



FINANCIAL PERFORMANCE EVALUATION, CHALLENGES AND PROSPECTS IN THE DEVELOPMENT OF ISLAMIC BANKING IN BANGLADESH

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Abstract

Islamic banking operates on principles adhering to the Quranic norms forbidding usury and transactions, including granting of loans or credits for interest. The study found that Islamic Banks have performed very well. Especially, Islamic bank Bangladesh Ltd. has shown outstanding performance in terms of every indicator. It is expected that the study will not only help the investors and depositors to make their decisions in more efficient way but also, it will motivate non-Islamic banks to convert their business mode according to Islamic Shariah. This study clearly identifies that during last 10 years. Several statistical tools and accounting tools are used to measure the performance of the Islamic banks in Bangladesh. Islamic banking has contributed in improving Bangladesh economy through making positive changes to all its economic indicators. Although challenges and prospects are specified here. This research paper is prepared based on current situation of Islamic banking activities and their types of services.

Keywords: Islamic Banking, Shariah, Investment, Profit, Deposit

INTRODUCTION

The origin of Islamic banking can be traced back to the practice of Mudarabah by the Prophet Muhammad (SM) himself. Islamic banking operates on principles adhering to the Quranic norms forbidding usury and transactions, including granting of loans or credits for interest. The economic rationale for eliminating Riba (interest) and establishing the Islamic banking system is based on values of justice, efficiency, stability and growth. It is assumed that under Center for Islamic Economics and Finance, Qatar Faculty of Islamic Studies, Qatar Foundation the system of Islamic banking, the industrial and/or commercial risk is shared more equitably between the entrepreneur and the capital owner and the returns on investment are shared among the investors based on their proportionate capital. The conventional banks tend to serve the most creditworthy borrowers, while the Islamic banking system presumably looks for the most productive and profitable projects. An Islamic Bank is a financial institution whose states, rules and procedures expressly state its commitment to the principal of Islamic Shariah and to the banning of the receipt and payment of interest on any of its operations. Bangladesh has a long history in Islamic finance. The first Islamic bank is Islamic Bank Bangladesh Limited (IBBL) which was established in 1983. Since then, Islamic finance has shown continuous strong growth, not only in terms of deposits and assets, but also in market share. Today, the central Bank oversees nine stand-alone Islamic Bank and few conventional banks with Islamic banking branches. Compared to the conventional banks, Islamic banks in Bangladesh have shown relatively better performance in the areas of loan recovery and varies others financial measures. Following such acceptance of Islamic bank in Bangladesh, varies private commercial banks and international banks in Bangladesh started offering various financial products and services in accordance with Islamic principles. Along with their tradition interest based banking services.

Around the world Islamic Banking system is getting popularity gradually due to its multidimensional benefits. Consequently, many traditional Banks have been converted into Islamic Shariah based Banks for the superiority of Islamic banking system. Thus, it is the curiosity of the investors, depositors, researchers and policy makers to know the performance of Islamic Bank operating in Bangladesh. So taking secondary data from the annual reports of the sample banks, the study has evaluated the performance of nine Islamic Banks listed at both Dhaka stock exchange and Chittagong stock exchange. Bangladesh is becoming a stronger and healthy country day by day in the field of financial performances. It is now a lower-middle income based country. Bangladesh is no more a lower income country. But development is a collective progress. Numerically developing is not enough to be sure that our financial security is enough. It is a country suffering from immense social, political, economic and environmental issues and these issues need to be addressed for the overall development of this country.

However, the economic development is one of the prime factors, which can resolve many of its current problems. The growth of business sectors and open market economy has created a great opportunity for Bangladesh for its development. The contribution of the banking sector is playing significant role in the development of this country. However, the emergence of Islamic banking system in Bangladesh has added a new height in the banking sector. Economic Development refers to changes that affect a local economy's capacity to create wealth for local residents. Economic development for Bangladesh can be identified through a number of indicators, including GDP growth, poverty issues, employment, healthcare, environment, education, trade and commerce etc. The conventional banking system dominates the financial sector with limited role of non-bank financial institutions and the capital market. The Banking sector alone accounts for a substantial share of assets of the financial system. Conventional banks contribute significantly in the economic development through the development of major contributory economic indicators directly or indirectly. Conventional banks in Bangladesh operate under branding of interest-based services and interest-free Islamic services (based on Islamic shariah). That is comparatively Islamic banks are superior in financial performance to that of interest-based conventional banks.

Objective of the Study

Primary Objectives

To identify the relationship among profit, total operating expenses, total amount of deposits and total amount of investment and to analyze the performance of the selected Islamic banks.

Secondary Objective

There are the secondary objectives to conduct the research which are specified below

- ✓ To understand the differences and similarities between Islamic banking system and Conventional banking systems.
- ✓ To identify indicators of financial progress and development of Islamic banks.
- ✓ To know the trend of contribution of Islamic banking system in the economy of Bangladesh.
- ✓ To describe the different areas where Islamic banks contribute most.
- ✓ To describe economies of scale in banking operation performed by Islamic.
- ✓ To identify the contribution of Islamic banking system in the economy of Bangladesh.
- ✓ To run the regression model to find whether there is a relationship among profit, Investment, deposits, total investment income and total operating expenses.
- ✓ To suggest the ways and means for improvement in policy and techniques.

- ✓ To analyze the performance of different Islamic modes and efficiency of the Islamic bank.
- ✓ To know the Operational success of Islamic banking in Bangladesh.

The Hypothesis

To find out the relationship among profit, Investment, deposits, total investment income and total operating expenses the following regression equation has been built.

$$Y = B_1 + B_2X_2 + B_3X_3 + B_4X_4 + B_5X_5 + \mu$$

Where,

Y = Total Amount of Earning after Tax

X_2 = Total Operating Expenses

X_3 = Deposit

X_4 = Total Investment

B_1 = estimator

B_2 = Co – efficient of Total Operating Expenses

B_3 = Co – efficient of Deposit

B_4 = Co – efficient of Investment

μ = standard error term

To regress the equation, following hypothesis has been set up:

Null Hypothesis

$$H_0: B_2 = B_3 = B_4 = 0$$

That is there is no relationship between explained variable with explanatory variables.

Alternative Hypothesis

$$H_1: B_2 \neq 0$$

$$B_3 \neq 0$$

$$B_4 \neq 0$$

That is there is a relationship between profit with explanatory variables.

LITERATURE REVIEW

The Islamic banking approach theoretically opposes the idea of discrimination in offering banking services to people of different social standings and provides for social cohesion between different classes. The predominant feature of Islamic banks is the provision regarding the prohibition of interest. There are Islamic scholars who deliver several concepts about Islamic banking and Islamic finance.

Safiullah, M. (2010) provided the comparative study of performance of interest based and interest free banking in Bangladesh. For this study four conventional banks and four Islamic banks were selected. The time period for this study was 5 years from 2004 to 2008. Study result based on commitment to economy & community, productivity and efficiency signifies that interest-based conventional banks are doing better performance than interest-free Islamic banks. But performance of interest-free Islamic banks in business development, profitability, liquidity and solvency is superior to that of interest-based conventional banks. That is comparatively Islamic banks are superior in financial performance to that of interest-based conventional banks.

Islam, M. M. & Mahmud, A. A. compared and analyzed performance of Islamic banking and conventional banking system in Bangladesh general business measures, profitability ratios management soundness, social profitability measures. The study shows that in spite of a few exceptions in general Islamic banks' overall performance was better than the conventional banks.

Mazari, A. (2011) in his study measured the financial performance of some selected Jordanian commercial banks for the period 2005-2009. In the study; bank size, asset management, and operational efficiency were taken as independent variable and dependent variable was taken as financial performance represented by; return on assets and interest income. The study concluded that banks with higher total deposits, credits, assets, and shareholders' equity does not always result in better profitability performance.

Ashraf & Rehman (2011) compared and analyzed performance of Islamic banking and conventional banking system in Pakistan by using of financial measures. The study analyzed the financial performance of selected banks from five different dimensions; profitability, earnings, liquidity, credit risk and asset activity for the period 2007-2010. The study concluded that the performance of Islamic Banks in Pakistan is lagging behind on the basis of performance because of increased operating cost and inefficiency from the part of management.

Kouser & Saba (2012) compared the performance of pure Islamic banks, mixed Islamic banks and conventional banks in Pakistan using CAMEL rating. The study revealed the following facts Islamic banks have adequate capital and have strong asset quality compared to

other banks in sample, Islamic banks in general have more competent management compared to conventional banks, the earnings of Islamic branches of conventional banks are greater than other banks.

Chowdhury (2002) in his study portrayed the state of banking industry of Bangladesh. In his study he emphasized that performance of banks requires knowledge about the profitability and the relationships between variables like market size, bank's risk and bank's market size with profitability. The study shed a light on the importance of performance evaluation of commercial banks in today's world. The study concluded that the banking industry in Bangladesh is experiencing major transition for the last two decades. The author recommended that the banks should endure the pressure arising from both internal and external factors and prove to be profitable.

Siddique & Islam (2001) undertook a study on commercial banks of Bangladesh for the financial year 1980-1995. The study revealed that the commercial banks, as a whole, are performing well and contributing to the economic development of the country. The average profitability of all Bangladeshi banks collectively was 0.09% during 1980 to 1995. The study concluded that although banking sector contributes to the national economy as well as to the individual organization, the performances of different categories of banks were not equally attractive.

Samad & Hassan (1999) evaluated the inter temporal and interbank performance of Islamic bank Islam Malaysia Berhad (BIMB) for the period 1984-1997 by using same performance measures and found that in inter-temporal comparison Islamic bank BIMB's made (statistically) significant progress in profitability while the BIMB risk increased. In interbank comparison the study found that BIMB is relatively more liquid and less risky compared to a group of 8 Conventional banks. A study conducted on five Islamic banks from MENA region analyzed their financial statements over the period 1993 – 2002 found that liquidity risk arises because of pre mature withdrawal by account holders due to a mismatch between investor's expectations of return and the actual return. Therefore, Islamic banks are required to keep adequate cash or cash equivalents to meet the demand. They identified the other reasons of liquidity risk can be the lack of confidence on the banking system, reliance on few large depositors, reliance on current accounts and restrictions of Islamic banks on sales of debt. The profitability of Islamic banks is low due to short term investments and low equity.

As per Siddiqui (2005) there are differences between Islamic and conventional banks with respect to mobilization of deposits and application of funds. In Islamic bank depositor profit is not pre-determined and principal amount is not guaranteed while Conventional banks have guaranteed principal and accrued interest. One of the major advantages of opening a PLS

savings account with the Islamic bank is that the initial deposit figure to open a savings account is only BDT100.00 (2.5 USD) where in any other Commercial banks in Bangladesh it is not less than BDT4000 (USD100). The Islamic bank invests its funds mainly under Murabaha, Musharaka, Bai-Muajjal, Hire Purchase and Qard E Hasana mode of investments. The remarkable advantages of Islamic bank are easy procedure of obtaining loan and quick action in processing loan activities.

Sarker (1999) has been taken into consideration a Banking Efficiency Model regarding performance evaluation of the Islamic banking in Bangladesh. He found some macro operational & micro operational problems of Islamic banking in Bangladesh. To measure efficiency of Islamic banks in Bangladesh, he looked at the performance and operational efficiency of Bangladeshi Islamic banks and suggested that Islamic banks can survive even within a conventional banking framework.

According to Ahmad & Chapra (2000) Islamic banks offer products and services which are very similar to conventional banks. However, the approaches of Islamic banks are clearly different from the ones of conventional banks. On another matter, there is a lack of interbank money market which also affects the performance of the Islamic banking in Bangladesh. Legal reserve requirements have also been observed.

Abd-Elsalam & Weetman (2003) state that there is a shortage of existing literature which has investigated compliance disclosure in corporate annual reports of the banking sector in the context of an emerging economy in general and Bangladesh in particular. In Bangladesh, different types of organizations are regulated by different regulators under different regulations. So, a complex process of banking regulation exists here. Thus, it is important to identify the regulatory requirements in preparing the financial statements of bank which is registered with the Registrar of Joint Stock Companies and Firms (RJSC) as a company, scheduled bank in Bangladesh, listed company on stock exchange and Islamic bank follows Shariah principles simultaneously.

Ahamad & Haron (2002) considered business attitudes towards Islamic banking products and services by forty-five corporate customers. The major finding was again that economic factors, such as profitability and the quality of services, were more significant for customers than religious reasons. However, one qualifying factor could be that the majority of respondents were non-Muslims who were generally less aware of the existence of Islamic banks and the substitutability of Islamic finance methods for products and services.

Kearney, A. T. (2012) discusses the future of Islamic Banking and identifies the challenges facing Islamic banking as the small size as many Islamic banks are smaller than their conventional competitor, Competition as conventional banks continue to launch Islamic

windows, so merely being shariah compliant is not a major differentiator, standardization and regulation. As different interpretations of the acceptability of various products from a shariah prospective makes standardization difficult and cost structure. As, despite the strong growth, most Islamic banks have not been consistently profitable, particularly since the global financial crisis.

All the researches above, on the basis of comparison of financial performances of the private commercial banks and Islamic Shariah based banks in Bangladesh. All of them add more value to the economy and develop the thoughts about Islamic Shariah based banking and conventional banking system. New ideas and innovations have been added with those studies and researches. Both kinds of banking system are trying to overcome their shortcomings with the help of that research. Between two banking system, Islamic based banking is better banking system. Although, in the running world both types of banking systems are popular. In Bangladesh the whole financial system was dependent on conventional banking system.

METHODOLOGY

Methodology of the study is prepared to find out the way of analysis. If the methodology of the study is properly adopted and the study runs properly according to the methodology, the study is supposed to be successful. The Conceptualization is the way of developing concepts about the topic and its related matter. The study follows a procedural approach in order to get complete picture of concentration of different Islamic banks initiatives to evaluate the financial performance, challenges and future prospects of Islamic Banking in Bangladesh. Linear Multiple Regression Model is used to generate the regression output with the help of SPSS software.

In order to make the study more meaningful and presentable, data is collected from different sources. The data collection sources can be accumulated two sources which are primary & secondary.

Primary source

We have collected data from Face to face conversation, Sharing practical knowledge and Focus group discussion with Officers and clients.

Secondary Source

Majority of the information are collected from secondary sources, such as- Periodicals published by Bangladesh Bank, Website, Newspapers and Journals & Magazine, Internet and various study selected reports, Various books, articles, compilations etc. regarding Islamic banking functions and, The Annual Report (Last 10 years) of selected Islamic Banks in Bangladesh.

ANALYSIS AND FINDINGS

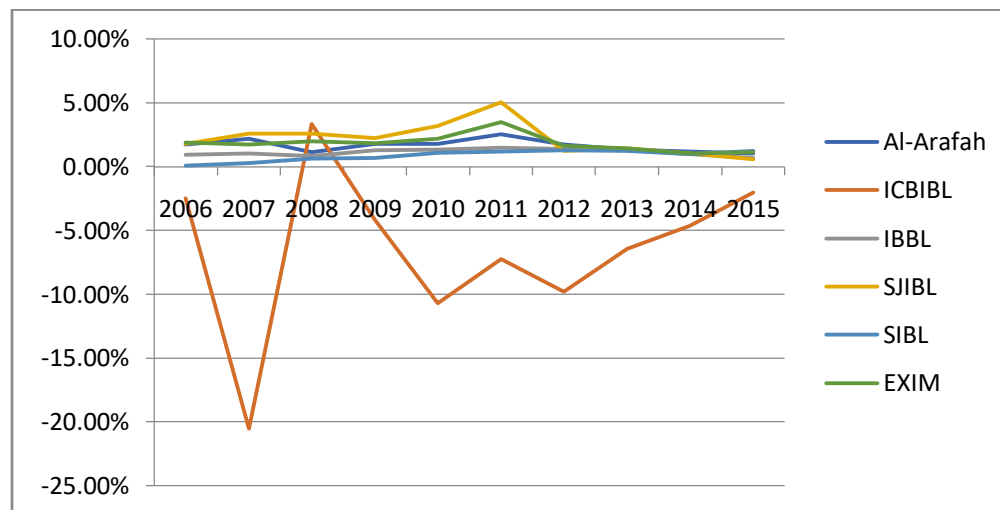
Ratio Analysis of Islamic Banks

We use several ratios to analysis the financial performance of the Islamic banks in Bangladesh. By using the ratios, we specify that the future prospect of the Islamic banking in the economy of Bangladesh.

ROA

ROA usually means return on total assets. It measures the efficiency of using total assets to net profit. In the graph, ROA of six selected Islamic banks have been explained.

Figure 1 ROA of six selected Islamic banks



From the graph, it is clear that all the banks except ICB Islamic bank has positive ROA and they have a slight variation but ICB Islamic Bank has the highest variation and in most of the years it has negative ROA. From the FY 2007 to FY 2011 Shahjalal Islamic Bank has the highest ROA and EXIM Bank and Al-Arafah Islamic Bank followed them. From FY 2012 to FY 2015 all the banks except ICB Islamic Bank have about same ROA and showed minimum dispersion. In case of ROA, ICB Islamic Bank showed the worst performance and Shahjalal Islamic Bank showed top performance.

ROI

ROI means the net profit compared to total investment. It denotes the efficiency of investment in profitable sectors. How efficiently the investments are made, the more ROI will be generated.

Figure 2 ROI of six selected Islamic banks

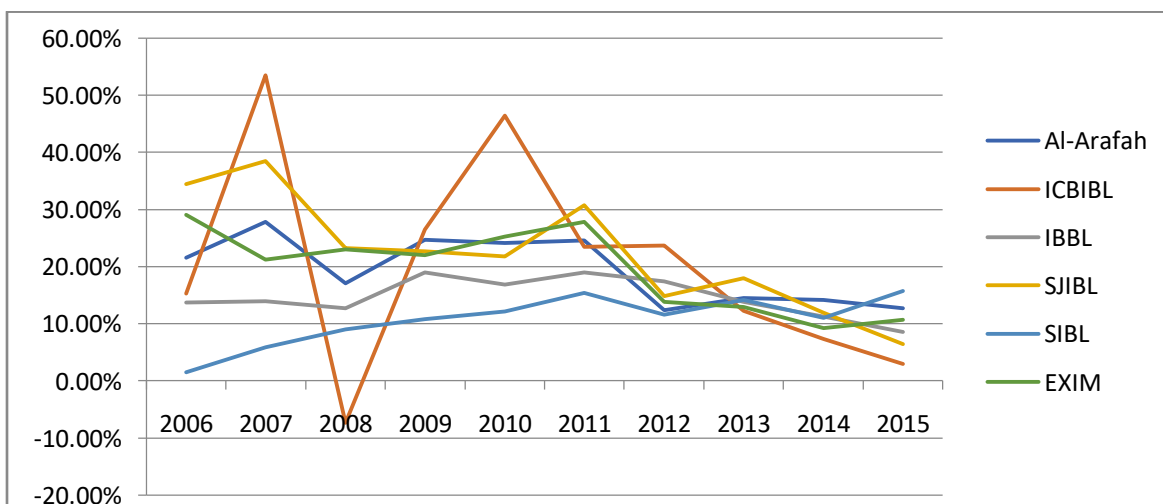


In case of ROI, almost same scenario is seen. Shahjalal Islamic Bank has top ROI from FY 2006 to FY 2009 and then it slightly downgraded from FY 2010 to FY 2015. All the banks rather than ICB Islamic Bank have slight dispersion in case of changes in ROI. ICB Islamic Bank has a large fluctuation in case of ROI. But in last few years it shows a positive sign for its investment because it shows an upward trend from FY 2010 to FY 2015.

ROE

ROE means the net profit created against equity. It focuses on the shareholders return for their investment. Here positive sign shows how much they will get for their capital and vice versa.

Figure 3 ROE of six selected Islamic banks

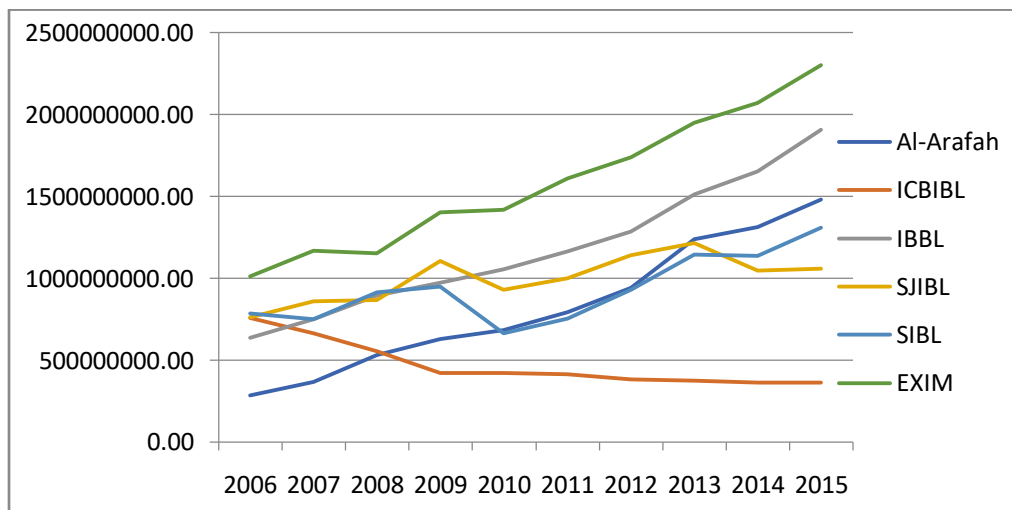


All the points of the graph show a downward trend in case of ROE. But the ROE of ICBIBL is fluctuating more than the others. It may focus their inefficient management system. Beside this, that type of overall situation may create for the effect of economic and political instability and the inefficient regulation of the share market. From FY 2011 it is seen that the rate is getting downward. If this continues than it may influence the investor to withdraw their fund.

Deposit Per Branch

Deposit per branch of a bank shows the average amount of deposit for every branch. Here it shows how much amount a bank has for meeting its demand for loan and other requirements.

Figure 4 Deposit per Branch of six selected Islamic banks



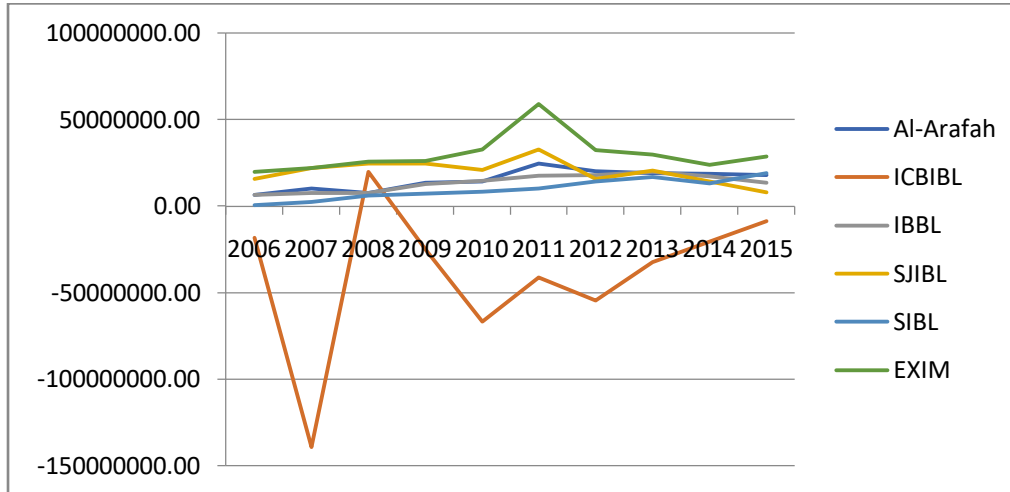
The graph shows that there is an increasing trend of deposit in most of the bank. Only ICIBL shows the opposite direction. From FY 2006 EXIM bank shows an outstanding performance in case of deposit. Though there is some fluctuation from FY 2010 but most of the bank increases their deposit. It will be so much beneficial for the economic development as it decreased the interest rate of borrowing. Beside this it may decrease the rate of deposit.

Current Ratio

In case of current ratio, almost same scenario is seen. Exim Bank has top current ratio from FY 2006 to FY 2015. In 2011 it seems to higher than average and then it slightly downgraded from FY 2012 to FY 2015. All the banks rather than ICB Islamic Bank have slight dispersion in case of changes in current ratio. ICB Islamic Bank has a large fluctuation in case of current ratio. But

in last few years it shows a positive sign for its investment because it shows an upward trend from FY 2010 to FY 2015.

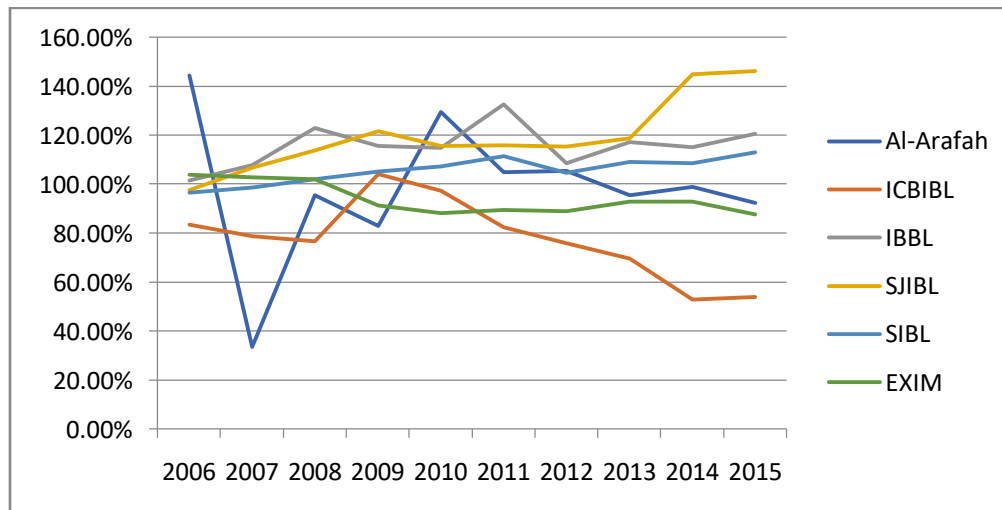
Figure 5 Current ratio of six selected Islamic banks



Quick Ratio

Quick ratio shows the amount of quick asset against its current liability. It shows the institutions capability to meet its liquidity requirement quickly.

Figure 6 Quick ratio of six selected Islamic banks



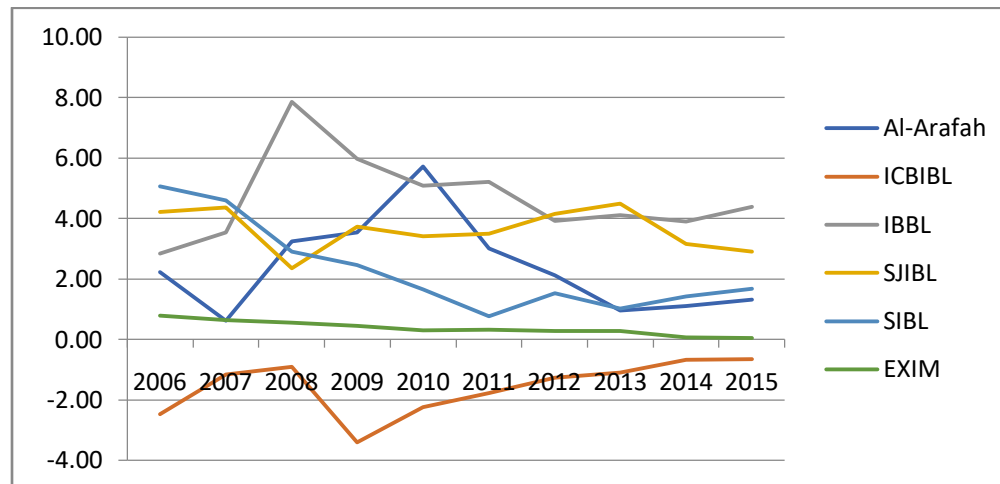
Different banks show different situation from FY 2006 to FY 2013. There is a huge fluctuation in maintaining its liquidity. But from FY 2013 IBBL, SJIBL and the SIBL perform better than the

others. But the entire bank must maintain it adequately. From FY 2011 ICBIBL shows a very worst situation. If this continues the bank will fall on a critical liquidity crisis.

Debt to Equity Ratio

Debt to equity ratio shows how much debt a firm takes relative to its equity. It also shows the source of the funds that are collected from the different parties.

Figure 7 Debt to Equity ratio of six selected Islamic banks



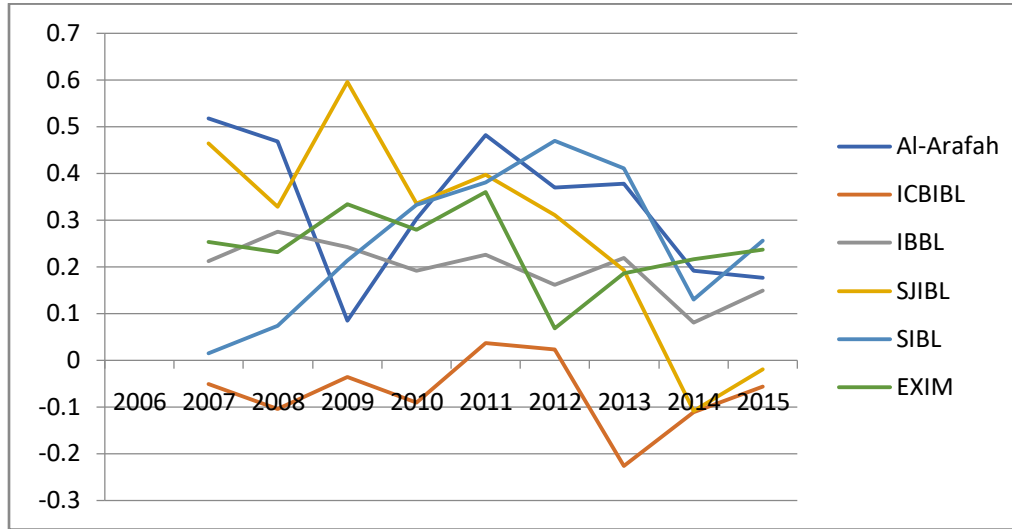
The graph indicates that most of the bank is intended to focus on the debt rather than the equity. In FY 2008 IBBL takes 7.86 times debt relatives to its deposits. But in that case ICBIBL shows an opposite direction. Here it mainly focuses on equity financing. But from FY 2011 most of the bank increased their dependence on debt. This may give them the tax facility. But it also increases the risk of bankruptcy.

Growth Rate to Total Credit

Growth rate to total credit ratio shows the rate of increase or decrease of credit in the firm. Positive rate shows that the bank is intended to debt financing rather than the other sources of financing.

By analyzing the graph, it can say that most of the bank is not interested to take loan for their activities. If we look at the trend of the graph, we will see that all the line is downward sloping though they are increase at the last. Here most of the banks are performing in the same way. From FY 2013 to FY 2014 there is a drastically decrease of this rate which shows a good sign for the business.

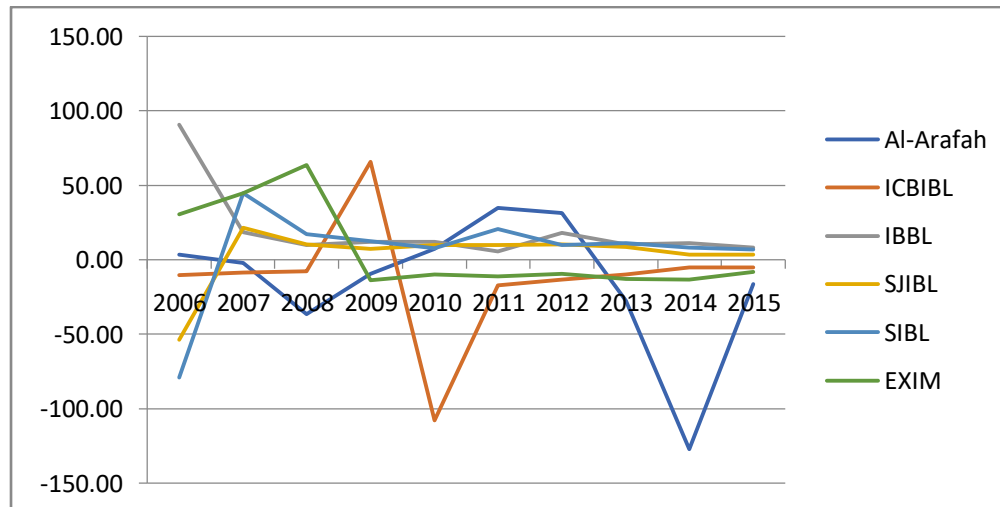
Figure 8 Growth Rate to Total Credit ratio of six selected Islamic banks



Total Credit to Volume of Working Fund

Credit to volume of working fund shows that how much an institution has to meet its liability requirement. The higher the ratio is the better the position is and vice versa.

Figure 9 Total Credit to Volume of Working Fund ratio of six selected Islamic banks

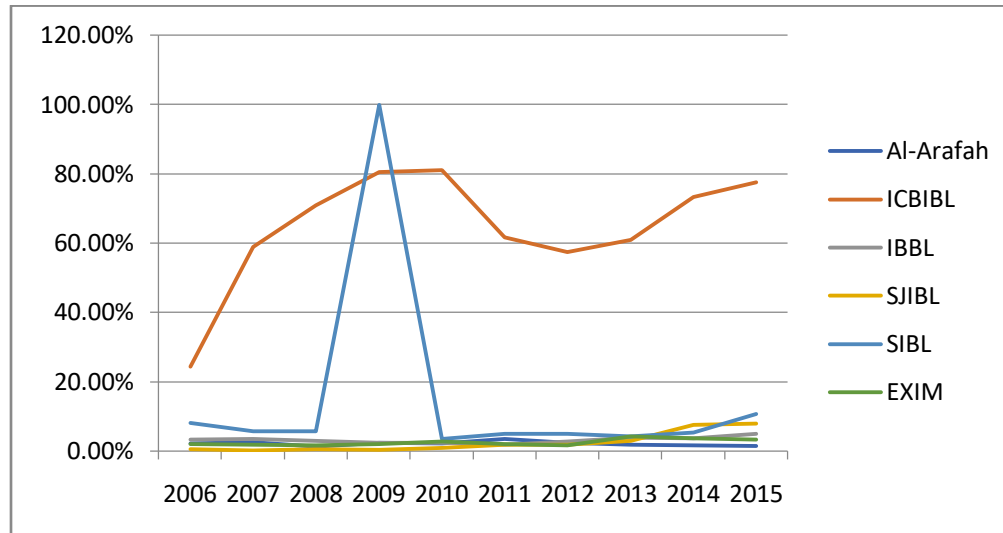


If we look from the FY 2007 to FY 2015 then we can easily see that all most all the bank except Al-Arafah, ICBIBL and EXIM are nearly maintaining their adequate working capital. In that case IBBL and the SIBL are in the best position. But the fluctuation of Al-Arafah and ICBIBL shows a very worst situation. There needs to imply an efficient regulation by the well-organized chain of command to handle this situation.

Classified Investment to Total Investment

Classified investment to total investment shows how much investment are classified relative to its total investment. If a firm can clearly show its portion, it will be able to know how much amount if investment will be regained or how much will not.

Figure 10 Classified Investment to Total Investment ratio of six selected Islamic banks



In that situation ICBIBL knows their investment classification better than the others. Here most of the banks scenery is same. But ICBIBL and SIBL have the large fluctuation in this case. In FY 2009 SIBL got the highest position. It stood up to 99.89%. But after that ICBIBL maintained a higher position on that from the FY 2011 to 2015.

Regression: Al-Arafah Islamic Bank Limited

Part One: Goodness of Fit

Goodness of Fit measures how well the calculated linear regression equation fits your data.

1. **Multiple R:** This is the correlation coefficient. It tells how strong the linear relationship is. In this regression output the value of multiple R is 0.923004 meaning a positive relationship of profit with total amount of investment, total operating expenses and total deposits in a whole. The relationship is 92.3004%.
2. **R squared:** This is r^2 , the Coefficient of Determination. It tells how many points fall on the regression line. In this calculation, the value or R squared is 85.1937% which means 85.1937% points fall on the regression line. That is regression line can explain 85.1937% of total variation.

3. **Adjusted R square:** The adjusted R-square adjusts for the number of terms in a model. The value of adjusted R squared of 77.7905% tells that if one explanatory variable is added in the model then regression will explain 77.7905% of total variation.

Part Two: ANOVA

Of all the information presented in the ANOVA table, the major interest will be focused on the value located in the "Sig." column, because this is the exact significance level of the ANOVA. In this regression analysis, the value of alpha is set to 0.05 and the significance F is 0.00669 that is the value of significance F is lower than the set alpha. It tells that the effects of explanatory variable are significant to the explained variable. So we reject null hypothesis and accept alternative hypothesis that is profit has a relationship with total investment, total operating expenses and total amount of deposits.

Part Three: Interpreting Regression Coefficients

From the information in regression output, the following regression equation can be generated.

$$\text{Profit} = -257767431 + 1.9658\text{TOE} - 0.08199\text{Deposit} + 0.07633\text{Investment}$$

It measures that TOE has a positive relationship with profit. If TOE increases, profit increases. Increased TOE denotes more operational activities and generates profit. One-unit increase in TOE generates 1.9658 unit of profit.

A negative coefficient of deposit (-0.08199) denotes negative relationship of deposits with profit as increased deposit is liable for the payment of interest. If deposit increased by 1, it will generate profit by 0.08199.

A positive coefficient of investment (0.07633) denotes positive relationship of investments with profit as increased investment generates profit. If investment increased by 1, it will generate profit by 0.07633 unit.

Regression: ICB Islamic Bank Limited

Part One: Goodness of Fit

Goodness of Fit measures how well the calculated linear regression equation fits your data.

1. **Multiple R:** This is the correlation coefficient. It tells how strong the linear relationship is. In this regression output the value of multiple R is 0.358851 meaning a positive relationship of profit with total amount of investment, total operating expenses and total deposits in a whole. The relationship is 35.8851%.
2. **R squared:** This is r^2 , the Coefficient of Determination. It tells how many points fall on the regression line. In this calculation, the value of R squared is 12.8774% which means

12.8774% points fall on the regression line. That is regression line can explain 12.8774% of total variation.

3. **Adjusted R square:** The adjusted R-square adjusts for the number of terms in a model. The value of adjusted R squared of -30.684% tells that if one explanatory variable is added in the model then regression will explain -30.684% of total variation.

Part Two: ANOVA

Of all the information presented in the ANOVA table, the major interest will be focused on the value located in the "Sig." column, because this is the exact significance level of the ANOVA. In this regression analysis, the value of alpha is set to 0.05 and the significance F is 0.827633 that is the value of significance F is much higher than the set alpha. It tells that the effects of explanatory variable are not significant to the explained variable. So we do not reject null hypothesis that is EAT has no relationship with total investment, total operating expenses and total amount of deposits.

Part Three: Interpreting Regression Coefficients

From the information in regression output, the following regression equation can be generated.

$$EAT = 2604475210 - 2.162087075 \times TOE + 0.047534984 \times \text{Deposit} - 0.259307456 \times \text{Investment}$$

It measures that TOE has a negative relationship with profit. If TOE increases, profit decreases. One-unit increase in TOE generates -2.16 unit of profit.

A positive coefficient of deposit (0.047534984) denotes positive relationship of deposits with profit. If deposit increased by 1, it will generate profit by 0.08199.

A negative coefficient of investment (-0.25930) denotes negative relationship of investments with profit. If investment increased by 1, it will generate profit by -0.25930 unit.

Regression: Islamic Bank Bangladesh Limited

Part One: Goodness of Fit

Goodness of Fit measures how well the calculated linear regression equation fits your data.

1. **Multiple R:** This is the correlation coefficient. It tells how strong the linear relationship is. In this regression output the value of multiple R is 0.9876 meaning a positive relationship of profit with total amount of investment, total operating expenses and total deposits in a whole. The relationship is 98.76%.
2. **R squared:** This is r^2 , the Coefficient of Determination. It tells how many points fall on the regression line. In this calculation, the value of R squared is 97.54% which means

97.54% points fall on the regression line. That is regression line can explain 97.54% of total variation.

3. **Adjusted R square:** The adjusted R-square adjusts for the number of terms in a model. The value of adjusted R squared of 96.31% tells that if one explanatory variable is added in the model then regression will explain 96.31% of total variation.

Part Two: ANOVA

Of all the information presented in the ANOVA table, the major interest will be focused on the value located in the "Sig." column, because this is the exact significance level of the ANOVA. In this regression analysis, the value of alpha is set to 0.05 and the significance F is 0.0000322199 that is the value of significance F is lower than the set alpha. It tells that the effects of explanatory variable are significant to the explained variable. So we reject null hypothesis and accept alternative hypothesis that is profit has a relationship with total investment, total operating expenses and total amount of deposits.

Part Three: Interpreting Regression Coefficients

From the information in regression output, the following regression equation can be generated.

$$Profit = -78201430 + 0.1400TOE - 0.0793Deposit + 0.10128Investment$$

It measures that TOE has a positive relationship with profit. If TOE increases, profit increases. Increased TOE denotes more operational activities and generates profit. One-unit increase in TOE generates 0.14 unit of profit.

A negative coefficient of deposit (-0.0793) denotes negative relationship of deposits with profit as increased deposit is liable for the payment of interest. If deposit increased by 1, it will generate profit by -0.0793 unit.

A positive coefficient of investment (0.10128) denotes positive relationship of investments with profit as increased investment generates profit. If investment increased by 1, it will generate profit by 0.10128 unit.

Regression: Shahjalal Islamic Bank Limited

Part One: Goodness of Fit

Goodness of Fit measures how well the calculated linear regression equation fits your data.

1. **Multiple R:** This is the correlation coefficient. It tells how strong the linear relationship is. In this regression output the value of multiple R is 0.859417 meaning a positive relationship of profit with total amount of investment, total operating expenses and total deposits in a whole. The relationship is 85.9417%.

2. **R squared:** This is r^2 , the Coefficient of Determination. It tells how many points fall on the regression line. In this calculation, the value of R squared is 73.8598% which means 73.8598% points fall on the regression line. That is regression line can explain 73.8598% of total variation.
3. **Adjusted R square:** The adjusted R-square adjusts for the number of terms in a model. The value of adjusted R squared of 60.7897% tells that if one explanatory variable is added in the model then regression will explain 60.7897% of total variation.

Part Two: ANOVA

Of all the information presented in the ANOVA table, the major interest will be focused on the value located in the "Sig." column, because this is the exact significance level of the ANOVA. In this regression analysis, the value of alpha is set to 0.05 and the significance F is 0.035017 that is the value of significance F is lower than the set alpha. It tells that the effects of explanatory variable are significant to the explained variable. So we reject null hypothesis and accept alternative hypothesis that is profit has a relationship with total investment, total operating expenses and total amount of deposits.

Part Three: Interpreting Regression Coefficients

From the information in regression output, the following regression equation can be generated.

$$\text{Profit} = -507495572 + 0.381688\text{TOE} - 0.11558\text{Deposit} + 0.127443\text{Investment}$$

It measures that TOE has a positive relationship with profit. If TOE increases, profit increases. Increased TOE denotes more operational activities and generates profit. One-unit increase in TOE generates 0.381688 unit of profit.

A negative coefficient of deposit (-0.11558) denotes negative relationship of deposits with profit as increased deposit is liable for the payment of interest. If deposit increased by 1, it will generate profit by -0.11558.

A positive coefficient of investment (0.127443) denotes positive relationship of investments with profit as increased investment generates profit. If investment increased by 1, it will generate profit by 0.127443 unit.

Regression: Social Islamic Bank Limited

Part One: Goodness of Fit

Goodness of Fit measures how well the calculated linear regression equation fits your data.

1. **Multiple R:** This is the correlation coefficient. It tells how strong the linear relationship is. In this regression output the value of multiple R is 0.859417 meaning a positive

relationship of profit with total amount of investment, total operating expenses and total deposits in a whole. The relationship is 85.9417%.

2. **R squared:** This is r^2 , the Coefficient of Determination. It tells how many points fall on the regression line. In this calculation, the value of R squared is 73.8598% which means 73.8598% points fall on the regression line. That is regression line can explain 73.8598% of total variation.
3. **Adjusted R square:** The adjusted R-square adjusts for the number of terms in a model. The value of adjusted R squared of 60.7897% tells that if one explanatory variable is added in the model then regression will explain 60.7897% of total variation.

Part Two: ANOVA

Of all the information presented in the ANOVA table, the major interest will be focused on the value located in the "Sig." column, because this is the exact significance level of the ANOVA. In this regression analysis, the value of alpha is set to 0.05 and the significance F is 0.035017 that is the value of significance F is lower than the set alpha. It tells that the effects of explanatory variable are significant to the explained variable. So we reject null hypothesis and accept alternative hypothesis that is profit has a relationship with total investment, total operating expenses and total amount of deposits.

Part Three: Interpreting Regression Coefficients

From the information in regression output, the following regression equation can be generated.

$$\text{Profit} = -507495572 + 0.381688\text{TOE} - 0.11558\text{Deposit} + 0.127443\text{Investment}$$

It measures that TOE has a positive relationship with profit. If TOE increases, profit increases. Increased TOE denotes more operational activities and generates profit. One-unit increase in TOE generates 0.381688 unit of profit.

A negative coefficient of deposit (-0.11558) denotes negative relationship of deposits with profit as increased deposit is liable for the payment of interest. If deposit increased by 1, it will generate profit by -0.11558.

A positive coefficient of investment (0.127443) denotes positive relationship of investments with profit as increased investment generates profit. If investment increased by 1, it will generate profit by 0.127443 unit.

Regression: EXIM Bank Limited

Part One: Goodness of Fit

Goodness of Fit measures how well the calculated linear regression equation fits your data.

1. **Multiple R:** This is the correlation coefficient. It tells how strong the linear relationship is. In this regression output the value of multiple R is 0.91502 meaning a positive relationship of profit with total amount of investment, total operating expenses and total deposits in a whole. The relationship is 91.502%.
2. **R squared:** This is r^2 , the Coefficient of Determination. It tells how many points fall on the regression line. In this calculation, the value of R squared is 83.7262% which means 83.7262% points fall on the regression line. That is regression line can explain 83.7262% of total variation.
3. **Adjusted R square:** The adjusted R-square adjusts for the number of terms in a model. The value of adjusted R squared of 76.7571% tells that if one explanatory variable is added in the model then regression will explain 76.7571% of total variation.

Part Two: ANOVA

Of all the information presented in the ANOVA table, the major interest will be focused on the value located in the "Sig." column, because this is the exact significance level of the ANOVA. In this regression analysis, the value of alpha is set to 0.05 and the significance F is 0.0037826 that is the value of significance F is lower than the set alpha. It tells that the effects of explanatory variable are significant to the explained variable. So we reject null hypothesis and accept alternative hypothesis that is profit has a relationship with total investment, total operating expenses and total amount of deposits.

Part Three: Interpreting Regression Coefficients

From the information in regression output, the following regression equation can be generated.

$$\text{Profit} = -15479533 - 1.460481.9658\text{TOE} - 0.08881\text{Deposit} + 0.152028\text{Investment}$$

It measures that TOE has a positive relationship with profit. If TOE increases, profit increases. Increased TOE denotes more operational activities and generates profit. One unit increase in TOE generates -1.460481 unit of profit.

A negative coefficient of deposit (-0.08881) denotes negative relationship of deposits with profit as increased deposit is liable for the payment of interest. If deposit increased by 1, it will generate profit by -0.08881 unit.

A positive coefficient of investment (0.152028) denotes positive relationship of investments with profit as increased investment generates profit. If investment increased by 1, it will generate profit by 0.152028 unit.

Finally, it can be said that total operating expenses (TOE), total deposits and total investment have effects on profit. That null hypothesis is rejected and alternative hypothesis is accepted.

Challenges and opportunities of Islamic Banking

The second half of the twentieth century witnessed a distinctly separate line of thinking on banking. This was institutionalized at the end of third quarter and subsequently emerged as a new system of banking called Islamic banking also called Profit-Loss-Sharing Banking (PLS). The world has now been experiencing operation of as many as 250 Islamic banks and financial institutions in more than 50 countries, Muslim and non-Muslim. There are religious as well as economic reasons, which have contributed to the emergence of PLS-banking as an alternative to its conventional counterpart. It is the prohibition of Riba in the Quran that, according to the proponents of the PLS-system, was the source of inspiration for establishing banks in line with Islamic Shariah. The basic intention behind establishing Islamic banks was the desire of Muslims to reorganize their financial activities in a way that do not contradict the principles of Shariah and enable them to conduct their financial transactions without indulging into Riba. These writers consider rate of interest in the conventional banking mechanism synonymous to Riba, the term as used in the Quran. One of the reasons for this is that the outcome of the productive effort is uncertain, and so interest necessarily involves an element of Gharar, that is, uncertainty. On this religious ground, proponents of the PLS-system urge the Islamic community to avoid all transactions with institutions those are interest-based.

Challenges

Standards: The Islamic Financial Services Board (IFSB) has not adopted a standard or guideline on Shariah compliant deposit insurance. The Islamic Deposit Insurance Group of the International Association of Deposit Insurers (IADI) has addressed several views on this matter and has concluded that Shariah compliance is a key challenge for an Islamic Deposit Insurance Scheme (IDIS). Four countries have implemented Shariah compliant deposit insurance schemes, including Bahrain, Indonesia, Malaysia, and Sudan. For example, Sudan uses a Takaful-based model whereas Malaysia uses a Wakalah-based model.

Governing framework: Although governments could take several alternative approaches to implementing an IDIS (for example, government regulation, Shariah contract, or a combination of both), the legal enforceability of each approach would need to be undertaken. Insurability of Islamic deposits. There seems to be a consensus regarding the insurability of Wadiah (safekeeping), or Qard, but Mudharabah (deposits accepted under profit-sharing contracts) remains problematic.

Jurisdictions are divided on the definition and treatment of PSIA: Some countries provide protection to both unrestricted and restricted PSIA (Profit Sharing Investment Account) holders, some only provide protection to unrestricted PSIAs, and some do not provide any protection to

PSIAs. Risk-based fees, in jurisdictions that apply risk-based fees for the funding of deposit insurance, the unique risks of IB would need to be quantified, implying the development of requisite analytical capacities and underlying data. Availability and liquidity of Shariah compliant investments IDISs need to operate in compliance with Shariah rules. In case of an ex ante-funded IDIS, the management and investment of funds could become problematic if Islamic instruments are limited. Moreover, to ensure a quick payout to depositors, deposit insurance funds need to be liquefied on short notice, which would mean that IDIS funds would, in turn, need to be invested in liquid instruments.

Coexistence with conventional banking: Coexistence with conventional banking. Several options are available for the governance of IDIS where conventional and Islamic banks coexist. Islamic deposits are covered by either conventional deposit insurance or an IDIS, and the IDIS can be housed either in a separate agency or a single agency that manages both conventional and IDIS. Each option will have its own governance, legal, and operational implications in particular where Islamic windows are allowed.

Priority of claims: While under a conventional Deposit Insurance Scheme (DIS) all depositors are ranked equally, this is not necessarily the case under an IDIS. In the case of an IDIS, a distinction could be made, first, between actual deposits (Wadiah) and Qard on the one hand and PSIAs on the other hand and second, between restricted and unrestricted PSIAs. This ranking of priority in the case of banking stress could affect the attractiveness.

Role in resolution: There is growing support for authorizing a DIS to fund bank resolution. Shariah compliance of such resolution activity by DIS is unclear.

Opportunities

Future policy and strategy: The first action that deserves immediate attention is the promotion of the image of Islamic banks as PLS banks. Strategies have to be carefully devised so that the image of Islamic character and solvency as a bank is simultaneously promoted. To this end, pilot schemes in some much selected areas should be started to test innovative ideas with profit-loss-sharing modes of financing as major component. Islamic banks should clearly demonstrate by their actions that their banking practices are guided by profitability criterion thereby establishing that only Islamic banking practices ensures efficient allocation of resources and provide true market signals through PLS modes. Islamic banks should continuously monitor and disseminate through various means the impact of their operations on the distribution of income primarily between the bank and the other two parties; the depositors and the entrepreneurs, and then on different income groups of the society. These presuppose establishment of a fully equipped research academy in each Islamic bank.

New banking philosophy for the Islamic banks: There seems to be a gap between the ideals and actual practice of Islamic banks in Bangladesh. In their reports, booklets, bulletins and posters these banks express their commitment to striving for establishing a just society free from exploitation. Study shows that a little progress has been achieved so far in that direction. Though this failure is attributed mainly to the pervasive influence of conventional banking system itself, lack of vigilance of the promoters of Islamic banking in realizing the objective is no less to blame. There should be a thorough review of policies that have been pursued by these banks for about a decade and points of departure have to be identified to redesign of their action

Need for re-organization of the whole financial system: Review of the problems of Islamic banking in general and Islamic banks of Bangladesh in particular poses a challenging feature for the promotion and survival of Islamic banks in Bangladesh. The policy implication is not that Islamic banks should never be floated within the conventional banking framework. Rather it is the conventional banking system whose operational mechanism needs to be re-examined and converted into PLS system considering beneficial impact of the latter on the economy. However, as long as Islamic banks are to operate within the conventional banking framework, the recommendations under the following heads may be taken note of.

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

Modern banking policies and practices: Islamic banks, with a view to facing the growing competition either fellow -Islamic banks or the conventional banks which have launched Islamic banking practices, will have to adapt their functioning in line with modern business practices, though improvement and expansion of the range of dealing in the banking sector. Thus, it is necessary for them to provide comprehensive banking and investment services to clients and simultaneously to take advantage of modern technological breakthroughs in areas such as electronic communication, computerization etc.

RECOMMENDATIONS

Islamic banking sector of Bangladesh shows that this sector is progressing steadily. The formation of Islamic banks and adoption of parallel Islamic banking by several conventional banks over the years can be an indicator of the high acceptability of this sector by the public. The main reason for the demand for Islamic banking can be attributed to the desire of people to engage in financial transactions that adhere to the rules of Shariah. The demand from this segment induces banks to either offer Islamic finance exclusively or as a parallel service with other conventional offers. The foremost factor making Islamic banking attractive to customers is adherence to the rules of Shariah. Convenience of opening accounts or the quality of the services offered does not have much impact on the consumer's decision of choosing an Islamic banking system.

The Islamic bankers believe that the Profit Loss Sharing (PLS) method represents financial advantages for the banks and offers benefits for the economy by causing lower interest stimulated instability. The banks are, however, not implementing the principals of Shariah fully. According to the conventional banks, these banks have not abolished interest from the transactions. This has caused the PLS method fail to have the impact it is intended to have on risks, profitability and the society. The foremost factor making Islamic banking attractive to customers is adherence to the rules of Shariah. Convenience of opening accounts or the quality of the services offered does not have much impact on the consumer's decision of choosing an Islamic banking system, but for the Shariah based activities of the Islamic banks, their reliable commitment to the customer also their well behave encourage the Muslim to be attracted by the Islamic banks. To facilitate a robust Islamic banking sector in the country following steps may be considered on urgent basis:

- It can be suggested that Islamic banking and finance should adhere to Islamic law without any restriction.
- Appointment of bankers who are operating the Islamic banking and finance must be based on merit and competency. In case of deficiency and inefficiency, the authorities must find solutions in order to uphold the sanctity of the Islamic banking and financial system.
- There should be training, seminars, and workshops for the bankers in order to upgrade their knowledge and understanding about Shariah and finance for the smooth running of the industry.
- Islamic banks should be firm and optimistic about the implementation of the real Islamic banking and finance without mix-up or coloring conventional banks as Islamic banks

globally. The Shariah advisory committee should not be based on political appointment but based on quality, competency, and merit. Otherwise, the wrong person would be in charge leading to mismanagement and inefficiencies.

- Muslim scholars should have a unanimous design of an Islamic banking and finance system under the auspicious of Islamic Development Banks without interference from conventional banks. There is a need for introducing the Baitul Mal across Muslim countries where the money should be saved and kept. The World Baitul Mal should be placed in any Muslim country rather than non-Muslim countries.
- Design Islamic money market and Islamic government financing instruments (i.e. shariah compliant public sector debt financing instruments with the desirable characteristics i.e. relatively low risk, simply designed, regularly issued, widely held and supported by a robust payment and settlement system
- Incorporate Islamic government financing instruments as an integral part of the overall public debt and financing program, and foster the development of an Islamic government securities market. This requires a systematic approach to linking government expenditures, asset acquisition, and asset generation with sovereign sukuk issuance program.
- Actively use Islamic government financing instruments in market-based monetary operations of the central bank to manage liquidity in the Islamic money market. This would facilitate also a uniform approach to dealing with both Islamic and conventional banks in the conduct of monetary operations.
- Develop efficient trading arrangements and the associated market microstructure for Islamic money and government finance instruments and develop in parallel the foreign exchange markets.
- Provide supervisory guidance and incentives for effective liquidity risk and asset liability management by IIFS, and in parallel foster privately issued money market securities.

At present Islamic banking is worldwide. They follow Islamic rules & laws appropriately. So, day by day Islamic Banking gains its popularity as a secure banking. As a result, customer put their steps to the door of Islamic banks. National Shariah boards can contribute to legal certainty and reduce shariah non-compliance risks. However; Islamic banking system can flourish even we do not have a superior national authority for finance related shariah interpretations. If governments or regulators take a more neutral position, they may prescribe just the minimum shariah governance structures for Islamic banking sector but abstain from the establishment of national

shariah boards. Legal certainty includes that court decisions are made by judges who have sufficient understanding of Islamic finance. This cannot be taken for granted in countries where Islamic finance laws are recent phenomena that did not exist when today's judges were studying law and starting their professional careers. Support provided to the incumbent judges by an Islamic finance consultancy body could create more consistent judicial decisions.

CONCLUSION

In Bangladesh, the Islamic Banking industry will celebrate its golden jubilee in the year 2033 marking its 50th year. And the present shape of the industry is being modernized in terms of this changing scenario forecasting in the world economy in the year 2033. The government can help to explore the growth opportunities for Islamic finance, as well as tax and regulatory developments to boost the country's Islamic Capital markets. With the proper implementation of regulations, education and understanding of Islamic financial products, and the provision of sufficient infrastructure, Bangladesh is set to become a major player in the field of Islamic finance of the world.

The situation in Bangladesh is unique in so far as a sizeable Islamic Banking sector exists, but the country lacks specific Islamic finance regulations and important segments of a comprehensive Islamic finance industry. The resulting vulnerabilities of Islamic banking sector have been recognized and are to be addressed by the authorities. Furthermore, the huge potential of Islamic finance in support of inclusive growth has also been recognized, and efforts are being made to create an environment that is conducive to realizing this potential. It would be in the interests of transparency, credibility and consistency to prepare an assessment of the status quo and compile all intended actions and chosen strategies in an Islamic finance sector development plan. Legal certainty is of prime importance for the further development of the industry, in particular with respect to cross-border transactions. The existing legal, regulatory and tax environment should be amended or adjusted to accommodate specificities, of Islamic finance. The final aim should be the creation of a comprehensive and consistent legal and regulatory framework for all sectors for the Islamic financial services industry. Islamic banks can satisfy most of the efficiency conditions if they can operate as a sole system in an economy. On the other hand, does not satisfy any of the efficiency conditions analyzed in the present study. However, when Islamic banks start operation within the conventional banking framework, their efficiency goes on decreasing in a number of dimensions. The deterioration is not because of Islamic bank's own mechanical deficiencies; rather it is the efficiency-blunt operation of the conventional banking system that puts a negative impact on the efficient operation of Islamic

banks. This does not mean that the survival of Islamic banks operating within the conventional banking framework is altogether threatened.

Even under the framework, Islamic banks can operate with certain level of efficiency by applying in a reasonable percentage the PLS-modes, the distinguishing features of Islamic banking. This has been possible in some countries of the Muslim world where the management of Islamic banks was cautious about possible impacts of every policy measure. Particularly, the management of these banks was judicious in selecting sectors or areas as major of their operations. Sudan Islamic Bank is a typical example in this respect. Islamic banks in Bangladesh have much to learn from experience of this successful bank. Having been considered the pro-efficiency character of Islamic banking and its beneficial impacts on the economy, government policy in Muslim countries should be in favor of transforming system into Islamic banking. From the practical implementation of customer dealing procedure during the whole period of our practical orientation in IBBL, we have reached a firm and concrete conclusion in a very confident way. Almost all the leading banks in our country have various extra facilities in offer for the customers in comparison with IBBL.

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

LIMITATIONS OF THE RESEARCH

This research considers only the 10 years data and the present scenarios of Islamic Banking in Bangladesh. We think that 10 years is not enough to find out the perfect conclusion about Islamic banking. We also used the secondary data which were published by that banks. Data should be collected and verified from primary sources. There were few variables in regression model. We could use more variables and we could use the several econometric test to verify the accuracy of the data selection.

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