



Managers' Attitude Toward the Application of Musharakah Financing: An Empirical Study of Islamic Banks in Pakistan*

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Abstract: The consensus among Islamic scholars, banking specialists, academicians, and practitioners is that a financial system based on Profit & Loss Sharing (PLS) principles would serve as a legitimate alternative to interest-based (*ribawi*) banking. Nonetheless, the real world diverges from this innovative and concrete perspective. The predominant academic literature currently published on this topic examines the issue philosophically, with a scarcity of research performing empirical examination. This study is specifically designed to empirically investigate the issues and challenges that Islamic banks would face while adopting *musharakah*-based financing from the standpoint of management. The research concentrates on Islamic banks in three major cities in the Punjab province of Pakistan. The data is collected through questionnaire from 50 respondents, who were managerial-level employees from the main branches of five full-fledged Islamic banks. The results show that Internal *Shari'ah* Review and risk factors do not significantly influence Islamic bank managers' attitude towards adopting *musharakah* financing. However, other factors such as customer preferences, operational challenges, moral hazard, government policies, and the internal control system of the organization exert a significant impact. This study has practical implications for Islamic bank managers and government authorities to comprehend the internal and external elements influencing managers' attitude toward using *musharakah* financing. This action enriches the existing body of literature on Islamic banking theory and practice related to *musharakah* financing practice.

Keywords: Islamic Banking, *Musharakah*, Theory of Reasoned Action (TRA). Moral Hazard, Risk Factors

JEL Classification: G21, M48, N25

* This research is the outcome of the first author's PhD Dissertation.

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Muhammad, A. M. & Khan, A. (2025). Managers' Attitude Toward the Application of Musharakah Financing: An Empirical Study of Islamic Banks in Pakistan. Turkish Journal of Islamic Economics, xx (x), xx-xx.



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DOI: 10.26414/A4274
TUJISE, x(x), 2025, xx-xx
tujise.org



Received: 03.07.2024
Revised: 13.01.2025
Accepted: 25.03.2025
Online First: 01.08.2025



Introduction

Equity financing, which includes *musharakah* financing in Islamic finance, originates in pre-Islamic merchant traditions (Arshed & Kalim, 2021). Profit and loss sharing in trade was invented by Prophet Muhammad (SAW), who used it with Khadijah (RA), a wealthy Makkahi woman who subsequently became his wife (Kahf & Khan, 1992). Prophet Muhammad (SAW) utilized this financial instrument in collaboration with Khadijah (RA) for approximately fifteen years. *Musharakah* was later adopted by the Muslim community to oversee major commercial companies, with a focus on profit and loss sharing. The historical roots of profit and loss sharing models extend beyond Islamic practices, with notable influences in Western commerce and finance history. In addition, the Western Commenda, a widely practiced system in the 10th century to finance Italian international trade, particularly maritime trade, exhibits distinct features akin to a profit and loss sharing system (Udovitch, 2011).

Renowned academics Siddiqi (1983) and Mawdudi (1969) presented the fundamental theoretical ideas of Islamic banking, emphasizing partnership-based finance as an alternative to *riba*-based banking. Iqbal (1999) asserts that because Islam places a strong emphasis on commerce, entrepreneurship, and risk-sharing, hence the fundamental components of the Islamic financial system are made to promote partnerships and trade. On the same note, Khan (1989) considers profit and loss sharing (PLS) as synonymous with Islamic financing. Burhonov (2006) observes that scholarly discourse on Islamic banking, emerging in the mid-1970s, primarily concentrated on the profit-sharing dimension of Islamic finance. He contends that the establishment of Islamic banks has coincided with the advancement of profit-and-loss-sharing (PLS) banking theory.

Eddy Yusof et al. (2009) criticized the debt-based financing of Islamic Banks, asserting that the *maqasid-al-shariah* for achieving socioeconomic justice cannot be realized unless Islamic Financial Institutions increasingly utilize PLS modes of financing. Consequently, given that the Islamic financial system is fundamentally based on the principle of Profit and Loss Sharing (PLS), the primary objective was to entirely supplant the conventional interest-based banking system, particularly in nations with predominantly Muslim populations. Hence, Islamic banks introduced these models to provide interest-free loans in societies adhering to religious beliefs prohibiting interest (usury). Scholars, academicians, and bankers have consistently asserted the superiority of the PLS banking system over interest-based banking, highlighting various reasons. They contend that until there is a significant

increase in the share of PLS modes in the total financing activities carried out by Islamic banks, the social gains resulting from the prohibition of interest may not be completely realized. In this regard, a study by Arshed et al. (2020) found that *musharakah* financing promotes economic growth, making it an important tool for poverty alleviation.

When it comes to the transaction that takes place between a bank and a customer, *musharakah* financing allows for a more comprehensive involvement of both parties. Due to the nature of the contract, the bank as a partner does more investigation to reduce information asymmetries and to some extent influence the clients' business decisions. On a positive note, the bank's involvement in decision-making can help clients develop their skills by providing technical and managerial support. Additionally, within this framework, banks can act as entrepreneurs, which has the potential to positively impact business decisions (Al-Harran, 1990). Likewise, a study conducted in Indonesia finds that *musharkahah* financing positively impacts the Islamic banking sector's financial performance (Widarjono, 2018). In the same way, equity-based Islamic banking products like *musharakah* and *mudarabah* can help Small and Medium Enterprises (SMEs) close the finance gap by sharing profits and losses with Islamic banks (Bensalem & Bouherm, 2021).

Similarly, *musharakah* financing is known for relieving the institution from moral hazards and adverse selection problems (Arshed & Kalim, 2021). However, it is paradoxical that the practical implementation of PLS-based i.e., *musharakah* financing is notably ignored in the global Islamic banking industry. Statistical data from various sources indicate that the utilization of *musharakah*-based financing is lower as compared to debt-based contracts. For instance, in Saudia Arabia, the share of *musharakah* financing is reported 1.9% out of overall shariah compliant financing (Deputyship for Economic Research & Statistics, 2024).

In Pakistan, a year-over-year comparison of *musharakah* financing from 2020 to 2023 shows no significant growth (State Bank of Pakistan, 2020, 2021, 2022, 2023). According to the State Bank of Pakistan (SBP), diminishing *musharakah* maintains the highest share (34.4 percent) in the overall financing of the Islamic Banking industry, followed by *musharakah* (22.7 percent) and *murabahah* (14.8 percent). (Refer to Table 1)

Table 1

Mode-wise Financing (Share in %)

Mode	2020	2021	2022	2023
Murabahah	13.4	15.3	15.7	14.8
Ijarah	4.9	4.8	4.6	4.1
Musharakah	24.8	21.4	22.9	22.7
Diminishing Musharakah	34.2	35.0	35.2	34.4
Salam	2.4	2.1	1.4	1.1
Istisna	8.9	7.6	8.4	8.6
Others	11.3	13.8	11.8	14.3
Total	100	100	100	100

Source: State Bank of Pakistan (Islamic Banking Bulletin – June 2020 – Sep. 2023)

The researchers have identified several factors that contribute to the PLS mechanism's marginal use in providing financing facilities to its clients. The study of Khan et. al. (2020) explored four main obstacles that hinder Islamic financial institutions in Pakistan from applying for PLS contracts, that includes risk factors, lack of awareness, regulatory constraints, and lack of government support. Similarly, Abu Bakar (2014) besides mentioning many advantages of PLS, maintains that the original idea of applying profit and risk-sharing instruments by the Islamic bank in its operation is currently difficult to practice due to various practical and operational reasons. Furthermore, Dar and Presley (2000) argue that PLS contracts are inherently subject to agency problems since entrepreneurs lack the incentive to fully allocate effort. They typically record a modest profit compared to the self-financed owner-operated enterprise. Therefore, there is an urgent requirement for empirical investigation to ascertain the fundamental reasons behind the reluctance of Islamic banks in Pakistan to use Profit and Loss Sharing (PLS) financing more extensively.

Thus, this research aims to empirically investigate managers' perspectives concerning the utilization of *musharakah* financing within Pakistan's Islamic Banking sector. To achieve this objective, the study intends to analyze the impact of seven key factors—operational difficulties, risk factors, customer preferences, moral hazard, internal *shari'ah* review, government policies, and organizational internal control system of financing—on managers' inclinations towards adopting *musharakah*-based financing. The variables have been derived from a thorough examination of the existing body of literature, with a significant amount of reliance placed on the most relevant research (Al-Harran, 1990; Jalaluddin, 1999; Gait, 2009; Ab-

dallah, 2009; and Zamil, 2014). Hence, the proposed model treats these factors as independent variables, while managers' attitude towards adopting *musharakah*-based financing serve as the dependent variable.

Literature Review

Historical evidence suggests that the PLS model was employed in Western finance and business (Udovitch, 2011; Kuran, 2004). Islamic banks then adapted it to offer Muslims an interest-free option. The PLS system has been in use for quite some time in many regions of the world. The Muslim Qirad, Byzantine Chreokoinonia, and Jewish Isqa all exhibit economic characteristics similar to the Western Comenda and may have been sources of this system (Jalaluddin, 2011).

Profit and Loss Sharing (PLS), a unique method wherein money from "investment deposit accounts" is used for investment financing via *musharakah* and *mudharabah* contracts, is said to be the distinguishing feature of Islamic banking intermediation (Ben Jedidia & Hamza, 2024). Moreover, the uniqueness of Islamic banking arises from its dependence on PLS, establishing it as an investment intermediary that utilizes investment capital instead of a traditional financial intermediary that relies on debt capital. In a similar vein, Khan and Bhatti (2008) describe the PLS system as the central component of Islamic finance intermediation. A'la Mawdudi (2013) asserts that the fundamental components of the Islamic financial system are designed to promote trade and collaboration, aligning with Islam's endorsement of commerce, entrepreneurship, and the idea of risk-sharing. Similarly, Siddique and Iqbal (2016) claim that the most viable alternative to the interest-based financing system within Islamic banking is the PLS model. Additionally, research findings from another study indicate that for Islamic banks to achieve completeness, it is essential to apply, practice, and promote the PLS modalities, namely *mudharabah* and *musharakah* (Ahmed, 2006). Farooq (2007) similarly states that the fundamental notions underpinning the push for Islamic banking and financial institutions were *mudharabah* and *musharakah* as their principal forms of operation.

Additionally, Askari and Krichene (2014) delineated two fundamental principles of Islamic finance: (1) the transition from a fractional reserve system to a 100% reserve banking system integrated with equity-based investment banking, and (2) an absolute prohibition on interest and interest-based debt (Askari & Krichene, 2014). Numerous scholars strongly assert that the genuine alternative to interest within an Islamic financial system lies in the Profit & Loss sharing mechanism, complemented by *qard-al-hashanah*. In contrast, other techniques such as *murabahah*, *ijarah*, *ijarah wa iqtina*, *salam*, and *istisna* are deemed to lack equal significance

in attaining the socioeconomic objectives of Islamic finance. Moreover, Nihar and Subramanyam (2011), along with Saad et al. (2013) echo similar perspectives that the key principle of Islamic banking is based on the prohibition of the interest and promotion of profit and loss-based system.

Abdallah (2009) illustrates that Islamic banks establish two-tier partnerships on both the asset and liability sides. On the liability side, there is a *mudarabah*-based relationship between the bank and the depositor. In contrast, on the asset side, the depositors' funds are channeled to the investors based on *mudarabah* and *musharakah*. In such a way, the bank avoids interest and earns an income shared between the depositors and the bank according to a pre-specified ratio. Linardi et al. (2015) assert that the PLS model is a preferable investment alternative for microfinance institutions. Their study concludes that the PLS model remains a viable investment alternative even when the opportunity cost of such investments is high.

Nonetheless, financial institutions frequently oppose PLS contracts in practice due to several obstacles, including regulatory requirements and moral hazard concerns (Sapuan, 2016). Likewise, another highlighted issue indicates that numerous Islamic banks are inadequately prepared to handle equity-based (*musharakah*) financing due to the intrinsic risk involved and the risk tolerance generally exhibited by conventional banks. Consequently, hardly 5% of financing in Malaysian Islamic banks employs equity-based contracts (Yustiardi et al., 2020). Gafoor (1995) asserts that frequent and widespread alterations in Government policy hinder the implementation of *musharakah* finance. Saifurrahman and Kassim (2024) assert that restricted loan access is the principal impediment to the growth of micro, small, and medium enterprises (MSMEs). The regulatory environment limits banking institutions' capacity to address the financial requirements of MSMEs, thereby hindering their access to credit and impacting the sector's growth. Moreover, they highlighted that the objectives of financial inclusion in the Islamic banking sector are obstructed by regulatory discrepancies and limitations that hinder Islamic banks from providing financial services to the MSME sector.

Similarly, Dar and Presley (2000) highlight various reasons for the limited adoption of PLS financing by Islamic Banks. Among these, the agency problem stands out as a significant factor. Moreover, fierce competition from traditional banks, the reluctance of Islamic banks to incur losses, and the impracticality of equity financing for short-term projects due to elevated risk levels contribute to the limited use of PLS financing. Also, unfavorable taxation treatment further dissuades Islamic Banks from employing PLS-based financing. Moreover, Khan and Bhatti (2008) assert that

operational challenges, ethical considerations in business practices, risky ventures with unrealistic profit expectations, absence of a specialized regulatory framework, ineffective procedures and limited expertise, high monitoring costs, loopholes in the tax system, the prevalence of high illiteracy constitute significant hurdles in the effective implementation of PLS instruments. A survey done among bankers in Lahore, Pakistan, by Saeed (2019) identifies excessive risk and a deficiency of experienced entrepreneurs as the primary factors contributing to the low incidence of *musharakah*.

Farooq and Ahmed (2013) further identify several factors hindering Islamic banks' adoption of *musharakah*-based financing. This includes a lack of interest from bank management in *musharakah* financing, the absence of guidelines or regulations from the Central Bank, the risk of financial loss, accounting difficulties, customer disinterest, a shortage of commitment, integrity, and skilled entrepreneurs, a deficiency in expertise, a lack of legal support from the government, the unavailability of checks and balances for *musharakah* enterprises, and taxation complications. These factors collectively contribute to the sluggish growth of *musharakah* as a financing mode in the Islamic Banking Industry. Sabrina and Abd Majid (2020) identify issues behind the low volume of PLS financing and are categorized into three categories. First, internal issues include high risk related to financing, deficiency in quality and quantity of trained human resources, complexity in handling, lack of innovative products, and lack of socialization from the banking staff. Second, the external issues include moral hazard and the community's lack of knowledge about Islamic banking. Third, regulatory issues include the lack of support from the regulator.

In the context of Pakistan, Hooker (2013) clarifies that Islamic Banks avoid PLS financing due to lack of faith in the Pakistani government. The financial industry exhibited less accountability due to political factors, which obscured pervasive corruption and ultimately caused Islamic banks to be reluctant in adopting PLS funding. Moreover, attraction for PLS from the business sector dwindled, as it would curtail extensive tax evasion and manipulation of tax returns by the business community. PLS financing requires financial transparency from all partners; however, businesses are unwilling to provide such information to the banks, leading to banks' disinterest in extending financing through PLS. Another aspect highlighted by Siddique et al. (2023) relates to the *shari'ah* approvals by the *shari'ah* board (SB) of Islamic banks. They emphasize that SBs play a pivotal role in fostering, regulating, and overseeing the advancement of the Islamic banking and finance sector. The *shari'ah* compliance framework adopted by SBs has far-reaching implications across various facets of Islamic banking, particularly in PLS modes of financing. They assert that rigorous *fatawa* (*shari'ah* decisions) issued by *shari'ah* Boards can hinder profitable transactions or

require the allocation of unlawful profits to charitable purposes, potentially leading to reduced profitability for Islamic banks. Consequently, bank management could significantly influence SB members in the issuance of *fatawa*.

Several research studies, including Ajili and Bouri (2018) and Khan et al. (2018), affirm that the *shari'ah* governance framework plays a crucial role in ensuring the compliance of Islamic banking operations with Islamic law. However, Nathan Garas and Pierce (2010) caution that the *shari'ah* opinions issued by Shari'ah boards (SBs) can negatively affect the performance of Islamic banks, potentially eroding stakeholders' confidence. Moreover, Ben Jedidia and Hamza (2024) draw attention to another significant concern: the displaced commercial risk associated with investments based on Profit and Loss Sharing (PLS) contracts. They indicate that banks may encounter the risk of money withdrawal if profits from PLS investments underperform relative to similar investments. This leads to a more selective approach in PLS financing and money creation through these deposits. They endorse the central banks' function in promoting the PLS mechanism in banking intermediation and fostering the development of innovative financial products that involve consumer participation.

In the aforementioned studies, especially in the context of Pakistan, a number of factors have been identified that contribute to hindrances in adopting *musharakah* financing. These factors can be categorized into internal factors and external factors. However, these studies fail to investigate the attitude of managers toward adopting *musharakah* financing which is the backbone of operations. The reluctance of managers could play a vital role in the overall banks' decision-making. Therefore, this study aims to explore the factors that change the attitude of the managers to adopt *musharakah* financing.

Theoretical Background

This study extends previous research investigations by incorporating internal and external variables into a modified theoretical framework. This framework is derived from the original Theory of Reasoned Action (TRA) established by Ajzen (Ajzen, 1980). The Theory of Reasoned Action (TRA) is the most extensively examined model concerning attitudes and behavior. In the TRA, it is posited that external variables, including demographic factors, attitudes toward specific targets, and personality traits, indirectly influence an individual's attitude and behavioral intentions. Gait (2009) references numerous well-known studies that have effectively endorsed the Theory of Reasoned Action (TRA) in elucidating human behavior. While most of the

support for this theory originates from social psychology, research utilizing TRA has demonstrated success across various disciplines. The theory, initially developed by Ajzen (Ajzen, 1980) and expanded upon by Sheppard et al. (1988), is designed to offer explanatory power for a broad spectrum of human behaviors.

This study employs a modified version of Ajzen's Theory of Reasoned Action (TRA) as the conceptual framework to examine how the TRA can predict and elucidate management attitude towards the potential integration of *musharakah* financing in Islamic banks in Pakistan. Notably, subjective norms were excluded from the model due to their uncertain theoretical and psychometric standing, aligning with the methodology proposed by Davis et al. (1989). Hence, this research investigates the influence of particular internal and external factors, acting as independent variables, on the attitude of managerial personnel in Islamic banks, which serve as the dependent variable, concerning the adoption of Profit and Loss Sharing (PLS) as their preferred financing method. External factors include moral hazards arising from the customer end, uncontrollable Risk factors, customer preferences, and government policies in promoting *musharakah* financing. Internal factors include Internal *shari'ah* board review, operational difficulties, and organizational internal control system of financing. These factors are derived from the literature review and tested in the context of managerial decision-making to explore their effect on the overall attitude of the managers to adopt *musharakah* financing. Hence, the following research questions are developed to achieve the objective of the study.

- How does Customers' Preference impact Managers' Attitude toward adopting *musharakah* financing?
- How do Operational Difficulties influence Managers' Attitude toward adopting *musharakah* financing?
- How do Risk Factors influence Managers' Attitude toward adopting *musharakah* financing?
- How does the Moral Hazard issue influence Managers' Attitude toward adopting *musharakah* financing?
- How do Government Policies influence Managers' Perspectives on embracing *musharakah* financing?
- How does the Internal *Shari'ah* Review affect Managers' Attitude toward adopting *musharakah* financing?
- What is the effect of the Organizational Internal Control System of Financing on Managers' Attitude towards the adoption of *musharakah* financing?

Methodology & Research Model

Research Model

The research model in Figure 1 is inspired by the theory of Reasoned Action (TRA). By utilizing an analytical approach, independent variables, namely Customers' Preferences (CP), Risk Factors (RF), Operational Difficulties (OP), Moral Hazard (MH), Government Policies (GP), Internal *shari'ah* Review (ISR), Organizational Internal Control System of Financing (OICSF) are developed. Moreover, the impact of these variables is tested on the manager's attitude towards adopting *musharakah*-based financing. The independent variables are derived from an extensive literature review. The theoretical framework of this study tests the impact of the hindrance factors (independent variables) on the manager's attitude towards adopting *musharakah* financing). Five fully operational Islamic banks, encompassing both domestic and foreign branches, are included in the study sample. These banks are in Punjab's three largest cities i.e., Lahore, Multan, and Faisalabad.

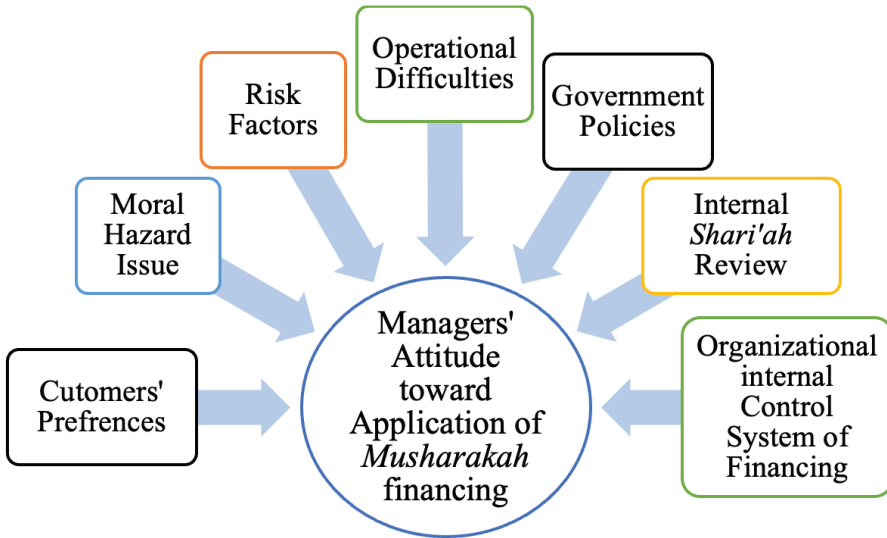


Figure 1: Research Framework

Source: Author generated based on the TRA model presented by Ajzen and Fishbein (1975)

The literature review indicates that researchers and experts in the field have identified several factors that could impact the implementation of *musharakah* financing in Islamic banks. Many of these studies examine the characteristics that influence the proportion of *musharakah* financing in a bank's overall portfolio through the perspective of borrowers. However, this study specifically examines the influence of these factors from the lenders' perspective, namely the attitude of Islamic banks' managers.

Table 2 provides summary derived from the literature research, outlines the principal issues affecting *musharakah*-based funding in Islamic banks.

Table 2

Factors extracted from literature that influence musharakah-based financing

S.No.	Factors	Frequency	Percentage
1	Moral Hazard	37	26.24
2	Operational Difficulties	33	23.40
3	Risk Factor	26	18.44
4	Customers' Preferences	16	11.35
5	Government Policies	11	7.80
6	Organization Internal Control System of Financing	10	7.09
7	Internal <i>Shari'ah</i> Review	8	5.67
	Total	141	100

Source: Extracted from past literature

Table 2 indicates that among 141 analyzed research studies, the predominant issue contributing to the limited implementation of *musharakah* financing in Islamic banks is 'Moral Hazard,' while 'Internal *Shari'ah* Review' ranks lowest. Nonetheless, its significance as an important factor cannot be overlooked.

This study examines the impact of seven significant factors on managers' attitude toward implementing *musharakah* in their financing practices which include moral hazard, operational difficulties, risk factors, customers' preferences, government policies, organization's internal control system of financing, and internal *shari'ah* review. Managers' attitude is the dependent variable in this study, while the seven aforementioned elements are the independent variables.

Definitions of Variables

Customers' Preferences

According to (Kotler & Keller, 2021), customer preferences mean specific desires, tastes, and requirements of individuals or groups regarding products, services, or experiences offered by businesses or organizations. The “Customers’ Preferences” variable in this study is related to the degree to which customers are inclined to choose *musharakah* financing as their preferred method of obtaining financing from Islamic banks to support their business.

Operational Difficulties

Operational difficulties in the context of banking business refer to challenges or obstacles faced by banks in their day-to-day operations, which can include issues related to technology, compliance, human resources, customer service, or process inefficiencies. These difficulties can hinder the smooth functioning of banking operations and impact the overall performance and customer experience (Liu, 2019). In the context of this study, the variable Operational difficulties encompass the challenges encountered by managers of Islamic banks in implementing *musharakah* financing. These challenges include various aspects such as accounting procedures, project assessment, cost monitoring, and insufficient entrepreneurial skills among staff in Islamic banking.

Risk Factors

Risk factors in banking refer to potential events or circumstances that could adversely affect a bank’s financial condition, operations, or reputation. The variable ‘risk factors’ in this study refers to the anticipated level of risk perceived by Islamic banks in employing *musharakah* financing. Past research suggests that the relatively low adoption of *musharakah* financing is attributed to Islamic bank management’s perception of it as a high-risk mode of financing.

Moral Hazard

Moral hazard in banking denotes the danger that emerges when an entity, protected from the repercussions of its activities, will engage in more hazardous conduct (Freixas & Rochet, 2023). Moral hazard emerges from information asymmetry, which can occur due to one party holding more information than the other *musharakah* financing.

Internal shari'ah Review

Internal *shari'ah* Review is operationalized by three dimensions, i.e., the authoritative position of internal *shari'ah* reviewers, the school of *fiqh* followed by the internal *shari'ah* reviewers, and the level of acceptance of *musharakah*-based financing contracts of internal *shari'ah* reviewers.

Government Policies

The quality and sustainability of an investment are significantly influenced by elements of the legal and regulatory framework, encompassing restrictions on tariffs, quotas, taxes, subsidies, and any abrupt alterations to these policies. Hence, it is important to account for these factors in risk assessment. Consequently, they exert a substantial influence on the attitude of bank managers.

Organizational Internal Control System of Financing

Bank's internal control system of financing encompasses three dimensions: the robustness of the internal control system, adjustments in the bank's regulations prompted by market conditions, and the perspective of top management.

Sampling, Reliability and Validity

A self-administered questionnaire has been developed to conduct the study and assess Islamic bank managers' attitude toward *musharakah* financing. The questionnaire items were primarily derived from current research literature, with careful consideration given to content validity, reliability, and design to reduce the likelihood of inaccurate and misleading response recording. Notably, reference was made to different works for constructing the questionnaire (Bradburn, 1989; Bradburn et al., 2004; Foddy & Foddy, 1993; Gait, 2009; Hayes, 2013; Jalaluddin, 2011).

The survey's respondents comprise Five full-fledge Islamic banks managers from three main cities in Punjab Province, Pakistan (see Table 3). They were requested to express the importance of 21 statements outlining significant obstacles in implementing *musharakah* financing. Furthermore, six statements were developed to evaluate managers' views on the implementation of *musharakah* funding, utilizing a five-point Likert scale. According to Mohan (2013), this scale measures attitude ranging from highly positive to highly negative, allowing respondents to express the intensity of their agreement or disagreement with meticulously formulated statements regarding the attitudinal object.

Table 3

Distribution of Respondents according to locations

City	Frequency	Percentage
Lahore	35	70
Faisalabad	9	18
Multan	6	12
Total	50	100

Source: Author generated (Primary Data)

The research used the Statistical Package for Social Sciences (SPSS 22.0) to analyze the collected data. The reliability of the questionnaire was tested through Cronbach's Alpha as a measure of internal consistency (see Table 4). Additionally, the relationship between the variables is tested through correlation and regression analysis.

Table 4

Reliability of the Instrument

Variable	Cronbach's Alpha
Internal <i>shari'ah</i> Governance (ISG)	0.655
Organization Internal Control System of Financing (OICSF)	0.940
Customers' Preferences (CP)	0.933
Government Policies (GP)	0.975
Risk Factors (RF)	0.946
Operational Difficulties (OD)	0.967
Moral Hazard (MH)	0.913
Managers' Attitude towards <i>musharakah</i> financing (MAMF)	0.957
Overall Scale	0.891

Source: Author generated

Next, the validity is performed through factor analysis. To reconstruct the variables, several factor analyses are performed. The items with a score of less than 0.5 are excluded. Therefore, in Table 5, the items with values greater than 0.5 are reported.

Table 5

Factor Analysis

Item	Component						
	1	2	3	4	5	6	7
	ISG	OICS	CP	GP	RF	OD	MH
ISG1	.808						
ISG2	.727						
ISG3	.634						
ISG4	.641						
OICSF1		.874					
OICSF2		.896					
OICSF3		.901					
OICSF4		.866					
OICSF5		.917					
OICSF6		.826					
CP1			.888				
CP2			.807				
CP3			.895				
CP4			.815				
GP1				.940			
GP2				.944			
GP3				.947			
GP4				.958			
GP5				.827			
RF1					.882		
RF2					.845		
RF3					.859		
RF4					.777		
RF5					.894		
RF6					.854		
OD1						.924	

OD2						.957	
OD3						.891	
OD4						.948	
OD5						.906	
OD6						.847	
MH1							.696
MH2							.825
MH3							.846
MH4							.801
MH5							.815
MH6							.844

Source: Author generated

Results and Discussion

Demographic Characteristics

Table 3 shows that 70% of participants are from Lahore, while only 12% were from Multan. Figure 2 depicts the pattern regarding the academic qualifications and working experience of the respond. Most participants have substantial banking experience ranging from 1 to 10 years (84%), with very few having less than a year of experience. Among respondents working in the same bank, the majority (56%) fall within the 1-5 years of experience category, and only one person has more than 10 years of experience in the same bank. Notably, a significant proportion of respondents hold bachelor's degree in Islamic banking or master's degrees in general education.

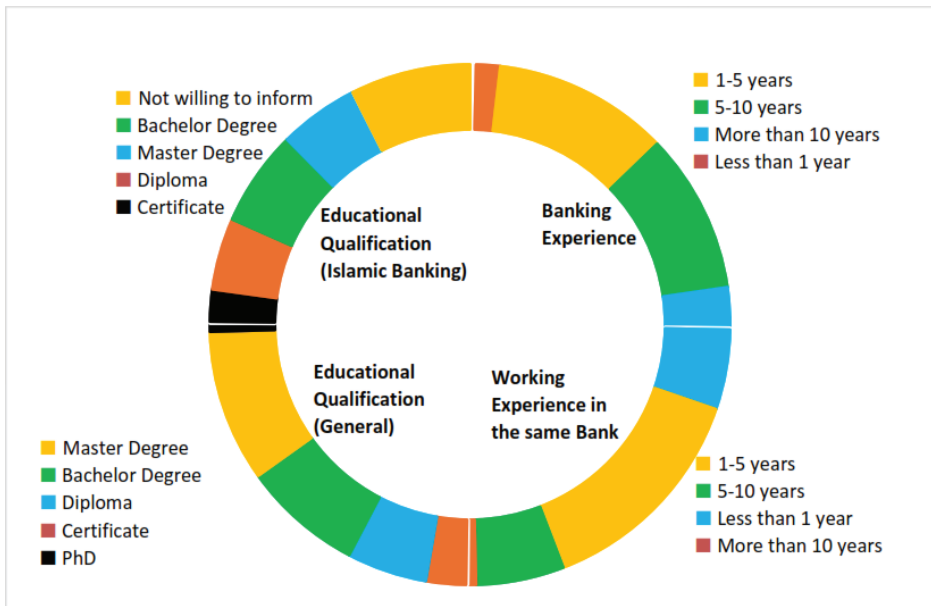


Figure 2: Summary of Respondents' Profile

Source: Authors' generated

Correlation between the Variables

Table 6 displays the correlation matrix among dependent and independent variables. In this study, Pearson correlation is used to test the correlation among the variables. The values of 'r' must lie between +1 and -1 where the '+' shows a positive correlation and '-' expresses a negative correlation. The correlation is weakened when the values are near 0. In Table 6, most of the variables are significantly correlated to each other.

Table 6

Correlation between Predictor Variables and Criterion Variables

Variable	ISG	OICSF	CP	GP	RF	OD	MH	MAMF
ISG	1							
OICSF	-.064	1						
CP	.017	.140**	1					
GP	.137**	.030	.233**	1				
RF	-.055	.016	.391**	.299**	1			
OD	.147**	-.061	.030	.176**	.301**	1		
MH	.010	.093	.136**	.409**	.191**	.125**	1	
MAMF	.111*	-.181**	.159**	.174**	-.127*	-.176**	-.052	1
**. Correlation is significant at the 0.01 level (2-tailed).								
*. Correlation is significant at the 0.05 level (2-tailed).								

Main Findings and Discussion

Ordinary Least Square (OLS) Regression was conducted to study the relationship between independent and dependent variables. The results in Table 7 reveal that internal shariah governance has an insignificant effect on the managers' attitude towards *musharakah* financing.

Table 7

Regression Analysis – Coefficients for Overall Factors on Managers' Attitude

Independent Variables	Dependent Variable
	Manager's Attitude Towards Mushar-kah Financing (MAMF)
Internal Shariah Governance (ISG)	.053 (.053)
Organizational Internal Control Sys-tem of Financing (OICSF)	-.184*** (.050)
Customers' Preferences (CF)	.167*** (.057)
Government Policies (GP)	.153*** (.051)

Risk Factors (RF)	-.002 (.073)
Operational Difficulties (OD)	-.108*** (.040)
Moral Hazard (MH)	-.125*** (.047)
Constant	2.991*** (.400)
R ²	0.126
Adj. R ²	0.109
F Statistics	7.490

Note: *** $p < .01$; Unstandardized coefficients are reported; Standard error is reported in parenthesis

Nonetheless, the internal control system of the firm has a significant yet negative correlation with managers' attitude, suggesting that a tight organizational control system leads managers to develop an unfavorable impression of the implementation of *musharakah* financing. The implementation of risk controls necessitates increased effort from managers, resulting in a negative attitude towards *musharakah* funding. Hanefah et al. (2020) assert that establishing a comprehensive internal control system for *Shar'iah* compliance is essential for the effective operation of Islamic financial institutions (IFIs) to ensure proper governance and management, especially when providing financing to customers. In this context, banks must adhere to strict rules for assessing and overseeing borrowers, which may result in their reluctance to *musharakah* finance and foster a negative attitude towards it.

However, it is undeniable that organizational control systems are essential for managing the bank's risk. Abdul-Rahman et al. (2014) assert that the fundamental element of risk management in financial institutions, particularly Islamic banks, is the internal control system and management information systems utilized for risk monitoring and reporting. The research by Nugraheni and Alimin (2022) underscores the importance of efficient screening, control, and monitoring systems in Islamic banks to enhance and support the financial proposals of clients pursuing PLS-based financing. Moreover, the study suggests that *musharakah* financing is one of the riskier products for Islamic banks and necessitates substantial risk management strategies.

Hooker (2013) indicates that businesses in Pakistan attempt to alter tax filings and avoid taxes. In *musharakah* finance, partners expect precise financial disclosures, leading enterprises to seek alternatives to this financing method. Table 7 illustrates a considerable and direct correlation between customer preferences and managerial views about *musharakah* finance. Consequently, a lack of client demand for *musharakah* finance will result in a negative attitude among managers towards this financing method, and *vice versa*. The findings further indicate that supportive governmental policies regarding *musharakah* funding fostered a good attitude among managers.

Moreover, Dar and Presley (2000) and Yustiardi et. al. (2020) identified that the inherent risk associated with *musharakah* financing discourages Islamic banks from pursuing this mode of financing. Surprisingly, Table 7 shows an insignificant impact of risk factors on managers' attitude toward *musharakah* financing, suggesting that managers are not concerned with the risks involved in extending financing through *musharakah*. Likewise, Khan and Bhatti (2008) assert that problems, such as operational difficulties in executing *musharakah* financing, create obstacles to the successful implementation of PLS instruments. The findings indicate a significant negative correlation between operational challenges and managers' perceptions of *musharakah* funding. It shows that with the increase in the operational difficulties in implementing *musharakah* financing the managers' attitude towards *musharakah* financing turns negative.

Sapuan (2016) identified that, among other impediments, moral hazards and legal requirements are two major issues that lead to the reluctance of Islamic financial institutions to adopt PLS contracts. The results show that there is an inverse but significant relationship between moral hazard and managers' attitude towards *musharakah* financing (see Table 7). Given that revenues are distributed between the Islamic bank and the consumer, there exists a significant likelihood that the customer may underreport profits or declare losses. Consequently, owing to the moral hazards managers tend to avoid *musharakah* financing.

Conclusion & Implications, and Limitations

This study aimed to investigate the factors that affect the manager's attitude towards *musharakah* financing. It is found that customer preferences, operational difficulties, moral hazards, government policies, and the bank's internal control system of financing substantially influence managers' attitude towards *musharakah* financing. Nonetheless, Internal *shari'ah* Governance and Risk Factors do not substantially influence managers' perceptions of *musharakah* financing.

This study is significant for practitioners in Islamic banking. For example, enhancing the internal control system of financing by streamlining protocols, fostering customer confidence in *musharakah* financing, developing strategies to mitigate or manage associated risks, alleviating operational challenges, and formulating strategies to minimize moral hazards. In this manner, the bank could enhance management's confidence to advocate for or recommend *musharakah* financing to the end clients. This study argues for the active engagement of the State Bank of Pakistan (SBP) in advancing the Profit and Loss Sharing (PLS) mechanism within banking intermediation, while fostering a conducive climate and providing support to Islamic institutions.

This study has limitations because it only looked at managerial-level employees of fully operational Islamic banks located in three major cities in Pakistan's Punjab province. As a result, the findings cannot be applied to other staff levels. The variables selected for this study are extracted from the past research literature, and their significant impact on the attitude of Islamic bank managers may differ across various regions. Subsequent investigations may benefit from revisiting this association using a more extensive dataset, ideally integrating the data from Islamic banks' head offices in Pakistan as well as other parts of the world. This approach would offer a broader scope for analysis and enhance the comprehensiveness of the research findings.

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