

# “MUDARABAH”

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## MUDARABAH

“*Mudarabah*” is a special kind of partnership where one partner gives money to another for investing it in a commercial enterprise. The investment comes from the first partner who is called “*rabb-ul-mal*”, while the management and work is an exclusive responsibility of the other, who is called “*mudarib*”.

The difference between *musharakah* and *mudarabah* can be summarized in the following points:

1. The investment in *musharakah* comes from all the partners, while in *mudarabah*, investment is the sole responsibility of the *rabb-ul-mal*.
2. In *musharakah*, all the partners can participate in the management of the business and can work for it, while in the *mudarabah*, the *rabb-ul-mal* has no right to participate in the management which is carried out by the *mudarib* only.
3. In *musharakah* all the partners share the loss to the extent of the ratio of their investment while in *mudarabah* the loss, if any, is suffered by the *rabb-ul-mal* only, because the *mudarib* does not invest anything. His loss is restricted to the fact that his labor has gone in vain and his work has not brought any fruit to him.

However, this principle is subject to a condition that the *mudarib* has worked with due diligence which is normally required for the business of that type. If he has worked with negligence or has committed dishonesty, he shall be liable for the loss caused by his negligence or misconduct.

4. The liability of the partners in *musharakah* is normally unlimited. Therefore, if the liabilities of the business exceed its assets and the business goes in liquidation, all the exceeding liabilities shall be borne *pro rata* by all the partners. However, if all the partners have agreed that no partner shall incur any debt during the course of business, then the exceeding liabilities shall be borne by the partner alone who has incurred a debt on the business in violation of the aforesaid condition.

Contrary to this is the case of *mudarabah*. Here the liability of *rabb-ul-mal* is limited to his investment, unless he has permitted the *mudarib* to incur debts on his behalf.

5. In *musharakah*, as soon as the partners mix up their capital in a joint pool, all the assets of the *musharakah* become jointly owned by all of them according to the proportion of their respective investment. Therefore, each of them can benefit from the appreciation in the value of the assets, even if the profit has not accrued through sales.

The case of *mudarabah* is different. Here all the goods purchased by the *mudarib* are solely owned by the *rabb-ul-mal*, and the *mudarib* can earn his share in the profit only in case he sells the goods profitably. Therefore, he is not entitled to claim his share in the assets themselves, even if their value has increased.

### **Business of Mudarabah**

The *rabb-ul-mal* may specify a particular business for the *mudarib*, in which case he shall invest the money in that particular business only. This is called *almudarabah al-muqayyadah* (restricted *mudarabah*). But if he has left it open for the *mudarib* to undertake whatever business he wishes, the *mudarib* shall be authorized to invest the money in any business he deems fit. This type of *mudarabah* is called '*al-mudarabah al-mutlaqah*' (unrestricted *mudarabah*)

A *rabbul-mal* can contract *mudarabah* with more than one person through a single transaction. It means that he can offer his money to A and B both, so that each one of them can act for him as *mudarib* and the capital of the *mudarabah* shall be utilized by both of them jointly, and the share of the *mudarib* shall be distributed between them according to the agreed proportion. In this case both the *mudaribs* shall run the business as if they were partners *inter se*. The *mudarib* or *mudaribs*, as the case may be, are authorized to do anything which is normally done in a course of business. However, if they want to do an extraordinary work, which is beyond the normal routine of the traders, they cannot do so without express permission from the *rabb-ul-mal*.

### **Distribution of the Profit**

It is necessary for the validity of *mudarabah* that the parties agree, right at the beginning, on a definite proportion of the actual profit to which each of them is entitled. No particular proportion has been prescribed by the Shar'iah; rather, it has been left to their mutual consent. They can share the profit in equal proportions, and they can also allocate different proportions for the *rabb-ul-mal* and the *mudarib*. However, they cannot allocate a lump sum amount of profit for any party, nor can they determine the share of any party at a specific rate tied up with the capital. For example, if the capital is Rs.100000/- they cannot agree on a condition that Rs.10000/- out of the profit shall be the share of the *mudarib*, nor can they say that 20% of the capital shall be given to *rabb-ul-mal*. However, they can agree on that 40% of the actual profit shall go to the *mudarib* and 60% to the *rabb-ul-mal* or vice versa.

It is also allowed that different proportions are agreed in different situations. For example the *rabb-ul-mal* may say to the *mudarib*, "If you trade in wheat, you will get 50% of the profit and if you trade in flour, you will have 33% of the profit". Similarly, he can say "If you do the business in your town, you will be entitled to 30% of the profit, and if you do it in another town, your share will be 50% of the profit."

Apart from the agreed proportion of the profit, as determined in the above manner, the *mudarib* cannot claim any periodical salary or a fee or remuneration for the work done for him by the *mudarabah*

All the schools of the Islamic *Fiqh* are unanimous on this point. However, Imam Ahmad has allowed for the *mudarib* to draw his daily expenses of food only from the *mudarabah* account.

The Hanafi jurists restrict this right of the *mudarib* only to a situation where he is on a business trip outside his own city. In this case he can claim his personal expenses,

accommodation, food etc., but he is not entitled to get anything as daily allowances when he is in his own city.

If the business has incurred loss in some transactions and has gained profit in some others, the profit shall be used to offset the loss at the first instance, then the remainder, if any, shall be distributed between the parties according to the agreed ratio.

### **Termination of Mudarabah**

The contract of the *mudarabah* can be terminated at any time by either of the two parties. The only condition is to give a notice to the other party. If all assets of the *mudarabah* are in cash form at the time of termination, and some profit has been earned on the principle amount, it shall be distributed between the parties according to the agreed ratio. However, if the assets of the *mudarabah* are not in the cash form, the *mudarib* shall be given an opportunity to sell or liquidate them, so that the actual profit may be determined.

There is a difference of opinion among the Muslim jurists about the question whether the contract of *mudarabah* can be affected for a specified period after which it terminates automatically. The Hanafi and Hanbali schools are of view that the *mudarabah* can be restricted to a particular term, like one year, six months, etc, after which it will come to an end without a notice. On the contrary, Shafi'i and Maliki schools are of the opinion that the *mudarabah* cannot be restricted to a particular time.

However, this difference of opinion relates only to the maximum time limit of the *mudarabah*. Can a minimum time limit also be fixed by the parties before which *mudarabah* cannot be terminated? No express answer to this question is found in the books of the Islamic *Fiqh*, but it appears from the general principles enumerated therein that no such limit can be fixed, and each party is at liberty to terminate the contract whenever he wishes.

This unlimited power of the parties to terminate the *mudarabah* at their pleasure may create some difficulties in the context of the present circumstances, because most of the commercial enterprises today need time to bring fruits. They also demand constant and complex efforts. Therefore, it may be disastrous to the project, if the *rabb-ul-mal* terminates the *mudarabah* right in the beginning of the enterprise. Specially, it may bring a severe set back to a *mudarib* who will earn nothing despite all his efforts. Therefore, if the parties agree, when entering into the *mudarabah*, that no party shall terminate it during a specified period, except in specified circumstances it does not seem to violate any principle of Shar'iah, particularly in the light of the famous *hadith*, already quoted which says: "All the conditions agreed upon by the Muslims are upheld, except a condition which allows what is prohibited or prohibits what is lawful."

### **Combination of Musharakah and Mudarabah**

A contract of *mudarabah* normally presumes that the *mudarib* has not invested anything to the *mudarabah*. He is responsible for the management only, while all the investment comes from *rabb-ul-mal*. But there may be situations where the *mudarib* also wants to invest some of his money into the business of *mudarabah*.

In such cases *musharakah* and *mudarabah* are combined together. For example, A gave to B Rs.100000/- in a contract of *mudarabah*. B added Rs.50000/- from his own pocket with the permission of A. This type of partnership will be treated as a combination of *musharakah* and *mudarabah*. Here the *mudarib* may allocate for himself a certain percentage of profit on account of his investment as a *sharik*, and at the same time he may allocate another percentage for his management and work as a *mudarib*. The normal basis for allocation of the profit in the above example would be that B shall secure one third of the actual profit on account of his investment, and the remaining two thirds of the profit shall be distributed between them equally. However, the parties may agree on any other proportion. The only condition is that the sleeping partner should not get more percentage than the proportion of the investment.

Therefore, in the aforesaid example, A cannot allocate for himself more than two thirds of the total profit, because he has not invested more than two thirds of the capital. Short of that, they can agree on any proportion. If they have agreed that the total profit will be distributed equally, it means that one-third of the profit shall go to B as an investor, while one fourth of the remaining two thirds will go to him as a *mudarib*. The rest will be given to A as “*rabb-ul-mal*”.