

# Development of Islamic Banking and Finance in Bangladesh: Current Status, Growth and Challenges

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***Abstract:** From the beginning of Islamic history, Muslims had the option to set up a framework without interest in assembling assets to fund profitable exercises and buyer needs. Bangladesh is the 3rd largest Muslim nation on the planet with a populace of 161 million Muslims, so it tends to be a consideration for rehearsing and applying Islamic Finance. Islamic banking is seeing amazing development in Bangladesh. One well-known Islamic Bank, IBBL was set up in 1983. Since its initiation in 1983, the Islamic financial industry has recorded solid execution and it can expand further in the future. This study aims to assess how Islamic banking is developing in Bangladesh and identify the present status of Islamic banking in Bangladesh. To attain the objectives of this paper, the required information has been collected from secondary sources. This paper also explores the challenges that are being faced by Islamic banking in Bangladesh and the possible suggestion of how to overcome those challenges is also discussed.*

***Keywords:** Bangladesh; Islamic banking; Islamic finance; Shariah, Islamic law.*

## 1. Introduction

Islam is a religion of practically 1.8 billion people of the globe, making up about 24.1% of the total populace (Abdullah & Rahman, 2017). It is a great religion from the Stone Age to the present-day time of innovation and advancement. Islam gives everything that human culture needs. The economy and financial system are one of those. Islamic finance is a financial system that works as per Islamic law. Islamic finance suggests the approaches by which companies in the Muslim world, including banks and other financial institutions, raise capital according to shariah. It additionally introduces to the kinds of projects that are sensible under Islamic law. As Bangladesh is the 3rd biggest Muslim nation on the planet with around 161 million populaces of which around 90% are Muslim, who have solid confidence in Allah, and they always want to lead their lives according to the rules given in the heavenly Quran and the route appeared by the prophet Mohammad (saw). Their based financial framework had been in real life directly from the British time and during that time it was prohibited for the Muslims to work in banks.

During the period 1947-1971, when the rulers didn't take any reasonable endeavor to build up a financial framework dependent on Islamic standards, Bangladesh showed up as another country on the world map in the year 1971. After getting freedom, financial institutions particularly banks assumed an important role in developing the economy of Bangladesh.

The financial arrangement of Bangladesh is a blended one containing nationalized, private, and foreign commercial banks. Bangladesh Bank is the central bank of the nation and directs financial strategies of the Government and controls every single bank. After getting freedom from Pakistan, Bangladesh nationalized the majority of the financial institutions, however, for a short period because of the disappointment in controlling them appropriately, a large number of them came back to their proprietors (Nguyen & Islam,2010).The financial segment is one of the quickly developing segments of the economy in Bangladesh. Since liberation, Bangladesh saw another pattern in the banking sector. Islamic banking was offered in Bangladesh route in 1983 for the first time by remote financial specialists from Kuwait and Saudi Arabia. Right now, Bangladesh positioned tenth on the planet regarding Islamic banking.

The objective of this paper is to know how Islamic bank has been developed in Bangladesh year by year and second, to review the present scenario and challenges that are being faced by Islamic banking in Bangladesh. And finally, some recommendations are made to meet the challenges.

The rest part of the paper has been organized into the following chapters. Chapter 2 is devoted to a review of literature and chapter 3 emphasizes the history of Islamic finance and banking and described how Islamic banking is developing in Bangladesh year by year. The present scenario of Islamic banking in Bangladesh has been analyzed in chapter 4. Chapter 5 Identified challenges that are being faced by Islamic banks in Bangladesh while chapter 6 provides some recommendations and conclusions.

## **2. Methodology**

The report is based on secondary data. Data has been gathered from different secondary sources included in different reports of Bangladesh Bank, Islamic Banks, and other national and international Research Organizations, and scholarly articles published in domestic and international journals. All the current Islamic banks in Bangladesh are covered. This paper especially focuses on the ongoing development and present situation of Islamic finance in Bangladesh. The present Islamic banking scenario and the performances of different Islamic banks are measured and analyzed from the financial statements of the Islamic banks and information from different relevant websites.

### 3. Review of Related Literature

The Islamic finance industry in Bangladesh is in existence for more than 30 years. There are a blended financial framework involving nationalized, private, and commercial banks. The prominence of Islamic finance is developing at a quick pace in Bangladesh. First Islamic Bank, Islami Bank Bangladesh Ltd (IBBL) was established in 1983. After that, a good number of Islamic banks have developed consistently. Presently the Islamic financial industry is settled with 24% of the overall industry and assumes a pioneering role in the nation's fast financial development. Numerous conventional banks are currently moving to Islamic standards from traditional standards. Indeed, most of the banks are attempting to dispatch at least one Islamic branch to satisfy their client demands. To date, a few works have been done on the improvement of Islamic finance in Bangladesh by specialists in the country. Hassan (1999) remarks that the real propelling activity of Islamic banks in Bangladesh has built up banking without riba. He likewise views that Islamic banks have united many new investors and business people under the financial framework. Hassan (1999) views that Islamic banks are facing tremendous challenges countrywide and internationally when it is making financial transactions. In any case, if proper laws and guidelines insist on the general public or at the global level, Islamic banks can show their progress appropriately. Mamun (2007) referenced that there is a popularity for non-riba financial administrations from a fragment of individuals in Bangladesh and want to keep the standards and principles set by Shariah.

Bhuiyan, Siwar, and Rashid (2011) inspected performance analysis of rural development scheme (RDS) of Islamic Bank Bangladesh Limited and clarified that traditional banks opening Islamic banking services as equal assistance are thought to do so just to add to their benefit, by drawing the attention of clients who esteem the Shariah-based framework. The quick development of Islamic banks during the recent decade has drawn the consideration of relevant authorities. Muhamad (2013) endeavored to explore the effectiveness and execution of five significant Islamic banks in Bangladesh. The paper proposed that Islamic banks have improved their effectiveness over the examination time frame. The paper additionally endorsed further research applying tactics with more features and making an investigation among conventional and Islamic banking. Mahmood and Islam (2015) express that Islamic banking first began in 1993 in Bangladesh which started in 1974 through marking the Charter of Islamic Development Bank. IBBL is the main bank that expressed Islamic banking in Bangladesh.

Sarker, Islam, and Rahman (2015) assessed the impacts of electronic relying upon execution of banks in Bangladesh and indicated that a nation's financial development essentially relies upon the financial institution particularly banking segments of that nation. Banking parts assume a significant job in the improvement of the economy.

Aziz, Husin, and Hashmi (2016) investigated and found in their paper that Islamic banks have a better performance record than conventional banks. Ahsan (2016) evaluated the execution of Selected Islamic Banks in Bangladesh and expressed that in Bangladesh; the expansion of Islamic banking is consistently advancing step by step, which is unlike the traditional banks. Islamic banks in Bangladesh have indicated moderately better execution regarding credit recovery and different other financial measures when contrasted with a conventional bank. Uddin, Ahsan, and Haque (2017) expressed that in Bangladesh, the banking sector consistently performs well and there have two principal mainstays of the financial division working inside the nation. Moniruzzaman (2018) evaluated on growth and prospect of Islamic Finance in Bangladesh and views that the people from lower-income groups in Bangladesh choose microfinance. Thus, unquestionably in Bangladesh, there is huge potentiality of Islamic finance. The first initiative of the Islamic microfinance program was taken by Islamic bank Bangladesh limited in 1995 which is named Rural Development Scheme (RDS) with a motive to eliminate countryside poverty through small and microfinance products.

### **3.1 The history of Islamic finance and banking**

During nineteenth-century, Muslims started feeling that the present system of banking and economy relied upon *riba* which isn't permissible in Islam and is completely prohibited in the total of its shapes whether business or non-business; and there must have another plan where its works and organizations fit in with the measures of Islamic law (Ali, 2015). The primary endeavor at the Islamic financial framework was founded in Malaysia in the middle of the 1940s and was founded in Pakistan in the late 1950s (Perry & Rehman, 2011). At that time, the landlords who were practicing Muslims deposited their cash to the bank, which was later credited to other landowners with the end goal of agriculture improvement. The borrowers during that time were not used to be charged for the late payment. The subsequent endeavor was through the making of the essential standard of Islamic banking rules which is to be rehearsed. The undertaking occurred in Egypt (1963-1967) by the foundation of MitGhamr Savings Bank. That bank was made in the town of MitGhamr drove by Ahmad (Mohammad, 2013). It has worked basically as saving- investment foundations instead of commercial banks (Ariff, 1988). Although the administrations are viewed as fundamental financial administrations, it was enough to meet the financial needs of the encompassing network. In Egypt, the Nasir Social Bank was set up in 1971 and marked as a *riba* free bank, although its sanction did not refer to Islam or Shariah. In 1974, a delegation authority from every single Islamic nation came together and made a formal meeting on the foundation of the Islamic Development Bank (IDB). The IDB is the leader of the Group and was set up with compatibility of the Declaration of Intent given by the Conference of delegation authority of Islamic countries which took place in Jeddah in December 1973. In July 1975, a meeting on behalf of the Executive committee of the IDB had taken place and

on 20 October 1975, the IDB officially initiated activities. The main inspiration of the Bank is to empower the financial improvement and social headway of member countries and Muslim society.

The participation of IDB remains at 56 nations from 4 landmasses: Asia, Africa, South America, and Europe. For becoming a member of IDB, a nation must satisfy certain conditions. To begin with, the nation must turn into a member of the OIC; then it should pay the main portion of its base membership to the Capital stock of Islamic Development Bank and should acknowledge all rules and regulations that might be chosen by the Islamic development bank Board of Governors. In 1977, three progressively Islamic Banks started operating business for instance Kuwait Finance House, Faisal Islamic Bank situated in Sudan, another bank Faisal Islamic Bank which is situated in Egypt, and Bahrain Islamic Bank (Perry & Rehman, 2011). In 1980, a few Islamic Organizations have set up for instance ANZ Global Islamic Finance of UK, Qatar Islamic Bank, Bank Islam Malaysia Berhad, Al-Baraka Islamic Bank of Bahrain, Islamic Bank Bangladesh Limited, and among others. A few nations like Bahrain, Iran, Sudan, Malaysia, and Pakistan started endeavors to actualize Islamic banking at bigger scales in individual nations. Sometime later, some of the traditional banks likewise presented Islamic financial items and administrations by working separate Islamic financial departments (Ali, 2015). A few nations endeavored to build up to full Islamic financial frameworks and disengage from the conventional financial frameworks. Such as Iran changed their whole banking system to Islamic banking in August 1983, during that period they initiated a three-year progress time (Perry & Rehman, 2011) then Sudan demonstrated the entire usage of Islamic financial framework. Whereas a few nations practice double framework, in this system the traditional financial framework works in correspondence with the Islamic financial framework, for instance, Asian countries (Malaysia, Pakistan, and Bangladesh).

### **3.2 Development of Islamic banking in Bangladesh**

The Islamic financial industry is in its infant stage; however, it has spread quickly, and a couple of years ago purported Islamic finance-related products were still viewed as a significant future market for the financial sector in the west. The banks expected a huge inflow of new cash from Muslim clients who might need to put away their cash as indicated by the standards of Islamic law. Bangladesh is considered the biggest Muslim nation on the planet where masses are profoundly dedicated to the Islamic lifestyle as directed by Allah (SWT) and Prophet Mohammad (saw). Normally, this aim stays as a profound cry in people's souls to mold & structure their lives as per the statutes of the Quran and sunnah. From these points of view, in August 1974, Bangladesh accepted the proposed sanction of IDB and decided to redesign its financial framework as indicated by Islamic Shariah. In November 1982, representatives of IDB came to Bangladesh and

demonstrated a distinct fascination to take an interest in building up a joint endeavor for Islamic Bank in the non-government sector. The authority found a lot of tasks had just been done and Islamic financing was in an organized structure. Two professional bodies specifically Bangladesh Islamic Bankers Association (BIBA) & Islamic Economics Research Bureau (IERB) made huge support towards the formation of Islamic banking in this country.

In April 1987 Oriental Bank Ltd which was named Al Baraka Bank Bangladesh had begun its banking and business exercises according to standards of Shariah. This was the joint work of the Islamic Development Bank, Al Baraka Investment and Development Company of Jeddah, the administration of Bangladesh, and a gathering of Bangladeshi business people. In June 1995, Al-Arafah Islamic Bank Ltd was created as a private organization. Around the same time, the prime Bank likewise began a dual banking system in Bangladesh. This bank was the first bank that had done such a sort of mixing of traditional and Islamic banking in the nation and later this dual banking system was followed by other private banks of Bangladesh. In 1997 Shamil Bank of Bahrain began banking operation in Bangladesh. It was a Bahrain-based Islamic retail bank which was used to be managed by the National Bank of Bahrain. Later, 2005 Al Falah Bank Ltd, a sister concern of Dhabi Group of UAE, assumed control over the Dhaka part of Shamil Bank of Bahrain.

In 2001 Shahjalal Islamic Bank started its journey as a sharia consistent non-Government sector commercial bank in this country. In 2004 Exim Bank changed its system to Islamic Banking to suit the interest of time just as to arrive at the Islamic Banking business to a huge network. EXIM Bank is the pioneer in the nation that changed over its method of activity and began its pace as a full-fledged Islamic Bank. In 2008, Bank Asia Limited began Islamic Banking activity to meet the customer demands by the opening of Islamic Windows. As of now, the bank has five Islamic windows in various urban areas of Bangladesh. In 2009 First Security Bank Limited (FSBL) changed over itself into Islamic Bank from the Conventional Bank. After transformation, the bank is now known as First Security Islamic Bank Limited (FSIBL). In 2009 Bangladesh Bank gave rules and regulations for Islamic banking. In 2012 Islamic interbank support showcase officially began its activity.

According to Central Bank Publication as of March 2018, eight full-fledged Islamic banks are working in Bangladesh with 1137 branches out of absolute 9973 branches of the banking sector. The banks are Islamic Bank Bangladesh Limited (IBBL), Shahjalal Islami Bank Limited, ICB Islamic Bank Limited, Union Bank Limited, Social Islami Bank Limited, Al-Arafah Islami Bank Limited, Export-Import Bank of Bangladesh Limited (EXIM Bank), and First Security Islamic Bank Limited. Besides, at present 18 Islamic banking branches of 9 commercial banks and 25 Islamic banking windows of 8

banks are likewise offering Islamic finance-related services. Also, in 2017 the Bangladesh Bank permitted Sonali Bank to open 6 new windows to give Islamic financial support to its customers. The bank applied for authorization to open 16 such windows however got approval for just six.

### 3.3 Current situation of Islamic Banking of Bangladesh

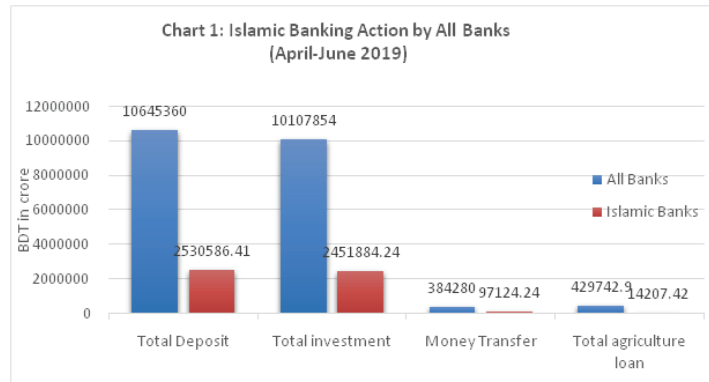
The Islamic Financial industry has encountered significant development and extension in Bangladesh. At present 24% of the total asset of the local banking division is held by Islamic banks, though Islamic banks have a limited scope of items to offer. Nevertheless, with 35,341 people, Islamic Banks cover 22.72% of the whole industry of the nation's financial part as far as deposit and investment. Deposits in the Islamic financial industry came to BDT2530586.41 million. Total Investments in the Islamic financial sector remained at BDT 2451884.24 million (April-June 2019). The number of Branches came to 1261 (including Islamic branches of Traditional Banks).

Table:1 Islamic Banking Actions Compared to All Banks

	All Banks (BDT in crore)	Islamic Banks (BDT in crore)	The portion of IB in All Banks (%)	The portion of IB in All Banks (%)
Total Deposit	10645360	2530586.41	23.8%	23.66
Total Investment	10107854	2451884.24	24.3%	24.16
Money transfers	384280	97124.24	25.3%	22.67
Total Excess Liquidity	605490.7	59972.52	-	-
Total Number of Branches	10396	1261	12.1%	12.05%
Total Agricultural Loan	429742.9	14207.42	3.3%	9.60%

**Source:** Islamic Banking Cell, Research Department, Bangladesh Bank, 2018-2019.

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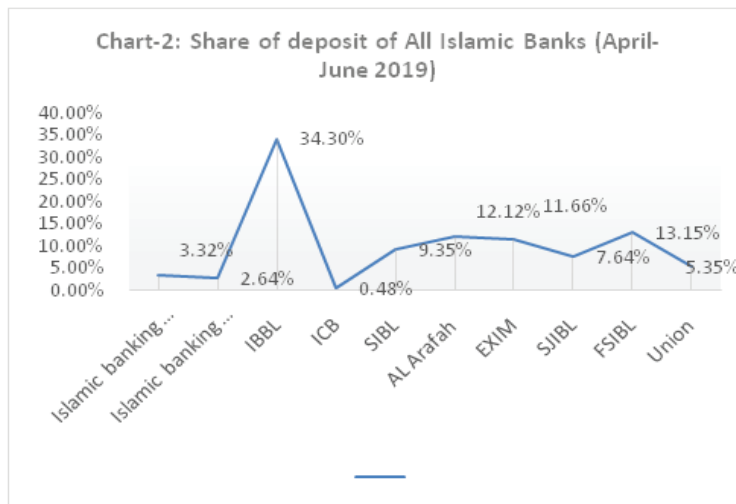


Source: Bangladesh Bank, Annual report, 2018-2019

### 3.4 Mobilization of Deposits

The total deposits are BDT 2379722.60 million for 8 full-fledged Islamic banks at the end of June 2019. And the 8 full-fledged Islamic banks have gained 94.04% of the deposits of the Islamic banking sector.

From chart 2 we can easily explain that, among all Islamic banks, Islamic Bank Bangladesh Limited (IBBL) shares 34.30% which is the highest share of deposits and second is for First Security Islamic Bank Ltd. (FSIBL) which shares 13.15% of total deposit then 12.12% shares for Al-Arafah Islamic Bank Ltd., 11.66% for EXIM Bank Ltd., 9.35% for Social Islamic Bank Ltd. (SIBL), 7.64% for Shahjalal Islamic Bank Ltd., 5.35% for Union Bank Limited (UBL), and Islamic banking branches, Islamic banking windows, and ICB Islamic Bank Limited share accordingly 3.32%, 2.64% and 0.48% of the total deposit of the Islamic banks (Bangladesh Bank, Annual report, 2018-2019).

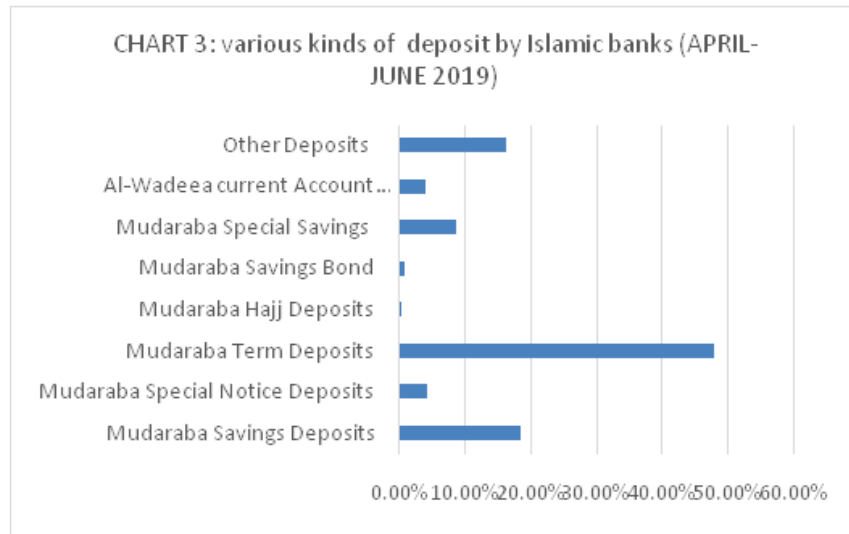


Source: Bangladesh Bank, Annual report, 2018-2019.



### 3.5 Different types of deposits by Islamic banks

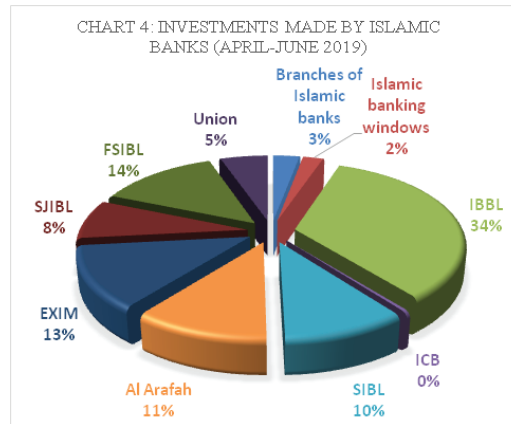
Among the various kinds of deposit in the Islamic financial sector, Mudaraba Time Deposit has the highest portion of the deposit that is accounted for 47.85%, the second is Mudaraba Savings Deposit (MSD) which is accounted for 18.37%, 16.11% for Other Deposits, 3.95% for Al Waddeeah Current Account Deposits, 4.21% for Mudaraba Special Notice Deposits, Mudaraba Savings Bond and Mudaraba Pilgrimage Deposits have accordingly 0.73% & 0.21%.



*Source: Bangladesh Bank, Annual report, 2018-2019*

### 3.6 Investments

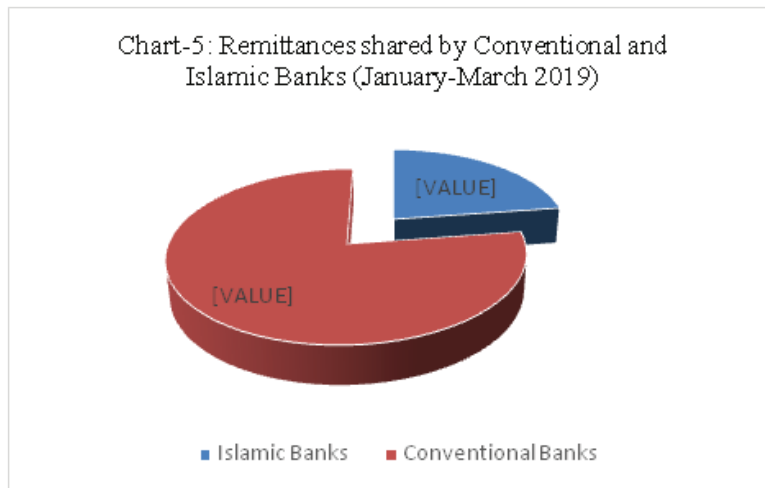
The total investment share (loans according to the traditional sense) of Islamic banks was 24.26% among all banks. All full-fledged Islamic banks have made 94.76%, and 2.96% by the Islamic banking branches of traditional banks, and therefore the rest 2.28% by the Islamic banking windows of the traditional banks. Islamic Bank Bangladesh Ltd. made the largest portion of investments which is accounted for 34.00% among the full-fledged Islamic banks at the end of the quarter of April-June 2019. We can see from chart-4, 13.41% of Investment made by First Security Islamic Bank Ltd. (FSIBL), 12.62% made by EXIM Bank Ltd., 11.06% made by Al-Arafah Islamic Bank Ltd., 10.06% made by Social Islamic Bank Ltd. (SIBL), and Shahjalal Islamic Bank Ltd. Union Bank Ltd.-UBL and ICB Islamic Bank Ltd. have invested accordingly 7.93%, 5.33%, and 0.35%.



*Source: Bangladesh Bank, Annual report, 2018-2019*

### 3.7 Share of Remittances by Conventional and Islamic Banks:

The Islamic financial industry represented 22.68% portion of remittances collected by the whole financial industry (January-March 2019) whereas conventional banks made 77.32%. The remittance shared by a conventional bank and Islamic bank is given in Chart-5.



*Source: Bangladesh Bank, Annual report, 2018-2019*

### 4. Challenges faced by Islamic banking and finance in Bangladesh

**Absence of distinct law:** There is a lack of distinct law for the activity of Islamic banking in this country. Bangladesh Bank (BB) controls Islamic banks as well as traditional banks.

National Bank gave a lot of rules on the activity of Islamic banking which have picked up the consideration of analysts and the worldwide Islamic financial network (Islamic, 2011).

***Lack of proper attention from the government:*** Rafiq (2014) contends that the Govt. ought to be progressively true in developing Islamic banking. In Bangladesh, Islamic banking is developing because of an overwhelming reaction from people in general. As they precipitously pick Islamic financial alternatives and abandon traditional banking, Bangladesh Bank appears to be compelled to allow Islamic banking. Nonetheless, the administration doesn't strengthen it for example in Malaysia, where the government always supports Islamic banking. Countries like Bangladesh Islamic banking are moving ahead because of public supports, notwithstanding the administration's absence of responsiveness.

***Lack of research to develop the Islamic finance industry:*** There is a shortage of research on Islamic banking in Bangladesh by and large. Bankers and different researchers in Bangladesh are reluctant to direct such investigation. Arif (2014) affirms that the importance of research isn't obvious to people, scholars, and researchers in this country. This is only because of people's irresponsibility and that is the reason why the business doesn't distribute assets to Islamic finance, although they are liberal in financing different big occasions.

***Absence of shariah supervisory committees:*** One major problem of shariah administration in this country is the absence of compulsory rules from Bangladesh Bank. In Bangladesh, there is a Central Shariah Board for Islamic Banks of Bangladesh but there is no proper acknowledgment of the Central Shariah Board for Islamic Banks of Bangladesh (CSBIB) by the central bank of Bangladesh.

***Less opportunity of Islamic Financial Learning program:*** Although Muslims of Bangladesh are religious, they have less knowledge about Islamic banking. They pick Islamic banks mainly on religious grounds. Indeed, even the majority of the clients of Islamic banks are inexperienced with Shariah-based Islamic items such as Musharaka, Mudaraba, Murabaha, Musawama, Salam, and Istisna. They simply lean toward Islamic banks because of the name of Islam with the bank. It's simply because of the absence of knowledge and absenteeism of the Islamic Finance proficiency program in Bangladesh. The colleges in Bangladesh have no separate department for Islamic finance and banking yet.

***Inadequate skilled human resources:*** Some inadequately skilled persons know multiple languages such as Arabic and English to direct research in shariah. The people who have information in shariah have little information on banking and finance. The primary explanation is, individuals are not able to get legitimate instruction and profound information for Islamic banks from instructive foundations.

***Islamic banking literature:*** Proper Islamic Banking Manuals, understanding material,

course readings, frameworks and methodology books, articles ought to be adapted to increase the knowledge of human resources.

**Legal framework:** Some broad laws and rules are given right now by controllers regarding the advancement of Islamic Banking in Bangladesh. So, it is necessary to change the financial laws and other related laws that influence Islamic Banking.

## 6. Conclusion and Recommendations

Considering the challenges mentioned above, some recommendations are given as follows- As Quran and sunnah are the foundation of Islamic banking, a strong lawful and administrative system for Islamic finance ought to be based on the ideas and rules as characterized by Shariah. Besides, Bangladesh bank should establish a central Shariah advisory body to synchronize various Shariah views issued by the different Shariah scholars. The conventional banks must have a devoted office to manage Islamic financial activities, rules, and guidelines identified with Islamic banking.

Consequently, the Management should build up a complete Islamic capital market and Islamic insurance (Takaful) structure for the nation to fortify its Islamic financial framework. The legislature should give at any rate equivalent treatment to Islamic banking as granted to its traditional side. Islamic banks additionally need to demonstrate that they are genuinely agreeing to shariah standards to pick up the trust of the administration. In Bangladesh still, there is no different department for Islamic finance in any college. The colleges and educational institutions can present short and long instructional classes extending from special courses, diplomas, Graduate, and Ph.D. projects to increase experts and educated human assets right now. Besides, to increase the number of skilled human resources in the Islamic finance industry, various scholarships can be offered to the top students who have an interest in seeking Diploma/MS/Ph.D. in Islamic finance at home and abroad. Because of the absence of appropriate information about Islamic finance, a large portion of the individuals in Bangladesh believes that there is no contrast among Islamic and regular financial framework. Islamic banking is required to have some programs to let the people know about Islamic financial products and administrations and the way how Islamic banks attempt to prevent interest from the transaction. Along these lines, inclusive awareness campaigns are required for the promotion of Islamic banking.

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