

## **Shariah parameters for Musharakah Contract: A comment.**

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### **Abstract**

*Bank Negara Malaysia (BNM), the central bank, has already published the draft of its latest Shariah parameter on Musharakah contract. The general aim of which are to provide a standard guidance on applying respective Shariah contracts in Islamic finance and also to promote the harmonization of Islamic finance market practices in Malaysia. The essential features attributable to a Musharakah contract, according to the draft will serve as guidance for Musharakah transactions and to ensure Musharakah business activities and innovations are within their risk management capacity and do not compromise the long-term sustainability of the business. The guidelines also aim to promote operational efficiency and best practices that would safeguard the interests of stakeholders and in particular participants. In this paper we provide the discussion how : i) the features identified in this parameter will serve to assist the Islamic financial services industry to identify, understand, apply and distinguish the contract from other contracts prevalent in the industry; ii) the features identified and described in this parameter are extracted from the text of fatwas opined. What do we expect from this paper may identify if a special rules apply to a types of contract musharakah especially in musharakah al-milk and musharakah al-aqd because their implication on conflict of interest.*

**Keywords:** Musharakah; Islamic finance; paramaterized.

### **Introduction**

Islamic finance has continued to expand and demonstrate its resilience in the current more challenging international financial environment. This expansion has been in terms of the increased range of Islamic financial products and services, the development of the Islamic financial infrastructure and institutions, the greater maturity of the Islamic financial markets and the more comprehensive supporting legal, regulatory and shariah framework.

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The role of a strong legal and shariah framework in the sustainable development of Islamic finance is very crucial. In addition, both legal and shariah are inter-related. Legal documentation needs to conform and consistent with the principles advocated by the Islamic law. However, the shariah principles are subject to different opinions or interpretations. The differences in opinion on the application of shariah in financial transactions across markets have often been pointed out to be a major issue which could hinder a more robust expansion of Islamic finance internationally.<sup>3</sup> Scholars like Muhammad Ayub (2007) and Gamal (2008) say that complete convergence is neither practicable nor achievable, as shariah also recognizes among others differences in customs and cultural practices between various societies, and differences in mazhab.

In recognizing the need to introduce standards which are acceptable and applicable to the Islamic finance industry, the central bank of Malaysia (or Bank Negara Malaysia) has introduced several parameter guidelines.<sup>4</sup> Standardization is seen as necessary to circumvent any contradictions and inconsistencies between different fatwa rulings and their application by these institutions with a view to activating the role of the Shariah supervisory boards of Islamic financial institution. BNM also agree that the aims of these guidelines is aimed to achieving convergence and harmonization of Islamic financial practices and to promote operational efficiency and best practices that would safeguard the interests of stakeholders and in particular participants.

Recently, Bank Negara Malaysia had issued the Draft of Shariah Parameters in musharakah contract in July 2010. Since, it is a draft version and it is still subject to some amendments. Even, if it is already accepted as guideline, it can also be amended for future use. Hence, this paper will make a critical comment on those guideline. And the same time, this comment is important for several reasons. First, this paper could be used to provide guidance on the nature and features of the musharakah contract to the Islamic financial services industry, for the various financial instruments including financing and investment. Second, this paper also discuss a specific definition on the basis of legitimacy in adopting the musharakah contract are described to facilitate the understanding of the Shariah contract requirements.

The term and conditions in this paper are extracted from the text of BNM and opined by two Islamic scholars: Maulana Taqi Usmani and Wahbah Zuhaili. The term and conditions outlined in this parameter may serve as general guidance for the application of the musharakah contract. Therefore, any practice by the Islamic financial institutions that not specified in the parameter may be conducted as long as it does not contradict the term and conditions outlined in the parameter. Finally, the present study as well investigates the impact of the parameter on the Islamic performance of musharakah contract in variety anchors: BNM Shariah parameter vs other Islamic scholars.

In the following sections, this paper will come out with several sub-topics. The sub-topic covers in section 2 about an overview of Shariah parameter for musharakah contract. This section will face the definition and types of musharakah; explore the legitimacy of musharakah contract; and highlight the terms and conditions of musharakah contract based on overview of BNM parameters vs other views. Section 3, discuss further comment on BNM parameter. Section 4, addresses the implication to financing and investment. Last section, discusses the conclusion.

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<sup>3</sup> Read further in Hegazy, W. (2005) Fatwas and the fate of Islamic finance: A critique of the practice of fatwa in contemporary Islamic financial markets, in Nazim Ali, S. (Ed.), *Islamic Finance: Current Legal and Regulatory Issues*, Islamic Finance Project. Harvard Law School, Cambridge.

<sup>4</sup> Bank Negara has already issued several parameter guideline consultative concept papers for Ijarah (SPRC 2) and Murabahah (SPRC 1) in July and August 2009. In fact, BNM in December 2009 published its latest draft concept paper - "A Shariah Parameter Reference 3 (SPRC 3) - on the Mudarabah contract.

## ***An Overview of Shariah Parameter for Musharakah Contract***

In classical fiqh, the discussion on financial transactions involves two main elements, i.e., definition, legitimacy, and terms and conditions of those financial transactions. We find that the same line of explanation was given in musharakah parameter. However, we will also identify on what is new in this parameter.

### ***Definition***

Musharakah is a word of Arabic origin which literally means sharing. The Mejjella (1329) define it as an "Agreement for association on the condition that the capital and its benefit be common between two or more persons". Meanwhile, Ibn Arfa (1984) defined it as: "An agreement between two or more persons to carry out a particular business with the view of sharing profits by joint investment". Another Muslim jurist, Mohammad Akram Khan (1990) defines a musharakah or partnership as: "A contract between two persons who launch a business of financial enterprise to make profit".

Based on the above definitions, the ideas of partnership are: first, to contribute capital to an enterprise or a venture, whether existing or new, or to owner of a real estate or moveable asset, either on a temporary or permanent basis. Therefore, the partnership can be used in the case of large users of funds to establish investment for short term or long term basis. Second, to share profit over the business with the share of loss. Thus, a partnership needs to be defined as a contract between two or more persons in carrying out a particular business with a view of not only sharing the profit but also loss and liability.<sup>5</sup> Third, partners share and control how the investment is managed. Fourth, liability in this partnership is unlimited. Therefore, each partner is fully liable for the actions and commitments of the other in financial matters.

In the terminology of Islamic fiqh, the modes partnership are termed as shirkah. Shirkah means sharing and in the book of Fiqh, it has been divided into two kinds. First, 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: i) 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. ii) 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. Second, Shirkat-ul-'aqd 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: i) Shirkat-ul-amwal where all the partners invest some capital into a commercial enterprise; ii) 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 shirkat-ul-a'mal which is also called Shirkat-ul-taqabbul or Shirkat-ul-sana'i' or Shirkat-ul-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.

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<sup>5</sup> See the view of Umar Chapra (2002)

### ***The Legitimacy of the Musharakah Contract***

The legitimacy of the Musharakah contract is established based on the Qur'an, the Sunnah of the Prophet Muhammad (SAW) and the consensus of Muslim jurists. Though most of the Islamic jurists agreed upon the permissibility of musharakah, The majority believes that it is permissible and shariah compliant. The following Qur'anic verses generally indicate the validity of Musharakah.

“...but if more than two, they share in a third...” (Al-Nisa':12)

The verse specifically underlines the rule of Islamic inheritance. However, in general context, Muslim jurists have regarded the text as containing general permissibility of any form of partnership.

“Verily many are the partners (in business) who wrong each other except those who believe and work deeds of righteousness and how few of them...” (Al-Sad: 24)

Based on both, Surah al-Nisa and al-Sad, in these verses, Allah SWT describes the partnership of the property. If a person dies without leaving behind any ascendants or descendants; but he has brothers and sisters more than two in number; then they will share a third of the property of the mortal. So, based on that, the partnership of the property is legal in the shariah (Al-Kawamelah, 2008). Shariah scholars generally agreed on the validity of a sale contract which is combined with lease contract. Also, there is no clear text in the shariah that prohibits musharakah. Considering the public interests and benefits of musharakah in the investment, it should be permitted in the shariah. (Smolo 2007). Some scholars however, disagreed to the validity of musharakah contract. To them, it should be declared invalid as it contains some elements of doubts. They claim that it is similar to interest as the primary purpose of musharakah is to give loan to the clients and to derive extra money from the amount of loan. (Al-Kawamelah, 2008). Several hadith also narrated the permissibility of musharakah. The Narration of Abu Hurayrah. Abu Hurayrah said that: The Prophet SAW said: Allah says: I am the third (partner) of the two partners as long as they do not betray each other. When one of them betrays the other, I depart from them”. (Sunan Abu Daud)

The Narration of Abu al-Minhal. Abu al-Minhal narrated that Zayd Ibn Arqam and al-Barra' Ibn 'Azib were partners, and they bought silver in cash and credit. Their practices were brought to the Prophet SAW, and the Prophet SAW pronounced that what was bought on cash then they could benefit from it and what was bought on credit then they should reject it.” (Musnad Ahmad)

The Prophet (pbuh) found the people using the partnership contract and did not question this behavior, and there are many hadith that indicate his approval of the contract.

One such hadith is: Allah supports the partners as long as they do not betray one another. In general, muslims have approved the legality of partnerships, with differences in opinion only existing over specific types.

The wisdom in permitting partnerships is clear. The contract allows individuals to combine their properties in a manner that allows them to produce more wealth than they could each produce individually. It is learned from the narration that Prophet Muhammad SAW approved the partnership formed between Zayd Ibn Arqam and al-Barra' Ibn 'Azib but disapproved their venture into business activity of purchasing silver on credit. The above type of partnership has been practised throughout the history of Muslims without objection from the jurists. Imam Ibn al-Munzir states in his book al-Ijma': “And they (Muslim jurists) agree on the validity of partnership where each of the two partners contributes capital in dinar or dirham, and co-mingles the two capitals to form a single property which is indistinguishable, and they would sell and buy what they see as (beneficial) for the business, and the surplus will be distributed between them whilst the deficit will be borne together by them, and when they really carry out (as prescribed), the partnership is valid.”

### ***Terms and Conditions of the Musharakah Contract***

From the above discussion, we could safely infer that musharakah is a permitted contract in shariah. However, scholars suggest some principles and guidelines that are needed to be observed strictly, so that this contract does not exceed the boundary of the Shariah and does not get assimilated with the interest based contracts. (Al-Kawamelah, 2008; International Fiqh Academy, 2004)

Base on the latest BNM parameter on musharakah contract, we will review it in the light of specific definition and guidelines on the basis of legitimacy in adopting the musharakah contract. The aim is to facilitate the understanding of the shariah contract requirements. In addition, the features identified in this parameter shall serve to assist the Islamic financial services industry to identify, understand, apply and distinguish the contract from other contracts prevalent in the industry. The parameter in musharakah covers capital, management, profit sharing, loss sharing and joint ventures. This parameter will also be discussed in the context of other scholar views. The discussion of each parameter is as follows:

#### *i) Capital contribution by all partners*

The essential conditions of a valid Musharakah capital are shown under BNM parameters are: i) shall be readily available; ii) shall be contributed by all partners; and iii) may be in the form of monetary asset such as cash or non-monetary assets that includes tangible and intangible assets. Monetary assets denominated in different currencies shall be valued based on the currency agreed by the partnership upon conclusion of the contract. Capital in the form of non-monetary assets shall be valued based on the valuation determined by a third party which may include authoritative bodies, experts or valuers, or as agreed upon by the contracting parties at the time of conclusion of the contract. All forms of debts shall not qualify as musharakah capital. All account receivables and payment due from other partner or third parties are considered as debt. A non-monetary asset with an integral debt component to the asset may be contributed as a musharakah capital provided that the integral debt is less than 50% of the asset value. Funds placed with the Islamic financial institutions in the form of deposits may be invested as capital in a musharakah contract.

The total amount of capital to be contributed by each partner shall be determined up front. The agreed capital may be contributed in one lump sum or on staggered basis. Additional capital may be injected upon mutual agreement of all partners. In this regard, the partners may agree to vary or revise the proportion of capital contribution, the profit sharing ratio or change of partners. Failure to contribute capital by the capital provider as per the agreed schedule shall constitute a breach of promise according to specified terms and conditions of the contract. The partners have an option to terminate the agreement or may agree to revise the agreement based on actual capital contribution. Musharakah capital comprising of monetary and non-monetary assets invested by each partner should be commingled representing the collective rights of each partner.

Once contributed as capital, the rights, obligation and liabilities of all assets contributed to the musharakah venture shall be jointly and severally assumed by partners. The capital invested shall not be guaranteed by any of the partners. Any of the partners acting as agents of each other shall be liable for misconduct or negligence to the partnership as a whole. Any partner acting on his own or as agent who has caused the loss of capital due to misconduct or negligence shall be liable to refund the loss of capital to the other partners. Any loss of capital in the course of the venture shall be recognized as capital impairment. Upon termination of the partnership, capital impairment loss shall be borne by the partners proportionate to capital contribution. A share of a musharakah capital may be transferred to existing partners or a third party according to the existing terms and conditions of the musharakah contract.

The Musharakah agreement may impose a condition that compels a partner to offer the redemption of the partner's share of capital to existing partners based on certain agreed terms and conditions. New partners may enter the musharakah during the tenure of the existing contract subject to the agreement of existing partners.

Any gain or loss in the value of capital from the transfer of share capital shall be enjoyed or borne by the partner that disposes of the shares. Any realized losses arising from the conduct of musharakah during the period shall be borne by each partner proportionate to equity share of each partner. Most of the Muslim jurists are of the opinion that the capital invested by each partner. Taqi Usmani says that capital contribution 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 like views by Imam Malik, Imam Abu Hanifa and Imam Shafi'i.

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. 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 X has contributed one motor car to the business, and Y has come with another motor car, each of the two cars is the exclusive property of its original owner. Now, if the car of X is sold, its sale-proceeds should go to X. Y 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. 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. First, *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.

Second, *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. Imam al-Shafi'i, says that the commodities of the first kind (*dhawat-ul-amthal*) 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. Base on the discussion on capital contribution by Taqi Usmani that the share capital in a musharakah can be contributed either in cash or in the form of commodities. However, according to Wahbah Zuhaili, contract musharakah is a form of partnership in which one of the partners' promises to buy the equity share of the other partner gradually until the title to the equity is completely transferred to him. The transaction starts with the formation of partnership, after which buying and selling of the equity take place between the two partners. It is therefore necessary that this buying and selling should not be stipulated in the partnership contract. In addition, the buying and selling agreement must be independent of the partnership contract. It is not permitted that one contract be entered into as a condition for concluding the other.

Wahbah agree that partnership capital must be non fungible example specified, and present at the time of the contract or at the time of making a trade. This follows from the fact that the partnership is initiated to realize profits through dealing in the property. If the capital were a liability or a non present property, then dealing in it would be impossible, and the reason for having a partnership would be nullified. However, it is not always necessary for the capital to be present at the time of writing the contract, but it must be present at the time of trading. Thus, consider the case where a person gives another RM1000 and asks him to match it with another RM1000, and to trade with the total capital and share the profits with him. If the second person later brings RM1000 and trades with the RM2000, the partnership is valid. In this regard, the partnership is actually realized only when the trading begins, and that is when the capital needs to be present.

The Hanafis, Malikis, and Hanbalis ruled that it is not necessary to mix the properties of the partners, since the purpose of the partnership is realized through the contract, and not through the physical mixing of properties. In analogy to silent partnership, profits from the capital are shared in accordance with the contract with mixing properties of the partners. Moreover, a partnership is primarily a contract of agency and delegation, which may be exercised without mixing properties. Therefore, the partnership is valid if the partners explicitly mention that one of them uses some Ringgit for trading, while the other uses certain other currencies. On the other hand, the Malikis argued that there must be some form of mixing of the capital, either physically or legally. Thus, Ibn Rushd said: 'Legal understanding would point out that partnerships are made better through mixing the capital, since partners would then have equal incentives in preserving each others wealth that they have in preserving their own'. At the other extreme, Zufar, the Shafi'i, and the Zaydis ruled that the two properties must be mixed in a manner that makes them indistinguishable from one another. Moreover, they ruled that the mixing must occur prior to the conclusion of the contract. This follows since any part of the partnership's capital that perishes must perish in the property of all partners, thus requiring mixture lest only one of the partners incur the entire loss. In this regard, they ruled that partnership essentially means the mixing of capital, without which it serves no economic purpose.

This difference in opinion results in different rulings for partnerships with capital of difference genere examples gold and silver. Since the majority of jurists do not require mixture of the capital, they permit partnerships where the partners contribute capital of different genera. On the other hand, the Shafi'i and Zufar do not allow such partnerships, since they require capital mixture to the point where the components cannot be recognized.

Most jurists agree that the capital of a partnership must be made of fungible monies examples gold and silver coins, or contemporary currencies. Thus, non fungibles examples real estate and cars, may not be used as capital in partnerships. This follows since such non fungibles have varying values, thus rendering the different partner's shares in capital and thus shares in profits unknown, leading to potential legal disputes. Moreover, non fungible properties are not eligible for agency and delegation. For instance it is not permitted for someone to tell another 'sell your house, and we share the price', since the house clearly belongs to the owner.

In contrast, it is permissible to say to another ‘you buy goods with RM1000 and I buy goods with RM1000, and we share whatever each of us makes’.

The Hanbalis and most of the Hanafis take this requirement to imply that gold and silver dust and nuggets are not permissible as contributions to the capital of a partnership, judging that such metals are non fungible. Some of the Hanafis ruled that such raw metals may be used as money, and thus the ruling depends on convention.

The Shafi’is went further by ruling universally that such raw metals are fungible, and hence permissible as capital in a partnership. The Hanafis also differed over copper coins, which are sometimes treated as money and at other times are not accepted as legal tender and treated as non fungible properties. Thus, Abu Hanifa, Abu Yusuf, the Shafi’is, the Hanbalis, and the Maliki jurist Ibn Al Qasim ruled that copper coins may not be used as capital in a partnership, whereas Muhammad ruled that if such coins are accepted as money, then they may be used as capital in a partnership.

On the other hand, the Malikis ruled that a partnership’s capital need not be monetary. Thus, they allow non fungibles of similar or different genera to be used as contributions to a partnership’s capital. In this case, the partner’s shares in capital are determined based on the values of their contributions. Since those values are known, they ruled that the contract is established in the same manner whether or not the capital is monetary.

#### ii) *Management of musharakah venture*

BNM suggest that, Musharakah venture may be managed in the following manner:- i) Management by all partners; or ii) Management by certain partners or single partner; or iii) Management by a third party. In the case of management by certain partners and by a third party, the non-managing partners shall not act on behalf of the partnership. A managing partner may be entitled to an agreed remuneration for their services as the manager in addition to their share in profit sharing as a partner. Alternatively, the agreed remuneration may also be in the form of a greater profit sharing ratio. Pursuant to management by a third party, the musharakah venture may appoint a third party to manage the venture based on relevant contract such as wakalah, ujah or mudarabah contract. Non-managing partners may waive their voting rights relating to the management of musharakah and this shall be specified in the contract. The managing partners as an agent shall be liable for any loss caused by his negligence or misconduct or breach of management contract.

Based on Taqi Usmani’s view, 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.

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. While, management of musharakah venture for Wahbah Zuhaili is a practice under which Islamic banks lend funds to companies by issuing floating rate interest loans pegged to the company’s rate of return. When the purpose of the loan is to acquire real estate, then an imputed rent will be agreed on and this will be shared between the borrower and the lender. It is used for investment project finance and for letters of credit as well as real estate.

With a musharakah contract, where all parties must contribute a share of the capital, and they share in any profits or losses in proportion to their investment contributions. Musharakah contracts hence represent a type of joint venture, one practical application being for syndicated financing to reduce the risk to each partner. Although there was no concept of limited liability in classical fiqh, this is now permitted otherwise the risks would deter investors.

*iii) Profit sharing rights*

BNM view regarding profit, shall be measured as an amount exceeding capital after deducting the cost and expenses attributable to musharakah venture. In cases where the musharakah is specified and meant for a specified project or activities, only expenses that can be identified by the partners or deemed direct expenses to the project may be deductible. The profit sharing ratio may either be proportionate to the capital contribution or be based on a ratio or percentage which is agreed upon by all partners irrespective of their capital contribution. It is not permissible to include a condition in musharakah contract that stipulates a pre-determined fixed amount of profit to one partner which deprives the profit share of the other partner. Based on that, a lump sum amount or fixed amount of profit may be permissible if it does not deprive the other partner from benefiting from, and sharing the profit.

The profit sharing ratio may be revised either subject to the mutual consent of the partners or subject to a certain benchmark agreed upon by the partners as the case may be. The profit expressed in the form of a certain percentage should not be linked to the capital amount. However, a profit sharing ratio may be ultimately translated into a fixed percentage based on the capital investment amount once profit is realized. A partner who has agreed to a certain profit sharing ratio may waive the rights to profits to be given to another partner on the basis of Tanazul (waiver) at the time of profit realization and distribution as well as at the time of the contract. However, a waiver of profit that takes place at the time of contract shall be by way of unilateral promise (wa'd).

The mechanism for estimating profit on Musharakah capital employed may be benchmarked to conventional benchmarks, such as but not limited to Base Lending Rate (BLR) in order to determine the indicative profit rate. Profit may be distributed from actual or realized profits through the sale of assets of the Musharakah partnership (al-tandhid alhaqiqi or al-fi'li)<sup>6</sup>. Profit distribution may also be on the basis of constructive valuation (al-tandhid al-hukmi)<sup>7</sup> on the assets including accounts receivables. In the case of constructive valuation based on market valuation or a third party verification, the unrealized profit shall be recorded as a reserve. Any allocation of funds to any partner prior to actual profit realisation shall be rationalized at a later stage. The partners shall then reimburse the amount they have received in excess of the rationalised profit, if applicable. During the Musharakah contract period, the partners may mutually agree to set aside a portion of the profit as a reserve or for any other purpose specified and mutually agreed by the partners. If the reserve fund is distributable to the partners, equitable claims by the partners shall be specified. Partners in Musharakah, shall not fully or partially guarantee the principal and profit of another partners.

A third party who is not related to any party in the Musharakah in terms of equity ownership and management control may guarantee the profit to the Musharakah venture subject to certain conditions. Pursuant to the principle of Tanazul (waiver), some partners may give some preferential treatment to other partners with regard to profit distribution. Any unusual investment income from Shariah prohibited activities of a Musharakah venture due to extenuating circumstances may be distributed to charity. The proportion of profit to be distributed between the partners by Taqi Usmani must be agreed upon at the time of affecting the contract. If no such proportion has been determined, the contract is not valid in shariah.

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 RM 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.

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<sup>6</sup> Actual valuation i.e valuation based on actual value of assets.

<sup>7</sup> Constructive valuation i.e valuation based on fair value of assets.

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.

Although, 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 shariah. 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 discussion 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. In this type of partnership, Wahbah suggest that profit sharing must be distributed in proportion to the partners' contributions to the capital of the partnership, regardless of whether they both worked or only one did. This Hanafi ruling follows from the view that profits are earned either by investing capital, by working, or by assuming liability for damages. In this first ruling, equality of capital shares leads to equality in profit shares.

Many Hanafis, with the notable exception of Zufar, also allowed unequal sharing in profits with equal capital shares if both parties worked, or if the one with the larger profit shares if both parties worked, or if the one with the larger profit share worked alone. In this case, the higher profit share can be justified by more work, either in terms of quantity or skill. This ruling is validated by the hadith: 'Profits are shared as stipulated in the contract, while losses are shared in proportion to capital shares'. This profit and loss sharing rule was also adopted by the Hanbalis and Zaydis.

However, the Hanafis did not permit the one who worked less to collect a larger profit share, and did not permit one of the partners to collect the entire profit. In all of the above, notice that what matters for those legal opinions is the condition of work, not the actual realization of work. The contrast, the Malikis, Shafi'is, Zahiris and the Hanafi jurist Zufar ruled that both profits and losses must be shared in proportion to capital in a limited partnership. Thus, they consider all profits and losses to be related to the capital, and hence must be shared according to the capital shares. Thus, they say that since it is not allowed for only one party to collect all of the profit or bear all of the losses, any proportion that deviates from capital shares would be equally impermissible.

#### iv) *Loss sharing*

Based on BNM view, capital loss incurs when a capital asset (investment or real estate) decreases in value. The loss is not realized until the asset is sold for a lower price than the purchase price. Loss shall be shared on the basis of *pari-passu* among the partners and proportionate to the capital contribution. Preferential treatment to a particular partner over the others in the same Musharakah venture in absorbing the loss shall not be permissible. The loss to the partners shall be limited to the capital contribution of each partner. Upon realization of loss, a partner may agree, without any prior condition, to bear the loss of another partner at the time such a loss is realized.

A third party may undertake to bear the loss of a partner. Specific conditions on third party guarantee of the capital are as follows:- i) The legal capacity and financial soundness of such a third party as a guarantor shall be independent from the Musharakah contract and partners; ii) The guarantee shall neither be provided in consideration for nor linked in any manner to the Musharakah contract; iii) The third party guarantor shall not hold the majority ownership of the guaranteed party; and iv) The guaranteed party shall not hold the majority ownership of the third party guarantor.

The loss due to misconduct, negligence and breach of terms and conditions by a managing partner shall be borne entirely by that partner. But Maulana Taqi Usmani, 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.

Losses in contract partnership by Wahbah scholar must be shared in proportion to the ratio of liabilities specified in the contract example that one of them will take two thirds of the work and the other will take one third. Thus, both profits and losses must be shared according to the same formula, which is equality to liability shares. In this regard, if losses are caused by the transgression of one of the partners, it is still shared by all partners according to the liability ratio, since they guarantee the work according to that ratio.

v) *Partnership venture*

Business ventures of musharakah shall be shariah compliant and may be conducted in various sectors such as trading, plantation, construction, manufacturing, investment and services. A musharakah contract may be adopted for non-commercial activities which are non-profit oriented.

Pre-contracting costs incurred to conclude musharakah contract such as the conduct of technical and feasibility studies of the financial viability of the musharakah venture by the Islamic financial institutions may be charged to the customer subject to the latter's consent.

No discussion concerning partnership venture by Taqi usmani. However, Wahbah Zuhaili jurist agree that any partnership property in the possession of one partner is considered a trust, since he would thus hold it with his partners' permission. Thus, since the partner is not holding the partnership property to collect a price or to guarantee some other payment as in pawning, he is not responsible for the perishing of what is kept in his possession. Thus, the partner's possession of such property is considered holding by legal proxy on behalf of his partners, and if the property were to perish in his possession, he is not required to pay any compensation. In this regard, the partner's claims regarding profits, losses, and perishing of properties, are all accepted based on his oath. On the other hand, as in all trusts, he is still responsible to compensate the other owners if he destroys their property through negligence of transgression.

In addition to the above parameters, BNM also introduce the following enhanced features of musharakah contract.

vi) *Origination and Execution of Musharakah Agreement*

BNM stressed a valid musharakah contract shall be concluded by an offer and acceptance between the partners and may be expressed by way of suitable documentation. A party to a musharakah contract shall conclude the contract personally or through an agent.

A party to a musharakah contract shall have the legal capacity to enter into a contract and provided that he is not restricted by any law. Upon the disbursement of the capital by the musharakah partners, all partners' rights to the profit and liability to losses are established. Any term or condition mutually agreed upon which does not contravene shariah shall be binding on the partners.

vii) *Termination and dissolution of musharakah agreement*

BNM agree that partners may mutually agree to terminate the contract at any time unless stated otherwise in the Musharakah agreement. Upon termination of Musharakah agreement, a partner may elect to acquire the entire asset of the Musharakah partnership. The acquisition by one partner of the other partner's entire asset may be satisfied as a debt due to the other partner, after taking into consideration the liabilities and determining profit and loss. A Musharakah contract shall be terminated upon expiration of specified tenure of the contract, even though the venture is still in progress unless the partners mutually agree to extend the partnership. Parties to a Musharakah contract may agree to end the partnership upon completion of business venture. A Musharakah contract may be terminated if a considerable portion of the capital is impaired, subject to terms and conditions. Such impairment may arise from losses due to extenuating circumstances that hinder the partnership to continue for the remaining period or from being on going concern.

The demise or bankruptcy of one of the partners shall terminate the Musharakah contract. However, the partners may agree to continue with the contract according to the terms in the Musharakah deed or agreement. A Musharakah financing agreement between an Islamic financial institutions and a customer specifies that the agreement is terminated if any of the following conditions occurs: (a) Both partners mutually agree to terminate after determining the liabilities of each partner; (b) Upon demise of the customer; (c) Court order to terminate the Musharakah is obtained by Islamic financial institutions; (d) Significant loss of capital that incapacitates the partnership; (e) Insolvency or bankruptcy of the customer; and (f) Violation of conditions in the agreement by any partner.

In the event that any of these conditions are met, both partners need to settle any outstanding liabilities at the date of termination. Upon the termination of the Musharakah contract, Musharakah assets shall be subjected to the liquidation process. Musharakah assets may be liquidated through actual liquidation in which the assets are disposed to the markets or third parties. The proceeds of the disposal shall then be measured against the capital to recover the capital and to distribute the profit or to record a loss accordingly. In the case of an actual liquidation, the assets shall be sold at market value and the proceeds of the sale shall be used as follows:- i) Payment of liquidation expenses; ii) Payment of financial liabilities that are owing to the partnership; and iii) Distribution of the remaining assets, if any, among the partners in proportion to their capital contribution.

A constructive liquidation of the partnership asset may be effected in the case where the partners agree to dissolve existing partnership and venture into another new partnership by investing the initial asset as capital in kind. Related with Taqi Usmani, musharakah is deemed to be terminated in anyone of the three following events. First, 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.

Second, 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. Third, if any one of the partners becomes insane or otherwise becomes incapable of effecting commercial transactions, the Musharakah stands terminated. Nevertheless in case 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 its 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 Prophet (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.”*

Certain factors or actions invalidate all types of partnership, while others invalidate certain types only. Wahbah Zuhaili enumerates four actions or factors that invalidate any partnership. First, if any of the partners dissolves a partnership, it becomes invalid. This follows from the non bindingness of the partnership contract. Have also seen that the Malikis consider the contract binding, and thus ruled that the partnership may only be dissolved by mutual consent. The Hanbalis allow each of the partners to terminate his partners' agency, in which case they no longer have the right to deal in his portion of the partnership property. Also allow unilateral dissolution of the partnership, in which case each partner is allowed access only to his own property.

Second, if a partner dies, the partnership is dissolved, whether or not the other partners know of his death. This follows since the joint agency and delegation is terminated by death. Third, if one of the partners reverts from Islam and joins its enemies, his legal status is equivalent to death, and the partnership is dissolved. Lastly, if any of the partners loses his sanity, or goes into a coma, for an extended period of time (some Hanfis said one month or more, while others said six months or more), then mutual agency is violated, and the partnership is dissolved.

**Further Comment on BNM Parameter**

Since the guideline does not focus on the types of musharakah, hence, the issue of conflicts of these contract has also been recently voiced due to being Islamic financing transaction. However, a number of transactions that have been structured using recently developed musharakah financing techniques have been categorized by some as being shariah compliant and it has been argued that only products based on classical principles of musharakah are shariah based. To determine the correctness of these categorizations, one must have a general understanding of the concepts of musharakah, and in particular the categories of three types of musharakah contract: shirkat al Aqd (contractual partnership), shirkat al Milk (co-ownership) and Musharakah Mutanakisah (diminishing Musharakah). In addition, the parameter also creates an implication on investment and financing. Those comments will be discussed separately below.

*Shirkat al Aqd (contractual partnership)*

In the context of shariah compliant financing, shirkat al Aqd means the creation of a joint venture partnership in which all the partners share the profit or loss generated by that joint venture. For example if two persons agree to undertake laundering 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 quantity of work each partner has actually done.

Therefore, any of the partners may take a greater share of the profits than the others because of his superior skill or special job or any other reason. If losses will be shared according to the partner's share in the profits. The application of Shirkat al Aqd is said to encapsulate the core principles of Islamic finance, namely the sharing of risk and profit and loss. By implementing a joint venture with its customer, the financier will directly participate in the risk of the business that it is seeking to finance.

In simple terms, if the joint venture is successful both the financier and the customer will benefit, as the profits will be distributed between them according to the pre-agreed ratios. If the joint venture is not successful, the financier and the customer will share the losses of the business in proportion to each of their respective investments. In any event, the customer will never be under an obligation to repay the capital investment made by the financier.

The majority of classical Islamic finance focus almost exclusively on principles that relate to shirkat al Aqd. The main principles of shirkat al Aqd are as follows: i) The proportion of profit to be distributed between the partners must be agreed upon prior to the consummation of the musharakah; ii) The shariah does not permit any of the partners to be guaranteed a pre-determined fixed return; iii) There is a difference of opinion among classical shariah scholars as to whether the ratio of profit for each partner should be proportionate to each partner's investment. The majority of contemporary scholars, however, permit the ratio of profit to differ from the proportion of investment made by each of the partners; and iv) There is unanimous consensus among both classical and contemporary shariah scholars that loss must be shared proportionately to each partner's investment.

*Shirkat al Milk (co-ownership)*

Shirkat-ul-milk is a form of partnership in which one of the partners' promises to buy the equity share of the other partner gradually until the title of the equity share is completely transferred to him. This transaction starts with the formation of a partnership, after which buying and selling of the equity takes place between the two partners. Shirkat-ul-milk can be used for plant and machinery, equipment, buildings and automobile financing. Hence, this contract means joint ownership of two or more persons in a particular property. This kind of shirkah may come into existence in two different ways, option and compulsory.

Optional (Ikhtiari): At the option of the parties e.g., 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 Ikhtiari. Here this relationship has come into existence at their own option, as they themselves elected to purchase the equipment jointly.

Compulsory (Ghair Ikhtiari): This comes into operation automatically without any effort or 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 a natural consequence of the death of that person. Whilst the principles of Shirkat al Milk are not new to Islamic finance, they have recently been used together with recently developed Musharakah Mutanakisah principles to create a new form of Musharakah financing.

#### *Musharakah Mutanaqisah (diminishing Musharakah)*

The Musharakah Mutanaqisah Partnership (MMP) contract, on the other hand, is based on a diminishing partnership concept. The MMP consists of three contracts, example musharakah, ijarah and bay'. First, the customer enters into a musharakah under the concept of 'Shirkat-al-Milk' (joint ownership) agreement with the bank to co-own the asset being financed. Second, the bank leases its share in the asset ownership to the customer under the concept of ijarah.

For example, customer pays a% of the asset cost as the initial share to co-own the asset whilst the bank provides for the balance of b%. Third, the customer gradually buys the bank's b% share at an agreed portion periodically until the asset is fully owned by the customer.

The periodic rental amounts will be jointly shared between the customer and the bank according to the percentage share holding at the particular times which keeps changing as the customer purchases the financier's share. The customer's share ratio would increase after each rental payment due to the periodic redemption until eventually fully owned by the customer.

Musharakah mutanaqisah can be applied in home financing products. Based on the joint-ownership concept, the banking institution leases the property to the customer who undertakes to incrementally acquire the full ownership of the property from the banking institution over an agreed period. The banking institution and the customer contribute their respective shares of the capital required to acquire the property according to a pre-determined ratio agreed to between them at the beginning of the contract. Once the customer has fully acquired the banking institution's share of the property, the partnership comes to an end with the customer becoming the sole owner of the property. This contract incorporates elements of both sale and lease or in ijarah contracts, which are integral in ensuring that no element of riba is involved in the musharakah mutanaqisah transaction. The dynamics, at different transaction stages, of a musharakah mutanaqisah contract for completed property.

#### *Implication to investment and financing*

In this section, the implication of musharakah contract on investment and financing will be discussed. The aim is to evaluate the performance of musharakah (equity participation) in terms of profitability and risk; to investigate musharakah management to recognise the obstacles and factors influencing decision-making.

#### *Implication to investment*

A musharakah contract is very similar to the conventional sense of a partnership arrangement where each party contributes capital in their specific capacity and each partner has management rights in proportion to their investment. However, the share of profit for each partner is determined as a proportion of the final total profit rather than a ratio of capital invested. In the event of a loss, each partner is obliged to lose only the amount invested in the project. Implication from the various features exposed the different types of business entity of investment sukuk. First type of investment sukuk is certificates of ownership in leased assets. For a description of investment sukuk, these are certificates that carry equal value and are issued either by the owner of a leased asset or an asset to be leased by promise, or by his financial agent, the aim of which is to sell the asset and recover its value from subscription, in which case the holders of the certificates become owners of the assets. Shariah rulings and requirements, issuer sells a leased asset or an asset to be leased on promise.

The subscribers are buyers of the asset. Mobilized funds are the purchase price of the asset and certificate holders become the owners of the assets jointly with its benefits and risks.

Second, the viability of certificates of ownership in usufructs. These certificates have various types, including the following: a) Certificates of ownership of usufructs of existing assets. These are documents of equal value that are issued either by the owner of usufruct of an existing asset or a financial intermediary acting on the owner's behalf, with the aim of leasing or subleasing this asset or receive rental from the revenue of subscription.

In this case, the holders of the certificates become owners of the usufruct of the asset. Issuer sells usufruct of an existing asset. Subscribers are buyers of the usufructs. Mobilized funds are the purchase price of the usufructs and certificate holders become the owners of the usufructs jointly with its benefits and risks. b) Certificates of ownership of usufructs to be made available in the future as per description. These are documents of equal value issued for the sake of leasing assets that the lessor is liable to provide in the future whereby the rental is recovered from the subscription income, in which case the holders of the certificates become owners of the usufruct of these future assets. Issuer sells usufruct of an asset to be made available in the future as per specification. Subscribers are buyers of the usufructs. Mobilized funds from subscription are the purchase price of the usufructs and certificate holders become the owners of the usufructs jointly with its benefits and risks. Third, the applicability of certificates of ownership of services of a specified supplier.

These are documents of equal value issued for the sake of providing or selling services through a specified supplier such as educational programmers in a nominated university and obtaining the value in the form of subscription income, in which case the holders of the certificates become owners of the services. Issuer sells services. Subscribers are buyers of the services. Mobilized funds are the purchase price of the services and certificate holders are entitled to sell all types of usufructs in addition to the funds of reselling such usufructs.

#### *Implication to financing*

Theoretical models of Islamic banking were based on the concept of profit and loss sharing (PLS) through musharakah modes of finance. There is still need for further auxiliary legislation in order to fully realize the goals of Islamic banking<sup>8</sup>. No law has been introduced to define modes of PLS financing in Musharakah. It is observed that whenever there is a conflict between the Islamic banking framework and the existing law, the latter prevailed. In essence, therefore, the relationship between the bank and the client, which of creditor and debtor, is left unchanged as specified by the existing law. The existing banking law was developed to protect mainly the credit transactions. Its application to other modes of financing also results in the treatment of those modes as credit transactions.

As we can find, there are three main areas where the Islamic banks find it difficult to finance under the PLS: a) Participating in long-term and low-yield projects, b) Financing the small businesses, and c) Granting non-participating loans to running businesses. The banks are unable or unwilling to participate in long-term projects. It is also observed from the term structure of investment of Islamic banks that most of their investments are of short term and medium term. The main reason, of course, is the need to participate in the enterprise on a PLS basis, which involves time consuming complicated assessment procedures and negotiations, requiring expertise and experience. The banks do not seem to have developed the latter and they seem to be averse to the former. There are no commonly accepted criteria for project evaluation based on PLS partnerships.

Small-scale business plays a major role in productive sectors. They are also a major group among the bank's clientele. Yet it seems difficult to provide them with the necessary finance under the PLS scheme, even though there is excess liquidity in the banks.

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<sup>8</sup> See Ahmed (2002)

The observations of Raquib and Ahmed (2003) is revealing which the service sector is made up of many small producers for whom the banking sector had not been able to provide sufficient financing.

Many of these small producers, who traditionally were able to obtain interest-based credit facilities on the basis of collateral, are now finding it difficult to raise funds for their operations. Running businesses frequently need short-term capital as well as working capital, and ready cash for miscellaneous on the spot purchases and sundry expenses. This is the daily reality in the business world. The PLS system is not geared to cater to this need. Even if there is complete trust and exchange of information between the bank and the business it is nearly impossible or prohibitively costly to estimate the contribution of such short-term financing on the return of a given business. Added to this are the delays involved in authorizing emergency loans.

### ***Conclusion***

The existences of instrument in Islamic banks come not only with profit-motive but also with socio-economic objectives. In conventional banking, most of the funds flow to large industries, multinational corporations and big industrialists. This is because, in an interest-based system, the sole criterion for the distribution of credit is the credibility of the entrepreneur.

Therefore, the distribution of credit in a conventional banking sense is directed in favour of large, rich industrialists, whereas in a profit-sharing system, bank finances will be more equitably distributed. This is because the criterion for the distribution of credit is the productivity of the project and therefore, the financing will go to the more productive project, even if the credibility of the enterprises is lower. Islamic banks are the only resorts for small and middle class entrepreneurs who do not get financing even for very good projects from conventional banks. Thus, with Shariah Parameter for Musharakah, Islamic institution can able to help and contribute into the development of socio-economic of the country. The features identified in this parameter shall serve to assist the Islamic financial services industry to identify, understand, apply and distinguish the contract from other contracts prevalent in the industry.

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