

15. DIMINISHING MUSHARAKAH

Another form of Musharakah, developed in the near past, is the 'Diminishing Musharakah.' According to this concept, a financier and his client participate either in the joint ownership of property or equipment, or in a joint commercial enterprise. The share of the financier is further divided into a number of units and it is understood that the client will purchase the units of the share of the financier one by one periodically, thus increasing his own share until all the units of the financier are purchased by him so as to make him the sole owner of the property, or the commercial enterprise, as the case may be.

The Diminishing Musharakah based on the above concept has taken different shapes in different transactions. Some examples are given below:

1. It has been used mostly in house financing. The client wants to purchase a house for which he does not have adequate funds. He approaches the financier who agrees to participate with him in purchasing the required house. 20% of the price is paid by the client and 80% of the price by the financier. Thus, the financier owns 80% of the house while the client owns 20%. After purchasing the property jointly, the client uses the house for his residential requirement and pays rent to the financier for using his share of the property. At the same time, the financier's share is further divided into eight equal units, each unit representing 10% ownership of the house. The client promises the financier to purchase a unit every three months. Accordingly, after the first term of three months he purchases one unit of the financier's share by paying 1/10th of the price of the house. It reduces the financier's share from 80% to 70%. Hence, the rent payable to the financier is also reduced to that extent. At the end of the second term, he purchases another unit increasing his share in the property to 40% and reducing the financier's share to 60% and consequently reducing the rent to that proportion. This process goes on in the same way until after the end of two years, the client purchases all of the financier's share reducing it to zero and increasing his own share to 100%.

This arrangement allows the financier to claim rent according to his proportion of ownership in the property and at the same time allows him periodical return of a part of his principal through purchases of the units of his share.

2. A wants to purchase a taxi to use it for offering transport services to passengers and to earn income through fares recovered from them, but he is short of funds. B agrees to participate in the purchase of the taxi, therefore, both of them purchase a taxi jointly. 80% of the price is paid by B and 20% is paid by A. After the taxi is purchased, it is employed to provide transport to passengers whereby a net income of Rs. 1000 is earned on a daily basis. Since B has 80% share in the taxi, it is agreed that 80% of the fare will be given to him and the remaining 20% will be retained by A who has a 20% share in the taxi. It means that B earns Rs. 800 and A earns Rs. 200 on daily basis. At the same time B's share is further divided into eight units. After three months A purchases one unit from B's share. Consequently B's share is reduced to 70% and A's share is increased to 30% meaning thereby that as from that date A will be entitled to Rs. 300 from the

daily income of the taxi and B will earn Rs. 700. This process will go on until after the expiry of two years A will have complete ownership of the taxi and B will take back his original investment along with the income distributed to him as mentioned.

3. A wishes to start the business of ready-made garments but lacks the required funds for that business. B agrees to participate with him for a specified period, say two years. 40% of the investment is contributed by A and 60% by B. Both start the business on the basis of Musharakah. The proportion of profit allocated for each one of them is expressly agreed upon. But at the same time B's share in the business is divided into six equal units and A keeps purchasing these units on a gradual basis until after the end of two years B comes out of the business, leaving its exclusive ownership to A. Apart from periodical profits earned by B, he gains the price of the units of his share which, in practical terms tends to repay him the original amount he invested.

Analyzed from the Shariah point of view this arrangement is composed of different transactions, which come to play their role at different stages. Therefore, each one of the foregoing three forms of diminishing Musharakah is discussed below in the light of Islamic principles.

House Financing on the Basis of Diminishing Musharakah

The proposed arrangement is composed of the following transactions:

1. To create joint ownership in the property (Shirkat-ul-Milk).
2. Giving the share of the financier to the client on rent.
3. Promise from the client to purchase the units of the financier's share.
4. Actual purchase of the units at different stages.
5. Adjustment of the rental according to the financier's remaining share in the property.

Detailed Steps of the Arrangement

- i) The first step in the above arrangement is to create a joint ownership in the property. It has already been explained in the beginning of this chapter that 'Shirkat-ul-Milk' (joint ownership) can come into existence in different ways including joint purchase by the parties. All schools of Islamic jurisprudence have expressly allowed this therefore no objection can be raised against creating this joint ownership.
- ii) The second part of the arrangement is that the financier leases his share in the house to his client and charges rent from him. This arrangement is also above board because there is no difference of opinion among the Muslim jurists in the permissibility of leasing one's undivided share in a property to his partner. If the undivided share is leased out to a third party its permissibility is a point of difference between the Muslim jurists. Imam Abu Hanifa and Imam Zufar are of the view that the undivided share cannot be leased out to a third party, while Imam Malik and Imam Shafi'i, Abu Yusuf and Muhammad Ibn Hasan hold that the undivided share can be leased out to

any person. But so far as the property is leased to the partner himself, all of them are unanimous on the validity of Ijarah.

- iii) The third step in the aforesaid arrangement is that the client purchases different units of the financier's undivided share. This transaction is also allowed. If the undivided share relates to both land and building, the sale of both is allowed according to all the Islamic schools. Similarly if the undivided share of the building is intended to be sold to the partner, it is also allowed unanimously by all the Muslim jurists. However, there is a difference of opinion if it is sold to a third party.

It is clear from the foregoing three points that each one of the transactions mentioned is allowed, but the question is whether this transaction may be combined in a single arrangement. The answer is that if all these transactions are combined by making each one of them a condition upon the other, then this is not allowed in the Shariah, because it is a well settled rule in the Islamic legal system that one transaction cannot be made a pre-condition for another.

However, the proposed scheme suggests that instead of making two transactions conditional upon each other, there should be a one sided promise from the client, firstly, to take the financier's share on lease and pay the agreed rent, and secondly, to purchase different units of the financier's share of the house at different stages. This leads us to the fourth step, which is the enforceability of such a promise.

- iv) It is generally believed that a promise to do something creates only a moral obligation on the promisor, which cannot be enforced through courts of law. However, there are a number of Muslim jurists who declare that promises are enforceable, and the court of law can compel the promisor to fulfill his promise, especially, in the context of commercial activities. Some Maliki and Hanafi jurists can be cited, in particular, who have declared that the promises can be enforced through courts of law in cases of need. The Hanafi jurists have adopted this view with regard to a particular sale called 'bai-bilwafa.' This bai-bilwafa is a special arrangement of the sale of a house whereby the buyer promises to the seller that whenever the latter gives him back the price of the house, he will resell the house to him. This arrangement was in vogue in countries of central Asia, and the Hanafi jurists have declared that if the resale of the house to the original seller is made a condition for the initial sale, it is not allowed. However, if the first sale is effected without any condition, but after effecting the sale the buyer promises to resell the house whenever the seller offers to him the same price, this promise is acceptable and it creates not only a moral obligation, but also an enforceable right of the original seller. The Muslim jurists allowing this arrangement have based their view on the principle that "the promise can be made enforceable at the time of need."

Even if the promise has been made before effecting the first sale, after which the sale has been effected without a condition, it is also allowed by certain Hanafi jurists.

One may raise an objection that if the promise of resale has been taken before entering into an actual sale, it practically amounts to putting a condition on the sale itself, because the promise is understood to have been entered into between the parties at the time of sale, and therefore, even if

the sale is without an express condition, it should be taken as conditional because a promise in an express term has preceded it.

This objection can be answered by saying that there is a big difference between putting a condition in the sale and making a separate promise without making it a condition. If the condition is expressly mentioned at the time of sale, it means that the sale will be valid only if the condition is fulfilled, meaning thereby that if the condition is not fulfilled in the future, the present sale will become void. This makes the transaction of sale contingent on a future event, which may or may not occur. It leads to uncertainty (Gharar) in the transaction, which is totally prohibited in the Shariah.

Conversely, if the sale is without any condition, but one of the two parties has promised to do something separately, then the sale cannot be held to be contingent or conditional with fulfilling of the promise. It will take effect irrespective of whether or not the promisor fulfills his promise. Even if the promisor backs out of his promise, the sale will remain effective. The most the promisee can do is to compel the promisor through a court of law to fulfill his promise and if the promisor is unable to fulfill the promise, the promisee can claim actual damages he has suffered because of the default.

This makes it clear that a separate and independent promise to purchase does not render the original contract conditional or contingent, therefore, it can be enforced.

On the basis of this analysis, the diminishing Musharakah may be used for house financing with the following conditions:

- a) The agreement of joint purchase, leasing and selling different units of the financier's share should not be tied-up together in one single contract. However, the joint purchase and the contract of lease may be joined in one document whereby the financier agrees to lease his share, after joint purchase, to the client. This is allowed because, as explained in the relevant chapter, Ijarah can be affected for a future date. At the same time the client may sign a one-sided promise to purchase different units of the financier's share periodically and the financier may undertake that when the client purchases a unit of his share, the rent of the remaining units will be reduced accordingly.
- b) At the time of the purchase of each unit, the sale must be effected by the exchange of offer and acceptance at that particular date.
- c) It is preferable that the purchase of different units by the client is effected on the basis of the market value of the house as prevalent on the date of purchase of that unit, but it is also permissible that a particular price is agreed in the promise of purchase signed by the client.

Diminishing Musharakah for Business of Services:

The second example given above for diminishing Musharakah is the joint purchase of a taxi run for earning income by using it as a hired vehicle. This arrangement constitutes the following:

- a) Creating joint ownership in a taxi in the form of Shirkat al-Milk. As already stated, this is allowed in the Shariah.

- b) Musharakah in the income generated through the services of the taxi. It is also allowed as mentioned earlier in this chapter.
- c) The client's purchase of different units of the financier's share. This is again subject to the conditions already detailed in the case of house financing. However, there is a slight difference between House financing and the arrangement suggested in this second example. The taxi, when used as a hired vehicle, normally depreciates in value over time, therefore, depreciation in the value of the taxi must be kept in mind while determining the price of different units of the financier's share.

Diminishing Musharakah in Trade

The third example of diminishing Musharakah as given above is that the financier contributes 60% of the capital for launching a business of ready-made garments, for example. This arrangement constitutes the following points only:

1. In the first place, the arrangement is simply a Musharakah whereby two partners invest different amounts of capital in a joint enterprise. This is obviously permissible subject to the conditions of a Musharakah already spelled out earlier in this chapter.
2. The client's purchase of different units of the financier's share. This may be in the form of a separate and independent promise by the client. The requirements of the Shariah regarding this promise are the same as explained in the case of house financing with one very important difference. Here the price of the financier's units cannot be fixed in the promise to purchase, because if the price is fixed before hand at the time of entering into a Musharakah, it will practically mean that the client has ensured the principal invested by the financier with or without profit, which is strictly prohibited in the case of Musharakah. Therefore, there are two options for the financier about fixing the price of his units to be purchased by the client. One option is that he agrees to sell the units on the basis of valuation of the business at the time of the purchase of each unit. If the value of the business has increased, the price will be higher and if it has decreased the price will be lower. Such valuation may be carried out in accordance with the recognized principles through experts, whose identity may be agreed upon between the parties when the promise is signed. The second option is that the financier allows the client to sell these units to anybody else at whatever price he can, but at the same time offers a specific price to the client, meaning thereby that if he finds a purchaser of that unit at a higher price, he may sell it to him, but if he wants to sell it to the financier, the latter will be agreeable to purchase it at the price fixed by him before hand.

Although both these options are available according to the principles of the Shariah, the second option does not seem to be feasible for the financier, because it would lead to injecting new partners in the Musharakah which will disturb the whole arrangement and defeat the purpose of Diminishing Musharakah in which the financier wants to get his money back within a specified period. Therefore, to implement the diminishing Musharakah's objectives, only the first option is practical.

Uses:

- All purchase of fixed assets
- House financing
- Plant and factory financing
- Car / transport financing
- Project financing of fixed assets.