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Why Islamic Banks Tend to Avoid Participatory Financing? A Demand, Regulation, and Uncertainty Framework

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Abstract

Participatory financing arrangements including Musharakah and Mudarabah are the essence of Islamic banking and represent the true spirit of Islamic banking and finance. Therefore, Islamic banks are expected to allow and promote participatory financing. In practice, Islamic banks adopt participatory financing arrangements for the scheme of deposits. However,they do not adopt participatory financing on the assets side due to several constraints. By far, the non-participatory financing arrangements, particularly Murabahah and Ijarah, are the most dominant modes of financing around the globe. Many authors have provided different explanations for the tendency of Islamic banks to avoid participatory financing. However,literature is divergent and the typology of the constraints to participatory financing is missing. Therefore, there is no unified understanding of the constraints to participatory financing. The present study employs insights form the extant literature using a systematic literature review and synthesizes a coherent participatory financing constraints framework using the thematic synthesis method to name and make sense of what makes participatory financing a less attractive option for Islamic banks. This study adds to the Islamic banking and finance literature by synthesizing the divergent literature,and conceptualizing a participatory financing constraints framework which can be used as a dependable framework for assessment in any related case study and policy implications. Moreover, it demonstrates an application of systematic review in Islamic banking research.

Keywords: *Constraints, Participatory financing, Mudarabah, Musharakah, Islamic banking, Islamic finance, Systematic literature review.*

1. Introduction

Islamic banking is a rapidly growing phenomenon particularly in the Muslim countries and the leading world financial hubs (Ahmad, 2000; Farooq, 2007; Iqbal,

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1997; Zaher & Hassan, 2001). From an obscure financial experiment, Islamic banking clearly has transformed into a major factor in global finance (Khan, 2010). The worldwide capital of Islamic banks grew from US$ 200 billion in 2000 to around US$ 3 trillion by 2016, with this figure expected to reach $4 trillion by the early 2020s (World Finance, 2018). The growth of Islamic banking is a result of structural and macro-economic reforms in the financial systems worldwide, global integration of financial markets, privatization, the liberalization of capital movements and the introduction of new and innovative Islamic products (Iqbal, 1997; Zaher & Hassan, 2001).

Despite the impressive growth of Islamic banking, a complete Islamic financial system is still nascent (Zaher & Hassan, 2001). Many issues and challenges related to the different aspects of the Islamic financial system need to be addressed yet. One of the most dominant issues currently faced by Islamic banks is the overwhelming use of debt-like non-participatory instruments in their overall financing operations. Participatory financing (including *Musharakah* and *Mudarabah* financing) is the essence of Islamic banking. Therefore Islamic banks are supposed to allow and promote participatory financing. However, in practice they do not adopt them as the main financing schemes. By far the non-participatory arrangements particularly *Murabahah* and *Ijarah* are the most dominant modes of financing around the globe.

The extant literature indicates that the strong and consistent tendency of Islamic financial institutions to rely on non-participatory financing results from necessity, not from preference (Aggarwal & Yousef, 2000; Bacha, 1995; Karim, 2002). *Musharakah* and *Mudarabah* have serious practical problems (Sumarti, Fitriyani, & Damayanti, 2014). To avoid these problems Islamic financial institutions rely mainly on non-participatory modes of financing (Nouman & Ullah, 2014).

Many authors have provided different explanations for the less utilization of participatory financing. However, the extant literature is divergent, with diverse studies focused on different dimensions of the issue. Due to the divergence in the literature there is no unified understanding of the constraints to participatory financing. Though Nouman and Ullah (2014) have attempted to integrate the extant literature. However, the typology of constraints remains missing. Therefore, this research strongly believes that it will be really useful and interesting to develop a coherent typology of the constraints identified by various scientific research efforts in the discipline.

This paper aims to extend the study of Nouman and Ullah (2014) and produce a coherent framework of the constraints to participatory financing. For this purpose, the present study employs insights form the extant literature using a systematic review and provides academia, practitioners, and policy makers with a coherent framework to name and make sense of what is making participatory financing a less attractive option for Islamic banks. The proposed framework provides grounds for creative reframing of the participatory financing arrangements, policy implications, and design of the control mechanisms for promoting participatory financing in Islamic banking.

The rest of the paper proceeds as follows: section 2 provides an overview of the theory and practices of Islamic banking, section 3 elaborates the review methodology employed in this study, section 4 presents the analysis of the literature, a coherent constraints framework has been developed in Section 5, and section 6 concludes the paper.

2. Participatory Financing in the Theory and Practice of Islamic Banking

Participation and risk sharing, commonly known as the profit and loss sharing, is the essence of the design of Islamic financial products (Aggarwal & Yousef, 2000; Ariff, 1988; Hearn, Piesse, & Strange, 2012). A participatory financing arrangement allows the bank to earn profit on invested capital if the bank is willing to tolerate loss in case of the project failure (Aggarwal & Yousef, 2000; Bacha, 1997). Moreover, the allocation of risk and reward to each partner, and the distribution of responsibilities among them are defined in the contract, which are enforced by the social values and the ethical standards set in the *Shari'ah* (Hearn et al., 2012).

The modes of participatory financing include *Mudarabah and Musharakah.* A *Mudarabah* arrangement entails partnership between investor(s) (*Rabb Al-Mal*) and entrepreneur(s) (*Mudarib*). Where an investor contributes capital while the entrepreneur employs effort and exercises complete control over the business (Abdouli, 1991; Aggarwal & Yousef, 2000). Profits are divided according to a pre-agreed ratio, while in the event of a loss the losses are exclusively borne by the investor. Whereas, the entrepreneur loses compensation for his efforts (Bacha, 1997; ElGindi, Said, & Salevurakis, 2009). *Mudarabah* is more akin to a limited liability partnership (Aggarwal & Yousef, 2000) and is further classified into restricted and unrestricted *Mudarabah* (Hearn et al., 2012). In case of the unrestricted *Mudarabah*, the agreement does not specify the place of business, its period, service or industry, the specific line of business, and customers or suppliers to be dealt with. On the other hand, the restricted *Mudarabah* has restriction on any of the above mentioned terms (Chapra, 1985, p. 247).

On the other hand, *Musharakah* is a type of partnership where all partners jointly contribute capital and manage the business venture (Abdouli, 1991; ElGindi et al., 2009). Profits are shared based on a pre-negotiated ratio, while losses are borne in proportion to the capital contributions by the partners (Aggarwal & Yousef, 2000; Hearn et al., 2012; Kayed, 2012; Yousefi, McCormick, & Abizadeh, 1995). *Musharakah* contracts are considered optimal in the development of Islamic private equity and venture capital markets, which require capital provision with some control and influence over their management (Al-Suwailem, 1998; Hearn et al., 2012; Khan & BenDjilali, 2003).

The non-participatory modes on the contrary do not involve profit and loss sharing and an entrepreneur must pay a usually predetermined return. These modes include *Ijarah* (lease), *Murabahah* ('mark-up' or cost plus sale), *Bai Muajjal* (deferred payment), *Istisna'* (commission to manufacture), *Salam* (differed delivery), *Qard Al Hasana* (charity loan) and *Jo'alah* (service fee) (El-Komi & Croson, 2013; Khan, 2010).

2.1. Partici patory financing in the theory of Islamic banking

Participatory financing dominates Islamic banking literature (Dar, Harvey, & Presley, 1999; Dar & Presley, 2000; Farooq, 2007; Kayed, 2012; Sadr, 1999). The advocates of Islamic banking argue that participatory financing is the essence of Islamic banking and represent the true spirit of the Islamic banking system (Ahmad, 2000; Chapra, 2000; Dusuki, 2007; Mansoori, 2011; Nouman & Ullah, 2014, 2016; Siddiqi, 1983, 1985). While the non-participatory modes of financing (also called trade-based financing modes), are acceptable only in the situations where participatory arrangements are clearly not suitable. For example, in the case of consumer or very small loans (Khan, 2010; Also see Kuran, 2004; Usmani, 2002; Warde, 2000; Zaher & Hassan, 2001). They claim that participatory financing arrangements are preferable to the non-participatory arrangements for several reasons, including their risk sharing features (Dar & Presley, 2000; Ebrahim & Safadi, 1995; Farooq, 2007). The non-participatory modes especially *Mudarabah* and *Ijarah* are criticized, which is justified to some extent on the basis that their net result is materially same as that of the interest-based borrowing when these are used within the framework of the conventional benchmarks like LIBOR etc. (Usmani, 2002, p. 165). Therefore, the *Shariah* supervisory boards have conceded that these are not the ideal models of financing and should only be used in case of need, with full observation of the *Shariah* prescribed conditions (Usmani, 2002, p. 165; 2007, p. 20). Moreover, this allowance should not be taken as a permanent rule for all sorts of transactions and the entire operations of Islamic Banks should not revolve around it (Usmani, 2002, p. 165). Furthermore, the basic philosophy of Islamic finance cannot be translated into reality unless Islamic banks expand the use of participatory financing (Sadique, 2012; Siddiqi, 1983; Usmani, 2002, p. 3; 2007, p. 240).

2.2. Partici patory financing in the practices of Islamic banks

The Islamic financial institutions (IFIs), particularly Islamic banks, adopt participatory financing modes for the scheme of deposits, especially for term deposit accounts. However, contrary to the expectations of advocates of Islamic finance, they tend to avoid participatory financing as the main financing scheme (See for example, Ahmed, 2011; Ariff, 1988; Ariss, 2010; Asutay, 2007; Dusuki, 2007; Jaffar, 2010; Lewis, 2008; Shahid, Shagufta, Ahmad, Ahmad, & Shafique, 2015; Shinsuke, 2012; Siddiqi, 1985; Sugema, Bakhtiar, & Effendi, 2010; Vahed & Vawda, 2008; Vogel & Hayes, 1998; Yousef, 2004; Zandi, Ariffin, & Shahabi, 2012). By far, the non-participatory arrangements are the most dominant modes of financing in Islamic banks globally. The strong and consistent tendency of Islamic financial institutions to rely on debt-like instruments while investing funds is referred to as *Murabahah* syndrome by Yousef (2004).

Given the dominant reliance on non-participatory, Islamic finance cannot be referred to as risk-sharing in any meaningful sense (Khan, 2010). The non-participatory financing might be considered sufficient in meeting the requirement of *Shariah* compliance, but these are clearly insufficient to achieve the specific objectives of the Islamic finance and the broader goals of *Shariah* (Kayed, 2012, p. 3; Khan, 2011; Mansoori, 2011; Sadique, 2012; Siddiqi, 2006).

3. Literature Review Methodology

The present study employs insights form the extant literature using a systematic review approach. According to Tranfield, Denyer, and Smart (2003) a systematic review "*provide[s] collective insights through theoretical synthesis*" (p. 220). Systematic reviews aim to "*answer a specific question, to reduce bias in the selection and inclusion of studies, to appraise the quality of the included studies, and to summarise them objectively*" (Petticrew, 2001, p. 99). A number of articles in the management sciences field appearing in the top ranking journals employ the systematic review approach (See for example Farashahi, Hafsi, & Molz, 2005; Knoben & Oerlemans, 2006; Pittaway, Robertson, Munir, Denyer, & Neely, 2004). The present study follows the same approach to answer the question 'what factors restrain participatory financing in Islamic banks?' This research applies and justifies systematic review on the following grounds:

First, According to Geraldi, Maylor, and Williams (2011) systematic review was traditionally employed in areas such as medicine to sum up findings based on quantitative and positivistic researches. However, the management research has diverse nature (Bryman, 1995) and follows differnt logic (Tranfield et al., 2003). Therefore, the quantitative analysis of the diverse sample of publication can result in the ontological and epistemological issues (Geraldi et al., 2011). Moreover, it may lead to the loss of the richness of the qualitative studies (Petticrew, 2001). The systematic review approach has "*methodologies that are more flexible*" (Petticrew, 2001, p. 98), accounting for the different conceptualisations and epistemologies. Moreover, it employs the qualitative reasoning of the reviewed studies (Geraldi et al., 2011).

Second, according to Petticrew (2001) good quality systematic reviews are superior over the traditional narrative review in the following ways:

- Systematic reviews always strive to answer a clear research question or test a stated hypothesis,
- good quality systematic reviews strive to locate all relevant studies,
- such reviews have an explicit criteria for deciding which studies to be included which helps in limiting the reviewer's selection bias,
- these examine the methods employed in the selected studies in a systematic manner to assess the quality of the studies. Moreover, it examines the potential biases and differences in the studies' results, and
- conclusions of such studies are based on the methodologically sound studies

Third, the objective of the study is to integrate the diverse literature to develop a holistic framework by synthesizing different explanations provided for the under utilization of participatory financing in the extant literature. Thus systematic review being "a *method of locating, appraising, and synthesising evidence*" (Petticrew, 2001) proves to be the most appropriate approach in this regard.

3.1 Sample selection

The systematic review strives to locate all relevant studies (Petticrew, 2001). For this purpose systematic review entails well defined criteria for searching and identifying the extant literature (Armitage & Keeble-Ramsay, 2009). Furthermore, it require an explicit criteria for deciding which studies to be included in the sample to reduce the selection bias (Petticrew, 2001; Petticrew & Roberts, 2006). To ensure that the search process employed in this study had been comprehensive enough and the selected sample is fairly representative of the literature the following literature review methodology has been employed:

The Web of Science was used as a starting point of the search. Relevant papers containing the keywords: *Musharakah*, *Mudarabah*, participatory financing, participation, partnership, profit and loss sharing, pain share gain share, and risk sharing were identified using this database. Additionally, databases including Elsevier (Science Direct), Wiley Online Library, Jstor, Springer Link, Taylor & Francis, and Emerald etc. were also searched using the above keywords. Moreover, archives of the key peer-reviewed scholarly journals on Islamic finance were explored to identify relevant publications. The in press articles were not considered. 1983 was considered as the starting point and the relevant literature published till 2017 were covered. Thus, the time span of the selected studies is 1983 to 2017.

The initial sample was refined through the following steps:

Step 1: Focus on the academic papers. Among the downloaded articles only the academic papers were considered. Many databases provide this option automatically by defining the article type.

Step 2: Focus on Islamic finance. Based on the analysis of the articles' abstracts, the sample was refined to publications explicitly related to Islamic finance. Publications that clearly did not aim at contributing to the Islamic finance at least in a broad sense were excluded from the sample, for example articles that were clearly focused on different knowledge areas such as agriculture and manufacturing industries.

Step 3: Focus on the rare utilization of participatory financing. Since this review paper is focusing on issues in participatory financing. Only those articles were considered that at least in a broad sense focus on the issue of the rare utilization of participatory financing.

Step 4: Checking completeness. To ensure that we do not miss a substantial number of relevant papers we cross-checked with the content of the selected papers through backward and forward chaining. In the *backward chaining* the references list of the each of the selected papers downloaded from the sources mentioned above was followed up to identify relevant articles cited therein. The same was done for the new papers identified via backward chaining. This helped us expand our literature from present into the past. On the other hand, for *forward chaining* we took each of our selected articles one by one and explored what other articles cite the particular article. The same process was repeated for the new identified articles as well. This process also known as 'citation searching' helps expand literature from past into present. Cross-checking via backward and forward chaining helped us identify a large number of additional articles complying with the selection criteria defined in step 1 to 3. Few articles were not accessible because of deferent reasons. These articles were accessed by corresponding directly to their authors.

To reduce the likelihood of missing relevant studies, many books authored by the seminal authors and relevant edited books have also been consulted. Most of the books were available online while few had to be purchased from the local market. Similarly, for relevant conference papers, the key conferences on Islamic finance were identified and their proceedings were explored. After cross-checking our sample grew to 108 relevant research studies complying with the selection criteria defined in step 1 to 3. Table 1 presents the breakup of the relevant studies identified till step 4.

Step 5: The final filter. Finally, the sample was reduced to those research studies that explicitly focus on problems in the participatory financing arrangements or the constraints faced by Islamic financial institutions in adopting participatory financing arrangements while investing. This reduced our sample to 91 research publications meeting the selection criteria. Table 1 presents the breakup of the 91 studies included in the final sample. Similarly, Table 2 presents the year wise and nature wise classification of the selected publications.

Table 1: Overview of the Number and the Type of Selected Publications in the Refining Step 4 and 5

Refining step #	Books	Chapters of edited books	Journal articles	IMF Working papers	Conference papers	Total
Step 4	15	14	66	3	10	108
Step 5	11	14	55	3	8	91

Table 2: Overview of the Final Sample of Selected Publications (Step 5)

Publication Year		Type of Papers*	
1983-1989	3	Theoretical	26
1990-1996	8	Qualitative	3
1997-2003	29	Quantitative	43
2004-2010	26	Qual & Quant	3
2011-2017	25	Literature Review	5

* Excluding Books

4. Analysis of the Literature

Following the approach of Marston and King (2006) the present study treats the selected research papers and books as documents, and analyzes them using the established qualitative research techniques. Moreover, the Qualitative Evidence Synthesis (QES) is applied for the analysis of the selected studies and development of the constraints framework. Paterson (2012) defines QES as ‘the synthesis or amalgamation of individual qualitative research reports that relate to a specific topic or focus in order to arrive at new or enhanced understanding about the phenomenon under study’. The QES entails an interpretative process by which ‘the constituent study texts can be treated as the multivocal interpretation of a phenomenon, just as the voices of different participants might be in a single qualitative study’ (Zimmer, 2006). The QES provides a broad overview of a body of research, therefore it has the ability to reveal more powerful explanations that are provided in the individual studies (Hannes & Lockwood, 2012). Hence, synthesis often leads to the increased level of abstraction and generalizability of the research findings (Sherwood, 1999).

Several methods can be applied for the synthesis of the qualitative evidence including thematic synthesis, framework synthesis, narrative synthesis, grounded theory, and meta-analysis (Hannes & Lockwood, 2012). The present study adopts the thematic synthesis method. The thematic synthesis follows a highly structured approach for the selection, organizing, and tabulation of the primary research data. It mainly entails listing the findings of selected studies and then combining them into similar descriptors or themes to develop a general description of the problem at hand (Hannes & Lockwood, 2012). The thematic synthesis 'uses thematic analysis techniques, as well as adaptations from grounded theory and meta-ethnography, to identify themes across primary research studies. Synthesis component entails an iterative process of inductively grouping themes into overarching categories that capture the similarities, differences, and relationships between the themes' (Paterson, 2012, p. 17). The developers of the thematic synthesis view 'informing practice or policy' as the intended outcome of the thematic synthesis (See for example Harden et al., 2004; Thomas et al., 2007; Thomas et al., 2003).

Analysis of the selected publications followed three steps. The first two steps were concerned with the identification, while the third step involved the classification of the major factors restraining the adaptation of participatory financing.

- In the first step the selected 91 publications were independently reviewed and coded. Codes represent the constraints explicitly appearing in the selected publications.
- In the second step the dozens of codes that emerged in the first step were refined through constant comparisons within and between codes to ensure that they accurately reflect the constraints to participatory financing. A total of 24 constraints to participatory financing were identified from the codes extracted in the first step with the overlapping items either eliminated or combined. Table 3 reports the constraints to participatory financing.
- In the last step link between the constraints were identified, grouping them into the broad overall themes. The constraints identified in the second step were classified into three distinct categories including: uncertainty, low demand, and regulatory constraints (See section 3.5 for details). Our intention was to develop the typology of constraints by connecting the rather abstract concepts into the broader sets of constraints for better conceptualization and policy implications. Since the literature was divergent, with diverse studies focused on few specific issues. This helped us integrate the extant literature and produce a coherent view about constraints to participatory financing.

Table 3: Factors Restraining the Application of Participatory Financing

Contributors	Constraints
Abdalla (1999); Adnan and Muhamad (2008); Ascarya (2010); Ascarya and Yumanita (2006); Farooq and Ahmed (2013); Greuning and Iqbal (2007); Hanif and Iqbal (2010); Kayed (2012); Khan (2010); Khan and Bhatti (2008); Khan (1989); Mansoori (2011); Nouman and Ullah (2014); Sadique (2010a, 2010b); Shaikh (2011); Siddiqi (1991, 2006)	Untrustworthiness
Abdalla (1999); Abdul-Rahman and Nor (2016); Abou-Ali (2002); Ahmed (2008a, 2008b); Ajija, Annisa, and Hudaifah (2012); Al-Harran (1999b); Ascarya (2010); Ascarya and Yumanita (2006); El-Gamal (2005); Farooq and Ahmed (2013); Hasan (2002); Iqbal, Ahmad, and Khan (1998); Iqbal and Molyneux (2005); Iqbal (1997); Kayed (2012); Khan (2010); Khan and Bhatti (2008); Khan (1995); Khan and Ahmed (2001); Mansoori (2011); Mirakhor and Zaidi (2007); Nienhaus (1983); Nouman and Ullah (2014); Roy (1991); Sadique (2010a, 2012); Samad, Gardner, and Cook (2005); Warde (1999, 2000); Yasseri (2002); Zaher and Hassan (2001)	Lack of skilled HR
Farooq and Ahmed (2013); Iqbal (1997); Nouman and Ullah (2014); Siddiqi (1991); Zaher and Hassan (2001)	Weak accounting procedures
Ahmed (2008b); Ajija et al. (2012); Al-Harran (1999b); Ascarya (2010); Ascarya and Yumanita (2006); Kayed (2012); Khan and Bhatti (2008); Nouman and Ullah (2014); Zaher and Hassan (2001)	Unawareness
Abdalla (1999); Abdul-Rahman and Nor (2016); Adnan and Muhamad (2008); Ahmed (2008a); Ajija et al. (2012); Akacem and Gilliam (2002); Al-Harran (1999a); Alam and Parinduri (2017); Ariffin, Kassim, and Razak (2015); Ascarya (2010); Ascarya and Yumanita (2006); Ayub (2007); Bacha (1997); Boumediene (2011); Chong and Liu (2009); Dar and Presley (2000); Dusuki (2007); El-Komi and Croson (2013); Farooq and Ahmed (2013); Farooq (2007); Greuning and Iqbal (2007); Hanif and Iqbal (2010); Hasan (2002); Huda (2012); Iqbal and Mirakhor (2011); Kayed (2012); Khalil, Rickwood, and Murinde (2002); Khan (2010); Khan and Bhatti (2008); Khan (1995); Mansoori (2011); Mansour, Abdelhamid, and Heshmati (2015); Marizah and Nazam (2016); Mirakhor and Zaidi (2007); Nouman and Ullah (2014); Othman and Masih (2015); Sadique (2010a, 2010b); Sadr and Iqbal (2002); Samad et al. (2005); Shaikh (2011); Sundararajan and Errico (2002); Warde (1999); Yasseri (2002)	Higher risk
Ascarya (2010); Ayub (2007); Dar et al. (1999); Dar and Presley (2000); Farooq (2007); Khan (1995); Nouman and Ullah (2014); Samad et al. (2005); Shaikh (2011)	Less applicability
Abdul-Rahman and Nor (2016); Abedifar, Ebrahim, Molyneux, and Tarazi (2015); Ahmad (1993); Ajija et al. (2012); Alam and Parinduri (2017); Ariffin et al. (2015); Ascarya (2010); Dusuki (2007); Farooq and Ahmed (2013); Farooq (2007); Khan (1995); Nouman and Ullah (2014); Sadique (2010a, 2010b, 2012); Sundararajan and Errico (2002); Warde (2000)	Complications

Ayub (2007); Iqbal and Mirakhor (2011); Mansoori (2011)	Protection of depositors' interest
Dar et al. (1999); Dar and Presley (2000); Dusuki (2007); Farooq (2007); Iqbal (1997); Khan (1995); Nouman and Ullah (2014); Siddiqi (2006); Zaher and Hassan (2001)	Shallow secondary market
Abedifar et al. (2015); Al-Muharrami and Hardy (2013); Ascarya (2010); Chong and Liu (2009); Dar and Presley (2000); Greuning and Iqbal (2007); Iqbal and Mirakhor (2011); Khan and Bhatti (2008); Marizah and Nazam (2016); Nouman and Ullah (2014); Sadique (2010a)	Risk averse depositors
Abalkhail and Presley (2002); Abdul-Rahman, Latif, Muda, and Abdullah (2014); Abdul-Rahman and Nor (2016); Abou-Ali (2002); Adnan and Muhamad (2008); Aggarwal and Yousef (2000); Ahmed (2008b); Ahmed (2002); Al-Muharrami and Hardy (2013); Al-Suwailem (1998); Ascarya (2010); Åström (2011); Bacha (1995); Baldwin, Dar, and Presley (2002); Bashir (1996); Boumediene (2011); Chong and Liu (2009); El-Din (1992, 2008); El-Gamal (2005); El-Komi and Croson (2013); Farooq (2007); Greuning and Iqbal (2007); Haque and Mirakhor (1986); Hassan and Kayed (2009); Huda (2012); Iqbal and Llewellyn (2002a); Iqbal and Molyneux (2005); Iqbal and Mirakhor (2011); Jouaber and Mehri (2012); Karim (2002); Khalil et al. (2002); Khan (2010); Khan and Bhatti (2008); Khan (1995); Khan (1989); (Mansour et al., 2015; Marizah & Nazam, 2016); Nagaoka (2010); Nouman and Ullah (2014); (Othman & Masih, 2015); Sadique (2010a, 2010b); Sadr (1999); Sadr and Iqbal (2002); Sarker (1999); Sundararajan and Errico (2002); Warde (2000)	Asymmetric information
Abalkhail and Presley (2002); Abdul-Rahman et al. (2014); Abdul-Rahman and Nor (2016); Abedifar et al. (2015); Abou-Ali (2002); Aggarwal and Yousef (2000); Al-Suwailem (1998); Ariffin et al. (2015); Ascarya (2010); Åström (2011); Bacha (1995); Baldwin et al. (2002); Bashir (1996); Boumediene (2011); Dusuki (2007); El-Din (1992); El-Gamal (2005); El-Komi and Croson (2013); Farooq (2007); Huda (2012); Iqbal and Llewellyn (2002a); Iqbal and Molyneux (2005); Jouaber and Mehri (2012); Khalil et al. (2002); Khan (2010); Khan and Bhatti (2008); Khan (1995); Khan and Ahmed (2001); Mansoori (2011); Mansour et al. (2015); Nagaoka (2010); Nouman and Ullah (2014); Pryor (2007); Sadr (1999); Sadr and Iqbal (2002); Sarker (1999); Siddiqi (1983, 2006)	Adverse selection

Abalkhail and Presley (2002); Abdul-Rahman et al. (2014); Abdul-Rahman and Nor (2016); Abedifar et al. (2015); Abou-Ali (2002); Adnan and Muhamad (2008); Aggarwal and Yousef (2000); Ahmed (2008a, 2008b); Ahmed (2002); Akacem and Gilliam (2002); Al-Muharrami and Hardy (2013); Al-Suwailem (1998); Ariffin et al. (2015); Ascarya (2010); Åström (2011); Ayub (2007); Bacha (1995, 1997); Baldwin et al. (2002); Bashir (1996); Boumediene (2011); Chong and Liu (2009); Dar et al. (1999); Dar and Presley (2000); Dusuki (2007); El-Din (2008); El-Gamal (2005); El-Komi and Croson (2013); Farooq (2007); Hanif and Iqbal (2010); Haque and Mirakhor (1986); Hasan (2002); Hassan and Kayed (2009); Huda (2012); Iqbal and Llewellyn (2002a); Iqbal and Molyneux (2005); Iqbal and Mirakhor (2011); Jouaber and Mehri (2012); Kayed (2012); Khalil et al. (2002); Khan (2010); Khan and Bhatti (2008); Khan (1995); Khan and Ahmed (2001); Khan (1989); Kuran (1995); Mansoori (2011); Mansour et al. (2015); Marizah and Nazam (2016); Mirakhor and Zaidi (2007); Nagaoka (2010); Nouman and Ullah (2014); Othman and Masih (2015); Pryor (2007); Rethel (2011); Sadique (2010a, 2010b, 2012); Sadr (1999); Sadr and Iqbal (2002); Samad et al. (2005); Sarker (1999); Shaikh (2011); Siddiqi (1983, 2006); Sumarti et al. (2014); Sundararajan and Errico (2002); Usmani (2002); Warde (1999, 2000); Yousef (2004); Zaher and Hassan (2001)	Moral hazards
Abdalla (1999); Ahmed (2008b); Amrani (2012); Dar and Presley (2000); El-Din (1992); Farooq and Ahmed (2013); Khan and Bhatti (2008); Sadique (2010a); Shaikh (2011)	Reluctance to share profit
Abedifar et al. (2015); Chong and Liu (2009); Dar et al. (1999); Dar and Presley (2000); Dusuki (2007); Farooq (2007); Hanif and Iqbal (2010); Khan (2010); Khan (1995); Nienhaus (1983); Othman and Masih (2015); Pryor (2007); Roy (1991); Sadique (2010a, 2010b); Samad et al. (2005); Sarker (1999)	Severe competition
Abalkhail and Presley (2002); Abdalla (1999); Abdul-Rahman et al. (2014); Abdul-Rahman and Nor (2016); Abedifar et al. (2015); Ahmed (2008a); Akacem and Gilliam (2002); Al-Muharrami and Hardy (2013); Alam and Parinduri (2017); Ariffin et al. (2015); Chong and Liu (2009); El-Gamal (2005); El-Komi and Croson (2013); Farooq (2007); Greuning and Iqbal (2007); Haque and Mirakhor (1986); Huda (2012); Iqbal et al. (1998); Iqbal and Llewellyn (2002a); Iqbal and Mirakhor (2011); Khalil et al. (2002); Khan and Bhatti (2008); Khan (1989); Marizah and Nazam (2016); Mirakhor and Zaidi (2007); Nagaoka (2010); Nouman and Ullah (2014); Othman and Masih (2015); Sadique (2010a, 2010b); Sadr (1999); Sadr and Iqbal (2002); Sarker (1999); Siddiqi (2006)	Higher appraisal and monitoring costs
Amrani (2012); El-Din (1992); Iqbal et al. (1998); Nienhaus (1983); Sadique (2010a)	Cost preference
Ahmed (2008b); Ajija et al. (2012); Khan and Bhatti (2008); Khan (1995); Nouman and Ullah (2014); Samad et al. (2005); Shaikh (2011); Usmani (2002)	Disclosure of business secrets

Ahmed (2008a, 2008b)	External interference
Abdul-Rahman et al. (2014); Dar et al. (1999); Dar and Presley (2000); Dusuki (2007); Farooq (2007); Khan (2010); Warde (1999)	Weak properly rights
Abdul-Rahman et al. (2014); Alam and Parinduri (2017); Ariffin et al. (2015); Ascarya (2010); Ascarya and Yumanita (2006); Farooq and Ahmed (2013); Haque and Mirakhor (1986); Hasan (2002); Hassan and Kayed (2009); Huda (2012); Iqbal and Molyneux (2005); Iqbal (1997); Kayed (2012); Khan and Bhatti (2008); Khan (1995); Khan and Ahmed (2001); Mansour et al. (2015); Nouman and Ullah (2014); Othman and Masih (2015); Rethel (2011); Roy (1991); Sadique (2010b); Shaikh (2011); Siddiqi (1991, 2006); Sundararajan and Errico (2002); Warde (1999); Yousef (2004); Zaher and Hassan (2001)	Weak regulatory and legal framework
Ascarya (2010); Ascarya and Yumanita (2006); Farooq and Ahmed (2013); Hassan and Kayed (2009); Kayed (2012); Nouman and Ullah (2014); Roy (1991); Usmani (2002, 2007); Warde (1999)	Non-supportive government
Abdul-Rahman et al. (2014); Ahmed (2008b); Dar et al. (1999); Dar and Presley (2000); Dusuki (2007); Farooq and Ahmed (2013); Farooq (2007); Hanif and Iqbal (2010); Khan (2010); Khan and Bhatti (2008); Khan and Ahmed (2001); Nouman and Ullah (2014); Sadique (2010a, 2010b); Shaikh (2011)	Tax shield benefits
Hanif and Iqbal (2010); Iqbal et al. (1998); Kayed (2012); Khalil et al. (2002); Khan and Bhatti (2008); Khan and Ahmed (2001); Mansoori (2011); Nouman and Ullah (2014); Shaikh (2011); Siddiqi (1991)	Inefficient accounting and auditing systems

(Extended from Nouman & Ullah, 2014, p. 52).

5. Typology of the Constraints

Table 3 indicates that a large set of abstract explanations for the less utilization of participatory financing has emerged from the analysis of the extant literature. All the distinct factors highlighted in the literature contribute together towards the less popularity of the participatory financing and put the non-participatory financing at a comparatively advantageous position. Although, the seemingly rather abstract elements are actually interconnected, it becomes difficult to conceptualize the big picture since the typology of constraints is missing. Therefore to bridge this gap a coherent framework has been proposed that outlines the typology of constraints participatory financing. This framework develops three distinct categories of the constraints namely uncertainty, low demand, and regulatory hurdles (See Figure 1).

The novel coherent constraints framework highlights that there are mainly three facets of lower preference for participatory financing. *First*, there are several factors in the contemporary business settings, prevailing social setting, and the bank's internal environment that underpin uncertainty in the success of participatory financing arrangements. *Second*, there is a lower demand for participatory financing in the market i.e., entrepreneurs prefer to use non-participatory arrangements for financing their ventures due to the inherent restraining characteristics of the participatory financing arrangements. *Finally*, there are certain factors in the regulatory framework that restraint the extensive utilization of participatory financing arrangements by Islamic

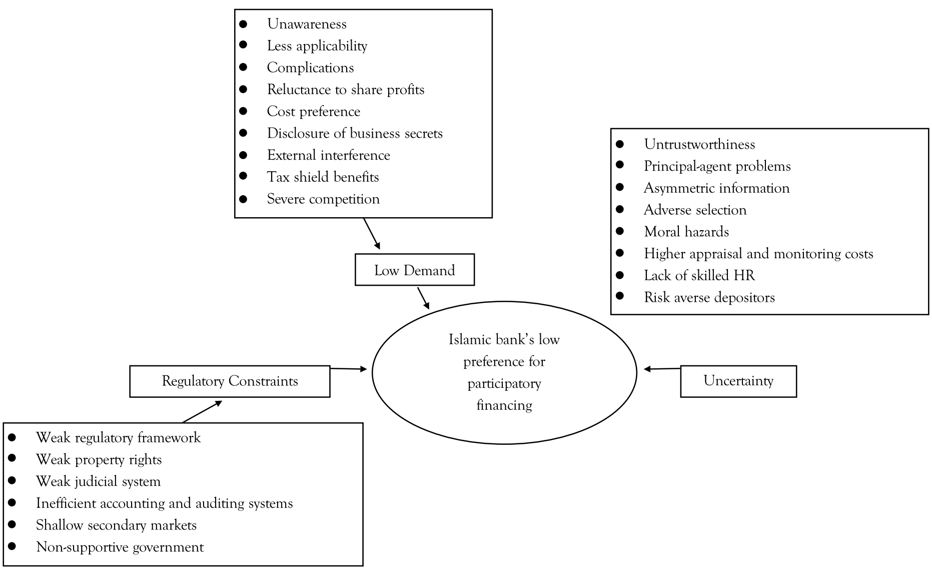

Figure 1: Demand, Regulation, and Uncertainty Framework

banks. Regulatory hurdles, as suggested by Abdul-Rahman et al. (2014), are a set of restraining factors derived from the regulatory structures, courts, laws, and government agencies exerting conformance pressures and shaping the lower preference of Islamic banks for participatory financing. Following is the detailed discussion on the three constructs of the constraints framework.

a. Uncertainty

According to Khan and Bhatti (2008, p. 49) the practical application of participatory financing has always been restricted by the business ethics constraints and operational difficulties in the Islamic banking industry. The current economic structure is biased, supporting the interest-based (and the non-participatory) system rather than the participatory paradigm (Sadique, 2010a). There are several factors in the contemporary business settings that induce uncertainty in participatory financing arrangements and in turn restrain their application in the Islamic banking industry (Khan, 1995). Table 4 summarizes the factors that induce uncertainty in the successful commencement and operation of participatory financing in Islamic banking.

Fairness is important to success of partnership arrangements. An experimental study by Zhou and Wu (2011) which employed different economic games suggests that people have increased demand for fairness when they have to share losses with

Table 4: Factors Inducing Uncertainty in Participatory Financing Arrangements

Low levels of reliability and trustworthiness in the market
Asymmetric information
Adverse selection
Moral hazards
Participatory financing arrangements involve higher project appraisal and monitoring costs which induces Islamic banks to bear additional costs of operation.
Projects and clients to be financed through participatory financing arrangements require to be evaluated very carefully for which managerial skills and expertise is required. However, there is a lack of skilled human resource in the Islamic banks.
Depositors of Islamic banks are risk averse. Thus, investing their funds in risky projects could prompt their depositors to withdraw their funds.

others. People demand justice in wealth allocation in both the loss and gain domains, but this preference in the context of loss sharing might not be the same as in the context of gain sharing (Zhou & Wu, 2011). Potential losses have greater impact on fairness preference and choice behavior than the equivalent gains (Kahneman, 1992; Tversky & Kahneman, 1981). Therefore, unfairness in division schemes would originate stronger reactions (higher rejection rates) among partners in loss sharing compared to gain sharing.

Similarly, Williamson in the Transaction Cost Theory suggests two other important behavioral premises of human agents: bounded rationality and opportunism (Williamson, 1981, 1985, 1993). Bounded rationality means that although human beings intend to behave rationally, their rationality is limited by their ability to "formulate and solve complex problems and to process information" (Williamson, 1981). Therefore, in (neo-) classical economic sense, their decisions are hardly ever optimal (Simon, 1945). Opportunism may be defined as "self-interest seeking with guile" (Williamson, 1981, 1993), which means that parties are willing to provide incomplete or false information to complete a transaction that will provide them with advantage (Alaghehband, Rivard, Wu, & Goyette, 2011).

Given bounded rationality, opportunism and increased demand for fairness under adversity, participatory financing arrangements are more exposed to compatibility, conflicts, and other contracting problems. Therefore, existence of a supportive and cooperative social environment is conducive to the successful operation of the participatory paradigm (Hassan & Kayed, 2009). In the nutshell, high moral standards in the society are prerequisite for the success of participatory financing arrangements. These contracts are not workable in an environment which lacks honest and fair dealings (Mansoori, 2011). The lack of reliability and trustworthiness in the society leads to agency problems in participatory financing including the asymmetric information, adverse selection, and moral hazards problems.

Asymmetric information is a situation that arises when insufficient knowledge of one party involved in the transaction about the other one, makes it impossible to take accurate decisions while conducting a transaction (Mishkin & Eakins, 2011). Since participatory financing arrangements are formulated in the form of principal-agent arrangements (Bashir, 1996), these are prone to the asymmetric information problem. The agent (an entrepreneur who seeks funds) being the insider (active) party has better knowledge about the project they wish to undertake. While the principal (a bank which provides the funding needed to initiate the project) being the outsider (passive) party usually has less knowledge about the potential returns and the associated risks of the project than the agent does (Khalil et al., 2002). According to Nouman and Ullah (2014) the asymmetric information creates problems in the participatory arrangements on two fronts: before the project is initiated (i.e., adverse selection) and after the initiation of the project (i.e. moral hazard).

Adverse selection is the problem faced due to asymmetric information before occurrence of the transaction (Mishkin & Eakins, 2011, p. 25). Borrowers have better inside information about themselves (including their abilities and intentions) and project (including its potential returns and likelihood of success), but they may not credibly signal it to the bank in the wake of exploiting interest of bank for their own benefits (Iqbal & Molyneux, 2005; Sarker, 1999). Since it is difficult for banks to determine the quality of a loan applicant, this creates several adverse selection problems (Mills & Presley, 1999).

Given the asymmetric information, the adverse (undesirable) selection is more likely to occur in case of participatory arrangements because the following type of borrowers actively seek funds on partnership basis and are therefore more likely to be selected:

1. The borrowers expecting their projects to provide low profits but high non-monetary benefits prefer participatory arrangements because they expect to realize high total returns at artificially low cost of capital (Pryor, 1985).

2. The borrowers expecting high profit from a risky project prefer participatory arrangement (Sarker, 1999) because their risk will be shared or even completely borne by bank (i.e., in case of *Mudarabah* because if the project fails, losses will be exclusively borne by the bank whereas, the entrepreneur will lose his efforts).

3. When the ratio of profit-sharing is decided on the basis of expected profit, potential borrowers inflate their declared profit expectation in the hope of profit sharing ratio being set low by bank (Nienhaus, 1983).

Due to adverse selection it is more likely that funds might be lent to inappropriate applicants, banks decide not to invest on partnership basis even though there are suitable parties (with promising projects) in the marketplace (Nouman & Ullah, 2014).

On the other hand, moral hazard is the problem faced due to asymmetric information after a project is initiated (Mishkin & Eakins, 2011, p. 26). Moral hazard in participatory arrangements is the risk (hazard) that the working partner might involve in activities that are undesirable (immoral) from the bank's point of view (Nouman & Ullah, 2014). These problems are associated with the under reporting or artificial reduction of the actual profit and the difficulty of observing the entrepreneur's actions (Amrani, 2012).

Since, participatory financing arrangements are formulated in the form of principal-agent arrangements, the moral hazard problems in such contracts are similar to those found in agency relationships (Ahmed, 2002, p. 43). The Principal-agent problem arises when the entrepreneur (agent) involves in activities that maximizes his interest at the cost of bank's (principal) interest. The moral hazard problem arises in such set-ups if an agent is slack about the firm's management, misuses the funds, and is not honest (Mishkin, 1995). *Mudarabah* contracts are more vulnerable to agency problems and moral hazards compared to *Musharakah* contacts since financier has no right to interfere in the business but is required to bear all losses (Bacha, 1997; Kayed, 2012). The prevalence of poor systems of accounting and auditing in most of the Muslim countries, and failure of the judicial systems in helping financial systems in case of default strengthen the probability of moral hazard in participatory financing arrangements.

The problem of adverse selection and moral hazards induce the risk of default in the participatory financing arrangements which in turn harm the interest of depositors. The Islamic banks would therefore need to evaluate the projects and clients to be financed through participatory financing very carefully. Moreover, they need to incur costly monitoring expenses to ensure that the behavior of entrepreneur is consistent with the bank's interests. The additional dead weight costs in pre-contract project appraisal and post-contract monitoring to control the adverse selection and moral hazards make partnership agreements costly compared to the non-participatory arrangements (Sarker, 1999). Furthermore, the pre-contract project appraisal and post-contract monitoring is not only expensive but also non feasible for Islamic banks because it requires managerial skills and expertise. However, there is a serious lack of qualified credit personnel for the evaluation and monitoring of the projects in the Islamic banks (Al-Harran, 1999b; Kayed, 2012). Moreover, depositors of Islamic banks are risk averse. Thus, investing their funds in risky projects could prompt their depositors to withdraw their funds (Al-Muharrami & Hardy, 2013).

In the nutshell, there are several distinct but interdependent operational factors in the contemporary business settings that underpin uncertainty in the participatory financing arrangements, which in turn restrict the commencement and successful operation of the participatory financing arrangements.

b. Lower demand

Few scholars view the problem from a different dimension. According to Amrani (2012) the extant literature grants the contractual choice exclusively to the bank, assuming that the avoidance of the participatory financing comes from the supply side in the market. However, there are many factors on the demand side that hinder the application of participatory financing. Table 5 summarizes the factors that hamper the demand for participatory financing.

According to Ayub (2007), Kayed (2012), and Usmani (2007), participatory financing arrangements have been widely criticized for being "old instruments" that are neither fitting for contemporary financial needs nor comparable with what the state-of-the-art conventional banking can offer. The reluctance of the Islamic banks

Table 5: Factors Contributing to Lower Demand for Participatory Financing

Participatory financing arrangements are less applicable.
More complicated to structure and deal with partnership financing.
Profitable businesses are not willing to share their expected high profits with Islamic banks.
Businesses are interested in the cost; not in the mode of financing.
Low demand for participatory financing because it may disclose business operations and its secrets to the financier and other parties.
Entrepreneurs prefer to maintain independence and avoid external interference.
Unfair treatment in taxation: Interest is tax deductible but profits are not.
Lack of understanding and knowledge in the society regarding the fundamentals of the Islamic finance and banking.
Due to severe competition from conventional banks and other financial institutions, Islamic banks have to offer comparable products

to adopt participatory financing arrangements have been widely attributed to the construct and the disposition of the participatory financing arrangements themselves (Kayed, 2012) which in turn lead to the lower demand for the participatory financing. For example, according to Samad et al. (2005) and Nouman and Ullah (2014) *Musharakah* and *Mudarabah* are less applicable. Moreover, these arrangements are more complicated to structure and deal with (Sadique, 2010a, 2010b, 2012; Warde, 2000).

Amrani (2012) and few other scholars are of the view that customers (borrowers) refuse the participatory financing arrangements for a given quality of their projects, since these arrangements become more expensive to the entrepreneurs if their profitability exceeds a certain level (Amrani, 2012). Therefore, they prefer non-participatory financing and interest bearing financing since they do not have to share their high business profits with the financier. Additionally, unfair treatment in taxation also contributes towards comparatively higher cost of participatory financing arrangements. Profit is taxed while interest is exempted (Dar & Presley, 2000). Thus, the tax shield benefit feature of the interest bearing modes of finance makes participatory financing the least attractive option (Khan, 2010). Furthermore, the need of rigorous accounting and periodic audits make participatory financing more complicated to deal with. Moreover, entrepreneur loses exclusive control over his business (Ahmed, 2008a). Thus, many entrepreneurs reject participatory financing because they do not want to disclose their operations and trade secrets to the financiers (Shaikh, 2011) and tend to protect their business from external interference (Ahmed, 2008a).

In the nutshell, there are many inherent factors in the standard participatory arrangements that make participatory financing a less attractive option for profitable and stable businesses. Therefore, Islamic banks need to develop incentive compatible financing products based on participation principles to promote participatory financing in the contemporary business environment.

c. Regulatory constraints

According to Yousef (2004) the economic and legal mechanisms underpins financial systems around the globe. These economic and legal mechanisms depend on the political structures, regulatory institutions, legal tradition, and institutional variables such as bureaucratic quality, corruption, and expropriation risk. The presence of a sound regulatory framework is prerequisite for the effective regulation of Islamic financial institutions (Wilson, 2003), and growth of participatory financing (Haque & Mirakhor, 1986). A sound regulatory framework for Islamic banking comprises of various components including the securities law, *Shari'ah* law, insolvency law, property law, business law, tax law. common law, civil law, and employment law (Abdul-Rahman et al., 2014). Following are the features of a sound regulatory framework (ISRA., 2011):

1. A supportive financial environment that assists and promotes the development of the industry.

2. A sound legal framework offering a comprehensive and proficient system conducive to the successful operation of the participatory financing arrangements.

3. A reliable and credible forum for clearing the legal disputes of the parties involved in the Islamic financing arrangements.

However, a sound regulatory framework is missing in Muslim countries (Haque & Mirakhor, 1986). For example, in most of the Muslim countries property rights are neither properly defined nor well protected (Abdul-Rahman et al., 2014; Warde, 1999), the judicial system is not capable of enforcing the terms of the contacts (Warde, 2000), secondary market for Islamic financial instruments is shallow and illiquid (Dar & Presley, 2000), the taxation policies are biased (Sadique, 2010a), the auditing and accounting systems are weak and inefficient (Iqbal, 1997). Thus, leaving participatory financing a less attractive option for Islamic banks. Table 6 summarizes the regulatory factors that restrain the application of participatory financing.

Prudential regulations imposed by the regulatory authorities also play an important role in restraining the application of participatory financing on a large scale. Sound regulations help in mitigating the problems of asymmetric information. On the other hand, regulations that are over restrictive can prove counterproductive, since it may

Table 6: Regulatory Factors Restraining the Application of Participatory Financing

Absence of a supportive regulatory framework
Banking laws enforce rules and controls on the allocation of bank's funds in direct investment
Lack of properly defined or protected property rights in Muslim countries
Weak judicial system in Muslim countries
Inefficient accounting and auditing systems
Lack of sound accounting procedures and standards consistent with the Islamic laws
Illiquid and shallow secondary market for Islamic financial instruments
The Islamic bank acting as managing partner for depositors is bound to protect the interest of depositors and to invest their money in less risky avenues.
Lack of commitment and support from government

restrict the number of products being offered by Islamic banks, increase transaction costs, and decrease financial efficiency (Wilson, 2003). Islamic banks are exposed to the equity investment risk that arises from investing funds on participation basis (Song & Oosthuizen, 2014). Moreover, the value of their deposits is not guaranteed. The value of deposits may become at stake in the event of severe losses (Wilson, 2003). In the wake of securing depositors interests the regulatory bodies impose various controls on the allocation of funds in direct investments involving profit and risk sharing (Abdalla, 1999; Abou-Ali, 2002; Khan, 2010). Therefore, Islamic banks are bound to invest their money in less risky avenues (Ayub, 2007; Iqbal & Mirakhor, 2011; Mansoori, 2011).

In case of participatory financing arrangements bank shares in profits and losses of venture. It is not a matter of concern if the bank is allowed, and is able to keep a close eye on the operations of the firm. However, suitable monitoring mechanisms have not been devised yet for the participatory financing arrangements, especially for *Mudarabah* arrangements where financier does not have the control right (Dar & Presley, 2000). Since, the bank cannot control the entrepreneur who manages the venture being financed through *Mudarabah*. Moreover, the bank cannot reduce the risk in participatory financing by requiring guarantee or collateral (El-Qorchi, 2005). Therefore, supportive prudential regulations are crucial for the successful operation of the participatory financing in the modern world (Ascarya, 2010; Dar & Presley, 2000).

In Pakistan various *Mudarabah* laws attempts to outline a basic regulatory framework including the *Mudarabah* companies and *Mudarabahs* Ordinance 1980, the *Mudarabah* Rules 1981, the State Bank of Pakistan's prudential regulations, and The Guidelines for Issuance of *Musharakah* Certificates for *Mudarabah*. However, standardized participatory financing contracts or bylaws need to be constructed keeping in view the legal frameworks of Islamic countries (Dar & Presley, 2000).

5. Conclusion

The constraints framework strengthens the axiom that Islamic finance is a dependent system requiring an economy based on Islamic setting. The viability of Islamic finance especially participatory financing depends on the presence of a "true Islamic state" where its religious, social, political, economic, legal, and educational institutions complement each other and function as a whole towards the accomplishment of common values and the desired goals (Hassan & Kayed, 2009). Moreover, it highlights the factors in the contemporary social, economic, and regulatory settings that strengthen the non-cooperative and risk-averse attitudes and hinder the viability of the participatory financing. Compared to participatory financing, the non-participatory financing is more consistent with the conventional banking traditions in the present setting. Banking culture, professional orientation of staff, similarity of products and services being offered, laws and regulations, and premises of competition, all put the non-participatory modes of financing at a comparatively advantageous position (Khan, 1995).

Given the lack of trustworthiness and cooperation in the market, lower demand for the participatory financing, and absence of supportive regulatory framework and enabling institutions, the main challenge faced by the Islamic financial service industry is the development of a mechanism that would reveal the fruits of Islamic finance to the global economy (Hassan & Kayed, 2009). Thus, there is serious need of policy implications, institutional reforms, and introduction of incentive compatible contracts based upon participation principle. Unless serious steps are taken by Islamic banks, academia, and regulatory and legal bodies, the non-participatory financing will continue to dominate the operations of Islamic banks.

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