

23. MUSHARAKAH IN BANK DEPOSITS

An important value of an Islamic society is mutual dealing. It also refers to deposits in banks. The operation of fixed deposits and savings accounts in Islamic banks will be different from conventional banks because the Islamic banks will be based on Musharakah (combination of Shirkah and Mudarabah) in which like conventional banks, people will invest in two ways:

1. Participation in setting up the bank like any other company by joint investment and the participants will be called the “shareholders.” They will have a partnership (Shirkah) effected by a mutual contract since they have used their capital and deed on the bank; and
2. Participation by opening their account in fixed deposit and savings account and participants will be called the “account holders.” These will not be the actual owner or shareholders of the bank – rather partners in profit only, meaning that they will have a contract of Mudarabah

The status of the bank or the shareholders will be that of a Mudarib and the account holders will be Rabb-al-Maal. The contract known as Musharakah will be a combination of Shirkah and Mudarabah. This is the reason why the profit ratio of depositors is less than the actual shareholders and the depositors will not have any voting power or the right of management because they are not involved in the deed but have only supplied the capital. This kind of dual relationship is not uncommon in Islamic jurisprudence therefore, if the Mudarib (Bank or the shareholders) wants to merge his assets with the assets of depositor, it is allowed in which case he will be regarded as owner of half the assets and Mudarib of the other half. This has already been discussed at length in chapter 13 on Musharakah.

In the previous chapter, the following facts have been established:

1. The actual status of deposits is debt and not amanah.
2. The excess paid on loan is interest, not profit.
3. If a bank is operating on Islamic principles, the bank and the depositor will have a partnership through a contract of Shirkah or Mudarabah in which case the depositor’s capital will not be regarded as loan.
4. The shareholders will act as Rabb-al-Maal as well as Mudarib.
5. The depositors will only act as Rabb-al-Maal.
6. Fixed deposits and savings accounts will be converted into Mudarabah accounts where the distribution of profit for each partner will be determined in proportion to the actual profit accrued to the business and not according to a fixed ratio or in proportion to the capital invested by him. Fixing lump sum amount is not allowed or any rate of profit tied up with any investment.

7. The entire set up of the bank is on a Musharakah basis where the relationship of the bank and shareholders is through a partnership agreement (Shirkah) because they are participating in labor as well as investment. The relationship between the bank and depositors is only that of Mudarabah because they have only invested without participating in labor. This combination of Shirkah and Mudarabah is called Musharakah in modern terminology.

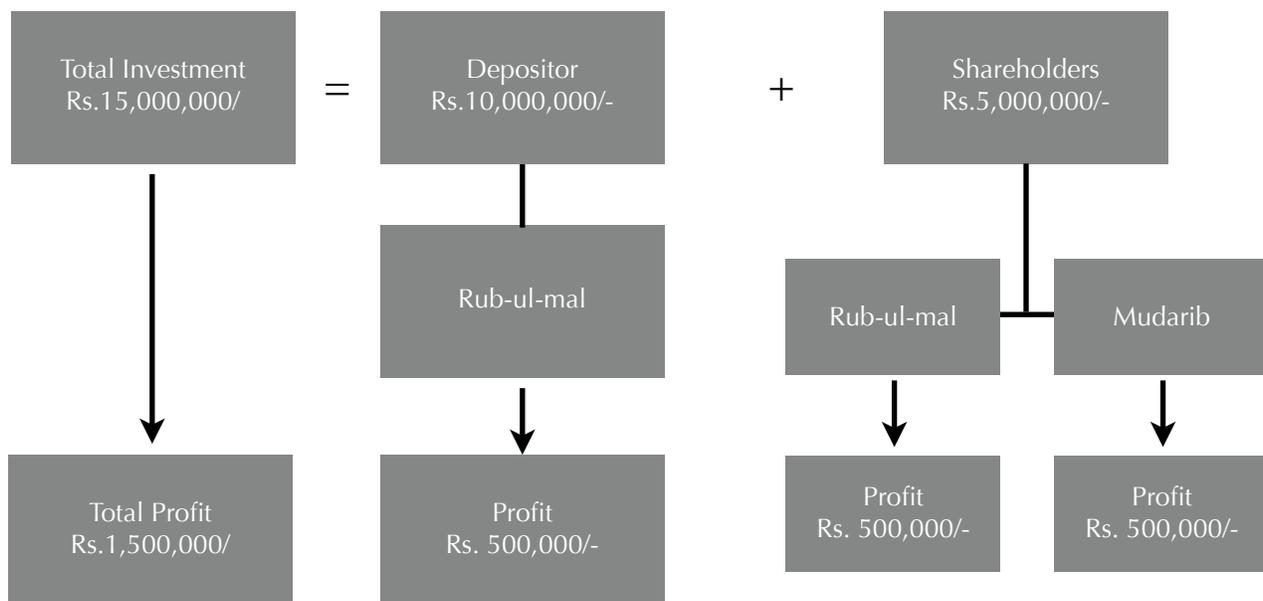
Distribution of Profit Under Musharakah Agreement

The distribution of profit will be done according to the rules of Musharakah. Before we begin the summary of the distribution of profit, it is appropriate to mention here that the conventional banks do not pay interest to current account holders, therefore, there is no need to convert the operation of the current account into any Islamic mode of financing. However, the distribution of profit to the rest of the partners and account holders is made on the following rules governing Musharakah.

It is not a condition for the final distribution of profit that all assets are liquid – rather the profit and loss is calculated on the basis of the evaluation of assets. In case of loss, each partner shall suffer the loss exactly according to the ratio of his investment and in case of profit; the profit will be distributed according to the agreed ratio between the partners. It should be taken into account that both parties are free to determine any ratio of profit of the bank as the manager (Mudarib), therefore it can be agreed mutually that the Rabb-al-Maal will have a higher profit margin and the Mudarib a lower margin. However, as a shareholding partner, the share of profit of the Mudarib cannot be less than the ratio of his investment since he is the sole provider of labor. The same rule applies to the operation of Islamic banks on the basis of Musharakah. The actual shareholders apart from being the managers are also shareholding partners; their ratio of profit cannot be less than their ratio of investment. However, their ratio of profit as Mudarib can be determined at whatever rate they please. The above may be explained as follows:

Suppose the total investment of the bank is Rs.15 million in which the depositors have invested Rs. 10 million on Mudarabah basis and the shareholders as Mudarib have invested Rs.5 million. This means that one third share of the total capital belongs to the shareholders and two third to the depositors. The role of the Mudarib in the 2/3rd capital raised by depositors is played by the shareholders, therefore their ratio of profit as manager (Mudarib) can be agreed between themselves through mutual consent but their ratio of profit, as shareholders cannot be less than 1/3rd. If their share is agreed at less than 1/3rd, it would mean that the depositors' share has exceeded 2/3rd although it has been established that they will not be managing the bank and their share of profit will not exceed their ratio of investment.

If it has been agreed in the above example that the shareholders as managing partners will get 1/3rd of the profit and the rest 2/3rd will be distributed equally between the depositors and shareholders as per the Mudarabah contract between them. For example, the profit amount is Rs.15 lacs then the shareholders will get its 1/3rd i.e. Rs.5 lacs as the investor (Rabb-al-Maal) and half of the 2/3rd profit i.e. Rs.5 lacs as the manager (Mudarib) whereas the other half of the 2/3rd profit will go to the depositors as Rabb-al-Maal. The previous illustration clarifies the shares of shareholders and depositors.



To sum up, the above procedure can be adopted to run the bank on the principles of Musharakah.

Running Musharakah Account on the Basis of Daily Products

Many financial institutions finance the working capital of an enterprise by opening a running account for them from where the clients draw different amounts at different intervals, but at the same time, they keep returning their surplus amounts. Thus, the process of debit and credit goes on up to the date of maturity and the interest is calculated on the basis of daily products.

Can such an arrangement be possible under the Musharakah or Mudarabah modes of financing? Obviously, being a new phenomenon, no express answer to this question can be found in the classical works of Islamic jurisprudence. However, keeping in view the basic principles of Musharakah the following procedure may be suggested for this purpose:

- A certain percentage of the actual profit must be allocated for the management.
- The remaining percentage of the profit must be allocated for the investors.
- The loss, if any, should be borne by the investors only in exact proportion to their respective investments.
- The average balance of the contributions made to the Musharakah account calculated on the basis of daily products shall be treated as the share capital of the financier.
- The profit accruing at the end of the term shall be calculated on a daily product basis and will be distributed accordingly.

If such an arrangement is agreed upon between the parties, it does not seem to violate any basic principle of the Musharakah. However, this suggestion needs further consideration and research by the experts of Islamic jurisprudence. Practically, it means that the parties have agreed to the principle that the profit accrued to the Musharakah portfolio at the end of the term will be divided

based on the average capital utilized per day, which will lead to the average of the profit earned by each rupee per day. The amount of this average profit per rupee per day will be multiplied by the number of the days each investor has put his money into the business, which will determine his profit entitlement on a daily product basis.

Some contemporary scholars do not allow this method of calculating profits on the ground that it is just a conjectural method, which does not reflect the actual profits really earned by a partner of the Musharakah. Because the business may have earned huge profits during a period when a particular investor had no money invested in the business at all, or had a very insignificant amount invested, still, he will be treated at par with other investors who had huge amounts invested in the business during that period. Conversely, the business may have suffered a great loss during a period when a particular investor had huge amounts invested in it. Still, he will pass on some of his loss to other investors who had no investment in that period or their size of investment was insignificant.

This argument can be refuted on the ground that it is not necessary in a Musharakah that a partner should earn profit on his own money only. Once a Musharakah pool comes into existence, all the participants, regardless of whether their money is or is not utilized in a particular transaction, earn the profits accruing to the joint pool.

This is particularly true of the Hanafi school, which does not deem it necessary for a valid Musharakah that the monetary contributions of the partners are mixed up together. It means that if A has entered into a Musharakah contract with B, but has not yet disbursed his money into the joint pool, he will be still entitled to a share in the profit of the transactions effected by B for the Musharakah through his own money. Although his entitlement to a share in the profit will be subject to the disbursement of money undertaken by him, yet the fact remains that the profit of this particular transaction did not accrue to his money, because the money disbursed by him at a later stage may be used for another transaction. Suppose A and B entered into a Musharakah to conduct a business of Rs. 100,000 They agreed that each one of them shall contribute Rs. 50,000 and the profits will be distributed by them equally. A did not yet invest his Rs. 50,000 into the joint pool. B found a profitable deal and purchased two air conditioners for the Musharakah for Rs. 50,000 contributed by himself and sold them for Rs. 60,000, thus earning a profit of Rs. 10,000. A contributed his share of Rs. 50,000 after this deal. The partners purchased two refrigerators through this contribution which could not be sold at a greater price than Rs. 48000 meaning thereby that this deal resulted in a loss of Rs. 2000. Although the transaction effected by As money brought loss of Rs. 2000 while the profitable deal of air conditioners was financed entirely by Bs money in which A had no contribution, yet A will be entitled to a share in the profit of the first deal. The loss of Rs. 2000 in the second deal will be set off from the profit of the first deal reducing the aggregate profit to Rs. 8000. This profit of Rs. 8000 will be shared by both partners equally. It means that A will get Rs. 4000, even though the transaction effected by his money has suffered a loss.

The reason is that once the parties enter into a Musharakah contract, all the subsequent transactions effected for Musharakah belong to the joint pool, regardless of whose individual money is utilized in them. Each partner is a party to each transaction by virtue of his entering into the contract of Musharakah.

A possible objection to the above explanation may be that in the above example, A had undertaken to pay Rs. 50,000 and it was known before hand that he would contribute a specified amount to the Musharakah. But in the proposed running account of Musharakah where the partners are coming in and going out every day, nobody has undertaken to contribute any specific amount. Therefore, the capital contributed by each partner is unknown at the time of entering into Musharakah, which should render the Musharakah invalid.

The answer to the above objection is that the classical scholars of Islamic jurisprudence have different views about whether it is necessary for a valid Musharakah that the capital is pre-known to the partners. The Hanafi scholars are unanimous on the point that it is not a precondition. Al-Kasani, the famous Hanafi jurist, writes:

“According to our Hanafi School, it is not a condition for the validity of Musharakah that the amount of capital is known, while it is a condition according to Imam Shafi’i. Our argument is that Jahalah (uncertainty) in itself does not render a contract invalid, unless it leads to disputes. And the uncertainty in the capital at the time of Musharakah does not lead to disputes, because it is generally known when the commodities are purchased for the Musharakah, therefore it does not lead to uncertainty in the profit at the time of distribution.” (Badai-us-sanai v.6 p.63)

It is, therefore, clear from the above that even if the amount of the capital is not known at the time of Musharakah, the contract is valid. The only condition is that it should not lead to the uncertainty in the profit at the time of distribution. Distribution of profit on the daily product basis fulfills this condition.

It is true that the concept of a running Musharakah where the partners at times draw some amounts and at other times inject new money and the profits are calculated on a daily product basis is not found in the classical books of Islamic jurisprudence, however, merely this fact cannot render a new arrangement invalid in the Shariah, so far as it does not violate any basic principle of Musharakah. In the proposed system, all the partners are treated at par. The profit of each partner is calculated on the basis of the period for which his money remained in the joint pool. There is no doubt in the fact that the aggregate profits accrued to the pool is generated by the joint utilization of different amounts contributed by the participants at different times. Therefore, if all of them agree with mutual consent to distribute the profits on a daily product basis, there is no injunction of the Shariah which makes it impermissible; rather, it is covered under the general guidelines given by the Prophet (Allah bless him and give him peace) in his famous hadith, as follows:

“Muslims are bound by their mutual agreements unless they hold a permissible thing as prohibited or a prohibited thing as permissible.”

If distribution on a daily product basis is not accepted, it will mean that no partner can draw any amount nor can he inject new amounts to the joint pool. Similarly, nobody will be able to subscribe to the joint pool except at the particular dates of the commencement of a new term. This arrangement is totally impracticable on the deposit side of the banks and financial institutions where the accounts are debited and credited by the depositors many times a day. The rejection of the concept of the daily products will compel them to wait for months before they deposit their surplus

money in a profitable account. This will hinder the utilization of savings for the development of industry and trade and will keep the wheel of financial activities jammed for long periods. There is no other solution for this problem except to apply the method of daily products for the calculation of profits, and since there is no specific injunction of the Shariah against it, there is no reason why this method should not be adopted.