

Constraints to Partnership Based Financing in Islamic Banks: A Systematic Review of Literature

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Abstract : Partnership has been understood as the essence of Islamic banking. However, in practice, the non-partnership paradigm dominates the operations of Islamic banks. Islamic banks adopt partnership contracts for the scheme of deposits, especially for term deposit accounts. However, they do not adopt partnership contracts (i.e., Musharakah and Mudarabah) as the main financing scheme. In practice, non-partnership contracts including Murabahah and Ijara are widely used for financing. Many authors have provided different explanations for the less utilization of the partnership contracts as a scheme of financing. However, the typology of constraints remains missing. The extant literature remains scattered, with diverse studies focused on different dimensions of the issue. Therefore, there is no unified understanding of the constraints in the application of the partnership contracts. This paper aims to highlight the major factors hindering the application of partnership contracts, and produce a coherent view by synthesizing different explanations provided in several studies conducted around the globe. The present study employs insights from the extant literature using a systematic review and provides academia, practitioners, and policy makers with a holistic framework to name and make sense of what is making partnership contracts a less attractive option for Islamic banks. A total of 84 relevant publications including 11 books, 14 chapters of edited books, 48 journal articles, 8 conference papers and 3 IMF working papers were selected using a systematic procedure. Analysis of these selected publications followed three steps: i) In the first step of analysis the constraints explicitly appearing in the literature set of 84 articles were extracted, ii) In the second step 27 factors hindering the application of partnership contracts were identified from the constraints extracted in the first step with the overlapping items either eliminated or combined, iii) In the last step the factors identified in the second step were classified into three distinct categories. 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. Our framework highlights that there are mainly three facets of lower preference for partnership contracts of 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 partnership contracts of financing. Second, partnership contracts have lower demand i.e., entrepreneurs prefer to use non-partnership contracts for financing their ventures due to the inherent restraining characteristics of the partnership contracts. Finally, there are certain factors in the regulatory framework that restrain the extensive utilization of partnership contracts of financing by Islamic banks. The present study contributes to the Islamic banking literature in many ways. It provides clarification to the heavily criticized operations of Islamic banks, integrates the scattered literature, and provides a holistic framework for better conceptualization of the key constraints in the application of the partnership contracts and policy implications. Moreover, it demonstrates an application of systematic review in Islamic banking research.

Keywords : Islamic banking, Islamic finance, Mudarabah, Musharakah, partnership, systematic review

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