

Profit/loss sharing method of finance: An empirical study in a western country. By Jalaluddin Abulkhair, Kuala Lumpur: A.S. Noorden, 2011, pp. xvii + 254. ISBN : 9789830653105

Reviewer : Aliyu Dahiru Muhammad, (PhD), Department of Economics, Kulliyyah of Economics and Management Sciences, International Islamic University, Malaysia. Email : alitahir797@yahoo.com.

This 254 page book explores the profit and loss sharing (PLS) method of finance used by small firms and financial institution in Australia. The main objective of the book is to find out the attitudes towards PLS, and motivations for and probability of using PLS by small business firms and financial institutions in Australia.

The book is organized in 12 chapters under three broad parts. Part one consists of “profit/loss sharing method of finance vis-à-vis traditional methods of finance”. This part focuses on the current methods of financing small business firms in Australia, the impact of high interest rates on bankruptcies of small business firms in Australia, and profit/loss sharing method of finance. Part two presents views of small business firms. This consist of profile of the sample surveyed, the attitude of small business firms, the profit/loss sharing methods and probability of applying profit/loss sharing method of finance by Australian business firms. Here, the author uses logit and probit to determine the probability level. The last part of the book determines the views of financial institutions on financing based on PLS. Like previous part, this part contains salient features of the sample of the financial institutions surveyed, their attitude towards PLS method of finance and conclusion and recommendations.

The author’s study area and sample are drawn from Western society (non-Muslim country). The findings will be useful in applying PLS as an alternative to predetermined interest based financial system in those societies and in other Muslim countries. The book identifies five major motivating factors for small business firms to borrow funds using the PLS as business support, risk sharing, risk of default in the conventional system, cost of borrowing and suitability of PLS. However, majority of small business firms in Australia are motivated to use PLS because of its risk sharing characteristics in situation of loss/business failure.

Similarly, the author establishes that a number of financial institutions in the Western world may favour the PLS simply because of its potential increase in demand for loans from small business firms with small equity and relatively higher risks. Similarly, on profitability side, the PLS may exceed the existing interest based return because of a greater risk attached to PLS and the higher the risk the higher the return. However, it should be noted that applications of PLS depends heavily on the regulations of a country, awareness of stakeholders and profitability among others.

The author highlights the traditional lending techniques and its assumptions. It basically lends money to small business firms on fixed interest, regardless of the market situation the borrower has to pay back the interest over and above the capital borrowed. In a situation of economic downturn, which is part of business life cycle, it will create hardships for the borrower. It was found that fixed interest charges may create hardships for businesses especially small business firms during economic slowdown. In addition positive correlation was established between interest rate and business bankruptcies during 1975-1995 and this should serve as lessons for borrowers and lenders. In addition, 59.5 per cent of the businesses surveyed expressed their intention to borrow on PLS. This is motivated by the five factors mentioned earlier. However, there are firms that object to the use of the PLS due to their perceptions on: (i) Some terms and conditions of PLS such as taxation and vigorous auditing by the lenders; (ii) Interference in management such as risk sharing, disclosure of confidential financial records to lender and the like; and (iii) that lender's return would be higher at the expense of borrowers' profit. It was found that 41 percent of financial institutions expressed their willingness to lend on PLS. The motivating factors for this intention are : (i) Business support such as control of loan repayment, low bad debts, improvement in business efficiency and commitment to succeed by borrowers; (ii) the method of PLS could increase demand for funds especially small business firms that are risky; and (iii) perception of interest payment in creating difficulties for borrowers

However, the reasons they shun from PLS are i) Fear of losing depositors ii) Unfamiliarity of the PLS and possibility of taking excessive risk by the borrowers. Interestingly, it was found that growth in the demand for fund is the most significant predictor in discriminating between the financial institutions that are prepared to lend on PLS and those that are not. Some of the recommendations by the author are: (i) Central monetary authority should allow PLS to operate in financial market given the huge potential demand; (ii) financial institutions should find some ways to minimize the concern of depositors over investing their funds in PLS rather than shun from it; (iii) financial institutions should investigate through research areas of simplified business performance, monitoring, auditing and record keeping to minimize the cost of PLS; and (iv) applications of PLS could be done in stages such as sharing profit first and then full fledged profit/loss sharing.

However, the author did not highlight the role of the dominant players of Islamic financial services such as Muslim Community Cooperation established in 1989 which is non-bank financial service provider; Islamic Cooperative Finance Australia; established in 1998 and Iskan Finance Pty Limited established in 2001. Abu Umar (2010) highlighted the divergence of Islamic financing practices from traditional Shari'ah in Australia. According to him, "Islamic finance has emerged as a potential area for further expansion of Australian trade with its neighbours such as Malaysia and Indonesia." Abu Umar also argues that a regulatory regime in compliance with Shari'ah principles can increase

significantly the domestic investment and attract capital inflow from Muslim majority countries. In addition, Islamic banking and financial contracts are treated as buying and selling properties and hence are taxed twice. In UK and Singapore this has been abolished, so Australia could follow, although, this was discussed slightly by the author.

The book has many interesting findings such as the positive relationship between interest rate and business bankruptcy; huge demand of PLS among small business firms in Australia as an indicator of “natural path” of doing business rather interest-based loan dominated arrangement; the need for knowledge sharing to speed up the theory and practice of Islamic finance across the globe; the emphasis on business skills and development as a way to mitigate risk from entrepreneurs rather than just shifting the business risk on third party among others. In fact, Australian monetary authority could learn from Britain Financial Services Board’s policy of non-discriminatory regime whereby it provides, as stated by Kettell (2011, p. 93) “a level playing field” in dealing with applications from conventional and Islamic firms. The book has achieved its objective and is worth reading by scholars and practitioners in the area of Islamic banking and finance.

References

Kettell, Brian. *Case Studies in Islamic banking and finance*. London : Wiley, 2011.

Abulkhair, Jalaluddin. *Profit/loss sharing method of finance: An empirical study in a western country*, Kuala Lumpur : A.S. Noorden, 2011.

Abu Umar, Faruk. *Theory and practice of modern Islamic finance : The case analysis from Australia*, USA : Brownwalker press, 2010.

Islamic banking and finance in South-east Asia : Its development and future (3rd edition). By Angelo M Venardos, Asia- Pacific Business Series- Vol. 6, World Scientific Publishing Co. Pte. Ltd., 2012. ISBN-13 : 978-981-4350-42-6 (pbk), pp. 235

Reviewer : Foyasal Khan, PhD Student, Department of Economics, Kulliyah of Economics and Management Sciences, International Islamic University Malaysia (IIUM). E-mail : foyasal.khan@gmail.com.

In the preface to the 3rd edition published in 2012, Angelo M Venardos has clarified that this book focuses largely on the development of Islamic Banking and Finance in the South-East Asian context and does not contain the technical and philosophical parts of Islamic Banking and Finance. This book was one of the first few books on the subject in South-East Asia published in 2005. Venardos - a non-Muslim and a banker by training -