14. MUDARABAH

Glossary

Mudarib	:	Working Partner (brings effort)
Ras-ul-Maal	:	Investment
Rab-al-Maal	:	Investor (brings capital)
Wakeel	:	Agent
Ameen	:	Trustee
Kafeel	:	Guarantor

Definition

This is a kind of partnership where one partner gives money to another for investing in a commercial enterprise. The investment comes from the first partner who is called the Rab-al-Maal while the management and work is an exclusive responsibility of the other, who is called Mudarib and the profits generated are shared in a predetermined ratio.

Types of Mudarabah

There are 2 types of Mudarabah, namely:

1. Al Mudarabah al Muqayyadah: The Rab-al-Maal may specify a particular business or a particular place for the Mudarib, in which case he shall invest the money in that particular business or place. This is called Al Mudarabah al Muqayyadah (restricted Mudarabah).
2. Al Mudarabah al Mutlaqah: However, if the Rab-al-Maal gives full freedom to the Mudarib to undertake whatever business he deems fit, this is called Al Mudarabah al Mutlaqah (unrestricted Mudarabah). However, the Mudarib cannot, without the consent of the Rab-al-Maal, lend money to anyone. The Mudarib is authorized to do anything which is normally done in the course of business. However, if they want to have extraordinary work which is beyond the normal routine of the traders, he cannot do so without the express permission of the Rab-al-Maal. He is also not authorized to:
   a) Keep another Mudarib or a partner
   b) Mix his own investment in that particular Mudarabah without the consent of the Rab-al-Maal.

Conditions of offer and acceptance are applicable to both. A Rab-al-Maal can contract a Mudarabah with more than one person through a single transaction. It means that he can offer his money to A and B both so that each one of them can act for him as a Mudarib and the capital of the Mudarabah shall be utilized by both of them jointly, and the share of the Mudarib.

Difference between Musharakah and Mudarabah

Musharakah	Mudarabah
All partners invest.	Only the Rab-al-Maal invests.
All partners participate in the management of the business and can work for it.	The Rab-al-Maal has no right to participate in the management which is carried out by the Mudarib only.
All partners share the loss to the extent of the ratio of their investment.	Only the Rab-al-Maal suffers loss because the Mudarib does not invest anything. However this is subject to a condition that the Mudarib has worked with due diligence.
The liability of the partners is normally unlimited. If the liabilities of the business exceed its assets and the business goes in to liquidation, all the exceeding liabilities shall be borne pro rata by all partners. But if the partners agree that no partner shall incur any debt during the course of the business, then the exceeding liabilities shall be borne by that partner alone who has incurred a debt on the business in violation of the aforesaid condition.	The liability of the Rab-al-Maal is limited to his investment unless he has permitted the Mudarib to incur debts on his behalf.
As soon as the partners mix up their capital in a joint pool, all the assets become jointly owned by all of them according to the proportion of their respective investment. All partners benefit from the appreciation in the value of the assets even if profit has not accrued through sales.	The goods purchased by the Mudarib are solely owned by the Rab-al-Maal and the Mudarib can earn his share in the profit only in case he sells the goods profitably.

Investment

In Mudarabah, the Rab-al-Maal provides the investment and the Mudarib the management expertise therefore the Rab-al-Maal should hand over the agreed investment to the Mudarib and leave everything to him with no interference from his side. However, he has the authority to:

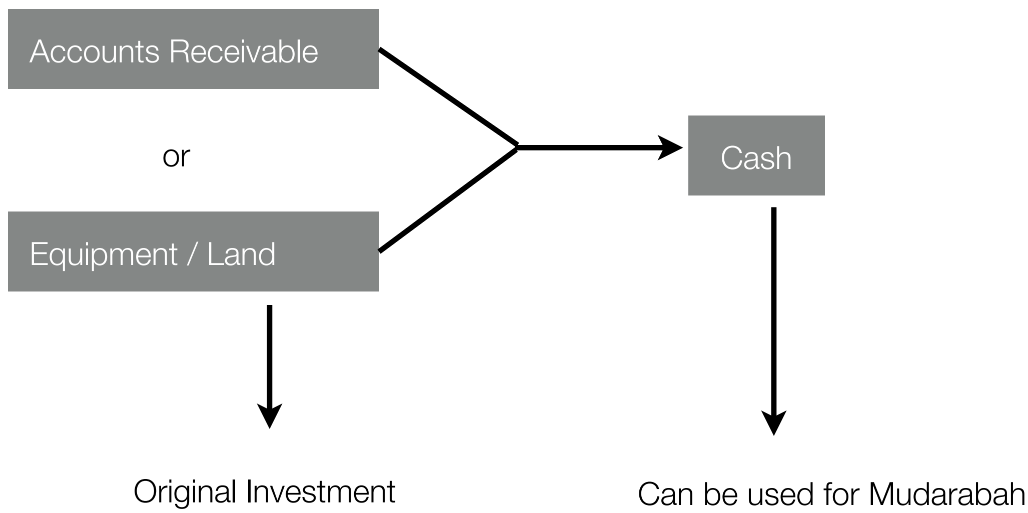
a) Oversee the Mudarib's activities and

b) Work with the Mudarib if the Mudarib consents.

In what form should the capital be? Should it be liquid or non-liquid assets like equipment, land etc. can these form capital?

The basic principle is that the capital in a Mudarabah is valid just the way as it is in a Shirkah which according to Hanafi fiqh should be in liquid form but according to other scholars equipment, land etc can also be included as capital. However, all agree on the following:

Assets other than cash can be used as an intermediate step, meaning:



However, this is subject to the determination of the exact amount of assets before it is used for Mudarabah. If the assets are not correctly evaluated, the Mudarabah is not valid.

Mudarabah Expenses

The Mudarib shares Mudarabah profit as per an agreed rate with the investor but his expenses for meals, clothing, conveyance and medical are not borne by the Mudarabah. However, if he is traveling on business and is overstaying the night, then the above expenses are covered from the capital. If the Mudarib goes on a journey which constitutes Safar-e-Sharai (more than 48 miles) but does not overstay the night, his expenses will not be borne by the Mudarabah.

All expenses which are incidental to the Mudarabah's function like wages of employees/workers or Commission in buying/selling or stitching, dyeing expenses etc have to be paid by the Mudarabah. However, all expenses will be included in the cost of commodities which Mudarib is selling. For example, if he is selling ready made garments then the stitching, dyeing, washing expenses etc. can be included by the Mudarib in the total cost of the garments.

If the Mudarib manages the Mudarabah within his city , he will not be allowed any expenses, only his profit share. Similarly, if he keeps an employee, this employee will not be allowed any expenses, just his salary.

If the Mudarabah agreement becomes Fasid due to any reason, the Mudarib's status will be like an employee, meaning:

a) whether he is traveling or doing business in his city, he will not be entitled to any expenses such as meals, conveyance, clothing, medicine etc.

b) he will not share any profit and will just get Ujrat-e-Misl (ordinary pay) for his job.

UJRAT-E-MISL
(The Mudarib's salary or wage according to the market value of that work. It should not exceed the profit share under the correct Mudarabah)

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Can be given in a void Mudarabah when it has produced profit but if it fails to produce profit, Ujrat-e-Misl will not be given

Distribution of Profit and Loss

It is necessary for the validity of a Mudarabah that the parties agree, right at the beginning, on a definite proportion of the actual profit to which each one of them is entitled. The Shariah has prescribed no particular proportion; rather it has been left to their mutual consent. They can share the profit in equal proportions and they can also allocate different proportions for Rab-al-Maal and Mudarib. However, in an extreme case where the parties have not predetermined the profit ratio, the profit will be calculated at 50:50.

The Mudarib and Rab-al-Maal cannot allocate a lump sum amount of profit for any party nor can they determine the share of any party at a specific rate tied up with the capital. For example, if the capital is Rs.100,000, they cannot agree on a condition that Rs.10,000 out of the profit shall be the share of the Mudarib nor can they say that 20% of the capital shall be given to the Rab-al-Maal. However, they can agree that 40% of the actual profit shall go to the Mudarib and 60% to the Rab-al-Maal or vice versa.

It is also allowed to agree on different proportions in different situations. For example, the Rab-al-Maal can say to the Mudarib "If you trade in wheat, you will get 50% of the profit and if you trade in flour, you will have 33% of the profit." Similarly, he can say "If you do the business in your town, you will be entitled to 30% of the profit and if you do it in another town, your share will be 50% of the profit."

Apart from the agreed proportion of the profit, as determined in the above manner, the Mudarib cannot claim any periodical salary or a fee or remuneration for the work done by him for the Mudarabah.

All schools of Islamic jurisprudence are unanimous on this point. However, Imam Ahmad has allowed for the Mudarib to draw only his daily food expenses from the Mudarabah Account. The Hanafi jurists restrict this right of the Mudarib only to a situation when he is on a business trip outside his own city. In this case he can claim his personal expenses, accommodation, food, etc. but he is not entitled to receive any daily allowances when he is in his own city.

If the business has incurred loss in some transactions and has gained profit in others, the profit shall be used to offset the loss in the first instance, then the remainder, if any, will be distributed between the parties according to the agreed ratio.

The Mudarabah becomes void (Fasid) if the profit is fixed in any way. In this case, the entire amount (Profit + Capital) will be the Rab-al-Maal's. The Mudarib will just be an employee earning Ujrat-e-Misl.

The remaining amount will be called (Profit).

This profit will be shared in the agreed (pre-agreed) ratio.

Roles of the Mudarib:

Ameen (Trustee):	To look after the investment responsibly, except in case of natural calamities.
Wakeel (Agent):	To purchase from the funds provided by the Rab-al-Maal
Shareek (Partner):	Share any profit
Zamin (Liable):	To provide for the loss suffered by the Mudarabah due to any act on his part.
Ajeer (Employee):	When the Mudarabah gets Fasid due to any reason, the Mudarib is entitled to only the salary, Ujrat-e-Misl.

In case there is a loss, the Mudarib will not even get the Ujrat-e-Misl.

Termination of Mudarabah

The Mudarabah will stand terminated when the period specified in the contract expires. It can also be terminated any time by either of the two parties giving notice. In case the Rab-al-Maal has terminated the services of the Mudarib, he will continue to act as Mudarib until he is informed of the same and all his acts will form part of the Mudarabah.

If all Mudarabah assets are in cash form at the time of termination, and some profit has been earned on the principal amount, it shall be distributed between the parties according to the agreed ratio. However, if the assets of Mudarabah are not in cash form, they will be sold and liquidated so that the actual profit may be determined. All loans and payables of the Mudarabah will be recovered. The provisional profit earned by the Mudarib and the Rab-al-Maal will also be taken into account and when the total capital is drawn, the principal amount invested by the Rab-al-Maal will be given to him, the balance will be called profit which will be distributed between the Mudarib and the Rab-al-Maal by the agreed ratio. If no balance is left, the Mudarib will not get anything. If the principal amount is not recovered fully, then the profit shared by the Mudarib and Rab-al-Maal during the term of the Mudarabah will be withdrawn to pay the principal amount to the Rab-al-Maal. The balance will be the profit, which will be distributed between the Mudarib and Rab-al-Maal. In this case too if no balance is left, the Mudarib will not get anything.

Uses of Musharakah / Mudarabah:

These modes can be used in the following areas (or can replace them according to the Shariah rules).

Asset Side Financing

- Short/medium/long term financing
- Project financing
- Small and medium enterprises setup financing
- Large enterprise financing
- Import financing
- Import bills drawn under import letters of credit
- Inland bills drawn under inland letters of credit
- Bridge financing
- Letter of credit without margin (for Mudarabah)
- Letter of credit with margin (for Musharakah)
- Export financing (Pre-shipment financing)
- Working capital financing
- Running accounts financing and short term advances

Liability Side Financing

- For current / saving / mahana amdani / investment accounts (deposit giving profit based on musharakah / Mudarabah – with predetermined ratio)
- Inter bank lending / borrowing
- Term finance certificates and certificates of investment
- Treasury bill and federal investment bonds / debenture
- Securitization for large projects (based on Musharakah)
- Certificate of Investment based on Murabaha (e.g. Al Meezan Riba Free)
- Islamic Musharakah bonds (based on projects requiring large amounts – profit based on the return from the project)