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# The Attitude of Bank Customers and Professional Bankers towards Islamic and Conventional Banks in Bangladesh

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## Introduction

An Islamic bank is a financial institution that operates with the objective to implement and materialize the economic and financial principles of Islam in the banking arena. It is defined as "a financial and social institution whose objectives and operations as well as principles and practices must conform to the principles of Islamic Sharīʿah (Jurisprudence), and which must avoid the interest in any of its operations".[1] It is also defined as "a Company which carries on Islamic banking business. Islamic banking business means banking business whose aims and operations do not involve any element which is not approved by the religion Islam." [2]

It follows, therefore, that what makes Islamic banking "different" from traditional Western banking is that there can be no interest (*ribā*) paid or charged for any transaction or service to ensure justice, welfare and non-exploitation. Of course, the investments of an Islamic bank must be channeled to the Islamic Sharīʿah approved (*ḥalāl*) sectors by Islamic modes of finance like *muḍārabah, mushārakah, bayʿ-muajjal, bayʿ-salam, ijārah,* hire purchase, etc., which are based on the sharing of risk and profit. Islamic bankers in effect generate "profit and loss" transactions in which the lender or bank shares in gains or losses based on the economic viability of the project and the credit worthiness of the customer.

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The early concept of the Islamic bank can be traced back to the very birth of Islam when the Prophet himself acted as an agent for his wife's trading operations. However, in the present period and in the current sense of a bank like financial institution it was in 1963, in Mit Ghamar, that the first Islamic interest-free bank actually came into being. Islamic banking is now a phenomenon. It has been growing at about 15 per cent per year (Langton, 1995). This pattern of growth has attracted traditional banks such a Chemical Bank, Citibank, Kleinwort Benson, Midland Montagu, ANZ Grindlays and Goldman Sachs to look more closely at joint ventures with their Islamic counterparts for major financial transactions that accord with the Sharīʿah.

Despite the phenomenal growth of Islamic banking practices worldwide, there is a debate among scholars about whether Islamic banking practices are any different from the conventional banking system. This debate is not confined to the academic circles only, but has also made its way to the banking community and the banks' customers. We argue that there is a lack of knowledge about the various Islamic-banking practices among the banking community as well as the banks' customers. A question that generally arises is why is the Islamic banking system growing so fast if it is not different from the conventional banking system. Analysis of the deposit and investment mechanisms and the opinions of the bankers and customers of both Islamic and conventional banks would be useful to understand and identify Islamic banking with its separate unique features and its impact on economy and society. The primary objective of this study is to examine the reality of apparent similarities between Islamic and conventional banks, which frequently tend to equate both systems of banking. This is done at the theoretical plane as well as by opinion survey of the users (i.e., bankers and customers) of the two systems.

The paper seeks to identify and clarify the controversial issues between Islamic and conventional banks in order to help remove the misconceptions about Islamic banking. It is due to incomplete and often distorted knowledge about Islamic banking that the civil society remains doubtful about the viability of such a system. As the civil society is an active and potential agent of dissemination of ideas and information in the society, its lack of knowledge and conviction has limited the scope of Islamic banking practices. Once the public is convinced about the utility and uniqueness of the system, Islamic-banking practices will grow further in many Muslim countries. The transformation of the present interest-based financial system into an interest-free Islamic system is one of the objectives espoused by many Muslims.

The paper is divided into six sections. Following this introduction, an overview of the essential features of Islamic banking and finance has been given in section 2. The survey methodology used in this study is presented in section 3. The deposit and financing techniques of Islamic and conventional banks have been analyzed in section 4. Section 5 analyzes the opinions of the bankers and customers of both Islamic and conventional banks. Section 6 presents the summary and conclusions of the study.

## 2. Principles of Islamic Banking and Finance

The best known feature of Islamic banking is the prohibition on interest. The Qur'ān forbids the charging of *ribā* on money lent. It is important to understand certain principles of Islam that underpin Islamic finance. The Sharīʿah consists of the Qur'ānic commands as laid down in the Holy Qur'ān and the words and deeds of the Prophet Muhammad (s.a.w.). The Sharīʿah disallows *ribā* and there is now a general consensus among Muslim economists that *ribā* is not restricted to usury but encompasses interest as well. The Qur'ān is clear about the prohibition of *ribā*, which is sometimes defined as excessive interest. "O You who believe! fear Allah and give up that remains of your demand for usury, if you are indeed believers." Muslim scholars have accepted the word *ribā* to mean any fixed or guaranteed interest payment on cash advances or on deposits. Several Qur'ānic passages expressly command the faithful to shun interest.[3]

The concept and role of money is crucial to any financial system. In an Islamic system, money is primarily and exclusively a measure of value, a means of exchange and a standard of deferred of payment. However, distinct from the ethos of Western economics and conventional banking, money is not regarded as a commodity in itself, to be bought, sold and used to beget money. In an Islamic framework, money has to operate through some real economic activity or service. It is a facilitator and an intermediary, not an active self-contained agent in itself. Capital is productive, not money per se. It is a means towards production, through creative entrepreneurial efforts. It is to be an instrument towards value-added through physical expansion of the economy. In other words, real economic progress and development consist in expansion of physical and human aggregates of the economy via creation of assets, products and services, not merely in the form of fiduciary financial expansion. It is through such a generation of wealth that well being takes place and the relationship between money-economy and physical-economy remains in real equilibrium.[4]

The rules regarding Islamic finance are quite simple and can be summed up as follows:

a) Any predetermined payment over and above the actual amount of principal is prohibited.

b) The lender must share in the profits or losses arising out of the enterprise for which the money was lent.

c) Making money from money is not acceptable in Islam.

d) *Gharar* (Uncertainty, Risk or Speculation) is also prohibited.

e) Investments should only support practices or products that are not forbidden or even discouraged by Islam

## 3. Methodology of the Study

A purposive random sampling was used to collect data on a series of questions regarding Islamic banking practices. Data of the study was collected from both primary and secondary sources. Two sets of the approved questionnaire[5] were used in the survey, through interview method, among the customers and bankers of selected Islamic and conventional banks in Dhaka City. The study includes 4 (four) Islamic and 4 (four) conventional private banks. The four Islamic banks are: Islami Bank Bangladesh Limited (IBBL), Al-Arafa Islami Bank Limited, Social Investment Limited and Al-Baraka Bank Limited. The four conventional banks are National Bank Limited (NBL), International Finance and Investment Corporation (IFIC) Limited, Arab Bangladesh Bank Limited (ABBL) and City Bank Limited (CBL). These banks were established in 1983, so we assume that the officers of these banks and their customers know and understand the similarities and differences in the banking practices of Islamic banks and conventional banks. Ten questionnaires were pre-tested among five bank officers and five customers. The final sample consists of twenty-five bank officers and customers of each bank. As such, 200 bankers and 200 customers were interviewed (Table 3) to record their opinions about some apparent similarities between Islamic and conventional banks. Findings of the study were consulted with the available literature and executives of the banks to confirm their reliability and acceptability.

## 4. Analysis of Deposit and Investment Mechanisms of Islamic versus Conventional Banking

### 4.1 Islamic Interpretation of Similarities and Differences of Deposit services provided by Islamic and conventional banks:

Various types of deposit services provided by Islamic and conventional banks have been given in Table 1. Although deposit services of Islamic banks look similar to those of conventional banks, a deeper scrutiny will show that they are indeed different. Payment of profit on deposits by Islamic banks is not equivalent to payment of fixed interest on deposit by conventional banks.

The conventional bank accepts deposits to supply money to the income generating activities of entrepreneurs. The major source of funds for conventional banks is customer deposit, on which the bank pays fixed interest rate. This deposit is a form of debt given to the bank by a bank customer. The bank has to pay to the depositor the principle as well as interest, regardless whether the bank makes a profit from the money or not. In case of a bad loan, the bank has to pay the depositor from its own resources. The depositor does not share risk with the bank, but gets paid for his debt to the bank. Islam views such transaction unjust because it allows unequal treatment of creditor (depositors) compared to the debtor (the bank).

On the other hand, Islamic banks accept deposits with the condition that the money will be put to work combined with the skills and management expertise of banks. The depositor would get back his principal amount together with a share of profit after the expiry of the contract. In fact, the depositor agrees to put his money in the bank's investment account and to share profits with the bank. In this case, the depositor is the supplier of capital and the bank is the manager of capital. The depositor does not earn interest on a fixed rate in Islamic banking system, but accepts some of the business risks and earns a share of the profit. The depositor is not guaranteed any pre-determined return on the nominal value of his deposit like interest-bearing banks, but is treated as a shareholder of the bank and as such, is entitled to a share of the profits made by the bank. Similarly, if the bank incurs losses, the depositor shares in these losses and the value of his deposit is reduced. Therefore, any shock to asset positions of Islamic banks is instantaneously reflected by changes in the values of shares (deposits) held by the public in the bank, and therefore, the real values of assets and liabilities of an Islamic bank would be equal at all times.[6] However, in the conventional banking system, because the nominal value of deposits is fixed, such a shock could cause a divergence between real assets and real liabilities. Since the bank engages in a two-way contract with both depositors and borrowers, the bank does not trade money for money, which is forbidden in Islam. Rather, the bank lends money, which is put to work by the borrower, and shares profit/loss of the invested capital. The Islamic equity system is proved to be a mechanism of efficiency, justice, welfare and fair growth.[7] Therefore, it may be concluded that although monetary benefits are paid to depositors in both Islamic and conventional banks, they are not the same. Payment to depositors by Islamic banks is variable while payment to depositors by conventional banks is fixed.

### 4.2 Islamic Interpretation of Similarities and Differences of Lending (Investment) services provided by Islamic and conventional banks:

Table 2 shows comparative financing techniques used by both Islamic and conventional banking system. Short-term trade financing techniques (*bayʿ-murābaḥah, bayʿ-muajjal, bayʿ-salam*, and *ijārah*) by Islamic banks are alleged to be similar to interest-bearing short-term lending by conventional banks on the following grounds:

a) Fixed charges as a percentage increase with time as compensation for violation of agreement for repayment schedule of investment taken by the entrepreneur from the bank;

b) Dated payment obligations which may not synchronize with a firm's cash-flow;

c) The borrower has to make payments whether or not he is succeeding in his business;

d) Security or mortgage is essential for investment;

e) Returns are practically calculated on the benchmark of an interest-based bank.

Islamic banks earn profit either from investment in trading (*bayʿ*) and leasing *(ijārah)* or in production/manufacturing. As a result, Islamic banks get directly involved in trade and industry, for which Islamic banks perform functions of both an intermediary and manager. Lack of expertise to appraise and monitor different types of industries and long drawn court procedures for recovery of bad loans in case of default by borrowers make Islamic banks hesitant for long-term *muḍārabah* or *mushārakah* modes of lending. Consequently, '*bayʿ*'and 'lease' modes of investment become dominant forms of financing by Islamic banks.

Maududi[8] looks into the difference between '*bay*ʿ' and 'interest' in the context of the equitable distribution and efficient management of risk. In interest-based transactions, risk is transferred to the borrowers so that all interest-bearing assets become risk free. This is socially inequitable and economically inefficient. On the other hand, trade by conforming to natural uncertainty is both equitable and efficient. In *ribā*-based transactions, the object of sale is time and its price is *ribā*. This is reemphasized in the context of the time value of money. Al-Masri[9] holds the view that a higher deferred price of an object of sale is legitimate, and it recognizes the time value of money in Islam. This value might be determined ex-ante. However, it is argued that a fixed price in a deferred sale does not mean a fixed return on capital because of the uncertainty and risk incorporated in such transactions. Alternatively, Khan[10] rejects this proposition and suggests that the time value of money can only be determined ex-post. Saadallah[11] also recognizes acceptance of the value of time by Sharīʿah scholars but only in relation to real transactions.

Therefore, the value of time is related to an actual transaction and its outcome. The postponement of liability justifies a greater return to capital under a *ribā*-based system. However, in actual transactions, the return to capital is linked to ownership of real goods, which carries an element of risk with it. Therefore, profit of Islamic banking consists of several factors including time, which is required to complete the actual transactions. *Ribā* does not consider risk sharing, whereas profit-loss considers risk-sharing. As a result, the capital involved in trade might grow or decline over time, while in *ribā*-based transactions, capital automatically increases over time.

Islamic banking is involved indirectly with commodity trading, as a manager of funds based on the request of the client. The business relationship between the bank and client on an actual basis considers every aspect of assurance of profitability, such as credit risk, liquidity risk, maturity risk and inflation risk. A prudent lending decision on behalf of the bank makes the probability of risk negligible. In case of genuine default, the Islamic bank recovers only the contracted amount (in case of *murābaḥah*) or remainder of the principal amount (in case of *muḍārabah* and *shirākah*) without any compensation for bearing risk. In case of willful default, there is no alternative to the Islamic bank except demanding compensation for bearing risk. However, Islamic banks do not account this compensation as part of its income, rather they distribute these monies to the poor.

The instruments of '***cost plus***' and '***leasing***' are devoid of interest. Although these two instruments are criticized as being very similar to those of interest-based banking and it is argued that these instruments have not brought much real change to the banking system, their use does carry an element of risk for the Islamic banks which makes them acceptable to the Sharīʿah. The Qur'ān clearly states that "***Allah has permitted trade and forbidden usury***" (2:275), and both cost-plus sales and leasing are forms of trade. For example, in the case of sale with cost-plus transactions, there must be a definite period during which the financier actually owns the commodity in question. This does not mean that he takes the physical possession of the commodity. He must be the legal owner for this period, bearing all risks, liabilities and benefits of this possession, which is called the "constructive" possession. He is, therefore, the genuine seller of the commodity and is entitled thereby to make a profit on the sale. It is the risk in trading which makes it an acceptable way of making profit. Fixed interest, on the contrary, carries no such risk and is, therefore, against Islamic principles as a way of making money.[12] Although in face value, a number of Islamic financing modes look similar to those of interest-based banking, we find that these are very different from each other in terms of justice, efficiency, stability and economic growth.

## 5. Questionnaire Survey Analysis of Banker and Customer Perception of Islamic and Conventional Banks

It is observed from the survey that an overwhelming group of the customers are businessmen. They total 57 per cent of the sample. The remaining groups are: self-employed (13 per cent), service holders (10 per cent), housewives (7 per cent) and others (3 per cent) (Table 4). The whole sample consists of customers in the-age group 35-60 years (Table 6), and 89% of them are male (Table 7). The education level is dominated by the graduate degree (68%) followed by the postgraduate degree (17%) and the under graduates (15%) (Table 8). It seems that the qualities of the respondent customers are unique in the perspective of generally understood social fabrics of Dhaka City.

However, the majority of bankers are officers (72%). Only 5% of the sample is senior executives (Table 5) most likely because they are busier than the officers. It is observed that the age, sex and education levels of the bankers are close to that of the customers under study.

Regarding the essence of the profit and loss sharing system of Islamic finance, Table 9 shows that the bankers are more aware than the customers. Fifty-five per cent of them believe that Islamic finance~~s~~ aim at both profit and losses. However, only 32% of the customers agree with them although most customers (62%) believe that Islam permits profit and forbids *ribā*. The opinions vary due to the fact that the Islamic bankers get formal training on Islamic Economics and Banking and the conventional bankers are aware due to their professional consciousness. However, both the bankers and customers are conscious about the relation of profit, in lieu of interest, to Islamic finance. It is the outcome of launching Islamic banking in the country in 1983. The basis of such observation is that 11% of the bankers and customers believe that Islamic finance always mean for investment in real assets, while 9% of them have mentioned that Islamic finance cannot earn *ribā* in anyway.

A majority (69%) of the bankers and customers (Table 10) view that *zakat* has been mobilized through the Islamic banking system. Twelve per cent of the respondents have mentioned that welfare activities are organized through the Islamic banking system, while 10% believe that Islamic banking system has introduced new products. Again, 7% of respondents view the concept of *ḥalāl* and *ḥarām* is introduced in the case of investment, buying and selling, while least of them (2%) mention that mobilization of financial resources to the real sector of the economy is well introduced. This indicates that the life and society of Bangladesh have benefited from Islamic banking, which further justifies a separate role of the Islamic Banking system in the economy of Bangladesh.

The next question is: what is the basis of the development of Islamic banking system in Bangladesh? 55% of bankers and 69% of customers (Table 11) think that this is due to 'mere faith in Islam' of the overwhelming Muslims (88%) of the country. In contrast, 15% and 23% of them, respectively, believe that the 'intention to earn profit' is the basis of development of Islamic banking system. However, 18% of the bankers have the opinion that the 'tendency to avoid interest' is the basis, while only 2% of the customers believe it as a basis. Such discrepancy is again observed: when 9% of the bankers said that 'to do welfare of the economy' is the basis, it is supported by only 3% of the customers. 3% of both bankers and customers agree that the basis is 'to ensure justice in the financial transactions'.

It follows that the item 'to avoid interest' as a basis of development of Islamic banking system has not drawn the attention of the majority of the respondents. Why does it happen so? Do they believe that Islamic banks have opened the back door for continuation of transactions like interest-based banks?

In fact, all respondents believe so (Table 12). They have mentioned several causes for opening such a back door. The major cause, according to the 73% of the customers and 60% of the bankers, is that the trading and the rental modes of investments of Islamic banks do not differ much from the transactions of interest-based banks. The agreement of payment of installment in due time and the extra payment for excess time of repayment of an investment under the trading and rental mode create the same financial burden to an investment customer. Besides, other arrangements (mortgage, security, registration etc.) for getting an investment loan from Islamic banks are the same as those of conventional banks.

On the other hand, 14% of the respondents view that the degree of risk in the present system of Islamic banking is not enough to justify this sort of banking. It is followed by 11% of the respondents, who view~~s~~ that Islamic banks are working along with the interest-based banks. The least of them (8%) believe~~s~~ that the products of present Islamic banks serve the purpose of interest-based banks.

In response to the question: what are the causes of crept of interest into the Islamic banking system, 45% of respondents replied that exploitation is going on through Islamic banking (Table 13). Alternatively, 19% mentioned two other causes: (i) the products of Islamic banks have failed to remove the curse of interest-based banking; and (ii) the bankers lead the Islamic-banking system to the garb of interest. Sixteen per cent believe that Islamic banking is introduced in a society, which is not reorganized on Islam. It seems that the bankers and customers are concerned about the interest factor, which tends to make both Islamic and conventional banks similar.

The next question is what are the reasons for which the Islamic banks do not operate in true spirit of Islamic Sharīʿah? In response, the majority (35%) of the respondents have mentioned that only the level of profit earning cannot be the success criterion for an Islamic bank, when Islamic banks are registered as a schedule commercial bank with a view to earning profit. While 32% think that the status of the Sharīʿah Council/Department is advisory, not supervisory in the system of Islamic banking, 20% has the opinion that Islamic banks do not ensure justice and welfare in financial transactions. A minority of respondents (12%) believe~~s~~ that exploitation still remains in the Islamic banking system. As a result, many Muslim businessmen and industrialists do not really patronize the Islamic banks. About 73% believe that the potential patrons do not find any business difference between Islamic and conventional banks (Table 15). The other two causes identified (20%) are: (i) lack of consciousness of the patrons, and (ii) confusion about Islamic banking. Minorities of respondents (8%) believe that people are not properly motivated to Islamic Banking.

Next, the risk factor of business came into consideration. This factor is always considered for generating profit in any business.

However, it is observed (Table 16) that the respondents opine that most of the Islamic modes of investment practiced by Islamic banks do not practically share risk for many reasons. While a majority of them (66%) believe that the insurance company covers risks, 21% said that Islamic banks do not buy practically for a sale. Ten per cent observe that buying and selling arrangements of Islamic banks are almost risk-free. Only 3% of the respondents believe that Islamic banks do business with depositors' money. Therefore, if there is any risk, it is borne by the depositors. It seems that the respondents are conscious about the relation of risk factor with Islamic banking.

Further, the respondents confirm that many customers are not interested in dealing with Islamic banks because they feel that only the title name of the banks has been changed and interest in a real sense has not been eliminated. Table 17 shows some causes behind these feelings. For example, many respondents (73%) feel that mark-up profit has created a financial burden like the interest burden of conventional banks. Other reasons are: (i) repayment of the bank's money by installment (10%), and (ii) a failure of payment of installment creates additional liability (7%). A few of them (6%) opine that Islamic banks, in most of the cases, do not consider business losses of the entrepreneur for adjusting repayments.

Possibility of reduction in the value of deposits through losses suffered by bank is a feature of Islamic banking system, but it may be harmful for deposit mobilization. With this view in mind, the respondents were asked: do they believe that the condition of deposit loss is not harmful for deposit mobilization? We received the response that possibility of loss is not detrimental to deposit mobilization. The respondents believe that the profit and loss sharing system of banking cannot ultimately make a loss of deposit. This opinion is expressed (Table 18) by 43% of respondents, while others (23%) view that the condition of deposit loss does not mean total loss of deposit. However, 20% of respondents believe that it is an actual element of investment, which makes the profit on the Islamic bank's deposit *ḥalāl* (legitimate) therefore acceptable. Fourteen per cent of respondents think that the condition of a deposit loss is insignificant to a true Muslim, who expects a garden in the heaven in the life hereafter. This implies that the respondents have expressed their strong feelings in favor of Islamic banking.

Regarding the present modes of investment practiced by Islamic banks both bankers and customers believe that it is compromised with the interest factor of conventional banks. For example, according to the respondents, *bayʿ-murābaḥah* and *bayʿ-mu'ajjal* modes of investment are compromised with the Pledge and Hypothecation techniques of interest–bearing banking. It is observed that 67% believe that finance under both systems of banking gave the same effect on business results. The remaining 33% view that both banks are (i) justice (*ʿadl*) and welfare (*iḥsān*)-free, (ii) working side by side, and (iii) working in the same value loaded society (Table 19).

Finally, a last question was asked about how to get rid of that situation. They quest for governmental reformation measures for moral building and eradication of false values of life, which would pave the way for Islamic baking. They have also mentioned several causes to support their opinions (Table 20). A majority of them (59%) feel that Islamic banks cannot work well in an immoral society. While 17% have mentioned that governmental power can change social values, 13% believe that governmental reformation measures are powerful to build a moral society. About 10% of them have expressed that false values of life give a detrimental environment to Islamic banking. This indicates that the bankers and customers hold a very strong opinion in favor of governmental measures for reformation.

The above analysis of the misleading similarities between Islamic and conventional banks, along with the understandings, values and attitudes of the bankers and customers about the Islamic baking system, indicates the degree of commitments to Islamic banks in Bangladesh.

## 6. Summary and Conclusion

The prohibition of *ribā* (interest) makes Islamic banking different from conventional banking. Of course, the investments of an Islamic bank must be channeled to the Islamic Sharīʿah approved sectors. The phenomenal growth of Islamic banks has attracted the attention of bankers, business community and bank customers. It is also contended that Islamic banks are not very different from conventional banks. This debate raises a natural question that if Islamic banks are no different from conventional banks, why they are growing so fast? A survey analysis of the deposit and investment mechanisms and the opinions of the bankers and the customers of both Islamic and conventional banks help our understanding and identification of this debate. Our theoretical analysis shows that Islamic bank practices are indeed different from those of conventional banks.

The central theme of this study is to examine some apparent similarities between Islamic and conventional banks, which frequently tend to equate the two systems of banking. The degree of relationships of the apparent similarities was found through a process of scientific investigation. Data of this study was collected from both primary and secondary sources. Two sets of questionnaire were used in the interview survey, among the customers and bankers of selected Islamic and conventional banks in Dhaka City. A purposive random sampling was used in the survey. Two hundred (200) bankers and two hundred (200) customers were interviewed to record their opinions about some apparent similarities between Islamic and conventional banks.

Islamic banking maintains *Al-Wadīʿah* Current, *Muḍārabah* Savings and Term Deposit accounts, and conventional banks maintain Current Deposit, Savings Deposit, and Term Deposit accounts. An analysis of these deposit mechanisms shows a misleading similarity that both Islamic and conventional banks pay money for the deposits of the customers, which is termed as profit in Islamic banking or interest in conventional banking respectively. While payment of return on deposit in Islamic banking contains element of risk, payment of interest in conventional banking does not contain the element of risk. Only payment on deposit apparently generates misunderstanding in the minds of bank customers whether Islamic banking is indeed different from conventional banks.

In terms of financing techniques, the prevalence of short-term financing in Islamic banks raises the questions of efficiency, equity and justness of Islamic banks. In addition, this also raises questions such as, whether Islamic banks pay profit? Or interest in the name of profit? We showed that the Islamic banking financing mechanisms are different from those of conventional banks. The misleading similarities between Islamic and conventional banking products are the result of the following observations:

First, fixed charges in percentage, which increases with time as compensation for violation of an agreement for repayment schedule of investment taken by the entrepreneur from the bank.

Second, dated payment obligations may not synchronize with the firm's cash flow.

Third, payment obligations are mandatory whether or not the business is making a profit. Fourth, a security or mortgage is essential for investment.

Finally, returns are practically based on the benchmark of an interest-based bank.

The survey analysis shows that both the bankers and bank customers have confusing notions about Islamic banking practices. We argue that this misconception is partly due to incomplete knowledge in the fundamentals of Islamic finance and due to the over-reliance on short-term trade financing. The investment portfolio of Islamic banks has generally favored trade-related activities over production-related activities, short-term profitability over long-term profitability and private profitability over social profitability. Almost 80 to 90 per cent of investment has been made to short-term trade-related activities. Heavy reliance on a short-term asset portfolio makes Islamic banks vulnerable, increases its risk and threatens its stability. On the other hand, the borrowers prefer short-term trade loans to profit-loss sharing instruments, which have weakened the bank's portfolio. The real rates of return of the Islamic bank's asset portfolio are lower than those of conventional banks.

Islamic banks have become, to an extent, successful in the field of deposit mobilization, but socially beneficial and development oriented utilization of these deposits did not happen. Employment generation and a flow of resources towards the lower and middle classes, particularly in the rural areas, have not taken place. Still, Islamic banks are involved in the heroic role of eliminating *ribā* from financial dealings in Muslim countries against a backdrop of regulation in the area of taxation, legal framework, and weak moral fabric of society. In order to remove misconception from the minds of bankers and customers, there is no alternative to publicity, research and training of Islamic banking practices. Research should focus on the development of financial products that conform to Islamic Sharīʿah, and training should be given to bankers, potential researchers and bank customers.

## Appendix

**Table 1: A Comparison of Deposit Mechanism between Islamic and Conventional Banks**

| Deposit Mechanism of Islamic Banks | Deposit Mechanism of Conventional Banks |
|---|---|
| Islamic banks accept *Al-Wadī‘ah (Trust) Current*, *Muḍārabah Savings* and *Term deposits*. It has been observed that the common practices of Islamic banks, in the sources of funds, are as follows: | Conventional banks accept *Current, Savings, and Fixed Deposits*. The main characteristics of these deposits are given below: |
| • *Al-Wadī‘ah* Current Deposit:<br>All Islamic banks operate *Al-Wadī‘ah* current accounts, commonly known as call deposits or demand deposits. The bank guarantees the full return of these deposits and the depositors are not paid any share of the profit or any other return in any form. *Al-Wadī‘ah* demand deposits are treated as *Amānah* (where deposits are handed over by the depositors to the bank as a trust and the bank does not have the authority to use them without obtaining the specific permission of the owner of the funds), or as *qarḍ ḥasan* (money deposited in these accounts is interest free loan from the depositors to the bank and the bank is free to utilize these funds at its own risk without any return to the depositors and without needing any authorization) | • Current Deposit:<br>Its characteristics are as good as those of *Al-Wadī‘ah* current deposits of Islamic banks. |
| • *Muḍārabah* Savings Deposit<br><br>The bank accepts deposits in a current account on the principle of *Al-Wadī‘ah* requesting depositors to give permission to the bank to use these funds at its own risk, but guarantees full return of deposits and shares any profits voluntarily.<br><br>The bank accepts savings deposits with an authorization to invest and share profits in an agreed manner for the period in which a required balance is maintained.<br><br>The bank treats savings deposits as *qarḍ ḥasan* from depositors to the bank and guarantees pecuniary or non-pecuniary benefits to the depositors.<br><br>The bank accepts savings deposits as part of an investment pool and treats them as investment deposits. | • Savings Deposit<br>❑ The bank accepts deposits from customers as a safe custodian of the customer's money.<br>❑ The bank accepts deposits from customers on a declared rate of interest to be paid for such deposited money.<br>❑ The bank uses these deposits at a higher rate of interest.<br>❑ The depositors can withdraw the balance at any time. |
| • *Muḍārabah* Term Deposit | • Fixed or Term Deposit |

| | |
|---|---|
| ❑ *Muḍārabah* Term deposits are called Profit Loss Sharing (PLS) Accounts or Participatory Accounts.<br>❑ Individuals or companies can open *Muḍārabah* Term deposit accounts either in domestic or foreign currency, provided that the bank is allowed to operate in foreign exchange.<br>❑ Deposit holders do not receive any interest. Instead, they participate in the share of the profit or loss of the bank.<br>❑ The return on *Muḍārabah* Term deposit accounts is determined according to the actual profits earned from the investment operations of the bank and share of the profit in an agreed proportion by depositors according to the amount of their deposits and the period they are held by the bank.<br>❑ Generally speaking, depositors do not have the right to withdraw from these accounts as is customary in time deposits in conventional banks. However, withdrawals can be made under special circumstances if the depositor forfeited his share of the profit for the amount withdrawn.<br>❑ Usually, banks insist on a specified minimum amount to open and maintain the *Muḍārabah* Term deposit account.<br>❑ Most banks issue an investment certificate to depositors stating the terms and conditions of the deposit. | ❑ Usually these accounts are opened for a specific period, e.g. three months, six months, one year or more.<br>❑ Deposit-holders receive interest at different rates of interest for different terms of fixed deposits.<br>❑ Generally the depositors cannot withdraw the money from these accounts. But however, withdrawals can be made under special arrangement forfeiting the interest to be added for the amount withdrawn. |

**Table 2: A Comparison of Investment Mechanism between Islamic and Conventional Banks**

| Investment Mechanism of Islamic Banks | Investment Mechanism of Conventional Banks |
|---|---|
| There are seven Islamic financing modes practiced by the most of the Islamic banks of the world:<br><br>• ***Bayʿ-Murābaḥah***<br>❑ The client approaches the Islamic bank with the request to finance his specific requirement like purchase of capital goods, raw materials, machinery equipment or consumer durable with specification and price information. The bank, after being convinced of the viability of the proposal, informs the client about the margin of profit, which the bank would like to make on the | Conventional banks provide finance by using the following techniques:<br><br>• **Loans**<br>❑ A loan is an advance sanctioned in lump sum.<br>❑ The borrower can draw it at a time or by pre-agreed instalment.<br>❑ The bank debits the money to the loan account opened |

| Investment Mechanism of Islamic Banks | Investment Mechanism of Conventional Banks |
|---|---|
| original price.<br>❑ The final price of the commodity, which includes the price of the commodity paid by the bank to the original seller and the bank's profit with other incidental costs, is deferred to a payment on an installment basis.<br>❑ The sale item is in the possession of the bank before sale to the client. | in the name of the borrower.<br>❑ Interest is usually calculated and charged quarterly. |
| • ***Bay'-Mu'ajjal***<br>❑ It is a sale contract in which provision is made for an immediate delivery of goods, while the payment of the price is postponed to a later date. The client approaches the bank for financing the purchase of goods. The bank purchases the required goods and resells them to the customer at an agreed price to be paid later.<br>❑ The agreed price includes the cost of goods to the bank plus the bank's margin of profit with other incidental costs.<br>❑ The customer is required to pay the agreed price on due date. | • **Cash Credits**<br>❑ It is made through a separate cash credit account.<br>❑ The bank allows the borrower to draw cash up to the limit of the credit by issuing check.<br>❑ Interest is charged on the daily balance of the account.<br>❑ It is a revolving credit facility. |
| • ***Ijārah***<br>❑ Bank maintains a number of various assets (with high degree of marketability) to respond to the needs of different customers.<br>❑ Banks lease these assets to any party to utilize for a term to be agreed upon.<br>❑ After the termination of the lease period, the assets are returned to the bank and the bank looks for a new lessee.<br>• ***Bay'-Salam***<br>❑ Salam is a sale of commodity, the delivery of which would be in a future date for cash price.<br>❑ Price is advanced in cash to the seller, who makes | • **Overdrafts**<br>❑ The bank allows the borrower, under this arrangement, to overdraw the current account, i.e., to draw money in excess of his credit balance, up to a certain limit.<br>❑ A check book is issued to the Borrower and he can draw check up to the limit of the agreed amount.<br>❑ Overdraft facility is allowed against the securities like share certificates and government promissory notes.<br>• **Purchase or Discount of Bills**<br>A customer at the time of opening a Letter of Credit signs |

<table>
<tr><th>Investment Mechanism of Islamic Banks</th><th>Investment Mechanism of Conventional Banks</th></tr>
<tr><td>the delivery of commodity of determined specification on a definite due date.<br>❑ Generally, agricultural products are purchased in advance under this mode of investment to infuse finance so that production is not hindered for want of money.</td><td>an agreement with the bank assuring that the latter will pay the bill received on the former on a certain date onward in exchange for a specific rate of interest determined at the time of agreement. If the bill happens to reach well ahead of the date mentioned, the bank might purchase the bill, if requested, with a discount. In this case, the bank has made the return twice: firstly, by charging interest and then by discounting the bill.</td></tr>
<tr><td>• Qarḍ Ḥasanah<br>It is loan without interest that plays a socially useful role engaging in income generating activities. It has a significant role to remove the financial distress caused by the absence of sufficient money in the face of dire need.<br><br>• Muḍārabah<br>It is a contract between two parties, in which one party supplies capital to other party carrying on some trade on the condition that the resulting profits be distributed in a mutually agreed proportion, while all losses be borne by the provider of the capital.<br>• Mushārakah<br>❑ Under this mode of finance, one or more entrepreneurs approach an Islamic bank for the finance required for a project. The bank provides total finance, and has the right to participate in the project.<br>❑ The profits are distributed according to an agreed ratio or as per the capital proportion. Losses are shared in exactly the same proportion in which the different partners have provided the finance for the project.</td><td>• Advances for Hire-purchase<br>❑ Advances are made to the client under the condition that repayment of principal would be made in installments along with interest charged.<br>• The immovable properties might be kept as security.</td></tr>
</table>

**Table 3: Distribution of the Questionnaire in the Final Survey**

| Name of Bank | No. of Distributed Questionnaire | | Total |
|---|---|---|---|
| | Bankers | Customers | |
| Islami Bank Bangladesh Limited | 25 | 25 | 50 |
| Al-Arafah Islami Bank Limited | 25 | 25 | 50 |
| Social Investment Bank Limited | 25 | 25 | 50 |
| Al-Baraka Bank Bangladesh Limited | 25 | 25 | 50 |
| National Bank Limited | 25 | 25 | 50 |
| IFIC Bank Limited | 25 | 25 | 50 |
| AB Bank Limited | 25 | 25 | 50 |
| The City Bank Limited | 25 | 25 | 50 |
| **Total : 8 Banks** | **200** | **200** | **400** |

**Table 4: Composition of the Customers by Profession**

| Type | Total | % of Total |
|---|---|---|
| Service holder | 20 | (10) |
| Businessman | 114 | (57) |
| Self Employed | 26 | (13) |
| Housewife | 14 | (7) |
| Others | 6 | (3) |
| Total | 200 | (100) |

Source: *Field survey data, 1998*

**Table 5: Composition of the Bankers by Profession**

| Type | Total | % of Total |
|---|---|---|
| Officer | 144 | (72) |
| Junior Executive | 28 | (14) |
| Mid Level Executive | 18 | (14) |
| Senior Executive | 10 | (5) |
| Total | 200 | (100) |

Source: *Field survey data, 1998*

**Table 6: Composition of the Age of the Bankers and the Customers**

| Type | Age | Total | % of Total |
|---|---|---|---|
| Banker | 35-60 years | 200 | (50) |
| Customer | 35-60 years | 200 | (50) |
| Total | | 400 | (100) |

Source: *Field survey data, 1998*

**Table 7: Composition of the Sex of the Bankers and the Customers**

| | Male | Female | Total |
|---|---|---|---|
| Banker | 160 *(80)* | 40 *(20)* | 200 *(50)* |
| Customer | 178 *(89)* | 22 *(11)* | 200 *(50)* |
| Total | 338 | 62 | 400 *(100)* |

Source: *Field survey data, 1998.* Note: *Figure in the parenthesis indicates the percentage of total.*

**Table 8: Composition of Education Level of the Bankers and the Customers**

| Education Level | Banker | Customer | Total |
|---|---|---|---|
| Under Graduate | 26 (13) | 30 (15) | 56 (14) |
| Graduate | 126 (63) | 136 (68) | 262 (65) |
| Post Graduate | 48 (24) | 34 (17) | 82 (21) |
| Total | 200 (100) | 200 (100) | 400 (100) |

Source: *Field survey data, 1998.* Note: *Figure in the parenthesis indicates the percentage of total.*

**Table 9: Profit and Loss Sharing System is the Essence of Islamic Finance**

| Causes | Bankers | Customers | Total |
|---|---|---|---|
| a) Islamic finance aims at both profit and losses. | 55% | 16% | 36% |
| b) Islam permits profit and forbids *ribā*. | 26 | 62 | 44 |
| c) Islamic finance cannot earn *ribā* in any way. | 10 | 8 | 9 |
| d) Islamic finance is always meant for investment. | 9 | 14 | 11 |

Source: *Field survey data, 1998.* Note: *Figure indicates the percentage of total.*

**Table 10: Benefits Accrued to the Society from Islamic Banking**

| Benefits | Bankers | Customers | Total |
|---|---|---|---|
| a) Zakat Fund has been mobilized through banking system. | 72% | 68% | 69% |
| b) Welfare activities are organized through banking system | 8 | 13 | 12 |
| c) The concept of *Ḥalāl* and *Ḥarām* in case of investment/buying and selling has been introduced. | 5 | 9 | 7 |
| d) Mobilization of Financial resources to the real sector of the economy has been introduced | 3 | 2 | 2 |
| e) New products of banking have been introduced. | 12 | 8 | 10 |

Source: *Field survey data, 1998.* Note: *Figure indicates the percentage of total.*

**Table 11: Basis of Development of Islamic Banking**

| Basis | Bankers | Customers | Total |
|---|---|---|---|
| a) Mere faith in Islam; | 55% | 69% | 62% |
| b) Intention to earn profit; | 15 | 23 | 19 |
| c) To avoid interest; | 18 | 2 | 10 |
| d) To ensure justice in the financial transactions; | 3 | 3 | 3 |
| e) To contribute to the welfare of the economy | 9 | 3 | 6 |

Source: *Field survey data, 1998.* Note: *Figure indicates the percentage of total.*

**Table 12: Causes of Continuation of Interest-based Transaction through Back Door by Islamic Banking System**

| Causes | Bankers | Customers | Total |
|---|---|---|---|
| a) Trading and Rental based modes of investment do not differ much from the interest-based transactions. | 60% | 73% | 67% |
| b) Products of present Islamic Banking are similar to those of interest-based banking system. | 7 | 9 | 8 |
| c) Risk-sharing in current practices of Islamic Banking is not proportional to its profiteering. | 12 | 16 | 14 |
| d) Islamic banks are working along with the interest-based banks. | 21 | 2 | 11 |

Source: *Field survey data, 1998.* Note: *Figure indicates the percentage of total.*

**Table 13: Causes of Interest Creeping into the Islamic Banking System**

| Causes | | Bankers | Customers | Total |
|---|---|---|---|---|
| a) | Exploitation is going on through Islamic system of banking | 38% | 53% | 45% |
| b) | Products of Islamic Banking have failed to remove the curse of interest from financial transactions. | 28 | 11 | 19 |
| c) | Banking professionals have led Islamic system of Banking to the garb of interest based banking | 16 | 23 | 19 |
| d) | Islamic system of Banking was introduced in a society, which was not re-organized on Islamic ideology. | 18 | 13 | 16 |

Source: *Field survey data, 1998.* Note: *Figure indicates the percentage of total.*

**Table 14: Present Success of Islamic Banks is Not in Conformity with Sharīʿah**

| Causes | | Bankers | Customers | Total |
|---|---|---|---|---|
| a) | The status of Sharīʿah Council/ Department is advisory, not supervisory in the system Islamic Banking | 28% | 37% | 32% |
| b) | Earning of profit cannot be the success criterion | 42 | 28 | 35 |
| c) | Justice and welfare in financial transactions are not ensured by Islamic Banks | 18 | 22 | 20 |
| d) | Exploitation still remains in Islamic banking system | 12 | 13 | 12 |

Source: *Field survey data, 1998.* Note: *Figure indicates the percentage of total.*

**Table 15: Causes of Not Patronizing the Islamic Banks by Rich and Prominent Muslim Businessmen and Industrialists**

| Causes | | Bankers | Customers | Total |
|---|---|---|---|---|
| a) | They do not find any real business differences between Islamic and conventional banking | 69% | 78% | 73% |
| b) | Not conscious about Islamic banking. | 12 | 7 | 10 |
| c) | Confused about Islamic Banking | 9 | 10 | 10 |
| d) | They are not motivated to I-Banking | 10 | 5 | 8 |

Source: *Field survey data, 1998.* Note: *Figure indicates the percentage of total.*

**Table 16: Most of Investment Financing Techniques by Islamic Banks do Not Share Risk Proportionally**

| Causes | | Bankers | Customers | Total |
|---|---|---|---|---|
| a) | The Insurance Company covers risks of Islamic banks' loans. | 73% | 58% | 66% |
| b) | Islamic Banks do not always buy for sale. | 15 | 28 | 21 |
| c) | Buying and Selling arrangements by Islamic banks are almost risk-free. | 9 | 11 | 10 |
| d) | Islamic banks do business with depositors money and share risk | 3 | 3 | 3 |

Source: *Field survey data, 1998.* Note: *Figure indicates the percentage of total.*

**Table 17: Many Customers are not interested in Dealing with Islamic Banks as they feel that only the Name has been Changed and Interest in Real Sense has not been eliminated**

| Causes | | Bankers | Customers | Total |
|---|---|---|---|---|
| a) | Mark-up profit makes customers liable for additional payment, which is same as that of conventional bank's fixed interest-based loan. | 62% | 83% | 73% |
| b) | Customers are required to repay banks money on installment basis | 14 | 7 | 10 |
| c) | Failure of installment payment creates additional liability | 16 | 6 | 11 |
| d) | The Islamic Banks in most cases do not consider business loss. | 8 | 4 | 6 |

Source: *Field survey data, 1998.* Note: *Figure indicates the percentage of total.*

**Table 18: Possibility of Loss of Deposit is not Detrimental to Deposit Mobilization**

| Causes | Bankers | Customers | Total |
|---|---|---|---|
| a) PLS system of banking does not lead to loss of value of deposit ultimately. | 49% | 36% | 43% |
| b) It is realized profit of investment which makes return on bank deposit *Ḥalāl*. | 17 | 23 | 20 |
| c) A true Muslim is not concerned about deposit loss, because he expects Haven in the life hereafter. | 13 | 15 | 14 |
| d) It does not mean total loss of deposit. | 21 | 26 | 23 |

Source: *Field survey data, 1998.* Note: *Figure indicates the percentage of total.*

**Table 19: Present Modes of investment of Islamic Banks are Compromised Modes of Financing with Interest**

| Causes | Bankers | Customers | Total |
|---|---|---|---|
| a) Both gives same effect on business results | 78% | 56% | 67% |
| b) Both are justice (*ʿadl*) and Welfare (*iḥsān*) free. | 9 | 13 | 11 |
| c) Both are working side by side. | 7 | 14 | 11 |
| d) Both are working in the same value loaded society. | 6 | 17 | 11 |

Source: *Field survey data, 1998.* Note: *Figure indicates the percentage of total.*

**Table 20: Moral Uplifting of the Society Will Pave the Way for Islamic Banking**

| Causes | Bankers | Customers | Total |
|---|---|---|---|
| a) Islamic banks cannot work well in an immoral society. | 62% | 56% | 59% |
| b) False values of life give detrimental environment to Islamic Banking. | 8 | 13 | 10 |
| c) Governmental power can change the social values. | 18 | 17 | 17 |
| d) Governmental reformation measures are powerful to build a moral society. | 12 | 14 | 13 |

Source: *Field Survey Data, 1998.* *Note*: *Figure Indicates the percentage of total.*

## Notes

[1] This definition was made by the Organization of Islamic Conference (OIC). See Islami Bank Bangladesh (1995), p.7.

[2] This definition was made in the Islamic Banking Act 1983 of Malaysia. See *ibid.*

[3] Nidaul Islam Magazine, November-December, 1995.

[4] Ahmad (1997).

[5] The questionnaires were submitted to Islamic Economics Research Bureau (IERB), the sponsor organization of the research project. Those were examined and approved by the appropriate authority of the IERB. The General Secretary of the IERB wrote a forwarding Letter to the Respondents. The questionnaire can be obtained from the author. All the questions appear in the form of tabulated responses in the Appendix of this paper.

[6] See Khan (986) for the stability of Islamic banking.

[7] Akkas (1996), pp.101-103.

[8] S. A. Maududi (1987).

[9] al-Masri (????).

[10] Khan (1987).

[11] Ridha Saadallah, "Concept of Time in Islamic Economics", Mimeo. Mentioned in *ibid.*

[12] See Institute of Islamic Banking and Insurance, London, *Islamic Banking Diploma Module-1*, Lesson 3, p.3.

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