International Journal of Islamic Finance, Vol. 01, No. 02 (2023) 103-109
Published by Department of Islamic Financial Management, Universitas Islam Negeri Sunan Kalijaga Yogyakarta
e-ISSN: 000xxx
http://ejournal.uinsuka.ac.id/febi/IJIF

Is the Investment Account the Blue Ocean of Islamic Banking?

Syafwendi Syafril
INCEIF University, email: 2100226@student.inceif.org

Abstract

Background: Profit-loss sharing (PLS) and prohibition of interest are fundamental principles of Islamic banking. However, Islamic banking practice today seems to move away from the ideal concept of promoting PLS. Most Islamic banks engage with less risky products and heavily rely on debt-based financing, such as Murabaha.
Objectives: This study aims to discuss the opportunity and challenge in offering PLS instruments to financial customer as blue ocean strategy of Islamic bank.
Novelty: Islamic bank is expected to increase the portion of PLS instrument by offering investment account to support real sector growth. Additionally, this study provides economic rationale behind PLS instrument that Islamic banking may take into account.
Research Methodology / Design: A qualitative approach is employed to identify the challenge and opportunity of using PLS in investment account. Data is collected from journal articles, books, and other documented sources. The content analysis is performed to investigate economic rationale behind investment account product and factors that make the instrument less popular among Islamic banking institution.
Findings: Profit and sharing investment account (PSIA) helps overall employment creation by investing in real economic sector developments. Additionally, PSIA creates potential for equitable income distribution through wise capital allocation, by channeling capital units to micro, small, and medium-sized firms.
Implication: The study can enrich Islamic finance literature in area of Islamic banking with regard to utilization of profit and sharing instrument for supporting real economic sector.

Keywords:
Islamic banking, Investment account, Profit and loss sharing, Islamic finance.

JEL Classifications:
G21, G24, G32

Received: September 18, 2023; Revised: October 23, 2023; Accepted: November 10, 2023; Available online: November 10, 2023

A. Introduction

Islamic bank provides financing facility by taking deposit from customers and creating numerous contract financing from this source of fund. Mostly, Islamic bank will also provide debt-based instrument. Kind of contract such as *murabahah* with *al-bay'* concept, *tawaruq* or commodity murabahah, *istisna*, and sale by instalment basis or *Bay Bitsamanin Ajil* (BBA) are widely used in Islamic banking practice nowadays. However, the ideal form of contract such as *mudharabah* and *musharakah* with profit and loss sharing (PLS) concept seems to be avoided and minimized proportionally in sized by IB. As if they are allergic to risk and looking for a facility that gives them a fixed return. Reflecting on this phenomenon, IB seems identical to conventional bank (CB) in terms of creating more loans by exercising deposit money from deposit - account holders. The only thing that differs IB to CB is using exchange-based contracts to replace *riba*, unfortunately, the goal is still the same, producing more debt.

Therefore, IB should move from deposit-taking behavior to PLS by using an investment account. This strategy allows IB not to compete with CB in offering fixed-return financial products. IB can grab a new opportunity by offering risk sharing product through investment account and targeting customer that can tolerate the risk at the same time do an investment to help real sector grow (Minhat & Dzolkarnaini, 2016; Syarifuddin, 2020). However, the question begins to emerge whether investment account is blue ocean strategy for Islamic banking or even worsening their performance.

Nowadays, Islamic banking is in comfort zone to provide a fixed-return financing facility rather than taking a courage to offer PLS instrument which is based on investment paradigm. Whereas the concept of Islamic banking today is the paradigm of traditional financial institution, whose primary objective is to maximize profit and provide more debt in society. This is most emphatically not the objective for which Islamic banking was formed. As a result, Islamic banking must be bold in taking new strategic measures toward supplying financial product facilities that are compliant with sharia principles and capable of achieving objective of *shariah*, such as justice, equitable income distribution, and substantial social benefit.

Profit Sharing Investment Account (PSIA) is a promising product in responding to the problems faced by Islamic banking today which seem to deviate from objectives of *shariah*. Even though this model is an ideal form of classical Islamic banking theory, however, it remains debatable and controversial to adopt in today's banking environment (AlShattarat & Atmeh, 2016). Therefore, further discussion and study need to carry on in order to know challenges and opportunity of this type of account in IB practice. As attempt to identify whether PSIA model become a blue ocean strategy for IB or even a threat to the sustainability of IB business, this study aimed to bring it into the table of discussion.

B. Literature Review

B.1. Theoretical Framework

PSIA is an instrument that allows financial customers to invest in project based on risk-sharing paradigm. IB have developed this to replace conventional interest-bearing deposit account by mobilizing customers fund to earn *shariah* compliant return (Archer et al., 2010). Customers as capital provider will cooperate with IB to invest their fund in a real project using PLS concept or will pay a fee as management compensation. PSIAs are classified into two types (Alhammadi et al., 2018):

a. Restricted PSIA

Restricted PSIA accounts are a form of investment account in which Investment Account Holders (IAH) provide the IFI with a specified investment mandate, including the purpose, asset class, economic sector, and investment period. IAH and IFI agree to share profit and risk in this product in accordance with the portion agreed upon. Additionally, the Islamic bank may be restricted from commingling its own funds with those of the limited investment account for investing purposes. Additionally, the proprietor of an investment account may apply additional limits. For instance, holders of investment accounts may urge the Islamic bank to refrain from investing their funds in instalment sales transactions or without a guarantee or security, or to conduct business directly rather than through a third party.

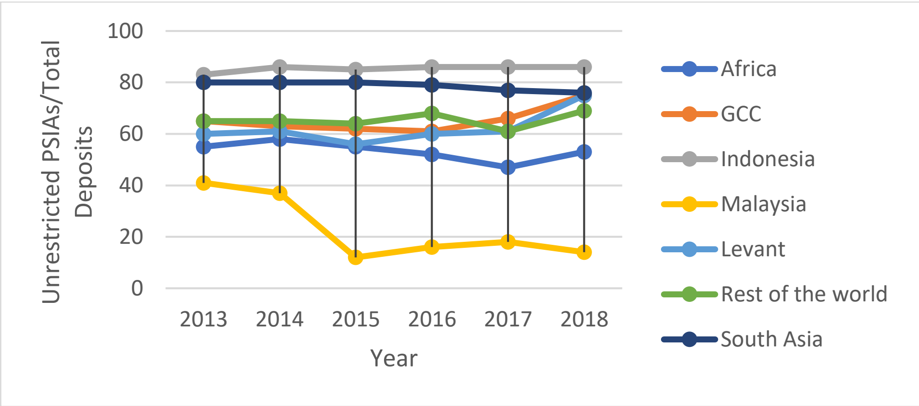
b. Unrestricted PSIA

In contrast to restricted IA, IAH will delegate authority to the IFI to make final investment decisions without imposing any specific conditions, criteria, or restrictions. The IB may combine the funds of the investment account holder with its own funds (owner's equity) or with other funds that the Islamic bank has the authority to utilize. The IAH and the IB generally share in the profits generated by the invested funds.

These types of IA are using *mudarabah or wakalah* contracts. Under *mudarabah* scheme, financial customer will take a role as *Rabb al Mall* (capital provider) to provide fund ready to invest and the IB provide a work as *mudarib* (asset manager or entrepreneur) and shares the profit. Meanwhile in *wakalah* contract, IB will act as *wakeel* (agent) on behalf of the customer to manage their fund properly and get monetary compensation as fee (*ju'alah*) for what IB has done.

Furthermore, the PSIA product is only suitable for risk takers who expect higher return in investment activity, such as investor in capital market sector. Meanwhile, the IAHs behavior are contrast compared to capital market investor which normally seek a low-risk and low-return like deposit account (Alhammadi et al., 2018).

PSIA is significant retail funding source for Islamic banks. According to the data collected by (Baldwin et al., 2019), the percentage of PSIA in total deposits varied significantly between 2013 and 2018, as can be seen at figure 1:



Source: Baldwin et.al. (2019)

Figure 1: PSIA as a Percentage of Total Deposits[1]

Figure 1 depict that except Malaysia, PSIAs accounted more than 50% of total deposits for the majority of period between 2013 and 2018. Meanwhile, the levant (Jordan, Lebanon, Syria, and Palestine), South Asia (Bangladesh and Pakistan), and Indonesia accounted for more than 75% of PSIAs in 2018. PSIAs as a percentage of total deposits in other regions, namely Africa (Nigeria and Sudan), the GCC (defined in Figure 1 as Bahrain, Qatar, Oman, and Kuwait; data not available for 2018), and the Rest of the World (defined in Figure 1 as Iran, Turkey, and Yemen), fluctuated between 2013 and 2018, but remained consistently the most important retail funding source for IB. Exceptional case occurred in Malaysia. Malaysia seems to be declined in term of using PSIA since the introduction of Islamic Financial Services Act of 2013. This legislation bring wind of change of IB funding landscape by prohibiting the smoothing returns paid to IAH (Ernst & Young, 2016). As a result of this change, the prevalence of PSIA drastically fell from 41% in 2013 to 14% in 2018.

C. Research Methodology

This study employs qualitative approach to achieve objectives of research, which is to identify the opportunity and challenge in utilizing PLS instrument such as investment in Islamic bank. Therefore, a critical review on investment account product in the the area of why this instrument is less popular compared to debt-based financing product is essential to conduct. Data was collected from news, reports, books, and related research article. All sources, documents, and articles related to PSIA are then read, reviewed, and wrote in order to conduct in depth analysis for the purpose of attaining the objective of this study.

[1] Africa (Nigeria and Sudan). GCC (Bahrain, Kuwait, Oman and Qatar). South Asia (Bangladesh and Pakistan). The levant (Jordan, Lebanon, Syria, and Palestine). Rest of the world (Iran, Turkey, and Yemen).

D. Result & Discussion

The obstruction factors of PSIA

IB are hesitant to adopt PLS instruments due to several reasons, including the bank's low appetite for risk, its unwillingness to bear the cost of monitoring such instruments, its experience with a lack of market transparency, and the bank's depositor's reluctance to take a risk. This aspect could reflect the banking system's lack of transparency, which results in a lack of trust between investors/depositors and banks, and therefore in depositors' unwillingness to assume long-term and risky positions with banks. As a result, depositors become risk hesitant, and banks become risk apprehensive, and even if they have attractive investment options based on profit and loss sharing, they may be unable to attract depositors ready to take the risk.

Another reason banks are hesitant to engage in profit and loss sharing is, a scarcity of credible institutional infrastructure for conducting common monitoring and sharing credit rating information on borrowers and entrepreneurs; this is referred to as informational asymmetry. As a result, banks lack regional and product diversification. This is not healthy, as it increases the dangers associated with the banking sector (Febianto & Kasri, 2007).

In addition, the absence of a secondary market that adheres to sharia principles in several jurisdictions makes it difficult for IBs to manage their liquidity which results in greater risk. As a result, IB suffer from a quasi-absence of risk-management techniques such as securitization, and from the underdeveloped of Islamic financial markets. All of these reasons contribute to IB's liquidity concerns by prohibiting them from managing their cash assets and diversifying their risk. These advantages make it more difficult for IB to forecast and stabilize the PSIA's rate of return, which is highly dependent on the level of competition among banks. Therefore, IB finds it more difficult to sustain market share and compete with conventional banks. This could eventually erode investors' confidence, prompting them to withdraw their funds (Hamza & Saadaoui, 2013).

Economic rationale of PSIA

The economic rational of why PLS is way more superior compare to interest in real economic sector can be seen through what was described by (Aggarwal & Yousef, 2000; Presley, 2012). Firstly, monetary return and productivity are dependent on the investment account. On the other words, the return of investment acquired from investment account will depend on actual productivity of the sector in which the fund is invested. Thus, the distribution of investable capital will be determined by the project's viability. As a result, the capital allocation will become more efficient.

Secondly, through the concept of PLS, the creation of money supply will increase only if the supply of goods and services in the real economic sector also improved correspondently. If the firm experiences a loss, the bank's refund of capital is reduced by the amount of loss. Therefore, within the frame of PLS system, the money supply is not allowed to offset the supply of goods and services. If the converse occurs, there will be a mismatch between money creation and supply of actual products, which could result in economic stagnation. However, by employing the PLS paradigm, the economy's inflationary pressures will be controlled properly.

Thirdly, the shift from deposit-taking behavior to investment account may increase the volume of investment that leads into job creation by market players such as entrepreneurs. Unlike investment financing, the debt instrument financing only considered to fund those projects with high turnover that may create higher profit to cover principles plus interest/fixed rate. In comparison, this eliminates projects that would have been accepted under the PLS model.

Finally, PSIA will possibly close the gap between richer and poorer by allocating the fund into real economic sector to produce more goods and services. For instance, SMEs can access capital from Islamic banking with the proposed of PLS system. This will reduce the unjust distribution resulting from a debt-based financing regime which acts more closely to the interest based-system.

E. Conclusions & Policy Recomendation

Islamic banks were developed to incorporate Islamic principles and values into the mainstream banking system, which existed prior to the advent of current Islamic economic concepts. The Islamic law and contract offer wide range variety of contracts in muamalah, starting from the sale-based, lease-based, until partnership-based which promotes PLS through mudharabah and musharakah. Although this contract is an ideal instrument that must be applied by IB to promote income distribution and real economic growth, in fact, many IBs are reluctant to adopt this instrument due to riskiness.

IBs are reluctant to offer PSIA to investors due to the risk associated with this activity compared to providing financing through a deposit account. IB will bear greater risk due to lack of managing liquidity and stabilizing PSIA rate of return. Moreover, from the client's standpoint, a normal bank customer has a tendency to avoid high-risk transactions and places a premium on the security of the entire deposit maintained. Thus, makes IBs reconsider in supplying this product. Although the possible returns to customers are far bigger than those offered by IBs' CASA products, the associated risk is commensurate to the return received.

However, if managed effectively, PSIA can contribute to economic growth. IB can manage this as a distinct instrument from what traditional banks offer. Among the benefits that might be felt directly or indirectly are the following: PSIA helps to overall employment creation by investing in real economic sector developments. Additionally, PSIA creates potential for equitable income distribution through wise capital allocation, by channeling capital units to micro, small, and medium-sized firms. All these facts are unquestionably the primary objectives of maqasid syar'i that IB should pursue.

Regardless of the pros and cons of using PSIA instead of deposit taking behavior, IB must dare to use this instrument as a significant distinct from its predecessor, conventional bank. Numerous empirical studies on this model have been conducted, followed by the discussion on how to manage risk, stability, and efficiency under PLS scheme through PSIA. Political will, courage, and a strong commitment are needed for bank management, shareholders, and stakeholders if they really want to realize an ideal practice and operation of IB which is aimed to achieve maqashid shariah. If all of these can be addressed affirmatively, then the IA product with the PLS concept has the potential to become a blue ocean strategy for banks, ready to compete in the banking industry and become a unique differentiator that distinguishes Islamic and conventional bank.

REFERENCES

Aggarwal, R. K., & Yousef, T. (2000). Islamic banks and investment financing. Journal of Money, Credit and Banking, 93–120.

Alhammadi, S., Archer, S., Padgett, C., & Abdel Karim, R. A. (2018). Perspective of corporate governance and ethical issues with profit sharing investment accounts in Islamic banks. Journal of Financial Regulation and Compliance, 26(3), 406–424. https://doi.org/10.1108/JFRC-01-2017-0014.

AlShattarat, W. K., & Atmeh, M. A. (2016). Profit-sharing investment accounts in islamic banks or mutualization, accounting perspective. Journal of Financial Reporting and Accounting.

Archer, S., Karim, R. A. A., & Sundararajan, V. (2010). Supervisory, regulatory, and capital adequacy implications of profit-sharing investment accounts in Islamic finance. Journal of Islamic Accounting and Business Research.

Baldwin, K., Alhalboni, M., & Helmi, M. H. (2019). A structural model of "alpha" for the capital adequacy ratios of Islamic banks. Journal of International Financial Markets, Institutions and Money, 60, 267–283.

Ernst & Young. (2016). World Islamic banking competitiveness report 2016. In Ernst and Young.

Febianto, I., & Kasri, R. (2007). Why do Islamic banks tend to avoid profit and loss sharing arrangements? 2nd Islamic Economics Conference.

Hamza, H., & Saadaoui, Z. (2013). Investment deposits, risk-taking and capital decisions in Islamic banks. Studies in Economics and Finance.

Minhat, M., & Dzolkarnaini, N. (2016). Islamic corporate financing: Does it promote profit and loss sharing? Business Ethics: A European Review, 25(4), 482–497.

Presley, J. (2012). Directory of Islamic Financial Institutions (RLE: Banking & Finance). Routledge.

Syarifuddin, S. (2020). Financing Schemes and Lost Profit Sharing in Islamic Banking: Challenges and Opportunities. ATESTASI : Jurnal Ilmiah Akuntansi, 3(1), 1–13. https://doi.org/10.33096/atestasi.v3i1.372.