

Risk Management Methods for Partnership Contracts in Islamic Banks: A Case Study of Al Salam Bank – Algeria

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Received:10/07/2025

Accepted:30/11/2025

Published: 11/12/2025

Abstract: This study aims to analyze the methods of risk management in *profit-sharing contracts* within Islamic banks, with a practical application to *Salam Bank of Algeria*. The study concludes that these contracts—based on the principle of profit and loss sharing between the bank and the client—are subject to elevated credit and operational risks. However, the bank has succeeded in managing these risks through a specialized risk management unit and a *credit ceiling* system.

The most prominent challenges identified include the predominance of simplified financing structures—such as *Murābahah*—at the expense of *participatory contracts*, and the weakness of Sharī'ah-compliant risk management instruments. Accordingly, the study recommends transitioning from *Murābahah* to *participatory contracts*, developing Islamic financial instruments (such as *ṣukūk*), and amending banking regulations to align with the specific nature of Islamic banks. While the model adopted by Salam Bank demonstrates effectiveness in risk management, the development of specialized tools and the harmonization of legal frameworks are essential to reinforce this model.

Keywords: Islamic banks – profit-sharing contracts – risk management – Salam Bank – credit ceiling.

JEL Classification: E50, E51

ملخص : تهدف هذه الدراسة إلى تحليل أساليب إدارة المخاطر في عقود المشاركة داخل المصارف الإسلامية، مع تطبيق عملي على مصرف السلام الجزائري. وتخلص الدراسة إلى أن هذه العقود، المبينة على مبدأ تقاسم الربح والخسارة بين المصرف والعميل، تتعرض لمخاطر ائتمانية وعملياتية مرتفعة. غير أن المصرف نجح في إدارتها من خلال وحدة متخصصة لإدارة المخاطر ونظام "السقف الائتماني". وتتمثل أبرز التحديات التي تم تحديدها في هيمنة صيغ التمويل المبسطة – مثل المراجعة – على حساب صيغ المشاركة، وضعف أدوات إدارة المخاطر المتوافقة مع الشريعة الإسلامية. وبناءً على ذلك، توصي الدراسة بالتحول من المراجعة إلى عقود المشاركة، وتطوير أدوات مالية إسلامية (مثل الصكوك)، وتعديل الأنظمة البنكية بما يتلاءم مع الطبيعة الخاصة للمصارف الإسلامية. وعلى الرغم من فعالية نموذج مصرف السلام في إدارة المخاطر، فإن تطوير أدوات متخصصة ومواءمة الإطار التشريعي يمثلان ضرورة لتعزيز هذا النموذج.

الكلمات المفتاحية : مصارف إسلامية – عقود مشاركة – إدارة المخاطر – مصرف السلام – السقف الائتماني.

1. Introduction:

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The final quarter of the twentieth century witnessed a revival in the emergence and development of Islamic banking, which expanded both within and beyond the Islamic world. This growth was guided by a distinct economic philosophy that Islamic banks introduced in the realm of financial transactions and economic development, presenting it as an alternative to similar practices adopted by conventional banks.

Accordingly, an Islamic bank does not undertake any investment or financing operation unless it is preceded by a thorough feasibility study assessing the project's viability from all relevant economic and social dimensions. Furthermore, it refrains from financing projects without conducting a comprehensive economic evaluation.

In this research paper, we explore the nature of Islamic banks and the use of partnership-based financing contracts within them. We also examine the methods employed to manage the risks associated with partnership contracts in Islamic banks. Moreover, we attempt to present and analyze the findings obtained from a case study of financing through partnership modes at Al Salam Bank, analyzing it in depth.

Based on this, the central research problem addressed in this study is encapsulated in the following core question:

What are the risk management methods adopted for partnership contracts at Al Salam Bank – Algeria, and how effective are they in mitigating these risks?

Sub-Questions:

1. What is the nature and the key characteristics of partnership contracts in Islamic banking?
2. What are the main types of risks associated with the partnership financing model?
3. What are the methods and procedures adopted by Al Salam Bank in managing these risks?
4. To what extent are these methods effective in mitigating risks and achieving the bank's objectives?

Significance of the Study:

The significance of this study stems from its focus on one of the most prominent Islamic financing instruments—partnership contracts—which are characterized by a high degree of risk and continue to pose a genuine challenge for Islamic banks. The study aims to clarify the actual practices involved in managing such risks, thereby offering a foundational knowledge base and practical recommendations for decision-makers and financial institutions seeking to enhance their Islamic financing products.

Objectives of the Study:

- To define the concept, characteristics, and objectives of Islamic banks.
- To analyze the nature and importance of partnership contracts within the Islamic banking system.
- To examine the methods used in managing the risks associated with these contracts.
- To assess the effectiveness of risk management at Al Salam Bank in Algeria.

- To provide a set of recommendations aimed at improving the performance of Islamic banks in this domain.

Research Methodology:

The study employed the **descriptive-analytical method** to present the theoretical framework concerning partnership contracts and the risks they entail. Additionally, the **applied method** was utilized through a case study of Al Salam Bank – Algeria, where data and information collected from the bank's Risk Management Unit were analyzed in order to evaluate the effectiveness of the implemented risk management strategies.

Structure of the Study:

The study is structured around three main axes:

1. **Theoretical Framework:** This includes an overview of Islamic banks and the principal characteristics and objectives of partnership-based financing contracts.
2. **Analytical Section:** This comprises a field analysis of the risk management mechanisms employed by Al Salam Bank – Algeria.
3. **Findings and Recommendations:** This section presents the key results of the study and proposes a number of recommendations for improving risk management practices in partnership-based financing.

First: The Nature of Islamic Banks

Islamic banks operate within an Islamic framework, providing banking and financial services while engaging in financing and investment activities across various sectors, in accordance with the rules and principles of Islamic Sharia. Their objective is to instill Islamic values and ethics within financial transactions and to contribute to the achievement of social and economic development.

1. Definition of Islamic Banks

An Islamic bank is a monetary and financial institution that conducts its activities based on foundations and principles derived from Islamic Sharia. It functions as a financial intermediary by mobilizing financial resources from members of society and investing them through financing instruments and mechanisms that differ from those employed by conventional banks. In addition, it offers a wide range of banking services, all with the aim of maximizing economic and social returns that support the development of the Islamic nation (Eid, 2007,, p. 398).

2. Characteristics of Islamic Banks

Islamic banks possess distinct characteristics that set them apart from conventional banks in terms of their principles, content, and underlying purpose. Among these characteristics are:

- Exclusion of interest-based transactions (riba): One of the most prominent features of Islamic banks is the prohibition of dealing with interest.

- Adherence to the principle of "al-kharaj bil-daman": This principle stipulates that entitlement to profit is conditional upon bearing the risk of loss. In other words, one who guarantees the asset is entitled to its yield.
- The principle of trusteeship (istikhlaf) over wealth: Wealth is considered the property of Allah, and humans are entrusted with its management. Therefore, human transactions with wealth must align with the will of its true Owner, Allah Almighty.
- Facilitating and promoting trade among Islamic countries: Islamic banks contribute to the stimulation of commercial exchange between Islamic states through mutual cooperation, including the exchange of expertise and the provision of mutual support.
- Adoption of the profit and loss sharing principle: This is one of the foundational tenets of Islamic banking, wherein both profits and losses are shared between the parties based on pre-agreed terms.
- Commitment to values, ethics, and social returns: Islamic banks strive to achieve social integration by allocating their direct and indirect investments across various sectors. In conducting feasibility studies, they consider not only economic returns but also the social impact of their investments.
- Existence of Sharia supervisory oversight: This refers to ensuring that all activities of the Islamic financial institution comply with the rulings of Islamic Sharia, as determined by fatwas and resolutions issued by the authorized Sharia boards. (Eid, 2007,, p. 390)

3. The Emergence of Islamic Banks

The idea of establishing Islamic banks emerged as early as the 1940s. In Malaysia, interest-free savings funds were introduced, and Pakistan adopted the idea in 1950 by creating a rural institution that accepted deposits without offering returns and re-lent them to small farmers interest-free.

Subsequently, Islamic banking institutions began to appear more formally, beginning in Egypt in 1963, when the Egyptian government, in cooperation with a delegation from West Germany, launched a local savings initiative as a pilot project to be assessed before expanding it nationwide. At its inception, this branch attracted approximately one thousand depositors.

Following this, Nasser Social Bank was established in Cairo in 1971, operating in the field of zakat collection and benevolent lending. A similar initiative followed in Pakistan. In 1974, the Islamic Development Bank was founded in Saudi Arabia, followed by Dubai Islamic Bank in 1975, the Sudanese Islamic Bank in 1977, Kuwait Finance House in 1977, and Faisal Islamic Bank in 1977. In Jordan, the first Islamic banking institution was the Jordan Islamic Bank for Finance and Investment, established in 1978, followed by the Arab International Bank in 1997.

The founding of Islamic banks was paralleled in some countries by the establishment of Islamic windows or branches by conventional commercial banks, offering Sharia-compliant financial services..

Certainly. Below is the formal academic English translation of the next section of your text, carefully preserving the scholarly tone, meaning, and terminology (Al-Wadi, 2007, p. 38)

4. Objectives of Islamic Banks (Ahmed, 2006, pp. 86-87)

4.1 Developmental Objective

Islamic banks contribute to achieving economic and social development through the following means:

- Eliminating interest and reducing project costs, thereby encouraging investment, creating new job opportunities, expanding the labor force, reducing unemployment, and consequently increasing national income.
- Promoting a culture of saving by eliminating interest, which facilitates saving especially among low-income groups.
- Raising awareness of Islamic banking and enhancing public trust in the Islamic economic system, positioning it as the optimal model for economic development.
- Working to retain capital within the nation, thereby increasing reliance on core domestic resources and capacities that are invested within Islamic countries.

4.2 Social Objective

Islamic banks seek to encourage investment activities by attracting capital and allocating it to economic sectors through Islamic financing instruments. Their efforts aim at advancing economic progress and providing financial and economic services and consultations to preserve and grow wealth. This is complemented by the innovation of new Islamic banking instruments and the enhancement of existing ones in order to attract more resources, direct them effectively, and ensure the bank's sustainability and adaptability to market changes.³

5. The Importance of Islamic Banks

The significance of Islamic banks lies in:

- Fulfilling the desire of Islamic societies to establish financial channels that operate independently of interest-based mechanisms.
- Providing a platform for the practical application of Islamic jurisprudence (fiqh al-mu'amalat) in banking activities.
- Serving as the practical embodiment of the principles of the Islamic economic system.

Second: Financing through Partnership Contracts in Islamic Banks

The partnership financing model is considered one of the most important financing instruments in Islamic banking. It is regarded as a fundamental investment mode that embodies the objectives of Islamic finance and ensures fairness between the parties involved (the bank and its clients). The use of this model contributes to achieving economic and social balance among citizens. The following provides an overview of the concept of the partnership contract and its key features.

1. Definition of a Partnership Contract

A partnership contract is an agreement between two or more parties to pool capital for undertaking specific, known business activities with the aim of generating profit to be shared among them. Equality in capital contributions, labor, or responsibilities among partners is not a prerequisite, nor is equal distribution of profit required. However, in the event of a loss, it must be borne proportionally by each partner according to their share in the capital. The following diagram illustrates the stages of the partnership process (Al-Ajlouni, 2019, pp. 113-114)

2. Characteristics of Partnership Contracts

Partnership contracts, as Islamic banking investment instruments, possess several distinctive features, including (Abdel-Hay, 2010, p. 05):

- **Pooling of capital:** The partnership is based on the exchange of individually owned assets, which are combined and converted from distinct ownership to joint ownership, thereby unifying their fate. Profits are shared as agreed upon, while losses are borne proportionally to each partner's capital contribution, resulting in diversified risk exposure for all parties.
- **Expression of economic cooperation and solidarity:** Partnerships represent a desired form of mutual collaboration among capital owners to finance large-scale projects requiring substantial capital, which no individual party is capable of, or willing to, undertake alone.
- **Due diligence and project evaluation:** Given the potential for loss—borne by all partners in proportion to their capital shares—careful and thorough project studies are essential before entering into a partnership. This contrasts with conventional banks, which are primarily concerned with securing interest returns and are less incentivized to conduct rigorous feasibility assessments.
- **Encouragement of saving and investment:** The legitimacy and availability of partnership contracts incentivize individuals to save, enabling Islamic banks to mobilize these savings and channel them into priority projects. This, in turn, supports productive investment, increases the funds available within the Islamic banking system, and promotes economic and social development through the redistribution of wealth toward projects beneficial to society.
- **Bank's joint participation:** The bank invests its own capital alongside depositors' funds in various projects. This promotes a balance between the bank's returns for shareholders and the profits paid to depositors, with all parties sharing in losses should they occur.

3. Types of Partnership Contracts

The forms of partnership-based financing vary according to the objectives and duration of each type. The most prominent include (Al-Moussawi, 2011, p. 49):

3.1 Permanent Partnership

In this form, the Islamic bank contributes to the capital of a productive or service-oriented project, becoming a co-owner and thus participating in the management and supervision of the project. Each partner is entitled to a share of the profits, if realized, based on mutual

agreement. In case of loss, it is distributed among the partners according to their respective capital contributions.

This type is also known as **perpetual partnership**, which remains valid as long as the project continues to operate within its legal framework. A related variant is the **fixed-term partnership**, where the bank's or investor's ownership share remains fixed for a specified period agreed upon by all parties. The goal of this arrangement is often to finance a commercial transaction, supply of equipment, contracting operation, or similar activities.

3.2 Diminishing Partnership Ending with Ownership

This model involves a partnership between the bank and the client, wherein the client is entitled to gradually replace the bank's ownership share in the project. The client may do this by repaying the bank's capital contribution either in a lump sum or in installments, based on mutually agreed terms and the nature of the financing arrangement.

The financing is based on a partnership contract where the bank contributes part of the capital as the funding partner, while the client contributes the remaining capital in addition to managing and executing the project. Under the contract, the bank's share gradually decreases as the client repays portions of the bank's investment. Eventually, the client becomes the sole owner of the project.⁷

4. Conditions for the Validity of a Partnership Contract

Certain conditions must be met for the partnership contract to be valid. These include (Belaajouz, 2009, p. 33):

4.1 Capital-Related Conditions

- The capital must be known in terms of **amount, type, and form** (currency or asset).
- The capital must **not be a debt owed by one partner to another**.
- It is **prohibited to mix a partner's private capital** with the partnership capital without agreement.
- **Equality of capital contributions is not required** among partners.

4.2 Profit Distribution Conditions

- The contract must **clearly specify the rules** governing the distribution of partnership outcomes—whether profit or loss.
- Profit shares must be **defined precisely**, either in **fractions** (e.g., half, one-third, one-fourth) or **percentages** (e.g., 30%, 20%, 50%).
- In the event of a loss not caused by misconduct or negligence by the managing partner, **losses must be distributed according to each partner's capital share**. It is **not permissible** to agree on a different method for distributing losses, unlike profit distribution. If the managing partner violates any terms of the contract or acts negligently, they are **liable for the resulting damage**.

Third: Applied Study on Risk Management at Al Salam Bank – Algeria

Al Salam Bank – Algeria is considered the second Islamic bank in the country, following Al Baraka Bank – Algeria. It is a subsidiary of Al Salam Bank – Bahrain, which operates in

three countries: Bahrain, Sudan, and the United Arab Emirates. Al Salam Bank has branches in major cities across the national territory and a financial board that offers financing contracts in accordance with Islamic Sharia principles. These can be clearly presented as follows:

1. Identification Sheet of Al Salam Bank

Al Salam Bank is the second bank operating in accordance with Islamic Sharia principles in Algeria.

- **Date of establishment:** June 8, 2006
- **Head office:** 223 Ouaked Street, Dely Brahim, Algiers
- **Corporate structure and capital:** The result of Emirati-Bahraini cooperation, with a subscribed and paid-up capital of 7.2 billion Algerian dinars at the start of operations in 2008, which was raised to 10 billion Algerian dinars in 2010.
- **Chairman:** Mr. Mohammed Omer Bin Yousif Al Mheiri (UAE national)
- **General Manager:** Mr. Nacer Haidar (Algerian national)
- **Number of employees by the end of 2016:** Estimated at 269
- **Bank's objective:** To carry out banking operations in accordance with Islamic Sharia principles. (bank, 2023)

2. Banking Services Provided by Al Salam Bank

Al Salam Bank offers a range of innovative services formulated by modern Islamic banking, and it is committed to delivering them in the best possible manner to its clients. Among these services are financing methods, which include: Murabaha, Ijara (leasing), Musharaka (partnership), Istisna'a (manufacturing contract), Salam (advance payment sale), and Qard Hasan (benevolent loan). (Bank., 2024)

3. Risk Study of a Partnership Financing Contract

The Risk Management Department plays a pivotal role in any bank, as it is the body responsible for assessing potential risks that may arise from granting financing. Before any credit decision is issued, the Risk Management Department must provide its opinion regarding the financed project, relying on both quantitative and qualitative indicators.

In this section, we shall refer to the Risk Management Unit of Al Salam Bank, outlining its main responsibilities and organizational structure in the first subsection, and presenting a risk analysis of a project submitted by one of its clients in the second. (Bank., Information from the Risk Management Unit, 2025)

3.1 Risk Management Unit of Al Salam Bank

The Credit Risk Unit at the Blida branch of Al Salam Bank – Algeria plays a central role in monitoring credit-related risks, serving as the entity in charge of credit risk assessment for the bank. In what follows, we address the responsibilities of the unit and its organizational structure.

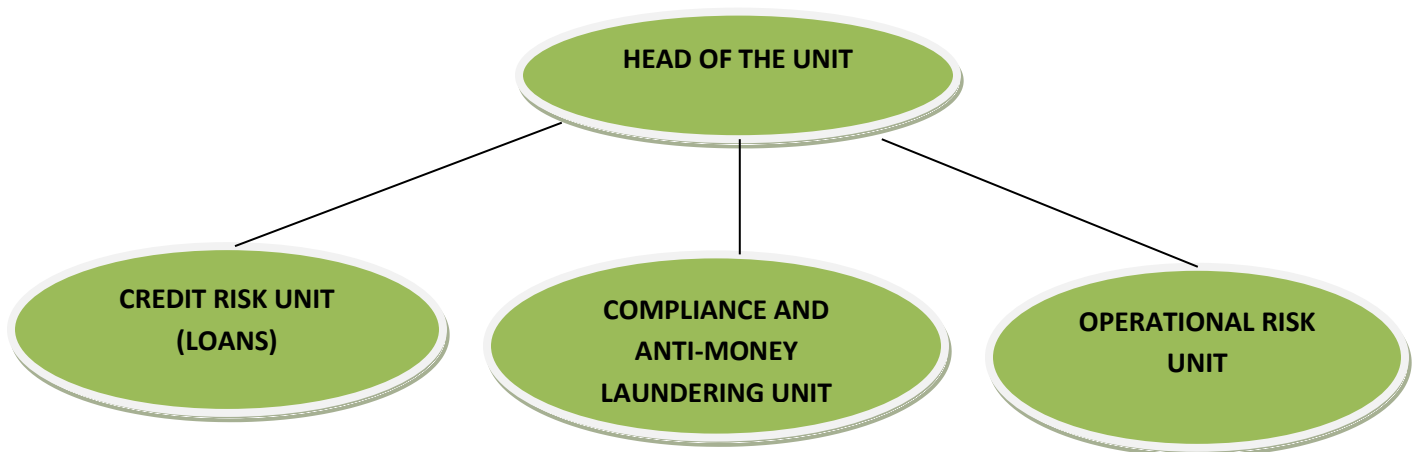
3.1.1 Main Responsibilities of the Credit Risk Unit:

- Coordinating with the General Administration to carry out operations in accordance with specific policy and strategy standards and ensuring that procedures and controls are sufficient to manage all types of risks.
- Reviewing policies related to various products and ensuring they align with the credit risk policy and adequately address all major risks inherent in related operations or products.
- Continuously reviewing the bank's risk profile to ensure it remains within the overall risk limits set by the bank's credit risk strategy.
- Reviewing counterparty credit risks within the same beneficiary or economic sector and providing an independent opinion with a clear recommendation.
- Reviewing the financial solvency assessments of the bank's clients, including methodologies and pricing mechanisms for credit operations.
- Defining objectives and permissible types of credit-related activities, contracts, or financial products for all clients.
- Monitoring and measuring exposure levels of clients, products, and credit sectors, including the concentration of credit risk.
- Conducting periodic stress testing of the bank's credit portfolio.
- Reviewing all major exceptions to the prevailing credit policy.
- Reviewing proposed strategies for clients classified as high-risk and requiring intensive follow-up procedures.
- Defining and documenting tools and techniques for risk analysis in accordance with prevailing guidelines and accounting standards.
- Periodically reviewing the credit risk policy for approval by the Board of Directors.

3.1.2 Organizational Structure of the Risk Management Unit

Below, we present the organizational structure of the Risk Management Unit at the Blida branch of Al Salam Bank – Algeria, along with its subordinate units.

Figure No. (03-01): Organizational Structure of the Risk Management Unit.



Source: Al Salam Bank, Risk Management Unit, Blida Branch.

4. Study of a Partnership Financing Application File

The Risk Management Unit of Al Salam Bank conducts an in-depth analysis of the client applying for financing, based on a set of quantitative and qualitative criteria. Quantitative criteria rely on the financial indicators of the financed company, such as activity ratios, liquidity, sales volume, self-financing capacity, etc. Qualitative criteria are based on various data points, including:

- Management, governance, and experience
- Stability of the business sector
- The company's market position within its sector
- Borrowing capacity
- The company's relationship with the bank (deposits, duration of engagement, defaults)
- The company's relationship with key public institutions (tax authority, social security)
- Sources of repayment
- Centralization of the company's portfolio

Following this analysis, the Risk Management Unit assigns a score based on the quantitative criteria and another score for the qualitative criteria. These scores are combined, and the total is used to classify the client's risk profile as low, medium, or high. The combined score is then compared to the company's turnover, after which the Risk Management Unit determines a credit ceiling within a specific monetary limit. (11)

4.1 Study of the Client's Financing Request

One of the most critical steps in granting banking finance is the study of the client's request and the related information. In this section, we examine a case at Al Salam Bank, where a client submitted a request for new financing facilities. In this case, the bank conducts a comprehensive study of the client, starting with the collection of personal and professional information, and an evaluation of the potential risks associated with the proposed project.

4.1.1 Details of the Client's Request

As part of the completion of a project consisting of **169 residential units**—apartments of types **F3, F4, and F5**, along with **25 commercial premises** and a **parking structure with a capacity of 180 vehicles**—located at **Lotissement Beau Séjour No. 04, Bouzaréah, Algiers**, with a total cost estimated at **1.3 billion Algerian dinars**, the client has submitted a request for **Istisna'a financing** in the amount of **190 million Algerian dinars** (the company acts as the manufacturer), backed by a **10% cash collateral**, with the remaining amount to be repaid in **quarterly installments over one year**, including a **12-month grace period**.

- The **limited liability company** was established on **December 22, 2010**, and operates in the construction sector. It also specializes in the study and execution of various types of construction projects—**residential complexes, hotels, hospitals, parking structures**, etc.

The company has completed several residential projects that have strengthened its technical capabilities and staff expertise. The company was initially founded with a capital of **100,000 Algerian dinars**, which has since increased to approximately **7.3 million Algerian dinars**.

- The company is managed by **Mr. (B.M.)**, who has been at the helm since its establishment and possesses **17 years of experience** in the construction sector. He also serves as the president of the **real estate cooperative** that is the project's awarding entity. The company is staffed with skilled and qualified personnel in the field.
- **Number of employees:** The company employs **23 workers**, including **4 executives**, **8 supervisors**, and **11 operational workers**, with an estimated **annual payroll of 12 million Algerian dinars**.
- **Declared operating equipment of the company includes:**
 - **Machine à projeter:** Acquired on 31/12/2012 at a cost of **1.25 million DZD**
 - **Système de coffrage:** Acquired on 06/10/2015 at a cost of **9.4 million DZD**
 - **Étuits métalliques:** Acquired on 04/11/2015 at a cost of **1.45 million DZD**
- **Declared physical assets of the company:**
 - **Concrete mixing plant (Centrale à béton)**
 - **Backhoe loader (Rétrochargeur)**
 - **Two telescopic forklifts (02 Clark télescopique)**
 - **A crane (Une grue)**

4.1.2 Details of the Current Project (Subject of the Financing)

The client stated the following:

- The project belongs to **Coopérative El Ittihad**, the awarding entity among the real estate cooperatives in the market. The cooperative has been active since **1998** and holds its accounts at **CNEP Banque**. According to the client, approximately **60% of the 169 apartments have already been sold off-plan**.
- The client confirmed that the cooperative is **not enrolled in the Mutual Guarantee and Warranty Fund for Real Estate Promotion**.
- According to the client, the **project completion rate is approximately 50%**, though **receivables collected do not exceed 200 million DZD as of 2023**.
- The project duration is **24 months**, signed at the **beginning of 2022**, but was **suspended for 3 to 4 months in 2023** due to a well-known disruption in raw material supply chains. Construction activities resumed in **October 2023**.
- The **anticipated apartment delivery date** is scheduled for the **second half of 2025**.

Table No. (03-01): Project Progress Rate

Unit of Measurement: In Million Algerian Dinars

ITEM	TOTAL AMOUNT	COMPLETED	REMAINING
LAND	447	447	—
CIVIL ENGINEERING	136	102	34

CONSTRUCTION WORKS	566	174	392
ELECTRICAL WORKS	66	—	66
AIR CONDITIONING	75	—	75
PLUMBING	45	—	45
TOTAL	1,336	723	613

Source: Al Salam Bank, Risk Management Unit.

It is evident from the data presented in the table that the project is experiencing a certain degree of delay, primarily due to disruptions in the supply of raw materials—particularly in the construction works, which are lagging behind by **392 million DZD** out of a total allocated amount of **566 million DZD**. Similarly, civil engineering works show a delay of **34 million DZD**. Apart from these, all other works—namely electrical installation, plumbing, and air conditioning—have been fully completed, and the entire land designated for the project has been utilized.

4.1.3 Financial Assessment of the Project (Projected Profitability / Expected Return)

The bank does not engage in project financing unless the proposed venture has been thoroughly evaluated from an economic standpoint. No investment is undertaken without first assessing the project's feasibility from all relevant dimensions. The following table illustrates the expected profitability of the financed project.

Figure No. (03-02): Project Profitability.

Unit of Measurement: In Million Algerian Dinars

Item	Amount (in Million DZD)
Projected Sales Revenue	1,670
Estimated Total Project Cost	1,336
Expected Project Profit	334
Business Activity Tax (2%) – TAP	7
Tax on Project Profitability (20%) – TAX	67

Net Project Profit	260
Overall Profitability Ratio	19%

Source: Al Salam Bank, Risk Management Unit.

Based on the assessment conducted by the Risk Management Unit, the project is expected to generate a turnover of **1,670 million Algerian dinars**, with an estimated total cost of **1,336 million Algerian dinars**. The projected gross profit of the project amounts to **334 million Algerian dinars**. After deducting the **Business Activity Tax (TAP)** and the **Project Profitability Tax**, the **net profit** is estimated at **260 million Algerian dinars**, representing **19%** of the expected gross profit.

Table No. (03-03): Financial Indicators of the Company.

ITEM		2021	2022	2023	Change 2022/2023
Equity		19	25	88	256%
Of which	Capital	7	7	7	0%
	Reserves	0	1	1	10%
	Accumulated Results (Retained Earnings + Current Period)	11	17	80	375%
Total Liabilities (Debts)		96	143	310	116%
Of which	Bank Liabilities	0	1	1	-06%
	Medium-Term Bank Liabilities	2	1	0	-
	Supplier Credit	5	28	131	374%

	Facilities				
	Accrued Taxes	13	20	47	135%
	Other Current Liabilities	75	93	131	40%
Leverage Ratio		501%	576%	351%	-39%
Bank Liabilities / Equity (Gearing Ratio)		14%	10%	2%	-83%
Total Assets		115	168	398	137%
Sales, Revenues		55	66	211	219%
EBITDA		10	13	23	73%
Net Profit		5	6	18	210%
Net Profit / Sales		5	6	18	210%
Net Working Capital		2	11	77	581%
Working Capital Requirements		2	12	76	513%
Operating Cash Flows		28	14	-39	-373%
Current Ratio (Liquidity Ratio)		1,23	1,02	1,08	6%
Quick Ratio		0,00	0,00	0,01	11012%
Accounts Receivable		79	133	318	139%
Inventory		13	15	54	271%
Inventory Turnover Period (Days)		119	121	57	-53%

Average Collection Period (Days)	392	585	277	-53%
Average Payment Period (Days)	32	144	137	-5%

Source: Al Salam Bank, Risk Management Unit.

Analysis:

- **Equity:** The increase in equity is attributed to the net result achieved in 2023, while the share capital remained constant throughout the study period.
- **Total Liabilities:** These consist mainly of the partners' current account.
- **Sales:** Represent the collection of the project's receivables.
- **Net Profit:** A satisfactory rate.
- **Net Working Capital:** The company recorded a surplus in working capital, which covers its working capital requirements.
- **Operating Cash Flows:** A cash deficit was observed, as cash outflows exceeded the cash inflows received from clients.
- **Current Ratio (Liquidity):** Good ratios, indicating the company's ability to meet its short-term obligations based on its short-term revenues.
- **Quick Ratio:** Indicates the company's inability to meet very short-term obligations.
- **Average Collection Period:** Reasonable, as the client operates through contractual agreements.

4.1.4 – Analysis of Strengths and Weaknesses and the Risk Management Department's Opinion on the Project

Strengths and weaknesses play a crucial role in enabling the Risk Management Department to assess the potential success or failure of the company in its field of activity.

4.1.4.1 – Strengths and Weaknesses

Strengths:

- The turnover of the limited liability company amounted to **210.8 million DZD** in 2023.
- The financial and moral solvency of the company's manager, who is also the president of the real estate cooperative **COOPERATIVE EL IT**.
- The client expressed intent to open an account for **COOPERATIVE EL IT** at the bank, representing an opportunity to attract part of the cooperative's turnover.
- The client prefers financing products that comply with **Shariah principles**.
- The client proposed a **first-degree mortgage** as collateral to secure the net credit facilities.

Weaknesses:

- Market volatility.

4.1.4.2 – Guarantees Provided by the Client

- A **first-degree mortgage**, regardless of the appraised value, assessed by a real estate expert accredited by the bank.
- **Personal and joint guarantees** from the company's partners.
- A **promissory note** signed for the full value of the facilities.
- **Repayment method**: An installment plan over **18 months**, payable at maturity.
- **On-site visits** to the project every **three months** to monitor the progress of works (conducted by the commercial department in collaboration with the branch and the bank's engineer).
- **Tax and parafiscal clearance certificate** upon activation.
- The bank's share of the profits: **20% (66.8 million DZD)**, equivalent to **29% annually (T24)**.

4.1.4.3 – Risk Management's Assessment of the Project's Risks

Following a thorough and in-depth review of the client's application, the **Risk Management Committee** assigns the client a final score and determines the project's risk level as follows:

Table No. (03-04): Risk Management Recommendation.

Final Rating and Risk Level					
Exposure Limit (DZD)	Determining the Ceiling Ratio of Own Funds	Risk Level	Type of Risks	Risk Classification	Final Score (%)
2 600 617 572	15%	5	Moderate Risks	Effective Debts	64.5
17 000 784 150		The Bank's Own Funds as of 31/12/2023 (DZD)			
The Company's Classification for the Year 2022					
Eligible Compatible Ceiling to Be Granted (DZD)		Realized Turnover (DZD)		The Company's Classification under Law 17-02	
42 885 228		66 000 168		Small	
The Company's Classification for the Year 2023 for Reference					
Eligible Compatible Ceiling to Be Granted (DZD)		Realized Turnover (DZD)		The Company's Classification under Law 17-02	

135 000 588	000 885 210	Small
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Source: Al Salam Bank, Risk Management Unit.

It is observed from the data presented in the table that the Risk Committee has classified the project as **moderate risk**. Given the small size of the company and its **turnover of DZD 210,885,000**, the Risk Committee recommended granting a **credit ceiling consistent with the company's size, within the limit of DZD 135,588,000**.

4-1-5. Credit Department Recommendations

4-1-5-1. Recommendation of the Director of Commercial Operations

In view of the profitability of the operation, we recommend approval of:

- **Financing of a participation in the amount of DZD 152 million for a period of 18 months**, to be repaid at maturity, covering:
 - **11 months for the implementation period**, and
 - **7 months for the collection period (15)**.

Table No. (03-05): Operation Details

ITEM	ESTIMATED BUDGET (MILLION DZD)
Turnover Excluding Taxes	1670
Purchase Price Excluding Taxes	1336
Profitability	334
Proposed Bank's Share of Profits: 20% (Commercial Directorate)	66.8

Source: Al Salam Bank, Risk Management Unit.

5. Proposal of the Financing Department

In light of the aforementioned, we recommend approving the granting of the following to the client:

- **Istisna'a financing** (*the bank as manufacturer*) in the amount of **DZD 190 million**, with a **cash collateral of 20%**, and the remaining balance to be repaid in **quarterly installments over 18 months**, subject to the following terms and guarantees:
 - A **first-degree mortgage** covering **100% of the net facilities**, appraised by a **real estate expert accredited by our bank**;
 - **Personal and joint guarantees** from the partners;
 - Signing of a **promissory note** for the total value of the facilities;

- **Profit margin:** 9%;
- **Repayment method:** quarterly installments;
- **On-site project inspection every three months** to monitor the progress of work (**Commercial Directorate with the branch + the Bank's engineer**);
- **Disbursement in tranches** based on the percentage of project completion (**40%, 30%, 30%**);
- Submission of **tax and parafiscal clearance certificates** at the time of activation;
- Verification of the **signatory's authority** to request the credit, mortgage the company's assets, and sign the agreements on behalf of Al Salam Bank Algeria.

6. Recommendation of the Head of the Commercial Sector

Approved as per the recommendation of the Commercial Directorate.

7. Facilities Committee Decision: 27/02/2024

In view of the above, the Facilities Committee has decided as follows:

- To grant **Musharakah financing in the amount of DZD 152 million**, for a period of **18 months**, to be repaid in full at maturity, covering **an 11-month implementation period and a 7-month collection period**, subject to the **mentioned terms and guarantees**

Conclusion:

Islamic banks are confronted with two distinct types of risk. The first is shared with their conventional counterparts, while the second is specific to Islamic financing instruments, placing a unique burden on Islamic banks to manage and control such risks effectively. The intensity and complexity of these risks vary depending on the nature of the Islamic financing instruments employed, with credit risk being particularly pronounced in *musharakah* (partnership) financing, given the bank's direct involvement as a partner. This necessitates a dedicated effort by Islamic banks to identify, assess, and mitigate the risks inherent to this financing model, as effective risk management constitutes a critical factor in the success of these institutions and the achievement of their strategic objectives. While entering into higher-risk financing may yield greater profits, the failure to manage such risks appropriately could lead to the loss of expected returns and the inability to realize long-term institutional goals.

Accordingly, the study arrived at the following key findings:

Study Findings:

- The risks associated with *musharakah* financing are multifaceted and necessitate a high level of evaluation and ongoing monitoring by the bank.
- Al Salam Bank – Algeria demonstrates a commendable awareness of the risks tied to partnership contracts, as evidenced by the establishment of a specialized Credit Risk Management Unit with a well-defined organizational structure. This unit employs precise quantitative and qualitative standards in evaluating clients and investment proposals.
- The empirical case study revealed that the bank is capable of maintaining risk control by implementing a "credit ceiling" policy, which considers the size of the enterprise and the

nature of its risk exposure. As a result, the project under study was classified as one of "moderate risk," with financing limits set accordingly.

- The bank adopts a cautious approach in managing investment-based financing, particularly for partnership contracts. This includes heightened attention to monitoring project progress and requiring periodic on-site inspections coordinated between the commercial division and the assigned technical engineer.
- The study further demonstrated that the bank's risk evaluation process, conducted by the Risk Committee, is based on clearly defined scientific criteria and serves as an effective mechanism for rationalizing credit decisions and mitigating unwarranted exposures.

Accordingly, the following recommendations are proposed:

- Transition away from the currently dominant financing model based on *murabaha*, and move toward broader use of investment-based contracts that reflect the genuine Islamic financing paradigm.
- Islamic banks should expand their utilization of profit-and-loss sharing instruments, particularly *musharakah*-based financing, and invest in developing innovative tools and methodologies to mitigate their associated risks.
- The bank should revise certain internal risk management procedures to ensure greater alignment with the principle of profit and loss sharing, a foundational concept in Islamic finance.
- It is imperative to establish credit limits for debt-based financing instruments and to prioritize and promote productive modes of financing, while also maintaining focus on the social, cultural, and religious dimensions that distinguish Islamic banks from their conventional counterparts.
- Continuous and rigorous monitoring of client financing and financial standing is essential—especially for equity-based contracts—so that the bank may proactively implement preventive measures prior to client default or insolvency.
- The bank should seek to move beyond the *murabaha*-centric model and embrace real market-based investment operations.
- The bank must address existing deficiencies in risk management tools for profit-and-loss sharing contracts by applying Islamic financial engineering outputs and developing additional instruments to enhance its risk control capabilities.
- Finally, efforts should be made to persuade central regulatory authorities to amend existing laws and regulations in ways that better accommodate the specific operational and structural needs of Islamic banking institutions.

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