

their experiences with the bank. I found that most of them could not differentiate between Islamic Banking System and conventional banking system. For secondary data, library-based research has been done for several months. A number of written materials on Islamic banking and finance have been read. Major references I read through in this research were *Malaysian Business* which frequently published articles related to Islamic Banking and Finance, *Corporate World* which reported issues in banking industry in the country annually, Bank Negara's (Central Bank) Annual Reports, Bank Islam Malaysia's Annual Reports which were the basic sources of secondary data. Of course, there were also other publications on Islamic Banking and Finance written by current leading scholars in the field and they provided me firm foundations to understand the issues on Islamic Banking System comprehensively.

5. Historical Background

5.1 Establishment and Objectives

There was a resurgence of Islamic fervour and calls for Islamic banking since the 1970s. In the early 1980s, the Malaysian government set up a steering committee to study the viability of Islamic banking in Malaysia context and how it should be developed as Malaysian Muslims, like their counterparts elsewhere in the world, had had the desire to practise Islamic Shariah in the field of banking and finance for a long time. This desire was reinforced in the beginning of 1970s by establishment of

a number of Islamic banks in the Muslim world, for example, Islamic Development Bank was established in Jeddah in 1974, Islamic Bank of Dubai which was the first Islamic commercial bank established in 1975. These events led the country into the reality of practising Islamic banking and finance according to Shariah principles in 1983.

There were two organisations, namely Tabung Haji (National Haji Foundation) and PERKIM (Malaysia Muslim Welfare Organisation), which had played the initiative roles in the process of forming Islamic bank in Malaysia according to the bank's introduction. A number of private organisations and individuals also joined the team in the later phases.

Consequently, the Prime Minister of Malaysia appointed a National Steering Committee on Islamic Bank on 30th July 1980. The Committee submitted a report with the suggestion on how an Islamic Bank should be developed on 5th July, 1981. The report was approved by the Government of Malaysia consequently the Committee drafted the following suggestions and policies:

- (i) An Islamic bank, which operates according to Islamic Shariah Principles, should be established.
- (ii) The bank should be incorporated as a limited liability company under the Companies Act, 1965
- (iii) The Islamic Banking Act should be legislated and

relevant existing Acts should be amended.

- (iv) Bank Negara Malaysia (Central Bank) should be the administrator of the Islamic Banking Act.
- (v) The Bank should set up a Religious Supervisory Council to supervise the its operations under Shariah principle.

5.2 Legal Frame of its Operation

After the government accepted the above Steering Committee's report, the Parliament and the Senate passed the Islamic Banking Act in the end of 1982. The Act was formally announced and gazetted in 1983. Hence, Malaysia's first Islamic bank was officially established.

The bank was registered as a limited liability company under the Companies Act 1965 on 1st March 1983. Its full name is Bank Islam Malaysia Berhad (BIMB) or Islamic Bank (M) Limited and its registered location was at Menara Tun Razak, Jalan Raja Laut, 50734 Kuala Lumpur.

5.3 Its Shareholders

The Bank's 1996 Annual Report stated that its authorised capital was RM 500 million, which was divided into 499,999,999 ordinary shares of RM1.00 per share and RM1.00 golden share which was held by the Ministry of Finance, Malaysia and which has special redeemable power. If anything goes wrong within the bank or hostile taken-over by outside parties, the Ministry will come to intervene and make sure that the bank

would not lose its established direction, mission and operate successfully according Islamic Shariah principles. (Bank Islam Malaysia 1995).

The current paid-up capital as at June 1996 was RM 133.405 million and the major shareholders are given in Appendix A.

We can see from the list in Appendix A that the Bank's shares are held by institutions instead of individuals. What does that mean? It means that the bank's shares have a steady following and will not move up and down according market demand and supply. Its paid up capital is also very small and its share price seldom falls below a certain level. At the time of writing this paper its shares were traded at RM7.35 per share on Kuala Lumpur Stock Exchange. If we say that the bank share prices are fixed, then a question would arise as who will find the bank's share attractive?

5.4 Its Board of Directors

Past records show that either Muslim scholars or academicians normally held the positions of Board of Directors (see Appendix B). They are from various educational organisations, such as mosques, societies or universities. This Board structure, in my opinion, may make the Islamic bank more conservative, as its directors were too scholastic and less operational or practical experience in real world of business. However, only the scholastic directors can ensure that the bank will operate under

the principles of Shariah and work in the best interest of its Muslim customers. The challenge is how to maintain aggressive growth and yet adhere the Shariah principles and make profits for its shareholders.

5.5 Supervisory Council

The bank has set up a Religious Supervisory Council (see Appendix C) to ensure its operations in respect of compliance with the rules of Shariah.

The Religious Supervisory Council, whose members were made up of Muslim scholars in the country, is established to advise the company on the operations of its banking business.

The Religious Supervisory Council has a minimum of three and maximum of seven members whose appointment must be acceptable to the Ministry of Finance for a term not exceeding two years and each member is eligible for reappointment.

The establishment of the council is necessary and to ensure that the bank operates on the ground of Shariah, without such council approval, the Ministry of Finance, the Central Bank will not allow the bank to operate.

5.6 Its Organisation Structure

The bank's organisational structure consists of three divisions: Retail Banking, Account and Legal & Corporate Secretarial. There are three other sub-divisions in the organisation. They are Human Resources, Corporate Banking and Treasury and International Banking Department (see Appendix D).

5.7 Its Branches

Currently, the bank has 73 branches nation-wide besides its headquarters located in Kuala Lumpur.

Table 1 shows its branch numbers and growth rate. The level of growth in numbers is very encouraging and significant. The growth rate of branches would not be only interested by its Muslim customers and shareholders as it would give them confidence about the bank, but also the Non-Muslims and the whole world Muslim communities too, as they are watching on how the bank is performing in the industry. A steady growth in number of branches shows that the bank is getting popular and support from the Muslim communities. Opening a branch in a particular location could reflect with the increasing demand and number of Muslim customers or institutions. From this point, the bank can be considered as healthy in the market.

Table 1 Branch Numbers and Growth Rates

Year 19xx	"86	"87	"88	"89	"90	"91	"92	"93	"94	"95	"96
Branches*	14	18	21	24	27	29	32	45	58	70	73
Growth Rate		28%	16%	14%	13%	7%	10%	40%	28%	20%	4%

**Branches are cumulative in numbers annually*

Source: BIMB Annual Reports 1986-1996

However, one should not be blinded by the numbers and growth rates of branches, as the numbers of branches and growth rates are influenced by various factors such as market size and market power. The Market size consists of a number of factors such as the population of potential customers who need Islamic Banking services in a particular location and general income level of customers in that particular location. The market size determines the size of an Islamic banking system, and it can not grow significantly in a short period, hence it limits the expansion of the system. In the early period, Bank Islam Malaysia had some privileges in providing Islamic banking services over conventional banks which were yet ready to provide the services, hence Bank Islam Malaysia had some kind of monopoly powers to set up branches nation-wide easily. And this special power was eliminated after the Central Bank liberalising its banking industry in setting individual bank's deposit rate and allowing conventional banks to offer Islamic services in the early 1990s. The immediate impact of the liberalisation on Bank Islam Malaysia clearly reflected after the 1995, the growth rate declined from 20% in 1995 to 4%