

Islamic Banking in Bangladesh: Achievements & Challenges

By

Abdul Awwal Sarker*

[Abstract: Islamic banking as a new paradigm started in Bangladesh in 1983 with the establishment of the first Islamic bank "Islami Bank Bangladesh Limited". After that, 6 more banks have been established in the country to reach the outcome of this welfare banking to the doorsteps of the people. In the past two decades, it has shown its great robustness in achieving the goal of Islamic Shariah. Observing the success, many conventional banks have been allured to open their own Islamic branches with the traditional ones. For a continued expansion of the Islamic Banking system, however, a number of issues that pose serious problems for Islamic banks will need to be carefully addressed. This paper discusses and makes recommendations on the more pertinent of these issues, viz., the development of an Inter-Bank Islamic Money Market, activation of Shariah Supervisory Boards, enactment of a full-fledged Islamic Banking Act, development of New Financial Products in line with the Islamic Shariah, and extension of investment in line with PLS framework, especially by constituting consortium or syndication by the Islamic banks. The paper suggests that micro, small, and medium enterprises (MSMEs) should get priority in the investment decisions of the Islamic banks. The paper also observes that the performance of the Islamic banks could be further improved by upgrading the quality of manpower by enhanced R&D spending and pro-poor investment decisions.]

Development of Islamic banking in the World

The second half of the twentieth century witnessed a major shift of thinking in devising banking policy and framework on the basis of Islamic Shariah. This new thought was institutionalized at the end of the third quarter of the century and emerged as a new system of banking called Islamic banking. The establishment of the Islamic Development Bank (IDB) in 1975 gave momentum to the Islamic Banking movement. Since the establishment of IDB, a number of Islamic Banking and financial institutions have been established all over the world irrespective of Muslim and non-Muslim countries. Over the past few decades, the Islamic financial industry has rapidly expanded worldwide. Currently about 260 Islamic financial institutions (IFIs) have total combined assets exceeding \$250 billion in more than 57 countries. The Islamic financial market is estimated to grow at annual rates averaging 15% in a year. Their rapid growth has gained considerable attention in international financial circles where various market participants have recognized promising potentials.

The Islamic finance market has become extremely sophisticated as well as increasingly competitive. Today, virtually all large western financial institutions are involved in Islamic finance whether through Islamic subsidiaries, "Islamic windows", or the marketing of Islamic products. In recent years, a range of new Islamic products have

* Deputy General Manager, Internal and Islamic Economics Division and External Economics Division, Research Department, Bangladesh Bank, Dhaka. Opinions expressed in the article are the author's own and do not reflect the view of Bangladesh Bank or Government.

appeared, such as Islamic bonds (or sukuk) and Islamic derivatives. While some of those products are widely accepted, others are still controversial.

Genesis of Islamic Banking in Bangladesh

Bangladesh is the third largest Muslim country in the world with around 135 million populations of which 90 percent are Muslim. The hope and aspiration of the people to run banking system on the basis of Islamic principle came into reality after the OIC recommendation at its Foreign Ministers meeting in 1978 at Senegal to develop a separate banking system of their own. After 5 years of that declaration, in 1983, Bangladesh established its first Islamic bank. At present, out of 49 banks in Bangladesh, 7 full fledged Islamic Banks and 19 Islamic Banking branches of 9 conventional banks are working in the private sector on the basis of Islamic Shariah. Islamic banks in Bangladesh since their inception have been gaining popularity in spite of some problems in their operation.

Islamic Banking Branches in Conventional Banks

An important development in Islamic banking in the last few years has been the entry of some conventional banks in the market and their use of Islamic modes of financing through their Islamic branches, windows, or units. It necessitates and encourages the mobilization of Islamic banking, which includes some of the giants in the banking and finance industry. Bangladesh was not indifferent to this turning move. Presently, 9 conventional banks have opened 19 Islamic banking branches alongside their interest-based branches. These conventional banks should focus on the safeguards that ensure the Islamic nature of these branches such as separation and compliance with Shariah. Separation of Islamic banking branches includes separation of capital, accounts, staff employed and office. However, the most important thing is compliance with Shariah. There should be strong Shariah supervisory boards in order to prepare the model agreement, to approve the structure of every new operation, and lay down the basic guidelines for each and every mode of financing.

Deposit Mobilization and Fund Utilization by the Islamic Banks in Bangladesh

The major part of the operational financial resources of Islamic banks is derived from different types of deposits mobilized on the principles of Al-Wadia (safe custodianship) and Al-Mudaraba (trust financing). Utilization of fund under the framework of Islamic banking has opened a multifarious way for making loan (the term "loan" in conventional banking is called "Investment" in the Islamic banking system) conforming to Islamic Shariah. Since Islamic banks can not lend on interest, they have devised different types of interest-free financing devices. A short description of the modes of financing used by the Islamic banks in mobilization and utilization of funds is given in Box 1.

Performance of the Islamic Banking System

The growth of Islamic banking in Bangladesh is progressing day by day. The remarkable shift or conversion of the conventional banks and their branches into Islamic lines gives the signal of high acceptance of the interest-free banking by the public in general. The Islamic banking industry continued to show strong growth in 2005 in tandem with the growth in the economy, as reflected in the increased market share of the Islamic banking industry in terms of assets, financing, and deposits of the total banking system.

The Islamic banks in Bangladesh started from a very limited resource base. But with the passage of time, they have shown strong performance in respect of mobilization of deposits. Total deposits of the Islamic banks and Islamic banking branches of the conventional banks stood at Taka 188557.4 million in September, 2005. This was 27.6% of the deposits of all private banks and 12.9% of the deposits of the total banking system. Total investment of the Islamic banks and the Islamic banking branches of the conventional banks stood at Taka 184547.2 million at the end of September, 2005. This was 31.4% of all private banks and 15.1% of the total banking system of the country.

The Statutory Liquidity Requirement (SLR) for the Islamic banks is fixed at 10% since the inception of the first Islamic Bank in 1983. This remains unchanged till date while SLR for the traditional commercial banks has been changed many times, which presently is fixed at 18%. It is evident from Table 1 that almost all of the Islamic banks have been facing excess liquidity problem while only one bank, the Oriental Bank Limited, is maintaining liquidity position below the required level. However, the excess liquidity of the Islamic banks and Islamic banking branches of conventional banks as of September 2005 was to the tune of Taka 7742.4 million (18.5% of private banks and 7.9% of all banks), which originated mainly due to the non-responsiveness of good borrowers for credit demand and the absence of adequate interest-free financial instruments in the country.

Islamic banks and the Islamic banking branches of the conventional banks have created enough employment opportunities in the banking sector by providing a good number of jobs to the people. The total persons employed in the Islamic banking system were 8220 as on September, 2005. This was 25.2% of the private sector banks' total employment and 7.6% of all banks. The total number of branches of the Islamic banks, including the Islamic banking branches of the conventional banks, in the country stood at 308 in September, 2005, of which 236 were urban and 72 were rural. The number of Islamic bank branches was 19.6% of all private banks and 4.9% of the banking system of the country. The position of IBBL in respect of deposit, investment, creation of employment, and branch network is given in Annexure 1.

**Table 1: Comparative Position of the Islamic Banking Sector
September, 2005**
(In million Taka)

Group of Banks	Deposit	Investment	Excess Liquid Assets	Man power	No. of Branches
1	2	3	4	5	6
Islamic Banking Sector	188557.4	184547.2	7742.4	8220	308
All Private Banks: 1/	682240.4	587575.2	41863.1	32576	1573
	(27.6)	(31.4)	(18.5)	(25.2)	(19.6)
All Banks Total: 2/	1463163.6	1220912.2	98126	108451	6336
	(12.9)	(15.1)	(7.9)	(7.6)	(4.9)

Notes: 1/ Figures in the parentheses indicate share of percentage of the Islamic banking sector to the all private banks. 2/ Figures in the parentheses indicate share of percentage of the Islamic banking sector to all banks.

Sources: Banking Regulation and Policy Department, Statistics Department and Central Accounts Departments of all Islamic banks and conventional banks having the Islamic banking branches.

The distribution of investment by mode as presented in Table 2, shows that Islamic banks' investment is mainly concentrated in the mark-up and rental-based modes of financing, which occupied 74.6% of total investments (Bai-Murabaha, Bai-Muajjal and Ijarah). Investments under the PLS modes accounted for only 1.38% (both in Mudaraba and Musharaka). This demonstrates a complete bias towards mark-up based financing followed by the Islamic banks in Bangladesh.

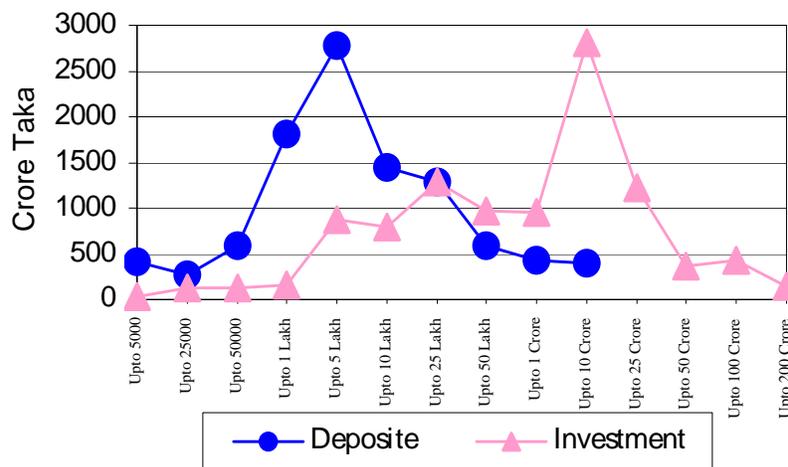
Table 2: Modewise Investment of Islamic Banks, September 2005

Mode of Investment	%
Bai Murabaha	28.00
Bai Muajjal	21.82
Ijara	24.74
Bai Istisnaa	14.51
Bai Salam	0.43
Musharaka	1.35
Mudaraba	0.03
Others	9.02
Total	100.00

An analysis of the deposits and investments distributed by the size of accounts of the Islamic banks also depicts a bias towards the big projects or clients. The distributive efficiency of the Islamic banks has been impaired due to the concentration of assets in the hands of a few investment clients. This is shown in Chart-1.

Chart-1

**Deposits and Investment by Size of Account
September 2005**



CAMEL Rating

The risk-weighted capital ratio and core capital ratio were maintained by the Islamic banks at prescribed level. Out of 7 Islamic banks, 4 banks maintained the capital ratio above the level while 3 maintained at lower level. This is due mainly to the shortfall of maintaining provision for loan loss. The ratio of non-performing loans (NPLs) to total loans of Islamic banks shows an improving trend, except for just one individual bank. Moreover, the asset quality of the Islamic banks has also improved. Some of them were able to remain below the accepted level on NPL, while some others were well above the level. An analysis of expenditure-income ratio indicates that the operating efficiency of the Islamic banks remained at satisfactory level excepting one bank which is designated as problem bank.

Earnings as measured by return on assets (ROA) and return on equity (ROE) vary largely within the Islamic banks. ROA of 4 Islamic banks showed a better performance while 2 performed below the accepted level. As regards ROE, 4 Islamic banks showed a strong performance while the other 3 were unable to sustain the previous level. An analysis of the Net Profit Margin (NPM) of the Islamic banks showed a positive trend but at lowers than the accepted level.

Islamic Financial Instruments in the Market

In Bangladesh, financial resource mobilization through issuance of Islamic financial instruments is at a nascent stage. No Islamic bank or financial institution has issued any Islamic financial instruments like bonds, debentures, or mutual funds in the primary or secondary market for mobilizing financial resources. They are fully dependent on the deposit funds. Bangladesh Government has introduced a Mudaraba Bond named “Bangladesh Government Islamic Investment Bond (Islamic Bond)” in October, 2004 with a view to mitigating the long-felt need for a Shariah-based monetary instrument which can be used as an approved security for the purpose of maintaining the SLR as well as providing an outlet for investment or procurement of funds by the Islamic banks. This bond is also open for investment by the private individuals, companies or corporations. Salient Features of the Government Islamic Investment Bond (GIIB) are given in Box 2.

Measures taken for promotion of Islamic Banking in Bangladesh

An Islamic economics cell was established at the Research Department of Bangladesh Bank in 1990, as a first step, to conduct analytical research work on Islamic economics, banking and finance. A series of national and international conferences and workshops have been arranged in Dhaka in joint collaboration with the Islamic Development Bank to understand and explore the current dynamics of this new paradigm of banking. The Cell has since been upgraded as Internal and Islamic Economics Division of the Research Department.

Though there is no complete Islamic banking act for controlling, guiding and supervising the Islamic banks in Bangladesh, some Islamic banking provisions have been incorporated in the amended Banking Companies Act, 1991 (Act No. 14 of 1991). Bangladesh Bank has not yet set up any separate department at its head office to control, guide and supervise the operation of the Islamic banks. Inspection and supervision of the Islamic banking operations are conducted by the Bangladesh Bank as per the general guidelines framed for the conventional banks. The role of Bangladesh Bank in controlling, guiding and supervising the Islamic Banks in Bangladesh in accordance with Islamic Shariah is at a preparatory stage. In observing the Shariah implementation status of the Islamic banks, Bangladesh Bank examines only the report of the respective banks’ Shariah Councils. The inspectors and supervisors of Bangladesh Bank have been undergoing massive training programmed on Islamic banking both at home and abroad to be familiar with the technicalities of the different operational methodologies of the Islamic banking system. Bangladesh Bank Training Academy and BIBM have also been arranging some training courses on Islamic banking and finance.

In view of the rapid expansion of Islamic banks in Bangladesh, Bangladesh Bank issued a letter to the Islamic banks to carefully address and examine the upcoming problems in due time. To help actualize those, Bangladesh Bank identified the following problems

and accordingly advised all Islamic banks on 5th March, 1997 to take appropriate measures through mutual discussion and co-operation:

- Development of an Inter-Bank Islamic Money Market
- Constitution of Central Shariah Supervisory Board
- Preparation of draft Islamic Banking Act
- Establishment of Islamic Insurance Company
- Development of New Financial Products in line with Islamic Shariah
- Constitution of Consortium/Syndicate by the Islamic banks for large financing

In response to Bangladesh Bank's call, "Islamic Banks Consultative Forum (IBCF)" was constituted by the Islamic banks and banks having Islamic banking branches in 1997 to take appropriate decision on the above identified areas. Later on, a Central Shariah Board of the Islamic Banks has also been formed with the active participation and financial contribution of the said banks and banking branches. In October, 2004, Bangladesh Bank issued a Mudaraba bond named "Government Islamic Investment Bond" on behalf of the government as a first ever Islamic financial instrument in Bangladesh to facilitate the Islamic banks and financial institutions to invest their funds (to be calculated as an outlet for maintaining SLR). Recently, a Focus Group on Islamic Banking has been constituted in Bangladesh Bank to develop necessary guidelines to facilitate setting up of Islamic banks, Islamic bank subsidiary or branches in Bangladesh.

Recently, Bangladesh Bank has become member to the Islamic Financial Services Board (IFSB), based in Malaysia, the body established to issue prudential and supervisory standards for the Islamic banking and finance industry. The existing supervisory process and procedures of Bangladesh Bank may be redesigned to evolve in line with the best international Islamic standards. Regulatory and supervisory standards, which can specifically address the unique peculiarities of the Islamic banking operations, are necessary to promote resilience and competitiveness of the Islamic banking sector. In this regard, the work of the IFSB would act as a catalyst to the development of a stronger and robust supervision framework in Bangladesh. In addition to that, a Competency Group on Islamic banking has been constituted at the Department of Banking Inspection (DBI) to develop 'Shariah Compliance Checklists' as a tool for bank supervisors to carryout their supervisory functions.

Challenges of Islamic Banking in Bangladesh

Islamic banks in Bangladesh have been encountering numerous challenges. First, they have not yet been successful in devising an interest-free mechanism to place their funds on a short-term basis. 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. Presently 60%-70% investments of Islamic banks are made on mark-up basis (Murabaha and Bai-Muajjal etc.). As a result, the ideal modes of investment (Mudaraba and Musharaka) are quite absent in their practices.

Concentration of Islamic banks' investment in short-term trade is a pertinent problem in Islamic banking. Islamic banks are heavily dependent on Bai Muajjal/Murabaha in their operations. This is due mainly to two reasons. Their orientation is mainly towards short term financing of trade transactions for which Bai Muajjal/Murabaha appear to be more convenient devices compared to the system of profit-loss sharing. Secondly, they are in competition with interest-based banks and are therefore anxious to earn at least as much on their investments as will enable them to give a return roughly comparable to prevailing interest rates to their investment account holders. This is easier to achieve by engaging in Bai-Muajjal/Murabaha transactions as "mark-up" can be fixed in a manner which more or less assures the required return. For that reason, the Islamic banks are reluctant to invest under Mudaraba or Musharaka, the true Islamic financial mechanisms. There is a genuine concern among Islamic scholars that if interest is largely substituted by a device like "mark-up", it would represent a change just in name rather than in substance, and the new system would not be any different from the interest-based system so far as equity is concerned. It is also emphasized that apart from equity considerations, the prohibition of interest in Islam is meant to stimulate overall production, which is the mainspring of growth. These blessings can only be reaped if the interest system is completely uprooted in the real sense of the term and replaced by a fundamentally different system like profit/loss sharing.

The implications of the Islamic financing modalities for Islamic banking are yet to be fully recognized. The Basel protocols are with reference to the interest-based banking system. In their present form, they are not directly applicable to Islamic banking that is essentially a different way of banking. Basel-compatible or Basel-compliant arrangements need to be worked out and got recognized at the appropriate level. Additional considerations for keeping Islamic banks as banks, checks against misuse of Islamic financial instruments, the Shariah audit, etc., also call for in-depth study and formulation of appropriate regulatory and supervisory standards.

It is evident from the Annual Reports of the Shariah Councils of the Islamic banks that, in many cases, Shariah Councils were disappointed at the inordinate delay in Shariah implementation in the banking transactions or unwillingness to follow Shariah guidelines in the banks by both the owners and management of the banks. In this regard, special mention can be made for Shariah guidelines forwarded to comply with the actual buying and selling in Bai Modes. Non-implementation of this single advice of the Shariah councils leads the Islamic banks to practice Bai-Muajjal modes in a corrupted manner, which can be termed as 'Corrupted Bai-Muajjal" modes of financing.

However, some of the topical problems being faced by the Islamic banks are:

- Absence of an organized Islamic inter-bank money market
- Absence of full-fledged legal framework for Islamic banking
- Shortage of trained and efficient manpower committed to Islamic banking
- Lack of co-ordination and co-operation among the Islamic banks

- Lack of Shariah-compatible regulatory and supervisory standards
- Inappropriate organization of the Shariah Councils and weak follow-up of the Shariah implementation status of the Islamic banks
- Lack of corporate governance in the Islamic banks

Concluding Remarks and Policy Options

Islamic banking system of Bangladesh, as a new paradigm of banking, has been able to establish its own presence with a continued expansion geared by increasing acceptance by the people. To continue this dynamic expansion, the first action that deserves immediate attention is the promotion of the image of Islamic banks as PLS banks. Strategies have to be carefully devised so that the image of Islamic character and solvency as a bank is simultaneously promoted. The following policy actions are suggested for immediate application:

a) Pilot schemes in some selected areas should be started to test innovative ideas with profit-loss-sharing modes of financing as major component. This type of scheme may be experimented both in urban and rural areas. This endeavor will serve as a ready reference that Islamic banks are in the process of transforming themselves as PLS banks. Side by side, they will gain experience from real situation as to the problems that might come up while implementing profit-loss-sharing modes on trial and error basis.

(b) Islamic banks should clearly demonstrate by their actions that their banking practices are not guided merely by profitability criterion. They must also establish that their practices ensure efficient allocation of resources and provide true market signals through PLS modes.

(c) Islamic banks should continuously monitor and disseminate through various means the impact of their operations on the distribution of income primarily between the bank and the other two parties: the depositors and the entrepreneurs, and then on different income groups of the society. These presuppose the establishment of a fully equipped research academy in each Islamic bank.

(d) As the Islamic banks have to promote their distributional efficiency from all dimensions together with profitability, Islamic banks, step by step, have to be converted into profit-loss-sharing banks by increasing their percentage share of investment financing through PLS modes. The Islamic banks, to do that, can be selective in choosing clients for financing under PLS modes. Islamic banks should immediately take measures to revert the trends of resource transfer from both low-income groups to high-income groups and from rural to urban areas. This is extremely important from the viewpoint of their banking philosophy as well as for their tacit commitment for distributional equity. The Islamic banks should also actively consider utilization of rural potentials from both efficiency and equity grounds in the context of the present day socio-economic conditions of Bangladesh.

(e) The Islamic banks can improve their allocative efficiency by satisfying social welfare conditions in the following manner. First, they should allocate a reasonable portion of their investible funds to social priority sectors such as agriculture (including poultry and fishery), MSME (micro, small and medium enterprises) sector, and export-led industries like garments, shrimp cultivation etc. Secondly, when the percentage shares of allocation of investible funds are determined among the sectors of investment financing, profitability of projects should be the criterion for allocating investment funds. The criterion would be best satisfied if more and more projects were financed under PLS modes.

(f) It is assumed that in the face of competition with interest-based institutions, a critical initial mass of the hybrid type is necessary not only for the survival but also ensuring efficiency of the PLS in a heterogeneous environment. The recent financial innovations may be tried to suit the need of the integrated global Islamic financial markets.

(g) Islamic ethics supports a poverty-alleviation strategy that is based on the principle of promoting economic growth with productive equity. Islamic banks should act as 'Banks for Enriching the Poor' (or as Rural Poor Bank and Urban Poor Bank), because the current collateral-based system for efficiently financing business/projects kicks the poor out of participation in economic activities. Banning interest should have the illuminating effect of allowing greater access by population to finance, and hence lead to a better income distribution, the ultimate objective of the glorious Shariah.

(h) Determination of profit and loss in profit-loss sharing arrangements and treatment of costs and reserves in such accounting is a pertinent issue to be addressed with utmost importance and priority. It may be mentioned that if the Islamic financial system is to become truly liquid and efficient, it must develop more standardized and universally (or at least widely) tradable financial instruments. The development of a secondary financial market for Islamic financial products is crucial if the industry is to achieve true comparison with the conventional system. It must also work hard to develop more transparency in financial reporting and accounting. Development in the wholesale and especially inter-bank money markets will be the key to Islamic finance growing outside its current little sphere of influence, and becoming a truly robust and dynamic banking system alongside the traditional system.

Box: 1

Deposit Mobilization and Fund Utilization Techniques of the Islamic Banks

Deposit Mobilization Techniques

Al-Wadiah Current Deposit Account

Al-Wadiah implies that the bank receives fund with undertaking to refund the deposit on demand and also with authorization from the depositors to use the fund for benefit of and at the risk of the bank. Bank's Current Account Deposits are managed on this principle. Islamic banks do not pay profit on this deposit.

Mudaraba Savings Deposit Account:

Mudaraba savings account of the Islamic banks is totally different from the savings account of the interest-based banks. Mudaraba principle implies that the bank receives deposits from the depositor with the authority that the bank will have exclusive right to manage the fund and the profit resulting from such deposits will be shared between the bank and the depositor at a pre-agreed Mudaraba ratio and the loss, not resulting from the negligence of the Bank or any of its representative, will be borne by the depositors. Profit and loss sharing savings deposit accounts and various term deposits of the Islamic banks are conducted on this principle. Islamic banks in Bangladesh receive deposits in the Mudaraba account on the basis of Mudaraba contract. Generally, Mudaraba savings account is not for any specific duration. Bank receives this sort of deposit subject to investment of the money in any Shariah approved venture by applying a legitimate Islamic mode of financing. In the case of Mudaraba deposits, the depositor is the Shahib-al-Maal and the bank is the Mudarib. The ratio of profit is determined at the time of contract. The relationship between the bank and depositor is of shareholders, not of the type of debtor-creditor.

Term Mudaraba Deposit Account

Islamic banks receive term deposit for a minimum period of 3 months to 3 years on the principles of Mudaraba. Bank invests the money, earns profit, and shares it with the depositor as per predetermined Mudaraba ratio agreed upon at the time of the contract. In case of loss, depositors bear the loss in proportion to their deposits at their accounts. The Mudaraba term depositors, if they like, can again deposit their money under a new contract. No cheque book is issued against any term Mudaraba Deposits. The basic difference between the Mudaraba savings deposits account and term Mudaraba deposit account is the question of specificity of the duration and weightage followed for calculation of profit.

Special Mudaraba Deposit Accounts

When an Islamic Bank receives Mudaraba deposits for investment in some business sector, or project, the deposit is called special Mudaraba deposits. In this case, an Islamic bank, while receiving deposits, comes to an agreement with the depositors that money to be received will be invested in some specific business ventures such as fertilizer or salt business; or in some specific sectors like industrial sector, textile sector, export-import sector etc. or some specific investment sector of the bank such as real estate, ship breaking or shipping project etc. Special Mudaraba depositors will share only in the profit and loss of those particular businesses, sectors or projects for which they have deposited their money. They are neither concerned nor related to the entire profit and loss business of the bank. In Bangladesh, deposits received by the Islamic banks are generally in the form of common pool Mudaraba deposits.

Box: 1 continued

Fund Utilization Techniques

Profit Sharing Principle : Mudaraba (short term) : Profit sharing principle for Islamic business contracts is based on the Mudaraba principle in which the owner of the capital provides funds to the capital-user or entrepreneur for some business or productive activity on the condition that profits generated will be shared between them. The loss, if any, incurred in the normal process or course of business and not due to neglect or misconduct on the part of the entrepreneur is borne by the capital-owner.

Profit and Loss Sharing Principle: Musharaka (long-term): Musharaka (company or partnership contract) is a form of business organization where two or more persons contribute to the financing as well as the management of the business, in equal or unequal proportions. Profits may be divided in any (but not necessarily be equal) ratio agreed upon between the partners because the two parties may share the work of managing the business or project in any amount mutually agreed upon. All providers of capital are entitled to participate in management but are not necessarily required to do so. The losses, however, will be shared in the exact proportion of the capital invested by each party.

Output Sharing Principle: In this type of contracts, output or produce is shared between the parties in contract. Output sharing contracts are mainly of two types namely, Muzara'a and Musaqat. Muzara'a is a contract between an owner of a piece of agricultural land and a farmer for farming it in return of a percentage of its crop. In case of bank, bank provides farmers land (which is possessed by the bank itself) for cultivation on crop sharing. Musaqat is one of the variants of Muzara'a. In this case, bank provides farmers orchards, gardens or trees (which are possessed by bank) for harvesting on crop sharing.

Murabaha or Mark-Up Principle: This is a cost plus contracts in which one party wishing to purchase equipment or goods and commodities approaches the other party to purchase those items and sell to him at cost plus a declared profit. By this method of contract, a party needing finance to purchase business machinery or equipment gets the necessary finance on deferred payment basis. Farmers may also get various inputs and agricultural implements from the bank on a deferred payment basis.

Lease Based Principle or Ijara: An individual short of funds may approach another with a surplus (the other party or financier) to fund the purchase of a productive asset and renting that to him on rent-payment basis. If the title of the asset is fully transferred to the user at the end of the period, i.e., lessee becomes the owner of the asset, then it will be called Hire Purchase or Ijara wa Iqtina.

Advance Purchase Principle: (i) **Bai-Salam:** The term Bai-Salam means advance payment or forward buying. The Salam contract is the sale of a good to be delivered to the purchaser at a future date, which is set at the time of the contract. This is a trade transaction contract and not a loan contract. This type of financing is most often used when a manufacturer needs capital to manufacture a final product for the buyer. In return for paying in advance, the buyer receives a more favorable price (i.e., splits the profit margin with the manufacturer). (ii) **Bai-Istisnaa:** A contract of acquisition of goods by specification or order where the price is paid progressively in accordance with the progress of a job. An example would be for the purchase of a house to be constructed, payments are made to the developer or builder according to the stage of work completed. Istisnaa contract opens the way to a number of new possibilities of business contracts including some forms of futures contract trading of processed commodities, as it permits deferring of both ends of the contract: delivery as well as payment.

Box: 2

Salient Features of the Government Islamic Investment Bond (GIIB)

The salient features of Government Islamic Investment Bond are summed up below:

1. This Government Islamic Investment Bond will be governed by the glorious Islamic Shariah i.e., the Islamic Bond will be governed on the principles of Mudaraba.
2. The GIIBs mean the documents of definite value issued in the name of their owners against funds they pay to the issuer or Bangladesh Bank.
3. Profit Sharing Ratios (PSR) relating to the Bond may be determined separately for each deal. Bangladesh Bank will act as Mudarib.
4. Under the Rules, any individual, private or public companies, Islamic banks and financial institutions may purchase the bond. Any non-resident Bangladeshi may also invest in the bond through his/her NFCD account maintained with any bank in Bangladesh.
5. The minimum amount of investment may be Taka 1,00,000.00 (one hundred thousand) or multiples thereof and the rates of return to be given to the Investors are as follows:
 - For the period of investment of six months: PSR is 80:20 in which 80 % profit will be given to the bond holders and 20% will be retained by the Bangladesh Bank.
 - For the period of investment of one year: PSR is 90:10 in which 90 % profit will be given to the bond holders and 10% will be retained by the Bangladesh Bank.
 - For the period of investment of two years: PSR is 95:05 in which 95 % profit will be given to the bond holders and 5% will be retained by the Bangladesh Bank.
6. GIIBs may be used as collateral for availing loan or investment from any financial institution. In this case, bond must be recorded in the Subsidiary General Ledger (SGL).
7. GIIBs are qualified securities for the purpose of complying with the liquid assets requirement to be maintained by the banks and non-bank financial institutions. With regard to this, the Bangladesh Bank may provide the discount window facility for banks and financial institutions to buy or sell GIIB with Bangladesh Bank.
8. There is a provision in the Rules that the bond holders will get interim profit on the maturity date of the bond. This interim profit will be adjusted after finalization of the investment accounts. The interim provision of profit is based on the received monthly profit realized on the invested funds in the Islamic banks or financial institutions (as per Clause No. 7-b of the Rules). The interim profit rates will be given as follows:
 - For 6-month GIIB: 2% less from realized average rate of profit generated through financing of the Islamic investment bond proceeds.
 - For 1-year GIIB: 1.5% less from realized average rate of profit generated through financing of the Islamic investment bond proceeds.
 - For 2-year GIIB: 1% less from realized average rate of profit generated through financing of the Islamic investment bond proceeds.
9. Determination of Return to the Bond: The trading of the GIIB will be based on the interim profit rate derived from the investments of those with the Islamic banks. The interim profit rate will be reviewed on a monthly basis.
10. The Formula for Calculation of the Profit on GIIB: The formula for calculation of the profit element to be paid to the bond investors is as follows :

$$\pi = \frac{prt(k)}{Y}$$

- where:
- π = Profit payable to the bond investor ;
 - P = Principal investment to the GIIB ;
 - r = Rate of Received monthly profit (in % per annum) from the investment of bond proceeds for 6 months bonds ;
 - t = bond period (number of days invested)
 - K = Profit sharing ratio to be applied to the Bond investor,
 - Y = 365 days.

Annexure-1

Achievement of Islami Bank Bangladesh Limited

In Million Taka

Year	1983	1985	1990	1995	2000	2004
Deposits	144.15	1563.85	4462.7	12669.33	32112.81	87841.01
Investments	28.21	890.31	3193.23	11511.74	27437.33	75858.56
Manpower	127	539	845	1350	2685	4261
Branches	3	13	49	90	116	151

