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Research Paper

Investment and entrepreneurship in Islamic law: a comparative analysis of the fundamental criteria

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ABSTRACT: *Islamic law has a well formulated system of requirements and rules governing investment and fund management, termed mudarabah in Arabic. In this contractual relationship, funds of one or more investors are provided on profit sharing basis to an entrepreneur, who contributes his effort and expertise, while the risk of genuine loss is solely borne by the investor. The prescribed system attempts to ensure that the formation, operation and conclusion of the investment process taking place on a just and equitable foundation, ruling out violation of the rights of any. Thus, the principle criteria lay down the conditions and rules that should be observed with regard to the contractors, capital, profit division, management, rights of parties as well as liquidation and invalidity. While the schools of Islamic law have different approaches to many of these issues based on fundamental precepts derived from the holy Qur'an and the prophetic traditions, each school provides a complete and coherent system that is well-balanced and equitable. The current study attempts to provide a brief and clear comparison of the positions of the schools of Islamic law on the major aspects pertaining to Islamic investment and fund management, as portrayed in the major works of each school.*

KEYWORDS: *investment, fund management, entrepreneur, financing, Islamic, equity*

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I. INTRODUCTION

Mudarabah is the second mode advocated by the Islamic commercial guidelines for financing ventures, after *shirkah al-'aqd*, or joint venture. In the Arabic language, *mudarabah* indicates an arrangement between two parties where the capital of one is given to the other for involvement in trade, on the agreement that the profit is to be shared between them, or that the latter is entitled to a defined share of the profit. The term *qirad* is also used to denote the contract of *mudarabah* in texts of Islamic law, while the terms *muqaradah* and *mu'amalah* too are used to indicate this contractual relationship.

In its Islamic legal sense, *mudarabah* is defined as a contract between two parties whereby one of them surrenders his capital to the other making the latter its owner, for investment in trade by the latter against a defined undivided share in the profit subject to specific conditions. Al-Jurjani has defined *mudarabah* succinctly as a partnership in profit through the capital of one and labour from another. Jurists are unanimous about the basic nature of *mudarabah*, that it means one person giving capital to another for trading against a defined share of the profit claimed by the fund manager (*'amil*), irrespective of the size of the share, which can be agreed upon as a third, a fourth or a half. Hanbali jurists have extended the meaning of *mudarabah* to include an instance where, although the capital is invested by one party, labour is provided by both parties, who share the profit among them, as well as an instance where both parties provide capital while labour is undertaken by one of them. According to the definition of al-Nawawi, *qirad* and *mudarabah* mean to relinquish a (sum of) capital to another (i.e. the fund manager) so that the latter may employ it in trading, for sharing the profit. Reference to relinquishing or surrender indicates that the contract of *qirad* is not valid in a usufruct such as the use of a house, e.g. to require the *mudarib* to rent out one's house for dividing the rental income between the two, or on the basis of a debt, irrespective of whether the debt is on the fund manager or a third party. Reference to the fund manager's entitlement to a share in the profit precludes agency. The essential elements pertaining to this mode including its meaning, legality according to schools of Islamic law, conditions necessary for its validity and some important rules, are analysed below, on specific areas that have some relevance to current-day Islamic financing operations.

II. BASIS OF MUDARABAH IN ISLAMIC TEXTS

The legality of *mudarabah* is based primarily on the consensus (*ijma*ʻ) of the prophetic companions and analogy (*qiyas*). Al-Sharbini states that the basis of the legality of *mudarabah* is *ijma*ʻ and need (*hajah*). Ibn Qudamah has narrated in *al-Mughni* the statement of Ibn Mundhir that scholars have unanimously agreed on the permissibility of *mudarabah* in principle. The basis of *qiyas* is the comparison of *mudarabah* to *musaqah*, due to both being contracts on the basis of labour from one and capital from the other, while the return (ʻ*iwad*) is indefinite. Al-Ramli has also stated the possibility that legality could be supported by the fact that the Holy Prophet (*Sal*.) had related with approval his having traded for Khadijah (*Rad.*) on the basis of *mudarabah* prior to Islam. According to Ibn Hazm, *mudarabah* was practised by the Quraysh who were used to investing their funds with traders against an agreed share of profit, which was later upheld by Islam. He asserts that while every chapter in *fiqh* has a known basis in the Qur'an or the Sunnah, *qirad* is based solely on sound *ijma*ʻ. It is established beyond doubt that *qirad* was in practice during the time of the Holy Prophet (*Sal*.), and he knew of it and approved it.

Although held permissible by the unanimity of jurists, *mudarabah* is an exception to the general principles in Shari'ah that prohibit *ijarah majhulah*, or undefined service contracts. According to al-Kasani, the dictate of *qiyas* or analogical reasoning is that the contract of *mudarabah* be impermissible, as the labour and wages are undefined. Wages in particular could even be considered absent, as the *mudarib* is not entitled to any guaranteed remuneration for his effort. However, *qiyas* is overruled in this instance, according to him, by evidence of the Qur'an, Sunnah, and *ijma*ʻ. Verses from the Qur'an such as "and others traverse (*yadribuna*) the earth seeking of the bounty (or increase, i.e. *fadl*) of Allah" and "there is no sin on you that you seek bounty or increase (i.e. *fadl*) from your lord," have been quoted in support of *mudarabah*, as these verses indicate general permission for attaining increase of wealth, through effort on capital belonging to another. *mudarabah* is also held exceptional because it has been recognised in spite of the involvement of profit not preceded by liability (*ribh ma lam yadman*) therein; the *mudarib* is entitled to a share of the profit without bearing liability for the capital.

Ijmaʻ of the prophetic companions is asserted on the basis of reports that indicate that a number of companions including ʻUmar, ʻUthman, ʻAli, ʻa'ishah and ʻAbdullah ibn Masʻud (*Rad.*) had invested property of orphans through *mudarabah*, without any objection being raised by the other companions. An incident involving the sons of ʻUmar (*Rad.*) where the latter had allowed them to keep half of what they had earned through investing public funds lent to them, justifying it as a form of *qirad* (i.e. *mudarabah*) with the approval of the companions, too, is cited in support. Men have practised this mode of investment from the time of the Holy Prophet (*Sal*.) to date in all periods without objection from any quarter; such unanimity of every period is credible proof (*hujjah*), on the basis of which *qiyas* has been overruled. In addition, a type of *qiyas*, too, indicates permissibility of this mode, which is the mutual need of both the investor and fund manager for a contract of this nature. Al-Kasani stresses in this context that contracts have only been legalised in view of the advantages (*maÎalih*) for the people and their needs.

Al-Ghazali has mentioned *ijma*ʻ as the basis of its legality. He has cited the narration referred to above involving the sons of Umar (*Rad.*), where the latter agreed to allow his sons to keep half of the profit on the suggestion of ʻAbd al-Rahman ibn ʻAuf (*Rad.*) that it be considered a *qirad*. Al-Ghazali observes that this indicates that *qirad* was well-known to the *Îahabah* and its permissibility was something that had already been decided among them. It is important to note that al-Ghazali has inferred the permissibility of *mudarabah* from this context provided by the narration and not from the transaction recounted therein, which dispels doubts raised by the fact that the transaction does not fully conform to the known rules of *mudarabah*. Al-Mawardi explains that in this event, the enterprise of the sons of ʻUmar (*Rad.*) was not of *qirad*, neither valid nor invalid. They had only relinquished part of their profit seeking to purify themselves, due to the suspicion entertained by ʻUmar (*Rad.*) regarding the circumstances. Al-Mawardi has added another two interpretations to the narration involving the sons of ʻUmar (*Rad.*). One of them is that the amount the sons were allowed to retain was fair wages (*ujrah al-mithl*) for the work carried out by them in a *qirad* that was invalid, due to lack of a preceding contract. The other is that in spite of the absence of a contract, the arrangement was treated as a valid *qirad* due to the general meaning of *qirad* being found therein, i.e. capital from one party with labour from the two sons, without their committing any violation in what they did.

Areas of unanimity on mudarabah

Ibn Rushd has provided in *Bidayah al-Mujtahid* a succinct introduction summarising the areas where there is unanimity on *mudarabah*. According to him, there is no difference among Muslim jurists regarding the permissibility of *qirad* (i.e. *mudarabah*), and that it belongs to the practices that existed in the age of ignorance and were (later) approved by Islam. They are unanimous that *qirad* means one person giving capital to another for trading against a defined share of the profit claimed by the fund manager (ʻ*amil*), irrespective of its size, which can be agreed upon as a third, a fourth or a half. There is unanimity that the permissibility of *qirad* is an

exception to the prohibition of undefined service contracts (i.e. *ijarah majhulah*), and that the concession in this regard has only been allowed for the purpose of providing convenience to people. Jurists agree that there is no liability on the fund manager with regard to capital that has met with destruction when he is not guilty of transgression, although they differ on what is considered transgression and what is not. They are also unanimous in general that the contract of *qirad* will not be accompanied by any condition that results in increasing the vagueness of profit or the level of risk involved, although differing on the conditions that result in this and those that do not. Similarly, while they agree that it is permissible with gold and silver coins, they have differed on other types of capital.

From the conditions pertaining to contractors, capital and profit in *mudarabah* as dictated by the schools of Islamic law, some that are important are stated hereunder.

III. CONDITIONS OF MUDARABAH

Capacity of the financier (rabb al-mal) and the fund manager (mudarib) to confer and accept agency

The *mudarib* transacting the capital with the permission of *rabb al-mal* requires that they be legally capable of agency (*wakalah*). The *rabb al-mal* assumes the role of a principal, while the *mudarib* represents an agent. Thus, if either is under interdiction, a contract of *mudarabah* is not valid between them.

Capital in the form of monetary currency

The Shafi'i, Maliki and Hanafi schools require that the capital in *mudarabah* be in the form of monetary currency (*naqd*), i.e. legally minted gold and silver money in circulation. Al-Rafi'i has cited *ijma'* as the evidence of this requirement. Thus, these schools do not allow commodities (*'urud*) or *mithliyyat* as capital in *mudarabah*, while in the contract of *shirkah al-'aqd*, Shafi'i and Hanafi schools had allowed *mithliyyat* as capital, and the Maliki school had even allowed commodities. Similar to commodities, usufructs such as tenancy of a house, too, are disqualified to become *mudarabah* capital. Hanbali jurists, who had allowed monetary currency as capital in *shirkah al-'aqd*, and according to a second report from Imam Ahmad, had also allowed commodities, have taken the same position with regard to capital in *mudarabah*. Thus, according to Hanbali jurists, what is permitted as capital in *shirkah al-'aqd* is permitted in *mudarabah* as well. This could possibly be due to their categorising *mudarabah*, too, as a variety of *shirkah al-'aqd*.

The restriction imposed with regard to *mudarabah* capital by schools other than the Hanbali is primarily due to the fact that permission for *mudarabah* has been granted on an exceptional basis. Therefore, it is permitted only in the manner originally approved. The *mudarabah* capital being in pure gold or silver is a condition for its validity, based on the *ijma'* of the prophetic companions. As explained by the Maliki jurist al-Khurashi, "*qirad* is a concession (*rukhÎah*), and consensus has emerged on its permissibility on the basis of gold and silver coins, leaving what is other than that to remain under the original prohibition." *mudarabah* is also a contract of uncertainty (*'aqd gharar*) due to the element of labour being unquantifiable, where the assurance of profit has been allowed due to need; therefore its permissibility is restricted to what is in currency in general, which is minted gold and silver.

Consequently, these schools have ruled that the capital of *mudarabah* may not be in kind. Capital in the form of commodities may not be readily tradable and thus result in undue constraint on the *mudarib*. In addition, as explained by al-Ghazali, conversion of the assets into capital becomes necessary for calculating profit, which could diminish if the price of the capital commodity goes up, even though the venture had not suffered a loss in reality. Hanafi jurists have upheld the prohibition of commodities as capital, arguing that it results in profit without risk (*ribh ma lam yadman*), forbidden in the hadith, as explained by them. *mudarabah* based on commodities leads to uncertainty of profit at the time of distribution, as valuation of the capital could only be done through estimation, resulting in the possibility of dispute.

Some Maliki jurists have inclined towards recognising metal coins (*fulus*) as capital in *mudarabah* when they happen to be the only prevalent medium of exchange, but considered the general prohibition to be applicable when gold and silver money too is in currency. The Hanafi jurist Imam Muhammad has allowed *shirkah* and *mudarabah* on the basis of metal coins when these are in circulation (*nafiqah*), based on his position that metallic coins in circulation are absolute mediums of value (i.e. *athman mutlaqah*, such as gold and silver currency), where a unit is equal to every other unit and has no distinct characteristics. Imam Abu Yusuf is reported to have allowed *shirkah* on metal coins, to the exception of *mudarabah*, due to the fact that determining the capital is necessary in *mudarabah* for profit distribution; if the coins go out of circulation, this could only be done by estimation, which would lead to the profit becoming imprecise. This situation does not arise in *shirkah*, as the partners could claim the capital by count.

Capital being existent ('ayn) and not debt (dayn)

The schools of Islamic law are in agreement that if the capital in *mudarabah* is in the form of debt, the contract is invalid. Consequently, if a creditor requires his debtor to trade using his debt on the basis of

mudarabah against a half share in profit, the contract is invalid, as unanimously upheld by jurists. Ibn Mundhir has narrated the consensus of scholars that it is impermissible for a creditor to convert his debt on another into a *mudarabah*. The reason is that funds in the hands of the debtor belong to him, which may become the property of the creditor only upon repayment of the debt and the creditor taking receipt. Moreover, such conversion is not permissible because a liability may not become converted into an *amanah*, and due to the possibility of the transaction giving rise to *riba*.

If the debtor initiates trading operations, he is entitled to the whole profit, while any loss devolves upon him solely, and the debt remains on him until settled. The creditor is not entitled to any share in the profit, due to the prohibition of gain without risk (*ribh ma lam yadman*). Jurists have explored a large number of variations pertaining to this transaction. According to some Shafi'i and Hanafi jurists, the purchased item initially becomes the possession of the creditor in some variations of this transaction, due to the existence of a valid contract of agency. However, the contract of *mudarabah* is not valid, as *mudarabah* may not be initiated on the basis of commodities; in addition, the *mudarabah* contract may not be made contingent upon another factor, according to Shafi'i jurists. However, funds deposited with another as *wadi'ah* could be converted into *mudarabah* capital, as the funds in this case belong to the depositor, except in the Maliki school. Nevertheless, if the trustee had become liable for the deposit due to a reason such as the deposit incurring loss because of infraction on his part, *mudarabah* on it is not permissible, as the deposit has turned into a debt in this instance.

Capital being surrendered to the mudarib

Jurists in general have agreed that it is necessary for the validity of *mudarabah* that the capital be surrendered to the fund manager (*mudarib*). The *mudarib* is required to have the capital under his control exclusively, free to transact it as he chooses. This is due to the fact that the capital is *amanah* at the initial stage, and requires the *mudarib* being given complete control over it (*takhliyah*), as in *wadi'ah*. The financier (*rabb al-mal*) may not retain his control over the capital. If a condition is stipulated to the effect that the financier will continue to exercise his control over the capital, the contract of *mudarabah* becomes invalid. Thus, the financier may not reserve the right to pay for what the *mudarib* had purchased, or stipulate that the *mudarib* should consult him in his transactions.

Al-Kasani in explaining the difference between *shirkah* and *mudarabah* in this respect says that this condition is necessary in the latter because it is formed on the basis of capital from one side and labour from the other, while labour may not materialise fully except after the capital leaves the control of the financier. Whereas *shirkah* is formed on the basis of labour from both sides, therefore, withholding the hand of the financier (i.e. partner) from labour would be contrary to the rationale of the contract. Similarly, if the contract of *mudarabah* stipulates that the financier participate in labour, it becomes invalid, irrespective of whether he does so in reality or not, as such a condition implies the financier's continuous control over the capital. All schools of Islamic law appear to be in concurrence in this respect.

Ibn Qudamah has recorded an alternative position reported from Imam Ahmad, which recognises as *mudarabah* a partnership between two parties based on labour from both and capital from one. This has been justified in view of the fact that the party that provides only labour is entitled to the stipulated share of profit against his work on the capital of the other, which is the actual sense of *mudarabah*. However, other jurists of the Hanbali school have supported the majority position that a condition stipulating the financier's labour along with the *mudarib* is invalid, and have interpreted Imam Ahmad's foregoing opinion to be relevant to a situation where the financier works along with the *mudarib* without stipulating it in the contract.

Declaring the proportion of profit

Knowledge of the proportion of profit accruing to each contractor is a necessary condition for the validity of *mudarabah*, in all schools of Islamic law. Profits of the venture are referred to as the subject matter of *mudarabah*, and ignorance of one's portion therein results in the invalidity of the contract. However, if general reference is made in the contract to profits being shared by the parties, without specifying the proportion of each contractor's share, jurists of all schools in general hold the contract valid, as this is understood to mean equal sharing. Profits in this instance are divided equally between the financier and the fund manager. If the contract refers to the funds being invested on the basis of *mudarabah* but does not spell out the share of the *mudarib*, the contract of *mudarabah* is held invalid, due to the profit share of the *mudarib* being unspecified (*majhul*). The financier is entitled to the whole profit and is also liable for the whole loss in this instance, while the *mudarib* receives just recompense (*ajr al-mithl*) for his labour, regardless of the outcome of the venture. When the share of the *mudarib* is agreed in the contract, the balance inevitably becomes the financier's share, due to the fact that the latter's entitlement to profit is based on his capital, while the *mudarib*'s claim results from stipulation. Thus, when the *mudarib* has claimed his share of the profit as stipulated, the balance rightly belongs to the financier, as profit is the offshoot of capital.

Profit share being fixed as a ratio of the total profit

Profit accruing to each contractor should necessarily be fixed as an undivided share, i.e. a ratio, such as a half, a third, or a fourth. Therefore, if it is agreed that one of them is entitled to a specific amount of profit, i.e. a lump sum, while the balance goes to the other, the contract becomes invalid. Ibn Mundhir has narrated the consensus of jurists that stipulation of a lump sum of profit for one contractor or both annuls the *mudarabah*. This is so because mutual sharing of profit, which is an objective in *mudarabah*, could only be achieved through this condition. Otherwise, if the venture results only in the stated amount of profit, it would be claimed by one of the parties to the exclusion of the other, thus failing in the objective of mutual sharing, in which event the contract would not be a *mudarabah*. Stipulation of a lump sum could also result in the indolence of the *mudarib* in seeking profit, as the benefit would accrue to the other. Similarly, if a lump sum amount is reserved for one party in addition to his profit ratio, the contract becomes invalid due to the same reason.

Hanafi jurists have allowed that the *mudarabah* could take place on the basis of two different profit ratios with regard to two different commodities or two types of duties, such as to agree on a ratio of 1:1 between the financier and the *mudarib* if the latter trades in wheat, and 2:1 if he trades in flour, or to agree on 2:1 if he operates within the city and 1:1 if he travels. This is justified on the basis of comparison (*qiyas*) with *ijarah*, where different rates could be fixed for different duties.

Some Maliki jurists have permitted the contractors to revise the stipulated ratio by agreeing on a fresh ratio different from the ratio initially agreed, even after the *mudarib* had commenced operations, regarding this to be condonable as realisation of profit remains uncertain. Other Maliki jurists have prohibited increase of the mudarib's share after commencement of operations.

Loss in mudarabah

Loss in *mudarabah* is exclusively related to the capital. Therefore, it is borne by the financier solely. No portion of the loss devolves on the *mudarib*. This is because loss is construed as decrease of capital, which is solely owned by the financier, where the *mudarib* does not have any ownership. Thus, loss is reflected only in the capital that is the contribution of the financier. Participation of both of them takes place only with regard to the increase of capital, i. e. profits. This is similar to the case of *musaqah* and *muzara'ah*, where participation takes place only in the produce, the worker not being liable for any loss in the plantation or land.

Maliki and Shafi'i jurists hold that if the *mudarib* is charged with liability (*daman*) for the venture, the contract becomes invalid, due to an escalation in the level of uncertainty (i.e. *gharar*) in the *mudarabah* as a result of such a condition. However, according to Hanafi and Hanbali jurists, when the *mudarib* is charged with any part of the loss, the condition becomes void while the contract remains valid, as such a condition does not lead to uncertainty of the profit. The basis adopted by them is that conditions that lead to uncertainty of profit invalidate *mudarabah*, while the ones that do not, become void themselves leaving the contract valid, such as a condition stipulating irrevocability (*luzum*) of the contract.

Conditions pertaining to labour

Shafi'i jurists rule that labour in *mudarabah* should be limited to trading operations. Other schools, too, have treated *mudarabah* as a trading venture. Thus, according to Shafi'i and Maliki jurists, if the contract of *mudarabah* stipulates an additional duty on the *mudarib* such as manufacture or value-addition, e.g. weaving cloth with yarn, milling wheat and baking bread, dying material etc, the contract becomes invalid. If the *mudarib* undertakes such activity by his own choice, the contract remains valid; however, he becomes liable for any loss arising from his actions, as ruled by Shafi'i jurists. In addition, any external labour required in the process will be at his personal expense. Similarly, a *mudarabah* venture requiring the purchase of animals, trees or other assets that yield an increase is ruled invalid by them, as the proceeds are not profits arising from trading. The Hanbali school that considers *mudarabah* similar in rules to *shirkah al-'inan*, has allowed the *mudarib* to undertake all what is permitted for a partner in *shirkah al-'inan* to undertake, and vice versa.

The financier is not allowed to specify a particular line of trade or impose restrictions in operation in a way that interferes with the freedom of the *mudarib* to transact, according to Shafi'i and Maliki jurists, as this increases the level of *gharar* in *mudarabah*. Specifying a line of trade that is continuously available where the *mudarib* will not face undue constraints is held permissible, and the *mudarib* is required to abide by such a condition. Specifying a location, too, invalidates the *mudarabah* according to Maliki jurists. Hanafi and Hanbali schools allow imposition of conditions even when the case is otherwise, as long as such conditions do not totally eliminate the possibility of profit. However, stipulating a condition preventing the *mudarib* from dealing in a particular commodity has been allowed by the consensus of jurists.

The contract of *mudarabah* may not be limited to a specific period of time, according to Shafi'i and Maliki jurists, as this could hinder the objective of *mudarabah*, and also increases *gharar*. If a condition limiting the period and forbidding transactions thereafter is imposed, the contract is invalid.

Hanafi and Hanbali schools allow such a condition, holding it equal to a condition specifying a particular commodity, and comparing *mudarabah* with *ijarah* in this respect.

IV. RULES OF MUDARABAH

Rules of *mudarabah* as discussed by the jurists are numerous, that cover every aspect of the contract from inception to profit division and termination. Of these, the outline of some basic rules is analysed below.

Revocability

Jurists are in agreement that the contract of *mudarabah* does not necessitate bindingness (*luzum*), and that either contractor is entitled to revoke the contract before the *mudarib* starts operations. After the *mudarib* has commenced operations, Imam Malik rules that the *mudarabah* becomes binding (*lazim*), due to the fact that furtherance of non-bindingness could prove detrimental to the parties. He also holds that *mudarabah* could be inherited. If the *mudarib* dies leaving sons who are trustworthy, they could replace their father in the business. The other schools hold that the contract of *mudarabah* is revocable by either party even after the commencement of operations, and that it is terminated with the death of either contractor, as is the case with non-binding contracts (*'uqud ja'izah*). Continuation of *mudarabah* with the successor of the deceased requires initiating a fresh contract.

Profits divided only after capital is realised in full

Jurists agree that the *mudarib* may claim his share of the profits only after the assets of the venture are liquidated, and the capital has been recovered in full. If the venture had resulted in a series of profits and losses, alternatively or in different transactions, the profits are diverted for offsetting losses, prior to the final summation of the profit of the venture. This is because profit signifies surplus of capital. Thus, what is not a surplus cannot be termed profit, as unanimously agreed upon by all jurists. Both al-Sarkhasi and al-Kasani have mentioned in this connection a *hadith* to the effect that "the parable of a believer is that of a trader—his profit is not given to him until he is given his capital (fully); so is the case of a believer—(the reward of) his optional devotions are not given to him until his compulsory devotions are completed for him." According to al-Kasani, this *hadith* indicates that division of profit prior to capital is inadmissible.

Shafi'i jurists have ruled that the *mudarib*'s ownership of the profit share only becomes established upon division of profits (after liquidation). If the parties distribute the profits by mutual consent prior to cancellation of the *mudarabah*, such profits remain provisional, and in the event of any loss emerging later, the *mudarib* is required to return what he had taken for offsetting it. The share of *mudarib* is also established upon liquidation of assets at the termination of *mudarabah*, even before the division of profits. Hanbali jurists too hold that liquidation of assets in the presence of the financier denotes termination of the *mudarabah*. If the financier requires the *mudarib* to continue the *mudarabah* without reclaiming the capital, it is counted as the initiation of a fresh contract, which is similar to his having retrieved the capital and returning it (once again) to the *mudarib*. If the profits are distributed prior to this or one of them takes a portion of *mudarabah* funds for himself with the permission of the other, the contract continues unbroken, so that if a loss occurs subsequently, the *mudarib* is required to return what he had taken, as it may not be termed profit until losses are offset. Al-Qurtubi has narrated the consensus of jurists that it is not permitted for the *mudarib* to draw his share of profits except in the presence of the financier, and that the latter's presence is a condition for the division of profits and drawing the *mudarib*'s share.

Duties of the mudarib

Shafi'i, Maliki and Hanbali jurists hold that the *mudarib* is expected to perform tasks that customarily form part of the relevant trade, such as display of merchandise and ensuring their safety, and receipt of payment. He is not required to carry out other tasks such as moving of heavy items, and may employ others for such purposes using the capital. However, if the *mudarib* chooses to perform such tasks that do not form part of his duty himself, he does not become entitled to any remuneration. If others are employed for performing tasks that form part of his duty, the *mudarib* is required to recompense them using his personal funds. Jurists have elaborated on diverse tasks where the *mudarib* is permitted to employ others using *mudarabah* capital. Hanafi jurists have discussed duties of the *mudarib* under four headings.

Shafi'i and Hanbali jurists hold that if the assets are in the form of debts when the contract is terminated, the *mudarib* is required to demand them, regardless of whether the venture had realised profits or not, as *mudarabah* requires returning the capital to its original form. According to Hanafi jurists, he is not required to demand debts if the venture had not resulted in profits, as there is no benefit for him in this labour, the *mudarib* being similar to an agent in this instance.

Mudarib's transactions

Shafi'i jurists have stated the general principle with regard to the dealings of the *mudarib* that his transactional powers are governed by *maÎlahah*, i.e. the best interests of the venture, similar to the transactional powers allowed for an agent. Sale or purchase when price disparity (*ghabn*) is severe is not allowed for the *mudarib*, as is the case with the agent. Hanbali jurists, too, consider the *mudarib* similar in rules to an agent, with some exceptions. The *mudarib* may not spend *mudarabah* capital in charity according to Shafi'i and Hanbali jurists, while Maliki jurists have allowed him to give away gifts of a small value.

Sale on credit is not allowed except with the permission of the financier in Shafi'i and Maliki schools; it is permitted according to the Hanafi school and the preferred opinion in the Hanbali school, as such sales are customary among traders. The *mudarib* becomes liable if he sells on credit without the financier's permission, according to the Maliki school. Shafi'i jurists require that the *mudarib* should ensure the presence of witnesses in such sales, failing which he is made liable for any default. Contrary to the agent, barter, i.e. exchange of commodities, is allowed for the *mudarib* as it could benefit the venture; also the purchase of defective commodities is permitted, if profit is expected therein, according to the Shafi'i and Hanbali schools. Similarly, Shafi'i jurists allow the *mudarib* to lease out the assets of the venture when he deems it advantageous.

The *mudarib* is not permitted to exceed the capital value in making purchases (i.e. to overtrade), in the Shafi'i, Hanafi and Hanbali schools. If the *mudarib* does so, the financier is not liable for such purchases, as the debt results in an additional liability on the financier exceeding the capital outlay. However, if profits have been realised in the venture, the *mudarib* may purchase against them as well, according to the Shafi'i school. Hanafi jurists rule that if the *mudarib* incurs debts with the permission of the financier, assets obtained against such debts become mutually owned by both of them on the basis of *shirkah al-wujuh*. This is because an asset purchased on credit may not become a *mudarabah*, as *mudarabah* is only allowed in existent capital ('*ayn*). Maliki jurists have allowed the financier the option of sharing the asset purchased on credit with the *mudarib* or paying for it, thus converting the whole into *mudarabah*.

The *mudarib* is not allowed to undertake a journey carrying the *mudarabah* assets unless permitted by the financier to do so, as travelling entails danger. In the event of his travelling without such permission, the *mudarib* becomes liable for any loss according to Shafi'i jurists. Sea voyage requires express permission in the contract. The other schools allow the *mudarib* to undertake a journey when it does not involve danger. However, if the financier imposes a restriction in this regard, it should be observed.

Shafi'i jurists allow the *mudarib* to desist from further transactions after profits have appeared in the venture and to attempt liquidation (*tandid*) for securing his share.

If the *mudarib* violates the dictates of the contract and does what he was required to avoid or purchases what was forbidden in the contract, he becomes liable (*damin*) according to all the schools of law, as he is transacting in another's assets without the latter's permission.

Mudarib investing with another

The *mudarib* is not allowed to invest the funds with another through a second contract of *mudarabah*, except with the permission of the financier. This has been defended on the basis that *mudarabah* has been permitted contrary to the dictate of *qiyas*, and is applicable only where one party finances without being required to provide labour, while the other is entrusted with labour. According to Maliki jurists, the *mudarib* becomes liable for the capital in this instance and the second *mudarabah* is held valid, leaving the first *mudarib* without any share in the profit. If the *mudarib* does so with the permission of the financier, the second *mudarabah* is held valid in all schools, as the first *mudarib* would merely be an agent of the financier in this instance. The profits are shared between the financier and the second *mudarib*. The first *mudarib* may not reserve a share of profit for himself, which would result in the invalidity of the second contract. The reason stated by Shafi'i jurists for this is that allocating a share of profit for a third party is unacceptable in *mudarabah*. However, Shafi'i jurists have permitted the financier to enter into a contract of *mudarabah* with two *mudarib*s at the same time provided they are free to transact independently. Hanafi and Hanbali jurists too have recognised the validity of such a contract, while the Maliki school allows it only when the two *mudarib*s are equal in their profit share, as they are similar to partners in *shirkah al-abdan* in this case.

Expenses of the mudarib

The *mudarib* is not entitled to claim personal expenses incurred in travel or otherwise, according to Shafi'i jurists, as he is entitled to a share of the profit. The Hanbali school too does not allow the *mudarib* to claim expenses during travel. A second position adopted by Shafi'i jurists recognises the right of the *mudarib* to claim expenses during travel, however, limits it to the amount spent in excess over the usual expense during residence. Any item procured for the journey on this basis that remains afterwards should be converted to capital. According to the Maliki and Hanafi schools, the *mudarib* may use *mudarabah* funds with moderation for his expenses after he leaves the territory, as his travel is for the purpose of the *mudarabah*, while Hanbali

jurists allow the *mudarib* to reserve the right to claim his expenses both in travel and in residence, as both are different phases of *mudarabah*. A report from Imam Ahmad allows expenses in travel when it is stipulated in the contract.

Increase and decrease of mudarabah assets

Material increase taking place in the *mudarabah* assets such as the harvest of trees and the litter of animals is claimed solely by the financier, as such increase is not consequential to trading operations, according to the preferred position of Shafi'i jurists, the other position being that it is counted as profit.

Loss resulting in *mudarabah* assets due to depreciation and damage is offset by profits. Similarly, when material loss takes place in the assets through natural disasters such as fire or through theft and confiscation after the *mudarib* has commenced operations, it is offset by profits. However, if such loss occurs before the *mudarib* had started operations, it is counted from the capital according to the Shafi'i school, as the contract had not yet become substantiated through action. Maliki jurists have ruled that any loss, even through natural disasters, is offset by profits, even if such loss occurs before commencement of operations, unless if the financier physically withdraws the capital and returns it to the *mudarib*. In the latter instance, a fresh *mudarabah* is deemed to have commenced.

If the financier had caused destruction of *mudarabah* assets, he becomes liable for the *mudarib*'s share of profit, and the destruction is construed as the financier receiving possession of what is due to him, according to Shafi'i jurists.

Shafi'i jurists have ruled that when *mudarabah* property is destroyed or is confiscated by another, the financier becomes the litigant if the assets did not comprise profits. If profits too were involved, litigation devolves on both. According to the Hanbali school, the *mudarib* is expected to carry out litigation, as *mudarabah* requires safeguarding the assets.

Financier withdrawing capital

If the financier withdraws a part of the *mudarabah* assets before the venture had resulted in profit or loss, the capital becomes limited to the remainder. If the assets comprised profit at the time of withdrawal, the withdrawn amount is held to consist of a proportionate amount of profit, wherein the share of the *mudarib* becomes established as stipulated in the contract, immune from any later loss. If the withdrawal took place after loss had appeared, the loss is divided between the withdrawn amount and the remainder, so that the proportionate amount of loss included in the withdrawn amount need not be compensated for through any later profit. The remainder in business, together with the amount of loss proportionate to it, becomes the capital. The Hanbali position on the issue is similar to that of the Shafi'i school.

mudarabah becoming invalid

Jurists agree that invalidity of *mudarabah* results in its abolishment, i.e. in the nonexistence of its effect, and if it happened before the *mudarib* had commenced operations, the capital is returned to the financier. When the contract of *mudarabah* becomes invalid afterwards, according to Hanafi, Shafi'i and Hanbali schools, the financier is entitled to the whole profit, as profit is the offshoot of his capital. The *mudarib* is not entitled to any portion of the profit, due to the fact that the basis of his right was stipulation, which became invalid with the invalidity of the contract. In this event, he becomes entitled to just recompense (*ujrah al-mithl*) for his labour.

Maliki jurists hold that when invalidity was the result of certain specific conditions stated in Malki law, such as limiting the tenure of *mudarabah*, the *mudarib* is entitled to *qirad al-mithl*, i.e. a fitting share in the profit if the venture resulted in profits. In the absence of profits, the *mudarib*is not entitled to anything. When the invalidity is of this form, the venture is not abolished, and the *mudarib*is allowed to carry on the operations. If *mudarabah* had become invalid due to other reasons, such as the financier stipulating his supervision, the *mudarib* is entitled to just recompense (*ujrah al-mithl*) from the financier, whether the venture had resulted in profits or not. According to another position adopted by Maliki jurists, if the venture had resulted in profits, the *mudarib* is entitled to the stipulated share of profit or just recompense, whichever is less, as when the lesser of the two happens to be the profit share, he had already expressed his contentment over it. If no profits have been realised, the *mudarib* is not entitled to any wages.

Shafi'i and Hanbali jurists hold that if the assets are in the form of debts when the contract is terminated, the *mudarib*is required to demand them, regardless of whether the venture had realised profits or not, as *mudarabah* requires returning the capital to its original form. According to the Hanafi school, he is not required to demand debts if the venture had not resulted in profits, as there is no benefit for him in this labour. The *mudarib* is similar to an agent in this instance.

V. CONCLUSION

Mudarabah, the second mode advocated by Islam for financing indicates an arrangement between two parties where the capital of one is given to the other for investment in trade for sharing the profit, while the loss is undertaken solely by the owner of capital. Scholars have unanimously agreed on the permissibility of *mudarabah* in principle. Its legitimacy is primarily based on *ijma*' of prophetic companions and analogy. The permissibility of *mudarabah* despite of the unspecific nature of labour and wages therein is an exception to the general principles prohibiting undefined service contracts.

Among the important conditions for the validity of *mudarabah* is that the contractors be legally capable of agency. While Hanbali jurists allow what is permitted as capital in *shirkah al-'aqd* to form the capital of *mudarabah*, others restrict *mudarabah* capital to monetary currency. This restriction is primarily due to exceptional permissibility granted to *mudarabah*, which dictates that it be allowed only in the manner originally approved. *Mudarabah* is invalid if the capital is a debt. The capital should be surrendered to the fund manager (*mudarib*). Profit accruing to each contractor should necessarily be fixed as an undivided share, and should be known at inception. Loss is exclusively related to the capital, therefore is borne by the financier solely. While Hanbali jurists who consider *mudarabah* similar in rules to *shirkah al-'inan*, allow the mudarib to undertake all what is permitted for a partner in *shirkah al-'inan*, others treat *mudarabah* as a trading venture, limiting labour in *mudarabah* to trading operations.

The contract of *mudarabah* is revocable by either party. Maliki jurists rule that it becomes irrevocable after the *mudarib* commences operations, on the basis that extension of revocability could prove detrimental to the parties. The *mudarib* may claim his share of profit only after the assets of the venture are liquidated, and the capital recovered in full. He is expected to perform tasks that customarily form part of the venture. His transactional powers are governed by the best interests of the venture. When the *mudarib* violates the dictates of the contract or commits what he was forbidden, he becomes liable for the capital. In the event of invalidity of *mudarabah*, the financier is entitled to any profits realised while the *mudarib* is recompensed for his labour. In some forms of invalidity, Maliki jurists allow the *mudarib* to claim a fitting share in the profit.

A study of the texts of Islamic law, together with other material such as compilations of rulings or *fatawa*, amply highlights the vast amount of information available on the implementation of Islamic modes of equity finance. The relevant rules and regulations, meticulously developed based on sound principles and fine-tuned over centuries through experience gained by their application in diverse societies and cultures, present a rich source for lively research. Any effort at upgrading equity models for modern practice should be accompanied by a careful analysis of the available material with full understanding of their logical and theoretical foundations, so as to avoid giving rise to contradictions in theory. Remedies hastily arrived at based on insufficient research without comprehending foundations underlying Islamic rulings could weaken its theoretical basis and consistency.

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