"MUSHARAKAH"

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MUSHARAKAH

'Musharakah' is a word of Arabic origin which literally means sharing. In the context of business and trade it means a joint enterprise in which all the partners share the profit or loss of the joint venture. It is an ideal alternative for the interest-based financing with far reaching effects on both production and distribution. In the modern capitalist economy, interest is the sole instrument indiscriminately used in financing of every type. Since Islam has prohibited interest, this instrument cannot be used for providing funds of any kind. Therefore, *'Musharakah'* can play a vital role in an economy based on Islamic principles.

'Interest' predetermines a fixed rate of return on a loan advanced by the financier irrespective of the profit earned or loss suffered by the debtor, while *'Musharakah'* does not envisage a fixed rate of return. Rather, the return in *Musharakah* is based on the actual profit earned by the joint venture. The financier in an interest-bearing loan cannot suffer loss while the financier in *Musharakah* can suffer loss, if the joint venture fails to produce fruits. Islam has termed interest as an unjust instrument of financing because it results in injustice either to the creditor or to the debtor. If the debtor suffers a loss, it is unjust on the part of the creditor to claim a fixed rate of return; and if the debtor earns a very high rate of the profit, it is injustice to the creditor to give him only a small proportion of profit leaving the rest for the debtor.

In the modern economic system, it is the banks which advance depositors' money as loans to industrialists and traders. If industrialists having only ten million of their own acquire 90 million from the banks and embark on a huge profitable project, it means that 90% of the project has been created by the money of the depositors while only 10% has been created by their own capital. If this huge project brings enormous profits, only a small proportion i.e. 14 or 15% will go to the depositors through the bank, while all the rest will be gained by the industrialists whose real contribution to the project is no more than 10%. Even this small proportion of 14 or 15% is taken back by the industrialists, because this proportion is included by them in the cost of their production. The net result is that all the profits of their enterprise is earned by the persons whose own capital does not exceed 10% of the total investment, while the people owning 90% of the investment get no more than the fixed rate of interest which is often repaid by them through the increased prices of the products. On the contrary, if in an extreme situation, the industrialists go insolvent, their own loss is no more than 10%, while the rest of the 90% is totally borne by the bank, and in some cases, by the depositors. In this way, the rate of interest is the main cause for imbalances in the system of distribution, which has a constant tendency in favour of the rich and against the interests of the poor.

Conversely, Islam has a clear cut principle for the financier. According to Islamic principles, a financier must determine whether he is advancing a loan to assist a debtor on humanitarian grounds or he desires to share his profits. If he wants to assist the debtor, he should resist from claiming any excess on the principal of his loan, because his aim is to assist him. However, if he wants to have a share in the profits of his debtor, it is necessary that he should also share him in his losses. Thus the returns of the financier in *Musharakah* have been tied up with the actual profits accrued through the enterprise. The greater the profits of the enterprise, the higher the rate of return to the financier. If the enterprise earns enormous profits, all of it cannot be secured by the industrialist exclusively, but they will be shared by the common people as depositors in the bank. In this way, *Musharakah* has a tendency to favour the common people rather than the rich only.

This is a basic philosophy which explains why Islam has suggested *Musharakah* as an alternative to the interest based financing. No doubt, *Musharakah* embodies a number of practical problems in its full implementation as a universal mode of financing. It is sometimes presumed that *Musharakah* is an old instrument which cannot keep pace with the ever-advancing need for speedy transactions. However, this presumption is due to the lack of proper knowledge concerning the principles of *Musharakah*. In fact, Islam has not prescribed a specific form or procedure for *Musharakah*. Rather, it has set some broad principles which can accommodate numerous forms and procedures. A new form or procedure in *Musharakah* cannot be rejected merely because it has no precedent in the past. In fact, every new form can be acceptable to the Shar'iah in so far as it does not violate any basic principle laid down by the Holy Qur'an, the Sunnah or the consensus of the Muslim jurists. Therefore, it is not necessary that Musharakah be implemented only in its traditional old form.

The present chapter contains a discussion of the basic principles of *Musharakah* and the way in which it can be implemented in the context of modern business and trade. This discussion is aimed at introducing *Musharakah* as a modern mode of financing without violating its basic principles in any way. *Musharakah* has been introduced with reference to the books of Islamic jurisprudence, and basic problems which may be faced in implementing it in a modern situation. It is hoped that this brief discussion will open new horizons for the thinking of Muslim jurists and economists and may help implementing a true Islamic economy.

The Concept of Musharakah

"Musharakah" is a term frequently referred to in the context of Islamic modes of financing. The connotation of this term is a little limited than the term "Shirkah" more commonly used in the Islamic jurisprudence. For the purpose of clarity in the basic concepts, it will be pertinent at the outset to explain the meaning of each term, as distinguished from the other. "Shirkah" means "Sharing" and in the terminology of Islamic Fiqh, it has been divided into two kinds:

1. *Shirkat-ul-milk:* It means joint ownership of two or more persons in a particular property. This kind of "Shirkah" may come into existence in two different ways: sometimes it comes into operation at the option of the parties. For example, if two or more persons purchase equipment, it will be owned jointly by both of them and the relationship between them with regard to that property is called "Shirkat-ul-milk". Here this relationship has come into existence at their own option, as they themselves elected to purchase the equipment jointly.

   But there are cases where this kind of "Shirkah" comes to operate automatically without any action taken by the parties. For example, after the death of a person, all his heirs inherit his property which comes into their joint ownership as an automatic consequence of the death of that person.

2. *Shirkat-ul-'aqd*: This is the second type of Shirkah which means "a partnership effected by a mutual contract". For the purpose of brevity it may also be translated as "joint commercial enterprise".

   Shirkat-ul-'aqd is further divided into three kinds:

   - *Shirkat-ul-amwal* where all the partners invest some capital into a commercial enterprise.
   - *Shirkat-ul-A'mal* where all the partners jointly undertake to render some services for their customers, and the fee charged from them is distributed among them according to an agreed ratio. For example, if two persons agree to undertake tailoring services for their customers on the condition that the wages so earned will go to a joint pool which shall be distributed between them irrespective of the size of the work each partner has actually done, this partnership will be a *shirkatul-a'mal* which is also called *Shirkat-ul-taqabbul* or *Shirkat-ul-sana'i'* or *Shirkatul-abdaan.*
   - The third kind of *Shirkat-ul-'aqd* is *Shirkat-ul-wujooh*. Here the partners have no investment at all. All they do is that they purchase the commodities on a deferred price and sell them at spot. The profit so earned is distributed between them at an agreed ratio.

All these modes of "Sharing" or partnership are termed as *"Shirkah"* in the terminology of Islamic *Fiqh,* while the term "*Musharakah*" is not found in the books of *Fiqh.* This term (i.e. *Musharakah*) has been introduced recently by those who have written on the subject of Islamic modes of financing and it is normally restricted to a particular type of "Shirkah", that is, the *Shirkat-ul-amwal,* where two or more persons invest some of their capital in a joint commercial venture. However, sometimes it includes *Shirkat-ul-a'mal* also where part also where partnership takes place in the business of services.

It is evident from this discussion that the term "*Shirkah*" has a much wider sense than the term "*Musharakah*" as is being used today. The latter is limited to the "*Shirkat-ul-amwal*" only, while the former includes all types of joint ownership and those of the partnership.

Since "*Musharakah"* is more relevant for the purpose of our discussion, and it is almost analogous to "*shirkat-ul-amwal*", we shall now dwell upon it, explaining at the first instance, the traditional concept of this type of *Shirkah*, then giving the brief account of it's application to the concept of financing in the modern context.

The Basic Rules of Musharakah

Musharakah or Shirkat-ul-amwal is a relationship established by the parties through a mutual contract. Therefore, it goes without saying that all the necessary ingredients of a valid contract must be present here also. For example, the parties should be capable of entering into a contract; the contract must take place with free consent of the parties without any duress, fraud or misrepresentation; etc., etc.

But there are certain ingredients which are peculiar to the contract of "*Musharakah"*. They are summarized here:

1. Distribution of Profit

The proportion of profit to be distributed between the partners must be agreed upon at the time of affecting the contract. If no such proportion has been determined, the contract is not valid in Shar'iah.

The ratio of the profit for each of the partner must be determined in proportion to the actual profit accrued to the business, and not in proportion to the capital invested by him. It is not allowed to fix a lump sum amount for any one of the partners, or any rate of profit tied up with his investment.

Therefore if A and B enter into a partnership and it is agreed between them that A shall be given Rs 10,000/- per month as his share in the profit, and the rest will go to B, the partnership is invalid. Similarly, if it is agreed between them that A will get 15% of his investment, the contract is not valid. The correct basis for distribution would be an agreed percentage of the actual profit accrued to the business.

If a lump sum amount or a certain percentage of the investment has been agreed for any one of the partners, it must be expressly mentioned in the agreement that it will be subject to the final settlement at the end of the term, meaning thereby that any amount so drawn by any partner shall be treated as 'on account payment' and will be adjusted to the actual profit he may deserve at the end of the term. But if no profit is actually earned or is less than anticipated, the amount drawn by the partner shall have to be returned.

2. Ratio of Profit

Is it necessary that the ratio of the profit of each partner confirms to the ratio of the capital invested by him? There is a difference of opinion among the Muslim jurists about this question.

In the view of Imam Malik and Imam Shafi'i, it is necessary for the validity of *Musharakah* that each partner gets the profit exactly in the proportion of his investment. Therefore, if A has invested 40% of the total capital, he must get 40% of the profit. Any agreement to the contrary which makes him entitled to get more or less than 40% will render the *Musharakah* invalid in Shari'ah.

On the contrary, the view of Imam Ahmed is that the ratio of profit may differ from the ratio of investment if it is agreed between the partners with their free consent. Therefore, it is permissible that a partner with 40% of investment gets 60% or 70% of the profit, while the other partner with 60% of the investment gets only 40% or 30%.

The third view is presented by Imam Abu Hanifah which can be taken as a via media between the two opinions mentioned above. He says that the ratio of profit may differ from the ratio of investment in normal conditions. However, if a partner has put an express condition in the agreement that he will never work for the *Musharakah* and will remain a sleeping partner throughout the term of *Musharakah*, then this share of profit cannot be more than a ratio of his investment.

3. Sharing of Loss

But in the case of loss, all the Muslim jurists are unanimous on the point that each partner shall suffer the loss exactly according to the ratio of his investment.

Therefore, if a partner has invested 40% of the capital, he must suffer 40% of the loss, not more, not less, and any condition to the contrary shall render the contract invalid. There is a complete consensus of the jurists on this principle. Therefore, according to Imam Shafi'i, the ratio of the share of a partner in profit and loss both must conform to the ratio of his investment. But according to the Imam Abu Hanifa and Imam Ahmad, the ratio of the profit may differ from the ratio of investment according to the agreement of the partners, but the loss must be divided between them exactly in accordance with the ratio of capital invested by each one of them. It is this principle that has been mentioned in the famous maxim:

Profit is based on the agreement of the parties, but loss is always subject to the ratio of investment.

The Nature of the Capital

Most of the Muslim jurists are of the opinion that the capital invested by each partner must be in liquid form. It means that the contract of *Musharakah* can be based only on money, and not on commodities. In other words, the share capital of a joint venture must be in monetary form. No part of it can be contributed in kind. However, there are no different views in this respect.

1. Imam Malik is of the view that the liquidity of capital is not a condition for the validity of *Musharakah*, therefore, it is permissible that a partner contributes to the *Musharakah* in kind, but his share shall be determined on the basis of evaluation according to the market price prevalent at the date of the contract. This view is also adopted by some Hanbali jurists.

2. Imam Abu Hanifa and Imam Ahmad are of the view that no contribution in kind is acceptable in a *Musharakah.* Their standpoint is based on two reasons:

Firstly, they say that the commodities of each partner are always distinguishable from the commodities of the other. For example, if A has contributed one motor car to the business, and B has come with another motor car, each of the two cars is the exclusive property of its original owner.

Now, if the car of A is sold, its sale-proceeds should go to A. B has no right to claim a share in its price. Therefore, so far as the property of each partner is distinguished from the property of the other, no partnership can take place.

On the contrary, if the capital invested by every partner is in the form of money, the share capital of each partner cannot be distinguished from that of the other, because the units of money are not distinguishable, therefore, they will be deemed to form a common pool, and thus the partnership comes into existence.

Secondly, they say, there are a number of situations in a contract of *Musharakah* where the partners have to resort to redistribution of the share capital to each partner. If the share-capital was in the form of commodities, such redistribution cannot take place, because the commodities may have been sold at that time. If the capital is repaid on the basis of its value, the value may have increased, and there is a possibility that a partner gets all the profit of the business, because of the appreciation in the value of commodities he has invested, leaving nothing for the other partner.

Conversely, if the value of those commodities decreases, there is a possibility that one partner secures some part of the original price of the commodity of the other partner in addition to his own investment.

3. Imam al-Shafi'i has come with a via media between the two points of view explained above. He says that commodities are of two kinds:

(i) *Dhawat-ul-amthal* i.e. the commodities which, if destroyed, can be compensated by the similar commodities in quality and quantity, e.g. wheat, rice etc. If 100 kilograms of wheat are destroyed, they can easily be replaced by another 100kg. of wheat of the same quality.

(ii) *Dhawat-ul-qeemah* i.e. the commodities which cannot be compensated by the similar commodities, like the cattle. Each head of sheep, for example has its own characteristics which cannot be found in any other head. Therefore, if somebody kills the sheep of a person, he cannot compensate him by giving him similar sheep. Rather, he is required to pay their price.

Now, Imam al-Shafi'i, says that the commodities of the first kind (*dhawat-ulamthal*) may be contributed to the *Musharakah* as the share of a partner in the capital, while the commodities of the second kind (*dhawat-ul-qeemah*) cannot form the part of the share capital.

By this distinction between *dhawat-ul-amthal* and *dhawat-ul-qeemah*, Imam al-Shafi'i has met the second objection on 'participation by commodities' as was raised by Imam Ahmad. For in the case of *dhawat-ul-amthal*, redistribution of capital may take place by giving to each partner the similar commodities he had invested. However, the first objection remains still unanswered by Imam al-Shafi'i.

In order to meet this objection also, Imam Abu Hanifah says that the commodities falling under the category of *dhawat-ul-amthal* can form part of the share capital only if the commodities contributed by each partner have been mixed together, in such a way that the commodity of one partner cannot be distinguished from that of the other.

In short, if a partner wants to participate in a *Musharakah* by contributing some commodities to it, he can do so according to the Imam Malik without any restriction, and his share in the *Musharakah* shall be determined on the basis of the current market value of the commodities, prevalent at the date of the commencement of *Musharakah*. According to Imam al Shafi'i, however, this can be done only if the commodity is from the category of *dhawat-ul-amthal*.

According to Imam Abu Hanifa, if the commodities are *dhawat-ul-amthal*, this can be done by mixing the commodities of each partner together. And if the commodities are *dhawat-ul-qeemah*, then they cannot form part of the share capital.

It seems that the view of Imam Malik is more simple and reasonable and meets the needs of the modern business. Therefore, this view can be acted upon. We may, therefore, conclude from the above discussion that the share capital in a *Musharakah* can be contributed either in cash or in the form of commodities. In the latter case, the market value of the commodities shall determine the share of the partner in the capital.

Management of the Musharakah

The normal principle of the *Musharakah* is that every partner has a right to take part in its management and to work for it. However the partners may agree upon a condition that the management shall be carried out by one of them and no other partner shall work for the *Musharakah*. But in this case the sleeping partner should be entitled to the profit only to the extent of his investment, and the ratio of the profit allocated to him should not exceed the ratio of his investment as discussed earlier.

However, if all the other parties agree to work for the joint venture, each of them shall be treated as the agent of the other in all the matters of the business and any work done by one of them in the normal course of business shall be deemed to be authorized by all the partners.

Termination of Musharakah

Musharakah is deemed to be terminated in anyone of the following events:

1. Every partner has a right to terminate the *Musharakah* at anytime after giving his partner a notice to this effect, whereby the *Musharakah* will come to an end.

In this case, if the assets of the *Musharakah* are in cash form, all of them will be distributed pro rata between the partners. But if the assets are not liquidated, the partners may agree either on the liquidation of the assets, or on their distribution or partition between the partners as they are. If there is a dispute between the partners in this matter i.e. that if partner seeks liquidation while the other wants the partition or distribution of the non-liquid assets themselves, the latter shall be preferred, because after the termination of *Musharakah*, all the assets are in joint ownership of the partners, and a co-owner has a right to seek partition or separation, and no one can compel him on liquidation. However, if the assets are such that they cannot be separated or partitioned, such as machinery, then they shall be sold and the sale proceeds shall be distributed.

2. If any one of the partners dies during the currency of *Musharakah*, the contract of *Musharakah* with him stands terminated. His heirs in this case, will have the option either to draw the share of the deceased from the business, or to continue with the contract of the *Musharakah*.

3. If any one of the partners becomes insane or otherwise becomes incapable of effecting commercial transactions, the *Musharakah* stands terminated.

Termination of Musharakah without closing the business

If one of the partners wants termination of the *Musharakah*, while the other partner or partners like to continue with the business, this purpose can be achieved by mutual agreement. The partners who want to run the business may purchase the share of the partner who wants to terminate his partnership, because the termination of the *Musharakah* with one partner does not imply its termination between the other partners.

However, in this case, the price of the share of the leaving partner must be determined by mutual consent, and if there is a dispute about the valuation of the share and the partners do not arrive at an agreed price, the leaving partner may compel other partners on the liquidation or the distribution of the assets themselves.

The question arises whether the partners can agree, while entering into the contract of the *Musharakah*, on a condition that the liquidation or separation of the business shall not be effected unless all the partners, or the majority of them wants to do so, and that a single partner who wants to come out of the partnership shall have to sell his share to the other partners and shall not force them on liquidation or separation.

Most of the traditional books of Islamic *Fiqh* seem to be silent on this question. However, it appears that there is no bar from the Shari'ah point of view if the partners agree to such a condition right at the beginning of the *Musharakah*. This is expressly permitted by some Hanbali jurists.

This condition may be justified, especially in the modern situations, on the ground that the nature of business, in most cases today, requires continuity for it's success, and the liquidation or separation at the instance of a single partner only may cause irreparable damage to the other partners.

If a particular business has been started with huge amounts of money which has been invested in a long term project, and one of the partners seeks liquidation in the infancy of the project, it may be fatal to the interests of the partners, as well as to the economic growth of the society, to give him such an arbitrary power of liquidation or separation. Therefore such a condition seems to be justified, and it can be supported by the general principle laid down by the Holy Profit (PBUH) in his famous *hadith*:

"All the conditions agreed upon by the Muslims are upheld, except a condition which allows what is prohibited or prohibits what is lawful."