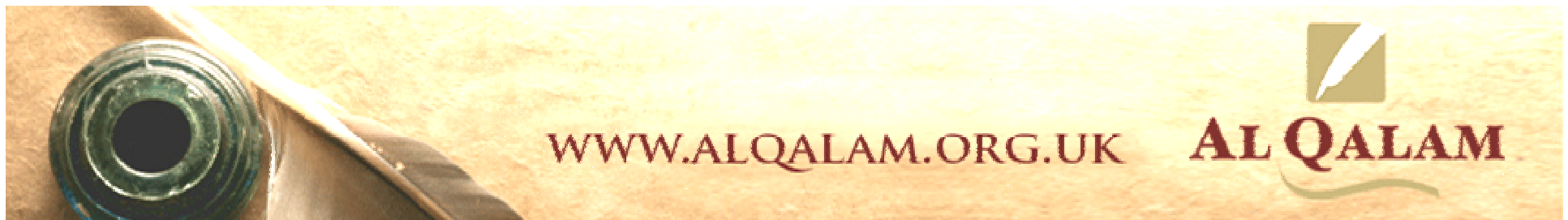


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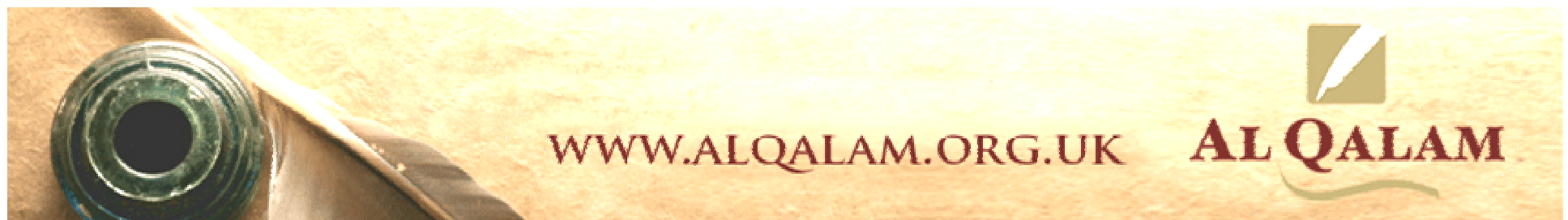
CONTRACTS OF INVESTMENTS

Musharakah & Mudharabah



Musharakah – Definition

- The lexical definition of Musharakah is sharing.
- In classical Fiqh textbooks, the word Shirkah is more commonly used. The term Musharakah has been introduced recently by those who have written on the subject of Islamic finance.
- There are two types of Shirkah:
 1. Shirkatul Milk
 2. Shirkatul Aqd
 - Shirkatul Amwal
 - Shirkatul A'mal
 - Shirkatul Wujoo

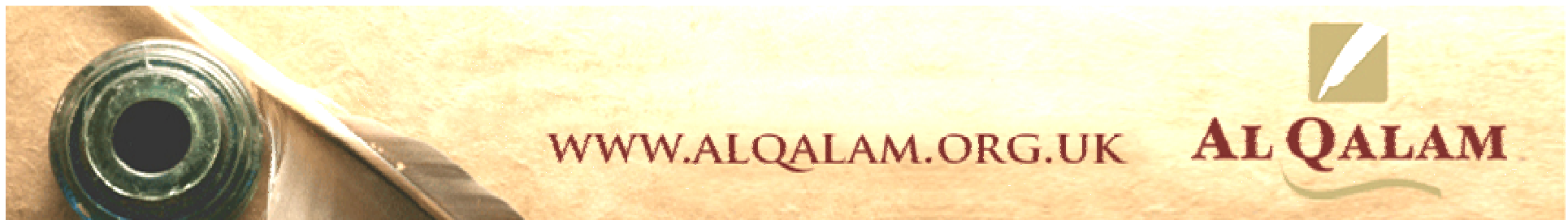


Shirkatul Milk – Shirkatul Aqd

- Shirkatul Milk is a joint acquisition not for the common purpose of investment or joint commercial enterprise.
- Shirkatul Aqd is a joint acquisition where the basic objective is to have a joint enterprise which results in a common profit.

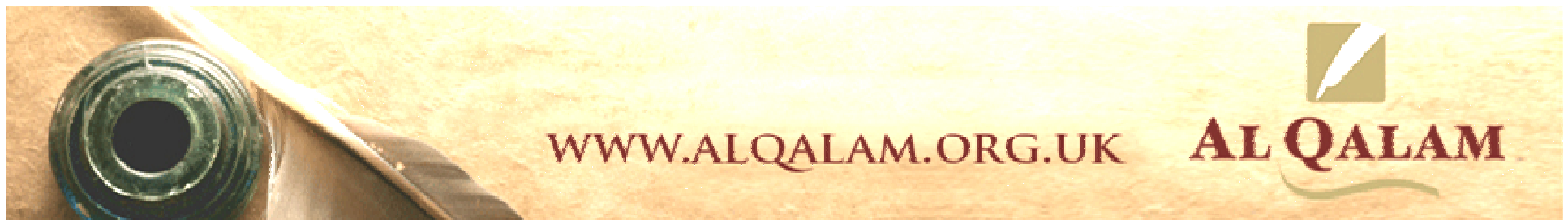
Shirkatul Milk

- If a bank finances a house on a Musharakah basis hoping to profit through rentals and the client only intends to use the property for personal use
- If a bank finances a house on a Musharakah basis hoping to profit through rentals and the client only intends to profit upon a further sale of the property.



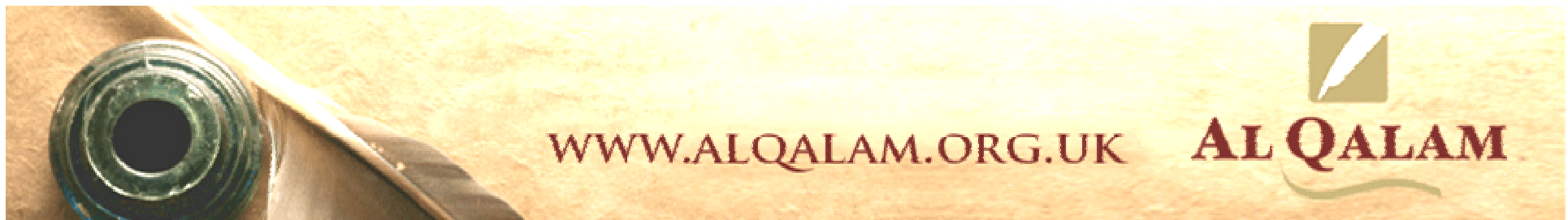
Shirkatul Milk – Shirkatul Aqd

- Shirkatul Amwal is where all the partners invest some capital into a commercial enterprise.
- Shirkatul A'mal is where all the partners jointly offer services to customers and the fee charged is distributed among them at a set ratio.
- Shirkatul Wujoo'h is where an investment is not actually made initially. They purchase commodities on a deferred basis and sell it at spot and distribute the profit between them at a set ratio.
- Musharakah as used in modern Islamic finance only includes Shirkatul Amwal and in some instances Shirkatul A'mal.



Musharakah

- Interest predetermines a fixed rate of return whilst Musharakah has no fixed predetermined rate of return.
- In interest based transactions, the financier is not burdened with the loss suffered by the client whereas in Musharakah, the loss suffered will be borne by both the financier and the client in proportion to their share.
- In the interest-based system, the bank depositors who contribute about 90% of the capital to a project only receive 10% whereas the client (industrialist) who may only contribute 10%, receives 90% of the profits acquired. Musharakah ensures that there is a fairer distribution of profit and loss.
- The 10% paid to bank depositors is then added to the cost of production and charged back by industrialists.

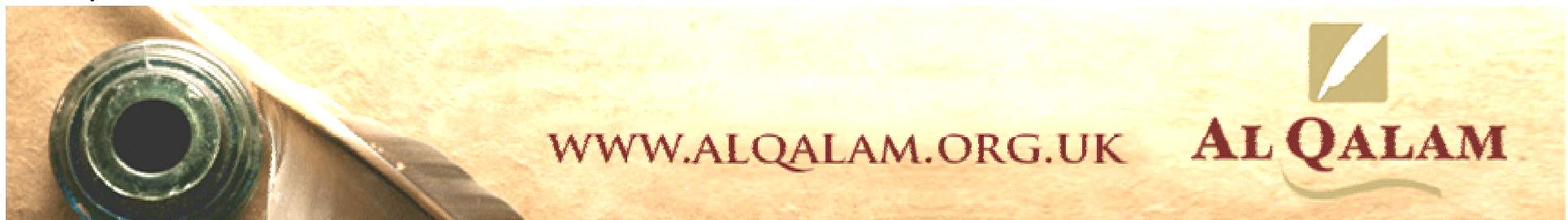


Musharakah – Basic Rules

- Musharakah is a relationship established by the parties through a mutual contract and therefore all necessary ingredients for a valid contract must be present.
- The proportion of profit to be distributed between the partners must be agreed upon at the time of effecting the contract.
- The ratio of profit for each partner must be determined in proportion to the actual profit accrued to the business and not a percentage of his investment or a lump sum.

Example

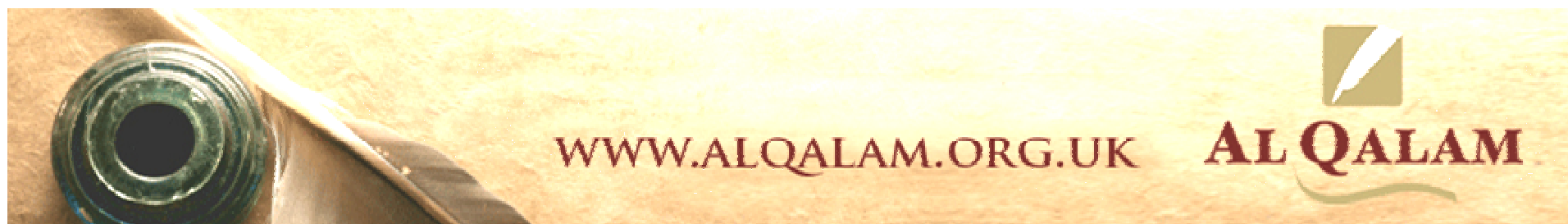
- If Zaid and Amr enter a Musharakah agreement and it is agreed between them that Zaid will receive a) £10,000 per month or b) 20% of his investment per annum then this is not valid.



Musharakah – Distribution of Profit/Loss

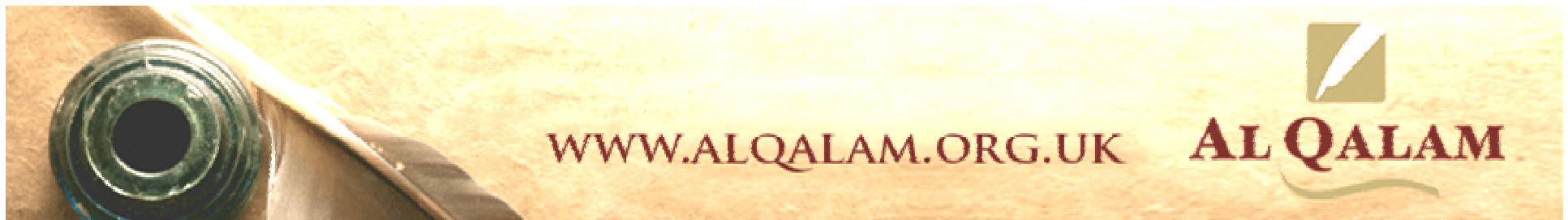
الوضيعة على المال والربح على ما اصطالحوا عليه

- If only one of the partners is working then he may receive a share of the profits more than the share of his investment.
- A non-working partner may not receive more than the share of his investment according to the majority of scholars. According to Imam Ahmed, he may receive more than his share.
- If both partners are working then according to Imam Shafi and Imam Malik, each partner must receive according to his share of the investment. According to the Ahnaf and Hanabila, each partner may receive a ratio differing to his investment.
- Losses will be shared according to the share in investment



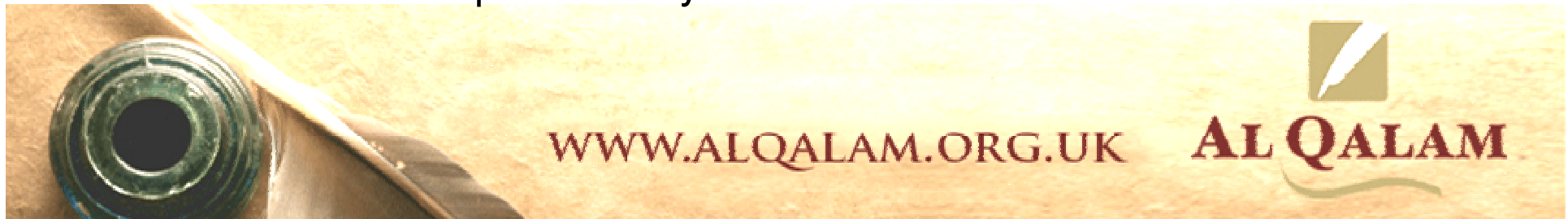
Musharakah – Liquidity of capital

- According to Imam Abu Hanifah and Imam Ahmed, the capital must be of liquid assets and may not be in the form of other commodities.
- According to Imam Malik, the capital may be in the form of either liquid assets or other commodities. This is also one narration from Imam Ahmed.
- Imam Shafi differentiates between different types of commodities.
 - Liquid assets may be used for the purpose of Musharakah
 - Assets which are of ذوات الأمثال may also be used and contributed towards the Musharakah
 - Assets which are of ذوات القيم cannot be contributed towards a Musharakah



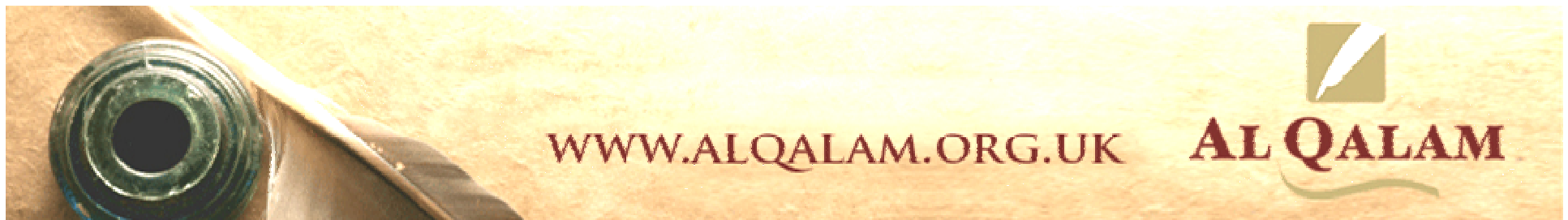
Musharakah – Liquidity of capital

- Imam Malik says that as Musharakah is permissible in liquid assets it should also be so in non-liquid assets.
- Imam Abu Hanifah and Imam Ahmed have two objections
 - If the contributions made were not of liquid assets, the assets of each partner will always be distinguishable from his partners. When his item is sold etc. he should receive the profit from his item. On the other hand, if liquid assets were contributed, one partners assets will be indistinguishable from the others and a common pool will be formed.
 - If non-liquid assets were contributed and the partners want to terminate the Musharakah, redistribution of the capital will not be able to take place as the item may have been sold on.
- Imam Shafi's opinion answers the second objection.
- Hazrat Thanwi has given Fatwa on the opinion of Imam Malik due to the needs of present day businesses.



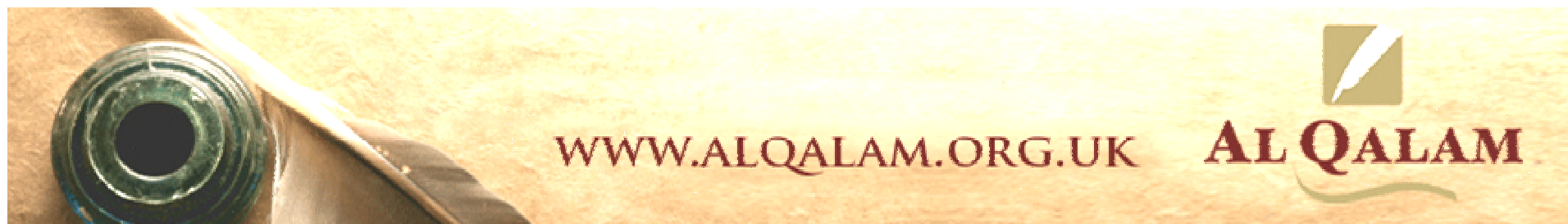
Musharakah – Termination

- Every partner has a right to terminate the Musharakah at any given time after notifying his partner, and the Musharakah will come to an end.
- After termination, the assets will be in joint ownership of the partners.
- If in liquid form, they may be distributed according to the share of the different partners.
- If in non-liquid form, and there is a dispute between different partners, some wanting to liquidate the assets and some wanting to distribute the assets as they are; the latter will be preferred.
- Other partners may buy out the share of one partner through mutual agreement.



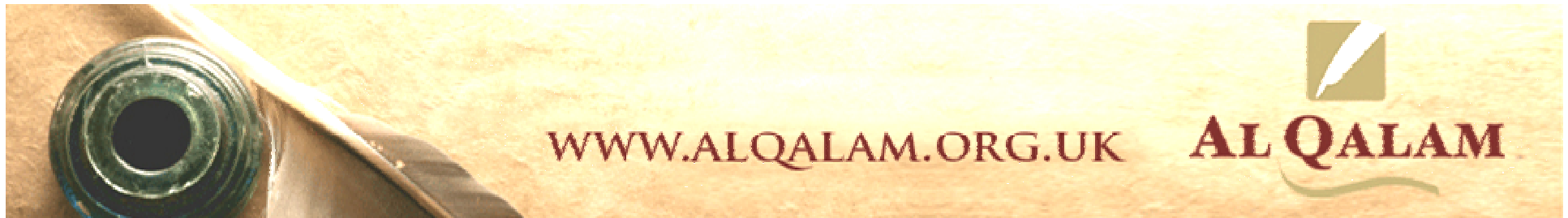
Mudharabah

- A type of partnership where one partner, رب المال, gives money to another, مضارب, to invest.
- The whole investment comes from the first partner and working is an exclusive responsibility of the other.
- The رب المال may specify a particular business for the مضارب and he must invest the money in that business only.
- He may also leave it open for the مضارب to invest in any business he deems fit.
- The رب المال may offer a Mudharabah contract to more than one person in the same contract. The different مضارب will run the business as though they were partners and they will share between them the share of the مضارب at the agreed proportion.



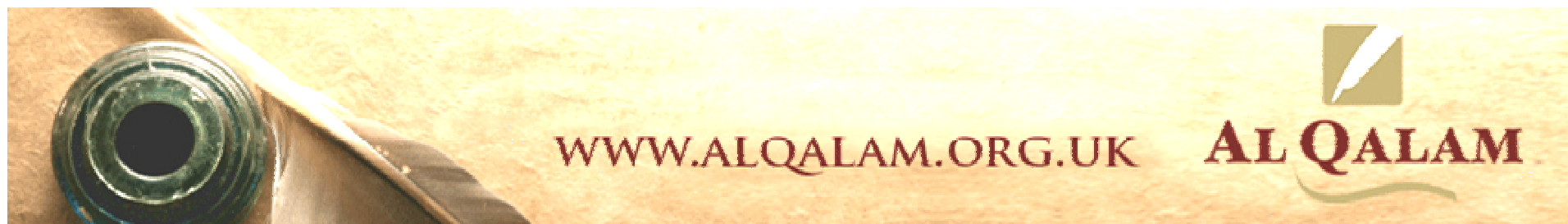
Mudharabah

- It is necessary for the validity of Mudharabah that the parties agree at the beginning on a fixed proportion of the profit for each party.
- A lump sum may not be fixed nor a percentage of the actual investment.
- Different proportions may be fixed for different situations for example different profit sharing ratio for wheat or rice business or different ratios for business in different locations.
- The مضارب cannot claim any periodical salary for the work done, his remuneration will be his share of any potential profit. Imam Ahmed allows the مضارب to claim his daily expenses of food only.
- Hanafi scholars have allowed the مضارب to claim personal expenses when on a business trip.
- Imam Abu Hanifah and Imam Ahmed are of the view that Mudharabah can be fixed for a set term whilst Imam Malik and Imam Shafi do not allow this.



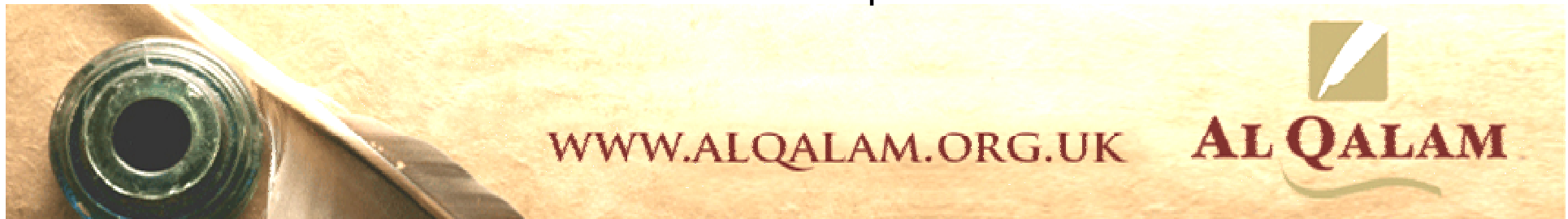
Musharakah v Mudharabah

- The investment in Musharakah comes from all the partners whilst in Mudharabah the investment is the sole responsibility of the **رب المال**.
- In Musharakah all the partners can participate in the management of the business and can work for it whilst in Mudharabah the **رب المال** has no right to become involved in managing the business.
- In Musharakah, all the partners share the loss according to the proportion of their investment, whilst in Mudharabah the loss is borne by the **رب المال** only and the **مضارب** will lose his labour.
- If the **مضارب** does not act with due diligence and suffers a loss, he will be liable.
- Liability of the partners in Musharakah is unlimited whereas in Mudharabah, the liability of the **رب المال** is limited to his investment.
- In Musharakah, all partners can benefit from any appreciation in the value of the assets.



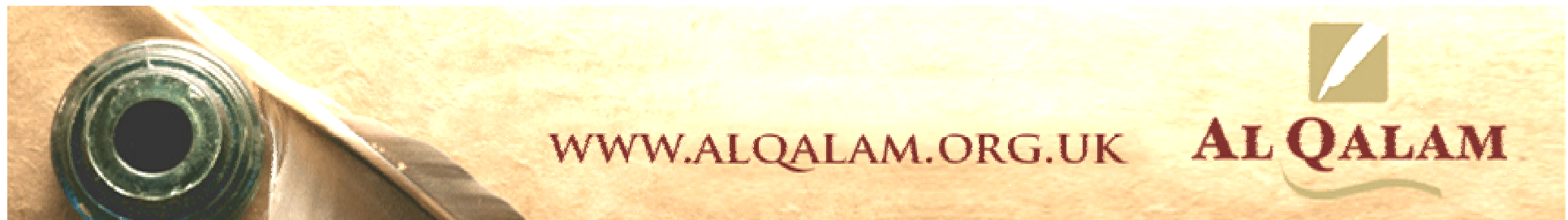
Musharakah Certificates

- Musharakah may be used on large scale financing projects by issuing Musharakah certificates which represent a proportionate ownership in the assets of the business.
- Once the money received from issuing these certificates has been used to buy a substantial number of non-liquid assets, the certificates may be treated as negotiable objects and may be bought and sold.
- Trading these certificates is not allowed when all the assets are still in liquid form.
- When there is a mixture of liquid and non-liquid assets, the certificates cannot be sold according to the Shafi school. According to the Hanafi school it is permissible.
- Most contemporary scholars including of the Shafi school, allow certificates to be traded if the non-liquid assets are more than 50%.



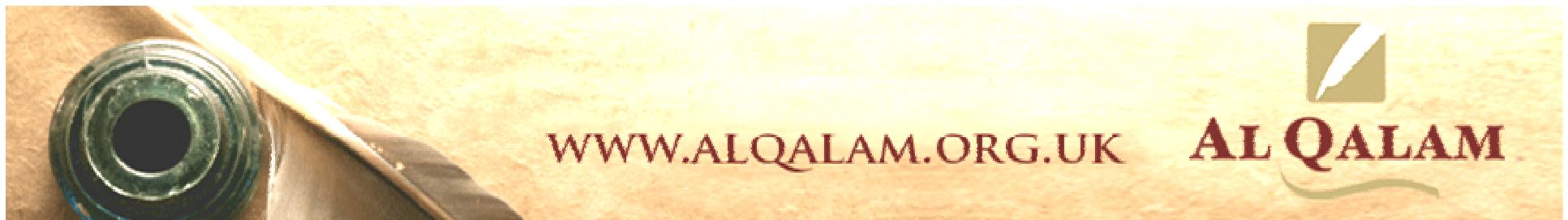
Financing of working capital

- Where financing is required for the working capital of the business, the running business should be evaluated.
- The value of the business may be considered as the share of the client.
- The amount given by the financier is treated as his share of the investment.
- Both the parties need to agree on a certain percentage of the profit to be given to both parties, although the financiers share of the profit must not exceed his share in the capital as he shall not be working.
- The Musharakah may be done on a fixed term basis after which the business is again evaluated and the profit distributed based on this valuation.



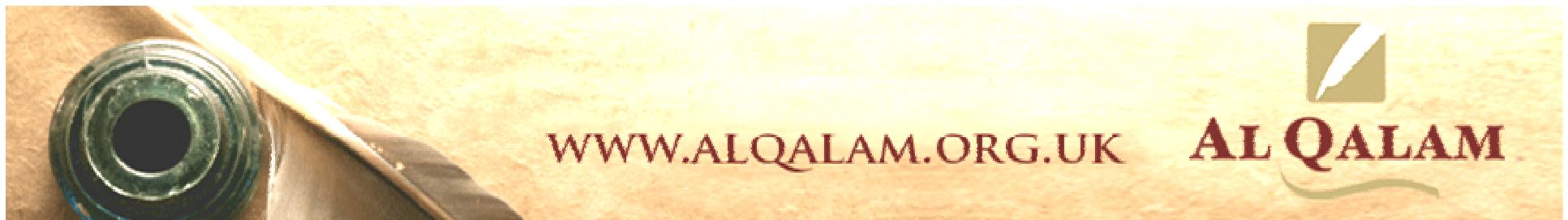
Running Musharakah accounts

- Many financial institutions open Musharakah accounts whereby depositors can deposit and withdraw amounts regularly and the bank uses the collective money to finance on Musharakah basis.
- The profit from such financing may be distributed on a daily product basis.
- Some contemporary scholars do not allow this because this method of calculating the profits does not reflect the actual profit earned by a depositor. The business may have earned a huge profit on a day when a depositor never had any money in the account and the business may have made a loss when he had deposited a lot of money. In this method of calculating he will be getting a share of the profit whilst his share at the time was negligible.



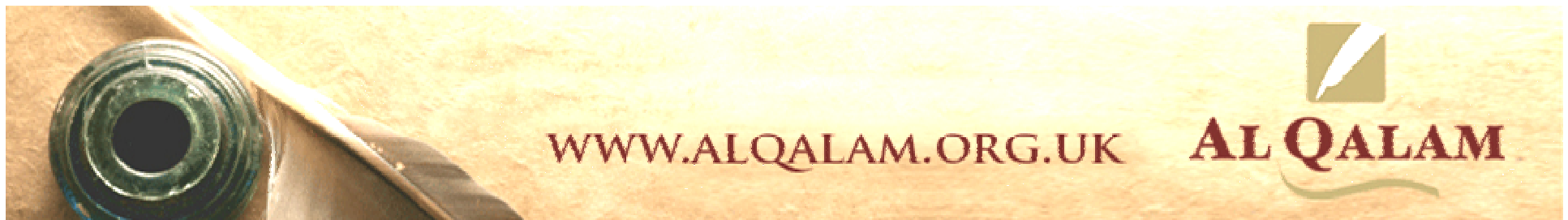
Running Musharakah accounts

- However, the objection may be refuted that it is not necessary in Musharakah that profit be earned on your money only. Once money has been put into the pool by various depositors into the fund, it becomes a joint pool.
- Another objection is that there is no understanding at the start as to how much is to be contributed by each partner.
- However, in the Hanafi school it is not a precondition to know the capital contributions made by the different partners for the validity of Musharakah.



Some Objections to Musharakah

- Risk of Loss
- Dishonesty
- Secrecy of the Business
- Clients unwillingness to share profits



Diminishing Musharakah

- Where the financier and client enter into a joint ownership of a property.
- The share of the financier is divided into smaller shares with the understanding that the client will purchase these shares from the financier one by one at regular periods in order to make the client the sole owner of the asset.
- Diminishing Musharaka can be used to finance property as well as businesses. However it is important that the Shariah rules of Musharakah and Ijarah must be upheld.

