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Article

Lack of profit-and-loss sharing contracts in Moroccan Islamic banks : an investigation during the Coronavirus pandemic

ISRA international journal of islamic finance

Provided in Cooperation with:

International Shari'ah Research Academy for Islamic Finance, Kuala Lumpur

Reference: Tarriko, Dalila/Hakmaoui, Abdelati (2023). Lack of profit-and-loss sharing contracts in Moroccan Islamic banks : an investigation during the Coronavirus pandemic. In: ISRA international journal of islamic finance 15 (3), S. 160 - 178.
<https://journal.inceif.edu.my/index.php/ijif/article/download/616/442/1178>.
doi:10.55188/ijif.v15i3.616.

This Version is available at:
<http://hdl.handle.net/11159/703279>

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LACK OF PROFIT-AND-LOSS SHARING CONTRACTS IN MOROCCAN ISLAMIC BANKS: AN INVESTIGATION DURING THE CORONAVIRUS PANDEMIC

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Received
26 August 2021

Revised
6 November 2021
13 September 2022
3 September 2023
23 September 2023

Accepted
23 September 2023

ABSTRACT

Purpose — The purpose of this paper is to examine the challenges and barriers to implementing profit-and-loss sharing (PLS) contracts in Moroccan Islamic banks (IBs).

Design/Methodology/Approach — The paper presents the results of exploratory qualitative research based on face-to-face interviews with local managers of Moroccan IBs in the Rabat–Casablanca region. The investigation was carried out in September 2020, during the Coronavirus (COVID-19) pandemic.

Findings — The findings reveal that various challenges, mainly institutional and operational, as well as the implications of the COVID-19 pandemic have been the main barriers to implementing PLS contracts in Moroccan IBs.

Originality/Value — The findings are supported by field research targeting the managers who are directly concerned with the commercialisation of PLS contracts. Moreover, the present paper discusses the subject within the Moroccan context, where Islamic banking is a relatively recent phenomenon.

Research Limitations/Implications — Given the limited number of IBs in Morocco and the COVID-19 lockdown measures, bank managers in the Rabat–Casablanca region were considered. Consequently, only 14 managers agreed to contribute to the present research. The findings depend on the experience of the respondents on the topic of the research; therefore, other factors and challenges may exist.

Practical Implications — The present paper may remind scholars and practitioners of the importance of PLS instruments, especially under the pressure of COVID-19. It is an attempt to explain the challenges faced by these agreements and to make some recommendations in the hope that they will see the light of day in the Moroccan market.

Keywords — Coronavirus pandemic (COVID-19), Institutional challenges, *Mudārabah*, *Mushārah*, Operational challenges, Profit-and-loss sharing (PLS)

Article Classification — Research paper

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**ISRA International
Journal of Islamic
Finance (IJIF)**
Vol. 15 • No. 3 • 2023
pp. 160–178

eISSN:
2289-4365

DOI:
doi.org/10.55188/ijif.v
15i3.616

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INTRODUCTION

Islamic banking first developed in Morocco in 2017. At the time this research was conducted, it was noticed that Islamic banks (IBs) in the country were still focusing their efforts on debt-based financing using the *murābahah* (cost plus profit) contract. Financial contracts based on profit-and-loss sharing (PLS) were still not being proposed to corporate customers, although they could be of great importance for entrepreneurship and financial inclusion. According to the *fiqh* (Islamic jurisprudence) literature, *mushārah* (partnership with profit-and-loss sharing) and *muḍārah* (business venture with profit sharing) are the main modes of the PLS principle (Febianto, 2012). In this regard, reports and studies have been conducted on the risks, specificities and customers' perceptions of PLS contracts. However, there are no empirical studies about the barriers to their implementation in the context of Moroccan IBs.

Indeed, the underuse of PLS contracts is a phenomenon which has been noticed in the majority of Islamic financial institutions (IFIs) around the world, even in *muḍārah* companies in Pakistan and in IBs in Malaysia, the latter being considered one of the most developed Islamic banking markets (Dar & Presley, 2000; Beng Soon & Ming-Hua, 2009). Moreover, PLS modes are reported to be less used even in Islamic microfinance institutions (IMFIs), which are growing in many countries worldwide (Syedah *et al.*, 2020).

Some scholars believe that IFIs as rational businesses are avoiding PLS modes of financing (Farooq, 2007). Some other authors are of the view that the rapidly growing IBs should aim at meeting the Muslims' demand for financial tools such as PLS, as these contracts are based on the ethical principles of Islamic finance (Beng Soon & Ming-Hua, 2009).

Numerous theoretical studies argue that PLS contracts are unique to Islamic banking and more beneficial compared to other Islamic financial modes (Mirakhor & Iqbal, 2007; Febianto & Kasri, 2007; Febianto, 2012). It is believed that the implementation of PLS instruments would increase the value proposition of IBs and strengthen their resilience to crises (Aisyah *et al.*, 2014). In addition, a considerable number of articles have discussed the capacity of PLS instruments to contribute towards social and financial inclusion. It is also argued that IMFIs would provide potential financing solutions to entrepreneurs by using *mushārah* and *muḍārah* (Sumarti *et al.*, 2013). PLS instruments are equally an important option for funding public utilities and infrastructure projects (Biancone & Radwan, 2018).

Many academic studies have attempted to explain this phenomenon and ascertain the barriers and challenges of PLS financing in the Islamic banking industry (Khan, 1995; Dar and Presley, 2000; Khan & Habib, 2001; Febianto & Kasri, 2007; Farooq, 2007; Febianto, 2012; Rasem, 2012; Farooq & Mufti, 2013; Aisyah *et al.*, 2014; Ajmi *et al.*, 2019; Titi Dewi *et al.*, 2019; Mesliera *et al.*, 2020). Such studies have pointed out the characteristics of PLS financial contracts that tend to favour the entrepreneur and not the investor, the specific risks resulting from PLS financing, asymmetric information and agency problems that arise in PLS contracts, and some additional institutional considerations.

This study focuses on the Moroccan Islamic banking context, where IBs are legally referred to as ‘participative banks’. It aims to examine the barriers and challenges that hinder the implementation of PLS contracts in Morocco. The study adopts an exploratory qualitative research methodology, using face-to-face interviews with local managers of Moroccan IBs in the Rabat–Casablanca region, to analyse the issue. The survey was carried out during the month of September 2020, under the circumstances of the Coronavirus (COVID-19) pandemic.

The rest of the paper is structured as follows. The next section reviews the literature that discusses the factors explaining the minimal use of PLS instruments by IBs. It is followed by the methodology section that presents the methods adopted in this research to investigate the lack of PLS contracts in Moroccan IBs. The findings and discussion sections follow thereafter. The last section concludes the paper.

LITERATURE REVIEW

Characteristics of PLS Financial Contracts

As mentioned previously, *mushārah* and *muḍārah* are the main products based on the PLS principle. *Mushārah* can be availed by entrepreneurs when they hold part of the funds and require funding from other partners in a business; while *muḍārah* can be used when the entrepreneur can provide his business skills and another partner joins in to provide the capital to establish the business. Profits under PLS contracts are shared in accordance with a predefined ratio, and the loss is shared by all partners in a *mushārah* and the capital provider in a *muḍārah*, respectively. However, to explain the limited use of PLS instruments, researchers underline that the nature of these contracts does not encourage banks to get involved in these partnerships.

In the case of *muḍārah* contracts, the entrepreneur has complete information about the business operations but in the case of losses, he will not be financially impacted (Farooq, 2007). Thus, the *rabb al-māl* (capital provider) bears the risk of losing all his capital while the *muḍārib* (entrepreneur) risks his time and efforts, except in the case of fraud, willful negligence and misconduct which, if proven, would render the *muḍārib* liable for losses. *Muḍārah* is described as a silent or sleeping partnership due to the restricted involvement of investors in the management (Dar & Presley, 2000). Consequently, under *muḍārah*, IBs provide the capital and bear the investment risk without participating in the decision-making process in the venture. Therefore, they are not particularly enthusiastic about this Islamic financial tool.

On the other hand, in the *mushārah* agreement, a financial contribution is required from all partners. The partners are financially liable for losses and they can participate in the management and decision-making process—an arrangement which is perceived to be the preferred Islamic financing mode (Mirakhor & Iqbal, 2007). The specificities of *mushārah* are deemed appropriate for enlisting partner participation or equity-financing. However, banks are traditionally specialised in financial intermediation and not for this category of business partnership (Dar & Presley, 2000). Thus, there is again less enthusiasm on the part of IBs to engage in *mushārah* ventures.

Asymmetric Information and Agency Problems

To explain the limited use of PLS arrangements, the financial contracting theory of the firm, moral hazard and asymmetric information problems have been invoked (Ajmi *et al.*, 2019). Given the similarities between PLS agreements and the agency relationship, scholars put forward the moral hazard and agency problem hypothesis to explain the limited use of PLS instruments. According to Khan (1995), the moral hazard hypothesis is dominant in PLS contracts. In the context of PLS modes, agency problems arise when the entrepreneur has an incentive to make less effort and report a lower level of profit to the bank (Dar & Presley, 2000). In fact, asymmetric information can be minimised with supervision, monitoring and alignment of interests (Aisyah *et al.*, 2014). Nevertheless, the implementation of a monitoring strategy incurs additional costs (Iqbal, 2007). As a result, the monitoring costs and the risk of losing all the capital invested do not encourage capital providers to enter into such agreements.

To stimulate investment of capital on a PLS basis, Hamza (2016) proposes the involvement of investment account holders (IAHs) (as capital providers) or investment deposit associations (as representatives of capital providers) as management board members in projects being financed through PLS modes to reduce the asymmetric information and establish an ethical agency relationship between capital providers and business entrepreneurs.

Risk Exposure

In Islamic banking, scholars distinguish between classical risks that are faced by all types of financial institutions and particular risks that are related to the specificities of Islamic finance and the PLS principle (Khan & Habib, 2001; Habib, 2011). In fact, PLS instruments are perceived to involve high risk (Titi Dewi *et al.*, 2019). Therefore, to better compete with their conventional counterparts, IBs tend to opt for less risky modes of financing (Dar & Presley, 2000; Febianto & Kasri, 2007; Febianto, 2012).

Classical Risks

The information asymmetry problem, which prevails especially under *muḍārabah* contracts, increases credit risk. When the agreed profit share is not achieved, it is difficult for the capital provider to ascertain whether the entrepreneur has difficulties to make the expected return on investment or the actual profit is being underreported. According to a study that evaluates the credit risk in Malaysian IBs, the PLS principle is attributed as one of the factors for the higher degree of credit risk in IBs due to issues of asymmetric information, lack of expertise and limited use of hedging techniques (Lassoued, 2018). Compared to *muḍārabah*, *mushārah* entails lower credit risk. Empirical research carried out on 63 IBs in the Middle East, South Asia and Southeast Asia demonstrates that *mushārah* can reduce IBs' credit risk as it allows the bank to control the business, share the financial risk and develop expertise in project management (Titi Dewi *et al.*, 2019). The bank is also able to better distinguish risk levels between high and low-quality firms.

On the other hand, liquidity risk may occur during the period when the bank is waiting for the profits under the PLS agreement to be shared to enable it to meet its obligations.

Furthermore, if the project fails, it will be difficult for the bank to convert the business assets into liquidity. According to a comparative study that examined the relationship between bank liquidity, capital and risk in banks in the MENA region, the PLS contract adds to the liquidity constraints of IBs, which need to develop enhanced risk management techniques. (Ben Salah & Boujelbene, 2018).

Operational risks may also arise at the different steps involved in a PLS contract, where IBs deal with many partners and, concurrently, comply with the Sharī'ah. Thus, to reduce this category of risks, rigorous control and enhanced technology are essential.

Specific Risks

IBs rely on investment accounts to finance PLS projects. Hence, further risks arise, notably fiduciary risk, withdrawal risk and displaced commercial risk.

Fiduciary risk is about maintaining the IAHs' confidence. It is associated with the fiduciary responsibilities of IBs (Simon & Abdullah, 2013). This risk may arise for two reasons:

1. When there is a lower rate of return which can be interpreted as a failure to comply with the investment contract or mismanagement of funds by the bank (AAOIFI, 1999). It can be considered as a failure to safeguard the interest of IAHs (Sandeep & Anand, 2013).
2. When the bank does not fully comply with Sharī'ah requirements, thus resulting in a backlash in stakeholders' confidence vis-à-vis the banks' operations (Khan & Habib, 2001; Habib & Khan, 2007; Habib, 2011).

In addition, IBs are exposed to withdrawal risk when the rate of return is lower compared to other banks (Khan & Habib, 2001; Habib & Khan, 2007; Habib, 2011). Therefore, if the IAH is not satisfied with the bank's efforts to generate the expected PLS profit, he may decide to withdraw his funds and seek other investment opportunities.

Displaced commercial risk arises as a result of volatility in the rate of return earned by IAHs (John, 2013). Consequently, to manage withdrawal risk and meet the expected rate of return to IAHs, IBs may be obliged to relinquish a part of their own profits (AAOIFI, 1999; Khan & Habib, 2001; Habib & Khan, 2007; Habib, 2011). To manage displaced commercial risk, profit equalisation reserve (PER) and investment risk reserve (IRR) are two techniques used to ensure a competitive rate of return to IAHs (Amin, 2017).

Institutional Considerations

According to the literature, the attitude, behaviour and reluctance of IFIs also explain the limited use of PLS contracts (Rasem, 2012). Furthermore, Farooq (2007) believes that despite the theoretical idealisation, IBs as businesses are rational in avoiding PLS modes for several institutional considerations.

Cultural Considerations

PLS contracts consist of long-term contractual relationships which involve close coordination and regular interactions among the partners. Indeed, partners' behaviours, communication and

working methods could reveal cultural contrasts. Thus, IBs have to ensure a cohesive culture in order to maintain this type of partnership and meet the objectives that have been set. Besides project feasibility and cultural contrasts, the relationship is further complicated by the need for privacy to protect the firm's competitive advantage or to avoid certain government regulations (Khan, 1995).

Need for Privacy

Taking into consideration the digital age and the scarcity of resources, entrepreneurs may prefer discreet activities based on trust. In fact, within a competitive environment, they may avoid sharing detailed information about the progress of their projects. Accordingly, most businessmen prefer not to provide full details about their activities while PLS agreements require keeping and revealing detailed records (Iqbal, 2007).

Prevalence of Traditional Banking Practices

In the first decades of Islamic banking activities, it was noticed that Islamic bankers tend to opt for mark-up modes which are similar to conventional modes of financing. Financial instruments such as *murābahah* and *ijārah* are less risky and generally short-term contracts. Indeed, their use is easier for IBs with regard to operations, technology and the qualifications required by bank personnel to develop and manage these products. Khan (1995) claimed that the mark-up mode is closer to the traditional culture of commercial banking. PLS modes, on the other hand, require IBs to develop trading techniques and get involved in businesses. Consequently, the bank has to play two different roles—that of a financial intermediary when it is involved in financing and the role of an entrepreneur—when it enters into PLS contracts (Aisyah *et al.*, 2014).

PLS in Moroccan Islamic Banking

Morocco has taken several steps for the implementation of IBs and Islamic windows. In 2007, three products called 'alternatives' (under the contracts of *ijārah*, *murābahah* and *mushāarakah*) were approved by Bank Al-Maghrib (the central bank) to fulfil the needs of customers and meet the increasing demand for Islamic banking in the country. In 2015, the legal code 103.12 relating to Islamic finance was promulgated. In 2017, five IBs and three Islamic windows were licensed.

With regard to PLS contracts, the literature discusses businesses' perceptions of PLS financing in Morocco. El meskine and Chakir (2017) conducted quantitative research in the 'Souss Massa' region covering 68 company executives to verify whether these companies are interested in these modes of financing. On the other hand, using the decomposed theory of planned behaviour, Badaj and Radi (2018) conducted a study based on the responses of the owner-managers of 153 small and medium enterprises (SMEs) to point out the factors that may influence their decisions on the use of PLS modes of financing, such as costs, limited access to traditional financing, religious beliefs, normative belief, attitude, and perceived behaviour of control. Other studies discuss the risks and specificities of PLS sharing in a general context. No empirical studies have been conducted about the barriers and challenges of PLS implementation in Moroccan IBs.

PLS Instruments and COVID-19 Pandemic

Numerous studies were conducted about how Islamic financial instruments can contribute to the recovery from the COVID-19 economic crisis. As-Salafiyah (2022) has investigated the studies published by Scopus-indexed journals on the role of Islamic economics during the pandemic. Using a research dataset last updated on 7 August 2021, she found that 51 studies were published on this topic. Theoretically, the Islamic banking industry provides ethical principles and diversified financial tools. Therefore, studies discussed the ability of the Islamic economy to introduce new strategies to tackle the economic and financial consequences of the COVID-19 pandemic. The PLS principle is one of the main principles underlined by researchers to face the negative effects of the pandemic (Abdul-Rahman & Gholami, 2020; Benamraoui, 2021; Nasrudin Fajri *et al.*, 2022).

As mentioned previously, PLS instruments allow partners to share profits as well as risks and losses. Therefore, they promote fairness and justice in wealth distribution (Abdul-Rahman & Gholami, 2020; Benamraoui, 2021; Nasrudin Fajri *et al.*, 2022). In other words, they provide a way to protect people who are struggling with financial difficulties as well as banks (Benamraoui, 2021) that may gain less profits than other banks but will show more resilience during crises (Nasrudin Fajri *et al.*, 2022). Actually, by using *mushārah* and *muḍārah*, the entrepreneur can be more financially comfortable, as he benefits from financial support. The negative outcome is shared among the partners. Furthermore, all the transactions are closely linked with reality. Therefore, financial risks are mitigated. In addition, irregularities and economic difficulties can be detected easily because each project is independently monitored and evaluated. As a result, problem situations can be prevented and corrected (Rospala *et al.*, 2020).

In this context, Chachi (2021) agrees with the efficiency of Islamic banking and PLS tools but he wonders about the stakeholders who will be willing to implement the suggested solutions. In the Moroccan case, for example, the crucial question is whether it will be possible to implement PLS solutions and if relevant parties are prepared to take the actions needed.

METHODOLOGY AND DATA COLLECTION

To answer the research question, an exploratory qualitative study was conducted using face-to-face interviews with local managers of IBs in the Rabat-Casablanca region. The qualitative approach remains the most appropriate to examine a phenomenon in greater depth. The main objective of qualitative methods is to answer two main aspects of a topic: the ‘how’ and the ‘why’ (Hamilton & Finley, 2020). It enables researchers to explore research topics in a wide range of disciplines. According to a recent study that assesses the prevalence and citation impact of academic research, the prevalence of qualitative research increased substantially between 1996 and 2019 (Thelwall & Nevill, 2021).

Given that Islamic finance is new in many countries, the qualitative approach is used by researchers as a powerful source of in-depth information to explore current issues. For instance, Zebal and Saber (2014) chose the qualitative method to explore the Islamic market orientation, its antecedents and consequences within IFIs in Bangladesh and the United Arab Emirates. Similarly, Echchabi and Abd. Aziz (2014) used the qualitative approach to understand in detail

customers' perceptions and experiences about Sharī'ah compliance of IBs in Malaysia. In addition, Mansoor and Kabir (2021) opted for the qualitative methodology to verify whether or not the practice of Islamic microfinance serves the underlying intents of Islamic law (*maqāṣid al-Sharī'ah*).

The qualitative approach is described as subjective because it is based on the interpretation of words and individual experiences of respondents regarding the research topic. Furthermore, it is a time-consuming process. However, this approach enables the interviewees to express themselves openly, and researchers can review their ideas, correct misinterpretations, and discover new facts about the topic.

According to the Moroccan central bank report about banking activity during the year 2020, the number of IBs in the whole country comprised 154 entities, which remains a small figure compared to the number of traditional banks, which exceeds 6000 entities. Moreover, 53 per cent of Islamic agencies are located in the Rabat–Casablanca axis. Thus, this study sought interviews with 17 respondents within Rabat and Casablanca. Among them, 14 IB managers accepted the request while three managers refused for confidentiality reasons. The choice of this category of managers was motivated by several reasons. In practice, local managers are responsible for coordinating with the top management; they follow its strategy and directives, and concurrently, they direct the operational functions of the bank in a defined geographical zone. Furthermore, they are aware of customer needs and complaints. Meanwhile, thanks to their daily work, they are aware of the challenges and risks of every financial tool. The list of IB managers who agreed to be surveyed is provided in **Table 1**.

Table 1: Overview of the Survey Sample

Bank	Position	City	Request Accepted/Refused
Bank A	Interim manager	Rabat	Accepted
Bank A	Bank manager	Rabat Hay Riad	Accepted
Bank A	Bank manager	Temara	Accepted
Bank A	Bank manager	Rabat Agdal	Refused
Bank A	Interim manager	Casablanca Ghandi	Accepted
Bank B	Bank manager	Rabat Hay Riad	Accepted
Bank B	Bank manager	Temara	Accepted
Bank B	Bank manager	Rabat Agdal	Refused
Bank B	Bank manager	Casablanca Ghandi	Accepted
Bank B	Bank manager	Casablanca Anfa	Accepted
Bank C	Bank manager	Rabat Agdal	Accepted
Bank C	Bank manager	Casablanca 2 Mars	Accepted
Bank D	Bank manager	Rabat Hassan	Accepted
Bank D	Bank manager	Casablanca Ghandi	Accepted
Bank E	Bank manager	Temara	Accepted
Bank E	Bank manager	Rabat Hassan	Refused
Bank E	Bank manager	Casablanca Anfa	Accepted

Source: Authors' own

Data Collection

Each interview lasted from 45 minutes to 2 hours 15 minutes and was held face-to-face in September 2020. The interview is the most common way to gather information in qualitative research. It reduces the chance that the researcher imposes their perspective or constrains the scope of discussion (Thelwall & Nevill, 2021). There are three types of interviews. The unstructured interview consists of suggesting a topic to the interviewee and letting them speak without guidelines. The structured interview is based on many specific and short questions following well-defined guidelines. There is also the semi-structured interview which relies on a few predefined questions. The last method is more flexible because it enables the interviewee to express their views according to an interview guide. As for the present exploratory research, semi-structured interviews were conducted. Hence, a few questions were selected about the challenges and barriers to the implementation of PLS financial contracts in Morocco. The interviewees were asked open questions around four major themes:

1. The Moroccan IBs' offering of products and services (a special focus on debt vs. partnership instruments)
2. Factors that hinder PLS implementation in Morocco
3. Major challenges to PLS agreements for Moroccan IBs
4. COVID-19's impact on PLS instruments

Content Analysis

Content analysis is the tool used in this research to transform the qualitative information given by the interviewees into material that is usable for attaining the researchers' objectives. It is a family of research techniques for making systematic, credible, or valid and replicable inferences from texts and other forms of communication (Drisko & Maschi, 2016). In practice, the researcher starts with the transcription of the answers gathered. Then, he codifies the transcribed data and classifies them into categories. Finally, he examines and interprets the data classified.

Data Transcription

Data transcription refers to the process of transforming the qualitative data collected, which could be in an audio or video format, into a text called 'verbatim'. Nowadays, advanced solutions are used to facilitate this process. Concerning the present research, for confidentiality reasons, no recording medium was used during the interviews. Therefore, the investigation relied on note-taking. Then, the notes were gathered in a text format without modifying the collected data.

Data Coding

At this level, the researcher has to codify and classify the collected data into cohesive categories. In fact, two methods could be used. Closed or deductive coding is used when the categories are predefined. Consequently, the researcher codifies and classifies information following these categories. Open or inductive coding permits identification of categories of content analysis from the text 'verbatim'. Furthermore, the coding could be made manually or by using automated

methods. Concerning the present study, it was based on the inductive method and only manual coding was used to extract the categories of analysis from the verbatim. The main categories of analysis of this research are presented in **Table 2**.

Table 2: Main Categories of Analysis

No.	Main Categories of Analysis
1	Institutional challenges
2	Operational challenges
3	COVID-19 repercussions

Source: Authors' own

Finally, data analysis is the last stage of the content analysis process through which the researcher tries to review and interpret the codified data. In other words, it is an attempt to assign meaning to these data, identify the main findings, and draw significant conclusions.

RESULTS

The present section includes the results of the data analysis. The exploration carried out showed that the delay of PLS contract implementation in the Moroccan market is mainly due to institutional challenges, but there are also the implications of the COVID-19 pandemic and operational challenges that affect the process of execution. These challenges are described in **Table 3**.

Table 3: Challenges to PLS Contract Implementation

Challenges		Respondents from IBs (N=14)
Institutional challenges	Standard contract form	14/14
	Availability of <i>takāful</i>	12/14
COVID-19 repercussions	Negative repercussions of COVID-19	14/14
Operational challenges	Human capital requirements	10/14
	Financial resources limitations	8/14
	Customers' requisites	2/14

Source: Authors' own

Institutional Challenges

The main challenges to PLS contract implementation that respondents highlighted are institutional. They mentioned that the first blocking factor is the lack of standard contracts, which should be provided by the Shari'ah board at the level of the central bank of Morocco. According to the interviewees, Moroccan IBs and even windows cannot put in practice any Islamic financial instrument before receiving the agreement and standard form contract from the Higher Council of Ulema and Bank Al Maghreb. One of the respondents stated: 'We are ready; we are just waiting for the standard contract form' (Bank Manager, Bank A, Hay Riad, Rabat). Furthermore, the majority of the interviewees highlighted the delay in the availability of *takāful*

(Islamic insurance) as a barrier to PLS contract implementation. These managers believe that *takāful* is essential for *mushārah* and *muḍārah* engagements, and this product has not yet been approved at the level of the Higher Council of Ulema.

COVID-19 Repercussions

The respondents confirm that the spread of the COVID-19 pandemic contributed to the delay in the implementation of PLS financial contracts. According to them, the drastic measures taken by the Moroccan government and other governments around the world such as lockdown restrictions, the interdiction of travelling, and the closure of restaurants, shopping centres and firms for months had an impact on the decision-making process and contributed to the delay of many projects. One of the interviewees confirmed: ‘Of course, it has an impact, due to the Coronavirus everything stopped’ (Bank Manager, Bank C, Rabat Agdal).

Operational Challenges

In addition, the respondents highlight the operational challenges of PLS contract implementation. They underline the role of expertise and employees in the successful launching of PLS contracts, as follows:

We don’t have expertise in PLS contracts and the available training is not yet adequate to the needs of Moroccan Islamic banks because they don’t focus on the specificities of the Moroccan context (Bank Manager, Bank A, Rabat).

Implementing a new instrument is not just about a new concept but it is about the operational side and the technical steps to follow to conclude a contract. I remember at the beginning, we had difficulties in just understanding and putting into practice the *murābahah* for vehicles (Bank Manager, Bank C, Casablanca 2 Mars).

On the other hand, respondents emphasise the financial challenges they face and the difficulty of refinancing. ‘We market a long-term *murābahah* with maturities up to 25 years, contrary to other countries that commercialise only short-term *murābahah*’ (Bank Manager, Bank C, Rabat Agdal). The lock-up of their funds in long-term *murābahah* explains the challenges in making financing available under other types of instruments such as PLS.

From another viewpoint, two of the respondents highlight the difficulty of concluding this type of risky agreement with clients who are not familiar with Islamic finance. ‘It is difficult to deal with customers who don’t know about the PLS principle and the characteristics of PLS instruments’ (Bank Manager, Bank E, Temara).

DISCUSSION

Institutional Challenges

Lack of Standard Contract Forms

As noted above, Moroccan IBs and windows cannot conclude PLS agreements without the standard contract forms that should be endorsed by the Higher Council of Ulema and the central

bank, Bank Al Maghreb. Indeed, the use of standard contracts will assist IBs in minimising the risk of Sharī'ah non-compliance and legal risk.

Differences in Sharī'ah interpretation represent a key reason for Sharī'ah non-compliance risk. Sharī'ah interpretation can vary from one Sharī'ah scholar to another. Therefore, the use of standard contracts is beneficial for IBs because they have been reviewed and accepted by the Higher Council of Ulema and they can be used by all IBs and windows operating in Morocco, enhancing trust, acceptance and confidence levels in the implementation of the contract amongst stakeholders.

Legal risk also emanates from the absence of standard contracts. Indeed, the newness of Islamic banking in Morocco and the use of common law increase this risk. Thus, the use of standard contract forms contributes to reducing legal conflicts and litigation. Banks would only have to update the contract with the customers' details and use it. Consequently, if there is a failure in the contract, the reputation of the bank will not be in danger.

Delay in the Provision of Takāful

Takāful is another key factor in the PLS launching process. Actually, during the last years, Islamic financial services were provided by Moroccan IBs without the concurrent provision of *takāful*. As mentioned in the literature review, *mushārah* and *muḍārah* expose IBs to multiple risks. Thus, there is a need for *takāful* to mitigate the risks involved in PLS financing. For IBs to expand the product range and increase the number of their transactions, the availability of *takāful* is essential as it represents an embedded element in the offering of Islamic financial products. *Takāful* would therefore have to be approved at the level of the Higher Council of Ulama and made available to IBs to facilitate the provision of Islamic financial services. *Takāful* is also an important segment to complete the Islamic financial framework in Morocco and enhance the reputation of its institutions.

COVID-19 Repercussions

To explain the lack of PLS instruments in Morocco, respondents ascertained that the Coronavirus context had an impact on Moroccan IBs, depositors and the measures adopted by the central bank.

With regard to IBs, the findings of the present study showed that they faced difficulties related to refinancing for two major reasons. Firstly, they are still in the first years of activity. Secondly, they finance long-term *murābahah*. However, following COVID-19, IBs were required to support their customers, similar to their conventional counterparts, through a moratorium on the repayment of bank credit maturities and for the reimbursement of leasing maturities until 30 June 2020 without payment of fees or penalties (OECD, 2020). To benefit from this moratorium, customers were asked to submit their applications to their respective banks. Taking into account the production cut and loss of employment due to the social distancing and lockdown measures, the Coronavirus context had negative repercussions on the financial situation of Moroccan IBs.

COVID-19 also had a significant impact on depositors. Depositors are generally concerned about the protection of their capital and how to make it work throughout their lifetime. Taking into consideration the massive information about the negative repercussions of the Coronavirus pandemic on the economy, depositors became more fearful, cautious and stressed about the future and the protection of their deposits. Indeed, during this challenging time, even if PLS products were made available in the Moroccan market, they would not have attracted the interest of investors. Certainly, a depositor in Profit-Sharing Investment Accounts (PSIA) is aware that, in case of loss, they will lose all their capital and in light of the bleak future that the COVID-19 pandemic presented, depositors would not have entered into such types of contracts. Thus, after the Coronavirus pandemic, more efforts are required to keep depositors reassured of the viability of PLS arrangements.

Under the pressure of the Coronavirus pandemic, the primary concern for the government was to manage the repercussions of the pandemic and mitigate its economic and social impact (OECD, 2020). At the level of Bank Al Maghreb, it was time to reflect on monetary measures to promote access to credit for businesses, support credit institutions in providing liquidity, and reinforce specific refinancing programmes for the benefit of Micro-, Small and Medium-sized Enterprises (MSMEs). The Bank had to support different categories suffering from the economic impact of COVID-19, including firms, employees and informal workers (OECD, 2020). Thus, the various efforts geared towards combating the effects of the Coronavirus pandemic inevitably impacted the progress of some planned projects linked to Islamic finance, such as causing a delay in the provision of *takāful* within the Moroccan market.

Operational Challenges

Financial Resources Limitations

Financial resources play a key role in the implementation of PLS instruments. With regard to the Moroccan context, respondents raised the difficulty of refinancing caused by two principal factors. Firstly, Moroccan IBs are still in the early stage of development; so, they are not yet able to recover their investment and generate profit. Secondly, to meet client needs, they offer long-term *murābahah*, up to 25 years, especially for home financing. Thus, the slow progress of Islamic financial tools, the unavailability of the Islamic money market, and the difficulty of having a lender of last resort impact on the liquidity risk of PLS agreements in IBs (Ben Jedidia & Hamza, 2014). Therefore, there is a real need for developed Islamic capital markets and financial innovation. Hamza (2016) recommends that IBs develop a new generation of investment deposits structured by asset-class risk, sector activity, medium-long maturity, and *ṣukūk* indexation.

Moroccan IBs can carry out PLS transactions using Profit-Sharing Investment Accounts (PSIA). This category of accounts should be dedicated to finance *muḍārabah* and *mushārah* projects. Under PSIA, investment account holders (IAHs) accept the risk of loss and share the profit, provided that the funds are invested in compliance with Sharī'ah principles. They do not participate in the decision-taking process and the governance of the bank. Nonetheless, there is a need for communication to attract depositors who would like to invest in IBs. Moreover, the

bank must make considerable efforts to achieve satisfactory results. Thanks to PLS products, IBs would be able to meet the economic needs and finance the requirements of SMEs as well as infrastructure and long-term development projects.

Human Capital Requirements

The role of the employee is imperative for the successful launch of *mushārah* and *muḍārah* instruments. Thus, IBs should appoint employees with the appropriate knowledge and qualifications, both academic and practical, and with the right attitude. Concerning the academic qualifications, it is recommended to take into account the specificities of the Moroccan context in the training programmes. For practical knowledge, internships abroad should be encouraged. On the other hand, given the newness of the Moroccan participation banking system, there is a need for motivated people who make efforts in conducting research and have a critical thinking approach; employees who do not limit themselves to the received information and demonstrate outstanding commitment and initiative with inquisitive minds.

Customers' Requisites

No one can deny that the special nature of PLS products requires a careful selection of customers. Additional criteria are also required. The bank, for instance, should invest significant efforts to carry out successful projects, but the depositor (*rabb al māl*) should be prepared to share the loss or the profit depending on the results and the agreements concluded. Furthermore, IB managers should have an ethical spirit. They should work hard and share all the information available.

To face this challenge, efficient communication about PLS products is imperative. Therefore, IB managers have to create a specific description of the ideal client, who shares similar objectives and values, such as commitment towards Shari'ah compliance and endorsement of an ethical spirit. IBs should enhance their efforts to develop the ability to distinguish good customers from bad ones and set up truthful reporting of profits and losses (Beng Soon & Ming-Hua, 2009).

CONCLUSION

Considering the benefits of PLS contracts in promoting risk-sharing, entrepreneurship, and financial and social inclusion, the present article has two main objectives. The first is to present a literature review on the predominance of mark-up modes and the limited use of PLS instruments in IBs, particularly considering the Moroccan context. The second is to figure out the challenges and barriers related to the lack of PLS contracts in Morocco. To the best of the authors' knowledge, there is no empirical research about the lack of PLS instruments within Moroccan IBs. Therefore, the qualitative research carried out focuses on IB managers to investigate this phenomenon. The findings reveal that this delay is due to various challenges, including institutional and operational, along with the implications of the Coronavirus pandemic.

According to the respondents, the main factors that hindered the implementation of *mushārah* and *muḍārah* in Morocco are institutional. The interviewees emphasised the

absence of standard contract forms that should be approved by the Higher Council of Ulema and provided by Bank al Maghreb. These contracts are considered as 'permission' for Moroccan IBs to enter into this type of agreement. Furthermore, they are crucial to managing the risk of Shari'ah non-compliance and legal risk at the level of IBs when offering PLS products. Moreover, there is a belief that it is difficult for IBs to offer PLS instruments to the market before the introduction of *takāful*. *Takāful* is another segment of Islamic finance which is yet to be developed in Morocco.

The present research also reveals that COVID-19 had an impact on the implementation of new Islamic tools such as *takāful* and PLS instruments in Moroccan IBs. During this period, the primary concern for the central bank was to deal with the negative repercussions of the COVID-19 pandemic and mitigate its economic and social impact. This too has contributed to the delay in the implementation of some planned projects linked to Islamic finance. IBs, similar to conventional banks, were asked to support their customers through a moratorium on the repayment of bank credit maturities and for the reimbursement of leasing maturities without payment of fees or penalties. Moreover, the distancing and lockdown measures have had negative repercussions on production and employment, which have in turn negatively affected the financial situation of IBs. On the other hand, due to the impact of COVID-19, depositors are more anxious about their funds and reluctant to invest.

With regard to the operational challenges, the managers call attention to the difficulty of refinancing. Interviewees highlight the fact that Moroccan IBs finance long-term *murābahah* and that they are still in the first years of activity to achieve benefits and make new investments. Moreover, it has been discussed that the success of these financial instruments depends on adequate human capital. In fact, there is a need for qualified employees to have a critical thinking attitude and an ethical spirit. The other challenge is depositors, who must accept sharing benefits and be aware of the risk of loss. As an entrepreneur, the customer should be a trusted partner and make all his efforts to reach the best results.

The results of this study may have implications for policymakers as well as for the research community. For policymakers, the research points to the fact that the Moroccan central bank and Higher Council of Ulema should accelerate the submission of standardised contracts and *takāful* to give the formal go-ahead to PLS products in Morocco. For practitioners, the research indicates that Moroccan IBs have to acquire and develop the appropriate tools that would enable them to select their partners and monitor the *mushārah* and *muḍārah* projects and consequently reduce risk and asymmetric information.

It is further recommended that the research community should focus on the inclusion of the specificities of the Moroccan context in Islamic banking training programmes because each national context has particularities and requirements of its own. Moreover, internships abroad should be sought in order to develop practical experience with regard to the operations of PLS instruments.

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DECLARATION OF COMPETING INTEREST

The authors declare that they have no known competing financial interests or personal relationships that could have appeared to influence the work reported in this paper.

ACKNOWLEDGMENT

The authors are thankful to the managers of the Islamic banks who have agreed to volunteer their time to contribute to the present research. The authors are also grateful to the journal's editor Dr Beebee Salma Sairally for her comments aimed at improving the quality of the paper.

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