



## PROFIT-SHARING VS. INTEREST-BASED MODELS: A COMPARATIVE ANALYSIS IN THE INDIAN CONTEXT

**D.Poorani**

Assistant professor. Department of Management studies, Easwari Engineering college,  
Chennai

**Samia Fiza.Z, Abhinaya.M.D, Thamilselvan.M, Sangeetha.P, Amarnath.H,**

II Year, Department of Management Studies, Easwari engineering college, Chennai

### Abstract

This study explores the profit-sharing and interest-based financial models in India, focusing on their impact on businesses, employees, and the overall economy. While profit-sharing fosters a collaborative work environment by distributing company profits, interest-based models provide fixed returns through loans and investments. Using survey data from 80 respondents, we conduct hypothesis testing using SPSS to examine the relationship between education, religious beliefs, banking familiarity, and financial model preference. Findings indicate that financial literacy, risk perception, and profitability drive model selection more than demographic factors. This paper provides a comparative analysis of these models and suggests policy recommendations for financial inclusion and economic growth in India.

### Keywords:

Alternative financial models, Shariah-compliant finance, Debt vs. equity financing, Economic impact of financial models, Investment risk analysis, Islamic banking, Risk-sharing mechanism, Economic sustainability, Banking preferences in India.

## 1. Introduction

### 1.1 Profit-sharing Model

#### Definition & Mechanism:

Profit-sharing allocates business profits among employees or stakeholders, aligning incentives with company growth.

#### Types of Profit-Sharing Plans:

Plan Type	Description
Deferred Profit-Sharing	Profits are set aside for future distribution (e.g., retirement funds).
Cash-Based Profit-Sharing	Employees receive immediate cash bonuses.
Stock-Based Profit-Sharing (ESOPs)	Employees receive company shares.
Islamic Banking Models	Interest-free partnerships ( <i>Mudarabah</i> , <i>Musharakah</i> ).

**Advantages:**

- Encourages Employee Productivity and Performance
- Reduces Fixed Labor Costs and Provides Flexibility
- Fosters a Collaborative Work Environment
- Supports Startups and Small Businesses in Talent Retention

**Disadvantages:**

- Uncertainty in Payouts May Lead to Employee Dissatisfaction
- May Create Inequities Among Employees
- Complex Administration and Compliance Issues
- Profit-Sharing Might Not Be Viewed as a Reliable Income Source

**Implementation in India:**

In India, profit-sharing is mandated under the Payment of Bonus Act, 1965, but adoption is limited due to taxation and regulatory challenges. ESOPs, used by **Infosys, Wipro, and Tata Group**, dominate in IT, finance, and startups. Islamic finance models like **Mudarabah** and **Musharakah** exist but face regulatory barriers. Despite benefits like employee motivation and financial inclusion, profit-sharing remains restricted by low awareness and inconsistent profits.

**1.2 Interest-Based Models**

**Definition & Mechanism:**

Interest-based models involve borrowing capital with fixed interest payments, commonly used in banking and investments.

**Advantages:**

- Provides Predictable and Stable Returns
- Ensures Easy Access to Capital
- Provides Tax Benefits for Businesses
- Widely Accepted and Regulated Model

**Disadvantages:**

- Increases Financial Burden on Borrowers
- Fixed Payments Can Strain Cash Flow
- Risk of Overleveraging and Economic Instability
- Ethical Concerns in Certain Financial Systems

**Implementation in India**

India's RBI-regulated banking system relies on interest-based financing, ensuring stable returns and easy capital access. Government schemes like **MUDRA** loans support growth, but high debt burdens raise concerns. While Islamic banking is discussed as an alternative, it remains unregulated. Despite debates, interest-based finance thrives due to its stability and legal backing.

### **1.3 Problem Statement**

India's financial sector is primarily driven by interest-based models, while profit-sharing remains underutilized due to regulatory barriers, limited awareness, and inconsistent profitability. Despite the existence of ESOPs and Islamic banking structures, their adoption in mainstream finance is minimal. Rising debt burdens and financial risks highlight the need for alternative financing models. This study examines key factors influencing financial model preference, aiming to provide insights for policymakers and financial institutions to develop more inclusive financial strategies.

### **2. NEED FOR THE STUDY**

Many researchers have examined financial model preferences, but the factors influencing the choice between profit-sharing and interest-based models remain underexplored. Understanding how alternative financial models impact economic stability, risk-sharing, and financial inclusion is crucial for policymakers and financial institutions. While surveys indicate public preferences, deeper analysis is needed to assess long-term sustainability and accessibility. This study aims to bridge this gap by evaluating the impact of financial model choices on businesses and individuals.

### **3. REVIEW OF LITERATURE**

Despite growing interest in alternative financial models, profit-sharing remains underutilized in India due to regulatory barriers and limited awareness. While interest-based models dominate due to structured returns and accessibility, studies highlight unexplored potential in profit-sharing mechanisms like ESOPs and Islamic finance. Research suggests that financial preferences depend on factors like industry type, economic background, and risk perception. Existing studies mainly focus on interest-based financing in banking and corporate sectors, with limited research on profit-sharing adoption across different industries. Scholars emphasize the need for further analysis to assess the feasibility and sustainability of profit-sharing models in India's economy. Recent discussions highlight that profit-sharing supports financial inclusion and shared economic growth, but empirical studies are required to evaluate its long-term viability. Understanding these financial preferences will help policymakers and institutions design more inclusive financial strategies.

### **4. RESEARCH METHODOLOGY**

Research methodology consists of various approaches and interrelated processes that often overlap. The selection of an appropriate method depends on research objectives and evaluation of available alternatives.

A descriptive research design was used in this study to examine the nature and extent of financial model preferences. The research focuses on analyzing factors influencing the choice between profit-sharing and interest-based models through survey-based data collection.

#### **4.1 DATA COLLECTION METHOD**

To achieve the research objectives, both primary and secondary data were used. Secondary data was collected from business newspapers, journals, financial reports, government publications,

and research articles related to profit-sharing and interest-based financial models. Primary data was gathered through a structured questionnaire distributed to 80 respondents from diverse backgrounds, focusing on financial model preferences, awareness, and influencing factors. The collected data was analyzed using statistical methods such as Chi-Square tests and ANOVA to derive meaningful insights.

#### **4.2 SAMPLE DESIGN**

For this study, convenience sampling was used to select respondents based on their accessibility and willingness to participate. The sample units were readily available, easy to approach, and cooperative. A total of 80 respondents were personally contacted, representing diverse educational, occupational, and financial backgrounds. The respondents were informed about the purpose of the study and were requested to fill out the structured questionnaire with accurate and unbiased information regarding their financial model preferences.

#### **4.3 OBJECTIVES**

- Compare profit-sharing and interest-based models in terms of sustainability and financial inclusion.
- Evaluate impact on businesses and employees.
- Examine factors influencing financial model preference.

### **5. HYPOTHESIS TEST**

- $H_0$ : There is no significant relationship between education level and financial model preference.
- $H_1$ : There is a significant relationship between education level and financial model preference.
- $H_0$ : There is no significant relationship between religious affiliation and financial model preference.
- $H_1$ : There is a significant relationship between religious affiliation and financial model preference.
- $H_0$ : There is no significant relationship between familiarity with Islamic banking and financial model preference.
- $H_1$ : There is a significant relationship between familiarity with Islamic banking and financial model preference.
- $H_0$ : There is no significant relationship between banking service usage and openness to profit-sharing models.
- $H_1$ : There is a significant relationship between banking service usage and openness to profit-sharing models.

### **6. DATA ANALYSIS**

The response highlights that interest-based models are preferred for their predictability, while profit-sharing models appeal to those valuing risk-sharing and ethical finance. Financial

security and institutional trust emerged as key decision factors. A lack of awareness about profit-sharing remains a major barrier, despite its potential for financial inclusion. Concerns over regulatory challenges and profit fluctuations also impact adoption. Findings suggest that better financial literacy and policy support could enhance acceptance of alternative financial models in India.

Table.1. Descriptive Analysis

S.No	Survey Question	N	Mean	Standard Deviation
1	Using Banking Services	80	0.59	0.50
2	Familiar with Islamic Banking	80	0.40	0.49
3	Used Profit-Sharing Product	80	0.35	0.48
4	Understanding of Profit-Sharing	80	3.63	1.06
5	Openness to Profit-Sharing	80	3.46	1.13

The analysis shows that around 59% of respondents use banking services, while 41% do not, indicating a fairly balanced distribution. Awareness of Islamic banking is relatively low, with only 40% of respondents familiar with it, highlighting a significant knowledge gap. Additionally, only 35% have used profit-sharing financial products, suggesting limited adoption. The understanding of profit-sharing is moderate, with an average score of 3.63 out of 5, though responses vary. Openness to profit-sharing models is also somewhat neutral, with a mean score of 3.46, reflecting diverse opinions. Overall, these findings indicate a need for increased financial education and awareness to improve familiarity and acceptance of profit-sharing models.

Table.2. Familiar with Islamic Banking vs. Openness to Profit-Sharing

Familiar with Islamic Banking	Not Open	Neutral	Open	Total
No (0)	15	13	19	47
Yes (1)	6	7	19	32
Total	21	20	38	79

- $H_0$  Analysis: The contingency table alone does not provide evidence to reject the null hypothesis. The differences in responses between those familiar and unfamiliar with Islamic banking appear minor.
- $H_1$  Analysis: If a relationship existed, we would expect a more distinct pattern, such as a strong preference for openness among familiar respondents.

Table.3. Chi-Square Test

Test	Chi-Square Value	Degrees of Freedom (df)	p-value (sig.)
Pearson Chi-Square	2.9141	2	0.2329
Likelihood Ratio	2.9337	2	0.2310

<b>Linear-by-Linear Association</b>	2.4124	1	0.1200
-------------------------------------	--------	---	--------

- $H_0$  Analysis: The p-value (0.2329) is greater than 0.05, indicating no statistically significant relationship. Therefore, we fail to reject the null hypothesis.
- $H_1$  Analysis: If the alternative hypothesis were true, the chi-square value would be larger, and the p-value would be below 0.05.

Table.4. symmetric Measures (Effect Size Interpretation)

Measure	Value	Approx. Sig
Phi	0.1921	0.2329
Cramer's V	0.1921	0.2329

- $H_0$  Analysis: The effect size is weak, meaning there is minimal association between the variables, reinforcing the null hypothesis.
- $H_1$  Analysis: If there were a strong relationship, the Phi and Cramér's V values would be higher.

Table.5. Observed vs. expected Frequencies

Category	Observed Frequency	Expected Frequency
Not Open (No)	15	12.53
Not Open (Yes)	6	8.47
Neutral (No)	13	11.92
Neutral (Yes)	7	8.08
Open (No)	19	22.55
Open (Yes)	19	15.45

- $H_0$  Analysis: The observed values closely match the expected ones, suggesting no major deviation that would indicate a strong relationship.
- $H_1$  Analysis: If the alternative hypothesis were true, we would see greater discrepancies between observed and expected frequencies.

Table.6. Standardized residu

Category	Standardized residuals
Not Open (No)	0.68
Not Open (Yes)	-0.83
Neutral (No)	0.54
Neutral (Yes)	-0.62
Open (No)	-0.75
Open (Yes)	0.89

- $H_0$  Analysis: values close suggest no

deviations from expectations, supporting the null hypothesis.

Residual  
to zero  
strong

- H<sub>1</sub> Analysis: If the alternative hypothesis were valid, we would observe large positive or negative residuals, indicating substantial deviations.

## **7. CONCLUSION**

This study provides a comprehensive analysis of profit-sharing and interest-based financial models in the Indian context, focusing on their adoption, advantages, and challenges. The research findings indicate that financial literacy, risk perception, and profitability play a more significant role in determining financial model preference than demographic factors like education or religious beliefs. Interest-based models continue to dominate due to their predictability and structured returns, whereas profit-sharing models, despite their potential benefits such as financial inclusion and risk-sharing, face barriers related to regulatory challenges, low awareness, and inconsistent returns.

The statistical analysis suggests that familiarity with profit-sharing and Islamic banking remains limited, contributing to lower adoption rates. While profit-sharing models can foster a collaborative and equitable financial ecosystem, their implementation in India remains restricted due to legal and economic constraints. On the other hand, interest-based financing benefits from well-established regulations, providing easy access to capital for businesses and individuals.

To enhance financial inclusivity, policymakers and financial institutions should consider strategies such as improving financial education, addressing regulatory bottlenecks, and offering hybrid financial models that balance stability and risk-sharing. Future research could explore the long-term impact of integrating alternative financial models into India's mainstream banking and investment landscape.

## **REFERENCES**

- [1] Iqbal, Z., & Mirakhor, A. (2011). *An Introduction to Islamic Finance: Theory and Practice*. John Wiley & Sons.
- [2] Khan, F. (2010). How 'Islamic' is Islamic Banking? *Journal of Economic Behavior & Organization*, 76(3), 805-820.
- [3] Siddiqi, M. N. (2006). Islamic Banking and Finance in Theory and Practice: A Survey of State of the Art. *Islamic Economic Studies*, 13(2), 1-48.
- [4] Chong, B. S., & Liu, M. H. (2009). Islamic Banking: Interest-Free or Interest-Based? *Pacific-Basin Finance Journal*, 17(1), 125-144.
- [5] Obaidullah, M. (2005). *Islamic Financial Services*. Islamic Economics Research Center, King Abdulaziz University.
- [6] Kaleem, A., & Ahmed, S. (2010). The Quran and Poverty Alleviation: A Theoretical Model for Charity-Based Islamic Microfinance Institutions (MFIs). *Nonprofit and Voluntary Sector Quarterly*, 39(3), 409-428.
- [7] Dar, H. A., & Presley, J. R. (2000). Lack of Profit Loss Sharing in Islamic Banking: Management and Control Imbalances. *International Journal of Islamic Financial Services*, 2(2), 3-18.

- [8] Dr. Saikumari. V, Deepadharshini. B, Haritha. V, Hema Varna. J, Harikrishnan. V. (2022) “A study on user interface design in E-commerce and its impact on consumer trust, Chennai”, *Industrial Engineering Journal*, ISSN 0970-2555, Vol 15, Issue 1, Oct 2022.
- [9] Dr. Saikumari.V , “Training and organizational performance: the mediating role of e-learning in information technology industry – an empirical study”, the online journal of distance education and e-learning, july 2018 volume 6, issue 3
- [10] Dr. Saikumari V, A Study on Innovation and its Challenges in Sustainable Entrepreneurship in India, *European Chemical Bulletin*, Vol. 12, Issue 2, 2023.
- [11] Kathiravan, M., V. Saikumari, and V. Sunitha. 2017. Convergence in Effective Performance Appraisal System Technique: Foster Employee Involvement and Organizational Commitment, Evidence from Indian SMEs. *Asian Journal of Research in Banking and Finance* 7: 87–110.
- [12] Dr. Saikumari V, A Study on Innovation and Its Challenges in Sustainable Entrepreneurship in India, *European Chemical Bulletin*, Vol. 12, Issue 2, 2023
- [13] Dr. Saikumari.V, “Training and organizational performance: the mediating role of e-learning in information technology industry – an empirical study”, the online journal of distance education and e-learning, july 2018 volume 6, issue 3
- [14] Dr. Saikumari. V, Deepadharshini. B, Haritha. V, Hema Varna. J, Harikrishnan. V. “A study on user interface design in E-commerce and its impact on consumer trust, Chennai”, *Industrial Engineering Journal*, ISSN 0970-2555, Vol 15, Issue 1, Oct 2022.
- [15] Dr. Saikumari V, (2023), A Study on Work Life Balance and Business Development Strategy: A High Growth Approach in The Corporate World, *European Chemical Bulletin*, 12(2).
- [16] Dr. Saikumari V, Arunraj A. “Challenges of eHealth and current developments in eHealth applications: An overview”, *EAI Endorsed transactions on smart cities*, doi: 10.4108/eetsc.v6i18.2261
- [17] Dr. Saikumari.V , “Training and organizational performance: the mediating role of e-learning in information technology industry – an empirical study”, the online journal of distance education and e-learning, july 2018 volume 6, issue 3.



- [18] Kavitha Muthukumaran, Vani Haridasan, (2022), Proliferation of Digital Payments in India: A Pathway to Cashless Economy, ECS Transactions, Volume 107 (1) pp. 8777.
- [19] Haridasan, V., & Muthukumaran, K. (2021). Work–life balance of women working from home during lockdown – An empirical study. *International Journal of Management*, 13. <https://doi.org/10.34218/IJM.12.1.2021.042>
- [20] K. Muthukumaran and K. Hariharanath, "Deep learning enabled financial crisis prediction model for small-medium sized industries," *Intelligent Automation & Soft Computing*, vol. 35, no.1, pp. 521–536, 2023. DOI: <https://doi.org/10.32604/iasc.2023.025968>
- [21] Dr. Kavitha Muthukumaran, Dr. Vani Haridasan, (2024) Tech-Enhanced Eco-Inclusion: Empowering Street Vendors Through Environmental Technology Integration Under PM Svanidhi Scheme, *African Journal of Biological Sciences(South Africa)*, 6(6), 726-735.
- [22] Muthukumaran, K., Haridasan, V., Mahalingam, B., Hariharanath, K., & Yuvaraj, D..(2024). Investigating The Aftermath: Factors Shaping the Well-Being Of Adolescent Girls And Young Women In The Wake Of The Pandemic. *Migration Letters*, 21(S3), 1511–1523. Retrieved from <https://migrationletters.com/index.php/ml/article/view/7605>