

funds to finance their expanding business; (ii) private sector borrowers seeking funds to finance their consumption needs; and (iii) governments seeking funds to finance their budgetary deficits. Can the needs of all three categories of borrowers be satisfied within the framework of equity financing? It is only the subject of private sector equity finance which is discussed in this section. Whether or not, and to what extent, equity financing can be used to meet the needs of consumers and government are issues which were discussed in Chapter Two of this book.

4.4:1. Channels of Equity in an Islamic Society

Islamic banking is equity-oriented and the Islamic instruments of financing would ideally be based on profit and loss sharing. This would bring a fundamental change in the role of Islamic banks and would convert them from creditors to partners.⁵

The channels that equity investment may take in an Islamic society are the same as elsewhere, namely, sole proprietorship, partnership (including both mudarabah and musharakah) and joint stock companies. Cooperation can also play an important role in an Islamic economy because of its harmony with the value system of Islam and the valuable contribution it can make to the realisation of its goals.

شرح اسلامک اکیڈمی

جدید و قدیم علوم کا خوبصورت امتزاج

تجربہ کار ماہرینِ تعلیم کی زیر نگرانی

اقراء طرز پر ☆ مقرر ☆ اقراء سے بہتر

قبائلمیپس بلدیہ ٹاؤن نمبر ساڑھے پانچ کراچی

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in proportion to the contribution made to capital. This is because losses, constitute an erosion in equity and must be charged to the capital. If a loss has been incurred in one period, it must be offset against profits in the subsequent periods until the entire loss has been written off and the capital sum restored to its original level. However, until the total loss has been written off, any distribution of "profit" will be considered as an advance to the partners. Accordingly, it would be desirable to build reserves from profits to offset any losses that may be incurred in the future.

The real world situation may be a combination of mudarabah and musharakah where all partners contribute to the capital but not to the entrepreneurship and management. In this case profits need not be shared in accordance with capital contributions. They may be shared in any proportion agreed to by the partners, depending on their contribution to the success and profitability of the business.

4.4. Equity Financing

Equity financing in an Islamic economy may have to be for either an indefinite period, as it is in the case of the stock of the joint stock companies or shares in partnerships, or a definite (short, medium or long) period as it is in the case of borrowed capital (loans, advances, bonds and debentures). Since borrowed capital would also be on the basis of profit-and-loss sharing and could not be interest-based, it would be in the nature of temporary equity financing and would mature on the expiry of the specified period. Such financing would hence not carry the same connotation as it does in the capitalist economies. It would, like equity capital but unlike qard al-hasanah, not enjoy any lien on the assets of the firm.

The inability to secure a lien on the assets of the business financed, possible in the case of interest-based lending, would make the financiers more careful in evaluating the prospects of the business and cautious in providing finance.

Moreover, it would be difficult to find medium or long term financing in an Islamic economy without sharing the ownership and control of the business. Expansion of the business would hence be closely related to the distribution of ownership and control. Similarly it would not be possible for anyone to earn an income on savings without being willing to share in the risks of business. Thus ownership, fruits and risks of business would become more widely distributed in an Islamic economy than is possible under capitalism.

There are three types of borrowers who are looking for funds to satisfy their financing needs. These are (i) private sector investors looking for

However, according to modern commercial practices the loss does not cut down the respective capitals of the partners or share-holders, but remains as it is in the accounts books of the musharakah in order to be adjusted against the future profits. It is pertinent to note that while adjusting the loss against future profits the accounting procedure automatically works in a manner so as to bear on the capitals subsequently.

4.3.4. Withdrawal of Members

In the early days of Islam the musharakah were generally formed on a short term basis, mostly of a joint venture type. It was, therefore, quite easy for a partner to withdraw from a musharakah. The withdrawal did not create many problems such as the taxation of capital expenditure, the continuous nature of business activities and goodwill. This is why the old jurists did not feel any need to impose restrictions on the withdrawal of a partner, but in the present complicated commercial practices, legal requirements and public control entangle a musharakah for a considerable period so deeply and firmly that no partner or shareholder can be absolved of his liability as such. So according to a modern urf the shareholder of a limited company cannot withdraw from it and receive back his capital invested therein. He can, however, sell his share to any person desirous of becoming a shareholder of that company. In a partnership business a partner can be permitted to withdraw and receive his capital back after fulfilling his liabilities as a partner according to terms and conditions settled between the partners.

4.35. Limited Liability

A distinguishing feature of modern musharakah (except the partnership) is the limited liability of their shareholders. They Cannot be held liable for more than the amount of capital they have invested. This requirement makes it necessary to regard the musharakah as an entity separate from the individuality of the shareholders. This common urf has given way to safe and stable musharakah resulting in big commercial organizations and flourishing business. 4

To sum up this section, the shirkah al-Inan, which implies unequal shares and is recognised by all schools, may tend to be the most popular. In this case, the profits are divided in accordance with a contractually agreed proportion, since the shariah admits an entitlement to profit arising from a partner's contribution to any of the business assets. However, the shariah makes it clear that losses are to be shared

4. Every partner has a right to participate actively in the affairs of musharakah if he wishes.

In all modern forms of musharakah, the partners have equal rights as mentioned above. In the limited companies and cooperative societies the shareholders delegate their powers (rights in respect of administration etc.) to some among them to be called directors or given any other appropriate title. In a partnership concern the partners, by a mutual agreement, distribute among themselves their responsibilities, duties and jobs, As mentioned above these practices are valid being urf of business community.

4.3.2. Distribution of Profit

The basis for entitlement to the profits of a musharakah are capital, active participation in the musharakah business and responsibility. Profits are to be distributed among the partners in business on the basis of proportions settled by them in advance. The share of every party in profit must be determined as a proportion or percentage. No fixed amount can be settled for any party.³

Limited companies and co-operative societies distribute their profit according to the capital of share-holders. If any share-holder participates actively in these modern musharakah he is paid for it and such payments are regarded as the expenditure of musharakah. This is modern urf and there is nothing un-Islamic in this urf.

4.3.3. Liability of Loss

All the jurist are, unanimously, of the view that the loss shall be borne by the partners according to their capitals. In all forms of musharakah (i.e. limited companies, co-operative societies and partnership) the loss is borne on the basis of capital invested.

There can be little doubt, after the citations above, of the unanimity of the principle. The jurists have categorically laid down that a party which has no capital invested in an enterprise, does not have to share its loss. From the explanation of the jurists, it is clear that it is not possible, after investment of capital, to avoid the risk of loss in the enterprise. This is a direct consequence of the prohibition of interest in Islam and is of fundamental importance for our analysis. The jurists point out that this is because of the fact that loss means destruction of a part of the capital and hence, as it occurs, is a liability of the owner of capital alone.

☆ ما حرم اخذہ حرم اعطاؤہ ☆ جس چیز کا لینا حرام ہے اس کا دینا بھی حرام ہے۔ ☆

of musharakah, which are those of shirkah al-inan. Other types of musharakah mentioned by jurists are nearly obsolete nowadays.

Capital to be invested by the partners may be unequal. For the majority of the jurists the capital should be in the shape of currency and not in the shape of goods. The condition for capital to be in the form of currency only was imposed when it was difficult to refer to the goods in terms of currency. This was true in the days of barter systems when the jurists framed the rules, but now goods are generally referred or accounted for in terms of currency. This condition should, therefore, be waived. In limited companies and co-operative societies the capital is invested in the form of equal units of currency called shares and the intended partners buy as many shares as they wish. This practice has universally been accepted as urf and is therefore according to Islamic principles.

4.3.1. Management

Musharakah is run and managed by the will and equal rights of participation of all the partners. Different aspects of musharakah business are as follows :

1. Every partner is an agent for the other, as all the partners benefit from the musharakah business. When a contract of musharakah is made the condition of agency is automatically presumed to be in existence in the contract. The actual possession of a partner over a property of the musharakah business is considered as possession of other partners in as much as if a partner purchases half portion of a specific good for himself and half portion thereof for the musharakah. When he takes possession of that specific good, this possession will be considered as possession of all the partners. If, however, a partner purchases some goods for himself only, it is exclusively for him and not for the musharakah business.

2. Every partner enjoys equal rights in all respects in the absence of any condition to the contrary.

3. Any condition regarding participation in and administration of the musharakah and variation in the share of profit on this ground is valid. The contract of musharakah is not invalid on grounds of a condition of non-participation in the musharakah business, but on the ground that a share in the profit exists.

☆ إذا اجتمع الحلال والحرام غلب الحرام ☆ جب حلال و حرام جمع ہو جائیں تو حرام غالب ہوگا ☆

The above modern musharakah principally resembles shirkah al-inan. The details are, however, considerably different due to change of circumstances and other factors including modern commercial techniques, economic conditions and legal requirements. Let us discuss briefly the conditions

prevailing in the business community.

3. **Co-operative societies.** This musharakah is also governed by statutory rules. Its commercial activities are influenced by the practices

are, however, influenced by the business practices (urf).

2. **Limited company.** This type of musharakah is strictly controlled by the statutory rules framed by the government. Its commercial activities

- (a) Partnership rules framed by the government,
(b) Business practices prevailing in the business community.

1. Partnership: It is regulated by-

(as defined above) are as under:
The modern business concerns being run on the basis of musharakah

4.3. Types of Modern Musharakah and its Conditions

These are of course models. In practice, however, the partners may contribute not only finance but also labour, management and skills, and credit and goodwill, although not necessarily equally.

shirkah al-abadan is where the partners contribute their skills and efforts to the management of the business without contributing to the capital. In shirkah al-wujuh the partners use their goodwill, their credit-worthiness and their contacts for promoting their business without contributing to the capital.² Both these forms for partnership, where the partners do not contribute any capital, would remain confined essentially to small-scale businesses only.

man on the other hand implies that all partners need not be adults or have an equal share in the capital. They are not equally responsible for the management of the business. Accordingly their share in profits may be unequal, but this must be clearly specified in the partnership contract. Their share in losses would of course be in accordance with their capital contributions. Thus in shirkah al-inan the partners act as agents but not as sureties for their colleagues.

consensus of opinion among the jurists of all schools- of thought (including Hanfia, Maleki, Shafei, Hanbali and Shia) that musharakah is a valid and legitimate contract in Islam. The jurists, however, differ over its form, conditions and other details.

4.2. Types of Musharakah

Originally musharakah or shirkah (Partnership) was of two types, namely,

- (a) Shirkah al-milk (non-contractual partnership)
- (b) Shirkah al-uqood (contractual partnership)

Shirkah al-milk (non-contractual) implies co-ownership and comes into existence when two or more persons happen to get joint-ownership of some asset without having entered into a formal partnership agreement; for example, two persons receiving an inheritance or a gift of land or property which mayor may not be divisible. The partners have to share the gift, or inherited property or its income, in accordance with their share in it until they decide to divide it. If the property is divisible and the partners still decide to stick together, the shirkah al-milk is termed ikhtiyariyyah (voluntary). However, if it is indivisible and they are constrained to stay together, the shirkah al-milk is characterised as jabriyyah (involuntary).

Shirkah al-uqood (contractual partnership) can, however, be considered a proper partnership because the parties concerned have willingly entered into a contractual agreement for joint investment and the sharing of profits and risks. The agreement need not necessarily be formal and written, it could be informal and oral. Just as in mudarabah, the profits can be shared in any equitably agreed proportion. Losses must, however, be shared in proportion to the capital contribution.

Shirkah al-uqood has been divided in the fiqh books into four kinds: al-mufawadah (full authority and obligation); al-inan (restricted authority and obligation); al-abdan (labour, skill and management); and al-wujuh (goodwill, credit-worthiness and contracts). In the case of mufawadah the partners are adults, equal in their capital contribution, their ability to undertake responsibility and their share of profits and losses. They have full authority to act on behalf of the others and are jointly and severally responsible for the liabilities of their partnership business, provided that such liabilities have been incurred in the ordinary course of business. Thus each partner can act as an agent (wakil) for the partnership business and stand as surety or guarantor (kafil) for the other partners.

The concept of brotherhood and equal treatment of all individuals in society and before the law is not meaningful unless accompanied by economic justice such that everyone gets his due for his contribution to society or to the social product and that there is no exploitation of one individual by another. The Prophet aptly warned: "Beware of injustice for injustice will be equivalent to darkness on the Day of judgement". This warning against injustice and exploitation is designed to protect the rights of all individuals in a society (whether consumers or producers and distributors, and whether employers or employees) and to promote general welfare, the ultimate goal of Islam.

Of special significance here is the relationship between the employer and the employee which Islam places in a proper setting and specifies norms for the mutual treatment of both so as to establish justice between them. An employee is entitled to a "just" wage for his contribution to output and it is unlawful for the employer to exploit his employee.

4.1. Definition of Musharakah & Its Historical Background

Musharakah or shirkah can be defined as a form of partnership where two or more persons combine either their capital or labour together, to share the profits, enjoying similar rights and liabilities.

From the very inception of human society, the methods to meet day to day needs have been changing with the change of social, economic, scientific, cultural and political circumstances, especially habits, fashions and the standard of living. These methods regulate the commercial activities and vary from place to place and time to time. The Arab society at the time of the rise of Islam had very simple financing methods and forms of business peculiar to that society.

The advent of the Holy Prophet saw the practice of musharakah already prevailing over the commercial activities in Arabia. He not only ratified it, but also himself did business on the basis of musharakah.¹

After Hijra, the muhajireen and the ansar were declared by the Prophet to be brothers. Subsequently they joined as partners, in the form of musharakah, muzara and musaqat, in their trade and commerce. The nature of the transaction, in the different forms, is identical. The different nomenclature in arabic refers to diverse activities such as muzara in agriculture, musaqat in gardening and musharakah in trade. The musharakah of capital and labour is called mudarabah.

These four forms were so developed that they became independent institutions and the jurists formed detailed rules about them. There is a

MUSHARAKAH FINANCING MODEL

Dr Saad Al-Harran

Introduction

In the contemporary world there is always a dilemma for the entrepreneur who has a promising idea for a new venture. How is he to raise the capital necessary to launch the venture? Borrowing the money is probably out of question. If the normal interest rate is 6% but the venture has a 10% chance of failing within a year, the lender will probably charge interest at a rate of 16%. High interest, plus amortization, will impose heavy fixed costs on the venture from the outset and this will increase the danger of failure, and in turn the interest rate. Moreover, if the venture's prospects can not be predicted with reasonable confidence, it will be very difficult even to calculate an appropriate interest rate. The alternative must be for the entrepreneur to admit a partner to the business who is entitled to receive a portion of profits from the venture, if any, in exchange for contributing the necessary capital to it. The partner's compensation is determined automatically by the fortunes of the business. There is no need to compute an interest rate and there are no fixed costs of debt, the partner will receive his profits only if and as earned.

However, Islam aims at establishing a social order where all individuals are united by bonds of brotherhood and affection like members of one single family. This brotherhood is universal and not parochial. It is not bound by any geographical boundaries and encompasses the whole of mankind and not anyone family group, tribe or race.

The purpose of this chapter is to thoroughly examine the framework for musharakah (equity participation) and other financial instruments of the Islamic banks. The chapter is divided into eight sections. The first will define musharakah and give its historical background while in the second the different types of musharakah will be identified. The third will deal with the conditions of present day musharakah and the fourth analyses equity financing and its channels of investment in an Islamic society. The fifth will identify the steps to be taken to transfer to an equity financing system and the sixth is concerned with the role of equity financing in mobilizing funds and stabilization of the system. The seventh section describes other financial instruments of Islamic banks. Additional subsections are included which examine ijara (leasing), murabaha (cost plus financing), qard al-hasanah (beneficence loans), bai muajjal (deferred payment sale), bai salam (purchase with deferred delivery) and tadamun (solidarity). Finally some conclusions are drawn.

☆ عام کی تخصیص نیت کے ساتھ دیا جاتا ہے قبول ہوتی ہے نہ کہ قضاء ☆