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Sectoral Distribution and Islamic Finance: Comparative Study of Conventional and Islamic Banks in Bahrain

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Abstract: The proponents of Islamic finance argue that unlike conventional finance it emphasizes the real economy. Such emphasis should be reflected in the sectoral distribution in an economy. In this paper, in light of a conceptualization of the real economy, the sectoral distribution of financial activities of conventional and Islamic banks in Bahrain is explored. The paper uses the data available from the Central Bank of Bahrain (CBB) regarding the sectoral distribution in both conventional and Islamic banks. The breakdown of banks into both retail and wholesale banks as well as onshore and offshore banks is examined to identify any important trends or patterns in light of the conceptualization of the real economy. The analysis of data finds certain concentration in the real estate sector. Islamic banks also have a bias toward consumer finance, which has implications in promoting a debt culture. Several other gaps between the commonly proclaimed merits of Islamic finance and the praxis in reality are also identified. The research is based on a single country, Bahrain, a financial hub for both conventional and Islamic banks. Even though Bahrain has a diversified economy, it is still limited in terms of some key sectors, such as manufacturing and agriculture. Thus, broader study including other countries with major presence of Islamic banks would be the next step in this research. Bias to certain sectors can be problematic in case of a potential crisis. Also, in certain respects, such as bias of Islamic banks toward consumer finance, it might be serving to promote debt culture that many developed countries are already beset with. The research can create better awareness about various patterns of sectoral distribution.

Keywords: Islamic banking, Islamic finance, Sectoral Distribution, Bahrain, Debt Culture

JEL Classifications: G00, G10

1. Introduction

While the essential principles behind Islamic finance can be traced back to the time of Prophet Muhammad, more than 1500 years ago, Islamic finance in the modern period emerged during the second half of the twentieth century as part of the post-colonial transformation of the Muslim world. Today, Islamic finance has evolved to become a strong competitor for its western counterpart primarily in Muslim-majority countries. However, as it lacks a separate infrastructure or comprehensive financial system, it is still quite limited to be a serious contender in the global financial markets (Iqbal, et al. 1998; Alharbi, 2015).

Islamic banks are financial institutions that claim to abide by Shari'ah principles in their activities through their role as financial intermediaries and provide banking services within the framework of Shari'ah-compliant contracts, supposedly with the goal of achieving a balance between economic and

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social return. The core principle of Islamic Finance is the prohibition of riba, commonly blanketly equated with interest. Riba is technically defined as stipulated excess in a financial transaction without any counter-value. Riba usually involves financial transactions to gain or increase wealth without engaging in a productive activity, which commonly leads to harm to at least one party, usually the debtor or fund-seeker. Following such principles, Islamic Banking is therefore based on transactions that are expected to have a productive purpose and do not deviate from the Islamic parameters. Consequently, Islamic banks are bound to limit their offerings to specific sectors and businesses that qualify to meet their standards.

Islamic finance, as Shari'ah-compliant alternative to conventional finance, is supposed to have a number of distinctions. Firstly, it is focused on the real economy, where the actual economic activities take place and financial sector primarily plays the facilitating role (Warde, 2010; Ariff and Lewis, 2014). Secondly, Islamic finance transactions are to be generally asset-linked, thus better connecting with the real economy (Farooq and Selim, 2017). Thirdly, it is primarily interested in profit-loss sharing, where risk is also fairly shared among the participants (Harrison and Ibrahim, 2016). Fourthly, Islamic finance activities are to be part of a larger economic and financial system that promotes economic justice and avoids undue concentration of wealth (Iqbal and Mirakhor, 2011).

In the context of the impressive overall growth of the industry an important aspect is the sectoral distribution, especially as the Islamic economy and finance/banking is expected to be closely linked with the real economy. In this paper, the sectoral distribution in Bahrain is examined to better understand the real economy connection as claimed in the literature on Islamic economics and finance.

2. Challenges of Islamic Banking

While the industry continues to grow steadily, Islamic finance's survival has been questioned and criticized. The main challenges that were present at its inception mostly remain the same, which include weak infrastructure of the Islamic financial system, regulatory constraints, liquidity problems, credibility, etc. Researchers and policy-makers have noted that innovations are required to develop instruments that enhance the liquidity concerns and address the other shortcomings of the industry. The dynamic challenges that the Islamic banking and global finance face in general in a fast-changing world have had an adverse impact on several top players in the market and it is important that measures are taken to tackle future obstacles and lay a proper foundation for future growth (Iqbal 2008).

There are several noticeable areas of improvements as well to grow Islamic Banking. Some of the improvements include (i) increasing the banks' asset size, even though there is currently no Islamic bank that can be identified as a contender to the top banks of the world due to the asset size, (ii) liquidity issues, especially pertaining to secondary markets; there is a lack of markets to sell, trade and negotiate financial assets of the bank, the improvement in this areas has been slow and murky; and (iii) concentrated banking; Islamic banks tend to focus on financing a few specific sectors and avoid direct competition with other lenders (or financiers)[1], which makes the banks vulnerable to cyclical shocks in particular sectors (Iqbal, 2008; Smith and Croft, 2017).

These challenges have implications for specific sectors IBs serve and focus on. In this paper we examine the sectoral distribution of IB activities in Bahrain, which is one of the pioneers in Islamic finance and also an international finance center.

3. Islamic Finance and the Real Economy

Islamic finance is supposed to be closely linked with the real economy (Ayub, 2007). However, what is real economy is rarely explained in the literature and generally it is understood as Islamic

[1] While the term 'lending' is applicable to conventional finance, in Islamic finance the appropriate term is 'financing'.

finance being asset-linked (asset-based or asset-backed) (Iqbal, 2014; Visser, 2009). However, reducing real economy to mere asset-link is a serious and misleading reductionism (Farooq and Selim, 2017).

In fact, real economy is a vital concern and as such greater attention is being paid to this theme since the last global financial crisis of 2008, which is largely attributed to ever-increasing financialization of the leading economies like the USA (Capie and Wood, 1997; Batko, 2013).

At the simplest level, the real economy can be conceptualized in terms of the dynamics of production, consumption, trade, technology, institution and human capital. Some relevant aspects of this conceptualization (Farooq, 2017) are as following.

a. A modern economy is based on the interface of the real sector and the monetary/financial sector, where the role of the financial sector is supposed to be facilitating or enabling the real sector. To avoid financialization, the focus should always be on the real sector activities and this sector should not be overwhelmed by the financial sector, where often income is generated without contributing to the real economy (Cetorelli, 2012).

b. Consumption is considered to be the purpose of all production, but production based on which consumption and trading take place is where the understanding of the real economy begins.

c. For economic growth, there must be a desired balance between the production of consumption goods and the capital goods. While all economies try to consume as much as possible, higher standard of living, as experienced in the developed countries, is generally facilitated by, among other things, greater capacity to produce capital goods.

d. Specialization leads to higher productivity, which in turn leads to greater surplus, but in a world of specialization, productivity and surplus, there is need for trading or exchange. However, before anything is traded, except what the nature offers freely, there must be production.

e. Technology is inseparable from the great accomplishments in a modern economy through industrialization, discovery and innovation.

f. The underlying customs and behavioral patterns help shape an economic system's institutional structure and environment, which affect the level and scope of activities in the real economy.

This conceptualization brings to focus certain sectors that are closely related to developing the real economy. For example, how an economy or system encourages and facilitates production in general and capital goods in particular, or how an economy deals with manufacturing and agricultural sector, where risk is generally higher, can have major implications for the real economy. Having this conceptualization is helpful to better understand the relevance of the sectoral distribution in an economy.

4. Islamic Banking in Bahrain

The Kingdom of Bahrain has a reputation of being one of the first countries to recognize and adopt the Islamic banking system in the MENA region. It has been extremely supportive of the industry's development and has helped in supporting new players to enter the market and paved the path for many innovations in the Islamic finance field. The first Islamic bank in Bahrain was established in 1979, when the Bahrain Islamic Bank was licensed. Since then, the sector has grown considerably. Now, Bahrain is home to some of the largest Islamic financial institutions not only in the Gulf but also anywhere in the world. According to Central Bank of Bahrain (CBB) Registry, the Kingdom is playing host to twenty-six Islamic banks and financial institutions, five industry-support organizations, seven Islamic insurance companies, two re-takaful companies and 89 Islamic mutual funds. As one of the hubs of Islamic finance, the experience of Bahrain is highly relevant to the subject of this paper.

5. Sectoral breakdown Bahrain's banking sector

Bahrain has a dual (conventional and Islamic) banking system, comprising 85% of total financial assets in the country. The conventional segment includes 23 retail banks, 69 wholesale banks, 2 specialized banks as well as 36 representative offices of overseas banks. The Islamic segment, offering a host of Sharia compliant products and services, include 6 retail banks and 16 wholesale banks (CBB website).

Retail banks, whether Islamic or Conventional, focus its core activities of deposit mobilization or financing towards individuals whereas wholesale banks usually focus its activities on corporates and other institutions. It is however noticeable that retails banks are also allowed to cater for corporate and institutional requirements in addition to the retail/consumer banking operations.

Keeping in perspective the dual banking system and the retail-wholesale split, in the following sections, we examine the distribution of financings amongst different industries and sectors within Bahrain. The structure of the secondary data collected through various Central Bank publications, is split into conventional and Islamic banks. Notably, the conventional banks in Bahrain, as part of a financial hub in the region as aforementioned, have different focus in being onshore (local) or offshore (overseas).

i. Conventional Banks

Conventional banks licensed in Bahrain have dealings in the retail and wholesale sectors. To each, there are two books of local and overseas exposures. Following is a summarized collation of data from the central bank through different publications which showcase the distribution and highlight the differences between each of the sectors involved, between local lending and those overseas.

a. Retail Banks:

Based on our study of the secondary data collected, despite fluctuation in the distribution of the retails banks' exposure amongst different industries, the overall trend remains largely stable with a few percentage points/decimals changing over the past 5-years data.

Conventional retail banks have a large concentration in real-estate related sectors (averaging 32-35% over the last 5 years, Table 1.1) with the targeted market niche consisting individuals, as well as corporates that seek to develop real-estate as means to collateralize and provide a platform based on which it is able to borrow more. This concentration owes to the specifics of the local market in which the conventional banks operate their financing book.

Table 1.1: Distribution of Conventional Retail Banks' Local Lending

Sector	Sept 2012	Mar 2013	Sept 2013	Mar 2014	Sept 2014	Mar 2015	Sept 2015	Mar 2016	Sep 2016
Manufacturing	11.9	12.1	11.8	11.9	12.3	12.4	13.4	12.4	12.3
Mining and quarrying	0.2	0.2	0.3	0.3	0.2	0.1	0.3	0.2	0.3
Agriculture, fishing and forestry	0.3	0.3	0.3	0.4	0.2	0.3	0.3	0.2	0.2
Construction	6.1	6.4	5.8	5.4	5.3	5.3	5.1	5.4	4.7
Financial	8.7	8.8	7.6	7.2	7.7	8.1	7.0	7.8	6.6
Trade	9.5	9.3	9.9	10.2	10.6	10.7	10.5	11.1	10.6
Personal / Consumer finance	12.6	12.1	12.3	12.6	11.9	12.3	12.3	12.5	12.9
Credit Card	-	-	-	0.5	0.6	0.6	0.6	0.6	0.6
Commercial real estate financing	16.2	16.5	16.8	17.4	19.2	18.7	19.2	19.5	20.1

Residential mortgage	10.6	10.4	11.3	12.2	11.2	11.1	10.7	10.3	10.3
Government	3.5	3.2	3.0	2.5	2.6	1.9	2.7	2.9	2.5
Technology, media & telecom	2.3	2.6	2.7	2.7	2.4	3.2	2.6	2.5	2.5
Transport	2.7	2.5	2.1	2.0	1.7	1.7	1.2	1.1	1.1
Other sectors	15.4	15.6	16.1	14.7	13.9	13.6	14.3	13.7	15.1
Total	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**
Top two recipient sectors	31.6	32.1	32.9	32.1	33.2	32.3	33.4	33.2	35.2
Real Estate/ Construction Exposure	32.9	33.2	33.9	35.0	35.8	35.1	34.9	35.3	35.2

With conventional bank's overseas book being less exposed to the real-estate and related sectors vis-à-vis the retails banks (at 19% compared with 35% concentration of conventional retail banks), we notice a large distribution towards other sectors mainly the manufacturing and financial sectors. The lower concentration in the real-estate sector is understandable given the difficulties in mortgaging the real estate developments overseas than the country in which the bank is operating. Further, the monitoring of progress of the developments of financed facilities is more cumbersome overseas than it is locally. The 5-year sector distribution follows in Table 1.2:

Table 1.2: Distribution of Conventional Retail Banks' Overseas Lending

Sector	Sept 2012	Mar 2013	Sept 2013	Mar 2014	Sept 2014	Mar 2015	Sept 201	Mar 2016	Sep 2016
Manufacturing	26.7	21.8	14.5	19.0	19.2	18.2	17.0	18.0	16.9
Mining and quarrying	2.5	2.4	0.8	2.0	2.8	2.5	2.6	2.6	2.6
Agriculture, fishing and forestry	0.5	0.5	0.3	0.4	0.2	0.2	0.1	0.1	0.1
Construction	7.5	8.1	6.3	7.1	6.2	5.5	5.4	5.1	4.8
Financial	9.2	8.7	7.4	8.4	8.3	12.9	13.2	12.0	12.5
Trade	10.3	10.5	10.8	9.3	8.1	9.6	9.0	9.9	9.5
Personal / Consumer finance	13.1	13.6	12.8	16.4	16.3	15.9	15.5	15.5	15.2
Credit Card	-	-	-	0.7	0.7	0.7	0.7	0.7	0.8
Commercial real estate financing	6.3	6.1	13.6	6.8	9.9	10.2	12.5	13.0	13.4
Residential mortgage	1.6	1.5	8.5	1.2	1.2	1.1	1.1	1.2	1.2
Government	2.6	2.3	2.8	2.9	2.8	2.6	3.2	2.7	5.5
Technology, media & telecom	4.9	4.5	3.2	6.3	6.1	5.6	5.1	4.6	3.9
Transport	4.4	4.3	2.7	3.0	2.6	2.8	2.7	2.9	2.7
Other sectors	10.3	15.6	16.2	16.4	15.6	12.2	11.8	11.5	11.1
Total	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**
Top two recipient sectors	39.8	37.5	30.7	35.4	35.3	34.1	32.5	33.5	32.1
Real Estate/ Construction Exposure	15.5	15.7	28.4	15.1	17.3	16.8	19.1	19.3	19.3

As shown in Fig.1, in combining both the local and overseas exposures, conventional banks have the following distribution:

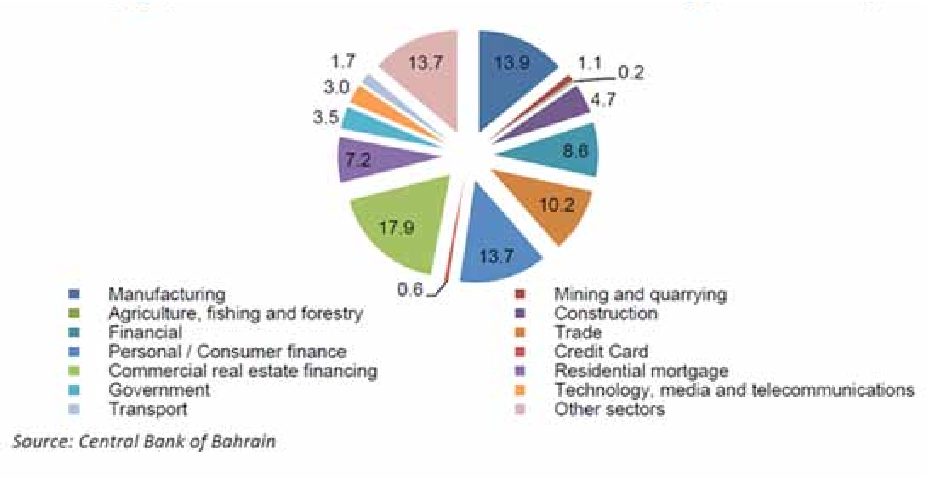


Fig. 1. Distribution of Conventional Retail Banks' Lending (% of total loans)

b. Wholesale banks:

With a fundamental difference in the targeted clientele between the retail banks and wholesale, we see lower concentration in the real estate sector for wholesale banks and more dependency on the manufacturing, financial sectors, together forming nearly half of the local lending in Bahrain. The focus is on corporate lending which is limited in context to the real-estate sector given the volatility and riskiness of the market. We therefore compare, as of September 2016, a 9.2% concentration in the real-estate sector compared with retail banks' 35.2% local lending for the same sector.

Table 2.1: Distribution of Conventional Wholesale Banks' Local Lending

Sector	Sept 2012	Mar 2013	Sept 2013	Mar 2014	Sept 2014	Mar 2015	Sept 2015	Mar 2016	Sep 2016
Manufacturing	31.7	32.1	30.4	29.1	28.4	27.4	25.6	24.6	25.0
Mining and quarrying	2.8	3.0	3.3	2.9	3.2	3.0	2.6	2.3	2.2
Agriculture, fishing and forestry	2.3	2.3	2.2	2.5	2.3	2.0	1.7	2.0	2.4
Construction	6.2	7.0	7.7	7.3	8.2	7.5	6.7	6.6	6.5
Financial	22.4	23.6	22.1	21.4	22.6	21.6	23.5	26.0	24.8
Trade	9.3	9.1	9.0	10.2	10.9	11.1	12.0	12.0	12.1
Personal / Consumer finance	2.2	2.3	2.3	3.5	2.0	2.1	2.0	1.9	2.0
Credit Card	1.5	1.3	2.0	1.7	-	0.1	0.1	0.1	0.1
Commercial real estate financing	-	-	-	-	1.5	2.4	3.9	2.5	2.0
Residential mortgage	0.5	0.5	0.6	0.7	0.8	0.7	0.7	0.8	0.7
Government	0.9	0.7	1.4	1.4	0.9	1.5	1.7	2.4	2.3
Technology, media & telecom	4.2	2.4	2.4	2.3	2.1	2.1	2.1	2.0	2.0

Transport	6.3	6.2	7.3	6.6	7.0	7.7	7.6	7.3	7.6
Other sectors	9.7	9.7	9.4	10.4	10.1	10.8	9.8	9.7	10.3
Total	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**
Top two recipient sectors	***54.1***	***55.7***	***52.4***	***50.4***	***51.0***	***49.0***	***49.1***	***50.5***	***49.9***
Real Estate/ Construction Exposure	***8.2***	***8.8***	***10.3***	***9.7***	***10.5***	***10.6***	***11.3***	***9.8***	***9.2***

Curiously, the wholesale banks' exposure to real-estate in overseas transactions is larger (at 16%) than retail banking counterpart (at 9%). This could be attributed to the companies which have different methods of payment and sources of debt servicing which enable the banks to participate more in the real-estate sector without being prone to the disadvantages of the said sector, given the other venues of credit-worthiness that a corporate has compared with an individual. The difference however is between local vs. overseas exposure which could be explained by the larger property market abroad than Bahrain which suffers from lower availability of lands given its small relative size of 765 km2 only.

Table 2.2: Distribution of Conventional Wholesale Banks' Overseas Lending

Sector	**Sept 2012**	**Mar 2013**	**Sept 2013**	**Mar 2014**	**Sept 2014**	**Mar 2015**	**Sept 2015**	**Mar 2016**	**Sep 2016**
Manufacturing	14.3	11.2	11.3	8.0	6.7	9.4	8.9	8.7	7.9
Mining and quarrying	6.6	1.1	1.0	1.2	1.0	3.3	3.5	4.8	3.9
Agriculture, fishing and forestry	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.5	0.5
Construction	5.2	7.1	7.6	7.0	7.7	11.8	11.0	14.0	15.0
Financial	31.2	44.2	39.9	37.5	38.8	24.5	23.2	16.9	17.1
Trade	4.3	6.0	5.9	6.5	7.4	6.1	6.8	6.4	7.1
Personal / Consumer finance	0.3	0.5	0.4	3.7	3.8	4.5	4.7	4.8	4.7
Credit Card	-	-	-	-	-	-	-	-	-
Commercial real estate financing	2.0	2.8	1.5	-	1.1	1.2	1.5	1.3	1.4
Residential mortgage	-	-	-	1.1	-	-	-	-	-
Government	12.3	6.3	9.6	9.5	7.7	8.5	8.4	8.4	9.4
Technology, media & telecom	3.5	4.1	3.0	8.4	2.5	2.3	1.9	1.5	1.1
Transport	5.1	4.5	5.2	2.8	4.2	3.5	5.4	6.8	7.7
Other sectors	15.2	12.1	14.7	14.6	19.1	24.7	24.7	25.9	24.3
Total	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**
Top two recipient sectors	***46.5***	***56.3***	***54.6***	***56.6***	***57.8***	***49.2***	***47.8***	***42.8***	***41.4***
Real Estate/ Construction Exposure	***7.1***	***10.0***	***9.1***	***8.0***	***8.9***	***13.0***	***12.4***	***15.3***	***16.3***

As shown in Fig.2, in combining the wholesale banks' lending between local and overseas, we see the following aggregate distribution.

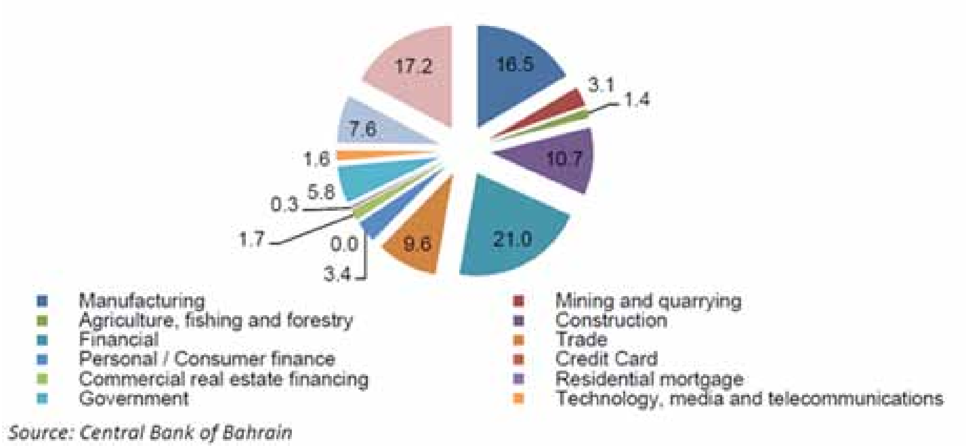


Fig. 2. Distribution of Conventional Wholesale Banks' Lending (% of total loans)

ii. Islamic Banks

The data collected for Islamic banks in Bahrain does not segregate between local and overseas financing. It groups together those and presents the figures for retail and wholesale banks only. Following is a collation of data on the same.

c. Retail Banks:

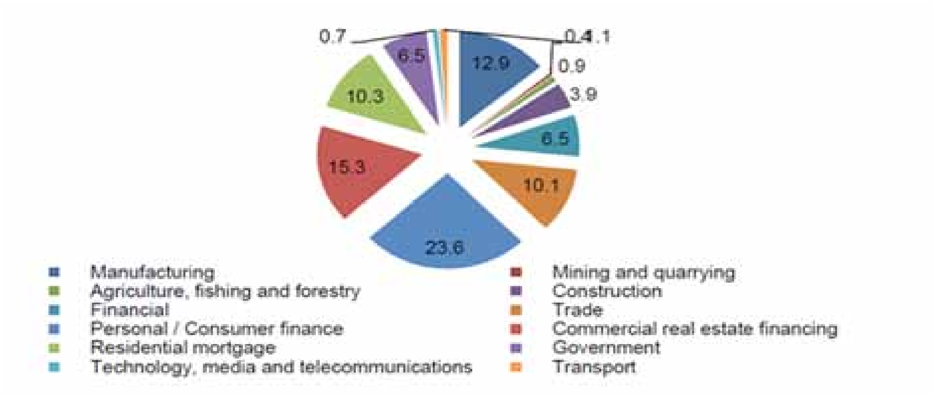
Retail banks have the tendency to concentrate its financing towards the real-estate sector. This is evident in Islamic banks in Bahrain where 29% of total financing of the retail banks is towards real-estate and related sectors. Consumer finance however takes a lead in the retail banks with the Muslim-majority country of Bahrain catering to the Shari'ah-compliance requirement of some of the retail customers.

Table 3.1: Distribution of Islamic Retail Banks' Financing

Sector	Mar 2013	Sept 2013	Mar 2014	Sept 2014	Mar 2015	Sept 2015	Mar 2016	Sep 2016
Manufacturing	18.7	15.9	16.8	14.6	14.3	13.5	12.5	12.9
Mining and quarrying	-	0.5	0.6	0.5	0.5	0.5	0.4	0.4
Agriculture, fishing and forestry	0.9	0.9	0.9	1.0	1.0	0.9	0.7	0.9
Construction	4.3	4.3	4.8	5.0	5.1	4.8	5.3	3.9
Financial	12.8	10.6	11.1	12.2	9.8	7.1	11.0	6.5
Trade	10.9	12.7	11.0	10.3	10.4	10.3	10.1	10.1
Personal / Consumer finance	20.7	17.8	15.1	17.4	19.9	21.6	20.8	23.6
Credit Card	-	-	-	-	0.7	0.9	0.9	1.0
Commercial real estate financing	13.9	18.2	16.7	16.9	15.5	14.5	14.9	15.3
Residential mortgage	4.8	5.0	7.0	7.1	8.0	9.0	9.3	10.3
Government	6.4	7.4	7.0	6.3	6.3	9.0	6.7	6.5

Technology, media & telecom	0.2	0.5	0.5	0.9	1.3	0.8	0.7	0.7
Transport	1.2	0.9	1.0	1.1	1.0	1.0	0.8	1.1
Other sectors	5.1	5.1	7.4	6.8	6.0	6.0	6.0	7.0
Total	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**
Top two recipient sectors	39.3	36.1	33.5	34.3	35.4	36.1	35.7	38.9
Real Estate/ Construction Exposure	23.0	27.6	28.5	29.0	28.6	28.4	29.5	29.4

Fig.3 is a representation of the latest data as of September 2016 based on economic activity (or sector) towards which Islamic retail banks have exposure:



Source: Central Bank of Bahrain

Fig. 3. Distribution of Islamic Retail Banks' Lending by Ecenomic Activity (% of total facilities)

d. Wholesale Banks:

Different than its conventional counterpart, there is less difference in the distribution of financing between the real-estate sectors with the retail Islamic banks concentrating at 29.4% while wholesale Islamic banks are at 27.4%. There is however a difference within the different activities that qualify for real-estate exposure being the construction and commercial real estate financing. Wholesale banks' construction activity has a larger percentage of overall financing at 16% compared with its counterpart of retail at 3.9%. This is while noting that commercial real estate financing is larger in retail financing at 15.3% compared with wholesale financing at only 0.5%. The difference could be explained by the construction being a larger activity overseas than it is in Bahrain given the aforementioned relative small size of the market in Bahrain than neighboring countries to which exposure is given. Noting that the other real-estate activity, namely residential mortgages, form nearly the same quantum for both wholesale and retail at approx. 10% of total financing portfolios.

Table 3.1: Distribution of Islamic Wholesale Banks' Financing

Sector	**Mar 2013**	**Sept 2013**	**Mar 2014**	**Sept 2014**	**Mar 2015**	**Sept 2015**	**Mar 2016**	**Sep 2016**
Manufacturing	22.3	22.1	19.3	24.7	25.6	24.0	24.4	19.2
Mining and quarrying	0.6	0.5	0.6	0.9	0.8	0.7	0.7	1.1

Agriculture, fishing and forestry	0.3	0.3	0.4	0.4	0.5	0.4	0.6	0.7
Construction	10.9	13.4	15.3	16.3	16.9	17.3	17.3	16.0
Financial	12.2	17.9	16.6	9.4	8.7	9.2	9.8	9.3
Trade	13.4	12.0	12.9	12.5	11.6	11.0	10.9	7.3
Personal / Consumer finance	8.2	7.5	8.3	8.9	9.7	9.8	9.7	21.3
Credit Card	-	-	-	-	-	-	-	-
Commercial real estate financing	0.8	1.5	1.7	1.6	1.6	0.9	0.9	0.5
Residential mortgage	2.9	2.0	2.2	2.5	2.4	3.3	3.0	10.9
Government	1.0	7.3	7.3	6.2	7.6	7.8	7.4	6.6
Technology, media & telecom	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Transport	2.2	3.9	1.7	1.2	1.2	1.3	1.7	1.1
Other sectors	24.8	11.3	13.5	15.2	13.2	14.2	13.4	5.7
Total	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**
Top two recipient sectors	47.1	40.0	35.9	41.0	42.5	41.2	41.7	40.6
Real Estate/ Construction Exposure	14.6	16.9	19.2	20.4	20.9	21.4	30.7	27.4

Fig. 4 is a representation of the latest data as of September 2016 based on economic activity (or sector) towards which Islamic wholesale banks have exposure:

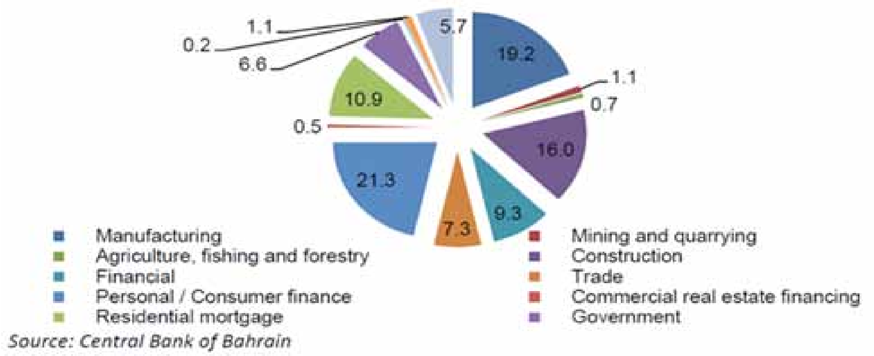


Fig. 4. Distribution of Islamic Wholesale Banks' Lending (% of total faclities)

6. Comparison between conventional and Islamic sectoral breakdowns

With the data presented above, we are now able to compare the sectoral distribution activities of activities of both Islamic and conventional banks.

Table 4: Distribution of Conventional vs. Islamic Lending/Financing - Retail Banks, based on data collected as of September 2016 follows:

Sector	Islamic	Conventional
Manufacturing	12.9	13.9
Mining and quarrying	0.4	1.1
Agriculture, fishing and forestry	0.9	0.2

Construction	3.9	4.7
Financial	6.5	8.6
Trade	10.1	10.2
Personal / Consumer finance	23.6	13.7
Credit Card	1.0	0.6
Commercial real estate financing	15.3	17.9
Residential mortgage	10.3	7.2
Government	6.5	3.5
Technology, media & telecom	0.7	3.0
Transport	1.1	1.7
Other sectors	7.0	13.7
Total	**100**	**100**
Top two recipient sectors	38.9	31.7
Real Estate/ Construction Exposure	29.4	29.8

The main difference found in retail bank distribution between Islamic and conventional as highlighted in the table above is the percentage of personal/consumer finance which the Islamic banks cater to (23.6%) vis-à-vis a lower 13.7% offered by the conventional banks. This indicates that the average consumer in Bahrain is more likely to lean towards Islamic Banking than conventional banking for the personal banking requirements such as personal loans (financing). These are predominantly financed through Murabaha structures wherein the consumer receives a sum of money based on a Murabaha contract with deferred payments inclusive of a markup the bank placed upon the sale of an underlying commodity to the consumer. This is evident by the following chart which splits the financings between the different structures of Islamic finance (based on figures as on September 2016; see Fig. 5).

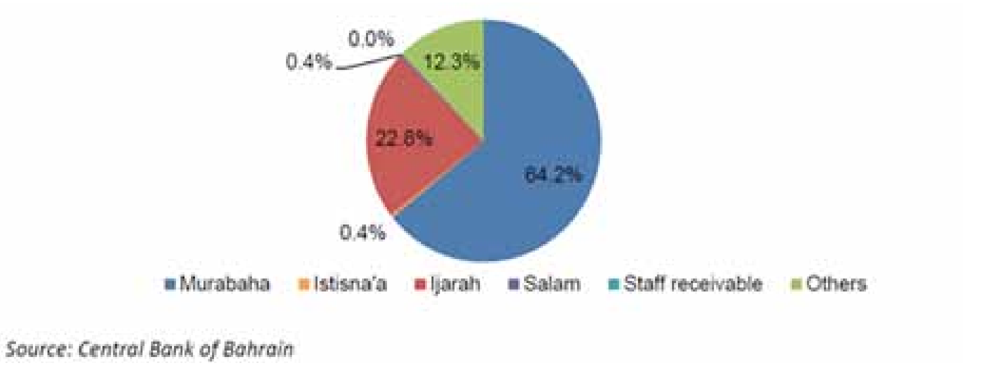


Fig. 5. Distribution of Islamic Retail Banks' Lending by Islamic Insterament (% of total facilities)

It is noteworthy that the real-estate exposure of both conventional and Islamic banks are nearly identical at around 29% each.

Table 5: Distribution of Conventional vs. Islamic Lending/Financing – Wholesale Banks, based on data collected as of September 2016

Sector	Islamic	Conventional
Manufacturing	19.2	16.5
Mining and quarrying	1.1	3.1
Agriculture, fishing and forestry	0.7	1.4
Construction	16.0	10.7
Financial	9.3	21.0
Trade	7.3	9.6
Personal / Consumer finance	21.3	3.4
Credit Card	-	0.0
Commercial real estate financing	0.5	1.7
Residential mortgage	10.9	0.3
Government	6.6	5.8
Technology, media & telecom	0.2	1.6
Transport	1.1	7.6
Other sectors	5.7	17.2
Total	**100**	**100**
Top two recipient sectors	40.6	38.2
Real Estate/ Construction Exposure	27.4	12.7

The differences are more dominant in wholesale banking than they are in retail banking with the real-estate sector being more than a quarter of all financings for Islamic wholesale banks compared to only 12.7% of total conventional financings for wholesale banks. This could be attributed to the investments that the Islamic sector makes into the real-estate developments witnessed in Bahrain such as Kuwait Finance House's Durrat Al-Bahrain, a reclamation of a series of islands catering for higher classes in which the Shari'ah-compliant bank has developed the project and bore the costs of the same as financing of its real-estate arm. The conventional sector compensates for the lower concentration in the real estate sector into having a larger exposure in the finance sector, transport and other sectors as well.

For wholesale banks, whose clientele are corporates and institutions, Murabaha form a larger percentage of overall Islamic financings than retails at 92% to retail's 64.2% respectively [see Fig. 6]

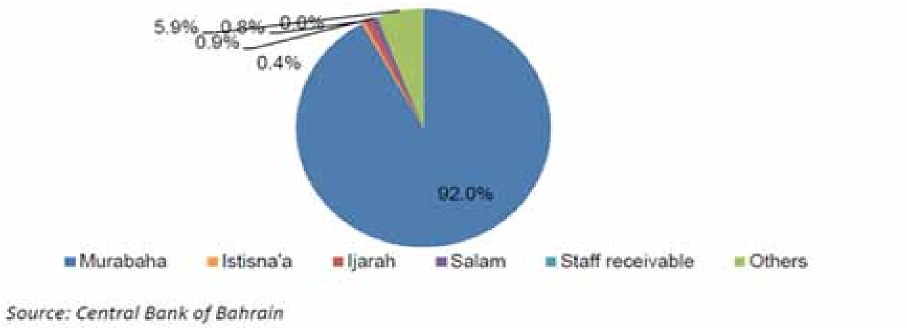


Fig. 6. Distribution of Islamic Wholesale Retail Banks' Lending by Islamic (% of total facilities)

7. Comparison between non-performing facilities

As suspected, given the concentration of Islamic and conventional banks' retail exposure, the non-performing facilities (NPF) largely relates to each respective distribution with Islamic banks' NPFs mainly focused in the real-estate sectors (construction or commercial real estate). Noteworthy is conventional bank's NPFs more in the manufacturing, mining and quarrying and agriculture sectors whereas the other sectors are of lower percentages. While no data alludes to the reasoning behind this, it is well known that the structuring of the conventional facilities is less complex and easily understood by the customers than that of the Islamic facilities which also may explain why the latter are more prone to defaults and non-performance than their conventional counterparts. Percentage of gross facilities per sector is as below Fig. 7:

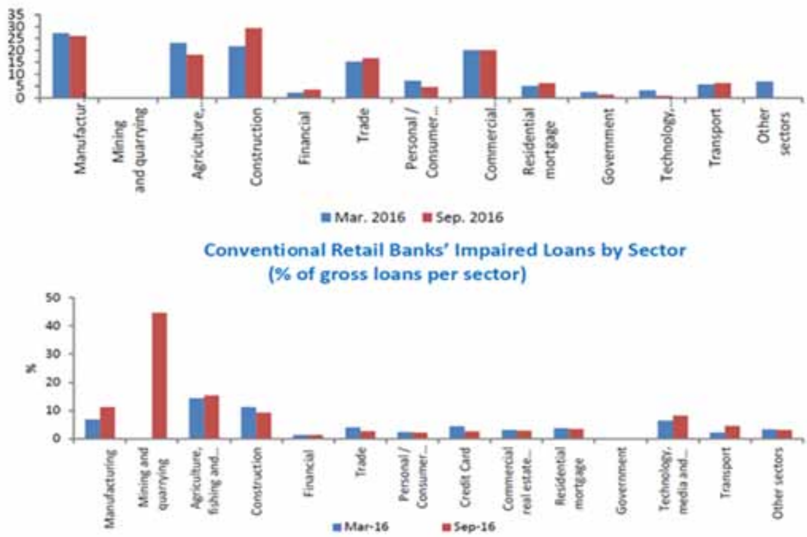


Fig. 7. Islamic Retail Banks' NPF's by Sector (% of gross facilities per sector)

Wholesale banks show lower NPFs for real-estate sector as a percentage of gross facilities in conventional banks than the Islamic counterparts. Technology, media and telecom sector served by Islamic finance has the larger non-performing facilities than other sectors in which the NPF percentage is considered low.

It is noteworthy that the conventional banks' wholesale operations saw a larger percentage in the real-estate sector than the retail banks. This further elucidates (Fig. 8) that the nature of lending in conventional banks differ in appetite and riskiness in overseas books than the local books.

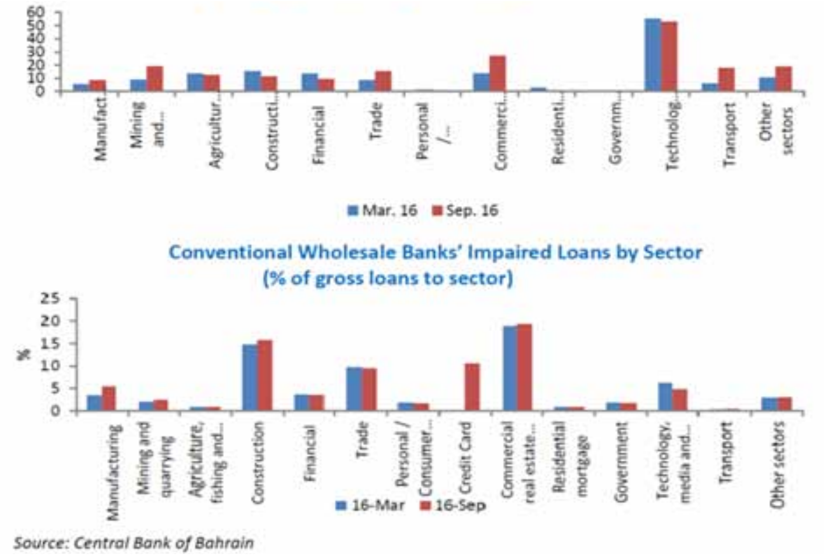


Fig. 8. Islamic Wholesale Banks' NPF's by Sector (% of gross facilities persector)

8. Between rhetoric and reality

The above presentation allows certain observations about the gap between the rhetoric and the reality pertaining to Islamic finance. Addressing these gaps can help strengthen the industry in the long run.

a. Bias toward real estate and construction

It is worthwhile to note that the 2008 crisis that originated in the USA was anchored in real estate finance, which is the nexus of the real estate sector and the financial sector (UNECE, 2008). Also known as the real estate or housing bubble, 2008 crisis was an eye-opener, as the real estate sector used to be regarded as "safe haven" for people's investment and spending. "When people have a low tolerance for risk, the real estate market often provides them with a safe haven because of the reduced volatility caused by lack of liquidity" (Ross, 2017, 104) [1]. The sentiment that helped build and feed the bubble is aptly captured by Strauss and Stone (2003, XV):

In fact, as long as anyone can remember, experts have agreed that investing in real estate is the best and safest bet you can make. Today, the market has grown to like all the attention it's getting. A recent article in USA Today said, 'Not since the 1960s has the housing market been so uniformly strong across the USA.' The article added that 'the market is largely devoid of extremes,' and 'today's hot markets can be found in all regions of the country.' In January 2003, existing single-family home sales climbed more than 3 percent over 2002, which had set the previous record. David Lereah, the chief economist for the National Association of Realtors, gave credit to lower interest rates and the fact that, 'real estate has become the safe haven for investment.' As long as this investment is looked upon as a long-term wealth builder and not a fly-by-night get-rich scheme, investors will make out great.

It was not just in the USA, but globally it has been a rather strong paradigm that real estate is a safe haven, and the best place to place one's safe "bet" for long-term returns. Since this was a globally shared paradigm, one cannot consider Islamic finance industry to have bucked the trend. But what is clear from the sectoral distribution presented above, and the similar kind of concentration in the real estate sector, while the industry is based on the distinction of being different from its conventional counterpart in terms of the religious prohibitions, in terms of approach, strategy or vision it seems to be beholden to the very system that it fundamentally criticizes and rejects. Thus, while Islam teaches "shared prosperity", where the system or society does not serve the rich, the Islamic finance industry has a bias toward the projects that cater to the rich and wealthy. Major projects financed by several Islamic finance institutions in Bahrain are focused on luxury real estate. Durrat al-Bahrain by Kuwait Finance House, Riffa Views by Arcapita, etc. are among relevant examples.

Conventional counterpart is criticized for having a "bias to the rich" (Kahf, 2013, 247; Farooq, 2014), while Islamic finance presumably does not, but the reality is still quite far from addressing that bias. Thus, it is not just taking the cue from the West regarding the paradigms of "safe haven", but also the industry is not properly and adequately in tune of the Islamic norms and values of shared and inclusive prosperity. It is important to keep in mind that being "Islamic" is not about only avoidance of prohibition, but also achieving positive goals (maqasid).

b. Risk sharing vs. risk-avoidance

Another distinctive claim of Islamic finance is that it offers fair or fairer risk-sharing comparing to its conventional counterpart (Askari, et al., 2012; Greuning and Iqbal, 2008). Iqbal and Molyneux (2005, 28) explain the problem with the conventional finance:

The most important feature of Islamic banking is that it promotes risk-sharing between the provider of funds (investor) and the user of funds (entrepreneur). By contrast, under conventional banking, the investor is assured a predetermined rate of interest. Since the nature of this world is uncertain, the results of any project are not known with any certainty ex ante, and so there is always some risk involved. In conventional banking, all this risk is borne by the entrepreneur. Whether the project succeeds and produces a profit or fails and produces a loss, the owner of capital gets away with a predetermined return. In Islam, this kind of unjust distribution is not allowed. In Islamic banking both the investor and entrepreneur share the results of the project in an equitable way. In the case of profit, both share this in pre-agreed proportions. In the case of loss, all financial loss is borne by the capitalist and the entrepreneur loses his labour.

The contrasting role and relevance of risk-sharing in Islamic finance is aptly articulated by Askari (2012): "A system resembling Islamic finance would preclude the assumption of excessive risk by prohibiting debt and risk-shifting in favor of risk-sharing and equity finance. … Islamic finance prohibits shifting the entire risk of the transaction to the borrower."

Unfortunately, while proclaiming to value fair risk-sharing and shun risk-shifting, Islamic finance industry is more in the risk-avoidance mode, especially as reflected in the sectoral distribution and the Islamic banks' product portfolio. In Bahrain Islamic retail banks' financing (Table 4) to Manufacturing/Mining/Agriculture constitutes 14.2 percent (conventional: 15.2%), while Trade/Personal Finance/Real Estate constitutes 59.3% (conventional: 49%). This distribution pattern is important because the Islamic finance industry is more focused on industries that are less risky (including, safe haven – real estate) and offer more fixed, predictable return opportunities.

The same is corroborated by the Islamic banks' product portfolios. Islamic retail banks in Bahrain is so concentrated on the fixed-return modes that they constitute 87.3% of the portfolio (Fig.5), while fixed return modes in Islamic wholesale banks' portfolios constitute 94% (Fig.6).

With profit-loss-sharing modes so marginalized and neglected, the distinctiveness of Islamic banking as practiced today leans toward risk-avoidance than risk-sharing.

c. Debt Culture

One of the key factors behind the 2008 global crisis is credit boom or excessive debt or credit bubble (Eichengreen and Mitchener, 2003). It is acknowledged that oversupply of credit reflected aggressive and irresponsible lending practices by leading industrialized countries, especially the USA. The crisis was symptomized by unsustainable debt or credit level, underlying which there was an endemic and incentivized debt culture. It would not be an exaggeration to say that the debt culture or a way of life based on debt has been normalized or even glamorized in modern times (Boynton, 2011; Villa, 2013; Clayton, 2016; Institute for American Values, 2008; Murphy, 2016). Researchers also identify excessive debt as one of the common factors behind all the crises in modern economies spanning the last few centuries (Yates, et al., 2011; Konzelmann and Fovargue-Davies, 2013; Arena, et al., 2015). In a debt culture, the financial system facilitates a role that is "debt-seeking, debt-promoting and debt-creating" (Farooq, 2015, 1169).

When one takes into consideration the macroeconomic dimensions one would expect that beyond the focus on the transaction level, Islamic finance would also be paying attention to the implications of the excessive debt, credit bubble and debt culture. Islamic banks' sectoral distribution and the accompanying pattern of portfolio composition seem to leaning to a pattern that is "debt-seeking, debt-promoting and debt-creating."

In regard to the debt-bias of Islamic finance industry, it should be clarified that only two modes, Mudaraba (passive partnership) and Musharaka (partnership in general) are profit-loss-sharing or PLS modes, which in turn are also risk-sharing modes. Murabaha, Istisna, Salam, Ijarah – all these are exchange-based, debt-creating products. As non-PLS, these modes are also not risk-sharing. Fig.5 shows that for Islamic Retail Banks in Bahrain, Murabaha alone constitutes 64.2%, while the combined share of non-PLS modes is 87%.

As per Fig. 6 for Wholesale Banks, the Murabaha share stands starkly at 92%, while the combined share of non-PLS, non-risk-sharing modes, is at least 92+%. Thus, the overwhelming dominance of debt-based products is disconcerting for at least two reasons. First, from human experience, it is now well-established that overindebtedness or credit boom is a key factor behind economic and financial crises, including the latest of 2008. Thus, one would expect Islamic finance would not just criticize the West legalistically or ceremonially, but also learn from its experience and benefit from the negative experience of serious and deep-rooted debt-bias. Secondly, and more importantly, Islam has allowed debt, but it has seriously discouraged getting into debt and also has mandated ways to help people out of debt (Farooq, 2015).

The debt-bias has the potential to feed the debt-culture in the Muslim world, as indicated by the prominence of the consumer finance using Murabaha. As Table 4 shows, consumer finance constitutes 13.7% of the conventional retail banks, while it is 23.6% of Islamic retail banks. For wholesale banks, the gap is much greater. Table 5.0 shows, consumer finance constitutes only 3.4% of conventional wholesale banks' sectoral allocation, while for Islamic banks it is a whopping 21.3%.

With such bias toward real estate and construction, bias against risk-sharing and bias toward debt-based products, as reflected in the sectoral allocation, Islamic finance has a lot more need and opportunity to reexamine its orientation and be more authentic from Islamic viewpoint in a holistic sense and be more relevant to the real economy through greater allocation toward those sectors that help build the economic capacity as part of a stronger and sustained development than merely enticing consumers to create and support more consumer demand, without contributing enough to creation of jobs and income/wealth of the people.

9. Conclusion

Bahrain's position as a financial center makes it ideal to study the differences between the sectoral breakdowns between Islamic and conventional banks. The further breakdown of those into retail and wholesale, onshore/local lending vs. offshore/overseas lending sheds further light into the difference it makes, based on our sample data of 5-years on sectoral distribution.

There are several main outcomes from analyzing these data. (a) Locality of the bank operations, on-shore or off-shore, has relevance to concentration of the exposure to real-estate sector both for the Islamic and conventional. (b) There is a fairly stable trend in the sectoral breakdown without much deviation over the past 5-years in Bahrain. (c) Except for the real-estate and other related sectors differences, there isn't much gap in most other sectors indicating that the consumers are largely indifferent between the conventional or Islamic modes of finance. This is with the exception of personal finance, which both locally and overseas has a good traction in the Islamic mode. Bahrain's experience indicates when it comes down to personal finance, sharia-compliant financings are preferable.

The factors behind consumer preference for IBs in regard to Shari'ah-compliant personal finance are beyond the limited scope of this paper. But an expanded study to explore those factors as applicable to Bahrain and also comparing these findings in Bahrain with other countries in GCC and beyond should provide further insight into the preferences in the sectoral distribution in Islamic finance.

This study of the sectoral distribution in Bahrain illuminates three key aspects – debt bias, risk avoidance and debt culture – indicating that there are a number of areas where Islamic banks have significant room for improvement or reorientation to bridge the gap between the ideals they uphold and/or proclaims on the one hand and the praxis on the other, tempered by the reality based on practical constraints or profit-oriented pragmatist behavior to be merely competitive to their conventional counterpart.

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