

***IMPLICATIONS OF PROFIT SHARING INVESTMENT
ACCOUNTS ON THE CAPITAL STRUCTURE OF ISLAMIC
BANKS – A COMPARATIVE STUDY***



By

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***Islamabad, Pakistan
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*A thesis submitted in partial fulfilment of
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It is certified that the contents and form of the thesis entitled

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Submitted by

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has been found satisfactory for the requirement of the degree of

Master of Philosophy in Business Administration (Finance)

Supervisor: _____

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Assistant Professor,
NBS, NUST*

To My Parents, Husband and Teachers with Respect and Love

Declaration

I hereby declare that I (Johaina Khalid) am the sole author of this thesis and that this work has not been published anywhere else before. This is a true copy of the thesis, including any final revisions, as accepted by my examiners.

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Abstract

Islamic banks are different from conventional banks in terms of nature of their deposits and loans. Modern [capital structure] theories which are used widely by conventional banks such as trade off theory and others are not appropriate for Islamic banks primarily because of profit sharing investment (PSI) accounts, a unique source of funds for Islamic banks. This study attempts to empirically investigate the impact of deposits on the market value, earnings per share and financial risk of shareholders of Islamic and conventional banks in Pakistan. We find evidence that deposits in conventional banks have a negative impact on market value and earnings per share (EPS). However, for Islamic banks no significant impact of deposits (PSI accounts) has been evidenced on market value; though increase in deposit accounts has been found to have a positive impact on earnings per share. Another important finding of the study is that the growth in PSI accounts in Islamic banks has been found to result in an increase in financial risk, contrary to what is predicted by the capital structure theory of Islamic Banks suggested by Deehani et al. (1999). This finding indicates the possible effects of the income smoothing practices, in which Islamic banks are engaged to make their PSI accounts rates similar to deposit rates offered by their conventional counterparts.

