

Prospects and Problems of Islamic Banking from Bank's Perspective: A Study of Bangladesh

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This paper focuses on the prospect and growth potentials of Islamic banks in Bangladesh as perceived by Islamic and conventional bankers. The study noted that there is a high demand for interest-free banking services from a segment of people in Bangladesh who have a strong desire to abide by the rules and principals set by Shariah. Along with religious requirement, economic exigencies provide a new outlook to the role of banking in promoting investment/productive activities, influencing distribution of income and adding stability to the economy. The Islamic banking sector is, however, criticized on several grounds by the Conventional bankers. The banks are believed not to apply the rules of Shariah completely. Islamic banks are said to include interest in their dealings to compete effectively with the Conventional banks. Moreover, conventional banks offering Islamic banking as a parallel service are thought to do so only to add to their profitability, by attracting people who value the Shariah based system by enjoying the advantages of the special treatments from the Central bank. According to the survey, suitable and supportive legal framework would facilitate better growth of this sector. Moreover, the lack of an inter-bank money market and sufficient supportive and link institutions in the sector, act as impediments to growth of Islamic banking. Also, banks perceive the availability of training and education on Islamic banking to be inadequate in Bangladesh. To deliver superior services to the clients and to attain greater efficiency, there is a need to have more institutions providing information on the operations and principals of Islamic banking.

Key Words: Conventional bank, Islamic bank, Shariah, Profit-loss sharing.

1.0 ISSUE

Bangladesh is the world's third largest Muslim majority country, with Muslims making up more than 85 percent of the population; A significant portion of the population demanding interest-free banking for quite a long time. In August 1974, Bangladesh signed the Charter of Islamic Development Bank and committed itself to reorganize its economic and financial system as per Islamic Shariah¹. As a consequence of this, the first interest-free Shariah-based bank in South and Southeast Asia, Islami Bank Bangladesh Limited was established in Bangladesh in 1983. Since then, six more full-fledged private Islamic banks, 10 conventional banks with parallel Islamic banking services and a number of conventional banks with Islamic banking windows have been established.

According to the Bangladesh Bank (BB), the central bank of the country, the total deposits of the Islamic banks and Islamic banking branches of the conventional banks stood at Tk 286.5 billion (\$ 4.09 billion) at the end of June 2007. This was 23.6 per cent of the deposits of all private commercial banks and 14.3 per cent of the deposits of the total banking system. Total investment of the Islamic banks and the Islamic banking branches stood at Tk 265.4 billion (\$

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3.79 billion) at the end of June 2007. This was 26.9 per cent of all private banks and 17.2 per cent of the total banking system of the country. The remarkable shifting or conversion of the conventional banks and their branches into the Islamic lines signals high acceptance of the interest-free banking by the public in general. The Islamic banking industry continued to show strong growth since its inception in 1983 in line with the growth of the economy, as reflected by the increased market share of the Islamic banking industry in terms of assets, financing and deposits of the total banking system (Rashid et al. 2004).

However, Islamic banking in Bangladesh is facing numerous problems or challenges. First, they have not yet been successful in devising an interest-free mechanism to place their funds on a short-term basis. Studies conducted on Islamic banking in Bangladesh show that the future of Islamic banks hinges on their ability to find a viable alternative to interest for financing all types of loans. Ahmad and Hassan (2007) concluded that Islamic banks in Bangladesh should recognize the fact that their success in abolishing interest has been only partial and they have a long way to go in their search for a satisfactory alternative to interest. They face the same problem in financing consumer loans and government deficits. Second, the risk involved in profit-sharing seems to be so high that almost all of the Islamic banks in Bangladesh have resorted to those techniques of financing which bring them a fixed assured return. As a result, there is a lot of genuine criticism that these banks have not abolished interest but, in fact, only changed the nomenclature of their transactions.

In terms of individual consumers, the evidence to date suggests that the presence of Islamic finance involves a substantial degree of market segmentation. While religious conviction is a logical key determinant of the use of Islamic finance services, it is often not the only concern, with most consumers also identifying bank reputation, service quality and pricing as being of relevance in determining their patronage of a particular financial institution. In contrast to the widespread and extensive analysis of attitudes, perceptions and knowledge of conventional financial institution products and services, the parallel analysis of the same concerns in Islamic finance is still in its infancy. This is an important deficiency in the literature given the global growth in Islamic financing techniques and the evolution of dual banking systems in many parts of the Middle East and South-East Asia encompassing both Islamic and conventional financial services. Further works on the attitudes and beliefs towards Islamic banking are thus necessary in finding the prospects and growth of this rapidly growing sector.

Since there are no profit-and-loss-bearing securities in Bangladesh, Islamic banks have been allowed to maintain their Statutory Liquidity Requirement (SLR) with Bangladesh bank at the rate of 10% (recently made 11%) of their total deposit liabilities, whereas the requirement is 18% (recently made 19%) for conventional banks in Bangladesh. However, the Islamic banks do not have the legal support of the Central bank in Bangladesh, neither have they had the necessary expertise and trained manpower to appraise, monitor, evaluate and audit the projects that are required to finance. As a result, they can not expand despite having huge excess financial liquidity (Lakshmi 2004).

As Islamic banking practices are expanding into conventional banks, Islamic lenders must pay greater attention to educating others about the sector. Meanwhile, banks also suffer from a chronic shortage of staff with knowledge and expertise of Islamic finance, as method of auditing and appraising in Islamic banks differs considerably from that of conventional banking system. Hence, this issue may be redeemed by emphasizing more on training on Islamic banking system.

With the rapid rise of Shariah-based systems, this study seeks to find out the view of the bankers regarding the acceptability, opportunities and challenges of Islamic banking in Bangladesh as Islamic banking is rapidly growing area of banking and holds great potential in the banking sector of Bangladesh. This study will benefit the Islamic banks, as well as other conventional banks adopting Islamic banking windows to capture their growth opportunities. This study will also help the policy makers and regulators to support, assist and formulate policies regarding Islamic banking in Bangladesh.

2.0 OBJECTIVES

The broad objective of the study is to find out the prospect and problems of Islamic banking in Bangladesh from bankers' perspective – both Islamic and Conventional. Specifically this study will look into:

- a) The factors that motivate banks to adopt Islamic banking methods
- b) The reasons which attract consumers towards Islamic banks
- c) The factors responsible for hindering growth of Islamic banks

3.0 METHODOLOGY

The study was conducted using both primary and secondary data and pertinent literature survey. The primary data was collected through interview and structured questionnaire survey of bank personnel of both categories of banks (Islamic and Conventional). Secondary data has been collected from various research books on Islamic banking and related publications. An extensive literature survey was undertaken to develop an insight into the nature and traditions of the Islamic banking sector in Bangladesh.

There are a total of 47 scheduled banks (listed with the central bank) in Bangladesh. These banks can be grouped into three categories: 1) Seven purely Islamic banks, 2) 10 banks offering Islamic banking as a parallel service and 3) Other conventional banks not offering Islamic banking (30). In light of above the population is divided into two sets: The first contains 17 banks which provide either pure or parallel Islamic banking services and the second population consists of the 30 banks which only provide conventional banking services.

A sample of 11 banks from the 1st set and 13 banks for the 2nd set are chosen on judgmental basis. For each set, a minimum of 100 responses were collected with minimum eight respondents from each of the banks using a structured questionnaire. Face-to-face interview was also conducted with a selected number of respondents from these banks. Statistical Index analysis incorporating t-test is conducted to see the differential views of the Islamic and conventional bankers regarding the prospects of Islamic banking in Bangladesh.

4.0 LITERATURE REVIEW

4.1 Origin of Islamic Banking

The origin of Islamic banking can be traced back to the practice of *mudaraba*² by the Prophet Muhammad (SM) himself. Islamic banking operates on principles adhering to the Quranic norms forbidding usury and transactions, including granting of loans or credits for interest. The economic rationale for eliminating *riba*³ (interest) and establishing the Islamic banking system is based on values of justice, efficiency, stability and growth. It is assumed that under

the system of Islamic banking, the industrial and/or commercial risk is shared more equitably between the entrepreneur and the capital owner and the returns on investment are shared among the investors on the basis of their proportionate capital. The conventional banks tend to serve the most creditworthy borrowers, while the Islamic banking system presumably looks for the most productive and profitable projects. The Islamic banking approach theoretically opposes the idea of discrimination in offering banking services to people of different social standings and provides for social cohesion between different classes.

The predominant feature of Islamic banks is the provision regarding the prohibition of interest. This characteristic sets the Islamic banks apart from conventional banks. The rationale, besides the Quranic injunction, that Muslim scholars provide behind this provision are as follows:

- The interest system is perceived to be incapable of allocating available liquid funds among firms and activities in the society according to the considerations of efficiency, productivity and growth. An Islamic system based on profit/loss sharing financial methods would offer an efficient substitute in principal.
- The interest system maintains a pattern of distribution which is biased towards wealthy individuals and large businesses who can afford to pay and receive interest. An Islamic financial system, on the other hand, justifies an income distribution pattern that promotes economic efficiency, productivity and other actual factors contributing to the total value added.
- The interest system contributes to 'passive behavior' to develop among people who possess liquid funds since the availability of excess funds acts as a deterrent from participating in risk financing. Islamic system as it promotes profit/loss sharing mode encourages risk sharing and active participation of the providers of the funds in the businesses they invest.
- Prohibition of interest does not affect saving/investment or mobilization of funds as it is based on the religious principles and is considered more ethical by religious people.

Islamic banking has the same purpose as conventional banking except that it operates in accordance with the rules of Shariah, known as Fiqh al-Muamalat⁴. Amongst the common Islamic concepts used in Islamic banking are profit sharing (Mudaraba), safekeeping (Wadiah⁵), joint venture (Musharakah⁶), cost plus (Murabahah⁷), and leasing (Ijarah⁸). Some of the salient features of Islamic Banking may be summed up as (Siddiqui, 2004):

1. While permitting the individual the right to seek his economic well-being, Islam makes a clear distinction between what is *halaal*⁹ and what is *haraam*¹⁰ in pursuit of such economic activity. Islamic banking is restricted to Islamic acceptable deals, which exclude those involving alcohol, pork, gambling, etc. Thus ethical investing is the only acceptable form of investment, and moral purchasing is encouraged. In broad terms, Islam forbids all forms of economic activity, which are morally or socially injurious.
2. While acknowledging the individual's right to ownership of wealth legitimately acquired, Islam makes it obligatory on the individual to spend his wealth judiciously and not to hoard it, keep it idle or to squander it.
3. While allowing an individual to retain any surplus wealth, Islam seeks to reduce the margin of the surplus for the well-being of the community as a whole, in particular the destitute and deprived sections of society by participation in the process of Zakat¹¹.

4. While making allowance for the ways of human nature and yet not yielding to the consequences of its worst propensities, Islam seeks to prevent the accumulation of wealth in a few hands to the detriment of society as a whole, by its laws of inheritance.
5. Viewed as a whole, the economic system envisaged by Islam aims at social justice without inhibiting individual enterprise beyond the point where it becomes not only collectively injurious but also individually self-destructive.

The Islamic financial system employs the concept of participation in the enterprise, utilizing the funds at risk on a profit-and-loss-sharing basis. This by no means implies that investments with financial institutions are necessarily speculative. This can be excluded by careful investment policy, diversification of risk and prudent management by Islamic financial institutions. Islamic banks and banking institutions that offer Islamic banking products and services are required to establish Shariah advisory committees/consultants to advise them and to ensure that the operations and activities of the bank comply with Shariah principles. Islamic banking should be synonymous with full-reserve banking, with banks achieving a cent percent reserve ratio. However, in practice, this is rarely the case.

4.2 Global Status of Islamic Banking

Islamic finance – financial institutions, products and services designed to comply with the central tenets of *Shariah* – is one of the most rapidly growing segments of the global finance industry. Islamic banking, based on the Qur'anic prohibition of charging interest, has moved from a theoretical concept to embrace more numerous banks with multi-billion dollar deposits world-wide. Islamic banking is widely regarded as the fastest growing sector in the Middle Eastern financial services market. Starting with the Dubai Islamic Bank in 1975 (and operations in the United Arab Emirates, Egypt, the Cayman Islands, Sudan, Lebanon, the Bahamas, Bosnia, Bahrain and Pakistan), the number of Islamic financial institutions worldwide now exceeds over three hundred, with operations in seventy-five countries and assets in excess of US\$400 billion (El-Qorchi 2005). Though initially concentrated in the Middle East (especially Bahrain) and South East Asia (particularly Malaysia), Islamic finance principles are now increasingly found elsewhere. It includes developed economies where a small number of Islamic financial institutions have been established and where large conventional banks have opened Islamic financing windows (such as in Europe and the United States) (El-Qorchi 2005).

While Islamic finance has been practiced for many centuries, it is important to recall that only in the last thirty years have the Islamic financial institutions offering *Shariah*-compliant products and services become more widespread and substantial. Indeed, even in Muslim countries it is only very recently that analogous Islamic finance products and services have been offered in direct competition to the financial products and services offered by conventional banks. Clearly, as Islamic products and services enter these markets, an important consideration is the attitudes, perceptions and knowledge of market participants towards these new methods of finance. For individual consumers and business firms, these factors determine the extent to which they choose to patronize these alternative products and services. Key concerns include the influence of religious persuasion and the relative pricing, costs and benefits, convenience and access of Islamic products and services versus conventional bank products and services. For conventional financial institutions, the presence of financial institutions offering Islamic financial products and services may affect their competitive position and how they construct new marketing strategies. It may also influence to their decision to introduce *Shariah*-compliant products and services themselves.

Many scholars believe that there are three contemporary phenomena which can explain the high growth of the Islamic banking sector (Siddiqi, 2002). The first is the widespread dissatisfaction with the performance and consequences of the monetary and financial sector all over the world since the end of the world war two, especially since the 1970s. The second is the fact that the Islamic financial movement appeared on the scene as an offshoot of a much broader resurgence among the Muslims. And the third factor is the Islamic approach to money, banking and finance which carried strong moral overtones since its inception. There is a widely shared perception that there is much more inequality in the distribution of income and wealth today than at any other time in the entire past of mankind. The fact that its rise coincided with the Muslim countries' coming out of colonial rule speaks volumes about its place in the Muslim psyche.

4.3 Other Related Studies

A substantial literature on individual consumers' attitudes towards conventional financial products and services is already in place, especially concerning selection criteria (or patronage) and customer satisfaction. Kaynak and Whiteley(1999), for example, observed that the convenience of a bank was a primary motivation for customers in selecting a specific institution. Further, the convenience motivation include location or other factors such as service quality (Wel and Nor 2003, Lee and Marlowe 2003). In contrast, Almosawi (2001) concluded that the bank's reputation was the most significant factor in the use of conventional banks' services, while Owusu-Frimpong (1999), Ta and Har (2000) and Kaynak and Harcar (2005) found that profitability factors, such as low service charges and high interest rates, were the major reasons why customers chose a particular bank. Kaynak and Harcar (2005) also concluded that a fast and efficient service was also an attractive feature valued by current and potential customers, while Gerard and Cunningham (2001) considered that for most customers the most important criterion for bank selection was feeling secure. In related work, Devlin (2002) showed that professional advice was the most significant motivation for the choice of a home loan institution by customers in the United Kingdom.

The increasingly competitive environment in which conventional banks operate has seen customer satisfaction the focus of increasing attention. Generally, there is a consensus among many studies that service quality is the primary factor in customers' satisfaction with conventional bank services (Jamal and Naser 2002). In sharp contrast to the voluminous work on consumers' perceptions, patronage and satisfaction with conventional bank services, relatively little work has been undertaken including Islamic banks. Erol and El-Bdour (1989) is considered to be the first study in Jordan of individual consumers' attitudes towards Islamic banking. The main finding was that factors such as a fast and efficient service, the bank's reputation and image, and confidentiality were the primary bank criteria for the choice of bank, whether Islamic or conventional. This implied that religious motivation in bank selection did not appear very important. Interesting, the study also found that bank customers (at least in Jordan) were generally aware of Islamic banks and their methods, usually from information provided by relatives and neighbors, but that expansion in the number of Islamic bank branches appeared to be insignificant in determining patronage.

In Egypt, Hegazy (1995) compared the demographic profiles of four hundred customers of two banks: the Islamic Faisal Islamic Bank and the conventional Bank of Commerce and Development. The results showed that 98.8 percent of the Islamic bank's customers were Muslims married with children, while 32.4 percent of the conventional bank's customers

were Christians and 54.3 percent were Muslims. This suggested that the choice of an Islamic bank is based, in part, on a religious motivation. A number of studies have examined the decision-making criteria business firms use when selecting a conventional bank. Gerrard and Cunningham (2000) concluded that specific types of businesses often had very particular attitudes towards conventional banks. For example, gazetted hotels in Singapore indicated that the pricing of services and location were important factors implied in their selection due to their historically limited dealing with banks.

In studies of firms in Hong Kong by Lam and Burton (2005) the key finding was that the size of the bank was a significant factor in the choice of a conventional bank because of the need for increasing amounts of credit. In Malaysia, Ahamad and Haron (2002) considered business attitudes towards Islamic banking products and services by forty-five corporate customers. The major finding was again that economic factors, such as profitability and the quality of services, were more significant for Malaysian corporate customers than religious reasons. However, one qualifying factor could be that the majority of respondents were non-Muslims who were generally less aware of the existence of Islamic banks and the substitutability of Islamic finance methods for conventional bank products and services. In fact, most respondents, both Muslim and non-Muslim, had a low level of knowledge about Islamic finance, especially most of the business financing methods. As with the work on individual consumer preferences in Malaysia, this study recommended that Islamic financial institutions in Malaysia needed to better market their products and services.

There are very few studies that have considered the attitudes of financial institutions towards Islamic methods of finance. Jalaluddin (1999) interviewed eighty Australian financial institutions based in Sydney on their attitudes towards Islamic profit/loss sharing methods of finance and whether they would be agreed to lend funds in accordance with these methods. Overall, more than forty percent of respondents were prepared to lend funds on a profit/loss sharing basis, motivated in part by the need to provide business support, strong growth in the demand for funds, the high risks of default under the conventional banking system, and the potential for higher returns to lenders. On the other hand, complications with firm management, a lack of familiarity with business conditions, and risk sharing with borrowers acted against financial institutions lending on a profit/loss sharing basis.

In another paper on financial institution attitudes towards Islamic finance, Karbhari et al. (2004) undertook focused interviews with financial institutions in London to investigate their attitudes towards the problems, challenges and opportunities facing Islamic banks in the United Kingdom. The major finding of this study was that most if not all respondents were convinced that involving Islamic methods of finance in conventional banks' operations would help promote the establishment of Islamic banks in the UK. In turn, this would increase Muslim and non-Muslim British customers' understanding of Islamic methods of finance. In addition, most of the respondents believed that the UK government did not support the establishment of Islamic banks. Karbhari et al. (2004) concluded that an education program could be a useful way to undertake future change in the UK financial sector with the partial evolution of a dual-banking system.

5.0 PERCEPTION OF ISLAMIC BANKERS OF BANGLADESH TOWARDS ISLAMIC BANKING SYSTEM

5.1 Characteristic Variables of the Islamic Banking System

The Islamic bankers gave their option, in a scale of 2 (strongly agree) to – 2 (strongly disagree), to eight characteristic variables of the Islamic banking system (Table 1). The most important variable perceived by the respondents is found to be the high growth in net income of the sector (1.05). Islamic banks offer loans for a variety of projects and the criterion for allowing a loan is not necessarily the credibility of the borrower. The success potential of the project is given main consideration, which should theoretically bring in higher income for the bank. In the same token the perception that Islamic banking is more profitable (0.84) is also an important character. Islamic banking as a whole is perceived to be more profitable than conventional banking reflects the subjective assessment of the respondents. Whether the Islamic banks truly abide by the actual Shariah rules or not, the system of banking is assumed to be more rewarding in monetary terms.

The other notable feature is profit-loss sharing (PLS) method (0.79). Broadly, the profit-loss sharing is a contractual arrangement between two or more transacting parties, which allows them to pool their resources to invest in a project to share in profit, loss and other risks. The PLS method complies with the equitable sharing of risks and profits between the parties involved in a financial transaction: (i) the entrepreneur or the actual user (borrower) of capital, (ii) the bank which serves as a partial user of capital funds and as a financial intermediary, and (iii) the depositors who are the suppliers of savings or capital funds. It is believed that in many cases interest is the cause of huge fluctuations in the business cycle of an economy, and since the PLS method is an alternative; it offers many benefits to an economy. This is unlike the interest-based commercial banking system, where all the pressure is on the borrower as they must pay back their loan, with the agreed interest, regardless of the success or failure of his venture.

Since the religious belief draws a segment of customers to Islamic banking, the sector has experienced steady growth in the number of clients (0.76) and fixed deposits (0.60). According to the respondents, the growth of fixed deposits in Islamic banking is high and positive even it operates on the principle of ‘zero-interest’. The depositors are by default, entitled to any profit/loss the banks earns; and this may at times give them a higher return in comparison to a fixed interest rate scheme. This may also signal that the amount of deposit by each client is increasing which again reinforces the belief that Islamic banking is lucrative, as there is significant growth of fixed deposits. The high growth of the number of fixed clients is because of limited number of Islamic banks and is another major reason that makes this system of banking so attractive. A limited number of banks were set up which provided Islamic banking services, but in the last few years, many conventional banks opened up parallel services offering Islamic banking services when they realized that a large customer base exists for Islamic banking system.

Table 1: Characteristic Variables of the Islamic Banking Perceived by Islamic Bankers

| Sl. No. | Variables | Index | St. Dev. |
|---------|--|-------|----------|
| 1 | High growth of net income in the Islamic banking sector | 1.05 | 0.72 |
| 2 | Islamic banking is more profitable than conventional banking | 0.84 | 1.08 |
| 3 | Profit-Loss sharing method represents economic advantages | 0.79 | 0.84 |
| 4 | High growth of the number of fixed clients in the Islamic banking sector | 0.76 | 0.94 |
| 5 | High growth of fixed deposits in the Islamic banking sector | 0.60 | 0.87 |
| 6 | Zero interest rate minimizes risk | 0.58 | 0.95 |
| 7 | High growth of debt-financed assets Islamic banking sector | 0.47 | 0.82 |
| 8 | Preferential treatment from central bank contributes to higher profitability | 0.26 | 1.06 |

The other characteristic variables mentioned for the Islamic banking sector are zero interest rate (0.58). The Islamic banking system relies on zero interest rate and believes that zero interest rate minimizes risk. This can be true in an instance when the bank is unable to earn sufficient profit and it will be excused from paying any returns/payments of interest to its depositors in that situation. In contrast with conventional finance methods, Islamic financing is not centered only on credit worthiness and ability to repay the loans and interest; instead the worthiness and profitability of a project are the most important criteria of Islamic financing while the ability to repay the loan is sub-segmented under profitability.

The high growth of debt-financed assets (0.47) reveals that more and more people are taking loans from Islamic banks to purchase wide ranging products. An innovative approach applied by some banks for home loans are called *Musharaka al-Mutanaqisa* that allows for a floating rate in the form of rental. Many Islamic banks have adapted the PLS method to make it applicable to increasing range of debt-financed assets. It would appear that this form of debt is becoming popular in recent years because of the flexibility it provides, and because it does not entail the burden of a fixed interest rate.

The preferential treatment from central bank (0.26) is perceived to be a less significant character of Islamic banks. The Bangladesh Bank has a lenient policy for Islamic banking where the liquidity and reserve ratio stands to be only 11% and 4% respectively. From the responses it can be deduced that the bankers believe the preferential framework for the Islamic banks stimulates to some extent growth. As mentioned previously, BB's leniently policy in turn increases their liquidity and their funds are more available for use in profitable investment projects.

5.2 Main Reasons for Adoption of Islamic Banking System

The study tried to find out factors motivating the adoption of Islamic banking system in a scale of 2 (strongly agree) to – 2 (strongly disagree). The most important factor motivating the adoption of Islamic banking is perceived to be the religious belief of a segment of customers (1.27). As noted the segment of religious people among banking customers feel a strong need to adhere to Islamic principles and rules in every aspect of their lives, and hence banks are drawn to this system. This has a two-fold impact on the growth of Islamic banking. Firstly, because of the religious orientation of the people of Bangladesh, Islamic banks are an attractive venture as they present a huge marketing and income opportunity. As a result the

market share of Islamic banking is on the rise. Secondly, religious belief appears to be the prime motivator for customers to avail of Islamic banking. The respondents surveyed quoted this variable for being the dominating factor for banks to adopt Islamic banking structure.

Islamic bankers reinforce moderately the fact that the clients pursue the system because of higher profitability (0.35). Many respondents also expressed the belief that because of the havoc wreaked on conventional banks by the global financial crisis, Islamic banks will flourish in the upcoming years because of expectations of higher profits and greater security. The survey revealed that expectation of higher profit is not only limited to the clients only; rather the bank management team also comes under its influence as well because of shared profit and loss. The profitability of this sector has been one of the predominating reasons for many conventional banks to adopt Islamic banking system and provide parallel services to their clients. The Islamic bank managers also perceive moderately the fact that the system is efficient (0.28). On the other hand they do not endorse that the preferential treatment from central bank (- 0.13) is a main reason for adoption of the system by the banks.

Table 2: Main Reasons for Adoption of Islamic Banking System

| Sl. No. | Variable | Index | St. Dev. |
|---------|--|-------|----------|
| 1 | Religious beliefs of potential customers is main reason for adoption | 1.27 | 0.96 |
| 2 | Comparatively higher profitability is main reason for adoption | 0.35 | 1.05 |
| 3 | Higher efficiency is main reason for adoption | 0.28 | 1.03 |
| 4 | Preferential treatment from BB is main reason for adoption | -0.13 | 1.08 |

5.3 Factors That Customers Like of Islamic Banks

The bankers option regarding variables that consumers like of Islamic banks in a scale of 2 (strongly agree) to - 2 (strongly disagree) is shown in table 3. The main factor liked by the consumers toward Islamic banking is it's coherence with the Islamic principles (1.15). The respondents believe that Islamic financial movement appeared on the scene as an offshoot of a much broader resurgence among the Muslim people. There is a widely shared perception that there is much more inequality in the distribution of income and wealth today than at any other time in the entire past of mankind. This applies to the distribution within nations as well as between nations. There is also a prevalent belief that the Islamic approach to money, banking and finance could possibly provide the solution.

The bankers believe that consumers are drawn to Islamic banking as they feel the service level to some extent superior (0.55). The respondents believe that improved levels of service will make this sector more attractive. If services can be made more fluid by eliminating the bureaucratic elements, then more and more customers will be drawn to this sector, which will lead to the flourishing of this sector. While the inherent standard-operating-procedures of Islamic banking, like the PLS method and zero-interest rate, are viewed to be economically superior to those of conventional banking, it is up to the Islamic banks to provide better and efficient services to make this sector more attractive. The response regarding the variable convenience of account handling is found to be insignificant (0.14). It can be noted here that Islamic banks allow opening of accounts with a modest amount of money.

Profit motive also appears to have no significance in attracting clients (- 0.04). An important characteristic which forms the basis for the development of Islamic banks is the relationship with depositors. They deal with their customers on investment grounds rather than a pre-

determined fixed interest rate. They invest the money of their depositors on high profitable projects after going through a strategic analysis in order to give a substantial return to their depositors. The popularity of Islamic bank can be linked to the expectation of higher profit gained through the Islamic banking system even though the clients are not much attracted by this. The officials surveyed are of the opinion that the client base of Islamic banks believes in profit-loss-sharing through their transaction in the Islamic bank modes.

Table 3: Factors That Attract Customers to Adopt Islamic Banking

| Sl. No. | Variable | Index | St. Dev. |
|---------|---|-------|----------|
| 1 | Adherence of Shariah rules is main factor to attract customers | 1.15 | 1.06 |
| 2 | Better service level is main factor to attract customers | 0.55 | 1.03 |
| 3 | Convenience of account handling is main factor to attract customers | 0.14 | 1.11 |
| 4 | Expectation of higher profits is main factor to attract customers | -0.04 | 1.15 |

5.4 Factors Hindering Growth of Islamic Banks

The bankers gave their option to 8 variables that hinders the growth of Islamic banking in a scale of 2 (strongly agree) to – 2 (strongly disagree). Regarding hindrances for growth the Islamic bank managers' shows strong agreement on the need of exclusive regulatory framework (1.16). Currently the Islamic banks are regulated by the same framework as that of conventional banks. Since the two banking systems work differently, many issues of Islamic banking cannot be settled by the existing policy. The role of the state in pursuing the comparative advantages of Islamic finance is also crucial in removing legal hurdles in the way of Islamic financial practices and enacting laws enabling the adoption of such practices. It can be said that launching of new framework supporting the interbank money exchange between Islamic and conventional banks will stimulate further growth of Islamic banks. Furthermore, a compatible regulatory framework will create an avenue for Islamic banks to compete freely with conventional institutions. It is further recommended to introduce a separate Islamic Bank Act to govern banks that provide facilities under the Islamic window concept. The respondents revealed that such a mechanism would protect both Islamic banks and its customers and at the same time reduce the chances of debts going bad.

The second-most important factor in deterring the growth of Islamic banking is the lack of support from the link institutions (0.98). Respondents have disclosed that because of the lack of secondary financial market for Islamic financial products, they cannot achieve true comparison with the conventional system. Development of supportive secondary money markets is essential to expand the growth of Islamic banking.

Inadequate post financing supervision has given many account holders the chance to take advantage of the Islamic banks' profit-loss sharing system (0.90). Islamic banks offer loans for a variety of projects and the criterion for allowing a loan is not necessarily the credibility of the borrower. The success potential of the project is given main consideration, which should theoretically bring in higher profit for the bank, while the ability to repay the loan is sub-segmented under profitability. However, the occurrence of bad debt has presented itself as quite a threat for the prosperity of Islamic banking. Under the present system of banking, there is a lack of proper supervision of post financing circumstances; hence the defaulting rate is high. So it can be gathered that an apt system of post financing administration would help the Islamic banking sector flourish.

Table 4: Factors Hindering Growth of Islamic Banking System

| Sl. No. | Variable | Index | St. Dev. |
|---------|---|-------|----------|
| 1 | Necessity of new regulatory framework to be introduced for coordination | 1.16 | 0.55 |
| 2 | Shortage of supportive and link institutions | 0.98 | 0.64 |
| 3 | Need for greater post financing situation in banks | 0.90 | 0.94 |
| 4 | Inadequate training and education facilities | 0.80 | 0.88 |
| 5 | Political intervention in borrower selection contributes to bad debts | 0.73 | 0.92 |
| 6 | Lack of suitable financing modes for inter-bank borrowing | 0.72 | 0.86 |
| 7 | Lack of qualified human resource | 0.39 | 1.09 |
| 8 | Rising ratio of bad debts to total debts | 0.11 | 0.93 |

Training facilities, coherent with the framework of Shariah banking is not available in a sufficient number (0.8). Most of the training given to the officers and staff of banks are in line with the conventional banking system. Compared to conventional banking concepts, Islamic banking is a very new discipline and has distinct rules and principles. This implies for a need of training in the procedures and principles of Islamic banking which would further accelerate the growth of the sector. By continuing to provide well-researched, high quality technical and product-focused training courses and faculty of recognized industry experts, the development of human capital can be assisted. One of the most important challenges that Islamic banks in Bangladesh face is the lack of Islamic banking professionals and the lack of Shari'ah scholars who have specialized in Islamic economics. Further the Shari'ah board should have a fair influence on the bank's operational and strategic planning.

From the survey it became evident that the bad debt is to some extent multiplying. The research has shown that intervention by political leaders has led to a handful number of debts going bad (0.73). Islamic bank has an effective method of choosing its borrowers. However at times, this process is marred by the intervention of dishonest politicians, who use their political power to influence selection of borrowers. Eventually this leads to rising bad debts, since most of the fraudulently chosen borrowers become defaulters. It can be deduced that if the infrastructure is strengthened, the negative impact of politics can be lessened. Also most Islamic bankers acknowledge the absence of inter-bank borrowing (0.72) to be a deterring factor in the growth of Islamic banking. As a factor responsible to dwarfing the growth of Islamic banking, respondents considered the lack of infrastructural inadequacies to be a major deterring cause. The lack of suitable financing modes is also connected to the impeding condition of inter-bank borrowing.

It is alleged that there is a lack of qualified human resource in the Islamic bank sector which to some extent is a significant factor for hampering growth (0.39). As Islamic banking is a relatively new concept in Bangladesh, particularly to bankers, there exists an ambiguous understanding on the Islamic principles of banking. One of the most important challenges that Islamic banks in Bangladesh face is the lack of Islamic banking professionals and the lack of Shari'ah scholars who have specialized in Islamic economics. So far, no institutions have been set up in Bangladesh to provide education and training to the personnel of Islamic banking. However the respondents believe that this does not overcome the magnetizing effect of religious stronghold of their targeted clientele.

Lastly the bankers consider bad debts to some extent rising (0.11) and are a deterring factor in their growth. However, in recent times the ratio of bad debts for Islamic banks has been on the rise, which poses an alarming signal for this sector. Because Islamic banks employ the profit-sharing method, and not the fixed-interest method, Islamic banks are deprived of earnings whenever a borrower under-states his profit from a particular venture in order to evade taxes. The respondents believe that this may act as a deterring force to the adoption of Islamic banking principles in the future.

5.5 Islamic Banking System as a Whole

From above sub-sections the major explanation for Bangladesh's Islamic finance boom is its operation in line with Islamic Shariah. The basic intention behind banking with Islamic banks is the desire of Muslims to reorganize their financial activities in a way that do not contradict the principles of Shariah and enable them to conduct their financial transactions without indulging into *riba*. Hence by the prohibition of *riba* and following the PLS system, was the source of inspiration for establishing Islamic banks. One of the reasons for this is that the outcome of the productive effort is uncertain, and so interest necessarily involves an element of *gharar*¹² that is, uncertainty.

Other than this religious appeal, there are economic reasons which have contributed to the emergence of Islamic Banking in Bangladesh as an alternative to conventional banking. Some economists consider the role of interest in the conventional banking mechanism as a major negative factor that contributes to cyclical fluctuations in the economy. Islamic banking seems to provide a response to both religious and economic issues. While religious requirement calls for avoiding any transaction based on interest, economic exigencies provide a new outlook to the role of banking in promoting investment/ productive activities, influencing distribution of income and adding stability to the economy.

6.0 PERCEPTION OF CONVENTIONAL BANKERS ABOUT ISLAMIC BANKING SYSTEM

6.1 Growth Factors of Islamic Banks as Perceived by Conventional Bankers

The conventional bankers view regarding the factors perceived to be responsible for the growth of the Islamic banking in a scale of 2 (strongly agree) to – 2 (strongly disagree) is shown in Table 5. According to them, the preferential treatment received by Islamic banks from central bank contributes to their profitability (0.76). The respondents believe that it is one of the most significant reasons for the development of the sector. Banks in the Islamic sector tend to receive some preferential treatments from the Bangladesh Bank (BB). Firstly, BB allows Islamic Banks to maintain a Statutory Liquidity Requirement of 11% where as this requirement is 19% for the conventional banks. This preferential provision allows the Islamic banks to divert some liquid funds for investment and thereby generate extra profit. Secondly, BB allowed Islamic Banks independent scope to fix their profit-and-loss sharing (PLS) ratios and markups commensurate with their own policy and banking environment. This freedom in fixing PLS ratios and markup rates has provided scope for Islamic banks to follow the *Shariah* principles independently. Lastly, BB allows Islamic Banks to reimburse 10% of their proportionate administrative cost on a part of their balances held with Bangladesh Bank. This facility has given some scope for enhancement of their profit base.

However, the respondents agreed that the profit-loss sharing method is advantageous to the economic performance of the banks (0.47). This method states that all parties involved in a particular financial transaction will equally share any profit or loss incurred. Economists believe that interest contributes to instability in the economy. Hence, an interest free banking system is more favorable in this sense. However, without a strong infrastructure, the benefits of an interest-free banking system may well erode. The conventional bankers do believe, if not very strongly, that conventional banking is more profitable than Islamic banking (0.14). That is why, they believe, Islamic banking has not flourished yet, and most of banks in Bangladesh do not offer Islamic banking services. They believe that, because of the higher profitability of conventional banking, banks throughout the country devote more resources to this sector. But few banks are trying to capture the market share of the segment that prefer Islamic banking system.

The Islamic banks operate on the Shariah based system of no interest payments. This minimizes risks for the banks as in the event of a loss; the bank would not be compelled to pay to the depositors. The respondents believe that Islamic banks do not, in practice, offer a zero interest rate to the customers. They tend to charge an amount to equate the payment of interest. As a result, this does not act as a risk minimizing factor for the banks (- 0.05).

Table 5: Growth Variables of the Islamic Banking Perceived by Conventional Bankers

| Sl. No. | Variable | Index |
|---------|---|-------|
| 1 | Preferential treatment from BB contributes to profitability for ventures in Islamic banking | 0.76 |
| 2 | Profit-loss sharing represents economic advantages | 0.47 |
| 3 | Conventional banking is more profitable than Islamic banking | 0.14 |
| 4 | Zero interest rate minimizes risk | -0.05 |

6.2 Factors That Can Attract Conventional Banks to Adopt Islamic Banking System

The study tried to identify the factors that may attract the conventional banks to adopt Islamic banking system. The survey showed that the respondents consider "religious beliefs of potential customers" (1.27) can be the main reason for adopting Islamic banking. According to them, there is a market segment constituting people interested in engaging in Shariah based banking. Capitalizing on the demand of this segment can be the main objective for investments in Islamic banking. Islamic Banking operates on principles adhering to the Quranic norms, forbidding any transaction involving interest. Hence, it provides people with the opportunity to engage in transactions that are in harmony with their religious beliefs. Therefore, it appears that whether conventional banks decide to offer Islamic banking services in the future would depend largely on the marketing opportunities that this segment offers, and the speed with which this segment is growing.

Next important attracting factor is preferential treatment from central bank (0.49) for adopting Islamic banking. The respondents believe that preferential treatments that Islamic Banks receive from the Bangladesh bank may contribute to their profitability. The major contributor to profitability is the low reserve ratio that is allowed for Islamic Banks. This enables the banks to utilize more resources and invest them in profitable ventures. Bangladesh Bank has also demonstrated leniency in when it comes to the fulfillment of statutory requirements by Islamic banks. Although this may help the Islamic banks to be more profitable, the respondents also believe that this does not offer a major advantage, and cannot be the sole basis for conventional banks to adopt Islamic banking.

Conventional banks are inclined towards the fact of relatively higher profitability as the incentive for adopting Islamic banking (0.38). According to the survey, Islamic Banking offers comparatively higher profitability compared to conventional banking system. This is mainly because Islamic Banking tends to attract a wide range of customers who value the Shariah based system. Also, the flexibility in the laws governing the operations of Islamic banks has made significant contributions to the growth of this sector as well, according to the respondents.

According to most respondents, it is the desire to serve the "religious segment" that induces banks to adopt Islamic banking. Most respondents do not think of the Islamic banking system as being more efficient than the conventional system (-0.18). Hence, they believe that this is not one of the reasons for adopting Islamic banking. The respondents believe that improved levels of service will make this sector economically more advantageous, and will complement the legal advantages that this sector possesses. However, respondents also noted that the fulfillment of social responsibilities, even at the expense of reduced profits, is sometimes the main motivation behind the establishment of Islamic banks. This perception may be barring the attainment of efficient services in this sector.

Table 6: Factors That Can Attract Conventional Banks to Adopt Islamic Banking System

| Sl. No. | Variable | Index |
|---------|---|-------|
| 1 | Religious belief of potential customers can be main reason for adoption | 1.27 |
| 2 | Preferential treatment from BB can be main reason for adoption | 0.49 |
| 3 | Comparatively higher profitability can be main reason for adoption | 0.38 |
| 4 | Higher efficiency can be main reason for adoption | -0.18 |

6.3 Factors That Discourage Adoption of Islamic Banking by Conventional Banks

To identify the reasons for not adopting Islamic banking system by the traditional banks the respondents are given to rank 5 different options (Table 5) in a scale of 2 (strongly agree) to – 2 (strongly disagree). None of the options found to be strong reasons for not adopting the Islamic banking system. Most conventional bankers agree that there is a little insufficiency in supportive and link institutions in Islamic banking system (0.23). Most respondents agree that a major reason for not adopting Islamic Banking is a shortage of supportive and link institutions in the Islamic Sector in Bangladesh. Islamic Banks need a number of supportive institutions/arrangements to perform functions that are being carried out by various financial institutions in the conventional framework.

Due to a small number of banks operating in the Islamic banking sector (16) in Bangladesh, the inter-bank money market is severely limited when compared to that for the conventional banking systems (31). However, again most respondents feel that this fact acts as a reason for not adopting Islamic banking (0.20). An inter-bank money market has two main functions: firstly, to provide the Islamic financial institutions with the facility of funding and adjusting their portfolios over the short-term and secondly, to serve a channel for the transmission of monetary policy. Financial instruments and inter-bank investment allow *surplus* banks to channel funds to *deficit* banks, thereby maintaining the funding and liquidity mechanism necessary to promote stability in the system.

The conventional banks believe that a lack of support from the government also act to some extent a reason for not adopting Islamic banking (0.10). Islamic banking is a newly emerging sector. Bangladesh Bank exercises authority over Islamic banks under laws and regulations engineered to control and supervise traditional banks whose goals and functions are different from Islamic banks. The commercial, banking, and company laws contain provisions that are narrowly defined and prohibit the scope of Islamic banking activities within conventional limits. Hence, it is necessary that special laws for the introduction and practice of Islamic banking be put in place. This will greatly enhance the ability of Islamic Banks to compete effectively with conventional banks.

There is a lack of training and educational facilities in Islamic banking in Bangladesh. As a result, the work force available to the banks in this sector is not sufficiently qualified. However, an index close to zero (0.03) shows that conventional bankers are indifferent towards the belief that a lack of qualified human resources makes Islamic banking less attractive. Because of the belief that conventional banks are more profitable, this sector is not able to attract the brightest minds of the country. In Bangladesh, this is a relatively new sector and sufficient training is not provided by the existing institutions on the operations and management of this sector.

The conventional banks disagree that a rise in the bad debt to total debt ratio is the main reason for not adopting Islamic banking (- 0.21). Despite the preferential treatment received by the Islamic Banks, the bad debts of this sector show a rising trend, which poses a significant problem for the growth of this sector. The respondents believe that this may act as a deterring force to the adoption of Islamic banking principles in the future.

Table 6: Factors That Discourage Adoption of Islamic Banking by Conventional Banks

| Sl. No | Variable | Index |
|--------|---|-------|
| 1 | Shortage of supportive and link institutions is main reason for non adoption | 0.23 |
| 2 | Absence of Islamic inter-bank money market is main reason for non adoption | 0.20 |
| 3 | Lack of legal support from government is main reason for non adoption | 0.10 |
| 4 | Lack of qualified human resource is main reason for non adoption | 0.03 |
| 5 | Rise in ratio of bad debts to total debts in Islamic banking sector is main reason for non adoption | -0.21 |

6.4 Comparison of Variables Common to both Islamic and Conventional Banks

A comparative analysis is made of the response variables (8) common to both Islamic and conventional bankers (Table 7). The responses from the two groups found to be quite different except for a couple of cases. Both the groups strongly (1.27) agreed that a religious belief of potential customers is the main reason for adoption of Islamic banking system. This can be the biggest marketing opportunity for Islamic banks. Most traditional Muslims view the charging or receiving of interest as being against their religion. Their Islamic beliefs prevent them from dealings that involve usury or interest (Riba). Islamic banking operates on principles adhering to the Quranic norms, forbidding any transaction involving interest. Hence, it provides people with the opportunity to engage in transactions that are in harmony with their religious beliefs. The second variable where both the groups responded quite closely (0.35 and 0.38) is “Comparatively higher profitability is main reason for adoption”.

The low index values indicate that higher profitability is not a significant reason for adopting Islamic banking system.

On the other hand, the Islamic bankers believe that ‘Islamic banking is more profitable than conventional banking’ (0.84) which the conventional bankers disagree (-0.14). Islamic system promotes profit/loss sharing mode and encourages risk sharing and active participation of the providers of the funds in the businesses they invest. This might provide the scope for receiving greater profits than a fixed amount of interest. The conventional bankers believe that the Islamic banks only claim, but do not actually follow the true Shariah based system of banking. According to them, the conventional system of banking is more lucrative and it stands as an honest method of banking as opposed to Islamic banking which they feel is only profitable as a Strategic Business Unit (SBU). The Islamic bankers endorse the view of risk minimization by zero interest rate (0.58). Conventional banks do not reinforce this claim (-0.05). They believe Islamic banks do not actually operate by the proper principles and completely abolish interest rates. Hence, risk is not reduced. Also, it must be kept in mind that Islamic banks in Bangladesh sometimes have a greater social and moral motive to fulfill, even at the expense of reduced profit.

Table 7: Index Values of the Variables Common to both Islamic and Conventional Banks

| SI No | Variable | Islamic Banking | Conventional Banking |
|--|--|-----------------|----------------------|
| 1 | Islamic banking is more profitable than conventional banking | 0.84 | -0.14* |
| 2 | Zero interest rate minimizes risk | 0.58 | -0.05* |
| 3 | Preferential treatment from BB is main reason for adoption | -0.13 | 0.49* |
| 4 | Preferential Treatment from BB contributes to higher profitability | 0.26 | 0.76* |
| 5 | Higher efficiency is main reason for adoption | 0.28 | -0.18* |
| 6 | Profit-Loss sharing method represents economic advantages | 0.79 | 0.47* |
| 7 | Comparatively higher profitability is main reason for adoption | 0.35 | 0.38** |
| 8 | Religious beliefs of potential customers is main reason for adoption | 1.27 | 1.27** |
| * Different at 5% level of significance | | | |
| ** Not different at 5% level of significance | | | |

Although the preferential treatment from BB is also an opportunity for Islamic banks as the policy helps them gain more liquidity than conventional banks, the index implies that Islamic banks are almost indifferent to its attraction as a reason for adoption (-0.13). On the other hand, conventional banks feel that the preferential treatment from BB is an attractive opportunity for Islamic banks to grow and strengthen the sector (0.49). Islamic banks do not quite agree that preferential treatment from Bangladesh Bank (in the form of lower reserve ratio) further assist in gaining profitability (0.26). But respondents from conventional banks perceive that the preferential treatment is giving them an edge to a great extent by increasing the liquidity of the banks (0.76).

Islamic bankers to some extent believe that higher efficiency is a factor for adoption of the system (0.28), which the conventional bankers quite disagree (-0.18). Finally the claim by

Islamic bankers that 'Profit-Loss sharing (PLS)' method represents economic advantages' (0.79) is not quite endorsed by traditional banks (0.47). The PLS method represents flexibility for the Islamic banks themselves and can mediate fluctuations in the economy as it is a system void of interest rate. The interest system is perceived to be incapable of allocating available liquid funds among firms and activities in the society according to the considerations of efficiency, productivity and growth and is biased towards wealthy individuals and large businesses. An Islamic system based on profit/loss sharing financial methods would offer an efficient substitute in principal, according to them. Conventional banks themselves do not have PLS method, but shows inclination of the banks towards agreeing to the advantages of this system to some extent.

6.0 CONCLUSIONS AND RECOMMENDATIONS

The study of the prospects and problems of the Islamic banking sector of Bangladesh shows that this sector is progressing steadily. The formation of Islamic banks and adoption of parallel Islamic banking by several conventional banks over the years can be an indicator of the high acceptability of this sector by the public. The main reason for the demand for Islamic banking can be attributed to the desire of people to engage in financial transactions that adhere to the rules of Shariah. The demand from this segment induces banks to either offer Islamic finance exclusively or as a parallel service with other conventional offers.

The Islamic bankers believe that the PLS method represents financial advantages for the banks and offers benefits for the economy by causing lower interest stimulated instability. The banks are, however, believed to not implement the principals of Shariah entirely. According to the conventional banks, these banks have not abolished interest from the transactions. This has caused the PLS method to fail to have the impact it is intended to have on risks, profitability and the society.

Conventional bankers believe that the preferential treatments that Islamic banks receive from central bank contribute to their profitability and this factor plays a crucial role in motivating some conventional banks to offer Islamic banking as a parallel service. Islamic finance, in theory, is designed to work for the greater benefit of the society. Such conventional banks are criticized for running Islamic banking branches not to serve this purpose but to act as profit centers or strategic business units. Islamic units enable these banks to cater to a segment in the market comprising people preferring the Shariah based system. At the same time, it enables the banks to enjoy greater liquidity facilitated by the especial treatments offered by the central bank.

Over the years, Islamic banking has emerged as an attractive venture due to the high income generated by the sector and the rising number of fixed clients in most Islamic banks. The fixed deposits and debt-financed assets in the sector however have been growing at a significant rate. Despite the high profitability and liquidity offered by the sector, Islamic banking is perceived to be less efficient than conventional banking.

The foremost factor making Islamic banking attractive to customers is adherence 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. However, such a lack of such attributes does deter customers from choosing a particular bank.

The primary factor that hinders the growth of Islamic banking in Bangladesh is the lack of a supportive legal framework. Banks believe that the introduction of an independent banking act would enable this sector to thrive. Other two relevant variables, acting as impediments to growth, are: lack of supportive and link institutions, and absence of an inter-bank money market in the country. According to the respondents, these are some major obstacles that must be addressed by the authorities for the prosperity of the sector.

The training and educational facilities available on Islamic banking are inadequate in Bangladesh and this adversely affects the efficiency of the banks. However, banks believe this has not been a significant factor in hindering the growth of the sector. The bad debts to total debts ratio of the sector has been roughly stable over the past five years. Political intervention has had some impact in contributing to the bad debts incurred. According to the banks, there is a strong need for the sector to provide post financing services to retain customers and to motivate them to stay loyal and honest.

All this suggests that Islamic banking is an attractive venture in Bangladesh. The high demand for interest-free services contributes to the immense growth potential of the sector. For competitive reasons, banks do not entirely abide by the rules of Shariah, and this prevents the system from having the expected impact. Moreover, a number of conventional banks have started Islamic Banking operations to enjoy greater profitability. The current legal framework of the country needs to incorporate provisions for this sector. Furthermore, greater emphasis should be placed on training and education available on this system, to assure competent Human Resources and better post financing services.

NOTES

- 1 Shariah: The basic principle in the Shariah (Islamic Canon Law) is that exploitative contracts based on interest or usury and speculation should be unenforceable. These laws are derived from three sources: the Quran, the Hadith, and the Sunnah.
- 2 Mudaraba: The term refers to a form of business contract in which one party brings capital and the other personal effort. The proportionate share in profit is determined by mutual agreement. But the loss, if any, is borne only by the owner of the capital, in which case the entrepreneur gets nothing for his labor.
- 3 Riba: Literally, an increase or addition. Technically it denotes in a loan transaction any increase or advantage obtained by the lender as a condition of the loan. Synonymous to rate of interest in the conventional banking mechanism.
- 4 Fiqh al-Muamalat: Basic Shariah Principles
- 5 Wadiah (safekeeping): A bank is deemed as a keeper and trustee of funds. A person deposits funds in the bank and the bank guarantees refund of the entire amount of the deposit, or any part of the outstanding amount, when the depositor demands it.
- 6 Musharaka: A partnership between two parties, both of whom provide capital towards the financing of a project.
- 7 Murabaha: It is a contract of sale in which the seller declares his cost and the profit.
- 8 Ijarah: This is a contract involving hiring or leasing through which the services of a person or a legal entity or organization is rented out or leased
- 9 Halaal: In Arabic-speaking countries, the term is used to describe anything permissible under Islamic law
- 10 Haraam: That which is forbidden

- 11 Zakaat: It is often compared to the system of tithing and alms but unlike these older systems, it serves principally as the welfare contribution to poor and deprived people in the Muslim lands, although others may have a rightful share.
- 12 Gharar: Uncertainty, hazard, chance or risk. Technically, sale of a thing which is not present at hand; or the sale of a thing whose consequence or outcome is not known; or a sale involving risk or hazard in which one does not know whether it will come to be or not.

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