

## The Role of Islamic Banking in the Rural Development of Bangladesh


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Islamic banking has become a key factor in the rural development of Bangladesh, providing financial services that address the needs of underserved populations in rural regions. This paper examines the role of Islamic banking in advancing rural development in Bangladesh, focusing on its potential to improve financial inclusion, boost agricultural productivity, and reduce poverty in rural regions. It also addresses the challenges Islamic banks face when trying to serve rural populations and provides recommendations for enhancing the impact of Islamic banking in fostering sustainable rural development. Through this analysis, the paper aims to demonstrate how Islamic banking can serve as a powerful tool in empowering rural communities and driving economic growth in Bangladesh. Despite challenges like limited awareness and banking infrastructure, the expansion of Islamic banking holds considerable potential for fostering sustainable rural development in Bangladesh.

**Keywords:** islamic banking, rural development, financial inclusion, poverty alleviation, microfinance, agricultural financing

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## 1. Introduction

Islamic banking has emerged as a key driver of financial inclusion and rural development in Bangladesh, a nation where agriculture continues to be the primary source of livelihood for most of its population. It operates in accordance with Shariah law, differs from conventional banking by prohibiting the charging of interest (riba) and promoting ethical financial practices, such as profit-sharing, risk-sharing, and equity-based financing.

Rural Bangladesh faces numerous socio-economic challenges, including high poverty rates, limited access to financial services, inadequate infrastructure, and an over-reliance on agriculture, which is vulnerable to market fluctuations and climate change. In countries like Bangladesh, where a significant portion of the population lives in rural areas and relies heavily on agriculture for their livelihood, Islamic banking plays a vital role in supporting rural development.

The growth of Islamic banking in Bangladesh has been accompanied by a shift towards more inclusive financial services, especially through microfinance and agricultural financing. Islamic banks have customized their offerings to meet the needs of rural communities, providing qard hasan (interest-free investment) for basic necessities, mudarabah (profit-sharing) for small businesses, and musharakah (joint ventures) for agricultural projects. These efforts have resulted in enhanced economic activity, better livelihoods, and a reduction in poverty across many rural areas.

## 2. Objective of the Study

The objectives of this study are to:

1. Explore the expansion of full-fledged Islamic banking branches in rural areas.
2. Explore the contribution of Islamic banking to rural development in Bangladesh.
3. Analyze how Islamic banking products address the financial needs of rural communities, especially within the agricultural sector.
4. Evaluate the effects of Islamic banking on financial inclusion, poverty reduction, economic growth and job creation of rural areas.
5. Propose suggestions for improving the role of Islamic banking in advancing rural development in Bangladesh.

## 3. Literature Review

Islamic banking has attracted growing attention as a tool for enhancing financial inclusion and supporting rural development in Bangladesh. This literature review explores existing research on the role of Islamic banking in rural Bangladesh, with a focus on its potential to improve financial inclusion, alleviate poverty, and address the challenges hindering its adoption.

Ahmed (2017) argues that Islamic banking is built on fairness and equity, offering a financial system that can be especially beneficial for rural areas where access to financial services is often limited. In rural Bangladesh, where most people are engaged in agriculture, access to capital is scarce, and farmers frequently turn to informal credit sources that impose high interest rates, making it hard for them to break free from cycles of debt. Islamic banking provides an alternative through models like Mudarabah (profit-sharing) and Musharakah (joint ventures), which enable rural farmers to obtain funding without the burden of interest (Karim & Khan, 2020).

Additionally, Islamic finance includes products such as Murabaha, where banks buy goods and sell them to customers at a higher price, helping rural communities access essential goods and services without resorting to interest-based loans. These ethical financial practices make Islamic banking a promising solution for rural Bangladesh, especially given the socio-economic challenges and financial exclusion faced by these communities (Hasan, 2019).

Islamic banking plays a crucial role in promoting financial inclusion and reducing poverty in Bangladesh, where a large portion of the rural population lacks access to formal financial services. According to Bangladesh Bank (2020), only a small fraction of rural households are connected to traditional banking systems. The inclusive nature of Islamic banking, with products tailored to low-income and rural communities, has the potential to bridge this gap. Similar to successful microfinance programs implemented by Islamic banks in countries like Malaysia and Indonesia, Bangladesh could adopt these models to foster financial inclusion and support poverty reduction efforts (Ariff, 2020).

By offering Shariah-compliant microfinance products, Islamic banks can provide small loans to farmers and rural entrepreneurs, which are essential for boosting agricultural productivity and supporting local businesses. Additionally, the concept of Zakat can be utilized to fund social welfare initiatives, offering extra assistance to those in need (Siddiqui, 2018).

Despite the significant potential of Islamic banking, there are several obstacles to its widespread adoption in rural Bangladesh. A key challenge is the lack of awareness and understanding of Islamic banking products among rural communities. Many people are unfamiliar with the principles of Islamic finance and may hold misconceptions about how it works. As Nisar and Khan (2021) point out, this lack of understanding can create reluctance to engage with Islamic financial institutions, slowing down its adoption in these areas.

Another major issue is the limited banking infrastructure in rural regions. Most Islamic banks are concentrated in urban areas, leaving rural populations underserved. Consequently, people in rural areas often lack access to basic banking services, such as savings accounts, loans, and mobile banking (Hasan, 2019).

Additionally, the social and cultural acceptance of Islamic banking varies across different regions. While Islamic finance aligns with the religious values of many rural people, there are still misconceptions about how well it fits with rural development. Nisar and Khan (2021) suggest that cultural perceptions and a lack of trust in new financial systems can prevent the adoption of Islamic banking, even when its benefits are clear.

## 4. Methodology

This study takes a qualitative approach to explore the role of Islamic banking in promoting rural development in Bangladesh. Secondary data will be gathered from a variety of sources, such as central bank (Bangladesh bank), academic papers, reports from Islamic banks, and different publications from both government and non-governmental organizations involved in rural development initiatives. The collected data will be analyzed to uncover patterns, challenges, and opportunities in the implementation of Islamic banking in rural area of Bangladesh.

To highlight the impact of Islamic banking in rural Bangladesh, the study will present tables and graphs that summarize key data, including the number of rural branches, accounts with Islamic banks, agents outlets, the volume of investment to rural businesses to change in income and poverty levels of rural people.

## 5. Findings

### 5.1 Number of Full-fledged Islamic Banks Branches

For comparison of the number of full-fledged Islamic banks, data from 2016, 2018, and 2020 have been used. At the end of the December 2016, the total number of full-fledged Islamic banking branches reached 1047 in where rural branches were 418. Details of the branch distribution are presented in Table-1.

Number of Bank Branches December 2016		
Full-fledged Islamic Banks	Urban	Rural
Islami Bank Bangladesh Limited	224	94
ICB Islamic Bank Limited	28	5
Social Islami Bank Limited	67	58
Al-Arafah Islami Bank Limited	71	69
EXIM Bank Limited	63	50
Shahjalal Islami Bank Limited	65	38
First Security Islami Bank Limited	82	76
Union Bank Limited	29	28
Total	629	418

**Table 1:** Source: Bangladesh Bank 2016

At the end of the December 2018, the total number of full-fledged Islamic banking branches reached 1197 in where rural branches were 504. Details of the branch distribution are presented in Table-2.

Number of Bank Branches December 2018		
Full-fledged Islamic Banks	Urban	Rural
Islami Bank Bangladesh Limited*	218	124
ICB Islamic Bank Limited	28	5
Social Islami Bank Limited*	83	72
Al-Arafah Islami Bank Limited	88	80
EXIM Bank Limited	76	47
Shahjalal Islami Bank Limited	70	52
First Security Islami Bank Limited	91	86
Union Bank Limited	39	38
Total	693	504

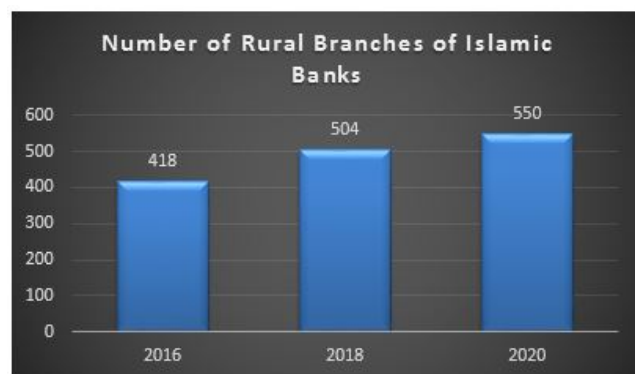
**Table 2:** Source: Bangladesh Bank 2018

At the end of 2020, the total number of full-fledged Islamic banking branches reached 1311 in where rural branches were 550. Details of the branch distribution are presented in Table-3.

Number of Bank Branches December 2020		
Full-fledged Islamic Banks	Urban	Rural
Islami Bank Bangladesh Limited	247	126
ICB Islamic Bank Limited	32	1
Social Islami Bank Limited	88	80
Al-Arafah Islami Bank Limited	96	88
EXIM Bank Limited	71	60
Shahjalal Islami Bank Limited	71	61
First Security Islami Bank Limited	109	86
Union Bank Limited	47	48
Total	761	550

**Table 3:** Source: Bangladesh Bank 2020

From the figure below, we can draw a conclusion about the number of rural branches of Islamic banks. In 2016, Islamic banks had 418 rural branches. By the end of December 2018, this number had increased to 504 — a rise of 86 branches over two years and the number reached 550 at the end of December 2020. This is a positive sign, as the growth in rural branches indicates greater financial inclusion for rural communities.



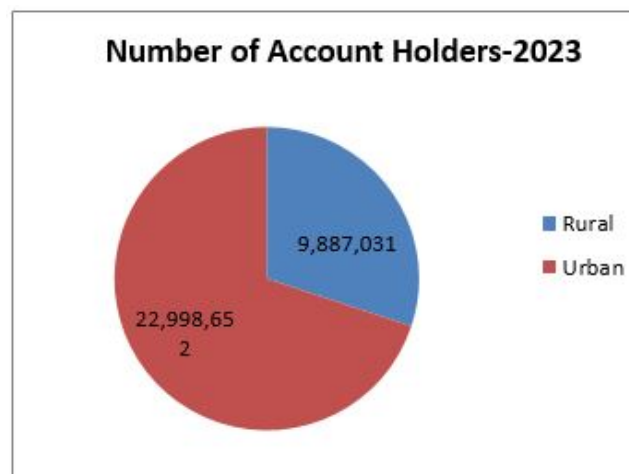
## 5.2 Poverty Alleviation

Islamic microfinance institutions such as Islami Bank Bangladesh Limited (IBBL) and Social Islami Bank Limited (SIBL) have contributed to an 8-10% reduction in rural poverty in districts with high levels of Islamic banking activity (Hossain & Khan, 2018). Interest-free loans (Qard-al-Hasan) have played a vital role, supporting 35% of rural borrowers engaged in agriculture and small enterprises (Karim et al., 2019). According to a World Bank report (2022), Islamic microfinance demonstrates a lower loan default rate of 5%, compared to 12% in conventional microfinance, largely due to its ethical and moral repayment framework.

## 5.3 Financial Inclusion

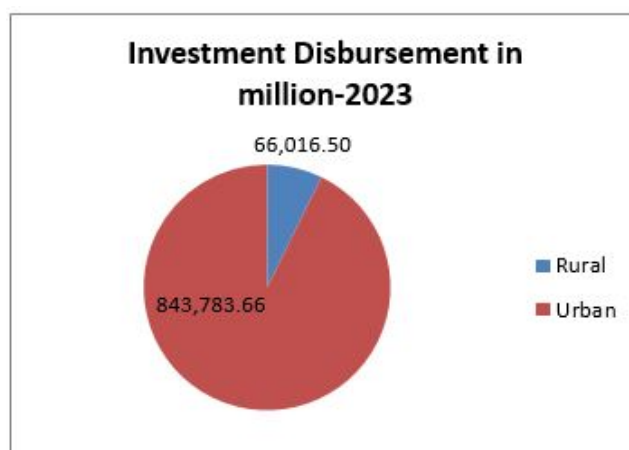
Financial inclusion is critical for economic development, particularly in rural areas where access to banking services is often limited. According to the *Bangladesh Bank* (2020), about 75% of rural households were unbanked until the early 2000s. However, with the growth of Islamic banking, there has been a notable improvement in financial inclusion.

### 5.3.1 Account Holders



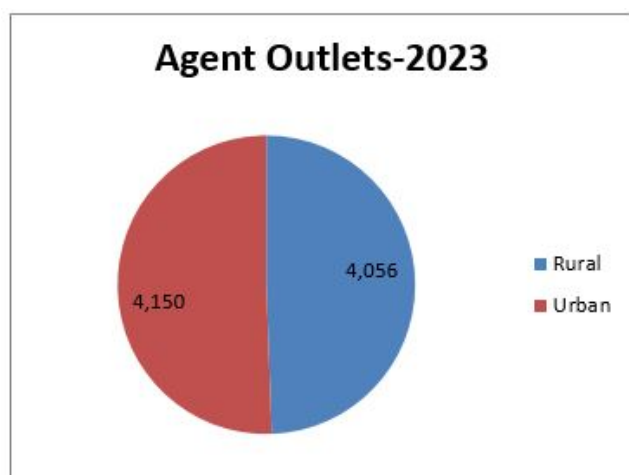
Bangladesh Bank (2023) mentions its Financial Inclusion Report that the total number of Islamic bank account holders reached 32,885,683 in 2023, with 9,887,031 of them coming from rural areas. This means that approximately 31% of Islamic bank account holders are based in rural regions.

### 5.3.2 Loan Disbursement



Bangladesh Bank (2023) mentions its Financial Inclusion Report that the total investment of Islamic banks reached BDT 909,800.16 million in 2023, in where BDT 66,016.50 million was invested to rural areas.

### 5.3.3 Agent Outlets



Total numbers of Islamic banks' agent outlets were 8206 in 2023, with 4056 of them coming from rural areas. This means that approximately 49% of agent outlets are based in rural regions.

### 5.4 Agricultural Sector Investment

The Islamic banking system has played a significant role in various sub-sectors of Agri (agricultural) and rural investment programs. At the end of December 2022 period, investments in the agricultural sector by Islamic banks amounted to BDT 20.03 billion. This figure was slightly lower by BDT 0.16 billion than the same time of the previous year. At December 2020 period, investments in the agricultural sector by the Islamic banking sector totaled BDT 12.13 billion. This amount was BDT 1.09 billion higher than the same time of the previous year. So, if we compare the total disbursement of investment of Agricultural sector from 2019 to 2022, BDT 8.99 billion has been increased. A summary of agricultural sector investments under the Islamic banking framework is presented in Table-4

(BDT in Billion)

Year	Investment Target	Actual Disbursement	Target Achieved
2022	21.45	20.03	93.4%
2021	18.19	20.19	110.99%
2020	11.26	12.13	107.71%
2019	15.40	11.04	71.73%

**Table 4:** source: Bangladesh 2022, 2018

### 5.5 Infrastructure Support

**Zakat and Sadaqah Programs:** Islamic banks frequently implement social welfare programs,

funded by Zakat and Sadaqah, focusing on improving healthcare, education, and sanitation in rural communities.

**Mobile and Agent Banking Services:** To enhance financial inclusion in remote areas, several Islamic banks have collaborated with mobile banking platforms and introduced agent banking services, thereby extending their outreach to underserved rural populations.

**Partnerships for Development:** Islamic banks utilize Mudarabah and Musharakah contracts to fund infrastructure projects, frequently collaborating with local governments or development organizations. These contracts facilitate the mobilization of funds for large-scale projects that benefit entire communities, including the development of rural marketplaces, road networks, and irrigation systems. Such infrastructure improvements increase market access, lower transportation costs, and boost agricultural productivity, ultimately creating more employment opportunities in rural areas.

The Islamic Development Bank Report (2018) stated that more than \$100 million in sukuk financing was directed toward rural infrastructure projects in Bangladesh. These initiatives have enhanced road connectivity, water supply, and access to energy in rural areas, which are essential for driving economic development.

### 5.6 Entrepreneurship Among Youth and Women

Islamic banks have placed a significant emphasis on fostering entrepreneurship among both youth and women in rural areas. Programs aimed at supporting women entrepreneurs provide them with the financial resources needed to establish small businesses. For instance, the Islami Bank Foundation offers financial products specifically designed to empower women in rural regions, enabling them to launch ventures in sectors such as agriculture, handicrafts, and small-scale industries.

According to the World Bank (2022), the emphasis on women's empowerment through Islamic microfinance has played a key role in reducing gender inequality and increasing women's participation in the rural economy. Women's involvement in economic activities not only creates income-generating opportunities but also contributes to the broader social and economic development of rural communities.

### 5.7 Job Creation

Islamic banking has played a significant role in job creation in rural Bangladesh by providing financing for agricultural initiatives, small businesses, and infrastructure projects. This has helped reduce unemployment and underemployment in rural areas, contributing to their overall economic growth.

The World Bank (2015) estimated that Islamic banking in Bangladesh generated over 100,000 direct and indirect jobs in rural areas through the financing of agricultural and small business ventures.

Ahamed and Khan (2016) reported that the support provided by Islamic banks to rural businesses in Bangladesh resulted in the creation of more than 50,000 jobs, particularly in agriculture and small-scale manufacturing industries.

## 6. Suggestions

The cultural and social acceptance of Islamic banking varies, and misconceptions about its compatibility with rural development still persist (Nisar & Khan, 2021). Several measures can be implemented to overcome obstacles and address the challenges-

- A major hurdle to the adoption of Islamic banking in rural Bangladesh is the lack of awareness about Islamic financial products. Banks should invest in awareness campaigns and financial literacy initiatives to educate rural communities on the benefits of Islamic banking.
- Islamic banks should partner with the government and NGOs to implement rural development programs. These collaborations can help enhance infrastructure, improve access to banking services, and strengthen the impact of Islamic finance on rural communities.
- Mobile banking and digital financial services should be utilized to bring Islamic banking products to rural areas. Digital platforms can help overcome geographical barriers and provide banking services to remote regions.
- Islamic banks should design financial products tailored to the specific needs of rural populations. This could include micro financing for farmers, seasonal investments with flexible repayment terms, and funding for agricultural infrastructure development.

- Training programs should be established to equip bankers with the necessary skills to effectively serve rural clients. This would enhance the overall efficiency of Islamic banking in rural areas.

## 7. Conclusion

In Bangladesh, Islamic banking has emerged as a key component of financial sector, providing Shariah-compliant solutions that resonate with the religious and ethical principles of a significant segment of the population. Since its introduction in the early 1980s, the industry has experienced remarkable growth in areas such as deposits, investments, remittances, and market share. By offering innovative financial instruments like Murabaha, Mudaraba, Islamic banks have significantly advanced financial inclusion, supported small and medium enterprises (SMEs), created job opportunity and contributed to poverty alleviation. Besides, The Islamic banking system has played a significant role in various sub-sectors of agricultural and rural investment programs. Different financial products specifically designed to empower women in rural regions, enabling them to launch ventures in sectors such as agriculture, handicrafts, and small-scale industries.

At last, it can be said that Islamic banking plays a crucial role in the socio-economic transformation of rural Bangladesh. By providing inclusive financial services and emphasizing ethical finance, Islamic banks have made significant contributions to rural development. Looking ahead, it is important for Islamic banking to keep evolving and responding to the needs of rural communities to support sustainable development in rural areas of Bangladesh.

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