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The impact of participatory Islamic finance on Shari'ah banks' profitability

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ABSTRACT

Shari'ah Banks offer financing based on Islamic values, fairness, equity, and ethics, promoting stable economies and prosperous societies through employing a variety of methods, including participatory finance. The aim of this research is to investigate how participatory financing impacts the profitability of Shari'ah banks in Somalia. Specifically, the study focused on analyzing the influence of mudarabah and musharakah financing on Islamic banks' profitability. The research employed a correlational design to examine the relationship between variables, and primary data was analyzed using SPSS. The results of this study indicate a strong positive correlation between participatory Islamic financing and the profitability of Shari'ah Banks. The findings suggest that both mudarabah and musharakah financing have statistically significant positive effects on the profitability of Shari'ah Banks. According to the findings, the study concluded that an increased implementation of participatory Islamic financing methods could potentially enhance banking institutions' profitability and performance. Moreover, the article recommends that Shari'ah banks should expand their services, increase product exposure to attract new customers, promote participatory Islamic financing, and develop clear risk-handling policies and strategies. This paper adds valuable insights to the existing literature on Islamic banking and finance while also providing guidance for Islamic financial institutions to improve their profitability, growth, and performance through participatory Islamic finance.

Contribution/ Originality: This research delves into a unique aspect of Islamic finance: the impact of participatory Islamic financing on profitability. Unlike prior studies that mainly explored the characteristics, profit margins, or nature of Islamic banks, this work focuses on a fundamental pillar of Islamic banking: participatory Islamic finance. This perspective sheds light on how this core feature influences the financial performance and profitability of Islamic banks, offering valuable insights for both academic research and practical industry applications.

1. INTRODUCTION

In 1963, the concept of Islamic Finance began to take shape in Egypt with the establishment of the first Shariah-compliant bank, Mith Gamr. Since then, over 1,000 Islamic financial institutions have emerged worldwide in the global financial landscape (Hanafi, 2021; ICD-Refinitiv, 2020). In the first stage, Islamic finance practices were initiated to serve political and cultural purposes; however, Islamic banks operationally play two critical roles in the financial environment: first as fund collectors from the public and second as fund distributers to society (Budiandru, 2021; Trisanty, 2018). Virtually, the Shari'ah banks fill this intermediary role by delivering several financial services, including profit sharing, profit and loss sharing, profit margin, fee-based services, interest-free loans, and other services that promote Islamic identity, economic development, and social justice (Kulmie, Abdulle, Hussein, & Mohamud, 2023). These institutions are rapidly growing regarding their assets, products, and clients (Hassan, Kayed, & Oseni, 2013). This shows how they play a critical role in the global financial industry, attract and retain customers, and innovate new Islamic financial services applicable to both Muslim and non-muslin communities.

The financial industry addresses society's investing and financing needs through a variety of means. The conventional banking system usually provides interest-based financing, while the Islamic banking system delivers real interest-free financial services to the community (Ahmad, 1994; Usmani, 1999). The difference lies in the philosophical, social, and economic principles that shape both systems, i.e., traditional and Shari'ah banking (Haron & Azmi, 2009). Moreover, scholars and numerous researchers critically argue that the Islamic financing system is a better alternative to the traditional financing system (Alrifai, 2015). In recent years, the Islamic finance industry has tremendously grown by over 20% yearly (Dawami, 2020). This is especially evident in the countries that have significantly supported their Islamic financial systems. Despite their characteristics and growth, Islamic financial institutions face risks, competition, and restrictive legal frameworks. The financing need for businesses and projects arises due to several reasons, including natural differences in resource endowments (Kahf & Khan, 1992). To effectively address these financing needs, Islamic banks use two prominent methods: profit sharing and profit and loss sharing. Both fundamentally make Islamic financing unique and crucial to the Islamic bank itself, business, and even projects. Simply put, participatory financing, based on risk and reward sharing, encompasses both profit sharing and profit and loss sharing. Islamic commercial banks are part of the country's financial system and play a crucial role in the business industry through financing projects, working capital, and even productions (Kulmie, et al., 2023). This clearly shows how Islamic financial institutions, through their financing instruments, such as participatory financing, contributed to the development of the economy, productive sectors, and social development (Kassim, 2016).

At the business level, Islamic finance practices significantly enhance the performance, resilience, and profitability of banking institutions (Kulmie, et al., 2023; Mas'ud, Setiawan, & Yuliarti, 2020). Scholars have mostly studied this industry, looking at the system's characteristics, governance, and structure. Before the 1970s, scholars eagerly established the theoretical foundations of this new model, focusing on the big picture, but Islamic banking practice primarily concentrates on profit margin contracts and a few mudarabah financings due to several reasons, including simplicity, riskiness, and capital requirements. As a result, participatory Islamic finance methods have not significantly increased. Yet, most of the studies concentrate on the non-participatory financing or conceptual aspects of the model. However, several studies on the effect of participatory Islamic finance, particularly profit and loss sharing (PLS) financing, on bank profitability, growth, sustainability, and riskiness were conducted by researchers including Alandejani and Asutay (2017), Abusharbeh (2014) and Grassa (2012) among others. The literature depicts conflicting results among researchers. Thus, the purpose of this study is to investigate the impact of Islamic participatory financing on Shari'ah banks' financial performance. Specifically, the study looked at the effects of profit-sharing (Mudarabah financing) and profit-and-loss-sharing (Musharakah financing) on Shari'ah banks' profitability.

2. CONCEPTUAL REVIEW

2.1. Foundations of Islamic Banking and Finance

Islamic finance is rooted in the principles of Shari'ah and, similar to other facets of Muslim existence, financial matters are governed by Islamic law in a manner distinct from conventional financial systems. The foundation of this unique system of life originates from the tawhid-centered worldview; further, this tawhid principle is the central element of all issues in Muslim society (Elgar, 2007; Hassan & Lewis, 2014). It shapes socioeconomic and financial matters through fair resource mobilization, production, and financing (Elgar, 2007). The fundamental Islamic principles that strictly govern financial matters must be followed in all business and investment issues (Lewis & Algaoud, 2001). As noted by Budiman, Satyakti, and Febrian (2021); Visser (2019) and Tlemsani and Al Suwaidi (2016) these rules are: (a) avoiding riba; (b) undertaking only halal (legal, permitted) business; (c) escaping maysir (gambling) and gharar (speculation or unreasonable uncertainty); (d) paying zakat; (e) promoting Islamic values and ethics; and (f) contributing to social advancement. Islamic financial institutions have a Shari'ah advisory board that supervises all transactions to ensure their compliance with Shari'ah principles, and currently this board formally exists in the structure of the Islamic financial institution (Alam, Ab Rahman, Mustafa, Shah, & Hossain, 2019; Rahman, 2010) since they play a crucial role as Shari'ah stands as the backbone of the Islamic financial system (Hassan & Lewis, 2014).

2.2. Islamic Participatory Financing

The Islamic financial system has a global orientation and currently presents its presence on international financial platforms due to its innovation, ethics, and resilience to crisis (Kulmie, et al., 2023; Team, 2014). The Islamic Financial contracts principally concern debt-creating modes and participatory modes. Participatory modes of financing are based on profit sharing and profit and loss sharing, while debt-creating methods are based on fixed charges. In terms of risk characteristics, the debt-creating modes are less risky compared to the participatory modes, which are characterized by considerable risk in nature (Abdul-Rahman & Nor, 2016). The participatory financing methods practically show that Islamic finance principles of equity, participation, and ownership are in place and play an essential role in developing, investing, and financing projects, small businesses, corporate firms, and government programs that all contribute to social advancement, economic growth, financial stability, and resilient institutions. In reality, Islamic finance has become prominent and obvious in the global financial system, and it has proven itself as a competitor of the conventional financial system (Rabbani et al., 2021; Tahir, Bakar, Ismail, & Wan, 2006).

2.2.1. Mudarabah Financing

Mudarabah is a profit-sharing model of business between the financier (Rabul Mal) and the entrepreneur (Mudarib). An entrepreneur always seeks profit, growth, and financial freedom. An entrepreneur is someone who creates and manages a business and is willing to face risk and earn profit (Kulmie, Abdulle, et al., 2023; Rusu, Isac, Cureteanu, & Csorba, 2012). They play a vital role in business, industry, and economic development by bringing ideas, creating jobs, and developing processes, systems, and models (Kulmie, et al., 2023; Nor, 2021). According to Nouman and Ullah (2023b) and Alrifai (2015) mudarabah is a financing agreement or contract where the financier (investor) provides the necessary capital or fund and the entrepreneur contributes his knowledge, skills, and experience. It allows both parties to share profits from the new business, while only the capital contributor takes all losses fully, unless there is negligence performed by the entrepreneur (Iqbal & Mirakhor, 2011). Islamic banks can function as mudaribs (capital providers) and sometimes become agents. The Islamic bank becomes a mudarib (capital provider) when it accepts to finance the projects while the entrepreneur contributes only skills and experience, and both agree to share the profits from the project or venture being financed. Conversely, the Islamic bank becomes an entrepreneur if individuals make deposits to the bank under a mudarabah, treating them as investments in the bank, and the Islamic bank uses these investments to make profits (Otuyo & Abiodun, 2021; Ryandono, Kusuma, & Prasetyo, 2021).

Further, under the mudarabah contract, the capital provider should clarify whether it is restricted or unrestricted mudarabah. If it is restricted, the entrepreneur must follow fully the instructions of not investing the funds in prescribed industries, projects, and locations, while unrestricted mudarabah gives the entrepreneur the capacity to choose or select the applicable industry or project to generate profit for both himself and the money owner. The legal principles of mudarabah transactions do not make religion a condition for the validity of a contract, but it makes it compulsory for the parties to have the capacity to enter the agreement, and the capital should be in monetary form (as the view of the majority of jurists), specified, determined, and known, and available cash (not debt) be delivered to the possession of the entrepreneur (mudarib) completely (Rahman, 2010). All losses from the mudarabah operations will be borne by the capital provider, with the condition that these losses are not caused by the negligence of the entrepreneur (s) (Alrifai, 2015; Iqbal & Mirakhor, 2011; Rahman, 2010). In terms of structuring a mudarabah contract, the mudarabah contract can be formed in many ways. The first can be a simple or bilateral mudarabah in which only two parties, i.e., a Shari'ah bank and an entrepreneur, establish the venture, and the second can be a multilateral mudarabah, which can be one of the following two types: Multilateral mudarabah, in which there is one investor and two or more entrepreneurs. In this situation, the fund owner provides capital to, for instance, an Islamic bank (an immediate entrepreneur), and then the Islamic bank transfers the fund to another entrepreneur (a final entrepreneur). The other type is when there are many capital providers and one entrepreneur (Rahman, 2010). Figure 1 illustrates Mudarabah financing structure.

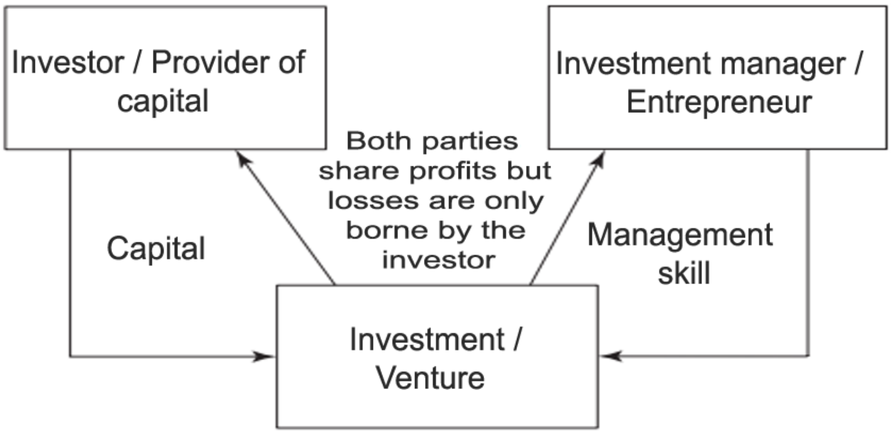

Figure 1. Mudarabah financing.

Source: Alrifai (2015).

2.2.2. Musharakah Financing

The word 'Musharakah' simply means sharing, and it means a joint enterprise, or joint commercial enterprise, in which all parties contribute investment capital, labor, management, and expertise, as well as share the profit and loss of the venture (Islam & Ahmad, 2022). Moreover, Musharakah constitutes the partnership concept and the ideal model of financing and is typically appropriate for financing business ventures and business projects (Islam & Ahmad, 2022). Under this model, all parties contribute capital either in cash or in kind, so that all parties become co-owners of this business. These parties should have the capacity to engage in the partnership contract with free consent, no force, misrepresentation, fraud, etc. (Jais, Sofyan, & Bacha, 2020). In the Musharakah structure, all members have equal rights to participate in the management process if there is no individual or group assigned to this role (Nouman, Ullah, & Jan, 2022). As its name suggests, the profit and loss sharing principle states that all parties should share either profit and loss based on the agreements or contracts developed before the business venture has started its operations. If there is a "sleeping partner", his profit should not exceed the extent of his investment (Rammal, 2004).

As noted by Rammal (2004) Musharakah can be an unlimited, unrestricted, and equal partnership where all partners have the same amount of capital, management role, and disposition rights. Additionally, there is another, more limited investment partnership. Generally, we can summarize it as follows: Permanent musharakah and diminishing partnership. The first type does not have an established end date; it continues to operate for as long as the parties involved are willing to, and it is usually used for long-term project financing (Abdalla, 1999; Kayed, 2012). For instance, investors commonly use the latter type to purchase real estate. The investor and the bank jointly purchase the property (Agustiar, 2021). The bank then gradually gives the investor a share of the property's equity in exchange for payments. The Musharakah business venture can come to an end if its maturity date is reached, the partner dies, or he wants to be out of the contract. In this case, it is permissible for the parties to solve the issue through the liquidation, partition, or distribution of the assets based on their preferences and choices in a peaceful, ethical, and legal way (Team, 2014). Figure 2 illustrates Musharakah Financing Structure.

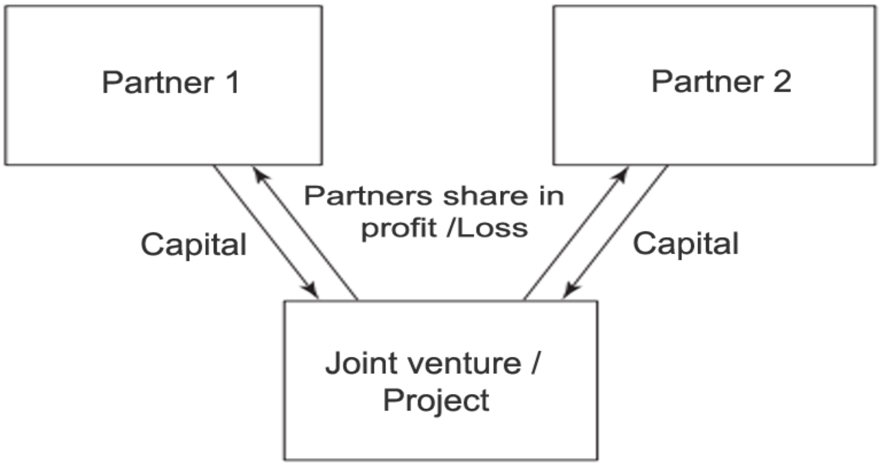

Figure 2 Musharakah financing.

Source: Alrifai (2015).

2.2.3. Application of Participatory Islamic Financing

Ideally, finance is an essential component of growth (Abu - Bader & Abu - Qarn, 2008) and business development. Islamic banks have a strategic role in bridging the gap between investors and the industry (Ng & Ariff, 2019) as well as making money more efficient and effective as it goes to the real economic sector and increasing economic value at the macroeconomic level (Budiandru, 2021). Participatory financing is widely accepted and considered the real style of financing that truly presents the actual nature of Islamic finance (Nouman & Ullah, 2023a). However, Shari'ah banks need to carefully evaluate participatory financing transactions to avoid the risk of non-performing financing contacts (Budiandru, 2021). As noted by Khoutem and Nedra (2012) the Shari'ah bank's role can be viewed as participative financial intermediation, facilitating financing and investing processes. Business firms, governments, entrepreneurs, and families require financing for a variety of reasons, and dealing with financial intuitions is one of the primary sources of financing. Likewise, the Shari'ah-compliant banks try to find profitable opportunities with acceptable risk, and consequently, funds are directed to any attractive project, business, or contract that increases their profitability, growth, and sustainability. Several Islamic financial products employ participatory financing. The mudarabah contract is applied to various deposits and financial products such as investment accounts, saving account project financing, Islamic funds, takaful products, and mudarabah sukuk (Hassan et al., 2013). Similarly, Musharakah financing is applied to several Islamic financial products, including trade financing, project financing, home financing, Musharakah letters of credit, Musharakah sukuk, and shares and equity products of Islamic funds (Hassan et al., 2013). Although participatory finance is the original fashion of Islamic finance (Nouman, Ullah, & Jan, 2019) its implementation is limited due to considerable risk, asymmetrical information issues, moral hazard, and a lack of trustworthy entrepreneurs (Yustiardhi, Diniyya, Faiz, Subri, & Kurnia, 2020).

2.3. Profitability

Profitability is the excess of income over expenses of the Shari'ah bank. Okphiabhele, Ibitomi, Dada, and Micah (2022) defined profitability as a business's capacity to generate revenue that is greater than the costs related to producing that revenue across all of its activities. When banks are profitable, it shows that they are committed to operating and realizing their goals. Profitability is an indicator used in measuring performance as it shows the management's effectiveness and efficiency in utilizing resources to produce a positive net return (Wahyuni & Handayani, 2022). Assessing bank performance is a difficult and complex process that involves measuring interactions between the environment, internal processes, and external activities (Ahmednoor, 2012) such as capital, credit, size, liquidity, risk control, management choices and decisions, inflation, competition, and market share (Sadiq & Omolara, 2023; Tan & Floros, 2012). Numerous studies investigated the performance and profitability of Islamic banks, including Kulmie, et al. (2023); Ahmednoor (2012); Asutay and Izhar (2007) and Diamond and Rajan (2001) using different indicators and models. As noted by Ahmednoor (2012) the prominent measures are CAMEL framework, market structural factors, ownership, and market concentration. CAMEL is an acronym standing for Capital adequacy, Asset quality, Management efficiency, Earnings performance and Liquidity.

Moreover, regulatory, and supervisory bodies employ the CAMEL model for performance assessment (Ilhomovich, 2009). Kosmidou (2008) argues that high capital and non-performing loans lead to low profits (Kidwell, Peterson, & Blackwell, 2000). There are specific performance measures regarding profitability, such as returns on assets, returns on equity, profit margin, and the net non-interest margin (Kidwell et al., 2000). Banks need to be competitive and profitable to cover their costs and maximize their wealth. The bank management should critically design effective strategies to enhance profitability and liquidity, as well as avoid risk and failure. To understand management capacity and performance, evaluate management systems, control mechanisms, and other factors (Echekoba, Egbunike, & Ezu, 2014). Management efficiency can be assessed with reference to diversification ratios, asset utilization ratios, expenditure-to-income ratios, and so on (Sangmi & Nazir, 2010). All these directly affect the profitability and performance of financial service firms. Since the goal of Shari'ah banks is to maximize profit and their wealth while controlling risks, it is essential to strategically plan their financing structures and procedures. However, the success of partnership businesses funded through participatory financing depends on management decisions (Nidaussalam, 2016). Therefore, Shari'ah Banks must constructively analyze the partners' management capacity to manage the business venture or project.

2.4. Conceptual Framework

The conceptual framework presented below in Figure 3 illustrates the relationship between the study variables. It shows how participatory financing as an independent variable affects the profitability of Shari'ah banks as a dependent variable.

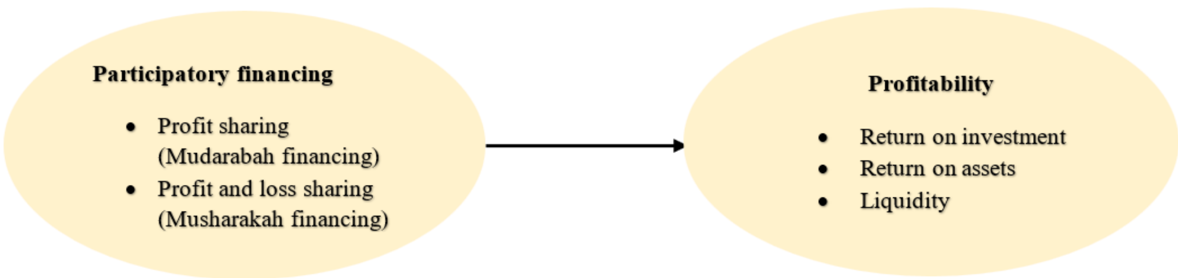

Figure 3. Conceptual framework.

3. REVIEW OF EMPIRICAL EVIDENCE

Islamic financial institutions have consistently struggled to prove themselves as a viable alternative to the traditional banking system and currently play a crucial role in the global banking industry. Studies show that the Islamic financial system is growing extremely fast and is an innovate and profitable industry (Alaoui & EL Marzouki, 2022). Participatory finance consists of mudarabah and musharakah financing, in which Shari'ah banks provide finance to others with the aim of earning profit. This method allows these institutions to maintain the value of their assets during tough business situations and crises (Čihák & Hesse, 2010). Several scholars have demonstrated that Islamic banks' ability to generate profits is essentially dependent on their financing methods (Bukhari & Qudous, 2012). Earlier studies have confirmed that financing based on profit sharing and profit-loss sharing (Mudarabah and Musharakah) increases the profitability of Islamic banks (Asutay & Izhar, 2007).

According to Syahri and Harjito (2020) profit-loss sharing arrangements can benefit shareholders in Islamic banking structures. In fact, researchers discovered that Islamic banks are remarkably successful. Theoretically, Islamic banks are required to retain more capital for financing purposes (Diamond & Rajan, 2001) to earn profit. As stated by Husain, Affandi, and Shukur (2015) a variety of internal factors, in particular choices about their financing modes, have a significant and positive influence on Malaysian Islamic banks' profitability. After analyzing the financial performance of Saudi Arabia's commercial banks, Gaddam, Al Khathlan, and Malik (2009) discovered a favorable correlation between financial performance and asset size, asset utilization, and operational efficiency. Ahmednoor (2012) reached similar findings, examining Islamic banking products and financial performance, and found a significant positive correlation between the size of an Islamic bank's product and its financial performance. Furthermore, Gustriani, Sari, Anggraeni, and Arnan (2020) found that mudarabah (profit-sharing) and musharakah (profit-loss-sharing) financing have a significant impact on bank profitability.

In their study, Kulmie, et al. (2023) explored the effects of Islamic financing methods on the profitability of financial institutions and concluded that an increased use of these methods, particularly mudarabah, is expected to significantly boost banking institutions' profitability. Nouman et al. (2022) looked at what makes Musharakah work in Pakistan's Islamic banking sector. They discovered that while Mudarabah and Musharakah are seen as good ways to finance businesses, they are hard to put into practice because of issues with working capital and commodities. They identified five contributing factors to the expansion of participatory financing: diversification, improved applicability, execution of large-scale projects, government intervention, and regulatory oversight. Both studies emphasize that Islamic participatory finance involves risk and reward sharing among investors, thereby promoting ethical and responsible investment practices. Furthermore, they highlight its role in fostering financial inclusion by providing access to capital for individuals and businesses while enhancing the overall performance and profitability of all involved parties. Belkhaoui, Alsagr, and Van Hemmen (2020) conducted a study on the financing methods, risk, efficiency, and Islamic banks' profitability in GCC countries. Their research reveals that financing options can influence the profitability of Islamic banks both directly and indirectly, with risk and cost-efficiency factors contributing to the indirect effect. In a separate study, Yanikkaya, Gumus, and Pabuccu (2018) examined the profitability trends of Islamic and conventional banks in the United Kingdom and Islamic Cooperation nations from 2007 to 2013. Their findings suggest that profit-loss-sharing financing encourages greater risk-taking than profit-margin contracts, which could boost Islamic institutions' profitability. Furthermore, Talam (2014) analyzed the impact of banking practices on financial performance in Kenya by examining annual reports from thirteen commercial banks. The results revealed that the Islamic banking ratio, bank size, capital ratio, and liquidity ratio all had a beneficial impact on financial performance. Consequently, it was concluded that Islamic banking had a favorable impact on the financial performance of Kenyan commercial banks.

Iqbal, Fikri, and Ahmi (2023) conducted a study to examine the relationship between profit and loss sharing, credit risk, and profitability of Shari'ah banks in Pakistan. Their research using secondary data from certain Islamic banks in Pakistan showed that there was a strong positive relationship between return on equity and musharakah in those secondary data sets. According to the research, Shari'ah banks should increase their support for Musharakah in order to mitigate high credit risk exposure. Additionally, the study proposes that Islamic banks can enhance their financial performance by implementing policies aimed at reducing credit risks and improving profitability. In a similar vein, Syahri and Harjito (2020) explored the impact of financing using profit-loss sharing principles on the profitability of commercial Islamic banks registered with Bank Indonesia. Their investigation revealed that Sharia Banks' profitability is significantly affected by financing products with profit-loss sharing principles such as

Mudharaba and Musharaka. Furthermore, as highlighted by Nouman and Ullah (2023) and Nor and Ismail (2020) participatory financing methods are designed to facilitate the achievement of Shari'ah's objectives, including prohibiting riba' and promoting trade, fair wealth distribution, economic growth, brotherhood, and peace in society. In summary, this approach enhances financial inclusion by supporting entrepreneurial activities, thereby strengthening partnerships within industries and the financial sector.

More than 20 years ago, Bashir (2000) assessed the performance of Islamic banks in the Middle East. The empirical analysis and results from this study shed light earlier on the relationship between banking features and performance indicators in Islamic banks and revealed that the profitability measurements of Shari'ah banks are favourably impacted empirically by increases in capital and loan ratios. Although several studies show mixed results regarding the profitability of Islamic banks, others, including Onakoya and Onakoya (2013), Siraj and Pillai (2012) and Moin (2008) compare both Shari'ah banks and traditional banking systems in terms of capital, efficiency, risk, and performance. For instance, Metwally (1997) examined the performance of 15 interest-free banks and 15 conventional banks and concluded that the two systems can be differentiated in terms of credit risk, liquidity, and leverage but not in profitability and efficiency. Moreover, numerous studies, both old and contemporary, including Mas'ud et al. (2020); Sitompul and Nasution (2019); Rahman and Rochmanika (2012) and Asutay and Izhar (2007) all discovered a favorable correlation between participatory financing and banks' ability to earn profits.

4. DESIGN AND METHODOLOGY

4.1. Research Design, Population, and Sample

A research design is employed to ensure that the data gathered is relevant and sufficient for responding to inquiries drawn from a specific study (Creswell & Clark, 2017). The study used a correlational design to determine the relationships between two or more variables (Singh, 2022). This allows us to measure the association among variables. The population of this study comprised directors, heads of departments, accountants, and employees of Salaam Somalia Bank in Mogadishu, Somalia. Krejcie and Morgan (1970) determined the sample size of 56 respondents. A census sampling technique and stratified random sampling were applied to select directors, heads of departments, accountants, and lower-level employees, respectively. The first method effectively eliminates the possibility of personal bias, which is beneficial for the study's outcomes, while the second one allows for the selection of a sample population that accurately represents.

4.2. Data Collection and Analysis

The study used primary data for the purpose of examining the effect of participatory financing on the profitability of Shari'ah banks. The data was collected through a closed-ended questionnaire. The validity of this instrument was calculated by using the content validity index (CVI). As a result, CVI's score was 0.87, which is reliable. Similarly, the reliability of the instrument was also tested using the Cronbach Alpha Method, and Cronbach's Alpha coefficient is 0.962, which means that the instrument was dependable (Straub, Boudreau, & Gefen, 2004). In addition, the Statistical Package for Social Scientists (SPSS) programme was utilized to analyze the data gathered from research participants and determine how the study variables related to one another.

5. RESULTS AND DISCUSSIONS

5.1. Demographic Information

According to the results in Table 1, men made up the most respondents (73.21%), with women making up 26.79% of the total. Cultural beliefs and social norms are among the factors contributing to this gender gap. The table also reveals that respondents who were 25 to 30 years old (46.43%) made up the majority, while those who were 31 to 36 years old (32.14%) came in second. A total of 7.14% of respondents were between the ages of 20 and 24, while 14.29% were beyond the age of 36. According to the results of the educational level test, 25% of the participants had diplomas, 66.07% had bachelor's degrees, and 8.93% had master's degrees. This indicates that study participants had a sufficient level of literacy and were better able to comprehend and evaluate the questionnaire's contents (Blair, Czaja, & Blair, 2013).

Table 1. Demographic information.

		Frequency	Percentage
Gender	Female	15	26.79
	Male	41	73.21
	Total	56	100
Age	20 – 24	7	7.14
	25 – 30	26	46.43
	31 – 36	18	32.14
	Above 36	8	14.29
	Total	56	100
Education level	Diploma	14	25.00
	bachelor's degrees.	37	66.07
	Master's degrees	5	8.93
	Total	56	100

5.2. Effects of Participatory Financing on the Profitability of Shari'ah Banks

The key goal of this study was to examine the effect of participatory Islamic financing on Shari'ah Bank's profitability in Somalia. The first objective was to examine the effects of profit sharing (mudarabah financing) on the profitability of shari'ah banks, while the second objective was to investigate the effects of profit and loss sharing (musharakah financing) on the profitability of shari'ah banks in Somalia. The empirical analysis's findings show a strong correlation ($r = 0.776$, $p < 0.05$) between profit sharing (mudarabah financing) and the profitability of Shari'ah banks. The results from the empirical analysis reveal that there is a strong correlation between profit sharing (mudarabah financing) and Shari'ah Bank's profitability ($r = 0.776$, $p < 0.05$). This shows that profit sharing (mudarabah financing) has a statistically positive effect on Shari'ah Bank's profitability, as shown in Table 2. This was based on the view of the most respondents, who agreed with the view that the profit-sharing structure of Islamic banking can increase its profitability. Therefore, we anticipate that expanding the use of Mudarabah will increase profitability.

Table 2. Correlations between Mudarabah (Profit sharing) and profitability of banking institutions.

		Mudarabah	Profitability of IBs
Mudarabah	Pearson correlation	1	0.776**
	Sig. (2-tailed)		0.000
	N	56	56
Profitability	Pearson correlation	0.776**	1
	Sig. (2-tailed)	0.000	
	N	56	56

Note: **. Correlation is significant at the 0.01 level (2-tailed).

Furthermore, as shown in Table 3, the mudarabah beta rating is 0.776. Based on the findings of the study, this demonstrates that a 100% increase in Mudarabah is anticipated to lead to a 77.6% increase in the profitability of shari'ah banks. This improvement can be realized only when Shari'ah banks provide all the necessary funds needed by their clients in their profit-sharing arrangement scheme with reasonable risk after assessing their skills and experience in business. Furthermore, the banks should not intervene in the business venture's management. All these issues help to establish a mudarabah-based business venture and run it smoothly, which eventually produces profits for both the capital provider and the entrepreneur.

Table 3. Coefficients[a].

Model		Unstandardized coefficients		Standardized coefficients	t	Sig.
		B	Std. error	Beta		
1	(Constant)	0.286	0.345		0.829	0.411
	Mudarabah	1.171	0.130	0.776	9.039	0.000

Note: a. Dependent variable: Profitability.

The study also investigated the influence of profit and loss sharing (Musharakah financing) on the profitability of Shari'ah banks in Somalia. The findings demonstrated a statistically significant and positive correlation between these variables. The Pearson correlation coefficient findings displayed a statistically significant positive correlation between profit and loss sharing and bank profitability ($r=0.884$, $p<0.05$), as presented in Table 4. The majority of participants affirmed that the profit and loss sharing or musharakah financing structure has the potential to enhance Shari'ah Bank's profitability, leading to this conclusion.

Table 4. Correlations between Musharakah and profitability of Islamic commercial banks.

		Musharakah (Profit-loss sharing)	Profitability of IBs
Musharakah	Pearson correlation	1	0.884**
	Sig. (2-tailed)		0.000
	N	56	56
Profitability	Pearson correlation	0.884**	1
	Sig. (2-tailed)	0.000	
	N	56	56

Note: **. Correlation is significant at the 0.01 level (2-tailed).

As per the data presented in Table 5, it is evident that the coefficient (r) stands at .884 with a p-value of less than 0.05. The positive nature of the r value signifies a substantial and positive influence of profit and loss sharing (musharakah financing) on the profitability of Islamic shari'ah banks. Consequently, the findings lead to the conclusion that a 100-unit increase in musharakah financing or contracts will result in an 88.4-unit rise in the profitability of Islamic Commercial Banks. The profit and loss sharing model can work effectively when all partners have enough information concerning the partnership since it improves their decision making, and partners need to clarify all necessary issues regarding the establishment, operation, and management. In general, shari'ah banks should have a written policy about profit and loss sharing structures.

Table 5. Coefficients[a].

Model		Unstandardized coefficients		Standardized coefficients	t	Sig.
		B	Std. error	Beta		
1	(Constant)	-0.168	0.257		-0.654	0.516
	Musharakah	1.286	0.092	0.884	13.911	0.000

Note: a. Dependent variable: Profitability.

This research was guided by two objectives. The first objective was to examine the effects of profit sharing (mudarabah financing) on the profitability of shari'ah banks. The results indicate that there is a statistically positive relationship between these two variables. The findings are in line with several previous studies, such as Alzoubi (2017) who stated that mudarabah is one of the most profitable financing tools. The study is also consistent with Belkhaoui et al. (2020); Islamiyati and Diana (2021); Yanikkaya et al. (2018); Rahman and Rochmanika (2012); Čihák and Hesse (2010) and Asutay and Izhar (2007). All these studies reveal that profit-sharing (mudarabah financing) instruments can help Shari'ah banks improve their profitability. The second objective was to investigate the effects of profit and loss sharing (Musharakah financing) on the profitability of Shari'ah bank's profitability in Somalia. The empirical analysis demonstrated that profit and loss sharing (Musharakah financing) has a significantly positive effect on Shari'ah bank's profitability. This finding is consistent with some previous studies, including Mwangi (2014), Rahman and Rochmanika (2012), Bashir (2000) and Ismael (2014). These studies argued that Shari'ah banks will perform better when they provide more Islamic financial products, particularly participatory financing.

6. CONCLUSION AND RECOMMENDATION

The purpose of this research was to investigate how participatory financing affects the profitability of Shari'ah banks. The results indicated that profit sharing and profit and loss sharing have a statistically significant positive impact on Shari'ah banks' profitability. The study concluded that implementing participatory financing to a greater extent could potentially enhance banking institutions' profitability. The presented research advises the bank's leadership to broaden the range of financial services provided and enhance the visibility of their products to appeal to a wider customer base. This should include a targeted effort to promote participatory financing through strategic financial service marketing initiatives. We also advise Shari'ah banks to thoroughly assess the risks associated with projects and partners, as these risks have the potential to harm the bank's assets. Moreover, it is crucial for these banks to develop clear policies, strategies, and frameworks for handling participatory financing. Lastly, the government and relevant institutions should provide support for the implementation of participatory financing through legal frameworks, technical assistance, and collaborations.

6.1. Limitations of the Study and Future Research Suggestions

We conducted this study in Mogadishu, Somalia, with a sample size of 56 respondents. Both sample size and study area may influence the generalizability of the results. Also, the study used a questionnaire as a research instrument, which may cause bias. But these are not major concerns for the validity of the study's findings, as respondents were well-literate and better equipped to understand and evaluate the questionnaire's content. However, it is better to study with larger samples and different methodologies. Since this study is crucial for understanding Islamic banking and finance theory and practices as it examined one of the main modes of financing employed by these institutions, it suggests further study on the application of participatory Islamic finance and how it is related to Islamic bank's risk exposure and control. Similarly, it is suggested to carefully study the nexus between participatory Islamic finance and sustainable development.

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