Islamic banks in the United Kingdom

- Growth in the 21st century
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1. Introduction

Islamic finance is growing across the globe. At an estimated 15% increase in assets every year, it outpaced the growth of traditional banks. And yet Islamic finance is still in its infancy – suffering from difficulties integrating into western economy as well as developing new instruments to compete with old – assets of Islamic financial institutions are estimated at £250billion globally\(^1\).

Islamic finance is not just limited to the Islamic world – significant markets now exist in the USA and the United Kingdom. In anticipation of the estimated growth of Islamic finance -and the challenges it would bring for the UK regulatory system - the Financial Services Authority (FSA) in the United Kingdom began preliminary work on the subject in 2002. Their early efforts to attract the growing market to the United Kingdom bore fruit and today London is considered as on the path of becoming the western centre of Islamic finance - a “gateway” according to the FSA managing director of retail markets, who went on to state that the “the potential for the growth of Islamic finance is clear”. As of May 2008, the United Kingdom is still the only nation in Europe to have licensed Islamic banks.\(^2\)

In addition to traditional banks offering Islamic financial services such as HSBC Amanah offering “Islamic window”(a separate Islamic service with separate accounts)\(^3\), new independent sharia’a-compliant Islamic banks are opening based in the United Kingdom that are only performing business that is considered as Islamic finance. Between 2004 and 2007, three new Islamic banks opened in the United Kingdom, aimed both at the retail and wholesale market. Are they growing?

1.1 Aim

The aim of the due paper will be to analyze Islamic banks in the United Kingdom. Specifically, one question will be asked and answered: How much have the Islamic banks in the United Kingdom grown? Note that the question is assuming that there are firms operating as Islamic banks in the United Kingdom, and that they are in fact growing, as this has already been established by previous research and from early findings by myself.

1.2 Delimitations

The major delimitation will be the time period the due paper will cover. Islamic banking only

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\(^3\) “Islamic Finance and the FSA”, FSA (2002).
appeared some 30 years ago on the world market, and the first wholly Islamic bank was not established in the United Kingdom until 2004. Thus, the paper is limited to dealing with Islamic banks in the United Kingdom in the 21st century – more precisely the years 2003 to 2007. The reader should also, at this point, take particular notice of the use of the phrase “Islamic banks” and note that it is different from Islamic finance (see Definitions below for further information). With these definitions, the reader should observe that I am researching a part of Islamic finance in the United Kingdom, but it will not give a complete picture of Islamic finance in the United Kingdom, just the growth of the British Islamic banks, who only pursue this method of operations.

1.3 Methodology

As the aim of the due paper have already been stated, the next question will be how to answer it. In order to measure growth of something, one must be able to measure its size. How is the size of a bank measured? There are several answers to this question. The revenue of the company can be measured. We can also look at the number of employees the company employs, or how much assets the company govern. Another perspective can be had from the market, if the stock of the company is traded in public. Ownership equity in the company can also be analysed. In order to gain as good a view as possible of the growth of this niche in banking industry, all of these measurements will be used, because none is perfect but together they will give the best possible view of the growth of the Islamic banks – each view will add something to a greater whole. The approach will be largely statistical, and presented in a thematic manner. There may also be additional information available, for example the number of branch offices set up by a company, which will further widen our understanding of the growth of Islamic banks. It is of some importance to note that the performance of the banks is not being measured, which would include measurements such as return on equity, return on assets, productivity per employee and so on.

In economic history, measuring the size of a company has always been a difficult task. It has nevertheless been necessary to do so, in order to follow trends in what is called “big business” - the largest corporations, by one definition. In his book “Big Business – the European Experience in the Twentieth Century” Youssef Cassis sums up the many available tools to measure company size; turnover (referring to revenue), paid-up capital, market value, total assets and workforce. But he continues - “None is perfect”. Cassis then discards some of the measurements because he lacks the data.4 Fortunately for the purposes of this paper, much of the data Cassis lacked for his subject, is available for our subject.

To measure the size of a company and how it changes over time, the following tools will be

4 Cassis (1999), p. 6-8.
utilized:

1) The number of employees. Measuring employees is usually frowned upon when comparing companies between industries because they often require different relative amounts of labour or capital. However, in this case, it is an important measurement to consider because the companies are relatively (but not entirely) similar in the same industry. Examining the number of employees, even so, tells us nothing about productivity or the amount of business that is conducted. For this paper, there is furthermore no information about different salaries or what kind of work the employees working at the company are doing. For this reason, the staff cost will be displayed as well (wages, salaries, pension contributions and incentive payments for the staff – excluding social security costs, recruitment costs, sharia’a supervisory board costs, directors salaries and pension contributions, and other staff costs). Unfortunately, the staff cost cannot readily be averaged per month per employee, because the statistics available on employees is sparse. Another thing to remember is that the data available measures the employees hired by the company, and thus it does not give a good estimate of the total number of people involved in the business – in particular information about outsourced services (which may range from cleaning services to financial advice) is lacking.

2) The assets. The assets of a company includes all the cash it has, all the equipment and property, and all the funds currently financing transactions or similar (for a traditional bank, the counterpart of that would be “money borrowed to others”). In short, assets measure the resources of a business entity. Measuring assets may not be entirely accurate though. The properties and equipment are not written down at today's market value (rather they maintain the value of the cost of purchase minus depreciation over time). In addition, for banks, prepayments (payments before delivery of service), accrued income (services sold but not paid for) and recoverable value added tax add more obstacles. Furthermore, measuring only assets tells us nothing about the value of intellectual property rights such as brand equity owned by the company, or employee loyalty and so forth (which may hold a value in itself).

3) Ownership equity\textsuperscript{5}. The ownership equity in a company represents the paid in capital modified for subsequent profits or deficits as well as dividends and new shares issued. Ownership equity may be a good measurement of company size because the ownership equity is the direct amount of what the owners have invested in the company. Thus, any additional funds invested, obtained from deposits from customers or other banks, can be

\textsuperscript{5} Also known as shareholders' equity, stockholder's equity, shareholders' funds, shareholders' capital employed.
dismissed – which is of particular interest in the case of banking. Ownership equity, ultimately, must carry the weight of the entire company's operations. But, while ownership equity tells us how much capital is employed from investors, it does not tell us whether or not any actual business is being performed (which may be of interest when measuring company size). It may for example be a holding company, which only serves to own shares of other companies.

4) Market value. Another measurement of a company's size is its market value – the value of the company's share multiplied by the total number of shares. Unlike measuring assets, it has the advantage of containing anything, including predictions of future results. Yet, that can also be considered a disadvantage. The market value of a company can fluctuate depending on the current economic situation. Thus, the market value of a company can decrease or increase regardless of changes in the company. Nevertheless, it is the best estimate of the actual worth of a company. Market value, of course, does not equal size – but it can be used as an indicator of size. Another phrase for market value is market capitalization (or “market cap”) that can be used to divide companies into categories of different size, primarily used to let investors separate between high-risk (low market cap) and low-risk (high market cap).6

5) Turnover (revenue). How much revenues a company is producing may tell us something about its size. As companies increase in size, both revenues and costs tend to go up. Revenues also fluctuate depending on market demand, the company's ability to supply the demand and the introduction of new products. For the purposes of this paper, revenues equal total operating income (or gross revenue).

6) Additional statistics. In addition to these primary five tools, additional information will be gathered where possible. For retail banks, for example, information about deposits may be available, as well as the number of customers or the number of branch offices the company has.

7) Review. This section will be for general comments about the growth of the company. What are the numbers telling us?

To conclude the the analysis of the growth of Islamic banks in the United Kingdom, the numbers from the individual companies will be added together. This will create the final overview of the growth of a niche industry.

A primary source of information regarding the growth of Islamic banks is available from financial reports from the banks in question. However, financial reports cannot automatically be trusted. The FSA demands a statutory audit of financial reports performed by the company in question, and they are usually audited by independent sources as well. However, there is no proof available that this has taken place in this particular case. Rather than assuming that the financial reports have in fact been audited in a truthful manner, and because it is beyond the reach of this paper to determine if they have been, it can instead be said that this paper stands and falls on the authenticity of the financial reports from the companies. From a statistical standpoint, the contents (where applicable) of this paper can be trusted as far as the financial reports from the companies can be trusted.

Secondary sources will also be utilized, including material from the FSA and previous research as well as news articles regarding the subject. In particular general information about the companies is of interest, but the paper does not depend on them as much as the financial reports from the companies.

Outlining the paper, I will begin with a short discussion on definitions and mentions of earlier research, and then move on to a brief background on Islamic finance in the world. This will be followed with a short description of theoretical and practical matters regarding Islamic finance. It will be presented as background information to give the reader a basic understanding of how Islamic finance is different from “traditional” banking, which is necessary to understand why there is an interest in researching Islamic banks as something special. After that, the statistical overview of the banks will begin and finally the paper will be concluded with a summary and general discussion.

1.4 Definitions
A few phrases have already been used - “Islamic finance”, “Islamic banking” and “Islamic banks”. These demand to be defined properly, both for the uses of this paper and beyond. The term Islamic finance (which is the same as Islamic Banking, but both are commonly used) refers to transactions and commerce that complies with the sharia'a (more about what this entails in the chapter “What is Islamic finance?”). Services that are considered as Islamic finance can be performed by any bank, should they choose to. Certain bonds may also be considered as part of Islamic finance, and that in turn means anyone can trade with them. Islamic finance is not limited to Islamic Banks.

Islamic banks, however, are limited to Islamic finance. For Islamic banks, it is not enough

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7 Handbook development, No 95, Jan 2008, FSA's website.
8 There seems to be a number of different ways to spell sharia, including shari'a, sharia, sharia'a, shariah.
to only operate partially as a sharia'a compliant bank. For Islamic banks, every part of the operations must be considered as compliant with sharia'a.

Retail banking refers to banking aimed at individuals. Wholesale banking refers to banking aimed at companies and institutions. This definition extends to its operations, but not its depositors (a wholesale bank may take deposits from individuals and vice versa).

1.5 Previous research
There has been plenty of previous research in the area of Islamic finance, mostly focused on the theoretical and practical areas of Islamic Finance (what guiding principles rule, and as a result of that how can trade be performed with Islamic finance?). Recent books on the subject include “Islamic finance: theory and practice” by Mills and Presley,\(^9\) and “Islamic Finance: theory, practice and challenges” by by Al-Omar and Abdel-Haq.\(^10\) Particular focus has also been placed on how to integrate Islamic Finance into “western” law, and what challenges this pose both for Islamic finance and the host country, as done in “Islamic Finance: The Regulatory Challenge”\(^11\) and “Islamic Finance in the UK: Regulation and Challenges”.\(^12\)

There have also been smaller studies – for example in December 2004, students at Kristianstad University College, Sweden, turned in their research on the subject of Islamic finance, which aimed at answering questions such as what Islamic finance is, how it works and how it is implemented in countries with a Muslim majority.\(^13\)

2. What is Islamic finance?
Islamic finance ultimately derives from the Muslims' belief of God as creator.

“The Almighty Allah is the real Owner of everything. Man is no more than His trustee. Man in Islam is Allah's Khalifa [vice regent] and representative on earth. As His trustee, man is obliged to obey the instructions of the One who appointed him in this capacity.”

And as all property is given in trust by God, sharia'a should govern how property is to be used.\(^14\)

When a bank declares itself to be “fully sharia'a compliant”, the decision has been taken to apply Islamic principles to financial transactions, whether in between Muslim and Muslim or on

\(^10\) Al-Omar and Abdel-Haq, 1996.
\(^12\) Ainley et al, 2007.
an international market. To make sure that the bank conducts itself according to promise, an internal “sharia'a supervisory board” is often established. There are also international institutions that work for a standardized and maintained use of the sharia'a, and in some countries it is demanded by secular law.\(^{15}\)

As a theoretical framework, the following guidelines should be followed when conducting transactions considered as Islamic finance: 1) Do not lie to sell your products, 2) Do not deceive others, 3) Do not boast about your products, 4) Do not sell products that have a negative influence on young people and society as a whole, 5) Uphold justice in all your dealings with your transactions with both friends and enemies, 6) Gambling and other risk-related purely speculative activities based on pure luck are prohibited. Black markets, cheating, concealing defective qualities of merchandise and adulteration are also prohibited activities. Muslim businessmen should also avoid misinterpretation. Third parties should also strive to avoid the disruption of trade. Selling of forbidden items, such as alcohol, dead bodies of animals or idols, is prohibited. Hoarding should be avoided. Business should be conducted in an open market. Transactions should not be completed with individuals under duress or being forced.\(^{16}\)

The two “directives” with the most impact on Islamic finance, however, are the prohibitions of *riba* and *gharar*. Riba means charging of “excess” fees, or in another word interest. Thus, in Islamic finance, a lender may not demand the return of a larger amount of cash, after a time period has passed, as payment for the loan. Prohibition of riba also means that fees that are too large should not be charged for products. The prohibition of gharar means that transactions should be conducted in a truthful and transparent manner, with no hidden or obscured parts (an example, selling wool but omitting that it is still on the sheep's body).\(^{17}\)

What does this mean in practice? Traditional banks (broadly speaking) operate by taking deposits and lending it again to others. The profits come from the difference in interest (take deposits for a low interest, lending to others for a higher interest) and the bank's ability to accurately measure the risk involved in each transaction. However, in Islamic finance, this would constitute as riba. Thus, the Islamic banks should instead be seen as an asset manager and not a financial intermediary. The depositors are not really depositors, but rather investors. The Islamic bank operates by “profit-loss sharing” - the depositors agree to a fund management deal with the bank and the profits from that deal are shared by the bank and the depositor (including a

management fee from the bank). However, profit-loss sharing also means that the depositor's money is at risk if the investment made with the money goes bad, even if the bank remains solvent.\footnote{Ghuddah et al (2006), p. 54-55.}

The instruments implemented by Islamic banks grow increasingly complex and disparate. To fully explain all the instruments provided here would take up more than the remainder of the paper. I will instead briefly mention a few examples here.

- A \textit{Mudaraba} contract is a contract where a bank and a potential client will work together on a project. For example, an engineer has an idea for a product but lack the financing, which the bank agrees to provide. In return the bank demands 20\% of any profits from the project. The bank issues certificates to its depositors. In case the project does not return profits, the loss is carried by the bank and its depositors.\footnote{Ghuddah et al (2006), p. 59-62.}

- A \textit{Murabaha} contract is a contract where an individual wishes to purchase something but lacks the cash for it. He (or she) negotiates the deal and contacts the bank, who will pay for the purchase and then sell it to the original individual who will pay at a later date. The amount of cash the individual pays to the bank is higher than the price of the original item. If the purchaser fails to pay the bank, the bank cannot charge additional interest from the purchaser, or sell the item back to the original seller for anything else than the original price. This type of “loan” which is central to Islamic finance previously had difficulties integrating into the United Kingdom. E.g, a stamp duty is paid by everyone upon purchase of real estate, and as such it would have to be paid twice (because the bank buys and resells the property). The double stamp duty on Islamic mortgages was abolished in April 2003.\footnote{Ghuddah et al (2006), p. 66-68, “Double Stamp Duty abolished on Islamic mortgages”, 2003.}

3. Background on Islamic finance

The year of 1945 marked the end of the Second World war, and as Japan surrendered Indonesia proclaimed its independence, an early sign of things to come. The following decades meant the end of European colonization in the Middle East, and by 1962 when Algeria seized independence from French occupation, most of the Muslim world was free from external rule.\footnote{Muslim Business Student Association (2008).}

Traditionally, the colonizing countries had managed economies and finances in the Muslim countries. However, the countries believed that they were better off managing themselves, and would seek to do so in a way compatible with Islamic beliefs. Thus, between the 1940s and the
1960s, efforts were made to produce a workable model for Islamic banking, mainly avoiding charging or paying interest for loans or deposits. In practice the models resulted in failure on a business level, but they nevertheless paved the way for further explorations and other models for Islamic banking.\textsuperscript{22}

In 1975, the first Islamic bank surviving until today was formed - The Dubai Islamic Bank, authorized under special laws that allowed it to operate in a manner consistent with the sharia'a (Muslim religious law). By 1985, 27 more Islamic banks had been established. Furthermore, non-Islamic banks had started offering Islamic services abroad, in the United Kingdom and elsewhere. At the end of the twentieth century, over 200 Islamic financial institutions were operating with managed assets in total over $160 billion.\textsuperscript{23}

In the United Kingdom, the first Islamic bank – Albaraka Bank - established a branch in London by the end of the 1980s and thus became the first Islamic bank to operate in the United Kingdom with a banking license. The branch shut down in 1993. Reasons for shutting down its services and leaving only a representative office happened for a number of reasons. Some say it was from pressure from the Bank of England that Albaraka Bank widen its shareholder base beyond one person, as well as internal structural problems.\textsuperscript{24} Others say it was due to complications with British law and the bank's inability to guarantee full repayment on request to depositors, which disqualified it from having a banking license.\textsuperscript{25}

4. Islamic banks in the United Kingdom

Once again I wish to stress what this paper is measuring; the growth of Islamic banks in the United Kingdom. It is a piece of Islamic finance, but it is not all of it. The five biggest banks in the United Kingdom ranked by Forbes after revenue, profits, assets and market value (HSBC Holdings, Royal Bank of Scotland, Barclays, HBOS and last Lloyds TSB group\textsuperscript{26}) all provide some form of Islamic finance in small or great extent. Thus, the Islamic banks operating in the United Kingdom are not alone on the market. They are, however, the only ones on the market that operate completely in compliance with the sharia'a. What does this mean for the paper?

1) The growth of the Islamic banks presented below cannot be seen as the growth of Islamic finance.

\textsuperscript{22} Muslim Business Student Association (2008).
\textsuperscript{23} Muslim Business Student Association (2008).
\textsuperscript{24} “Dallah Albaraka group” (2008).
\textsuperscript{25} Muslim Business Student Association (2008).
\textsuperscript{26} “The World's Biggest Companies”, Forbes (2007).
2) The banks can be seen as a niche industry. Because they operate under similar rules on the same market, they can be grouped together to form an overview of just not the individual companies but the niche industry in total.

Islamic Bank of Britain (IBB) was the first Islamic bank in the United Kingdom in the 21st century, established in 2004. It was followed by the European Islamic Investment Bank (EIIB) which was incorporated in 2005 and authorized in 2006. A third bank, Bank of London and the Middle East (BLME) was incorporated in 2006 and authorized in 2007.

4.1 Islamic Bank of Britain plc (IBB)
Islamic Bank of Britain was the first Islamic bank to be approved by the FSA. IBB launched on the London Stock Exchange (AIM market) on 12th October of 2004. IBB provides both retail and wholesale banking services. In the retail operations, they provide services such as current accounts, savings accounts, personal and home finance. They also provide an online banking service since 2006 that enables their customers to manage their assets via the website. Similar services are offered for their wholesale market.

Their mission statement reads: “To be the leading provider of sharia'a compliant Islamic retail banking services in the United Kingdom; to achieve consumer recognition for superior service quality; and to deliver value for customers, staff and shareholders.”

At incorporation, the bank stated that it would “open branches throughout the UK, wherever there are significant concentrations of the Muslim community.”

For the year 2004, the company had two fiscal years, the first one ending on 31st of July (a start-up phase), and the latter lasting for 5 months until 31st December. The financial reports made available from the latter year, as well as all subsequent annual financial reports have been audited by KPMG Audit plc and found to give a true and fair view of the state of the company's affairs. The bank also operates under the surveillance of a sharia'a Supervisory board.

27 IBB's website, EIIB's website, BLME's website.
28 IBB's website.
29 Financial reports from IBB.
1. The number of employees

Table 1. Average number of employees, and staff costs in £ million at IBB for the second fiscal year 2004 to 2007

<table>
<thead>
<tr>
<th></th>
<th>2004 (5 months)</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average number of employees</td>
<td>63</td>
<td>102</td>
<td>144</td>
<td>175</td>
</tr>
<tr>
<td>Staff costs (£ million)</td>
<td>552,460</td>
<td>2,983,414</td>
<td>3,840,296</td>
<td>4,424,536</td>
</tr>
</tbody>
</table>

Source: IBB final results for 5 month period 2004 and annual reports & financial statements for the years 2005-2007

In Table 1 we can see the increase of employees between the years 2004 and 2007. The average number of employees has continued to rise from 63 in 2004 (second fiscal year) to 175 in 2007. Staff costs also increased, but not as fast the average number of employees.

2. The assets

Table 2. Total assets, and its sources at IBB for the end of second fiscal year 2004 to 2007 in £

<table>
<thead>
<tr>
<th></th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Murabaha and Wakala receivables and other advances due from banks</td>
<td>47,022,681</td>
<td>78,037,676</td>
<td>100,286,964</td>
<td>141,768,471</td>
</tr>
<tr>
<td>Property and equipment</td>
<td>3,547,073</td>
<td>3,798,951</td>
<td>3,965,370</td>
<td>3,443,355</td>
</tr>
<tr>
<td>Other Assets</td>
<td>434,272</td>
<td>7,452,873</td>
<td>13,759,761</td>
<td>19,725,001</td>
</tr>
<tr>
<td>Total Assets</td>
<td>51,004,026</td>
<td>89,289,500</td>
<td>118,012,095</td>
<td>164,936,827</td>
</tr>
</tbody>
</table>

Source: IBB final results for 5 month period 2004 and annual reports & financial statements for the years 2005-2007

In Table 2 is displayed the total assets and its sources. Particular focus should be placed on two things. First, the value of the property and equipment has remained relatively similar in total value over the years. Second, there has been a great increase of Murabaha and Wakala receivables which accounts for most of the growth of the total assets (although in relative terms it has remained the same).
3. Ownership equity

Table 3. Ownership equity after all adjustments, and retained profit & losses account at IBB for the end of second fiscal year 2004 to 2007 in £

<table>
<thead>
<tr>
<th>Data</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ownership Equity</td>
<td>47,014,047</td>
<td>40,564,540</td>
<td>31,731,287</td>
<td>24,825,309</td>
</tr>
<tr>
<td>Retained profits and losses account</td>
<td>-5,923,208</td>
<td>-12,372,715</td>
<td>-21,205,968</td>
<td>-28,137,072</td>
</tr>
</tbody>
</table>

Source: IBB final results for 5 month period 2004 and annual reports & financial statements for the years 2005-2007

As we can see in Table 3, IBB has seen continuous setbacks in poor performance which has resulted in severe losses. IBB issued shares throughout 2004 and 2005, which accounts for discrepancies in the ownership equity decrease. By the end of 2007, the company had lost more than half of the investments made by its original shareholders. There have been no dividends during any of the operating years. Regarding the poor performance, the chairman of IBB said in 2005 that it had faced significant specialist legal and consultant costs to enter the market, but expected these costs to decrease in the following years.30

4. Market Value

Table 4. Share price, market value, and number of shares at IBB for the end of second fiscal year 2004 to 2007 in unmodified £

<table>
<thead>
<tr>
<th>Data</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share price</td>
<td>0,28</td>
<td>0,29</td>
<td>0,15</td>
<td>0,105</td>
</tr>
<tr>
<td>Number of shares</td>
<td>343,705,882</td>
<td>419,000,000</td>
<td>419,000,000</td>
<td>419,000,000</td>
</tr>
<tr>
<td>Market value</td>
<td>96,237,647</td>
<td>121,510,000</td>
<td>62,850,000</td>
<td>43,995,000</td>
</tr>
</tbody>
</table>

Source: IBB final results for 5 month period 2004 and annual reports & financial statements for the years 2005-2007 and Businessweek.com data on share prices

Table 4 summarizes the market value of IBB from 2004 to 2007. As previously mentioned, additional shares were issued during 2004 and 2005. Note that the market value is always given as a snapshot, and does not measure the average market value over time. Full overviews of the history of the share price are available online.

5. Turnover (revenue)

Table 5. Revenues at IBB for the end of second fiscal year 2004 to 2007 in unmodified £

<table>
<thead>
<tr>
<th>Data</th>
<th>2004 (5 months)</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenues</td>
<td>676,398</td>
<td>2,207,961</td>
<td>3,010,979</td>
<td>4,696,862</td>
</tr>
</tbody>
</table>

Source: IBB final results for 5 month period 2004 and annual reports & financial statements for the years 2005-2007

Revenues have been consistently increasing for the company (see Table 5), although that should not be surprising considering the significant investments made. Of course, just reviewing the turnover gives only half the picture in terms of profits, and the costs for the company have increased as much and more.

6. Additional statistics

Two additional statistics are available regarding IBB (shown in Table 6). The first one is the number of customers they have (retail and wholesale clumped together). The number of customers may tell us something about market penetration, or the size of the company's brand equity. On its own, it doesn't tell us much, however, because the number of customers gives no depth. To somewhat remedy this, the total amount of deposits made by customers will be presented as well, although the reader should remember that, while it will give us a calculated average, it does not tell us whether the deposits came from new or old customers. IBB also does not define what a “customer” is, which means it's open for misinterpretation.

Secondly, statistics are available regarding the number of bank offices that IBB has established. The number will be presented, but does of course not tell us the size of the offices, or if some are different than others. In 2007 two new commercial centres were launched, one from a converted office and another in a new location. Commercial centres are aimed solely at the wholesale market.
Table 6. Number of customers, and total deposits in £, and (calculated) average deposits per customer £, and total amount of offices operating at the end of the period, from 2004 to 2007

<table>
<thead>
<tr>
<th>Data</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of customers</td>
<td>N/A</td>
<td>14,023</td>
<td>30,814</td>
<td>42,000</td>
</tr>
<tr>
<td>Deposits from customers</td>
<td>N/A</td>
<td>47,714,593</td>
<td>83,853,383</td>
<td>134,640,612</td>
</tr>
<tr>
<td>Average amount of deposits from each customer</td>
<td>N/A</td>
<td>3403</td>
<td>2721</td>
<td>3206</td>
</tr>
<tr>
<td>Total number of operating offices</td>
<td>2</td>
<td>6</td>
<td>7</td>
<td>8</td>
</tr>
</tbody>
</table>

Source: IBB final results for 5 month period 2004 and annual reports & financial statements for the years 2005-2007, and IBB’s website

7. Review

Trying to ascertain whether or not IBB has grown in size is a difficult task. Certainly, it now employs more people than it did in 2004 and 2005. Customers and offices have also increased, as well as assets governed by the bank. Normally, this would all tell us that there is a growth in progress. On the other hand, the market value of the company, and the ownership equity, have plummeted steadily downwards.

The simple answer to ownership equity falling is that the bank is expanding, and investing more money than it is making to build up the organization (the number of offices would confirm this, as well as statements from the Chairman found in the financial reports). However, why has the market value fallen? There are several possible explanations, including but not excluded to 1) external factors such as a bank market in crisis, 2) the belief that the company will be unable to turn years of losses into profit, 3) the decreased belief in Islamic finance and its ability to show profit in the United Kingdom. Unfortunately, it is beyond this paper to pursue these possibilities or others. For the purposes of measuring the size of the company, it is enough to say that the value of it has decreased.

4.2 European Islamic Investment Bank plc (EIIB)

The bank was incorporated on the 11th January of 2005, and received authorization from FSA on the 8th of March 2006. The shares were introduced to the market on the London Stock Exchange (AIM market) on the 17th of May 2006. The bank deals solely with wholesale, and claims to be the first Islamic investment bank in the United Kingdom.
EIIB's business model aims to bridge Western financial markets with those of the Islamic world. Specifically, the following services are offered as of May 2008: Islamic treasury and capital markets, asset management including private banking, structured trade finance, private equity and corporate advisory, and sharia'a advisory.

The company issued shares throughout 2005 and (in a smaller extent) 2006. Some shares were given as payment in 2005 to employees for the following 36 months.

The annual reports for the years 2005, 2006 and 2007 were audited by Ernst & Young LLP who found that the financial statements gave a true and fair view of the state of the company's affairs. The bank also operates under the surveillance of a sharia'a Supervisory board.31

1. The number of employees

Table 7. Average number of employees, and staff costs in £ at EIIB for the years 2005 to 2007

<table>
<thead>
<tr>
<th>Data</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>(355 days)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Average number of employees</td>
<td>6</td>
<td>20</td>
<td>42</td>
</tr>
<tr>
<td>Staff cost</td>
<td>230,282</td>
<td>1,602,394</td>
<td>2,987,658</td>
</tr>
</tbody>
</table>

Source: EIBB annual reports and financial statements for the years 2006-2007

Additional employees have been hired throughout the company's active time, as seen in Table 7. Staff costs went up accordingly. EIIB also reported the number of employees at the end of each period, but this number has been discarded because it gives very little for a measurement over time.

2. The assets

Table 8. Property and equipment, and total assets at EIIB for the end of years 2005 to 2007 in £

<table>
<thead>
<tr>
<th>Data</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property and equipment</td>
<td>96,493</td>
<td>347,644</td>
<td>409,325</td>
</tr>
<tr>
<td>Total Assets</td>
<td>112,410,581</td>
<td>236,279,157</td>
<td>275,314,101</td>
</tr>
</tbody>
</table>

Source: EIBB annual reports and financial statements for the years 2006-2007

Table 8 provides an overview of the growth of the assets of EIIB. The company diversified its business from mostly having assets “due from financial institutions”, extending it to other financial arrangements, property investments and a deposit to secure sales in 2006 and 2007.

31 EIIB's website, and Annual reports from EIIB.
3. Ownership equity

Table 9. Ownership equity after all adjustments, and retained profit & losses account at EIBB for the end of years 2005 to 2007 in £

<table>
<thead>
<tr>
<th>Data</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ownership Equity</td>
<td>111,155,762</td>
<td>185,703,977</td>
<td>180,919,407</td>
</tr>
<tr>
<td>Retained profits and losses account</td>
<td>+1,586,116</td>
<td>+3,230,954</td>
<td>-1,119,160</td>
</tr>
</tbody>
</table>

Source: EIBB annual reports and financial statements for the years 2006-2007

The company experienced initial profits resulting in increase of Ownership equity during its two first operating years, as seen in Table 9. The third year resulted in a loss. New shares were issued during 2005 and 2006, accounting for the large discrepancies in Ownership equity. No dividends have been given from any of the operating years.

4. Market Value

Table 10. Share price, market value, and number of shares at EIBB for the end of years 2005 to 2007 in unmodified £

<table>
<thead>
<tr>
<th>Data</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share price</td>
<td>N/A</td>
<td>0,105</td>
<td>0,0655</td>
</tr>
<tr>
<td>Number of shares</td>
<td>1,524,347,000</td>
<td>1,825,562,531</td>
<td>1,825,562,531</td>
</tr>
<tr>
<td>Market value</td>
<td>N/A</td>
<td>191,684,066</td>
<td>119,574,346</td>
</tr>
</tbody>
</table>

Source: EIBB annual reports and financial statements for the years 2006-2007

As the company was introduced on the London Stock Exchange during 2006, market value cannot be estimated before that (displayed in Table 10). The value of the share has been dropping throughout 2006 and 2007. Note that the market value is always given as a snapshot, and does not measure the average market value over time. Full overviews of the share price are available online.
5. Turnover (revenue)

Table 11. Revenues at EIBB for the fiscal years 2005 to 2007 in unmodified £

<table>
<thead>
<tr>
<th>Data</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenues</td>
<td>3,840,502</td>
<td>7,841,065</td>
<td>13,012,053</td>
</tr>
</tbody>
</table>

Source: EIBB annual reports and financial statements for the years 2006-2007

EIBB has experienced significant growth in revenues (see Table 11), more than tripling its total operating income during its three operating years.

6. Additional statistics

There are no additional statistics available that may help us to measure the size of the company. The Chairman does speak of market penetration in the United Kingdom, Middle East and Malaysia, as well as an alliance with a Malaysian bank – and while these things may tell us something about the company's size, they are also impossible to quantify or compare. EIBB has also continued to develop new services for their customers.32

7. Review

In terms of employees, assets and revenues, EIBB has grown in size. Ownership equity has taken a hit from poor performance in 2007, and has had only a small growth before that. Market value of the company has decreased by one third in 2007.

4.3 Bank of London and The Middle East plc (BLME)

The bank was incorporated in August 2006 and received FSA authorization in July 2007. The company was originally launched. The stock is not traded in public, rather newly issued shares are offered as private placements (to a select group of financiers). It is a bank aimed at the wholesale market.

Their business strategy is “the building of an institution which will provide business solutions, using innovative Sharia'a compliant investment and financing products, whilst addressing all the financial needs of our customers”.

The bank issued shares on several occasions; in August 2006, February 2007, November 2007, December 2007 and (not covered by this paper) February 2008. Some shares were issued to employees as incentive schemes (November and December 2007).

Since the bank is privately owned, financial records are only available from the time of its authorization in July 2007 to the end of the year. Thus, the only statistics available are from a 17 month period (7th of August 2006 to 31st of December 2007). BLME is included in this paper out of a wish for completeness (both of the overview and individual companies), rather than measuring growth within the particular company. The report made available has been audited by KPMG Audit plc and found to give a true and fair view of the state of the company's affairs. The bank also operates under the surveillance of a sharia'a Supervisory board.

1. The number of employees
The average number of employees for BLME was 19 over a 17 month period. The company incurred a total of £4,116,761 in staff costs during the period. The company reported having 34 employees at the end of 2007. Part of the staff cost was paid in issued shares.

2. The assets
At the end of the fiscal year in 2007, BLME reported a total of £297,720,601 in assets. Of these, £180,531,933 (61%) were assets “due from financial institutions”. Property and equipment were written down at £963,045.

3. Ownership equity
Ownership equity was reported at £179,402,020 at the end of 2007, including retained profit & losses of £175,657. No dividends were paid out following the year of 2007.

4. Market Value
As previously stated, BLME is not available on the public market, and thus a market value cannot be given or estimated.

5. Turnover (revenue)
BLME reports a revenue of £9,274,163 for the period 7th of August 2006 to 31st of December 2007.

6. Additional statistics
No additional statistics are available regarding the size of the company.

7. Review
To determine the growth of BLME is difficult, as all the records available cover only one period.
Certainly the company has developed, from pre-authorization to operating as a bank in the latter half of 2007. Share issues have been constant. The facts are that before August 2006 there was no company, and at the end of 2007 the company had 37 employees, assets over £297million, ownership equity of £179million and revenues totalling £9million.

So when did this growth take place? The chairman explains the development of the company by dividing it into two periods, “pre-authorization” and after authorization. However, a third period is also in use – the date when the company got access to initial financing funds from issued shares, which was in February 2007. In the first period (up until February 2007), the bank mainly worked with market research (to result in financing) and getting the authorization to go through (this period was financed by £2million seed capital from another bank). After February 2007 (when £175million were made available), the bank focused on recruiting key staff and building up infrastructure as well as temporary fund management.

Thus, two questions have been answered – when the growth took place, as well as if this data can be incorporated into the total overview of Islamic banks in the United Kingdom. It is, based on the explanation above, safe to assume that revenues and ownership equity were mainly established in 2007 (thus we can ignore the 5 months in 2006). Regarding employees, the average number of employees for the 17 months will be treated as correct for 2007, but this may not be completely accurate.

5. Growth of a niche industry
Can – and should – the Islamic banks in the United Kingdom be grouped together for a statistical overview? The short answer to this is that they can be. They are operating on grounds, in similar markets, in a similar niche (Islamic finance), in the same years. However, they are not homogeneous institutions. Indeed, there are several distinctive traits for each bank. As such, the banks are not identical, but similar.
Graph 1. Employees (average) in Islamic banks by company and in total for the years 2003-2007

As seen in Graph 1, the number of employees in Islamic banks have increased from none in 2003 to 236 on average in 2007. The growth of employees has been consistent and from all three companies when introduced.

Graph 2. Assets (£ million) in Islamic banks by company and in total for the years 2003-2007

Graph 2 displays the growth of assets in Islamic banks, from none in 2003 to a total of £737.7 million at the end of year 2007. Assets have been thoroughly increasing, both for individual
banks and the niche industry seen as a whole.

*Graph 3. Ownership equity (£ million) in Islamic banks by company and in total, and total retained profits and losses, for the years 2003-2007*

Graph 3 shows the increase in ownership equity for individual companies and a total overview, as well as the total profits and losses from the three Islamic banks. Ownership equity in the Islamic banks increased from none in 2003 to £385 million by the end of 2007. Growth in Ownership equity has been due to new shares issued. No company has seen fit to pay dividends. By the end of 2007, two banks (IBB and EIIB) were showing negative amounts in their retained profits & losses account, and the third bank (BLME) showed a very small profit of £175,657. The niche industry as a whole had over £29 million in retained losses by the end of 2007. Thus, the growth in the ownership equity has primarily been from new investments, and the growth has been held back by poor profitability.

*Source: Annual reports and financial statements from IBB, EIIB and BLME*
Graph 4. Market value (£ million) for IBB and EIIB and in total for the years 2003-2007

Source: Annual reports and financial statements from IBB, EIIB and BLME

In Graph 4 we can see the total market value of the niche industry (excluding BLME as per earlier comments). Total market value peaked in 2006 when EIIB was introduced. Initial market value of the two companies have shrunk during 2007. Total market value, which was zero in 2003, had grown to £163.6 million by the end of 2007.

Graph 5. Turnover (£ million) in Islamic banks by company and in total for the years 2003-2007

Source: Annual reports and financial statements from IBB, EIIB and BLME

Graph 5 displays the total as well as individual turnover (revenues) from the three banks.
Steady growth across the board both for individual banks as well as the niche industry as a whole. Non-existent in 2003, total revenues had reached almost £27 million by the end of 2007.

6. Conclusions and discussions

The aim of this paper was to answer the question “How much have the Islamic banks in the United Kingdom grown?”. It is impossible to describe the growth of Islamic banks in the United Kingdom as a percentage, because there was literally no such niche industry in 2003. And yet, at the end of 2007, the industry employs over 230 persons, governs assets of approximately £737.7 million and has an ownership equity of £385.1 million. Revenues have risen from nothing in 2003 to £26.97 million in 2007. Each measurement adds to a better understanding of the growth of Islamic banks in the United Kingdom.

This paper was started with a brief introduction of how to measure size in companies and what it means. The research provided here has demonstrated how growth can be measured in different ways depending on what we analyse. The different measurements can even give different results, as we see in the case with IBB. The company has “grown” in terms of employees, assets and revenues (and customers and offices). Ownership equity and retained losses have on the other hand decreased, and market value along with it. EIIB has had a similar development, also seeing significant increases in number of employees, assets and revenues. Retained earnings and market values have however decreased. BLME, a private company, is the only Islamic bank to show a (small) retained profit at the end of 2007. Since the bank only began trading in February 2007, it is too early to say how the bank is developing.

Seen as a niche industry, growth for Islamic banks in terms of ownership equity or market value is due to new market entrants rather than good performance from individual banks. Yet, employees, assets and revenues are up as both a combination of new banks as well as growth from individual banks.

There is also a lesson to be learned here for future attempts at measuring company growth – not only can different measurements give different results – they may even indicate that the company is both growing and decreasing in size. Furthermore, as has been shown within this paper, any number of obstacles can arise during the gathering of statistics, that may distort the results and should as such be included (differences in accounting reports, lack of additional statistics and so on). Of course if the data to be measured has been selected beforehand such an encumbered study as this won't be necessary. But for studies in economic history, determining company size is no simple matter. There are also more tools that can be used to measure company size, such as market
penetration, brand equity and market share – which all require something more than just analysing internal statistics. In truth a study of growth can be as complex as the author wants it to be – down to the last customer, employee and letter.

I regret that the size of the paper and the available time did not give more time to further explore causes and obstacles for the growth described herein. In particular, comparisons with High Street banks in London would have complemented the growth of this niche industry well, since it would give us not just insight into Islamic banks, but also the market and the country. Comparisons could also have been made, given size, with Islamic banks in the USA or other countries that do not hold a majority of Muslims.

Researching the subject of Islamic finance, I have furthermore come across several interesting discussions that simply do not fit here – for example there is some criticism aimed at Islamic finance calling it “smoke and mirrors”, claiming that even though the operations may be different, everything the customer sees is the same as a traditional bank.

More research is needed on the subject of Islamic banks and Islamic banks and finance, not just in the United Kingdom but elsewhere. Particular focus should be placed not just on measuring growth, or even performance, but also trying to understand its causes better. Especially practical result studies that do not concentrate on theories or practical theories regarding Islamic finance, but rather market research, are required for a better understanding of what place Islamic finance has in the modern business world.
7. Litterature and sources

7.1 Litterature


7.2 Sources: Company websites

Bank of London and the Middle East (BLME): http://eiib.co.uk [2008-05-28]

European Islamic Investment Bank (EIIB): http://www.eiib.co.uk [2008-05-28]


7.3 Sources: Annual reports and financial statements, stock quotes

(Annual reports and financial statements are available from the websites of the companies.)


Final Results - 5 month period to December 2004 (2005) *Islamic Bank of Britain*


7.4 Internet sources


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“European Islamic Investment Bank creates private equity and corporate advisory unit” (2008-04-25) Hedgeweek. Available online at:


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