APPLICATION OF MUDHARABAH FOR SAVING ACCOUNT IN ISLAMIC FINANCE: (WITH SPECIAL REFERENCE TO AMANA BANK LIMITED)

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Abstract

Islamic finance is one of the fastest growing industry in the world. It has structured the banking and financial products and services within the parameters of Shariah. The Shriah compliant tools for financial transaction have been prudently designed by the scholars to offer the products and services. The Mudharabah is one of the tool which is employed by the Islamic financial institutions (IFIs) to provide various financial products and services. From the inception of industry Mudharabah has been used by the IFIs as an alternative mechanism for saving account. However, the modern it has been catered the interest of researchers whether the nature of Mudharabah fulfill all the features of saving account. In this regard there are number of challenges and issues are identified and those issues are rectified by the IFIs in their practices. On the other hand, some IFIs removed the Mudharabah from the operation of saving accounts. However, in Sri Lanka, many IFIs have practiced Mudharabah as a tool for their saving account. Therefore, this study has been carried out in order to find out whether the same challenges are still available at the IFIs in Sri Lanka. Amana Bank which is the pioneer in Islamic finance in Sri Lanka and the only fully fledged Islamic bank in the country has been selected as sample for this study. Qualitative method was employed to carry out this research. Primary data were gathered though interview and group discussion with banking professionals. Secondary data was obtained through research articles, website news, official websites of IFIs and the like. As the objectives of this study some challenges were found on the modern application of mudharabah in saving account. The researchers have put forward some recommended for the better usage of Mudhrabah saving account for future operations.

Keywords: Mudharabah, challenges, mudharabah saving account, IFIs

Introduction

Islamic finance is one of the fastest growing industries in the world. The recent forecasting done by the rating agencies shows the growing rate between 20-25 percent a year. (Nimsith S, Shibly, F.H.A., & Irfan M.I.M, 2015). In addition to this another strong example is that 7 out of top 10 conventional banks with an international presence have commenced Islamic banking (Sailanmuslaim, 2012). Since Islamic finance has been built based on trading, the origin of modern Islamic banking could be said to have commenced 1400 years ago when prophet Mohammed himself acted as an agent for his wife's trading activities.

Islamic finance has been initiated in Sri Lanka by the establishment of Amana Investment in 1997. Currently there are around sixteen institutions are practicing Islamic finance in the banking and financial sector (IFN News 2016). The Islamic financial services industry has gained much popularity among service providers and customers alike. Many financial service institutions, including state and private banks, have established Islamic financial service divisions, catering to the growing demand for this emerging service line. In Sri Lanka, Islamic banking system is running parallel with the existing conventional banking system. To be competitive in the dual banking system. The basic strategy that Islamic banks should have offer sharia-compliant services which match those offered by the conventional banks.

Since interest is prohibited in Islam, Islamic banking services are based on profit and loss sharing (PLS) and other interest – free trade activities which do not allow the paying and receiving of interest and promotes profit sharing in the conduct of banking. In this regard, Islamic banks accept deposits based on profit sharing (mudharabah is commonly used as underlying contract for various Islamic deposits and finance products such as saving account, investment account, project financing working capital financing, mudharabah sukuk and thankful products.

Objectives

This study is intended to explore the modern application of mudharabah by IFIs for saving accounts in order to identify the suitability of mudharabah to reflect all the features of saving accounts and to identify the issues and challenges faced the IFIs in this regard.

Research question

Based on the objectives above, this study is concerned with following research questions:

1. How do IFIs apply Mudharabah for saving account?
2. What are the challenges faced by the IFIs while practicing mudharabah for saving account?

Research problem

Savings are key for the financial intermediaries for their effective operations and main component of the liabilities side. Conventional banks' saving accounts are attractive with fixed interest rate and the capital guarantee. Further, time to time, they offer pretty gifts and gifts vouchers to attract the customers and to maintain good marketing strategy. On the other hand, in IFIs where fixed rate of return in saving account considered as non-Sharia compliant and the capital also cannot be guaranteed if IFIs use Mudharabah as their product for savings. Thus, as a competitor of conventional financial institutions, IFIs may face difficulties attract the customers and to maintain their savings in line with conventional financial institutions do.

Methodology

This study is an exploratory study designed to explain application of mudharabah for saving account and also find out the challenges, faced by Islamic financial institution while applying mudharabah for saving accounts Since Amana bank is the pioneer IFI and the fully fledged Islamic bank in Sri Lanka, it had been chosen by the researches for this study. Further, Amana bank was adjudged the best Islamic banking service provider in Sri Lanka at the Islamic finance news poll conducted in December 2011. And also, it is Sri Lanka's first licensed commercial bank to operate in complete harmony with the principles of Islamic banking. Guided by its principles. (Annual Report of Central Bank, 2005)

The data collected for this study through both primary and secondary sources. Primary data has been collected through interview and discussion with senior staff of Amana bank. In addition, required information was collected through Sharia advisors of the bank who work at sharia board.

Secondary data were collected through books, magazines, research papers, online information, Amana bank's brochures, annual reports and website information.

Literature review

Mudharabah (profit sharing) is also known as "silent partnership" (al-zuhhayli,2007) whereby it involves a financier (rabbulmal), who provides a specific amount of capital and act as a sleeping or dormant partner and an entrepreneur (mudharib), who acts as a trustee or a business agent. The mudharib is required to utilize and manage the capital in prudence and good manner to generate optimal profits for the mudharabah (profit sharing) investment, while adhering to the laws of sharia. The mudharib does not invest any property in the business venture accept for his knowledge and skills. He is also not entitled to claim any wage for conducting the business venture. Mudharabah (profit sharing) is one of the oldest business forms used by the pre-Arabs for trade activities. Literally, the word mudharabah is derived from the phrase 'al-darbfi al- ard" which means to make journey(ISRA,2011). The literal meaning of this partnership is that, in the past this contract required the parties involved to make journey to run their business.

BUSINESS OF MUDHARABAH

The rab-al-mal may specify a particular business for the mudharib, in which case he shall invest the money in that particular business. Only this is called al mudharabah al-muqayyadha (restricted mudharabah). But if he has lift it open for the mudharib to undertake whatever business he wishes, the mudharib shall be authorized to capitalize the money in any business he deems fit. This type of mudharabah is called "al- mudharabah al muthlaqah" (un restricted mudharabah)

A rabbulmal can contract mudharabah with more than one person through a single transaction. It means that he can offer his money to both, so that each one of them can act for him as mudharib and the capital of the mudharabah shall be utilized by both of them jointly, and the share of the mudharib shall be distributed between them according to the agreed proportion (Marikar 2009).

DISTRIBUTION OF THE PROFIT

It is necessary for the validity of mudharabah that the parties agree right at the beginning, on a definite proportion of the actual profit to which each one of them is entitled. No particular proportion has been prescribed by the sharia rather, it has been left to their mutual consent. They can share the profit in equal proportions, and they can also allocate different proportion for the rab-al-mal and the mudharib. However, they cannot allocate a lump some amount of profit for any party, nor they can determine the share of any party at a specific rate tied up with the capital. For example, if the capital Rs 10,000 they cannot agree on a condition that rupees 10,000 out of the profit shall be the share of the mudharib, nor can they say that 20% of the capital shall be given to rab-al-mal. However, they can agree on that 40% of the actual profit shall go the mudharib and 60% to the rab-al-mal. (Kabir Hassan 2013).

The above statement clearly shows there is no fixed return over Mudharabah investment and the capital also subject to the performance of the entrepreneur.

THE DISSOLUTION AND TERMINATION OF MUDHARABAH CONTRACT

The mudharabah contract is designed to fulfil the needs of fund provider(rabbulmal) and the entrepreneur (mudharib) and to protect their interest. The contract is normally dissolved when both parties have agreed on the completion of the business venture with the settlement of profit distribution and closing of accounts. All the Islamic scholars agree that mudharabah is non- binding before commencement of the work and may be dissolved by either party. According to al-Zuhayli (2007), the Hanafi, hanbali and shafi scholar's death of either party. But the maliki scholars disagree with the other scholars and assert that once work begins, the contract becomes binding on both parties. In the case where one of the parties dies, the contract can be inherited by his heirs. According to non-safe scholars, the contract is also terminated if one of the parties becomes mentally unstable; however, the Hanafi's rule that the mudharabah contract will not be void if the rabbulmal is put under legal guardianship.

In terms of capital requirement, the Hanafi's scholars rule that the contract can be dissolved only if the partnership capital is in monitory form. But the shafi and hanbali scholars agree that the dissolution of the partnership is valid even though the capital is non- monetary, as long as both parties agree to sell it and share the profit according to the pre- determined ratio.

ANALYSIS

Application of Mudharabah for Saving Account in Amana bank

According to the first part of objectives of this study, the researchers are intended to analyze the application of Mudharabah in Amana bank for the Savings account.

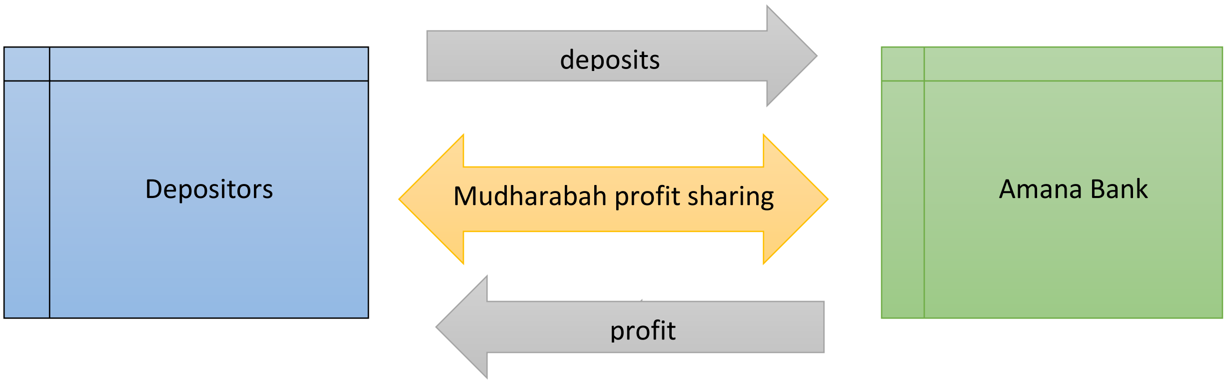
Savings accounts of Amana Bank are based on the principle of profit sharing. They offer our investment a share of the profits earned through their investment tool. The higher the profit payable to us. They bring us peace of mind by refraining from investing our money in any socially harmful business activities so that we can enjoy returns without guilt.

Product features of Amana bank which have been shown in following table

Product concept	Mudharabah (profit sharing)	
Profit sharing ratio	customer 40%	Bank 60%
Profit paid	Monthly	
Minimum investment	2500rs	
Benefits	choice of pass book or statement E-statement facility standing Instruction facilities.	

Mudharabah is used by Islamic banks for taking deposit from depositors. The depositors provide money to bank as rab- al-mal to be invested by bank as mudharib on the basis of profit and loss sharing pre agreed specific ratio.

Mudharabah refers to a contract made by two parties to finance a business venture. The parties are rab al mal (investor) who provide the capital and a mudharib (bank) who manages the project if the profit will be distributed based on pre- agreed ratio. In the event of a business loss the loss shall be borne by the provider of the capital.



Based on the analysis of data gathered, this study has found the following issues and challenges in the current practice of mudharabah contract at Amana bank.

1. Rate of return risk

IFIs cannot predict their profits over their business. Thus they did not fix their profit rate in their saving where mudharbah is applied. Further, the profit cannot be same amount every time. This uncertainty can cause changing in the expectation rate of return on the investment account holders. That they have on their liability side. Because the rate of return on the investment on mudharabah by Islamic bank are not known accurately till the end of the investment, thus, Islamic bank has to wait until the output of his investment to identify the level of revenue will be earned. Therefore, during this period, the rate of return risk will present if the expected prevailing rate of change in the market, then the investors may expect similar rate form the bank.

2.Credit risk

Conventional financial institutions rarely face the credit risk in saving account. However, the possibility of credit risk in IFIs Mudharabah saving account is high. Because, the actual profit and the business IFIs are involved are not transparent and the customer cannot get the sufficient information. Further, customers as a fund providers have to bear the loss occurred without the negligence of the IFIs as business partner. However, there is no clear tool to judge the negligence of the Mudharib.

3.Equity investment risk

Investing in mudharabah will expose Islamic banks to higher risk as mudharabah based on profit and loss sharing investment. Islamic bank need to consider the financing risk in equity based on assets and the potential of losing the capital if the business makes any losses because mudharabah subjected to loss capital even if these is a proper monitoring. In short, Islamic banks should take care when they chose the projects in order to reduce any potential losses that can arise from the investment.

4.Marketing Risk

Conventional financial institutions offer attractive gifts and promotions other than the fixed rate of return. As competitor Amana Bank also advertise in their brochures and official websites many types of gifts for the saving account holders such as gift for students and New Year promotions. How these extra benefit considered in Sharia other than agreed profit ratio in the contract? Is these allowable in Islam. Amana bank has a responsibility to clarify these issues.

5.Multiple contracts in a single contract

Another common issue in IFIs operation is mingling more than one contracts in a single transaction in order to reflect the required nature of particular banking product. In this regard Mudharbah saving account also has sub contracts such as wa'd, kafla and the like.

Conclusion and Recommendation

According the objectives of the study the study has explained the current practice of Mudharabah in Amana bank. Qualitative method has been used to conduct this survey. Further this Study has found five main challenges in the practice of Mudhrabah account. The first four challenges are contradiction with the nature of Mudharabah and the features of saving account. Therefore, the IFIs should have to educate their customers by seminars or leaflets the nature of Mudharabah such as the rate of return cannot be predicted and the Mudharabah they used are unrestricted therefore, the IFIs do not explore all the businesses they involve. Further, IFIs should educate the customers this is a profit sharing partnership contract and the loss if any will be bear by the customers. The fourth issue is derived from the marketing strategy of IFI. It should be said by the bank the gifts and other promotions are not from the agreements. On the other hand, the fifth one is commingling more than one contracts in to single mudharabah agreements. This is an unsolved issue in the Islamic banking industry. However, the respective Sariah board should consider to make all the contracts and agreements to be signed by the customers separately and independently without being one condition for the other.

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