

CRITICAL REVIEW WITH META-ANALYSIS

## Profit Distribution in the Islamic Banks-Daily Product Basis and Allocation of Weightages

**Mohammad Yahya Mujaddidi \***

Chairman Shari'ah Board, Bakhtar Bank Kabul and Manager Shari'ah Control,  
Dubai Islamic Bank, Dubai, UAE

### Keywords

Islamic Banks Deposits

Weightages

Daily Product

Profit Distribution

**Received:** 01 January 2017

**Accepted:** 25 May 2017

**Abstract.** Within the past three decades, the Islamic banking industry has gained cumulative growth momentum given the growing demand for Shari'ah-compliant financial instruments. Islamic banking has now achieved greater recognition as a viable alternative to the conventional banking; as depicted by various convincing data including the increasing growth of its deposits globally. The majority of Islamic banks have also benefitted from the profit distribution mechanism that has considerably improved over time. However, amidst this positive growth, there has been growing criticisms on numerous areas of Islamic banking. This scenario includes an important issue on the usage of daily product basis and allocation of weightages for profit distribution in the Islamic banks. This study, therefore, aims to examine its compatibility with the principles of Shari'ah and to weigh the objections in the criticisms against these principles.

**KAUJIE Classification:** K2

**JEL Classification:** G2

©2017 JIBM. All rights reserved.

## INTRODUCTION

In the solicitation of deposits, the contract commonly used by the Islamic banks is *muḍārabah*, which is a partnership in profit whereby one party provides capital (*rabb al-māl*) and the other party provides entrepreneurship (*muḍārib*) [AAOIFI, Standard, 13]. Through *muḍārabah*, the bank is entrusted with the funds in good faith by the *rabb al-māl*, i.e., the depositor of money to the bank. As per the principles of *muḍārabah*, the profit should be shared between the *muḍārib* and *rabb al-māl*, or in common terms, the bank and the depositor, at a pre-agreed ratio. The basis of this distribution differs according to each bank with

\*Corresponding author: Mohammad Yahya Mujaddidi

†Email: [yahyamujaddidi@gmail.com](mailto:yahyamujaddidi@gmail.com)



various weightages and methodologies used for distribution of profits amongst the shareholders and depositors. This study primarily focuses on this area and aims to find if justice prevails in the entire system.

Despite there being some methods that are utilized in the global Islamic finance market for profit distribution, only the most popular and critical method, i.e., the daily product method, is examined in this study. Furthermore, the “Weightages” system is also used by the Islamic banks to distribute profits of the deposit pools amongst the shareholders and different tiers of depositors. As there is a dearth of guidelines to determine these “Weightages” and each Islamic bank uses its parameters for this purpose, there is a significant gap in the Islamic banking literature in this regard. Hence, this paper also seeks to analyse this gap.

To this end, this paper is divided into four sections. The second section defines the daily product profit distribution mechanism and highlights various views in this regard that are obtained from distinguished sources and scholars. The third section details the various parameters used for assigning weightages to the deposits in the Islamic banks along with some discussions on the recommended method of assigning weightages. This section also seeks to highlight the actual practice being followed in the industry. Finally, an overall conclusion is made with requisite recommendations and suggestions. Data from three Islamic banks operating in Pakistan, namely; Dubai Islamic Bank Pakistan Limited, Meezan Bank Limited, and The Bank of Khyber-Islamic Banking have been obtained for the purpose of this study.

## PROFIT DISTRIBUTION SYSTEM-DAILY PRODUCT BASIS

Profit distribution system on a daily product basis is a system in which profits of the partnership contracts including *mushārah* and *muḍārah* are calculated each day for distribution to the partners or depositors. Through this system, the profit is paid for each deposit based on the number of days it remains in the investment account. There is, therefore, a positive correlation between the profits earned and the duration of time that the fund stays in the account (Usmani, 2013).

As an example, an Islamic bank is expected to give profits on a daily product basis at the rate of 9% per annum to its savings deposit account holders. If a depositor opens a savings account on 1<sup>st</sup> January with the amount of Rs. 100,000, withdraws Rs. 20,000 on the 15<sup>th</sup> of the month, and then deposits another Rs. 100,000 on the 25<sup>th</sup> of the month, he will be eligible for profit equal to “average balance in the account\*profit rate\*number of days in the month/number of days in a year” for each transaction he does in the account. For example, he will be eligible for Rs. 345 for the first 14 days ( $45,161 * 9\% * 31/365 = \text{Rs. } 345$ ), and so on. This process is repeated until the depositor closes his account. The following table illustrates a clearer picture of the amount that this depositor earns for a one-month deposit, starting from 1<sup>st</sup> January, with the already mentioned transactions (Al-Shubāīlī & Abdullah, 2005).

**TABLE 1**  
**The profit ratio of depositors on saving account**

Date	Debit	Credit	Balance	Deposit Remains With the Bank	Average Balance	Profit Rate	Profit Amount
01-Jan-17		100,000	100,000	14	45,161	9%	345
15-Jan-17	20,000		80,000	10	25,806	9%	197
25-Jan-17		100,000	180,000	7	40,645	9%	311
			Total	31	111,613		853

According to Justice (R) Muhammad Taqi Usmani, the daily product method of distributing profits is the most practical and equitable solution to profit distribution in the Islamic banks. His view is backed by numerous arguments given below:

1. Firstly, the method can address the difficulty of ascertaining the profits of the bank; since actual liquidation poses a significant challenge, given that the Islamic banks are expected to work on an on-going basis.
2. Secondly, the method fulfills the requirements of *muḍārabah* and other traditional partnership contracts by being able to hand over the fund(s) at once, to the fund manager. Since some of the jurists are of the opinion that once the *muḍārib* commences the *muḍārabah* business, it is not permissible for him to receive any additional fund from the fund provider (thus increasing the *muḍārabah* capital). The daily product method provides a simple solution by considering each transaction a separate *muḍārabah* deal, and thus giving its due profit.
3. Thirdly, this method is practical because the withdrawal of a portion of the *muḍārabah* capital before the end of the period requires the dissolution of *muḍārabah* to the extent of the withdrawn funds and it takes place by this method (Usmani, 2005).

Many other scholars from various jurisdictions allow the usage of this mechanism. Their first reasoning is the validity of using “consent of parties” in the contract along with an agreement.<sup>1</sup> Secondly, the fact that profit could be distributed irrespective of the capital contribution ratio as in the case of common *muḍārabah*, is supported by the saying of 'Allamah al-Kasani that the entitlement to the profit in *Shirkat al-a'māl* is based on the condition of work and not on the availability of work (Al-Kāsānī, 1989). It is also mentioned in Al Mabsut that if one of the partners becomes ill or absent or does not work and the business is conducted by the other partner, the profit will still be distributed by their agreement (Al-Sarakhsī, 1993). The same view can be attributed to Ḥanbalī jurists where they are also of the opinion that in the case of any common work between two partners, the profit would be distributed amongst them similarly. It is reported that Imām Ahmad's answer conformed to the views of *ḥadīth* Sa'd and Ibn Masud when he was asked about the same issue (Ibn

<sup>1</sup>The Council of the International Islamic *Fiqh* Academy, Organization of the Islamic Conference, Decision No. 122 (5/13) on “*Qirād* or Common *muḍārabah* in Financial Institutions (Investment Account)”, 13<sup>th</sup> session, held in Kuwait on 22-27 December 2001.

Qudāmah, 1985).<sup>2</sup>

As far as Mālikī jurists are concerned, they suggest that minor challenges such as the illness of a partner for a day or two should not affect the profit distribution that was agreed upon (Imam Malik ibn Annas). In another situation, the majority of Ḥanafī, Mālikī and Ḥanbalī jurists have allowed *sharikat al-‘inān* even without commingling of the capitals (Al-Samarqandī, 1984; Qudāmah, 1985; Rushd, 1988). All this makes it more convincing that the profits could be shared irrespective of the capital contribution.

There are, however, a number of other jurists who oppose this method due to the following reasons:

1. Firstly, they are of the view that there should not be any relationship between profit, loss and the period during which the deposit stays within a bank. On this ground, they dismiss the daily product method as its profits are positively correlated to time. They further criticise the methodology because it does not consider economic factors by allowing a possibility of overstating profit in cases of a bleak future and vice versa ( Sulaīymān, 1998).
2. Secondly, they share the view of some scholars who have declared it “void” to have a clause of “limited time” in *muḍārabah* contracts. According to these scholars, the element of “time” should not be considered in the calculation of profit (Shubailī & Abdullah, 2005).
3. Thirdly, they consider the view of those scholars who do not allow the commingling of any extra funds given by the *rabb al-māl*, after the commencement of the initial *muḍārabah*. This view is against the system of profit distribution on a daily product basis, which is based on commingling of funds (Ḥassan, 1982).

Despite these criticisms, Justice (R) Muhammad Taqī Usmani upholds his views by stating that the present day *muḍārabah* used in the Islamic banks is a contract that is new and independent from the classical type of *muḍārabah*. He advocates for the fact that its permissibility should not be merely based on the features of classical partnership contracts alone, but also the other goals of Sharī‘ah. With respect to Sharī‘ah compliance, in addition to Justice Usmani, many other reputed scholars and organisations like Nadwat al Barakah also permit this mechanism of profit distribution that considers the “amount” and “time” elements. Also, the International Islamic *Fiqh* Academy, under the Organisation of the Islamic Conference, has pronounced that there is no Sharī‘ah issue in this method wherein the profit is distributed based on the amount of each investor and the duration of its stay in the investment.<sup>3</sup> Above all, the Sharī‘ah Board of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) has decided that the scoring or numeric method, i.e., the daily product method can be used for the distribution of profit among the

<sup>2</sup>By *ḥadīth* S’ad and Ibn Masood Ibn Qudamah meant the *ḥadīth* mentioned in Sunun Abu Dawud from Abi Ubaidah. It is narrated by Abdullah ibn Masood (RA) that “Me, ‘Ammār and S’ad became partners in what we would receive on the day of Badr. S’ad then brought two prisoners, but me and ‘Ammar did not bring anything”. (Sunun Abu Dawud, Kitab al-Buyu, Bab al-Sharikah ala Ghayr Ras Mal, *ḥadīth* No. 3388). Al Manziri said: The *isnād* of this *ḥadīth* is broken *munqat’*, because Abu Ubaidah did not hear from his father (Mukhaṣar Sunun Abī Dāwūd, vol. 5, p. 53).

<sup>3</sup>The Council of the International Islamic *Fiqh* Academy, Organization of the Islamic Conference, Decision No. 122 (5/13) on *Qirāḍ* or Common *muḍārabah* in Financial Institutions (Investment Account), 13<sup>th</sup> session, held in Kuwait on 2227 December 2001.

participants of general investment accounts (AAOIFI Standard, 40).

### ‘WEIGHTAGES’ IN PROFIT DISTRIBUTION

The previous section on the ‘use of the daily product in profit distribution’ in the Islamic banks provides clarity on the fact that its usage is permissible in the eyes of Sharī‘ah, as long as it adheres to the Sharī‘ah principles. However, the next question is whether the profit is to be distributed equally amongst the depositors, and if not, what criteria should profit distribution be based upon.

There are numerous types of depositors in the Islamic banking industry. For instance, some depositors deposit money that matures after several years, while some others deposit for shorter periods. The latter type of depositors contributes less to the actual creation of profit in the *muḍārabah* pool and vice versa. There are also investors that invest less money for longer terms. This scenario nullifies the benefit of long-term deposits contributing more to the actual profit. It could, therefore, be understood that depositors assume different risks and roles in the actual profit of the *muḍārabah* pool. Given the above, this section seeks to examine this issue critically to arrive at a justifiable conclusion and recommendations.

To arrive at a distributable profit for various depositors, it is common for the Islamic banks to use ‘weightages’. Weightages in the Islamic banks may be described as assigning various values to different types of deposits, to compensate the depositors in an optimum way. The basis for assigning these values differs from bank to bank. Central banks may also be involved in the process by monitoring it through their guidelines and directives, from time to time, as in the case of Pakistan.

As discussed earlier, the bigger the size and duration of deposits, the higher is their contribution to the actual profit of the *muḍārabah* pool. Therefore, it is common for deposits like ‘savings account’ to be assigned lower weightages, since a portion of such deposits is kept idle to meet the liquidity requirements of the Bank and the numerous withdrawals allowed in these type of accounts. In addition to this, the profit of ‘savings accounts’ is usually distributed at each profit distribution period, as opposed to the other long-term deposits which keep both the principal and profit in the common pool until the deposit matures. Based on this explanation, the latter-mentioned accounts are deemed to be deserving of more profit (CIMB Islamic, 2012). At this juncture, an illustrated example of profit distribution based on weightages, as stated below, would enable greater understanding of the overall concept.<sup>4</sup>

**TABLE 2**  
**The distribution of profit among various depositors**

Tenure	Deposit (Rs.)	Weightage
Savings Account	8,000	6%
One Year Fixed Deposit	7,000	12%
Three Years Fixed Deposit	6,000	18%
Five Years Fixed Deposit	5,000	28%
Seven years Fixed Deposit	2,000	36%
Total	28,000	

<sup>4</sup>The illustration is taken from Depository Product’s Presentations of Dubai Islamic Bank Pakistan Limited (Dubai Islamic Bank Pakistan Limited, 2005).

In the example mentioned above, it is assumed that the depositors' share in the profit earned by the pool is Rs. 1,800, which is further distributed amongst the various depositors as shown below:

**TABLE 3**  
**Allocation of weight by Islamic banks**

Tenure	Deposit (Rs.) X	Weightage Y	Weighted Average Z= X * Y	Weighted Profit P*	Rate R**
Saving Account	8,000	6%	480	191	2.39%
One Year	7,000	12%	840	334.5	4.78%
Three Year	6,000	18%	1,080	430	7.17%
Five Years	5,000	28%	1,400	557.5	11.15%
Seven Years	2,000	36%	720	287	14.34%
Total	28,000		4,520	1,800	

P \* = Profit:  $480 \div 4,520 \times 1,800 = 191$  & so on  
R \*\* = Rate:  $191 \div 8,000 \times 100 = 2.39\%$  & so on

From the practices of the Islamic banks taken in the study, it could be inferred that weightage allocation is positively correlated to (a) the size of the deposit amount, and (b) the tenure of the deposit; while it is negatively correlated with profit distribution frequency, i.e., monthly, quarterly, semi-annually, or at maturity.<sup>5</sup> No specific formula was found to be used by the understudy banks for assigning weightages. The banks, at times, were found to assign weightages regarding their preferences. Before the instructions given by the State Bank of Pakistan (2012), some banks were found to have assigned weightages to the rate-sensitive categories (tiers) of deposit which were as high as five times the weightages of the non-rate sensitive tiers. In curbing such practices, the current instruction has set a maximum limit of '3 times' difference between the maximum and the minimum weightages assigned to different categories of deposit.<sup>6</sup>

Furthermore, the moral aspects of the practice of weightage allocation were also found to be largely ignored. This issue was apparent in the case of 'saving account' depositors

<sup>5</sup>Provision No. 8.2 of Profit Distribution Policy of Dubai Islamic Bank Pakistan Limited (Dubai Islamic Bank Pakistan, 2014) 2<sup>nd</sup> Revision-2014.

<sup>6</sup>Provision No. 4.2.3 of Instructions for Profit and Loss Distribution and Pool Management for Islamic Banking Institutions by State Bank of Pakistan in 2012, Provision No. 2.3.4 (Profit Sharing Ratio and Weightages) of Liability Products Manual Product Guide Version 1.0, of Meezan Bank Limited used before November 2012 (issuance of "Instructions" by SBP) where a weightage of 0.23 was assigned to Saving Account Tier 1 (up to 100k) while equity of the Bank was assigned a weightage of 1.83 which was equal to COII5 years maturity. It is apparent that the COII and Bank's own equity were assigned with the highest weightages due to their rate sensitivity and Bank's own interest respectively, and Dubai Islamic Bank Pakistan Limited prior to the "Instructions" had assigned 60% weightage to its own equity from April 2007 till January 2008, which is three points lesser than the five years maturity against 18% assigned to the second Tier of Normal Savings (over Rs. 25,000 up to Rs. 99,999). The situation was worst from February to June 2008 whereby the weightages of the mentioned Tier of Normal Savings came down to 10% from December 2012 until February 2013.

to which low weightages were assigned, as they did not belong to the rate-sensitive tiers of the common *muḍārabah* pool, where customers typically demanded more profits. It was observed that the entire process of assigning weightages lacked a sound logical basis. For example, for the purpose of assigning weightages, The Bank of Khyber takes into consideration the tenure, profit payout option, purpose of deposit (such as *hajj*, *‘umrah*, purchase of new house, marriage, education, etc.) and also the type of customer (whether he/she was a pensioner, widow, orphan, permanently disabled patient, newly reverted Muslim, etc.).<sup>7</sup> Similarly, Meezan Bank Limited considered the investment tenure, profit payment option, amount tiers, type of account, and market trend in determining various weightage allocations of their deposits.<sup>8</sup>

Similar to the daily profit distribution mechanism, “assigning weightages” is a contemporary issue and needs to be assessed regarding its compliance with the general principles of Sharī‘ah, as mentioned in the previous section. In assigning weightages, various parameters have been suggested by the scholars of Islamic financial institutions, as given below:

1. Firstly, the weightages assigned should be known, transparent, and based on an agreed-upon formula that reflects logic and justice between the bank and its depositors. It should be arrived upon in such a manner that it is well-established and not depriving any depositor or tier/category of deposits of the profits that they deserve and not high enough to affect the deserved profits of other depositors or tiers.
2. Secondly, the prior knowledge and agreement of the depositors on the formula of weightages are necessary. Therefore, changes in the weightages need prior knowledge and consent of the depositors. Also, options should be given to the depositors to withdraw their funds without any penalty if they were not happy with the change in weightages.
3. Thirdly, any changes in the weightages should be done based on a proper study and analysis of the market dynamics and supply of funds in the market. Requisite approvals from the Sharī‘ah boards of the banks should also be sought (CIMB Islamic, 2012).
4. The fourth parameter was something not new to the industry. It was suggested that the longer and bigger the period and size of the deposits, the higher the weightages to be assigned and vice versa.<sup>9</sup>

In a publication released by the Islamic *Fiqh* Council, Justice Muhammad Taqi Usmani mentions the view of Allamah al-Kasani which forbids disproportionate sharing of profit on capital contribution amongst partners, except in cases where the profit matches their ratio of work contribution. This view holds that the share in profit should match the responsibilities of each partner. To this, Justice Usmani adds that it refers to *mushārah* type of partnerships wherein the condition of work becomes the subject matter of a contract. However, he

<sup>7</sup>Provisions No. 46 and 48 of Policies and Practices of The Bank of Khyber-Islamic Banking Group (Islamic Banking Group, 2005)

<sup>8</sup>Provision No. 6, Policy and Framework for Profit and Loss Distribution and Pool Management, Meezan Bank Limited, Revised Policy No. 3, September 2013.

<sup>9</sup>*Fatwā Nadwat al-Barakah* 11th, (fifth session on Contemporary Issues in Banks), held in Jeddah on 11-12 *Ramaḍān* 1416, corresponding 1315 February 1996, and Article 5/1 of AAOIFI’s Sharī‘ah Standard on Profit Distribution in Investment Accounts on the basis of *muḍārabah*,. (Measuring the criteria requires numeric calculation of the profit (Daily Product)).

argued that since the subject matter of *mudārabah* contracts in Islamic banking is a capital contribution, this issue does not come under the ambit of Allamah al-Kasani's viewpoint. Apart from the permissibility of having different profit ratios for the depositors, Justice Usmani also justifies the permissibility of assigning weightages to different deposit holders in accordance with the views of various Ḥanafī and Ḥanbalī jurists (Usmani, 2003).

However, in the absence of a defined and transparent formula as well as agreed-upon factors for assigning weightages, this method could be misused by the banks, by giving weightages of their own choice without taking into consideration elements such as morality and justice. It is, therefore, imperative that unjust behaviour and assigning of low weightages to the normal savings accounts which are assumed as non-rate sensitive deposits should be examined.

In reality, 'savings account' holds a vital role in the total percentage of the common *mudārabah* pool, even though such accounts are subject to constant withdrawals by their holders. It could be for this reason that the Sharī'ah Advisory Council of the Central Bank of Malaysia disapproved weightage assignment when the Council was once asked about the issue of assigning higher weightages to the long-term deposits of the banks (Sharī'ah Advisory Council of the BNM, 2010). Their opinion was based on the view of 'Allamah al-Kasani' and the Council advocated that the element of weightage assignment brings uncertainty which makes the Sharī'ah contract repugnant. The Council also explained that the assignment of weightages would affect the calculation of net profit for both *mudārib* and *rabb al-māl* by changing the pre-agreed profit sharing ratio to a new effective profit sharing ratio.

Furthermore, it was claimed that the presumption that the long-term investments are riskier than the short-term investments was not true, especially in the light of the type and area of the investment portfolio. Above all, the assignment of weightages was understood to increase non-transparency, as the depositors would then only receive insufficient information on the internal practices of the banks. It was therefore argued that this practice nullifies the very principles of Sharī'ah (Sharī'ah Advisory Council of the BNM, 2010).

Moreover, some of the contemporary scholars have objected to the weightage mechanism because it may result in doubtful transactions similar to *ribā* transactions (*shubhāt al-ribā*). They cautioned that this type of distribution is based on the mere estimation of returns on *mudārabah* and *mushārah* investments, instead of definite and certain investment returns. They also warned that as a result of this practice, people's wealth might be devoured through pretenses. In line with this argument is a narration related by Ibn 'Abbās (RA) wherein he defines *bāṭil*/falsehood as the practice of devouring someone's wealth without any consideration. The allowance of 'weightages' allocation could therefore also be questioned on this ground (Yusuf, 2008).

Some jurists have raised their concerns over time against the critics mentioned above. They have argued that profit distribution based on weightages gives rise to a new profit sharing ratio, which, if agreed to by the depositors, was similar to agreeing on a profit ratio that is different from the capital contribution ratio, having already established the permissibility



of having a profit ratio different from the capital contribution ratio. However, as far as losses are concerned, the ‘weightages’ system shares them at the time of actual loss, adhering to the principles of Sharī‘ah.

These scholars further argued that similar to the approach of accepting the modern day *mushārah* and *muḍārah* contracts in Islam, as previously discussed, there should be no objection to any new transacting partnership contracts, as long as it retains the essence of Sharī‘ah. Some scholars permit this practice on the grounds of custom and necessity of the market, for example, in the case of deposit and withdrawal of funds on a daily basis. In addition, it is also permissible given the impracticality to determine the exact benefit of each deposit to the common pool (Saqib al-Din, 2013).

According to Justice Usmani, renowned scholars like Shaikh Dr. Wahbah al-Zuhayli and Dr. Ahmad al-Najar had also supported this practice in their books. A group of scholars in the Islamic Ideology Council of Pakistan also permitted the ‘weightages’ allocation in profit distribution. Justice Usmani further states that there are dozens of texts in the *fiqh* literature which clearly depict the fact that profit-sharing amongst partners could be in accordance with any agreed ratio, with the requirement that it does not deprive any of the partners of their share of profits earned from the subject matter of *muḍārah* and *mushārah*. However, losses ought to be shared in proportion to the capital contribution ratio. This principle is derived from the saying of 'Ali ibn abi Talib (RA), and it is reported by 'Abdul Razaq in his *Musannaf* that this principle is applied to both *mushārah* and *muḍārah* (Usmani, 2003).

Classical texts show that there have been instances where certain varied types of partnership contracts were allowed based on the theory of necessity. For instance, a few jurists had mentioned an incident wherein a jeweler was allowed to assign his shop to a third party by paying a consideration in the form of a “share” in the profits of the jewelry. Shams al A'imah Al Sarakhsi argued in his book that this was like “*salam*”, which was allowed by the needs of common people. Similarly, once the children of the second caliph of Islam, 'Umar (RA) had made some profits from goods which were brought by them from Yemen. The caliph had initially refused to give a share of the profits to his children. However, later, upon the recommendations of a few companions of the Prophet (PBUH), he had finally agreed to share half of the profits with them, despite having no *muḍārah* agreement with his children (Usmani, 2008).

It is a common practice in the Islamic banks that higher weightages are assigned to the rate-sensitive tiers and vice versa. The same is the case in Pakistan wherein almost all banks agree on a 50:50 profit sharing ratio with their depositors. Under this regime, if a bank earns a profit of Rs. 100 million, it will first be distributed between the bank and the depositors as per the agreed ratio. Consequently, Rs. 50 million will remain for further distribution between the depositors, including the shareholders since their funds are also commingled with the common *muḍārah* pool. Here, the problem occurs when the profits are distributed based on weightages. Thus, with the existing system, 70-75% of the profits are given to the rate-sensitive depositors including the shareholders, 20% of the remaining profits are given

to the other fixed depositors, and only the balance of 5-10% goes to the savings account holders.

It can, therefore, be observed that there are several issues in the ‘weightages’ mechanism, when it comes to the distribution of profits, as outlined below:

1. Firstly, this system considers the ratios that allocate ‘weightages’ to the total capital shared by the bank and the depositors and not merely on the depositor’s share.
2. Secondly, though it is allowed to have an agreed ratio of profit-sharing by the banks and the depositors, it is only the bank that makes the decision of assigning ‘weightages’ amongst depositors, with no discretion of the latter.
3. Thirdly, there are no regulatory restrictions on the banks regarding the assignment of ‘weightages’, they are free to decide and change the ‘weightages’ as they will. However, the State Bank of Pakistan has made it compulsory for them to announce the assigned ‘weightages’ at least three working days before the beginning of the concerned period.<sup>10</sup>
4. Lastly, in the absence of specific parameters and criteria for assigning of weightages, the system opens the door to an unjust allocation of weightages by the individual banks.<sup>11</sup>

## CONCLUSION

Given justice and equity, profit distribution on daily product basis could still be justified as the best method for distributing profits/losses. In the Qur’ān and Sunnah, there is no provision to restrict the legitimacy of *mushārah* or *muḍārah* as was attempted by a few jurists. In fact, those discussions of the jurists were based on what was available to them during their life and also affected by their environment. Most of the traditional partnerships came into existence as a result of the needs of people in trade, such as *shirkat al-a‘māl* and *shirkah al-wujūh*. Considering that such contracts were allowed due to the need of the trade at that time, it could be successfully argued that any new type of partnership/*mushārah* should not be declared impermissible or unlawful merely because of its mismatch with the already existing traditional partnership contracts as detailed in the books of classical jurists.

These contemporary contracts should be declared permissible as long as they do not conflict with the basic principles of Sharī‘ah. Thus, by applying this logic to the contemporary form of *muḍārah* or *mushārah* contracts as used by the Islamic banks, it can be seen that the parties who commingle their funds based on these contracts are still exposed to the element of profit or loss, i.e., no party is given a fixed profit. This condition deems them permissible in the eyes of Sharī‘ah.

Furthermore, though it is not the actual profit that is being distributed in the daily product method, in the absence of a sound alternative, it could be suggested that the Islamic banks could continue with this system, provided that it is done with the mutual consent of the concerned parties from the very first day of their contract with the bank. This solution could also be emphasised in the light of two ancient practices in *shirkat al-a‘māl* permitted by the

<sup>10</sup>Provision Number 4.2.2 of Instructions for Profit and Loss Distribution and Pool Management for Islamic Banking Institutions 2008-State Bank of Pakistan.

<sup>11</sup>ibid, Provision Number 4.2.3.

Ḥanafī Jurists. One of the practices was the situation in which two or more partners would agree on undertaking some work on a *mushārah* basis and mutually agree on the profit sharing ratio, which may be equal or different. In the case of an equal ratio, a partner may conduct more work than his colleague, but they would still be entitled to an equal share of profit. There is no objection of jurists on this type of *mushārah*.

The other practice was such in which two persons would enter into a *mushārah* with different currencies and in case they had bought goods without commingling their funds, then it was considered to be Sharī'ah-compliant if they shared profits by an agreed ratio.

Therefore, if the parties have agreed on the distribution of profits based on the daily product method, it is considered valid as it does not contradict the principles of Sharī'ah. In fact, it is an accounting method adopted by the partners due to the lack of any appropriate alternative system for the calculation of profits on an on-going business. This could also be argued by the maxim which says that "Muslims will be held to their conditions, except the conditions that make the lawful unlawful, or the unlawful lawful" (Al-Zuhīyī, 2006).

Considering the arguments of various critics on the daily product method of profit distribution, they could be challenged because there is an indirect relationship between profits and time. Also, time often has an impact on work, capital, rights, or even loans as evident from the impact of deferred payments on the common man's life, even if it is a Sharī'ah-approved transaction. For instance, the deferred payment for a car bought for five years will be costlier i.e., will be for more profit, than a car bought for two years using deferred payment. Most importantly, it is neither mere economic output nor money nor time that affect the profits of a business. These arguments made by the critics are therefore still weaker from an academic point of view. The element of a contribution of all investors' funds in the achievement of profit provides further justification.

Nevertheless, some issues remain with the daily product profit distribution particularly in the case of non-participation of the funds in the business and misuse of the product by unscrupulous partners. Therefore, some restrictions are recommended to be imposed in line with the maxim that 'necessity must only be assessed and answered proportionately' (Al-Zuhīyī, 2006). Reducing or restricting the number of withdrawals, time of deposits and duration of its stay in the investment accounts could address the issues mentioned above to a greater extent. For instance, if a person deposits some money in the common *muḍārah* pool at the end of a day, be it just a few minutes before the closing time, the person is still considered to be entitled to profits for that day, regardless of the time duration. In this way, an account holder can generate profits without letting his funds take part in the business.

Rephrasing the above example in a more specific way would make it clearer to the reader. In case a person deposits Rs. 5 million on Friday at 4 pm in the common *muḍārah* pool and if he withdraws it on Monday at 9 am, then his funds will be entitled to three days of profit. Since the banks in Pakistan remain closed on Saturdays and Sundays, the deposited Rs. 5 million yields this person profits without actually contributing to the business operations. In using this drawback of the system, a businessperson who does not need his funds during the holidays can deposit them with the bank and get profits of three days per week, in

addition to the safekeeping of his funds. In light of the potential misuse highlighted above, it could be recommended that these funds should be considered for profits in the next working day of their receipt in the common *mudārabah* pool.

In addition to the above, it is also evident that frequent withdrawals of funds tend to disrupt the *mudārabah* operations. These reasons necessitate the need to impose some restrictions on the withdrawals from the whole system. Furthermore, in considering the views of certain scholars, it would be more desirable to distribute profits on a ‘weekly’ basis, as opposed to daily and even monthly basis, to balance the benefits of both the extremes. This condition is also required because *ribā*-free investments need sufficient time to generate profit.

On the other hand, the Weightage system could be proven beneficial if it is formulated based on a transparent and logical formula, free from any form of bias. Despite certain objections on the usage of weightage allocation, considering its benefits and the absence of a good alternative method, it could be recommended to be used by the Islamic banks on the condition that it is not taken as a permanent solution for profit distribution. Efforts must still be undertaken by the stakeholders of the industry to develop a more equitable and fair system as a substitute for this method. The current system provides no option to the depositors but surrenders the “differences”, if any, in their rights of the profits of the bank’s common pool. Also, at present, the profits are at the discretion of the Islamic banks as they have the privilege of freedom in assigning weightages. This scenario has led to the recommendation that the criteria for assigning weightages should be regulated by either the central banks or any International Sharī‘ah bodies, or both.

In addition to the above, special attention should be given to normal saving account holders by creating an independent and separate pool from the fixed deposits or other rate-sensitive deposits. This measure could help to determine the actual profits earned by these deposits as opposed to the current practice of the industry, wherein the highly profitable portfolios are transferred to the rate-sensitive depositors. The pro-rata distribution of profits concerning the capital contributions could also reduce the existing challenges to a greater extent, as suggested by the Shāfi‘ī and Mālikī jurists.

## REFERENCES

- AAOIFI Standard. (2016). *Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) Sharī‘ah standards*. Al Riyadh, Saudi Arabia: Dar al-Maiman
- Al-Kāsānī, A. A. B. (1989). *Badā’ i’ al-Ṣanā’i’ fī Tartīb al-Sharā’i*. Beirut, Lebanon: Dār Iḥyā al-Tūrath.
- Al-Samarqandī, I. A. (1984). *Tuḥfah al-Fuqahā* (2nd ed.). Beirut, Lebanon: Dār al-Kutub al-’Ilmīah.
- Al-Sarakhsī, M. A. (1993). *Al-Mabsūṭ*. Beirut, Lebanon: Dar al-M’rifah.
- Al-Sayūtī, J. A. (1983). *Al-Ashbāh wa al-Nazā’ir fī Qūā’id wā Frū’ fiqh al-Shāfi’īah* (1st ed.). Beirut, Lebanon: Dār al-Kutub al-’Ilmīyah,.

- Al-Zuḥiyli, M. (2006). *Al Qaua'id Al Fiqhiyah wa Taḥqiqatuha fil Mazāhib al Arba'ah*. Damascus, Syria: Dar al Fikr.
- Anas, A. I. M. (1990). *Al Mudā'uanah Al-Kubrā*. Beirut, Lebanon: Dār al-Ṣādir.
- CIMB Islamic. (2012). *Global Islamic Finance Report (GIFR), 2012*. London, UK: Edbiz Consulting.
- Dubai Islamic Bank Pakistan Limited. (2005). *Depository products*. Dubai Islamic Bank Pakistan Limited, Islamabad, Pakistan.
- Dubai Islamic Bank Pakistan Limited. (2014). *Profit distribution policy of Dubai Islamic Bank Pakistan Limited*. Dubai Islamic Bank Pakistan Limited, Islamabad, Pakistan.
- Ḥassan, H. S. (1982). *Taḥwīr al-'Amāl al-Maṣrafiyah Bemā Yatafiq wa al-Sharī'ah al-Islāmīyah*. Muscat, Oman: Maṭba'ah al Sharq.
- Islamic Banking Group. (2005). *Policies and practices of the Bank of Khyber*. Islamic Banking Group, Peshawar, Pakistan.
- Qudāmah, A. A. I. (1985). *Al-'Umdah Fi'l Fiqh: 'Ala Madhab Al-Imam Ahmed Ibn Hanbal* (1st ed.). Beirut, Lebanon: Dār al Fikr li Ṭaibāh wa Tawzī'.
- Rushd, I. (1988). *Al-Bayān wa al-Taḥṣīl*. Beirut, Lebanon: Dār al-Gharb al-Islāmī.
- Saqib al-Din, M. (2013). *Islami bankari aur mutafiqh atway ka Tajziyah*. Karachi, Pakistan, Deeneislam.com.
- Sharī'ah Advisory Council of the BNM. (2010). *Sharī'ah resolutions in Islamic finance* (2nd ed.). Kuala Lumpur, Malaysia: Bank Negara Malaysia.
- Shuba, A., & Abdullah, Y. I. (2005). *Al-Khidamat al-Istihmariyah fi al-Masarif wa Ahkamuha fi al-fiqh al-Islami: Al-Sanadiq wa al-Wadai al-Istihmariyah* (1st ed.). Riyadh, Saudi Arabia: Dar Ibn al Jauzi.
- State Bank of Pakistan. (2012). *Instructions for profit and loss distribution and pool management for Islamic Banking Institutions*. State Bank of Pakistan, Karachi, Pakistan.
- Sulaiyman, A. (1988). *Hukm al-Mudarabah bi Mal al-Wadiah aw al-Qirad aw huma Maan*. Faculty of Dar al-Ulum Magazine, Issue no. 11.
- Usmani, M. T. (2003). *Islam Aur Jadid Maeeshat-o-Tijaraht* (Islam and contemporary economy and trade). Karachi, Pakistan: Maktaba ma'ariful Quran
- Usmani, M. T. (2008). *Ghaiyr Soodi Bankari: Mutailqah Fiqhi Masail Ki Tahqiq Aur Ishkalaat Ka Ja'izah*. Karachi, Pakistan: Quranic Studies Publication.
- Usmani, M. T. (2013). *Buḥūth fī Qadāya Fiqhīyah M'āshirah*. Damascus, Syria: Dār al Qalam.
- Yusuf, M. A. (2008). *Murawajah Islami Bankari: Tajziati Mutali'Ah, Shara'i Jaiyazah-Fiqhi Naqd Wa Tabsirah*. Karachi, Pakistan: Maktabah Bayanat.

\*\*\*\*\*