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Islamic Banking in Bangladesh: Challenges and Prospects

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Abstract

Starting its journey in 1983, Islamic banking has been gaining increasing market share of the total banking industry; 8 full-fledged Islamic banks, along with 19 Islamic banking branches and 25 Islamic banking windows, hold more than 20% market share in total banking deposits and 23% in credit. This percentage of share has made Bangladesh one of the 12 systematically important jurisdictions in the world. This industry, compared to its conventional counterpart, is also performing well in many aspects such as ROI and NPL. The scenario changes when the banking scenario of other Muslim countries with similar demographics and economic status are compared with. The Islamic banking scenario in Bangladesh could be made more robust if the challenges in the way were properly addressed. The absence of a comprehensive Shariah based framework to bring all the related industry players under one umbrella is one of the most crucial factors hindering growth. Terrorist financing propaganda, lack of diversified service portfolio, insufficient product innovation and absence of skills and product knowledge training are few of the other challenges to be addressed. Even though, throughout the world, 60% of the Islamic banking customers are non-Muslims, in Bangladesh, this segment is not yet targeted as the Islamic products are, even now, offered to customers using religious appeal rather than pitching product qualities and professional benefit. If Bangladesh is to reach its fullest potential in this segment of banking, steps from multiple front need to be taken. The untapped non-Muslim customer segment penetration can be the first step. Partnering with NGOs and thus tapping further into micro-finance, public project financing through Shariah based syndication, creating a corporate governance culture by training Islamic finance analysts, and bringing in stress testing modules to check the resilience of Islamic banking in the country for different categories of financing are the few ways towards further growth in this industry. In order to bring out the potential growth, there has to be a strategic time bound roadmap setting out all the landmarks to be achieved.

Keywords: participatory banking, systematically important jurisdiction, Shariah, riba, Suku

1. Introduction

1.1. Background

Islamic finance, with some $1.88 trillion worth globally, has been experiencing rapid growth for the past few years. The reason, according to World Bank specialists, behind this rapid worldwide growth is the emphasis on risk sharing which is sought after by many who have suffered in the recent most financial crisis. Besides, the global Islamic banking industry is competing by not only acquiring Sharia-compliance sensitive customers but also targeting value-seeking customers who find the pricing and offerings provided by Islamic banking products competitive to conventional ones. In 2016, the domestic market share of Islamic banking increased in 18 jurisdictions and the number of jurisdictions that has achieved domestic systematic importance has expanded to 12. Jordan is the latest addition with a domestic market share of 15.2% (Islamic Financial Services Board, 2017).

This expansion trend is no different in Bangladesh as well. Since its inception in the early 80s, Islamic banking industry in Bangladesh has demonstrated substantial performance in tandem with the growth of the economy. Since then, this industry has been able to gain a growing market share of the total banking industry. As of 30th June 2017, there are 8 full-fledged Islamic banks maintaining their operation through 1068 branches. Besides the full-fledged Islamic banks, conventional commercial banks are also operating in this segment through 19 Islamic banking branches and 25 Islamic banking windows (Islamic Banking Cell, Research Department, Bangladesh Bank, 2017). Even though the global economy, affected by a couple of events ranging from Brexit and US political election results to geopolitical conflicts and volatility in energy prices, has been suffering from volatility for the last two years and as a result the global Islamic financial services industry growth has remained stagnant, the Islamic banking industry in Bangladesh has been continuing its operation with robust performance. The domestic share of Islamic finance in Bangladesh is above 15% making the country one of the 12 systematically important jurisdictions which collectively hosts 88% of the global Islamic banking assets (Islamic Financial Services Board, 2017). However, when compared with the figures for Malaysia, Bangladeshi statistics on Islamic finance seems to have a lot more potential to grow. Malaysia and Bangladesh started their development journey from a similar standpoint but the Islamic banking industry development in Malaysia has surpassed the development in Bangladesh in many aspects.

Even looking at the recent economic indicators ie: 2017 GDP growth rate of 7.1%, per capita income of $1602 and recent up gradation from low income country (LIC) to lower-middle income country (LMIC) the future of the expansion of Islamic finance looks even brighter. Islamic banks now collect 30% of the total remittance flow in Bangladesh (Islamic Banking Cell, Research Department, Bangladesh Bank, 2017). The total deposit share of Islamic banks is now more than 20% and that of credit share is 23%. This figures still have the potential to grow much further. When it comes to profitability measurement, Islamic banks are holding few of the top ranked positions. There NPL position is also better compared to that of the conventional ones. In 2016, The default rate on loans for general banking was 9.2 percent, but it was 4.3 percent for sharia-based banking.

Even after so much growth, Islamic banks as a part of the financial system faces lots of challenges. There is yet to be dedicated Shariah based law to govern the Islamic banking industry players. This lack of law has lead organizations to follow separate accounting estimates and methods which in turn makes it difficult to compare their performance. According to past research, the market was concentrated towards the Muslim population only. Still now, there seems to be no definite step to address the non-Muslim population. There is lack of co-ordination among the current market players which hinders the Shariah based syndication of large scale projects. Absence of specific Islamic knowledge based skill among the employees is still a big issue. Their ineptitude in explaining the product clearly to the customers has contributed towards having a perception that Islamic banking products are yet to be fully Shariah compliant in Bangladesh. To bring out the advantage of having a Muslim majority population several steps must be taken. The world has successfully implemented Shariah based financing in many pockets of the world. Morocco is the latest addition to these pockets. The government has approved five banks to provide Shariah based products and services on January 02, 2017 (Anon., 2017). Even to market these products to non-Muslim professionals the government has named the service "Participatory Banking" rather than "Islamic Banking". Many countries like Morocco understands the benefit of Islamic banking. The demand of the industry has led to an industry size of more than $2 trillion globally. Islamic finance is now present in more than 75 countries in the world. Such Shariah based sustainable financing is also possible in Bangladesh. Proper efforts to facilitate Islamic banking growth can help Bangladesh to become an important crossroad among the other countries of the Asia-Pacific region.

In order to tap into this immense possibility, adequate and reliable information are crucial for policy making. For the improvement of the Islamic banking practices, it is imperative to have an in-depth look into the current status of operations, challenges and prospects of the Islamic banking activities. Looking into the different avenues of trends, dimensions and challenges would also be a great facilitation towards taking necessary steps to handle challenges on the way and to undertake future course of action.

1.2. Objective of The Study

The broad objective of the study is to find out the growth prospects of the Islamic banking industry in Bangladesh. Specifically, this study aims to:

I. Analyze the current status of the industry
II. Compare performance with the conventional banking industry
III. Identify the challenges faced by Islamic Finance institutions in Bangladesh
IV. Identify the growth opportunities for the Islamic Banking products and services

1.3. Methodology

The study is descriptive in nature, trying to analyze the Islamic Banking services market in Bangladesh. The study is conducted using primary as well as secondary data and literature review. The primary data is collected through semi- structured interview of bank personnel from both Islamic and Conventional banks. Secondary data has been collected from various research books on Islamic banking and related publications (i.e. journals, annual reports, periodicals). The study population includes 8 full-fledged Islamic banks operating with 1068 branches, 19 Islamic banking branches of 9 conventional commercial banks and 25 Islamic banking windows of 8 conventional commercial banks in Bangladesh

1.4. Rationale

There are a number of studies on the perception of Islamic Banking Services in Bangladesh and comparison of performance between conventional and

Islamic banks. There are a few researches done on the prospects of this segment of banking in Bangladesh, but these studies were done a long time back. Since then, a huge amount of development has occurred. Yet there has been no recent study shedding light on the new challenges faced by the industry. There are updated studies on Islamic banking in different regions of the world, i.e. Asia, MENA, done by ADB, IFSB. Bangladesh is yet to have proper recent work on the prospects of Islamic Financial industry. Hence, this paper aims to analyze the current market scenario of Islamic Banking in Bangladesh and point out the challenges faced, followed by the enlistment of certain recommendations to leverage on the prospects of future growth.

1.5. Structure of the Article

The first chapter lays out, along with a brief introduction of Islamic banking, the objectives and methodology of this paper. The second chapter focuses on the origin of Islamic Banking and its principles, followed by the types of products and services offered globally by different types of financial institutions. This chapter goes through the existing studies on Islamic banking, from both global perspective and Bangladeshi perspective. In the third chapter, the paper discusses the current status of this industry in Bangladesh, from global as well as country perspective. The position of Bangladesh in global Islamic banking industry is also elaborated. Recent performance of the Islamic service providing institutions are discussed here. In the next subsection of this chapter, a comparison is done with the conventional banks in terms of ROI and profitability. Subsequent sub-sections focus on the challenges faced by and prospects for the industry in Bangladesh. Finally, the paper concludes with a few recommendations that can be followed to ensure the growth of Islamic banking in a sustainable manner.

2. Literature review

2.1. Origin of Islamic Banking

The most important principles that characterize Islamic Banking are the prohibition of the payment of interest (Riba), sale of risky assets (Gharar) and gambling or speculation (Maysir) (Velayutham, 2014). Islamic finance is a financial service that is compliant with the main tenets of Islamic law which comes from the Holy Quran, Hadith, Sunna, Ijma, Qiyas and Ijtihad (Gait & Worthington, 2007). While the western financial system majorly works from a capitalistic point of view, Islamic financial system focuses on making an equitable distribution of economic resources among all the parties (Iqbal, 1997). Islam does not permit the unjustifiable increase of capital either in the form of loans or sales. This principle aims to establish justice and equality. Many scholars have tried to define Islamic banking from broad as well as narrow perspectives and in the process, have highlighted on other principles of this financing system. Among the other principles, risk sharing is one where the provider of capital and the entrepreneur both share risk and return of the venture. Also, speculative behavior is prohibited in Islam if there is extreme uncertainty involved. In order to reduce risk, this financing system sets disclosure of information as a sacred duty which in turn minimizes the probability of moral hazard as well as asymmetric information. Islamic finance also prohibits short sales and financing of activities that are harmful to the society (Kammer, et al., 2015).

2.2. Types of Products and Services

In order to comply with the Islamic principles, various Islamic institutions and the Islamic windows of the conventional banks provide services using specific types of Islamic financing products. Islamic finance products can be categorized into three major broad groups such as Profit-and-loss sharing (PLS) contracts, non-PLS contracts, and fee-based products. Among the mentioned three categories, PLS financing best reflects the core spirit of Islam. PLS financing helps to promote a more equitable distribution of income which leads to efficiency in resource allocation. Musharaka and Mudarabah are the two types of PLS financing. Musharaka is a joint partnership mechanism where partners provide capital and share profit as per pre-agreed ratios but suffer loss in proportion to capital contribution (Hussain, et al., 2015). On the other hand, in case of Mudarabah, one party works as the financier and the other works as mudarib or entrepreneur. The share in profits are set on pre-agreement basis but losses are borne by the capital provider only. This mode is used for mutual fund management.

Although PLS financing has the closest connection to Islamic principle, non-PLS financing is the most common in practice. Murâbaḥah, Ijārah, Salam and

Istisna are the instruments under this financing method. Murâbaḥah is a sale transaction where the bank purchases the goods for delivering them to the customer who will make the payment of the goods at a later date agreed on by the two parties. However, unlike conventional financing, the financed amount cannot be increased if there is any default or late payment unless the buyer does so intentionally. Ijarah is equivalent to lease financing of the conventional counterpart. Salam is a forward agreement to deliver specified amount of goods at pre-specified price at a specified place at a future date in exchange for a spot payment whereas Istisna contract facilitates the transaction of a commodity before it comes into existence but this is a contract in which neither any fund nor any goods are transacted at the time of signing the contract. Under the last category, Fee-based services, usually three types of contracts exist: Wakalah, Kafalah and Ju'ala. When the bank acts as an agent of the customer or issues a LC facility, Wakalah mode is used whereas Kafalah is used when a financial guarantee is provided where the bank gives a pledge to a creditor on behalf of the debtor Ju'ala is an Istisna contract that is used for the rendition of a specific service as opposed to the manufacture of any goods. In the capital market segment, Sukuk is the most important product where financing is backed up by assets, equity, and asset based securities. Lastly, in the insurance segment, the major product is Takaful which incorporates the feature of joint risk-sharing (Newaz, et al., 2015).

2.3. Islamic Financial Institutions

The activities of Islamic finance are carried out through the issuance of these products by full-fledged Islamic finance institutions or windows and branches of conventional banks. These Islamic financial institutions are the ones that are based on Quran's principles. These are not mere banking institutions, rather financial intermediaries acting on Sharia principles (Warde, 2000). The global Islamic banking asset size is now USD 1.5 trillion, the global volume of Sukūk is USD 318.5 billion and that of Islamic funds' assets is USD 56 billion. At the same time, Takaful segment amounts to USD 25 billion (Islamic Financial Services Board, 2017). The acceptance of Islamic finance is rapidly increasing in countries with dual financial systems over the world. In 2016, the Islamic finance market enjoyed increased market share in 18 countries globally. The share remained unchanged or suffered a marginal decrease in 13 countries. This high growth has been attributed to many factors by scholars. Widespread dissatisfaction with the overall performance and impacts of the financial as well as the monetary system is stated as one of the reasons. The strong movement of the Islamic financial system and the presence of strong morality in that system are the other two factors behind the success of continuous growth of Islamic finance (Siddiqi, 2000).

2.4. Studies on Global Islamic Banking

As the market of Islamic finance products are growing globally as well as in Bangladesh and the significance of this sector is on the rise over the years, few studies have been done on the perception and the success factor of Islamic finance industry in Bangladesh by various authors at different points in time. Findings suggest that Islamic banking is attractive to the customers of Bangladesh because this system is loyal to the rules set out by Shariah ((Yousuf, et al., 2014); service quality or ease of account opening is not a significant factor for choosing Islamic banks. The same finding came as a result of another study where it was concluded that Shariah compliance is the single most important factor towards customer motivation (Nabi, et al., 2017). Although Bangladesh is a Muslim majority country, Islamic banking services are also gaining popularity among the non-Muslim population (Parvez, 2014). The non-Muslim population of the country prefer Islamic banking services not because of the non-interest based principle but because of better quality and service provided. A large portion of this segment of customers comes from the Sylhet region of the country ((Uddin, et al., 2016). In the global perspective, there have been several studies on the perception of this industry as well. According to a study in Pakistan, the most important factor for the selection of Islamic banking service from a specific institution is mass media presence as the customers get to know about Islamic finance products and mechanism in detail (Awan & Azhar, 2014). Responsiveness of the banking staffs, influence of friends and relatives and the image and goodwill of the bank are among the other factors influencing the decision of selection of Islamic banks. Another study done on the corporate customers finds that the factors for this segment are cost & benefit to the company, quality of the service provided, size and reputation of the financial institution, and attitude of bank personnel (Rustam, et al., 2011). In Malaysia a survey of corporate customers were done who believed Islamic banking to be a very strong alternative to the conventional banking system (Ahmad & Haron, 2007). According the surveyed corporate customers, the most important factor for them in choosing a bank as their financial partner is the cost of products and services.

2.5. Comparison of Islamic and Conventional Banks

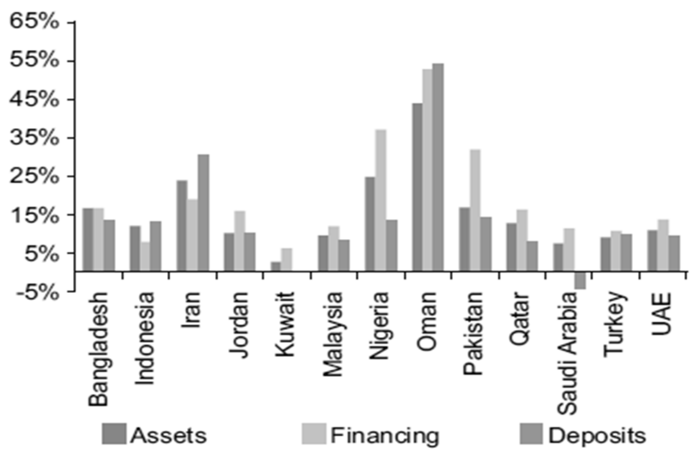
Various studies have conducted comparative analysis of the performance of conventional banks and Islamic banks in Bangladesh. Based on various internal & external analysis on the data from 2009-2013, it was found out that conventional banking is surpassing Islamic banking in terms of profitability, liquidity and credit risk management; however, in case of solvency, the latter was the one outperforming (Nabi, et al., 2017). In another comparative study, the conventional bankers pointed out that Islamic banks in Bangladesh have not completely abolished the interest method from their transaction, causing a possible loss in customer loyalty towards those banks (Ullah & Chowdhury, 2013). Other studies have found out similarities between the two modes of banking. Similarity was found in the purpose of serving (Ahmad, 2008) and in the customer segment of serving (Nienhaus, 2013). Similar studies have been conducted in other countries as well. A study done on selected banks of Egypt suggest that conventional banks are doing better in terms of risk management whereas Islamic banks have a superior position in management of loans because of their superior asset quality, measured by loans loss reserve (LLR) (Youssef & Samir, 2015). In Malaysia, according to a comparative study, Islamic banks have higher stability than their conventional counterparts. It was concluded that cost-income-ratio, total assets, Herfindahl Index, market share, inflation and real GDP are the factors affecting the probability of default for the Islamic banks in Malaysia.

From the literature review it is found out that even though the Islamic banking industry has been performing well in this country, the customer perception is still majorly impacted by a single factor. There is a need for shifting the perception based on one factor to multiple factors. For that, the Islamic finance industry has to expand its reach by setting up an elaborate legal, tax and regulatory system like that of Malaysia's (Anon., 2014). Such a system requires, as prerequisite, the identification of the current status of Islamic Banking and the challenges on the way towards further growth.

3. Islamic banking in Bangladesh

3.1. Current Status of Islamic Banking from a Global Perspective

Islamic banking services are growing worldwide in both popularity and size. This industry service is being practiced on a more intensive scale than ever. The scenario is similar in Bangladesh as well. Bangladesh managed a robust growth in terms of asset, financing and deposit portfolios. In the year 2016, Bangladesh managed to maintain a higher year-on-year growth than Malaysia. The 2016 industry growth in Bangladesh (year-on-year) is higher than that in Indonesia, Kuwait, and Saudi Arabia (Islamic Financial Services Board, 2017).



Source: PSIFIs, IFSB; IFSB Secretariat Workings

Now Islamic banking industry market share of assets is more than 20% of the total banking assets in Bangladesh. This market share has made Bangladesh able to achieve domestic systematic importance[3]. As the graph shows, among the top 35 jurisdictions in terms of domestic market share of Islamic banking, Bangladesh stands in the 10th position.

[3] The countries where Islamic banking assets holds more than 15% of the total banking industry asset market share are said to have domestic systematic importance.

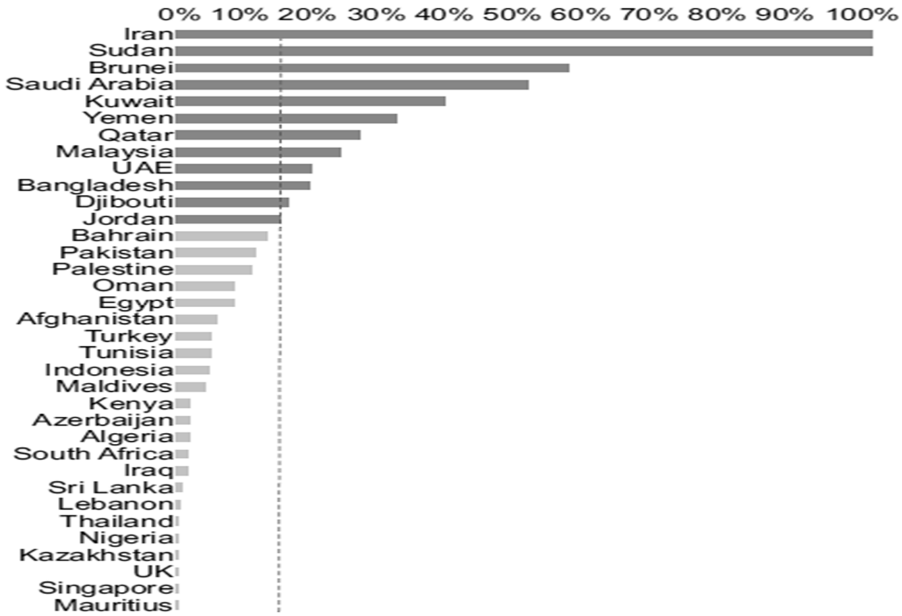


Figure 2: Islamic Banking Share in Total Banking

Current Status of Islamic Banking from a Country Perspective

Even though surplus liquidity came down by 1.81%, at the end of the April-June 2017 quarter, the growth in deposits, investments and remittance of this sector was 4.82%, 4.60% and 33.13% respectively.4

According to a report of Bangladesh Bank, total Deposits in Islamic banking industry reached at Tk. 1.99 trillion at the end of April-June 2017 quarter, which is a 13.61% increase compared to corresponding quarter of the last year (Islamic Banking Cell, Research Department, Bangladesh Bank, 2017). Investment-Deposit Ratio (also improved to 0.93 in April-June 2017 quarter which was 0.89 at the end of the previous year. Surplus Liquidity reached Tk. 78.86 billion at the end of April-June 2017 quarter, a increase of more than 150% compared to the corresponding quarter of the last year. At the same time, total Remittances figure circulated by this sector reached Tk.

[4] Islamic Banking Cell, Research Department, Bangladesh Bank, 2017

86.68 billion which is 8.52% lower compared to the same quarter last year. Along with the ratio and absolute financial figures, the infrastructure facilities of Islamic banks have also improved. There are 1112 branches (Full-fledged Islamic banks and Islamic banking windows and branches) at the end of June 2017. The manpower in this sector has also gone up to 30336 during this period. In just one year this industry has made a net employment of more than 1000 people.

Table 5: Islamic Banking Activities compared with all banks in Bangladesh

	April – June 2017		
Item	All Banks	Islamic Banks	Shares of Islamic Banks Among All Banks (%)
Total Deposits (In Crore Taka)	877,882.80	199,424.90	22.72
Total Credit (In Crore Taka)	772,594.90	185,244.93	23.98
Remittances (In Crore Taka)	28,714.25	8,866.82	30.88
Total Excess Liquidity (In Crore Taka)	110,800.00	7,886.01	7.12
Total Number of Bank Branches	9,720	1,112	11.44
Total Agricultural Credit (In Crore Taka)	20,998.70	833.59	3.97

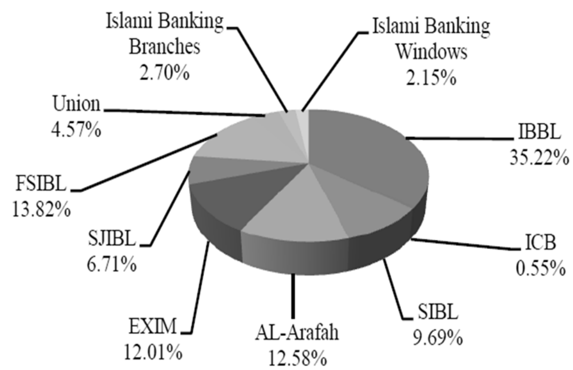


Figure 3: Share of Deposits of all Islamic Banks (April-June 2017)

Source: Islami Bank Cell, Research Department, Bangladesh Bank

If the intra-bank performance is analyzed, it is found out that full-fledged Islamic banks account for 96% of the total Islamic banking industry deposit, with a total deposit value of Tk. 1.88 trillion. Among these banks, IBBL (Islami Bank Bangladesh Limited) holds the biggest share with 36% (Islamic Banking Cell, Research Department, Bangladesh Bank, 2017). Other leading shareholder of the total deposit market are First Security Islami Bank Ltd.(13.82%), Al-Arafah Islami Bank Ltd. (12.58%), Exim Bank Ltd. (12.01%), Social Islami Bank Ltd. (9.69%), Shahjalal Islami Bank Ltd. (6.71%), Union Bank Limited (4.57%), Islami banking branches (2.70%), Islami banking windows (2.15%) and ICB Islamic Bank Limited (0.55%).

3.2. Performance Compared to Conventional Banks

The Islamic banking in Bangladesh is growing substantially over multiple years. But when this growth is compared with the ones of conventional banking, mixed results are found. Among the four groups of banks ie: state owned, foreign conventional, local conventional, and Islamic banks, state owned ones charge the lowest average lending rate of 14% over the last 5 years. This has been possible because of their nationwide reach through thousands of branches all throughout the country. The highest charge was from the local conventional banks with an average value of 15.93%. The Islami banks charged the second highest rate with 14.92%.

Table 6: Comparison of ROI across Banks (2012-2016)

	Islamic Banks		**Local Conventional Banks**		**State Owned Banks**		**Foreign Banks**	
Month	**Mean**	**Standard Deviation**	**Mean**	**Standard Deviation**	**Mean**	**Standard Deviation**	**Mean**	**Standard Deviation**
January	14.79	1.059	15.943	1.332	13.975	0.725	15.1	0.896
February	14.903	0.818	15.729	1.027	14.263	0.537	15.35	0.647
March	15.141	0.849	15.946	1.201	14.228	0.528	15.418	0.596
April	15.028	0.972	15.949	1.208	14.194	0.504	15.482	0.344
May	15.156	0.832	15.959	1.214	14.217	0.509	15.452	0.309
June	15.035	0.965	15.956	1.221	14.202	0.505	15.252	0.625
July	15.031	0.970	15.950	1.210	13.889	0.678	15.204	0.964
August	14.913	1.027	15.924	1.181	13.874	0.698	15.170	1.013
September	14.759	1.226	15.856	1.111	14.098	0.486	15.0875	0.984
October	14.837	1.197	15.855	0.944	14.128	0.491	15.044	0.977
November	14.649	1.029	15.824	0.947	14.080	0.514	14.925	0.977
December	14.793	1.043	16.179	0.850	14.058	0.497	14.993	1.118
Average	**14.920**	**0.972**	**15.923**	**1.121**	**14.100**	**0.556**	**15.206**	**0.7880**

A ranking, based on panel data from 2012-2016, in terms of profitability of individual banks indicates that Al-Arafah Islami bank has the highest profitability among all the banks listed on DSE. Also, among the top ten banks there is another full-fledged Islami bank i.e. Social Islami Banks Ltd.

3.3. Challenges Faced by Islamic Banking Industry in Bangladesh

Although Islamic banking in Bangladesh has gained domestic systematic importance, the industry faces a lot of challenges in its way of continuous growth. Although the conventional banking has its governing law, Islamic banks are yet to have such set of laws that are compliant with the Shariah principles. In 2016, incomes against all assets were 5.5 percent for general banking and 7.3 percent for Islamic banking. The default rate on loans is also low in Islamic banking. The default rate on loans for general banking was 9.2 percent, but it was 4.3 percent for sharia-based banking. In spite of this superior performance, there is yet to be a proper set of governing law for this sector. In 2009, however, Bangladesh Bank circulated guidelines on the basis of IFSB-2 in order to identify risk related to investment and financing by this sector. After that it issued "Guidelines for Conducting Islamic Banking". But this was just a start as the guideline was yet to issue all the aspects needed to have a comprehensive set of law. There is still a need for comprehensive Shariah based framework and a unified accounting principle to follow. This unified framework is also needed for specific pockets within the whole Islamic banking industry. For example, there is a sizeable Takaful market in Bangladesh and it is governed by the Insurance Act 2010. But this act does not cover the specification of Islamic Insurance services.

In recent times there has been a lot of concern about terrorist activities. There are allegations that Islamic banks are financing these activities and this propaganda has emerged as a major challenge for Islamic banking in this country, along with other countries. There must be a law stating the banks to stay away from such financing schemes and the consequences of patronizing terrorist activities. There is also a need for service diversification in this industry. Compared to the conventional counterpart, the Islamic banks do not offer a wide range of services which will help to attract a pool of new customers. In order to attract this new pool, the banks need to let the people know the difference between Islamic banking and conventional banking, and the benefits that Islamic banking provides. In Bangladesh, there is a huge gap in customer knowledge about Islamic banking. They have just one common perception that Islamic banks prohibit interest; they rarely have any knowledge about the difference in the offerings and operation mechanisms of the two types of banks. This gap in the knowledge of the customers, both existing and potential, is a big contributor to the list of challenges faced. Also, the employees providing service lack proper knowledge and training on the products they are supposed to sell. This lack of training and product orientation is one of the other reasons for which customers are not fully aware of the benefits Islamic banking products can provide.

Throughout the world, 60% of the Islamic banking customers are non-Muslims (Anon., 2017). Yet, in our country, products of this industry are targeted only towards the Muslim population. This is due to the attitude of the employees as the service is preached to the customers from a religion-based perspective rather than from a professional perspective. Hence, a huge pool of potential customers is remaining unaddressed. As, said by Md Azizul Haque, an expert on Islamic banking, “It is observed that Islamic banking becomes religion-based rather than being professional. It is dangerous”.

Bangladesh Bank, back in 2010, launched “Islami Interbank Fund Market” to ensure liquidity management. But the tools need modification in line with changes in the market. The lack of continuous innovation will remain a big challenge in ensuring further growth. Bangladesh government has a huge need of fund to carry out infrastructure projects to achieve vision 2021. The development of the Sukuk market with product innovation can give the authority access to Shariah based funds with substantial liquidity.

From the interviews, another major challenge that came out was the perception of the people of this country of the Islamic banking products. A portion of the population perceives that even though the Islam prohibits riba or interest, in Bangladesh, the banks are yet to make the mechanism interest-free. They believe that the profit sharing mechanism that the banks refer to is basically a different name for the same conventional banking interest. Changing this perception requires a huge effort and a nationwide campaign on Islamic banking product knowledge. In order to remove this perception, there must be a proper audit mechanism to ensure that no such fraudulent mechanism is in place. But, irony is that there is no such Shariah compliant audit bindings in the country yet. Again, most importantly, there is no proper governance mechanism to ensure compliance. Without proper corporate governance, this industry cannot ensure sustainable growth in the market. But a step towards the implementation of corporate governance practices in all the Islamic banking institutions is yet to be taken. And again, in order to ensure governance and Shariah based audit, there must be trained auditors who specializes in inspecting frauds if any. Among the other challenges faced by this industry, some are stated below:

- Shortage of supportive institutions to ensure customer reach
- Lack of co-operation among the intra-industry players
- Absence of Apex Training Bodies to continuously train the professionals
- Absence of Secondary Securitization Market
- No incorporation of subjects related to Islamic Finance in the curriculum even at university levels

- Lack of syndication efforts to finance public projects in a completely Shariah compliant manner
- Insufficient budget for research and development to come up with innovative products
- No implementation of advanced stress testing tools to test the risk of investments in certain industries

3.3.1. Prospects for Future Growth

Many non-Muslim dominated economies, such as United Kingdom, Japan, South Africa, France, and Hong Kong, China, are moving to tap into the Islamic financial service market. Many have taken initiatives to spread these services. United Kingdom serves customers through Islamic financial institutions. It has also tapped into the Sukuk market in mid-2014 (Anon., 2015). London is already considered the hub of Islamic Finance in the Western world. This role is played by Singapore in Asia. Bangladesh is yet to tap into this market. Non-Muslims in our country, especially in Sylhet prefer the services of Islamic banking. They do not prefer it because of the Shariah compliant but because of its strong ethical codes. Tapping into this customer segment could be a huge prospect for the Islamic financial services industry.

There remains a huge market for Islamic debt instruments for the corporate sector via the issuance of Sukuk. In Malaysia, corporate Sukuk outstripped conventional bonds with as market share of 60%. Malaysia is now the largest market holder of Sukuk instruments in Asia. There is also demand for Islamic equity investment products in Bangladesh. DSEX Shariah Index was formed in partnership with S&P Dow Jones Indices but there is rarely any data analysis or analyst recommendations on this segment. In order to popularize Islamic investment products and give customers a proper understanding of this market, analyst participation is a must.

In Bangladesh still, a sizeable portion of the total population lives in poverty. Islamic finance has played a major role in poverty alleviation. There is further scope for this industry to improve the lives of the bottom of the pyramid by partnering with microfinance institutions and NGOs. Islamic banks in the country has also huge potential to contribute further to the development of infrastructure projects by providing funds to the government by way of syndication. As Bangladesh has been promoted to lower-middle income country status, the demand for funds in infrastructure development will keep rising.

It is said that the world is moving towards another major financial crisis. If this happens, Bangladesh is expected to take the hit as well. Islamic banks have a prospect to reach people before the financial crisis starts taking its toll. Conventional banks participate in exotic structuring of securitized assets which ultimately keeps selling the same loan to multiple parties by slicing and dicing it and this mechanism ultimately multiplies the fundamental risk. On the other hand, Islamic institutions focus on the core risk of the underlying business rather than mechanizing new risk. These characteristics of Islamic institutions can reduce existing financial risk and people will be more attracted towards Islamic products if they can be properly made aware of this valiant feature.

In order to turn the prospects into reality certain steps must be taken by the related authority. The most important step to take in order to realize the benefits of Islamic banking is to have a unified Shariah based set of laws to govern all the Islamic banks. This must ensure, among other things, that corporate governance is practiced with full compliance. There has to be a certified auditor who has the training and capacity to audit the Shariah compliance of the banks. Besides this unified law, there has to be policy guidelines and strategy roadmaps, both from the government and the Islamic finance bodies, to enhance the co-operation among the industry players so that syndication of Shariah products is possible for further large-scale financing and investment.

Campaigns has to be designed from two fronts: one to change the perception of the people about the negative aspects of Islamic product regarding its partial or non-compliance with Shariah rules and the other one to illustrate the benefits and modes of Islamic banking products so that people get to understand which products fulfil which sort of needs.

Bangladesh has taken a lot of steps to enhance the financial literacy of the general people. CFA Society has been formed in Bangladesh as well. This society and other apex bodies can play a major role to develop Islamic finance knowledge in the country. University level curriculum can be modified to include subjects or topics on Islamic finance. This knowledge enhancement program has to be modified to train the existing employees as well.

As there is a growing demand, steps need to be taken to develop the Islamic bond market in the country. Sukuk is a popular product worldwide. Malaysia is a leader in the Sukuk issuance market. Bangladesh, with the help of international agencies, can take initiatives to develop and popularize such a market. Malaysia is also a leader in Islamic asset management; it initiated this service by providing license to existing fund managers after skills development. With similar population demographics, Bangladesh can take a similar step for this sort of market development. In order to enhance the market share of Islamic financial products and bring in innovation, supportive and link organizations needs to be present. Research and development facilities should be built.

Bangladesh has achieved many milestones through one simple step: Designing roadmaps and long-term visions, i.e. Sustainable Development Goal, Vision 2021, and Millennium Development Goal. In order to create a growth environment and achieve the goals of Islamic financial inclusion, a strong visionary roadmap needs to be developed with participation from both the private and public bodies. Adding to this, Islamic financial market is serving certain segments in the country. Its reach can be enhanced by moving into other safe and profitable segments by identifying them using latest stress testing mechanisms. But again, for this step we need to have expert inhouse personnel who can estimate and modify the inputs to the models when and where necessary.

4. Conclusion

Islamic Financial System can bring out the most efficient banking system if it gets support from the private and public bodies in terms of governance and direction. A unified set of laws to govern all the bodies is the most crucial step in the process. Whereas non-Muslim countries, such as UK, China, South Africa are realizing the benefits of Islamic banking, Bangladesh is yet to fully realize the benefit of what Islamic banking has to offer. India's state of Kerala has allowed Islamic financial services to be provided by non-financial institutions. South Africa has entered the Sukuk market in 2014. Malaysia, with a very similar demographic status to Bangladesh, has made significant leap towards Islamic banking and has demonstrated significant achievement. Today Malaysia is offering services in the interbank money market, the debt and equity capital market, asset management, *Takāful*, other nonbanking financial activities, and the derivatives market as well. With proper initiatives, Bangladesh can also reap all the benefits that Islamic banking has to offer to the people of the country.

This study tries to shed light on the current challenges and prospects of the Islamic finance industry. The information presented in this paper can be used in further research to test the application of modern stress testing tools of

Islamic finance. The data presented here can also be used to find out the key factors of success in Islamic finance in Bangladesh.

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