

Deposit Accounts (Profit Sharing) in Islamic Financial Institutions in Sri Lanka: Analyzing the Perceptions and Attitudes of the Depositors

(Special reference to Batticaloa District)

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Background of the study

Mobilization of funds from savings-surplus units in the economy is an important task of a financial system. The purpose of a financial system is to facilitate the flow of funds so Islamic banking deposits are fundamentally structured in a different way than the conventional banking deposits. Each type of Islamic banking deposits, such as savings, demand, and timed deposits, is devised using the approved Shari'ah contracts such as qard, wadiah, murabahah, and mudarabah. These contracts are opposed to the conventional concepts, as they are based on the concept of a 'lender-borrower' relationship. In addition, the Shari'ah-approved contracts are unique as they feature a different nature of risk and return. Islamic banks are engaged in mobilizing savings from a unique group of savers by offering *Shariah* compliant products that also vary with respect to other dimensions of return, risk, liquidity, maturity, safety, stability and the like.

Deposits in common parlance are backed by the motive of safekeeping. Islamic law also deals with the notion of deposits in the framework of *Amanah*. However, bank deposits cannot be put into this category, since a bank invites and seeks deposits for its own interests. The banks' intention while accepting currencies as deposits is not the safekeeping but the utilization thereof, and, on demand, to return it in full. The general consensus, therefore, is that where the deposit is a sum of money or something, which is perishable through use, shall be deemed to be a loan if the depository is permitted to utilize it. In addition, if it is clear that a bank deposit is a loan, it means that any increase paid by the bank over the sum deposited constitutes *Riba*. Conventional banks broadly invite current account deposits, time deposits, and savings deposits.

Literature review

It may be noted that Islamic deposits may be modeled after the classical contracts of *Wadiah* and *Qard*. These contracts do not allow any excess over and above the principal as a stipulation either in the contract or even as a unilateral gift by the bank that is not customary. Islamic banks treat the current deposits as *Wadiah* and *Qard*, saving deposits as *Wadiah* and *Mudarabah* and investment deposit as *Mudarabah*.

Musharakah and Mudarabah can also be combined. For example, banks manage depositors' funds on the basis of Mudarabah; they can also deploy their funds in the business with the condition that the ratio of profit for a sleeping partner cannot be more than the ratio that their capital has in the total capital. (Ayyub P: 113)

It is important to remember that the foundation of the whole concept of RF banking (riba-free and gharar-free) is to attract community deposits and savings and redeploy these deposits and savings into the community as investments to generate economic prosperity, job opportunities, and a better future for all. (Yahya Abdur rahman 2010)

The results of a survey of 17 Islamic financial institutions conducted by Khan and Habib (2001) confirms that Islamic financial institutions face some risks arising from profit-sharing investment deposits that are different from those faced by conventional financial institutions.

The bankers consider these unique risks more serious than the conventional risks faced by financial institutions. The Islamic banks feel that returns given on investment deposits should be similar to those given by other institutions. They strongly believe that the depositors will hold the bank responsible for a lower rate of return and this may cause withdrawal of funds by them. (Ayyub 2009)

“An Islamic bank is a deposit-taking banking institution whose scope of activities includes all currently known banking activities, excluding borrowing and lending on the basis of interest. On the liabilities side, it mobilizes funds on the basis of a Mudarabah or Wakalah (agency) contract. (Jarhi and Munawar, 2001.)

This is especially the case for *Mudarabah* contracts (henceforth referred to as profit-sharing contracts). The uniqueness of profit-sharing contracts in deposit products has been given due recognition in theory and in practice, as most of the Islamic banks in Sri Lanka offered this product. In addition, the unique features and characteristics of profit-sharing based deposit accounts are also highlighted in the prudential standards issued by prominent regulatory bodies such as AAOIFI and IFSB.

Nevertheless, it is argued by many Islamic banks practitioners, especially in Sri Lanka, that the concept of profit sharing in deposits products is not practical in reality, because the depositors do not behave according to, nor accept the principles that have been laid down in the *Shari'ah*. Thus, it is argued that both the depositors and the Islamic bankers have treated the product similar to any other conventional banking deposits products.

The main aim of this study, hence, is to explore and examine the level of awareness, knowledge, perceptions, and attitude of the Islamic banking depositors in Sri Lanka towards characteristics of profit-sharing deposits accounts in accordance with the fundamental *Shari'ah* principles but also the regulations existing. In addition, this research also attempts to explore the significant determinant factors that encourage the depositors to engage with Islamic banking deposits accounts in general and profit-sharing deposits accounts in particular.

Methodology and Design

In fulfilling the aim of the study, primary data collection was adopted through a survey questionnaire technique. The questionnaires were distributed to three Islamic financial institutions namely Amana Bank limited, Al-Safa PLC and LOLC – Al-Falah Islamic Unit which are taken as sample for this study. The questionnaire asked various pertinent questions, which intended to elicit the depositors' opinions, perceptions, and attitudes towards the unique characteristics of Mudarabah contract as specified in *Shari'ah Muamalah* principles. The characteristics among others are: (i) concept of uncertain deposits returns; (ii) concept of non-guarantee for the deposits; (iii) concept of profit equalization reserve. The population for this study consisted of all the Depositors in the Islamic financial institutions in Batticaloa District. A simple random sampling technique is used to select the respondents

surveyed for this study, 125 questionnaires were administered to respondents chosen from three institutions. A total 65 of the returned questionnaires were complete and fit for analysis purpose. Descriptive techniques such as; frequencies, percentages, means, standard deviation (Std.) and column charts, line charts, pie charts, graphical illustration etc. also are used. Spearman correlation and multiple regression analysis Chi-Squared Test are used to test hypothesis of the study.

Finding and conclusion

In general, the results of the study show that the level of awareness of the need to have Islamic banking deposits accounts because of religious reasons is considered as high among the depositors. Nevertheless, the results also indicate that a high level of awareness is not being translated into a high level of understanding concerning the objectives of the products, which are structured in accordance to the *Shari'ah*-compliant contracts. This can be seen in the major findings of this study: the characteristics of profit-sharing contracts, which arguably are the most desirable *Shari'ah*-compliant contracts, are not acceptable to the depositors. This indirectly implies that they are still strongly influenced by the nature of conventional banking products. In addition, the logistic regression results further proved that related factors ('financial services' and 'income') emerged as the main determinants in creating demand for profit sharing deposits accounts.

The results of the research should draw the attention of the Islamic bankers and the regulators to finding ways for improving the level of understanding among the depositors. However, the critical successful factor in educating the depositors is highly dependent on the level of knowledge exhibited by the Islamic bankers themselves, which can be a real concern as highlighted by the findings of this study.

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