

A DISSERTATION

ON

Money Laundering and it's necessity in economy to maintain
production, employment & growth for creating social development &
welfare.

SUBMITTED TO

The University of Dhaka
For M. Phil Degree

SUBMITTED BY

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গ্রন্থাগার



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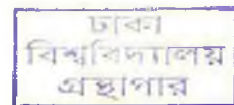
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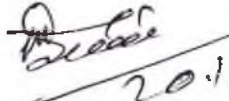
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*Islamic banking and it's superiority in economy to maximize production, employment & growth for
ensuring social development & welfare.*

In the name of Allah, the most Merciful, the most Beneficent.

DECLARATION

I hereby declare that the dissertation on “Islamic banking and it’s superiority in economy to maximize production, employment & growth for ensuring social development & welfare” is my own work except where otherwise indicated.


20.12.09

(Md. Sharif Uddin Pramanik)

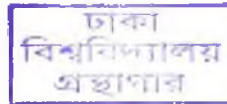
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CERTIFICATION

This is to certify that the thesis on “Islamic banking and it’s superiority in economy to maximize production, employment & growth for ensuring social development & welfare” for the award of the Master of Philosophy (M. Phil) in Banking to the University of Dhaka is a record of bonafide research carried out by Md. Sharif Uddin Pramanik under my supervision.

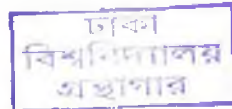
I have gone through the draft and final version of the thesis thoroughly and found it quite ok. I recommend it for evaluation.


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In the name of Allah, the most Merciful, the most Beneficent.

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I am also grateful to Professor M. Muzahidul Islam, Chairman, Department of Banking for his cordial advice.

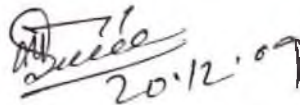
I am grateful to Shah Abdul Hannan, Ex-Chairman, Board of Directors, Islami Bank Bangladesh Limited as I was first time encouraged from his speech delivered in Executive Development Program (EDP) at Mohammad Younus Auditorium of the Bank where he drew special attention of the executives specially, who has madrasah background then economics or commerce for study and research on different aspects of Islamic economics and banking under any University for recognition as that was highly demand of the time to established the superiority of Islamic economic and banking before the world.

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GLOSSAY OF TERMS

M. Phil: Master of Philosophy
IBBL: Islami Bank Bangladesh Limited
NBL: National Bank Limited
OIC: Organization of Islamic Conference
AD: Authorized Dealer
IBTRA: Islami Bank Training and Research Academy
IERB: Islamic Economic Research Bureau
IDB: Islamic Development Bank
FRM: Fixed Return Mechanism
VRM: Variable Return Mechanism
CRR: Cash Reserve Ratio
SLR: Statutory Liquidity Reserve
CD: Current Deposit
FDR: Fixed Deposit Receipt
AWCA: Al-Wadia Current Account
MSA: Mudaraba Saving Account
MSND: Mudarab Special Notice Deposit
MTDR: Mudaraba term Deposit Receipt
MSS: Mudraba Special Scheme
MSB: Mudaraba Saving Bond
MHS: Mudaraba Hajj Scheme
MMS: Mudaraba Mohor Scheme
MMPDR: Mudaraba Monthly Profit paid Depoit Receipt
MPB: Mudaraba Perpetual Bond
CC: Cash Credit
OD: Over Draft
HP: Hire Purchase

HPSM: Hire Purchase under Shirkat-al-Meelk

LC: Letter of Credit

REPO: Re-Purchase Option

OBC: Out ward Bills for Collection

IBC: Inward Bills for Collection

ATM: Automated Teller Machine

DD: Demand Draft

TT: Telegraphic Transfer

RDS: Rural Development Scheme

HDS: House hold Durables Scheme

IBF: Islami Bank Foundation

RR: Rate of Return

Sm: Sollallahu alihi wa sallam

Rd: Radiallah anhu

CSR: Corporate Social Responsibility

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In the name of Allah, the Merciful, the Beneficent.

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CHAPTER-1

Background of the study

1.1. Introduction

From the ancient time, interest is being treated as an inseparable part of financial transactions, but its ill impacts are exploiting & depriving the general people in each & every ages.

In all the ages, several prominent philosophers, economists and most of the religious books including the Holy *Qur'an* agitated and excited against the interest. In spite of the fact, it was not been possible to abolish the interest in full throughout the ages. In fact, the rich and the exploiter tactfully in any means exploited the oppressed and the simplest applying interest tool.

Since formalization of financial transaction and establishment of institutional bank only the interest has been being used as the main exploiting instrument of the rich in the field of trade & commerce especially, in money trading through banking. Resultantly, the rich are becoming richer, the poor are becoming the poorest and the world economy is rushing towards unrest pushing it into serious nature of uncertainty. The calamitous depression in 1929 was the terrible instance of it. Simultaneously production, employment generation, economic growth and welfare of the society are seriously hampered due to direct impact of strong profit motive of traditional bank.

The age of Abbasids, specially, the period of caliph Al-Mamun (813 AD-833 AD) became the then up most developed state which has been being treated 'The Golden Age of Islamic Civilization' and 'The Augustan Age of Islam' in the history through following interest free Islamic economic system.

But due to long absence of Islamic state and rules, study & research of knowledge especially, on Islamic ideology & economics seriously declined among the Muslims and diversified from real concept of Islam. As a result, politics & economic affairs are being considered as the subjects beyond Islam.

The ill role of non Muslim world during the decade 60 of this century centering the issue of Israel & *Al-Aksa* re-aware the Muslim world on their own intrinsic entity, resultantly, the OIC has been formed in decade 70. With the initiative of OIC, Islamic Development Bank (IDB) charter was adopted in 1974 and accordingly formed in 1975 with a view to establish Islamic *shariah* based interest free economic system.

Under the guidance of IDB the Islamic Bank has been being established phase by phase in the member countries of OIC including Bangladesh to abolish the interest and ensure optimum production, employment and growth.

Islamic Bank has unexpectedly expanded by the short span of 30 years and unimaginingly been accepted to the people due to its interest free nature but it can not playing required roles in economy through maximization of production, employment & growth and to ensure social development & welfare due to some acute problems & obligations.

1.2. Statement of the problem

Islamic bank has been facing several genuine problems in utilizing it potencies which are stated here under:

1. Can not applying participatory modes

In Bangladesh, experience of Islamic Bank in participatory financing is not positive, though Islamic economists & scholars claim that *mudaraba* & *musharaka* are the prime & superior financing mechanism in economic development & growth. At the initial stages, IBBL introduced said modes but could not be succeeded due legal support.

2. Inadequate role in money market & capital market

Islamic Bank is merely participating in money market & capital market, but bulk of speculative transactions in both the market pushing the economy into serious uncertainty, against which Islamic banking & economic system can not presenting required mechanism & derivatives to save the economy & mankind and can not establishing superiority in both the field, rather, it can not playing required roles to meet up emergency liquidity & fund crisis of the Government, as well as each-other among the banks due to want of Islamic derivatives & mechanism.

3. Lack of comprehensive systems & guide lines to apply participatory modes under interest based economic framework

Most of corporate & large scale business concerns avail loan facilities from several banks & financial institutions at a time because, single bank or institution can not meet up their financial requirements individually due to single party exposure limit bar of each bank & financial institution. In such cases mix financing or syndicate financing is being applied where Islamic participatory modes are not allowed jointly with Interest based banks. Mentionable that around 80% of total loans & advances is being availed by the said business concerns. In this regard, no system & guide line is yet suggested to apply Islamic participatory modes in above cases under interest based economic structure.

4. Lack of instruction & guide line in currency trading & hedging

Currency trading & exchange is the most essential part of banking & economic affairs, especially, in global context. In the modern age it is very widely diversified & upgraded. In Islam, only spot transaction is allowed with some conditions i.e. the physical or constructive possession of the counter values of both currencies must be handed over before dispersing and the counter values of same currency must be of equal amount in case of coin & note exchange, but forward transaction & dealing with forward market which are occupying major part of economy are strictly prohibited in Islam along with hedging in most cases also. So, role of Islamic banking in this field is very limited. In this regard proper guide line is immensely required through good research to establish superiority of Islamic Bank.

5. Lack of legal support in favor of Islamic Bank & banking system

The Muslim states are not Islamic states except Iran. In true sense, the constitution of Muslim states as well as rules-regulations and policy of Central Bank does not match with Islamic banking & economic system. In the most countries Islamic Bank has been incorporated under existing company act & running under interest based Bank company act enacting some special laws except Iran, Pakistan, Malaysia, Philippines and Jordan where have adopted Islamic banking and financial acts, rather, Islamic Bank

had to follow IMF, World Bank & Central Bank's prescriptions. In these circumstances Islamic Bank can not extending its potencies.

6. Negative & anti flow of world economic & banking system

Now the world is being treated as global village. No state can survive alone without global trades & aids which are undertaken applying interest. Islamic Bank & Islamic state had to join in said interest based village as the least dominant player. So, there is very little scope to reveal it's superiority in anti environmental flows.

7. Islam compliance manpower

In establishment of any ism and implementation of its rules-regulation there must required concern knowledge based dedicated people specially, manpower in case of economic ism (system). But to established Islamic economic and banking system there are serious crisis of required level manpower.

1.3. Objective of the study

Since Islamic banking is less experienced banking system so, a lot of research are required to run ahead as superior based on practical experience, and on the light problems.

The specific objectives of the study

1. To find out the lacking & reasons of un-success in participatory financing at the very early stage of Islami Bank Bangladesh Ltd as participatory financing system is the key mechanism in maximizing production employment and growth.
2. To find out the way that how can Islamic Bank assist the Govt. to meet up emergency liquidity & fund crisis to keep the economy stable.
3. To find out the defectives and shortcomings of traditional banking system.
4. To suggest the mechanisms, derivatives and policy measures for improving of efficiency level through equity based participatory financing in the field of money market & capital market in view of Islam under environment of Islamic state and non-Islamic state as well.

1.4. Rationale of the Study

Since adaptation of IDB charter in 1974 and establishment of it in 1975 under OIC the Islamic Bank has unexpectedly and very rapidly been expanded only within the short span of around 30 years. Three hundreds of Islamic Banks & Islamic Financial Institutions have in the mean time been established having more than one thousand of branches in Muslims as well as in non Muslim countries including western world only within last 2 decades. But required level of study and research has not been undertaken as symmetric as expansion especially, based on practical experience and operational problems.

To present the Islamic Bank as more innovated, modernized, easier and more welfare oriented for the economy than that of conventional which has been developed and expanded all over the world as genuine response to the real needs of time through long times research & study since establishment of Bank of Barcelona in 1401 AD.

To establish Islamic Bank and Islamic banking system as the superior in the economy as well in the banking sector, a lot of research & study were required especially, in the field of equity based (profit loss sharing in finance) financing, money market, capital market, foreign trade, inter state financing and in currency exchange. So this study in the above fields in view of Islam for ensuring maximum production, employment, economic growth & social welfare has been undertaken through theoretical analysis, performance analysis followed by an empirical investigation.

To the best of the knowledge of the present researcher the subject matter has not yet been researched.

1.5. Methodology of the study

The methodology of the study in banking requires detailed process, i.e. clearly defined purpose, well identified problem, structured design, frankly revealed limitation and adequate analysis applying high ethical standard corresponding to the objective of the study. In the present study superiority of Islamic banking in economy has been established first presenting its glorious intrinsic potentialities and secondly through comparing practical performance of both the banking and

financial systems using analytical tools. The study is basically, descriptive in nature.

1.5.1. Theoretical approach-potentiality study

Theoretical approach is applied for establishing the superiority of Islamic banking in economy to maximize production, employment & growth through highlighting its intrinsic potencies & potentialities and also pointing out shortcomings and defectiveness of conventional part. Theoretical analysis has been developed in separate chapter comprising the following issues/points for establishing superiority:

1. Goal analysis.
2. Economic system analysis.
3. Interest analysis-merit-demerit and impact in economy.
4. Money creation system and money trading as commodity creates speculation and shocks the whole economy.
5. Analysis of commitment of Islamic Bank to the principles of Islamic *Shariah*.
6. Pricing mechanism analysis in collecting cost bearing deposit.
7. Pricing mechanism analysis in financing.
8. Analysis of foreign exchange mechanism specially, future and option market transaction.
9. Analysis of Bank role in money market.
10. Analysis of bank role in capital market.
11. Analysis of reward on capital.
12. Risk sharing analysis.
13. Ethical standard maintaining.

1.5.2. Practical approach-performance study

Practical approach is applied for studying comparative performance of Islamic bank and conventional bank running in Bangladesh since 2000 as most of Islamic Bank and conventional private banks in Bangladesh have been performing very effectively since then, through which superiority of any one of above two banking system is been determined.

1.5.3. Empirical analysis-analytical framework for efficiency study

The empirical part of the study has been designed from practical performance to test the findings. Only the desk study and interview methods have been followed among commonly used methods for empirical study. The desk study relies the information and statistics prepared from publications, books, journals, annual reports, bulletins, web sites etc. On the other hand, interviews have been run with the cooperation of bank executives, officials of central Bank and some of the entrepreneurs by applying particular sampling methods. In these ways, collected data has been cross-checked.

1.5.4. Types and Sources of Data

The data has been obtained from secondary sources as well as primary sources. The secondary sources include the books, journals, reports, publications, bulletins, web sites etc. and the primary data has been obtained through observation, survey and personal interview.

1.5.5. Secondary data

The data has already been formulated for the purpose other than hand out of which concerned and mere concerned to the study have been collected as secondary data which are obtained from books, journals, reports, bulletins published by national & international research institutions, central Bank, security exchange commission, ICB, sample Banks, Ministry of finance and IBTRA (Islami Bank Training & Research Academy).

Reliability, accuracy and validity of those data have been testified and evaluated applying systematic criteria and own prudence of the researcher.

1.5.6. Primary data

The data has been originated only for the purpose at hand. Opinions have been obtained from the personnel of concerned institutions, business enterprises and sample banks through observation, interview and survey. In this regard 3 sets of questionnaires have been prepared. Thus collected information has accordingly been procured, tabulated and analyzed corresponding with the objective of the study. The major features of the 3 sets of questionnaires have been furnished in another section of this chapter. Proper care has been taken to maintain authenticity of data and all precautionary measures have also been taken to minimize the errors by cross-checking at different stages.

1.5.7. Sample design

Sampling techniques have been applied in consideration with the nature of universe, sample size and confidence level which have been designed with utmost care to make the study free from extraneous variable and caution has also been taken in selection of sample Banks, respondents and study years as well.

1.5.8. Selection of sample Banks

A random sampling method has been followed in selecting sample banks branches as study has mainly been made on Islamic Banking system and side by side on modern conventional banking system in private sector. To maintain homogenous nature of 2 banks namely National Bank Limited from conventional part and Islami Bank Bangladesh Limited from Islamic banking part are chosen as sample bank, as both have been doing very well out of 5th generation private banks established in 1983 almost in same time. Though 6 private banks were established in 1983 where one IFIC were converted from the non bank financial institution. The five are namely, the city Bank Ltd., National Bank Ltd., Islami Bank Bangladesh Ltd., AB Bank Ltd. and United commercial Bank Ltd.

It is expected that the said two sample banks and their 10 homogenous branches are very much representative of the population as part of data collection from secondary sources. On the other hand, for primary data collection said two Banks

and 20 branches have been surveyed and interviewed where employees & entrepreneurs are respondents.

1.5.9. Selection of study years

The study has been covered a period of 9 years since 2000 to 2008 as the first Islamic bank and most private sector conventional banks in Bangladesh have been performing very effectively since 2000 and within these period an extraordinary and radical revolution has also been made in Islamic banking sector and as well as conventional banking sector through launching the easiest & modernized derivatives & innovations in parallel with development in IT sector. So selection of years is appropriated for the study.

1.5.10. Selection of respondents

130 numbers of respondents have been interviewed for primary data collection, where 60 officials have been selected from 20 branches (10 branches from each sample bank) taking 3 from each branch, 10 from Central Bank and 60 entrepreneurs of said 20 branches taking 3 from each branches.

1.5.11. Data Analysis & Interpretation

Several techniques have been applied in this stage, among which simple arithmetical & statistical averages, percentiles, ratio analysis and tabular presentation of data have been used. Three Hypothesis tests have been done and graphical presentation of some variables has also been applied to establish relationship among them.

1.5.12. Questionnaire Design

Three categories of questionnaire (shown at the appendices) have been designed and prepared for obtaining primary data. Name of the categories are stated here under:

1. One for sample Banks officials.
2. Second for central banks officials and;
3. Third for entrepreneurs of sample banks branches.

1.6. Plan of study

This section provides a brief description of the present study. The description is structured and planned under nine chapters which are as follows:

Chapter-1: Background of the study

This chapter is detailed with introduction, statement of problems, objectives, rationale of the study, methodology, plan of the study and limitation of the study.

Here primary discussion and purpose of thesis is described.

Chapter-2: Basic difference between Traditional and Islamic banking system

This chapter shows the introduction of both banking system, history of Islamic Bank and identifies basic difference of both banking.

Chapter-3: Review of Literature

In this chapter discussed several literatures and summarized those point wise relating the title of the thesis and purpose of the study with bibliography.

Chapter-4: Superiority analysis-Theoretical approach: Potentiality study

This chapter is discussed the potentiality of Islamic banking and identified the shortcomings of conventional banking to establish superiority of Islamic banking.

Chapter-5: Superiority analysis-Practical approach: Performance study

This chapter is detailed with performance of Islmi Bank Bangladesh Limited and National Bank Limited as sample bank for analyzing efficiency of any banking system.

Chapter-6: Empirical study-Efficiency analysis: Bangladesh perspective

This chapter is examined the surveyed data and interview result then analyzed with the practical performance of sample banks through different ratios to show the efficiency bank.

Chapter-7: Summary of the findings

This chapter finds out the results of study from theoretical analysis then surveyed data interpretation and from performance analysis then from empirical analysis.

Chapter-8: Conclusion and policy suggestion

This chapter includes the summary of the study and concluding remarks for policy suggestion which may be used for future guidelines in banking sectors specially, in Islamic banking sector.

2.16. Limitation of the study

The study examined comparative performance, efficiency, potentiality and intrinsic entity of Islamic banking system & conventional banking system as well. Several limitations and shortcomings have been faced to examine the above issues. Some of which are stated hereunder:

1. The study has been undertaken on only single country experience i.e. Bangladesh which did not represent the global context.
2. Study of basic reference books of Islamic economics as literature like, *Tafsir, Hadis, & Fiqh* have not been up to the mark as most of those are in Arabic.
3. Required level of information could not be obtained regarding Islamic money market & capital market from Central Bank, Security Exchange Commission and Investment Corporation of Bangladesh as there had no sufficient data as new area of study.
4. There was no existence of nationalized Islamic Bank in the country. So problem or prospect and experience could not be studied.
5. No nationalized conventional bank could be studied due to shortage of time and fund.
6. Instance of Islamic banking in Islamic states is only Iran. To study the experience, in this regard, for present researcher was not so easy.
7. Some important data from sample bank could not be collected as those were secret information on their eyes.
8. The researcher is a bank executive, so managing required time for the study was quite tough.

In spite of these limitations I am inclined to say that such types of limitation are almost common in data based work, rather positive result in all cases is not yet practical. However, all out possible efforts have in this regard been made in obtaining the data through cross-checking by different data collection methods including personal observation, exchange of views etc.

In conclusion, I believe that the said limitations of the study may effect a very little adverse on the findings.

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CHAPTER-2

Basic difference between Traditional and Islamic Banking

2.1. Introduction

To identify the basic difference between traditional and Islamic banking a brief discussion on definition, history, goal, objective and function is required.

2.2. Definition of Bank

Bank is a financial institution that collects society's surplus cash and gives a part of that as loan to investors for earning profit. So, Bank is an intermediary institution that makes relationship between the owner of surplus savings and the investor of deficit capital (Khan 2008).¹

A bank is an institution whose debts are widely accepted in settlement of other people's debts (Prof. R.S. Sayers).²

Bank is an institution, the principal function of which to collect the unutilized money of the people and to lend it to others (R P Kent).³

The activities of banks are changing with the change of time. It is logical that banking activities will change with the change of culture, time and perception of people in a country. So, it is really difficult task to give the valid & precise definition that fits in all times and all situations (Khan).⁴

2.3. Goal and objective of bank and banking system

Objective of Bank may be derived from definition of Bank and Banking which are as follows:

1. To earn profit as 'Bank is a business organization. Like all other business institutions, bank's major objective is also to earn profit' (Khan).⁵
2. To safe keep the money and valuables.
3. To render different services to the people specially, financial services and non-financial to some extents.
4. To meet up financial requirements of the people and of the state as well.

5. To foster economic development of the country and of the world to further extent as Development banks specially work for the development of the country, specific region or for the world by undertaking construction and infrastructural works, rehabilitation programs, educational development programs etc.

2.4. Concept of banking System

The term 'Banking' is a system to perform all the activities of bank. In the prevailing world, commercial banking systems are more or less similar in principle. The dissimilarities exist in the scope of commercial banking activities in different countries. Communist country's commercial banking systems are completely different. Capitalist country's systems differ in respect of the free market economic banking activities. On the other hand banking system is classified in two on religious view point which are as follows:

2.4.1. Traditional banking system

The traditional banking are run by the procedure and laws made by human being. The bank does not bear the responsibility of profit/loss of the customer. The main objective of such banking is to improve the fate of a few classes of people, no scope for human welfare; all activities of which are operated with interest. The relation between banker and the customer is nothing but debtor and creditor (Raquib 2007).⁶

2.4.2. Islamic banking system

During 2nd half of the 20th century a new system of banking named Islamic Banking system emerged and shook up the world community specially the economists to think afresh for the mankind. Most of the Muslim countries and some non Muslim countries are practicing Islamic banking system along with or competing with conventional banking system except Iran, where entire economy and banking system transformed from conventional to Islamic one.

2.5. Definition of Islamic Bank

Islami Bank is a financial institution whose statutes, rules and procedures expressly state its commitment to the principles of Islamic *shariah* and to the banning of the receipt and payment of interest on any of its operations (OIC 1978).⁷

Islamic Banking is a banking system that is based on the principle of Islamic law (also known as *shariah*) and guided by Islamic economics. Two basic principles behind Islamic banking are the sharing the profit & loss and significantly, the prohibition of collection & payment of interest. Collecting interest is not permitted in Islamic law (Rezanur Rahman).⁸

Islamic banking is described as a system of financial intermediation that avoids receipt and payment of interest in its transactions and conducts its operations in accordance with the objectives of an Islamic economy. Islamic banking is based on the Islamic legal concepts of *shirkah* (partnership) and *mudarabah* (profit sharing) (IERB 2003).⁹

2.6. Goal and objectives of Islamic bank and banking system

The Islamic banking is an integral part of Islamic economic system and Islamic way of life as the Holy *Qur'an* has condemned and banned *riba* (interest) declaring war on behalf of Allah and His Messenger/ Prophet (*sm*) against the interest mongers. Goal of Islamic banking is to establish the tenets of Islamic *shariah* for wellbeing (*falah*) of all human beings by offering contemporary financial services in conformity with *shariah*, by contributing towards development and poverty alleviation undertaking financial activities which are officially and socially desirable and profitable and lastly to serve *ummat-al-Islam* and other nations having Muslim population.¹⁰

According to Islamic economics research bureau there are four primary objectives of Islamic banking which are as follows:

1. Islamic banks are expected to provide contemporary financial services in accordance with the law set forth in the *shariah*.
2. Islamic banks strive to be more development oriented as the profit sharing nature of the Islamic banking system establishes a direct relationship between the bank's return and the investment.
3. Since all business investment must be for the public good, Islamic banks are expected to allocate financing to those projects that will benefit society the most and;
4. Islamic banks strive to ensure equitable distribution of income and resources to all the parties to the transaction (IERB 2003).¹¹

2.7. History of Islamic Bank with latest evolution

The concept of Islamic financial system i.e. Islamic banking system is not new one, at the very early of Islam the prophet (*sm*) maintained business with Kadiza (*ra*) under Islamic financial system, latter on *baitul-maal* played role of Islamic bank in very limited scopes that is to pay interest-free *quard-e-hasana* to the needy since *Khilafath-e-Rasheda* up to age of Abbasids, though the pious Muslims maintained their financial transactions following Islamic modes like *mudaraba*, *musharaka*, *ijara*, *bai-muajjal*, *bai-murabaha*, *bai-salam*, *bai-istisna* etc in individual and private initiative. But the history of present styled Islamic bank is product of just second half of the 20th century.

In the decade of 1950s, the concept of Islamic banking was a matter of thinking and research and the result was preserved in the papers of different scholars of the Muslim world. The 1960s was the decade of practical experiment and 1970s was the decade for establishment. The decade of 1980s was the decade of success and expansion at a faster rate.¹²

The first attempt

The first attempt to establish an Islamic financial institution took place in Pakistan in the late 1950s with the establishment of local Islamic Bank in a rural area (**IARB, 2003**).¹³ The experiment was initiated by some pious landlords who deposited funds at no interest, which were then loaned to small land owners for agricultural development. The borrower did not pay interest on the credit advanced, but a small charge was levied to cover the bank's operational expenses. The charge was far lower than the rate of interest. Although the experience was encouraging, two main factors were responsible for its failure. First, the depositors-landlords regarded the deposits as a one-time event with the increasing number of borrowers the gap between available capital and credit demanded was huge. Secondly, the bank staff did not have complete autonomy over the bank's operation; depositors showed considerable interest in the way their money was lent out.¹⁴

The second attempt

The second pioneering experiment of putting the principles of Islamic banking and finance into practiced was conducted in Egypt from 1963 to 1967 through the

establishment of the Mit Ghamr saving Bank by Dr. Ahmed-al-Naggar by his personal endeavor with a view to bring some development in socio-economic field in a rural area of the Nile Delta. The experiment combined the idea of German savings banks with the principles of rural banking within the general framework of Islamic values.¹⁵ The banking operation was based on the same Islamic principles of no-interest to depositors or from the borrowers. Unlike the Pakistani bank the borrower had to have deposits in the bank in order to request a loan. The experiment soon become successful; more branches were opened in different parts of the country, and the amounts of deposits increased. Hence, what started as a single bank operation expanded to form network of local savings banks. Although the project made a good start and initial results were more than encouraging it suffered a setback owing to changes in the political atmosphere.¹⁶ The present Islamic bankers of the world have treated the short life of Mitghamr Bank as the first model of Islamic banking. A survey report by the National Institute for Management Development, Cairo, Egypt shows that the Mitghamr Bank was tremendously successful in achieving its objectives. In addition, the tremendous success of the bank was the cause of its closure by the vested interest in 1967 (Raquib, 2007),¹⁷ nevertheless, the project was revived in 1971 under the name of Nasser Social Bank. This was the first Islamic bank in an urban setting based in Cairo. The bank is a public authority with an autonomous status. Its purpose is mainly to promote social concerns such as granting of interest-free loans for small projects on a profit- loss- sharing basis, and assistance to the poor and needy students for university and higher education. Because of these social functions, Nasser Social Bank was granted an exemption from the banking and credit law of 1957 in its initial stages. The bank was originated under the ministry of treasury but it is now functioning under the ministry of social welfare and insurance. Its capital comes from the funds allocated by the president from extra budgetary resources, appropriation from the state budget, and contribution from the ministry of *Awqaf* (IERB, 2003).¹⁸ The principles of operation of the Nasser Social Bank are very similar to those of the Mit Ghamr Savings Bank. However, the latter offers a full range of normal banking services and a wide range of investment activities through equity participation.¹⁹

Islamic banking, with a very different approach contemporary to that in Egypt, emerged in Malaysia. It was a financial institution developed for the Pilgrims of Malaysia. These institutions were established in response to what was the contention of the Malaysian Muslims that money spent on pilgrimage must be clean and untainted with '*riba*'. Since this was not possible by depositing money with the ordinary banks, a special financial institution had to be created. Consequently, Pilgrims Saving Corporation was established in 1963 which was later incorporated in to the Pilgrims Management Fund Boar (Tabung Haji) in 1969.²⁰

2.8. Main functions of Islamic Bank

Islamic bank is engaged in all other forms of traditional banking functions and provides contemporary financial services but in distinct manners as it has several distinguishing factors like interest free nature and commitment to socio-economic justice.

To consider the above factors Islamic Bank has to perform some extra ordinary functions and has to play special roles for the welfare of mankind and of economy as well in addition to the common functions of banking performed in distinct manners with the guide lines of Islamic economics to establish the objectives of Islamic *shariah*.

1. Intermediation

The task performed by the banks to recycle money from savers to investors is called financial intermediation. It is primary function of the bank Intermediation is mainly two types in nature, one is collecting funds i.e. fund mobilization and another is deploying funds i.e. financing, details of which are a follows:

a. Fund mobilization function-Collecting fund-: Islamic Bank collects funds from three main sources such as capital, deposit and borrowing.

i. Capital building

Islamic Bank collects perpetual and long-term funds by issuing perpetual and long-term securities like shares and bonds. Unclaimed dividend and undistributed profit form bank's fund also. Sales of unnecessary and unusable assets increase the capital. In case of issuing shares Islamic bank pays

dividend and pays profit on *mudaraba* basis with predetermined part of dividend in case of issuing bonds.

ii. Deposit collection

One of the main functions is collecting surplus savings. Mainly bank collects two types of deposits which are as follows:

***Al-wadiah* current deposit-deposit without profit**

Bank offers to the surplus money/saving holders specially, to the business holders or business concerns for depositing their money in bank on the condition that they will not be allowed any sorts of profit. Here bank is committed to allow withdrawal of the fund partly or fully without any restriction within banking hour and depositors give consent the bank to deploy the fund. Bank preserves the funds with assurance of returning on demand. The depositors also feel safe keeping of their funds. Such type of deposit is called demand deposit, current deposit or call deposit. It is cost free or almost zero cost deposit for the bank.

***Mudaraba* deposit-cost bearing deposit**

Islamic banks collect cost bearing deposits on *mudaraba* mechanism i.e. profit to be distributed as per predetermined agreed ratio and loss to be borne by the depositors. As per *shariah* '*mudaraba*' mechanism is defined and explained as- "in a business one part will provide/deploy fund and another part deploy labor and intellect. Here 1st part is called '*Sahib-al-maal*' (owner of the capital) and 2nd part is called '*mudareeb*' (entrepreneur). Here interference of *Sahib-al-maal* in business is not allowed but negligence of *mudareeb* is accountable. If any profit is earned from the business then it will be distributed as per predetermined agreed ratio and if incurred any loss then it will be borne by *Sahib-al-maal* only, here *mudareeb* loses the benefit against his labor brain storming. It may be further explained that depositors will get part of profit as reward earned by bank from investment of deposit funds as per predetermined agreed ratio. If incurred loss on investment of deposit fund then depositors will not get any reward even deposited money will be reduced by loss amount.

Presently Islami Bank Bangladesh Limited is maintaining predetermined agreed ratio of profit is at least 65% for depositors and at best 35% for bank.

It may be mentioned that Islamic banking business is joint venture with *mudaraba* depositors that means deposit is not debt to the Islamic bank like conventional one. It will treat as equity in Islamic economic frame work. Rather depositors are partners of bank business specially, in deployment/ investment of deposit fund. Actually it is profit-loss sharing system. Since the deposit fund is the blood of banking business i.e. around 90% funds are deposit fund so to share in profit and loss by depositors as key partners is quite justified.

Islamic Banks maintain several *mudaraba* deposit accounts for collecting funds where some schemes are only on social welfare and religious view point. *Mudaraba* accounts are as follows:

MSA-*mudaraba* savings account: Withdrawal allowed chequable deposit for individual non business concerns.

MSND-*mudaraba* special notice deposit: It is also withdrawal allowed chequable deposit but for business concerns.

MSS-*mudaraba* special scheme: Monthly installment deposit for 5 and 10 years term.

MSB-*mudaraba* savings bond: Term deposit for 5 and 10 years.

MTDR-*mudaraba* term deposit receipt: It is for the terms of 3 , 6, 12, 24 and 36 months with any denominations.

MMPDS-*mudaraba* monthly profit paid deposit scheme: For 3 and 5 years denominating to Tk.100,000/- and multiplied. Banks pay provisional profit on monthly basis which is finalized on yearly account finalization.

MHS-*mudaraba* Hajj scheme: It is monthly deposit account with any denominations for the term expected by the depositor to enable the Holy Hajj for betterment in the here after.

MMS-*mudaraba* mohor scheme: It is also monthly deposit account with any denominations for the term expected by the depositor to relieve obligation of husband for ensuring payment wife right.

MCWDS-*mudaraba* cash *waqf* deposit scheme: It is perpetual deposit denominating to Tk.50,000/- and multiplied to encourage the *Awqaf* system of Islam for the well being of the mankind.

iii. Borrowing

Islamic Banks collect short term funds to meet up liquidity from other Islamic Banks and financial institution by selling of short-term *mudaraba* bonds as Islamic Money Market components. They also borrow from Central Bank without interest on emergency basis for which Islamic Banks had to maintain cost free SLR and CRR with Central Bank. Islamic Bank can not participate on REPO and reverse REPO to meet up short term requirement of liquidity as those are interest based.

b. Financing function-Deploying fund

Islamic Banks use their funds mainly for investment details of which are as follows:

i. Investment to the clients

Most of the funds are deployed in investment to the client specially, to the business concerns mainly under 3 mechanisms which are as follows:

***Shirkat* mechanism (Partnership)- *Mushraka* and *mudaraba*.**

Ijarah* mechanism (leasing on rental basis, near to term financing)-Hire purchase under *shirkatul meelk

***Bai*-mechanism (Buying and selling)-*Bai-muajjal*, *bai-murabaha*, *bai-salam*, *bai-istisna* etc.**

Musharaka

It is joint venture business mechanism among two or several parties where each party provides fund at any ratio and joins the management of business. Here profit will be distributed on predetermined agreed upon ratio and loss if incurred, will be distributed as per capital ratio which will be calculated after certain period.

Under this mode of finance Islamic Bank participates in the business of entrepreneur like joint venture business where both bank and entrepreneur will provide fund at any ratio. Here Bank can participate in the management of the

business though Central Bank in conventional economy does not allow participation in management of client's business.

As per terms of *musharaka* mode profit will be distributed on predetermined agreed upon ratio and loss if incurred, will be distributed as per capital ratio which will be calculated after certain period (as per agreement). Practically it is profit-loss sharing mechanism where both the bank and entrepreneur shared in the outcome of business.

Mudaraba

Just like cost bearing deposit collection mechanism. There depositor is '*Sahib-al-maal*' (owner of the capital) and Islamic Bank is '*mudareeb*' (entrepreneur) but in financing mechanism Islamic Bank is '*sahib-al-maal*' and client is '*mudareeb*'.

Entire funds of entrepreneur business will be provided by the Bank only i.e. no fund will be provided by the entrepreneur. Here interference of Bank (*sahib-al-maal*) in business is not allowed but negligence of client/entrepreneur (*mudareeb*) is accountable. If any profit is earned from the business then it will be distributed as per predetermined agreed ratio and if incurred any loss then it will be borne by Bank (*sahib-al-maal*) only, here client (*mudareeb*) loses the benefit against his labor and brain storming. The profit and loss will be calculated after certain period. It may be explained that the Bank will get part of profit as reward earned by the client from investment of bank funds as per predetermined agreed ratio. If incurred loss on investment of bank funds then Bank will not get any reward even invested money will be reduced by loss amount.

Actually it is profit-loss sharing system. Since the fund is the blood of business and entire funds are provided by bank so to share in profit and loss by Bank as key partner is quite justified.

Hire purchase under *shirkat-al-meelk* (HPSM):

It is term financing mechanism against fixed and serviceable assets like land, building, cart, machineries etc. first Islamic Bank purchase the asset then it lease out to the client for specific period with the conditioned that client will pay rent on installment basis and purchase the asset at the end of the lease

period on agreed upon price or on installment basis. Here rent is to be calculated on per predetermined rate of return (on **FRM**) on the unpaid price of the asset. This mechanism is near like Hire purchase of conventional banking. Here difference is only in ownership of the asset. In hire purchase ownership is retained by Bank up to adjustment of liability or by the client but in case of HPSM ownership is retained jointly (Central Bank does not allow joint ownership where registration is required) where bank part will reduce and client part will increase with payment of price on installment basis that is ownership of the leased asset will shift from Bank to client gradually. Merit here is that if any accident or damage occurred then loss to be borne jointly as per proportionate ownership that means risk is shared jointly whereas in case of Hire purchase risk is borne by bank or by client.

Bai-mechanism (bai-muajjal, bai-murabaha, bai-salam & bai-istisna):

Bai-mechanism is buying and selling of goods which include credit and advance sales. ***Bai-murabaha & bai-muajjal*** are credit selling and ***bai-salam & bai-istisna*** are advance selling. Goods may be purchased or own produced. Actually bai-mechanism is applicable for shopkeepers, business concerns and individuals. But Islamic scholars allowed it to practice in banking.

In case of ***bai-murabaha*** and ***bai-muajjal*** Bank first buy the trading or consumption goods as per specification of the client then sale out it to the said client on credit at agreed upon price with the condition that the sale price is to be paid within specific period. Difference between sale price and purchase price is the profit for Bank. Here declaring cost or purchase price of goods to the client is not obligatory for the bank in case of ***bai-muajjal*** but it is obligatory in case of ***bai-murabaha***. Payment may be made at a time or on installment.

In case of ***bai-salam*** and ***bai-istisna*** Bank first pays the agreed price to the client as advance to purchase the specified goods with the condition that goods are must be delivered as per specification within specific period. Here Bank get the goods on lesser price since payment is made on advance and in the mean time Bank can sell out those other wise on better price. Difference between sale price and purchase price is the profit for Bank.

This mechanism is direct backed by assets. So fund diversion and use it in unproductive purpose is quite tough. Even here money is transformed to goods then to money again which control the speculation.

Some social welfare investment schemes

Beyond business motive Islamic banks maintain its social responsibilities by some social welfare investment schemes which are as follows:

Rural Development Scheme (RDS)-for reduction of rural-urban disparity, equitable distribution of income and economic uplifting of the rural people Islamic Bank introduced this micro finance scheme for the poor to alleviate the poverty with the perspective Action Plan to reach the landless people with the scheme covering all the villages within the year, 2010. It is supervisory investment where range is Tk.5,000/- to Tk.200,000/-with ignoring profit motive i.e. at lowest R.R.

House hold durables scheme (HDS)-Bank sells house hold items or commodities like TV, refrigerator, motor cycle, furniture etc on monthly installment basis for low income generating people, specially, service holders who are unable to purchase such items on cash.

ii. Investment to share and securities

Islamic Banks invest their funds in Islamic securities. It is less risky than any and easier to convert into cash. Investment may be short, medium and long term. They also operate different business activities. They can buy any portion of shares of corporate firms and can participate in the ownership of the firm and in determining financial & investment policy.

2. Liquidity function

Bank uses funds in cash and near cash form to maintain bank's liquidity for meeting up day to day needs like payment of cheques, encashment of instruments, expending of capital and revenue expenses etc. liquidity means the capacity to produce cash on demand. It is necessary for a banker to keep a certain percentage of the deposits in the form of liquid cash as reserve, either in his own vault or with the central bank. Such liquid cash does not earn anything and remain idle. So, a banker invests his excess money in such assets which are liquid

in nature and at the same time earn an income but can be turned into cash quickly.

3. Bill discounting

Islamic bank avoids bill discounting as it is mainly interest based.

4. Money creating function

Islamic Banks create money by issuing like payment order, draft etc against investment, issuing LC, Bank guarantee etc and making different natures of deposits.

5. Money market function

Islamic Banks collect short term funds to meet up liquidity from other Islamic Banks and financial institutions by selling of short-term *mudaraba* bonds as Islamic money market components. They also can borrow from Central Bank without interest on emergency basis which may on *mudaraba* basis. They can not participate on REPO and reverse REPO to meet up short term requirement of liquidity as those are interest based and to facilitate liquidity management of the government. Islamic scholars studying for money market instruments which may better devices to control demand and supply of money.

However some money market instruments are introduced in different Muslim countries, such as Islamic bonds in Bangladesh, PTC-participation term certificate & MC-*mudaraba* certificate in Pakistan, *muqarada* certificate & *mudaraba* bonds in Jordan, GIC-government investment certificate in Malaysia, Egypt and Yemen, and IDC-Islamic deposit certificate and IIC-Islamic investment certificate are under process as proposed by IDB.

6. Capital Market function-merchant banking

Islamic Banks do not practice merchant banking function actively till now as most conventional capital market transactions are act speculation and gambling. Islam and Islamic Bank discourage all types of speculations and strictly prohibit the gambling. Islamic scholars are gradually introducing speculation and gambling free derivatives which are playing effective role in raising capital with restrictive transaction. MPB-*mudaraba* perpetual bonds in Bangladesh, is one of them. IBP certificate (Islamic bank's portfolio certificate for investment and development) and unit investment fund of IDB are great initiatives in this field.

7. Foreign business function

Islamic Banks play important roles in foreign trade and business. Export, import, foreign remittance, buying-selling and exchange of foreign currency and issuing traveler cheque are the main functions in this field. Advising, add confirming, payment, collection, negotiation of documents, endorsement on documents, dealing room operation in spot trading of currencies only and issuing credit report of the client are supplementary functions there.

8. Factoring function

Now a day, factoring is being treated as an improved version of financial intermediation and has already become an important tool for financial intermediation, specially, in western world. Islamic banks are not involve till now in factoring as most of factoring functions are interest based i.e. debt purchasing, invoice discounting etc though collection of others receivables and recovery of debts of other banks on commission may be interest free and may be practiced in future.

9. Social welfare programs/functions

To uplift the weaker section of the society Islamic bank has introduced many social welfare programs under Islamic Bank Foundation, a sister concern of the bank on the view of corporate social responsibilities (CSR) and social welfare commitment of Islam and Islamic bank like hospital, school, college, *madrasah*, university, scholarship, relief, donation etc.

2.9. Basic difference between traditional and Islamic Banking

Basic differences are identified on following points:

1. Difference in Goal and objective

Goal and objective of traditional banking is welfare oriented but profit motive is preferred that is has to earn profit by any means so, welfare of human being be treated negligible and welfare in the world here after is absolutely ignored. On the other hand, the goal and objective of Islamic banking system is to establish socio-economic justice and to reduce imbalance in this world and final well-being in the **World Here After** which is the goal of Islamic economic system in the light of the goal of Islam and Islamic *shariah*.

2. Difference in using interest as earning tool in operation

Beyond service function entire activities of traditional banking system are predetermined interest based, as counter interest is fully banned in any of operation of Islamic banking.

3. Difference in pricing mechanism in collecting cost bearing deposit

Conventional Banks collect cost bearing deposits on predetermined interest rate. They pay interest to the depositors on pre-declared interest rate whether profit is earned by bank or lost. The bankers attract the deposits declaring relatively higher rate of interest applying professional qualities. Changing in earning profit deploying deposit funds is not considerable to ascertain the interest rate on deposit i.e. if more profit earned by bank the depositors do not get further amount beyond predetermined rate and if lesser profit earned by the bank or incurred loss in any adverse situations then they could not pay less amount than pre-declared rate. It is fixed return mechanism (FRM) of conventional banking system in collecting deposit. Changing the rate acts as the tool for attracting deposits. In most countries, government or regulatory authority of money market fixes the rate to a certain range which might be changed time to time to control the economic indicators, very specially, inflation, saving, investment etc. It makes the economy unstable and hampers the saving decisions.

On the hand, in case of Islamic banks, they collect cost bearing deposits on *mudaraba* mechanism i.e. profit to be distributed as per predetermined agreed ratio and loss to be borne by the depositors. As per *shariah* '*mudaraba*' mechanism is defined and explained as- "in a business one part will provide/deploy fund and another part deploy labor and intellect. Here 1st part is called '*sahib-al-maal*' (owner of the capital) and 2nd part is called '*mudareeb*' (entrepreneur). Here interference of *sahib-al-maal* in business is not allowed but negligence of *mudareeb* is accountable. If any profit is earned from the business then it will be distributed as per predetermined agreed ratio and if incurred any loss then it will be borne by *sahib-al-maal* only, here *mudareeb* loses the benefit against his labor and brain storming. It may be explained that depositors will get part of profit as reward earned by bank from investment of deposit funds as per predetermined agreed ratio. If incurred loss on investment of deposit fund then

depositors will not get any reward even deposited money will be reduced by loss amount. It is variable return mechanism (**VRM**) of Islamic banking system in collecting deposit, it varied on investment/financing performance of Islamic bank. So customers will run to the best investment performer bank, resultantly, competition in best investment sector will automatically increase which fuel the economic cycle. Here controlling of the interest rate by regulatory authority is not require as diversification of investment will be made on equilibrium point of savings and best investment sectors.

However in conventional economic and banking frame work Islamic bank had to treat the deposit as debt and had to maintained loss compensating reserve to maintain competitive RR.

4. Difference in pricing mechanism in financing fund by bank

Conventional banks deploy their funds on predetermined interest rate basis. The bankers attract the clients declaring relatively lower rate of interest within the range with providing quality services. Changing the earnings/return of the client from utilization of loan or performance of business is not considerable to ascertain the interest rate on loan i.e. if more profit/return earned by the client banks do not get further amount beyond predetermined rate and if lesser profit earned or incurred loss in any adverse situations then the banks do not take less amount than pre-declared rate. It is injustice for the client. All the finance mechanisms are on fixed return mechanism (**FRM**) as rate of return is predetermined. Change of the rate of interest acts as the tool for attracting investments. The government or regulatory authority of money market fixes the interest rate applying pricing mechanism to a certain range which changes time to time to control the economic indicators. It makes the economy unstable and hampers the investment decisions. It is also asserted that regulatory authority had to change the interest rate on borrowing several times in a year.

On the other hand, in case of Islamic Banks, they deploy/invest their fund mainly on 3 mechanisms:

1. **Shirkat** mechanism (Partnership)- *mushraka* and *mudaraba*

2. *Ijarah* mechanism (leasing on rental basis, near to term financing)-hire purchase under *shirkat-al- meelk*
3. *Bai*-mechanism (buying and selling)-*bai-muajjal, bai-murabaha, bai-salam, bai-istisna* etc.

Musharaka: It is joint venture business mechanism among two or several parties where each party provides fund at any ratio and joins the management of business. Here profit will be distributed on predetermined agreed upon ratio and loss if incurred, will be distributed as per capital ratio which will be calculated after certain period.

Under this mode of finance Islamic Bank participates in the business of entrepreneur like joint venture business where both bank and entrepreneur will provide fund at any ratio. Here Bank can participate in the management of the business though Central Bank in conventional economy does not allow participation in management of client's business.

As per terms of *musharaka* mode profit will be distributed on predetermined agreed upon ratio and loss if incurred, will be distributed as per capital ratio which will be calculate after certain period (as per agreement). Practically it is profit-loss sharing mechanism where both the bank and entrepreneur shared in the outcome of business.

It is clear that return of both the Bank and entrepreneur from invested fund is not on predetermined fixed return mechanism (**FRM**). Rather it is on variable return mechanism (**VRM**) which will be determined on outcome of business after certain period that means it varied on performance of business. So Bank will run to the best business sector so investment will be maximized as investment is inversely related to predetermine interest rate. Resultantly, competition in best business sector will automatically increase which fuel the economic cycle and economy will be debt free as *musharaka* fund is not debt to the client.

Mudaraba: Just like cost bearing deposit collection mechanism. There depositor is '*sahib-al- maal*' (owner of the capital) and Islamic Bank is '*mudareeb*'

entrepreneur) but in financing mechanism Islamic Bank is '*sahib-al-maal*' and client is '*mudareeb*'.

Entire funds of entrepreneur business will be provided by the Bank only i.e. no fund will be provided by the entrepreneur. Here interference of Bank (*sahib-al-maal*) in business is not allowed but negligence of client/entrepreneur (*mudareeb*) is accountable. If any profit is earned from the business then it will be distributed as per predetermined agreed ratio and if incurred any loss then it will be borne by Bank (*sahib-al-maal*) only, here client (*mudareeb*) loses the benefit against his labor and brain storming. The profit and loss will be calculated after certain period. It may be explained that the Bank will get part of profit as reward earned by the client from investment of bank funds as per predetermined agreed ratio. If incurred loss on investment of bank funds then Bank will not get any reward even invested money will be reduced by loss amount. It is also variable return mechanism (VRM) of Islamic banking system in financing funds that means it varied on investment/financing performance of entrepreneur. So Bank will run to the best business sector, resultantly, competition in best business sector will automatically increase which fuel the economic cycle. Economy will be debt free as *mudaraba* fund is not debt to the client. However, business of the entrepreneur is joint venture with Islamic Bank where Bank will provide entire fund and entrepreneur will maintain the business without own fund. Actually it is profit-loss sharing system. Since the fund is the blood of business and entire funds are provided by bank so to share in profit and loss by Bank as key partner is quite justified.

Hire purchase under *shirkat-al-meelk* (HPSM): It is term financing mechanism against fixed and serviceable assets like land, building, cart, machineries etc. first Islamic Bank purchase the asset then it lease out to the client for specific period with the conditioned that client will pay rent on installment basis and purchase the asset at the end of the lease period on agreed upon price or on installment basis. Here rent is to be calculated on predetermined rate of return (on FRM) on the unpaid portion of price of the asset. This mechanism is near like Hire purchase of conventional banking. Here difference is only in ownership of the

asset. In hire purchase ownership is retained by Bank up to adjustment of liability or by the client but in case of HPSM ownership is retained jointly (Central Bank does not allow joint ownership where registration is required) where bank part will reduce and client part will increase with payment of price on installment basis that is ownership of the leased asset will shift from Bank to client gradually. Merit here is that if any accident or damage occurred then loss to be borne jointly as per proportionate ownership that means risk is shared jointly whereas in case of Hire purchase risk is borne by bank or by client.

So, HPSM-hire purchase under *shirkat-al-meelk* is superior to HP-hire purchase.

Bai-mechanism (bai-muajjal, bai-murabaha, bai-salam, bai-istisna, etc.):

Bai-mechanism is buying and selling of goods which include credit and advance sales. *bai-murabaha* & *bai-muajjal* are credit selling and *bai-salam* & *bai-istisna* are advance selling. Goods may be purchased or own produced. Actually *bai*-mechanism is applicable for shopkeepers, business concerns and individuals. But Islamic scholars allowed it to practice in banking.

In case of *bai-murabaha* and *bai-muajjal* Bank first buy the trading or consumption goods as per specification of the client then sale out it to the said client on credit at agreed upon price with the condition that the sale price is to be paid within specific period. Difference between sale price and purchase price is the profit for Bank. Here declaring cost or purchase price of goods to the client is not obligatory for the bank in case of *bai-muajjal* but it is obligatory in case of *bai-murabaha*. Payment may be made at a time or on installment.

In case of *bai-salam* and *bai-istisna* Bank first pays the agreed price to the client as advance to purchase the specified goods with the conditions that goods must be delivered as per specification within specific period. Here Bank get the goods on lesser price since payment is made on advance and in the mean time Bank can sell out those other wise on better price. Difference between sale price and purchase price is the profit for Bank.

From the above discussion it is asserted that financing mechanisms of Islamic Bank is quite different and superior to conventional mechanisms

5. Difference in banker-customer relation ship

Debtor-creditor relation ship-debt based system: In case of deposit collection, deposit fund of conventional bank is debt of the bank that is it must be returned with interest as agreement. So, depositors are creditors and bank is debtor. In case fund deployment, bank is creditor and customers (client) are debtors. Here deployed fund is debt of the client that is it must be returned with interest accordingly.

As all the mechanisms are debt based it (specially finance mechanism) drowns the whole economy in debts. Default and bankruptcy take place as common phenomena, and resources are mounted at the riches from the poor. Imbalance, ill distribution and exploitation spread every where.

Partner or share holder relation ship-debt free equity based participatory system: *Musharaka* and *mudaraba* fund is not debt to the client. It treats as equity or share of the client's business in Islamic economic frame work so, relation is partner or share holder each other. As a result entrepreneurs never be bankrupt in this economic system. Rather Bank as a partner monitors and looks after the business as a result fund diversion or willful default could not be made.

On the other hand, as the *shirkat* mechanism (*musharaka* and *mudaraba*) is equity based profit-loss sharing system, not debt based derived from interest like conventional the prominent economists James Robertson and John Tomlinson have strongly recommended the conversion of debt in to equity realizing the evils of debt based economy.²¹

6. Difference in financed means

Cash means financing: In the most of finance cases conventional banks pay cash to the client. There is no strict restriction to purchase specified goods and commodities as banks need predetermined interest. How and where funds are utilized is not vital point. So clients can take chance to divert the fund on

unproductive and beyond business purposes which create speculation and play negative role in economy.

Kinds or asset/goods means finance: Bai mechanism of Islamic banks is direct backed by assets/goods. So fund diversion and use it in unproductive purpose is quite tough. Even here money is transformed to goods then to money again which control the speculation. So this mechanism is superior to cash credit or to any form of loans not backed by assets.

7. Difference in class or mass banking trend

As conventional banks have strong commitment to profit preferring motive they bank at key places with key and valued customers.

So, their banking automatically turns in to class banking.

On the other hand, Islamic banks have strong commitment to CSR as per goal of Islam where profit motive is negligible they bank mainly at under developed and rural places with mass people initiating welfare oriented multipurpose programs.

So, their banking automatically turns in to mass banking.

8. Difference in trading of money as commodity

Conventional banks trade money on one of the wrong presumptions on which all theories of interest are based is that money has been treated as a commodity. It is, therefore, argued that just as a merchant can sell his commodity for a higher price than his cost, he can also sell his money for a higher price than its face value, or just as he can lease his property and can charge a rent against it, he can also lend his money and can claim interest thereupon. These presumptions are countered by prominent economists.

According to Jaques B Geinas (1989), this financial system based on money trading is unfair, ecologically destructive and economically inefficient. The money–must-grow imperative derives production (and thus consumption) to higher than necessary levels. It skews economic effort towards money out of money, and against providing real services and goods. It also results in a massive world-wide diversion of effort away from providing useful goods and services, into making money out of money. At least 95% of the billions of dollars

transferred daily around the world are for purely financial transactions, unlinked to transactions in the real economy.²²

According to Professor Khorshid Ahmad, this baseless money created by the banks and financial institutions itself has become the subject of speculative trade through the derivatives in the form of ‘**Futures**’ and ‘**Options**’ in the International markets. It means that in the beginning, claims over money have been treated as money. Now, claims over claims are being treated as claim. According to an estimate, over 150 trillion US dollars worth of derivatives are circulating in the world, whereas the combined GDP of all the 188 countries of the world is around 30 trillion US dollars only. Almost 80% of this trade is in the hands of some two dozen big banks and hedge funds.³⁶ It creates serious nature of speculation which shocks the economy one by one.

On the other hand, Islamic principles, however, do not subscribe to this presumption. Money and commodity have different characteristics and therefore they are treated differently that is Islamic banks do not practice money trading and do not use complex derivatives financial instruments based on futures and options like conventional one. However, foreign currency trading is approved by *shariah* treating commodities in limited extend. So, Islamic banks buy and sell the (FCs) only for spot transaction and for settlement of export import and remittance requirement. Though *Shariah* treated one currency against other as commodity but prohibited its hoarding on profit motive, overnight trading, and futures-options transactions as those create speculation and interest based also.

9. Difference in risk sharing

In conventional banking system customers do not share the risk of loss of bank in case of deposit collection as deposit fund is treated debt to the bank. In case financing//lending banks do not share the risk of loss of client’s business as lending fund is also debt to the client.

On the other hand, in Islamic banking system banks and customers share the loss each other as they are partner or share holder like joint venture.

10. Difference in ethical dimension and *halal-haram* restriction

Conventional banking and economics has no commitment in ethical dimension and *halal-haram* restrictions.

The activities like pornography, gambling, prostitution, the promotion of alcohol, tobacco, cigarettes, cinema, socially harmful, disliking and mischief creating thing etc would be treated in the capitalist system a productive because it is supposed to be satisfying some demand, rather they encouraged in most cases for the shake of maximizing profit giving up social peace and order.

On the other hand, Islamic banking is based on ethical framework. It is also a movement from pecuniary situation to an economy of ethical norms & social commitments. There is a framework of *halal* and *haram* within which all economic activities, private and public, has to take place. The activities like above is unacceptable in Islam.

Islam discouraged and disliked financial activities for peace keeping and welfare of the society like excess spending, luxuriousness, keeping the properties beyond proper use alms seeking etc.

The said financial transactions, activities and businesses both for earning and spending seriously affect the development, peace, welfare, justice and balance of the society. So, Islamic banks do not involve by any means with the said activities rather they strictly prohibited their financing in the above cases directly or indirectly in order to ensure social peace and order even they negatively consider any involvement with the above activities in selecting the client. Simultaneously Islamic economic system has strong commitment to reduce and abolish the said ill activities from the economic and financial affairs.

11. Difference in commitment to CSR

Conventional has strong commitment to profit preferring motive so commitment CSR is negligible. They have rare initiative in social welfare activities.

On the other hand Islamic bank has strong commitment to social welfare as their goal is wellbeing of human being. So to uplift the weaker section of the society Islamic bank has introduced several social welfare programs under Islamic Bank Foundation, a subsidiary institution of the bank on the view of

corporate social responsibilities (CSR) and social welfare commitment of Islam. Programs are as follows:

- a. Establishment of Hospital, Community hospital, Homio medical centre etc specially, for the poor to ensure good health as one of the basic needs.
- b. Establishment of educational institutions-School, college, university, medical college, vocational college, *madrasah*, girls madrasah, model *forkania maktab* etc. to comply the *fard* of seeking knowledge.
- c. Scholarship for poor and meritorious students-
- d. Donation and lump-sum grants for poor and meritorious students and also for treatment, marriage of the poor daughter etc.
- e. Fellowship for research on Islamic economic and Islamic banking.
- f. Night school for the distressed.
- g. Relief and rehabilitation program.
- h. '*Monoram*' sales center for products of distressed woman for their self-reliant.
- i. Service center to save the people of the coastal area from natural disasters and calamities.
- j. Cost free credit program for self reliant of distressed people, specially, for woman and orphan and;
- k. Social awareness creating programs (Rally, procession, seminar etc.

So there is far difference between conventional banking and Islamic banking in implementing corporate social responsibilities.

*Islamic banking and it's superiority in economy to maximize production, employment & growth for
ensuring social development & welfare.*

In the name of Allah, the most Merciful, the most Beneficent.

CHAPTER-3

Review of literature

3.1. Goal of economic system and human welfare

The goal of each and every economic system is welfare of human being but in practical it depends on its world-view that is religious believe specially, accountability to Supreme Being or any authority and real ownership of the resources.

According to Dr. M. Umer Chapra (1993) the goals of an economic system are determined by its world-view that means, if it is thought that the universe has come into existence by itself, then human beings are not accountable to anyone and are free to live as they please. Their purpose in life would then be to seek maximum pleasure, irrespective of how this is realized and how it affects others or their environment. On the other hand, if thought that human beings and what they possess have been created by the Supreme Being and they are accountable to Him, then they may not consider themselves either absolutely free to behave as they please or helpless pawns on the chessboard of history, unconcerned about the direction in which history is moving. Rather they have a mission. They must use the resources and must treat each other and their environment in a way that would help to fulfill their mission that means, economic goal will differ in both the above cases (Chapra 1993).¹

3.2. Goal of Islamic economic & banking system and welfare Here & Here after

The goal of Islamic economic system is to use all the resources to actualize the *maqasid al- shariah* that is goal of Islam.

According to Imam Shatebee, the principal goal of Islam is intense commitment to brotherhood and justice for spiritual as well as material well-being (*falah*) of all the people through ensuring fulfillment of *jaruriat*-need (safeguarding and protection of *al-deen*-religion, protection of *al-nafs*-life, protection of *al-'aql*-

intellect, protection of *al-nasl & al-nasab*-lineage, protection of *al-maal*-wealth and protection of freedom as very clearly basic needs) then *al-haajiyaat* (the supportive needs) then *al-tahseeniyaat* (the embellishments). Therefore, to establish socio-economic justice and to reduce imbalance in this world and final well-being in the World Here After is the goal of Islamic economic system as well as Islamic banking system in the light of the goal of Islam and Islamic *shariah*.

According to Abdur Raquib (2007), the objective of Islamic banking is not only to earn profit, but also to do good and welfare to the people. Islam upholds the concept that money, income and property belong to Allah and this wealth is to be used for the good of the society.

3.3. Production

3.3.1. Adverse effect on production

Interest based loan favors the rich and adversely effects the production.

According to justice maulana Muhammad Taqi Usmani (2000) interest-based loans have a persistent tendency in favor of the rich and against the interest of the common people. It carries adverse effects on production and allocation of resources as well as on distribution of wealth.²

3.4. Employment generation

3.4.1. Capitalism hampers employment generation and socio-economic justice

In capitalism trade, industry and the means of production are owned and controlled by individuals mainly to earn and maximize profit and serve self interest of individuals. Its out comes are unfair distribution of wealth (and thus power), tendency toward market monopoly or oligopoly or oligarchy or imperialism, human and economic exploitation, social alienation, inequality, unemployment, and economic instability, finally the rich become richer and the poor become poorer.

Abdur Raquib (2007) referred the critics of capitalism who claimed some problems which include unfair distribution of wealth (and thus power), a tendency toward market monopoly or oligopoly or government by oligarchy, imperialism and other forms of human and economic exploitation, and

phenomena such as social alienation, inequality, unemployment, and economic instability.³

He also finds out that capitalism is-

- i. Complete material dependent economic system leading to promoting exploitation, inequality and injustice.
- ii. All the thinking and equipments of earnings are personal and its uses depend on individual decision. So, this situation comes at a moment where all the aspects of human welfare are affected and mobilization of wealth and its components are gradually accumulated with a few groups of individuals. Under this situation, the rich gradually become richer and the poor gradually become poorer.⁴

3.4.2. Causes of less employment generation

Full employment would not be made if goal of economic system and its strategy to achieve the goal mismatched.

According to Dr. M. Umar Chapra (1993) both the systems (Capitalism & Socialism) have failed to realize their professed goals of need-fulfillment, full employment and equitable distribution of income and wealth. This is because their world-view and the strategy derived from it, are not in harmony with their professed goals. The goals are humanitarian, based on their religious ideals of justice, brotherhood and sacrifice for the good of others. The strategies are however, based on the concepts of 'survival of the fittest and maximum want satisfaction' in the market system, and 'class struggle and material conditions of life' in socialism.⁵

3.4.3. Strategies to maximize employment generation

Initiating rural based development programs with support of industrial development and equity based investment system will expand the employment opportunities.

According to Dr. M. Umer Chapra (1993) if equity had been one of the primary goals of development, the policy of import substitution would have been use initially to support primarily agriculture and small and micro enterprises (SMEs) in developing countries. This would have helped to fulfill needs and expand employment opportunities in rural areas and small towns. Workers would

have found jobs either in their own villages and towns or near them. They would have thus not been uprooted from their families and social surroundings.⁶

He suggested that since a majority of the population in developing countries lives in rural areas, its well-being could only have been ensured through rural and agricultural development. Rural development was, therefore, not an option, it was indispensable. Rural development could not, however, have taken place without support from industrial development. To enable the farmers to undertake investments in fertilizers, better seeds and improve technology, it was necessary to raise their incomes. This was not possible without providing employment to the unemployed and the underemployed members of rural families. It would not be possible to do so without simultaneously developing small-scale and micro industries in rural areas.⁷

According to John Tomlinson the re-establishment of stable money and the emphasis on security which will be required within equity investment program will encourage people to take a longer view. More businesses will then be considered viable and the number of new jobs can increase dramatically.⁸

3.5. Social development and welfare

3.5.1. Strategies for social development and welfare of developing countries

Social development and welfare of developing countries depends on rural and agricultural development with the support of industrial development simultaneously diversification and modernization of all the sectors.

According to Dr. M. Umar Chapra (1993) wellbeing of the people of developing countries could only have been ensured through rural and agricultural development since a majority of the population in developing countries lives in rural areas. Rural development was, therefore, not an option, it was indispensable. Rural development could not, however, have taken place without support from industrial development. To enable the farmers to undertake investments in fertilizers, better seeds and improve technology, it was necessary to raise their incomes. This was not possible without providing employment to the unemployed and the underemployed members of rural families. It would not be possible to do so without simultaneously developing small-scale and micro industries in rural areas.

Agricultural and industrial developments were, therefore, not the alternatives to choose from. They were rather complementary and mutually supporting with respect to both input and output. The issue was not industrial or agricultural development but rather the human being and his well-being. If the well-being of all had been the goal, the interrelationship between industry and agriculture and the contribution that each can make to the other and to the realization of agreed socio-economic goals would have been appreciated.⁹

3.6. Allocation of resources & power

3.6.1. Allocation of resources & power under conventional banking system

Under conventional banking system, credit trends toward the rich. As a result resources go to them.

According to Dr. M. Umar Chapra (1993) the rich are able, by the sheer weight of their purchasing power to get scarce national resources diverted to the production or import of luxuries and false symbols of prestige which do not fall within the category of needs and the relatively easy access of the rich made to the enormous financial resources of the banking system through credit.¹⁰

He quoted that the banking system tends to reinforce the unequal distribution of capital. Even Morgan Guarantee Trust Company, sixth largest bank in the US. has admitted that the banking system has failed to finance maturing smaller companies or venture capitalist' and 'though awash with funds, is not encouraged to deliver competitively priced funding to any but the largest, most cash-rich companies'. Hence, while deposits come from a broader cross-section of the population, their benefit goes mainly to the rich.¹¹

He argued that since there are substantial inequalities of income and wealth and since the rich are also able to have a far greater access to credit, they are able to buy whatever wish at the prevailing prices and to tilt the allocation of resources in their favor.¹²

According to Lester Thurow, credit tends to go to those who are lucky rather than smart or meritocratic.¹³

According to Abdur Raquib (2007), conventional banking operates predominantly on the principle of financial collateral with the result that the

concentration of wealth, income and power take place. The emphasis shifts from the viability of the project to the financial worth of the borrower.¹⁴

3.6.2. Allocation of resources under Islamic banking system

Allocation of resources and income under Islamic banking system made for the benefit of the society and emphasized trustworthiness, viability and usefulness of the project instead of creditworthiness of the client.

According to Shah Abdul Hannan (2003), since all business investment must be for the public good, Islamic banks are expected to allocate financing to those projects that will benefit society the most (**Hannan, 2003**).¹⁵

He also stated that Islamic banks strive to ensure equitable distribution of income and resources to all the parties to the transaction.¹⁶

According to Abdur Raquib In Islamic banking system security is not irrelevant, but more emphasis is given on trustworthiness of the entrepreneur and viability and usefulness of the project/entrepreneur from the national perspective.¹⁷

3.7. Distribution of income in economy

3.7.1. Distribution of income and resource as per Islam

Islam not only requires the fulfillment of everyone's need but also emphasizes an equitable distribution of income and wealth. All the resources of this world are sacred trust from Allah, created for human being. So these are utilized as per instruction of Allah to implement His plan that is goal of Islam-welfare and justice.

According to the Holy *Qur'an*, what Allah has bestowed on His Messenger (and taken away) from the people of the township, belong to Allah,- to His Messenger and to kindred and orphans, the needy and the wayfarer in order that it may not circuit between the wealthy among you. So take what the messenger assigns to you and deny yourselves that which he withhold from you. And fare Allah of course, Allah is strict in punishment (***Sura Al-Hashr* 59:7**).

According to Abdur Raquib (2007), the strong commitment of Islam to brotherhood and justice demands that all resources at the disposal of human beings, a sacred trust from God, be utilized to actualize the *maqasid al-Shariah*.¹⁸

3.8. Accelerating economic growth

John Tomlinson argued that on conversion of debt to equity growth will be dependent upon the continuing development of new ideas and new productive capacity. Growth will not be dependent upon the creation of new debt. Economic expansion will depend upon the positive flow of new savings and new profits.¹⁹

3.9. Islamic economic system and socio-economic justice

Islamic economic system refers Islamism (*Deen-bil-Maaf*) that is comprehensive process to use all the resources to actualize the *maqasid al-shariah*-goal of Islam and to establish socio-economic justice and to ensure fundamentals of Islam through compliance of certain divine restrictions which are as follows:

riba/interest, gambling, hoarding, bribe, lottery, cheating, adultery, stealing, robbery, snatching, rioting, kidnapping/hijacking, extortion, nakedness, adulteration-ill mixing, smuggling, miserliness, misusing/rough using, forced occupying of other's assets, socially harmful and mischief creating thing, dealing in unlawful goods and services etc.

According to Abdur Raquib (2007), under Islamic economic system profit motive is acceptable to a reasonable extent, private ownership is not totally negated even it does not deny the market forces and market economy and religion is intensively related with state and economic activities. After recognizing private ownership, profit motive and market forces Islam has put certain divine restrictions on the economic activities and decisions. These restrictions are being imposed by Allah, the Almighty which cannot be removed by any human authority. These restrictions are *riba*/interest, gambling, hoarding, dealing in unlawful goods and services etc.²⁰

3.10. Importance of moral development in economic development

Goal, objective and programs of Islamic Bank are for the wellbeing of human being. It could not be actualized without moral, economic and material development. So, Islamic Bank highly emphasized the moral development of their manpower, customer and of the society through training, workshop, seminar, publications etc.

M. Umer Chapra stated that while secular societies continue to belittle the need for moral development, all of them now profess commitment to development with justice. Material development with justice is not possible without moral development.²¹

3.11. Currency & money-the key tools of economy and causes of unrest of world economy

Treating money as commodity is the cause of unrest of world economy and tool of speculation.

According to Justice Maulana Muhammad Taqi Usmani (2000), one of the wrong presumptions on which all theories of interest are based is that money has been treated as a commodity. Islamic principles, however, do not subscribe to this presumption. Money and commodity have different characteristics and therefore they are treated differently especially on two scores:

Firstly, money (currency of same denomination) is not held to be the subject-matter of trade like other commodities. Its use has restricted to its basic purpose i.e. to act as a medium of exchange and a measure of value.

Secondly, if for exceptional reasons, money has to be exchanged for money or it is borrowed, the payment on both sides must be equal, so that it is not used for the purpose it is not meant for i.e. trade in money itself.²²

Imam Al-Gazzali (late Hizra 505) has given clear opinion regarding money that the creation of *dirhams* and *dinars* (money) is one of the blessings of Allah... They are stones having no intrinsic usufruct or utility, but all human beings need them, because every body needs a large number of commodities for his eating, wearing etc, and often he does not have what he needs and does have what he needs not..... therefore, the transactions of exchange are inevitable. But there must be a measure on the basis of which price can be determined, because the exchanged commodities are neither of the same type, nor of the same measure which can determine how much quantity of one commodity is a just price for another. Therefore, all these commodities need a mediator to judge their exact value..... Allah Almighty has, therefore, created *dirhams* and *dinars* (money) as judges and mediators between all commodities so that all objects of wealth are measured through them..... and their being the measure of the value of all

commodities is based on the fact that they are not an objective in themselves. Had they been an objective in themselves, one could have a specific purpose for keeping them which might have given them more importance according to his intention while the one who had no such purpose would have not given them such importance and thus the whole system would have been disturbed. That is why Allah has created them, so that they may be circulated between hands and act as a fair judge between different commodities and work as a medium to acquire other things.²³

3.12. Money in the eye of prominent economists and scholars

Justice Maulana Muhammad Taqi Usmani (2000) opined that money is only a medium of exchange and a measure of value is universally accepted by almost all the economist of the world, but unfortunately a large number of these economists failed to recognize the logical outcome of this concept.

After holding that money is a commodity the modern economists have plunged into a dilemma that was never resolved satisfactorily. The commodities are classified into the commodities of the first order which are normally termed as ‘consumption goods’ and the commodities of the higher order which are called ‘production goods’. Since money, having no intrinsic utility, it could not be included in ‘consumption goods’. Most of the economists had no option but to put it under the category of ‘production goods’, but it was hardly proved by sound logical arguments that money is a ‘production goods’.²⁴

According to Ludwig Von Mises (1980), of course, if we regard the twofold division of economic goods as exhaustive, we shall have to rest content with putting money in one group or the other. This has been the position of most economists; and since it has seemed altogether impossible to call money a consumption good, there has been no alternative but to call it a production good. It is true that the majority of economists recon money among production goods.²⁵ Regarded from this point of view, those goods that are employed as money are indeed what **Adam Smith** called them “**dead stock, which.... Produces nothing**”.²⁶

3.13. Ill impact of trading money and its complex derivatives

Money trading i.e. buying and selling of currency through complex derivatives based on future and option create speculation which turned the economy in to terrible recession and its financing system diverts the economic efforts away from providing useful goods and services, into making money out of money.

According to John Gray (1998) and Michael Albert (1993), Most significantly, perhaps transaction on foreign exchange markets have now reached the astonishing sum of around \$1.2 trillion a day, over fifty times the level of the world trade. Around 95 percent of these transactions are speculative in nature, many using complex new derivative's financial instruments based on futures and options. According to Michael Albert, the daily volume of transactions on the foreign exchange markets of the world holds some \$900 billions-equal to France's annual GDP and some \$200 million more than the total foreign currency reserves of the world central banks. This virtual financial economy has a terrible potential for disrupting the underlying real economy as seen in the collapse in 1995 of Barings, Britain's oldest bank.²⁷

According to James Robertson (1998), today's money and finance system is unfair, ecologically destructive and economically inefficient. The money –must-grow imperative derives production (and thus consumption) to higher than necessary levels. It skews economic effort towards money out of money, and against providing real services and goods.

.....(It) also results in a massive world-wide diversion of effort away from providing useful goods and services, into making money out of money. At least 95% of the billions of dollars transferred daily around the world are for purely financial transactions, unlinked to transactions in the real economy.²⁸

3.14. Interest is injustice both for borrower and lender and Islamic outlook

Under interest based economic and banking system, the borrower had to pay interest to the lender on prefixed rate, though he loses in business, it is injustice for the borrower. On the other side, lender had to take interest from the borrower on prefixed rate though borrower earn huge amount, it is injustice for the lender.

But in case of Islamic economic and banking system, both the borrower and lender get profit on pre-agreed ratio, if earn profit in business and both bear loss on capital ratio if loss in business.

According to Justice Maulana Muhammad Taqi Usmani (2000),

If the intent of sharing the profit of the borrower is designed on the basis of an interest-based loan, it will mean that the financier wants to ensure his own profit, while he leaves the profit of the borrower at the mercy of the actual outcome of the business. There may be a situation where the business of the borrower totally fails. In this situation he will not only bear the whole loss of the business, but he will have also to pay interest to the lender, meaning thereby that the profit or interest of the financier is guaranteed at the price of the destructive loss of the borrower, which is obviously a glaring injustice.

On the other hand, if the business of the borrower earns huge profits, the financier should have shared him in the profit in reasonable proportion, but in an interest-based system, the profit of the financier is restricted to a fixed rate of return which is governed by the forces of supply and demand of money and not on the actual profits produced on the ground. This rate of interest may be much less than the reasonable proportion a financier might have deserved, had it been a joint venture. In this case the major part of the profit is secured by the borrower, while the financier gets much less than deserved by his input in the business, which is another form of injustice.

Thus, financing a business on the basis of interest creates an unbalanced atmosphere which has the potential of bringing injustice to either of the two parties in different situations. That is the wisdom for which the *Shariah* did not approve an interest based loan as a form of financing.²⁹

3.15. Philosophy to discourage the loan in Islam:

The Holy Prophet (*sm*) has condemned borrowing loans without genuine need and refused to pray *Janaza* of a person who died indebted.³⁰

Justice Maulana Muhammad Taqi Usmani (2000) explained the philosophy as once the interest is banned, the role of loans in commercial activities become very limited, and the whole financing structure turns out to be equity-based and backed by real assets.³¹

3.16. Impacts of interest-based loan and financial system in economy

According to Justice Maulana Muhammad Taqi Usmani (2000) interest-based loans have a persistent tendency in favor of the rich and against the interest of the common people. It carries adverse effects on production and allocation of resources as well as on distribution of wealth.⁴⁷ He explained that once the interest is allowed, and advancing loans, in itself, becomes a form of profitable trade, the whole economy turns into a debt-oriented economy which not only dominates over the real economic activities and disturbs its natural functions by creating frequent shocks, but also puts the whole mankind under the slavery of debt. It is no secret that all the nations of the world, including the developed countries, are drowned in national and foreign debts to the extent that the amount of payable debts in a large number of countries exceeds their total income.³²

According to Peter Warburton (1999), the credit and capital markets have grown too rapidly, with too little transparency and accountability. Prepare for an explosion that will rock the western financial system to its foundation.³³

According to James Robertson (1990), the pervasive role of interest in the economic system results in the systematic transfer of money from those who have less to those who have more. Again, this transfer of resources from poor to rich has been made shockingly clear by the Third World debt crisis. But it applies universally. It is partly because those who have more money to lend, get more in interest than those who have less; it is partly because those who have less, often have to borrow more; and it is partly because the cost of interest repayments now forms a substantial element in the cost of all goods and services, and the necessary goods and services looms much larger in the finances of the rich. When we look at the money system that way and when we begin to think about how it should be redesigned to carry out its function fairly and efficiently as part of an enabling and conserving economy, the arguments for an interest-free inflation-free money system for the twenty-first century seems to be very strong.³⁴

James Robertson (1990) also added that the transfer of revenue from poor people to rich people, from poor places to rich places, and from poor countries to rich countries by the money and finance system is systematic.... One cause of the

transfer of wealth from poor to rich is the way interest payments and receipts work through the economy.³⁵

According to Justice Maulana Muhammad Taqi Usmani (2000), since interest-bearing loans have no specific relation with actual production, and the financier, after securing a strong collaterals, normally has no concern how the funds are used by the borrower, the money supply effected through banks and financial institutions has no nexus with the goods and services actually produced on the ground. It creates a serious mismatch between the supply of money and the production of goods and services. This is obviously one of the basic factors that create or fuel inflation.³⁶

He also observed that the whole economy of the world has thus been turned into a big balloon that is being inflated on daily basis by new debts and new financial transactions having no nexus whatsoever with the real economy. This big balloon is vulnerable to the market shock and can be bust any time. It really did several times in the recent past whereby the Asian Tigers reached the brink of total collapse, and the effects of these shocks were felt in the whole world to the extent that the media started crying that the market economy is breathing its last.³⁷

James Robertson (1998) has commented impact of interest based system and it derivatives that the money-must-grow imperative is ecologically destructive....(It) also results in a massive world-wide diversion of effort away from providing useful goods and services, into making money out of money. At least 95% of the billions of dollars transferred daily around the world are of purely financial transactions, unlinked to transaction in the real economy.

People are increasingly experiencing the workings of the money, banking and finance system as unreal, incomprehensible, unaccountable, irresponsible, exploitative and out of control. Why should they lose their houses and their jobs as a result of financial decisions taken in distant parts of the world? Why should the national and international money and finance system involve the systematic transfer of wealth from poor people to rich people and from poor countries to rich countries? Why someone in Singapore be able to gamble on Tokyo Stock Exchange and bring about the collapse of a bank in London?....why do young people trading in derivatives in the City of London get annual bonuses larger than

the whole annual budgets of primary schools? Do we have to have a money and financial system that works like this? Even the financier George Soros has said (“Capital Crimes”, *Atlantic Monthly*, January, 1997) that “the untrammelled intensification of laissez-fair capitalism and the extension of market values into all areas of life is endangering our open and democratic society. The main enemy of the open society, I believe, is no longer the Communist but the Capitalist Threat”.³⁸

James Robertson (1998) realized the evil consequents of interest based system and suggested for equity based Islamic system-would it be desirable and possible to limit the role of interest more drastically than that, for example by converting debt into equity throughout the economy? This would be inline with Islamic teaching, and with earlier Christian teaching that usury is sin. Although the practical complications would make this a goal for the longer term, there are strong arguments for exploring it... the extent to which economic life world-wide now depends on ever-rising debt, the danger of economic collapse this entails, and the economic power now enjoyed by those who make money out of money rather than out of risk-bearing participation in useful enterprises.³⁹

According to Michael Rowbotham, there has been a massive outpouring literature on the subject of Third world debt. The books are characterized by one feature. Whereas the arguments and policies of the IMP and World Bank have been based upon an apparently reasonable theory, the studies give case after case and country after country, in which the theory has not worked in practice. Either loans have led to development, but repayment has proved impossible; or the projects funded have failed completely leaving the country with a massive debt and no hope of repayment, or repeated additional loans have become necessary simply to provide funds for the repayment of past loans. The debtor countries, as a group, began the 1990s fully 61% deeper in debt than they were in 1980.⁴⁰

Cheryl Payer (1974) compared the debt-based system with peonage or debt slavery system as the system (present international financial system) can be compared point by point with peonage on an individual scale. In the peonage or debt slavery system....., the aim of the employer/creditor/merchant is neither to collect the debt once and for all, nor to starve the employee to death, but to keep

the laborer permanently indentured through his debt to the employer.... Precisely the same system operates on the international level...it is debt slavery on an international scale. If they remain within the system, the debtor countries are doomed to perpetual underdevelopment or rather, to development of their exports at the service of multinational enterprises, at the expense of development for the needs of their own citizens.⁴¹

Bade Onimode (1989) showed the result of interest based debt of IMF and World Bank that in virtually all cases, the impact of these (IMF and World Bank) projects has been basically negative. They have resulted in massive unemployment, falling real incomes, pernicious inflation, increased imports with persistent trade deficits, net outflow of capital, mounting external debts, denial of basic needs, severe hardship and deindustrialization.....

The sectors that have been worst hit are agriculture, manufacturing and the social services, while the burden of adjustment has fallen regressively on the poor and weak social groups.⁴²

Jaques B Geiinas (1998) showed the impact of foreign loan that the foreign – aid-based development model has proved itself powerless to bring a single country out of economic and financial dependence. However, it has turned out to be a source of fabulous wealth for certain Third World elites, giving birth to a new form of power and socio-political class that can rightly be called the ‘aidocracy’.⁴³

According to Justice Maulana Muhammad Taqi Usmani (2000), the evil consequences of interest were never so evident in the past than they are today. Injustice in a personal consumption loan was restricted to a debtor only, while the injustice brought by the modern interest affects the economy as a whole.⁴⁴

3.17. Ill impact of money creation by bank

Due to creation of money debts increase abnormally just like bubble.

Michael Rowbotham (1998) expressed his great concern that how the money changers and bankers have succeeded in legalizing the creation of money by the private banks, in spite of the strong opposition from several rulers in England and USA, and how the **Rothchilds** acquired financial mastery over the whole of Europe and the **Rockfeller** over the whole of America is a long story.⁴⁵

Justice Maulana Muhammad Taqi Usmani (2000) explained that the net result of money creation is that the modern banks are creating money out of nothing. They are allowed to advance loans in the amounts ten times more than their deposits. The coins and notes issued by the government as genuine and debt-free money have now a very significant proportion in the total money in circulation, most of which is artificial money created by advances made by the banks. The proportion of real money issued by the governments has been constantly declining in most of the countries, while the proportion of the artificial money created by the banks out of nothing is ever-increasing. The spiral of loans built upon loans is now the major part of the money supply. Taking the example of UK according to the statistics of 1997 the total money stock in the country was 680 billion pounds, out of which only 25 billion pounds were issued by the government in the form of coins and notes. All the rest i.e. 655 billion pounds were created by the banks. It means that the original debt-free money remained only 3.6% of the whole money supply while 96.4% is nothing but a bubble created by the banks.⁴⁶

Patric S.J. Carmack and Bill Still (1998) exclaimed that why are we over our head in debt? Because we are laboring under a debt-money system, in which all our money is created in parallel with an equivalent quantity of debt that is designed and controlled by private bankers for their benefit. They create and loan money at interest, we get the debt....

.....So, although the banks do not create currency, they do create checkbook money, or deposits, by making new loans. They even invest some of this created money. In fact, over one trillion dollars of this privately-created money has been used to purchase US bonds on the open market, which provides the banks with roughly 50 billion dollars in interest, less the interest they pay some depositors. In this way, through fractional reserve lending, banks create far in excess of 90% of the money, and therefore cause over 90% of our inflation.⁴⁷

Professor Khorshid Ahmad showed that the baseless money created by the banks and financial institutions itself has now become the subject of speculative trade through the derivatives in the form of Futures and Options in the International markets. What it means is that in the beginning, claims over money

have been treated as money. Now, claims over claims are being treated as such. According to an estimate, over 150 trillion US dollars worth of derivatives are circulating in the world, whereas the combined GDP of all the 188 countries of the world is around 30 trillion US dollars only. Almost 80% of this trade is in the hands of some two dozen big banks and hedge funds.⁴⁸

3.18. Role of Islamic Bank against recession and deflation

According to Dr. Ahmad Muhammad Ali, Islamic banking is distinctive in two respects: concentrating on the real sector of the economy, it imparts tremendous stability to the economic system by achieving an identity between monetary flows and goods and services, and by operating on a system of profit and loss sharing in its evolved state, it insulates the society from the debt-mountain on the analogy that if the economies enter into recessionary or deflationary phases, the principles of profit and loss sharing protects the states and economic operators from the evils accumulation of interest and minimizes defaults and bankruptcies.⁴⁹

According to Abdur Raquib (2007), the fundamental objective of Islamic banking is to bring about departure from the conventional system moving from a debt-based relationship to an equity-based and stake-taking economy. While there are scopes for some debt based transactions on the principle of *quard-e-hasana*, the overall thrust of the Islamic banking would be towards equity based and risk sharing arrangements. This is distinct from the capitalist approach where the whole economy is revolve round making money by manipulating, managing the evils of interest and compounding interest mechanism as interest is the root cause of exploitation in society and leads to the inequitable distribution of income and wealth in the economy.⁵⁰

3.19. Riba (interest) in the eye of traditional economists and scholars

According to Mr. Riazul Hasan Gilani, the counsel of the Federation of Pakistan, any increased amount stipulated in a contract of loan right from the beginning does not fall within the definition of *riba Al-Qur'an* and that is falls under the definition of *riba al-fadl*. If the debtor was not able to pay at date of maturity for a valid reason, any increased amount imposed upon the debtor for giving him more time does fall in the definition of *riba Al-Qur'an*. Since the

most banking transactions of today stipulated interest right from the beginning of the transaction, they are not covered by the prohibition of *riba Al-Qur'an*, they are rather governed by the principles of *riba Al-fadl*.⁵¹

Mr. Khalid Ishaq, advocate & jurist-consult of Pakistan advanced argument that the basic cause of the prohibition of *riba* is *Zulm* (injustice) as the Holy *Qur'an* says-And if you repent (from charging interest) then you are entitled to your principal. You will not wrong (*zulm*) and will not be wronged i.e. no *zulm* will be done upon you (*Sura Al-Baqara, Ayat-279*). It is also argued that there is no *zulm* at all in charging interest from a rich person who has borrowed money to earn huge profits therewith. Since the basic *illat* of the prohibition is missing in the commercial interest charged by the banks and the financial institutions, it can not be held as prohibited.⁵²

3.20. Theory of interest countered by Muslim scholars

The three arguments in imposing interest are interest is a reward for saving, a productivity of capital and an inevitable consequence of the difference between the value of capital goods today and their value a year hence.

Recent Muslim Scholars place the major emphasis of their explanation of the law on the lack of a theory of interest. They have countered the countered the argument that interest is a reward for saving, a productivity of capital and an inevitable consequence of the difference between the value of capital goods today and their value a year hence.

A. Mirakhor (1995) summarized those three arguments in the following way:

- a. To the argument that interest is a reward for saving, Muslim scholars respond that such payments could only be realized if savings were used for investment to create additional capital and wealth. According to them, the mere act of abstention from consumption should not entitle anybody to a return.
- b. To the argument that interest is justified as productivity of capital, they respond that although the marginal productivity of capital may enter as one factor into the determination of the rate of interest, interest per se, has no necessary relation with the capital productivity. Interest, they argue, is paid on money, not on capital, and has to be paid irrespective of capital

productivity. In distinguishing between interest as a charge for the use of money and a yield from the investment of capital, Muslim scholars argue that it is an error of modern theory to treat interest as the price of, or return for, capital. Money, they argue, is not capital, it is only 'potential capital' which requires the service of the entrepreneur to transform the potentiality into actuality; the lender has nothing to do with the conversion of money into capital and with using it productively.

- c. To the argument that interest arises as an inevitable consequence of the difference between the value of capital goods today and their value a year hence, they respond that this only explains its inevitability and not its rightness. Even if the basis for time preference is the difference between the value of commodities this year and the next, Muslim scholars argue, it seems more reasonable to allow next year's economic conditions to determine the extent of the reward.

Muslim scholars maintain that when a person lends out, the funds are used to create either a debt or an asset (i.e., through investment). In the first case, there is no justifiable reason why the lender should receive a return. Further, there is no justification from the point of view of the smooth running of the economy, or from the point of view of any tenable scheme of social justice. The state should attempt to enforce an unconditional promise regardless of the use of borrowed money.

If the money is used to create additional capital wealth, the question is raised as to why the lender should be entitled to only a small fraction (represented by interest rate) of the exchange value of the utilities created by the use made of loaned-out money. Justice demands that he should be remunerated to the extent of the involvement of his financial capital in creating the incremental wealth.⁵³

*Islamic banking and it's superiority in economy to maximize production, employment & growth for
ensuring social development & welfare.*

In the name of Allah, the most Merciful, the most Beneficent.

CHAPTER-4

Superiority Analysis

Theoretical Approach-potentiality study

4.1: Introduction

Between banking and economic system there is deep correlation in performing and exposing their potentialities in fostering the development of a country and world as well and also in ensuring the welfare of the society and the world community. Banking sector can play an important and effective role in economy if the goal, characteristics, mechanism etc of banking system matched with those of economic system. Conventional banking has been working under conventional economic system, specially, under capitalistic framework for long time. But they could not able to reduce imbalance between poor & rich and could not establish socio-economic justice & welfare. Rather the poor become poorer and the rich become richer and the world economy has been shocked one by one due to defectiveness of its self interest serving world view, profit preferring motive, absolute individual freedom of choice, system, mechanism, characteristics etc specially, excessive and rough use of interest as key tool of exploitation for the capitalist. On the other hand, by the short span of 30 years, Islamic banking has been played extra-ordinary & glorious role under Islamic economic system and better role under conventional economic framework due to its stable system, divine principles, welfare oriented characteristics, moral dimension, exclusively interest free, profit- loss & risk sharing mechanism, social welfare initiative and accountability to any being finally, to Supreme Being.

To establish superiority of bank or banking system it requires analysis of their goal, system including its shortcomings, principles, tools specially interest,

mechanism applying in fund mobilizing and financing, role playing in economy, moral dimension, initiatives for social responsibilities etc.

A comparative study and analysis are furnished here under to establish the superiority of Islamic banking over the conventional one:

4.2. Goal analysis

The major objective of a bank is to earn profit as bank is a business organization **(Khan 2008)**.¹

According to Dr. M. Umar Chapra the goals of an economic system are determined by its world-view that meant if it is thought that the universe has come into existence by itself, then human beings are not accountable to anyone and are free to live as they please. Their purpose in life would then be to seek maximum pleasure, irrespective of how this is realized and how it affects others or their environment. The serving of self-interest and the survival of the fittest would then seem to be the most logical norms of behavior. On the other hand, if thought that human beings and what they possess have been created by the Supreme Being and they are accountable to Him, then they may not consider themselves either absolutely free to behave as they please or helpless pawns on the chessboard of history, unconcerned about the direction in which history is moving. Rather they have a mission. They must use the resources and must treat each other and their environment in a way that would help to fulfill their mission that means, Economic goal will differ in both the above cases **(Chapra 1993)**.²

From the said discussion, it is cleared that the goal of conventional economic system is serving self interest where only the fittest survives as he is not accountable to any being in fulfilling self interest motive and in affecting others or their environment. This goal matched with the objective of conventional banking system that is earning profit by any means where welfare of human being is negligible and welfare in the world here after is absolutely ignored.

On the other hand, Dr. M. Umar Chapra also cleared that under Islamic economic system, no one is absolutely free in behaving or performing any economic

activities, rather man is accountable to the Supreme Being for his economic activities. So, the goal of Islamic economic system is to use all the resources to actualize the *maqasid al-shariah* that is goal of Islam. The principal goal of Islam is intense commitment to brotherhood and justice for spiritual as well as material well-being (*falah*) of all the people through ensuring fulfillment of *jaruriat*-need (safeguarding and protection of *al-deen-religion*, protection of *al-nafs-life*, protection of *al-'aql-intellect*, protection of *al-nasl & al-nasab-lineage*, protection of *al-maal-wealth* and protection of freedom as very clearly basic needs) then *al-haajiyaat (the supportive needs)* then *al-tahseeniyaat (the embellishments)*. Therefore, to establish socio-economic justice and to reduce imbalance in this world and final well-being in the **World Here After** is the goal of Islamic economic system as well as Islamic banking system in the light of the goal of Islam and Islamic *shariah*.

Therefore, the goal of Islamic banking and Islamic economic system is wide and superior.

4.3. Economic system analysis

Excellent out put of an economic system depends on its world view i.e. goal and its inter-alia performance that means intrinsic strength and stability of the system, its characteristics, principles, key tools, devices and capability to ensure justice & well being of human being.

In capitalism, the profit motive and private ownership are given unbridled power to make economic decisions. Here self-interest and absolute individual freedom of choice in consumption and production activities is highly emphasized which tends to unfair distribution of wealth and thus power, a tendency toward market monopoly or oligopoly or government by oligarchy, then imperialism and other forms of human and economic exploitation, and phenomena such as social alienation, inequality, unemployment and economic instability (Raquib 2007).³ There is no arrangement or provision to compel any one to do something for the welfare of the society. So only the fittest survives in the market, they rapidly become from rich to the richest, inversely other become from poor to the poorest.

As long term result, capitalism has divided the world into two opposite classes. The rich and rich states are becoming more and more wealthy and on the other hand, the poor and the poor states are falling into serious poverty & the poorest situation in the same speed (**Robertson 1988**).⁴

Some millions of riches are flying toward the vast sky mounting the wealth. Conversely, billions of ordinary people are being driven toward the serious devastation of hunger and price hiking. Practically, the total wealth of the world does not increase sizably in real sense and actual per capita income does not enlarge on global context.

In socialism, all the means and elements of earnings are under the community ownership of the society. There is no scope to attain the right of personal interest by using any property under personal ownership and no importance of personal liking or disliking. The individual had to work exclusively for the interest of the society. Country's land and resources should be owned and controlled by the state. Economic demand and supply are controlled by the government and the role of market becomes insignificant.⁵

So, individual initiatives and capabilities do not exclusively materialize for the society. As a result people become aimless diverting from the goal and the production seriously being hampered as self-interest and liking is hampered.

In secularism, concept is related to 'Laicite' i.e. separation of state and religion. Secularity is the state of being free from religious or spiritual qualities. It refers to believes that laws, education etc should be based on facts, science etc rather than religion i.e. human activities and decisions should be free from religious interference. So, a secularist society becomes uncommitted to any one vision of social order. There is no common, shared and moral canopy and its spiritual core been turned just like black vacuum.⁶

Under the above economic framework conventional banks do not consider whether social welfare & justice would be hampered or not, imbalance & exploitation would be widen or not and the poor would be deprived or not in

fulfilling their goal that is profit motive. So the rich and the fittest are gathering most resources and the poor are falling in to serious hungry.

But in Islamic economic system profit motive is acceptable to a reasonable extent. Private ownership is not totally negated. Even Islam does not deny the market forces and market economy. Religion is intensively related with state and economic activities. Both activities are run as per guidance of religion in the light of its goal and objectives.

After recognizing private ownership, profit motive and market forces Islam has put certain divine restrictions on the economic activities and decisions. These restrictions are being imposed by Allah, the Almighty, whose knowledge has no limits, cannot be removed by any human authority. These restrictions are *riba*/interest, gambling, hoarding, bribe, lottery, cheating, adultery, stealing, robbery, snatching, rioting, kidnapping/hijacking, extortion, nakedness, adulteration-ill mixing, smuggling, miserliness, misusing/rough using, forced occupying of other's assets, socially harmful and mischief creating thing, dealing in unlawful goods and services etc.

Islamization implies a meticulous implementation of the Islamic strategy to raise the spiritual as well as material well-being of all people and to establish socio-economic justice, which are the central objective of Islam and Islamic economic system.

On the spiritual side, the peace of mind that is essential to inner happiness cannot be attained except by increasing the nearness of the human being to his Creator, in this case Islam is capable of bringing about but secularism does not aspire to.

On the material side, **islamization** demands the allocation and distribution of all resources, a sacred Trust from Allah, in such an efficient and equitable manner that the *maqasid* (goal/objectives) are realized and the *hayat-e-tayyibah* is made possible for all. This necessitates the balanced and effective use of the constituent elements of the Islamic strategy to hold aggregate claims within the bounds of resource availability and goal-realization. **Islamisation** does not thus mean an absence of liberalization. It does, however, mean a different kind of

liberalization-one in which all public and private sector economic decisions are first passed through the test of moral values before they are made subject to the discipline of the market.⁷

Under the above Islamic economic framework Islamic banks have to consider whether social welfare & justice would be hampered or not, imbalance & exploitation would be widen or not and the poor would be deprived or not in fulfilling their goal. So the rich and the fittest are rising reasonably and the poor and worthless are fattening gradually.

So as a system Islamic economic and banking system is superior one.

5.4. Interest analysis-merit-demerit and impact in economy

Interest is the key tool of conventional economic and banking system but it is strictly prohibited in Islamic economic and banking system. So analysis of its merit-demerit, economic impact, defectiveness of theory is highly required.

4.4.1. Interest adversely affects the investment, employment, production and growth

Allah says that whatever *riba* you give so that it (*riba*) increases in the wealth of the people, but it does not increase at Allah (Al-Qur'an).⁸

In said *Ayah* Allah simply says that the *Riba* does not increase at HIM i.e. it carries no reward in the hereafter. In the economic aspect the verse may analyze that any sorts of *riba* given to increase in the wealth of the people does not increase the wealth in the eye of Allah, that means *riba* does not or will not increase the wealth of the people or of the nation in great sense i.e. provider's wealth reduced and receiver's same quantity of wealth increased.

In case of investment, it is well established theory that interest rate and investment is inversely related that means if rate of interest increased then investment decreased and if rate of interest decreased then investment increased, finally when rate of interest be zero then investment be maximized (Akkas 1996).⁹

Resultantly, employment, production, income, savings and again investment would be increased cyclically.

Graphical example:

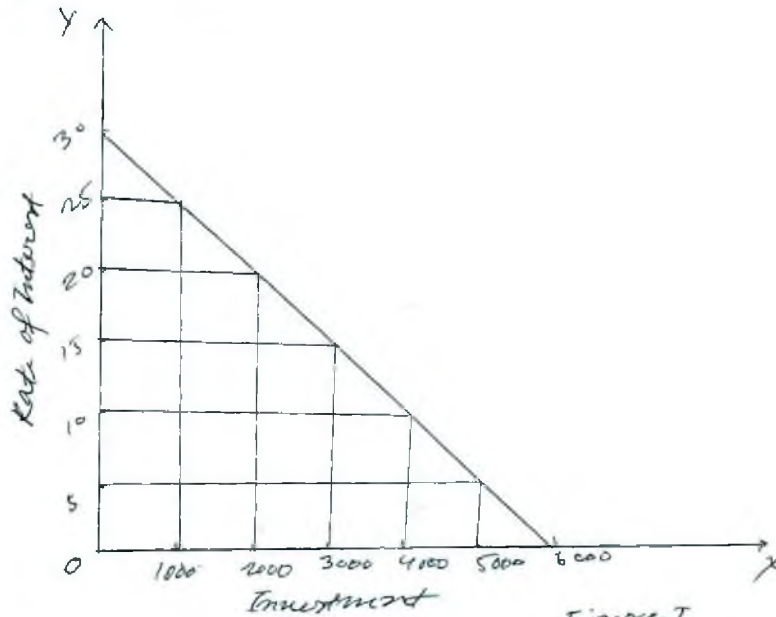


Figure-I

In the above graph Y axis indicates rate of interest and X axis indicates investment position which are increasing inversely with rate of interest that means when rate of interest become zero then investment position will be maximized.

Here question may be arisen that in case of zero rate of interest what would be the means of capital be and why would capital be deployed? The answer is profit-loss sharing investment, the main mechanism of Islamic economic and banking system.

4.4.2. Receiving any sort of loan is discouraged in Islam to avoid indebted death

Under capitalist system, loans are purely commercial transactions meant to yield a fixed income to the lenders. In most cases interest-based loan is not backed by real asset which subsequently turns in long run in to speculation.

If the interest is banned, the role of loans in commercial activities become very limited, and the whole financing structure will turn out to be equity- based and

backed by real assets. So, in order to limit the use of loans, the *shariah* has permitted to borrow money only in cases of dire need, and has discouraged the practice of incurring debts for living beyond one's means or to grow one's wealth. In case of lending, Islam does not recognize loans as income-generating transactions. They are meant only for those lenders who do not intend to earn a worldly return through them. They, instead, lend their money either on humanitarian grounds to achieve a reward in the Hereafter, or merely to save their money through safer hand.

The well-known event that the Holy Prophet (*sm*) refused to offer the funeral prayer (*salat-ul-janazah*) of a person who died indebted was, in fact, to establish the principle that incurring debt should not be taken as a natural or ordinary phenomenon of life. It should be the last thing to be resorted to in the course of economic activities. He has condemned borrowing without genuine need. This is one of the reasons for which interest has been prohibited, because, given the prohibition of interest, no one will be agreeable to advance a loan without a return for unnecessary expenses of the borrower or for his profitable projects. It will leave no room for unnecessary expenses incurred through loans (Usmani 2000).¹⁰

4.4.3. Interest is injustice both for borrower and lender

If the intent of sharing the profit of the borrower is designed on the basis of an interest-based loan, it will mean that the financier wants to ensure his own profit, while he leaves the profit of the borrower at the mercy of the actual outcome of the business. There may be a situation where the business of the borrower totally fails. In this situation he will not only bear the whole loss of the business, but he will have also to pay interest to the lender, meaning thereby that the profit or interest of the financier is guaranteed at the price of the destructive loss of the borrower, which is obviously a glaring injustice.

On the other hand, if the business of the borrower earns huge profits, the financier should have shared him in the profit in reasonable proportion, but in an interest-based system, the profit of the financier is restricted to a fixed rate of

return which is governed by the forces of supply and demand of money and not on the actual profits produced on the ground. This rate of interest may be much less than the reasonable proportion a financier might have deserved, had it been a joint venture.

In this case the major part of the profit is secured by the borrower, while the financier gets much less than deserved by his input in the business, which is another form of injustice to the financier.

Thus, financing a business on the basis of interest creates an unbalanced atmosphere which has the potential of bringing injustice to either of the two parties in different situations. That is the wisdom for which the *Shariah* did not approve an interest based loan as a form of financing.¹¹

4.4.4. Interest-based loan and financial system drown the nation in debts

If interest is allowed, advancing loans, in itself, becomes a form of profitable trade, and the whole economy turns into a debt-oriented economy which not only dominates over the real economic activities, rather it disturbs its natural functions by creating frequent shocks, and also puts the whole mankind under the slavery of debt. It is no secret that all the nations of the world, including the developed countries, are drowned in national and foreign debts to the extent that the amount of payable debts in a large number of countries exceeds their total income.¹²

Since in an interest-based system funds are provided on the basis of strong collaterals and the end-use of the funds does not constitute the main criterion for financing, it encourages people to live beyond their means. The rich people do not borrow for productive projects only, but also for conspicuous consumption.

Similarly governments borrow money not only for genuine development programs, but also for their lavish and for projects motivated by their political ambitions rather than being based on sound economic assessment. Non-project related borrowings, which were possible only in an interest based system have thus helped in nothing but increasing the size of our debts to a horrible extent.¹³

4.4.5. Interest makes the rich richer and the poor poorer

The pervasive role of interest in the economic system results in the systematic transfer of money from those who have less to those who have more. Again, this transfer of resources from poor to rich has been made shockingly clear by the Third World debt crisis. But it applies universally. It is partly because those who have more money to lend, get more in interest than those who have less; it is partly because those who have less, often have to borrow more; and it is partly because the cost of interest repayments now forms a substantial element in the cost of all goods and services, and the necessary goods and services looms much larger in the finances of the rich.

On the same way the transfer of revenue from poor people to rich people, from poor places to rich places, and from poor countries to rich countries is made by the money and finance system which is systematic caused by interest payments and receipts work through the economy.¹⁴

4.4.6. Interest-based loan and debt-money system create inflation

Since interest-bearing loans have no specific relation with actual production, and the financier, after securing a strong collaterals, normally has no concern how the funds are used by the borrower, the money supply effected through banks and financial institutions has no nexus with the goods and services actually produced on the ground. It creates a serious mismatch between the supply of money and the production of goods and services. This is obviously one of the basic factors that create or fuel inflation.¹⁵

On the other hand, under a debt-money system all our money is created in parallel with an equivalent quantity of debt that is designed and controlled by private bankers for their benefit. They create and loan out money at interest, we get the debt.

So, although the banks do not create currency, they do create checkbook money, or deposits, by making new loans. They even invest some of this created money. In fact, in USA, over one trillion dollars of the privately-created money has been

used to purchase US bonds on the open market, which provides the banks with roughly 50 billion dollars in interest, less the interest they pay some depositors. In this way, through fractional reserve lending, banks create far in excess of 90% of the money, and therefore cause over 90% of inflation.¹⁶

4.4.7. System of controlling of interest rates makes the economy a stagnating sea of human misery

Controlling of interest rates by the government makes the economy a stagnating sea of human misery and bound to restart the business cycle.

In this monetary management system, a government does by lowering or raising interest rates. It alternately encourages or discourages borrowing, thereby speeding up or slowing down the creation of money and the growth of the economy. The fact, that, by raising interest rates, people and businesses with outstanding debts can be suddenly hit with huge charges on their debts, simply as a management device to deter other borrowers, is an injustice.

This method of controlling banks, inflation and money certainly works. But an economy, dependent upon borrowing for supplying money, strapped to a financial system in which both debt and the money supply are logically bound to escalate, is forcedly punished for the borrowing. Many past borrowers are rendered bankrupt; homes are repossessed, businesses are ruined and millions are thrown out of works as the economy sinks into recession. Until inflation and over heating are no longer deemed to be a danger, borrowing is discouraged and the economy becomes a stagnating sea of human misery. Of course, no sooner has this been done, than the problem is lack of demand, so it requires must reduction of interest rates and had to wait for the consumer confidence and to return the positive investment climate. As a result the business cycle begins all over again.¹⁷

4.4.8. Ill impact of interest-based money creating financial system

The money-must-grow imperative is ecologically destructive. It also results in a massive world-wide diversion of effort away from providing useful goods and services, into making money out of money. At least 95% of the billions of dollars

transferred daily around the world are of purely financial transactions, unlinked to transaction in the real economy.

The experience and out come of workings of money, banking and finance system is treated as unreal, incomprehensible, unaccountable, irresponsible, exploitative and out of control as the people lose their houses and their jobs as a result of financial decisions taken in distant parts of the world, as the national and international money and finance system involve in systematic transfer of wealth from poor people to rich people and from poor countries to rich countries, as someone in Singapore be able to gamble on Tokyo Stock Exchange and bring about the collapse of a bank in London and as young people trading in derivatives in the City of London get annual bonuses larger than the whole annual budgets of primary schools. Even the financier George Soros has said (“Capital Crimes”, Atlantic Monthly, January, 1997) that “the untrammelled intensification of laissez-faire capitalism and the extension of market values into all areas of life is endangering our open and democratic society.”¹⁸

All the above appalling situations faced by the whole world today are the logical outcome of giving an unbridled power to the interest-based financial system to reign the economy.

4.4.9. Adverse global impact of debt-based/interest-based economic and banking system

The third world debt is not just a financial matter, but a political one. There were always severe conditions attached to IMF and World Bank loans. Although ‘program aid’ required borrowing nations to conform to a package of economic and social expenditure measures aimed to ensure that funds are used for development, yet when projects failed and debts increase, ‘program aid’ was followed by ‘structural adjustment’ that entailed supervising the development of the entire economy of the indebted countries. Thus the lenders justified their total interference in the domestic policies of the third world nations. As these policies too failed to bring a turn around in the debt trends, ‘austerity programs’ were

introduced whereby expenditure on social services, welfare and education were cut to a considerable extent.¹⁹

Between 1980 and 1989 some thirty three African countries received 241 structural adjustment loans. During that same period, average GDP per capita in those countries fell 1.1% per year, while per capita food production also experienced steady decline. The real value of the minimum wage dropped by over 25%, government expenditure on education fell from \$11 billion to 7 billion and primary school enrolments dropped from 80% in 1980 to 69% in 1990. The number of poor people in these countries rose from 184 million in 1985 to 216 million in 1990, an increase of seventeen percent.²⁰

There has been a massive outpouring literature on the subject of Third world debt. The books are characterized by one feature. Whereas the arguments and policies of the IMP and World Bank have been based upon an apparently reasonable theory, the studies give case after case and country after country, in which the theory has not worked in practice. Either loans have led to development, but repayment has proved impossible; or the projects funded have failed completely leaving the country with a massive debt and no hope of repayment, or repeated additional loans have become necessary simply to provide funds for the repayment of past loans. The debtor countries, as a group, began the 1990s fully 61% deeper in debt than they were in 1980.²¹

The present international financial system can be compared point by point with peonage on an individual scale. In the peonage or debt slavery system the aim of the employer/creditor/merchant is neither to collect the debt once and for all, nor to starve the employee to death, but to keep the laborer permanently indentured through his debt to the employers. Precisely the same system operates on the international level. It is debt slavery on an international scale. If they remain within the system, the debtor countries are doomed to perpetual underdevelopment or rather, to development of their exports at the service of multinational enterprises, at the expense of development for the needs of their own citizens.²²

In virtually all cases, the impact of these (IMF and World Bank) projects has been basically negative. They have resulted in massive unemployment, falling real incomes, pernicious inflation, increased imports with persistent trade deficits, net outflow of capital, mounting external debts, denial of basic needs, severe hardship and deindustrialization and the agriculture, manufacturing and the social services sectors have been worst hit, while the burden of adjustment has fallen regressively on the poor and weak social groups.²³

The foreign –aid-based development model has proved itself powerless to bring a single country out of economic and financial dependence. However, it has turned out to be a source of fabulous wealth for certain Third World elites, giving birth to a new form of power and socio-political class that can rightly be called the ‘aidocracy’.²⁴

4.4.10. Theory of interest by economists is unjustifiable

‘Interest is a reward for saving, a productivity of capital and an inevitable consequence of the difference between the value of capital goods today and their value a year hence’ is the well established theory for interest.

But recent Muslim Scholars place the major emphasis of their explanation of the law on the lack of theory of interest. They have countered the arguments. ‘Mirakhor’ summarizes those three arguments in the following way:

- a. To the argument that interest is a reward for saving, Muslim scholars respond that such payments could only be realized if savings were used for investment to create additional capital and wealth. According to them, the mere act of abstention from consumption should not entitle anybody to a return.
- b. To the argument that interest is justified as productivity of capital, they respond that although the marginal productivity of capital may enter as one factor into the determination of the rate of interest, interest per se, has no necessary relation with the capital productivity. Interest, they argue, is paid on money, not on capital, and has to be paid irrespective of capital

productivity. In distinguishing between interest as a charge for the use of money and a yield from the investment of capital, Muslim scholars argue that it is an error of modern theory to treat interest as the price of, or return for, capital. Money, they argue, is not capital, it is only 'potential capital' which requires the service of the entrepreneur to transform the potentiality into actuality; the lender has nothing to do with the conversion of money into capital and with using it productively.

- c. To the argument that interest arises as an inevitable consequence of the difference between the value of capital goods today and their value a year hence, they respond that this only explains its inevitability and not its rightness. Even if the basis for time preference is the difference between the value of commodities this year and the next, Muslim scholars argue, it seems more reasonable to allow next year's economic conditions to determine the extent of the reward.

Muslim scholars maintain that when a person lends out, the funds are used to create either a debt or an asset (i.e., through investment). In the first case, there is no justifiable reason why the lender should receive a return. Further, there is no justification from the point of view of the smooth running of the economy, or from the point of view of any tenable scheme of social justice. The state should attempt to enforce an unconditional promise regardless of the use of borrowed money. If the money is used to create additional capital wealth, the question is raised as to why the lender should be entitled to only a small fraction (represented by interest rate) of the exchange value of the utilities created by the use made of loaned-out money. Justice demands that he should be remunerated to the extent of the involvement of his financial capital in creating the incremental wealth.²⁵

From the above study it is asserted that-

Interest prevents people from undertaking real economic activities. This is because when a person or person entity having money is allowed to earn more money on the basis of interest, either in spot or deferred transactions, it becomes easy for him to earn without bothering himself to take pains in real economic

activities. This leads to hamper the real interests of the humanity, because the interests of the humanity can not be safeguarded without real trade skills, industry and construction.²⁶

In addition, practically interest-based loans have a persistent tendency in favor of the rich and against the interest of the common people. It carries adverse effects on production and allocation of resources as well as on distribution of wealth.²⁷

So, interest based economic and banking system is inferior to interest free profit-loss sharing system.

4.5. Money creation system and money trading as commodity creates speculation and shocks the whole economy

The history of ‘money creation’ refers back to the famous story of the goldsmiths of medieval England. They used to loan out four, five, even ten time more gold certificates than they had in their safe room.

Initially, it was abuse of trust and a sheer fraud on the part of the goldsmiths not warranted by any norm of equity, justice and honesty. It was a form of forgery and usurpation of the power of the sovereign authority to issue money. But over time, this fraudulent practice turned into the fashionable standard practice of the modern banks under the ‘fractional reserve’ system.²⁸

One of the wrong presumptions on which all theories of interest are based is that money has been treated as a commodity. It is, therefore, argued that just as a merchant can sell his commodity for a higher price than his cost, he can also sell his money for a higher price than its face value, or just as he can lease his property and can charge a rent against it, he can also lend his money and can claim interest thereupon.

Islamic principles, however, do not subscribe to this presumption. Money and commodity have different characteristics and therefore they are treated differently. The basic points of difference between money and commodity are as follows:

- a) Money has no intrinsic utility. It cannot be utilized in direct fulfillment of human needs. It can only be used for acquiring some goods or services. A commodity, on the other hand, has intrinsic utility and can be utilized directly without exchanging it for some other thing.
- b) The commodities can be of different qualities while money has no quality except that it is a measure of value or a medium of exchange. Therefore, all the units of money of the same denomination are hundred percent equal to each other. An old and dirty note of Rs.1000/= has the same value as a brand new note of Rs.1000/=.
- c) In commodities, the transactions of sale and purchase are effected on an identified particular commodity. If 'A' has purchased a particular car by pin-pointing it, and seller has agreed, he deserves to receive the same car. The seller cannot compel him to take the delivery of another car, though of the same type or quality. Money on the contrary, cannot be pin-pointed in a transaction of exchange. If 'A' has purchased a commodity from 'B' by showing him a particular note of Rs.1000/= he can still pay him another note of the same denomination.

Based on these basic differences Islamic *shariah* has treated money differently from commodities especially on two scores:

Firstly, money (currency of same denomination) is not held to be the subject-matter of trade like other commodities. Its use has restricted to its basic purpose i.e. to act as a medium of exchange and a measure of value.

Secondly, if for exceptional reasons, money has to be exchanged for money or it is borrowed, the payment on both sides must be equal, so that it is not used for the purpose it is not meant for i.e. trade in money itself.²⁹

'Imam Al-Gazzali' said that the creation of *dirhams* and *dinars* (money) is one of the blessings of Allah.... They are stones having no intrinsic usufruct or utility, but all human beings need them, because every body needs a large number of commodities for his eating, wearing etc, and often he does not have

what he needs and does have what he needs not..... Therefore, the transactions of exchange are inevitable. But there must be a measure on the basis of which price can be determined, because the exchanged commodities are neither of the same type, nor of the same measure which can determine how much quantity of one commodity is a just price for another. Therefore, all these commodities need a mediator to judge their exact value..... Allah Almighty has, therefore, created *dirhams* and *dinars* (money) as judges and mediators between all commodities. So, the one who owns them is as he owns every thing, unlike the one who owns a cloth, because he owns only a cloth, therefore, if he needs food, the owner of the food may not be interested in exchanging his food for cloth, because he may need an animal for example. Therefore, there was needed a thing which in its appearance is nothing, but in its essence is everything. The thing which has no particular form may have different forms in relation to other things. The same is the case of money. It is not an objective in itself, but it is an instrument to lead to all objectives.....

So, 'Al-Gazzali' added that the one who is using money in a manner contrary to its basic purpose is, in fact, disregarding the blessing of Allah. Consequently, whoever hoards money is doing injustice to it and is defeating their actual purpose. He is like the one who detains a ruler in a prison.....

If it is allowed for him to trade in money itself, money will become his ultimate goal and will remain detained with him hoarded money. And imprisoning a ruler or restricting a postman from conveying messages is nothing but injustice.³⁰

Money is only a medium of exchange and a measure of value is universally accepted by almost all the economist of the world, but unfortunately a large number of these economists failed to recognize the logical outcome of this concept, so clearly elaborated by 'Imam Al-Gazzali' that money should not be treated as a commodity meant for being traded in. After holding that money is a commodity the modern economists have plunged into a dilemma that was never resolved satisfactorily. The commodities are classified into the commodities of the first order which are normally termed as 'consumption goods' and the commodities of the higher order which are called 'production goods'. Since

money, having no intrinsic utility, it could not be included in 'consumption goods'. Most of the economists had no option but to put it under the category of 'production goods', but it was hardly proved by sound logical arguments that money is a 'production goods'.³¹

Of course, if we regard the twofold division of economic goods as exhaustive, we shall have to rest content with putting money in one group or the other. This has been the position of most economists; and since it has seemed altogether impossible to call money a consumption good, there has been no alternative but to call it a production good. It is true that the majority of economists recon money among production goods.³²

Nevertheless, arguments from authority are invalid; the proof of a theory is in its reasoning, not in its sponsorship; and with all due respect for the masters, it must be said that they have not justified their position very thoroughly in the matter. Regarded from this point of view, those goods that are employed as money are indeed called by Adam Smith as "dead stock, which.... produces nothing."³³

'Imam Al-Gazzali' has taken the concept of 'medium of exchange' to its logical end. He has concluded that when money is exchanged for money of the same denomination, it should never be made an instrument generating profit by such exchange. This approach of Imam 'Al-Gazzali' fully backed by the clear directives of the Holy *Qur'an* and *Sunnah*, has however been admitted to be true by some realistic scholars, even in societies dominated by interest. Many of them after facing the severs consequences of their financial system based on trade in money have admitted that their economic plight was caused, inter-alia, by the fact that money was not restricted to be used for its primary function as medium of exchange.³⁴

Neglecting the above arguments modern conventional banks are creating money out of nothing. They are allowing advances and loans in the amounts around ten times more than their deposits specially, in the western countries. The coins and notes issued by the government as genuine and debt-free money have now a very insignificant proportion in the total money in circulation which has been

constantly declining in most of the countries, while the proportion of the artificial and derivative money created by the banks out of nothing is ever-increasing. The spiral of loans built upon loans is now the major part of the money supply. As example of UK according to the statistics of 1997 the total money stock in the country was 680 billion pounds, out of which only 25 billion pounds were issued by the government in the form of coins and notes. All the rest i.e. 655 billion pounds were created by the banks. It means that the original debt-free money remained only 3.6% of the whole money supply while 96.4% is nothing but a bubble created by the banks,¹⁰¹ though the conventional 'quantity theory' of money has suggested many devices like control of interest rates by the government or central bank to control the money supply. These remedies are not the cure of the disease. These are temporary measures and themselves have their side effects that subject the economy with shocks of the business cycle.³⁵

This baseless money created by the banks and financial institutions it self has become the subject of speculative trade through the derivatives in the form of '**Futures**' and '**Options**' in the International markets. It means that in the beginning, claims over money have been treated as money. Now, claims over claims are being treated as claim. According to an estimate, over 150 trillion US dollars worth of derivatives are circulating in the world, whereas the combined GDP of all the 188 countries of the world is around 30 trillion US dollars only. Almost 80% of this trade is in the hands of some two dozen big banks and hedge funds.³⁶

The whole economy of the world has thus been turned into a big balloon that is being inflated on daily basis by new debts and new financial transactions having no nexus whatsoever with the real economy. This big balloon is vulnerable to the market shock and can be bust any time. It really did several times in the recent past whereby the Asian Tigers reached the brink of total collapse, and the effects of these shocks were felt in the whole world to the extent that the media started crying that the market economy is breathing its last.³⁷

Most significantly, perhaps transactions on foreign exchange markets have now reached the astonishing sum of around \$1.2 trillion a day, over fifty times the

level of the world trade. Around 95 percent of these transactions are speculative in nature, using complex new derivative's financial instruments based on futures and options derived on trading of money. According to Michael Albert, the daily volume of transactions on the foreign exchange markets of the world holds some \$900 billions-equal to France's annual GDP and some \$200 million more than the total foreign currency reserves of the world central banks. This virtual financial economy has a terrible potential for disrupting the underlying real economy as seen in the collapse in 1995 of Barings, Britain's oldest bank.³⁸

This financial system based on money trading is unfair, ecologically destructive and economically inefficient. The money-must-grow imperative derives production (and thus consumption) to higher than necessary levels. It skews economic effort towards money out of money, and against providing real services and goods.

It also results in a massive world-wide diversion of effort away from providing useful goods and services, into making money out of money. At least 95% of the billions of dollars transferred daily around the world are for purely financial transactions, unlinked to transactions in the real economy.³⁹

Since Islamic banks do not practice money trading and do not use complex derivatives financial instruments based on futures and options like conventional one, the whole economy will turn in to debt-shock free real economy from debts-mounted recessionary phases. So, such Islamic banking is superior to modern conventional one.

4.6. Analysis of commitment of Islamic Bank to the principles of Islamic *Shariah*

Islamic *Shariah* means divine guide lines for human being, designed by the Almighty Allah to ensure human welfare here, in this world and here after, in the world after death. To achieve the welfare strict and meticulous compliant of the principles of Islamic *Shariah* is to be ensured. An Islamic Bank has its strong commitment in this regard as stated in the definition of Islamic Bank designed by

OIC i.e. Islamic Bank is a financial institution whose statutes, rules and procedures expressly states its commitment to the principles of Islamic *Shariah*.

4.6.1. Impact of principles of Islamic *shariah*

To ensure human welfare the Almighty Allah set the complete codes in undertaking human affairs in the Holy *Qur'an* which are treated the principles of Islamic *shariah* or *ahkam-e-shariah*. The Islamic scholars identified its in 5 natures:

1. *Fard and wazib* (Compulsory affairs): Reward in complying and punishment in non-complying.
2. *Mandub* (recommended affairs): Reward in complying and no punishment in non-complying.
3. *Mubah* (allowed showing silence): No reward no punishment.
4. *Makruh*/disliked: No reward and punishment but against the *Takwah* and socially discouraging.
5. *Haram* (strictly prohibited): Punishable on the eye of law in this world and punishable here after also.

Clear cut principles of Islamic *shariah* concern with economic and financial affairs where commitment of Islamic Bank applicable are stated here under.

4.6.2. Impacts of Islam prohibited principles i.e. *shariah* prohibited transactions, activities and businesses

Islam prohibited some financial transactions, activities and businesses as those play adverse role in economy, even in society which are as follows:

a. Prohibited activities and transactions

Interest, Bribe, Gambling-lottery, Cheating, Adultery-prostitution, Stealing, Robbery, Snatching, Rioting, Kidnapping/hijacking, Addiction-promotion of alcohol (wine, heroine) , tobacco, cigarette , nakedness-pornography, porno cinema etc., Adulteration-ill mixing, Hording, Using money or

currency as commodity, Smuggling, Miserliness, Misusing or rough using, Forced occupying of other's assets, Socially harmful, disliking and mischief creating thing, Extortion etc.

Among the above adultery-prostitution, addiction (wine, heroine), nakedness-pornography, porno cinema etc seriously attract the young generation and destroy their future, consequently whole nation will be intellectual less and turn in to anti development situation.

Islam discouraged and disliked the following financial activities for peace keeping and welfare of the society:

b. Discouraged and disliked activities

1. Excess spending- which turn into blameworthy and destitute.
2. Luxuriousness.
3. Keeping the properties beyond proper use.
4. Alms seeking

The said financial transactions, activities and businesses both for earning and spending seriously affect the development, peace, welfare, justice and balance of the society. Islamic banks do not involve by any means with the said activities rather they strictly prohibited their financing in the above cases directly or indirectly in order to ensure social peace and order even they negatively consider any involvement with the above activities in selecting the client. Simultaneously Islamic economic system has strong commitment to reduce and abolish the said ill activities from the economic and financial affairs.

On the other hand, conventional banking and economics has no commitment against said ill activities rather they encouraged in most cases for the shake of maximizing profit giving up social peace and order. So Islamic banking is superior in ensuring social peace and order.

4.6.3. Impacts of Islam instructed principles -instructed transactions, activities and businesses

Islam instructed some financial transactions, activities and businesses both for earning and spending which are as follows:

1. Implementation of *zakat* and *ushar*
2. Prevailing *quard-e-hasanah*
3. Applying *shirkat* (participating), *ijara* (leasing) and *bai* (buying-selling) mechanisms in financial activities as economic and banking system.
4. Encouraging private ownership with trusteeship of Allah.
5. Encouraging *sadakah*, *waqf* etc as charitable activities.

Zakat and Ushar:

As per order of Allah *zakat* and *ushar* are the obligatory (*farz*) worship to the capable Muslims which to be distributed among 8 groups (sectors) of people to de-concentrate the resources as Allah said “hence, the resources are concentrated among the riches”.⁴⁰ *zakat* provider increases the resources step by step (on multiplying way) as declared by the Almighty-“and what you pay from *zakat* expecting Allah’s favor then those are the multiplied increaser of resources”.⁴¹ The scholar of Islamic economics showed that *zakat* payer’s assets reduced first time on paying but it increased the purchasing power of the poor (who get *zakat*) and create additional demand so further production is made by the entrepreneur who are *zakat* payers in most cases and earn profit which increased the resources of the entrepreneur that means *zakat* payer. The scholars also showed that *zakat* increased production which generate employment and fuel the economic development. On the above view and to follow the order of Almighty Allah Islamic banks motivate, collect and distribute the *zakat*.

The prophet (*sm*) stated that *zakat* would be collected from the rich and to be distributed to the poor mainly. It is not mercy rather rights (*haq*) to the poor in the wealth of the rich imposed by the original Owner (Allah) of all the wealth. In case of poverty elevation, proper distribution of wealth and in reducing imbalance in the society, *zakat* & *ushar* play effective and important role in economy.

Quard-e-hasanah:

Benevolent loan i.e. loan without interest. It has to be granted on the ground of compassion i.e. to remove the financial distress caused by the absence of sufficient money or resources in the face of dire need. To remove financial hardship of needy people Islam encouraged ***quard-e-hasanah*** declaring benefit in the life here after.

Shirkat (participating), ijara (leasing) and bai (buying-selling):

To save the mankind from evil consequence of interest and interest based financial activities Islam presented ***shirkat, ijarah*** and ***bai*** based economic system. All financial and economic transactions must be undertaken through these mechanisms by which economy would be stable, balanced and equitable.

Private ownership with trusteeship of Allah:

Since all resources at the disposal of human beings have been provided by Allah, the merciful, man as ***khalifah*** is not their primary owner. He is just a trustee (***amin***). This trusteeship (***amanah***) does not mean a negation of private property. It carries a number of very important implications which create a revolutionary difference in the concept of private ownership of resources in Islam and other economic systems like capitalism and free market globalize system:

- i. The sources are for the benefit of all and not just a few. They must be utilized efficiently for the benefit and satisfaction of all;
It is He Who has created for you all things that are on earth; Moreover, His design comprehended the heavens, for He gave order and perfection to the seven firmaments; and of all things He has perfect knowledge.⁴²
- ii. Every one must acquire resources in a legitimate way. And in a manner indicated by the ***Qur'an*** and the ***Sunnah***.
- iii. In their wealth there is a rightful demand of the needy who asks and the deprived;
And those in whose wealth are a recognized right.⁴³ No one is authorized to destroy or waste the God-given resources;

When he turns his back, His aim everywhere is to spread mischief through the earth and destroy crops and cattle. But Allah loves not mischief.⁴⁴

Sadaqah: is one kinds of gift or charity. These are non refundable & material benefit free financial or any kinds of assistance. It may be provided to any level of human being if required by him in any hardship situation though he had many things at certain place, but presently he is help less. In broad sense incurring cost for family, relative or friend is also **sadaqah**. It is **nafal abadah**. Allah Almighty cordially liked this **abadah** and declared very much benefit in the World Here After to encourage **sadaqah**.

Waqf: These are charitable activities like setting up rest house, tube well, inn, toilet-bath room, religious school-library etc for social and human welfare. Islam declared huge benefits in the life here after to encourage these activities.

The above instructed financial transactions, activities and businesses very effectively play role for the peace, welfare, justice and balance in the society and also play positive role in economy. As such Islamic banks encourage the people to follow and practice the said instructions and activities. They introduced **waqf** account, provide **quard-e-hasanah** the poor through Islamic Bank Foundation, collect **zakat** and distribute it as per directives of the Holy **Qur'an**.

On the other hand, there is no role of conventional banks in the above fields. So, Islamic banking system is superior one.

4.7. Pricing mechanism analysis in collecting cost bearing deposit

Conventional Banks collect cost bearing deposits on predetermined interest rate. They pay interest to the depositors on pre-declared interest rate whether profit is earned by bank or lost. The bankers attract the deposits declaring relatively higher rate of interest applying professional qualities. Changing in earning profit deploying deposit funds is not considerable to ascertain the interest rate on deposit i.e. if more profit earned by bank the depositors do not get further amount beyond predetermined rate and if lesser profit earned by the bank or incurred loss in any adverse situations then they could not pay less amount than pre-declared

rate. It is fixed return mechanism (**FRM**) of conventional banking system in collecting deposit. Changing the rate acts as the tool for attracting deposits. In most countries, government or regulatory authority of money market fixes the rate applying pricing mechanism i.e. base rate plus risk premium to a certain range which might be changed time to time to control the economic indicators, very specially, inflation, saving, investment etc. It makes the economy unstable and hampers the saving decisions. It is asserted that regulatory authority had to change the interest rate on deposit several times in a year.

In case of Islamic banks, they collect cost bearing deposits on *mudaraba* mechanism i.e. profit to be distributed as per predetermined agreed ratio and loss to be borne by the depositors. As per *shariah* '*mudaraba*' mechanism is defined and explained as- "in a business one part will provide/deploy fund and another part deploy labor and intellect. Here 1st part is called '*sahib-al-maal*' (owner of the capital) and 2nd part is called '*mudareeb*' (entrepreneur). Here interference of *sahib-al-maal* in business is not allowed but negligence of *mudareeb* is accountable. If any profit is earned from the business then it will be distributed as per predetermined agreed ratio and if incurred any loss then it will be borne by *sahib-al-maal* only, here *mudareeb* loses the benefit against his labor brain storming. It may be further explained that depositors will get part of profit as reward earned by bank from investment of deposit funds as per predetermined agreed ratio. If incurred loss on investment of deposit fund then depositors will not get any reward even deposited money will be reduced by loss amount. It is variable return mechanism (**VRM**) of Islamic banking system in collecting deposit.

The following example may clear the matter:

Example:

a customer deposited Tk.100,000/- at an Islamic Bank on *mudaraba* mode for one year term, here predetermined agreed ratio is at 65% for depositor and at 35% for Bank (presently IBBL maintains predetermined agreed ratio at least 65% for depositor and at best 35% for Bank) and loss to borne by

the depositor only. Islamic Bank financed/invested said Tk.100,000/- in *shariah* permissible business.

Say earned profit Tk.20,000/- from said investment. It will be distributed as under:

Customer/depositor will get = 13,000/- at 65% where RR of depositor will stand at 13% and;

Bank will get = 7,000/- at 35%

If earned Tk.30,000/- then distribution will be-

Customer/depositor will get = 19,500/ at 65% where RR of depositor will stand at 19.5% and;

Bank will get = 10,500/- at 35%

If earned Tk.10,000/- then distribution will be-

Customer/depositor will get = 6,500/ at 65% where RR of depositor will stand at 6.5% and;

Bank will get = 3,500/- at 35%.

If incurred loss of Tk.10,000/- it will be borne by the depositor only then his deposit balance will stand at Tk.90,000/ (100,000/-minus 10,000/-).

From the above scenario it is clear that return of both the customers and Bank from deposited fund is not on fixed return mechanism (**FRM**) and it varied on investment/financing performance of Islamic bank that is variable return mechanism (**VRM**) both for depositor and Bank. So customers will run to the best investment performer bank, resultantly, competition in best investment sector will automatically increase which fuel the economic cycle. Here controlling of the interest rate by regulatory authority is not require as diversification of investment will be made on equilibrium point of savings and best investment sectors.

It is mentionable that Islamic banking business is joint venture with depositors that means deposit is not debt to the Islamic bank like conventional one. It will treat as equity in Islamic economic frame work so Islamic bank never be bankrupt in Islamic economic system. Rather depositors are partners of bank business specially, in deployment/ investment of deposit fund. Actually it is profit-loss sharing system. Since the deposit fund is the blood of banking business i.e. around 90% funds are deposit fund so to share in profit and loss by depositors as key partners is quite justified.

From the above discussion it is also clear that pricing mechanism that is **VRM**, of Islamic Banks in collecting deposit is superior to conventional mechanism.

However in conventional economic and banking system Islamic bank had to treat the deposit as debt and had to maintained loss compensating reserve to maintain competitive RR.

4.8. Pricing mechanism analysis in financing

In broad sense, conventional Banks deploy and finance their funds to the borrowers mainly on four mechanisms which are as follows:

i) Loans:

It is lump sum basis lending for a certain period at an agreed rate of interest. The entire amount is to be paid on an occasion either in cash or by transfer in borrower's current account which he can draw at any time. The interest is charged for the full amount sanctioned whether withdrawn or not. It may be with or without security. A loan once repaid in full or in part can not be withdrawn again. It may be sanctioned as fresh if required by the borrower. Loans are two kinds. One is **demand loan**-for a short period usually to meet up working capital requirement payable on demand of the bank. Another is **term loans**- for a period of one year and above to purchase machine, equipments etc. Repayments usually made on installment basis. Most of term loans are under **hire purchase** mode where client usually repaid the interest and part of price of equipment on installment basis. Finally client purchases the item after full adjustment of respective liabilities.

Loans are further classified as working capital loan, project loan, export-import loan, bridge loan, composite loan and consumption loans such as car loan, house loan, medical loan, wedding loan, credit card etc.

ii) Cash Credit:

It is allowed to borrow up to a certain limit. Borrower can draw the sanctioned amount as and when required and he can put back any amount if feel surplus. It is separate from current account. It is running account also for frequently deposits and withdrawals. Interest is charged on withdrawal amount only not on whole sanctioned amount like loans. It is two kinds also. One is **CC pledge** and another is **CC hypothecation** of goods.

iii) Overdraft:

Overdraft is an arrangement between a banker and client where the second is allowed to withdraw over and above his credit balance in the current account up to an agreed limit. It is a temporary accommodation against securities like shares, promissory note, FDR etc. it may without security for small amount. Interest here is charged on drawn amount only.

iv) Bill discounting:

Banks discounted and purchased the bill from the client as short term investment/lending. Discounted bills are ideal assets to invest a bank's temporary surplus not only because it is legal evidence of indebtedness but also because of its self liquidating nature. The repayment of the amount is guaranteed by the drawer, acceptor and endorsers. After deducting the discount/interest from the amount of instrument, the rest amount of bill is credited in the account of the client. In this form of lending, the interest is received by the banker as advance.

Since, on the other hand deploying of funds is on predetermined interest rate. The bankers attract the clients declaring relatively lower rate of interest within the range with providing quality services. Changing the earnings/return of the client from utilization of loan or performance of business is not considerable to ascertain the interest rate on loan i.e. if more profit/return earned by the client banks do not get further amount beyond predetermined rate and if lesser profit earned or incurred loss in any adverse situations then the banks do not take less

amount than pre-declared rate which is injustice for the client. All the above mechanisms are on fixed return mechanism (FRM) of conventional banking system in financing the funds where rate of return is predetermined. Change of the rate of interest acts as the tool for attracting investments. The government or regulatory authority of money market fixes the interest rate applying pricing mechanism to a certain range which changes time to time to control the economic indicators. It makes the economy unstable and hampers the investment decisions. It is also asserted that regulatory authority had to change the interest rate on borrowing several times in a year.

In the most of above cases Banks pay cash to the client. There is no strict restriction to purchase specified goods and commodities as banks need predetermined interest. How and where funds are utilized is not vital point. So clients can take chance to divert the fund on unproductive and beyond business purposes which create speculation and play negative role in economy.

On the other hand, said mechanisms are debt based which drowns the whole economy in debts. Default and bankruptcy take place as common phenomena, and resources are mounted at the riches from the poor. Imbalance, ill distribution and exploitation spread every where.

In case of Islamic Banks, they deploy/invest their fund mainly on 3 mechanisms which are as follows:

1. *Shirkat* mechanism (Partnership)- *mushraka* and *mudaraba*
2. *Ijarah* mechanism (leasing on rental basis, near to term financing)-hire purchase under *shirkatul meelk*
3. *Bai*-mechanism (buying and selling)-*bai-muajjal*, *bai-murabaha*, *bai-salam*, *bai-istisna* etc.

Musharaka:

It is joint venture business mechanism among two or several parties where each party provides fund at any ratio and joins the management of business. Here profit will be distributed on predetermined agreed upon ratio and loss if incurred,

will be distributed as per capital ratio which will be calculated after certain period.

Under this mode of finance Islamic Bank participates in the business of entrepreneur like joint venture business where both bank and entrepreneur will provide fund at any ratio. Here Bank can participate in the management of the business though Central Bank in conventional economy does not allow participation in management of client's business.

As per terms of *musharaka* mode profit will be distributed on predetermined agreed upon ratio and loss if incurred, will be distributed as per capital ratio which will be calculate after certain period (as per agreement). Practically it is profit-loss sharing mechanism where both the bank and entrepreneur shared in the outcome of business. The matter may be cleared from the following example:

Example:

An Islamic Bank financed Tk.200,000/- in entrepreneur's business on *musharaka* mode for 5 years term where entrepreneur's capital is Tk.100,000/-, here predetermined agreed ratio is at 40% for Bank and at 60% for entrepreneur and loss to borne as per capital ratio i.e. Bank : Entrepreneur = 200,000 : 100,000 = 2 : 1. Profit or loss will be calculated on yearly basis.

Say, after one year earned profit is Tk.100,000/- from said investment. It will be distributed as under:

Bank will get = 40,000/- at 40% where RR of Bank finance will stand at 20% and;

Entrepreneur will get = 60,000/- at 60% where RR of client will stand at 60%.

If earned profit is Tk.120,000/- then distribution will be-

Bank= 48,000/ at 40% where RR of Bank finance will stand at 24% and;

Entrepreneur= 72,000/- at 60% where RR of client will stand at 72%.

If earned profit is Tk.80,000/- then distribution will be-

Bank= 32,000/ at 40% where RR of Bank finance will stand at 16% and;

Entrepreneur = 48,000/- at 60% where RR of client will stand at 48%.

If incurred loss of Tk.30,000/- it will be borne as under:

Bank=20,000/ at 2 : 1 ratio (as per capital ratio) where rate of loss of bank finance will stand at 10% and;

Entrepreneur=10,000/- where loss of client capital will stand also at 10% then Bank's investment balance will stand for next year at Tk.180,000/ (200,000/-minus 20,000/-) and balance of client's capital will stand at Tk.90,000/- (100,000/- minus 10,000/-).

From the above scenario it is clear that return of both the Bank and entrepreneur from invested fund is not on predetermined fixed return mechanism (**FRM**). Rather it is on variable return mechanism (**VRM**) which will be determined on outcome of business after certain period that means it varied on performance of business. So Bank will run to the best business sector, resultantly, competition in best business sector will automatically increase which fuel the economic cycle and economy will be debt free as *musharaka* fund is not debt to the client. Investment will treat as equity of the client's business in Islamic economic frame work so entrepreneur never be bankrupt in this economic system. Rather Bank as a partner will monitor and look after the business as a result fund diversion or willful default could not be made and to share in profit and loss by capital providers is quite justified also as capital is the blood of business.

On the other hand, said mode is not on predetermined fixed return mechanism (**FRM**) rather it is on variable return mechanism (**VRM**) which is not predetermined and it will be determined on getting result of business. Here diversification of investment will be made on equilibrium point of bank finance and performance of best business sectors. So controlling of the interest rate by regulatory authority is not required

Since, under this mechanism return on investment is not fixed and predetermined so investment will be maximized as investment is inversely related to predetermined interest rate.

Therefore, pricing mechanism under *musharaka* financing mode is superior.

Mudaraba:

Just like cost bearing deposit collection mechanism. There depositor is '*sahib-al-maal*' (owner of the capital) and Islamic Bank is '*mudareeb*' (entrepreneur) but in financing mechanism Islamic Bank is '*sahib-al-maal*' and client is '*mudareeb*'.

Entire funds of entrepreneur business will be provided by the Bank only i.e. no fund will be provided by the entrepreneur. Here interference of Bank (*sahib-al-maal*) in business is not allowed but negligence of client/entrepreneur (*mudareeb*) is accountable. If any profit is earned from the business then it will be distributed as per predetermined agreed ratio and if incurred any loss then it will be borne by Bank (*sahib-al-maal*) only, here client (*mudareeb*) loses the benefit against his labor and brain storming. The profit and loss will be calculated after certain period. It may be explained that the Bank will get part of profit as reward earned by the client from investment of bank funds as per predetermined agreed ratio. If incurred loss on investment of bank funds then Bank will not get any reward even invested money will be reduced by loss amount. It is variable return mechanism (VRM) of Islamic banking system in financing funds. The matter may be cleared from the following example:

Example:

An Islamic Bank financed Tk.100,000/- to an entrepreneur on *mudaraba* mode for 5 years term, here predetermined agreed ratio is at 40% for Bank and at 60% for entrepreneur and loss to borne by the Bank only.

Say, after one year earned profit is Tk.20,000/- from said investment. It will be distributed as under:

Entrepreneur will get = 12,000/- at 60% where RR of client will stand at 12% and;

Bank will get = 8,000/- at 40% where RR of Bank will stand at 8%.

If earned profit is Tk.30,000/- then distribution will be-

Entrepreneur = 18,000/ at 60% where RR of client will stand at 18% and;

Bank = 12,000/- at 40% where RR of Bank will stand at 12%.

If earned profit is Tk.10,000/- then distribution will be-

Entrepreneur = 6,000/ at 60% where RR of client will stand at 6% and;

Bank = 4,000/- at 40% where RR of Bank will stand at 4%.

If incurred loss of Tk.10,000/- it will be borne by the Bank only then Bank's investment balance will stand for next year at Tk.90,000/ (100,000/-minus 10,000/-).

From the above scenario it is clear that-

Return of both the Bank and entrepreneur from invested fund is not on fixed return mechanism (**FRM**). It is on variable return mechanism (**VRM**) that means it varied on investment/financing performance of entrepreneur. So Bank will run to the best business sector, resultantly, competition in best business sector will automatically increase which fuel the economic cycle. Economy will be debt free as *mudaraba* fund is not debt to the client. It will treat as equity of the client's business in Islamic economic frame work so entrepreneur never be bankrupt in this economic system. Rather Bank is partner of client's business. Here controlling of the interest rate by regulatory authority is not required as diversification of investment will be made on equilibrium point of bank finance and best investment sectors.

However, business of the entrepreneur is joint venture with Islamic Bank where Bank will provide entire fund and entrepreneur will maintain the business without own fund. Actually it is profit-loss sharing system. Since the fund is the

blood of business and entire funds are provided by bank so to share in profit and loss by Bank as key partner is quite justified.

Variable return mechanism (**VRM**) is not predetermined it will be determined on getting result of business, therefore, this pricing mechanism, in financing is superior as investment is inversely related to predetermined interest rate.

On the other hand the *shirkat* mechanism (*musharaka* and *mudaraba*) is equity based profit-loss sharing system, not debt based derived from interest like conventional. The prominent economists James Robertson and John Tomlinson have strongly recommended the conversion of debt in to equity realizing the evils of debt based economy.⁴⁵

So, *shirkat* mechanism is superior to debt based mechanism.

Hire purchase under *shirkat-al-meelk* (HPSM):

It is term financing mechanism against fixed and serviceable assets like land, building, cart, machineries etc. first Islamic Bank purchase the asset then it lease out to the client for specific period with the conditioned that client will pay rent on installment basis and purchase the asset at the end of the lease period on agreed upon price or on installment basis. Here rent is to be calculated on predetermined rate of return (on **FRM**) on the unpaid portion of price of the asset. This mechanism is near like Hire purchase of conventional banking. Here difference is only in ownership of the asset. In hire purchase ownership is retained by Bank up to adjustment of liability or by the client but in case of HPSM ownership is retained jointly (Central Bank does not allow joint ownership where registration is required) where bank part will reduce and client part will increase with payment of price on installment basis that is ownership of the leased asset will shift from Bank to client gradually. Merit here is that if any accident or damage occurred then loss to be borne jointly as per proportionate ownership that means risk is shared jointly whereas in case of Hire purchase risk is borne by bank or by client.

So, HPSM-hire purchase under *shirkat-al-meelk* is superior to HP-hire purchase.

Bai-mechanism (bai-muajjal, bai-murabaha, bai-salam, bai-istisna, etc.):

Bai-mechanism is buying and selling of goods which include credit and advance sales. *bai-murabaha* & *bai-muajjal* are credit selling and *bai-salam* & *bai-istisna* are advance selling. Goods may be purchased or own produced. Actually *bai-mechanism* is applicable for shopkeepers, business concerns and individuals. But Islamic scholars allowed it to practice in banking.

In case of *bai-murabaha* and *bai-muajjal* Bank first buy the trading or consumption goods as per specification of the client then sale out it to the said client on credit at agreed upon price with the condition that the sale price is to be paid within specific period. Difference between sale price and purchase price is the profit for Bank. Here declaring cost or purchase price of goods to the client is not obligatory for the bank in case of *bai-muajjal* but it is obligatory in case of *bai-murabaha*. Payment may be made at a time or on installment.

In case of *bai-salam* and *bai-istisna* Bank first pays the agreed price to the client as advance to purchase the specified goods with the conditions that goods must be delivered as per specification within specific period. Here Bank get the goods on lesser price since payment is made on advance and in the mean time Bank can sell out those other wise on better price. Difference between sale price and purchase price is the profit for Bank.

This mechanism is direct backed by assets. So fund diversion and use it in unproductive purpose is quite tough. Even here money is transformed to goods then to money again which control the speculation. So this mechanism is superior to cash credit or to any form of loans not backed by assets.

From the above discussion it is asserted that financing mechanisms of Islamic Bank is superior to conventional mechanisms.

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4.9. Analysis of foreign exchange mechanism specially, future and option market transaction

As foreign currency trading is approved by *shariah* treating commodities Islamic banks buy and sell those (FCs).⁴⁶ It is allowed for spot transaction and for

settlement of export import and remittance requirement. Though *Shariah* treated one currency against other as commodity but prohibited its hoarding on profit motive, overnight trading, and futures-options transactions as those create speculation and interest based also.

4.10. Analysis of Bank role in money market

Conventional Banks invest surplus funds in treasury bills and short term securities issued by Govt. It is less risky than any other securities and easier to convert into cash. In the most cases bank gets predetermined interest. The massive investment of commercial banks in said government securities is due to inadequate investment opportunities outside the government obligations and also reflects their desire to improve the quality of their assets. Banks also play vital role in economy by using money market instruments like commercial papers, trade bills, treasury bills, certificate of deposits, short term bonds, REPO & reverse REPO etc to facilitate liquidity management of government and to control money supply and inflation as well.

Since near past Money Market in developed countries are playing vigorous role in economy through trading of its complex derivatives. It results in a massive world-wide diversion of effort away from providing useful goods and services into making money out of money. At least 95% of the billions of dollars transferred daily around the world are for purely financial transactions, unlinked to transactions in the real economy, most of which are speculative in nature and gambling also. Some one in Singapore gambles on Tokyo Stock Exchange and brings about the collapse of a Bank in London. Some lose their houses and their jobs.⁴⁷

On the other hand, Islamic Banks collect short term funds to meet up liquidity from other Islamic Banks and financial institutions by selling of short-term *mudaraba* bonds as Islamic money market components. They also can borrow from Central Bank without interest on emergency basis which may on *mudaraba* basis. They can not participate on REPO and reverse REPO to meet up short term requirement of liquidity as those are interest based and to facilitate liquidity

management of the government. Islamic scholars studying for money market instruments which may better devices to control demand and supply of money.

However some money market instruments are introduced in different Muslim countries, such as Islamic bonds in Bangladesh, PTC-participation term certificate & MC-*mudaraba* certificate in Pakistan, *muqarada* certificate & *mudaraba* bonds in Jordan, GIC-government investment certificate in Malaysia, Egypt and Yemen, and IDC-Islamic deposit certificate and IIC-Islamic investment certificate are under process as proposed by IDB.

All the above derivatives are based on profit loss sharing backed by investment in business concern. It is just for liquidity meeting up and money supply controlling.

So, these derivatives would not be causes of speculation and could not be used as tools for gambling.

4.11. Analysis of bank role in capital market

Modern conventional Banks play vital in capital market through its merchant banking activities. To raise capital they issue share, debenture, bond and other long term securities and sell those in domestic stock markets and also in international markets who are tiger players.

Through trading, underwriting, counseling and dealing in foreign exchange derivatives Merchant Banks earn huge profit.

Peter Warburton (1999) commented that capital markets have grown too rapidly, with too little transparency and accountability.⁴⁸

Trading of securities and billions dollar of daily transactions of complex derivatives in the capital markets are purely speculative in nature as they do not raise capital because capital is raised only on first selling or transaction. It is also gambling and diversion of effort away from productive investment and providing useful goods and services into making money out of money.

Islam and Islamic Banks discourage all types of speculations and strictly prohibited the gambling. So they do not participate actively in conventional

capital market transactions. Islamic scholars are gradually introducing speculation and gambling free derivatives which play effective role in raising capital with restrictive transaction. MPB-*mudaraba* perpetual bonds in Bangladesh, is one of them. IBP certificate (Islamic bank's portfolio certificate for investment and development) and unit investment fund of IDB are great initiatives in this field.

4.12. Analysis of reward on capital

The important issue is that whether the case of deposit collecting or financing by bank there cannot be a fixed predetermined return on capital or investment i.e. one party having assured return and the whole risk of an entrepreneurship to be borne by others. This does not mean that Islam stands for a zero rate of return or denies a return on capital or investment. Capital is productive, as it leads to value added, and as such is entitled to a share from what it is producing. It is just reasonable that capital must be rewarded, but must share risk also.⁴⁹

Further mentionable that reward on capital should be variable depending on the degree of risk or hazards.

However, Islam challenges, the right of capital to a predetermined, fixed and assured reward without sharing any risk of the project or enterprise and argued that the return shall be variable in nature on the actual performance of the project or enterprise or the economy as a whole where degree of risk must be considered.

Islam prohibits any reward without sharing the risks or hazards in the economic undertakings. This is the basic principle of Islamic banking and financial system. So, if some one wants to give money to another by way of loan, to help him in need, he should go for *quard-e-hasana*, where he is assured of his principal amount only having no increase on that. However, if there is a question of return, it has to go with risk sharing with the philosophy that reward and risk must go together. In Islamic principle, reward without risk i.e. interest is prohibited in all its forms, whether it is simple or compound, low rate or high rate, personal or institutional, private or public, on a consumption loan or on a productive investment. Whatever the category may be, any predetermined, fixed increase on

the basis of time without sharing the risks of the project or enterprise is *riba* and this is prohibited in Islam. Without sharing risk, expectation of reward is exploitation and *zulm*. To get rid of such exploitation and *zulm* Islamic banking keeps its operations *riba* free and introduces profit loss sharing mechanisms.

4.13. Risk sharing mechanism analysis

Islamic bank is not only banker but also a partner in business. The system essentially involves sharing of risk between the owner of capital and the entrepreneurs, as well as sharing the result of the collective efforts. Thus, it differs from an interest-based system in which the risk is mainly borne by the entrepreneur or by the user of capital. On the other way, we may call the Islamic banking as participatory banking both the cases of deposit receiving and financing.⁵⁰

So Islamic banking is superior in risk sharing.

4.14. Moral dimension and ethical standard maintaining

Islamic banking is based on ethical framework. It is not only shifting from a debt-based economy to an equity-based economy but also a movement from pecuniary situation to an economy of ethical norms & social commitments. There is a framework of *halal* and *haram* (permissible and non permissible) within which all economic activities, private and public, have to take place. The activities like pornography, gambling-lottery, prostitution-adultery, addiction-promotion of alcohol, tobacco, cigarettes etc, porno-cinema, interest, nakedness, adulteration-ill mixing, hoarding, miserliness, misusing/rough using, socially harmful-mischief creating thing, excess spending-which turn into blameworthy and destitute, luxuriousness etc are treated in the capitalist system as productive items because it is supposed to be satisfying some demand but in the Islamic framework those are unacceptable though productive in some extents. Islamic bank is committed to prevent those as unethical, socially disordered and mischief creating items but conventional one has no such commitment. Therefore, ethical and social dimensions are integral part to the Islamic banking approach.⁵¹

4.15. Corporate social responsibilities analysis

Initiatives for social wellbeing are less or anti-profit motive that is initiating different programs for the most people of the society specially, for the poor and distressed. Goal of conventional banking is mostly profit motive. So they do not appreciate beyond profit social welfare programs within banking framework. As the member the society Bangladeshi conventional Bank maintains few activities under social responsibilities which are as follows:

1. Monthly saving deposit scheme-here customers are very few
2. Consumer credits scheme-mostly for purchasing car but not for lower salaried service
3. Argo-credits scheme-for special area only
4. Non profitable or charitable programs:
 - a. Establishment of school and college
 - b. Occasional arrangement of games, tournament etc
 - c. Donation to Government and Army relief fund at the time of natural calamities and;
 - d. Scholarship program for the poor meritorious students

On the other, hand Islamic bank has intense commitment to brotherhood and justice for spiritual as well as material well-being (*falah*) of all the people to ensure socio-economic justice, to reduce imbalance and to fulfill the basic need then the supportive needs the embellishments. So Islamic bank has initiated the following programs to fulfill the commitment to social wellbeing which are as follows:

1. Low denominated monthly saving deposit scheme where lowest denomination may be Tk.100/- (MSS, Hajj scheme, Mohor scheme etc)
2. Rural development deposit scheme where lowest denomination may be Tk.10/-

3. Cash *waqf* deposit scheme
4. Small business investment scheme with man guarantee only amounting Tk.50,000/-
5. Consumer investment scheme (house hold durables scheme) up to Tk.200,000/- for service holder where monthly repayment installment may be 50% of salary.
6. Small transport scheme for driver with man guarantee up to Tk.200,000/-
7. Rickshaw/auto rickshaw/van scheme up to Tk.50,000/-
8. Argo-equipment scheme
9. Rural development scheme- for reduction of rural-urban disparity, equitable distribution of income and economic uplifting of the rural people Islamic Bank introduced this micro finance scheme for the poor to alleviate the poverty with the perspective Action Plan to reach the landless people with the scheme covering all the villages within the year, 2010. It is supervisory investment where range is Tk.5,000/- to Tk.200,000/-with ignoring profit motive i.e. at lowest R.R.
10. *Quard-e-hasana* scheme in case of emergency need
11. Non profitable or charitable programs:

To uplift the weaker section of the society Islamic bank has introduced some social welfare programs under Islamic Bank Foundation, a subsidiary institution of the bank on the view of corporate social responsibilities (CSR) and social welfare commitment of Islam and Islamic bank. The programs are as follows:

 - a. Establishment of Hospital, Community hospital, Homio medical centre etc specially, for the poor to ensure good health as one of the basic needs.
 - b. Establishment of educational institutions-School, college, university, medical college, vocational college, *madrusah*, girls *madrusah*, model *forkania maktab* etc. to comply the *fard* of seeking knowledge.

- c. Scholarship for poor and meritorious students-
- d. Donation and lump-sum grants for poor and meritorious students and also for treatment, marriage of the poor daughter etc.
- e. Fellowship for research on Islamic economic and Islamic banking.
- f. Night school for the distressed.
- g. Relief and rehabilitation program.
- h. '*Monoram*' sales center for products of distressed woman for their self-reliant.
- i. Service center to save the people of the coastal area from natural disasters and calamities.
- j. Cost free credit program for self reliant of distressed people, specially, for woman and orphan and;
- k. Social awareness creating programs (Rally, procession, seminar etc.

From the above it is clear that Islamic bank has strong commitment to social welfare and implementing accordingly. So, Islamic banking is superior in this regard also.

Finally, from the potentiality study it is well established that Islamic banking system is superior to conventional banking system.

Islamic banking and its superiority in economy to maximize production, employment & growth for ensuring social development & welfare.

In the name of Allah, the most Merciful, the most Beneficent.

CHAPTER-5

Superiority Analysis

Practical approach-Performance study

5.1: Introduction

'Performance' means how performed the assigned job or activities. If performed as per instructions and guide lines of the assigner it will be treated good performance and if performed with deviation from the guide lines then it will be treated negative performance with the degree of deviation. In practical, expected result and out come is treated good performance where deviation from guide lines is negligible. The performance of a bank is rated through some indicators, main of which are as follows:

Deposit, Loan, investment (in case of Islamic bank interest based loan is prohibited so entire fund deployment position is called investment), profit, export, import, foreign remittance, income, expenditure etc.

Performance study has mainly been made on Islamic Banking system and side by side on modern conventional banking system in private sector. To maintain homogenous nature of 2 banking system NBL from conventional part and IBBL from Islamic banking part are studied as both have been doing very well out of 5^{1st} generation private banks.

5.2. Position and performance of sample bank: Bangladesh perspective

The two sample banks named National Bank Limited and Islami Bank Bangladesh Limited were established during 1983 almost in same time.

Extra ordinary growth and remarkable performance was practically come out since 2000. So performance since year 2000 and 2005 to 2008 are under study for sample banks as year 2009 is not yet completed. Position and performance of sample banks are as follows:

5.2.1. Islami Bank Bangladesh Limited, first branch opened on 30.03.1983.

(Tk. in million)

Particulars	2000	2005	2006	2007	2008
01. Authorized capital	1000	5000	5000	5000	10000
02. Paid up capital	320	2765	3456	3802	4752
03. Total equity	2395	8331	10436	14958	18572
04. Total debt	36971	114664	140246	180143	216819
05. Total deposit	32113	107779	132419	166325	200343
06. No. of deposit A/cs	1116,006	2705180	3207131	3802709	4361896
07. Welfare deposit (MSS, Hajj, Mohar, RDS)	1516 (excl'd RDS)	13827 (excl'd RDS)	22274 (excl'd RDS)	30590 (excl'd RDS)	38533 (excl'd RDS-1270)
08. A/cs against Sl. 07	-	-	-	-	1410985
09. Total loan-advance and investment	27471	97178	117133	165286	187587
10. No. of loan A/cs	-	-	-	-	397278
11. Welfare loan-up to 200,000/- (HDS, SBIS, AHS, RDS)	-	2541	3729	4553	4813
12. A/cs against Sl. 11	-	-	-	-	363336
13. Stuck up/classified loan- advance & investment	2844	3047	3898	4246	4311
14. Operating profit	677	2869	3315	5162	7952
15. Profit before tax prov. (after other provisions)	330	2162	2909	3781	6834
16. Interest income & investment income	2530	8447	11295	14856	19953
17. Other income	678	2137	2743	2844	4277
18. Total income	3208	10584	14038	17700	24230
19. Interest/profit paid on deposit	1847	5885	8019	9411	12162
20. Expenses: salary-allowance (excluding RDS)	410	1168	1848	2035	2834
21. Other expenses	274	665	856	1092	1282
22. Total expenses	2531	7718	10723	12538	16278
23. Export	16889	36169	51133	66690	93962
24. Import	25327	74525	96870	137086	168329
25. Remittance	7644	36948	53819	84143	140404
26. No. of Branches	116	169	176	186	196
27. Branches at capital	23	30	32	32	33
28. Branches at division	15	16	16	18	18
29. Branches at district	50	55	55	55	57
30. Branches at upazilla	28	68	73	81	88
31. AD Branches	27	35	35	38	38
32. Manpower position (including RDS)	2685 (453)	6202 (867)	7459 (1486)	8426 (1944)	9397 (1928)
33. Agri-Credit Program:	-	-	-	-	-
a. Outstanding (AHS)	-	-	-	107	82
b. No. of clients against Sl. a	-	-	-	344	276
c. Total fund disbursed	-	-	-	-	-
34. Rural credit (RDS):	-	-	-	-	-
a. Outstanding	-	1106	2242	2885	3012
b. No. of clients against Sl. a	-	-	-	-	321484
c. No. of member/depositor	-	164116	295012	350278	416830
d. Total fund disbursed	-	6033	9303	13969	18768
e. Total village covered	-	4560	8057	10023	10676
f. Employees involved	-	978	1486	1944	1928

(Table-1)

5.2.2. National Bank Limited, first branch opened on 23.03.1983.

(Tk. in million)

Particulars	2000	2005	2006	2007	2008
01. Authorized capital	1000	1000	2450	2450	2450
02. Paid up capital	430	620	805	1208	1873
03. Total equity	1427	2735	3274	4566	6131
04. Total debt	30234	35666	43522	51965	66096
05. Total deposit	23616	32984	40351	47961	60195
06. No. of deposit A/cs	-	328763	455414	478310	547578
07. Welfare deposit (monthly installment basis)	-	2723	4096	5452	7332
08. A/cs against Sl. 07	-	37252	63226	89200	98190
09. Total loan-advance and investment	21182	30585	38949	44236	59828
10. No. of loan A/cs	-	15427	15097	73943	71407
11. Welfare loan-up to 200,000/- (small, agri/rural, consumer)	61	89	56	48	55
12. A/cs against Sl. 11	-	-	-	-	1039
13. Stuck up/classified loan- advance & investment	5826	1906	1967	1651	2729
14. Operating profit	924	851	1147	2115	3131
15. Profit before tax prov. (after other provisions)	334	581	1059	2035	2836
16. Interest income & investment income	2007	2806	3996	5399	6726
17. Other income	982	1397	1733	1793	2192
18. Total income	2989	4203	5729	7192	8918
19. Interest/profit paid on deposit	1356	1898	2450	2833	3595
20. Expenses-salary & allowance	434	671	912	1076	1208
21. Other expenses	275	783	1220	1068	984
22. Total expenses	2065	3352	4582	4977	5787
23. Export	21671	21344	28019	31824	36284
24. Import	22420	31648	42458	62759	78226
25. Remittance	4662	13618	21354	27561	39878
26. No. of Branches	66	76	91	101	106
27. Branches at capital	14	17	18	20	21
28. Branches at division	9	14	15	16	17
29. Branches at district	28	30	32	33	33
30. Branches at upazilla	15	15	26	32	35
31. AD Branches	28	30	30	30	30
32. Manpower position	2025	2183	2270	2432	2737
33. Agri-Credit Program:	-	-	-	-	-
a. Outstanding	11	100	98	33	68
b. No. of clients against Sl. a	-	-	-	-	-
c. Total fund disbursed	63	179	238	155	325
34. Rural credit scheme:	Not introduced	Not introduced	Not introduced	Not introduced	Not introduced
a. Outstanding	-	-	-	-	-
b. No. of clients against Sl. a	-	-	-	-	-
c. No. of clients involved	-	-	-	-	-
d. Total fund disbursed	-	-	-	-	-
e. Total village covered	-	-	-	-	-
f. Employees involved	-	-	-	-	-

(Table-2)

5.3. Position and performance of 20 branches of homogeneous nature of two sample banks

In studying position and performance of homogeneous branches of sample banks year only 2008 is under study because data of preceding years is very tough as banker treats branch data as most confidential.

5.3.1 (a). Position of Branch of IBBL as on 31.12.2008

(Tk. in million)

Sl. No	Performing factor	Local office	Agrabad Br.	Khulna Br.	Sylhet Br.	Bogra Br.
01	Deposit	8881	3931	1838	5006	2004
02	No. of deposit accounts	80683	72627	43395	48677	54712
03	Loan-advance	20648	7833	5584	543	2117
04	Stuck up/classified loan-advance	233	390	405	25	176
05	Operating profit	941	285	111	149	81
06	Export	31817	1789	19	10	143
07	Import	31994	7978	3995	123	1279
08	Remittance	4034	1504	475	4535	1007
09	Manpower (excluding rural and agro project)	332 (00)	99 (00)	71 (00)	52 (00)	66 (25)
10	Efficiency in fund utilization Loan (investment)/depositx100	232%	199%	304%	11%	106%
11	Efficiency in customer handling (Total deposit accounts/manpower)	244	734	611	936	829
12	Efficiency in business i.e. (Sl. 1+3+6+7+8) divided manpower	293	234	178	196	99

(Table-3.a)

5.3.1 (b). Position of Branch of IBBL as on 31.12.2008

(Tk. in million)

Sl. No.	Performing factor	Nawabpur Road Br.	Saidpur Br.	Farmgate Br.	Savar Br.	Haji Camp Br.
01	Deposit	1592	488	2599	1198	1077
02	No. of deposit accounts	15848	26500	38917	41562	19214
03	Loan-advance and investment	8049	645	1514	288	123
04	Stuck up/classified loan-investment	4	22	153	15	2
05	Operating profit	245	23	93	30	34
06	Export	2708	3	3367	-	-
07	Import	13478	1243	2543	-	-
08	Remittance	282	91	618	977	363
09	Manpower (excluding rural and agro project)	105 (00)	14 (18)	60 (00)	32 (17)	19 (00)
10	Efficiency in fund utilization Loan (investment)/depositx100	506%	132%	58%	24%	11%
11	Efficiency in customer handling (Total deposit accounts/manpower)	151	1892	649	1299	1011
12	Efficiency in business i.e. (Sl. 1+3+6+7+8) divided manpower	249	176	177	77	82

(Table-3.b)

5.3.2 (a). Position of Branch of NBL as on 31.12.2008

(Tk. in million)

Sl. No.	Performing factor	Dilkusha Br.	Agrabad Br.	Khulna Br.	Sylhet Br.	Bogra Br.
01	Deposit	4241	1874	533	1312	635
02	No. of deposit accounts	10567	10912	5594	11311	5672
03	Loan-advance	8306	3984	114	100	1084
04	Stuck up/classified loan-advance	995	23	13	3	20
05	Operating profit	43	163	-(23)	32	59
06	Export	11885	326	9	-	13
07	Import	15509	5006	2675	13	3895
08	Remittance	724	1266	199	668	270
09	Manpower (excluding rural and agro project)	145	44	33	25	31
10	Efficiency in fund utilization Loan (investment)/depositx100	196%	213%	21%	8%	171%
11	Efficiency in customer handling (Total deposit accounts/manpower)		248	170	452	183
12	Efficiency in business i.e. (Sl. 1+3+6+7+8) divided manpower	280	283	107	84	190

(Table-4.a)

5.3.2 (b). Position of Branch of NBL as on 31.12.2008

(Tk. in million)

Sl. No.	Performing factor	Babu Bazar Br. Dhaka	Saidpur Br.	Kawran Bazar Br.	Savar Br.	Uttara Br.
01	Deposit	757	280	1611	788	1136
02	No. of deposit accounts	4358	3190	9986	7510	9523
03	Loan-advance and investment	725	112	936	68	365
04	Stuck up/classified loan-investment	50	3	249	-	3
05	Operating profit	60	7	58	24	47
06	Export	-	-	236	-	-
07	Import	2456	62	925	1	150
08	Remittance	119	65	324	573	577
09	Manpower (excluding rural and agro project)	32	18	35	21	28
10	Efficiency in fund utilization Loan (investment)/depositx100	96%	40%	58%	9%	32%
11	Efficiency in customer handling (Total deposit accounts/manpower)	136	177	285	358	340
12	Efficiency in business i.e. (Sl. 1+3+6+7+8) divided manpower	127	29	115	68	80

(Table-4.b)

5.4. Comparative position of sample banks in banking sector in performing foreign exchange functions in the year' 2008

a. In import

(Tk. in million)

Islami Bank Bangladesh Ltd.	Sonali Bank Ltd.	Janata Bank Ltd.	Agrani Bank Ltd.	Prime Bank Ltd.	National Bank Ltd.
1 st	2 nd	3 rd	4 th	5 th	6 th
168329	161730	123988	109793	75900	62760

(Table-5)

a. In export

(Tk. in million)

Islami Bank Bangladesh Ltd.	Janata Bank Ltd.	Sonali Bank Ltd.	Prime Bank Ltd.	Agrani Bank Ltd.	National Bank Ltd.
1 st	2 nd	3 rd	4 th	5 th	6 th
93962	83746	80976	48300	46013	36280

(Table-6)

b. In collecting remittance

(Fig. in million US dolar)

Islami Bank Bangladesh Ltd.	Sonali Bank Ltd.	Agrani Bank Ltd.	Janata Bank Ltd.	National Bank Ltd.	Uttara Bank Ltd.
1 st	2 nd	3 rd	4 th	5 th	6 th
1996	1334	761	660	577	508

(Table-7)

5.5. Year wise comparative performance of sample banks**5.5.1. Position of Capital**

(Tk. in million)

Performing year	Authorized capital				Paid up capital			
	Amount		Ratio		Amount		Ratio	
	IBBL	NBL	IBBL	NBL	IBBL	NBL	IBBL	NBL
2000	1000	1000	50%	50%	320	430	43%	57%
2005	5000	1000	83%	17%	2765	620	82%	18%
2006	5000	2450	67%	33%	3456	805	81%	19%
2007	5000	2450	67%	33%	3802	1208	76%	24%
2008	10000	2450	80%	20%	4752	1873	72%	28%

(Table-8)

5.5.2. Deposit position

(Tk. in million)

Performing year	Deposit position							
	Amount		Ratio		Number of A/cs		Ratio	
	IBBL	NBL	IBBL	NBL	IBBL	NBL	IBBL	NBL
2000	32113	23616	58%	42%	1116006	-	-	-
2005	107779	32984	77%	23%	2705180	328763	89%	11%
2006	132419	40351	77%	23%	3207131	455414	88%	12%
2007	166325	47961	78%	22%	3802709	478310	89%	11%
2008	200343	60195	77%	23%	4361896	547578	89%	11%

(Table-9)

5.5.3. Welfare deposit position

(Tk. in million)

Performing year	Welfare deposit position							
	Amount		Ratio		Number of A/cs		Ratio	
	IBBL	NBL	IBBL	NBL	IBBL	NBL	IBBL	NBL
2000	1516	-	-	-	-	-	-	-
2005	16151	2723	86%	14%	-	-	-	-
2006	23102	4096	85%	15%	-	-	-	-
2007	31766	5452	85%	15%	-	-	-	-
2008	38713	7332	84%	16%	1410985	98190	93%	7%

(Table-10)

5.5.4. Loan and advance position including investment

(Tk. in million)

Performing year	Loan and advance position							
	Amount		Ratio		Number of A/cs		Ratio	
	IBBL	NBL	IBBL	NBL	IBBL	NBL	IBBL	NBL
2000	27471	21182	56%	44%	-	-	-	-
2005	97178	30585	76%	24%	-	-	-	-
2006	117133	38949	75%	25%	-	-	-	-
2007	165286	44236	79%	21%	-	-	-	-
2008	187578	59828	76%	24%	397278	71407	85%	15%

(Table-11)

5.5.5. Welfare loan and advance position including investment

(Tk. in million)

Performing year	Welfare loan and advance position							
	Amount		Ratio		Number of A/cs		Ratio	
	IBBL	NBL	IBBL	NBL	IBBL	NBL	IBBL	NBL
2000	-	-	-	-	-	-	-	-
2005	2541	89	97%	3%	-	-	-	-
2006	3729	56	99%	1%	-	-	-	-
2007	4553	48	99%	1%	-	-	-	-
2008	4813	55	99%	1%	363336	1039	99.70%	0.30%

(Table-12)

5.5.6. Operating profit and profit after provision but before tax

(Tk. in million)

Performing year	Operating profit				Profit after provision			
	Amount		Ratio		Amount		Ratio	
	IBBL	NBL	IBBL	NBL	IBBL	NBL	IBBL	NBL
2000	677	924	42%	58%	330	334	50%	50%
2005	2869	851	77%	23%	2162	581	79%	21%
2006	3315	1147	74%	26%	2909	1059	73%	27%
2007	5162	2115	71%	29%	3781	2035	65%	35%
2008	7952	3131	72%	28%	6834	2836	71%	29%

(Table-13)

5.5.7. Export and import position

(Tk. in million)

Performing year	Export position				Import position			
	Amount		Ratio		Amount		Ratio	
	IBBL	NBL	IBBL	NBL	IBBL	NBL	IBBL	NBL
2000	16889	21671	44%	56%	25327	22420	53%	47%
2005	36169	21344	63%	37%	74525	31648	70%	30%
2006	51133	28019	65%	35%	96870	42458	70%	30%
2007	66690	31824	68%	32%	137086	62759	69%	31%
2008	93962	36284	72%	28%	168329	78226	68%	32%

(Table-14)

5.5.8. Remittance and Total foreign business position

(Tk. in million)

Performing year	Remittance				Total foreign business			
	Amount		Ratio		Amount		Ratio	
	IBBL	NBL	IBBL	NBL	IBBL	NBL	IBBL	NBL
2000	7644	4662	62%	38%	49860	48753	51%	49%
2005	36948	13618	73%	27%	147642	66610	69%	31%
2006	53819	21354	72%	28%	201822	91831	69%	31%
2007	84143	27561	75%	25%	287919	122144	70%	30%
2008	140404	39878	78%	22%	402695	154388	72%	28%

(Table-15)

5.5.9. Number of branch and AD branch ratio

Performing year	IBBL			NBL		
	Number		Ratio	Number		Ratio
	Total Br.	AD Br.		Total Br.	AD Br.	
2000	116	27	23%	66	28	42%
2005	169	35	21%	76	30	39%
2006	176	35	20%	91	30	33%
2007	186	38	20%	101	30	30%
2008	196	38	19%	106	30	29%

(Table-16)

5.5.10. Ratio of branch at capital

Performing year	IBBL			NBL		
	Number		Ratio	Number		Ratio
	Total Br.	Br. at capital		Total Br.	Br. at capital	
2000	116	23	20%	66	14	21%
2005	169	30	18%	76	17	22%
2006	176	32	18%	91	18	20%
2007	186	32	17%	101	20	20%
2008	196	33	17%	106	21	20%

(Table-17)

5.5.11. Ratio of branch at division city/town beyond capital

Performing year	IBBL			NBL		
	Number		Ratio	Number		Ratio
	Total Br.	Br. at division		Total Br.	Br. at division	
2000	116	15	13%	66	9	14%
2005	169	16	9%	76	14	18%
2006	176	16	9%	91	15	16%
2007	186	18	10%	101	16	16%
2008	196	18	9%	106	17	16%

(Table-18)

5.5.12. Per Branch man power (excluding manpower of rural project)

Performing year	IBBL			NBL		
	Number		Per Br. Man power	Number		Per Br. Man power
	Total Br.	Man power		Total Br.	Man power	
2000	116	2232	19	66	2025	31
2005	169	5224	31	76	2183	29
2006	176	5973	34	91	2270	25
2007	186	6482	35	101	2432	24
2008	196	7469	38	106	2737	26

(Table-19)

5.5.13. Loan and advance in agro and rural project including investment

(Tk. in million)

Performing year	Loan and advance including investment							
	Amount		Ratio		Number of A/cs		Ratio	
	IBBL	NBL	IBBL	NBL	IBBL	NBL	IBBL	NBL
2000	-	-	-	-	-	-	-	-
2005	1106	100	92%	8%	-	-	-	-
2006	2242	98	96%	4%	-	-	-	-
2007	2992	33	99%	1%	-	-	-	-
2008	3094	68	98%	2%	-	-	-	-

(Table-20)

5.6. Comparative position of two branches of homogeneous nature

Comparative position of two branches of sample bank situated at same area and established almost same time are shown here under:

**5.6.1. Comparative position of Local Office of IBBL opened on 30.03.1983
and Dilkusha Branch of NBL opened on 23.03.1983**

(Tk. in million)

Sl. No	Performing factors	Position 2008		Ratio	
		IBBL Local office	NBL Dilkusha	IBBL Local office	NBL Dilkusha
01	Deposit	8881	4241	68%	32%
02	No. of deposit accounts	80683	10567	88%	12%
03	Loan-advance and investment	20648	8306	71%	29%
04	Stuck up/classified loan-investment	233	995	1% (to loan)	12%
05	Operating profit	941	43	96%	4%
06	Export	31817	11885	73%	27%
07	Import	31994	15509	67%	33%
08	Remittance	4034	724	85%	15%
09	Manpower (excluding rural & agro project)	332	145	-	-
10	Efficiency in fund utilization Loan (investment)/depositx100	232%	196%	-	-
11	Efficiency in customer handling (Total deposit accounts/manpower)	244	73	-	-
12	Efficiency in business i.e. (Sl. 1+3+6+7+8) divided manpower	293	280	-	-

(Table-21)

**5.6.2. Comparative position of Agrabad Branch of IBBL opened on
23.08.1983 and Agrabad Branch of NBL opened on 18.08.1983**

(Tk. in million)

Sl. No	Performing factors	Position 2008		Ratio	
		IBBL Agrabad	NBL Agrabad	IBBL Agrabad	NBL Agrabad
01	Deposit	3931	1874	68%	32%
02	No. of deposit accounts	72627	10912	87%	13%
03	Loan-advance and investment	7833	3984	66%	34%
04	Stuck up/classified loan-investment	390	23	5%(to loan)	1%
05	Operating profit	285	163	64%	36%
06	Export	1789	326	85%	15%
07	Import	7978	5006	61%	39%
08	Remittance	1504	1266	54%	46%
09	Manpower (excluding rural & agro project)	99	44	-	-
10	Efficiency in fund utilization Loan (investment)/depositx100	199%	213%	-	-
11	Efficiency in customer handling (Total deposit accounts/manpower)	734	248	-	-
12	Efficiency in business i.e. (Sl. 1+3+6+7+8) divided manpower	234	283	-	-

(Table-22)

5.6.3. Comparative position of Khulna Branch of IBBL opened on 22.08.1984 and Khulna Branch of NBL opened on 12.09.1983

(Tk. in million)

Sl. No	Performing factors	Position 2008		Ratio	
		IBBL Khulna	NBL Khulna	IBBL Khulna	NBL Khulna
01	Deposit	1838	533	78%	22%
02	No. of deposit accounts	43395	5594	89%	11%
03	Loan-advance and investment	5584	114	98%	2%
04	Stuck up/classified loan-investment	405	13	7%(to loan)	11%
05	Operating profit	111	-(23)	126%	-26%
06	Export	19	9	68%	32%
07	Import	3995	2675	60%	40%
08	Remittance	475	199	70%	30%
09	Manpower (excluding rural and agro project)	71 (00)	33 (00)	-	-
10	Efficiency in fund utilization Loan (investment)/depositx100	304%	21%	-	-
11	Efficiency in customer handling (Total deposit accounts/manpower)	611	170	-	-
12	Efficiency in business i.e. (Sl. 1+3+6+7+8) divided manpower	178	107	-	-

(Table-23)

5.6.4. Comparative position of Sylhet Branch of IBBL opened on 10.10.1983 and Sylhet Branch of NBL opened on 06.11.1983

(Tk. in million)

Sl. No	Performing factors	Position 2008		Ratio	
		IBBL Sylhet	NBL Sylhet	IBBL Sylhet	NBL Sylhet
01	Deposit	5006	1312	79%	21%
02	No. of deposit accounts	48677	11311	81%	19%
03	Loan-advance and investment	543	100	84%	16%
04	Stuck up/classified loan-investment	25	3	5%(to loan)	3%
05	Operating profit	149	32	82%	18%
06	Export	10	-	100%	-
07	Import	123	13	90%	10%
08	Remittance	4535	668	87%	13%
09	Manpower (excluding rural and agro project)	52 (00)	25 (00)	-	-
10	Efficiency in fund utilization Loan (investment)/depositx100	11%	8%	-	-
11	Efficiency in customer handling (Total deposit accounts/manpower)	936	452	-	-
12	Efficiency in business i.e. (Sl. 1+3+6+7+8) divided manpower	196	84	-	-

(Table-24)

5.6.5. Comparative position of Bogra Branch of IBBL opened on 17.10.1985 and Bogra Branch of NBL opened on 04.12.1984

(Tk. in million)

Sl. No	Performing factors	Position 2008		Ratio	
		IBBL Bogra	NBL Bogra	IBBL Bogra	NBL Bogra
01	Deposit	2004	635	76%	24%
02	No. of deposit accounts	54712	5672	91%	9%
03	Loan-advance and investment	2117	1084	66%	34%
04	Stuck up/classified loan-investment	176	20	8%(to loan)	2%
05	Operating profit	81	59	58%	42%
06	Export	143	13	92%	8%
07	Import	1279	3895	25%	75%
08	Remittance	1007	270	79%	21%
09	Manpower (excluding rural and agro project)	66 (23)	31 (00)	-	-
10	Efficiency in fund utilization Loan (investment)/depositx100	106%	171%	-	-
11	Efficiency in customer handling (Total deposit accounts/manpower)	829	183	-	-
12	Efficiency in business i.e. (Sl. 1+3+6+7+8) divided manpower	99	190	-	-

(Table-25)

5.6.6. Comparative position of Nawabpur Road Branch of IBBL opened on 15.12.1986 and Babu Bazar Branch of NBL opened on 31.08.1987

(Tk. in million)

Sl. No	Performing factors	Position 2008		Ratio	
		IBBL Nawabpur	NBL Babu Bazar	IBBL Nawabpur	NBL Babu Bazar
01	Deposit	1592	757	68%	32%
02	No. of deposit accounts	15848	4358	78%	32%
03	Loan-advance and investment	8049	725	92%	8%
04	Stuck up/classified loan-investment	4	50	0.05%(to loan)	7%
05	Operating profit	245	60	80%	20%
06	Export	2708	-	100%	-
07	Import	13478	2456	85%	15%
08	Remittance	282	119	70%	30%
09	Manpower (excluding rural and agro project)	105 (00)	32 (00)	-	-
10	Efficiency in fund utilization Loan (investment)/depositx100	506%	96%	-	-
11	Efficiency in customer handling (Total deposit accounts/manpower)	151	136	-	-
12	Efficiency in business i.e. (Sl. 1+3+6+7+8) divided manpower	249	127	-	-

(Table-26)

5.6.7. Comparative position of Saidpur Branch Ninlphamary of IBBL opened on 26.11.1991 and Saidpur Branch Nilphamary of NBL opened on 06.06.1988

(Tk. in million)

Sl. No.	Performing factors	Position 2008		Ratio	
		IBBL Saidpur	NBL Saidpur	IBBL Saidpur	NBL Saidpur
01	Deposit	488	280	64%	36%
02	No. of deposit accounts	26500	3190	89%	11%
03	Loan-advance and investment	645	112	85%	15%
04	Stuck up/classified loan-investment	22	3	3%(to loan)	3%
05	Operating profit	23	7	77%	23%
06	Export	3	-	100%	-
07	Import	1243	62	95%	5%
08	Remittance	91	65	58%	42%
09	Manpower (excluding rural and agro project)	14 (18)	18 (00)	-	-
10	Efficiency in fund utilization Loan (investment)/depositx100	132%	40%	-	-
11	Efficiency in customer handling (No. of deposit accounts/manpower)	1892	177	-	-
12	Efficiency in business i.e. (Sl. 1+3+6+7+8) divided manpower	176	29	-	-

(Table-27)

5.6.8. Comparative position of Farmgate Branch of IBBL opened on 31.10.1989 and Kawran Bazar Branch NBL opened on 28.03.1989

(Tk. in million)

Sl. No	Performing factors	Position 2008		Ratio	
		IBBL Farmgate	NBL Kawran Bazar	IBBL. Farmgate	NBL. Kawran Bazar
01	Deposit	2599	1611	62%	38%
02	No. of deposit accounts	38917	9986	80%	20%
03	Loan-advance and investment	1514	936	62%	38%
04	Stuck up/classified loan-investment	153	249	10% (to loan)	27%
05	Operating profit	93	58	62%	38%
06	Export	3367	236	93%	7%
07	Import	2543	925	73%	27%
08	Remittance	618	324	66%	34%
09	Manpower (excluding rural and agro project)	60 (00)	35 (00)	-	-
10	Efficiency in fund utilization Loan (investment)/depositx100	58%	58%	-	-
11	Efficiency in customer handling (Total deposit accounts/manpower)	649	285	-	-
12	Efficiency in business i.e. (Sl. 1+3+6+7+8) divided manpower	177	115	-	-

(Table-28)

5.6.9. Comparative position of Savar Branch of IBBL opened on 23.09.1989 and Savar Branch NBL opened on 30.01.1991

(Tk. in million)

Sl. No.	Performing factors	Position 2008		Ratio	
		IBBL Savar	NBL Savar	IBBL Savar	NBL Savar
01	Deposit	1198	788	60%	40%
02	No. of deposit accounts	41562	7510	85%	15%
03	Loan-advance and investment	288	68	81%	19%
04	Stuck up/classified loan-investment	15	-	0.5% (to loan)	-
05	Operating profit	30	24	56%	44%
06	Export	-	-	-	-
07	Import	-	1	-	100%
08	Remittance	977	573	63%	37%
09	Manpower (excluding rural and agro project)	32 (17)	21 (00)	-	-
10	Efficiency in fund utilization Loan (investment)/depositx100	24%	9%	-	-
11	Efficiency in customer handling (No. of deposit accounts/manpower)	1299	358	-	-
12	Efficiency in business i.e. (Sl. 1+3+6+7+8) divided manpower	77	68	-	-

(Table-29)

5.6.10. Comparative position of Hajji Camp Branch of IBBL opened on 19.11.2000 and Uttara Branch of NBL opened on 29.09.2001

(Tk. in million)

Sl. No.	Performing factors	Position 2008		Ratio	
		IBBL Hajji Camp	NBL Uttara	IBBL Hajji	NBL Uttara
01	Deposit	1077	1136	49%	51%
02	No. of deposit accounts	19214	9523	67%	33%
03	Loan-advance and investment	123	365	25%	75%
04	Stuck up/classified loan-investment	2	3	-	-
05	Operating profit	34	47	42%	58%
06	Export	-	-	-	-
07	Import	-	150	-	100%
08	Remittance	363	577	39%	61%
09	Manpower (excluding rural and agro project)	19 (00)	28 (00)	-	-
10	Efficiency in fund utilization Loan (investment)/depositx100	11%	32%	-	-
11	Efficiency in customer handling (Total deposit accounts/manpower)	1011	340	-	-
12	Efficiency in business i.e. (Sl. 1+3+6+7+8) divided manpower	82	80	-	-

(Table-30)

5.7. Corporate social responsibilities of the sample banks

5.7.1. Under subsidiary institution

Islami Bank Bangladesh Limited and National Bank Limited have been playing important role for well being of the society since the very beginning in the concerned areas under Islamic Bank Foundation established in 1991 (actually established in 1983, in the first Board Meeting named *Sadaka Tahbil*) and National Bank Foundation established 1989 respectively. Their activities and performance as on 31.12.2008 are shown here under:

(Tk. in million)

Sl. No.	Particulars	Performance		Ratio	
		IBBL	NBL	IBBL	NBL
01	No. of Hospital established	6	-	100%	-
02	No. of Medical centre/community hospital (including Homio medical)	8	-	100%	-
03	No. of School established	2	1	67%	33%
04	No. of Collage established	2	1	67%	33%
05	No. of <i>Madrasah</i> established	1 (girls)	-	100%	-
06	No. of Medical collage established	1	-	100%	-
07	Medical institution	2	-	100%	-
08	No. of Engineering collage established	-	-	-	-
09	No. of Technical collage established	5	-	100%	-
10	Scholarship paid (Number of students)	5 (580)	1.24 (125)	80% (82%)	20% (18%)
11	Donation/grant for education	21	-	100%	-
12	Donation for treatment relief and other	38	5	88%	12%
13	Total contribution (10+11+12)	64	6.24	91%	9%

(Table-31)

5.7.2. Under direct banking activities as on 31.12.2008

Initiatives for social wellbeing are less or anti-profit motive that is initiating different programs on lowest profit for the most people of the society specially, for the poor and distressed. As the member of the society Bangladeshi Banks maintain some direct banking activities under social responsibilities which are shown here under:

(Tk. in million)

Sl. No	Particulars of welfare activities /functions	IBBL			NBL		
		Lowest limit/denomination	Amount	No. of A/cs	Lowest limit/denomination	Amount	No. of A/cs
01	Rural scheme's deposit	Tk.10/-	1270	416830	-	-	-
02	Monthly saving deposit	Tk.100/-	38533	994155	Tk.500/-	7332	98190
03	Rural scheme's credit/investment	Tk.5,000/-	3012	321484	-	-	-
04	Small, consumer & agro credit/invt	Tk.10,000/-	1801	43653	Tk.25,000/-	55	1039
05	Per Branch (average) Deposit maintained for '2008	Tk.45,930/- (Per account)	1022	22255	Tk.109,930/- (Per account)	578	5166
06	Per Branch (average) Welfare deposit maintained for '2008	Tk.28,209/- (Per account)	203	7199	Tk.74,671/- (Per account)	69	926

(Table-32)

In the above 32 tables the most of indicators and factors of performance apparently shows that performance and efficiency of Islami Bank Bangladesh Limited is far better than that of National Bank Limited in both the cases of over all bank performance as well as branch performance and in corporate social responsibilities.

So, Islamic banking is superior to conventional banking.

In the name of Allah, the most Merciful, the most Beneficent.

CHAPTER-6

Empirical Analysis-Efficiency Study

6.1. Introduction

The empirical part of the study has been designed from practical performance to test the efficiency. 'Efficiency' means the highest possible performance level of a production unit or a market or an economic or banking system under the condition that no one can be better-off without making someone else worse-off. In case of banking, it qualifies the best possible performance level of a bank. Efficiencies of a bank are rated through some ratios and tests.

Only the desk study and interview methods have been followed among commonly used methods for empirical study. Efficiency will be measured first from quantitative analysis then in terms of ratios.

6.2. Quantitative analysis

It is made from sample survey and interview. Sample survey has been conducted using 3 sets structured questionnaires (Appendices-i, ii, iii) where questionnaire-1 for officials (not bellow than Principal officer) of sample bank branches, questionnaire-2 for officials (not bellow than Deputy Director) of central bank and questionnaire-3 for entrepreneurs (clients- one regular, one overdue and one dropt out) of sample bank branches. All the respondents were interviewed also.

Results of survey and interviews in efficiency criteria is very positive for Islamic bank due to integrity and sincerity of the banker but quality of service is not up to the mark due to mass banking and job loading.

6.3. Ratio analysis:

Efficiencies of two sample banks are to be measured in terms of ratios which are shown here under:

6.3.1. Productive efficiency

Productive efficiency means productivity of the bank and out put of the employee. It includes efficiency in fund utilization, efficiency in deposit

customer handling, efficiency in main business (deposit, loan/investment, export, import, & remittance) handling and efficiency in loan recovery. In fund utilization only deposit is considered as fund. Results of productive efficiency are furnished here under:

a. Efficiency in fund utilization i.e. total deposit-loan ratio (Loan/investment divided deposit x 100)

(Tk. in million)

Performing year	IBBL			NBL		
	Amount		Ratio	Amount		Ratio
	Deposit	Loan/investment		Deposit	Loan/investment	
2000	32113	27471	86%	23616	21182	89%
2005	107779	97178	90%	32984	30585	93%
2006	132419	117133	88%	40351	38949	97%
2007	166325	165286	99%	47961	42236	88%
2008	200343	187587	94%	60195	59828	99%

(Table-33)

b. Efficiency in deposit customer handling i.e. per employee deposit accounts

Performing year	IBBL			NBL		
	Total Deposit A/cs	No. of employees	A/cs Per employee	Total Deposit A/cs	No. of employees	A/cs Per employee
2000	1116006	2685	416	-	2025	-
2005	2705180	6202	436	328763	2183	151
2006	3207131	7459	430	455414	2270	201
2007	3802709	8426	451	478310	2432	197
2008	4361896	9397	464	547578	2737	200

(Table-34)

c. Efficiency in main business handling i.e. per employee main business (Amount of deposit + loan/investment + export + import + remittance)

(Tk. in million)

Performing year	IBBL			NBL		
	Amount of main business	Employees Excluding RDS	Ratio	Amount of main business	No. of employees	Ratio
2000	109444	2232	49	93551	2025	46
2005	352599	5335	66	130179	2183	60
2006	451374	5973	76	171131	2270	75
2007	619530	6482	96	214341	2432	88
2008	790625	7469	106	274411	2737	100

(Table-35)

d. Efficiency in loan/investment recovery i.e. ratio of stuck up/classified loan to total loan

(Tk. in million)

Performing year	IBBL			NBL		
	Classified amount	Total amount	Ratio	Classified amount	Total amount	Ratio
2000	2844	27471	10%	5826	21182	28%
2005	3047	97178	3%	1906	30585	6%
2006	3898	117133	3%	1967	38949	5%
2007	4246	165286	3%	1651	44236	4%
2008	4311	187578	2%	2729	59828	5%

(Table-36)

6.3.2. Allocative efficiency

Allocative efficiency means the best possible utilization of bank's fund and financial resources to the mass people to fulfill the basic need and to ensure the social development & welfare neglecting profit motive. It includes the following ratios:

a. Loan/investment-welfare loan/investment ratio (welfare investment divided investment x100)

(Tk. in million)

Performing year	IBBL			NBL		
	Amount		Ratio	Amount		Ratio
	Investment	Welfare Invest.		Investment	Welfare Invest.	
2000	27471	-	-	21182	61	0.3%
2005	97178	2541	3%	30585	89	0.3%
2006	117133	3729	3%	38949	56	0.1%
2007	165286	4553	3%	42236	48	0.1%
2008	187587	4813	3%	59828	55	0.1%

(Table-37)

b. Per branch loan/investment accounts handling

Performing year	IBBL			NBL		
	Total loan A/cs	No. of branch	A/cs Per branch	Total loan A/cs	No. of branch	A/cs Per branch
2008	397278	196	2027	71407	106	674

(Table-38)

c. Area based diversification of business or rural based branch ratio

Performing year	IBBL			NBL		
	Number		Ratio	Number		Ratio
	Total Br.	Br. at Upazilla		Total Br.	Br. at Upazilla	
2000	116	28	24%	66	15	23%
2005	169	68	40%	76	15	20%
2006	176	73	41%	91	26	29%
2007	186	81	44%	101	32	32%
2008	196	88	45%	106	35	33%

(Table-39)

6.3.3. Distributive efficiency

Distributive efficiency means maintaining equity and justice in distribution of return or profit i.e. encouraging the small deposits specially, monthly basis saving scheme and covering the remote & under developed areas. The ratios in this regard furnish here under:

a. Rate of profit/interest paid to depositors (profit/interest paid on deposit divided total deposit x 100)

(Tk. in million)

Performing year	IBBL			NBL		
	Total deposit	Total PPD/IPD	Ratio	Total deposit	Total PPD/IPD	Ratio
2000	32113	1847	5.75%	23616	1356	5.74%
2005	107779	5885	5.46%	32984	1898	5.75%
2006	132419	8019	6.05%	40351	2450	6.07%
2007	166325	9411	5.66%	47961	2833	5.90%
2008	200343	12162	6.07%	60195	3595	5.97%

(Table-40)

b. Total deposit-welfare deposit ratio (Welfare deposit divided deposit x100)

(Tk. in million)

Performing year	IBBL			NBL		
	Amount		Ratio	Amount		Ratio
	Deposit	Welfare deposit		Deposit	Welfare deposit	
2000	32113	1516	5%	-	-	-
2005	107779	13827	13%	32984	2723	8%
2006	132419	22274	17%	40351	4096	10%
2007	166325	30590	18%	47961	5452	11%
2008	200343	39803	20%	60195	7332	12%

(Table-41)

c. Per branch deposit accounts handling

Performing year	IBBL			NBL		
	Total Deposit A/cs	No. of branch	A/cs Per branch	Total Deposit A/cs	No. of branch	A/cs Per branch
2000	1116006	116	9621	-	66	-
2005	2705180	169	16007	328763	76	4326
2006	3207131	176	18222	455414	91	5005
2007	3802709	186	20445	478310	101	4736
2008	4361896	196	22255	547578	106	5166

(Table-42)

6.3.4. Operational efficiency

Operational efficiency means the capacity to minimize the operational cost with a given level of profit or to maximize the profit with a given level of operational cost. To measure the operational efficiency the following ratios are furnish here under:

a. Cost benefit ratio (operating profit divided total revenue expenditure x100)

(Tk. in million)

Performing year	IBBL			NBL		
	Operating profit	Expenditure	Ratio	Operating profit	Expenditure	Ratio
2000	677	2531	27%	924	2065	45%
2005	2869	7718	37%	851	3352	25%
2006	3315	10723	31%	1147	4582	25%
2007	5162	12538	41%	2115	4977	42%
2008	7952	16278	49%	3131	5787	54%

(Table-43)

b. Cost of manpower or per employee salary & allowance (excluding RDS)

(Tk. in million)

Performing year	IBBL			NBL		
	Salary-allowance	Manpower Excluding RDS	Salary per employee	Salary-allowance	Manpower	Salary per employee
2000	410	2232	0.184	434	2025	0.214
2005	1168	5224	0.224	671	2183	0.307
2006	1848	5973	0.309	912	2270	0.402
2007	2035	6482	0.314	1076	2432	0.442
2008	2834	7469	0.379	1208	2737	0.441

(Table-46)

6.3.5. Stabilizational efficiency

Stabilizational efficiency means the capacity to absorb the shocks of business cycle and to stabilize investment fluctuation in the economy. Trend to growth is vital factor in this regard. If growth be around unique it can absorb the shock and

if incurred loss any year trend of equity can absorb it easily. So the main business branch opening and equity trends analyzed here under:

a. Deposit trend

(Tk. in million)

Performing	IBBL		NBL	
	Total deposit	Trend	Total deposit	Trend
2005	107779	-	32984	-
2006	132419	23%	40351	22%
2007	166325	26%	47961	19%
2008	200343	20 %	60195	26%

(Table-45)

b. Loan/investment trend

(Tk. in million)

Performing	IBBL		NBL	
	Total investment	Trend	Total loan	Trend
2005	97178	-	30585	-
2006	117133	21%	38949	27
2007	165286	41%	42236	8
2008	187587	13%	59828	42

(Table-46)

c. Operating profit trend

(Tk. in million)

Performing	IBBL		NBL	
	Operating profit	Trend	Operating profit	Trend
2005	2869	-	851	-
2006	3315	16%	1147	35%
2007	5162	56%	2115	84%
2008	7952	54%	3131	48%

(Table-47)

d. Debt-Equity Ratio (Debt/equity=times)

(Tk. in million)

Performing year	IBBL			NBL		
	Amount		Ratio	Amount		Ratio
	Debts	Equity	Ratio	Debt	Equity	Ratio
2000	36971	2395	15.44	30234	1427	21.19
2005	114664	8331	13.76	35666	2735	13.04
2006	140246	10436	13.44	43522	3274	13.29
2007	180143	14958	12.04	51965	4566	11.38
2008	216819	18572	11.67	66096	6131	10.78

(Table-48)

e. Equity building up trend

(Tk. in million)

Performing	IBBL		NBL	
	Equity	Trend	Equity	Trend
2005	8331	-	2735	-
2006	10436	25%	3274	20%
2007	14958	43%	4566	39%
2008	18572	24%	6131	34%

(Table-49)

6.3.6. Efficiency in CSR

Banking sector plays vital role in corporate social responsibilities. Mainly it runs through sister concerns and some direct initiatives. Their performance is analyzed here under:

a. Sister concern

Islami Bank Bangladesh Limited and National Bank Limited have been playing important role for well being of the society since the very beginning in the concerned area under Islamic Bank Foundation and National Bank Foundation respectively. Their activities and performance as on 31.12.2008 are analyzed below:

(Tk. in million)

Sl. No.	Particulars	Performance		Ratio	
		IBBL	NBL	IBBL	NBL
01	No. of Hospital established	6	-	100%	-
02	No. of Medical centre/community hospital (including Homio medical)	8	-	100%	-
03	No. of School established	2	1	67%	33%
04	No. of Collage established	2	1	67%	33%
05	No. of <i>Madrasah</i> established	1 (girls)	-	100%	-
06	No. of Medical collage established	1	-	100%	-
07	Medical institution	2	-	100%	-
08	No. of Engineering collage established	-	-	-	-
09	No. of Technical collage established	5	-	100%	-
10	Scholarship paid (Number of students)	5 (580)	1.24 (125)	80% (82%)	20% (18%)
11	Donation/grant for education	21	-	100%	-
12	Donation for treatment relief and other	38	5	88%	12%
13	Total contribution (10+11+12)	64	6.24	91%	9%

(Table-50)

b. Through direct banking activities as on 31.12.2008

Initiatives for social wellbeing are less or anti-profit motive that is it had to initiate different programs on lowest profit for the most people of the society

specially, for the poor and distressed. Some direct banking activities under social responsibilities are analyzed here under:

(Tk. in million)

Sl. No	Particulars of welfare activities /functions	IBBL			NBL		
		Lowest limit/denomination	Total amount	Total A/cs	Lowest limit/denomination	Total amount	Total A/cs
01	Rural scheme's deposit	Tk.10/-	1270	416830	-	-	-
02	Monthly saving deposit	Tk.100/-	38533	994155	Tk.500/-	7332	98190
03	Rural scheme's credit/investment	Tk.5,000/-	3012	321484	-	-	-
04	Small, consumer & agro credit/invt	Tk.10,000/-	1801	43653	Tk.25,000/-	55	1039
05	Per Branch (average) Deposit maintained for '2008	Tk.45,930/- (Per account)	1022	22255	Tk.109,930/- (Per account)	578	5166
06	Per Branch (average) Welfare deposit maintained for '2008	Tk.28,209/- (Per account)	203	7199	Tk.74,671/- (Per account)	69	926

(Table-51)

In the above 19 tables the most of indicators and ratios show that efficiency of Islami Bank Bangladesh Limited is far better than that of National Bank Limited

In the name of Allah, the most Merciful, the most Beneficent.

CHAPTER-7

Finding of the study

7.1. An overview on the findings

In establishing superiority of Islamic banking in economy two approaches were followed. The first approach has been showed the better potentiality of Islamic banking system in fostering the development of a country and world as well through maximizing production, generating employment & increasing economic growth and also in ensuring the welfare of the society and the world community through comparative analysis of goal, characteristic, mechanism, inner strength of the system, principles, tools, short coming of interest and commitment to CSR of both banking systems.

The second approach, on the other hand, has been showed better performance of Islamic bank through analyzing the factors of performance that is capital, equity, debt, deposit, loan/investment, classified loan, number of customer handled, number of branches, profit, export, import remittance etc of both the sample banks and in final empirically analyzed the efficiency of the bank through applying ratio tools and different efficiency criteria.

7.2. Findings from theoretical approach

7.2.1. Goal of Islamic Banking is wide and welfare oriented

The goal of conventional economic system is serving self interest where only the fittest survives as he is not accountable to any being in fulfilling self interest motive and in affecting others or their environment. This goal matched with the objective of conventional banking system that is earning profit by any means where welfare of human being is negligible and welfare in the world here after is absolutely ignored.

On the other hand, under Islamic economic system, no one is absolutely free in behaving or performing any economic activities, rather man is accountable to the Supreme Being for his economic activities. So, the goal of Islamic economic and

banking system is to use all the resources to actualize the *maqasid al- shariah* that is intense commitment to brotherhood and justice for spiritual as well as material well-being (*falah*) of all the people through ensuring fulfillment of *jaruriat-the basic needs* then *al-haajiyat-the supportive needs* then *al-tahseeniyat-the embellishments*. Therefore, to establish socio-economic justice and to reduce imbalance in this world and final well-being in the **World Here After** is the goal of Islamic economic system as well as Islamic banking system which is wide and welfare oriented.

7.2.2. Islamic Economic system increase economic development and ensure socio economic justice.

Under capitalism, socialism and secularism framework conventional banks do not consider whether social welfare & justice would be hampered or not, imbalance & exploitation would be widen or not and the poor would be deprived or not in fulfilling their goal that is profit motive. So the rich and the fittest are gathering most resources and the poor are falling in to serious hungry.

But in Islamic economic system profit motive is acceptable to a reasonable extent. Private ownership is not totally negated. Religion is intensively related with state and economic activities. Both activities are run as per guidance of religion in the light of its goal and objectives.

Under Islamic economic framework Islamic banks have to consider whether social welfare & justice would be hampered or not, imbalance & exploitation would be widen or not and the poor would be deprived or not in fulfilling their goal. So the rich and the fittest are rising reasonably and the poor and worthless are fattening gradually. So as a system Islamic economic and banking system is superior one.

7.2.3. Interest tool adversely affects the whole economy of the state as well as the world

Interest is the key tool of conventional economic and banking system but it is strictly prohibited in Islamic economic and banking system due to it's adverse affects which are as under:

1. Interest adversely affects the investment, employment, production and growth:

Interest rate and investment is inversely related that means if rate of interest increased then investment decreased and if rate of interest decreased then investment increased, finally when rate of interest be zero then investment be maximized, Resultantly, employment, production, income, savings and again investment would be increased cyclically.

2. Interest-based loan and financial system drown the nation in debts:

If interest is allowed, advancing loans, in itself, becomes a form of profitable trade, and the whole economy turns into a debt-oriented economy which not only dominates over the real economic activities, rather it disturbs its natural functions by creating frequent shocks, and also puts the whole mankind under the slavery of debt. It encourages people to live beyond their means. The rich people do not borrow for productive projects only, but also for conspicuous consumption. Similarly governments borrow money not only for genuine development programs, but also for their lavish and for projects motivated by their political ambitions which thus helped in nothing but increasing the size of debts to a horrible extent.

3. Interest makes the rich richer and the poor poorer:

The pervasive role of interest in the economic system results in the systematic transfer of money from those who have less to those who have more. On the same way the transfer of revenue from poor people to rich people, from poor places to rich places, and from poor countries to rich countries is made by the money and finance system which is systematic caused by interest payments and receipts work through the economy.

4. Interest-based loan and debt-money system create inflation

Since interest-bearing loans have no specific relation with actual production, and the financier, after securing a strong collaterals, normally has no concern how the funds are used by the borrower, the money supply effected through banks and financial institutions has no nexus with the goods and services

actually produced on the ground. It creates a serious mismatch between the supply of money and the production of goods and services. This is obviously one of the basic factors that create or fuel inflation.

On the other hand, under a debt-money system all our money is created in parallel with an equivalent quantity of debt that is designed and controlled by private bankers for their benefit. They create and loan out money at interest, we get the debt.

So, although the banks do not create currency, they do create checkbook money, or deposits, by making new loans.

5. System of controlling of interest rates makes the economy a stagnating sea of human misery

Controlling of interest rates by the government makes the economy a stagnating sea of human misery and bound to restart the business cycle.

In this monetary management system, a government does by lowering or raising interest rates. It alternately encourages or discourages borrowing, thereby speeding up or slowing down the creation of money and the growth of the economy. The fact, that, by raising interest rates, people and businesses with outstanding debts can be suddenly hit with huge charges on their debts, simply as a management device to deter other borrowers, is an injustice.

This method of controlling banks, inflation and money certainly works. But an economy, dependent upon borrowing for supplying money, strapped to a financial system in which both debt and the money supply are logically bound to escalate, is forcedly punished for the borrowing. Many past borrowers are rendered bankrupt; homes are repossessed, businesses are ruined and millions are thrown out of works as the economy sinks into recession. Until inflation and over heating are no longer deemed to be a danger, borrowing is discouraged and the economy becomes a stagnating sea of human misery. Of course, no sooner has this been done, than the problem is lack of demand, so it requires must reduction of interest rates and had to wait for the consumer

confidence and to return the positive investment climate. As a result the business cycle begins all over again.

6. Adverse global impact of debt-based/interest-based economic and banking system

The third world debt is not just a financial matter, but a political one. There were always severe conditions attached to IMF and World Bank loans. Although 'program aid' required borrowing nations to conform to a package of economic and social expenditure measures aimed to ensure that funds are used for development, yet when projects failed and debts increase, 'program aid' was followed by 'structural adjustment' that entailed supervising the development of the entire economy of the indebted countries. Thus the lenders justified their total interference in the domestic policies of the third world nations. As these policies too failed to bring a turn around in the debt trends, 'austerity programs' were introduced whereby expenditure on social services, welfare and education were cut to a considerable extent.

The present international financial system can be compared point by point with peonage on an individual scale. In the peonage or debt slavery system the aim of the employer/creditor/merchant is neither to collect the debt once and for all, nor to starve the employee to death, but to keep the laborer permanently indentured through his debt to the employers. Precisely the same system operates on the international level. It is debt slavery on an international scale. If they remain within the system, the debtor countries are doomed to perpetual underdevelopment or rather, to development of their exports at the service of multinational enterprises, at the expense of development for the needs of their own citizens.

7. Money creation system and money trading as commodity creates speculation and shocks the whole economy

Modern conventional banks are creating money out of nothing. They are allowing advances and loans in the amounts around ten times more than their deposits specially, in the western countries. The coins and notes issued by the

government as genuine and debt-free money have now a very insignificant proportion in the total money in circulation which has been constantly declining in most of the countries, while the proportion of the artificial and derivative money created by the banks out of nothing is ever-increasing. The spiral of loans built upon loans is now the major part of the money supply.

This baseless money created by the banks and financial institutions it self has become the subject of speculative trade through the derivatives in the form of 'Futures' and 'Options' in the International markets. It means that in the beginning, claims over money have been treated as money. Now, claims over claims are being treated as claim. According to an estimate, over 150 trillion US dollars worth of derivatives are circulating in the world, whereas the combined GDP of all the 188 countries of the world is around 30 trillion US dollars only. Almost 80% of this trade is in the hands of some two dozen big banks and hedge funds.¹⁰⁴ The whole economy of the world has thus been turned into a big balloon that is being inflated on daily basis by new debts and new financial transactions having no nexus whatsoever with the real economy. This big balloon is vulnerable to the market shock and can be bust any time. It really did several times in the recent past.

Since Islamic banks do not practice money trading and do not use complex derivatives financial instruments based on futures and options like conventional one, the whole economy will turn in to debt-shock free real economy from debts-mounted recessionary phases. So, such Islamic banking is superior to modern conventional one.

7.2.4. Commitment of Islamic Bank to the principles of Islamic *Shariah* ensure social justice and social order

Islamic *Shariah* means divine guide lines for human being, designed by the Almighty Allah to ensure human welfare here, in this world and here after, in the world after death. To achieve the welfare strict and meticulous compliant of the principles of Islamic *Shariah* is to be ensured. An Islamic Bank has its strong commitment in this regard as stated in the definition of Islamic bank.

Islam prohibited some financial transactions, activities and businesses as those play adverse role in economy, even in society which are as follows:

Interest, Bribe, Gambling-lottery, Cheating, Adultery-prostitution, Stealing, Robbery, Snatching, Rioting, Kidnapping/hijacking, Addiction-promotion of alcohol (wine, heroine) , tobacco, cigarette , nakedness-pornography, porno cinema etc., Adulteration-ill mixing, Hording, Using money or currency as commodity, Smuggling, Miserliness, Misusing or rough using, Forced occupying of other's assets, Socially harmful, disliking and mischief creating thing, Extortion etc.

Among the above adultery-prostitution, addiction (wine, heroine), nakedness-pornography, porno cinema etc seriously attract the young generation and destroy their future, consequently whole nation will be intellectual less and turn in to anti development situation.

Islam discouraged and disliked the following financial activities for peace keeping and welfare of the society like excess spending, luxuriousness, keeping the properties beyond proper use and alms seeking.

The said financial transactions, activities and businesses both for earning and spending seriously affect the development, peace, welfare, justice and balance of the society. Islamic banks do not involve by any means with the said activities rather they strictly prohibited their financing in the above cases directly or indirectly in order to ensure social peace and order even they negatively consider any involvement with the above activities in selecting the client. Simultaneously Islamic economic system has strong commitment to reduce and abolish the said ill activities from the economic and financial affairs.

On the other hand, conventional banking and economics has no commitment against said ill activities rather they encouraged in most cases for the shake of maximizing profit giving up social peace and order. So Islamic banking is

7.2.5. Strong commitment of Islamic Bank To CSR

Conventional has strong commitment to profit preferring motive so commitment CSR is negligible. They have rare initiative in social welfare activities.

On the other hand Islamic bank has strong commitment to social welfare as their goal is wellbeing of human being. So to uplift the weaker section of the society Islamic bank has introduced several social welfare programs under Islamic Bank Foundation, a subsidiary institution of the bank on the view of corporate social responsibilities (CSR) and social welfare commitment of Islam.

7.3. Findings from practical approach

This approach is showed better performance of Islamic bank through analyzing the factors of performance that is capital, equity, debt, deposit, loan/investment, classified loan, number of customer handled, number of branches, profit, export, import remittance etc of both the sample banks. Here comparative performance of sample studied for the year 2000 & 2005 to 2008 and for the year 2008 of 20 homogeneous branches. In both the cases performance of Islami Bank Bangladesh Limited apparently showed better than National Bank Limited.

7.4. Findings from empirical analysis

In empirical analysis the efficiencies are found:

7.4.1. Findings from survey and interview

Results of survey and interviews in efficiency criteria is very positive for Islamic bank due to integrity and sincerity of the banker but quality of service is not up to the mark due to mass banking and job loading.

7.4.2. Findings from efficiency criteria

Efficiencies of two sample banks are measured in terms of ratios which are shown here under:

1. Productive efficiency

It includes efficiency in fund utilization, efficiency in deposit customer handling, efficiency in main business (deposit, loan/investment, export, import, & remittance) handling and efficiency in loan recovery. In fund utilization only deposit is considered as fund. Here it has proved that productive efficiency of Islamic bank is better.

2. Allocative efficiency

Allocative efficiency has showed the best possible utilization of bank's fund and financial resources to the mass people to fulfill the basic need and to ensure the

social development & welfare neglecting profit motive. Here Islamic Bank is in far better position.

3. Distributive efficiency

Distributive efficiency has showed equity and justice in distribution of return or profit i.e. encouraging the small deposits specially, monthly basis saving scheme and covering the remote & under developed areas. Here Islamic bank is in better position.

4. Operational efficiency

Operational efficiency has showed the capacity to minimize the operational cost with a given level of profit or to maximize the profit with a given level of operational cost. Here it is proved that Islamic Bank is behind the conventional reasoning mass bankink.

5. Stabilizational efficiency

Stabilizational efficiency has showed the capacity to absorb the shocks of business cycle and to stabilize investment fluctuation in the economy. Trend to growth is vital factor in this regard. If growth be around unique it can absorb the shock. Here Islamic bank is far ahead due to mass banking based and strong equity position.

7.5. Performance in CSR

Initiatives for social wellbeing are less or anti-profit motive that is it had to initiate different programs on lowest profit for the most people of the society specially, for the poor and distressed.

Due to profit preferring motive conventional bank is far behind in this content. On the other hand, Islamic bank has extended their efforts due to strong commitment to well being of mankind to comply the goal of Islam.

In the name of Allah, the most Merciful, the most Beneficent.

CHAPTER-8

Conclusion and Policy Suggestion

8.1. Conclusion

Islamic bank can satisfy most of the efficiency criteria if it operates in Islamic economic framework and can play best role in economic development through maximizing production, generating employment and increasing economic growth applying participatory modes and complying social commitment of Islam. It can also satisfy most efficiency criteria under conventional framework in better extend than conventional bank due strong ethical dimension and commitment to CSR. It can play more positive role in maximizing production, generating employment and increasing growth if some special initiative are taken by Islamic bank as well as Central Bank and Government.

8.2. Policy suggestion

It is evident from the research that Islamic bank could be the most efficient and superior system if it can operate in Islamic economic framework. However it could also efficient and superior under conventional framework if comply and implement the following suggestions:

1. Participatory mode to be practiced gradually in case of industry specially.
2. Profit to be distributed to the depositors form the profit of bank's overall business instead of investment income only.
3. Bai mode to practiced for trading concern and for consumption case only.
4. Special rules and regulation of the state to enacted in favor of Islamic banking.
5. More Islamic banks and financial institutions to established.
6. Separate Central bank to be established for money market transaction

7. Separate Capital market to be established with Islamic instrument and derivatives.
8. Share and complex derivatives trading in capital market to be reduced as it do not raise capital rather it creates speculation and gambling. Only primary issue may allow for raising capital. Surrender and re-issue may be allowed directly from Concern Company if and when required.
9. Islam followed and Islamic banking knowledge based manpower is required for Islamic banking both in Bank and Central Bank.

Questionnaire-1

(For the officials of both NBL and IBBL)

Name of the Respondent:

Address:

A. Bank efficiency criteria:

1. What are the reasons for low growth in fund utilization in NBL? Please serialize in order to importance.
 - Careful selection of clients in order to avoid further deterioration in loan recovery.
 - Lack of sound management.
 - Absence of effort to promote clients.
 - Lack of proper attitude of the borrowers after availing the loans towards its investment properly
 - Unforeseen interference.
2. What are the reasons for low growth of deposit in NBL? Please serialize in order to importance.
 - Slow growth of money supply.
 - Low interest rate offered on deposits.
 - Lack of quality service.
 - Lack of upgrade technological supports.
 - Any other, please write down.-----
3. Why the performance & position of NBL are not so good than that of IBBL? Please serialize in order to importance.
 - Fall in liquidity trap due to non-recovery of loans.
 - Heavy borrowings by the directors of the banks
 - High cost of deposit or borrowing.
 - Increase in overdue & bad loan.
 - Unforeseen interference of directors in sanctioning loan.
4. What are the reasons behind better growth of deposit of Islami Bank Bangladesh Limited? Please serialize in order to importance.
 - Sound & effective management position.
 - No alternative investment opportunity exists in Islamic way.

Favorable religious environment i.e. strong desire of the depositors to avoid interest on religious ground and firm confidence about religious character of IBBL.

Rules & regulations of Central Bank favor IBBL.

Any other causes. Please put down.

1.

2.

3.

5. Why profitability of Islami Bank Bangladesh Limited is far better than that of NBL?
Please serialize in order to importance.

Profit-loss sharing deposit system.

Cost controlling & proper utilization of fund.

Islamic banking system is the cause.

No unforeseen interference of the directors in sanctioning investment/loan.

No or less investment/loan availed by the directors as most of them are representatives of Trust/organization/Foreign sponsors.

6. Why the second and third generation of Islamic banks in Bangladesh have not been doing so well like IBBL? Please serialize the reasons in order to importance.

Most of the directors are not Islamic personalities. They could not able to grow confidence of general people in ensuring real Islamic banking.

Main objective i.e. establishing the Islamic banking and economic system is not clear to the people.

The most reputed and prominent *Ulama* groups are not with them.

Want of strong commitment to Islamic economics and banking in the officials, specially, in the high officials.

If you think any other important reasons please mention.

1.

2.

3.

B. Economic development and social welfare criteria:

1. Islamic banks are playing better role in economy, specially, in social welfare through enhancing following function/activities:

a. Collecting retail and marginal deposit through mass banking policy i.e. initial deposit of saving account is Tk.100/-, RDS deposit is Tk.10/- (weekly), Lowest denomination of MSS/DPS, *Mohor* and Hajj saving accounts is Tk.100/- and through opening of more rural branches. **Agreed : disagreed.**

b. Enhancing /diversifying investment/ credit facilities among marginal people through RDS (rural development scheme), HDS (household durable scheme), SBIS (small business investment scheme), AIIS (agricultural investment implementation scheme) etc. **Agreed : disagreed.**

c. Implementing social and religious commitment of Islamic economics and Islamic banking through following functions under IBF (Islami bank foundation):

* Collecting and distributing *Zakat*.

* Establishing several hospital, Community hospital, health centre etc.

* Establishing many school, college, *madrasah*, *yatimkhanah*, universities etc.

* Arranging scholarship, donation to the poor & meritorious students.

* Providing donations, grants, gifts, relief to the needy, poor, widow, orphan etc.

* Relief and *quard-e-hasana* to flood and *sidor* affected area.

Agreed : disagreed.

2. Conventional private banks including NBL are playing lesser role in economy, specially, in social welfare on following reasons:

a. Profit maximization is the main motive. **Agreed : disagreed.**

b. Mass banking is discouraging in private sector commercial banking due to profit maximization motive. **Agreed : disagreed.**

c. Retail deposit and financing like RDS of IBBL are not viable for commercial private banks. So, these are discouraging as social and religious commitment is not their views. **Agreed : disagreed.**

d. Private commercial banks had to practice some retail banking due to central bank pressure. **Agreed : disagreed.**

C. Potentiality criteria:

1. In participatory financing system of Islamic banking, bankers have to be joined in the management of the project. In such case merits are as under:

- It is so tough to conceal the position of the business by the client. Yes : No.
- Case of fund diversion by the client is to be tough. Yes : No.
- Easy counseling between bank & client will protect the fund. Yes : No.
- Production is to be increased up to Break-Even point as there is no question of interest.

Here demerits also which are as follows:

- Client's freedom & secrecy may hamper which may affect the business growth. Yes : No.
 - In case of excess profit payment by the client exceeding usual interest rate of conventional bank may discourage him (client) to perform the participatory system. Yes : No.
2. In case of participatory financing system legal support is required i.e. legal structure of the country as well as of the central bank to be changed & amended on following grounds:
- In case of incurring loss due to fund diversion and fund misshaping by the client bank need legal supports. Yes : No.
 - It is one kind of business involvement (direct or indirect) of the bank which is restricted by the Central Bank. It requires amendment of central bank's regulations. Yes : No.

D. Other criteria:

1. Number of clients with name who were dropped out due to fail the business caused by clients since last 5 years:
2. Number of clients with name who were dropped out due to fail the business by natural causes since last 5 years:
3. Number of clients with name who were dropped out due to fail the business caused by bank since last 5 years:
4. Number of clients with name who were left the branch/Bank due to default willfully since last 5 years:
5. Number of clients with name who were left the branch/Bank due to desired banking system (conventional or Islamic) since last 5 years:

6. Number of clients with name who were left the branch/Bank with dissatisfaction since last 5 years:
7. The number of clients with name against whom legal action has been taken since last 5 year:
8. The number of clients with name against whom legal action has been taken though failed in the business on genuine causes since last 5 year:
9. Number of clients with name who performed glorious success in business availing bank finance enhancing the limit at least 10 times since inception of the branch:
10. Number of clients with name who performed glorious success in business availing bank finance enhancing the limit at least 5 times since inception of the branch.

Questionnaire-2

(For the officials of Central Bank)

Name of the Respondents:

Address:

1. Why the performance & position of private conventional banks are not so good than that of IBBL? Please serialize in order to importance.

Fall in liquidity trap due to non-recovery of loans.

Heavy borrowings by the directors of the banks

High cost of deposit or borrowing.

Increase in overdue & bad loan.

Unforeseen interference of directors in sanctioning loan.

2. What are the reasons behind better growth of deposit in Islami Bank Bangladesh Limited? Please serialize in order to importance.

Sound & effective management position.

No alternative investment opportunity exists in Islamic way.

Favorable religious environment i.e. strong desire of the depositors to avoid interest on religious ground and firm confidence about religious character of IBBL

Rules & regulations of Central Bank favor IBBL.

Any other causes. Please put down.

1.

2.

3.

4.

3. Why profitability of Islami Bank Bangladesh Limited is far better than conventional banks? Please serialize in order to importance.

Profit-loss sharing deposit system.

Cost controlling & proper utilization of fund.

Islamic banking system is the cause.

No unforeseen interference of the directors in sanctioning investment/loan.

[] No or less investment/loan availed by the directors as most of them are representatives of Trust/organization/Foreign sponsors.

4. Why the second and third generation Islamic banks in Bangladesh have not been doing so well like IBBL? Please serialize the reasons in order to importance.

[] Most of the directors are not Islamic personalities. They could not able to grow confidence of general people in ensuring real Islamic banking.

[] Main objective i.e. establishing the Islamic banking and economic system is not clear to the people.

[] Most reputed and prominent *Ulama* groups are not with them.

[] Want of strong commitment to Islamic economics and banking in the officials, specially, in the high officials.

[] If you think any other important reasons please mention.

1.

2.

3.

5. Islamic banks are playing better role in economy, specially, in social welfare through enhancing following function/activities:

a. Collecting retail and marginal deposit through mass banking policy i.e. initial deposit of saving account is Tk.100/-, RDS deposit is Tk.10/- (weekly), Lowest denomination of MSS/DPS, *Mohor* and Hajj saving accounts is Tk.100/- and through opening of more rural branches. **Agreed : disagreed.**

b. Enhancing /diversifying investment/ credit facilities among marginal people through RDS (rural development scheme), HDS (household durable scheme), SBIS (small business investment scheme), AIIIS (agricultural investment implementation scheme) etc. **Agreed : disagreed.**

c. Implementing social and religious commitment of Islamic and Islamic banking through following functions under IBF (Islami bank foundation):

* Collecting and distributing *Zakat*.

* Establishing several hospital, Community hospital, health centre etc.

* Establishing many school, college, *madrasah*, *yatimkhanah*, universities etc.

* Arranging scholarship, donation to the poor & meritorious students.

* Providing donations, grants, gifts, relief to needy, poor, widow, orphan etc.

* Relief and *quard-e-hasana* to flood and *sidor* affected area.

Agreed : disagreed.

6. Conventional private banks are playing lesser role in economy, specially, in social welfare on following reasons:

a. Profit maximization is the main motive. **Agreed : disagreed.**

b. Mass banking is discouraging in private sector commercial banking due to profit maximization motive. **Agreed : disagreed.**

c. Retail deposit and financing like RDS of IBBL are not viable for commercial private banks. So, these are discouraging if social and religious commitment is not views.

Agreed : disagreed.

d. Private commercial banks had to practice some retail banking due to central bank pressure. **Agreed : disagreed.**

7. Islamic banks have been facing some difficulties which are barrier to expose its potentialities:

a. Law of land and rules-regulations of the central bank are not quite favorable to the Islamic banking. **Agreed : disagreed.**

b. Anti Islamic environment of the state i.e. government, central bank, finance ministry, tax authority, custom authority, local govt. authority, conscious classes of the people, intellectuals etc are secular in mind. **Agreed : disagreed.**

c. Prescriptions of international authority like IMF, world bank, Bassel committee specially to maintain provision, capital requirements, risk factors etc are for interest based bank and financial institutions which are very tough to match with Islamic banking. **Agreed : disagreed.**

d. Crisis of scholars of Islamic banking and economics because there are mare scope in home and abroad to produce scholars specially, at university of developed countries.

Agreed : disagreed.

8. Most officials of central Bank think that another banking system i.e. Islamic banking system beyond prevailing system is not required for economy on following reasons:

a. Lack of sufficient knowledge of Islam, specially, as complete code of life including political and economic guide lines in Islam. **Agreed : disagreed.**

b. Political jealousyness.

c. Wrong concept regarding Islam as it would be limited in basic prayer and in *madrasah*-mosque. **Agreed : disagreed.**

- d. They think that Islamic banking is one kind of cheating in the name of interest free slogan, in practical, it is interest based indirectly. **Agreed : disagreed.**
 - e. They are Muslims but their minds are secular in accepting any Islamic system. **Agreed : disagreed.**
 - f. To develop the country any anti world flow, specially, in case of economy is quite bar and also un-sustainable. **Agreed : disagreed.**
9. Islamic bank can not play sufficient roles in money market on the following reasons:
- a. Money market components and derivatives like treasury bills, short term bonds, REPO, Reverse REPO etc are interest based. **Agreed : disagreed.**
 - b. Call money market mechanisms are also interest based. **Agreed : disagreed.**
 - c. Islamic derivatives like short term government *mudaraba* bonds for money market are very few. **Agreed : disagreed.**
 - d. Islamic banks and financial institutions are also very few for meeting up call money requirement i.e. liquidity crisis through inter Islamic bank transactions. **Agreed : disagreed.**
 - e. Separate Islamic money market as dual economy system (paralleling conventional and Islamic) like Malaysia is not yet introduced in Bangladesh. **Agreed : disagreed.**
10. For smooth running and better development of Islamic banking the following measures are very essential:
- a. Separate rules and regulations of central bank as well as of the land are to be changed in favor of Islamic bank and Islamic economy. **Agreed : disagreed.**
 - b. Separate controlling and supervisory authority lead by Islamic personalities. **Agreed : disagreed**
 - c. Separate bank management institution under government for Islamic banking. **Agreed : disagreed.**
 - d. Separate Islamic banking and economic research institute under Govt. **Agreed : disagreed.**
 - e. Studies of Islamic banking and economics is to be imposed as compulsory in all levels and stages of education. **Agreed : disagreed.**
11. Islamic banks can not play sufficient role in capital market due to following reasons.
- a. Most derivatives and components are directly or indirectly interest based. **Agreed : disagreed.**
 - b. Islamic derivatives and components are very few as experience of modern Islamic banking is only for few decades. **Agreed : disagreed.**

- c. Transactions of capital market are almost financial not economic i.e. raising of capital made only by first public offering (IPO) so, secondary market transactions do not play role in economy i.e. in raising capital. In this business when one party gained conversely countered part incurred loss. **Agreed : disagreed.**
- d. As per internationally reputed prominent economist like Jams Robartson 96% of capital market transactions are speculative. All types of speculation are discouraged by Islam. So, Islamic banks should discourage it. **Agreed : disagreed.**
- e. It is like gambling and cheating business of some dominant players for which many small and raw players are kicked out from the market now and then in home and abroad. So, Islamic banks should discourage it as Islam prohibited the gambling and cheating. **Agreed : disagreed.**
- f. Want of speculation free separate capital market *basketing*/arranging Islamic financial products and derivatives. **Agreed : disagreed.**

Questionnaire-3

(For the customers/entrepreneurs/clients of NBL and IBBL)

Name of the Respondent:

Address:

Name of the Bank maintaining account/business with:

A. Ethical standard in banking:

1. Clients/customers had to face the following situations:
 - a. In most cases of loan sanctioning clients had to manage the manager by unethical ways. **Agreed : disagreed.**
 - b. In some cases of loan sanctioning clients had to manage the Zonal office/Head office/both unethically. **Agreed : disagreed.**
 - c. In some case, specially, in large amount sanctioning clients had to manage the director unethically. **Agreed : disagreed.**
 - d. In rescheduling and waiver cases clients had to manage the some authorities unduly. **Agreed : disagreed.**
 - e. In case of cash transaction customers had to pay some money to the cashier as *bokshish*. **Agreed : disagreed.**
 - f. In taking important services customers had to pay some money or *bokshish* to respective desk. **Agreed : disagreed.**

B. Service quality of the bank:

1. Please comment regarding service quality of the bank:
 - a. Overall service quality of the bank/branch as observed by you. **Bad : good : moderate : excellent.**
 - b. Service quality of cash officials. **Bad : good : moderate : excellent.**
 - c. Service quality of general banking officials (beyond cash section). **Bad : good : moderate : excellent.**
 - d. Service quality of loan and advance section officials. **Bad : good : moderate : excellent.**
 - e. Service quality of foreign exchange officials. **Bad : good : moderate : excellent.**
 - f. Mention three excellent performance/services/qualities of the bank on your eye:
1.....

2.....

3.....

C. Problems and prospects of Islamic banking on your eye:

1. Islamic banks have been facing some difficulties which are barrier to expose its potentialities:
 - a. Law of land and rules-regulations of the central bank are not quite favorable to the Islamic banking. **Agreed : disagreed.**
 - b. Anti Islamic environment of the state i.e. government, central bank, finance ministry, tax authority, custom authority, local govt. authority, conscious classes of the people, intellectuals etc are secular in mind. **Agreed : disagreed.**
 - b. Political jealousy. **Agreed : disagreed.**
 - c. Wrong concept regarding Islam as it would be limited in basic prayer and in *madrasah*-mosque only, not in banking and economy. **Agreed : disagreed.**
 - d. Some peoples think that Islamic banking is one kind of cheating in the name of interest free slogan, in practical, it is interest based indirectly. **Agreed : disagreed.**
2. For smooth running and better development of Islamic banking, the following measures are very essential:
 - a. Separate rules and regulations of central bank as well as of the land are to be changed in favor of Islamic bank and Islamic economy. **Agreed : disagreed.**
 - b. Separate controlling and supervisory authority lead by Islamic personalities.
 - c. Separate bank management institution under government for Islamic banking. **Agreed : disagreed.**
 - d. Separate Islamic banking and economic research institute under Govt. **Agreed : disagreed.**
 - e. Studies of Islamic banking and economics is to be imposed as compulsory in all levels and stages of education. **Agreed : disagreed.**

D. Role in economic and social development:

1. Islamic banks are playing better role in economy, specially, in social welfare through enhancing following function/activities:
 - a. Collecting retail and marginal deposit through mass banking policy i.e. initial deposit of saving account is Tk.100/-, RDS deposit is Tk.10/- (weekly), Lowest denomination of MSS/DPS, *Mohor* and Hajj saving accounts is Tk.100/- and through opening of more rural branches. **Agreed : disagreed.**

b. Enhancing /diversifying investment/ credit facilities among marginal people through RDS (rural development scheme), HDS (household durable scheme), SBIS (small business investment scheme), AIIS (agricultural investment implementation scheme) etc. **Agreed : disagreed.**

c. Implementing social and religious commitment of Islamic and Islamic banking through following functions under IBF (Islami bank foundation):

* Collecting and distributing *Zakat*.

* Establishing several hospital, Community hospital, health centre etc.

* Establishing many school, college, *madrasah, yatimkhanah*, universities etc.

* Arranging scholarship, donation to the poor & meritorious students.

* Providing donations, grants, gifts, relief to needy, poor, widow, orphan etc.

* Relief and *quard-e-hasana* to flood and *sidor* affected area.

Agreed : disagreed.

2. Conventional private banks are playing lesser role in economy, specially, in social welfare on following reasons:

a. Profit maximization is the main motive. **Agreed : disagreed.**

b. Mass banking is discouraging in private sector commercial banking due to profit maximization motive. **Agreed : disagreed.**

c. Retail deposit and financing like RDS of IBBL are not viable for commercial private banks. So, these are discouraging if social and religious commitment is not views.

Agreed : disagreed.

d. Private commercial banks had to practice some retail banking due to central bank pressure. **Agreed : disagreed.**

E. Business performance:

1. Date and amount of 1st availed loan/ investment: Date..... Tk.....

2. Own capital at the time of availing 1st limit: Tk.....

3. How many times limit has been enhanced? Time.....

4. Date and amount of last limit availing: Date..... Tk.....

5. Own capital at the time of last limit availing: Tk.....

6. Causes of failing business (if failed):

a.

b.

c.

7. Causes of leaving the bank/branch (if left):

a.

b.

c.

8. Tools for success in business:

a.

b.

c.

9. Suggestions for the banker:

a.

b.

c.

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Islamic banking and it's superiority in economy to maximize production, employment & growth for ensuring social development & welfare.

In the name of Allah, the most Merciful, the most Beneficent.

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