

AN ASSESSMENT OF THE APPLICATION OF SIYASAH AL-SHAR'IYYAH IN PARTNERSHIP SYSTEM (*MUSHĀRAKAH*) OF ISLAMIC FINANCE

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Abstract

The application of Shari'ah covers all aspects of human life be it social, religious, economics and political. As such, the linkage between Siyāsah as-shar'īyah and Islamic economics and finance cannot be overemphasized. This centres on the acquisition and the use of the available resources for providing satisfaction to the individuals in order to perform their obligation to Allah, the society and at the same time attain a better life here and hereafter. It is clear that Islamic finance and its instruments (Musharakah inclusive) work based on the Injunctions of Shari'ah and governed by the principles of Shari'ah which is based on avoidance of: (a) Interest (b) uncertainty or ambiguity relating to subject matter (c) excessive speculation. Recently, there are several Shari'ah issues when using Mushārahah as an Islamic Financial Instrument. The study therefore looks at the concept of Mushārahah (Partnership) in relation to Siyāsah as-shar'īyah: looking at its types, its modern form and conditions governing it, as well as its basic operation in the contemporary period so as to see clearly how it is applied in the sphere of Siyāsah as-shar'īyah. The methodology adopted was reviewing the past works carried in related areas as well as analysing the data collected. From the findings, it is recommended that Islamic financial instruments should be used more in order to ensure a more fair and equitable distribution of God-given resources.

Keywords: *Siyāsah al-shar'īyah; Mushārahah; Islamic Economics and Finance; Shari'ah; Resources.*

1.0 Introduction:

According to Zowk (2011), the concept of “*Mushārahah*” or “*Shirkah*” refers to a form of partnership in which decision is taken by two or more persons to combine either their capital or labour together, to share profits or losses, thus

enjoying similar rights and responsibilities. Nadeem (2011) believed that engaging poor people through business partnerships is an innovative approach being advocated these days in the form of social entrepreneurship and inclusive business models. This approach is

particularly helpful as poverty alleviation strategy and aims at Small and Micro-enterprise development. He added that Islam also offers many kinds of business partnership models to cater for the needs of different segments of society. Musharakah is therefore one of the possible partnership solutions which is more compliant to the dictates of Shari'ah. Therefore, with Musharakah system, Islam provides instruments for employment creation, enhancing distributive justice, productive use of assets, asset building and wealth creation.

According to Alharran (2013), from the very inception of human society, the methods to meet day to day needs have been changing with the change of social, economic, scientific, cultural and political circumstances, especially habits, fashions and the standard of living. These methods regulate the commercial activities and vary from place to place and time to time. The Arab society at the time of the rise of Islam had very simple financing methods and forms of business belonging exclusively to that society. The advent of the Holy Prophet (SAW) therefore saw the practice of *mushārah* already prevailing over the commercial activities in Arabia. He did not only ratify the practice but also did business on the basis of *Mushārah*. Zowk (2011) added that after the Hijrah *Musharakah* was made based on the principle of *Ukhuwwah al-Islāmiyyah* (Islamic brotherhood). The Ansar and the Muhājirūn were made partners and engage on different forms of *Musharakah* ranging from: *muzārah'ah* (in agriculture) and

musāqāt (in gardening), in their trade and commerce.

According to Usmani (2012) *Mushārah* is not any new concept as a mode of financing business. It existed in old times and set some broad principles which can accommodate numerous procedures. This means that *Mushārah* as a mode of financing is equally applied in the modern times in the area of Islamic Economics and Finance.

To start this form of partnership (*Musharakah*) business, financial contribution is sought from interesting members who want to be part of it. In this case, three alternatives are always open to them among which they choose: (a) admitting a partner in to the business, (b) borrowing funds or (c) combination of both borrowing and partnership. Usmani (2012) believes that a more secured among the three alternatives is admitting a partner to contribute capital in to the business and receiving a share according to the portion of the capital he contributed. It started before the advent of the Prophet (SAW) and he did not only approve it but also conducted business on its basis. Sanusi (2011) is of the view that *Siyāsah as-shar'iyyah*, on the other hand is based on the avoidance of economic injustice, unjust enrichment, unfair exploitation and greed. *Sharī'ah* governance is the backbone of an Islamic financial system and plays an important role in guiding its overall functioning and operation both locally, nationally and globally. Economic justice relates to the concept of brotherhood and equal treatment of all individuals in society

equal before the law. Everybody is rewarded based on his contribution to the business so that it is free from exploitation of one partner by another. Therefore for the purpose of this study a linkage is established between *Siyāṣah sharʿiyyah* and the concept of partnership. This enables us to see the areas of application of *Siyāṣah sharʿiyyah* in the sphere of Islamic Economics and Finance with specific reference to *Mushārahah*. This show the benefits derived for applying *Siyāṣah sharʿiyyah* in Islamic economics and finance in partnership (*Musharakah*) system.

2.0 Conceptual Framework

2.1 Partnership (*Mushārahah*) System

According to Usmani (2012) the concept of partnership (*mushārahah*) is translated literally to mean “sharing”. In the business and trade context, on the other hand, it means joint enterprise in which all the partners share the profit or loss of the joint venture. It is a contract of partnership in which two or more partners provide capital and share profits and losses based on the principle of profit and loss sharing (PLS). Nadeem (2011) sees *Mushārahah* as the engagement of two or more parties having a common interest to form a partnership. It is a relationship between two or more persons to engage a business venture through a mutual contract and distribute the profits (or losses) of the business run by all of them or by one of them on behalf of the others. Furthermore, Ibn Arfa (1984) defines it as: “An agreement between two or more persons to carry out a particular business with the view of sharing profits by joint investment”. Akram

Khan (1990) sees it as “a contract between two persons who launch a business of financial enterprise to make profit”.

However, Islamic Development Bank (IDB) in 1993 added that in such a contract, losses must be shared in the proportion in which the participating partners have invested their capital but profits are shared in any mutually agreed proportion in conformity with the guidelines of the Shariʿah. It is a better alternative for the interest-based financing mode which boosts our production and distribution. This is because interest which is accepted as a driving mechanism in the capitalist economy is exploitative, economically unjust and only perpetuates a situation where the rich gets richer and the poor gets poorer. In other words, it has a constant tendency in favour of the rich against the interest of the poor because of its unjust nature which serves only the interest of the minority who own the capital at the detriment of the majority who have not got the capital to invest. This is against the principle of *maslaha* (public interest). Islam prohibits interest from the viewpoint of Qurʿan. Some of the verses that prohibit interest include the following:

‘Those who devour usury will not stand except as stand one whom the Evil one by his touch Hath driven to madness. That is because they say: "Trade is like usury," but Allah hath permitted trade and forbidden usury. Those who after receiving direction from their Lord, desist, shall be pardoned for the past; their case is for Allah (to judge); but those who repeat (The

offence) are companions of the Fire: They will abide therein (forever)'.(275) Allah destroys interest and gives increase for charities. And Allah does not like every sinning disbeliever (276). Indeed, those who believe and do righteous deeds and establish prayer and give zakah will have their reward with their Lord, and there will be no fear concerning them, nor will they grieve. (277) O you who have believed, fear Allah and give up what remains [due to you] of interest, if you should be believers.(278) And if you do not, then be informed of a war [against you] from Allah and His Messenger. But if you repent, you may have your principal - [thus] you do no wrong, nor are you wronged(279). And if someone is in hardship, then [let there be] postponement until [a time of] ease. But if you give [from your right as] charity, then it is better for you, if you only knew(280). And fear a Day when you will be returned to Allah . Then every soul will be compensated for what it earned, and they will not be treated unjustly.(281). (See Qur'an 2:275-281, Şahih International).

In another verse In Surah Ali Imran:

‘O you who have believed, do not consume usury, doubled and multiplied, but fear Allah that you may be successful. (See Qur'an 3:130, Şahih International).

Similarly, In Surah An Nisa’:

‘And [for] their taking of usury while they had been forbidden from it, and their consuming of the people's wealth unjustly. And We have prepared for the disbelievers among them a painful punishment’. (See Qur'an 4:161, Şahih International).

Finally, In Surah Ar Rum, taking riba was also strongly discouraged:

And whatever you give for interest to increase within the wealth of people¹ will not increase with Allah. But what you give in zakāh, desiring the face [i.e., approval] of Allah - those are the multipliers. (See Qur'an 30:39, Saheeh International).

According to the Hadith of the Prophet (S.A.W.), it was reported on the authority of Abu Hurairah that:

‘Avoid the seven sins that doom one to Hell, Associating others with Allah (Shirk), magic, killing a soul whom Allah has forbidden killing, consuming Interest (Riba), consuming the property of orphans, fleeing on the day of the march (to the battlefield), and slandering chaste women’. (See Şahih Bukhāri: Volume 8, Book 82, Number 840).

From the above Hadith, it is clear that taking interest is one of the seven deadly sins which can easily lead to hellfire.

Apart from Islam, other religious views like Christianity have also condemned the use of interest in any

form of economic activity and not to be used for providing funds of any kind. For Instance:

In Deuteronomy Chapter 23 Verse 19 it was stated that:

‘Do not charge your brother interest on money, food, or any other type of loan.’ (See Book of Deuteronomy 23:19)

In Leviticus Chapter 25 Verse 36-37 it was added that:

‘Take thou no usury of him, or increase: but fear thy God; that thy brother may live with thee. Thou shalt not give him thy money upon usury, nor lend him thy victuals for increase’. (See Book of Leviticus 25:36-37)

Furthermore, in the book of Exodus Chapter 22 Verse 25:

‘If thou lend money to [any of] my people [that is] poor by thee, thou shalt not be to him as a usurer, neither shalt thou lay upon him usury’.

Finally, the book of Ezekiel Chapter 18 Verse 13 stated that:

Hath given forth upon usury, and hath taken increase: shall he then live? he shall not live: he hath done all these abominations; he shall surely die; his blood shall be upon him.

Interest results to injustice either to the creditor or to the debtor and is the main cause of the imbalances and widening the income between the haves and the have nots.

2.3 Legalisation of *Musharakah* and the Prohibition of *Ribā* (Interest)

The Islamic financing mode of partnership (*mushārah*) is legalized in the Qur’ān and the Sunnah. Therefore, the evidence of *mushārah* is clear in the verse:

‘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...’ (See Qur’an 38:24).

This verse clearly shows the evidence of practising *Mushārah* based on the condition that the partners must be conscious of, and dutiful to Allah (SWT) in their business dealings and in a just way and based on mutual agreement as regard sharing the benefits of the business of suffering its losses. Therefore, a partnership relationship will not be qualified as *Mushārah*, according to the verse above unless it is in consistency with the *Sharī’ah*. The evidence of *Musharakah* is also found according to the Sunnah in the Hadith narrated by Anas bin Malik (R.A.) narrating the story of two (2) brothers who conducted business on this basis as contained in the Hadith:

“...there were two partners. One of them needs to spend most of his time praying in the mosque behind the Prophet (pbuh). The other one used to spend his time on business in the market. On the day of profit distribution, the latter claimed for more profit than what was agreed in view of his efforts in making profit. The case was submitted to the Prophet (pbuh) in which he says, “Be aware

that the profit you gained was in fact due to your partner's active in praying in the mosque". (See Riyadus Şaliheen, Babun Fit Tawakkul 'Alā Allah).

The Hadith shows that responsibility can be shared for the smooth running of the business and the distribution to be based on economic justice in conformity with the Sharī'ah. In addition to that:

Abu Hurayrah (R.A), trusted companion of prophet P.B.U.H narrated: 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)

Furthermore, there are different views of Muslim scholars on how the operation of Mushārah should be. For instance, on the nature of capital contribution, there is diversity of opinions. Most Muslim jurists are of the opinion that the share of capital contributed by each business partner must be in monetary form and not in kind. In addition, they admitted that no part of it can be contributed in kind. Of importance in this respect are the views of the four scholars of Sunni schools of Islamic Law. According to Imam Malik (b. 711/93 AH – d.795/179 AH) it is not necessary for the capital to be in monetary form but contribution in kind is permissible and the share of each partner shall be determined on the basis of evaluation according to the market price prevalent at the date of the contract. Imām Abū Ḥanīfā (b.699/ 80AH — d.767/148 AH) and Imām Ahmad

(b.780/164AH — d.855 / 241 AH) on the other hand holds the view that no contribution in kind is permissible in musharakah; all contributions must be in monetary form. Their argument was supported by two reasons:

1. They based their first argument on the fact that the commodities of each partner are always distinguishable from the commodities of each other and so long as this happens, no partnership can take place. They argued that if the capital invested is in liquid form, the share of each partner cannot be distinguished from that of the other, a common pool of resources is formed and consequently mushārah partnership comes into existence.
2. Their second argument was based on the redistribution of the share-capital to each partner. Capital contributed in the form of commodities to them makes the redistribution difficult and is likely to lead to a situation where one partner gets harmed in such redistribution process. Imām Shāfi'i (b.767/ 150AH— d.820/204 AH) came with a moderated opinion while dividing commodities into two categories namely: *Dhawāt-ul-amthāl* (commodities which if destroyed can be compensated by the similar commodities both in quality and quantity eg wheat) and *Dhawāt-ul-qeemah* (commodities which if destroyed cannot be compensated by the similar commodity eg cattle). He added that if the commodity is *Dhawāt-ul-amthāl* it can form part of *Mushārah* as the share of a partner while if the commodity is *Dhawāt-ul-qeemah*

they cannot form part of the *Mushārah* capital as the share of a partner. (See Usmani, Ibid, pp.25-27).

The concept of Interest on the other hand is clearly prohibited from the viewpoint of the Quran as can be seen in the verse:

'O ye who believe! Fear Allah, and give up what remains of your demand for usury, if ye are indeed believers. If ye do it not, take notice of war from Allah and His Messenger. But if ye turn back, ye shall have your capital sums: Deal not unjustly, and ye shall not be dealt with unjustly.' (See *Qur'an* 2:278-279)

It is evident from this verse that Interest and using it in business amounts to disbelieve in Allah (SWT) which will in turn destroy the entire life of those using it here and the hereafter as all dealings based on it are off the track of Allah's blessing. It also emphasizes that business dealings in Islam are conducted based on the principle of:

'there should be neither harm nor reciprocating harm.' (See *An Nawawi, Hadith* 32).

From the view point of Sunnah, It is clear that dealing with interest in any form invokes the wrath of Allah and His Messenger and that all the participants therein, regardless of their degree of participation are all considered as committed the same rate of crime as contained in the Hadith reported by Jabir (RTA):

"...the Messenger of Allah cursed the devourer of usury, its payer, and its scribes, and its

two witnesses. And He said that they are equal (in sin). (See Sahīḥ Bukhāri, Vol.8, Book82, Number 842)

It is therefore categorically clear that *Mushārah* as a part of Islamic Finance is based on the equilibrium between the rules laid down by the *Qur'ān* and the *Sunnah* as the basis of *Sharī'ah* and the commitment of people to act based on the injunctions of the *Sharī'ah* as well as the prohibition of interest.

Furthermore, there is a consensus of opinion among the jurists of all schools of thought (including *Ḥanafī*, *Mālikī*, *Shāfi'ī*, *Hanbalī*) that *mushārah* is a valid and legitimate contract in Islam. The jurists however differ over its form conditions and other details (Alharran, 2013).

2.4 Types of *Musharakah*

The concept of *Musharakah* is said to be generally divided into two (2) broad categories though with the addition of the third type known as *mushārah Mutanāqisah*; the types are as follows:

1. *Shirkah al-Milk* (non-contractual):
In this case, the business commences on the ground of ownership of an asset or a property without having entered into a formal partnership agreement. The property can either be divisible or indivisible based on its nature. In the former case, since they decide to be together despite the divisibility of the asset or property, then it is termed as "*ikhtiyāriyyah*" (Voluntary). In the latter case, they are compelled by the

indivisible nature of the asset to stay together having no other option, then it is referred to as (Jabriyyah) meaning ‘Involuntary’ A clear example of Musharakah of this form is inherited property of a deceased person like land.

2. Shirkatul ‘Aqd (Contractual): The outstanding feature of this type of Musharakah is the issue of effecting mutual agreement on the mode and manner in which the business will be conducted. In other words, the parties involved enter into legal agreement for joint investment and the sharing of the profit as well as suffering the risks involved. The agreement however, can be effected mutually either formally and written or informally and Oral. (See Zowk, 2011, pp.52).

Furthermore, the latter type of Musharakah that is *Shirkatul ‘Aqd* is further categorized into four (4) sub divisions which are presented below:

- a. Mufāwah (equal/unlimited partnership) - In which the partners are adults, equal in their capital contribution and undertake joint responsibility and their share of profits and losses. In addition, each partner can act as a wakīl (agent) for the partnering process.
- b. Shirkah al-Inān (partnership in capital) - It is also referred to as Shirkah al amwāl In which the partners need not be adults and their share of the profits may be unequal because they are not responsible for the management of the business. The partners in this case also act as agents to the partnership. *It is a type of*

partnership in which the partners contribute both capital and work to a business. (See Zowk, 2011, pp.53)

- c. Shirkah al-abdān (*partnership in services*) - where the partners contribute their naturally endowed qualities such as knowledge, skills, experience and effort to the management of the business without contributing to the capital.
- d. Shirkah al-Wujūh (*partnership in goodwill*) - the partners in this case, use their goodwill, reputation, credit-worthiness and their contacts for promoting the partnership without contributing to the capital. (Usmani, 2012, pp.23-25)

3. Musharakah Mutanāqīshah (Diminishing Partnership): This type of musharakah is based on the concept of diminishing of the share of the financier usually a bank till the customer gets the full ownership of the property financed. In other words, it is the situation whereby the fraction owned by the financier continuously erodes till the customer becomes the full owner of the commodity in question. It is based on two options. Let us consider a situation where by a person wants to obtain a photocopy machine or a taxi for the sake of earning his livelihood.

- i. The first option is that the customer pays say 20% of the total cost of the commodity to be purchased and the financier contributes the remaining 80% to co-own the commodity based on Shirkatul milk (joint ownership). In such a situation

the customer will then gradually redeem the financier's 80% share at an agreed portion periodically until the commodity (taxi or photocopy machine) is fully owned by the customer.

- ii. Second, the bank leases its share (80%) in the customer ownership to the customer under the concept of Ijārah (leasehold), i.e. by charging rent; and the customer agrees to pay the rental to the bank for using its share of the property.

The scholars agreed that it is best to implement Mushārah Mutanāqishah Partnership for financing large capital projects whereby assets can be leased out according to agreed rental. This is because joint ownership of a commodity is accepted by all schools of Islamic jurisprudence since the financier sells its shares to the customer. (See Usmani, 2012, pp.59-62).

To sum it, it is clear from the above types of Mushārah clearly showed that contribution by members of the partnership need not be necessarily in financial terms. It can be non-financial in nature by rendering any service which works towards the progress of the partnership.

2.5 The Basic Rules / Features of Musharakah

According to Usmani (2012) the basic rules of *Mushārah* can be seen in the relationship established by the parties through a mutual contract. Therefore, it means most (if not all) the necessary ingredients of a valid contract must be present here also. For

example, the parties should be capable of entering into a contract; the contract must take place with free consent of the parties without any duress, fraud or misrepresentation, etc.

The existence of the Partners and their ability

The existence of the business partners is a pre-condition to the conduct of the Mushārah partnership. This is for the sole reason of managing the business. Furthermore, before involving a person as a partner in the Mushārah business, he must be sane & mature and be able to enter into a contract. The contract must take place with free consent of the parties without any fraud or misrepresentation. (Usmani, 2012, Ibid, pp.35)

Ownership and Management of the business

All assets of Mushārah are jointly owned in proportion to the capital of each partner. With regard to the management process, each partner has the right to take part in the management of the business. However, they may agree that one of them should manage the business. In this case, the sleeping partner should be entitled to the profit only to the extent of his investment but a management fee however, can be paid to the partner managing the Mushārah provided the agreement for the payment of such fee is independent of the Mushārah agreement. (Ibid)

The rate of profit/loss sharing should be determined

The share of each partner in the profit earned should be identified at the time of the contract. If however, the ratio is not determined beforehand the contract becomes *fāsid* (void). Therefore, identifying the profit share is necessary. Losses on the other hand are shared by all partners in proportion to their capital. No partner will be liable to suffer the risk alone. (Ibid)

Contribution to Capital

Share capital in a Mushārahkah can be contributed either in cash or in the form of commodities. In the latter case, the market value of the commodities shall determine the share of the partner in the capital. (Fawzi and Zowk, 2011, pp.13)

The Presence of the Commodity:

This means the price and commodity itself have to be clear as there is no legalization of trade based on Sharī'ah when the commodity is not in existence. (Ibid).

2.6 Termination of Musharakah

Mushārahkah will terminate if the purpose of forming the Shirkah has been achieved; if any of the partners applies for termination; if any of the partners die or becomes insane or incapable of effecting commercial transaction. If the assets of the Mushārahkah are in form of cash, all of them will be distributed pro rata between the partners otherwise, the partners may agree either to liquidate the assets or to distribute them between the partners as they are.

If there is a dispute between the partners in this matter i.e. one partner seeks liquidation while the other wants partition or distribution of the non-liquid assets themselves, the latter shall be preferred, because after the termination of Mushārahkah, all the assets are in the 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. However, in the case of the death or insanity of any of the partners, the contract of Mushārahkah with him stands terminated. His family or heirs will have the option either to withdraw the share of the deceased from the business or to continue with the contract of Mushārahkah.

2.6.1 Termination of Mushārahkah without Closing the Business

Musharakah can be terminated if one of the partners wants termination of the Mushārahkah, 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 departing partner, because the termination of Mushārahkah 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 on the distribution of the assets themselves.

3.0 Siyāsah Shar'īyah and its Application in Musharakah

The term Siyāsah Shar'īyah refers to the policy that is based on the Qur'an and Sunnah, by the ruler administering justice and the subjects giving loyalty and obedience. It is explained by the Qur'an as follows:

Verily, Allah commands that you should render back the trusts to those to whom they are due; and that when you judge between men, you judge with justice... O you who believe! Obey Allah and obey the Messenger, and those of you (Muslims) who are in authority' (See Qur'an 4:58-59)

The term Siyāsah shar'īyah according to Kamali (1989) refers to a broad doctrine of Islamic law which authorizes the ruler to determine the manner in which the Sharī'ah should be administered". He added that the view of Khallāf was that it as:

"tantamount to acting on *maṣlahah* (public Interest) which the lawgiver has neither upheld nor overruled" (See Kamali, 1989, pp.63)

In other words, it denotes administration of public affairs in an Islamic polity with the aim of realizing the interest of, and preventing harm to, the community in harmony with the general principles of Sharī'ah even if it disagrees with the particular rulings of the *mujtahidūn* (interpreters of Sharī'ah)" According to Ibn Qayyim, *Siyāsah shar'īyah* denotes "any measure

which actually brings the people closest to *Ṣalāh* (beneficence) and furthest away from *fasād* (corruption)..." (See Kamali, Ibid, pp.63)

The Islamic business operation of Musharakah is with no doubt tightly related to the concept of Siyāsah shar'īyah since the latter urges setting the equilibrium between the rules of Allah (SWT) and the commitment of people to serve Him). According to Zubair (N.d) Maqāsid ash-Sharī'ah on the other hand is based on the concept of *falāh* (success) and *hayātan ṭayyibah* (good life) all of which are achieved through the establishment of economic justice and fair play between the various economic agents based on the injunctions of the *Shari'ah* as set up by the divine guidance.

He added that the technical meaning of Siyāsah Shar'īyah is that it is the understanding and guideline of rule that is created by the imam, judge or authorities based on the Maqāsid ash-Sharī'ah (Objectives of Shariah) and do not contradict with the Qur'ān and Sunnah (primary sources of Sharī'ah) and also secondary sources in Islam to help them manage ruling based on the Sharī'ah. It must be preserved, organized, established, purified. The *Ijtihād* that are to be made must be relevant to Islam and also make consideration of *Maṣlahah*. It must be based on the way of Islam and fulfill the teaching of Islam in many aspects. According to Chapra (2000) "a deep understanding of *Maqāsid Ash Sharī'ah* entails the intense commitment of every individuals and

organization, brotherhood and social welfare” (See Kahf, 2006). This clearly shows that the concept of *Maqāṣid ash Sharī’ah* seeks the general goodness of the Ummah as tied based on the principle of *al-Ukhuwwah al-Islāmiyyah* (Islamic brotherhood) in the entire human activities be it at individual level, the organizational level or even at the state level. In addition, this indicates that profit maximization and excessive exploitation should not be the main motive of the business activities but maximization of output should be encouraged in the society to enhance productivity and development of the Islamic community. The Islamic banks are distinct from other banks by several characteristics; perhaps most notable is its compliance with *Sharī’ah* and its principles in all banking operations and activities. This commitment can be translated by the banks. It is the most important characteristic of Islamic banks that distinguishes them from conventional banks. On the hand, the existence of *Sharī’ah* Supervisory body in Islamic banks contributes to further assurance to the shareholders and depositors, and without any doubt, confidence is one of the most important success factors for banks. To ensure compliance with Islamic Shariah principles in all banking operations and finance, the Kuwait banking laws impose the formation of the *Fatwā* and *Sharī’ah* Supervisory Board in Islamic banks. This Board is an Independent body that plays an important role in Islamic Financial Institutions, especially in giving *Fatwa* (Islamic religious ruling) resolutions and Islamic ruling on the correctness of the transactions and

their validity according to the Shariah parameters and rules on financial transactions. In addition to that, it is also responsible for the duties of Shariah supervisory to ensure Shariah compliance in all Islamic banks’ operations and activities. (See Kahf, pp.16).

It is important to note that in the conventional financial system, the relationship between the Surplus Fund Units (SFUs) and the Deficit Fund Units (DFUs) is purely based on the interest rates. In Islamic financial intermediation all the prohibited elements such as *ribā*, *gharar* and *maysir* must be done away with. From the Shariah point of view, every contract is considered as lawful and permissible so long as it is in line with the instructions and guidelines laid by *Sharī’ah*. In Islamic finance the flow of resources is necessary from the SFUs (such as individuals who lend money to others) to the DFUs (such as the government and other financial institutions) for expansionary activities in the economy. (See ISRA, Islamic Financial System, pp.6, 8, 67 and 244).

According to the Security Commission Malaysia (2009), this leads to the growth and development of the economy based on the concept of justice and the welfare of individuals in the society based on the efficient system of flow of the *Rizq-Allah* (God-given resources). In addition, it has been noted without any iota of doubt that the institution of interest rate is unjust to both the lenders and borrowers as a result of which the Islamic financial system is sought. For instance it is detrimental

to the lenders who will not get anything apart from the fixed rate of interest rate that goes to him even if the business has made a great success. It is equally detrimental and unjust to the borrower who has to pay the fixed rate of interest regardless of the outcome of the business whether he made profit or incurred losses. Furthermore, the use of Ribah attracts a punishment of double-nature in this world and in the hereafter:

1. Allah's blessings will be removed from all his earnings.
2. Punishment and torture in the hellfire in the hereafter.

In view of this, Islamic finance came with the sole effort of striving for justice, fairness, trust, honesty and a balanced society and for the realization of the *Maqāṣid al-Sharī'ah*. With the promotion of economically productive activities, Islamic finance relates strongly to the real sector which forms the backbone of the financial system and promotes the overall working and stability of the system. It moves the society from the uncertainties of the financial sector to the certainties of the real sector and prevents excessive leveraging as one of the causes of the global financial crisis of 2007 to 2009. This section of the paper therefore tries to point out the specific areas of application of the Siyāsah Shar'īyah in the field of Islamic finance in the contemporary period with emphasis on the mushārah mode of financing.

3.1 Impact of Siyāsah Shar'īyah in Musharakah

Having laid the foundation, the paper seeks to point out specific areas in which the Siyāsah Shar'īyah proved

its importance in the circle of Islamic economics and Finance. To be specific, Siyāsah Shar'īyah, as a Shari'ah oriented public policy has had impact in many areas of economic development through the practice of mushārah as a mode of financing business. In other words, it has helped in making the life of any society better in the following ways:

i. Purification of earnings:

Islamic banking through *mushārah* and other instruments of Islamic finance has helped in purifying the earnings of individuals as well as business enterprises. This centers on the fact that Islamic finance is against all the non-shari'ah compliant economic activities like *riba* (usury), *gharar* (uncertainty) and other fraudulent practices in economic activities. This leads to a situation where the economy moves towards the real sector in order to boost the economy and at the same time earn the blessings of Allah (swt) in this world as well as in the next world. With specific reference to *riba* which is the main source of economic crisis in the global level it is prohibited because of the series of damages it causes in the economy.

According to ISRA (2012) Siddiqi gave five reasons for the prohibition of *riba* summarized as follows: It leads to corruption in the society as contained in Qur'an (30:37-41) which makes the economy not to be based on Islamic brotherhood but based on the principles of who gets what? When? and how? It implies *akalu amwāl an Nāsi bil bātil* (the improper appropriation of other people's property. (See Quran 4:160-1). In the

institution of capitalism where interest is the main driving force of the economy, people lend money expecting a fixed return on their lent money regardless of the outcome of the business. In Mushārahah, both the profit and the loss are shared based on mutual agreement based on ‘*La dharara wa la dhirara*’. In addition, its ultimate effect leads to destruction of the economic society. The removal of Allah’s blessings from all transactions in riba based transactions leads to a negative growth of the economy. Mushārahah is based on the hardworking of the business partners and the society for profit only and not to riba as contained in Quran (2:276). Furthermore, it demeans and diminishes human personality because of the punishment in the next world. The Quran narrated that those who use the interest will be raised as those affected by demons on the day of resurrection as contained in Quran (2:275). Finally, it is unjust as contained in Quran (2:279). The word injustice was mentioned in the Quran fifty three (53) times in the Quran which means putting everything in its right place and achieving the objective of establishing equilibrium within the market and society where everyone receives his due share in terms of rights and obligation (ISRA, 2012).

ii. Employment opportunities

Musharakah plays a vital role in financing business operations based on Islamic principles, which prohibit making a profit on interest from loans. For example, supposing that an individual (A) wants to begin a business but has limited funds. Individual (B) has excess funds and wishes to be the financier in

mushārahah with A. The two people would come to an agreement to the terms and begin a business in which both share a portion of the profits and losses. This negates the need for A to receive a loan from B. In addition, to this, employment opportunities are also created especially on the basis of *mushārahah Mutanāqishah* as chance is created to a customer with insignificant amount of capital as his contribution and later to emerge as the whole owner of the property. This goes a long way to help those with limited or no capital to be engaged in economic activity which helps in reducing the rate of unemployment in the society and at the same time improving the welfare of the society.

According to Kamarudin & Ismail (2013), “Based on profits and losses principle, Islamic participative financial intermediation reduces costs of information as well as transaction and permits risk sharing. They also highlight the fact that participative intermediation leads to an equitable, stable and sustained economic development. It can help to resolve a variety of problems: poverty and unemployment.”

iii. Elimination of exploitation

The concept of shariah is based on the concept of *adālah al-Iqtisādy* (economic justice) and *Ukhuwwah al-Islāmiyyah* (Islamic brotherhood). The capitalist system and the system of interest rate is seen as unjust and the cause of destruction of the economic society as it leads to negative growth of the economy and removal of Allah’s blessings from all transactions dealing directly or indirectly with *riba*. Thus mushārahah emerged as a

better alternative mode of financing based on Shariah principle which seeks to the hardworking of the business partners and the society for profit only and not to *riba* which implies *akalu amwāl an Nāsi bil bātil* (the improper appropriation of other people's property) as contained in Quran 4:160-1. This was agreed by Nadeem (2011) that the system of Islamic finance makes people reinforce each other by sharing the same goal as partners in business. Furthermore, the system strives for poverty reduction, engages people in financial services, to prevent people from exploitation and promote social and economic fairness.

According to Imam Muslim (N.d), the *Sharī'ah* has clearly spelt out that all business transactions must be strictly based on truth and justice and kindness. It is very vehement in its condemnation of any form of commercial dishonesty. It denounced all sorts of deceitful dealings and illegal profits in the strongest possible terms. It disallowed all transactions which are not based on justice and fair play. It strongly disapproved all transactions which involve any kind of injustice or hardship to the buyer or the seller and urged that it should be based on the concept of *al 'Adl wal Iḥsān* (justice and goodness) in a way that both the buyer and the seller are truly sympathetic and considerate towards each other. It condemns every kind of injustice and exploitation in human relations and orders its followers to conduct business with the spirit of justice tempered with human kindness. (See, Qur'an 16:90, Qur'an 5:2 and Ṣaḥīḥ Muslim, Book 10, Hadith No. 3608).

iv. Facilitation of Economic Growth and Development

Islamic economics activities as opposed to the capitalist system deals with the real sector activities in which each member of the community is encouraged to work hard for success in his business. It facilitates the process of getting the members of the society employed. Higher level of employment leads to increase in production and income and consequently economic growth is facilitated. If this economic growth is sustained over time then it leads to economic development. This was supported by Dusuki and Bouheraoua (2011) that one of the primary concerns of the *Sharī'ah* is safeguarding the property of the individuals as this leads to ensuring a decent life at the individual level, and to achieve economic growth and development of a given society or nation. Capitalism on the other hand, with their concept of fixed return regardless of the business is detrimental to the system leading a negative growth in this economy. Furthermore, taking of interest apart from being an unjust action, it manifests laziness in the economy from the part of the taker who unjustly appropriates the wealth of another person.

v. As a tool for monetary policy

The application of Shariah rules in banking makes impossible the use of usurious monetary tools especially the debt bond. However, mere prohibition of usurious monetary tools does not solve the problem with the Muslim central banks; instead there is the need to develop new Islamic tools which will help in the formulation of Shariah

compliant monetary policies. Countries like Sudan through their central bank (Central Bank of Sudan) introduced central bank's Musharakah certificate as a monetary tool. In addition, the musharakah mode of financing is seen today as an alternative for treasury bills. According to Udovitch (1970), the Islamic modes of financing *Mudarabah* & *Musharakah* were able to mobilize the entire reservoir of monetary resources of the medieval Islamic world for financing agriculture, crafts, manufacturing and long distance trade. They were used not only by Muslims but also by Jews and Christians to the extent that interest bearing loans and other overly usurious practices were not in common use. Furthermore, Chapra (1992), Kahf (1982), Siddiqi (1983) and Zarqa (1983) all supported the idea that profit sharing is more stable than the interest based system resulting in prevention of fluctuations in rates of return.

4.0 Challenges Facing *Musharakah* System

In a study conducted by Al Haram (1990) on Sudan Islamic Bank discovered that in the process applying Musharakah identified some problems such as difficulty in identifying sound financing opportunities, the risk of fraud, taxation system, and highly complex nature of equity financing. He also mentioned that the banks find it expensive to employ specialists for financing on *Musharakah* basis.

For instance, Khan (1995) points out that several studies have been conducted and results indicate that the

dominant factor in the low level of application of *Musharakah* is the *moral hazard*. He also concludes in his study that PLS instruments, which can allow profit retention by the user of funds and redeem consequently could be more popular, particularly among risk-averse start-up firms.

Furthermore, Gafoor (1995) identified some of the crucial problems associated with the PLS as follows:

- a. Investments under the Profit and Loss Sharing (PLS) are associated with high risk and uncertainty.
- b. Government participation in a project under Profit and Loss Sharing (PLS) complicates the process in estimating a return rate on the funds borrowed.
- c. Long-term projects offering low returns.
- d. Earnings are not immediate with long-term projects.
- e. Too many and too frequent changes in the Government policies.
- f. Lack of desire in the entrepreneurs to declare profits and share it with the bank.
- g. Non availability of proper and timely information from the entrepreneurs.
- h. Low ethical stands in the society today.
- i. Poor management skills in the entrepreneurs.

The Islamic Research and Training Institute (IRTI) and affiliate of IDB in Jeddah survey report conducted in 1998 indicates that various Islamic banks in different countries had been exposed to some Thirty (30) major and minor problems in the application of *Musharakah* financing. According

to Khan (1995) financing Islamic Banks based on Profit and Loss Sharing (PLS) shows that the small firms have relatively few assets and being riskier, would prefer the profit-sharing mode of financing to spread their risk. Larger firms, on the other hand have a solid asset base and better managerial experience. Tajul Islam (2005) added that financing under the equity participation method is most risky for banks in developing countries due to major reasons such as (a) lack of proper accounting, (b) lack of honesty, integrity, and character of investors (c) insufficient number of skilled entrepreneurs and (d) presence of contrary laws and regulations.

In another study, Nihar (2011) identifies that the low content of PLS contracts in the financial statements of the Islamic banks shows that competition has made the banks to adjust their contracts for survival and therefore making them not to deviate substantially from a conventional bank. Jouaber & Mehri (2011) identified moral hazard and adverse selection as the major causes of marginal use of PLS method of financing in the Islamic Financial Institutions. Furthermore, Goud (2012) in his article “Indonesia can serve as a testing ground for PLS bank financing” that profit and loss sharing contracts are inherently more difficult to operate in a banking environment because of adverse selection and moral hazard.

Considering the case of Pakistan, Hooker (2013) explains that “PLS was avoided by the Islamic Banks because of a lack of credibility in the Pakistani government. The financial sector was

said to be characterized by little accountability and rampant corruption so Islamic Banks were reluctant to use PLS as they would have difficulty monitoring their investments. Akram (1994) added that there was also little demand for PLS from businesses; extensive tax evasion made the business community comfortable with cooking the books on tax returns however PLS demands accurate accounts so that returns on investment can be shared with precision between the two parties. Businesses were reluctant to supply this information to banks and in turn banks were hesitant to believe the quality of the information provided.”

Summarizing the various hindrance factors influencing the application of Mushārahah financing by Islamic banks we conclude that these may fall into following three major categories:

- a. Internal Factors which include Management’s monitoring and Controlling Techniques, the role of top management, effect of *Shariah* supervision
- b. External Factors which include Customers’ Preferences and Government Policies.
- c. Communal factors which include Moral Hazard, High Risk and Operational Difficulties

5.0 Prospects of *Mushārahah* mong Muslims

The application of Siyāsah shar'īyah in Islamic economic and finance has immensely helped in the Muslim world in the understanding the concept of Islamic business financing and has led to the appreciation of the process which seeks to establish a business activity in terms of

partnership based on equity, fairness, justice and mutual assistance. According to Usmani (1999) Musharakah plays a significant role in financing business operations based on the principles Shariah (the Islamic Law), which prohibit interest from loans. He added that apart from financing long-term investment projects, it is also commonly used for funding entrepreneurs with the working capital to purchase raw materials or goods as well as transactional banking service in the form of Letter of Credit (L/C). Furthermore, it can be used for financing imports and exports where an exporter or importer can arrange for a single transaction on the basis of Musharakah and share the profit with the financier according to a pre-agreed ratio.

It therefore, helps in business process based on trading and investment partnership which will boost the real sector of the economy in terms of employment and income generation, elimination of exploitation, increase in the rate of productivity and consequently higher level of economic growth and development. Apart from being more Sharī'ah compliant, the relationship that exists between the financial providers and the entrepreneur is based on mutual assistance and understanding as a result of which they share the business risks and benefits as agreed in their mushārahah agreement. This encourages the entrepreneurs to maximize their efforts and offer important services to the society and the lender or the financial institution will be directly linked to the real sector of the economy not as a mere

lender (See Security Commission Malaysia 2009, pp.110-112).

6.0 Conclusion and Recommendations

From the above discussions, it is clear that the application of Siyāsah shar'īyyah in the circle of Islamic economics and finance has helped tremendously our economic activities of today not only at individual level but also at the societal and the global level. This is because the process of Sharī'ah seeks the *maṣlahah* (public interest) of the Ummah by promoting the concept of unity and brotherhood among the partners in business based on their commitment of their service to their Lord. It is their commitment to serve Allah as related to the concept of *Ibādah* (worship). In addition, it led to improvement of business activities as it helped in the area of prohibition of the widely known system of interest rate leading to purification of one's earning, employment opportunities, economic growth and development and a lot of both foreseeable and unforeseeable benefits contained therein. The concept of mushārahah which formed the backbone of the study has been subjected to various explanations by the classical as well as the contemporary scholars in order to ease the understanding of the concept as well as its basic operation and application in the modern day Islamic economic and financing activities.

In view of this, it is therefore recommended that the concept of Siyāsah shar'īyyah should be adopted and applied in the area of Islamic economic and finance to enhance the performance of the real sector by

taking advantage of the benefits of such application.

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