

Loan Facilities of Islamic & Conventional Banks: Bangladesh Perspective

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Abstract

Effective flow of investments and savings culture is the precondition of the economic development of any country. We know that there are 56 commercial banks in Bangladesh. Except specialized banks, 46 banks are operating in the country in which 4 are public, 31 private and 11 are foreign banks. Deposit collection and lending are the main function of these banks. Though the various segments from which banking institutions make a profit, the most significant part is the investment or loan facilities. Broadly speaking, banking institutions are run by this profit sector of the banking institution. The financial statements of Bangladesh Bank for (FY 2018) have been prepared in accordance with International Financial Reporting Standards (IFRSs) where it illustrated that the total income in the investment sector increased from Taka 27.49 to 43.06 Billion in 2017-2018. This paper attempts to discuss the issues that govern the banking practices in Bangladesh and it also paint out the real picture of the lending practices followed by NCBs, PCBs and ICBs in Bangladesh.

Keywords: *Islamic & conventional banking lending system, Islamic modes of financing*

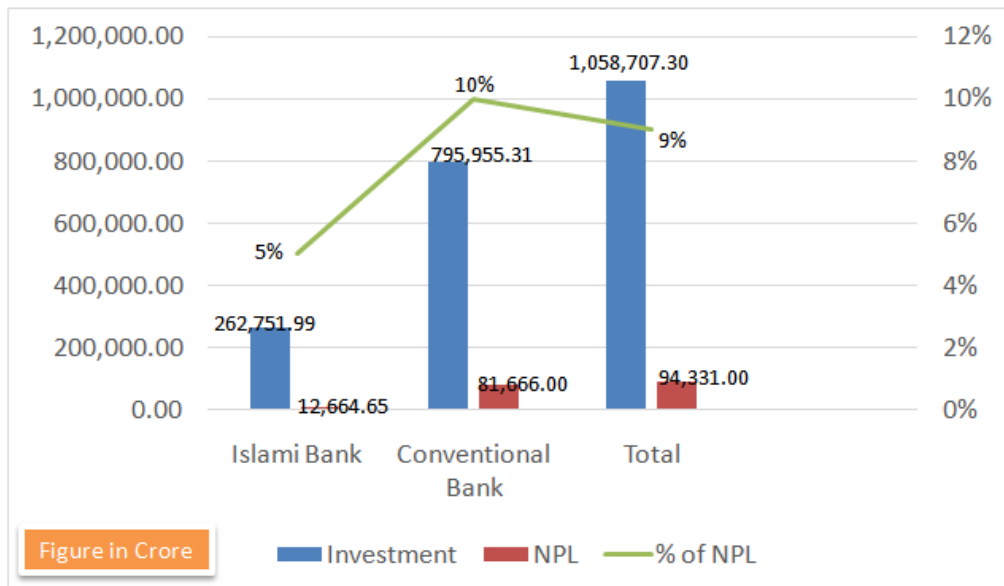
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I. Introduction

The primary business of a bank is managing the spread deposits that it pays consumers and the rate it receives from their loans. However, banks also earn revenue from fee income that they charge for their products and services that include wealth management advice, checking account fees, overdraft fees, ATM fees, interest and fees on credit cards and also from the loan or investment. In Bangladesh, Private Commercial Banks investment facilities can be categorized into two groups: i) Conventional PCBIF: 31 conventional PCBs are now operating in the industry they perform the banking functions in conventional fashion i.e. interest-based operations. ii) Islamic Shariah-based IBs: There are 8 Islami Shariah-based IBs in Bangladesh and they execute banking activities according to Islami Shariah-based principles i.e. Profit-Loss Sharing (PLS) mode (BB, 2016) and that two types of loan facilities are continuous, one is Islamic finance and the other is conventional loan. Whereas the prime source of revenue and cost of funds to conventional banks is charging interest through lending and accepting deposits for interest respectively. Interest is the major driver of operations of conventional banks although other valuable services including guarantees, funds transfers, safety of wealth, facilitation in international trade etc. are also provided for reward and form substantial part of income of banks. As the conventional banks are established under the principles of capitalism and transect business by charging interest, which is unacceptable (forbidden) in Islamic law.

On the other hand, Islamic Banks invest their money following different mechanisms like Murabaha, Musharaka, Mudarabah, Bai-Muajjal, Bai-Salam etc. to avoid fixed interest. In Islamic banking investment mechanisms, the Islamic financial relationships between investor and borrower are of a participatory in nature (Ahmad 1993). Bangladesh is one of the largest Muslim countries in the world. The people of this country are deeply committed to Islamic way of life as enshrined in the Holy Quran and the Sunnah. Naturally, it remains a deep cry in their hearts to fashion and design their economic lives in accordance with the precepts of Islam. So, Muslims left with no choice except to establish their own financial institutions under Islamic principles as the first bank of its kind in Southeast Asia Islami Bank Bangladesh Limited on March 30, 1983. With committed to conduct all banking and investment activities on the basis interest free profit loss sharing system, the popularity has shown tremendous growth in last two decades. [5]



The popularity of the Islamic banking system is not limited to the Islamic banks only. Increasingly large international conventional banks are showing interest in the Islamic banking system as well (Haque, Osman and Ismail; 2009). For this consequence, two commercial banks of Bangladesh has been converted from Conventional Principal to Islamic Principal last year namely IFIC Bank and Standard Bank Ltd.

II. Literature Review

In most of the earlier researches in Bangladesh about the comparison of Islamic and conventional banking loan facilities aimed at the conceptual phenomena. A very few works have been done regarding their competitive attributes. Moreover, no such study is found comparing the profit rate on investment and lending rate of different banks which could facilitate the borrower to choose the cheap source for their borrowing in Bangladesh though a few researches have been done in this field in Malaysia. In Malaysia, in a comparative research of deposit rate of Islamic banks and conventional banks and non-banking financial institutions, it was found that the Islamic banks provide the lowest rate of return on deposits than any other sort of banks and financial institutions which might create dissatisfaction among the depositors in Islamic banks (Erusan and Ibrahim). Considering these things, this paper is designed to measure the similarities & dissimilarity and profit rate on investments of Islamic banks (ROI) and fixed rate of interest on loan of conventional banks from year 2015 to 2019 among Islamic banks, local conventional banks, foreign conventional banks and state owned commercial banks. The paper reveals that the Islamic Banks in Bangladesh are serving its customers by providing investment in a moderate rate which is lower than other conventional banks except state owned commercial banks resulting a very good trend of success over time. Arabinda made an important study entitled "Profitability of the PCBs in Bangladesh". He mentioned that the profitability of PCBs was affected by some controllable & uncontrollable factors during 1983 to 1995. He also mentioned that the profitability of PCBs was better than the profitability of NCBs during the 1983-95 due to selected causes i.e. better customer services, poor services of NCBs, handsome salary of PCBs, huge liquidity, skill manpower, properly use of modern tools & technology, personal liaison & other incentives for client services etc. Hassan & Reza prepared a study on "Efficiency Through Competition comparison of commercial Banks of Bangladesh in respect to several dimension of deposits, They identified the during 1983 PCBs are allowed to start the banking activities for the betterment than the services of NCBs. Practically activities of PCBs were increased day by day to face the challenging situation with the NCBs in Bangladesh through the deposit, loan & other dimensions. Sorhabuddin & others in a study entitled "Growth & Structure of the Banking Sector of Bangladesh" found that after the advantages of PCBs in Bangladesh, financial performance of the banking sector in general has improved. Later on, N S Toor (1994) has said that the profits are needed by the banks for a number of reasons, such as banks are basically commercial organizations and in order to ensure that the depositors and lenders have faith and confidence on themselves.

III. An Overview of Conventional Bank and Islamic Banking Loan or Investment policy

3.1 Lending system of Commercial Bank in Bangladesh

Bangladesh has a unique Banking system with multiple types of Banking with Nationalized Commercial Banks (NCBs), Private Commercial Banks (PCBs), Foreign Commercial Banks (FCBs), Islamic Commercial Banks (ICBs), Specialized Development Banks and the Cooperative Banks. Loans comprise the most important asset as well as the primary source of earning for the banking institutions. Almost every bank in Bangladesh provides various types of loans or credits for their clients for helping to make their life easy and simple. Likewise, conventional bank can also offer some products, services and lending facilities which are similar to those offered by an Islamic bank.

Table Different types of Bank Loan in Bangladesh Under NCBs, PCBs, FCBs

Business Loan	Car Loan
Personal Loan	Education Loan
Home Loan	Overseas Loan
Personal Lone	SME Loan
Credit Card Loan	Agriculture Loan

- **Car Loan:** For many of us the most sought after dream is to own a car. As possessing a car is no longer luxury but necessity. Many commercial bank offer the financial support by providing Car Loan facility. The custom-design car loan with easy repayment schedules gives borrower the opportunity to purchase a brand new or reconditioned car.
- **Home Loan:** When you wish to purchase a house, applying for a home loan can help you to a great extent. It provides you the financial support and helps you buy the house for yourself and your loved ones. These loans generally come with longer tenures (20 years to 30 years). The rates offered by some of the top banks in Bangladesh with their home loans start at 09%. Your credit score is checked before the loan request is approved by the lender. If you have a good credit score, there is a fair chance that you will be able to enjoy lower rates of interest with your home loan.
- **Education Loan:** Now-a-days to give your child the best education or to get a higher degree either at home or abroad requires a substantial amount of finance. To relieve from this burden All commercial bank offers education loan that ensures uninterrupted study through steady flow of cash.
- **Small Business Loans:** Small Business Loans are loans that are provided to small scale and medium scale businesses to meet various business requirements. These loans can be used for a variety of purposes that help in growing the business. Some of these could include purchase of equipment, buying inventory, paying the salaries of employees, marketing expenses, paying off business debts, meeting administrative expenses, or even to open a new branch or take up a franchise. The eligibility criteria for small business loans varies from lender to lender, but the common ones are the age of the business owner, the number of years the business has been operational, income tax returns, and statement of the previous year's turnover that has been audited by a Chartered Accountant (CA).
- **Loan against Salary:** Life is full of surprises. We often tumble into unforeseen cost that leaves us especially the fixed income people unprepared. To face this unpredictability in life commercial Bank has introduced "Loan against Salary" scheme. This scheme tailored to provide loan to fixed income people against their salary to mitigate any emergency

- **Cash Advances:** These loans are offered by credit card issuers and allow credit card users to withdraw cash from an ATM machine using the credit card. The amount of cash that can be withdrawn from a credit card in this way will depend on the credit limit available. The cash has to be paid back with interest, which is usually calculated from the day the cash has been withdrawn. There are also other fees associated with a cash advance, such as cash advance fees and ATM or bank fees.
- **Loan against Credit Card:** Loan against credit card is like a personal loan that is taken against your credit card. These are usually pre-approved loans that do not require any additional documentation. Depending on the lender, this can be converted into a personal loan that is interest free within a certain period. After that, it will attract a certain percentage of interest. There is a processing fee associated with converting the credit limit that is pre-assigned into a loan.
- **Agriculture Loan:** Agriculture loans are loans that are provided to farmers to meet the expenses of their day-to-day or general agricultural requirements. These loans can be short term or long term. They can be used for raising working capital for crop cultivation or to buy agricultural equipment.

3.2 Islamic Bank investment facilities in Bangladesh

On the other hand, Implementation and materialization of the economic and financial principles of Islam in the Banking area and justice in trade, commerce and industry and to build socio-economic infrastructure, create opportunity for income and sustained economic growth of a country is the cornets tone of the is Islamic Finance (IF), Islamic Bank of Bangladesh are offered the following investment facilities

Table 1 Displaying Islamic mode of financing Categorized objectively

Sharia Based	Sharia Compliance/Bai-Mode
Musharaka	Murabaha
Mudaraba	Ijara
	Diminishing Musharka
	Bia Salam
	Bai Muajjal
	Istisna'a

3.3 Sharia compliance/Bai-Mode

Bai-Murabaha

Bai-Murabaha may be defined as a contract between a buyer and a seller under which the seller sells certain specific goods (permissible under Islamic Shariah and the Law of the land), to the buyer at a cost plus agreed profit payable in cash or on any fixed future date in lump-sum or by installments. The profit marked-up may be fixed in lump-sum or in percentage of the cost price of the goods.

Bai-Mujjal

Bai-Muajjal may be defined as a contract between a Buyer and a Seller under which the Seller sells certain specific goods permissible under Islamic Shariah and Law of the land) to the Buyer at an agreed fixed price payable at a fixed future date in lump sum or within a fixed period by fixed installments. The seller may also sell the goods purchased by him as per order and specification of the Buyer. In this Bank, Bai-Muajjal is treated as a contract between the Bank and the Client under which the Bank sells the goods, purchased as per order and specification of the Client, to the client at an agreed price payable at any fixed future date in lump sum or within a fixed period by fixed installments.

Bai-Salam

Bai-Salam may be defined as a contract between a Buyer and a Seller under which the Seller sells in advance the certain commodity/product permissible under Islamic Shariah and the law of the land to the Buyer at an agreed price payable on execution of the said contract and the commodity/product is/are delivered as per specification, size, quality, quantity at a future time in a particular place. In other words, Bai-Salam is a sale whereby the seller undertakes to supply some specific Commodity/Product to the buyer at a future time in exchange of an advanced price fully paid on the spot. Here the price is paid in cash, but the delivery of the goods is deferred

Bai-Istisna

Istisna'a is a contract between a manufacturer/seller and a buyer under which the manufacturer/seller sells specific product after having manufactured, permissible under Islamic Shariah and Law of the Country after

having manufactured at an agreed price payable in advance or by installments within a fixed period or on/within a fixed future date on the basis of the order placed by the buyer.

3.4 Sharia Based

Musharaka

According to Hadith Qudasi (revelation reported by Prophet Muhammad PBUH) *“Indeed, Allah the Exalted says: I am the third of the two partners so long as the one does not cheat the other, and when he cheats, I withdraw myself”* (Khan, 1989). Literal meaning of Musharaka is sharing. Its root in Arabic language “Shirka” means being a partner. Musharaka means a joint enterprise formed conducting some business in which all partners share the profit according to pre agreed ratio while loss is shared according to the ratio of contribution (Meezan bank guide 2002). For a valid Musharaka fulfillment of certain conditions required. First is there must be an agreement written (verbal) among the partners clearly stating the terms and conditions including management, capital contributions, profit and loss sharing among the partners. Second, capital can be contributed to cash as well as in assets. However, once an asset is contributed as capital that belongs to firm and contributing partner is relieved from the bar of risks and returns attached with ownership. Third, profit is distributed according to agreement of partnership however sleeping partner cannot claim share in profit more than his proportionate share in equity. None of the partner can guarantee the capital or profit share to any other partner (Sharia standard 12). Under Musharaka, IFIs are receiving deposits and finances business requirements for profit and loss sharing.

Mudaraba

Mudaraba is a type of partnership whereby skill and money brought together to conduct business. Profit is shared according to agreement while loss is born by capital provider only. Under this scheme of financing IFIs provide capital to financially weak but skilful people to do the business and share outcome with IFIs. This scheme is also used in deposit collection. Mudaraba contract can be restricted or unrestricted. No one can claim a lump sum amount of profit it must be based on actual outcome (Sharia standard 13).

3.5 Ijara Mode

Hire Purchase under Shirkatul Melk

Hire-Purchase under Shirkatul Melk has been developed through practice. Actually, it is a synthesis of three contracts: (a) Shirkat; (b) Ijarah, and (c) Sale. These may be defined as follows:

Definition of Shirkatul Melk: Shirkat' means partnership. Shirkatul Melk means share in ownership. When two or more persons supply equity, purchase an asset and own the same jointly, and share the benefit as per agreement, and loss in proportion to their respective equity, the contract is called Shirkatul Melk

Definition of Ijara: The term 'Ijara' has been defined as a contract between two parties, the lessor and the lessee, where the lessee enjoys or reaps a specific service or benefit against a specified consideration or rent from the asset owned by the lessor. It is a lease agreement under which a certain asset is leased out by the lessor or to a lessee against specific rent or rental for a fixed period.

Definition of Sale contract: This is a contract between a buyer and a seller under which the ownership of certain goods or asset is transferred by the seller to the buyer against agreed upon price paid by the buyer. In the case of Hire Purchase under Shirkatul Melk, the lessor bank sells or transfers its title to the asset under a sale contract on payment of sale price.

Thus in Hire Purchase under Shirkatul Melk mode, both the bank and the client supply equity in equal or unequal proportion for purchase of an asset like land, building, machinery, transports, etc., purchase the asset with that money, own the same jointly, share benefit as per agreement and bear the loss in proportion to their respective equity. The share/part or portion of the asset owned by the bank is leased out to the client partner for a fixed rent per unit of time for a fixed period. Lastly, the bank sells and transfers the ownership of its share to the client against payment of price fixed for that part either gradually part by part or as a whole within the lease.

Sector wise performance of investment in the year of 2014-2015 and 2018
(MillioninTaka)

Sector	2016		2015		2018
	Amount	% to total Investment	Amount	% In Total Investment	% In Total Investment
Industrial(Excluding portion of SME)	219377	35.59%	17291	32.4%	35.59%
Commercial	43873	7.12%	36854	6.93%	7.12%
Real Estate	74972	7.78%	44159	8.30%	7.78%
Agriculture	15425	2.50%	10638	2.00%	2.5%
Transport	7592	1.23%	7207	1.63%	1.23%
SME	244713	39.70%	229864	43.32%	39.70%
Other	37467	6.08%	28881	5.74%	6.08%
Total	616419	100.00%	530194	100.00%	100.00%

And the other information in terms of Mode
(MillioninTaka)

Mode	2016		2015		2018
	Amount	% to total Investment	Amount	% In Total Investment	% In Total Investment
Bai Murabaha	322176	60.00%	331239	62.48%	62.00%
HPSM	139567	22.64%	123856	23.36%	22.64%
Bai Muajjal	54387	8.82%	34818	6.57%	8.82%
Bill purchased & Negotiation	14204	2.30%	15004	2.83%	2.30%
Quard	14047	2.82%	14564	2.72%	2.28%
Bia Salam	6436	1.05%	5320	1.00%	1.05%
Mudaraba	5000	0.81%	5000	0.94%	0.81%
Musharaka	602	0.10%	530194	0.07%	0.10
Total	616419	100.00%	530194	100.00%	100.00%

IV. How Is Islamic Finance Different from Conventional Finance?

Similarities and Differences Islamic Financial Institutions (IFIs) are operating in the same society where conventional banks are operating and perform all those functions which are expected from a financial institution. IFIs are assisting business world by providing all the services required to run the economy smoothly, however, the philosophy and operations are different.

4.1 Financing and Investments

The second phase in savings mobilization process is extension of credit facility to business and industry for return. Both types of institutions (Islamic and Conventional) are providing financing to productive channels for reward. The difference lies in financing agreement. Conventional banks are offering loan for a fixed reward while IFIs cannot do that because they cannot charge interest. IFIs can charge profit on investments but not interest on loans. In conventional banking three types of loans are issued to clients including short term loans, overdrafts and long-term loans.

4.2 Overdrafts/Credit Cards etc.

Conventional banks offer the facility of overdrawing from account of the customer on interest. One of its form is use of credit card whereby limit of overdrawing for customer is set by the bank. As for facility of financing is concerned that is not offered by Islamic banks except in the form of Murabaha (which means IFI shall deliver the desired commodity and not the cash) however facility to shop/meet requirement is provided through debit card whereby a customer can use his card if his account carries credit balance. Under conventional banking a customer is charged with interest once the facility availed however under Murabaha only profit is due when the commodity is delivered to the customer.

4.3 Short term loans

Short term and mediumterm loans are provided to customer to meet working capital requirements of firm by conventional banks. As for inventory investment is concerned that is provided by Islamic banks through

Murabaha. Murabaha financing is asset based financing and anyone can request to an IFI for provision of an asset generally used for Halal (lawful) purposes. By default, under Islamic financial system IFIs cannot lend cash for interest (only exception is Qarz e Hasna-Charity loan). One of the features of Murabaha is in case of delay in payment by customer IFI cannot ask for extra amount as time value of money like conventional banks. However, penalty is imposed on defaulter if stipulated in original contract of Murabaha duly signed by the customer but same cannot be included in the income of IFI. This penalty must be spent for charitable purposes. Although Murabaha is being used by IFIs successfully and have succeeded in meeting short to medium term requirements of firms by providing a successful replacement of conventional loans yet certain differences exist in both type of financing.

4.4 Leasing

Leasing is relatively recent source of financing whereby usufruct of an asset is transferred to lessee for agreed amounts of rentals. Same facility is provided by IFIs under agreement of Ijara. All ownership risks are born by IFIs during Ijara tenure. First is rental under Ijara are not due until asset is delivered to the lessee for use. Second additional rent cannot be demanded in case of default except a penalty (if stipulated in original contract of lease) which is not the income of IFI.

4.5 Agricultural Loans

Agricultural loans include both types of loans short-term as well as long-term. Short-term loans are required by farmers for seeds and fertilizers and long-term loans are required to develop additional lands and purchase of equipments. Conventional banks are providing credit facility by charging interest. Same facility is provided by IFIs to the farmers under Bai Slam, Bai Murabaha Musharaka and Mudaraba (discussed in appendix B). Under Bai Salam cash is provided to farmers for purchase of seeds and fertilizers however this is not loan rather purchase of finished crops to be delivered by farmers.

4.6 House financing

Housing finance/Mortgages is the more secured form of financing for both conventional banks and IFIs. Under conventional system loan is provided for interest while under Islamic financial system facility is provided through diminishing Musharaka. Under diminishing Musharaka house is purchased jointly by IFI and customer. IFI rents out its share in property to customer for an agreed amount of rent. Share of financier is divided in units of small denomination. Customer pays the installments to IFI consist of rentals plus purchase price of a unit. Stake of customer in property is increasing while of IFI is decreasing with payment of every installment. Finally, with the payment of last installment stake of IFI reaches to zero and property is transferred in the name of customer.

V. Prospects of Investment or Loan facilities in Bangladesh

The banking industry in Bangladesh has even gone a step further by promoting financial inclusion of the modern and client oriented investment of loan facilities in the last 10 years. This has helped to expand the monetization of the rural economy, and consequently it has become more market oriented. A capital-friendly legal bias is quite evident in market oriented economies in both developed and developing economies. Bangladesh banking system is now face with a slow-motion banking crisis principally at the government-run banks along with some private banks sector. Of the 30 listed banks, 24 witnessed profit growth, five saw profit fall and one registered losses in the January-June period of this year compared with that in the same period of the previous year and 21 banks witnessed profit growth in the January-March, 2019 quarter while nine banks saw profit fall, according to the un-audited financial statements of the banks. Due to the high interest rate, the banks' interest income surged in the period of January-June this year. Remittance inflow hit record \$16.4 billion in the immediate past fiscal year 2018-2019, which was 9.48 per cent or \$1.42 billion higher than the amount received in FY18, \$14.98 billion.

Name of the Bank	Profit in Crore		Previous Year Income
	2018	2019	
Exim Bank	61.3%	79.47%	18.17%
IFIC Bank		91.65%	
Trust Bank		48.51%	
First Security Islami Bank		46.5%	
AB Bank	61.60%	18.37%	11.45%
ICB Bank	19.43%	20.57%	Same

Due to the high interest rate, the banks' interest income surged in the period of January-June this year. Remittance inflow hit record \$16.4 billion in the immediate past fiscal year 2018-2019, which was 9.48 per cent or \$1.42 billion higher than the amount received in FY18, \$14.98 billion. The other four banks that saw a decline in their profits were Rupali Bank (21.26 per cent), National Bank (16.89 per cent), BRAC Bank (12.04 per cent) and Standard Bank (7.01 per cent). ICB Islamic Bank was the only bank that incurred losses in the first half of this year. ICB Islamic Bank has been incurring losses for years. The entity showed Tk 19.43 crore in losses in the January-June period against losses of Tk 20.57 crore in the same period of 2018.

VI. Methodology

The purpose of this study is to evaluate and compare the investment system of Islamic Banks, Conventional banks, and State-owned commercial banks in Bangladesh. 5 listed Islamic banks and 5 Conventional banks have been selected to conduct the research to analyze their investment policy in this regard. While conducting the study, the types of loans provided by Islamic and Conventional Banks and the way they are provided have been focused. The data for this study have been taken from the banks' annual statements existing on the banks' websites. In addition, another source of data was through references to the library and the review of different articles, papers, and relevant previous studies and board meeting of the Banks. This study uses a comparative analysis to describe and measure, evaluate and state the information of investment or loan facilities of State-owned commercial banks as well as applied an econometric multivariate regression model to test the significance of variables on performance of State-owned commercial banks of Bangladesh.

VII. Conclusion

The main source of profit of bank is granting loans to any individual or organization. Investment is a profitable and sound source of income. At present, Bangladesh has a mixed banking system comprising nationalized, private, and foreign commercial banks. Bangladesh Bank is the central bank of the country and oversees monetary policies of the Government and all commercial banks. In this study, investment procedure and investment mode, and method of state-owned commercial banks in Bangladesh are analyzed based on their principal whether it is Islamic or Conventional. Conventional banks provide different type of loans at a fixed interest rate which is the price of using the money for a specified period of time paid by the borrower to banker.

On the other hand, Islamic Banks invest their money following different mechanisms like Murabaha, Musharaka, Mudarabah, Bai-Muajjal, Bai-Salam, etc. to avoid fixed interest. In Islamic banking investment mechanisms, the Islamic financial relationships between investor and borrower are of a participatory in nature (Ahmad, 1993). Though Bangladesh is the third largest Muslim country in the world with around 135 million populations of which 90 percent are Muslim. The hope and aspiration of the people to run banking system on the basis of Islamic principle, for this reason Islamic banking industry continued to show strong growth in 2005 in tandem with the growth in the economy, as reflected in the increased market share of the Islamic banking industry in terms of assets, financing, and deposits of the total banking system. Total investment of the Islamic banks and the Islamic banking branches of the conventional banks stood at Taka 184547.2 million at the end of September, 2005. This was 31.4% of all private banks and 15.1% of the total banking system of the country but this scenario is change with an amazing rate with double in the next some continuous year.

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