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Factors Affecting Profit Distribution Management of Islamic Banks: Moderating Role of Corporate Governance

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Abstarct

This study aimed to ascertain the factors that affect the Profit Distribution Management (PDM) practices employed by Islamic banks (IBs) to retain their market share. It further analysed whether the presence of Islamic corporate governance can smoothen the profit sharing mechanism followed by the IBs. The study utilized the panel data analysis technique to analyse the data collected from 40 full-fledged IBs for the period 2010-2017 from three different regions, that is, South Asia, Middle East and South East Asia. The findings of the study support the premise that third party funds, asset composition, capital adequacy and market share all have a significant and positive impact on the PDM practices of IBs. Moreover, Islamic corporate governance strengthens the relationship between market share and the PDM practices of IBs. The results of this study have policy implications for the regulators of IBs and financial institutions as they provide insight into the factors that affect the PDM practices of IBs.

Keywords: asset composition, Islamic corporate governance index, market share, Profit Distribution Management (PDM), third party funds

Introduction

The flexibility of Islamic Banks (IBs) helped the economy to recover from the global financial crisis in the 21st century. This flexibility is a major cause of the development of the Islamic banking industry, globally (Rosman, Abd Wahab & Zainol, 2014). Previous studies undertaken to sort out customer motivation to choose the appropriate IB found that the customers want to maximize their profits by depositing their funds with the IBs, in addition to their religious beliefs (Rachmawati & Ekki, 2004). Customers having savings accounts in IBs compare the return on their deposits with the interest rate offered by conventional banks. Customers are very sensitive about the return they receive on their deposits and if

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these returns fail to meet their expectations, then they might prefer to switch to other banks to get better returns on their investments (Ismal, 2011). Contemporary research also highlights the fact that the pattern of profit distribution is the primary concern of every potential depositor of both conventional and Islamic banks (Ali et al., 2020). There is a strong relationship between interest rates offered by conventional banks and the profit-sharing rates offered by IBs (Sundararajan, 2008; Chong & Leu, 2009). Due to the influence of interest rate, the management of IBs takes measures such as Profit Distribution Management (PDM) which is defined as the IBs' discretion to pay deposit rates based on the market rates (interest rates) and away from assets return (Farook et al., 2012).

For smooth profit distribution, IBs need to maintain reserves. Generally, IBs aintain two types of reserves known as Profit Equalization Reserve (PER) and Investment Risk Reserve (IRR) to pay an attractive rate of return to Investment Account Holders (IAHs). To create PER, IBs deduct the income generated from investment activities before allocating it between the bank and IAHs according to the agreed ratio. On the contrary, IRR is created from the share of IAHs after deducting the bank's share. Stakeholder theorists claim that stakeholders should have a say in the firm's decision-making process and managers should also include the interests of all stakeholders in their fiduciary duty, not just those of shareholders. Islamic economic system provides a strong basis for a stakeholder theory because Islam recognises the rights of every individual in the society. Islam expects the managers of a firm to uphold social justice and not to discriminate between different members of a society. Therefore, a better treatment of IAHs is expected in distributing returns to them, as the Islamic economic system ensures compliance with the rules to enforce an effective governance system for the sake of social justice.

PDM is a serious concern for IBs as they have full authority from profit sharing to managing risks inherent in their Islamic contracts to maintain competitive returns. By utilising PDM, they are able to compete with other banks, especially with conventional banks because they are in a similar banking environment. In this context, most of the studies were conducted to determine the impact of banks' financial characteristics that affect the PDM practices of IBs. Third party funds and their effective utilization, asset composition and market share are the factors identified in researches that affect the PDM practices of IBs (Mulyo & Mutmainah, 2013; Wafaretta & Rahman, 2016; Nur et al., 2019). A recent work of Ali et al. (2020) in the context of Pakistan also highlighted the role of internal, bank specific, external and macroeconomic variables in relation to profit distribution, where the variable of interest is customer awareness towards the Islamic banking system.

Besides other variables, empirical studies have identified a negative association between the bank's market share and its PDM practices. IBs with a high market share are supposed to have a higher profitability with a large number of loyal depositors. Hence, they offer better features, greater return, and lower risk. Therefore, banks with a high market share are less willing to engage in PDM practices because they are already superior in the market.

This study attempts to highlight the research gap by introducing Islamic corporate governance as a moderating variable between market share and the PDM practices of IBs. The relationship between corporate governance and the PDM practices of IBs should be studied deeply. The presence of the *Shariah* Supervisory Board (SSB) in addition to the Board of Directors (BOD) ensures good corporate governance to maximize shareholder value by monitoring *Shariah* application in the banks. Due to the considerable market share of IBs, their BOD and SSB may not encourage their management to engage in PDM practices, although PDM is not prohibited by *Shariah* scholars. However, in accordance with the principles of PLS, the returns of the depositors need to be based on assets return. Therefore, this study intends to highlight the research gap and aims to look into the relationship between corporate governance, market share and PDM. In the above context, the objective of this study is to determine the factors that affect the PDM practices of IBs. Moreover, the study aims to determine the moderating impact of corporate governance index on the relationship between market share and PDM practices of IBs. Based on the objectives of the study, the following research questions were formulated.

1. What is the impact of factors (third party funds, effective utilization of third party funds, asset composition, capital adequacy and market share) on the PDM practices of IBs?

2. Whether Islamic corporate governance moderates the relationship between market share and the PDM practices of IBs?

The study contributes significantly and suggests bank managers to improve their PDM practices in the light of its findings. It also contributes to the contemporary literature regarding the PDM practices of IBs and has policy implications for monitoring these practices.

Literature Review

Due to the increased competition with conventional and other Islamic banks, the majority of IBs depend on their depositors' money (Haron & Ahmad, 2000). Several studies have identified that religion is not the sole reason for customers to deposit

their money in IBs. Contemporary studies highlight the fact that depositors compare the rate of return and the pattern of profit distribution for both conventional and Islamic banks before depositing their money in an IB, in addition to religious reasons (Philip, 1997; Haron & Ahmad, 2000; Ali et al., 2020). Therefore, IBs need to pay a competitive "rate of profit" to the depositors at par with the interest rate of conventional banks. Moreover, if an IB fails to pay a comparable rate of return, the depositors tend to withdraw their money from that bank (Haron & Ahmad, 2000). In this context, IBs employ what is known as "profit distribution management" or PDM, defined as the discretion of IBs to pay deposit rates based on market rates (interest rates) and away from asset returns (Farook et al., 2012). IBs practice PDM by establishing reserves to ensure payment to their depositors in case there is a decline in profits. Conversely, at the moment when IBs are able to generate a huge profit, they store the funds in the reserves after depositor allocation. In this way, IBs can pay the depositors a rate of return at par with the interest rate offered by conventional banks. Through PDM, they are able to compete with other banks. Due to the significance of the PDM practices of IBs, several empirical studies (such as Mulyo & Mutmainah, 2013; Wafaretta & Rahman, 2016; Nur et al., 2019) have pointed out the financialfactors, such as third party funds and their effective utilization, asset composition and market share, that may affect these practices.

Third Party Funds and Profit Distribution Management (PDM) Practices

Deposits greatly affect the growth of the IBs (Yusoff & Wilson, 2005). Deposits consist of the amount collected by the banks from the community under a depository agreement and they play a very important role in the growth of the banks. Like conventional banks, IBs offer three types of accounts: 1) current accounts or demand deposit accounts 2) savings accounts and 3) investment accounts. IBs offer the current account facility under the concept of *Wadiah.* In this current deposit agreement, the bank is obliged to refund the whole amount deposited by the customers on demand. In demand deposits, the customers are not entitled to receive any kind of remuneration as their funds are guaranteed and are not utilized in any profit and loss sharing (PLS) projects. However, the bank has the authority to use these funds to fulfil its shorter liquidity needs, if any. Savings account facility is also provided under the concept of *Wadiah*. The only difference between savings and demand deposits in Islamic banking is that depositors' income can only be earned if the bank makes a huge profit and decides to pay the premium or *hiba* to the savings account holders (Karim & Archer, 2013).

The third facility provided by IBs is a major source of earning for both the banks and the customers. The investment account facility operated by the banks under the

concept of *Modaraba al-mutlaqa* principle allows the customers to deposit their money as *ab-ul-maal* (owner) and gives full authority to the bank to invest these funds in profitable ventures as *mudarib* (active partner). The profit of the venture(s) is shared according to the previously agreed ratio. The major difference between investment account and the conventional fixed deposit is the loss of the customers' funds in case of continued losses sustained by the bank (Khan et al., 2008). A higher proportion of third party funds also increases the chances of the withdrawal of funds by the customers. Based on the above discussion, the following hypothesis was formulated about the use of third party funds and PDM practices of IBs:

H1. There is a significant impact of third party funds on the PDM practices of IBs.

Effective Utilization of Third Party Funds and Profit Distribution Management (PDM) Practices

Third party funds represent a bank's efficiency in distributing its customers' funds in different financing and investing activities. In the context of Islamic banking, the IBs are responsible to effectively utilize the customers' funds by investing them in various avenues. The effective utilization of third party funds can also be observed from the steady cash flows that show the efficiency of the bank in earning optimal profits from its investments (Mulyo & Mutmainah, 2013). The presence of idle resources shows the inefficiency of the banks in investing these funds in various financing activities, effectively. This inefficiency results in low profits which, in turn, makes it difficult for the banks to smoothly distribute the profits and hence arises the need to manage the profits in order to retain the customers (Farooq et al., 2012). Nur et al. (2019) also found that high effectiveness of the utilization of depositors' funds may enhance the PDM practices of the bank. So, from the above literature it can be hypothesized that the PDM practices of banks depend upon the effective utilization of third party funds.

H2. There is a significant impact of the effective utilization of third party funds on the PDM practices of IBs.

Asset Composition and Profit Distribution Management (PDM) Practices

The assets and liabilities of all firms, whether financial or non-financial, are significantly interrelated (Semonson & Youm, 2008). Due to the prohibition of interest in the *Shariah*, IBs must deal in those instruments that can only be used to mobilize the deposits. Hence, IBs offer two types of contracts: 1) equity based contracts and 2) fixed margin contracts. Conventional banks mostly focus on investing in those instruments that reduce overall risks and maximize profits; however, IBs invest more in low-risk debt-like instruments (fixed margin contracts)

instead of high-risk profit-sharing instruments (equity based contracts) to retain their customers (Sundararajan, 2008). Based on the above discussion, the following hypothesis is formulated:

H3. There is a significant impact of asset composition on the PDM practices of IBs.

Capital Adequacy and Profit Distribution Management (PDM) Practices

Capital adequacy shows the efficiency of the banks to earn an adequate amount of capital in order to bear losses that may occur due to risky earning assets, change in market rate and investment in fixed assets. The ideology of Islamic banking is based on equity capital structure, which consists of shareholder equity and investment deposits based on profit and loss sharing (PLS). If the structure of Islamic banking is based purely on PLS, then the need to maintain an adequate amount of capital is low because customers are willing to share in the actual profits of the bank (Kartika & Adityawarman, 2014). Low Capital Adequacy Ratio (CAR) indicates the inefficiency of the bank to meet any uncertain conditions (Zheng, Moudud-ul-Huq, Rahman & Ashraf, 2017). Low CAR maintained by the bank does not strengthen the belief of the customers about the bank that it is in a strong position, instead they think that the bank is only fulfilling the preconditions of internal banking imposed by the State Bank (Mulyo & Mutmainah, 2013). Based on the above discussion, the following hypothesis is formulated:

H4. There is a significant impact of capital adequacy on the PDM practices of IBs.

Market Share and Profit Distribution Management (PDM) Practices

Islamic banking industry poses intense competition to its players to compete for high deposit shares, as IBs with a high market share enjoy a strong position that, in turn, reduces the need to practice PDM. Due to this competition, IBs are under pressure to match their rate of return with the current interest rate in order to secure a high market share (Wafaretta & Rahman, 2016). IBs have to face this pressure because the customers are price sensitive. The foremost motive of the customers while choosing a bank is to maximize their funds by obtaining a high return (Kasri & Kasim, 2009).

Banks with a high market share become risk averse, that is, they do not share profit directly with the customers and set reserves to meet any future losses, as high investment indicates a high level of risk. The low income generated from the investment activities leads IBs to take risks in order to provide the agreed profit return to their depositors, although the profits do not reach or remain below the expectations of the banks (Wafaretta & Rahman, 2016). On the basis of the above discussion, the following hypothesis is formulated:

H5. There is a significant impact of market share on the PDM practices of IBs.

Corporate Governance and Profit Distribution Management (PDM) Practices

Corporate governance has grasped the attention of researchers because of its immense importance in monitoring the efficiency of resources in all economic sectors (Abu-Tapanjeh, 2009). Governance structure is mostly composed of the Board of Directors (BOD) and senior management; however, due to the distinct features of Islamic banking resulting from the commitment to the *Shariah* principles, these institutions incorporate certain issues of their stakeholders that may not be so in the conventional banking system (IFSB, 2013). Literature about governance in IBs is very limited. Most of the studies examine the impact of corporate governance on the profitability of IBs (Mollah & Zaman, 2015). On the contrary, this study contributes to the literature by providing evidence about the impact of BOD and SSB on the extent of PDM practices in IBs.

Empirical findings of Chariri (2019) confirmed that the *Shariah* board significantly and positively affects the financial performance of IBs. The current study, however, stresses on the further investigation of the conduct, activities, and impact of corporate governance and its contribution to the management and accountability of the Islamic financial institutions. Risfandy (2019) also stated that BOD has a positive nexus with the extent of PDM in IBs. A higher extent of BOD involvement is associated with a higher extent of PDM, since BOD encourages managers to engage in PDM practices to attract depositors, give more loans, and earn more profit.

Moderating Role of Corporate Governance between Market Share and Profit Distribution Management (PDM)

There is little evidence available about the effectiveness of Islamic Corporate Governance (ICG) in protecting the interests of the IAHs of IBs (Alhammadi et al., 2018). There is a dearth of empirical studies on the role of ICG in monitoring the practices of IBs, in particular their customer treatment.

Risfandy (2019) suggested that the impact of SSB and BOD depends on the level of the bank's market share. The effects of SSB on PDM are higher in the banks with a low market share because SSB can compel the management to use PDM practices to a great extent only when the bank has a low market share. On the contrary, SSB is less able to compel the management when the bank has a higher market share. SSB needs to understand that in order to win the competition and attract more funds from the depositors, IBs have no choice rather than engaging in

PDM. The association between BOD and SSB also depends on the bank's market power. BOD can have more influence on the bank compelling it to engage in PDM. This is possible only if the bank has a considerable market power and vice versa.

Based on the above discussion, it can be claimed that ICG practices strengthen the relationship between market share and the PDM practices of IBs, that is, ICG helps to increase the market share and, in turn, a high market share helps the bank to smoothly distribute the profit.

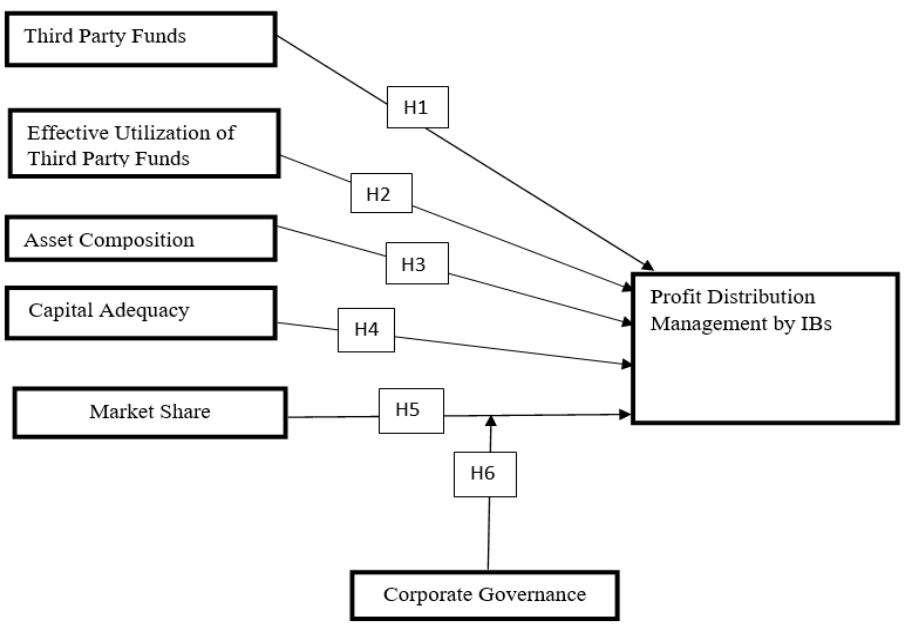
H6. Corporate governance index moderates the relationship between market share and the PDM practices of IBs.

Conceptual Framework

The study used the most relevant explanatory variables from the previous studies that may have impacted the PDM practices of IBs, that is, third party funds, their effective utilization, asset composition, capital adequacy and market share. Furthermore, the proposed framework would provide an opportunity to determine whether corporate governance moderates the relationship between market share and the PDM practices of IBs.

Figure 1

Conceptual Framework



Methodology

This study used the data of full-fledged IBs only for determining their PDM practices due to the fact that the banks with an Islamic window still tie their return with the interest rate provided by their parent conventional bank (Hosen & Muhari, 2013). Therefore, the sample of this study consists of 40 full-fledged IBs selected from the following three regions: 1) South Asia (Pakistan and Bangladesh) 2) Middle East (Kuwait, Bahrein, Saudi Arabia, UAE and Qatar) and 3) South East Asia (Malaysia and Indonesia). Data was collected for the period 2010-2017. Secondary data was required for this study, which was available online on the official websites of the banks. Moreover, the most recent ICG index, constructed by the CIBAFI (Council for IB's and Financial Institutions) and World Bank, was used in the current study. The study used STATA software to analyse the panel data through fixed and random effect models.

Measurement of Variables

Third Party Funds

Third party funds are funds entrusted by the society under a depository agreement. To determine the dependence of banks on general public funds, third party funds are used as a proxy. These funds are measured by dividing the deposits with total assets (Farooq et al., 2012; Mulyo & Mutmainah, 2013).

Effective Utilization of Third Party Funds

Effective utilization of third party funds reflects the IBs' ability to distribute general public funds in financing. The effectiveness of third party funds is measured with the help of financing to deposit ratio (FDR) (Kartika & Adityawarman, 2014; Mulyo & Mutmainah, 2013).

Effective utilization of third party funds = Financing of the bank / Total deposits

Asset Composition

Asset composition of any bank reflects the percentage of assets and liabilities. Asset composition is measured as the amount of financial assets, that is, fixed margin assets divided to the total assets (Farooq et al., 2012; Kartika & Adityawarman, 2014; Mulyo & Mutmainah, 2013).

Capital Adequacy

Capital adequacy portrays the bank's capacity to keep enough capital to cover possible losses. To measure the capital adequacy of the banks', capital adequacy ratio is used.

Capital Adequacy Ratio=Tier One capital + Tier Two capital/Risk Weighted Assets

Market Share

Market share is measured by dividing the total financing of the bank with the total financing of all the IBs (Rettab et al., 2010).

Market Share=Total Financing of the Islamic Bank /Total Financing of all Islamic banks

Profit Distribution Management (PDM)

Profit Distribution Management (PDM) is measured by using the asset spread (Farooq et al., 2012).

PDM = Return on Assets-Return on Investment Account Holder (RIOAH)
ROIAH = Profit Distributed to Depositors (less Sukuk and other irrelevant accounts / average value of IAH's accounts)

Corporate Governance

In accordance with literature related to the corporate governance of IBs, this study focused on the following six themes of corporate governance: 1. Board of Directors 2. Board Committees 3. Internal Control and External Audit 4. Risk Governance 5. *Shariah* Governance and 6. Transparency and Disclosure. Each theme was expressed by six individual items used to effectively evaluate the corporate structure of the IBs.

The Corporate Governance Index (CGI) used for this study is given below.

Table 1

The Corporate Governance Index (CGI)

NO.	Corporate Governance Themes	Items
1.	Board of Directors	6
2.	Board of Committees	6
3.	Internal Control and External Audit	6
4.	Risk Governance	6
5.	*Shariah* Governance	6
6.	Transparency and Disclosure	6
	Score of CGI	36

The aggregate score of CGI is 36. It indicates that each theme has its own 6 items identified from the literature and the guidelines related to corporate governance. The approach used in this study is also used in content analysis, whereby each item can take the value of 1 or 0 depending on whether or not it is present (Hanief & Sudaib, 2007).

Table 2

Theme 1 (Board of Directors)

No.	Items	References	Score
1.	Board size	Annual reports or bank websites	Noted only (this is not a component of the index)
2.	Qualification / experience of directors	(IFSB, 2006; BCBS, 2015)	If disclosed: 1; otherwise: 0
3.	Number / proportion of independent directors	(IFC & Huakamah, 2008; Aebi et al., 2012)	Majority: 1; Otherwise: 0; at least 2
4.	Chairman is not the CEO Yes 1; otherwise 0	(IFC & Huakamah, 2008; Da Silva & Leal, 2005)	Yes: 1; otherwise: 0
5.	Number of board meetings / year	IFC & Huakamah (2008)	If more than 6, then 1; otherwise: 0
6.	One or more female members	IFC & Huakamah (2008)	Yes: 1; Otherwise: 0
7.	Formalized Code of Ethics / Business Conduct	IFC & Huakamah (2008)	Yes: 1; Otherwise: 0
8.	Aggregate Score		6

Table 3

Theme 2 (Board of Committees)

No.	Items	References	Score
1.	Governance Committee	BSBC (2015) IFSB (2006)	Yes: 1; otherwise: 0
2.	Executive Committee	Bader (2009).	Yes: 1; otherwise: 0
3.	Audit Committee	IFSB (2006) Love & Klapir, 2002).	Yes: 1; otherwise: 0

No.	Items	References	Score
4.	Remuneration / Nomination Committee	BCBS (2015) (Love & Klapir, 2002).	Yes: 1; otherwise: 0
5.	Risk Committee	BCBS (2015) IFSB (2013).	Yes: 1; otherwise: 0
6.	Ethics and Compliance Committee	BCBS (2015).	Yes: 1; otherwise: 0
	Aggregate Score		6

Table 4

Theme 3 (Audit Committee)

No.	Items	References	Score
1.	Audit Committee size	Annual reports or bank websites	Noted only (this is not a component of the index).
2.	Number of independent members of Audit Committee	(BCBS, 2015; IFC & Huakamah, 2008)	Majority: 1; Otherwise: 0
3.	Independent Chairperson of Audit Committee	James-Overheu and Cotter (2009)	Yes: 1; otherwise: 0
4.	Number of Audit Committee meetings	BCBS (2015)	4 or more: 1; less than 4 or not disclosed: 0
5.	Existence of internal audit department / unit	BCBS (2015)	Yes: 1; otherwise: 0
6.	Internal audit reporting to the board / Audit Committee	BCBS (2015)	Yes: 1; otherwise: 0
7.	External auditor appointed	BCBS (2015)	Yes: 1; otherwise: 0
	Aggregate Score		6

Table 5

Theme 4 (Risk Governance)

No.	Items	References	Score
1.	Board guidance on risk appetite	(BCBS, 2015; IFSB, 2013)	Yes: 1; otherwise, 0

No.	Items	References	Score
2.	Risk Committee chair is independent	BCBS (2015)	Yes: 1; otherwise, 0
3.	Majority of the members of Risk Committee are independent	IFSB (2013)	Yes: 1; otherwise, 0
4.	Chief Risk Officer (CRO) exists	(BSBC, 2015; IFSB, 2013)	Yes: 1; otherwise, 0
5.	CRO reports to BOD or Risk Committee	IFSB (2013)	Yes: 1; otherwise, 0
6.	CRO is a member of the Executive / Risk Committee	(Aebi et al., 2012).	Yes: 1; otherwise, 0
7.	Aggregate Score		6

Table 6

Theme 5 (Shariah Governance)

No.	Items	References	Score
1.	Number of *Shariah* Board members	AAOIFI (2004)	3 or more: 1; otherwise: 0
2.	Duties of *Shariah* Board	IFSB (2009)	Yes: 1; otherwise: 0
3.	Member (non-voting) with non-*Shariah* background	IFSB (2009)	Yes: 1; otherwise: 0
4.	Number of *Shariah* Board meetings	IFSB (2009)	If more than 6: 1; otherwise: 0
5.	*Shariah* review / audit department / unit	(AAOIFI, 2004; IFSB, 2009)	Disclosed: 1; otherwise: 0
6.	Statement on the use of prohibited income	AAOIFI (2004)	Yes: 1; otherwise: 0
7	Aggregate Score		6

Table 7

Theme 6 (Transparency and Disclosure)

No.	Items	References	Score
1.	Corporate Governance Report	(BCBS, 2015; IFC, 2014; OECD, 2015)	Yes: 1; otherwise: 0

No.	Items	References	Score
2.	Remuneration policy of board members and senior executives is disclosed	(BCBS, 2015; OECD, 2015)	Yes: 1; otherwise: 0
3.	*Shariah* (Compliance / Audit) Report	AAOIFI (2004)	Disclosed: 1; otherwise: 0
4.	Risk Management Report	IFC (2014)	Yes: 1; otherwise: 0
5.	Internal Audit / Control Report	HKSA, 2001; OECD, 2015)	Yes: 1; otherwise: 0
6.	Corporate Social Responsibility Report	UNEP (2011)	Yes: 1; otherwise: 0
7.	Aggregate Score		6

Econometric Model

The general estimation equation used for this study is stated as follows:

$$PDM_{it} = \alpha_{it} + \beta_1 TPF_{it} + \beta_2 EUTPD_{it} + \beta_3 AC_{it} + \beta_4 CA_{it} + \beta_5 MS_{it} + \beta_6 MS\_CGit + \varepsilon_{it} \ldots\ldots\ldots\ldots (1)$$

where TPF = Third Party Funds, EUTPD = Effective Utilization of Third Party Funds, AC = Asset Composition, CA = Capital Adequacy, MS = Market Share, and CG = Corporate Governance. Moreover, the value of α indicates the intercept of the equation and β is the coefficient that shows the change in the value of the dependent variable due to the effect of the independent variable. The value i signifies the individual IB (i = 40) and t signifies the time period (t = 2010-2017).

Results

Descriptive Statistics

Table 8 presents the statistics of all the variables. The dependent variable, that is, PDM is averaged at 1.130, with the standard deviation of 2.071. The mean value of 113% shows that IBs extensively use PDM techniques to smoothen their profit-sharing structure. The highest value of PDM is 1.71, which relates to South East Asian (Indonesia) banks for the year 2012. It shows that in this years the banks of this region focused more towards PDM and retained their customers by providing the agreed profit ratio. The lowest value is -1.26 for Middle Eastern (Bahrain) banks in 2010, which indicates that the banks of this region concentrated less towards the redistribution of profits to their customers via PDM.

Table 8

Descriptive Statistics

Variables	Mean	Std. Dev	VIF	Tolerance
PDM	1.130	2.071	-	
TPF	0.771	0.337	1.43	0.698
EFTPF	1.837	1.900	1.17	0.851
AC	0.521	0.197	1.30	0.771
MS	0.253	0.069	1.11	0.899
CAR	18.484	6.893	1.28	0.779

Note. N=40, T=10, Obs.= 72,

Third Party Funds (TPF) has the mean value of 0.771 and the standard deviation of 0.337. The mean of 77% indicates the availability of an adequate amount of third party funds that, in turn, enables the banks to perform better management and distribution of profits. Effective Utilization of Third Party Funds (EUTPF) has the mean value of 1.837 and the standard deviation of 1.900. The mean value of 183.7% shows that the banks effectively distribute the third party funds in different financing activities. Asset Composition (AC) has the mean value of 0.521 (52%) and the standard deviation of 0.197. The mean value shows that IBs now invest in both equity based as well as fixed margin contracts on an equal basis. Market Share (MS) has the mean value of 0.253 and the standard deviation of 0.069. The mean value of 25.3% shows that IBs still need to be more competitive to gain a higher market share. Capital Adequacy Ratio (CAR) has the mean value of 18.484 and the standard deviation of 6.893.

Corporate Governance Index (CGI) has the mean value of 0.625 (62%) and the standard deviation of 0.088. Table 8 also shows the Variance Inflation Factor (VIF) for all the independent variables. From the results, it is clear that there is no problem of multicollinearity, as according to the rule of thumb all the values of VIF are less than 10 and the values of 1/VIF are greater than 0.10.

Pearson Correlation Matrix

The independency of the variables under study was examined through correlation matrix illustrated in Table 9. From the matrix value, it is clear that there is no problem of multicollinearity.

Table 9

Pearson Correlation Coefficients Matrix

	TPF	EFTPF	AC	MS	CAR	BA
TPF	1					
EFTPF	0.102	1				
AC	0.151	-0.225	1			
MS	-0.210	-0.0501	0.092	1		
CAR	0.388*	0.222	0.008	0.092	1	
BA	-0.245	-0.314*	0.372*	0.083	-0.153	1

*p<.10, **p<0.05, ***p<.01

Hausaman Specification Test

The results of Hausman test suggested that the regression estimates derived from the random effects model are more appropriate for the analysis because they are more consistent and efficient. The test failed to meet the assumptions of the fixed effect model in which prob > chi^2= 0.3741 for PDM.

Results of the Random Effects Model

Table 10 shows the results of the random effects model, where the value of R^2 indicates that all the explanatory variables in the model brought 42.8% change in the dependent variable, that is, PDM. The value of prob > chi2= 0.000 indicates that the model is appropriate as the value is significant. The coefficient value of the variable TPF is 0.958 significant at 1% level, which implies that overall PDM is significantly linked with this variable. This result is in line with the work of Khan et al. (2008), which suggests that a higher proportion of TPF increases the chances of the withdrawal of funds by the customers. Thus, it requires more PDM by the IBs. Another variable EUTPF showed an insignificant relationship with PDM. This result is inconsistent with the work of Nur et al. (2019), which posits that the Effectiveness of Depositors Fund (FDR) can be a benchmark for IBs to increase their PDM. The coefficient value of AC is 2.221 at 5% significance level, which indicates that PDM is highly affected by this variable. Previous studies showed that IBs invest more in low-risk debt-like instruments (fixed margin contracts) instead of high-risk profit-sharing instruments (equity based contracts) to retain their customers (Sundararajan, 2008). The coefficient value of MS is -0.540 significant at 5% level, which implies that there exists a negative relationship of MS with PDM. From the above results, it is clear that IBs perform less PDM when they have

a high market share. This result is in line with the work of (Wafaretta & Rahman, 2016). The coefficient value of CAR is -0.151 significant at 1% level, which implies that IBs maintain an adequate amount of capital to smoothen their profit distribution. A high CAR maintained by the banks strengthens the belief of the customers that the banks are in a strong position to meet the regulatory requirements of central banks and thus require less PDM (Mulyo & Mutmainah, 2013). The coefficient of moderation term ICG (MS*CG) is 0.621 significant at 1% level, which implies that the moderator of this study positively moderates the relationship between MS and PDM. From the results of regression, it is clear that MS and PDM activities of IBs are highly affected by the implementation of ICG practices. This result is consistent with the findings of (Risfandy, 2019).

Table 10

Consolidated Estimation Results (Random Effects)

	β	R.SE	T-Stat.
Constant	-2.056	0.858	-2.40
TPF	0.958	0.181	5.29***
EUTPF	0.067	0.059	1.17
AC	2.221	0.947	2.35**
MS	-0.540	0.257	-2.10**
CAR	-0.151	0.057	-2.63***
CG	0.357	0.181	1.97*
MS*CG	0.621	0.158	3.93***

R^2 0.428

Prob > chi2 0.000

PDM as a Dependent Variable

N=40, T=10, Obs.= 72 *p<.10, **p<0.05, ***p<.01

Region Specific Results

Table 11 provides the results for the regression estimates of the PDM practices of IBs for each region: 1. South Asia 2. Middle East and 3. South East Asia. The pooled OLS regression estimation provides the results for all the regions. The results for TPF confirm the significant positive impact on PDM in all three regions. The results of the estimation indicate that the PDM practices of IBs operating in any region depend upon funds collected from the general public.

The results for EUTPF show an insignificant relationship with PDM for the Middle Eastern and the South East Asian regions. However, only for the South Asian region, this relationship becomes significant at 10% confidence interval with

the coefficient value (-0.633). The results for AC shows that it is positively and significantly related with PDM for all the regions. The results for MS shows that it is significantly but negatively related with PDM for all the regions. The results for CAR shows that it is insignificantly related with PDM for all the regions. The results for CGI shows that it is significantly and positively related with PDM for the Middle Eastern and South East Asian regions. The results of moderating variable MS*CG showed a significant positive impact on the relationship between MS and PDM practices followed by IBs in the Middle Eastern and South East Asian regions.

Table 11

Region Wise Results of Regression Estimates (PDM)

Variables	South Asia[*1] (Pooled OLS Results)		Middle Eastern[*2] (Pooled OLS Results)		South East Asian*[3] (Pooled OLS Results)	
	β	t-Stat	β	t-Stat	β	t-Stat
Constant	8.309	1.63	1.970	-1.48	4.001	0.34
TPF	13.624	1.79*	1.452	1.89*	6.149	2.74***
EUTPF	-0.633	-1.85*	-0.015	-0.31	-1.639	-1.12
AC	3.470	1.78*	4.960	2.80***	4.636	1.71*
MS	-13.387	-2.23***	-3.852	-1.68*	-10.129	-2.20**
CAR	-0.007	-0.06	0.027	0.80	-0.192	-1.47
CG	0.270	1.60	0.021	2.10**	0.360	1.89*
MS*CG	0.877	1.55	0.406	2.46**	7.937	2.69*
R^2	*0.828*		*0.624*		*0.552*	
F-Statistics	*5.51***		*7.60****		*2.20**	

*Note. [*1.] N = 10, T= 10, obs.= 16, Note[*2.] N = 10, T= 10, obs.= 16, Note[*3.] N = 10, T= 10, obs.= 40. *p<.10, **p<0.05, ***p<.01*

Breush-Pagan / Cook Weisberg Test

The results of this test showed that there is no issue of hetrokediscity in the model because the *p*-value is insignificant (0.268) and the value of chi-square is small (1.23). So, the null hypothesis of "constant variance" is accepted since the data is homoscedastic.

Table 12

Breush-Pagan / Cook Weisberg Test

Statistics	PDM
Chi-square (1)	1.23
Prob>chi	0.268

Conclusion

This study analysed the impact of third party funds and their effective utilization, as well as that of asset composition and market share in conjunction with the moderating role of Islamic CGI on the PDM practices of IBs. The findings confirmed that good governance in the presence of a high market share enables the IBs to get a strong market position that, in turn, smoothens their profit-sharing structure. This study is an attempt to understand the phenomenon of the PDM of IBs. In this regard, IBs not need follow any regulation. So, how they manage their profit to maintain a good relationship with their investment account holders remains their own discretion. The results of the study showed that market share impacts the PDM practices of IBs and Islamic CGI moderates this relationship, which means that when IBs build a strong corporate governance structure then their market share increases. Ultimately, with a high market share, IBs don't need to manage their profit to retain their customers.

A high market share enables the IBs to influence the market instead of getting influenced by the market trend. The customers of IBs need to be treated differently from those of conventional banks. Therefore, IBs should seek different strategies to maintain the loyalty of their customers and one of these strategies is PDM. The findings also showed that CGI impacts the extent of the PDM practices performed by IBs in the presence of other relevant factors. Furthermore, the results also indicated the influence of these factors separately for each region, which depicts the uniqueness of that particular region. For South Asia, the main hypothesis of the study was rejected because there was found no moderating role of CGI between market share and the PDM practices of IBs. This indicates weakness in the corporate governance structure, especially in the areas of risk governance, *Shariah* governance, board committees, and board of directors. Moreover, the finding of this study also confirmed the stakeholder theory argument especially in the context of IBs, which perform PDM to retain their customers for the growth of their deposits.

Managerial Implications and Future Research Directions

This study recommends that the IBs manage such asset portfolios where the returns of fixed margin assets have a minimum effect on their profitability, as the composition of assets determines the extent of the PDM practices of IBs. Additionally, IBs should revise their corporate governance structure according to the recent Islamic CGI discussed in this study. Moreover, IBs should discuss matters in their annual disclosure such as their risk sharing structure especially for the investment account holders, methods used for the calculation of profit distribution, and governance rules related to PER and IRR.

Further research may also be conducted by increasing the sample size, such as by considering the IBs of other regions. Moreover, future studies can also focus on the Displaced Commercial Risk (DCR), which is a unique risk faced by the IBs, to investigate the exposure of IBs to DCR due to their PDM practices.

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