24. PROJECT FINANCING

The concept of Musharakah and Mudarabah is based on some basic principles. As long as these principles are fully complied with, the details of their application may vary from time to time. Let us have a look at these basic principles before touching on the details:

1. Financing through Musharakah and Mudarabah does never mean the advancing of money. It means participation in the business and in the case of Musharakah, sharing in the assets of the business to the extent of the ratio of financing.

2. An investor/financier must share the loss incurred by the business to the extent of his financing.

3. The partners are at liberty to determine, with mutual consent, the ratio of profit allocated to each one of them, which may differ from the ratio of investment. However, the partner who has expressly excluded himself from the responsibility of work for the business cannot claim more than the ratio of his investment.

4. The loss suffered by each partner must be exactly in proportion to his investment.

Keeping in view these basic principles project financing is discussed below.

In the case of project financing, the traditional method of Musharakah or Mudarabah can be easily adopted. If the financier wants to finance the whole project, the form of Mudarabah can come into operation. If investment comes from both sides, the form of Musharakah can be adopted. In this case, if the management is the sole responsibility of one party, while the investment comes from both, a combination of Musharakah and Mudarabah can be brought into play according to the rules already discussed.

Since Musharakah or Mudarabah would have been effected from the very inception of the project, no problem with regard to the valuation of capital should arise. Similarly, the distribution of profits according to the normal accounting standards should not be difficult. However, if the financier wants to withdraw from the Musharakah, while the other party wants to continue the business, the latter can purchase the share of the former at an agreed price. In this way the financier may get back the amount he has invested along with a profit, if the business has earned a profit. The basis for determining the price of his share shall be discussed in detail later on (while discussing the financing of working capital).

On the other hand, the businessman can continue with his project, either on his own or by selling the first financier's share to some other person who can substitute the financier. Since financial institutions do not normally want to remain partner of a specific project for good, they can sell their share to other partners of the project as aforesaid. If the sale of the share on a one time basis is not feasible for the lack of liquidity in the project, the share of the financier can be divided into smaller units and each unit can be sold after a suitable interval. Whenever a unit is sold, the share of the financier in the project is reduced to that extent, and when all the units are sold, the financier totally comes out of the project.

Financing of a Single Transaction

Musharakah and Mudarabah can be used more easily for financing a single transaction. Apart from fulfilling the day to day needs of small traders, these instruments can be employed for financing imports and exports. An importer can approach a financier to finance him for that single transaction of import alone on the basis of Musharakah or Mudarabah. The banks can also use these instruments for import financing. If the letter of credit has been opened without any margin, the form of Mudarabah can be adopted, and if the letter of credit is opened with some margin, the form of Musharakah or a combination of both will be relevant. After the imported goods are cleared from the port, their sale proceeds may be shared by the importer and the financier according to a preagreed ratio.

In this case, the ownership of the imported goods shall remain with the financier to the extent of the ratio of his investment. This Musharakah can be restricted to an agreed term, and if the imported goods are not sold in the market up to the expiry of the term, the importer may himself purchase the share of the financier, making himself the sole owner of the goods. However, the sale in this case should take place at the market rate or at a price agreed between the parties on the date of sale, and not at a preagreed price at the time of entering into a Musharakah. If the price is preagreed, the financier cannot compel the client / importer to purchase it.

Similarly, Musharakah will be even easier in the case of export financing. The exporter has a specific order from abroad. The price at which the goods will be exported is well known before hand, and the financier can easily calculate the expected profit. He may finance him on the basis of Musharakah or Mudarabah, and may share the amount of the export bill at a preagreed percentage. In order to secure himself from any negligence on the part of the exporter, the financier may stipulate a condition that it will be the responsibility of the exporter to export the goods in full conformity with the conditions of the letter of credit. In this case, if some discrepancies are found, the exporter alone shall be responsible, and the financier shall be immune from any loss due to such discrepancies, because it is caused by the negligence of the exporter. However, being a partner of the exporter, the financier will be liable to bear any loss, which may be caused due to any reason other than the negligence or misconduct of the exporter.