

Introduction to Musharakah:

'Musharakah' is a word of Arabic origin which literally means sharing. In the context of business and trade it means a joint enterprise in which all the partners share the profit or loss of the joint venture. It is an ideal alternative for the interest-based financing with far reaching effects on both production and distribution. In the modern capitalist economy, interest is the sole instrument indiscriminately used in financing of every type. Since Islam has prohibited interest, this instrument cannot be used for providing funds of any kind. Therefore, 'Musharakah' can play a vital role in an economy based on Islamic principles.

'Interest' predetermines a fixed rate of return on a loan advanced by the financier irrespective of the profit earned or loss suffered by the debtor, while Musharakah does not envisage a fixed rate of return. Rather, the return in Musharakah is based on the actual profit earned by the joint venture. The financier in an interest-bearing loan cannot suffer loss while the financier in Musharakah can suffer loss, if the joint venture fails to produce fruits. Islam has termed interest as an unjust instrument of financing because it results in injustice either to the creditor or to the debtor. If the debtor suffers a loss, it is unjust on the part of the creditor to claim a fixed rate of return; and if the debtor earns a very high rate of profit, it is injustice to the creditor to give him only a small proportion of the profit leaving the rest for the debtor.

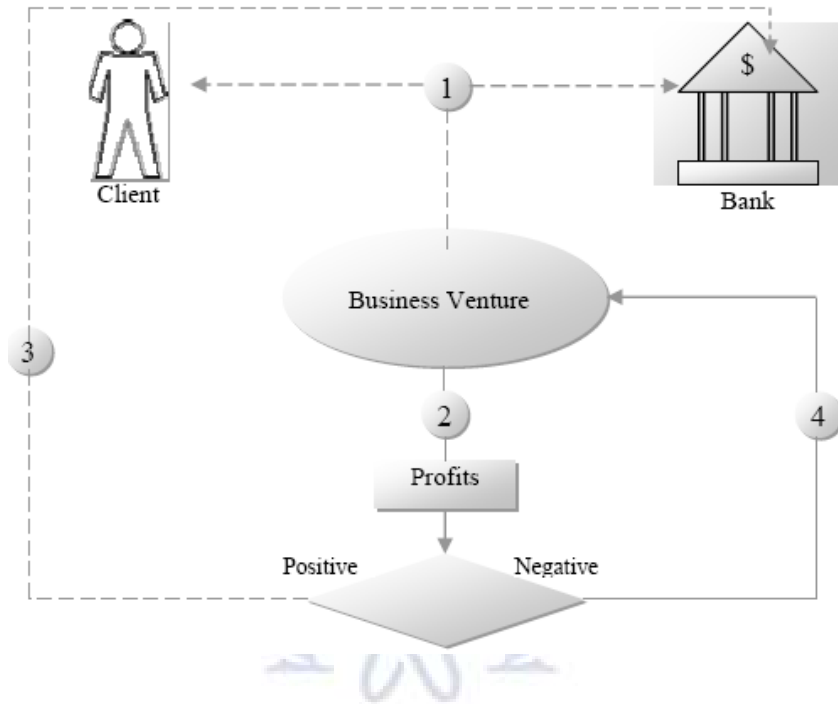
In the modern economic system, it is the banks which advance depositors' money as loans to industrialists and traders. If industrialists having only ten million of their own, acquire 90 million from the banks and embark on a huge profitable project, it means that 90% of the project has been created by the money of the depositors while only 10% has been created by their own capital. If this huge project brings enormous profits, only a small proportion i.e. 14 or 15% will go to the depositors through the bank, while all the rest will be gained by the industrialists whose real contribution to the project is not more than 10%. Even this small proportion of 14 or 15% is taken back by the industrialists, because this proportion is included by them in the cost of their production. The net result is that all the profit of the enterprise is earned by the persons whose own capital does not exceed 10% of the total investment, while the people owning 90% of the investment get no more than the fixed rate of interest which is often repaid by them through the increased prices of the products. On the contrary, if in an extreme situation, the industrialists go insolvent, their own loss is no more than 10%, while the rest of 90% is totally borne by the bank, and in some cases, by the depositors. In this way, the rate of interest is the main cause for imbalances in the system of distribution, which has a constant tendency in favor of the rich and against the interests of the poor.

Conversely, Islam has a clear cut principle for the financier. According to Islamic principles, a financier must determine whether he is advancing a loan to assist the debtor on humanitarian grounds or he desires to share his profits. If he wants to assist the debtor, he should resist from claiming any excess on the principal of his loan, because his aim is to assist him. However, if he wants to have a share in the profits of his debtor, it is necessary that he should also share him in his losses. Thus the returns of the financier in Musharakah have been tied up with the actual profits accrued through the enterprise. The greater the profits of the enterprise, the higher the rate of return to the financier. If the enterprise earns enormous profits, all of it cannot be secured by the industrialist exclusively, but they will be shared by the common people as depositors in the bank. In this way, Musharakah has a tendency to favor the common people rather than the rich only.

This is the basic philosophy which explains why Islam has suggested Musharakah as an alternative to the interest based financing. No doubt, Musharakah embodies a number of practical problems in its full implementation as a universal mode of financing. It is sometimes presumed that Musharakah is an old instrument which cannot keep pace with the ever-advancing need for speedy transactions. However, this presumption is due to the lack of proper knowledge concerning the principles of Musharakah. In fact, Islam has not prescribed a specific form or procedure for Musharakah. Rather, it has set some broad principles which can accommodate numerous forms and procedures. A new form or procedure in Musharakah cannot be rejected merely because it has no precedent in the past. In fact, every new form can be acceptable to the Shariah in so far as it does not violate any basic principle laid down by the Holy Qur'an, the Sunnah or the consensus of the Muslim jurists. Therefore, it is not necessary that Musharakah be implemented only in its traditional old form.

Mechanism:

A simple musharaka financing structure is presented below



Activity:

- 1: Client and Bank discuss business plan and jointly contribute to capital of the venture;
2. Client and Bank jointly set up the business venture and manage its operations, sharing the responsibilities as per pre-agreed terms; Business generates positive or negative profits;
3. Profits if positive, are shared as per a pre-agreed ratio;
4. Profits if negative, are shared in proportion to capital contributions; effectively bringing down the asset value while keeping their respective shares in it unchanged.