

Mudharba : Principles and Practical Applications**

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I. INTRODUCTION

All praise is due to Allah, the Cherisher of the universe, and praise be on the seal of the prophets, Muhammad, peace be upon him.

The origin of the word mudharaba comes from dharaba fil ardh, meaning to travel far on earth indicating an example of the efforts used in investing done by the mudharib. Another synonym of mudharaba is giradh. Its origin comes from garadha, meaning to cut, implying one's setting aside a part of his capital for investment¹, which is done by rabulmal, or capitalist, or financier.

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The paper, as it stands, is in a preliminary form, which would require further improvements through, at least, the expansion of some parts. I pray to Allah to assist us along the road of learning for His sake and the sake of His message.

(1) ابن منظور ، لسان العرب مجمع اللغة العربية ، المعجم (Ibn Manzoor) الوسيط ، دار المعارف ، القاهرة 1392 هـ (1972 م) الجزء الأول ، ص 536 .
(Academy of Arabic)

The Hanafis and Hanbalis, following the convention prevailing in Iraq have used the words *mudharaba*. Meanwhile, the Malekis and Shafe'is have used the word *giradh* or *mugaradha* following the convention of Hijaz. Both words have acquired the same meanings linguistically, that is, to invest the financial capital provided by others for a share of profit.

In *fiqh*, both *mudharaba* and *giradh* refer to a profit-and-loss-sharing (PLS) contract of a company in which the first party (or parties) (*rabbulaml*, or the capitalist) participates with financial capital, and the second party (*mudharib*, or the worker) with his effort². The resulting profit is apportioned between the two parties according to a preagreed formula.

(2) Schools of thought give different wordings of that definition, but with the same general meaning, Compare :

عبدالستار أبرغدة ، الحضاربتى او القراض والتطبيقات المعاصرة .

(Abu Ghudda), The Second Islami Bank Conference, 1403H (1983), p. 3

* الاهام مالک . الموطأ ، روايته يحيى بن يحيى الليثى ، اعداد احمد راتب عرهوش ، الطبعة السادسة ، دار النفايس ، بيروت ، 1401 هـ (1982) ، صفحته (Imam Malek) 480.

* الشوكانى (محمد بن على بن محمد الشوكانى) ، نيل الاوطار ، دار الجيل ، بيروت ، 1973 ، الجزء ، الخامس ، صفحته 390 - 392 . (Al-Shawkani)

* البهوتى (منصور بن يونس بن ادريس البهوتى) ، شرح منتهى الارادات ، دار الفكر ، القاهرة ، 1046 هـ الجزء ، الثانى صفحته 327 (Al-Bahouti)

* القارى (احمد بن عيدان القارى) ، مجلته الاحكام الشرعية ، دراسته و تحقيق عبدالوهاب ابراهيم ابو سليمان و محمد ابراهيم احمد على الطبعة الاولى ، مطبوعات تهماته ، جدة 1401 هـ (1981) ، ص 536 (Al-Qari)

* السيد سيابق ، فقه السنن ، دار الكتاب العربى ، بيروت ، الطبعة الاولى ، (Sabiq) 1391 هـ (1961) ، المجلد الثالث ، صفحته 202 .

II. MUDHARABA AS A COMPANY

Contemporary writers of Islamic jurisprudence have defined mudharaba as a profit-and-loss-sharing (PLS)¹. Since this contract is a form of a company, it would be helpful to review the related classification of contracts and companies. It must be noted though that the classification of mudharaba as a contract owes its origin to the Hanbali school, whose opinion in this regard dominated the opinion of those classifying mudharaba as a semi-employment arrangement in which one party's services are compensated for through payment².

Companies are classified into two categories. The first category is the property company شركة المال in which an asset and/or its services are jointly owned by more than one person³. The property company is either voluntary or obligatory⁴. It is voluntary as in the case of more than one person being gifted some asset and having accepted such gift, or when they jointly purchase some asset. It is obligatory in the case of bequest. In the case of such company, no partner can take any actions regarding the share of the other partner.

The second kind is the contractual company شركة العتود in which persons agree on some course of a joint action⁵, particularly a formula for providing capital and sharing profit⁶. Contractual companies are of five kinds :

1. Rein Company شركة العنان in which a number of persons

(1) Please refer to the introduction above.

(2) Al-Qari, op. cit., p. 536.

(3) Sabiq, op. cit., p. 255-256.

(4) Al-Qari, op. cit., p. 536.

(5) Sabiq, op. cit., p. 356.

(6) Compare this opinion with that of Abu Ghuddah, op. cit., p. 3, where he states that the first party volunteers his efforts. My opinion is that the question of dividing profits is separate from that of compensating the second party for his efforts. When that party gets no share of the profits, he also bears no share of the loss. In this case, he becomes an agent who must be compensated for his work. As will be discussed later on, when the second party violates some of the mudharaba conditions, he guarantees the return of the principal plus profits in full, and gets only his wage in the effort spent.

jointly provide capital and effort for investment. Neither capital nor effort need to be shared equally, while profit is to be divided according to a preagreed formula.

2. **Mudharaba Company** شركة المضاربة in which persons provide a second party specific resources for investment for a prespecified share of the profit. When the profit share of the capital provider is set to zero, the company collapses to a mere (interest-free) loan. When the profit share of the second party is set to zero, the company collapses to a mere *ibdha*, *ابضاع*, or a trading arrangement through which the first party provides "merchandise" to the second party who sells it obtaining none of the resulting profit, but being compensated only for his effort⁶. The second party may accept such arrangement for the benefits resulting from pooling some of his resources with those of the first party in investment. The larger size of capital could bring forth higher profits on the investment of the second party's funds⁷.
3. **Labour Company** شركة الابدان which is composed of persons pooling their efforts and expertise to undertake jointly certain tasks and share the returns according to some preset proportions. It is not necessary that members of such company should have the same profession, not the returns gained be a result of the effort of both⁸.
4. **Party Company** شركة المعاوضة which gives all partners equal power to act on behalf of each other in all fields. It thus encompasses all the categories of companies combined¹⁰. Parity in power between partners has been considered by some as sufficiently critical to insist they also should be equal in

(7) وزارة الاوقات والشؤون الاسلاميه ، الموسوعة الفقهية ، 1400 هـ (1980) (7) الجزء الاول ، صفحتہ 173-178 (Fiqh Encyclopedia)

(8) It is also called bodies, skills, or undertaking company, Sabiq, p. 360.

(9) Sabiq, op. cit., p. 359-360); Al-Qari, op. cit., p. 561-562.

(10) Al-Qari, op. cit., p. 563.

wealth¹¹. Others, noting that absolute parity cannot be ascertained, opined that such company would be prohibited¹².

5. Goodwill Company شركة الوجوه in which partners do not provide any capital. Instead they use their goodwill to obtain credit from suppliers. This is why the Shafe'i and Maliki schools prohibited such company, noting that companies are related to either effort or capital, whereas both are absent¹³. However, the Hanafis and Hanbalis have approved it on the basis of the effort it involves¹⁴.

We can therefore conclude that mudharaba is best viewed as company in the form of a contractual arrangement. This view facilitates its treatment as a set of economic relationships, within the legal institutional framework. Obviously behavioral as well as analytical implication can be more easily visualized in this context.

III. LEGITIMACY

Scholars are unanimous about the legality of mudharaba. The companions of the Prophet have dealt according to this form, and examples are many¹⁵. Al-Shafe'i reports that Umer the Calif placed funds owned by an orphan with someone to use it in mudharaba.

The two sons Umer, Abdullah and Ubaidullah, were reported to have gone to join the army in Iraq. On their return, they passed by Al-Bassra, where its governor, Abu Mussa Al-Asha'ary, offered to lend them money which they could use for trade, on the condition that they would repay the principal to the Calif in Madina. They used the money to buy merchandise in Iraq which they sold in Madina for a profit. When they came to the Calif Umer to repay the principal, he asked if all the soldiers in the army were loaned in the same manner. When they said no, Umer deduced that the two men were

(11) Sabiq, op. cit., p. 357—359.

(12) This is the opinion of Al-Shafe'i, Sabiq, op. cit., p. 358.

(13) Sabiq, op. cit., p. 359.

(14) Al-Bahouti, op. cit., p. 339, and Sabiq, op. cit., p. 359.

(15) Al-Shawkani, op. cit., p. 394, and Sabiq, op. cit., p. 203-204.

particularly loaned because they were his children. He therefore demanded the payment of the principal and the profit.

Yet, Ubaidullah remarked that if the money were lost, they would have had to repay regardless. One person present suggested that the deal would be considered as *mudharaba* in which profit would be shared equally between the two men and *Baitulmall*. Umer approved¹⁶.

Uthman, the Calif, reported that he was given money for *mudharaba*¹⁷. The Prophet, peace be upon him, himself worked on *mudharaba*-basis with Khadija's money¹⁸. In addition Hakiem Ibn Hezam reported that when Al-Abbass, gave money to anyone on the basis of *mudharaba*, he would set a condition that the *mudharib*¹⁹ would not use it in trading in perishables, nor the goods purchased be carried by sea or through a flood route. Otherwise the *mudharib* guarantees the principal. The Prophet, peace be upon him, when petitioned to review that condition, gave his approval²⁰.

The consensus of the scholars is that *mudharaba* existed before Islam, and the Prophet, peace be upon him, approved of it²¹; according to Ibn Hajar. In addition Ibn Hazm says "Each section of *fiqh* has a known origin in *Qura'an* and *Sunnah*, except for *girad*, which has none such, but it is a correct and absolute consensus²²".

(16) Imam Malak, op. cit., p. 479-480; Al-Shafe'i, and Al-Darqatni in Al-Shawkani, op. cit., p. 394.

(17) Al-Shawkani, op. cit., p. 394; Imam Malek, op. cit., p. 480.

(18) (Ibn Hazm) على بن سعيد بن حزم المجلى دار الاتحاد العربى الطباعة القاهرة 1387 هـ (1907).

(19) *Mudharib*, is the second party in the *mudharaba* contract.

(20) Al-Shawkani, op. cit., p. 394, reported by Al-Darqatni and Al-Baihaqi.

(21) Sabiq, op. cit., p. 203.

(22) Abu Ghudda, op. cit., p. 3; and Al-Abadi, عبدالله المرجم العبادى، موقف الشريعة من المصارف الاسلامية، الاتحاد الدولى للبنوك الاسلامية، القاهرة، الطبعة الاولى 1402 هـ (1981)، صفحته 208-214.

IV. PREREQUISITS

There are five conditions which need to be satisfied in order to have a legitimate mudharaba. They include the contractual form, and conditions related to partners, capital, labour (effort), as well as profit²³.

A. Contractual Form :

As a contract, mudharaba must contain the two main elements, viz, an offer and its acceptance. Details related to the form of the offer and its acceptance are many, and have been elaborated by jurists²⁴.

It must be noted, in addition, that the contractual relationship between the two parties : rabbulmal and the mudharib is flexible in the sense that it fits into different moulds, some of which are²⁵ :

1. When the mudharib receives the capital, he is considered as a trustee who is obliged to return the funds if requested before starting to work.
2. When the mudharib starts working, he becomes an agent of rabbulmal, acting on his behalf.
3. When profit is realized, the relationship becomes a contractual company in which profit is to be shared.
4. If for some reasons to be elaborated below, mudharaba becomes void and therefore nullified, it is transformed automatically to an employment contract. In this case,

(23) Al-Abadi, op. cit., p. 214, and Abu Ghudda, op. cit., p. 4. The five conditions have been mentioned by

Al-Nawawi in : *الامام القنوي ، روضته الطالبين ، المكتب الاسلامي للطباعة والنشر.*

The following exposition of those conditions has been adopted from Abu Ghudda, op. cit.

(24) See, for example, Al-Qari, op. cit., p. 549—553.

(25) The above forms are listed by Abu Ghudda while being credited to the Hanafi school among others. See Abu Ghudda, op. cit., p. 9, 10.

rabbulmal gets all the profit and bears all the losses. The mudharib gets a corresponding wage if mudharaba is profitable. Otherwise, he gets no wage at all²⁶.

5. If the mudharib violates some of the conditions or restrictions contained in the contract, he becomes an usurper who is fully responsible for guaranteeing the return of the capital in full.

B. Conditions Related to Partners :

Mudharaba partners must be legally competent. Rabbulmal (capitalist) must be competent to appoint an agent, either directly or through his legal guardian. The mudharib must be competent to act as an agent²⁷.

C. Conditions Related to Capital :

The mudharaba capital should have the following characteristics :

1. It should be in monetary, or at least financial form not in merchandise form (عروض التجارة). The reason is that the value of merchandise might change during the period of mudharaba, which introduces uncertainty to the value of capital and, hence, to the profit. However, the Hanafis and Hanbalis opined that merchandise would be acceptable, if the mudharib is authorized to sell it at the outset and then use it as capital. The Hanbalis also approved of providing capital in the form of tools and machinery. In this case, depreciation must be deducted from profits. This amounts to treating depreciation in the same manner that losses are compensated for from successive gains in the case of financial capital, for the rule is to keep one's capital intact²⁸.

(26) This is justified because it prevents void mudharaba to become more profitable to the mudharib than the legitimate one.

(27) Abu Ghudda, op. cit., p. 4.

(28) This is the opinion of the author, which is alluded to by Abu Ghudda (op. cit., p. 5), but found no basis for it. The basis here is that the principal of keeping capital intact before sharing profit must be applied equally to both financial and real capital.

2. It should be present either at the time of concluding the contract or at the time of starting operations.
3. It should not be in the form of debt (receivables), for debt may or may not be collectable. It is possible that the mudharaba contract appoints the mudharib as a collecting agent to collect the debt and then invest it. If the debt is owed to the mudharib himself, it should be present with him at the time of contract²⁹.
4. It should be of quantity and quality known at contract time.
5. It should be handed in to the mudharib. The Hanbalis ruled out that it is sufficient to make it available part by part depending on the investment requirements.
6. It should not be composed of funds mortgaged with the mudharib against a debt owed by rabbulmal, even if rebbulmal allows the mudharib to use the mortgaged funds for investment. It is noted in this regard that the rules related to mortgage according to the Malekis is that the mortgage funds are to be kept as security but not to be used for any purpose. It is also noted that some shareholders in Islamic banks borrow using their shares as collateral. To apply the above rule renders that either the bank is not allowed to invest the value of these shares, or when it does, (a) it does not guarantee the principal, and (b) the net profit (after deducting costs) goes to rabbulmal³⁰. This is similar to the case of *Ibda'* in which all the net profit goes to the capitalist.

(29) The scholars disagreed on whether a debt owed to the mudharib qualifies to be capital. This was probably in concern for its presence with him ; Abu Ghudda, *op. cit.*, p. 5.

(30) Please refer to Sabiq, *op. cit.*, p. 153-160 for the conditions of the mortgage. Abu Ghudda (*op. cit.*, p. 16) puts forward the view that the value of the stocks are considered as a trust when invested by permission of the mortgagee. The profit in this case may be shared by both parties. The opinion we offer above is close to the general mortgage rules.

D. Conditions Related to Labour :

The mudharib, who presents labour in the mudharaba arrangement, is supposed not to violate the rules of the contract. He is also supposed to stay within the restrictions set out by rabbulmal, provided that such restrictions would not completely close the door for investing the funds.

The Hanafis and Hanbalis allow for a time limit to be set for mudharaba, while the Malekis and Shafe'is do not. The mudharib may provide the funds on the basis of mudharaba to another mudharib (subcontracting), but rabbulmal may prohibit him from doing so.

A question is raised on whether the mudharib can be asked to provide guarantees. Scholars have agreed that an absolute guarantee of capital automatically nullifies the mudharaba contract, with the exception of the Hanafis who nullify the condition, keeping the contract in effect. Meanwhile guarantees against negligence, contract violations, and inability to meet one's obligations are permissible.

A question arises on whether rabbulmal is allowed to work with the mudharib. Some scholars give a negative answer, on the basis that the mudharib must have full authority to act. Some Shafe'is reason that (when rabbulmal can appoint two mudharibs, neither would have full authority. Therefore, they allow rabbulmal to work with the mudharib even if this limits the latter's power.

Abu Ghudda³¹ uses this opinion as a basis of approving the participation of rabbulmal in contemporary companies, in managerial or technical capacities, especially that these companies have legal (as opposed to natural) personalities where decisions are made by a selected group.

In addition, scholars allowed rabbulmal to volunteer his assistance to the mudharib without payment, and when the second party to the mudharaba contract is not rabbulmal (e.g., parent or guardian), he may work with the mudharib.

(31) Abu Ghudda, op. cit., p. 15.

Finally, the mudharib is authorised to do the following categories of tasks³² :

1. A category related to the nature of mudharaba and to business convention in general, e.g., to purchase, sell, lease, mortgage, etc.³³.
2. A category related to his power of discretion (if he is so allowed), e.g., giving the capital to another mudharib, or mixing it with another.
3. A category that is not allowed unless explicitly stated in the contract, e.g., borrowing, donation, etc.

E. Conditions Related to Profit :

Profit, according to the Hanafi opinion can be earned in three ways. The first is to use one's capital. The second is to employ one's labour. The third is to employ one's judgement which amounts to taking risk as in the case of subcontracting. The last way of earning profit is called by scholars *dhaman* ^{ذمان}.

In mudharaba, the way profit must be apportioned between *rabbulmal* and the mudharib must be agreed upon and stated in advance. Since profit is defined by Muslim scholars as growth of capital, the share of the mudharib must be related to profit and not to capital.

(32) These are taken from Al-Abadi, op. cit., p. 230 as adapted from (Al-Mirghaniani) 'المير غنياني' الهدايتة، المكتبة الاسلامي، القاهرة، الجزء الثالث، ص 210-211.

(33) Compare this with Abu-Ghudda, op. cit., p. 7, 8 ; where he accepts the concept of Business common practices and convention.

(34) The other three schools mention the first two only. See Al-Abadi, op. cit., p. 231—233 ; and (Al-Kassani). الكاساني (علاء الدين). مسعود الكاساني) بدائع الصنائع في ترتيب الشرائع، تقديم و تعريب احمد مختار عثمان، مطبعة العاصمة، القاهرة.

V. SUMMARY OF BASIC RULES³⁵

A. General Rules :

1. Profit is to be shared jointly according to a preagreed and declared formula.
2. Profit is to be calculated as growth in capital. When no profit is realized, the mudharib must be compensated for his efforts.
3. Release of funds by capitalist either at once or in parts as need arises.
4. Restrictions, permission, and authorization, when agreed are allowed.

B. Reasons for Nullification :

1. Restricting profit distribution to one party of the company in exclusion of the other.
2. The mudharib's bearing a part of the loss without his violation of contract rules.
3. Indetermination of the mudharib's profit share (qualitative description is not enough).
4. Setting a condition on the mudharib to guarantee principal, without his violating the contract.
5. Making the participation of rabbulmal in work a precondition.

VI. SCOPE³⁶

Some fiqh writers have limited the scope of mudharaba to mere commercial activities, viz, buying and selling. We can mention in

(35) Summarized from Abu Ghudda, op. cit., p. 7.

(36) Al-Abadi, op. cit., p. 218, 219 ; Abu Ghudda, op. cit., p. 8.

this regard the Maleki Ibn Rushd³⁷, the Shafe'i Ibn Hajar³⁸, and the Hanafi Al-Sarkhassi³⁹.

Other scholars expanded the scope of mudharaba to include trade, agriculture and industry. In this group, we find from the Malekis Sahnoun⁴⁰, from the Hanafis Ibn Abdeen⁴¹, and practically all the Hanbali scholars⁴². The opinion of these depend on two arguments. The first is that the scope of mudharaba was narrowed to reduce uncertainty الغرر. However, while a wider scope would increase uncertainty, this would not necessarily lead to conflict⁴³. The second is that business practices at the time may have influenced the proponents of a narrow scope. It is therefore better to allow what is acceptable by convention without getting to specifics which change by time and customs⁴⁴.

V. FUND PLACEMENT THROUGH INSTITUTION

Writers have recently tried to investigate whether mudharaba is applicable to "Islamic" banks⁴⁵. This was a reaction to the effort of

(37) ابن رشد (محمد بن أحمد بن محمد بن رشد القرطبي-الجهدي) ، (Ibn Rushd, Sr.) ، بدايته المجتهد و نهايته المقصد ، الطبعة الرابعة ، دار المعرفة ، القاهرة 1398 هـ (1978).

(38) ابن حجر (شهاب الدين أحمد بن حجر الهيثمي) تحفته ، المحتاج بشرح المنهاج .

(39) السرخسي (محمد بن أحمد السرخسي) ، المبسوط ، مطبعة السعادة القاهرة .

(40) سحنون (عن الإمام بن سعيد بن حبيب التنوخي القهر و اني) (Sahnoun) المدونة الكبرى (عيد السلام مالك بن انس) ، دار الفكر ، بيروت 1398 هـ (1978).

(41) ابن عابدين (محمد امين) ، حاشيته رد المختار على الدر (Ibn Abdeen) المختار الطبعة الثانية ، مصطفى البابي الحلبي ، القاهرة 1386 هـ (1966).

(42) Al-Bahooti, op. cit.,

(43) Abu Ghudda, op. cit., p. 8.

(44) Ibid. ; Ibn Abdeen, op. cit.

(45) محمد عبدالله العربي ، محاضرات في النظام الاسلامية ، مطبعة يوسف ، القاهرة 1385 هـ (1965).

* عيس عبده ، بنوك بلا فوائد ، بيروت ، دار المفتح ، 1965 (Abdu)

* سامي حمود ، تطوير الاعمال المصرفية بما يتفق والشريعة (Hammoud)

* الإسلامية ، دار الاتحاد العربي للطباعة ، القاهرة ، 1976.

Al-Abadi, op. cit.

establishing financial institutions which would follow the rules of Sharia'. However, this situation is not peculiar to banks. Any institution, whether financial or non-financial can obtain funds to invest from savers. Therefore, in what follows, the application of mudharaba is discussed in relation to all investment institutions, taken to encompass, commercial, agricultural, industrial and financial enterprises of all sizes and legal structures.

Placing funds through these institutions is characterized by pooling of funds and continuity of placement. Those characteristics have been thought to be non-conforming to the rules of mudharaba. In addition, the requirement of settlement of operations before calculating the profit has been considered as problematic. This is discussed in what follows, before the alternative adaptations to mudharaba are reviewed.

A. Pooling and Continuity :

1. Pooling of Funds.

Whenever a mudharib accepts funds from more than one person, and whenever he does not invest each sum in a separate venture, he is pooling funds. This does not present any particular problem in the case of these sums owned by the same individual. All scholars allow for pooling in this case either before investing the (first and consecutive) sums, or after the first sum has been liquidated. The malekis approve of pooling the different sums owned by the same individual at all times⁴⁶. When different sums advanced are owned by different individuals, the following principles must be observed :

- (a) The mudharib must be capable of handling the investment of all the funds he received.
- (b) The mudharib must have the permission of those who place funds with him to pool⁴⁷.

(46) Abu Ghudda, *op. cit.*, p. 20.

(47) The Malekis do not require permission, Abu Ghudda, *op. cit.*, p. 20.

2. Continuity of Mudharaba.

Continuity of mudharaba can be justified as automatic renewal of which is based on prior approval. Therefore if funds were placed for one year, and mudharaba ended in six months, it would be understood implicitly that the mudharib is permitted to reinvest in another mudharaba.

Abu Ghudda⁴⁸ raises the question of whether the profit would be reinvested or paid out, which would imply that the loss of the first mudharaba (or a part thereof) can be offset by some of the profit of the second mudharab. This would be unfavourable to rabbulmal. It would also imply that the profit of the first mudharaba would offset the loss (or part thereof) of the second one, thus depriving the mudharib of his profit share due on the first mudharaba.

Abu Gudda suggests in this regard to design mudharaba operations lasting from the beginning to the end of the financial year⁴⁹. Funds placed before the beginning of the year would be treated as interest-free loans. Funds withdrawn (against rules of contract ?) would not earn any profit.

This solution is impractical, for it constrains the investing institution with regard to choosing the proper timing and maturities for its investment. Particularly, pooling of funds would require relating the maturity structure of investments as a whole with that of funds received as a whole.

My opinion is that whether the profit should be distributed at the end of each mudharaba or reinvested must be left to the agreement between the mudharib and rabbulmal. It would even be better to allow the investing institution to set the date of profit distribution, preferably at the end of the financial year.

B. Settlement and Profit Calculus :

Scholars use the word *tandheedh* تَنْدِيض to mean the liquidation of all real assets of a mudharaba arrangement (through their cash

(48) Ibid.

(49) Abu Ghudda, op. cit., p. 21.

sale), immediately before calculating the profit. However, questions were raised on whether asset evaluation would be sufficient for the purpose of settlement.

Abu Ghudda's opinion⁵⁰ is that there is no need for actual liquidation when neither rabbulmal nor the mudharib is withdrawing from mudharaba. In the case of fund pooling, the party whose fund-placement matures would be considered withdrawing (by permission) from mudharaba, and therefore has sold to the other partners the part of his share in the assets which has not been liquidated yet, as evaluated on the date of his withdrawal. This is legitimate as an agent-conducted trust sale بيع الامانة على سبيل التولية.

It must be noted, however, that evaluating assets at withdrawal time would complicate the accounting process, especially that in some institutions, entry and withdrawal are made almost daily. If we would authorize the mudharib to distribute profits only at the end of the financial year, then funds are withdrawn, the final settlement would not be made until the end of the financial year. At the same time assets would be evaluated.

C. Attempts for Alternative Adaptations :

The opinions elaborated above are motivated by the flexibility inherent in Islamic Sharia' when it comes to protecting legitimate interest of all parties concerned, avoiding the imposition of unnecessary harm, and giving ample room for lawful economic activities. Some scholars attempted to find alternative adaptations of mudharaba. Four are reviewed in this section. The fifth is a call to stick to the form of a simple mudharaba company as, when interpreted with the above spirit, this can fulfil our contemporary needs.

1. The Investing Institution as Both Mudharib and Rabbulmal⁵¹: This form considers the investing institution as mudharib, and those advancing funds as rabbulmal. However, since the investing institution advances the same funds to direct investors (businessmen), it can be considered as rabbulmal.

(50) Abu Ghudda, op. cit., p. 17.

(51) Al-Arabi, op. cit., p. 36, Al-Abali, op. cit., p. 257.

This from is clear and simple. Yet it helps little in answering the questions related to pooling and profit calculus⁵².

2. The Investing Institution as Partner and Then Rabbulmal⁵³ :

This opinion considers the institution as a partner with those who placed funds with it, through its participation with its own financial resources supplied by its shareholders. Then the institution carries out the management of the financial pool on hand in the capacity of an agent to both shareholders and those who placed funds with it.

This opinion leads to two results. The first is that since the institution is a partner with others, profits and losses are to be shared. The second is that the institution can be given an extra percentage of the profit for its own management effort. In addition, this opinion allows for pooling as well as settlement before liquidation⁵⁴.

3. The Investing Institution As Agent⁵⁵ :

If those who place funds authorize the institution to invest their funds, it acts as mudharib, while the owners of the financial pool are rabbulmal. If the authorization is to finance projects, in return for a commission paid out to the institution by fund owners, it acts as an agent.

4. The Investing Institution as a Joint Mudharib :

This alternative is contributed by Hammoud⁵⁶ who views

(52) Abu Ghudda, op. cit., p. 10.

(53) (Theoretical and Practical Encyclopedia) الاتحاد الدولي للبنوك الاسلامية، الموسوعة العلمية والعملية للبنوك الاسلامية، القاهرة 1937هـ (1977)، الجزء الاول، ص 23-27.

(54) Abu Ghudda, op. cit., p. 10.

(55) Al-Jammal، المصارف و بيوت التمويل الاسلامية، دار الشروق 238-239، Al-Abadi, op. cit, p. 238-239، الطبعته الاولى، ص 192.

(56) Hammoud, op. cit., p. 428, ff. ; Al-Abadi, op. cit., p. 234-239 t The Theoretical and Practical Encyclopedia, op. cit., p. 23-27.

mudharaba as composed of three parties : rabbulmal, the project manager as a special mudharib, and the Institution as a joint mudharib in the sense that he acts as such for more than one rabbulmal. Hammoud then draws similarity between the concept of a joint mudharib and a joint worker, who provides his services for more than one person, e.g., a repairman in his shop, a laundry man, a tailor, etc.

The specification of the joint mudharaba and its claimed similarity with joint workmanship allows Hammoud to draw some important but controversial conclusions. First, is that the right to restrict mudharaba moves from rabbulmal to the joint mudharib. Second, the joint mudharib guarantees the principal to rabbulmal as the joint worker guarantees the goods provided to him by his (joint) employers, e.g., things to repair or to clean. Third, dividing profit does not require tandeedh, since that is meant to keep capital intact which is done through the guarantee of mudharib.

The above results have met with strong objections from several sources⁵⁷. In particular, the similarity drawn between the joint mudharaba and the joint worker. such claimed similarity has no jurisprudential support. In addition, the joint worker guarantees the objects in his custody only under certain conditions⁵⁸.

5. The Mudharaba as a Company : An Eclectic View :

Abu Gudda⁵⁹ considers the different Muslim schools of thought to be successive attempts to formulate an opinion, ijthad. While individuals may hesitate in moving from one school of thought to another depending on convenience, the society as a whole should do so, especially when it is looking for an important general application.

(57) The Theoretical and Practical Encyclopedia, op. cit., Al-Bbadi op. cit., Abu Ghudda, op. cit., p. 11, 12.

(58) Fiqh Encyclopedia, op. cit., p. 297, 298.

(59) Abu Ghudda, op. cit., p. 13, 14.

Abu Ghudda continues to say that it is important to distinguish between the case in which a jurisprudential opinion is based on texts (of Qura'n or Sunnah), and the case in which an opinion is based on jurisprudential rules which in turn have been deduced from other opinions through ijtiḥad or which itself leaves some room for ijtiḥad.

Some opinions in Fiqh are mere applications of the following rules :

- | | |
|--|-----------------|
| (a) The realization of legitimate interests. | المصالح المرسله |
| (b) Elimination of means to transgress. | سد ذرائع الفساد |
| (c) Convention. | العرف |
| (d) Necessity or lack thereof. | الضرورة |

From the above, Abu Ghudda reaches some important conclusions⁶⁰ :

1. The mudharaba contract had been known in pre-Islamic times, but then approved by the Prophet, peace be upon him.
2. The conditions set in detail by Muslim scholars were the product of necessity and convention at their time.
3. Therefore, those conditions are the product of ijtiḥad solely⁶¹.
4. Mudharaba is suited to cover the modern institutional set-up for investment, for it has kept its legal form, that is being a company, whose most important characteristics is the forgiving of slight discrepancies.

We can therefore conclude that the tendency to develop laborious alternatives with tedious jurisprudential justifications is not justified, not needed.

V. MODERN APPLICATION

When mudharaba was used during the early years of Islam, the number of investors was limited, the size of capital was small, and

(60) Abu Ghudda, op. cit., p. 14.

(61) Abu Ghudda supports this opinion by referring to Ibn Rashd Sr., op. cit., vol. 2 p. 252, and others, Abu Ghudda, op. cit., p. 14.

technology allowed for simple commercial, agricultural and manufacturing ventures. However, the form of mudharaba as a PLS company has been easily adaptable to quantitative as well as qualitative changes.

Contemporary conditions require creative institutional framework, within which the PLS company arrangement can develop to face the challenges of huge number of investors, enormous financial resources, and ever expanding technological frontiers. In this section, some applications of mudharaba are discussed under both non-banking and banking arrangements.

A. Non-Banking Arrangements :

People can channel their savings to investment directly through either fund placement or shareholding.

1. Fund Placement :

A saver can place his funds directly with an investor who could be an individual businessman or a company, both working in trade, production, or services. This form is a straightforward mudharaba contract which would satisfy the necessary conditions mentioned above.

In an Islamic economy, it should be permissible for individual and corporate business concerns to accept investment deposits meaning funds placed with such institutions for investment purposes according to the rules of mudharaba. Those deposits can be collected against deposit certificates⁶² which can be standardized legally into two forms :

- (a) General investment certificates.
- (b) Specific investment certificates.

Those certificates can be issued in various denominations and maturities. They would be tradable, which would create a secondary market for them.

2. Shareholding :

Savers can hold stock in companies which carry out investment themselves directly, or in companies which place funds with other direct investors hold stock in companies, i.e., financial and holding companies.

(62) محمد علي الجارحي، نحو نظام نقدي و مالي اسلامي، المركز العالمي لابحاث الاقتصاد الاسلامي، جده 1409 هـ (1981).

B. Banking Arrangements :

Banks here are meant to be a particular kind of financial companies which accepts demand deposits and is capable of providing certain services, e.g., bank guarantees, letters of credit, etc. Banks therefore carry out the same functions of financial intermediation which finance companies undertake.

On the demand side, banks can obtain funds through selling stock as well as taking investment deposits. The latter can be done either directly through marketing investment (general and specific) certificates. Those certificates have the same characteristics as those issued by a finance company.

On the supply side, banks can finance investment through purchasing stock, direct placing of funds, and purchasing of investment certificates issued by financial and non-financial companies.

C. Financial Intermediation :

It is obvious that trade, production and services companies would be attracting funds of maturity structure suited for their own operations. Finance and banking institutions, meanwhile, have to accept funds in the maturities desired by savers, which may not be best suited for the maturities demanded by investors. It is therefore a common complaint that a finance or a banking institution has to attempt to balance the generally shorter maturities on the saving side with the generally longer maturities on the investment side.

This is usually done through producing a financial asset (an investment certificate) of higher quality than would be produced by the individual saver, for the same maturity. The higher quality results from attaching the name of the issuing institution, as backed by a superior balance sheet.

However, the higher quality of financial assets will not assist in transforming shorter (saving) maturities to longer (investment) without an effective secondary market⁶³.

(63) Islamic banks and finance companies badly need to co-operate towards creating such market.

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