Taka in million)	% OF TOTAL INVESTMENT	INVESTMENT IN 1994 (Taka in million)	% OF TOTAL INVESTMENT
Commercial	3447.04	62.43%	5202.71	64.59%
Industrial	1670.02	30.25%	2166.00	26.89%
Real Estate	173.80	3.15%	194.50	2.42%
Transport	108.30	1.96%	176.80	2.19%
Agriculture	22.40**	0.40%	23.40**	0.29%
Others	99.79	1.81%	291.92	3.62%

**Source: Annual Report 1994**

⊠ This does not include the bank's finance in Fertilizer & Agricultural Implements which amounts to Taka 1365.40 million in 1994 and Taka 1192.50 million in 1993

**Islami Bank's Investment in the Industrial Sector**

An analysis of Islamic bank's investments reveals that , the growth rate of investment in any other sector is not much as compared to the commercial sector. Investment in the industrial sector increased from 1984 to 1985, and then started to fall, for example, the percentage in relation to the total investment decreased in 1987 to 13% from 24% in 1985. Again we can observe from the record that, the investment growth rate started increasing from the year 1988. It is seen that, although, the total investment in the industrial sectors increased to about Taka 892 million in 1994 from 614 million in 1990, yet the percentage of the total investment shows a decreasing trend. We also observe that, the trend of investment in industrial sector increased in 1992 and 1993 similar to the increase in 1988 and 1989. In 1994, however, the investment reduced drastically to about Taka 892 from 1670 million in 1993, registering a decrease in the total investment from 28% to 9%. By then the flow of investment was channeled to 'other sectors' indicating that the bank is increasingly leaning towards profit earning projects than development projects.

The bank invests a major portion of its fund in Germinates and textile industries and mostly uses the Hire-purchase mode of investment. Under the hire-purchase mode a total of Taka 885, 303, and 502, million was invested in 1990 to 1993 respectively. Bai-Muajjal was in second position with a total of Taka 41.48 and 68 in these industries.



The bank invested Taka 926 million in garments industries, which constituted 49% of the total investment in industrial sector. The second important sector was the textile industry where the bank invested Taka 584 million from 1990 to 1993. This is 30% of the total investment of the bank in the industrial sector during that period. The smallest investment was flowed to the other industries, figure shows an investment of only 405 million, and i.e. 21% of the total invest of the bank.

### **Conclusion:**

It may be concluded from the above discussion that the IBBL's shows an overall success in both deposits and investment positions since it started its banking activities. As regards to the deposits side it may be observed that the total deposits increased over past ten years even though, the average deposit growth rate from 1988 to 1994 is only 23%. It is also observed that, the bank did not succeed much in accumulating deposits under various term deposits. This ultimately results in a reduction of the long-term investment of the bank, especially investment towards industrial sectors. It is always assigned that the growth rate of bank branches should increase the savings position of the bank, which was not the case with the Islami Bank. This occurred, despite the fact that, one of the important advantages of opening a PLS Savings Account with the Islami Bank is that one can open a Savings Account with only Taka 100.00 (2.5 US \$) where as the initial deposit figure in any other commercial banks in Bangladesh is not less than Taka 4000 (US \$ 100). Moreover the formalities for opening a Savings Account with the Islami Bank are very easy and simple.

As regards the overall investment position of the Islami Bank Bangladesh it may be concluded that, since the beginning of banking activities the bank has not invested any amount in any project on the Mudarab mode of investment. Although, the Islamic banking theory as regards investment of funds and acceptance of deposits is based on two fundamental techniques such as Mudaraba (capital financing) and Musharaka (Partnership), still these principles are being applied only for collecting deposits and not for the investment. While answering to a question the chief of the Investment Department informed me that initially the bank tried to invest funds under the 'Mudaraba' mode but failed to realize expected results. For the time being they have stopped operating transaction on this mode. The investment position of the bank since 1983 shows that investment under the Musharaka mode of investment constitutes a very insignificant percentage of the total investment. The bank invested a major portion of its funds under the Murabaha and Bai-Muajjal mode of investment. In spite of the fact that the bank invests its funds towards various sectors of the nation's economy still the sector-wise investment position indicates that the bank concentrates much in investing towards commercial sectors. The investment record shows that the percentage of investment towards the industrial sector is reduced to 9.35% in the year 1994 from 28.16% in 1993, registering a reduction of almost 18% in one year. This trend in investment indicates that the IBBL is more interested in investing towards commercial sectors than other sectors.

While interviewing officers in the investment department it was informed that in order to, make investment under Musharaka mode of investment honest and sincere entrepreneurs are required. They experienced a hard time in many cases while introduced financing under the Musharaka mode. In most cases it was found that although the entrepreneur is an honest person he lacks in sufficient equity capital. The bank has not concentrated much in financing small and cottage industry owners in rural Bangladesh. The bank has not invested yet under the Mudaraba mode of investment while it is one the main mode of investment of Islamic banks. It needs a lot of care and the investment under this mode costs much to administer and supervise the loan. Islamic Economists and Professionals are carrying on their research to find a proper means, as to how the Musharaka and Mudarabah modes of investment, may be made more effective and profitable in financing towards various sectors of a nation's economy.

It was observed from the response of a few small-scale industrialists that the remarkable advantages they get from the bank are easy formalities of obtaining loan and quick action in processing loan activities. Moreover, clients of all levels can have free access to the bank and can discuss business matters with senior officials. Senior officials of the Bank also keep a regular contact with customers and bank managers frequently visit them in their places of business. The chief of the Investment Department of the IBBL said they were experiencing a lot of problems and difficulties in establishing the idea of an Islamic banking system in the country. But the situation is getting better

than before. A majority of the People in rural and urban areas is aware of the benefit of this bank, and every year the number of customers is increasing.

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