

Distribution of Profits in Islamic Banking: A Case Study of Faysal Islamic Bank of Sudan (FIBS)

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ABSTRACT. The focus of this study is distribution of profits in Islamic banking, taking Faysal Islamic Bank of Sudan as a case study. The problem arises due to Islamic banks' commitment to share the actual profits resulting from investing depositors' money, with them. After describing the nature of deposits and the terms and condition of *mudaraba*, the author examine FIBS figures for two consecutive years to show how part of the profits accruing on the investment of current deposits, which actually belong to the shareholders, were diverted to boost the profit share of depositors into investment accounts.

Introduction

This research deals with the distribution of profits in Faysal Islamic Bank of Sudan (FIBS). where all deposits are held in one pool and used for investment. This practice makes the determination of each party's share in investment, and hence in the profit, a difficult task. Since only a portion of each party's deposits is invested, the task is made even more difficult. The money used for investment consists of the bank's capital (from shareholders), and a certain percentage of the funds of current accounts, and funds in saving and investment accounts. Saving accounts and current accounts are not eligible for profit. So any profit accruing to these accounts goes to the bank (shareholders). A holder of an investment account is entitled to profit after the completion of an agreed period of time, and he has the right to withdraw his money or a part of it at any time.

The first problem we have to face concerning distribution of profit is, how can the bank determine the actual profit of every holder of an investment account? The bank's money is invested in various projects. Some of these may be completed before the end of the financial year, and their profit known. However, some of them are not, so the bank cannot determine the profits from these uncompleted projects. The right of every holder of an investment account to withdraw part or all of his money at any time, also makes it difficult for the bank to determine the actual profit for any financial year.

The second problem we face is that most Islamic banks cannot use all the money available for investment, either because the regulations do not allow them, or because funds available for investment are larger than the banks' investment portfolio. Thus it is difficult for the Islamic bank to determine how much of the invested money is its own, and how much belongs to the holders of investment accounts.

Investment Accounts in Islamic Banking

FIBS accepts investment accounts (*Mudarabah* funds) and uses them in investment. The owners of these funds are entitled to profit according to the participation of their funds in the actual investment. The bank does not use all these funds in investment, but retains a part of them to meet withdrawals. Theoretically, these reserves, along with new deposits which are continually being made, enable the banks to meet all demands for withdrawals.

The Bank is entitled to a certain percentage of the profit on investment accounts as an agent (*Mudarib*). It is also entitled to profit as an owner (*Rub al Mal*) of the bank's funds participating in investment. These funds include a proportion of the bank's capital and of current and saving accounts whose repayment is guaranteed to their depositors.

Accounting in Islamic Banking

Revenues in Islamic banking are the result of services rendered by these banks, and profits from participation (*Musharakah, Mudarabah*). The account books of Islamic banks contain a *Mudarabah* account, in which the balances from different *Mudarabas* (positive or negative) are shown. The resulting balance in this account is transferred to the profit and loss account. In the profit and loss account, all revenues and expenses are shown. The balance, positive or negative, is transferred to the balance sheet. If any profits are to be distributed, then they will be shown in the distribution account.

Financial statements in Islamic banking aim to measure the various activities of the bank in order to show the performance of the bank and the profit or loss of every activity. By aggregating the balances of all activities of the bank, an amount of net revenue is shown. These financial statements are prepared in accordance with accounting principles, rules and concepts, which, in the case of Islamic banking, should be in conformity with Islamic Law. This, however, needs a separate study. Here we shall briefly discuss accounting difficulties related to depositors' share in profit.

1- Retaining of reserves poses a problem. Do depositors have to participate in them or not? If they have to participate then this should give them some rights in the reserves. However, it is believed that, because these deposits are of a short-term nature, it would be better to retain reserves after distribution of the depositors' share in profit. This will limit depositors' rights to those investments in which their money has actually participated. As stated before, interviews in Islamic banks revealed that some of them retain reserves after distribution of depositors' profit, while others retain them before such distribution.

2- The depositors' percentage of the profit should be prescribed in advance. This will minimize the possibility of disputes.

3- The rights of depositors as participants also needs clarification. Are they similar to shareholders in their rights and duties or they are different? The answer to this question, however, depends on the extent to which they participate in the reserves retained. If they receive their profit before reserves are retained, then they are participants of a different category than the shareholders.

4- Profits have to be computed on the basis of the volume of money that participated in investment and on the duration of time for which the money was deposited. Expenses, disbursements, provisions and depreciation related to depositors' investment should be actual, and not exaggerated, in order to arrive at the depositors' actual profits.

It would be preferable, however, to consider depositors as a different group, and not to equate them with the shareholders. This is mainly because investment deposits are of a short-term nature. Reserves should be retained after distribution of depositors' profit. Projects in which these deposits are invested should be completed or liquidated before the depositors withdraw their investment. Failing that a fair valuation should be made to protect their rights. Placing depositors in a distinct category avoids many accounting difficulties and other complications.

Bank's Share in *Mudarib's* Profit

Islamic banking extends finance to entrepreneurs on the terms of *Musharakah*. Many difficulties arise in that Islamic banks monitor these projects to a minimal extent in order to minimize expenses. It would be helpful to prescribe the following in contracts between the banks and their clients

1- Clients combine their own money with that given by the banks on a *Musharakah* basis. It is desirable to mention this clearly in the contract.

2- Another area which needs clarification in contracts is, which expenses should be borne by the *Mudarabah* fund and which by the client himself?

3- The period of time during which the operation should be completed must also be prescribed. However, the money realized from operations, in certain cases, should be transferred to the bank at once and not used by the client in private operations.

4- The clients share as an entrepreneur should be clearly stated in the contract.

5- Situations whereby the client remains fully responsible for loss should also be clearly defined and prescribed.

These points should be agreed and clearly stated in the contract, so that accounting can be established on that basis. Other banks' contracts related to other activities such as *Murabaha*, *Ijara* etc. should also be carefully written, specifying each party's rights and duties. Hence each party would know his responsibilities, which would help to avoid disputes over the distribution of profit.

Distribution of Profit in FIBS

Faysal Islamic Bank of Sudan (FIBS) may reflect a good example for Islamic Banking where all deposits are held in one pool and used for investment. Net profit on investment deposits (*Mudarabah* deposits) in FIBS is calculated according to principles that have been suggested by the *Shari'ah* Supervisory Board. These principles can be summed up as follows

1- All investable deposits (90 percent of the total investment deposits) are to be considered as actually invested. The remaining 10 percent are kept as reserves to meet withdrawals.

2- With the exception of earnings from banking and other services, investment depositors share in all income generated.

3- Administrative expenses are to be borne exclusively by the banks' shareholders.

4- Profits are to be distributed among the shareholders and the investment deposit-holders, taking into consideration items 2 and 3 above.

5- Investment depositors are not entitled to participate in profits from current and savings deposits.

FIBS as an owner (*Rab ul Mal*) and an agent (*Mudarib*) is entitled to two shares in the profit;

firstly, a percentage of the profit as *Mudarib* and secondly, a share of the total profit proportionate to the bank's share in the *Mudarabah's* capital.

Table A shows the funds of different deposits actually invested in FIBS for the year 19X1^(*).

The percentage of investment deposits ready for investment in the bank for this year was 100%, held at 90% as stated above. However, the funds available for investment were not fully invested. The actual investment is thus apportioned between the different sources. For example, the actual invested fund for current deposits in January, 19X1 is equal to:

current deposits in column 3 × total actual investment divided by
total funds ready for investment.

The amount which is ready for investment is: 109,926 (i.e. 157,037 × 70%).

The actual invested fund is: 75,540 calculated as follows:

$$\frac{109,926 \times 176,539}{256,900} = 75,540$$

(*) To maintain confidentiality one digit has been replaced by X.

The shareholders' share is represented by the capital plus reserves plus retained profits minus fixed assets and direct investment. This means that bank's capital minus (fixed assets + direct investment) is equal to the amount of the bank's capital which is used in investment.

Table A
Investment percentages for different deposits
(LS '000')

Type of deposit	Actual deposit	Investment percentage	Funds for investment	Actual invested funds
	1	2	$1 \times 2 = 3$	4
	LS (000)	%	LS (000)	LS (000)
<i>January 19X1</i>				
Current deposits	157,037	70%	109,926	75,540
Invt. deposits	77,228	100%	77,228	53,070
Savings deposits	12,454	90%	11,209	7,703
Shareholders	58,536	100%	58,537	40,226
Total			256,900	176,539
<i>February 19X1</i>				
Current deposits	161,198	70%	112,839	74,433
Invt. deposits	76,007	100%	76,007	50,137
Savings deposits	13,117	90%	11,805	7,787
Shareholders	55,951	100%	55,951	36,908
Total			256,602	169,265
<i>March 19X1</i>				
Current deposits	163,553	70%	114,487	76,563
Invt. deposits	76,151	100%	76,151	50,926
Savings deposits	13,600	90%	12,240	8,185
Shareholders	54,266	100%	54,266	36,291
Total			257,144	171,965
<i>April 19X1</i>				
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.				
<i>September 19X1</i>				

Total actual invested funds as shown in column 4 determine individuals amount allocated for the purpose of distribution of profit. In other words total actual invested fund figure appears at the end of the Financial year first. After that each individual amount (deposit) is computed and determined accordingly.

Table B, shows the total investment for FIBS for the year 19X1. The information in this table is divided into three groups.

a) The monthly actual investment which represents the total sum in column No. 4, Table A.

b) The investment deposit funds which actually participated in the bank's investment. These funds are shown in column No. 4, Table A, against investment deposits.

c) Shareholders; the returns from shareholders + current and savings deposits will go to the bank (shareholders). Therefore, these three items are considered as one. This is shown in column No. 4, Table A. The total sum of money in this column is equal to (a)-(b) above (i.e., in January 19X1, it was LS 123,459,000.

Table B
Participation of investment deposits in actual investment
(LS '000')

	January	February	March..	Total annual investment
a) Credit facilities (Actual investment)	176,539	169,265	171,965 ..	1,532,422
b) Investment deposits	53,070	50,137	50,926 ..	431,791
c) Shareholders (Include current & savings deposits)	123,469	119,128	121,039 ..	1,100,630

The term credit facilities, used by the bank, is more appropriately applied to the credit finance which is used in conventional banks. In the case of Islamic banking it may be preferable to use the term "investment" instead.

Investment deposits shown in the Table are the deposits which participated in the actual investment. Investment deposits which are ready to participate in investment are more than these sums, as shown in Table A, column No. 3.

The profit generated from investment in the financial year 19X1, was LS. 15,278,000, which consisted of two types of earnings:

	(LS '000')
1 - Earnings from investment activities:	12,244
2 - Earnings from foreign currency:	<u>3,034</u>
Total	<u>15,278</u>

These profits do not include net revenues from banking services and other revenues generated from direct investment, such as, subsidiary companies.

The above profit is distributed between shareholders and investment depositors in the ratio 72% and 28% respectively, calculated as follows:

1- The percentage of shareholders' funds used in the actual investment is equal to total of shareholders' funds divided by total annual investment, multiplied by 100, that is,

$$\frac{1,100,630 \times 100}{1,532,422} = 72\%$$

2- The percentage of investment deposits used in the actual investment is equal to: total investment deposits divided by total annual investment multiplied by 100; that is,

$$\frac{431,791 \times 100}{1,532,422} = 28\%$$

- a) Share of shareholders in profit is (LS. 000')

$$\frac{72}{100} \times 15,278 = 11,000$$
- b) Share of investment depositors in profit is (LS. 000')

$$\frac{28}{100} \times 15,278 = 4,278$$
- a + b, that is, total profit is equal to

$$11,000 + 4,278 = 15,278$$

Table C, shows the investment deposits in foreign and local currency. These consist of two types; foreign currency deposits and local currency deposits. The investment depositors' share in profit would therefore be divided between foreign and local currency deposits.

Table C
Investment in local and foreign currency
(LS '000')

1	2	1 + 2 = 3
Total foreign currency in branches (converted to LS)	Total local currency in branches	Total foreign and local currency
373,716	291,404	665,120

The total foreign and local currency in branches is divided by 9 to obtain an average, though there is no need to do so, as the resulting amount (share of deposits in profit) will be the same in both cases. However, as the aim is to show the methods used by the bank, the research follows the same procedures as used by the bank. The profits are calculated for nine months only, because the bank has by agreement with its depositors, increased its profit ratio to 30%, as from the beginning of the tenth month of 19XI. The financial year also was changed to the *Hijri* calendar, therefore The average of foreign currency is (LS `000')

$$\frac{373,716}{9} = 41,524$$

The average of local currency is (LS `000')

$$\frac{291,404}{9} = 32,378$$

Total : 41,524 + 32,378 = 73,902 or

$$\frac{665,120}{9} = 73,902$$

a) *Distribution of profits between deposits in foreign and local currency*

As shown earlier, the share of depositors in profit is LS 4,278,000.

1 - Share of foreign currency in profit =

Average deposits in foreign currency divided by average deposits in foreign and local currency multiplied by depositors' share in profit, that is, (LS '000')

$$\frac{41,524}{73,902} \times 4,278 = 2,403$$

2 - Share of deposits in local currency in profits =

Average deposits in local currency divided by average deposits in foreign and local currency multiplied by depositors' share in profit, that is, (LS '000')

$$\frac{32,378 \times 4,278}{73,902} = 1,874$$

b) Share of depositors in profits after deducting the bank's share

1 - Share of investment deposits (foreign currency) =

Share of investment deposits in profit \times 75% (LS '000') = $2,403 \times 75\% = 1,802$

2 - Share of investment deposits (local currency) =

Share of investment deposits in profit \times 75% (LS '000') = $1,874 \times 75\% = 1,405$

Total (LS '000') = $1,802 + 1,405 = 3,207$

As shown above, the share of FIBS in the profit as an agent is 25%. However this ratio increased to 30% in the following years. The profits for the last three months of 19XI are calculated on this new ratio. For simplicity the discussion will ignore these three months' profits.

Distribution of the Investment Depositors Share in Profits between Branches (Foreign and Local Currency)

Table D, shows deposits (foreign and local) in each branch, and how profit is distributed among the different branches.

Table D
Share of local and foreign currency in profits
(LS '000')

Branches	Foreign currency (converted to local currency)	Share in profits	Local currency	Share in profits
Branch A	128,996	0.626	110,072	0.498
Branch B	1,445	0.007	3,459	0.015
Branch C	1,900	0.009	1,360	0.006
-	-	-	-	-
-	-	-	-	-
-	-	-	-	-
Total	175,435	0.851	186,654	0.845

Note: as stated above profit was distributed for only 9 months, thus foreign currency deposits (converted to local currency) and local currency deposits at the time of distributing profit were 175,435.00(1 and 186,654.000 respectively.

a) Share of investment deposits (foreign currency) = total of investment deposits (foreign currency) in branches divided by total of investment deposits for the financial year multiplied by the depositors' share in profits (foreign currency) = (LS '000')

$$\frac{175,435 \times 1,802}{373,716} = 0.845 \text{ (see b above)}$$

(from Table C)

b) Share of investment deposits (local currency) = total of investment deposits (local currency) in branches divided by total of investment deposits for the financial year multiplied by the local currency deposits share in profit (see 2 in b above) = (LS '000')

$$\frac{186,654}{291,404} \times 1,405 = 0.900$$

(from Table C)

c) Branch A's share in foreign deposits profit = total of investment deposits (foreign) in branch A divided by total for all branches in the financial year multiplied by all branches' share in profit, that is: (LS '000')

$$\frac{128,996}{175,435} \times 0.851 = 0.626$$

By using the same technique, the share in profits can be calculated for each branch.

Distribution of Profits in FIBS in 14X2 (19X2)

The following review of the distribution of profits for the year 14X2 (19X2) permits a comparison between this year and the previous one. The first thing to observe is that, the financial year has been changed from the Gregorian calendar to Hijri. Table A1 shows the various deposits which were mobilized for investment in FIBS in the financial year 14X2 (19X2).

Table A1
Investment percentages for different deposits (LS m) 14X2 (19X2)

	Actual deposit	Investment %	Deposits ready for investment	Actual invested funds
	1	2	1 × 2 = 3	4
<i>The 1st Month</i>				
Investment deposits	66.1	90%	59.5	59.5
Shareholders	48.0	100%	48.0	48.0
Savings deposits	15.4	90%	14.0	14.0
Current deposits	194.9	70%	136.4	59.0
Total			257.9	180.5
<i>The 2nd Month</i>				
Investment deposits	70.7	90%	63.6	63.6
Shareholders	44.1	100%	44.1	44.1
Savings deposits	15.6	90%	14.0	14.0
Current deposits	204.9	70%	143.4	61.3
Total			265.1	183.0
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<i>The 12th Month</i>				
Investment deposits	59.1	90%	53.2	53.2
Shareholders	8.0	100%	8.0	8.0
Savings deposits	23.0	90%	20.7	20.7
Current deposits	254.5	70%	178.1	74.5
Total			260.0	156.4

It is clear from Table A1 that the part of current deposits which participated in actual investment is computed as a balancing figure, while it was computed as a proportion of total investment in 19X1. The reason for that was to favour investment deposits, as they are deposited with the primary aim of obtaining profit. In contrast, current deposits are not entitled to profit and the profit generated from them is transferred to the bank. The change was made according to a recommendation from the *Shari'ah* Supervisory Board. It is argued that investment deposits should be given the priority as far as distribution of profit is concerned.

For example, in January 19X1, the amount of investment deposits which actually participated in investment was LS 53,070,000, while the total amount available was LS 77,228,000. If the 19X2 method was used, then the investment deposits which should have participated in investment would have been $77,228,000 \times 90\% = \text{LS } 69,505,000$.

Table B1 shows the annual actual investment and the share of investment deposits and shareholders' funds (including current and savings deposits) in the actual investment.

Table B1
Participation of investment deposits in actual investment.
(LS m) 14X2 (19X2)

Month	Shareholders funds (used in invt.)	Invt. deposits (used in invt.)	Actual invt.
	1	2	1 + 2 = 3
The 1st Month	121.0	59.5	180.5
The 2nd Month	119.4	63.6	183.0
The 3rd Month	112.2	63.0	175.2
The 4th Month	114.4	61.0	175.4
The 5th Month	99.0	76.4	175.4
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-			
-			
The 12th Month			
Total	1,264.8	744.2	2,009.0

From Table B1 the following information is obtained:

- i - The total annual actual investment is LS 2,009 m.
- ii - The total annual investment deposits which participated in investment were LS 744.2 m.
- iii - The total annual shareholders' funds which participated in investment were LS 1,264.8 m.

We know that the total profit for the year 14X2 is LS 24.9 million, generated from two activities:

- a) Investment activities' profits LS 20.1 m.
 - b) Foreign currency profits LS 4.8.
- Distribution of profits can be calculated as follows

Percentages of investment deposits and shareholders' funds in investment

1 - Percentage of the investment deposits in investment = total annual investment deposits invested divided by total annual investment $\times 100$

$$\frac{\text{ii}}{\text{i}} \times 100 = \frac{744.2}{2,009} = 37\%$$

2 - Percentage of the shareholders funds in investment =

$$\frac{\text{iii}}{\text{i}} \times 100 = \frac{1,264.8}{2,009} \times 100 = 63\%$$

Share of depositors and shareholders in profits

1 - Share of investment deposits in profits = $24.9 \times 37\% = \text{LS } 9.2 \text{ m.}$

2 - Share of shareholders' funds in profits = $24.9 \times 63\% = \text{LS } 15.7 \text{ m.}$

Total (1 + 2) = $9.2 + 15.7 = \text{LS } 24.9 \text{ m.}$

Table C1 shows the investment deposits (local and foreign currency) in the branches of FIBS. The information in this Table is used to obtain the share of local and foreign currency deposits in the profits generated from the investment deposits, that is, 9.2 m; and hence to compute the share of the bank in the profits as an agent.

Table C1
Investment in local and foreign currency
(LS m)

Branch	Foreign currency deposits (converted to LS)	Local currency deposits	Total
	1	2	1 + 2 = 3
Branch A	362.3	224.0	586.3
Branch B	7.7	22.0	29.7
Branch C	132.2	2.5	134.7
Branch D	23.0	16.5	39.5
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Total	536.8	306.0	842.8

a) Local currency deposits = 306 m divided by 12 = 25.5 m.

b) Foreign currency deposits 536.8 m divided by 12 = 44.7 m.

c) Total (a + b) = $25.5 + 44.7 = 70.2 \text{ m.}$

(Again it is not necessary to divided by 12. However, as the purpose is to illustrate the method as used by the bank, then the procedures used are shown).

Share in profits before deducting the bank's share as an agent

1 - Local currency deposits share in profits =

$$\frac{a}{c} \times 9.2 = \frac{25.5}{70.2} \times 9.2 = \text{LS}3.3\text{m.}$$

2 - Foreign currency deposits share in profits =

$$\frac{b}{c} \times 9.2 = \frac{44.7}{70.2} \times 9.2 = \text{LS}5.9\text{m.}$$

Total profits = 3.3 + 5.9 = LS 9.2 m.

Share in profits after deducting the bank's share in profits

i - Share of deposits (local currency) in profits = $3.3 \times 70\% = \text{LS } 2.3 \text{ m.}$

ii - Share of deposits (foreign currency) in profits = $5.9 \times 70\% = \text{LS } 4.1 \text{ m.}$

Total = 2.3 + 4.1 = LS 6.4 m.

The bank ratio as an agent is 30%. The share of the bank in profit is:

$9.2 \times 30\%$ or $9.2 - 6.4 = \text{LS } 2.8 \text{ m.}$

Distribution of the investment depositors profits among branches (foreign & local currency)

Table D1 shows the share of each branch in profits (foreign & local currency deposits). The information in this Table is used to calculate each branch's share in the profits (column No. 2 and No. 4).

Table D1
Share of local and foreign currency in profits
(LS m) 14X2 (19X2)

Branch	Deposits in foreign currency converted to LS	Share in profits	Deposits in LS	Share in profits
	1	2	3	4
Branch A	362.4	2.8	224.0	1.7
Branch B	7.7	0.06	22.0	0.2
Branch C	132.2	1.0	2.5	0.02
Branch D	23.0	0.2	16.5	0.1
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.				
.				
Total	536.8	4.1	306.0	2.3

i - Investment depositors share in profits after deducting the bank's share is = LS 6.4 m.

ii - Total of foreign currency deposits = 536.8 m.

iii - Total of local currency deposits = 306 m.

iv - Total of foreign & local currency deposits = $536.8 + 306.0 = 842.8 \text{ m.}$

a) Foreign currency depositors share in profits = Total foreign currency deposits / total of foreign & local currency deposits \times investment depositors' share in profits, that is, $\text{ii/iv} \times \text{i} = 536.8/842.8 \times 6.4 = \text{LS } 4.1 \text{ m.}$

b) Local currency depositors share in profits = $\text{iii/iv} \times \text{i} = 306/842.8 \times 6.4 = \text{LS } 2.3 \text{ m.}$

Share of branches in profits

Branch A's share in profits = Branch A total in foreign currency/total for all branches in foreign currency \times total share of all branches in profits, that is:

$$\frac{362.4}{536.8} \times 4.1 = \text{LS } 2.8 \text{ m.}$$

By using the same method, each branch's shares in profits can be computed.

Comparison between Distribution of Profits in 19X1 & 14X2

In the year 19X1, the proportion of current deposits available for investment was 70%. The actual funds from the current deposits which participated in investment were a percentage of these deposits computed on the 70% basis. The average proportion was 45% of the total actual investment, that is: $695/1,532 \times 100$.

The proportion of investment deposits available for investment, for the same year, 19X1, was 100%. However, these funds were not wholly invested. The proportion actually invested was 67% of the total funds, that is: $430/645 \times 100$. These funds represented 28% of the total actual investment, that is $430/1,532 \times 100$.

In 14X2 (19X2) the current deposits were used to fill the gap between the amount of total actual investment and the amount of other deposits, that is, saving deposits, investment deposits and shareholders funds. However, the percentage of current deposits used in investment to the total actual investment was $794/2,009 \times 100 = 40\%$. This percentage is 5% less than the percentage of current deposits used in investment in the previous year. This, however, shows that a large proportion of the generated profit is considered to be generated from current deposits. As mentioned before, the actual beneficiaries of such profit are the shareholders.

The proportion of investment deposits which participated in total actual investment in 14X2 (19X2) was 90%, as demonstrated previously (Table A1), a difference of 23% over the previous year. This means that the decrease of 5% of current deposits used in investment in 19X1, was filled by investment deposits. This is the reason for the increase in the percentage of investment deposits by 23% in the year 14X2. This, in turn, increased the percentage of investment deposits in the total actual investment to 37% that is:

$$744/2,009 \times 100, \text{ compared to } 28\% \text{ in } 19X1$$

If we examine the shareholders' share in total investment we find that it consists of three elements: the shareholders fund, the current and the savings deposits. The shareholders fund percentage which participated in actual investment is very low compared to its share in profits, because the share of current and savings deposits goes to shareholders. For example, the shareholders fund in 19X1 was LS 330 m, while their share in total actual investment was LS 1,100 m. This means a sum of LS 770 m is pooled from current and savings deposits: about 233% of the shareholders fund. The current and savings deposits represented 50% of the total investment, that is $770/1,532 \times 100$, while the shareholders proportion was only 22%, that is: $330/1,532 \times 100$.

The position is similar for the year 14X2 (19X2). The shareholders fund was LS 275 m, while the share of shareholders in total actual investment was LS 1,265 m; almost LS 1,000 m is pooled from current and savings deposits, representing about 364% of the shareholders fund. The current and savings deposits represented 49% of the total investment, that is:

$990/2,009 \times 100$, while the shareholders' percentage in total investment is only 14%, that is: $275/2,009 \times 100$.

It is acceptable from *Shari'ah* point of view for an Islamic bank to give the holders of current and savings deposits a part of the profits earned, though without preagreement. By so doing, FIBS might encourage holders of these deposits to deposit more. At the same time, the practice will not harm the bank, because, as we have seen, these profits are mostly generated from the investment of current and savings deposits. The bank has to guarantee the principal of these funds, whether its investment results in profit or loss.

The share of investment deposits in profits for 19X1 was LS 3.2 m (for 9 months), a percentage of 4.3% ($3.2/74 \times 100$), (table D), while their share in profits for 14X2 (19X2) was LS 6.4 m, 9.1% of the total investment, that is, $6.4/70.2 \times 100$ (table C1). Although the investment deposits ratio in profits decreased to 70%, compared with 75% in 19X1, their percentage in profits increased to 9.1% in 14X2 (19X2), as opposed to only 4.3% in the previous year. This is again because the share of investment deposits which participated in total investment increased at the expense of the shareholders' share, or to be more accurate, at the expense of current deposits.

A comparison between the investment deposits share in profits and the interest rates in conventional banks is not given, because it is assumed that investors in FIBS are more interested in interest-free banking than in a high return of profit. Recent studies show that almost all depositors in FIBS choose Islamic banking for religious reasons rather than other factors. Even though the depositors may make a comparison between rates of profits from one Islamic bank to another, it is believed that they are more interested in an efficient service and strict adherence to Islamic teachings than in high rates of profits. It can thus be concluded that the volume of investment deposits is a function of efficiency and strict conformity to Islamic teachings.

Limited Period *Mudarabah*

From the above methods used by FIBS to distribute profits between the holders of investment deposits (*Rub al Mal*) and the bank 'shareholders' (*Mudarib*), it is observed that many difficulties arise, because different funds are held in a single pool. Some Islamic banks distinguish between investment of *Mudarabah* funds and that of other funds. An example of these banks is al Baraka Bank (Sudan).

In "Limited Period *Mudarabah*" every fund is separately invested, whereby an Islamic bank issues *Mudarabah* securities, or certificates. These are a special kind of promissory note, issued in LS 10 or other denominations. When such securities are issued, they represent a share in an investment project monitored by the bank that issues them. The relationship between the bank and the holders of these securities is based on

the *Mudarabah* contract. The investment lasts for a specific period of time, predetermined according to the feasibility study. When the investment, which might be a project or a trade operation, is liquidated or completed, the profit will be distributed in the pre-determined ratio between the bank and the security-holders. If a loss occurs, the holders of *Mudarabah* securities would bear it, according to *Mudarabah* contract. The distribution of profit between security-holders themselves would be according to the number of securities held by each.

Mudarabah securities may thus be likened to 'common stocks' or ordinary shares. While the stockholder provides 'equity' and shares in profits and losses and, in theory, in the control of the business the *Mudarabah* security-holder shares in profits and bears losses, though he does not effectively share in the control of the business. His is a more risky venture.

Ordinary shares aim to finance a specified project or trade operation, in other words a venture. A share in a company entitles its holder to the proportionate share in the assets and profits of that company. Hence the owner of a share in a company whose capital is represented by 100 such shares, owns one-hundredth of the assets of that company and is entitled to one-hundredth of the profits⁽²⁾. However, the difference between the *Mudarabah* security-holder and an ordinary shareholder is that the former does not play any part in the management of the business, but shares in the profits and the risks.

This similarity between *Mudarabah* securities and shares does not mean that the consequences are the same - as, for instance, in selling, discounting or using these securities as a mortgage.

Shares can be offered for sale in the stock market, and the purchaser of the shares is entitled to all the rights appertaining to those shares. He will thus be entitled to vote in respect of his shares and will receive dividends⁽³⁾.

Although *Mudarabah* securities are similar to shares, they represent capital for a short-term project, which will be liquidated in the near future, unlike shares, which represent a capital for an entity which will continue for an indefinite period of time. Another drawback to the supply of *Mudarabah* securities for sale is that their holders are liable to bear the whole loss in a project.

The value of *Mudarabah* securities depends on the feasibility of the project and the efficiency of its management, which makes it uncertain and not fit for discounting. Usually, a security which can be discounted is a security which forms a loan and a promise by the borrower to pay back that loan within a stated period of time. Such a bill can be sold or discounted before maturity. However, discounting of bills or securities is not permitted according to Islamic Law as it involves interest.

As far as mortgage is concerned, it is acceptable to use *Mudarabah* securities as guarantees.

However, limited period *Mudarabah* as a form of finance has many disadvantages. The main drawback is that financial institutions which use this method would not be efficient in mobilizing public savings, for they would mobilize only the savings of the high-income groups; within the high-income classes, only those with a low propensity to consume, are expected to acquire such an investment. Furthermore, liquidity-preference which depends on the transaction-motive and the precautionary-motive,⁽⁴⁾ will be high. The public will tend to keep a relatively high percentage of their income in cash rather than channeling it into financial institutions for investment, because funds deposited for investment have to be kept in the bank and will not be immediately available to meet transaction and unforeseen needs.

It might be argued that such moneys can be pooled into current accounts, so that they participate, partially, in investment, yet are available and can be called at any time. However, the mobilization of money into the banking system will be more efficient if incentives are given to the public. We find that in the UK., most commercial banks have introduced a current account called "current plus", whereby all current accounts will start earning interest. The point to be emphasised is that incentives make mobilization of different kinds of money into the banking system more efficient, whereas limited period *Mudarabah* will increase the tendency towards keeping more cash with the public for transaction and precautionary purposes.

Another disadvantage of limited period *Mudarabah* is its impracticability for commercial banks. It is more orientated to investment banking than to commercial banking, and it would be difficult and costly for a commercial bank to manage and follow up projects financed by this method.

The most important role played by limited period *Mudarabah* is that it provides a type of finance whereby the depositors' fund is segregated from the bank's money. Thus each party's share in profit is more easily distinguished and hence distributed. It also helps to put an end to the controversial point of "full liquidation". Full liquidation or realization of the goods of *Mudarabah*, that is, converting it to money (*Tandeed*) is required by jurists before profit can be distributed. The aim is to enable the financier (*Rub al Mal*) to recover his capital, in the first place, and then the profit accruing will be shared between him and the agent (*Mudarib*) as agreed. Valuation of the inventory of the operation would not stand as an alternative to full liquidation, because the price of the goods may appreciate or depreciate, as stated by Ahmed Ibn Hanbal⁽⁵⁾.

To conclude, two techniques for mobilizing deposits in Islamic banking may be used to substitute interest based deposits; namely, (a) *Mudarabah* contract, where all funds are held in one pool for investment and (b) Limited Period *Mudarabah* contract, where each group of *Mudarabah* certificates is invested in one project and profit is distributed when the project is liquidated.

The first technique, though efficient in mobilizing different classes of savings, is problematic as regards determining each party's participation in investment and hence in profit. Moreover, the situation is more problematic when considering the right of depositors to withdraw and add to deposits. The second technique, (i.e. Limited Period *Mudarabah*), though not as efficient in mobilizing savings as the first has the advantage

that each depositor's share in investment and in profit can be easily determined and distributed.

End Notes

- 1- B.A. Bashir. "Portfolio Management of Islamic Banks". unpublished Ph.D. thesis, University of Lancaster. U.K., 1983.
See also. T.E. Ahmed, "*The Impact of Religion on the Management Control System of Banks*," unpublished Ph.D. Thesis. Bath University. U.K.. 1987.
- 2- F. Benham. *Economics: A General introduction*, Sir Issac Pitman & Sons Ltd., London. 6th ed.. 1960, p.394.
- 3- R.J. Briston. *The Stock Exchange and Investment Analysis*, George Allen & Unwin Ltd., London. 1973, p.65.
- 4- J.M. Keynes. *The General Theory of Employment, interest and Money*, Macmillan and Co. Ltd.. London, 1936, pp. 170, 195.
- 5- S.H. Homoud. *Islamic Banking*, Arabian Information, London. 1986. pp. 215-15.

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توزيع الأرباح في البنوك الإسلامية : حالة بنك فيصل الإسلامي السوداني

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المستخلص : يدرس هذا البحث توزيع الأرباح في البنوك الإسلامية آخذاً في اعتباره حالة بنك فيصل الإسلامي السوداني. وتنشأ المشكلة في توزيع الأرباح من أن البنوك الإسلامية ملتزمة بتوزيع الأرباح الفعلية الناتجة عن استثمار أموال المودعين المختلفين. وقد قام البحث - بعد دراسة طبيعة الودائع وشروط وأحكام المضاربة في بنك فيصل الإسلامي السوداني - باستعراض طريقة توزيع الأرباح لسنتين متتاليتين موضحاً أن نصيب الودائع الجارية من الأرباح والذي يصب في مصلحة المساهمين، قد أدى إلى زيادة نصيب أصحاب ودائع الاستثمار في السنة الثانية عندما اختلفت نسب وطريقة توزيع الأرباح.