

A Study on *Muḍārabah* in Islamic Law and
Its Application in Malaysian Islamic Banks

Submitted by
Amir Shaharuddin

To the University of Exeter
As a Thesis for the Degree of Doctor of Philosophy
In Arab and Islamic Studies

May 2010

This thesis is available for Library use on the understanding that it is copyright material and that no quotation from the thesis may be published without proper acknowledgement.

I certify that all material in this thesis which is not my work has been identified and that no material has previously been submitted and approved for the award of a degree by this or any other University.

.....

ACKNOWLEDGEMENT

I owe my deepest gratitude to Prof. Robert Gleave, whose encouragement, guidance and support from the initial to the final level enabled me to complete this study. He becomes my role model of a successful researcher and helpful supervisor. I am also deeply grateful to the Ministry of Higher Education of Malaysia and Islamic Science University of Malaysia for the financial support they gave me in order to pursue my study in the UK. Then, I would like to thank my family particularly wife, Dr. Yasmin Hanani Mohd Safian and sons, Asim, Harith, Humam and Fawwaz. This study would not have been possible without them.

ABSTRACT

The contrast between the theory and practice of Islamic banking is generally acknowledged by many scholars. After more than three decades in operation, the rapid growth of the Islamic banking industry is, in reality being driven by the application of the debt-like contracts (e.g. *murābahah* and *ijārah*) rather than the profit and loss sharing contracts (e.g. *muḍārabah* and *mushārahah*). As the adaptation of the former contracts creates "unauthentic" Islamic financial products, many have questioned their compliance with *sharī'ah* principles. The present study analyses this issue by examining the application of *muḍārabah* rules in Malaysian Islamic banking practices. It evaluates the extent to which the current practices fulfil the principles and the ethical framework of the *muḍārabah* contract as propounded by the classical jurists. The study also analyses the justifications of Malaysian *sharī'ah* scholars for modification of the doctrine, adapting it to the modern banking business. The study found that the local *sharī'ah* scholars have adopted an incoherent legal methodology when making their *ijtihād*. They can be very rigid, concentrating solely on the legal technicality and at the same time be very flexible, adapting an unregulated doctrine of *maṣlaḥah*. Therefore, some of their resolutions could be seen as contradictory to the rulings found in classical *fiqh*.

CONTENTS

ABSTRACT	2
LIST OF TABLES	7
LIST OF FIGURES	7
INTRODUCTION CHAPTER	
Research Problem: Theory versus Practice	14
Objectives of the Study	16
Review on the Studies of Muḍārabah in Islamic Banking and Finance	18
Methodology of the Study	24
<i>Al-Mabṣūṭ</i> of Sarakhsī	25
<i>Mukhtaṣar al-Khālil</i> of Khalīl bin Ishāq and <i>Al-Dhakhīrah</i> of al-Qarāfi.	28
<i>Minhāj al-Ṭālibīn</i> and <i>al-Majmūʿ sharḥ al-Muhadhdhab</i> of al-Nawawī	30
<i>Al-Mughnī</i> of Ibn Qudāmah	33
<i>Field Work</i>	35
Limitations of the Study	37
Outlines of the Study	38
CHAPTER ONE: THE DEVELOPMENT OF <i>MUḌĀRABA</i> RULES OF THE FOUR <i>SUNNI</i> SCHOOLS OF LAW	
Introduction	40
The Definition of <i>Madhhab</i> in Islamic Law	40
The Development of Islamic Law during the Second Century Hijri	41
How the <i>Madhhab</i> began?	45
The Dissemination of the Ḥanafī School	50
The Early Development of Ḥanafīs Rules on <i>Muḍārabah</i>	55
The Dissemination of the Mālīkī School	60
The Early Development of Mālīkīs Rules on <i>Muḍārabah</i>	65
The Dissemination the Shāfiʿī School	70
The Early Development of Shāfiʿīs Rules on <i>Muḍārabah</i>	75
	4

The Dissemination of the Ḥanbalī School	82
The Early Development of Ḥanbalīs Rules on <i>Muḍārabah</i>	86
<i>Muḍārabah</i> in the Contemporary Juristic Writings	90
Conclusion	93
CHAPTER TWO: <i>MUḌĀRABAH</i> DOCTRINES OF THE FOUR <i>SUNNI</i> SCHOOLS OF LAW	96
Introduction	96
The Definition of <i>Muḍārabah</i> and its Relationship with Other Partnership Contracts	97
<i>Literal meaning</i>	97
<i>Legal Meaning</i>	98
The Relationship between <i>Muḍārabah</i> and <i>Mushārah</i> Contracts	100
The Legitimacy of <i>Muḍārabah</i> Contract	104
Capital in <i>Muḍārabah</i>	110
Work in <i>Muḍārabah</i>	118
The Relationship between Investor and Agent manager	122
Profit in <i>Muḍārabah</i>	137
Disputes between Investor and Agent Manager	142
Conclusion	144
CHAPTER THREE: PRELIMINARY BACKGROUND OF MALAYSIAN ISLAMIC BANKING SYSTEM	
Introduction	147
The Models of Interest-free Bank	148
An Overview of Islamic Banking in Malaysia	158
<i>Shari'ah</i> Governance of Malaysian Islamic Banking Institutions	163
The Classical Jurists' Rules on <i>Bay' al-ṭinah</i>	169
The Application of <i>Bay' al-ṭinah</i> in BIMB Islamic Card (BIC)	176
The Justification and Methodology of Malaysian <i>Shari'ah</i> Scholars	178

Conclusion	182
CHAPTER FOUR: ANALYSIS OF THE APPLICATION OF <i>MUḌĀRABAH</i> IN MALAYSIAN ISLAMIC BANKS	
Introduction	184
The Milestones, Vision and Core Values of BIMB	185
BIMB's Deposits and Wealth Management Products	191
<i>Saving Accounts</i>	191
<i>Investment Accounts</i>	194
<i>Wealth management products</i>	197
<i>Structured Investment Instruments</i>	201
Capital Guarantee in <i>MuḌārabah</i> Banking Products	205
The Utilisation of <i>MuḌārabah</i> Funds	209
<i>Financing Facilities of BIMB</i>	212
<i>Islamic Securities</i>	218
<i>The Malaysian Islamic Inter bank Money Market (IIMM)</i>	226
<i>Weighted Method (WM)</i>	233
Analysis of the Current Practice of Profit Distribution in Malaysian Islamic Banks	235
Conclusion	239
CHAPTER FIVE: <i>MAŞLAḤAH-MAFSADAḤ</i> CALCULUS IN ASSESSING THE COMPLIANCE OF ISLAMIC BANKING PRODUCTS	
Introduction	242
Have Islamic Banks Learnt from the Recent Financial Crisis?	244
Historical Sketch on <i>Maşlahah</i> Theory in Islamic Law	247
Adapting the <i>Maşlahah</i> Principle in Assessing <i>Bay' al-Tawarruq</i> Issue	251
Conclusion	255
CONCLUSION	257
BIBLIOGRAPHY	260
APPENDIX	269

LIST OF TABLES

Table 1: <i>Muḍarabah</i> section in kitāb <i>al-Mabsūt</i>	26
Table 2: Sub-topics of <i>muḍarabah</i> cases in <i>al-Mudawwanah</i>	66
Table 3: Additional topics/issues in <i>Kitāb al-Muhadhdhab</i>	77
Table 4: <i>Muḍarabah</i> contract in kitāb <i>al-Wajīz</i>	80
Table 5 : The development of <i>muḍarabah</i> rules in <i>al-Mughnī</i>	88
Table 6: The contribution of partners in <i>mushārah</i> contracts.....	100
Table 7: List of fully-fledged and subsidiary of Islamic Banks in Malaysia..	161
Table 8: Classification of BIMB products based on Islamic commercial contracts applied	190
Table 9: The categorisation of BIMB deposit and wealth management products	191
Table 10: Cash prizes draw in <i>al-Awfar</i> saving and investment accounts.....	192
Table 11: Profit rates of BIMB deposit accounts from 16 November to 15 December 2009.	193
Table 12: The salient features of general investment account.	194
Table 13: Profit sharing ratio and indicative profit rate of BIMB’s investment accounts.....	195
Table 14: Stocks within Baraka Aging Population Index as at 30 th October 2009.....	203
Table 15: <i>Muḍarabah</i> funds by type of deposits	210
Table 16: Income derived from investment of depositors’ funds	210
Table 17: Profit from General Investment Deposit.....	211
Table 18: BIMB financing by type	212
Table 19: BIMB financing by contract	213
Table 20: Comparison between Islamic and conventional bonds.....	220
Table 21: An Example of Weighted Method in Islamic Bank.....	233

LIST OF FIGURES

Figure 1: The relationship between depositors, bank and entrepreneurs.....	149
Figure 2: The <i>modus operandi</i> of BIC card	177
Figure 3: List of Banking Products Offered by BIMB	189
Figure 4: Geographic allocation of <i>an-Najāh</i> NID-ī fund investment	204
Figure 5: The <i>modus operandi</i> of BIMB's home financing	214
Figure 6: The <i>modus operandi</i> of BIMB's working capital financing	216
Figure 7: The <i>modus operandi</i> of Malaysian <i>sukūk</i>	222
Figure 8: Inter-relationships between <i>Fiqh</i> Doctrine, <i>Shārī’ah</i> Advisors and Islamic Banking Sector	242

INTRODUCTION CHAPTER

Ribā is undeniably forbidden in the Islamic legal tradition. The prohibition is clearly declared in the Qur’ān as evidenced in the verses 2:275-281:

“God has permitted trading and prohibited *ribā*”.

“God destroys *ribā* and nourishes charity”.

“O believers fear God and forego what still remains in the *ribā* if you really believe. But if you do not, then beware the declaration of war from God and His Messenger. And if you repent, you shall keep your principal”¹.

Although the prohibition is unequivocally stipulated in the above verses, the exact meaning of *ribā* is not clearly elaborated. The definition of *ribā* is therefore derived from the *ḥadīth* of the Prophet. Based on the analysis of several *aḥadīth* (plural form of *ḥadīth*), the majority of jurists classified *ribā* into two types; (1) *ribā* in loan (*ribā al-nasī’ah*) and (2) *ribā* in sale (*ribā al-faḍl*). *Ribā* in loan is the act of extending delay to a debtor in return for an increase in the borrowed principal. It was widely practised at the time of the Prophet and thus regarded as a clear object of the Qur’anic prohibition of *ribā*². One of the examples of *ribā al-nasī’ah* during the pre-Islamic period was recorded by Mālik (d.179/795) in *al-Muwatta’*. Based on the authority of Zayd b. Aslam, he narrated:

Ribā in the *jahiliyya* (pre-Islam) was when a man gave a loan to a man for a set term. When the term was due, he (the lender) would say, 'Will you pay it off or increase [it for] me?' If the borrower paid, he took it. If not, the lender increased the debt and lengthened the term for the borrower³.

The prohibition of *ribā al-nasī’ah* indicates that any compensation for the loan was prohibited in early Islam, irrespective whether the loan is intended for consumption or production purposes. As for a consumption loan, the practice of charging *ribā* was viewed as undermining the charitable attitudes and human kindness among Muslims. It opposes early Islamic teaching that encourages the

¹ ‘Alī‘Abdullah Yūsuf (trans.), *The Meaning of the Holy Qur’ān*. Bretwood, Md.: Amana, 1991.

² Frank E. Vogel and Samuel L. Hayes III, *Islamic Law and Finance, Religion, Risk and Return*, London: Kluwer Law International, 1998, pp. 73.

³ Mālik b. Anas, *al-Muwatta’*, ḥadīth no. 1965, Beirut: Dār al-Gharb al-Islāmī, vol.2, 1997, pp.204.

support of the poor by the rich. Muslims are asked by the Qur'ān to sacrifice the possibility of a profitable opportunity when giving loans to others. In addition, Muslims are also recommended to extend the time to the borrowers when they are having problems in repaying their loans⁴. On the other hand, a loan which constituted compensation for production is also banned because money (capital) is not recognised as one of the factors of production within an Islamic economic framework⁵. The Islamic legal tradition rejects the notion that 'money could yield money' without bearing any risk. For money to generate money, it must be linked with a certain degree of risk i.e. involved in trade.

The linking of the lawfulness of gain to risk-taking is based on two classical legal maxims. The legal maxims state that (1) *al-kharāj bi-dhamān* - gain comes with the liability for loss and (2) *al-ghunmu bi al-ghurmi* - gain is the result of risk taking. These legal maxims are derived from *ḥadīth*. The first legal maxim is actually a saying of the Prophet reported in the five major Sunni *ḥadīth* collections (Ṣahīh al-Muslim (d.261/875), Sunan Ibn Mājah (d.273/887), Sunan Abī Dāwūd (d.275/889), Sunan al-Tirmidhī (d. 279/893) and Sunan al-Nasā'ī (d.303/916)⁶. The second legal maxim is derived from the understanding of *ḥadīth* on pledge (*al-rahn*) narrated by al-Dāraqūṭnī (d.385/995)⁷ and al-Hākīm (d.405/1015). The risk-taking principle is strongly recommended within the Islamic business framework because it leads to justice and fairness. In contrast, guaranteed return on investment is seen as more likely to bring injustice to the borrower (entrepreneur). This is because the borrower is obliged to repay the lender regardless of his business outcome.

On the other hand, the meaning of *ribā al-faḍl* is derived from a number of *aḥādīth*. One of them was narrated by Abū Sa'īd al-Khudrī:

⁴ Qur'ān 2:280.

⁵ Umer Chapra, *Towards a Just Monetary System*, Leicester: The Islamic Foundation, 1985, pp.64.

⁶ Ibn Ḥajar al-ʿAsqalānī, *Bulūgh al-Marām min Adillat al-Aḥkām, Kitāb al-Buyu'*, ḥadīth no.37, Mecca: Maktabah an-Nahḍah al-Ḥadīthah, 1979, pp. 183.

⁷ Dāraqūṭnī ʿAli ibn ʿUmar, *Sunan al-Dāraqūṭnī, Kitāb al-Buyū'*, ḥadīth no. 125-129, Cairo: Dār al-Maḥasin, vol. 3-4, 1980, pp.32-33.

Gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates, salt for salt, like for like, equal for equal, hand to hand. If these types differ then sell them as you wish, if it is hand to hand.⁸

Based on this *ḥadīth*, the classical jurists formulated rules on *ribā* in sale. The *ḥadīth* stipulates that equality and spot transactions are necessary when exchanging similar *ribawī* items. For example, exchange of the same quality of dates is permitted only in equal amount (e.g. one kilogramme for one kilogramme) and performed without any time interval. If the *ribawī* items are dissimilar (e.g. gold for barley), the exchange must be done unequally. The question arises then, why restrict the exchange of *ribawī* items to exactly equal quantities? What is the rationale for exchanging dates, for example, with similar characteristics?

It is argued that the rule aims to establish justice in business transactions⁹. The commodities mentioned in the *ḥadīth* (wheat, barley, dates, salt) formed the staple foods of the common people at that time. When these commodities were exchanged on credit, for example ten bushel of wheat now for ten bushel of wheat later, they tended to be transformed into loans of commodities similar to the monetary loan¹⁰. The borrower normally was required to return an extra quantity of wheat during repayment. The Prophet prohibited such unequal exchange and insisted that exact mathematical equivalency must be fulfilled. Instead of barter transactions, the Prophet commanded the use of currency as a medium of exchange.

A Prophetic *ḥadīth* narrated from Abū Saʿīd al-Khudrī states:

Bilāl brought to the Prophet some *barnī* (good quality) dates whereupon the Prophet asked him where these were from. Bilāl replied, 'I had some lower quality of dates which I exchanged for these – two *ṣāʿ*'s for a *ṣāʿ*'. The Prophet said, 'Oh no, this is precisely *ribā*. Do not do so, but when you wish to

⁸ Ibn Ḥajar al-ʿAsqalānī, *Fatḥ al-Bārī bi sharḥ Saḥīḥ al-Bukhārī*, Beirut: Dār Iḥyāʾ al-Turāth al-ʿArabī, vol. 4, 1981, pp.302.

⁹ Umer Chapra, *Towards a Just Monetary System*, pp.59.

¹⁰ Ziaul Haque, *Ribā The Moral Economy of Usury, Interest and Profit*, Kuala Lumpur: S. Abdul Majeed & Co, 1995, pp.53.

buy, sell the lower quality of dates against something (cash) and then buy the better dates with the price you receive."¹¹

The use of currency is preferred over barter transactions because it could help reduce the possibility of an unfair exchange¹². This is because a fair equivalent measurement is difficult to determine in a barter transaction compared to the use of currency which serve as medium to provide neutral measure of value. Most of the classical jurists were of the opinion that the *ribawī* items were not confined to the six commodities stipulated in the 'gold for gold' *ḥadīth*. They agreed that other items which share a similar *ʿillah* (legal cause) are also included in the prohibition. There was disagreement however concerning the determination of the *ʿillah*. The Shāfiʿīs and Mālikīs defined the *ʿillah* of gold and silver in the *ḥadīth* as monetary currency. In this regard, they did not differentiate between the raw metals, minted coins or jewellery. Thus, if gold jewellery was traded for gold coins, it must be carried out in equal weight and in spot transaction. The *ʿillah* (monetary currency) ruled out other metals such as copper, bronze and nickel. These metals were not commonly used as a medium of exchange and therefore could be traded unconditionally.

It is noteworthy that since paper money has functioned in a way similar to gold and silver coins in the contemporary period, the modern jurists had recognised it as one of the *ribawī* items. During the third conference of the International Islamic Fiqh Academy (IIFA), a *fatwā* regarding the utilisation of paper money in daily commercial dealings and transactions had been issued. The fatwa stated:

"Paper money is a currency that stands with its own value. Its rule is similar with the rule of gold and silver. Thus, it is treated as one of *zakatable* as well as *ribawi* items"¹³.

On the other hand, the Shāfiʿīs and Mālikīs were of the opinion that the *ʿillah* of the other four commodities (wheat, barley, dates and salt) is "foodstuff".

¹¹ Muslim ibn Ḥujāj, *Ṣaḥīḥ Muslim; Kitāb al-Musāqāt*, ḥadīth no. 96, Beirut: Dār Iḥyā' al-Turāth al-ʿArabī, vol. 3, 1985, pp.1215.

¹² Umer Chapra, *Towards a Just Monetary System*, pp. 60.

¹³ Resolution 21(3/9), al-Ahkām an-Nuqūd al-Waraqiah wa Taghyir Qīmah al-ʿUmlah, Amman, 16 October 1986. www.fiqhacademy.org.sa/qarat/3-9htm. Accessed on 22nd November 2009.

Despite agreeing on the *‘illah*, they differed in defining the meaning of foodstuffs. Are all kinds of foodstuffs included in the prohibition of *ribā al-faḍl*? What kind of foodstuff is implied by the *ḥadīth*? According to Shāfi‘ī jurists, the foodstuffs mentioned in the *ḥadīth* signify three categories of foods. Firstly, the wheat and barley indicate foods used for everyday nutrition. Secondly, the dates imply foods used as a dessert and thirdly the salt indicate foods used for seasoning (to make the cook more edible)¹⁴. In contrast, the Mālikīs divided the foodstuffs into two categories; nutrition (similar to the Shāfi‘īs) and the storability. The latter category refers to foods which are not easily perishable and may be stored for a period of time. Hence, both schools ruled that all foodstuffs which satisfy the characteristics of either one of the categories will be considered as *ribawī* items and thus have to follow strict equality requirement in their barter or sale transaction.

Meanwhile, the Ḥanafīs and the Ḥanbalīs (in one of their narrations) regarded the *‘illah* as measurement which is determined either by weight or volume. They viewed gold and silver were stipulated in the *ḥadīth* to signify all goods (irrespective whether foodstuffs or not) that can be measured by weight whereas the four commodities (wheat, barley, dates and salt) indicate goods which can be measured by volume. The Zāhirīs rejected all the *‘illahs* discussed by the four Sunni schools of law. For them, *ribā al-faḍl* only occurs in the six commodities which Allah has delineated, and any other goods remain in their state of permissibility. Their position is due to their denial of analogical reasoning (*qiyās*) as a principle of jurisprudence¹⁵.

It is not my intention here to prolong the juridical debate concerning the legal cause of *ribā al-faḍl*. However, it is obvious from the classical discussions that the main reason behind the prohibition is to establish an ethical framework for Muslim economic endeavour. *Ribā* is banned by the Islamic legal tradition to

¹⁴ Wahbah al-Zuhaylī, *al-Fiqh al-Islāmī wa Adillatuh, Financial Transactions in Islamic Jurisprudence* Maḥmūd A. El-Gamal (trans), Beirut: Dār al-Fikr, 2003, vol.1, pp. 324.

¹⁵ Wahbah al-Zuhaylī, *The Juridical Meaning of Ribā, Interest in Islamic Economic, Understanding of Ribā*, (edited) AbdulKader Thomas, London: Rutledge Taylor & Francis, 2006, pp.39.

ensure a fair and just economic system. The classical jurists viewed *ribā* as the root cause of exploitation and manipulation which in turn causes depression among the impoverished people in the community. Hence, the banning of *ribā* is seen as the impetus for the social and economic reform.

The wisdom behind the prohibition of *ribā* is generally acknowledged within Muslim society until modern days. Since the early 20th century, interest in the conventional banks has been much criticised by Muslim religious scholars. They equated the practice of charging interest with *ribā al-nasī'ah* applied during the pre-Islamic period. The conventional banks make profit through becoming a financial intermediary, receiving money from depositors by guaranteeing a fixed rate of return, and lending the money to borrowers with a higher interest rate. As such, *ribā al-nasī'ah* occurs in the relationships between the three parties, and this makes dealing with conventional bank forbidden. However, despite the obvious existence of *ribā* in the banking institutions, Muslims can not deny the essential role of banks in the context of modern life. Hence, they face the challenges of working out an alternative to the conventional banking system.

The effort to provide the alternative started at theoretical level in its early phase. During that time, the discussions regarding *ribā* were more juridical in nature. Interestingly, a few prominent scholars of that period including Muhammad 'Abduh (d.1316/1905) and his disciple Rashīd Riḍā (d.1337/1935) were of the opinion that interest generated by saving bank accounts and insurance companies were admissible¹⁶. They viewed interest distributed by the banks to depositors as a share of the profit from investment as permitted. The argument has influenced Tantawī, the current *Shaykh al-Azhar* and Sheikh Wāṣil, the previous *mufti* of Egypt who held similar opinions.¹⁷ However, the majority of current scholars including Mawdūdī (d.1381/1979) and al-

¹⁶ Nabil A. Saleh, *Unlawful Gain and Legitimate Profit in Islamic Law*, London: Cambridge University Press, 1986, pp.28.

¹⁷ Mahmoud A. El Gamal, *An Economic Explication of The Prohibition of Ribā in Classical Islamic Jurisprudence*, 2001, www.ruf.rice.edu/~elgamal/files/riba. Accessed on 27 November 2008.

Qardhawi rejected such re-interpretations of *ribā* to accommodate the banking interest. It appears nowadays that the mainstream opinion of the majority of Muslims upholds the 'equation' ruling¹⁸. Consequently, the theoretical debate on *ribā* has been devolved to a practical level. At this juncture, the development of the debate received significant contributions from scholars of an economic educational background. The works of Muslim economists such as Khurshid Ahmad and Muhammad Nejatullah Siddiqi provided a clear framework for the establishment of interest-free banking institutions.

In this regard, the profit and loss sharing (PLS) principle has been viewed as the ideal model for interest-free banking institutions. The model is based on the two Islamic classical commercial contracts namely *muḍārabah* and *mushārahah*. The distinctive difference between the PLS model and the conventional banking system lies in the fact that the former is based on the risk sharing principle while the latter is based on the guaranteed return. Briefly speaking, the theory of PLS signifies that the Islamic bank will act a middle-party between depositors (*rabb māl*) and entrepreneurs (*muḍārib*). The main task of the Islamic banks is to invest the depositors' money into viable business projects run by trustworthy entrepreneurs. Any profit generated from the business venture will be shared between the three parties based on a pre-determined profit ratio. However, the monetary loss will be borne solely by the depositors. The bank and the entrepreneurs will only lose their time and effort.

Research Problem: Theory versus Practice

The first Islamic commercial bank was established in 1963, in Mit Ghamr, Egypt. Since its inception, the industry experienced remarkable growth. Islamic banks currently are operating in almost all Muslim countries. They are reported to have grown at 15 to 20 percent every year. However, the way the Islamic banks have progressed so far in many ways has deviated from the PLS theory. In any Islamic banks worldwide, the contracts of *muḍārabah* and *mushārahah*

¹⁸ Saeed, Abdullah, Riba, *Encyclopedia of Islam Second Edition*, Edited by: P. Bearman , Th. Bianquis , C.E. Bosworth , E. van Donzel and W.P. Heinrichs. Brill, 2008. Brill Online, EXETER UNIVERSITY. Accessed on 27 November 2008.

have become the least popular contracts. In Malaysia for example, both contracts constitute less than 5 percent of the total Islamic banks' transactions. Instead of PLS based contracts, the predominant contracts are the debt-like sale contracts such *bay' al-ʿinah*, *bay' al-murābahah* and *bay' bithamanin ājil*. The over reliance on these contracts has raised the issue of the authenticity of the Islamic banking operation. This is because by applying the debt-like contracts, Islamic banking products appear to be identical to their conventional counterparts.

Islamic bankers argue that the PLS banking system has major practical problems. Most problems highlighted involve the lack of a bank's expertise in supervising business projects, the risk-averse attitude among the depositors and the agency problem. Due to these impediments, the PLS theory has been neglected. As an alternative, Islamic bankers adopt the 'duplication' orientation. This orientation indicates that conventional banking instruments will be adopted after necessary 'Islamic alteration' has been carried out. As a result of this orientation, the products offered by the two banking systems appear to be insignificantly different. For instance, in the liability side of the banking business, conventional saving and current account are redesigned as *wadīʿah* accounts whereas general investment accounts become *muḍārabah* accounts. Similarly, in the asset side, short term loans have been transformed as *bay' al-ʿinah* and *bay' al-murābahah* financing, while medium and long term loans as *bay' bithamanin ājil*.

The duplication orientation has been successfully implemented because it receives support from *sharīʿah* scholars who uphold a pragmatic approach. The pragmatic approach implies that they pay great attention to the practical aspects of the banking business when evaluating the *sharīʿah* compliance of a proposed product. As we shall see in the proceeding discussion, such an approach has made a general presumption that these *sharīʿah* scholars are lenient and relaxed as some of their decisions appear to contradict the prevalent rulings of the classical Islamic commercial rules.

The problem with both the duplication and the pragmatic orientations lies on the ‘form over substance’ issue. The duplication process, which transforms a conventional banking product into an Islamic one, very much focuses on the change in terminology rather than the essence of the product. As the substance of the products remains, many wonder whether *ribā* is actually removed from the Islamic banking system. While discussing this matter, Umer Chapra, one of the eminent scholars in the Islamic banking admitted that:

“Despite the fact that Islamic banking has developed rapidly for the past 30 years, with an impressive number of products that have applied various Islamic classical commercial contract, I do believe that the element of interest (*ribā*) is still exists”¹⁹.

Hence, it is not surprising that nowadays there is a growing tendency among researchers to discuss the authenticity of Islamic banking products²⁰. This group of researchers believe that the current practice of Islamic banking has deviated from its objective; to abolish *ribā* from the current conventional financial system. There is stronger call from the fundamentalists to re-instill the philosophy of Islamic moral economy (IME) in all products and services offered by the Islamic banks²¹. They demand the the Islamic bankers, *sharī‘ah* scholars and the relevant government authorities adopt a ‘substance over form’ approach in order to sustain the development of the Islamic banking system. This undeniably requires a major paradigm shift for everyone involved.

Objectives of the Study

In respect of the authenticity issue in the current practice of Islamic banking system, the present study primarily aims to (1) analyse the classical theory of *muḍārabah* and (2) examine its application in the Malaysian Islamic banks.

¹⁹ M. Umer Chapra, Innovation and Authenticity in Islamic Finance, paper presented at the *Eight Harvard Conference in Islamic Finance*, Massachusetts, April 2008.

²⁰ See for example, Shamin Ahmad Siidiqui, 'Understanding and Eliminating Ribā: Can Islamic Financial Instruments be Meaningful Implemented'. *Journal of Management and Social Sciences*, vol.1, no.2, 2005, 187-203.

²¹ Mehmet Asutay, 'Islamic Banking and Finance: Social Failure', *New Horizon* (169), October 2008.

With regard to the first objective, this study will analyse the *muḍārabah* doctrine of the four *Sunni* schools of Islamic law. As such, the classical legal texts of the Ḥanafīs, Mālikīs, Shāfi'īs and Ḥanbalīs will be examined to formulate their doctrine of the contract. The disagreement between them pertaining to the detailed practices of the contract will also be scrutinised. The main objective in discussing the rules is to comprehend the ethical framework of *muḍārabah* contract as propounded by the classical jurists. I hypothetically think that there is strong connection between the establishment of *muḍārabah* contract and the prohibition of *ribā*. Both subjects are asserted by the Islamic legal tradition to promote justice and fairness in Muslim economic affairs. By having a sound understanding regarding the philosophy of *muḍārabah* contract, it is hoped that Islamic bankers and their *sharī'ah* advisors could develop a better equity-based banking instrument.

In addition to this, the study will also examine the current practice of *muḍārabah* in the Malaysian Islamic banking institution. It attempts to investigate the extent to which local Islamic bank applied the *muḍārabah* theory as developed by the classical jurists. Realising that *muḍārabah* had not been practised for more than 150 years, modification of its original theory seems unavoidable. The present study aims to examine the modification and analyse the justifications of the Malaysian *sharī'ah* scholars. By analysing the justifications, it is hoped that this study will be able to determine whether the *muḍārabah* products in the Malaysian Islamic banks comply with the doctrine of *muḍārabah*, as laid out in the Islamic legal tradition. The emphasis is not on the compliance of every detail of the classical *muḍārabah* rules but rather to the spirit and the ethical framework of the contract. I personally believe that the current practice of *muḍārabah* in Malaysian Islamic banks is far from perfect. Thus, the present study attempts to highlight the loopholes and suggest ways to improve the system.

In a broader perspective, this study also aims to be a valuable addition to the existing literature on the practical issue of Islamic law in the contemporary Muslim society. Taking *muḍārabah* as an example, it demonstrates the conflict

faced by the current Muslim community in applying the classical jurists' rules in their modern life. It discusses the dilemma between sticking to the established principles and meeting the complex demands of the contemporary period. In the context of Islamic banking industry, it shows the continuous struggles between the fundamentalists who firmly uphold the classical jurists' doctrine and the modernist who appear very flexible in response to the changing demand of the financial market.

Review on the Studies of *Muḍārabah* in Islamic Banking and Finance

The *muḍārabah* contract was developed in the context of pre-Islamic Arabian caravan trade²². The contract was practised largely by those who were not capable of engaging directly in trading activities – these included women, orphans and the elderly. They would entrust money to skilful and reliable traders to transport merchandise from Mecca and trade with them in Syria, Yemen and other places in the Arab peninsular²³. One of the salient features of the contract is that profit generated from the business will be shared according to a pre-determined ratio (such as 50:50). The monetary loss however will be borne entirely by the capital provider and the traders would only lose his expanded time and effort.

In the classical *fiqh* (Islamic jurisprudence) texts, the rules of *muḍārabah* have been elaborated in great detail. The contract has been discussed since the early development of Islamic law. All the earliest texts of the four *Sunni* schools of law devoted separate chapters or sections to this subject although varying in their scope of discussion. The earliest Ḥanafī rules on *muḍārabah* are found in the works of al-Shaybānī (d.189/205) namely his *al-Jāmi' al-ṣaghīr* and *al-Jāmi' al-kabīr*. In the other schools, the rules of *muḍārabah* were recorded in the texts which, it is said, were written by the *madhhāb*'s eponyms; *al-Muwatta'* of Mālik (d. 179/795), *Kitāb al-Umm* of al-Shāfi'ī (d.204/820) and *Masā'il Imām Aḥmad* of Aḥmad ibn Ḥanbal (d.241/855).

²² Abraham L Udovitch, *Partnership and Profit in Medieval Islam*, Princeton N.J: Princeton University Press, 1970, p.172.

²³ Aḥmad ibn Sa'īd Ibn Hazm, *al-Muḥallā bi al-Āthār*, Beirut: Dār al-Fikr, vol. 7, n.d. pp.92.

In the context of modern application, the *muḍārabah* contract has been used as the underlying principle that governs the relationship between the depositors and Islamic banks. Hence *muḍārabah* has attracted quite considerable attention from contemporary researcher. The previous studies on this subject could be divided into two broad categories; theoretical and empirical. The theoretical studies, in turn cover two main themes. Firstly, they focus on explaining the rules of *muḍārabah* from the perspective of Islamic jurisprudence. In my opinion, while such studies are abundant in the Arabic language, there are not many in-depth analyses of *muḍārabah* rules in other languages including English. Presumably, this is because most of the contemporary jurists are originally from Arabic speaking countries. With a few exceptions such as the work of Taqī Usmani (*An Introduction to Islamic Finance*), the published studies on this subject are mainly produced by scholars with economics backgrounds. Hence, their discussions tend to be simple and general avoiding the classical jurists' differences of opinion (*ikhtilāf*).

El-Sharif²⁴ and Borhan²⁵ in their Phd theses had elaborated the doctrine of *muḍārabah* in Islamic law. In terms of the content (subject coverage), their studies are undeniably comprehensive. They explain the positive law (what we should do) of all main topics in the *muḍārabah* contract. However, their analyses are found to be lacking in argumentation. In other words, El-Sharif and Borhan' studies are excellent if one wishes to know the rules of *muḍārabah* are but dissatisfying if one wishes to understand the rationale behind them. The fundamental questions relating to the problem of agency such as to what extent the capital provider will be informed regarding their investment and the limit of the agent manager in making business decisions are not clearly explained in either thesis. Besides, in elaborating the rules of *muḍārabah*, both scholars had taken a generic approach where most of the rules are expressed without dispute.

²⁴ El-Sharif B.B.K. *Law and Practice of Profit Sharing in Islamic Banking with Particular Reference to Muḍārabah and Murābaḥah*, Phd Theses University of Exeter, 1990.

²⁵ Borhan J.T. Bin, *The Doctrine and Application of Partnership in Islamic Commercial Law With Special Reference To Malaysia Experiments in Islamic Banking and Finance*, Phd Theses University of Edinburgh, 1997.

Presumably, their purpose is to articulate a standard framework of *muḍārabah* for current banking practices. Both researchers also examined the practice of *muḍārabah* in the Islamic banks. El-Sharif investigated the *muḍārabah* application in several Islamic banks in the Middle East while Borhan focused on two Islamic financial institutions in Malaysia. Surprisingly, though admitting the need to enhance the current application, neither of them critically argues the *sharī'ah* compliance of the *muḍārabah* products. The present study is distinct from those of El-Sharif and Borhan as it will highlight the contradiction between the theory and the practice of the *muḍārabah* products in the Islamic banking system.

As far as the Western scholars are concerned, they have not yet embarked on specific examinations of the application of Islamic law in this area, except for a few works by Frank Vogel²⁶. Nonetheless in 1970, Abraham Udovitch produced an excellent analysis of partnership contracts which includes a discussion of *muḍārabah*.²⁷ His work, however gives more emphasis to Ḥanafī law comparing it to the other *Sunni* schools of law.

The second theme of the theoretical studies concentrates on the economic justifications in advocating *muḍārabah* as the ideal solution to be used to abolish injustice of the interest-based financial system. As argued by Umer Chapra, the conventional banking system plays an important role in promoting economic inequalities. This is because the conventional banks usually give finance based on the creditworthiness of borrowers. They then have the ability to offer collateral which is valued higher than the amount of financing required. Based on this method, the financing of the conventional banks increasingly becomes a business of transferring wealth to wealthy businessmen. The phenomenon widens the gap between rich and poor, as entrepreneurs with no collateral but economically promising projects may fail to get financing from ordinary conventional banks. In contrast, the application of *muḍārabah* in

²⁶ Frank E. Vogel and Samuel L. Hayes III, *Islamic Law and Finance, Religion, Risk and Return*, London: Kluwer Law International, 1998.

²⁷ Abraham L Udovitch, *Partnership and Profit in Medieval Islam*, Princeton N.J: Princeton University Press, 1970

Islamic banks is believed to lead to a more efficient allocation of capital since it depends on the profitability and productivity of a proposed project rather than the creditworthiness of the borrower. In addition to that, it will also promote economic growth since in theory; Islamic banks would tend to be involved in long-term projects with higher return rates²⁸.

The empirical studies concentrate on examining the performance of *muḍārabah* products in Islamic financial institutions. The *muḍārabah* contract is particularly used to create investment and saving accounts. In these accounts, the depositors who put their money in Islamic banks are regarded as investors while the banks which responsible to generate profit are perceived as traders. However in practice, Islamic banks are not involved directly in the business as the classical rules indicate. Similar to conventional banks, they act as financial intermediaries mobilising the funds for entrepreneurs. In the classical *fiqh*, such a practice was termed as ‘*muḍārib yuḍārib*’. Thus, one can see that *muḍārabah* is similar to venture capital as practised by the Western capitalists.²⁹ Although both contracts seem similar there is still a distinctive difference between them. *Muḍārabah* and venture capital are similar in the sense that they emphasise the profit of the business rather than interests on loan as conventional banks do. However, they differ in terms of the involvement of the capital provider in running the business. The venture capitalists often participate in the business by supplying managerial know-how to entrepreneurs. In contrast, the participation of capital provider is not permitted in *muḍārabah* according to majority of classical jurists. Therefore, in my opinion, *muḍārabah* practice is more similar to equity investment by a shareholder in a public listed company.

A review of empirical literature on this subject reveals that the *muḍārabah* products have been successful in generating funds for Islamic banks. However, the same concept of product fails to provide capital for entrepreneurs. In other words, there is an imbalance concerning the utilisation of *muḍārabah* products

²⁸ Umer Chapra, *Towards a Just Monetary System*, pp. 107-120.

²⁹ Timur Kuran, *Islam and Mammon, The Economic Predicaments of Islamism*, Princeton: Princeton University Press, 2004, pp.9

by Islamic banks. *Muḍārabah* investment and saving accounts contribute significantly in attracting deposit but *muḍārabah* financing mobilises a very small portion of funds for entrepreneurs. For example in 2005, the investment and saving accounts contributed 64.4 percent of the total Islamic banking deposit whereas the *muḍārabah* financing accounted only 0.5 percent the total Islamic banks' financing.³⁰ Instead of profit and loss sharing financing products, Islamic banks prefer to provide funds through debt-like products which are adopted through the contracts of *bay' bithaman ajil*, *murābahah*, *ijārah* and *wakālah*.

The failure of *muḍārabah* financing has made some scholars reconsider the relevance of the contract in today's banking environment. The ability of the *muḍārabah* contract to meet with the sophisticated needs of contemporary society has been doubted. One of the scholars argues that *muḍārabah* in the classical *fiqh* texts, was a simple *muḍārabah* in which would only suit Muslim social structures in the past. As trustworthiness is the key success of a *muḍārabah* venture, it was a relatively easy to identify the quality of trust of a business partner in a small society like it was in Madinah,³¹ where people knew each other very well. However, trust is difficult to identify nowadays since the banks deal with giant companies as well as large scale businesses³².

In my opinion, the argument is valid if we only imagine that Muslim civilisation never expanded outside Madinah after the lifetime of the Prophet. However, history tells us that the Muslim empire had expanded beyond the Arab peninsular and Muslim traders conducted international trade with European countries and North Western India from the early 10th century CE. Furthermore, as suggested by Udovitch, the *muḍārabah* contract was applied and introduced to Southern Europe by Muslim traders through the Italian

³⁰ Central Bank of Malaysia, Annual Report 2005, Kuala Lumpur.

³¹ A.L.M. Abdul Gafoor, *Muḍārabah-based Investment and Finance*, *Journal of Islamic Banking and Finance*, vol 19, no 5, 2002.

³² Mohammad Hashim Kamali, *Equity and Fairness in Islam.*, Cambridge: The Islamic Text Society, 2005, pp.104.

seaports during that period³³. In view of the extent of the economy of Muslim empire, the argument that *muḍārabah* contract only applicable for small society thus unconvincing.

Researchers have identified the agency problem as the main cause for the failure of *muḍārabah* financing in Islamic banks. The agency problem is said to be rooted in two principal rules of the contract. The first rule is pertaining to the obligation of capital provider to absorb all monetary losses. According to Obiyathullah, as profit is defined as revenue minus cost, such a rule will give the entrepreneur every incentive to increase the cost of the business that accrues to him as benefit.³⁴ For example, the entrepreneur will probably include his personal electricity bill as part of the business expenses. Furthermore, the second rule which restricts the capital provider from interfering in the business may even encourage him to do so. As stressed by Homouyon Dar and John Presley, the rules create imbalance in the governance structure of *muḍārabah* financing and therefore it has failed to mobilise financial resources in Islamic banks³⁵.

In conclusion, a review of the literature in this subject reveals two main issues regarding the application of *muḍārabah* in Islamic financial institutions. Firstly, there is lack of studies which analyse critically the classical theory of *muḍārabah*. In my opinion, the need for such a study in this subject is significant, particularly in English because the language increasingly become medium of communication amongst Islamic bankers. In this study, I intend to present a comprehensive study of the classical *muḍārabah* theory, which perhaps will be a valuable resource for Islamic bankers as well as researchers in enhancing their understanding on the virtues of Islamic banking.

³³ Abraham L. Udovitch, *At the Origins of Western Commenda: Islam, Israel, Byzantium?* Speculum, vol. 37 no.2, April 1962, pp.198-207.

³⁴ Obiyathullah Ismath Bacha, *Adapting Mudarabah Financing To Contemporary Realities: A Proposed Financing Structure*, *Journal of Accounting, Commerce and Finance*, vol. 1, no.1, 1997.

³⁵ Homouyon A. Dar and John R. Presly, *Lack of Profit and Loss Sharing in Islamic Banking: Management and Control Imbalances*, Economic Research Paper No. 00/24, University of Loughborough.

Secondly, the prior studies have indicated several practical problems faced by Islamic banking institutions in applying the *muḍārabah* contract. It seems that the contract has not functioned effectively in the contemporary period. Thus, it will be interesting to investigate how the Islamic banking institutions apply the classical *muḍārabah* contract in their daily banking operation. Do Islamic banks really comprehend the spirit of *muḍārabah* or do they just apply certain elements of the contract which benefit them? Do they make adjustments or modifications to the classical theory of *muḍārabah*? What are their justifications in making such *ijtihād*? In investigating these sorts of questions, the present study will focus on the Malaysian Islamic banking experience.

Methodology of the Study

The present study is divided into two main sections. The first section analyses (theoretical) the classical theory of *muḍārabah* whereas the second section examines its (empirical) application in the current banking system. As indicated earlier, the subject of *muḍārabah* had been discussed by jurists since early stage of the juristic development. Hence, it was found that the contract was written in almost all classical legal texts. For the purpose of this study however, I will concentrate on the following texts as my primary sources:

1. *Al-Mabṣūṭ* of Sarakshī (d.490/1097) of the Ḥanafī school.
2. *Mukhtaṣar al-Khālil* of Khalīl bin Ishāq (d.776/1374) and *Al-Dhakhīrah* of al-Qarāfī (d.684/1285) of the Mālīkī school.
3. *Minhāj al-Ṭālibīn* and *al-Majmūʿ sharḥ al-Muhadhdhab* of al-Nawawī (d.676/1278) of the Shāfiʿī school.
4. *Al-Mughnī* of Ibn Qudāmah (d. 620/1223) of the Ḥanbalī school.

The above texts are chosen based on three main criteria. Firstly, they present the most comprehensive discussions of *muḍārabah* contract within their respective schools. In identifying a comprehensive text, I study (in chapter one) numerous classical legal texts; beginning from the early period where *muḍārabah* rules were preliminary discussed until its discussion became mature

or comprehensive. A particular text is viewed as comprehensive when it covers all important issues of *muḍārabah* practices. My investigation in this topic covers the period from the second until the eighth century Hijri.

Secondly, the above texts are chosen because they held authority within the schools. *Al-Mabsūṭ* is considered as the most authoritative texts in elaborating the *zāhir al-riwāya* of the Ḥanafīs. *Mukhtaṣar al-Khālil* and *al-Dhazkhīrah* are considered by the Mālikis as the most important texts in understanding the school's doctrine. Similarly, the texts *al-Majmu' sharḥ al-Muhadhdhab* and *al-Mughnī*, besides becoming the main references in *fiqh* comparison (*fiqh al-muqāran*), are also the most reliable sources in studying the rules of the Shāfi'īs and Ḥanbalīs.

Thirdly, all the texts exhibit inter and intra *madhhab* disagreement (*ikhtilāf*). What I mean by intra *madhhab* disagreement is the dispute between jurists of a particular school, such as between the Ḥanafīs masters (Abū Ḥanīfa, Zufar (d.158/775), Abū Yūsuf (d.182/798) and al-Shaybānī (d.189/805)). On the other hand, inter *madhhab* disagreement refers to dispute between jurists of different schools, for example between the Ḥanafīs and Shāfi'īs schools. The main reasons for studying the disagreement are to examine the justifications behind every rule and to identify a specific ethical framework which each school depends upon when developing their *muḍārabah* doctrine.

The following section is the detailed description regarding the legal texts chosen:

Al-Mabsūṭ of Sarakhsī

The text *al-Mabsūṭ* was written by Muḥammad b. Aḥmad b. Abī Sahl al-Sarakhsī, a renowned Ḥanafī jurist of the fifth century Hijri, who lived and worked in Transoxania region. He was categorised by Ibn Hanā'ī (d.979/1571) as one of the third rank jurists within the Ḥanafī school. The first is the rank of independent *mujtahid*, specified only for Abū Ḥanīfa who had been perceived

as the founder of the school. The second rank is the students of Abū Ḥanīfa, especially Abū Yūsuf and al-Shaybānī. They are regarded as *mujtahid fī al-madhhab* who only practised *ijtihād* within the boundaries of the school. The third rank is the rank of *mujtahid* who practiced *ijtihād* in those particular cases that Abū Ḥanīfa and his students did not address. Based on this typology, Sarakshī was viewed as a jurist who though incapable of differing from the methodology (*uṣūl*) and positive legal rulings (*furū*) founded by the Ḥanafī masters, nonetheless solved unprecedented cases in accordance with their principles³⁶.

Sarakshī wrote *al-Mabsūṭ* based on *al-Kāfī* of Muḥammad al-Marwāzī (d.334/945). *Al-Kāfī* is a text that compiled the *zāhir al-riwāya* rulings of al-Shaybānī, the foundational texts of the Ḥanafī school. Therefore, *al-Mabsūṭ* is in turn an epitome of the *zāhir al-riwāya* rulings. As a thirty-volume text, the discussion of legal rulings in *al-Mabsūṭ* is comprehensive (as its name implies), covering nearly all topics and sub-topics in Islamic law. With regard to the *muḍārabah* contract, probably *al-Mabsūṭ* is the most comprehensive legal text that explains the detailed rules of the contract. This is an interesting fact since contemporary scholars believe that Sarakshī wrote the text while in imprisonment³⁷. The discussion of *muḍārabah* is divided into 26 separate sections (*bāb*). The sections explain various practical issues of the contract and were written in *masā'il* (problem) style. In the modern presentation, perhaps the sections could be classified into the following sub-topics.

Table 1: *Muḍārabah* section in kitāb *al-Mabsūṭ*

No	Sub-topic	Section
1	Definition and Legality	- Introduction to <i>kitāb al-muḍārabah</i> - The conditions in <i>muḍārabah</i>
2	Capital Issues in Muḍārabah	- <i>Muḍārabah</i> with merchandises (<i>al-urūḍ</i>) - Agent-manager who asks investor to convert the <i>muḍārabah</i> contract into loan contract

³⁶ 'Ali Jalabī b. Amr Allah b. 'Abd al-Qādir al-Ḥamīdī ar-Rūmī, *Ṭabaqāt al-Ḥanafīyyah*, Jordan: Dār Ibn al-Juzī, 2003, pp.94.

³⁷ Norman Calder. "Sarakshī, Muḥammad b. Aḥmad b. Abī Saḥl Abū Bakr, Sham al-A'imma". *Encyclopædia of Islam, Second Edition*. Edited by: P. Bearman, Th. Bionquis, C.E. Bosworth, E. Von Donvel, W.P. Heinrichs. Brill, 2009. Brill Online. Exeter University. Accessed on 11 February 2009.

3.	Profit Distribution Issues	<ul style="list-style-type: none"> - Forcing the contracting parties to give part of the profit to others - The loss of <i>muḍārabah</i> asset before and after purchasing - Guarantee against losses made by an agent-manager - The claims made by an agent-manager and an investor - The witness in <i>muḍārabah</i>
4.	Empowerment of Agent-manager (<i>muḍārib</i>)	<ul style="list-style-type: none"> - The permitted activities of the agent-manager - The permitted and prohibited activities of an agent-manager - The purchase and sale of an agent-manager - The maintenance (<i>naḥqah</i>) of an agent-manager - <i>Murābaḥah</i> (sale with mark up price) in <i>muḍārabah</i> - Agent-manager who sells (a <i>muḍārabah</i> asset) and buy it back for himself at lower price - An agent-manager who entrusts another party in another <i>muḍārabah</i> arrangement - Agent-manager freed slaves (using <i>muḍārabah</i> asset) and claimed (the action was based on) part of his shares of profit - <i>Shafā'ah</i> in <i>muḍārabah</i> - Partnership in <i>muḍārabah</i> - <i>Murābaḥah</i> between the agent-manager and the investor
5.	The Roles of Investor	<ul style="list-style-type: none"> - The investor (<i>rabb ul-māl</i>) who works with agent-manager
6.	Dispute Between The Contracting Parties	<ul style="list-style-type: none"> - Dispute between agent-manager and investor
7.	Miscellaneous	<ul style="list-style-type: none"> - The crime of a slave in <i>muḍārabah</i> - <i>Muḍārabah</i> with people of different religion - The plea (<i>iqrār</i>) of agent-manager while dying

As indicated in table 1 above, a large part of the discussion is devoted to explain the scope of empowerment given to agent-manager (*muḍārib*). This includes the issues of agent manager's permitted and prohibited activities, the guidelines of maintenance (*naḥqah*) claims, the involvement of an agent-manager in other partnership contracts and so on. In explaining these issues, Sarakshī normally states first, the agreed opinions of the Ḥanafī masters and justified their evidences (*dalīl*). If the matter was disputed among them, he would explain the reason of their disagreement. In exhibiting the internal *ikhtilāf*, Sarakshī however, did not make any determining preference (*tarjīh*). In other words, he did not make *ijtihād* in cases where rules had been decided by the Ḥanafī masters. This approach, besides demonstrating his loyalty to the

Ḥanafī masters, also explains the reason why he was regarded as the third rank jurist within the school.

Mukhtaṣar al-Khālil of Khalīl bin Ishāq and *Al-Dhakhīrah* of al-Qarāfī.

Mukhtaṣar al-Khālil was written by Khalīl b. Ishāq b. Mūsā b. Shu‘aib al-Djundi, an Egyptian jurist of the eight century Hijri. Khalīl learned Mālikī doctrine from ‘Abd Allāh al-Manūfī (d.749/1348) despite the fact that his farther was a Ḥanafī. Besides his master, Khalīl was influenced by another leading Mālikī of the sixth century Hijri namely Ibn al-Ḥajīb (d.646/1246). *Mukhtaṣar al-Khālil* is regarded as the most recognised legal manual of Mālikī school, where, to some extent replaced the role of the *Muwatta’* of Mālik and the *Mudawwanah* of Saḥnūn (d.240/854) in disseminating the school’s doctrine³⁸. Since the middle eight century Hijri, the *Mukhtaṣar* was increasingly used as the subject of teaching in Mālikī *madrassa* in North Western Africa and Spain. The wide acceptance to this text is attributed to its comprehensiveness and concision. The *Mukhtaṣar* consists of 61 chapters all the important topics of Mālikī law including the ritual, personal law and *mu‘āmalāt* (commercial transactions).

The concision is clearly demonstrated by the fact that the text can only be well understood by means of a commentary. Due to its significance, the *Mukhtaṣar* had attracted many commentators. Among the famous commentaries are *al-Tāj wa al-Iklīl* of al-Muwāq (d.897/1491), *Mawāhib al-Jalīl* of al-Ḥaṭāb (d.954/1548), *Sharḥ al-Khurashī* of Khurashī (d.1101/1690), and *Ḥāshiyah al-Dusūqī* of Dusūqī (d.1230/1815). In this study, I particularly rely on the *Ḥāshiyah al-Dusūqī* in understanding the rules of the *muḍārabah* contract. *Ḥāshiyah al-Dusūqī* is in fact the enhancement of al-Dardīr’s (d.1201/1786) work namely *Sharḥ al-Kabīr*. According to Dusūqī, his main purpose in writing

³⁸ Bencheneb, M. “Khālil b. Ishāq b. Mūsā b. Shu‘aib al-Djundi.” *Encyclopedia of Islam Second Edition*. Edited by: P. Bearman, Th. Bianquis, C.E. Bosworth, E. van Donzel and W.P. Heirinchs. Brill 2009. EXETER UNIVERSITY. Accessed on 28 November 2009.

the commentary (*Hāshiyah*) is to clarify certain issues in which from his point of view require further explanation³⁹.

It should be noted however; as far as this study is concerned the conciseness of the *Mukhtaṣar* has a few shortcomings. The *Mukhtaṣar* does not explain the legal evidence (*dalīl*) used by the Mālikī jurists in supporting their rulings. There is no doubt that the *Mukhtaṣar* is excellent text for one wish to know the rules of Mālikīs. However, the text is insufficient for one wish to analyse their justifications. Besides, the school's rulings are presented in undisputed style. Inter and intra *madhhab* disagreement (*ikhtilāf*) was minimally recorded. This style is understandable since the text was intended to be a legal manual of the school.

Hence, in order to obtain more information regarding the *dalīl* and the *ikhtilāf*, it is pertinent for me to look at other Mālikī texts. In this regard, I choose to study the text *al-Dhakhīrah* which was written by Abū al-ʿAbbas Aḥmad b. Abī ʿAlā Idrīs al-Qarāfī, also an Egyptian Mālikī scholar from the North African Berber tribe of the Ṣanhādja⁴⁰. Al-Qarāfī was better known as a legal theoretician than a jurist. During his life time, many scholars, Māliki and non-Māliki alike travelled from Syria and North Africa to study *uṣūl al-fiqh* with him. *Al-Furūq* is one of his masterpieces in the subject. The text *al-Dhakhīrah* is probably the only major work of al-Qarāfī in *fiqh*. Nonetheless, it is still recognised as an important legal text within the school. The strength of the text lies on the approach taken by al-Qarāfī in which he tried to adapt the knowledge of *uṣūl al-fiqh* in elaborating the positive branches of law (*al-furūʿ*). By adapting such an approach, readers of *al-Dhakhīrah* will be enlightened with the legal evidences relied upon by the Mālikī jurists.

³⁹ Dusūqī, Muḥammad ibn Aḥmad ibn ʿArafāh, *Hāshīyat al-Dusūqī ʿalā al-Sharḥ al-kabīr (ʿalā Mukhtaṣar Khalīl) li Aḥmad al-Dardīr maʿa taqīrāt li Muḥammad ʿUllaysh*. Cairo: ʿIsā al-Bābī al-Ḥalabī, vol. 1, n.d.

⁴⁰ Jackson, S.A. "Shihāb al-Dīn al-Qarāfī." *Encyclopedia of Islam Second Edition*. Edited by: P. Bearman, Th. Bianquis, C.E. Bosworth, E. van Donzel and W.P. Heirinchs. Brill 2009. EXETER UNIVERSITY. Accessed on 28 November 2009.

The case of disagreement between Mālikī jurists' concerning the consequence of a void *muḍārabah* provides a good example to explain this point. The Mālikī jurists had differed in determining the basis of remuneration for the agent manager (*muḍārib*) in a void *muḍārabah* contract. Some Mālikīs ruled that the agent manager should be paid based on *qirāḍ mithil* and the other ruled on '*ujr mithil*'. The distinctive difference between the two payment methods is that the remuneration is not guaranteed in the former whereas guaranteed in the latter. In his *al-Dhakhīrah*, al-Qarāfī did not only mention the opinions of the previous Mālikīs jurists but tried to explain their justifications. And more importantly he determined preference (*tarjīh*) based on his own argument. The argument is significant as it demonstrates al-Qarāfī's mastery of *uṣūl fiqh* knowledge. According to him, since *muḍārabah* was legitimised on the basis of exception of *ijārah* contract (a methodological issue discussed in detail in chapter two), the remuneration of agent manager should be paid based on reasonable market wages ('*ujr mithil*')⁴¹. In addition to that, the organisation of *muḍārabah* topic is better presented in *al-Dhakhīrah* as al-Qarāfī summarised the Mālikī rulings and emerges with the essential elements (*arkān*) and the conditions (*shurūṭ*) of the contract.

Minhāj al-Ṭālibīn and *al-Majmū' sharḥ al-Muhadhdhab* of al-Nawawī

Similar to the case of the Mālikī school, my selection of Shāfi'ī legal sources also required two different texts; *Minhāj al-Ṭālibīn* and *al-Majmū' sharḥ al-Muhadhdhab*. Both texts are usually attributed to the most celebrated Shāfi'ī jurist of the seventh century Hijri; Yaḥyā b. Sharaf b. Murī al-Nawawī. Al-Nawawī only lived for approximately 45 years. Despite his relatively short lifetime, al-Nawawī left a considerable amount of outstanding work which retained his high reputation until present day. The text of *Minhāj al-Ṭālibīn* is one of the reflections of his gifted intelligence. It is regarded almost as the law book par excellence within the Shāfi'ī school. Al-Nawawī wrote the *Minhāj al-Ṭālibīn* based on *Kitāb al-Muḥarrar* of al-Rāfi'ī (623/1224). He summarised all

⁴¹ Aḥmad b. Idris al-Qarāfī, *Dhakhīrah*, Bayrut: Dār al-Gharb al-Islāmi, 1994, vol.6, pp. 43-45.

the important rulings of the school and presented them in a legal manual style. The text *Minhāj al-Ṭālibīn* is significant due to its simple and concise approach to explaining the complicated *fiqh* doctrine. Even the organisation (*taqsīm* and *tabwīb*) of the discussed topics is modern in its presentation. The Shāfi'i books after the seventh centuries were mostly based on the commentaries of the text. Among the famous commentaries were *Tuḥfah al-Muḥtāj* of Ibn Ḥajar al-Haytamī (d.974/1566) and *Nihāyah al-Muḥtāj* of al-Ramlī (d.1004/1596) and *Mughnī al-Muḥtāj* of al-Sharbīnī (d.977/1570). In examining the *muḍārabah* rules described in the *Minhāj al-Ṭālibīn*, I refer to the commentary of al-Sharbīnī. The commentary is useful as it explains the legal reasons which often missed out by al-Nawawī.

The main reason for studying the other text of Shāfi'i school is to obtain information regarding inter and intra *madhhab* disagreement. In this respect, I found the text *al-Majmū' sharḥ al-Muhadhhab* to be the most appropriate. Although *al-Majmū'* is usually attributed to al-Nawawī, the text was actually a combined work of al-Subkī (d.771/1369) and al-Muṭi'i (d.1400/1979). Neither of al-Nawawī nor al-Subkī managed to complete the text during their relatively short period of lifetime. Al-Nawawī commented 140 pages of the original text of *al-Muhadhhab* whereas al-Subkī continued until the chapter of *murābaḥah* (mark-up sale) contract. The commentary was left incomplete for nearly six centuries until al- al-Muṭi'i came forward to accomplish it⁴².

Al-Nawawī wrote *al-Majmū'* based on *al-Muhadhhab* of al-Shirāzī, which I believe to be the earliest comprehensive legal text of the Shāfi'i school. Contrary to *Minhāj al-Ṭālibīn*, *al-Majmū'* was written by adopting a commentary approach. As explained by al-Nawawī in the introduction chapter, his remarks on al-Shirāzī's work include clarifying the status of *ḥadīth*, the meaning of terminologies (*alfāz al-lughāt*) and the names of jurists (*asmā' al-aṣḥāb*). Al-Nawawī also clarified disagreement between al-Shirāzī with other

⁴² Ḥasan al-Ma'naqash, *al-Ilāqāt al-Tarbawiyah min Khilāl Muqaddimah al-Majmū' al-Nawawī*, <http://attarbawya.maktoobblog.com/> Accessed on 1 December 2009.

Shāfi'is jurists and jurists from other schools⁴³. Al-Nawawī asserted that *al-Majmū'* not only meant to articulate the opinion of al-Shirāzī but also aimed to represent the doctrine of the Shāfi'is. He wrote:

"Please be informed that although I named this book as *sharh al-Muhadhdhab* [in fact] it is commentary for the *madhhab* as a whole...⁴⁴."

All types of commercial contracts were discussed at the end of *al-Muhadhdhab*. Therefore, the text related to *muḍārabah* was commented by al-Muṭi'ī. Al-Muṭi'ī explained and elaborated the contract based on the principles laid down by al-Nawawī. He imitated al-Nawawī approach; explaining the original text (*matn*) using various sources. In order to exemplify this, let us examine how al-Muṭi'ī described the definition of *al-qirāḍ* (terminology used by the Shāfi'is) at the beginning of the *muḍārabah* chapter.

Al-Shirāzī wrote in *al-Muhadhdhab*:

[The contract] is executed with the term *al-qirāḍ* because it was the terminology of Hijāzi people and with the term *al-muḍārabah* since it was the terminology of Iraqi people....

Al-Muṭi'ī explained the above text by integrating the opinions of several jurists including Ibn Baṭāl, Ibn Qudāmah, al-San'ānī and al-Nawawī. He started with describing the origin words of *al-qirāḍ* and *al-muḍārabah*. Referring to Ibn Baṭāl, al-Muṭi'ī explained that the word *al-qirāḍ* was derived either from *al-qarḍ* (cutting) or *muqāraḍah* (equality). *Al-qirāḍ* is said to be derived from *al-qarḍ* since the investor and agent-manager will be cutting their deposition of money. At first, the investor will cut some portion of his money to give to agent-manager. After that, when the business is to be liquidated, the agent-manager will cut some portion of profit to share with the investor. *Al-qirāḍ* is also said to be derived from *muqāraḍah* based on the saying '*al-shā'irānī taqāraḍā*'; two poets are praising each other since their works are equally compatible. Meanwhile, based on al-San'ānī's view, the term *muḍārabah* is said derived

⁴³ Nawawī, Yaḥya ibn Sharaf, *al-Majmū' sharḥ al-Muhadhdhab lil Shirāzī*. al-Qāhirah: Zakariyā 'Alī Yūsūf, 1966-69, vol 1, pp.7-9.

⁴⁴ Ibid

from '*al-ḍarb fī al-ʿard*' (making a journey). It is called *mudarabah* because the contract normally requires the agent-manager to travel for the sake of business.

In order to confirm the statement that *muḍārabah* was the terminology of Iraqi residents, al-Muṭiʿī proved it by referring to Ibn Qudāmah of the Ḥanbalī jurists. After clarifying the origin of both terminologies, the legal meaning of the contract is defined. In this regard, al-Muṭiʿī relied on the definition of al-Nawawī as stipulated in *Minhāj al-Ṭālibīn*. The point that I wish to draw attention here is that the above example shows al-Muṭiʿī's enormous efforts in upholding al-Nawawī's writing method to complete the *al-Majmūʿ*. As observed, al-Muṭiʿī explained the definition of the contract by referring to the works of previous jurists either from the Shāfiʿīs or from other schools. By referring to the various sources, al-Muṭiʿī also maintained the approach of inter and intra disagreement employed by al-Nawawī in the earlier chapters of *al-Majmūʿ*. In addition to that, the completed text sustains its authority within the Shāfiʿīs school because al-Muṭiʿī always relied on the *Minhāj al-Ṭālibīn* as the main reference in his writing.

Al-Mughnī of Ibn Qudāmah

The text *al-Mughnī* was written by ʿAbdallāh b. Aḥmad b. Muḥammad Ibn Qudāmah al-Maqdisī, probably the greatest jurist of the Ḥanbalī school during the seventh century Hijri. Ibn Qudāmah received his early education in Damascus where he studied the Qurʿan and *ḥadīth*. When he was in early 20's, Ibn Qudāmah started his academic journey to Baghdad with his cousin ʿAbd-Ghanī al-Maqdisī (d.600/1203). They spent four years in the city studying various branches of Islamic knowledge especially the Ḥanbalī law. After several other visits to Baghdad, Ibn Qudāmah then settled in Damascus and established his circle.

The text of *al-Mughnī* is one of Ibn Qudāmah's treatises in *fiqh*. It was written based on *mukhtaṣar* al-Khiraqī (d.334/945), the first legal manual of the Ḥanbalī school. The text is recognised as the most complete legal treatise not

only in studying the school's doctrine but also in examining the subject of *fiqh* comparison (*fiqh al-muqāran*). In commenting on the *mukhtaṣar*, Ibn Qudāmah did not only clarify the rules, justifications and terminologies used by al-Khiraqī but include discussion of jurists from other schools as well. I will use one example from the text to demonstrate this particular point. In explaining the rules of credit transaction in a *muḍārabah* contract, al-Khiraqī stated:

"If an agent-manager sells on credit without being ordered to do so, he will be accountable according to one of the narrations; the other [narration] said he is not accountable"

Ibn Qudāmah described in great detail the above rule:

The general rule for the agent-manager and other partners is that if the methods of transaction are stipulated, [the investor says] transact by cash or credit, by local or other currencies, [the instructions are all] permissible and [the agent-manager] can not contradict them. The transactions are permissible because they are conducted with permission. Thus, do not get involved in transactions in matters which are not clearly permitted to, [the agent-manager's condition is similar to *wakīl*]. If the methods have not been presented in detailed (*muṭlaq*), there is no dispute over the permissibility of conducting cash transactions, however there are two narrations regarding credit transactions. One of them stipulates that the transaction is not allowed. It was the opinions of Mālik, Ibn Abī Laylā and al-Shāfi'ī, because *muḍārib* is an agent in the contract thus he is not permitted to transact in credit without having explicit permission, similar to a *wakīl*, an agent (*muḍārib*) is not permitted to make transaction except in a vigilant manner. Credit transaction exposes capital into losses..... The second narration stipulates that the credit transaction is permissible. This is the opinion of Abū Ḥanifa and preferred by Ibn 'Aqīl. The reason for this is the [initial] permission was granted to conduct business, and *muḍārabah* will be practiced for common activities in business. This [credit transaction] is the common practice among traders. And the agent-manager aims to make profit, and credit transaction could possibly bring a lot of profit⁴⁵.

The above example clearly demonstrates the approach of Ibn Qudāmah in writing his *al-Mughnī*. He explained the disagreement of Ḥanbalī rules over

⁴⁵ Ibn Qudāmah, 'Abd Allāh ibn Aḥmad, Muwaffāq al-Din. *Al-Mughnī/ tahqīq 'Abd Allāh ibn al-Muḥsin al-Turkī, 'Abd al-Fattāḥ Muḥammad al-Ḥulw*. Al-Riyād: Dār 'Ālam al-Kutub, 1999, vol. 7, pp. 147.

the permissibility of conducting credit transaction by comparing them to the opinions of other great *sunni* jurists such as Mālik, Ibn Abī Laylā (d.148/745), Abū Ḥanīfa and al-Shāfi‘ī. Every different rule was explained with the respective justifications. By adopting this approach, readers of *al-Mughnī* do not only attain information about the Ḥanbali rules but also gain preliminary fact about other’s schools position. Hence, as far as this study is concerned, the text *al-Mughnī* satisfies all the three criteria determined earlier.

Field Work

A study on the classical *muḍārabah* doctrine raises many issues with regard to its suitability in the modern world. By reading the legal texts, I find out that many of the classical rules appeared to be impractical within the context of the complicated banking business. For example, I wonder how the Islamic banks deal with prevalent rules of majority *Sunni* jurists who confined the activity of *muḍārabah* business to purely trade transaction (*tijārah*). Adhering to the rule means *muḍārabah* is not suitable as the basis of banking and financing operations. How the present practice is justified with respect to its deviation from the classical *muḍārabah* rule? As such, field work was necessary to complete this study. With a list of other inquiries, I need to discuss the matters with scholars who directly involved in deciding the *shari‘ah* compliance of Islamic banking products.

After contacting a number of *shari‘ah* scholars, I managed to interview five of them. They are:

1. Professor Dr. Joni Tamkin Borhan, who is currently member of *shari‘ah* council of RHB Islamic bank and former member of National *Shari‘ah* Advisory Council (NSAC) founded by Central Bank of Malaysia. He also teaches at the Department of *Shari‘ah* and Economic, Academy of Islamic Studies, University of Malaya.
2. Associate Professor Dr. Engku Rabiah Adawiyah Engku Ali, who is currently member of the NSAC and serves at Ahmad Ibrahim Kuliyyah of Law, International Islamic University of Malaysia.

3. Associate Professor Dr. Shamsiah Mohammed, who is currently member of *sharī'ah* council of Standard Chartered Bank and Malaysian Securities Commission. She is also a member of Department of *Sharī'ah* and Law, Academy of Islamic Studies, University of Malaya.
4. Nazri Chick, former head of *sharī'ah* department of Bank Islam Malaysia Berhad (BIMB). Recently, he has moved to the Islamic bank in Dubai as *shārī'ah* auditor.
5. Ahmad Sharafi Idris, Secretariat of *Sharī'ah* Department of RHB Islamic bank.

Through the interviews, I obtain the viewpoint of Malaysian *sharī'ah* scholars pertaining to the current practice of *muḍārabah* contract in the local Islamic banks. Discussions with Nazri Chick and Ahmad Sharafi are particularly significant, as I gain in depth information about the framework and the practices of *sharī'ah* governance in the local Islamic banks. However, perhaps one will argue about the reliability of these sources since my case study (in chapter four) mainly focusing on *muḍārabah* products of BIMB. How I could use information from scholars who sit in different *shārī'ah* boards of Islamic banks (RHB Islamic and Standard Chartered) to analyse the compliance of BIMB's products? In order to answer to this argument, it is essential to describe the rules concerning *muḍārabah* products offered by various Islamic banks in Malaysia.

Muḍārabah products in the Malaysian Islamic banking institutions are identical despite being labelled with various names i.e. Sakinah account of BIMB and Amanah account of HSBC Amanah. These different names are given merely for strategic marketing purposes. The underlying *muḍārabah* contract is applied in the same manner to draw funds from depositors and investors. The practice of *muḍārabah* is governed and regulated by the Central Bank of Malaysia. All Islamic banks in the country are obliged to follow the standards and guidelines stipulated by the Central Bank in creating their *muḍārabah* products. Therefore, given the parameters in which *muḍārabah* products are operating, the information obtained from the scholars mentioned is relevant and justifiable.

It is also important to note that for the Qur'ānic translation, I have used 'Abdullāh Yūsuf 'Alī's translation of the Holy Qur'ān. Meanwhile for the *ḥadīth* and the classical *fiqh* texts, mostly I use my own translation.

Limitations of the Study

Although various classical Islamic commercial contracts are being practised by the Islamic banks, the present study focuses only on the application of *muḍārabah* contract. Undoubtedly, the focus is beneficial in many ways. It gives opportunity for me to understand thoroughly the classical *muḍārabah* rules and examine its current application problems. *Muḍārabah* contract becomes the focus of this study as the contract is widely claimed as the fundamental principle of the Islamic banking operations.

However, given the fact that the current practice of Islamic banks has deviated from its original theory, perhaps the study of *muḍārabah* contract alone will be inadequate to demonstrate the complete picture of the authenticity issue. This is because the contract is applied minimally in generating income for the Islamic banks. In terms of utilisation of the banks' deposit, the *muḍārabah* contract only constituted 5 percent of banking transactions. This means, a large part of Islamic banks' profit is derived from the application of other contracts such as *bay' al-murābahah*, *bay' al-ṭinah* and *ijārah*. In view of this issue, the findings of this study are considered limited in the sense that it does not offer a holistic finding with regard to the *shari'ah* compliance issue in the Islamic banks. The present work is just a case study to depict some of the weaknesses of the existing products offered by the banking institutions. Obviously, more studies are required to achieve a solid conclusion in this matter.

Compared to the Western banks, the present situation of transparency within Islamic banks leaves much room for improvement. Islamic banks do not openly share their products' information and operations with the public. In many cases the most essential information such as the exact way of calculating the share of profit of different types of deposit holders is private. Some of the Islamic

banks' personnel who I contacted declined to share their thought and experiences. They claimed that they are bound by strict confidentiality rules. In view of these limitations, my analysis on the current practices of *muḍārabah* contract is restricted to the best available sources which include the Islamic bank's annual reports, Islamic bank's websites, customer copy of products agreement, obtainable personnel for interview, academic papers and books.

Outlines of the Study

After the Introduction, the study is divided into five chapters and a conclusion. Chapter 1 elucidates the historical background of the four *Sunni* schools of law and then examines their development of *muḍārabah* rules. The examination in this subject covers the period between the second until the eighth centuries Hijri. It aims to provide information regarding the different orientations in which each school depended upon in formulating their *muḍārabah* doctrines. Chapter 2 explains the detailed rules of the contract as described by the classical jurists. This chapter analyses their rulings pertaining to various practical issues of *muḍārabah* including an explanation on its definition, relationship with other *sharīkah* (partnership) contracts, legal evidences and essential elements (*arkān*). The discussions highlight the disagreement between the schools and analyse their respective justifications. The chapter concludes with two distinctive ethical frameworks of the Shāfi'īs and the Ḥanafīs which formed the basis in assessing the Malaysian *sharī'ah* scholars' orientation.

Chapter 3 provides preliminary background of the discussion regarding the *muḍārabah* application in Malaysian banking experience. It mainly discusses (1) the theory of interest-free bank and presents (2) an overview of Malaysian Islamic banking system. For the first topic, the chapter reviews the models' of Muḥammad Baqer al-Sadr and Muḥammad Nejatullah Siddiqi in outlining a practical framework for an Islamic bank. Discussion of an overview of Malaysian Islamic banking system sheds light the history, growth, *sharī'ah* governance system and the methodology adopted by local *sharī'ah* committees. The chapter also discusses the Malaysian application of *bay' al-ṭinah* which has

been subject of criticism by most of the Middle East *sharī'ah* scholars. After that, chapter 4 analyses the *modus operandi* of general and specific investment *muḍārabah* products offered by Bank Islam Malaysia Berhad (BIMB). The discussions highlight some critical issues arising from *ijtihād* made by the local *sharī'ah* scholars in modifying *muḍārabah* contract into modern banking practices. The *ijtihād* is broadly discussed under two main subjects; (1) the utilisation of *muḍārabah* capital and (2) the profit distribution method. In the first subject, the chapter analyses the extent to which the financing, Islamic bonds and Islamic money market products uphold the profit and loss sharing principles. Meanwhile, discussion of the second topic highlights the *ijtihād* on profit equalisation reserve (PER), indicative profit rate, interim profit payment and capital guarantee.

Analyses of the *ijtihād* exhibit two main approaches adopted by the Malaysian *sharī'ah* scholars in assessing the compliance of *muḍārabah* products in Islamic banks. Firstly, they tend to argue on the basis of principle of *maṣlaḥah* when justifying their deviation from the prevalent classical rules. Secondly, sometimes the *sharī'ah* scholars also can be too rigid with the legal technicality of the classical rules by trying to apply the controversial contracts in modern banking practices. In both situations I argue the approaches are taken in order to please the demands of Islamic bankers. As a result, the current *muḍārabah* products offered by the local Islamic banks do not fully realise the philosophy of the contract. Therefore in chapter 5, I introduce a new discussion concerning the *maṣlaḥah* theory in Islamic law. I argue there is a need to formulate a well-defined *maṣlaḥah* doctrine in order to assist the *sharī'ah* scholars in attaining more appropriate *ijtihād* in Islamic banking and finance matters.

CHAPTER ONE: THE DEVELOPMENT OF *MUḌĀRABAH* RULES IN THE FOUR *SUNNI* SCHOOLS OF LAW

Introduction

The focus of this chapter is the development of *muḌārabah* rules in early schools of Islamic law. It discusses the juristic growth of the contract from second until eighth century Hijri. The classical legal texts examined included *Jāmi' al-ṣaghīr*, *Khizānat al-Fiqh* and *al-Mabṣūṭ* of the Ḥanafī and *al-Muwaṭṭa'*, *al-Mudawwanah*, *al-Kāfī fī Fiqh ahl al-Madīnah*, *Bidāyat al-Mujtahid* and *al-Dhakhīrah* of the Mālikīs. For the Shāfi'īs, the legal texts studied are *al-Umm*, *al-Muhadhdhab*, *al-Wajīz* and *Minhāj al-Ṭālibīn*. The Ḥanbalī legal texts studied are the *Masā'il* of Ibn Ḥanbal, *al-Mukhtaṣar* of al-Khiraqī, *al-Mughnī* and *al-Furū'*. It is found that the contract was developed at different phases between the schools. The rules were presented in a highly developed manner earlier among the Mālikīs and Ḥanafīs compared to the Shāfi'īs and Ḥanbalīs.

Before the discussion, the present chapter introduces the historical background of the *Sunni* schools of Islamic law. The discussion explains the distinctive methods employed by the early jurists in interpreting the law which consequently led to the emergence of different *madhhabs* (plural form *madhāhib*). It also identifies each school's prominent jurists and their authoritative legal texts. The discussion is essential as the basis to understand the context in which *muḌārabah* rules were formulated and developed.

The Definition of *Madhhab* in Islamic Law

The term *madhhab* is conventionally translated as 'school of law'. Literally, it means "the way one goes". In the past, the term is referred to a toilet as well. It is narrated in a *ḥadīth* that if the Prophet Muhammad wanted to go to toilet, he

would go away to *madhhab*⁴⁶. In addition to this, *madhhab* is also used to signify the doctrine, tenet or opinion upheld by a person. In the field of Islamic law, the term *madhhab* had been used by the classical jurists to indicate both the individual opinion and the opinions of a whole school concerning a particular case⁴⁷. In Islamic legal history, the number of *madhhabs* was actually quite large. In addition to the four well-known *sunni madhhab*, there are other *madhhabs* that contributed significantly to the development of Islamic law such as the *madhhabs* of al-Awzā'ī (d.157/773-774), Sufyān al-Thawrī (d.161/777-778), al-Ibāḍiyyah, al-Zāhiriyyah, Ibn Jarīr al-Ṭabarī (d.310/923) and various Shi'ī *madhhabs*. However, not all of them have survived into the modern period. The most significant *madhhabs* that remain in practice in most part of the Muslim world are the Ḥanafīs, Shāfi'īs, Mālikīs, Ḥanbalīs of the *sunnis* and al-Zaydiyyah and Ja'fariyyah of Shi'ite. On the other hand, the *madhhab* of Ibāḍiyyah remain in practice in Oman whereas the *madhhab* of al-Awzā'ī, Sufyān al-Thawrī, the Zāhirīs and Ibn Jarīr al-Ṭabarī have died out.

The Development of Islamic Law during the Second Century Hijri

The institution of the *madhhab* emerged as a result of a hundred years of effort made by the early Muslim jurists in interpreting the *sharī'ah*⁴⁸. This interpretive effort was carried out to deduce legal rulings for new legal problems which increasingly arose in the early second century Hijri. During this period, the Muslim Empire experienced a vast expansion in which Islam spread from the Arabian peninsular. During the Umayyad era (43/661-132/750) the centre of government was moved to Damascus, then to Baghdad when the Umayyads were overthrown by the Abbasids (132/750-656/1258). As a result of the Empire's expansion, the Muslim community who lived a simple desert life faced challenges in governing the more civilised nations which had previously been under the administration of the Byzantine and Sassanid kingdoms.

⁴⁶ 'Umar Sulaimān al-'Ashqar, *al-Madhhal ilā dirāsāt-il- al-madhāhib wal al-madāris al-īqhiyyah*, Aman: Dār al-Nafā'īs, 2007, pp.48.

⁴⁷ Christopher Melchert, *The Formation of the Sunni Schools of Law, 9th-10th Centuries*, Leiden: Brill, 1997, pp.xvi.

⁴⁸ Peri Bearman, Rudolph Peters, Frank E. Vogel, *The Islamic School of Law, Evolution, Devolution and Progress*, Massachusetts; Harvard University Press, 2005, pp.viii.

As a response to this unprecedented situation, the early Muslim jurists were divided into two main schools. The first school was known as the *aṣḥāb al-ra'y* or rationalists. They were the jurists who exercised human reasoning in solving legal problems especially when there were not so many sound *ḥadīth* to be consulted. They were reported to be inspired by ʿAbd Allāh b. Masʿūd (d. 32/652-3), a Companion who was sent by the Prophet to teach Islam to the residents of Iraq. ʿAbd Allāh b. Masʿūd was known to adopt legal reasoning when making judgements in cases that were not clearly mentioned in the Qurʾān or Sunnah. His method was widely accepted by jurists in Iraq where its residents came from different belief systems and cultural backgrounds. Debate and discussion on theology were common in Iraq, as Muslims comprised many new converts from Persian, Greeks and Indians. Influenced by this theological discussion (*ʿilm al-kalām*), the jurists (*fuqahāʾ*) tended to use human reasoning to justify their legal rulings. In addition, the jurists in Iraq went further by involving in their discussion hypothetical legal problems. They not only applied their jurisprudential knowledge to solve the actual problems but also tried to give judgements on problems which have not yet occurred, nor were likely to occur. Perhaps, based on this phenomenon Schacht asserted that Iraq was the intellectual centre for the development of Islamic jurisprudence (*fiqh*) as a new discipline of knowledge - not Medina as is usually assumed⁴⁹. Ḥammād ibn Abī Sulaimān (d.120/737-738) and his student Abū Ḥanīfah (d.150/767) were among the prominent rationalists of Iraq at this time.

The second school of early jurists is known as *aṣḥāb al-ḥadīth*. This group of jurists relied heavily on *ḥadīth* of the Prophet and reports (*āthār*) from Companions as well as Successors in justifying their legal rulings. Schacht suggested that the *aṣḥāb al-ḥadīth* emerged as a result of their dissatisfaction with the rationalists concerning their over-reliance on human reasoning in the religious matters⁵⁰. His theory implied that the *aṣḥāb al-ḥadīth* came after the rationalists with the former disagreeing with some methods applied by the latter

⁴⁹ Joseph Schacht, *An Introduction to Islamic Law*, Oxford: Clarendon Press, 1964. pp.29.

⁵⁰ Ibid, pp.34.

such as the practice of legal devices (*ḥīlah*) and analogy (*qiyās*). According to them, both methods would defeat the spirit of the law and evade the strict requirement as indicated by *ḥadīth*⁵¹.

Schacht's theory contradicted most Muslim scholarly views. Although Muslim scholars acknowledged that the rivalry between the two schools was intense, they believed that it was not the main factor which led to the establishment of the *aṣḥāb al-ḥadīth* school. They were of the opinion that the two schools emerged due to disagreements in exercising personal opinion (*ra'y*) to deduce legal rulings for unprecedented cases⁵². Since, the time of Companions, Muslims disagreed over the extent to which personal opinion should be used in religious matters. There were Companions such as 'Abd Allāh b. Mas'ūd who used his personal opinion extensively. On the other hand, there were also Companions such as 'Abd Allāh b. 'Abbās (d.68/687) who preferred to not to use opinion but to rely exclusively to *ḥadīth*. Influenced by these two methods, subsequent generations of jurists were divided into two schools respectively. Therefore, Muslim scholars viewed rationalists and *aṣḥāb al-ḥadīth* as emerging simultaneously.

The *aṣḥāb al-ḥadīth* preferred not to make judgement where there was no relevant *ḥadīth* or *āthār* from later authorities. They would prefer to use *ḥadīths* with *isnāds* (chains of transmission) rather than analogical reasoning. The *aṣḥāb al-ḥadīth*, according to some, were originally specialists in *ḥadīth*. They did not study *fiqh* separately from hearing and transmitting *ḥadīth*⁵³. Contrary to the rationalists who devoted their time to study *fiqh*, the *aṣḥāb al-ḥadīth*' main concern was to collect and preserve *ḥadīth*. As *ḥadīth* is their main source, the *aṣḥāb al-ḥadīth* were known as the pioneer in developing the science of *ḥadīth* (*ʿulūm al-ḥadīth*). Since the early second Hijri, they were present in various parts of the Muslim Empire particularly in Medina. Ibn Shihāb al-Zuhrī (d.124/742), Rabī'ah b. Abī 'Abd al-Raḥmān (d.136/753-4) and Yaḥyā b. Sa'īd

⁵¹ Christopher Melchert, *The Formation of the Sunni Schools of Law, 9th-10th Centuries*, pp.7-8.

⁵² Muhammad Abu Zahra, *The Four Imams*, Aisha Bewley (trans). London; Dar al-Taqwa, 2001, pp.184.

⁵³ Christopher Melchert, *The Formation of the Sunni Schools of Law, 9th-10th Centuries*, pp.7-8.

al-Anṣārī (d.143/760-1), all teachers of Mālik (d. 179/795-6) were the key figures of *aṣḥāb al-ḥadīth* in Medina.

Beginning in the second half of the second century, Shāfi'ī (d.204/820) emerged with his doctrine intended to mediate between the *aṣḥāb al-ḥadīth* and rationalist schools. Shāfi'ī was a student of both schools, being first a disciple of Mālik, and then becoming a disciple of Muḥammad al-Shaybānī (d.189/205), one of the two great followers of Abū Ḥanīfa. For the majority of Muslim scholars, Shāfi'ī was reputed to be the founder of Islamic legal theory (*usul al-fiqh*). His remarkable book, *al-Risālah* established a systematic legal procedure for deducing new legal rulings by synthesising the methods of the *aṣḥāb al-ḥadīth* and the rationalists. Shāfi'ī propounded different solutions to those of the *aṣḥāb al-ḥadīth* concerning the problem of conflicting *ḥadīth*. The *aṣḥāb al-ḥadīth*, when faced with conflicting *ḥadīth* would narrate all of them without giving any preference for practice. According to Shāfi'ī the conflicting *ḥadīth* should be treated as followed; (1) it should be assumed that one of the conflicting *ḥadīth* might represent an exception to a general rule (2) a particular *ḥadīth* with a stronger chain of authority (*isnād*) should be preferred over another with a weak chain (3) if these do not solve the problem, the theory of abrogation (*naskh*) should be employed, where the earlier *ḥadīth* abrogates the later one⁵⁴.

Shāfi'ī also recognised analogical reasoning (*qiyās*) as the rationalists do. *Qiyās* is applied when a jurist extends a given ruling established by the Qur'ān and Sunnah to a new case, on the ground that the legal basis (*'illah*) of the two cases are similar. However, Shāfi'ī did not assert the freedom of opinion fully. He criticised the method of *istiḥsān* (juristic preference) which was widely used by Abū Ḥanīfah and other rationalists. He was reported to say, 'anyone who uses *istiḥsān* has legislated for himself' and he devoted a chapter in his book *al-Umm* to invalidating *istiḥsān*⁵⁵. But what was the *istiḥsān* of which al-Shāfi'ī

⁵⁴ N.J Coulson, *A History of Islamic Law*, Edinburgh University Press, 1964, pp. 58

⁵⁵ Muhammad Abu Zahra, *The Four Imams*, pp.184.

disagreed? According to al-Kharkhī (d.340/952), *istihsān* means a jurist departs from an established precedent in favour of another ruling for a stronger reason. This means that the rationalists would apply the concept of *istihsān* when the strict application of analogy would have led to a different legal ruling. The ruling based on *istihsān* was seen as contrary to the interest of the public. For al-Shāfi'ī, the use of *istihsān* to abandon the legal ruling deduced from analogy was considered as exploitation of personal opinion over its limit.

To conclude, by the end of second century Hijri, the term *madhhab* as we are familiar with it today did not yet exist. Based on a methodological difference, Muslim jurists during this period were divided into two groups namely the rationalists and traditionalists. Then Shāfi'ī came and tried to compromise between the strict rejection of all human reasoning propounded by the traditionalists and the unrestricted use of personal opinion adapted by the rationalists.

How the *Madhhab* began?

Scholars have differed in their explanation of how the four Sunni *madhhab* (Ḥanafīs, Mālikīs, Shāfi'īs and Ḥanbalīs) emerged in the history of Islamic law. I begin with the theory of Ibn Khaldūn (d.732/1332) which is subscribed to by the majority of modern Muslim scholars. According to Ibn Khaldūn, the *madhhab* emerged as a result of the early jurists' division into rationalists (*aṣḥāb al-ra'y*) and *aṣḥāb al-ḥadīth*. These two schools not only differed in term of their methodology in interpreting the law, but also they can be distinguished by their geographical location. Kufah and Basrah in Iraq were the centre of the rationalists while Medina and Mecca in Hijaz were the hub of traditionalists. This is based on the notion that a few well-known scholars who are thought to be the leaders of rationalists (such as Abū Ḥanīfah) were based in Kūfah, while Mālik the leader of *aṣḥāb al-ḥadīth*, as evidenced in his *al-Muwatṭā'*, was based in Medina. Abū Ḥanīfah appeared as the representative of the Iraqi school while Mālik representative of the Ḥijazi school. Then, Shāfi'ī blended the two doctrines and established his own school. Shāfi'ī succeeded Mālik and became

the leading jurist in Medina. His school however expanded in Egypt when he migrated and spread his doctrine there. Later, the school of Aḥmad ibn Ḥanbalī (d.241/855) emerged. According to Ibn Khaldūn, the adherents of Ḥanbalī school were few in number, and the majority of them were based in Baghdad and Syria. The Ḥanbalīs were described as jurists who possessed the best knowledge of the Sunnah and greatly depend upon them as source of law⁵⁶.

Ibn Khaldūn's description of how the *madhhab* begun has received considerable attention from the Western scholars. Western scholars generally recognised the division of early jurists into rationalists and traditionalists. They also located many rationalists in Kūfah and Basrah. Among them were Abū Ḥanīfah and his notable students Abū Yūsuf (d.182/798) and Muḥammad al-Shaybānī (d.189/805). Influenced by Ibn Khaldūn, Schacht proposed the regional theory. According to Schacht, the *madhhabs* begun from regional schools (Iraqī and Ḥijazi) before they transformed into personal schools. This means the Iraqī school turned into the Ḥanafīs and the Ḥijazi school shifted to the Mālīkīs. However, the general theory has become a topic of debate amongst the Western scholars. Some of them, such as Melchert, agreed with this perspective, whilst others such as Hallaq put forward difference hypothesis. The critics of the regional theory raised the question over the basis for distinguishing the Iraqī or Ḥijazi jurists. Was it based on the collective legal doctrine?⁵⁷ As we know, there was no such collective legal doctrine upheld by jurists in each region. During that time, there were hundreds of groups centred on renowned jurists and each group had distinct legal doctrines.

Based on the above argument, Hallaq proposed that the *madhhab* begun from personal schools before developing into doctrinal schools⁵⁸. The personal schools included the 'circles' of a number of prominent jurists such as Abū Hanīfah, Ibn Abī Laylā (d.148/765), Mālīk, Shāfi'ī, Aḥmad ibn Ḥanbal, Awzā'ī

⁵⁶ Ibn Khaldūn, 'Abd al-Raḥmān ibn Muḥammad, *The Muqaddimah, An Introduction to History*, Franz Rosenthal (trans), London: Routledge & Kegan Paul, 1986, vol. 3, pp. 3-9.

⁵⁷ Hiroyuki Yanagihashi, *A History of the Early Islamic Law of Property, Reconstructing the Legal Development, 7th-9th Centuries*, Leiden: Brill, 2004, pp.7

⁵⁸ Wael B. Hallaq, *The Origins and Evolution of Islamic Law*, Cambridge: Cambridge University Press, 2005, pp. 155.

and Sufyan al-Thawrī. These prominent jurists' circles had attracted many followers who learned *fiqh* from their masters and applied their doctrine in courts or taught it to other students in new circles. However, out of the many circles, only four of them developed into the doctrinal schools. According to Hallaq, the doctrinal schools possessed four characteristics lacking in the personal schools. There are (1) a cumulative legal doctrine that consists of legal opinions of the so-called founder and his great followers (2) a distinctive legal methodology (3) substantive boundaries and (4) loyalty⁵⁹.

In my view, the regional theory probably needs further clarification. The theory could explain the emergence of the Ḥanafīs, Mālikīs and Shāfi'īs but is insufficient when describing the beginning of the Ḥanbalīs. As described above, the Ḥanafīs and Mālikīs originated from the Iraqī and Ḥijazi schools whereas the Shāfi'īs was the compromise between the two. But, what was the position of the Ḥanbalīs? With regard to the basis of the regional theory, Ibn Khaldūn was of the opinion that the Iraqī and Ḥijazi jurists were distinguished by their methodology for interpreting the law. The Iraqī jurists were rationalists who used personal opinion extensively whereas the Ḥijazi jurists were *aṣḥāb al-ḥadīth* who strictly stuck to the *ḥadīth*. Nevertheless, the depiction of Mālik as the leader of traditionalists was denied by most of the Western scholars including Schacht⁶⁰. According to them, Mālik was not recognised as a pure traditionalist since many of his rulings were based on his own legal reasoning. Melchert supports this notion by providing evidences that the later generation of Medinan jurists after Mālik issued rulings which were based on opinion rather than *ḥadīth*⁶¹. Instead of Mālik, Melchert asserts that the true leader of *aṣḥāb al-ḥadīth* was Aḥmad ibn Ḥanbal. He further suggested that the traditionalist school developed in Iraq not Medina as usually assumed⁶². Hence, Melchert's theory refuted the claim that the Iraqī jurists could be generalised as rationalists.

⁵⁹ Hallaq, *The Origins and Evolution of Islamic Law*, 156-157.

⁶⁰ Joseph Schacht, *The Origins of Muhammadan Jurisprudence*. Oxford: Clarendon Press, 1950.

⁶¹ Christopher Melchert, *The Formation of the Sunni Schools of Law, 9th-10th Centuries C.E.*, pp. 160-165.

⁶² *Ibid.*, pp. 1-13.

The majority of Muslim scholars viewed the institution of *madhhab* as emerging during, or soon after, the eponyms' lifetime. They considered the eponyms as the founders of the *madhhabs*. For example, Ali Jum'ah divided the development of Shāfi'ī school into four phases ; (1) early establishment (2) the old doctrine (3) the new doctrine and (4) dissemination of Shāfi'ī doctrine. According to him, the first three phases occurred during the lifetime of al-Shāfi'ī while the phase four took place after Shāfi'ī's death⁶³. Meanwhile the Mālikī school was taught and established during Mālik's life due to his *al-Muwattā'*. Abū Ḥanīfah was reputedly the founder of the Ḥanafīs school because of his outstanding position amongst the rationalists during his time. He stood as the most authoritative jurist in Iraq who promulgated the use of personal opinion (*ra'y*). Contrary to the three eponyms, Aḥmad ibn Ḥanbal was better known to some Muslim scholars as specialist in *ḥadīth* rather than *fiqh*. For example, Ibn Jarīr al-Ṭabarī denied that he was a jurist and other jurists such as al-Ṭahawī (d.321/933), al-Dabūsī, al-Nasafī, 'Alā' al-Samarqandī, al-Farahī and al-Ghazālī ignored his opinion in their writings on jurisprudential disagreement (*fiqh al-ikhtilāf*)⁶⁴. Nevertheless, Aḥmad ibn Ḥanbal is still reputed to be the founder of the Ḥanbalīs school. The Inquisition (*miḥna*) was viewed as the impetus for the rise of the school. This is due to the fact that the reputation of Aḥmad ibn Ḥanbal's as the religious leader (*Imām*) grew tremendously after the incident.

However, most Western scholars disagreed with the claim that the eponyms were the founders of the *madhhab*. They also opposed the view that the *madhhab* emerged since the eponyms' lifetime. Melchert, the most cited author in this subject, suggested that the *madhhabs* of the Shāfi'īs, Ḥanafīs and Ḥanbalīs emerged between the late 200's/800's and early to mid 300's/900's. Contrary to a view prevalent among Muslim scholars, Melchert named Ibn

⁶³ 'Ali Jum'ah Muḥammad, *al-Madkhal ilā Dirāsāt -il- al-Madhāhib al-Fiqhiyyah*, Cairo: Dār al-Salām, 2007, pp.23.

⁶⁴ 'Umar Sulaimān al-'Ashqar, *al-Madkhal ilā Dirāsāt -il- al-Madhāhib wal al-Madāris al-Fiqhiyyah* pp.181.

Surayj (d.306/918), al-Karkhī (d.340/952) and al-Khallāl (d.311/923) as the founders of the Shāfi'īs, Ḥanafīs and Ḥanbalīs respectively. The three jurists were considered as the founders of the madhhabs for two main reasons; (1) being chiefs of schools in their time and (2) founding a systematic teaching method for their respective schools. Ibn Surayj was reported as the first who initiated a normal course of advanced study which required his students to produce a *ta'liqah*, a sort of doctoral dissertation describing the Shāfi'ī doctrine. As a result of this teaching method, graduates from Ibn Surayj's circle were identified as having inherited the title of being Shāfi'īs.

Al-Karkhī founded the school of Ḥanafīs in the same style of Ibn Surayj. His circle attracted many more known students than any Ḥanafī teacher during his time. Most importantly, al-Karkhī's *Mukhtaṣar* was the first *Mukhtaṣar* on which the later generation of Ḥanafī jurists wrote commentaries. Al-Khallāl was known as the first of the Ḥanbalī jurists to compile the most comprehensive legal doctrine of Aḥmad ibn Ḥanbal. He pioneered a study circle teaching Aḥmad ibn Ḥanbal's legal doctrine as jurisprudence, a form of study which the traditionalists were unaccustomed. As for the Mālikīs, no particular jurist was identified as the founder of the school. This is because after Mālik's death, the school of Mālikīs experienced expansion in three different regions (Andalusia, North Africa and Iraq). In each region had own leading jurists⁶⁵.

For the purpose of this study, I am inclined to support the view that the *madhhab* was actually a product of later jurists. With great respect to the eponyms, during their lifetime, the schools had not yet achieved the doctrinal status but were maintained as personal schools. It was their loyal followers who perpetuated their doctrine and brought the schools to the next level. This is evident when we examine the development of *muḍārabah* rules in each school. As will be explained later, the rules of *muḍārabah* were preliminary in nature during the time of eponyms, but developed gradually after their death.

⁶⁵ Christopher Melchert, *the Formation of the Sunni Schools of Law, 9th-10th Centuries C.E.*, pp.156-170.

The Dissemination of the Ḥanafi School

The Ḥanafis school was named after Abū Ḥanīfah al-Nu‘mān b. Thābit (d.150/767). Abū Ḥanīfah was born in Kufa and grew up in a family originally from Persia. According to most bibliographical sources, Abū Ḥanīfah’s family was *mawlā* of the tribe of Taymallāh b. Tha‘laba. Zūṭa, the grandfather of Abū Ḥanīfah was captured in Kabul and later brought to Kufah as a slave. When he was freed, he and his descendants became *mawlās* of the tribe⁶⁶. However, the report was denied by Abū Ḥanīfah’s grandson Ismā‘īl (d.212/827-8) asserting that his family had never been enslaved⁶⁷. Despite the disagreement over Abū Ḥanīfah’s family status, it was commonly agreed that his father was a successful trader. Abū Ḥanīfah himself also began his career as trader, selling *khazz* (silk fabric) before embarking his life in searching of knowledge.

At first Abū Ḥanīfah was interested in the discussion of theology (*kalām*). However, he then inclined towards the study of Islamic jurisprudence (*fiqh*)⁶⁸. Abū Ḥanīfah’s studied *fiqh* for eighteen years with Ḥammād ibn Abī Sulaymān. Ḥammād was a student of Ibrāhīm al-Nakha‘ī (d. 95/713-4), a Successor who learned from the Companion (of the Prophet Muḥammad), ‘Abd Allāh ibn Mas‘ūd. Reviewing the bibliographical sources, one will find variant descriptions of the achievements of Abū Ḥanīfah in *fiqh*. His views had opponents and supporters. For example al-Dhahabī (d.748/1348) described him as one of the greatest jurists in Iraq⁶⁹. On the other hand, there are a number of reports claimed that the traditionists often accused him of being too innovative⁷⁰. The reason why there was such disagreement about him is because Abū Ḥanīfah employed several methods of legal thinking such as the

⁶⁶ Yanagihashi, H. “Abu Hanifa” *Encyclopaedia of Islam, THREE*. Edited by: Gudrun Kramer, Denis Matringe, John Nawas and Everett Rowson. Brill, 2008. Brill Online. Exeter University. Accessed on 2 July 2008.

⁶⁷ Khaṭīb al-Baghḍādī, Aḥmad b. ‘Alī, *Tārīkh Baghdād*, Beirut: Dār al-Kitāb al-‘Arabī, 1966, vol.6, pp.243-245.

⁶⁸ Muḥammad Abū Zahra, *The Four Imams*, pp.128-130.

⁶⁹ Dhahabī, Muḥammad ibn Aḥmad, *Kitāb Tadhkirat al-ḥufāz*, Beirut: Dār Iḥyā’ al-Turāth al-‘Arabī, n.d, vol. 1&2, pp.168-169.

⁷⁰ Muḥammad Abū Zahra, *Abū Ḥanīfah: ḥayātuhu wa ‘asruhu ‘ārā’uhu wa fiqhuhu*, Cairo: Dār al-Fikr al-‘Arabī, 1947, pp.224.

principles of *qiyās* (analogy), *istiḥsān* (juristic preference) and *ḥiyāl* (legal device) in deducing new legal rulings. His approach was criticised by the traditionists who rejected the use of personal opinion (*raʿy*) in religious matters.

Abū Ḥanīfah succeeded Ḥammād ibn Abī Sulaymān's circle after his teacher's death. During that period, there were other renowned jurists who also held *fiqh* circles such as the *qāḍī* of Kufa, Ibn Abī Laylā and the traditionist, Sufyān al-Thawrī. Abū Ḥanīfah had disagreement with both of them in many issues. For example, al-Shāfi'ī mentions in his book *Kitāb mā ikhtalafa fī-hi Abū Ḥanīfah wa Ibn Abī Laylā 'an Abī Yūsuf* that Abū Ḥanīfah and Ibn Abī Laylā had disagreement in 250 cases, sub cases and issues⁷¹. A question which emerges from this analysis is, then how did Abū Ḥanīfah teachings reach the point of predominance in Iraq at the expense of the teachings of his contemporaries?

Many scholars regarded the two notable students of Abū Ḥanīfah, Abū Yūsuf and al-Shaybānī as the key figures in disseminating their master's teachings which eventually formed a distinctive school of law. Shaybānī was known for his role in compiling the most authoritative texts of the Ḥanafīs legal doctrines called *zāhir al-riwāyah* (the prevailing opinion). The texts attributed to him are *al-Aṣl*, *al-Jāmi' al-Kabīr*, *al-Jāmi' al-ṣaghīr*, *al-Siyar al-kabīr*, *al-Siyar al-ṣaghīr* and *al-Ziyādāt*. The texts consist of the *fatwā* of Abū Ḥanīfa as well as the juridical opinions of Abū Yūsuf and al-Shaybānī. It should be noted however, al-Shaybānī was eighteen years old when Abū Ḥanīfah died. Hence, considering his age, it is impossible that he narrated all of Abū Ḥanīfah *fatwas* by himself. It is believed that many of the narrations came from Abū Yūsuf with whom al-Shaybānī studied⁷². In addition to the *zāhir al-riwāyah*, the Ḥanafīs legal sources include texts known as *nawādhir al-riwāyah*. It refers to the collections of legal rulings which were not mentioned in the *zāhir al-riwāyah*. Based on both sets of texts, the Ḥanafīs legal doctrines were transmitted to the subsequent generation of jurists.

⁷¹ Yanagihashi, H. "Abu Hanifa" *Encyclopaedia of Islam*, THREE.

⁷² 'Ali Jum'ah Muḥammad, *al-Madkhal ilā dirāsāt -il- al-madhāhib al-fiqhiyyah*, pp.86.

In addition to the contribution of al-Shaybānī, the appointment of Abū Yūsuf as the first chief judge (*qāḍī al-quḍah*) during the period of Hārūn al-Rashīd (170-193/786-809) also played important role in the dissemination of Abū Ḥanīfa's doctrine. Abū Yūsuf was thought to have manipulated his position in the government to influence the appointment of other Ḥanafī *qāḍī* in the Muslim empire. This notion however has been challenged by Nurit Tsafir who opined that Abū Yūsuf did not have significant influence in the appointment or dismissal of a *qāḍī*⁷³. Based on the evidences in Khurasan, Egypt, Syria and Basra, she suggested that it was popular pressure which was the determining factor in the appointment of a *qāḍī*. In other words, a *qāḍī* was selected among local jurists on the basis of local approval, and this *qāḍī* then became the local community representative.

Beginning from the second half of the second century, Ḥanafī doctrines were spread largely from Kufah to other areas such as Basra, Baghdad, Anbar, Isfahan, Egypt and Maghrib. As indicated above, the students of Abū Ḥanīfa contributed significantly to the spread of the Ḥanafī doctrines. They convened study circles to teach Abū Ḥanīfa's doctrine in many parts of Muslim empire. For example Zufar b. al-Hudhayl (d.158/775) was the first who initiated Ḥanafī circle in Basra and Isfahan⁷⁴. The dissemination of the Ḥanafī doctrine also received strong support from the 'Abassid caliphs. This was evident when the 'Abassid government changed the *qāḍī* appointment policy. A *qāḍī* used to be appointed based on his influence within the local community which reflect the dominant legal tradition of a place. However, gradually the 'Abassid government replaced the policy and appointed *qāḍīs* from Baghdad who were expected to implement the will of state. Apparently, many of the *qāḍīs* who were willing to cooperate with the government were affiliated to the Ḥanafī school.

⁷³ Nurit Tsafir, *the History of an Islamic school of law: the early spread of Ḥanafīsm*, Massachusetts: Harvard University Press, 2004, pp.20.

⁷⁴ Ibid.

Baghdad was the earliest centre of the development of the Ḥanafīs school. The spread of the Ḥanafīs doctrine in Baghdad was led by al-Karkhī (d.340/952)⁷⁵. With the exception of Abū Ḥanīfah and his two students, al-Karkhī had many more known students than any other Ḥanafī teacher before him. Beginning from the fifth/eleventh centuries, the school appeared noticeably in Khurasan and Transoxania. According to Eyyup, the cities of Balkh in Khurasan and Bukhara in Transoxania gradually became the centre of the Ḥanafīs school. The Ḥanafīs jurists in these cities developed distinct academic networks in which they had at least one leading figure in each generation, and each figure had their own numerous famous students⁷⁶.

As for the growth of the Ḥanafī legal texts, the works of Shaybānī has become the main sources in which the school's legal doctrine was developed. Being the earliest texts, *Kitāb al-Asl*, *Jāmi' al-kabīr* and *al-Jāmi' al-ṣaghīr* are little more than compilation of legal rulings of the three Ḥanafī masters. A century after al-Shaybānī's death, al-Ṭaḥāwī (d.321/933) an Egyptian Ḥanafī wrote the first commentary on *al-Jāmi' al-ṣaghīr*. As observed by Ya'akov Meron, the *Mukhtaṣar* of al- Ṭaḥāwī did not show any improvement from al-Shaybānī's texts. The text is not systematically organised in which rulings were scattered. There is no specific chapter devoted to cover a particular topic. Similar to *Kitāb al-Asl*, *Mukhtaṣar* of al-Ṭaḥāwī also did not explain the legal reasoning to support the rulings⁷⁷. In addition to that, the other important Ḥanafīs legal texts written during the third/ninth centuries were *Mukhtaṣar* of al-Karkhī, *al-Kāfī* of al-Ḥākim al-Shahīd al-Marwazī (d.334/945) and *Khizānat al-Fiqh* of Abū Layth al-Samarqandī (d.373/983). *Mukhtaṣar* of al-Karkhī is a commentary of *Mukhtaṣar* of al-Ṭaḥāwī. On the other hand, *al-Kāfī* and *Khizānat al-Fiqh* are compilations of *zāhir al-riwāyah* rulings.

⁷⁵ Christopher Melchert, *the Formation of the Sunni Schools of Law, 9th-10th Centuries C.E.*, pp.125

⁷⁶ Eyyup Said Kaya, *Continuity and Change in Islam Law: The Concept of Madhhab and the Dimensions of Legal Disagreement in Ḥanafī Scholarship of the Tenth Century* in Peri Bearman, Rudolph Peters, Frank E. Vogel, *The Islamic School of Law, Evolution, Devolution and Progress*, Massachusetts; Harvard University Press, 2005, pp.26.

⁷⁷ Ya'akov Meron, The Development of Legal Thought in Ḥanafī Texts, *Studia Islamica*, no. 30, Larose: Maisonneuve & Amp, 1969, pp.74.

In the fourth/tenth centuries al-Qudūrī (d.428/1037) wrote a commentary of *Mukhtaṣar* of al-Karkhī. Qudūrī made improvements in the Ḥanafī legal text with regard to the introduction of new terminology and the organisation of the topics' arrangement⁷⁸. In the second half of the fourth/tenth centuries, Sarakshī (d.490/1097) wrote his remarkable book *al-Mabsūṭ*. The book was written based on *al-Kāfī* by al-Ḥākim al-Shahīd al-Marwazī. *Al-Mabsūṭ* is considered as the most authoritative texts in elaborating the *ẓāhir al-riwāyah* rulings. As a thirty-volume book, the discussion of legal rulings in *al-Mabsūṭ* is comprehensive (as its name implies), covering nearly all topics and sub-topics in Islamic law. Sarakshī's work is vital because he explains the basis or reasoning in which Abū Ḥanīfah, Abū Yūsuf and al-Shaybānī used to justify their rulings.

In the fifth/eleventh centuries, two other outstanding legal texts were produced by the great Ḥanafīs jurists. The texts are *Badā'i' al-Sanā'i'* of al-Kāsānī (d. 587/1191) and *al-Hidāyah* of al-Marghīnānī (d. 593/1197). Kāsānī's work was inspired by his master and father in law, 'Alā' ul-Dīn al-Samarqandī (d.539/1144) the author of *Tuḥfāt al-Fuqahā'*. It should be noted however, despite the qualities of *Badā'i' al-Sanā'i'*, the book has left a little impact on the later development of the Ḥanafī doctrines. It seems that the jurists of al-Kāsānī's time were not impressed with his work and his name is hardly mentioned in the Ḥanafī literature in the subsequent centuries⁷⁹. As for *al-Hidāyah*, the book is a commentary of al-Marghīnānī' earlier book namely *Bidāyah al-Mubtadi'*. Al-Marghīnānī wrote the *Bidāyah al-Mubtadi'* based on the texts of *Jāmi' al-ṣaghīr* of al-Shaybānī and *Mukhtaṣar* of al-Qudūrī. *Al-Hidāyah* received much attention from the later Ḥanafī jurists. The book has been commented by many jurists including al-Bābartī (d.786/1364) in his *al-'Ināyah 'ala al-hidāyah* and Ibn Humām (d.861/1457) in *Fathu al-qadīr*.

⁷⁸ Ibid, pp.78.

⁷⁹ Yakov Meron, pp.83, Heffening, W. 'al-Kasani, Ala' al-din Abū Bakr b. Mas'ud, called Mālik al-ulama'." Encyclopedia of Islam. Edited by: P. Bearman, Th. Bianquis, C.E Bosworth, E. Van Donzel and W.P. Heinrichs. Brill, 2008. Brill Online. Exeter University. Accessed on 22 July 2008

The Early Development of Ḥanafis Rules on *Muḍārabah*

The earliest Ḥanafī legal texts that discussed the rules of *muḍārabah* are *Jāmi' al-ṣaghīr* and *Jāmi' al-kabīr* of al-Shaybānī. Both texts demonstrate that Abū Ḥanīfah and his disciples had established the fundamental principles of the topic for later development. This is based on the notion that the *muḍārabah* rules in the texts are relatively comprehensive. In *Jāmi' al-ṣaghīr*, al-Shaybānī records Abū Ḥanīfah's views on various issues including (1) the maintenance (*nafaqah*) of agent-manager (2) the invalid *muḍārabah* (3) the practice of recursive *muḍārabah* (4) unacceptable capital (i.e. capital other than *dirhām* and *dīnār*) and (5) dispute between the contracting parties.

According to Abū Ḥanīfah (as recorded by Shaybānī), an agent-manager has no right to claim on his personal expenses if he conducts the business locally⁸⁰. However, he has the right to do so if he travels for business purposes. The personal expenses are defined as the food, drinks and clothes of the agent-manager. It is also ruled that the contract would be rendered invalid if the agreement stipulates that one of the contracting parties receives a fixed amount of money (e.g. ten dirham) in addition to his/her shares of profit. In such an invalid contract, the investor would be obliged to pay current hire wages (*ujr mithil*) to the agent-manager.

Abū Ḥanīfah also permitted the practice of recursive *muḍārabah*. This occurs when an agent-manager becomes the middle-man, receiving capital from original investor and act as capital provider in another *muḍārabah* arrangement. Abū Ḥanīfah also illustrated how the profit should be distributed between the three parties. He gave an example where the original investor and the first agent-manager agreed on a 50:50 of profit ratio. Then a similar ratio is agreed between the first and the second agent-manager. When profit is obtained, the second agent-manager will receive half of the profit and the remaining profit

⁸⁰ Sarakshī, Muḥammad ibn Ahmad. *Kitāb al-Mabsūṭ*. Misr: Maṭba'at al-Sa'ādah, 1324-1331/1906-13, vol. 22, pp. 63.

will be shared between the first agent-manager and the original investor. This means each of the two parties will receive only a quarter of the initial profit⁸¹.

Abū Ḥanīfah also ruled that the *muḍārabah* capital must be in monetary currency (*dīnār* or *dirhām*). He rejected any form of capital other than both units of currency⁸². Apart from that, Abū Ḥanīfah also described to what extent the investor have control for his investment. He permitted the investor to specify the place in which the agent-manager is allowed to conduct the *muḍārabah* business. If the agent-manager transgresses the investor's injunction, he would be responsible for any loss incurred⁸³. Besides, he also explained the scope of empowerment given to the agent manager. Abū Ḥanīfah established several principles in solving the dispute between the contracting parties. According to him, if the investor and the agent-manager disagree over the amount of capital (for example, case where agent-manager claims that he had been given capital worth 2000, whereas the investor denies it and claims that the 2000 comprised 1000 of capital and another 1000 of profit), Abū Ḥanīfah ruled that the agent-manager's claim will be accepted. However, if the dispute related to the type of the contract (for example, in a case where the agent manager claims that the contract is *muḍārabah* (thus, profit should be distributed) whereas the investor claims it was *biḍā'ah* (agent-manager was trading for free), Abū Ḥanīfah ruled that the investor's claim is accepted⁸⁴.

As indicated earlier, the text of *Jāmi' al-ṣaghīr* is merely a compilation of rulings without highlighting the legal reasoning behind them. For example, al-Shaybānī did not explain on what basis Abū Ḥanīfah allowed the agent-manager to claim his personal expenses while travelling and why he allowed the practice of recursive *muḍārabah*. In this respect, Sarakshī, through his book *al-Mabsūṭ* in the fourth/tenth centuries, has made excellent contribution. Sarakshī elaborated the basis used by the Ḥanafīs masters in justifying their

⁸¹ Shaybānī, Muḥammad ibn al-Ḥasan, *Jāmi' al-ṣaghīr*, Beirut: Dār 'Ālam al-Kutub, 1986, p. 425.

⁸² Ibid, p. 426.

⁸³ Ibid, p. 425.

⁸⁴ Ibid, p. 427.

rulings. However, before we discuss further detail on *al-Mabsūṭ*, an analysis of *Kitāb Khizānat al-Fiqh* of Abū Layth al-Samarqandī, one of the essential Ḥanafī works during the third/ninth centuries, is appropriate.

In the introduction to his book, Abū Layth al-Samarqandī states that the *Khizānat al-Fiqh* was a compilation of legal rulings of the Ḥanafī jurists of his time. The book was written in a simple way to help students of *fiqh* understand and memorise Ḥanafī legal doctrine⁸⁵. Hence, the organisation of the book resembles student notes in which the rulings are arranged in a list. For examples, he listed ten activities which are permitted for the agent-manager in managing the capital entrusted to him. In addition to the two activities mentioned in the *Jāmiʿ al-ṣaghīr* (*wadīʿah* and *biḍāʿah*), Abū Layth al-Samarqandī ruled that an agent-manager is permitted to borrow (*īʿārah*), to rent warehouses, to hire employees or vehicles, to purchase by cash or credit, to appoint an agent, to approve slave to conduct *muḍārabah* business, to give or take collateral (*rahn*) and to travel with the capital. Among other activities which are prohibited for the agent-manager are to give loans, to donate, to give to charity and to free slaves using the *muḍārabah* revenues and to receive credit letters (sing; *saftajah*, plu; *saftātaj*). As for the investor, Abū Layth al-Samarqandī added three more permissible conditions that could be specified by the investor as a means of monitoring his investment. Apart from the location of business (mentioned in *Jāmiʿ al-ṣaghīr*), the investor has the right to specify the period of time, the type of business, the kind of produce and the price which the agent-manager must comply when making a business deal.

Indeed, the rulings compiled in the *Khizānat al-Fiqh* demonstrated that the Ḥanafī rules of *muḍārabah* had been developed dramatically during the end of the third/eight centuries. The development of the rules is significant particularly in determining the scope of relationship between the investor and the agent-manager. Abū Layth al-Samarqandī's work shows that the Ḥanafī jurists had clearly defined the boundaries between the two parties. In addition to that, Abū

⁸⁵ Abū Layth al-Samarqandī, Naṣr ibn Muḥammad, *Khizānat al-Fiqh*, Beirut: Dār al-Kutub al-ʿIlmiyyah, 2005, pp.27.

Layth al-Samarqandī probably was the first Ḥanafī jurist who provides a definition of the *muḍārabah*. He defines it as a contract of partnership in which the capital is from one party and the work is from the other⁸⁶.

However, *Khizānat al-Fiqh* is similar to *Jāmi' al-ṣaghīr* in the sense that both texts do not provide the legal reasoning to support their rulings. As mentioned before, the work of Sarakshī during the end of the fourth/tenth centuries had appeared to fill this gap. In my opinion, Sarakshī's *al-Mabsut* perhaps could be regarded as the most comprehensive text of the *muḍārabah* topic not only within the Ḥanafīs school but also the other three Sunni schools of law. Sarakshī discusses the *muḍārabah* rules in 26 chapters (*bāb*). He elaborates in great detail regarding many important topics such as the permitted activities for the agent-manager, the recursive *muḍārabah*, the guaranty of agent-manager, the dispute between the two parties, the profit distribution, *muḍārabah* with people of different religion and the lost of the capital. However, in this section, I will focus on the issue of the maintenance (*nafaqah*) of agent-manager. I will highlight Sarakshī's explanation of the legal reasoning used by the Ḥanafīs masters in justifying their legal rulings as well as the comprehensiveness of his discussion.

It should be recalled that Abū Ḥanīfah permitted the agent-manager to claim on his personal expenses if he travels for business proposes but not if he does the business locally. According to Sarakshī, the rule is based on the analogy (*qiyās*) to *wakālah*, *biḍā'ah* and hiring contracts. Since an agent in *wakālah* contract or *al-mustabda'* in *biḍā'ah* contract or an employee in hiring contract do not have the right to claim on their personal expenses when they exercise their roles locally so does the agent-manager. Furthermore Sarakshī added that '*Did you see that an agent-manager before the muḍārabah used to stay at the place and support his maintenance using his money and therefore this should be maintained after the muḍārabah*'⁸⁷. However, if the agent-manager travels, his action implies that he has experienced hardship for the sake of the *muḍārabah*

⁸⁶ Abū Layth al-Samarqandī, *Khizānat al-Fiqh*, pp.236.

⁸⁷ Sarakshī, *al-Mabsut*, vol.22, pp.62.

business. It is commonly viewed that a person will not be encouraged to travel for business using his own money in which he knows that the profit is uncertain. Therefore, considering the difficulties faced by the agent-manager during travelling, Abū Ḥanīfah granted the agent-manager the right to claim on his/her personal expenses⁸⁸.

In clarifying the details of the topic, Sarakshī states that the Ḥanafī masters (Abū Ḥanīfah, Abū Yūsuf and Shaybānī) are in agreement in defining the personal expenses as foods, drinks, clothes and transportation. These things are considered as the basic needs of a traveller. However, there is disagreement between the Ḥanafī masters over the inclusion of medical costs as part of the maintenance of the agent-manager. Abū Ḥanīfah was reported as including these, but a report in the *zawāhir al-riwāyah* mentioned that there are other Ḥanafīs masters ruled against Abū Ḥanīfah. According to Sarakshī, those who disagreed with Abū Ḥanīfah justified their rulings on the basis of two main reasons. Firstly, they argued that the rule is consistent with the rule in the issue of the maintenance (*nafaqah*) of a wife in which a husband is not legally responsible to support his wife's medical cost. Secondly, it is presumed that the medical claim would be rarely happened, thus such uncommon case is not recognised⁸⁹.

Sarakshī, however, did not explain clearly the limit of an agent-manager's possible claim. He only recommended that the claim should be made responsibly and reasonably (*ma'rūf*). Perhaps this general guideline is tied with the common practice of traders. Thus, the limit of the claim will vary depend on the size of the business and the period in which *muḍārabah* is practised. Nonetheless, it is strongly emphasised that the personal expenses must had direct benefit to the business.

Al-Mabsūt of Sarakshī clearly shows that the Ḥanafī rules on *muḍārabah* has been finalised during the fourth century Hijri. Sarakshī had covered all

⁸⁸ Sarakshī, *al-Mabsut*, vol.22, pp.63.

⁸⁹ Sarakshī, *al-Mabsut*, vol.22, pp.63.

important issues of the topic. However, *al-Mabsūṭ* was written in the *masā'il* (legal problem) style, make the discussion too lengthy. In the fifth/eleventh centuries, al-Marghīnānī produced a more concise but comprehensive legal text namely *al-Hidāyah*.

The Dissemination of the Mālikī School

The Mālikī school was established based on the adoption of Mālik bin Anas's doctrine. His full name was Abū 'Abd Allāh Mālik bin Anas bin Mālik bin Abū 'Āmir bin 'Amr bin al-Ḥarith bin Ghaymān bin Khuthayn bin 'Amr bin Ḥarith al-Aṣḥabī. His family was originally from Yemen. The great grandfather of Mālik namely Abū 'Āmir migrated to Medina because of his disagreement with one of the governors in Yemen⁹⁰. Mālik was born and spend his entire life in Medina. The city during that time was the main reference of scholars especially in the science of *ḥadīth*. Medina was the home of many Companions (*ṣahābah*) and Successors (*tābī'ūn*). Mālik narrated *ḥadīth* from the Successors such as Nāfi' (d.117/735), the client of 'Abd Allāh ibn 'Umar, Ibn Shihāb al-Zuhrī (d.124/742) and Rabī'ah ibn Abī 'Abd al-Raḥmān (d.136/753-4).

Rabī'ah ibn Abī 'Abd al-Raḥmān was also Mālik's teacher in *fiqh*. He was known as Rabī'ah *al-ra'y*. Influenced by his teacher, Mālik was said to have incorporated *al-ra'y* in developing his *fiqh* doctrine⁹¹. Apart from relying on *ḥadīth* and the Medinan jurists practices, Mālik also applied the principles of *maṣāliḥ al-mursalah* (public interest) and *sadd al-dharā'i'* (blocking pretences). The reputation of Mālik as the leading jurists in Medina had attracted many scholars from various parts of Muslim world to study under him.

Similar to other schools, Mālik's doctrine was spread by his students. According to Ibn Khaldūn, the school was very actively cultivated in Spain and North-western Africa until the dynasties of Cordova and Qayrawān were

⁹⁰ Muḥammad Abū Zahra, *The Four Imams*, pp.2.

⁹¹ Schacht, J. 'Malik b. Anas'. *Encyclopaedia of Islam*. Edited by: P.Bearman, Th. Bianquis, C.E Boswort, E. van Donzel and W.P. Heinrichs. Brill, 2008. Brill Online Exeter University. Accessed on 26 August 2008.

destroyed⁹². This includes the city of Andalusia, Qairawan and a large part of Tunisia. This situation is explained by the fact that most of the scholars from these areas travelled to Ḥijaz (Medina) to learn the Islamic sciences, since it was the centre of religious scholarship.

However, the Mālikī school did not last for long time in its origin land Medina. Approximately after 60 years of Mālik's death, the number of Mālikī jurists in Medina had fallen⁹³. One of the reasons for this phenomenon was the political events within the city. In year 266 Hijri, the Umayyad and Abbassid had fought each other in their attempt to control Medina. As a result of this, learning and knowledge had become secondary in the eye of Medina rulers. Nevertheless, I shall mention Mālik's important students who had maintained the survival of Mālik's doctrine in Medina: 'Uthmān bin Kinānah (d.185/801), Ibn Nāfi' (d.186/802), 'Abdul Mālik bin al-Mājishūn (d.214/829) and Maṭraf bin 'Abdullah (d.220/835). 'Uthmān and Ibn Nāfi' succeeded as leaders of Mālik's circle after his death. Ibn Nāfi' was the teacher of Saḥnūn (d.240/855), the compiler of *al-Mudawwanah*. An Andalusian jurist, 'Abd al-Mālik Ibn Ḥabīb (d. 238/853) learned the doctrine from al- Mājishūn and Maṭraf and spread the Mālikī doctrine in Andalusia. This at least is the official Mālikī account of its spread.

Outside of Medina, the doctrine of Mālik was transmitted in Egypt. The transmission was carried out by several prominent Mālik's students such as 'Abdul Rahmān Ibn al-Qāsim (d.191/807), Aṣḥab (d.203/819) and Ibn 'Abd al-Ḥakām (d.214/829). Within the Mālikī *madhhab*, Ibn al-Qāsim was regarded as having achieved a similar position like al-Shaybāni of the Ḥanafī school. Both jurists were the key figures in transmitting their eponyms' doctrines. Ibn al-Qāsim's transmission of *al-Muwatta'* was considered the soundest and his replies to Saḥnūn's inquiries in *al-Mudawwanah* were considered the most

⁹² Ibn Khaldūn, *The Muqadimah An Introduction to History*. vol.3, pp.16.

⁹³ Muḥammad al-Mukhtār al-Māmī, *al-Madhhab al-Mālikī, Madārisuhu, Mu'ālafātuhi, Khaṣā'isuhu wa Sammātuhi*, al-'Ayn: Markāz Zā'id li al-Turath wa al-Tārīkh, 2002, pp.51.

comprehensive collection of Mālik's rulings⁹⁴. Ibn 'Abd al-Ḥakām also wrote one of the earliest Mālikī texts, namely *al-Mukhtaṣar al-kabīr fī al-fīqh*. In general, the works of Egyptian jurists significantly influenced the dissemination of Mālikī school since they were studied in Baghdad, Qayrawān and Andalusia⁹⁵. In addition to that, the narration of the Egyptian jurists pertaining to Mālik's legal opinions was considered the most reliable source within the school⁹⁶. The later Mālikīs jurists used to come to Egypt to hear Mālik's rulings from Ibn al-Qāsim and his contemporaries. The Egyptian school was perceived as the closest to the Medinan Mālikīs in following Mālik's principles.

In Iraq, the doctrine of Mālik was introduced by his students 'Abd al-Rahman bin Mahdī (d.197/813) and 'Abd Allah bin Maslamah al-Qa'nabī (d.220/835). After them, the school was led by Ibn Mu'adhhal. The dissemination of the Mālikīs doctrine enhanced further during the time of Ismā'īl bin Ishāq (d.282/895), one of Ibn Mu'adhhal's students. Ismā'īl became a *qādī* in Baghdad for 36 years and was actively taught the Mālikīs doctrine in the city⁹⁷. It should be noted that the Mālikī jurists in Iraq seem to be less extreme in holding their *madhhab* opinions. This is a result of their interaction with the other *madhhahib* such as the Ḥanafīs and Shāfi'īs. For example, al-Qādī Ismā'īl was reported to have chosen a middle position with regard to the issue of conflicting between *ḥadīth* and *ra'y*⁹⁸. This stand contradicted to his contemporaries in Medina and Egypt in which they would prefer *ḥadīth* over *ra'y*. However, the history of the Mālikīs in Iraq came to end after their last key figure, 'Abd Wahhāb bin Nasr died in 422 Hijri. After him, the line of succession of the Mālikīs jurists is difficult to make out.

⁹⁴ Muḥammad Abū Zahra, *The Four Imams*, pp.84.

⁹⁵ Jonathan E. Brockopp, *Early Mālikī Law, Ibn Abd al-Ḥakām and his Major Compendium of Jurisprudence*, Leiden: Brill, 2000, pp.49.

⁹⁶ 'Umar Sulaimān al-'Ashqar, *al-Madkhal ilā Dirāsāt- il- al-Madhāhib wal al-Madāris al-Fiqhiyyah*, pp.155.

⁹⁷ Christopher Melchert, *the Formation of the Sunni Schools of Law, 9th-10th Centuries*, pp.170-171.

⁹⁸ Ibid.

As indicated earlier, the Mālikī school was disseminated widely and maintained for a considerable amount of time in Spain and North-western Africa. Among the earliest jurists in North-western Africa who studied under Mālik was ‘Ali b. Ziyād (d.183/799). He was the teacher of the two Mālikī jurists namely Asad bin al-Furāt (d.213/828) and Saḥnūn who had played pivotal role in developing the school's earliest texts. As is generally known, *al-Muwattaʿ*⁹⁹ was the main reference of scholars in understanding Mālik's legal opinions. After learning *al-Muwattaʿ* from Mālik, Asad bin al-Furāt had travelled to Iraq to study with al-Shaybanī of the Ḥanafīs. Then he appeared trying to produce a new doctrine for the Mālikīs which followed the same style of the Ḥanafīs. He compiled problems discussed by the Ḥanafīs and brought them to Ibn al-Qāsim. Ibn al-Qāsim responded to the problems and his answers were compiled in a text named as *al-Asādiyyah*. The *Asādiyyah* had received a mixed feedback amongst the Mālikīs in Qairawān. They found that some of the answers contradicted to the well-known *fatwā* within the school. Saḥnūn brought the *Asādiyyah* to Ibn al-Qāsim and asked him to revise the text. Ibn al-Qāsim made a lot of revisions and Saḥnūn compiled the amendments in *al-Mudawannah*⁹⁹. It was reported that Asad had refused to delete from his text the problems that had been reconsidered by Ibn al-Qāsim and Saḥnūn¹⁰⁰. Since then *al-Mudawannah* was widely accepted by the Mālikīs in North-western Africa and many jurists regarded it as second only to *al-Muwattaʿ*.

Among the earliest jurists who spread the Mālikī doctrine in Andalusia was Yaḥyā bin Yaḥyā (d.234/849). He narrated *al-Muwattaʿ* from Mālik and after that went to Egypt to study under Ibn al-Qāsim. The dissemination of the Mālikīs in Andalusia was supported by Yaḥyā bin Yaḥyā's influence in the government. When he died, the leadership of the school was led by ‘Abd al-Mālik Ibn Ḥabīb. He was the author of an important Mālikī jurisprudence text namely *al-Waḍīḥah* in which he tried to imitate the method of Mālik in *al-*

⁹⁹ ‘Umar Sulaimān al-’Ashqar, *al-Madkhal ilā Dirāsāt- il- al-Madhāhib wal al-Madāris al-Fiqhiyyah*, pp.148.

¹⁰⁰ Ibn Khaldūn, *The Muqadimah An Introduction to History*. vol. 3, pp.15.

*Muwatta*¹⁰¹. After that, al-‘Utbī (d.254/868) one of Ibn Ḥabīb's students produced a revised version of his teacher's text called as *al-Utbiyyah*. According to Ibn Khaldūn, the people of Andalusia had concentrated on studying the *al-Utbiyyah* and abandoned other texts¹⁰². After that, the line of succession went to Ibn Labābah (d.314/926) and Ibn ‘Umar al-Makwī (d.401/1011). Other leading figures amongst the Andalusian jurists were Ibn ‘Abd al-Barr (d.463/1071) and al-Bājī (d.474/1081). Ibn Abd al-Barr wrote *al-Kāfī fil fiqh ahlul Madīnah* while al-Bājī produced *al-Muntaqā*, a commentary of *al-Muwatta*². In the fifth century, the Mālikīs in Andalusia were led by Ibn Rushd al-Hafid (d.595/1198). His work on Islamic law namely *Bidāyah al-Mujtahid* had been recognised as one of the most important manuals in the *fiqh* of disagreement. This is because in his work Ibn Rushd did not only record the opinions of jurists but also explained the reasons behind their disagreement.

During the fifth century Hijri, the Mālikī school in Egypt re-emerged. It was developed by Abū Bakr al-Ṭurṭuṣhī (d.520/1126), one of al-Bājī's students. The school produced a number of great Mālikī jurists such as Ibn al-Ḥajīb (d.646/1248), al-Qarāfī and Khalīl bin Ishāq. The jurists of this school were very loyal to the legal opinions founded by the previous Mālikīs¹⁰³.

Based on the preceding discussion, perhaps we could conclude that the main texts of the Mālikīs in the second century Hijri were *al-Muwatta*², *al-Mudawwanah*, *al-Waḍīhah* and *al-Utbiyyah*. Later, in the third century Ibn Abī Zā'id (d.310/922) from Qairawān produced an important book namely *Nawādhir wal al-Ziyādāt*. The book is significant as it gathers the principles (*al-usūl*) and the substantives (*al-furu'*) rulings of the previous Mālikī masters. The book became the main reference of the Mālikīs until Ibn al-Ḥajīb produced its commentary (*Jamī' al-Ummahāt*) and al-Qarāfī wrote *al-Dhakhīrah* in the middle of the seventh century Hijri. Ibn al-Ḥajīb also wrote *al-Mukhtasar* of the

¹⁰¹ ‘Umar Sulaimān al-‘Ashqar, *al-Madkhal ilā Dirāsāt il- al-Madhāhib wal al-Madāris al-Fiqhiyyah*, pp.150

¹⁰² Ibn Khaldūn, *The Muqadimah An Introduction to History*. vol. 3, pp.16.

¹⁰³ Muḥammad al-Mukhtār al-Māmī, *al-Madhab al-Mālikī, Madārisuhu, Mu‘ālafātuḥu, Khaṣā’isuhu wa Sammātuḥu*, pp. 104.

book *al-Tahdhib* by al-Barāda'ī (a student of Ibn Abī Zā'id). *Al-Tahdhib* was an abridgment of Ibn Abī Zā'id's *Mukhtaṣar lil al-Mudawwanah*. The work of Ibn Ḥajīb was widely accepted by the majority of the Mālikīs. In the following century (eighth), Khalīl bin Ishāq wrote a *Mukhtaṣar* of Ibn Ḥajīb's work. Since then, the *Mukhtaṣar* of al-Khalīl became, *par excellence*, the principal teaching book within the school.

The Early Development of Mālikīs Rules on *Muḍarābah*

In this section, I will investigate the development of *muḍarābah* rules in five early Mālikī texts, namely, *al-Muwaṭṭa'* of Mālik, *al-Mudawwanah al-Kubrā* of Saḥnūn, *al-Kāfī fī Fiqh Ahlul Madīnah* of Ibn 'Abd al-Barr, *Bidāyah al-Mujtahid* of Ibn Ruṣhd and *al-Dhakhīrah* of al-Qarāfī.

As mentioned earlier, *al-Muwaṭṭa'* and *al-Mudawwanah al-Kubrā* became the main reference of the Mālikī law since its early establishment. The former was written in *ḥadīth* narration style whereas the latter was written in problem or *masā'il* style. *Al-Muwaṭṭa'* consists of 20 rules on various issues of *muḍarābah*. This includes the issues of permitted and prohibited activities in the contract, types of accepted capital, conditions (*shurūṭ*), the maintenance of agent-manager and his negligence as well as the method in solving disputes between the contracting parties¹⁰⁴. For examples, Mālik stated that '*the agent-manager has right to use part of capital to cover his nafaqah (maintenance) when he travels which includes foods, clothes and other needs subject to the availability of the capital and in a reasonable manner. If the agent-manager resides with his family there is no maintenance or clothes from the capital*'¹⁰⁵. In my opinion, although the rulings in *al-Muwaṭṭa'* cover various issues, it does not represent the complete *muḍarābah* doctrine of the Mālikī school.

¹⁰⁴ Bājī, Sulaymān ibn Khalāf, *al-Muntaqā sharḥ Muwaṭṭa' Mālik*, Beirut: Dār al-Kutub al-Ilmīyyah, 1999, vol.7, pp.71-128.

¹⁰⁵ Ibid.

On the other hand, the text of *al-Mudawwanah* consists of 69 *muḍārabah* cases study. These cases were extended from the rulings of Mālik in *al-Muwaṭṭaʿ*. I divide the cases into the following sub-topics:

Table 2: Sub-topics of *muḍārabah* cases in *al-Mudawwanah*

No.	Sub-topic	Cases
1	<i>Muḍārabah</i> capital	
	a Types of capital	Dinār, Dirhām, Fulūs, Molten gold and silver, wheat, barley, trust (wadi ^c ah), debt
	b Damages of capital	-Some of the capital damaged and the remaining was invested and bring profit to business - Capital lost before the business commences
	c Commingling of capital	- capital commingle with agent-manager's asset - capital commingle with asset from previous <i>muḍārabah</i>
2.	The nature of <i>muḍārabah</i> business	Supplying leather (as capital) for shoe manufacturing business
3.	Profit ratio	- Agreeing that only one party will receive all profit - Profit ratio for two and more agent-managers - Agreeing that part of the profit will be donated to poor
4.	Maintenance (<i>naḥqah</i>) of agent-manager	Food, accommodation and limitations
5.	The zakah (almsgiving) in <i>muḍārabah</i>	- paying zakah of <i>muḍārabah</i> revenues without the presence of investor
6.	The scope of empowerment for agent-manager	- Appoint agent (<i>wakīl</i>) - Hire assistant - Entrust capital as wadi ^c ah to the other party -Entrust capital to other party in another <i>muḍārabah</i> contract -travelling matters - credit transaction issues - agent-manager breaches investor's rule concerning credit transaction - Defect of the <i>muḍārabah</i> assets - agent-manager buys/sells <i>muḍārabah</i> assets to investor
7.	The role of investor	-Participation of investor in <i>muḍārabah</i> business -Participation of investor's slave in <i>muḍārabah</i> - Restrict agent-manager from selling/buying certain things - Prohibit agent-manager from travelling - Specify agent-manager to deal with certain people only
8.	Dispute between investor and agent-manager	- dispute on the ratio of profit
9.	<i>Muḍārabah</i> with slaves	- Involve different types of slaves (i.e. <i>makātīb</i>) in <i>muḍārabah</i> - Involve <i>muḍārabah</i> with person who ignorance of the <i>ḥukm</i>

		- agent-manager buys investor's slave (as assistant in the business) -agent-manager frees slave using <i>muḍārabah</i> capital
10.	Guarantee in <i>Muḍārabah</i>	-Investor asked agent-manager to guarantee his capital

Saḥnūn enhanced further the discussion of *muḍārabah* in his *al-Mudawwanah al-Kubrā*. He detailed out the rules of the contract found in *al-Muwaṭṭa'*. For example, in describing the types of accepted capital, a general rule was recorded stipulating that '*al-muqāraḍah (muḍārabah) with merchandise is not permitted*'¹⁰⁶. In *al-Mudawwanah*, Saḥnūn elaborated the rules of currencies (*dīnār, dirham, fulūs*), molten gold and silver ingot, wheat, barley, debt and trust (*al-waḍī'ah*) as capital in *muḍārabah*. In addition, the rules of profit distribution are not clearly discussed in *al-Muwaṭṭa'*, but it is explained in *al-Mudawwanah*.

The text of *al-Mudawwanah* also provides evident that the students of Mālik made *ijtihād* based on his rules. For example, Mālik ruled that an agent-manager is entitled for personal expenses when he travels to a place where he does not have any family members. Mālik was asked about a man who conducts *muḍārabah* business in city A in which he does not have any family member, then he travels (for business purpose) to city B which is his home town. According to Mālik, his journey from city A to city B will not be covered, but on his return to city A, he could claim on his personal expenses. Saḥnūn asked Ibn al-Qāsim, if the person has family in both cities A and B. Ibn al-Qāsim ruled that, based on Mālik's principles; the agent-manager is not entitled for travel expenses¹⁰⁷. The example illustrates two main points. First, Mālik's rules had been regarded as the underlying principles for future development, and second, it shows that Ibn al-Qāsim did not merely memorize the rules of Mālik but also make his own *ijtihād*. Such an *ijtihād* expands the school's doctrine.

¹⁰⁶ Ibid.

¹⁰⁷ Saḥnūn ibn Sa'īd al-Tanukhī, *al-Mudawwanah al-Kubrā li al-Imām Mālik bin Anas*, Baghdad: Maktabah al-Muthannā, 1970, vol.5, pp.93.

Beginning from the third century Hijri, the Mālikīs jurists started to produce *mukhtaṣar* of both texts in which they adopted a text book approach. These *mukhtaṣar* recorded the rules of Mālik and his prominent students and were studied by the later Mālikīs. The production of these *mukhtaṣar*, however, has been argued as leading to the wide practice of *taqlīd*. This is because the majority of Mālikīs tend to memorise the rules in *mukhtaṣar* and rarely make new rulings and practise *ijtihād*.

In this context, I will highlight the text of Ibn ‘Abd al-Barr, written in the fourth century Hijri, which in my opinion demonstrates this *taqlīd* phenomenon. One finds that the text is merely the record of rulings from the problems discussed in *al-Mudawwanah*. Nevertheless, although the majority of the Mālikīs seem to be in the *taqlīd* group, there are some others who make much effort to practise *ijtihād*. I examine two texts of jurists which are said belong to this group. The first is *Bidāyah al-Mujtahid* of Ibn Rushd in the sixth century and the second is *al-Dhakhīrah* of al-Qarāfī in the seventh century Hijri.

Kitāb al- Kāfī fī fiqh ahl al-Madīnah of Ibn ‘Abd al-Barr is a good example of *mukhtaṣar* produced by the Mālikī jurists. It seems that the content of the text was heavily influenced by the *al-Mudawwanah al-Kubrā*. Ibn ‘Abd al-Barr recorded the rulings of Mālik and his prominent students without adding any new rulings. The significant change is in the style of presentation of the text. In contrast to the *ḥadīth* narration style in *al-Muwatṭa’* and problem style in *al-Mudawwanah*, the text of *al- Kāfī* was written in a text book style. Perhaps, the text book style was more suitable to facilitating the teaching of Mālikī doctrine to the public. In the text of *al-Kāfī*, the discussion of *muḍārabah* is divided clearly into five sub-topics which are entitled as the permitted and prohibited activities in *muḍārabah* , combined *muḍārabah* (with other contact), rules of void *muḍārabah* , zakāh of *muḍārabah* and negligence in *muḍārabah* . In each

sub-topic, the rules of *muḍārabah* are elaborated with a little explanation of their reasoning¹⁰⁸.

Mālik's rules obviously possessed the highest authority within the school. His rules were narrated by many of his students. It is noticed that in some cases, there is contradictory narration of Mālik's rulings. For example, in the case of a void *muḍārabah* contract, Ibn 'Abd al-Ḥakām ruled that all void *muḍārabah* will be treated as *qirāḍ mithil*. However, according to Ibn al-Qāsim, not all void *muḍārabah* will be treated as *qirāḍ mithil* because in some cases the void contract would be converted into *ujr mithil*. The two jurists claimed that their rules were based on Mālik's own opinions. The difference between the rules is the remuneration of agent-manager (for work has been done) is not guaranteed in *qirāḍ mithil*, as it depends on the profit earned. However, the agent-manager surely will be paid whether the business makes profit or not if a void *muḍārabah* converts into *ujr mithil*. In relation to the conflicting narrations, Ibn 'Abd al-Barr did not make any preference (*tarjīh*) but simply reports the two of them¹⁰⁹.

Kitāb Bidāyah al-Mujtahid is a text that highlights the disagreement among earliest jurists in Islamic law. In general, according to Ibn Rushd, the jurists agreed on the basic element of the *muḍārabah* contract but differ on its details. For example, the jurists unanimously agreed that the empowerment given to the agent-manager is not absolute but restricted. However, they differed in deciding the limitations for the agent-manager in performing his task. Mālik, Abū Ḥanīfah and al-Shāfi'ī had different opinions regarding a credit transaction executed by an agent-manager without obtaining an explicit permission from the investor. Mālik and al-Shāfi'ī disapproved the transaction whereas Abū Ḥanīfah permitted it. Ibn Rushd did not only record the rules made by the jurists but he also provided their justifications and reasonings. The explanation of jurists' justification is vital because with that understanding, people could

¹⁰⁸ Ibn 'Abd al-Barr, *Kitāb al-Kāfi fī Fiqh ahlul Madīnah al-Māliki*, Riyadh: Maktabah al-Riyadh al-Hadīthah, 1980, vol.2, pp.771-779

¹⁰⁹ Ibid.

understand better why the disagreements occurred. In the case of a credit transaction, Ibn Rushd explained that the disagreement occurred because the jurists differed in determining whether the action is a common or rare practice among the public. Abū Ḥanīfah allowed the credit transaction because he believed it was practised widely by the traders. On the other hand, Mālik and al-Shāfi‘ī were of the opinion that the credit transaction was practised occasionally¹¹⁰. It should be noted however, Ibn Rushd did not express his own preference with regard to the jurists’ disagreement. He just presented the different views and explained the reason behind the disagreement and left it to readers to evaluate or decide which rules are more appropriate. In this respect, probably he wanted to encourage *ijtihād* among the later jurists.

In the seventh century Hijri, al-Qarāfi produced *al-Dhakhīrah*. The text is distinctive due to al-Qarāfi's approach that not only presented the rulings of the Mālikīs but attached them with the legal methodology (*usūl al-fiqh*) of the school. In addition to that, al-Qarāfi enhanced further the organization (*taqīm and tabwīb*) of *muḍārabah* topic. The presentation of the topic is sophisticated, even modern in its presentation. It begins with the literal and legal definition of the term *qirad* and continues with discussion on the evidence (*dalīl*) of its permissibility. Al-Qarāfi summarised the rulings of the previous Mālikīs and emerges with the essential elements (*arkān*) and conditions (*shurūṭ*) of the contract¹¹¹.

The Dissemination of the Shāfi‘ī School

In Islamic law history, al-Shāfi‘ī was known as the first jurist who attempted to produce a compromise doctrine between the traditionalists (*aṣhāb al-ḥadīth*) and rationalists (*aṣhāb al-ra‘y*) schools. He tried to mediate between the strict rejections of all human reasoning propounded by the traditionalists and the unrestricted use of personal opinion adapted by the rationalists. Al-Shāfi‘ī

¹¹⁰ Ibn Rushd, Muḥammad ibn Aḥmad, *Bidāyatul Mujaḥid wa Nihāyah al-Muqtasid*, Cairo: Dār al-Salām, 1995, vol. 4, pp.1843.

¹¹¹ Qarāfi, Aḥmad ibn Idrīs, *al-Dhakhīrah*, Beirut: Dār al-Gharb al-Islamī, 1994, vol.6, pp.23-92.

began his *fiqh* study with jurists in Medina. One of his teachers in Medina was Mālik, with whom he studied for nearly 16 years beginning from 163 until 179 Hijri. After Mālik's death, al-Shāfi'ī travelled to Iraq to learn the *fiqh* of the rationalists. He attended circles of many rationalist jurists and debated with them concerning the *fiqh* problems. This included the circle of al-Shaybānī, one of the two great followers of Abū Ḥanīfah. After staying for considerable of time in Iraq, al-Shāfi'ī returned to Mecca to start his circle in *masjid al-harām*. In year 199 Hijri, al-Shāfi'ī migrated to Fustat, Egypt and settled down there until his death. It should be noted however, between the year 195 to 199 Hijri, al-Shāfi'ī made two visits to Iraq¹¹².

Based on his life journey, al-Shāfi'ī's legal rulings were divided into two groups. The first group was known as the old doctrine (*al-madhhab al-qadīm*) which indicates al-Shāfi'ī's rulings in Iraq while the second, called the new doctrine (*al-madhhab al-jadīd*) was his legal rulings in Egypt. The Shāfi'ī jurists ruled that the old doctrine was valid when it does not contradict the new doctrine. However, when both doctrines seem contradict to each other, the new doctrine will overrule the old one.

Al-Shāfi'ī had many students coming from various regions such as Egypt, Iraq and Khurasan. His most famous Egyptian students were al-Buwayṭī (d.231/846), al-Muzanī (d.264/878) and Rabī' ibn Sulaimān al-Murādī (270/884). Based on the *Ṭabaqāt al-fuqahā' al-Shāfi'iyyah* of Ibn Qāḍī Shubah, Kevin Jaques has produced an excellent analysis regarding the position of the three jurists within the Shāfi'īs school. According to Ibn Qāḍī Shubah, al-Buwayṭī was posited as the first rank amongst the three¹¹³. He was described as the closest, most loyal and the most pious student of al-Shāfi'ī. Al-Buwayṭī succeeded al-Shāfi'ī as leader of his circle after his death.

¹¹² 'Alī Jum'ah Muḥammad, *al-Madkhal ilā Dirāsāt –il al-Madhāhib al-Fiḥiyyah*, Cairo: Dār al-Salām, 2007, p. 21-22.

¹¹³ R. Kevin Jaques, *Authority, Conflict and the Transmission of Diversity in Medieval Islamic Law*, Leiden: Brill, 2006, pp.107-111.

After al-Buwayṭī, the leadership of Shāfiʿīs was led by al-Muzanī. Distinct from al-Buwayṭī, al-Muzanī was described as a controversial student of al-Shāfiʿī. This is because many of his rulings appeared to contradict his teacher's legal rulings. Therefore, it was not surprising that some scholars regarded him as an independent jurist (*mujtahid muṭlaq*). However, despite the doubt over al-Muzanī's affiliation to the Shāfiʿīs school, his contribution to the development of the school was the most significant. He wrote *al-Mukhtaṣar* which was a compilation of Shāfiʿī's legal rulings and his own *ijtihād*¹¹⁴. The *Mukhtaṣar* was considered as the most important early text of divergent opinion (*ikhtilāf*) in the school in which the later Shāfiʿīs jurists developed their legal doctrine. The third important student of al-Shāfiʿī was Rabīʿ ibn Sulaimān al-Murādī. He was known as the primary transmitter of *Kitāb al-umm*, the most important al-Shāfiʿī *fiqh* book. The Muslim scholars unanimously believed that al-Shāfiʿī was the original author of the book. Rabīʿ ibn Sulaimān al-Marādī was acknowledged as the compiler of al-Shāfiʿī's writings and named the book according to al-Shāfiʿī's idea.

One of the earliest of al-Shāfiʿī's students in Iraq was al-Karābīsī (d.248/862). He was known for his role in transmitting the old doctrine of al-Shāfiʿī. The new doctrine however was transmitted by al-Anmāṭī (288/902), who was said to have learnt the jurisprudence of Shāfiʿīs from al-Rabīʿ and al-Muzanī in Egypt. The transmission of the new doctrine in Iraq enhanced further during the time of Abū al-ʿAbbās ibn Surayj (306/918), al-Anmāṭī's student. Ibn Surayj was the first jurist who was described as having the chieftaincy within the Shāfiʿīs school in Iraq. He initiated a normal course of advanced study which required his students to produce a *taʿlīqah*, a sort of doctoral dissertation describing Shāfiʿī doctrine¹¹⁵. As graduates from Ibn Surayj's circle began to carry the title “Shāfiʿī”, the dissemination of the *madhhab* became more obvious. One of Ibn Surayj's great students was Abū Ishāq al-Marwazī (d.340/951). He succeeded his teacher as the chief of the Shāfiʿīs in Iraq. Then,

¹¹⁴ ʿUmar Sulaimān al-ʿAshqar, *al-Madkhal ilā dirāsāt il- al-madhāhib wal al-madāris al-fiqhiyyah*, p.171

¹¹⁵ Christopher Melchert, *The Formation of the Sunni Schools of Law, 9th-10th Centuries C.E.*, pp.

the order of the chieftaincy went to al-Dārakī (375/986) and Abū Ḥāmid al-Isfarāyīnī (406/1017)¹¹⁶.

Apart from Iraq, the doctrine of Shāfi‘ī was transmitted largely in Khurasan. According to al-Nawawī, the school of Shāfi‘īs used to categorise into the “jurists of Iraq” and the “jurists of Khurasan”. Based on the principles laid down by Shāfi‘ī, both groups developed their specific method (*ṭarīqah*) in expanding Shāfi‘ī legal doctrine. Al-Nawawī described the *ṭarīqah* of both groups as follows:

The narration of our Iraqi jurists pertaining to the text (*nuṣūṣ*) of al-Shāfi‘ī, his *madhhab* principles and the opinions (*wujūh*) of his early followers is more accurate (*atqan*) and valid (*athbat*) comparing to the narration of Khurasan jurists in general, the Khurasani is better in terms of *taṣarrufan*, research (*baḥthan*), expansion (*tafi‘an*) and systematise (*tartīban*)¹¹⁷.

Muḥammad ibn Nasr al-Marwazī (d. 294/907) and Ibn Khuzaymah (d. 311/924) were among the earliest Shāfi‘īs in Khurasan. They were reported to have travelled to Egypt to learn from al-Shāfi‘ī’s students. After that, the Shāfi‘īs in Khurasan were led by their student namely Abū ‘Alī al-Thaqafī (328/941). Then the sequence of chieftaincy went to Abū Ishāq al-Marwazī, the student of Ibn Surayj of Iraqi group. This suggests that the teachings of Ibn Surayj had influenced the Shāfi‘īs in both regions. After that, the chieftaincy of Shāfi‘īs in Khurasan continued with Abū Bakr al-Qaffāl al-Marwazī (d. 418/1031).

However, according al-Subkī (d. 756/1357), beginning with the period of Abū ‘Alī al-Sanjī, the *ṭarīqah* of Iraqi and Khurasani Shāfi‘īs had been faltering. Being the student of Abū Bakr al-Qaffāl al-Marwazī and Abū Ḥāmid al-Isfarāyīnī, the leader of Khurasanis and Iraqis respectively, Abū ‘Alī al-Sanjī begun to merge the two *ṭarīqah*. His efforts were continued by Imām al-Ḥaramayn (d. 478/1091) who wrote *Nihāyat al-maṭlab fī ‘ilm al-madhhab*. In

¹¹⁶ Christopher Melchert, *The Formation of the Sunni Schools of Law, 9th-10th Centuries C.E.*, pp. 103-106 & ‘Ali Jum’ah Muḥammad, *al-Madkhal ilā Dirāsāt -il al-Madhāhib al-Fiqhiyyah*, pp. 38-39.

¹¹⁷ ‘Ali Jum’ah Muḥammad, *al-Madkhal ilā Dirāsāt -il al-Madhāhib al-Fiqhiyyah*, pp. 40.

this book, Imām al-Ḥaramayn compiled the legal rulings of both *ṭarīqahs* and made *tarjīḥ* between the conflicting opinions. Al-Ghazālī (d.505/ 1118), the student of Imām al-Ḥaramayn, developed further his teacher’s work and since then Shāfi’ī jurisprudence was no longer divided.

In this study, the development of Shāfi’ī rulings on *muḍārabah* is examined based on the four main al-Shāfi’ī texts. The texts are *al-Umm* of al-Shāfi’ī, *al-Muhadhdhab* of Abū Ishaq al-Shīrāzī (d.472/1085), *al-Wajīz* of al-Ghazālī and *Mīnhāj al-Ṭālibīn* of al-Nawawī. These texts represent the Shāfi’ī *madhhab* written in the second (*al-Umm*), fourth (*al-Muhadhdhab*), sixth (*al-Wajīz*) and seventh (*Mīnhāj al-Ṭālibīn*) century Ḥijri. Undoubtedly, for the majority of Muslim scholars, *Kitāb al-Umm* is regarded as Shāfi’ī’s most important text in *fiqh*. They believed that al-Shāfi’ī was the original author of the text. The transmitter of the text, Rabīʿ ibn Sulaymān al-Murādī had been described as faithful and truthful who transmitted al-Shāfi’ī legal rulings without interpretation or manipulation¹¹⁸. However, Calder has raised doubts over the actual authorship of *Kitāb al-Umm*. He argued that the book might be written after the period of Rabīʿ ibn Sulaymān al-Murādī¹¹⁹. For the purpose of this study however, we will assume that *Kitāb al-Umm* represents the legal rulings of al-Shāfi’ī.

Based on al-Shāfi’ī’s text, Abū Ishaq al-Shīrāzī wrote *al-Muhadhdhab*. Abū Ishaq al-Shīrāzī was known for his loyalty to the principles laid down by Shāfi’ī. He had added new legal rulings in his book but they did not diverge from what would have been al-Shāfi’ī’s opinion because they are based on his method. Besides *al-Muhadhdhab*, Abū Ishaq al-Shīrāzī also wrote another important book in *fiqh* namely *al-Ṭanbīh*. On the other hand, *Kitāb al-Wajīz* represented al-Ghazālī’s continuing effort in narrowing the range of divergent opinions within the Shāfi’ī school. The main reference of the book was *Kitāb al-nihāyat al-maṭlab fī ‘ilm al-madhhab* of Imām al-Ḥaramayn, who was al-

¹¹⁸ R. Kevin Jaques, *Authority, Conflict and the Transmission of Diversity in Medieval Islamic Law*, pp.110.

¹¹⁹ Norman Calder, *Studies in Early Muslim Jurisprudence*, Oxford: Clarendon Press, 1993, pp.82.

Ghazālī's teacher. Before writing *al-Wajīz*, al-Ghazālī wrote *al-Basīṭ fī al-madhhab* and *al-Wasīṭ*. In fact, *al-Wajīz* is a condensation of *al-Wasīṭ*, which in turn, is an abridgment of *al-Basīṭ fī al-madhhab*¹²⁰.

Kitāb Minhāj al-Ṭālibīn of al-Nawawī has been regarded almost as the law book par excellence within the Shāfi'ī school. The book is a commentary on the *Muḥarrar* by al-Rāfi'ī (623/1224). Al-Nawawī made improvements from the earlier book by mentioning the divergent opinions not pointed out by al-Rāfi'ī. Furthermore al-Nawawī presented the evidence used by each of the diverging parties and made *tarjih* to indicate which opinion is the most correct¹²¹. The Shāfi'ī books after the seventh/thirteen centuries were mostly based on the commentaries of *Minhāj al-Ṭālibīn*. Among the famous commentaries were *Tuḥfah al-muḥtāj* of Ibn Ḥajar al-Haytamī and *Nihāyah-muḥtāj* of al-Ramlī (d.1004).

The Early Development of Shāfi'īs Rules on *Muḍārabah*

In *Kitāb al-Umm*, the discussion of *muḍārabah* is entitled as *bāb al-qirād*. It is further divided into four sub-topics; (1) the impermissibility of merchandise (*al-urūd*) as capital (2) the stipulated conditions (*al-shurūṭ*) of *muḍārabah* (3) loan (*al-salaf*) in *muḍārabah* and (4) the accounting of *muḍārabah* business.

Al-Shāfi'ī ruled that the merchandise can not be accepted as *muḍārabah* capital. This rule contradicts that of Mālik who was reported to have permitted certain types of merchandise as capital. However, al-Shāfi'ī did not explain the reason behind such prohibition. He only indicated that the *muḍārabah* contract would be render invalid (*fāsīd*) if merchandise was capital. According to him, in an invalid *muḍārabah* the investor would receive the capital and profit if any. However, the investor was obliged to pay current hire wages (*ujr al-mithil*) to the agent-manager for the work had been done.

¹²⁰ R. Kevin Jaques, *Authority, Conflict and the Transmission of Diversity in Medieval Islamic Law*, pp.110.

¹²¹ *Ibid*, pp.232.

With regard to the stipulated conditions (*al-shurūṭ*) of *muḍārabah*, al-Shāfiʿī ruled that the contract would be rendered invalid if the amount of capital was unknown and the duration of the contract was fixed i.e. one year. He explained that the rule against the fixed duration of *muḍārabah* is made to prevent an unknown amount of capital. In his justification al-Shāfiʿī gave an example:

‘if I pay to you one thousand dirham to work on it for a year, then you buy and sell (trading) during the first month and make a profit of one thousand dirham, later for the next trading you will use the one thousand of profit which belongs to me and you; in which I might not agree to participate in the trading. Thus you will use capital which is unknown to me...¹²²

From the example, perhaps we could conclude that the *muḍārabah* from al-Shāfiʿī point of view is carried out on a job basis. It means the contract commences and ends when a single trade (buying and selling) is completed. When both parties wish to continue with other trading activity, another *muḍārabah* arrangement should be agreed.

Al-Shāfiʿī also ruled that it was discouraged (*makrūh*) for the agent-manager who initially took money as *muḍārabah* capital, to ask the investor to amend the contract into a loan contract. Al-Shāfiʿī claimed that he agreed with all Mālik’s rulings concerning the accounting of *muḍārabah*. This however excludes his ruling to permit the absence of the capital during the profit distribution if the agent-manager was deemed as a truthful person.

In my opinion, the discussion of a *muḍārabah* contract in *Kitāb al-Umm* was preliminary in nature. Al-Shāfiʿī can not be regarded as establishing distinct principles of *muḍārabah* since many of his rulings were found to be similar to the earlier jurists. For example, the ruling on the impermissibility of merchandises as capital contradicts Mālik but was similar to the opinion of Abū Ḥanifah and Ibn Abī Laylā. Two centuries after the time of Shāfiʿī, the *muḍārabah* rulings within the school experienced a significant growth. This

¹²² Al-Shāfiʿī, Muḥammad Idrīs, *Kitāb al-Umm*, Beirut: Dār al-Maʿrifah, 1973, vol. 4, pp.9.

development was evident in the *Kitāb al-Muhadhdhab* of Abū Ishāq al-Shīrāzī who organised the discussion of *muḍārabah* into 32 sections. Table 3 below shows the additional topics/issues as compared to the earlier text of al-Shāfi‘ī.

Table 3: Additional topics/issues in *Kitāb al-Muhadhdhab*¹²³

No.	Topics/Issues
1	The terms of the contract; qirāḍ, muḍārabah and any other terms that indicate similar meaning
2	The conditions of <i>muḍārabah</i>
	a. The share of the profit must be agreed in proportion
	b. All contracting parties must share the profit.
	c. The share can not be agreed on a fixed amount of money
	d. The contract can not accept any unknown forthcoming conditions (<i>shart al-mustaqbal</i>)
3	The scope of activity for <i>muḍārabah</i> is limited to trading activities
4	The agent-manager is expected to perform the ordinary business tasks himself
5	Restriction to agent-manager from entrusting the capital to others in another <i>muḍārabah</i> contract without investor's permission
6	The agent-manager should trade with goods that had been specified by the investor
7	Restriction to agent-manager from purchasing goods worth more than the capital
8	Restriction to agent-manager from selling good below the market price and selling in credit without investor's permission
9	Restriction to agent-manager from purchasing slave using the <i>muḍārabah</i> capital without investor's permission
10	Restriction to agent-manager from travelling with <i>muḍārabah</i> capital without investor's permission
11	The disagreement on the issue 'when' the contracting parties have the right to utilise the profit
12	The distribution of the profit can not be executed before the liquidation of the business in case where only one party agreed to do so.
13	The agent-manager was considered liable to the damage of the capital if it was due to his negligence.
14	Both parties have the rights to terminate the contract
15	The contract will be terminated automatically when one of the contracting parties dies or becomes mad
16	Commercial transactions carried out by the agent-manager in an invalid <i>muḍārabah</i> were legally binding. However, the agent-manager had no right of the profit generated from the transactions.
17	Disputes between the investor and agent-manager
	a. Dispute on the damage of the capital
	b. Dispute on the negligence of the agent-manager
	c. Dispute on the returning of the capital
	d. Dispute on the agreed proportion of profit share
	e. Dispute on the amount of the capital
	f. Dispute on the aim of purchasing slave
	g. Dispute on the prohibition to purchase slave
	h. Dispute on the mistake in announcing the <i>muḍārabah</i> profit
No.	Topics/Issues
1	The terms of the contract; qirāḍ, muḍārabah and any other terms that indicate similar meaning
2	The conditions of <i>muḍārabah</i>

¹²³ Abū Ishāq al-Shīrāzī, *Kitāb al-Muhadhdhab fī al-Fiqh madhhab al-Imām al-Shāfi‘ī*, Egypt : Isa al-Babī al-Halabī, 1929, vol.1, p.385-390.

	a.	The share of the profit must be agreed in proportion
	b.	All contracting parties must share the profit.
	c.	The share can not be agreed on a fixed amount of money
	d.	The contract can not accept any unknown forthcoming conditions (<i>sharḥ al-mustaqbal</i>)
3		The scope of activity for <i>muḍārabah</i> is limited to trading activities
4		The agent-manager is expected to perform the ordinary business tasks himself
5		Restriction to agent-manager from entrusting the capital to others in another <i>muḍārabah</i> contract without investor's permission
6		The agent-manager should trade with goods that had been specified by the investor
7		Restriction to agent-manager from purchasing goods worth more than the capital
8		Restriction to agent-manager from selling good below the market price and selling in credit without investor's permission
9		Restriction to agent-manager from purchasing slave using the <i>muḍārabah</i> capital without investor's permission
10		Restriction to agent-manager from travelling with <i>muḍārabah</i> capital without investor's permission
11		The disagreement on the issue 'when' the contracting parties have the right to utilise the profit
12		The distribution of the profit can not be executed before the liquidation of the business in case where only one party agreed to do so.
13		The agent-manager was considered liable to the damage of the capital if it was due to his negligence.
14		Both parties have the rights to terminate the contract
15		The contract will be terminated automatically when one of the contracting parties dies or becomes mad
16		Commercial transactions carried out by the agent-manager in an invalid <i>muḍārabah</i> were legally binding. However, the agent-manager had no right of the profit generated from the transactions.
17		Disputes between the investor and agent-manager
	a.	Dispute on the damage of the capital
	b.	Dispute on the negligence of the agent-manager
	c.	Dispute on the returning of the capital
	d.	Dispute on the agreed proportion of profit share
	e.	Dispute on the amount of the capital
	f.	Dispute on the aim of purchasing slave
	g.	Dispute on the prohibition to purchase slave
	h.	Dispute on the mistake in announcing the <i>muḍārabah</i> profit

As indicated in table 3, the *muḍārabah* rules were improved mainly in three topics: (1) the stipulated conditions of *muḍārabah* (2) the empowerment of agent-manager and (3) the dispute between the investor and agent-manager. The rules regarding the conditions of *muḍārabah* were mostly related to the profit share. It was stipulated that the profit share should be agreed in proportion i.e. one-third. If the contracting parties agreed on a fixed amount of profit i.e. 100 dirham, the contract would be invalid. This condition was forbidden because the total profit probably would be only 100 dirham, leaving only the investor receiving the profit. Furthermore, it was ruled that the profit in *muḍārabah* contract must be shared by all the contracting parties. Similar to the

sale (*bayʿ*) and hire (*ijārah*) contracts, the *muḍārabah* can not accept any unknown forthcoming conditions (*sharṭ al-mustaqbal*).

The text of al-Shīrāzī also elaborated the extent to which the agent-manager was empowered. The text clearly demonstrated that the empowerment was not absolute but restricted. Al-Shīrāzī ruled four restrictions to be placed upon on the agent-manager in managing the capital. The rules asserted that without having explicit permission from the investor, the agent manager was not allowed to (1) entrust capital to others in another *muḍārabah* arrangement (2) purchase goods worth more than the capital (3) sell things below the market price and (4) travel with the capital.

Another important development of *muḍārabah* rulings found in al-Shīrāzī's text was the discussion regarding the dispute between the investor and the agent-manager. Perhaps, the inclusion of this topic indicates that the *muḍārabah* had been practised widely and many cases of dispute had been brought to the court. The dispute could occur when both parties conflicted over the issues of (1) the damage of the capital (2) the negligence of agent-manager (3) the returning of capital (4) the agreed proportion of profit share (5) the amount of capital (6) the aim in purchasing slaves (7) the prohibition to purchase slaves and (8) the mistake in declaring profit. Apart from the development of the rulings, al-Shīrāzī was the first who demonstrated the evidence of *muḍārabah* based on the *athar* of 'Umar al-Khaṭṭāb.

Undoubtedly, al-Shīrāzī had made significant improvements on the *muḍārabah* rulings. Perhaps, al-Shīrāzī had covered all main topics in the *muḍārabah* practices. This fact became more obvious when we compare al-Shīrāzī's text with the text of *al-Wajīz* of al-Ghazālī. It was found that al-Ghazālī just added a few rulings from what were found in the text of al-Shīrāzī. However, *al-Wajīz* was different from *al-Muhadhdhab* in terms of the structural discussion of the *muḍārabah* topic. In other words, al-Ghazālī summarised all rulings made by the previous generations of jurists and organised the topic in a systematic way.

The presentation of *muḍārabah* contract in *Kitāb al-Wajīz* is shown in table 4.
Table 4: *Muḍārabah* contract in *Kitāb al-Wajīz*¹²⁴

No.	Section One: The Essential Element (<i>rukʿn</i>)	
1.	The Capital	
	a.	Should be in monetary (<i>naqḍān</i>)
	b.	Should be specific (<i>muʿayyān</i>)
	c.	Should be known (<i>maʿlūmān</i>)
	d.	Should be delivered to the agent-manager (<i>musallamān</i>)
2.	The Work	
	a.	Should be trading activities (<i>tijārah</i>). Trading was defined as obtaining profit from the act of buying and selling. It excluded the craft and manufacturing activities.
	b.	Free from any restrictions that cause difficulty to the agent-manager in conducting the business, i.e. restrict the agent-manager to trade with only a particular person.
	c.	Unfixed duration
3.	The Profit	
	a.	Should be exclusively for the two parties (<i>makhṣuṣān</i>)
	b.	Should be shared (<i>musytarak</i>)
	c.	Should be known to all contracting parties (<i>maʿlūmān</i>)
	d.	Should be agreed in proportion (i.e. one-third) and not a fixed money such as 100 dirham
4.	The Form of Expression (<i>ṣiġḥah</i>)	
	The acceptable forms included <i>qāraḍtuka</i> or <i>ḍārabtuka</i> or <i>ʿāmltuka</i> <i>ʿalā</i> <i>ʿanna al-rabha bainanā</i>	
5& 6	The contracting parties (the investor and the agent-manager)	
	The relationship between the two parties is based on the agency (<i>wakālah</i>) contract	
No.	Section One: The Essential Element (<i>rukʿn</i>)	
1.	The Capital	
	a.	Should be in monetary (<i>naqḍān</i>)
	b.	Should be specific (<i>muʿayyān</i>)
	c.	Should be known (<i>maʿlūmān</i>)
	d.	Should be delivered to the agent-manager (<i>musallamān</i>)
2.	The Work	
	a.	Should be trading activities (<i>tijārah</i>). Trading was defined as obtaining profit from the act of buying and selling. It excluded the craft and manufacturing activities.
	b.	Free from any restrictions that cause difficulty to the agent-manager in conducting the business, i.e. restrict the agent-manager to trade with only a particular person.
	c.	Unfixed duration
3.	The Profit	
	a.	Should be exclusively for the two parties (<i>makhṣuṣān</i>)
	b.	Should be shared (<i>musytarak</i>)
	c.	Should be known to all contracting parties (<i>maʿlūmān</i>)
	d.	Should be agreed in proportion (i.e. one-third) and not a fixed money such as 100 dirham
4.	The Form of Expression (<i>ṣiġḥah</i>)	
	The acceptable forms included <i>qāraḍtuka</i> or <i>ḍārabtuka</i> or <i>ʿāmltuka</i> <i>ʿalā</i> <i>ʿanna al-rabha bainanā</i>	
5& 6	The contracting parties (the investor and the agent-manager)	
	The relationship between the two parties is based on the agency (<i>wakālah</i>) contract	

¹²⁴ Ghazālī, Muḥammad Abū Ḥamīd, *al-Wajīz fī fiqh madhhab al-Imām al-Shāfiʿī*, Beirut : Dār al-Maʿrifah, 1997, vol. 1, pp.221-223.

As indicated in table 4, al-Ghazālī concludes that there are six essential elements (*rukn*) of a *muḍārabah* contract. They are capital, work, profit, form of expression (*ṣiġḥah*) and contracting parties (investor and agent-manager). In each of these essential elements, there are stipulated conditions (*shurūṭ*) to be met. Clearly, al-Ghazālī's *muḍārabah* model was derived from the rulings of the previous jurists. It is noticed that al-Ghazālī's only added two new rulings; first the condition stipulating that the capital must be in the possession of the agent-manager and second, the work in *muḍārabah* is defined as purely trading activity; the act of selling and buying for profit.

In the seventh century Hijri, al-Nawawī improved further the discussion on *muḍārabah*. From his time onwards, the Shāfi'īs have a clear definition of *al-qirāḍ* or *muḍārabah*. In his *Minhāj al-Ṭālibīn*, al-Nawawī defined *muḍārabah* as a contract whereby money is paid to agent-manager to be traded with and profit is to be shared. Another text of al-Nawawī (*al-Majmū' sharḥ al-Muhaddhab*) is also significant in the sense that it highlights the divergence of opinions (*ikhtilāf*) amongst the Shāfi'īs jurists. A case in point is when investor said to agent manager 'I give you money as *muḍārabah* but all profit will belong to me' or he said 'I give you money as *muḍārabah* and all profit is for you'¹²⁵. According to al-Shīrāzī when such conditions are stipulated, the contract is void. In the first, the contract will automatically change to *biḍā'ah* contract whereas the second turn to loan (*qarḍ*) contract. More importantly, al-Shīrāzī argued as if the rule is unanimously agreed by the Shāfi'īs jurists¹²⁶. Al-Ghazālī followed the same approach of al-Shīrāzī by emphasising that the profit must be shared (*mushtarak*)¹²⁷. However, according to al-Nawawī, the Shāfi'īs jurists disagreed in that matter. Some of the Shāfi'īs jurists permit both kinds of conditions.

To conclude, I find that the rules of *muḍārabah* in *Kitāb al-Umm* of al-Shāfi'ī are preliminary in nature. Although al-Shāfi'ī had ruled various aspect of the

¹²⁵ Sharbīnī al-Khaṭīb, Muḥammad ibn Muḥammad, *Mughnī al-muhtāj ilā ma'rifah ma'āni al-alfāz al-minhāj*, Cairo : Maṭba'at Mustafā al-Bābī al-Halabī, 1958, vol.2, pp.312.

¹²⁶ Shīrāzī, *Kitāb al-Muhaddhab fī al-Fiqh madhhab al-Imām al-Shāfi'ī*, pp.385.

¹²⁷ Ghazālī, *al-Wajīz fī fiqh madhhab al-Imām al-Shāfi'ī*, pp.222.

muḍārabah but yet it would be exaggerate to claim that he had founded the fundamental principles of the contract. Hence, I argue that the *muḍārabah* rulings of the Shāfi'īs school were developed after the lifetime of al-Shāfi'ī. Based on the analysis of al-Shīrāzī's *al-Muhadhdhab*, I suggest that this development happened extensively in particular during the fourth/tenth centuries. The text of al-Shīrāzī covered all important rulings which became the basis of *muḍārabah* doctrine of the school. The jurists in the following centuries did not produce significant new rulings but they did improve and refine the *muḍārabah* discussion. Al-Ghazālī presented the discussion in a systematic way. He analysed all the rulings of the previous jurists and come out with the structure i.e. the essential elements (*arkān*) and stipulated conditions (*shurūḥ*) of the *muḍārabah* contract. However, the approach in the writings of al-Shīrāzī and al-Ghazālī are identical in the sense that both jurists tried to demonstrate an agreed Shāfi'īs rulings on the *muḍārabah* contract. In contrast, al-Nawawī's texts comprise of divergent opinions (*ikhtilāf*) within the school. He also initiated the Shāfi'ī definition of the term *muḍārabah*.

The Dissemination of the Ḥanbalī School

As discussed earlier, during the early second century Hijri, Muslim jurists were divided into two main schools; *aṣḥāb al-ra'y* (rationalists) and *aṣḥāb al-ḥadīth*. One of prominent personalities of the *aṣḥāb al-ḥadīth* was Aḥmad Ibn Ḥanbal, the eponym of the Ḥanbalī school. Ibn Ḥanbal was born in Arab family who had actively participated in the Muslim conquest of Iraq and Khurasan. His father died while serving as army in the city of Marw, when he was three years old. Since then, Ibn Ḥanbal was brought up by his mother in Baghdad.

Ibn Ḥanbal was undeniably a traditionist. He devoted himself to study *ḥadīth* since he was sixteenth years old. However, it should be noted that before Ibn Ḥanbal started his quest for *ḥadīth*, he was one of the students of Abū Yūsuf. For some reasons, the legal reasoning taught by the Ḥanafīs master did not attract Ibn Ḥanbal rather he found himself more interested in studying the *ḥadīth* criticism (*ʿulūm al-ḥadīth*). Hence, he left the circle of Abū Yūsuf and

travelled to the cities of Kufah, Basrah, Mecca, Medina, Yemen and Syria to collect and preserve *ḥadīth*. Among the famous traditionists whom he visited and learned from were ‘Abd al-Razzāq (d.211/812) in Yemen and Sufyān ibn ‘Uyaynah in Mecca.

The framework of *ḥadīth* criticism was heavily adapted by Ibn Ḥanbal when developing his legal doctrine. He profoundly upheld the authority of the Qur’ān and *ḥadīth* by inferring rules as directly as possible to the textual evidence from both sources. He only ruled the non-controversial matter and refused to give rules on problems in which conflicting of traditions were reported¹²⁸. Based on the principles laid down by Ibn Ḥanbal, the Ḥanbalī school was known for their dependence on *ḥadīth* through *isnād* comparison methodology. In addition to the strident advocacy of *ḥadīth*, the Ḥanbalīs jurists declined to use personal opinion widely in deducing new legal rulings. Their tendency is to let the Quranic verses or *ḥadīth* speak the rules themselves without involving in argumentative discussions.

However, such a strict methodology had slowly changed beginning from the fourth century Hijri. As observed by Melchert, this transformation happens as response to the change of methodological approach adopted by jurists of the other schools of law. Before, the Ḥanbalīs jurists did not study *ḥadīth* separately from *fiqh*. However, when the jurists of other schools begin to incorporate extensively *ḥadīth* in their legal texts, the Ḥanbalīs jurists begin to accept the need for separate expertise in *fiqh* and *ḥadīth* criticism. They realised that it was no longer sufficed for them to know volumes of *ḥadīth* but they need to obtain the knowledge of *usul fiqh* (legal methodology) as well¹²⁹.

¹²⁸ Susan A. Spector, Ahmad ibn Ḥanbal’s Fiqh, *Journal of The American Oriental Society*, vol. 102, no. 3, Jul-Oct 1982, pp. 461-465.

¹²⁹ Christopher Melchert, Traditionist-Jurisprudents and the Framing of Islamic Law, *Islamic Law and Society*, Leiden: Brill. 2001, vol.8, no.3, pp. 383-406.

According to Ibn Khaldūn, the followers of the Ḥanbalīs *madhhab* were smaller as compared to the Ḥanafīs, Mālikīs and Shāfi'īs¹³⁰. The *madhhab* did not expand beyond Iraq and Syria regions. The main centre of the Ḥanbalīs from the middle of the second to the end of the fifth century Hijri was Baghdad. From among the numerous jurists whose names have been preserved in *ṭabaqāt* work, I shall cite here some of official Hanbalīs account of its early spread in the city. They were the two sons Ibn Ḥanbal namely Sālih (d.266/879) and 'Abd Allāh (d.290/903), Abū Bakr al-Athrām (d.260/873-4), Ḥanbal bin Ishāq (d.273/886), Abū Dāud al-Sidjastāni (d.275/887) and Abū Bakr al-Marwāzī (d.275/887). These jurists were the narrators of *al-Masā'il* which is the collection of Ibn Ḥanbal's responses to problems put forward during his circle. It should be noted that Ibn Ḥanbal actually did warn his followers from writing down his rulings. He refused to risk his rulings to become authoritative and superior to the Qur'ān and *ḥadīth*¹³¹. Despite the command, the *masā'il* was regarded as one of the earliest texts attributed to Ibn Ḥanbal particularly in formulating his legal doctrine. However, the problem with the text is that it has many versions in which they are very different from one another.

The systematic collection of Ibn Ḥanbal's legal doctrine was produced during the time of Abū Bakr al-Khallāl (d.311/923). Abū Bakr al-Khallāl travelled to many places to meet up the students of Ibn Ḥanbal and gathered his rulings in the text named *al-Jāmī'*. The rulings were recorded with a chain of narrators (*isnād*)¹³². Al-Khallāl's work has been well appreciated by the later Ḥanbalīs and was recognised as the fullest possible sources of Ibn Ḥanbal's *fiqh*. After that, Abū al-Qāsim al-Khiraqī (d.334/945) wrote the first legal manual (*mukhtaṣar*) of the Ḥanbalīs. It was claimed that the *mukhtaṣar* of al-Khiraqī had been commented by more than three hundred jurists. However, the most significant commentaries are the commentary of *qādī* Abū Ya'lā (d.458/1066)

¹³⁰ Ibn Khaldūn, 'Abd al-Raḥmān ibn Muḥammad, *the Muqaddimah, an Introduction to History*, pp.3-9.

¹³¹ Laoust, H. "Aḥmad ibn Ḥanbal." *Encyclopaedia of Islam, Second Edition*. Edited by: P. Bearman, Th. Bianquis, C.E. Bosworth, E. van Donzel and W.P. Heinrichs. Brill, 2008. Brill Online. EXETER UNIVERSITY. Accessed on 18 December 2008.

¹³² 'Abd al-Qadīr b. Badrān, *al-Madkhal ilā Madhhab Ibn Ḥanbal*, 'Abd Allāh b. Muḥsin (editor), Beirut: Mu'asasah al-Risālah, 1981, pp. 124.

and *al-Mughnī* of Ibn Qudāmah. The commentary of Abū Yaʿlā was smaller than *al-Mughnī* of Ibn Qudāmah. This is because Abū Yaʿlā only commented the exact text of al-Khiraqī's *mukhtaṣar* whereas Ibn Qudāmah added discussion of new positive legal rulings (*furūʿ*). In addition to that, Ibn Qudāmah included the rules of other *sunni* jurists who contradicted to the Ḥanbalis and discussed their disagreement¹³³.

Ibn Qudāmah appeared to be a prolific Ḥanbalī jurist of his time. Besides *al-Mughnī* he composed three other Ḥanbalī texts namely *al-Umdah*, *al-Muqniʿ* and *al-Kafī*. Based on the contents and the writing style of the texts, it was viewed that they were written for the different level of Ḥanbalī followers. *Al-Umdah* was written for early stage of student in Islamic law, presumably with little knowledge of the Ḥanbalī legal doctrine. The text listed the core rules of the Ḥanbalī *madhhab* without any discussion of their legal evidences (*dalīl*). The second text, *al-Muqniʿ* comprises of more positive legal rules with a modest explanation of the legal evidences and legal justification (*taʿlīl*). It is claimed that the text was suitable for the Ḥanbalī who are neither the early nor the middle levels. The third text, *al-Kafī* was written for the middle level Ḥanbalī whom are labelled as *mujtahid* within the *madhhab*. The text emphasises more on discussion of the legal evidence used by the Ḥanbalī jurists¹³⁴. The highest level text was *al-Mughnī* in which it presented the disagreement between different schools of Islamic law.

Ibn Taymiyyah (d. 728/1328) emerged in the early eight century Hijri. His affiliation to the Ḥanbalī school however, has become a subject of interest among contemporary researchers. Some view that he was a Ḥanbalī who at later stage became absolutely independent jurist and capable of forming his own school. The others consider him a loyal Ḥanbalī right until the end of his

¹³³ Ibid, pp. 426.

¹³⁴ ʿUmar Sulaymān al-Ashqar, *al-Madkhal ʿilā Dirāsāt -il al-Madhhab wa al-Madāris al-Fiqhiyyah*, pp. 191.

life. Since the subject is beyond the scope of this study, my viewpoint in this matter is based on a study conducted by al-Matroudi¹³⁵.

Based on comparison of the general principles and sources of law employed by Ibn Ḥanbal and Ibn Taymiyyah, al-Matroudi concludes that the latter was affiliated to the school of the Ḥanbalīs. However, Ibn Taymiyyah's loyalty to the school doctrine was lower as compared to other Ḥanbalī jurists. Ibn Taymiyyah contradicted Ibn Ḥanbal in many issues such as in his *fatwā* concerning the 'triple divorce'. He also criticised some rulings of later Ḥanbalīs which he believed had been influenced by innovation resulting from the misuse of *maṣlahah* principles, invalid analogy and creative method of *fiqh* writing¹³⁶.

Ibn Taymiyyah left considerable amount of notable treatises in *fiqh* such as *al-Muḥarrar* and the *fatāwā* of Ibn Taymiyyah. The latter have been collected in various compilations such as *Majmū' al-Fatāwā*, *al-Fatāwā al-Kubrā*, *al-Fatāwā al-'Iraqiyyah* and *Majmū' al-Rasā'il*. Nevertheless, because of his controversy, none of his great treatises are examined in this study.

The Early Development of Ḥanbalīs Rules on *Muḍārabah*

The development of Ḥanbalīs rules on *muḍārabah* is examined in the four legal texts. They are *Masā'il* Ibn Ḥanbal, *Mukhtaṣar* al-Khiraqī, *al-Mughnī* of Ibn Qudāmah and *al-Furū'* of Ibn Muflaḥ (d.763/1362). The *Masā'il* only recorded two responses of Ibn Ḥanbal relating to the *muḍārabah* issue. The first response is regarding the transgression of agent manager. Ibn Ḥanbal ruled that if agent manager appeared to have breach the contract agreement, all profit generated from the business will be given to the investor. The agent manager will be paid a reasonable hire wage (*ujr mithil*) for the work had been done. However, if the business suffer losses, the agent manager will be liable to replace the capital. The second response is pertaining to the question whether merchandises (*al-*

¹³⁵ Abdul Ḥakim I. al-Matroudi, *The Ḥanbali School of Law and Ibn Taymiyyah Conflict or Conciliation*, London: Routledge, 2006.

¹³⁶ *Ibid*, pp.186-191.

urūḍ) can be accepted as capital in the contract. Interestingly, the *Masā'il* which I refer to (the narration of Ishāq b. Mansūr al-Marūzī d.251), did not provide answer to the question. Ibn Ḥanbal's view in the matter was taken from another version of the text¹³⁷.

Having reviewed the note of *muḍārabah* in the *Masā'il*, I personally think that it represents a far less than preliminary discourse of Ḥanbalī's doctrine on the contract. In terms of the subject contents, the discussed issues did not give clear indication of the *muḍārabah* salient features. The two rules recorded in the *Masā'il* represent only negligible section of vast practical issues of the contract. Besides, the *Masā'il* also lack of juristic clarification as the responses of Ibn Ḥanbal were stipulated in very brief statements. Hence, as far as *muḍārabah* contract is concerned, I think the *Masā'il* can not be regarded as the main source that established the fundamental principles of Ḥanbalī doctrine for later development.

Approximately a century later, al-Khiraqī emerged with his legal manual (*mukhtaṣar*) of the school. Although the *mukhtaṣar* did not represent a complete doctrine, it comprised fundamental elements of the *muḍārabah*'s discussion. Al-Khiraqī elucidated the rules under the chapter of *shīrkaḥ* (partnership) contract. He probably the first Ḥanbalī jurist who expounded the theory that *muḍārabah* was legitimised in conformity with the analogy (epistemology discussion elaborated in detail in chapter 2). Al-Khiraqī described 9 problems (*mas'alah*) of the contract in which Ibn Qudāmah in his *al-Mughnī* expanded them into 41 sections (*fuṣūl*). The summary of the *mas'alah* and *fuṣūl* are shown in table 5:

¹³⁷ Aḥmad ibn Ḥanbal, *Masā'il al-Imām Aḥmad Ibn Hanbal wa Ishāq b. Ruwayyah* narrated by Ishāq b. Mansūr al-Marūzī, Medina: Saudi Arabia, 2004.

Table 5 : The development of *muḍārabah* rules in *al-Mughnī*

No.	Al-Khiraqī's text (<i>mas'alah</i>)	Ibn Qudāmah's clarification (<i>fusūl</i>)	
1.	Profit is distributed according to pre-agreed ratio	1.	Issue in the determination of agent manager's share
		2.	Issue where profit ratio was not spelled out in proportionate division
		3.	Issue in which profit will be only received by one party
		4.	Mudārabah contract of multiple agent managers
		5.	Mudārabah contract of multiple investors
		6.	Allocating profit to third party
		7.	Mudārabah becomes invalid if agent manager is guaranteed with profit
2.	Agent manager will become liable (ḍāman) if he makes credit transaction in one of the narrations. The other narration says that he is not liable.	8.	Travelling issue of agent manager
		9.	Agent manager is perceived as <i>wakīl</i> (agent) in managing investor's money
		10.	Can agent manager buy things using foreign currency?
		11.	Can agent manager buy defect items?
		12.	The purchase of slave with the intention to free him/her without permission from the investor
		13.	Various other issues pertaining to purchasing of slave using <i>muḍārabah</i> capital
		14.	Agent manager purchases something valued more than the capital
		15.	Issues concerning sexual intercourse of agent manager and slaves bought using <i>muḍārabah</i> capital
		16.	Agent manager entrusts the capital to others without having investor's permission
		17.	Agent manager commingles the capital with other funds
		18.	Agent manager purchases alcohol and pork
3.	If an agent manager had agreed to work on <i>muḍārabah</i> contract with someone, he can not engages another <i>muḍārabah</i> with others, especially if the second contract cause harm to the first venture.	19.	Various issues dealing with agent manager who involved in multiple <i>muḍārabah</i> business
		20.	Agent manager has right to conduct <i>muḍārabah</i> business himself based on custom (<i>'urf</i>) principles.
		21.	Issue in which capital was stolen
		22.	Issue in which slave bought for <i>muḍārabah</i> was murdered by another slave
4.	There is no profit for <i>muḍārabah</i> until the capital has been restored.	23.	Case where capital is 100 and loss is 10. Then the investor takes the 10.
		24.	Case in which investor uses capital to purchase thing for his own purpose
5.	Agent manager purchases two sale items in which he earns profit for one and makes loss for the other.	25.	Investor who engages into <i>muḍārabah</i> contract while in dying condition
		26.	Investor dies during the <i>muḍārabah</i> contract
		27.	Agent manager dies and nobody knows the owner of <i>muḍārabah</i> capital which is in his possession
6.	When agent manager expects profit from <i>muḍārabah</i> business, he is not allowed to take the profit without permission from the investor	28.	Case where one of the contracting parties wants to divide the expected profit whereas the other refuses
		29.	<i>Muḍārabah</i> is one of the contract of <i>al-jā'izah</i> ; could be terminated at any time by either of the contracting parties.
		30.	<i>Muḍārabah</i> contract was terminated in which the business bear debt.

		31.	<i>Muḍārabah</i> would be terminated if one of the contracting parties dies or become mentally unstable.
7.	Case where investor and agent manager agreed to collectively share the profit and the monetary loss.	32.	Conditions (<i>shurūf</i>) in <i>muḍārabah</i>
		33.	<i>Muḍārabah</i> with fixed duration limit
		34.	Agent manager imposed condition to support his maintenance (<i>nafqah</i>).
		35.	Invalid conditions are classified into three types
		36.	Explanation on the rules of invalid <i>muḍārabah</i>
8.	Case <i>hiwālah</i> (transfer of debt) in <i>muḍārabah</i> .	37.	<i>Muḍārabah</i> capital should be known and precisely determined
		38.	Case where a person brought two bags of money and said that I invest one of them
9.	The acceptability of property in safekeeping as <i>muḍārabah</i> capital	39.	The investment of money obtained from extortion.
		40.	Agent manager is perceived as trustworthy person
		41.	Disputes in <i>muḍārabah</i>

Obviously, the rules of *muḍārabah* were developed significantly during the time of Ibn Qudāmah. He expanded the previous discussion on *muḍārabah* to certain extends achieved its maturity level. The 41 *fusūl* resemble all important rulings of the contract within the context of medieval commercial dealings. Therefore, I conclude that the Ḥanbalī rules on this subject became complete during the late sixth century Hijri. In order to verify this premise, we will investigate further the discussion of the contract in later Ḥanbalī jurists' writing. In this regard, we will examine the text *al-Furū'* of Ibn Muflaḥ.

As compared to the *al-Mughnī*, the discussion of *muḍārabah* contract in *al-Furū'* is more concise. In elaborating the Ḥanbalī rules of *muḍārabah*, Ibn Muflaḥ emphasised two topics (profit and empowerment of agent manager). Among the issues of profit addressed were the cases of unspecified profit ratio and distribution of profit while the business remains. The discussed problems relating to the empowerment of agent manager involved the questions to what extend an agent manager was allowed to make bussines travel, purchase, hire and held responsibility in managing the investor's money¹³⁸. It is found that all the rules asserted by Ibn Muflaḥ were repetitive to the rules expounded by Ibn Qudāmah. Besides, the rules are stipulated without explaining their justifications. Nevertheless, the text *al-Furū'* is still worth reviewing as it contains a lot of inter-disagreement within the school. Ibn Muflaḥ exemplified

¹³⁸ Abdullah Muḥammad b. Muflaḥ al-Maqdisī, *al-Furū'*, Beirut: 'Ilam al-Kutūb, 1985, vol. 4, pp.383.

all different narrations and opinions of later Ḥanbalīs and made *tarjih* between them.

***Muḍārabah* in the Contemporary Juristic Writings**

The previous discussions show the growth of *muḍārabah* doctrine from the period of the second until the eighth century Hijri. From the discussions, we know that despite varying in their phases of development, all of the four *Sunni* schools had a comprehensive doctrine by the end of the sixth century Hijri. These classical rules were believed to be the references in governing the *muḍārabah* practices of the medieval period.

With the re-introduction of the *muḍārabah* in the Islamic banks since 1970's, one will likely to wonder whether the modern jurists had enhanced the classical doctrines when adapting them to the modern banking business environment. Have the modern jurists incorporated the recent application of the *muḍārabah* contract in their writings? The investigation on this issue brings me to the review of three works of the modern jurists. They are *Fiqh al-Islāmī wa-Adillatuh* of Wahbah al-Zuḥaylī, *Fiqh al-Sunnah* of Sayyid Sābiq, and *Fiqh al-Manhājī 'alā Madhhab al-Shāfi'* of Muṣṭafā al-Khin, Muṣṭafā al-Bughā and 'Alī al-Sharbajī. These books were written based on different writing methods and approaches. Wahbah al-Zuḥaylī wrote his book using the *fiqh* comparison method in which *muḍārabah* rules were explained by highlighting the classical jurists' disagreement. Meanwhile Sayyid Sābiq who was influenced by the *salafī* movement¹³⁹, attempted to produce a *fiqh* doctrine that tied its rules as directly as possible to *sunnah*. The third book was produced by a group of contemporary Shāfi'ī scholars who aim to provide a simple but comprehensive Shāfi'īs' legal doctrine for current Shāfi'īs.

¹³⁹ Established to institute religious behaviour and practices that capture the purity of Islam, as understood by the *salāf* (early Companion of the Prophet). This group asserts that all Muslims actions must be based upon the Qur'ān and sunnah. For detail discussion, see Quitan Wiktorowicz, The Salafi Movement in Jordan, *International Journal of Middle East Study*, 32 (2000), 219-240.

As far as the subject coverage is concerned, Wahbah al-Zuhaylī's work represents the most comprehensive discussion on the *mudārabah* contract. He adopts al-Kāsānī's approach and describes the rules within the classification of unrestricted and restricted contract (*muḍārabah muṭlaqah* and *muḍārabah muqayyadah*). The classification has influenced many contemporary scholars when writing the *fiqh* aspect of Islamic banking and finance¹⁴⁰. The classification also has been adopted widely by the Islamic bankers in designing their investment products. However, in terms of the development of new rulings, Wahbah's work is less significant. The rules discussed in his book are merely compilation of the classical jurists' rulings. There is no serious attempt being made to make *ijtihād* in relation to the modern application of the *muḍārabah* in the Islamic banks. Perhaps, the only new contribution of Wahbah in this subject is his remark on whether various forms of contemporary corporations could be regarded as applying the *muḍārabah*. Interestingly, he views that none of the modern corporations are established exactly under the principles of the contract. For instance, he asserts that the joint-stock company is created through the application of hybrid contracts (not solely on *muḍārabah* as generally assumed). This is because the shareholders might be considered as *rabb al-māl* (investors) but the managers and employees are regarded as workers who work for fixed wages (under hire-wages employee contract)¹⁴¹.

Sayyid Sābiq discusses the rules of the *muḍārabah* in much more concise manner. His method of writing consists of the following discussion outlines: definition, legal evidences, rationale of permissibility, essential elements (*arkān*) and conditions (*shurūṭ*). He analyses the rules by adopting non-affiliation of *madhhab* approach. As such, most of the rules are presented in undisputed style. It should be noted however, the undisputed style is fairly maintained throughout the book because the writer avoids the detailed discussions pertaining to the practical issues of the contract. For example, in elucidating the scope of empowerment of an agent manager, Sayyid Sābiq

¹⁴⁰ See for example, *An Introduction to Islamic Finance* of Muḥammad Taqī Usmani, Karachi, 1998.

¹⁴¹ Wahbah al-Zuhaylī, *al-Fiqh al-Islāmī wa Adillatuh*, Damascus: Dār al-Fikr, 1997, vol. 5, pp.3930.

briefly stated that ‘*when the contract of muḍārabah was agreed and the agent manager possessed the capital; he was perceived to be a trustworthy person. He would not be liable unless for his negligence*’¹⁴². He did not elaborate in detail what is meant by the word negligence. What are the activities allowed and prohibited for an agent manager? These were the issues with which the classical jurists had differed. Furthermore, in relation to our purpose of investigation, *Fiqh al-Sunnah* does not bring any enhancement of the classical *muḍārabah* doctrine. The *muḍārabah* rules in the book are basically the collection of agreed or standard rulings of the medieval jurists.

A similar finding is found when reviewing the third book, *Fiqh al-Minhājī ‘alā Madhhab al-Shāfi‘ī*. The application of the *muḍārabah* in the contemporary banking sector does not attract the writers' attention. Rather they maintain the approach of not involving in the *ijtihādī* discussion and simply narrate the classical Shāfi‘ī's doctrine. Moreover, some of the classical rules described seem unfeasible in the context of current business situations. For instance, the writers uphold the classical rule of the Shāfi‘ī's who against any determination of the duration in a *muḍārabah*. According to the rule, *muḍārabah* investment can not be specified for a limited period but should be left open until one of the contracting parties decides to withdraw from the contract. Considering the present business environment, such an investment deal is difficult to work out. Without having a specified period of investment, *muḍārabah* venture will be very risky for most of the current investors. Nonetheless, this issue has not been discussed by the authors of *Fiqh al-Minhājī ‘alā Madhhab al-Shāfi‘ī*.

¹⁴² Sayyid Sābiq, *Fiqh al-Sunnah*, Beirut: Dār al-Kitāb al-‘Arabī, 1985, vol. 3, pp.208.

Conclusion

The emergence of various schools in Islamic law is a result of different orientations adopted by the early jurists when interpreting the divine sources of *sharī'ah* (the Qur'ān and Sunnah). During the second century Hijri, the two distinct schools were *aṣḥāb al-ra'y* (rationalist) and *aṣḥāb al-ḥadīth*. In developing their *fiqh* doctrines, the former school would use human reasoning whereas the latter school would strictly infer rules to the divine sources. The early prominent jurists such as Mālik, Abū Ḥanīfah, Ibn Abī Laylā, al-Awzā'ī, Sufyān al-Thawrī, al-Shāfi'ī, Aḥmad ibn Ḥanbal were attached to one of the orientations though varying in their degree of adaptation. These jurists established their personal schools through teaching circles held in cities such as Kufah, Basrah, Baghdad, Madinah and Damascus. The personal schools were then slowly transformed into doctrinal schools by their loyal students. Out of a number of personal schools, only four survived in the current *Sunni* world. They are the Ḥanafīs, Mālikīs, Shafi'īs and Ḥanbalīs.

Our investigation concerning the development of the *muḍārabah* rules reveals similar trend of juristic growth. With the exception of Aḥmad ibn Ḥanbal, all other eponyms could be considered as the founders of the *muḍārabah* discussions within their respective schools. As is evident in *al-Muwatta'*, *Jāmi' al-ṣaghīr* and *al-Umm*, the salient features of the contract were explained preliminary by Mālik, Abū Ḥanīfah and al-Shāfi'ī. The subsequent generations of jurists expanded the fundamental rules in line with the changes of economics and business settings. For instance, from 4 major topics of the *muḍārabah* discussed by al-Shāfi'ī, al-Shīrazī elaborated them into 32 sections. The expansion process happened at different phases between the schools.

It is appeared that the Mālikīs and the Ḥanafīs have advanced in their legal writing of the *muḍārabah* contract earlier than the Shāfi'īs and the Ḥanbalīs. The Mālikīs had a complete text in the subject probably at the end of the second century and the Ḥanafīs had it in the late third century Hijri. The Shāfi'īs had a comprehensive discussion of the *muḍārabah* contract by the end of the fourth

century. Meanwhile, the Ḥanbalīs only had a well written doctrine of the contract by the end of sixth century. My finding refines Schacht's theory who believed that all the essential questions in Islamic law had been thoroughly discussed and finally settled by the fourth century Hijri. Schacht is right in reference to the three schools named earlier.

The majority of jurists during the fifth century Hijri and onwards did not produce significant new rules in *muḍārabah*. However, they did organise the discussion of the topic in a more systematic way. Most of the discussions of this period consist of *muḍārabah*'s definition, legal evidences (*dalīl*), essential elements (*arkān*) and conditions (*shurūḥ*). In addition, the writing style of the text had been changed; from problem-based (*masāʾil*) to legal manual (*mukhtaṣar*) style. Hence, the discussions of the *muḍārabah* of this period normally were concise and brief.

The study on the development of *muḍārabah* rules has helped me understand better the classical discussions regarding the contract. By understanding each school historical background, I could identify the different methodologies adopted by the classical jurists when formulating their *muḍārabah* doctrines. The root of disagreement among the schools becomes clearer after knowing each school orientation in interpreting the *sharīʿah*. The Ḥanafīs were known as inclining to adopt human reasoning extensively. Thus, most of their rules regarding the practice of *muḍārabah* seemed to be accommodating the needs of *muḍārib* (agent manager). In contrast, the Ḥanbalīs and Mālikīs were viewed as the supporters of traditionalists' group. They would rely heavily on *sunnah* in deducing new problems of the *muḍārabah* business. However, since the *sunnah* pertaining to the *muḍārabah* contract was limited, Ahmad ibn Ḥanbal and Mālik's responses (*fatāwā*) had become their main source of reference.

On the other hand, al-Shāfiʿī was known as the jurist who attempted to produce a compromise doctrine between the traditionalists and the rationalists group. He tried to mediate between the strict rejections of all human reasoning propounded by the former and the unrestricted use of personal opinion adapted

by the later. This is done by developing a science of Islamic legal methodology which known as *uṣūl fiqh*. In the following chapter we will see more clearly these differences of legal methodology when discussing the detail rules of a *muḍārabah* contract.

CHAPTER TWO: *MUḌĀRABAH* DOCTRINES OF THE FOUR SUNNI SCHOOLS OF LAW

Introduction

The present chapter studies the doctrine of *muḌārabah* of the four major *Sunni* schools of law (Ḥanafīs, Mālikīs, Shāfi'īs and Ḥanbalīs). It analyses their rulings pertaining to various practical issues of the contract, starting from the outset until it is to be liquidated. The discussions are organised into several sections. They begin with an explanation on the literal and legal meaning of the word *muḌārabah* and its relationship with other *sharīkah* (partnership) contracts. Then it looks into the question of whether *muḌārabah* was legitimised against or in conformity to the rules of analogy (*al-qiyās*). Next, the chapter analyses the legal evidence used by the classical jurists in justifying the legitimacy of the contract. It assesses the opinion of Ibn Ḥazm (d.456/1064) who challenged the legality of *muḌārabah* evidences from the Qur'an and the *hadīth* of the Prophet.

After that, the discussion continues by elaborating the rules of *muḌārabah*'s essential elements (*arkān*). They are identified as capital, work, investor, agent manager and profit. For capital, the chapter explains the classical jurists' opinion in determining the eligibility of gold, silver, goods, debts and property in safekeeping (*wadī'ah*) as a form of *muḌārabah* investment. Discussion on work describes the legal and practical reasons why the majority of jurists restricted *muḌārabah* to trading activities. With regard to the investor and agent manager, the key discussion is to examine the relationship between the two parties. It focuses on the scope of empowerment given to the agent manager in investing the entrusted capital. Discussion on profit explains the rules and guidelines stipulated by the classical jurists concerning the proportional division of profit and its distribution method.

In analysing the classical jurists' rules, I adopt the comparative inter-*madhhab* approach. Hence, throughout the following sections, I highlight the disagreement between the schools over many issues and analyse their

justifications and legal reasoning. It is hoped that this chapter will be a valuable addition to our understanding of the classical *muḍārabah* theory. A comprehensive understanding of the theory is important to evaluate the *sharī'ah* compliance of *muḍārabah* products in the Islamic banking institutions which will be dealt in the next chapter.

The Definition of *Muḍārabah* and its Relationship with Other Partnership Contracts

Literal meaning

In the classical *fiqh* texts, *muḍārabah* is also known as *al-qirāḍ*. Both terminologies indicate a similar meaning with the former was used by people in Iraq while the latter was used by people in Hijaz. In relation to this geographical basis, the Ḥanafīs and Ḥanbalīs usually referred the contract as *muḍārabah* whereas the Mālīkis and Shāfi'īs referred it as *al-qirāḍ*. The term *muḍārabah* literally is derived from the expression of *ḍarb fī al-'ard* which means "making a journey". It is called *muḍārabah* because the contract normally requires the agent manager to travel, transporting merchandises from one place to another.

Meanwhile, the origin of *al-qirāḍ* was derived from two possible words; *qaraḍ* and *muqāraḍah*. The former means cutting and the latter means equality. *Al-qirāḍ* was said derived from *qaraḍ* because the investor and the agent-manager will be cutting their deposition of money for each other. At the beginning of the contract, the investor will cut some portion of his money and entrust them to the agent-manager. When the business is to be liquidated, the agent-manager will cut some portion of profit generated from his works to share with the investor. On the other hand, *al-qirāḍ* was possibly derived from *muqāraḍah* due to the element of equality embedded in the contract. *Al-qirāḍ* is viewed as an

equal contract since it requires both contracting parties to share certain degree of risks before they can enjoy any business profit¹⁴³.

According to Sarakshī, the term *muḍārabah* is preferred over *al-qirāḍ* because it is mentioned in the Qur'an. He stated in *Kitāb al-Mabsūṭ*, 'indeed we (the Ḥanafīs) chose the first terminology (*muḍārabah*) because it is in congruence with the book of Allah'¹⁴⁴. He based his opinion on the verse 73:20, "Others travelling through the land seeking of Allah's bounty'. Sarakshī viewed that the phrase 'travelling through the land' as specifically denoting the contract of *muḍārabah*. However, Sarakshī's opinion was disputed by majority of jurists. They believed that the phrase indicates a broad meaning in which could be interpreted as *muḍārabah* or other types of business journeys made for the sake of God. Hence according to the majority of jurists, the verse is not valid evidence in justifying the preference of the term *muḍārabah* over *al-qirāḍ*. Based on this view, the difference between both terminologies is seen merely as due to the divergence of geographical background and therefore could be used interchangeably. For the purpose of this study, however, I will use the term *muḍārabah*. My reason for choosing the terminology is only based on its popularity. In the modern literature either in *fiqh* or in the Islamic banking subject, the term *muḍārabah* is used more widely as compared to *al-qirāḍ*.

Legal Meaning

In spite of the different terminologies, the classical jurists were unanimous in their legal definition of the contract. They referred *muḍārabah* or *al-qirāḍ* as a contract between two parties, one (called the investor) entrusts money to the other party (called the agent-manager) to commence a business venture. Any realised profit will be shared between the two parties based on the profit ratio decided at the beginning of the contract.

¹⁴³ Shīrbīnī, Muḥammad ibn Muḥammad. *Mughnī al-Muḥtāj Ma'āni al-fāz al-Minhāj/ sharḥ Muḥammad al-Shīrbīnī al-Khaṭīb 'alā matn al-Minhāj li-Abī Zakarīyā Yaḥya ibn Sharaf al-Nawawī*. Misr: Sharikat wa Maṭba'at Mustafā al-Bābī al-Ḥalabī, 1958, vol. 2, pp. 309.

¹⁴⁴ Sarakshī, Muḥammad ibn Aḥmad. *Kitāb al-Mabsūṭ*. Misr: Maṭba'at al-Sa'ādah, 1324-1331/1906-13, vol. 22, pp. 18.

The following are the legal definitions of *muḍārabah* described by the jurists of the main references in this study:

1. Sarakshī of the Ḥanafīs explained, '*muḍārabah is derived from ḍarb fī al-‘arḍ, it is called with such term because the agent-manager is entitled for the profit derived from his efforts and works, he is the investor's partner in profit, capital and business decision making*'.
2. Al-Khalīl of the Mālīkīs defined, '*qirāḍ is an act of appointing an agent (tawkīl) to conduct business by giving (the agent-manager) cash for some return of business' profit*¹⁴⁵.
3. Al-Nawawī of the Shāfi‘īs illustrated, '*qirāḍ or muḍārabah takes place when a man had been handed money to trade with and (any realised) profit will be shared between the two parties*¹⁴⁶.
4. Ibn Qudāmah of the Ḥanbalīs explained the contract as, '*a person gives someone his money to trade with and any realised profit will be shared between the two parties based on the pre-agreed ratio*¹⁴⁷'.

The above definitions demonstrate dissimilar approaches taken by the jurists when describing the *muḍārabah* contract. Sarakhsī explained the contract from the perspective of agent-manager; al-Khalīl and Ibn Qudamah from the viewpoint of investor and al-Nawawī from the outlook of an outsider. Nonetheless, all of them addressed similar salient features which form the fundamental elements of the contract. In order to execute a valid *muḍārabah* contract there are five elements need be clearly identified; the investor (*rabb al-māl*), agent manager (*muḍārib*), capital, work and profit.

It is noteworthy that the contract of *muḍārabah* was often discussed together with the *mushārah* contract. In the following section, we will examine further the relationship between the two contracts.

¹⁴⁵ Dusūqī, Muḥammad ibn Aḥmad ibn ‘Arafah, *Hāshīyat al-Dusūqī ‘alā al-Sharḥ al-kabīr (‘alā Mukhtaṣar Khalīl) li Aḥmad al-Dardīr ma’a taqrīrāt li Muḥammad ‘Ullaysh*. Cairo: ‘Isā al-Bābī al-Ḥalabī, n.d. vol. 3, pp. 518.

¹⁴⁶ Shirbinī, *Mughnī al-Muḥtāj ma‘āni alfāz al-Minhāj*, vol. 2, pp. 309.

¹⁴⁷ Ibn Qudāmah, ‘Abd Allāh ibn Aḥmad, Muwaffaq al-Din. *Al-Mughnī/ tahqiq ‘Abd Allāh ibn al-Muḥsin al-Turkī, ‘Abd al-Fattāḥ Muḥammad al-Ḥulw*. Al-Riyād: Dār ‘Ālam al-Kutub, 1999, 4th edition, vol. 7, pp.132.

The Relationship between *Muḍārabah* and *Mushārah* Contracts

Mushārah literally means sharing. Legally, it refers to partnership contracts in which two parties agreed to set up a joint business venture. The *mushārah* partnership could take place in many forms. The most common forms elaborated by the classical jurists were; *shirkah al-‘inān* (limited partnership), *shirkah al-mufāwah* (unlimited partnership), *shirkah al-‘amāl/abdān* (works partnership) and *shirkah al-wujūh* (credit partnership). There was disagreement between the classical jurists in classifying *muḍārabah* within this *mushārah* framework. The Ḥanbalī jurists considered the former as part of the latter. Therefore, they elaborated the rules of *muḍārabah* under the broad chapter of *kitāb al-shirkah*. In contrast, the majority of jurists including the Ḥanafīs, Mālikīs and Shāfi‘īs treated *muḍārabah* and *mushārah* as two distinctive contracts. They normally explained the rules of the former under a separate chapter which excluded from the rules of *shirkah al-‘inān*, *al-mufāwah*, *al-‘amāl/abdān* and *al-wujūh*.

In his magnum opus *al-Mughnī*, Ibn Qudāmah provided a clear distinction between these *mushārah* contracts. His definitions could be summarised in table 6 below:

Table 6: The contribution of partners in *mushārah* contracts

Types	Partner A	Partner B
<i>Muḍārabah</i>	capital	work
<i>Inān</i>	capital and work	capital and work
<i>Mufāwah</i>	capital and work	capital and work
<i>‘Amāl/ Abdān</i>	work	work
<i>Wujūh</i>	Work and debt	Work and debt

The contracts are defined based on the contribution of each individual partner. *Muḍārabah* is a contract whereby capital and work are provided by two distinctive parties. As ruled by the majority of jurists, the partner who provides capital is not permitted to participate in the business. The business' activities are entirely the responsibility of the other partner, called as *muḍārib*.

On the contrary, *shirkah al-ʿinān* and *shirkah al-mufāwāḍah* are partnership contracts based on the contribution of money and work by every partner. However, the liability held by the partners in the former is limited whereas the liability in the latter is unlimited. In *shirkah al-ʿinān*, the loss will be shared between the partners according to their contribution of shares in capital, whereas in *shirkah al-mufāwāḍah* all partners will bear equally the losses even though they exceed their contributed shares. This different rule is the result of dissimilar conditions required by the jurists when executing the contracts. In *shirkah al-ʿinān*, the contribution of capital by the partners does not necessarily have to be equal. The legal rights of each partner in utilising the capital also could vary since they are insignificantly related. However, in *shirkah al-mufāwāḍah* all aspects of the contract such as the contribution of capital, legal right in making business decisions, distribution of profit/loss and religion of partner (for some jurists) are required to be equal.

Shirkah al-amāl/abdān is a contract solely based on the labour contribution of the partners. It takes place when two or more individual agree to embark on a joint labour project and share the wages from their work. There is no capital contribution made by either of the partner. According to the Ḥanafīs and Ḥanbalīs, the partners of work partnership may be of similar or different specialisation¹⁴⁸. In a housing project for example, according to both schools, contractors of different expertise such as in building, roof installation and plumbing could possibly form a partnership. However, the Mālikīs ruled that the partners should be of similar specialisation¹⁴⁹. They only allowed a group of carpenters for example to work together and make furnishes for profit. The Mālikīs restrict the partners to be similar specialisation mainly to minimise *gharār* (uncertainty) arising due to the difference in nature of the work. Since work can not be measured accurately, sharing of profit from difference works of partners will lead to *gharar*. The Shāfiʿīs held similar argument with the

¹⁴⁸ Ibn Qudāma, *Al-Mughnī*, vol. 7, pp. 113.

¹⁴⁹ Dusūqī, *Ḥāshiyat al-Dusūqī ʿalā al-Sharḥ al-kabīr ʿalā Mukhtaṣar Khalīl*, vol. 3, pp. 364-368.

Mālikīs but they reach a conclusion prohibiting entirely all sort of work partnership¹⁵⁰.

In the context of modern business milieu, *shirkah al-wujūh* or credit partnership could be best described as a contract of two or more individuals who agree to set up a business by using borrowed capital. This means none of the partners contribute capital using their own money but they will work for the business. The proportion of credit held by each partner in forming the business will determine their ownership in the business and consequently their capacity in making business decisions and their ratios in sharing profit or loss.

The approach adopted by Ibn Qudāmah in elaborating the above contracts is understandable. He clearly viewed *muḍārabah* as an extended form of the *mushārah* contract. From Ibn Qudāmah's perspective, all the contracts share similar *mushārah* fundamental concepts. The contracts require the partners to bear a certain degree of business risk before they can share any potential profit. As explained earlier, the differences between the contracts mainly depend on the contribution of the partners¹⁵¹. A question remains in our mind; why did the majority of jurists not consider *muḍārabah* as part of the *mushārah* contracts?

Instead of classifying *muḍārabah* as part of the *mushārah* contracts, the majority of jurists regarded the former as one of the contracts of exchange (*uqūd al-mu'āwadah*). Specifically, they considered *muḍārabah* as similar to hire-wages contract. As its name implies the contract of exchange involves a trade between two monetary values. In the case of *muḍārabah*, the works of agent manager is monetarily recognised and therefore should be exchanged with fair wages. The basic rule of the contract of exchange necessitates that the wage of any employees is to be precisely determined before work is carried out. Any ambiguity relating to the wages will turn the contract into an invalid transaction. However, *muḍārabah* contract certainly does not comply with this

¹⁵⁰ Shirbinī, *Mughnī al-Muḥtāj Ma'āni Alfāz al-Minhāj*. vol. 2, pp. 212.

¹⁵¹ Though one must also bear in mind that in *muḍārabah*, only the investor will bear the monetary loss.

basic rule. The income of agent manager is uncertain or even unsecured as it depends on the amount of *muḍārabah* business profit. Having realised this issue, the majority of jurists inferred that *muḍārabah* contract was legitimised on the basis of dispensation (*rukḥṣah*) and exception. This concept was often referred in the classical texts as a contract permitted against the rule of analogy (*‘alā khilāf fil qiyās*). It indicates that the analogy of hire-wage contract can not be applied in the *muḍārabah* since the latter was legitimised on the basis of special consideration¹⁵². The *rukḥṣah* concept has profound impact particularly in determining the nature of work allowed in the contract. We will discuss the issue in detail later in this chapter.

Our concern at the moment is to examine why the classical jurists legitimised the *muḍārabah* even though it opposes the condition which requires certainty regarding the wages for the working party. The legal reason, as stated by Sarakshī was mainly to fulfil the pressing economic necessity of the society¹⁵³. The *muḍārabah* contract was needed in order to allow the two groups of people in the community to perform a business partnership. The first group are those who possess surplus cash but have limited trading skill while the second group are the traders who desperately need capital. Through the practice of *muḍārabah* contracts both groups could form a business venture and possibly gain better financial situation. In fact, the *muḍārabah* was not the only contract legitimised on these exceptional grounds. The same legal reason was applied by the majority of jurists in justifying the legitimacy of *al-muzāra‘ah* (sharecropping) and *bay‘ salām* (forward sale) contracts. Applying the analogy of hire-wages and the rule of certainty in the object of sale to the contracts would turn them into unlawful transactions. In *al-muzāra‘ah*, the sharecroppers agree to cultivate the land based on unknown wages whereas in *bay‘ salām* the goods were sold even though they were not in possession of the seller. However, considering the needs of the society, both types of contract were legalised by the classical jurists.

¹⁵² Ḥasan al-Amīn, *al-Muḍārabah al-Shar‘iyyah wa-Taṭbīqahā al-Ḥadīthah*, Jeddah: al-Ma‘had al-Islāmī lil-Tanmiyyah, 2000, pp.23.

¹⁵³ Sarakshī, *Kitāb al-Mabsūf*, vol.22, pp. 19.

The Ḥanbalīs viewed the legality of *muḍārabah* to be in conformity with the rule of analogy. They emphasised that *muḍārabah* is not a contract of exchange but is one of the *mushārahah* contracts. Hence, for the Ḥanbalīs the issue of uncertainty of the agent manager's income does not arise. *Muḍārabah* is totally different from the contract of hire-wages between employee and employer. Knowing the nature of *muḍārabah* as part of partnership contract, the agent manager is aware that his income is not fixed and guaranteed. He shares the risk of conducting a business together with the investor as provider of capital.

The Legitimacy of *Muḍārabah* Contract

Contrary to the majority of classical jurists, Ibn Hazm (d.456/1064) thought that the legitimacy of *muḍārabah* was established solely based on the consensus (*ijmā'*). He did not accept the validity of the verses of the Qur'an and *ḥadīth* of the Prophet on which relied most of the classical jurists in justifying the legal position of the contract. In his *Marātib al-Ijmā'*, Ibn Hazm stated that:

‘All topics in Islamic jurisprudence have evidence in the Qur'an and the *sunnah* except *al-qirāḍ*. We did not find any evidence from the *sunnah* but there is evidence from the *ijmā'*.¹⁵⁴

This section attempts to appraise Ibn Hazm's opinion by analysing the legality and the authority of *muḍārabah*'s legal evidences.

Some jurists considered the verse 73:20, '*Others travelling through the land seeking of Allah's bounty*' as one of the pieces of evidence which indicates the legitimacy of the *muḍārabah* contract. The verse uses the verb *yaḍrib* which is the similar root word of *muḍārabah*. Thus according to the jurists, the phrase '*travelling through the land*' specifically denotes the *muḍārabah* contract¹⁵⁵.

¹⁵⁴ Nawāwī, Yahya ibn Sharaf, *al-Majmū' sharḥ al-Muhadhdhab lil Shīrāzī*. al-Qāhirah: Zakariyā 'Alī Yūsūf, 1966-69, vol. 14, pp. 191.

¹⁵⁵ El Sharif B.B.K. *Law and practice of profit sharing in Islamic banking with particular reference to muḍārabah and murābahah*. Phd Thesis, University of Exeter, 1990, pp.

Besides, al-Māwardī believed that the contract is also mentioned in the Qur'an in another verse. He referred to the verse 2:198, '*It is no sin for you to seek (by trading) the bounty of your Lord*'¹⁵⁶. This verse encourages Muslims to perform various business activities as a means of achieving Allah's bounty. The verse uses the word *ibtaghū* (searching) which has no relation to the *muḍārabah* contract. However, al-Māwardī interpreted the general encouragement as referring to the *muḍārabah* contract alone.

Based on the justifications, perhaps we can understand why Ibn Ḥazm refused to accept the relevance of the verses. He disagreed with the jurists who broadened the meaning of the verses into *muḍārabah* contract. From his point of view, there is no sufficient evident to link the verses to the said contract. Therefore, Ibn Ḥazm contended that the verses should be maintained in their general meaning which includes all types of business contracts made for the sake of Allah.

The *aḥādīth* (plural form of *ḥadīth*) of the Prophet that demonstrate the legality of *muḍārabah* could be classified into *sunnah qauliyyah* and *sunnah taqrīriyyah*. The former signifies a verbal statement from the Prophet while the latter refers to his affirmation of an action done by someone other than him. One of the *sunnah qauliyyah* was narrated in the collection of *ḥadīth* of Ibn Mājah. The Prophet (pbuh) was reported as saying '*Three transactions have God's blessing; sale with deferred payment, muqāradah (i.e. muḍārabah) and mixing wheat with barley for home usage and not for sale*'¹⁵⁷. However, the authenticity of the *ḥadīth* was doubted by majority of the traditionists. The *ḥadīth* is classified as *ḍa'īf* (weak) because one of the narrators namely Naṣr ibn al-Qasim is *majhūl* (his credentials are not known)¹⁵⁸.

¹⁵⁶ Shirbinī, *Mughnī al-Muḥtāj Ma'āni Alfāz al-Minhāj*, vol. 2, pp. 309.

¹⁵⁷ Ibn Mājah, *Sunan Ibn Mājah, Kitāb al-Tijārāt, Bāb al-Sharikah wa al-Muḍārabah*, ḥadīth no.2377, Stuttgart: Thesaurus Islamicus Foundation, 2000, pp. 331

¹⁵⁸ Mohd Faiz Hakimi *et. al*, *Muḍārabah Perkongsian Modal dan Untung*. Kuala Lumpur: Academy of Islamic Studies, University of Malaya, 2008, pp. 40.

The other *ḥadīth* in this regard is *sunnah taqrīriyyah*. In the *ḥadīth*, the Prophet did not give a verbal verdict on the permissibility of *muḍārabah* contract but he did acknowledge silently the contract performed by Companions. Ḥakīm ibn Ḥizām and ‘Abbās ibn ‘Abd al-Muṭallib were reported as stipulating several conditions to their agent-managers in *muḍārabah* contracts. They prohibited the agent-manager from buying living things and from travelling through sea and flooded valleys. The Prophet was informed of the conditions and he did not oppose to them. According to majority of jurists, the Prophet's approval clearly indicates the legitimacy of *muḍārabah* contract. Furthermore, the *ḥadīth* was classified as *ṣaḥīḥ* and narrated by many traditionists such as al-Dāruqūṭnī¹⁵⁹ and Ibn Ḥajar al-‘Asqālānī¹⁶⁰.

As far as I have been able to ascertain, the two *aḥādīth* mentioned here are the most relevant evidence from the Prophet Muḥammad in proving the legitimacy of the *muḍārabah* contract. There are other *aḥādīth* reported by the traditionists but they are indirectly related to the contract. For example, a traditionist Abū Dāwūd included *ḥadīth* between the Prophet and Ḥakīm ibn Ḥizām as one of the evidences. It was reported that the Prophet had given one *dīnār* to Ḥakīm to buy an animal for holy slaughtering (*al-‘aḍḥiyyah*). Ḥakīm bought a sheep with the money. He then sold the sheep for two *dīnār*. Having two *dīnār* in his hand, Ḥakīm bought another sheep for one *dīnār* and returned to the Prophet with the remaining one *dīnār*. The Prophet donated the money to charity and praised Ḥakīm's trading skill.

Abū Dāwūd narrated this *ḥadīth* and categorised it under the sub-topic of *muḍārib yukhālif* (agent-manager who breaches a *muḍārabah* contract)¹⁶¹. He opined that when the Prophet gave one *dīnār* to Ḥakīm, it was based on the

¹⁵⁹ Dāruqūṭnī, ‘Āli ibn ‘Umar, Sunan al-Dāruqūṭnī/ ‘uniya bi-taṣḥīhi wa-tarqīmihi wa-taḥqīqihi al-Sayyid ‘Abd Allāh Hashīm Yamānī al-Madanī. Al-Qahirah: Dār al-Maḥāsīn, 1980, vol. 3-4, Bāb al-buyū‘, ḥadīth no.246, pp. 63.

¹⁶⁰ Ibn Ḥajar al-‘Asqālānī, Aḥmad Ibn ‘Alī. *al-Maṭālib al-‘āliyah bī-zawā‘id al-thamāniyah*/ taḥqīq Abī Bilāl Ghunaym ibn ‘Abbas ibn Ghunaym, Abī Tamīm ibn Ibrahīm Muḥammad. Al-Riyāḍ: Dār al-Waṭar, 1997, vol. 2, Bāb al-Qirāḍ, ḥadīth no. 1472, pp. 118.

¹⁶¹ Abū Dāwūd, Sulaymān ibn al-Ash‘ath, *Sunan Abū Dāwūd*, ḥadīth no. 3384, Cairo: Dār Iḥyā’ al-Sunnah al-Nabawīyah, 1950, vol. 3, pp. 256.

contract of *muḍārabah*. However, this opinion contradicts the majority of jurists who often referred the *ḥadīth* as a case of *wakālah* (agency) contract. According to the majority of jurists, the Prophet had appointed Ḥakīm as his agent to buy certain thing in the market. As an agent, Ḥakīm not only did what he supposed to but came back to the Prophet with a surplus of one *dīnār*. Although Ḥakīm seemed to disobey the original order, his action was approved by the Prophet. Hence, based on this *ḥadīth*, the jurists gave permission to an agent to do extra effort for the benefit of his master (the man who gives him the authority). More importantly, the *ḥadīth* is regarded by the jurists as a case of *wakālah* not *muḍārabah* contract.

As far as Ibn Ḥazm is concerned, he clearly rejected the validity of the *ḥadīth* of Ibn Mājah because it is classified as *ḍaʿīf*. However, one would wonder about his basis in rejecting the *ḥadīth* of al-Dāruqūṭnī and al-'Asqālānī since its authority has been recognised by many traditionists. Commenting on this matter, al-Nawawī offered a very simple explanation. He presumed that Ibn Ḥazm never heard of the *ḥadīth*¹⁶². In my opinion, perhaps this matter demonstrates a bigger issue relating to Ibn Ḥazm's legal methodology. Ibn Ḥazm's rejection of the *ḥadīth* confirms his strict standard in accepting a particular *ḥadīth* as the sources of law. The present case is another example whereby Ibn Ḥazm in his *Kitāb al-Iḥkām* had rejected many *aḥādīth* which his adversaries rely on¹⁶³. Therefore, I hypothetically think that he did not recognised *sunnah taqrīriyyah* as having similar authority to *sunnah qauliyyah*.

In addition to *ḥadīth*, the jurists also rely on *āthār* (the reports of the practice of Companions) in justifying the legitimacy of *muḍārabah*. The most often quoted *āthār* was the *muḍārabah* practised by ʿAbdallāh and ʿUbaidullāh, the sons of ʿUmar al Khaṭṭāb. The *āthār* was discussed by al-Sarakshī, al-Nawawī, al-Qarāfi and Ibn Qudāmah in their introductions to the *muḍārabah* chapter. It was reported that the sons of the second Caliph were in the army in Persia and

¹⁶² Nawawī. *al-Majmūʿ sharḥ al-Muhadhdhab lil Shīrāzī*. vol. 14, pp. 191.

¹⁶³ Arnaldez, R. 'Ibn Ḥazm, Abū Muḥammad ʿAlī b. Aḥmad b. Saʿīd'. *Encyclopedia of Islam, Second Edition*. Edited by P. Bearman, Th Bianquis, C.E. Bosworth, E. Van Donzel and W.P heinrichs. Brill 2009. Brill Online. EXETER UNIVERSITY. Accessed on 24 August 2009.

participated the battle of Nahawand. On the way back to Medina, they met Abu Musā al-‘Ash‘ārī who was the governor of Basra. Abu Musā al-‘Ash‘ārī wanted to send Basra’s provincial tax to ‘Umar al-Khaṭṭāb. He then asked ‘Abdallāh and ‘Ubaidullāh to send the money with the suggestion that they bought Iraqi merchandise and sell them with profit in Medina. Both of them agreed with the idea and successfully implemented it. They earned some profit from the trade. Upon arrival in Medina, ‘Abdallāh and ‘Ubaidullāh had an argument with their father. ‘Umar-al Khaṭṭāb demanded his sons to return both capital and profit to the *baitul māl* (treasury). However, ‘Ubaidullāh refused to do so and argued that they were entitled some of the profit since they held some degree of risk in the business venture. At first Umar al-Khaṭṭāb refused to accept the argument. However, he then changed his decision after one of the meeting’s members suggested that they turned the whole contract into *muḍārabah*. Finally, ‘Umar al-Khaṭṭāb decided that his two sons received half of the profit and the rest of the money went to the *baitul māl*¹⁶⁴.

The legality of the *āthār* however was questioned by some of the classical jurists. This is because it appeared that from the beginning, ‘Abdallāh and ‘Ubaidullāh were not clearly aware that they performed the business based on a *muḍārabah* contract. The contract was decided at the last stage when they wanted to hand over the tax money to ‘Umar al-Khaṭṭāb. Hence, according to al-Nawawī, the Shāfi‘ī jurists had divided into three groups. The first group was of the opinion that it was not a *muḍārabah* contract. The second group thought it was an invalid *muḍārabah*, thus, whatever amount of money received by the two sons of ‘Umar al-Khaṭṭāb was considered as compensation. The third group, however, opined that it was a valid *mudarabah*. This group maintained that this was an exceptional case where *muḍārabah* contract was not agreed in advance¹⁶⁵. The Mālikī’s opinions were similar to the second group. As explained by al-Bājī (d.494), ‘Umar al-Khaṭṭāb decided to refer the contract as *qirāḍ al-mithil*. This means the decision to share equally the profit was made

¹⁶⁴ Sarakshī, *Kitāb al-Mabsuṭ*, vol.22, pp. 18, al-Nawawī, *al-Majmū‘*, vol. 15, pp. 189, Ibn Qudāmah, *al-Mughnī*, vol.7, pp. 133.

¹⁶⁵ al-Nawawī, *al-Majmū‘*, vol. 15, pp. 189

after comparing his sons' case to a similar *muḍārabah* arrangement¹⁶⁶. Considering the jurists' argument, it is clear to us that despite being a famous piece of legal evidence, the *āthār* do not illustrate a definite verification on the legitimacy of *muḍārabah* contract.

In addition to that, Sarakshī reported another *āthār* to justify the legitimacy of *muḍārabah*. He claimed that the contract was practised by ‘Umar al-Khaṭṭāb when he invested an orphan's money entrusted to him. ‘Umar's action raised an important issue. Was a guardian of orphans allowed to invest their money in *muḍārabah* business without asking prior permission from them? Sarakshī explained that ‘Umar al-Khaṭṭāb performed the transaction within his capacity as the guardian as well as the leader of the state. As such, he was allowed to invest the orphans' money in business which he considered would be profitable. From Sarakshī's perspective, the decision to invest in a *muḍārabah* contract was a wise judgment because it could possibly generate more money for the orphans. Undeniably, it would be the most desirable thing, if ‘Umar managed to find someone who could trade for the orphans voluntarily. However, it was also understood that not many people were willing to do that for free. Therefore, the *muḍārabah* contract was seen as one of the ways to achieve his objective for the sake of the orphans¹⁶⁷.

Having examined the *muḍārabah* legal evidence, we now understand that their validity is arguable. The verses of the Qur'an (73:20 and 2:198) do not address the contract specifically. The same verses could be used to prove the legitimacy of other commercial activities. Meanwhile, the *sunnah qauliyyah* which showed the oral approval of the Prophet had been criticised as a weak evidence. Its *isnād* consists of a less qualified narrator. The problem in accepting the *āthār* of the Companions is that they did not demonstrate a perfectly valid *muḍārabah* contract. Despite these issues, the jurists claimed that they had reached a consensus in legitimising the contract. All of them agreed in recognising the

¹⁶⁶ Bājī, Sulaymān ibn Khalaf, *al-Muntaqā sharḥ Muwaṭṭa' Mālik* taḥqīq Muḥammad ‘Abd al-Qādir ‘Āṭā. Bayrūt: Dār al-Kutub al-‘Ilmīyah, 1999, vol.7, pp.68.

¹⁶⁷ Sarakshī, *al-Mabsūṭ*, vol.22, pp.18.

muḍārabah as a legitimate commercial activity for Muslim society. Ibn Qudāmah for instance confirmed the ruling in the following statement:

All of the people of knowledge (*‘ahl al-‘ilm*) agreed on the permissibility of *muḍārabah* in general¹⁶⁸.

It would be noteworthy to highlight here that the discussion concerning the legal evidence for *muḍārabah* also signifies the origin of the contract. The *sunnah taqririyyah* proved that *muḍārabah* was developed before the advent of Islam. It appears very likely that Ḥakīm ibn Ḥizām and ‘Abbas ibn ‘Abd al-Muṭallib had been practising the contract during the pre-Islamic period. When Muḥammad became Prophet, Ḥakīm and ‘Abbas sought his opinion regarding the terms and conditions they used to put forward to their agent manager. Prophet Muḥammad had no objection to approving the contract. This clearly set forth another example of the Arab custom’s (*‘urf*) influences on Islamic law. As explained earlier, the ‘Islamic’ doctrine of *muḍārabah* was rudimentary in nature during the early Islam. It developed extensively at beginning of the second century Hijri as a response to the socio-economic changes within the Muslim community.

Capital in *Muḍārabah*

In principle, the jurists of the four major schools were in agreement in accepting gold and silver coins as capital in *muḍārabah* contracts. The rule was stated for example by al-Nawawī and Ibn Qudāmah in the following way:

It is required for *al-qirāḍ* to be valid, the *māl* (capital) must be in the form of *darāhim* (silver coins) or *danānir* (gold coins)¹⁶⁹.

There is agreement (between the jurists) in accepting *darāhim* and *danānir* as capital in the contract¹⁷⁰

Gold and silver coins were unanimously accepted because they served as the mediums of exchange during the medieval period. Both metals became the currencies of that time because they possessed intrinsic value which was

¹⁶⁸ Ibn Qudāmah, *al-Mughnī*, vol.7, pp. 133.

¹⁶⁹ Shirbinī, *Mughnī al-Muḥtāj Ma‘āni Alfāz al-Minhāj*. vol. 2, pp. 212.

¹⁷⁰ Ibn Qudamah, *al-Mughnī*, vol.7 p.123

consistent throughout all times and in all places. The consistent value of the coins is crucial in determining the *muḍārabah* profit. This is because at the end of the contract, an agent manager is required to return the capital to the investor. Profit from the business is identified as any surplus from the capital. For this reason, the value of the capital must be consistent. Fluctuation in its value would certainly affect the share of the investor and the agent manager.

Based on this justification, goods or merchandises (*al-ʿurūḍ*) were not accepted as a form of *muḍārabah* investment¹⁷¹. If an investor supplies finished consumer products to the agent manager as capital in *muḍārabah*, the contract will be rendered invalid. As indicated earlier, the rule is to avoid uncertainty during the determination of *muḍārabah* profit. Unlike gold and silver, the price of goods normally fluctuated¹⁷². The fluctuation in their prices will make the amount of *muḍārabah* profit indefinite. Suppose for example, when the agent manager wanted to return the goods to the investor, their price became substantially higher. The agent-manager would then need to use some portion of the profits in returning the goods to the investor. In this case, he technically obtained less share of the profit than he deserved. In contrast, if the price of the goods became significantly lower, the agent manager would pay much less money. In this situation, the agent-manager would gain more profit at the expense of the investor's share¹⁷³.

The preceding justifications signify two main criteria considered by the classical jurists in accepting or rejecting a particular commodity as a *muḍārabah* capital. The criteria are (1) the consistent value of a commodity and (2) its function as legal tender in the society. The second criterion was particularly applied in rejecting other commodities such as copper coins, *fulūs* and unminted gold (*tibr*). These commodities were fiduciary currency with little or no intrinsic value. Although they were used as medium of exchange by some people, their circulation within the community was not universal. The

¹⁷¹Sarakshi, *al-Mabsut*, vol.22, p.33, Ibn Qudamah, *al-Mughni*, vol.7 p.123, Nawawi, *al-Majmūʿ*, vol.14 p.194, Qarāfi, *al-Dhakhīrah*, vol. 6, pp. 30.

¹⁷² Al-Qarāfi, *Dzhakhīrah*, Bayrut: Dār al-Gharb al-Islāmi, 1994, vol.6

¹⁷³ Nawawī, *al-Majmūʿ*, vol.14 p.194

justifications also imply that the capital of *muḍārabah* can be varied according to times and societies. This is due to the fact that a legal tender accepted by society could possibly change and does not necessarily to be in the form of gold and silver coins. This was evident when the classical jurists used to accept foodstuff and wheat as *muḍārabah* capital in Mecca and Bukhara. Their main justification was that people in the cities had utilised them as mediums of exchange¹⁷⁴. Besides, the Ḥanafīs jurists who at first rejected the ‘commercial dirham’ (*darāhim tijāriyyah*)¹⁷⁵ as *muḍārabah* investment, had later permitted it because of its prevalence use in local business transactions¹⁷⁶.

It is worth mentioning that Sarakshī had mistakenly mentioned Mālik as one the prominent jurists who permitted goods as capital in *muḍārabah*. He stated Mālik’ opinion in this matter as follows:

Mālik, may God have mercy upon him said that *muḍārabah* with goods is permissible because goods are valuable properties which are usually relied upon in trade¹⁷⁷.

A closer examination on Mālikī major works however shows a contradictory position taken by Mālik. In *al-Muwaḍḍa’* for instance, Mālik clearly disallowed goods as a form of *muḍārabah* investment. He ruled that:

Al-qirāḍ is valid only if the investment is in the form of cash of either gold or silver. It may not consist of any goods and merchandise¹⁷⁸.

Sarakshī did not give any reference to support his statement. However, as suggested by Udovitch, the statement attributed to Mālik by Sarakshī might have been a generalisation based on the *muḍārabah* in goods through the use of *hīlah* (legal stratagem)¹⁷⁹. The legal stratagem in this context takes place when

¹⁷⁴ Sarakshi, *al-Mabsut*, vol.22, p.21

¹⁷⁵ Udovitch described it as some sort of token coinage based on an important local commodity whose circulation was restricted to one town or a town and its immediate environment. It is not to be confused with the silver coins used widely in the medieval period.

¹⁷⁶ Udovitch, A.L. *Partnership and Profit in Medieval Islam*, Princeton: Princeton University Press, 1970, pp.178

¹⁷⁷ Sarakshi, *al-Mabsut*, vol.22, p.33

¹⁷⁸ Al-Bāji, *Muntaqā sharḥ al-Muwaḍḍa’*, vol.7 pp.79

¹⁷⁹ Udovitch, *Partnership and Profit in Medieval Islam*, pp.182

an investor entrusts goods to an agent manager and instructs him to sell them, and use the cash realised from the sale as investment in the *muḍārabah*. Mālik was reported to have approved such legal trick. Apart from him, the transaction was approved by several prominent jurists including Ibn Abī Lailā, al-Auzā'ī, Ḥamād ibn Sulaymān, Ṭāwus and Aḥmad ibn Ḥanbal [in one of his narrations]¹⁸⁰. As we may expect, a similar position was taken by the Ḥanafīs. They considered the transaction as hybrids of the *wakālah* (agency) and *muḍārabah* contracts¹⁸¹. The former took place when the agent manager converted the goods into cash. In this transaction, the agent manager was regarded as the representative (*wakīl*) of the investor. The latter contract commenced immediately after the cash was in the hands of the agent manager. He would invest the cash according to the terms and conditions of a *muḍārabah* contract.

The legal stratagem was seen as an example of the classical jurists' response to the economic needs of the society. It was argued that the traders of long-distance business were in need of a more flexible rule that can accept goods as capital in the *muḍārabah* contract. Basically, the traders made profit by buying goods in a market that was low and selling them in one that is high. However, such a business model did not always generated profit as intended. Sometimes, a trader would be in the position where he had a lot of unsold goods. For various reasons he could not pursue the business on his own. Thus, a *muḍārabah* arrangement with an itinerant trader would provide a convenient and profitable solution¹⁸². The trader would entrust the unsold goods to other trader and embark into *muḍārabah* contract. As explained earlier, the legal stratagem would make the arrangement possible. The jurists who accepted the legal stratagem further allowed the agent-manager to return the value of the goods instead of their actual material. Hence, in the case where the invested goods were not to be sold, their value would be recorded at the beginning of the

¹⁸⁰ Ibn Qudamah, *al-Mughni*, vol.7 p.123-24

¹⁸¹ Sarakshī, *al-Mabsūṭ*, vol.22, pp.33

¹⁸² Udovitch, *Partnership and Profit in Medieval Islam*, pp.182

contract and when the business was to be liquidated, the recorded value would be based upon to determine *muḍārabah* profit¹⁸³.

However, the legal stratagem was rejected by the Shāfi'ī jurists. As explained in *al-Majmū'*, their rejection was based on two underlying justifications:

If the agent manager was given goods and was told to sell them, *muḍārabah* with the proceeds of the sale is not permissible due two reasons (1) the unknown value, and *al-qirāḍ* with unknown capital is void (2) the contract was agreed based on *ṣifāt* (attribute/feature), *al-qirāḍ* with such capital is void.

Shāfi'ī jurists clearly put emphasis on the technicality of the *muḍārabah* contract developed through the legal stratagem. For them, the *muḍārabah* contract begins once the agent manager accepts the goods as capital. The problem is that upon receiving the goods, neither the agent manager nor the investor knows their exact value. The value will be known only after the goods are sold in the market. Thus, the *muḍārabah* agreed earlier was based on unknown capital. This definitely contradicts the fundamental condition of the contract which necessitate the capital to be clearly known and identified. Those who agreed with the legal stratagem might argue that the *muḍārabah* is executed not based on unknown capital but based on capital with clear attributes and features (*ṣifāt*). The Shāfi'ī jurists however did not accept the argument and maintained their emphasis on the definite value of the capital from the beginning of the *muḍārabah* contract.

In addition to goods, the classical jurists also discussed the eligibility of debt as a form of *muḍārabah* investment. In discussing the topic, they illustrated two different cases in which debt was used as capital. They unanimously disapproved the first and approved the second case. The first case happens when a creditor asked his debtor to be his agent manager (in a *muḍārabah* contract) using the borrowed money. In this case, Ibn al-Qasim of the Māliki feared that the agent manager might not be able to settle his debt during the

¹⁸³ Ibn Qudamah, *al-Mughnī*, vol.7 p.123-24

commencement of the *muḍārabah* contract. If this happened, the *muḍārabah* business would be set up based on capital which did not exist (*māl ghā'ib*). It would possibly lead to a usurious loan especially when the business plan went wrong. Ibn al-Qāsim's concern for this situation was recorded by Saḥnūn in *al-Mudawwanah*:

[Saḥnūn] what do you think if I ask someone who owed me money to invest it in *al-qirāḍ*. Is it permissible or not? [Ibn al-Qāsim] The transaction is not permissible according to Mālik. [Saḥnūn] Why? [Ibn al-Qāsim] I am afraid of the late payment and increase in the debt¹⁸⁴.

However, the classical jurists agreed in approving *ḥawālah* (the act of transferring of debt) in the *muḍārabah* contract. The *ḥawālah* could take place for example:

When an investor says to an agent-manager; 'take the debt which the person owed me and work with it as *muḍārabah*. Then [the agent manager] took it and worked with it. The act is permissible according to all of the jurists¹⁸⁵.

The jurists asserted that there was a distinctive difference between the two cases. In the first case, the debt is considered an unsecured asset. This is because it remained in the hands of the debtor who was supposed to transform himself into an agent manager. As explained by ibn al-Qāsim, the possibility of delayed or even unsettled debt payment remains. However in the second case, the debt becomes almost a secured asset. The *ḥawālah* is a matter of transferring money from a debtor to an agent manager. In other words, the investor was viewed as having empowered the agent manager to collect the debt and to use the money collected as a *muḍārabah* investment. Once the money is in the possession of the agent manager, the contract will take in effect. As pointed out by Udovitch, the flexibility shown by the classical jurists in accepting the practice of *ḥawālah* had been beneficial for the traders of the long-distance business. The mechanism enabled the investments run more smoothly between them. Consider the following case as an example:

¹⁸⁴ Saḥnūn, 'Abd al-Salām ibn Sa'īd, *Al-Mudawwanah al-Kubrā lil Imām Mālik*, Baghdad: Maktabat al-Munthannā, 1966, vol.5, pp.88.

¹⁸⁵ Ibn Qudāmah, *al-Mughnī*, vol.7, p.182.

If merchant A is leaving with goods or capital for some distant point at which merchant B has unpaid debt from C, A can be empowered to collect from C and invest in goods on a *muḍārabah* basis for the return trip¹⁸⁶.

It would be appropriate at this point to highlight another important requirement concerning the *muḍārabah* capital. The *ḥawalah* case mentioned before indicates that the capital of *muḍārabah* must be physically handed over to the agent manager. In fact, the *muḍārabah* contract only takes effect when the agent manager receives the capital. The classical jurists insisted on this rule in order to ensure that the agent manager had total control in making business decision. Sarakhsī explained:

One of the rules in *muḍārabah* is that the capital should be a trust (*amānah*) in the hands of agent manager. This cannot be fulfilled unless the investor alienated himself from the money¹⁸⁷.

Other type of asset which was discussed in detail by the classical jurists was the property in safe keeping or termed as *wadī'ah*. The investment of *wadī'ah* in the *muḍārabah* contract is similar to the case of using orphan's money as capital. This is because both types of assets are regarded as trusts (*amānah*) conferred by the owner to a person or guardian for a specific period. The rule of *wadī'ah* contract dictates that the entrusted money should be kept in the trustee's custody within the agreed period. Similarly, the custodian of orphans is obliged to ensure the safety of the children's money until they become mature. Having said that; can the trustee of *wadī'ah* or the guardian of orphans invest the money entrusted to them in a *muḍārabah* contract? As we have discussed earlier, the classical jurists had no objection in permitting the latter. It was permitted following the action of 'Umar al-Khaṭṭāb narrated in the famous *athār*.

However, the classical jurists differed in determining the eligibility of *wadī'ah* money. The Ḥanafīs and Ḥanbalīs appeared to be the most flexible jurists in this matter. They allowed the investment of *wadī'ah* money even without

¹⁸⁶ Udovitich, *Partnership and Profit in Medieval Islam*, pp.187.

¹⁸⁷ Sarakshī, *al-Mabsūṭ*, vol.22, pp.84.

asking the prior permission from the original owner¹⁸⁸. Interestingly according to Ibn Qudāmah, the reason the Ḥanbalī jurists allowed such an investment is because they treated the trustee as have a position similar to the original owner in utilising the money. The right however comes with condition. The trustee is obliged to guarantee the *wadī'ah* money. This means he will be liable to return it to the original owner irrespective whether the investment succeeds or not. In general, the rule was agreed by the Shāfi'ī jurists. However, they imposed additional conditions such as requiring the trustee to seek permission of the owner of the *wadī'ah* before investing it in *muḍārabah*¹⁸⁹. In addition to that, they also required the money used in the investment to be precisely determined and known by all of the contracting parties. The conditions are stipulated to minimise any possible dispute in the course of the business. On the other hand, the Māliki jurists refused to accept *wadī'ah* money as a form of investment. They worried that the practice would place burden on the trustee especially when the *muḍārabah* venture suffered losses. Ibn al-Qāsim commented on this issue by saying '....I afraid the trustee who had invested the *wadī'ah* would turn it to debt on him'¹⁹⁰.

In conclusion, our preceding discussions indicate several basic characteristics of *muḍārabah* capital. Firstly, it must be in the form of monetary currency/money. Money was unanimously accepted as a form of *muḍārabah* investment because it possessed fairly consistent value which is crucial in determining the worth of profit/loss at the end of the contract. Secondly, fixed assets or finished consumer products are not accepted as capital in *muḍārabah*. Thus, a business partnership formed by two parties whereby the first party provides a fixed asset (e.g. a car) and the second contributes work (driving) is not considered as a *muḍārabah* contract. The business agreement will be treated as a hire-wages contract. As described by the classical jurists, the *muḍārabah* contract was purely based on the contribution of money from the investor and work of the agent manager. Thirdly, the capital must be in the form of secured

¹⁸⁸ Ibn Qudāmah, *al-Mughnī*, vol.7, pp.183, Udovitch, *Partnership and profit in Medieval Islam*, pp.187

¹⁸⁹ Al-Nawawī, *al-Majmū'*, vol.14 p.195

¹⁹⁰ Saḥnūn, *al-Mudawwanah al-Kubrā*, vol. 5, pp.88.

assets and legally authorised. As far as the security of assets is concerned, they collectively rejected debt as a form of investment. However, with the exception of the Shāfi'īs they were quite flexible in permitting the *ḥawālah*. The jurists ruled that the investor must possess complete authority when investing his money. For this reason, a *mudārabah* of stolen money was certainly rendered invalid. However, they differed in determining the rule for *wadī'ah* in which the authority of its trustee in utilising the entrusted money was quite ambiguous.

Work in *Mudārabah*

In this section, we will identify the scope of *mudārabah* investment as determined by the classical jurists. We would like to examine their opinion over whether an agent manager was allowed to invest the capital in various economic sectors (i.e. manufacturing, agriculture or services) or was restricted to execute a particular type of economic activity?

A review of the medieval Islamic legal texts reveals that *mudārabah* was primarily viewed by the classical jurists as a commercial contract executed in trade (*tijārah*). The *mudārabah* capital was normally used in a series of purchases and sales with the hope of realising profit. The utilisation of *mudārabah* capital in non-trade activities was considered unusual. In relation to this, the view of the Shāfi'īs and Mālikīs seem to be more rigid when compared to the Ḥanafīs. They strictly confined the job of agent manager as involving the retail activities (buying and selling to attain profit). Any other commercial activities carried out by the agent manager during the operation of *mudārabah* will render the contract invalid. Al-Nawawī explained the rule as follow:

And the job of agent manager is trading (*tijārah*) and its related activities such as marketing and packaging, if *al-qirāḍ* was agreed whereby an agent manager was asked to buy wheat, grind and bake it into bread, or cotton for weaving, the contract will be rendered invalid¹⁹¹.

¹⁹¹ Sharbinī, *al-Mughnī al-Muḥtāj*, vol.2, pp.311.

A similar position was taken by the Mālikīs and their rule was based on Mālik's opinion recorded in *al-Mudawwanah*:

[Sahnūn]: what is your opinion if I give to a man money as *qirāḍ*. The man buys leather and makes slippers, shoes and boots from it with his hands and then sells them. Whatever proceeds endowed by Allah will be divided between us equally. [Ibn al-Qāsim] There is no good in that according to Mālik¹⁹².

As evident in *al-Dhakhīrah* of al-Qarāfī, the later Mālikīs consistently maintained the above ruling¹⁹³. They rejected a *muḍārabah* which requires the agent manager to get involved in any manufacturing activity. Questions promptly arise. What are the reasons for disallowing *muḍārabah* in non-trade operation? Why did the Shāfi'īs and Mālikīs rigidly limit *muḍārabah* investment into trade activity?

The answer lies on two main reasons; legal (*uṣūl*) and practical. As we may recall from the preceding discussion, *muḍārabah* was viewed by the majority of jurists as a contract legitimised on the basis of the principle of *rukḥṣah* (dispensation). *Muḍārabah* originally does not comply with the basic rule of hire-wages contract. It contradicts the rule that requires the income of the working party to be precisely determined in advance. Nevertheless, on the ground of a pressing economic necessity of the society, the contract was allowed. The consent however comes with limitations. This followed a principle established by the classical jurists who stipulated that a thing founded on the contrary of analogy can not be used as analogy to others¹⁹⁴. Since, the initial permission of *muḍārabah* was to facilitate partnership in trade, any other commercial activities undertaken by the agent manager would be considered as beyond its allowed limit. If, for instance, the agent manager invested the capital to the manufacturing industry, the transaction would be governed by a contract of hire-wages in which the investor will keep the entire proceeds and the agent manager is entitled equitable wages.

¹⁹² Sahnūn, *al-Mudawwanah al-Kubrā*, vol.5, pp.89.

¹⁹³ Al-Qarāfī, *al-Dhakhīrah*, vol. 6, pp.36

¹⁹⁴ S.M. Hasanuz Zaman, *Muḍārabah* in non-trade operation, *JKAU: Islamic Econ.*, vol. 2, pp. 69-87.

This practical justification demonstrates the inability of *muḍārabah* to facilitate a business partnership in a complex commercial dealing. Let us consider manufacturing industry as an example. The *muḍārabah* was viewed as an inappropriate contract to support partnership in manufacturing projects because it would lead to an inequality of the risk shared by the partners. The contract necessitates that all the monetary cost is to be funded by the investor. In the context of a manufacturing project, this means the investor will bear the cost of everything, from the promotion of the industry down to the purchase of land, machinery, construction, installation, maintenance, wages, raw material and etc. On the other hand, the agent manager is only expected to put in his skill and management ability to ensure the products are manufactured for sale. Despite the huge difference in risk borne by both parties, the investor still becomes the sole party who absorb the monetary loss. In view of this imbalance, the business model is strongly believed to be difficult to work out. Considering the amount of money involved in a manufacturing project, it would be hard to find investors willing to bear the entire cost of the project and share a portion of the profit with the managing agent. Furthermore in *muḍārabah*, the subsistence (*naḥqah*) of the agent manager during travel is to be chargeable to the *muḍārabah* account. The rule would lessen the agent manager's motivation in maximising the profit of the business. He could probably increase his expenses to reduce the business profit. This condition is surely unfair to the investor and makes the contract unlawful according to the Islamic law¹⁹⁵.

On the other hand, the Ḥanafī jurists appeared to be more relaxed in this issue. Contrary to the Shāfi'īs and Mālikīs, they did not confine the task of the agent manager to a retailing job (buying and selling to attain profit). The Ḥanafīs expanded the job scope of the agent manager to include pre-sale processing and after sale service. However, they did not preclude a *muḍārabah* in which the pre-sale processing involved craft or manufacturing activities. According to

¹⁹⁵S.M. Hasanuz Zaman, *Muḍārabah in non-trade operation*, *JKAU: Islamic Econ.*, vol. 2, pp. 69-87.

them, an investor is allowed to entrust his capital to an agent manager on the condition that the latter buys raw materials and turns them into finished consumer products. The products would be sold and any realised profit would be shared between the two parties on the basis of a pre-determined ratio. Sarakshī explained:

For the work which is stipulated for the agent manager is the kind that traders practice in the pursuit of the attainment of profit. It is comparable to buying and selling. Similarly, if the investor instructs the agent manager to use the capital to purchase leather and then cut it into boots, buckets and leather bags, this is all part of the practice of the traders in the pursuit of the attainment of profit, and its stipulation is permissible in a *muḍārabah*.

Note that the Ḥanafī jurists were also of the opinion that *muḍārabah* was legitimised on the basis of the principle of *rukḥṣah*. However as evident in the above case, they did not view the *rukḥṣah* principle had affecting the way *muḍārabah* capital should be invested. In the case where the agent manager was capable of producing finished consumer products, he would be supposed to do it himself. In the context of small scale business, the action seems to be a wise business decision as compared with hiring workers for the production process. From the Ḥanafī jurists' perspective, these pre-sale processes undertaken by the agent manager were still within the definition of trading activities. It is important to note that the Islamic classical legal texts did not show how extensively such arrangement were utilised in financing the industrial production in the Islamic cities during the medieval period. However, the Geniza documents (an accumulation of 200,000 Jewish manuscript fragments) contain several examples of exactly this type of commercial-industrial arrangement involving minting, weaving and textile-dyeing¹⁹⁶.

As far as I could ascertain, the text of *al-Mughnī* did not addresses the said issue directly. All *muḍārabah* cases discussed by Ibn Qudāmah related to pure trading activities. Hence, it is not clear whether the Ḥanbalīs support the restricted scope of *muḍārabah* business or otherwise. Nevertheless, since they

¹⁹⁶ Udovitch, A.L, *Partnership and Profit in Medieval Islam*, pp.186.

viewed that *muḍārabah* was legitimised in conformity of the analogy (not on the basis of *rukḥṣah*), presumably they would have no objection to conduct the contract in non-trade operations.

Muḍārabah implemented in the Malaysian Islamic banking institutions is totally different from the classical jurists' framework. As we shall explain in the next chapter, *muḍārabah* funds in the local Islamic banks are not been utilised to support trading activities but to provide financing for various economic sectors i.e. housing construction, transportation and money/capital market. The Malaysian *shārī'ah* scholars do not agree with the strict view of the Shāfi'ī jurists but uphold the opinion that *muḍārabah* work should be open and unrestricted. Their justification in opposing the Shāfi'īs is worth reviewing. Based on interview with two local *shārī'ah* scholars, I could sense that they are not fully acquainted with the classical jurists' arguments in confining the *muḍārabah* work to trading activities. According to the scholars, the strict view of the classical jurists was the result of different economic conditions. In the past, Muslims lived in a simple life in which trading was the dominant economic activity. Therefore, trading became the most extensive dealing in *muḍārabah* contract. However, since the economic life of Muslims has changed significantly nowadays, there is a need to expand the scope of *muḍārabah* work to cater for a variety of complex financial dealings. Based on this argument, the scholars strongly believed that the rule to restrict the *muḍārabah* work to trading activities is no longer relevant¹⁹⁷.

The Relationship between Investor and Agent manager

Our preceding discussions point out that the role of the investor and the agent manager in setting up a *muḍārabah* contract had been clearly delineated by the classical jurists. According to them, a *muḍārabah* contract will be established when one party (the investor) contributes capital and the other party (the agent manager) runs the daily business operations. The following discussion

¹⁹⁷ Interview with Dr. Engku Rabiah Engku Ali and Dr. Shamsiah Mohammed on 11th and 9th August 2008.

elucidates how the venture is going to work. It examines the jurists' rules in governing the relationship between the two parties. For example it deals with questions; to what extent is an agent manager empowered? Did he have absolute power in making business decisions? If not, did the investor have the right to know what the agent manager was using the money for? Did the investor have mechanism to assure the trustworthiness of the agent manager?

The majority of jurists were of the opinion that the business operation was exclusively the responsibility of agent manager. The Ḥanafī, Mālikī¹⁹⁸ and Shāfi'ī¹⁹⁹ jurists did not allow the investor to participate in *muḍārabah* business. They ruled that if an investor participates in the business the contract will be rendered invalid. The participation is prohibited from the beginning of the contract specifically when the capital had been handed over to the agent manager. The exclusion of the investor from the business was argued to be necessary in order to express the authority given to agent manager in controlling the business operation. Sarakshī explained the rule as follows:

If *muḍārabah* agreed with the condition that the investor will work with the agent manager, the contract rendered invalid because one of the conditions in determining its validity is the separation (*takhliyah*) between the agent manager and the investor²⁰⁰.

It seems that when the investor is prohibited from participating in the business, the agent manager will obtain total control over the *muḍārabah* business. However, a closer look at the classical jurists' discussion reveals that the empowerment given is not absolute but restricted. The jurists imposed certain limitations to the agent manager in performing his task. In this respect, the Ḥanafīs appeared to be the most flexible and relaxed as compared to the other *Sunni* schools of law.

According to the Ḥanafīs, the scope of empowerment of agent-manager is identified based on the expression (*ṣīghah*) used at the beginning of *muḍārabah*

¹⁹⁸ Al-Qarāfi, *al-Dhakhīrah*, vol. 6, pp.37.

¹⁹⁹ Sharbinī, *al-Mughnī al-Muhtāj*, vol.2, pp.311.

²⁰⁰ Sarakshī, *al-Mabsūṭ*, vol.22, pp.83

contract. They divided the expression into three; (1) the general expression (*ṣīghah muṭlaqah*) (2) the expression when the investor said to the agent-manager ‘*act according to your opinion*’ and (3) restricted expression. An example of the general expression is when the investor says to the agent-manager, ‘*start a business with my initial capital of 1000 dirhām and we will share the profit equally*’. The expression will empower the agent manager to execute various types of business transactions which are thought to generate profit and are customarily practiced by traders. The business transactions allowed include all types of sales, appoint a representative (*wakālah*), put *muḍārabah* capital in safe keeping (*wadī‘ah*), collecting debt, transfer of debt (*hawālah*) and hire an employee or transportation²⁰¹.

In addition, based on the general expression, the Ḥanafī jurists permitted the agent manager to perform credit transactions. According to the Ḥanafīs, an agent manager is allowed to sell *muḍārabah* commodities in credit to customers even without having prior permission from the investor. As explained by Sarakhsī, credit transaction is allowed mainly because of two reasons; (1) the transaction was customarily practised by traders and (2) it could bring more profit to the business. Sarakhsī explained the justification in the following statement:

We said that the credit sale is part of traders’ practices and it is closer in attaining the investors’ objective which is profit. Profit is usually obtained from credit sale not cash sale²⁰².

On the other hand, the Mālikī²⁰³, Shāfi‘ī²⁰⁴ and Ḥanbalī jurists ruled against credit sale. They did not permit the agent manager to purchase or sell on credit without obtaining a clear and explicit permission from the investor²⁰⁵. The Ḥanbalīs in particular laid down several guidelines before allowing the agent manager to execute credit transactions. For example, if the agent manager wants to buy on credit, the amount of credit allowed must not exceed the

²⁰¹ Sarakhsī, *al-Mabsūṭ*, vol.22, pp.38

²⁰² Ibid

²⁰³ Al-Qarāfi, *al-Dhakhīrah*, vol. 6, pp.73

²⁰⁴ Sharbinī, *al-Mughnī al-Muḥtāj*, vol.2, pp.315

²⁰⁵ Ibn Qudāmah, *al-Mughnī*, vol.7, pp.147

amount of *muḍārabah* capital²⁰⁶. If he wants to sell on credit, he must ensure the creditworthiness of customer. If the agent-manager happens to sell on credit to a customer whose creditworthiness is doubtful, he would become liable for any loss incurred²⁰⁷. The main reason for majority of jurists ruled against credit transaction because they viewed it as a risky deal. From their perspective, credit transaction involves high risk of incurring losses or reducing the *muḍārabah* capital. Since the investor is the sole party who bears the monetary loss in the *muḍārabah*, his approval in dealing with such transaction is mandatory.

In addition to that, the jurists justified their rule based on an analogy with that of the *wakālah* contract. Based on the general expression (*ṣīghah muṭlaqah*), an agent of a *wakālah* contract is prohibited from executing credit transaction. Similarly, the agent-manager in *muḍārabah* is prohibited from doing so²⁰⁸. The Ḥanafīs disagreed with the analogy. They viewed *wakālah* and *muḍārabah* to be two distinct contracts. The main objective of *wakālah* is to buy or sell at a reasonable price according to the order of the original owner. The agent of *wakālah* is not expected to bring any profit. Since a reasonable price is normally realised by dealing in cash, there is no need for the agent of *wakālah* to execute credit transaction. In contrast the main objective of *muḍārabah* is to maximise profit. As claimed by traders, a higher profit is usually attained by dealing in credit. Therefore the agent manager in *muḍārabah* is allowed to execute such transaction²⁰⁹.

The disagreement over the credit transaction issue demonstrates two different considerations by the classical jurists in determining the scope of empowerment of agent manager. The Ḥanafī jurists appeared to give priority in the attainment of profit whereas the majority of jurists emphasise more the safety of the investment. For the Ḥanafīs, the determinant factor in deciding the scope of empowerment of agent manager is the custom of traders (*ʿurf al-tujjār*). This

²⁰⁶ Ibn Taymīyah ʿAbd Salām ibn ʿAbd Allāh, *al-Muḥarrar fī al-Fiqh ʿalā Madhhab al-Imām Aḥmad ibn Ḥanbal*, Beirut: Dār al-Kutūb al-ʿIlmiyah, 1999, vol 2, pp.531.

²⁰⁷ Ibn Qudāmah, *al-Mughnī*, vol.7, pp.147

²⁰⁸ Ibid

²⁰⁹ Sarakshī, *al-Mabsūṭ*, vol.22, pp.38

means, if an act is widely practised by traders, it can be executed by an agent manager without obtaining prior permission from the investor. However, for the majority of jurists the determinant factor is the risk element. They did not allow the agent manager to execute any transaction which exposes the business into danger. Based on this premise, it is also true that the Ḥanafīs seem to be on the agent manager's side whereas the other schools are on the investor's side. We will see more examples of these deliberations when we discuss more cases of *muḍārabah* empowerment.

Our next case is travelling for the purpose of conducting *muḍārabah* business. According to the Ḥanafīs, the *ṣīghah muṭlaqah* expressed at the beginning of the contract would allow the agent-manager to make business trips whenever he thinks it necessary. The rule is based on three main justifications. Firstly, they base their rule on the literal meaning of *muḍārabah*. As mentioned earlier, *muḍārabah* is derived from the expression of *ḍarb fīl-arḍ* in the Qur'an, which means making a journey. In view of this terminology background, the Ḥanafīs asserted that the word *muḍārabah* explicitly entails the permission to travel. Secondly, the Ḥanafī jurists made analogy with the *wadī'ah* contract. Since a trustee of *wadī'ah* contract is permitted to travel with asset in safekeeping, the same rule should be applied to agent manager in a *muḍārabah* contract. In fact, the permission to travel for the latter has greater priority. The jurists had permitted the trustee of a *wadī'ah* contract to travel even though he is prohibited from utilising the asset in his safekeeping. Rationally, an agent-manager should be permitted to travel because he has control over the capital. The third justification perhaps is the most significant. Similar to the case of credit transaction, the Ḥanafīs argued on the basis of the traders' custom in the attainment of profit. They admitted that travelling is one of the basic activities of any business. In order to maximise profit, traders have to conduct their business locally and abroad. Therefore, based on the general expression, an agent manager should be allowed to make business travel without having prior permission from the investor²¹⁰.

²¹⁰ Sarakshī, *al-Mabsūṭ*, vol.22, pp.39

The Mālikīs' rule seems to be similar to that of the Ḥanafīs. They allowed the agent manager to embark on business travel if the investor did not prevent him to do so at the beginning of the contract²¹¹. However, the Shāfi'īs emerged to be the strictest jurists in this matter. Al-Shirazī explained their rule as follows:

And do not travel with the capital without having permission from the investor. This is because the agent manager was asked to perform his job with careful and vigilant consideration. And travelling is not regarded as a vigilant decision because it could cause loss to the capital²¹².

Consistent with their rule on credit transaction, the Shāfi'īs maintained the approach of emphasising the safety of the capital over the attainment of profit. They viewed travelling to be a risky activity which could cause loss to the business. Hence, explicit permission from the investor is compulsory before the agent manager could make any business trip. Meanwhile, the Ḥanbalīs had two different rulings with regard to travelling based on the *ṣiġhah muṭlaqah*. The first ruling is similar to the Shāfi'īs who prohibited the agent-manager from travelling without having clear and explicit permission from the investor. The second ruling is similar to the Ḥanafīs and Mālikīs who permitted travelling with the condition that the journey is safe²¹³.

It is noteworthy that there is a significant difference between the circumstances of travelling discussed by the classical jurists compared with the business travelling in the present day. As is evident in the Shāfi'īs' argument, travelling in the past refers to caravan trade where properties of *muḍārabah* were carried from one place to another by the agent manager in his effort to sell them. Given the condition of routes between Mecca, Medina, Basrah, Kufah, Baghdad, Damascus and Yemen at that time, we could understand why the Shāfi'ī jurists were concerned with the safety of the properties. In the remote areas between the cities, the properties were exposed to robbers. However, business trips in modern days happen in a complete different environment. Nowadays a

²¹¹ Dusūqī, *Ḥāshiyat al-Dusūqī 'alā al-Sharḥ al-kabīr 'alā Mukhtaṣar Khalīl*, vol. 3, pp.525.

²¹² Al-Shirazī, *Kitāb al-Muhadhdhab fī al-Fiqh madhhab al-Imām al-Shāfi'ī*, vol.1, p.386

²¹³ Ibn Qudāmah, *al-Mughnī*, vol.7, pp.147.

businessman rarely travels to various places with all his products and goods. But, he will go to meet his potential clients with prototype and arranges the delivery of the sale items later on. Therefore, the safety factor which concerned by the Shāfi'ī jurists is now become secure. Based on this premise, I could argue that it would be misleading to apply the Shāfi'ī's rule in our contemporary period. The classical rule was made in a different context. Nevertheless, the case of travelling demonstrates the distinctive methods adopted by the two groups of jurists. The first group gives priority to the traders' custom in the attainment of profit whereas the second group is concerned more about the safety of *muḍārabah* investment.

The case of travelling is also significant in demonstrating the classical jurists' opinions with regard to *muḍārabah* expenses. In principle, all of them agreed that the expenses of the *muḍārabah* business are to be borne by the investor. The expenses include the cost of facilities which contribute directly to the operation of the business such as hiring transportation, employees, stores and etc. However, the subsistence of the agent manager (i.e. foods and clothes) is excluded from the expenses. This is because the agent manager will not be paid any wages during the business period. His income depends on the business profit determined after the business is liquidated. Nevertheless, when the agent manager travels (for the purpose of business), he is allowed to claim his subsistence on the *muḍārabah* account. According to Ḥanafīs and Mālikīs, the *ṣiġhah muṭlaqah* would not only give permission to the agent manager to travel but also to claim his subsistence during the business journey. Mālik stated the rule as follows:

And the subsistence of the agent manager including foods and clothes during travelling is taken from the capital, and whatever is appropriate for him provided that the capital is adequate. If the agent manager resides with his family, he is not entitled the subsistence from the capital and the clothes²¹⁴.

²¹⁴ Al-Bāji, *Muntaqā sharḥ al-Muwatṭa'*, vol.7, pp.79

Sarakshī argued that the claim should be permitted because the business trip is conducted for the sake of *muḍārabah* business. During the journey, the agent manager had put a lot of effort to bring profit to the venture and therefore the capital should cover his personal expenses. It is also argued that without such a travelling allowance, an agent manager would not be motivated to make a business trip which consequently affects any possible profit to the business. Sarakshī explained:

This is because his travel and journey is for the *muḍārabah*. And a person will not undertake hardship to travel and pay its cost using his own money for an uncertain profit which he may or may not achieve. The agent manager is willing to undertake such hardship with a view to the benefit that might accrue to him. This will not happen unless he spends from the capital in his possession sufficiently²¹⁵

On the other hand, the Shāfi'īs²¹⁶ and Ḥanbalīs²¹⁷ ruled that the agent-manager has no right to claim on travel expenses unless it was agreed at the beginning of *muḍārabah*. Both schools strongly recommended that the parties clarify the cost of travelling before the trip take place. They did not consider the *ṣīghah muṭlaqah* as the approval for the agent manager to travel and subsequently claim on his subsistence. As we may expect, the reason for this rule is to prevent business loss due to over spending on travelling expenses. The Shāfi'ī and Ḥanbalī jurists worried that the agent manager would have every incentive to increase the travelling expenses for his own benefit.

The concern over the agency problem is understandable since no clear guideline was stipulated by the classical jurists in determining the maximum limit of the claim. A fixed maximum expense was not laid down by the jurists since the cost of travelling varies all the time. However as stipulated by the Ḥanafīs, the general rule in this matter is that the extent of the agent manager's expenses is determined by commercial custom and their quality is determined by his social status²¹⁸. The claim on ointment provides a good example with

²¹⁵ Sarakshī, *al-Mabsūṭ*, vol.22, pp. 62-63.

²¹⁶ Al-Nawawī, *al-Majmū'*, vol.14 pp.205

²¹⁷ Ibn Qudāmah, *al-Mughnī*, vol.7, pp.147

²¹⁸ Udovitch, A.L, *Partnership and Profit in Medieval Islam*, pp.233.

regard to the first point (custom). Apart from foods, clothes and transportation the Ḥanafī jurists differed in allowing the agent manager to claim on the ointment used during travelling. As explained by Sarakshī, the claim on the ointment is only allowed when the agent manager travel to the regions where the use of the ointment is customary (i.e. Hijaz and Iraq), but not to areas in which this is not the case. Meanwhile in explaining the point of social status, Sarakshī compared it with the maintenance (*nafaqah*) of a wife in marriage contract. As a husband is required to provide equivalent accommodation, foods and clothes to his wife that she used to live before marriage, an agent manager is also entitled for the same quality of subsistence before he embarks into *muḍārabah* business trip²¹⁹. Hence, the point which we could address from the preceding discussions is that the agent manager's expenses is not rigidly regulated by the classical jurists but it left open to the discretion between the contracting parties.

The second type of expression is when the investor said to the agent-manager 'act according to your opinion'. According to the Ḥanafīs, this expression granted more flexibility to the agent-manager in conducting the *muḍārabah* business. In addition to all transactions mentioned before, the expression permitted the agent-manager to commingle the entrusted capital and execute recursive *muḍārabah*. Commingling of capital means the agent-manager has the right to pool together the *muḍārabah* capital given by the original investor with his own money or other investors. Recursive *muḍārabah* happens when the agent-manager use the capital to act as capitalist in another *muḍārabah* arrangement²²⁰. Both transactions were viewed by the classical jurists as transactions beyond the general scope of agent manager's empowerment. This is because by executing either the commingling of capital or recursive *muḍārabah* the investor will be obliged to enter into partnership with other parties. The basic rule of *muḍārabah* specifies that the agent manager has no right to draw the investor into such situation. Therefore, the classical jurists

²¹⁹ Sarakshī, *al-Mabsūṭ*, vol.22, pp.63.

²²⁰ Wahbah al-Zuhaylī, *Al-Fiqh al-Islāmī wa 'Adillatuh, Financial Transaction in Islamic Jurisprudence*, Mahmoud A. El-Gamal (translator), Damascus: Dār al-Fikr, 2003, vol.1, p.505

stressed that explicit permission is required before the agent manager is allowed to execute them. In identifying this permission, the Ḥanafīs appeared to be the most flexible school. They ruled that the expression ‘*act according to your opinion*’ is adequate to demonstrate the investor’s permission²²¹.

However, according to the Mālikīs and Ḥanbalīs, a more specific permission is required. The expression of ‘*act according to your opinion*’ is insufficient to indicate the investor’s approval. They emphasised the explicit permission to avoid any dispute in the future. Ibn Qudāmah and al-Qārafī stated the rules as follow:

If a person accepts *muḍārabah* contract with someone and then want to accept another *muḍārabah* with other; it will be allowed only if **the first investor permits it**²²².

And it is stipulated in *al-Kitāb (al-Mudawwanah)* that an agent manager is not allowed to entrust others in *muḍārabah* unless with **permission**. This is because the agent manager does not have right to entrust other²²³.

On the other hand, the Shāfi‘īs agreed with the Mālikīs and Ḥanbalīs in the case of commingling of capital but maintained their strict view in the recursive *muḍārabah*. The majority of Shāfi‘īs did not permit the agent-manager to entrust *muḍārabah* capital to the other party, even if the investor was to approve it. They argued that since *muḍārabah* contract was legitimised on the exceptional ground (‘*ala khilāf al-qiyās*’), it should always be conducted in its basic form. According to them the basic form of *muḍārabah* is essential because it justifies the right of the investor and the agent manager in sharing the *muḍārabah* profit. In *muḍārabah*, the right to any portion of the profit is earned either by virtue of the money invested, or by virtue of the work carried out. If the agent manager acts as capitalist in another *muḍārabah* arrangement his right to share the profit will be questionable. The intermediary role played by the agent manager in the recursive *muḍārabah* is not recognised by the majority of

²²¹ Sarakshī, *al-Mabsūṭ*, vol.22, pp.39.

²²² Ibn Qudāmah, *al-Mughnī*, vol.7, pp.159.

²²³ Al-Qarāfī, *al-Dhakhīrah*, vol. 6, pp.69.

Shāfi'is as he is neither the owner of the capital nor the worker for the business²²⁴.

In view of the current practice of *muḍārabah* in Islamic banking institutions, the cases of commingling of capital and recursive of *muḍārabah* are very significant. This is because both transactions are the fundamental elements of every *muḍārabah* product in the local Islamic banks. Malaysians Islamic banks practice commingling of capital by receiving capital from many customers and invested them in similar investment portfolios. The banks also implement the recursive *muḍārabah* by playing an intermediary role between the depositors and the entrepreneurs. Islamic banks do not personally run the *muḍārabah* business but will entrust the money given by the depositors to trusted and reliable entrepreneurs. In this matter, the Islamic banks clearly adopt the Ḥanafīs' rule. The general consent given by the depositors at the beginning of the contract is regarded as sufficient evidence to allow the banks to carry out commingling of capital and recursive *muḍārabah*.

Our previous discussions so far reveal the two distinctive methods adopted by the classical jurists in formulating their *muḍārabah* doctrine. We find out that in governing the unrestricted *muḍārabah*, the Ḥanafīs seem to be the most lenient jurists whereas the Shāfi'īs appear to be the strictest. Based on the general expression (*ṣīghah muṭlaqah*) or the expression of *act according to your opinion*, the Ḥanafīs allowed the agent manager to perform credit transaction, travel for the purpose of business, claim on his subsistence, commingle *muḍārabah* capital as well as entrust the capital to other party. It is argued that these transactions were customarily practised by traders and could bring more profit to the *muḍārabah* venture. In contrast, the Shāfi'īs did not permit all the transactions unless the agent manager obtains explicit permission from the investor. Their rulings in these matters demonstrate their cautious approach when regulating *muḍārabah* of unrestricted conditions. The Shāfi'īs are more

²²⁴ Sharbinī, *al-Mughnī al-Muḥtāj*, vol.2, pp.314.

likely to give priority to the protection of investor's capital than the possible profit made by the agent manager.

However, as we shall see in the following discussions a contradictory approach was adopted by the two schools in formulating the rules of restricted *muḍārabah*. Restricted *muḍārabah* takes place when the investor specifies certain guidelines to the agent manager in conducting the business. In this respect, the Ḥanafīs appeared to be supporting more the investor as they allow him to stipulate many guidelines to the agent manager which the Shāfi'īs viewed as unnecessary. The rules include limiting the scope of business, the object of trade and the person that the agent manager could deal with and the duration of the *muḍārabah* contract. According to the Shāfi'īs, these conditions are not permitted as they will significantly limit the flexibility of the agent-manager in performing his task. However, the Ḥanafīs allowed the stipulation of the rules in view of the fact that they might benefit the business.

Generally, the jurists agreed that the investor has the right to impose conditions to the agent-manager. This ruling is a derivative of *ḥadīth* of Ibn 'Abbās and Ḥakīm ibn Hizām who were reported as stipulating conditions such as prohibiting their agent-manager from travelling with merchandises through sea, valley and from buying a living thing. The Prophet (pbuh) was informed of the conditions and he did not oppose to them. Basically the conditions laid down by the investors must be useful, practical and not seriously limit the flexibility of the agent-manager.

It is agreed unanimously by the jurists that the investor could specify the location in which the business will take place²²⁵. Hence, for example it is permitted for the investor to say to the agent-manager; '*trade at Kufah market*'. The condition requires the agent-manager to conduct his business at the Kufah market only. If the agent-manager purchase and sale at other than the stipulated

²²⁵ Sarakshī, *al-Mabsūṭ*, vol.22, pp.40, Ibn 'Abd al-Barr, *Kitāb al-Kāfi fī Fiqh Ahlul Madīnah al-Mālikī*. Riyadh; Maktabah al-Riyādh al-Ḥadīthah, 1980, vol.2, pp. 773. Sharbinī, *al-Mughnī al-Muhtāj*, vol.2, pp.311, Ibn Taimīyah, *al-Muharrar fī al-Fiqh 'alā Madhhab Imām Aḥmad ibn Hanbal*, vol.2, pp.532.

place, the *muḍārabah* contract will be rendered invalid and he will become liable to any loss incurred. Such a condition is permissible because it is a preventative measure for the investor to secure his capital²²⁶. For instance, the investor chose the Kufah market because he probably knows most of the customers there. Perhaps, by restricting the business place, he could avoid any business fraudulent that will cause loss to his investment. The condition of location restriction is also vital for investor who wants to invest in short term period. The condition permits the investor to access his capital quickly and at any time could instruct the agent manager to convert the investment into cash. Unlike the unrestricted *muḍārabah*, the investor would not have to wait the agent manager to return from a journey of undetermined duration²²⁷.

In addition to the restriction of location, the Ḥanafīs and Ḥanbalīs also permitted the investor to specify the scope of business and the types of goods that the agent manager was allowed to invest/trade with²²⁸. For, example, the investor could say to the agent-manager; ‘*invest in food*’ or ‘*purchase and sale apple*’. According to Sarakshī, the restrictions are permitted to minimise risk in the *muḍārabah* contract. This is because the agent-manager might specialise in certain types of business to the exclusion of others and thus the investor wish to confine the agent manager’s activity to his speciality²²⁹. The Mālikīs²³⁰ and Shāfi‘īs²³¹ however did not allow the restriction of object of trade particularly those which rarely found in the market. An example of such condition is when the investor instructs the agent manager to sell red sapphire. As the precious stone is rarely found, the restriction would seriously limit the flexibility of the agent-manager in conducting the business. Adhering to such condition will also prevent the agent-manager from earning profit, which is the ultimate aim in *muḍārabah*.

²²⁶ Sarakshī, *al-Mabsūṭ*, vol.22, pp.40,

²²⁷ Udovitch, A.L, *Partnership and profit in Medieval Islam*, pp.211.

²²⁸ Sarakshī, *al-Mabsūṭ*, vol.22, pp.40, Ibn Qudāmāh, *al-Mughnī*, vol.7, pp.177.

²²⁹ Sarakshī, *al-Mabsūṭ*, vol.22, pp.41

²³⁰ Dusūqī, *Ḥāshiyat al-Dusūqī ‘alā al-Sharḥ al-kabīr ‘alā Mukhtaṣar Khalīl*. vol. 3, pp.521.

²³¹ Sharbinī, *al-Mughnī al-Muḥtāj*, vol.2, pp.311.

The Hanafis and Ḥanbalīs also allowed the investor to specify persons whom the agent-manager should deal with²³². Thus, when the investor says ‘*deal with Aḥmad only*’, the agent-manager cannot buy and sell with any other person. From the investor point of view, the condition is important as it ensures the agent-manager deals with a right person, as individuals are different in terms of creditworthiness, trustworthiness and reliability in fulfilling obligation²³³. Contrarily, the Mālikīs²³⁴ and Shāfi’īs²³⁵ disallowed condition that requires the agent-manager to deal with a specific person. The important consideration in prohibiting such a condition is that it will seriously confine the flexibility of the agent-manager. For both schools, the agent-manager should have freedom to choose the person with whom he would deal because probably, dealing with the specific person named by the investor will not bring profit to the *muḍārabah*²³⁶.

The Ḥanafis and Ḥanbalīs also permitted conditions, which stipulate the duration of *muḍārabah* contract²³⁷. For example, the investor could say to the agent-manager ‘*invest my money for a year*’. This condition will empower the agent-manager to manage the capital within the stipulated period. According to Ibn Qudāmah, if the agent-manager continued to invest the capital after the stipulated period, the *muḍārabah* contract will automatically turn into debt contract. In other words, the investment at that time will make the agent-manager responsible and liable for any loss incurred²³⁸.

On the other hand, the Mālikīs and Shāfi’īs disallowed the investor to restrict the *muḍārabah* contract to a specified period²³⁹. They justified their ruling based on three main arguments. Firstly, they argued that the *muḍārabah* contract is initially a general contract without time limits similar to marriage

²³² Sarakshī, *al-Mabsūṭ*, vol.22, pp.42, Ibn Taimīyyah, *al-Muharrar fī al-Fiqh ‘alā Madhhab Imām Aḥmad ibn Ḥanbal*, vol.2, pp.532

²³³ Sarakshī, *al-Mabsūṭ*, vol.22, pp.42

²³⁴ Dusūqī, *Ḥāshīyat al-Dusūqī ‘alā al-Sharḥ al-kabīr ‘alā Mukhtaṣar Khalīl*. vol. 3, pp.521.

²³⁵ Sharbinī, *al-Mughnī al-Muḥtāj*, vol.2, pp.312.

²³⁶ Sharbinī, *al-Mughnī al-Muḥtāj*, vol.2, pp.313.

²³⁷ Ibn Qudāmah, *al-Mughnī*, vol.7, pp.177 & Jazīrī, ‘Abd Raḥmān, *al-Fiqh ‘alā al-Madhahīb al-‘Arba’ah*, Bayrūt: Dār al-Kutūb al-‘Ilmiyah, 1990, vol2, pp.49

²³⁸ Ibn Qudāmah, *al-Mughnī*, vol.7, pp.177

²³⁹ Sharbinī, *al-Mughnī al-Muḥtāj*, vol.2, pp.312 & Jazīrī, *al-Fiqh ‘alā al-Madhahīb al-‘Arba’ah*, vol. 2, pp. 52.

contract. As such, it should remain in general as it is. Secondly, they viewed the condition as worthless for both the investor and the agent-manager. Thirdly, they were of the opinion that the time limit will put the agent-manager under serious pressure to achieve profit for the business. The jurists viewed that the agent-manager should be given no-time limit to earn profit because no one can guarantee when he can achieve it²⁴⁰.

The preceding discussions again demonstrate two distinctive schools of Islamic law in formulating the framework of restricted *muḍārabah*. The Ḥanafīs and Ḥanbalīs are more flexible in allowing the investor to stipulate guidelines and conditions to the agent manager as compared to the schools of Mālikīs and Shāfi'īs. They permitted the investor to specify the object of trade, the person whom the agent manager could deal with and the duration of the business. These restrictions are considered as preventive measures taken by the investor to safeguard his investment. However, the Mālikīs and Shāfi'īs were reluctant to impose the restrictions and to maintain the freedom of the agent manager. They viewed that the restrictions will seriously limit the authority of agent manager in performing his task. As far as Islamic banking is concerned, the restricted *muḍārabah* contract is also adopted by the Malaysian Islamic banks in creating their investment products. Islamic banks claim that they apply the concept of restricted *muḍārabah* since the product has limitation in its portfolio and duration of the investment²⁴¹. A detail analysis on this subject is presented in the following chapter. However, as a brief finding, the current practice appears to be different from the framework described by the classical jurists. Nowadays, the Islamic bank as agent manager has more power when compared to the depositors (the investor). The conditions laid down in the investment product are entirely decided by the bank instead of the depositors. The situation totally contradicts the medieval *muḍārabah* in which the investors are seen as the controlling party.

²⁴⁰ Ibn Qudāmah, *al-Mughnī*, vol.7, pp.17

²⁴¹ Application of Sharī'ah Contracts in Banks Islam's Products and Services, Bank Islam Malaysia Berhad: Kuala Lumpur, Access at www.bankislam.com.my on 15 April 2010.

Profit in *Muḍārabah*

The classical jurists' discussion regarding provisions of *muḍārabah* profit can be broadly divided into two aspects. The first aspect relates to the proportional division whereas the second concerns with the distribution method.

It was agreed unanimously by the jurists that profit in *muḍārabah* should be distributed in ratio or proportion. The proportion must be decided at the beginning of the contract by both contracting parties. The division of *muḍārabah* profit in the form of fixed amount is not accepted and will invalidate the contract. The fixed amount of profit is prohibited because it leads to the inequitable situation of sharing the proceeds of the business. This could happen in various cases. For example, suppose an investor agreed to embark on a *muḍārabah* contract and promised to pay his agent manager a fixed 100 *dirhām*. After sometime, the agent manager came back and declared that the business did not make any profit except the amount of his guaranteed income. In this case, all the profit will go to the agent manager and the investor will get nothing. And it is even worse if the profit is claimed to be less than 100 *dirhām*. In order to keep his promise, the investor has to use his own money to pay to the agent manager²⁴². Hence, the fixed amount of profit could be manipulated for the benefit of agent manager. Knowing the limit of his income, the agent manager will have no incentive to maximise *muḍārabah* profit for the sake of an investor. In contrast, the proportional division of profit will avoid such problems. This is because the shares of the concerned parties will depend on the actual amount of profit realised from *muḍārabah* business. For the agent manager, the more profit declared from the business the larger amount of money he would receive.

The classical jurists did not determine the accepted standard division of the profit. It is entirely down to the discretion of the investor and the agent manager at the time the *muḍārabah* is being negotiated. The cases discussed by the jurists in the classical legal texts were theoretical in nature. They are not

²⁴² Sarakshī, *al-Mabsūṭ*, vol.22, pp.23.

indications of the prevalent practice of *muḍārabah* of the medieval period. The most frequent ratio mentioned was 50:50. Perhaps, the equal division was highlighted in most of the cases to provide simple examples for the general readers. It is notable however that the formulaic phrase used by the classical jurist in this subject often begins with investor's offer. For instance an investor would say to an agent manager: "I will entrust you 1000 *dirhām* in the form of *muḍārabah* on the basis of half the profit". Besides the negotiation element, the phrase demonstrates the investor's position as the dominant party in the *muḍārabah* contract. As provider of the capital, the investor is the one who makes offer and stipulates conditions to safeguard his investment. As the working party, the agent manager would have no other choice either to accept or reject the offer. In contrast, the present practice of *muḍārabah* in the Islamic banks illustrates the opposite scenario. Most of the matters including the provisions of profit ratio are determined by the banks. Depositors do not have the opportunity to discuss the issue with the banks since *muḍārabah* investment product has become the 'take it or leave it' affair offered by Islamic banks.

The issue of proportional division of *muḍārabah* profit did not raise many disputes among the classical jurists. All of them agreed that the ratio or proportion must be clearly determined and known (*ma'lūm*) as well as spelled out between the two contracting parties. Perhaps the only disagreement in this subject is the case when the contract mentioned only one party would receive the share of the profit. According to the majority of jurists as the risk of *muḍārabah* must be borne by both the investor and the agent manager, so too should the profit of the business be shared. Hence, the Ḥanafīs, Shāfi'īs and Ḥanbalīs ruled that if all the profit is assigned to the agent manager, the capital will be governed on the basis of loan (*qarḍ*) contract. In this case, the agent manager is responsible to return the full amount of capital and bear the monetary losses. On the other hand, if it was agreed that only the investor would receive the profit, the agreement would be treated as an *ibḍā'* contract²⁴³. This means the agent manager would not be liable to any risk at all in the deal.

²⁴³ Sarakshī, *al-Mabsūṭ*, vol.22, pp.24, Sharbinī, *al-Mughnī al-Muḥtāj*, vol.2, pp.312 & Ibn Qudāmah, *al-Mughnī*, vol.7, pp.142.

However, Mālik was of the opinion that a *muḍārabah* contract remains intact even when it was agreed that all the profit will be given exclusively to the agent-manager. It was reported that Mālik was asked about a similar case and he replied: “that is very good and surely no problem”²⁴⁴.

After discussing the proportional division of *muḍārabah* profit, we will now move on to the issue of profit distribution process. It begins with the requirement for the agent manager to return the capital to the investor. The jurists asserted that as *muḍārabah* could not begin without the investor relinquishing control over his capital, so too, the contract could not be liquidated unless the agent manager restore the capital to the physical possession of the investor²⁴⁵. The return of capital is crucial to determine the *muḍārabah* profit. This is because the profit of the contract is defined as any surplus from the capital. Hence, after all the profit is been restored, any remaining money will be divided by both parties according to the pre-agreed proportion. Ibn Qudāmah explained the rule as follows:

And there is no profit for the agent manager until he restores the capital. This means the agent manager is not entitled to anything from the business until he returns the capital to the investor, and when there is loss and profit, the former will absorb the latter irrespective of whether they occur at the same or different times. This is because profit means any surplus from the capital and anything which has no excess has no profit²⁴⁶.

If, for some reason the investor and the agent manager divided the profit without returning the capital, the original *muḍārabah* was considered as continuing in force. Sarakshī illustrated a similar case to explain the position of the Ḥanafis in this matter. Suppose an investor entrusted 1000 *dirhām* to an agent-manager. From the capital given, the agent-manager managed to earn an additional 1000 *dirhām*. Then, both of them distributed the profit equally and took 500 *dirhām* each. The capital remained in the possession of the agent-manager and he continued the business with it. After that, the business was

²⁴⁴ Sahnūn, *al-Mudawwanah al-Kubrā*, vol.5, pp.89-90.

²⁴⁵ Udovitch, A.L, *Partnership and Profit in Medieval Islam*, pp.246.

²⁴⁶ Ibn Qudāmah, *al-Mughnī*, vol.7, pp.165.

unsuccessful and made losses. According to Sarakshī, the previous distribution of profit is invalid. Therefore, the 500 *dirhām* which the agent manager took as profit is to be considered as capital. The agent manager should return the money to the investor and then only the *muḍārabah* would be dissolved. The insistence of returning of the capital is based on a *ḥadīth* of the Prophet. It is reported that the Prophet says ‘A Muslim is like a trader, just as the trader’s profit is not complete until his capital is restored, so too a recommended worship of a Muslim is incomplete until he performs the obligatory worship’²⁴⁷.

The case above also indicates that the Ḥanafīs recognised the right of the concerned parties to share the expected return of the *muḍārabah* business. In other words, although the contract is not yet dissolved, the investor and the agent manager are allowed to take their projected shares. However, as the original *muḍārabah* business is still continuing, the profit taken is conditional. The profit taken is subject to the performance of *muḍārabah* business after the distribution. If there is loss incurred in the subsequent business, the agent manager has to return the profit as part of the capital. The most prevalent view of the Shāfi‘īs (*al-aẓhar*) agreed to this ruling²⁴⁸. The majority of Shāfi‘īs did not consider any sales or commercial contracts executed using money from *muḍārabah* expected profit as legally binding. In a theoretical case study, they refused to recognise the act of the agent manager who bought and freed a slave with such profit. They argued that the expected profit is not absolutely owned by the agent manager, thus he has no right to free the slave²⁴⁹.

However, the Ḥanbalīs recognised the absolute ownership of expected profit taken from a continuing *muḍārabah* business. In justifying the rule, the Ḥanbalīs made an analogy with *musāqāh* contract²⁵⁰. As the worker in this contract owns his shares starting with when the fruit is beginning to grow, the agent manager also has the right of ownership from the expected return of

²⁴⁷ Sarakshī, *al-Mabsūṭ*, vol.22, pp.105.

²⁴⁸ Sharbinī, *al-Mughnī al-Muḥtāj*, vol.2, pp.318.

²⁴⁹ Al-Nawawī, *al-Majmū‘*, vol.14 pp.210.

²⁵⁰ Refer to partnership contract between a farm owner and a worker to maintain and waters trees with the fruits being shared between the two parties.

muḍārabah business²⁵¹. On the other hand, the Mālikīs seemed to be the strictest schools in this matter. Unlike the Ḥanafīs and Shāfi'īs, they prohibited the distribution of expected *muḍārabah* profit completely. Mālik in particular did not permit the agent manager to take his expected shares without the presence of the investor. He stressed that the distribution of profit should be carried out in the presence of the investor who receives his capital in full amount. Even, if the investor was present during the distribution of profit but he did not physically possess the capital, the distribution process is not considered valid²⁵².

It is important to bear in mind that the above classical jurists' discussion was made on the basis of a simple *muḍārabah* contract which usually took place between two parties and carried out to finance a specific trade project. Hence, the determination of profit for each concerned party is relatively easy. However, *muḍārabah* in Islamic banks was practised in a complex business setting. Islamic banks receive *muḍārabah* capital from many depositors at different times. The money is then pooled together and invested in various projects which vary in their completion periods. So how can the banks determine the actual profit for the depositors? The task seems more problematic given the right of every depositor to withdraw part or all of his money at any times. In additions to that, because of the national banking legislation, not all the depositors' money is invested. Some of the money is kept as reserve in the Central Bank. Hence, a similar question arises of how the Islamic banks determine the actual profit for the depositors in this situation²⁵³.

The above issues are the challenges faced by the Islamic banks in implementing the *muḍārabah* theory. Surely, the present *sharī'ah* scholars in the Islamic banks are required to make new *ijtihād* to adapt the classical theory to modern banking practices. This issue will be analysed in detail in chapter four.

²⁵¹ Ibn Qudāmah, *al-Mughnī*, vol.7, pp.164.

²⁵² Al-Bāji, *Muntaqā sharḥ al-Muwaḍḍa'*, vol.7, pp.119.

²⁵³ El-Tegani A. Ahmed, "Distribution of Profit in Islamic Banking: A Case Study of Faisal Islamic Bank of Sudan (FISB)", *J.KAU: Islamic Economic*, 1996, vol. 8, pp. 15-32.

Disputes between Investor and Agent Manager

Besides elaborating the rules of essential elements (*arkān*), the classical jurists also gave special attention to the discussion regarding disputes in the *muḍārabah* contract. Most of the discussed cases were related to disagreement over capital, profit and agent manager's negligence. In my personal opinion, besides assisting the judges dealing with the disagreement, the discussions also indicate the actual practice of *muḍārabah* contract. In other words, the dispute cases show that *muḍārabah* was not merely a theory but had been implemented by Muslims during the medieval period. As *muḍārabah* contract took place in the society, disagreement between investor and agent manager would be likely occurred. The disagreements were brought to the legal court for official settlement. These common cases were analysed by the classical jurists and recorded in their legal treatises.

Unlike the discussions of *muḍārabah's* essential elements, the classical jurists appeared to be in agreement over the verdict for most disputes. The uniformity of opinions was attained as a result of the agreed principle used in solving the cases. The classical jurists unanimously uphold the opinion that *muḍārabah* was established on the premise that an agent manager is viewed as a trustworthy person. Based on the premise, the classical jurists ruled that agent manager's claim will be accepted in the dispute cases concerning (1) the amount of entrusted capital (2) the amount of declared profit (3) the claim of capital damage and (4) the denial of negligence. If, for instance, the investor and the agent manager argued about the amount of capital in which the former claims it was 1000 *dirhām* whereas the latter says it was less, the agent manager's claim will be accepted before the court²⁵⁴. Similarly, an agent manager's claim on profit will be accepted without inferring any doubt. If an investor questioned the declared profit, he has to support his doubt with evidence. In the words of al-Nawawī, the rule was explained as follows;

²⁵⁴, Al-Qarāfī, *al-Dhakhīrah*, vol. 6, pp.50, Sharbinī, *al-Mughnī al-Muḥtāj*, vol.2, pp.321, Ibn Qudāmah, *al-Mughnī*, vol.7, pp.184.

And the agent manager is deemed right with his oath when he said: there is no profit or I do not make profit except this amount²⁵⁵.

The classical jurists were also in favour of the agent manager in the dispute regarding any damage occurred to the capital. For example, agent manager is trusted when he proclaims that the capital lost while in his possession. He will not be responsible to replace the capital if the lost is not because of his negligence. On the other hand, the investor who doubts the incident or accuses the loss was due to the negligence of the agent manager will be required to bring evidence²⁵⁶. Without having evidence, prosecution for agent manager's negligence will be considered as a weak case. This is based on the premise that an agent manager is deemed as trustworthy and reliable. Ibn Qudāmah illustrated a similar case to explain the rule:

If an agent manager bought a slave, and the investor said 'I had prohibited you from the purchase'. And the agent manager denied it, then the accepted saying (*qaul*) is the saying of agent manager because initially there is no prohibition. And we do not know any disagreement (*khilāf*) in this matter²⁵⁷.

As far as I could ascertain, the only case where investor's claim is deemed rightful is when it involves dispute over the determination of profit ratio. Sarakshī explained:

If agent manager says after the realisation of profit that investor had agreed of the provision of half of the profit, and investor says, 'I only agreed to give you (agent manager) one-third of the profit'. The claim of the investor will be accepted together with his oath. This is because profit belongs to the investor, and the agent manager is entitled to it with condition. The agent manager also claims in excess of the condition stipulated to him and the investor had denied it²⁵⁸.

It is important to note that the cases highlighted above are discussed with the presumption that the prosecutor (investor) was unable to provide evidence to support his claim. Without the investor's evidence, the judgments in favour of

²⁵⁵ Sharbinī, *al-Mughnī al-Muhtāj*, vol.2, pp.321.

²⁵⁶ Dusūqī, *Hāshiyat al-Dusūqī 'alā al-Sharḥ al-Kabīr 'alā Mukhtaṣar Khalīl*. vol. 3, pp.536, Sharbinī, *al-Mughnī al-Muhtāj*, vol.2, pp.321.

²⁵⁷ Ibn Qudāmah, *al-Mughnī*, vol.7, pp.184.

²⁵⁸ Sarakshī, *al-Mabsūṭ*, vol.22, pp.89.

the agent manager are in congruence with a legal maxim; *al-baiyinah 'alā man idda'a wal yamīn 'alā man ankara* the evidence is on the prosecutor and the oath is on the accused.

The previous cases also demonstrate the standard of documentation and the level of transparency of classical *muḍārabah*. Without a proper record, investor and agent manager had argued on the exact amount of entrusted capital and the agreed proportion of profit. And due to the non-existence of the disclosure information guideline, the investor has doubt over transactions made by the agent manager. As a result, both parties had argued for the issues of negligence and breach of the contract. However, in the context of modern banking practices, some of the classical disputes are no longer significant. The strict requirement of banking documentation will clearly record the amount of deposit and the profit ratio. Thus, it will be hard to imagine depositors and Islamic banks having a dispute on such matters. Contrarily, the issue of negligence remains important. At this point, it is worth mentioning the opinion of Malaysian *shārī'ah* scholars regarding the definition of gross negligence of an agent manager. According Nazri Chik, former head of BIMB *shārī'ah* department, the guidelines issued by Bank Negara are the determinant factor in determining whether an Islamic bank has been neglectful or otherwise. Hence, as long as an Islamic bank acts within its authority granted by the Bank Negara, it can not be accused as negligence even though huge losses were made from the bank's erroneous business strategy²⁵⁹.

Conclusion

Muḍārabah is one of the classical contracts that advocate the principle of risk sharing in mobilising financial resources in an Islamic economy. The contract encourages equity partnership between investors and entrepreneurs in venturing business projects. During the Prophet time, *muḍārabah* was practised largely by those who were not capable of engaging directly in trading activities – these

²⁵⁹ Interviewed with Nazri Chik, Bank Islam Malaysia Berhad, Kuala Lumpur, 10 August 2008.

included women, orphans and the elderly. They would entrust money to skilful and reliable traders to transport merchandise from Mecca and trade with them in Syria, Yemen and other places in the Arab peninsular. When Islam spread from the Arab peninsular, the contract continued to be practised by Muslims traders during the Umayyad (43/661-132/750) and the Abbasids (132/750-656/1258) periods. This is evident from the growth of *muḍārabah* rules developed by the classical jurists. The extensive application of *muḍārabah* in international trade had required the jurists to develop comprehensive doctrines of the contract.

The classical *Sunni* jurists differed in elaborating the practical rules of *muḍārabah* with the most distinctive doctrines being found in the Shāfi'i and the Ḥanafī schools. The former school appeared to be more rigid as it upheld a 'law determines market' approach. For the Shāfi'is, *muḍārabah* is more than just an ordinary commercial contract. It served a central role in establishing justice and fairness within the society. They imposed many restrictions on the operation of the contract, especially on the agent manager's license in managing the investors' capital. For instance, agent manager was not allowed to conduct any credit transaction, recursive *muḍārabah*, commingling of capital and made business traveling without having explicit permission from the investor. The Shāfi'i jurists believed that the contract of *muḍārabah* should be implemented according to strict observance of the original rules in order to achieve its desired objectives.

In contrast, the Ḥanafīs were more flexible and lenient in formulating their *muḍārabah* doctrine. They paid considerable attention to market forces in deciding the scope of empowerment to the agent manager. In many cases, the customary practices of traders (*urf al-tujjār*) were used as the determining factor in deciding rules for the contracting parties. The Ḥanafī jurists adopted such a flexible approach because they give priority on the realisation of profit from a *muḍārabah* venture. Hence, for the Ḥanafīs the general expression (*ṣiḡḡah muṭlaqah*) was sufficient to empower an agent manager to carry out many transactions which were prohibited by the Shāfi'i jurists. Nonetheless, it

should be noted that despite the relaxed and lenient approach, the Ḥanafī jurists maintained the philosophy of *muḍārabah* which is to preserve the notion of profit and loss sharing.

Inspired by the notion of profit and loss sharing, the early modern Muslim economists proposed the *muḍārabah* as the ideal basis in establishing Islamic banks. *Muḍārabah* is supposed to be the fundamental principle in running the operations of Islamic banks as alternatives to interest-based financial institutions. In theory, Islamic banks act as middle-parties between depositors as capital providers (*rabb māl*) and entrepreneurs as agent managers (*muḍārib*). Islamic banks are responsible for channeling the depositors' money into viable business projects run by trustworthy entrepreneurs. Any profit generated from the business venture will be shared between the three parties based on pre-determined profit ratio. The subsequent chapters will observe in detail how the Malaysian Islamic bankers implement the *muḍārabah* in the real banking business.

CHAPTER THREE: PRELIMINARY BACKGROUND OF MALAYSIAN ISLAMIC BANKING SYSTEM

Introduction

In the previous chapter, we have discussed the rules of *muḍārabah* as formulated by jurists of the four *Sunni* schools of Islamic law. These classical rules have been viewed as the ideal basis for current Islamic banking practices. In subsequent chapters, we aim to evaluate the extent in which *muḍārabah* rules are applied by Malaysian Islamic banking institutions. The present chapter provides preliminary background for the discussions. It explains (1) the theory of interest-free bank and presents (2) an overview of Malaysian Islamic banking system. As far as the theory is concerned, the chapter reviews the models expounded by two prominent scholars in Islamic finance, namely Muḥammad Baqer al-Ṣadr and Muḥammad Nejatullah Siddiqi. The section shows how both scholars incorporated the *muḍārabah* contract in their outlines of practical models of an interest-free bank.

Discussion of the overview of Malaysian Islamic banking system sheds light the history, growth, *sharī'ah* governance system and the methodology adopted by local *sharī'ah* advisory committees. It shows the numerous efforts made by the Central Bank of Malaysia (BNM) in facilitating the industry's rapid growth since its inception in 1980's until present days. The chapter also elucidates the three level of supervision formed to ensure the compliance of Islamic banking products to the principles of *sharī'ah*. In an attempt to understand the methodology of the local *sharī'ah* advisory committees, this chapter analyses their justification in legalising the contract of *bay' al-ṭinah* for the creation of the so-called "Islamic" credit card. It is hoped that by understanding these preliminary discussions, readers can appreciate my argument in the following chapter.

The Models of Interest-free Bank

The theory of interest-free banking has been discussed by Muslim scholars since the late 1940's. The earliest reference in this subject is attributed to the work of Qureshi entitled *Islam and the Theory of Interest*²⁶⁰. Qureshi proposed the application of the *muḍārabah* contract as the primary basis for replacing interest in the conventional banking system. The contract of *muḍārabah* is believed to be a better alternative than other possible contracts because it supports a profit and loss sharing (PLS) principle. Contrary to the interest-based banking system, the PLS principle, it is argued, could lead to socio-economic justice and equitable distribution of wealth. Beginning in the early 1950's, jurists and Muslim economists started to explore this subject and developed a workable model of interest-free bank. In 1955, Muḥammad Uzair published two notable articles, entitled as '*Interestless Banking: Will it be a Success*' and '*An Outline of Interestless Banking*'. Uzair enhanced further the conceptual of interest-free bank by suggesting a triangular relationship between depositors, bank and entrepreneurs under a *muḍārabah* contract²⁶¹.

In the 1960's, more comprehensive studies of interest-free banking theory were written. One of them was *al-Bank al-lā Ribawī fil Islam* produced by Muḥammad Baqer al-Ṣadr. Ṣadr developed his model of interest-free bank in isolation from the mainstream jurists and Muslim economists. This was partly because he was a Shī'ī scholar living in Najaf which at that particular time was closed to other parts of the Muslim world²⁶². Ṣadr's work is significant as it was the first workable model of interest-free bank produced by a traditionally trained jurist. He begins the discussion of the model by pointing out a distinction between an interest-free bank functioning in an economic system which totally based on the Islamic principles and an interest-free bank

²⁶⁰ Muhammad Nejatullah Siddiqi, *Muslim Economic Thinking: A Survey of Contemporary Literature* in Studies in Islamic Economics, Khurshid Ahmad (ed.), The Islamic Foundation: Leicester, 1980.

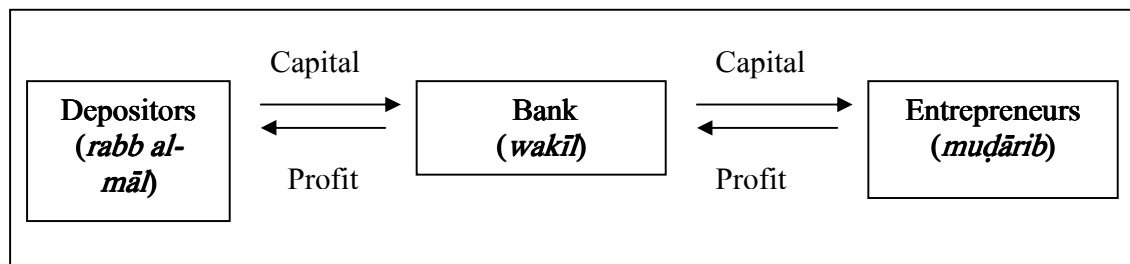
²⁶¹ Ibid.

²⁶² Rodney Wilson, The Contribution of Muḥammad Bāqir al-Ṣadr to Contemporary Islamic Economic Thought, *Journal of Islamic Studies*, vol. 9 no.1, 1998, pp.47.

operating as partial component of the interest-based financial system. Şadr argues that the wisdom (*ḥikmah*) behind the prohibition of *ribā* could be realised under the former condition but would not necessarily materialise under the latter circumstances. His main argument is based on the notion that Islamic economic components are closely integrated; every component influences one another to achieve the desired goals.

However, despite admitting the possible inability of obtaining the *ḥikmah* under the latter circumstances, Şadr maintains the obligation to set up an interest-free bank within a conventional financial system. Şadr's model of interest-free banking was developed on the basis of two important points. First, an interest free bank should be run as a commercial entity aiming to make a profit²⁶³. Second, the revenue of the bank should be generated from the proceeds of human labour not from the exploitation of capital²⁶⁴. Şadr viewed an interest-free bank as functioning principally as a financial intermediary. This means the bank acts as an agent (*wakīl*) who collects funds from depositors and channels them to potential entrepreneurs. Figure 1 below illustrates the relationship between the three parties.

Figure 1: The relationship between depositors, bank and entrepreneurs



Based on Şadr's model, the contract of *muḍārabah* is executed between depositors as capital providers (*rabb al-māl*) and entrepreneurs as agent-manager (*muḍārib*). The bank just plays an intermediary role which tries to establish a business relationship between the two parties. The bank is neither an agent-manager nor a capital provider in this agreement. Şadr wrote:

²⁶³ Sadr, Muḥammad Bāqir, *al-Bank al-Lā Ribawī fī al-Islām*, Beirut: Dār al-Ta'āraf lil Maṭbu'āt, 1977, pp.9

²⁶⁴ Ibid.

The bank is actually not a contracting party in this *muḍārabah* contract. This is because it is neither capital provider nor agent-manager; it only plays intermediary role between the two parties; instead of the entrepreneurs meet the capital providers one after another asking for funds, the bank gathers the depositors' money and deal with the entrepreneurs directly²⁶⁵

As an agent (*wakīl*), it is part of the bank's duties to identify honest, capable, reliable and knowledgeable entrepreneurs for depositors. Once entrepreneurs with such qualities have been identified, the bank will make investment in their businesses on behalf of the depositors. This particular point differentiates a *muḍārabah* account from the investment account of a conventional bank. In a *muḍārabah* account, the period of investment only starts when the bank manages to initiate a *muḍārabah* deal with entrepreneurs. However, in investment accounts the period of investment starts immediately when the customer deposits their money into the account.

According to Şadr, all the deposits under *muḍārabah* contracts will be pooled together and invested in various sorts of businesses. As a general rule, profit generated from the business will be shared between the depositors and entrepreneurs according to a pre-determined ratio. The profit ratio, as suggested by Şadr, should be higher than interest rates offered by the conventional bank. This strategy is vital for the survival of the interest-free bank especially in the context of a dual banking system where customers have options to maximise their saving²⁶⁶. Meanwhile, the bank will receive *ju'ālah* (fee or commission) for its intermediary work. However, Şadr's idea regarding the bank's *ju'ālah* appears problematic. Şadr proposes that the *ju'ālah* of the bank should consist of a fixed fee and share of the bank in the *muḍārabah* profit. While the reasoning for the fixed fee is understandable, Şadr's justification in allowing the bank to share the *muḍārabah* profit needs further clarification. In Şadr's justification, he just stated that the bank as an agent in the *muḍārabah* venture

²⁶⁵ Ibid. pp.41

²⁶⁶ Ibid. pp.34.

has the right to impose additional conditions on depositors and entrepreneurs such as the requirement to share their profit²⁶⁷.

As for the issue of profit distribution, Şadr realised the complexity of present *muḍārabah* accounting. This is because the bank will receive deposits from customers at different times and the money will be invested in business projects which vary in their completion period. How an interest-free bank determines the exact portion of profit for each individual customer in such situation? Based on Şadr's suggestion, the profit will be distributed to depositors based on two main factors; (1) the amount of deposit and (2) the duration of investment. In an example, Şadr illustrated a scenario where a bank has to distribute 20,000 *dinars* of profit to all depositors who had deposited 1,000,000 *dinars*. The arithmetical example is not easy to understand, but it is interesting as an example of Şadr's concern for practicality.

Firstly, the total profit is divided into two sections (10,000 *dinar* each section). The first section indicates the profit in relation to the amount of deposit whereas the second section shows the profit in relation to the duration of investment. For the first section, 10,000 *dinar* of profit is generated from one million *dinar* investment. Therefore the arithmetical formula for depositors in this section is: $10,000 \div 1,000,000 \times \text{the amount of capital}$. For example if a customer put in 50,000 *dinar* deposit, his share will be 500 *dinar*. As for the second section, that is profit in relation to the duration of investment, Şadr suggested the 10,000 *dinar* of profit is divided into time basis, quarterly, monthly or weekly, to be decided by the bank. The method implies that the depositors will be paid based on their investment period; the longer the higher share of profit.

In my opinion, this method is debatable since it is similar to the interest rate formula of conventional banking. In addition to that, Şadr ignored the fact that various *muḍārabah* businesses make different rates of profit. It is possible that one deposit might be more profitable than others. Şadr' suggestion to distribute

²⁶⁷ Ibid, pp.207.

equally the profit seems unfair to some of the depositors. His suggestion is that the bank be required to obtain consent from all depositors to share their profit equally based on the bank's accounting formula. This is a very simplistic suggestion to solve the problem.

Another controversial point in Şadr' model of interest-free bank is related to the capital guarantee. As discussed in chapter two, one of the salient features of *muḍārabah* contract is that disallows the agent-manager from guaranteeing the capital from any losses. The reason for this rule is to maintain the concept of profit and loss sharing embedded in the contract. However, Şadr insisted that all money deposited in the interest-free bank should be guaranteed. Perhaps, Şadr was influenced by the practice of conventional banks that imposed a protection scheme to guarantee their depositors' money. For interest-free banking, Şadr proposed that the guarantee is undertaken by the bank itself. According to him, the guarantee is acceptable under the rule of *sharī'ah* since the bank is a third party in the contract²⁶⁸. He argued that there is no evidence in the *sharī'ah* which prohibits capital guarantee from an outside party of *muḍārabah*.

Şadr acknowledged the possibility of business failure in the *muḍārabah* contract. He agreed to the classical jurists' rule; if *muḍārabah* business suffers losses, the depositors will not get anything from their investment. Nevertheless, Şadr was of the opinion that the zero-return *muḍārabah* investment is very unlikely to happen in the context of interest-free banking operation. This is because all the money will be pooled together and utilised to support various kind of investments. It is unimaginable that all the investments suffer losses simultaneously. The losses could be from some of the investments while others presumably make huge profit. The huge profit will absorb the losses and therefore bank always has something to share with the depositors.

In addition to this, Şadr is aware that the *muḍārabah* venture might face an agency or moral hazard problem. However, his suggestions to overcome this

²⁶⁸ Ibid, pp.32.

issue are general in nature rather than specific economic solutions. He stressed the importance of dealing with trustworthy and experienced entrepreneurs. The bank is required to develop a vigilant mechanism in monitoring entrepreneur's business such as specifying the nature of business, the limit within which it is to be conducted and the obligation to give regular financial reports. Şadr's recommendations demand a radical change of interest-free bankers' outlook. Contrary to the ordinary bankers whose job is mainly to analyse the creditworthiness of a customer before lending him a sum of money, bankers in an interest free bank are expected to function as project managers.

In summary, Şadr' model of interest-free banking is based on the application of *muḍārabah* between the depositors and entrepreneurs. The former provides capital and the latter conducts the business. The bank only plays an intermediary role between the two parties. The bank's main task is to secure the deposits and find reliable entrepreneurs to channel the money. It also has an obligation to guarantee the deposit and monitor the business operation. Profit generated from the business will be shared between the depositors, entrepreneurs and the bank. In addition to the share of profit, the bank also entitled to a fixed fee for its intermediation work.

A part from Şadr, the theory of Islamic banking was elaborated in detail by Muḥammad Nejatullah Siddiqi. In fact, Siddiqi's work on this subject was much more widely quoted by Islamic economists compared to Şadr²⁶⁹. One of the contributing factors to this situation is the holistic approach adopted by Siddiqi in developing his model. Having neo-classical economic educational background, Siddiqi not only elaborated his model purely based on the *fiqh* rules but integrated it with recent state of financial reality. He presented an economic discourse on how to establish and run an interest-free bank. He started developing the model in the late 1960's inspired by the work of Abū 'Alā al-Mawdudī. His work published first in Urdu entitled as *Ghair Sūdi Bankarī* (Banking without Interest). Nevertheless, the present book which is my

²⁶⁹Rodney Wilson, *The Contribution of Muḥammad Bāqir al-Şadr to Contemporary Islamic Economic Thought*, pp.50.

focus in this section is the revised version of Siddiqi's previous work published in 1983 in English. Although Şadr and Siddiqi agreed that *muḍārabah* is the fundamental basis of interest-free banking system, they differed in outlining its practical model. In Şadr's view, an interest-free bank would not be part of the *muḍārabah* contracting parties. The bank just acts as a middle party who links between the depositors and the entrepreneurs. In contrast, from Siddiqi's perspective, the bank should participate directly in the *muḍārabah* venture. Siddiqi's model was based on two-tier *muḍārabah* known in the classical legal texts as *muḍārib yuḍārib*.

Based on the proposed model, an interest-free bank will play two different roles during the business endeavour. In relation to the depositors, the bank will be regarded as *muḍārib* (agent manager) who hold responsibility in generating profit from the financial resources obtained. Meanwhile, when the bank entrusts the funds to real entrepreneur, it will be considered as investor. Interestingly, Siddiqi himself had raised question over the permissibility of such financial intermediation based on the two-tier *muḍārabah*²⁷⁰. He might share similar view with some Shāfi'ī jurists who rejected the practice since the middle party (bank) did not make significant contribution to the business venture. Nevertheless, Siddiqi advanced his model as he relied on the previous scholars namely Qureshi, Maududī and Uzair who in support of the idea²⁷¹.

Siddiqi's idea regarding the setting up of interest-free banks also does not base itself on pure *muḍārabah* contract. He suggested that an interest-free bank could be established based on the hybrid contracts of *shirkat ul-'inān*²⁷² and *muḍārabah*. The shareholders own the bank based on the former contract while the depositors own it based on the latter. Siddiqi's idea regarding this matter was actually adapted from the Western concept of joint-stock corporation. Persons/partners who provide capital in establishing the bank are regarded as owners and known as shareholders. Even though, they have the right to be

²⁷⁰ Tariqullah Khan, *An Analysis of Risk Sharing in Islamic Finance with Special Reference to Pakistan*, Jeddah: Islamic Research Training Institute, 1996, pp. 18.

²⁷¹ Ibid

²⁷² that is a partnership contract based on the joint of capital and work

involved in daily banking operations, usually the task is entrusted to a management team. The managers are appointed by the shareholders through a board of directors or a council of representatives, formed to represent and safeguard their long term interest. The bank's managers or staff will be paid based on fixed salaries. On the other hand, the income of shareholders will depend on the amount of bank's net profit. It will be distributed in proportionate to the size of shareholders' capital. The same rule will be applied in spreading any loss suffered. So what are the main business activities of an interest-free bank?

In answering the question, Siddiqi shared the view of some previous scholars. He insisted that the revenue of interest-free bank should be generated mainly from the application *muḍārabah* contracts. He suggested interest-free banks play an intermediate role in the two-tier *muḍārabah* arrangement. This is done by mixing up the shareholders' funds and the depositors' money. The commingled funds will then be invested with another party (the entrepreneur) on the basis of another profit sharing contract. The most important rule for this contract is the requirement to produce quarterly accounting reports either by the bank or the entrepreneurs. This means the bank and entrepreneurs are required to report the state of their whole business and determine the total profit or loss in every quarter. As for depositors, the quarterly accounting report is vital in providing information regarding the investment of their money. They will know what the bank does with the money and have some indication relating to potential profit or loss. Similarly, the quarterly accounting report produced by the entrepreneurs is crucial for the bank because such a procedure could protect the bank from deception and fraud, as the ongoing profit or loss can be studied in relatively early period.

It should be noted however that the requirement to produce quarterly accounts does not mean either that the depositors or the bank will demand their capital back at the end of each quarter. In fact, the depositors in *muḍārabah* accounts will deposit their money for an undetermined period and the bank will probably invest for several quarters. The main purpose of requiring the quarterly

accounting report is just to give information regarding the use of capital. After analysing the financial reports, if either the depositor or the bank wishes to withdraw from the contract, on the view of their own interest, they are free to do so. If not, the *muḍārabah* deposit account and the *muḍārabah* investment will both remain intact²⁷³.

In addition to the *muḍārabah* investment account, Siddiqi suggested the creation of a current account which he termed as 'loan account'. Depositors who open this type of account will benefit from the safety of the deposited money and the convenience in making daily business transactions. The account holders will have the right to draw cheques and transfer money to others. Siddiqi asserted that the bank will not charge anything for these facilities. However, the bank is authorised to invest the money as long as it remains in the account. Any profit earned from the investment will go entirely to the bank and the account holder will have no share in it. If the investment suffers loss, it must be borne by the bank while the account holders deposit is guaranteed²⁷⁴.

Besides, Siddiqi proposed that the deposited money of loan account to be utilised in advancing short-term loan to meet the entrepreneurial demand for working capital. This refers to an entrepreneur who is in need of additional capital temporarily (i.e for few days) which he expects to return with the income he anticipates from the sales of his products. Siddiqi admitted that the contract of *muḍārabah* can not be applied to solve the short-term loan problem. A *muḍārabah* contract agreed at the final stage of business does not resemble a true profit and sharing concept. Rather it will be seen as an act of manipulating financial distress of entrepreneur for bank's own benefit. Furthermore, no entrepreneur is likely to be willing to enter into partnership in such condition. This is because by agreeing a *muḍārabah* contract, the entrepreneur must share a part of his profit with the bank at the juncture where he supposes to earn it on his own. Hence, by using substantial funds from the loan account deposit, the

²⁷³ Muḥammad Nejatullah Siddiqi, *Banking Without Interest*, Leicester: The Islamic Foundation, 1983, pp. 40-42.

²⁷⁴ Ibid, pp.48.

short-term financing should be advanced on an interest-free basis²⁷⁵. Siddiqi, however stressed that these loan have to be repaid in any case even if the enterprise makes a loss. In this regard, he allowed the taking of sureties or collaterals against the loans. For example, in the case of bankruptcy, the bank should have power to recover the unpaid loan by selling borrower business' asset.

Siddiqi's idea regarding the interest-free of short-term loan clearly illustrates his vision to portray an Islamic bank as not merely as a profit-oriented business entity but at the same time fulfils its socio-economic responsibility. In encouraging such activities, the central bank has an important role to play. For instance, the central bank could impose a regulation that strictly requires Islamic banks to advance free loans or otherwise; they will not be allowed to accept deposits in loan accounts. Despite being rather theoretical in this matter, Siddiqi's model of interest-free bank has become the main reference in the establishment (but not running) of Islamic banks worldwide.

It is clear that from Siddiqi's and Şadr's perspectives the *muḍārabah* contract should become the major source of income for an interest-free bank. They believe that the wide application of *muḍārabah* will distinguish an interest-free from an interest-based bank since the former is based on profit and loss sharing principle while the latter is based on guaranteed return. In the following chapter, we will examine how far the contract of *muḍārabah* is applied in daily Islamic banking operations. However, before we embark into the discussions, it is appropriate to begin with the overview of Malaysian Islamic banking system. I will explain the history, growth, *sharī'ah* governance practices and methodology adopted by the local *sharī'ah* advisory committees. It is hoped that by having sufficient information on the topics, readers will be able to understand better my argument in the next chapter.

²⁷⁵ Ibid, pp. 57-58.

An Overview of Islamic Banking in Malaysia

The establishment of Bank Islam Malaysia Berhad (BIMB) in 1983 marked the beginning of Islamic banking industry in Malaysia. The emergence of Islamic banking in the country was driven by both external and internal factors. The principal external factor was the commencement of interest-free banking institutions in the Middle East, heavily influenced by Islamic resurgence movement.²⁷⁶ When Muslim countries obtained independence, there was a call from the majority of the population to set up a banking system that is free from interest. As a result of the combined efforts of Islamic economists, jurists and government, several Islamic banks were established. These were initiated in 1963, when the first Islamic bank was founded in Mit Ghamr, Egypt. The industry grew rapidly in the 1970's through the establishment of the Islamic Development Bank in 1974, the Islamic Bank of Dubai in 1975, the Islamic Bank of Faisal in Egypt in 1977, the Islamic Banks of Faisal and the Bank of Islamic Finance and Investment in Jordan in 1978 and the Islamic Investment Company Ltd in UAE in 1979.

The success of these Islamic banks inspired Muslims in Malaysia. In 1980, Bumiputera Economic Congress proposed that the government allow the establishment of an Islamic bank in the country. As a response to the proposal, a National Steering Committee was set up to study the possibility of having an Islamic bank, examining in particular its legal and economic impacts. Based on the study conducted by the committee, the Malaysian government agreed to allow the establishment of BIMB²⁷⁷. However, in contrast to the approach adopted by Iran and Sudan in which their financial systems were drastically changed in total towards an interest-free system, the government of Malaysia decided to implement a dual banking system. This meant the Islamic banking institutions would be introduced gradually, firstly by allowing BIMB to operate along side established conventional banks.

²⁷⁶ Hamed Hamoud Alajlan, Usury, *Moral Economy and Islamic Banking: A Critical Examination Ideal Notion and Business Practices with Reference to Kuwait*, Phd Thesis University of Exeter, 2006.

²⁷⁷ The History of Islamic Banking in Malaysia, Central Bank of Malaysia, www.bnm.gov.my/index. Accessed on 14 August 2008.

BIMB had been awarded a monopoly status for 10 years to give opportunity to the bank to strengthen its business operations. During the first decade of its establishment, BIMB had shown a relatively promising performance. The bank maintained a significant growth of profitability, an average profit of 21% from 1984 to 1997. However, like many other Islamic banks, the profit generated by BIMB is largely contributed by debt-based products rather than equity-based products. In other words, the principles of *bay' bithaman ajil* and *murābaḥah* are applied more widely compared to *muḍārabah* or *mushārakah*. Moral hazard and the lack of knowledgeable bankers in selecting, evaluating and managing a profitable project had been given as the main reasons for the situation²⁷⁸.

In 1993, the Central Bank of Malaysia introduced its “Islamic Banking Scheme” (IBS). The scheme allows conventional banks to offer Islamic banking products through their existing facilities. The main objective of this scheme is to speed up the dissemination of Islamic banking products to local customers within the possible shortest period. There were 24 conventional banks which responded to the call and provided Islamic products through their 1663 branches²⁷⁹. The IBS banks are required to set up a division is responsible for the Islamic banking operations in terms of (amongst other things) product development, marketing and credit control. According to the Guidelines of IBS issued by the Central Bank, the Islamic banking division should be led by a Muslim senior manager who possesses relevant background in Islamic banking and has sufficient banking experience²⁸⁰. It is commonly acknowledged that during the early stages of IBS, the majority of bankers did not have sufficient knowledge of Islamic banking principles. Therefore, the Central Bank has required the conventional banks to provide regular training and educational programmes to their staff in order to enrich their knowledge in the said area.

²⁷⁸ Abdus Samad & M. Kabir Hassan, The Performance of Malaysian Islamic Bank During 1984-1997, *International Journal of Islamic Financial Services*, vol.1, no.3

²⁷⁹ Norma Md. Saad, *Macro Economic Application in South East Asian Countries*, Kuala Lumpur: International Islamic University of Malaysia Press, 2004, pp.52.

²⁸⁰ Guidelines on Skim Perbankan Islam, Kuala Lumpur: Central Bank of Malaysia, n.d. pp.8

There are several issues raised by the opponents of Islamic banking regarding the implementation of IBS. Firstly, it is argued that the conventional banks that participated in the scheme actually exploited the rise of religious sentiment amongst the Muslims for their own economic benefits. In other words, the conventional banks were not really committed to achieving the virtues of Islamic banking in order to promote equal distribution of wealth, alleviation of poverty (and so on) but rather they were interested in maximising their shareholders' profit. Hence, the over reliance on debt-like products by the Islamic banking institution comparing to the equity-based products remains unresolved. Secondly, the implementation of IBS raises doubt for some devout Muslims, particularly with regard to issue of the commingling of funds. This is because customers of conventional and Islamic accounts in IBS banks will deposit their money in the same place, which leads to a public assumption that the money will be commingled with non-Islamically invested funds, and thereby invested in the same business. Although the Central Bank requires the conventional banks to disclose separate financial statements so that they might know the daily balances of the banks' assets and liabilities relating to IBS, doubt still surrounds some conscious Muslims.

However, for some other Muslims, the issue is not significant. Perhaps, they rely on the *sharī'ah* committee approval which is accountable to the internal and external auditing of the banks' operations. In general, as more customers have access to the Islamic products, the IBS has successfully increased its penetration of Islamic banking market. In fact, the IBS banks have outperformed the full-fledge Islamic banks. In December 2002, the IBS banks collectively accounted for 70% of Islamic banking deposits whereas BIMB and Bank Muamalat (the second full-fledged Islamic bank founded in 1999) contributed the remaining 30 percent.

Since 2005, the Central Bank begun to put wind down the IBS scheme. The policy is implemented following the Financial Sector Master plan²⁸¹. The IBS

²⁸¹ Financial Sector Masterplan, Kuala Lumpur: Central Bank of Malaysia, 2004.

banks are encouraged to transform their Islamic 'windows' into separate Islamic subsidiaries. The incorporation of Islamic subsidiaries is hoped to further strengthen the institutional capacity of Islamic banks towards achieving 20 percent of total banking market share by 2010. An Islamic bank subsidiary, led by a Chief Executive Officer (CEO) with greater autonomy in running its own business entity, was established. This will capitalise on Islamic banking potential to the fullest extent, as the investors both locally and internationally can participate in the bank's activity through direct equity participation. As of January 2008, eight IBS banks have transformed their Islamic banking divisions into Islamic banks subsidiaries.

Since 2005, the Central Bank also started to liberalise the local Islamic banking market. The liberalisation means the government granted licenses to foreign Islamic banks and allows them to offer products and services to local customers. Its main objective is to create a healthy competition among the Islamic banks as a driving force for growth. To date, two Middle East banks namely Al-Rajhi Banking & Investment Corporation (Malaysia) Berhad and Kuwait Finance House (Malaysia) Berhad have commenced their operation in Malaysia. Table 7 below shows the current list of the full-fledge and the subsidiaries of Islamic banks in Malaysia.

Table 7: List of fully-fledged and subsidiary of Islamic Banks in Malaysia

No.	Name
1	Affin Islamic Bank Berhad
2	Alliance Islamic Bank Berhad
3	Al-Rajhi Banking & Investment Corporation (Malaysia) Berhad
4	AmIslamic Bank Berhad
5	Asian Finance Bank Berhad
6	Bank Islam Malaysia Berhad
7	Bank Muamalat Malaysia Berhad
8	CIMB Islamic Bank Berhad
9	EONCAP Islamic Bank Berhad
10	Hong Leong Islamic Bank Berhad
11	Kuwait Finance House (Malaysia) Berhad
12	Maybank Islamic Berhad
13	RHB Islamic Bank Berhad

Besides the banking sector, the Malaysian government is also committed to developing the Islamic Capital Market (ICM). The huge amount of global Islamic funds estimated to be USD\$1.3 trillion has attracted the government to

make Malaysia the hub of Islamic finance. In an attempt to draw these funds, Malaysia offers *sharī'ah*-based unit trusts, *sharī'ah*-compliant stocks and *sukūk* (Islamic bonds) as alternatives to conventional investment instruments. Since their inception, these Islamic investment instruments have shown a remarkable growth. The number of Islamic unit trust companies has increased sharply from just 7 companies in 1995 reaching 71 companies in 2004²⁸². The investors in the Malaysian stock market namely Bursa Malaysia, have also a huge selection of *sharī'ah*-compliant stocks as 816 companies were listed as *sharī'ah*-approved companies in 2005. These *sharī'ah* compliance stocks accounted for 82.5% of the total listed companies in Bursa Malaysia. As for the *sukūk* market, the value of *sukūk* issued was approximately USD11.05 billion in the same year²⁸³.

Based on the preceding discussion, it is clear that since its inception Islamic banking industry in Malaysia has experienced a rapid growth. This remarkable development is achieved mainly due to two main factors (1) unflagging support from the government and (2) strong demand from majority Muslims population. Undoubtedly, the Malaysian government is very committed to establishing the Islamic banking system in the country. Its governing institution, the Central Bank of Malaysia (BNM) has made numerous efforts to facilitate the growth of the industry. The most recent initiative taken is the establishment of the International Centre for Education in Islamic Finance (INCEIF) which aims to be the knowledge leader in the said area. Meanwhile, the huge support received from majority of Muslims is driven mainly by the religious factor. It goes without saying that other factors such as the competitiveness of profit rates, quality of services etc. are not important for them. However, it shows that customers who patronise the Islamic banks over the conventional banks generally believe that the products and services offered fully comply with the principles of *sharī'ah*. Realising this matter, the focus of BNM nowadays is to enhance the regulatory framework of Islamic banking institutions. Specifically, the BNM strives to improve the *sharī'ah* governance

²⁸² Mohammed al-Qorshi, Islamic Finance & Development IMF Magazine, December 2005, vol. 42, no. 4

²⁸³ The Islamic Capital Market Brochure, Kuala Lumpur: Bursa Malaysia, 2005, pp.9

and risk management system within the local Islamic banking environment. In the following section, I will discuss the current *sharī'ah* governance framework adopted by Islamic banks in the country.

***Sharī'ah* Governance of Malaysian Islamic Banking Institutions**

Undoubtedly, the major concern of Islamic banking institutions is to conduct their business in accordance to principles laid down by *sharī'ah*. In order to ensure that all their products and services are *sharī'ah* compliant, every Islamic bank in Malaysia has set up a *sharī'ah* committee. The main duty and responsibility of the committee is to assure the business operations in Islamic banks comply with *sharī'ah* principles at all times. The committee is also responsible for approving new products and services proposed by the bank management.

The members of each *sharī'ah* committee are appointed by the board of directors of an Islamic bank upon the recommendation of its nomination committee. Normally the appointment is for a renewable term of two years. The *sharī'ah* committee members are expected to have vast knowledge in Islamic law, either in Islamic legal methodology (*uṣūl al-fiqh*) or Islamic commercial transactions (*fiqh al-mu'āmalāt*)²⁸⁴. Since the *sharī'ah* committee members are appointed and their allowances are paid by the banks, it is argued that the bank's management may influence them in making proposed products legal. In other words, there some people who are not convinced that the *sharī'ah* committee members has full freedom in expressing their opinions and is fully independent. However, based on my interviews with 4 scholars who directly involve in the committees, such a complaint is not justified. According to them, the *sharī'ah* committees have total freedom to make ruling although it may not in favour of the bank. Furthermore, their opinions are respected by the bank's management. In her defence of the *sharī'ah* committee, Engku Rabiah argues that there is no 'negative influence' from the bank management except,

²⁸⁴ Guidelines on the Governance of *Sharī'ah* Committee for the Islamic Financial Institutions, Kuala Lumpur: Central Bank of Malaysia, December 2004.

administratively speaking; they sometimes have to respond to the problems too quickly.²⁸⁵ Another scholar, Joni Tamkin contends that the banks respect resolutions made by the committees because their endorsement are needed to maintain the banks' reputation.²⁸⁶ The Islamic banks are aware that the existence of any non-compliant *sharī'ah* element in their operation will affect the confidence of the public.

In order to avoid a conflict of interest and for reasons of confidentiality, the BNM restricts the multiple appointments of scholars within the same industry. However, a scholar is permitted to become a member of *sharī'ah* committees in different industries. For example if a scholar is appointed as member of *sharī'ah* committee in BIMB, he is not eligible to become committee member in other Islamic bank. However, he can still be appointed as member of committee in other industries such as in *takāful* (Islamic insurance) or fund management²⁸⁷. The policy has a profound impact on the *sharī'ah* landscape of Islamic banking institutions in the country. It creates more opportunities for the *sharī'ah* scholars to get involved in this industry. As the number of Islamic financial institutions increases every year, more *sharī'ah* scholars are needed to fill in the *sharī'ah* committee quota. This is because previously the same scholars who deem to have high reputation in *fiqh al-mu'āmalāt* were likely to sit on many committees. Such phenomena are viewed as hindering original *sharī'ah* discussion as the decisions were drawn from opinions of a few similar scholars.

Currently, there are more than 40 scholars appointed as members of the *sharī'ah* committee in various Islamic banks in Malaysia. Their educational profiles are presented in Appendix 1. As clearly indicated in the appendix, the majority of the members are academics in universities. Perhaps academics become the popular choice as committee members because the BNM has prohibited the function of *sharī'ah* supervision in the development of private business. The

²⁸⁵ Interview with Dr. Engku Rabiah Engku Ali, 11 August 2008, International Islamic University of Malaysia, Kuala Lumpur.

²⁸⁶ Interview with Prof. Dr. Joni Tamkin, 14 August 2008, University of Malaya, Kuala Lumpur.

²⁸⁷ Guidelines on the Governance of Shariah Committee for the Islamic Financial Institutions.

restriction aims to maintain the public confidence in decisions or resolutions made by the committee members. Most of them specialise in Islamic law, holding doctorate from various universities in United Kingdom, Middle East or Malaysia. In addition to that, as a consequence of the liberalisation, the committees' members are not limited to Malaysian scholars but also consist of foreign experts especially from the Middle East.

In order to depict more clearly the role of *sharī'ah* committee within the Islamic banks, I reproduce the latest report of BIMB's *sharī'ah* advisory council²⁸⁸. In 2009, the Council held 9 meetings to review various products, transactions and processes in line with the *sharī'ah* requirements and had also approved the following products:

- i. Current account based on *wakālah* contract.
- ii. Issuance of *murābahah* Medium Term Notes.
- iii. *An-Najāh* NID-i structured investment product based on *muḍārabah muqayyadah* contract.
- iv. Islamic Convertible Redeemable Non-Cumulative Preference Shares (CRNCPS).
- v. Islamic syndicated structure facility based on *istiṣna'* contract convertible to *ijārah muntahiah bi-tamlīk*.
- vi. Legal documentations for product based on commodities transaction from other Institutions.
- vii. Legal documentations for Islamic profit rate swap (*musāwamah*) and cross currency profit rate swap (*murābahah*) products.
- viii. Structured product and legal documents for Islamic new frontier index.
- ix. Legal documentation for equity option product.
- x. Legal documentations for standard Inter-bank commodity *murābahah* Association of Islamic Banking Institutions Malaysia.

²⁸⁸Bank Islam Malaysia Berhad (BIMB) Financial Statement 2009, Kuala Lumpur, http://www.bankislam.com.my/bimbpdf/AR09-Financial_Statements.pdf, Accessed on 30 December 2009.

- xi. Transaction legal documentations *bay' murābahah Medium Term Notes Issuance Programme*.
- xii. Transaction documents for the syndicated business financing-i facility.
- xiii. Legal documentations for personal financing-i *Tawarruq*.
- xiv. Legal documentations for business financing-i *Tawarruq*.
- xv. Legal documentations for BBA and *Istiṣna* 'house financing.
- xvi. Legal documentations of *ijārah muntahiyah bi-tamlīk* facility.
- xvii. Multiple 'aqad of Negotiable Islamic Debt Certificate (NIDC).
- xviii. Replacement of Novation agreement.
- xix. Variations in Islamic Negotiable Instruments (INI) and Islamic Negotiable Instruments of Deposit (INID).
- xx. Variations in *al-awfār* Savings Account-i and Investment Account-i (previously known as Savings Multiplier) product features.

In addition, the Council in the said meetings also reviewed, adopted and approved several initiatives of the bank in strengthening the *sharī'ah* governance of the bank which include the following:

- i. *Wakālah* contract guideline (version 1.0).
- ii. *Tawarruq* (financing) concept guideline (version 1.0).
- iii. *Wadī'ah* contract guidelines (version 3.0).
- iv. Revised terms of reference for *Sharī'ah* Supervisory Council.
- v. Terms of reference for zakat committee.
- vi. Business zakat payment guideline (version 1.0).
- vii. Dress code guidelines.
- viii. *Sharī'ah* compliance training programme.

The above report suggests that BIMB *sharī'ah advisors* had been actively involved in creating a number of innovative Islamic banking products. They have moved towards offering sophisticated financial products such as derivatives (swap) and negotiable instrument deposit (NID). It would be interesting to investigate their orientation in supporting such progressive development of Islamic banking products.

A part from the *sharī'ah* committee, Islamic banks in Malaysia have internal *sharī'ah* departments. This department consists of full-time *sharī'ah* officers who mainly function as liaison between the bank and the *sharī'ah* committee members. The *sharī'ah* officers serve as a secretariat, drafting the minutes of the *sharī'ah* committee meeting. Besides this, they are involved in the design of new products particularly in giving advice on the appropriate Islamic contract to be adopted in the proposed products. Once the proposal of new product is prepared, it then will be presented to the *sharī'ah* committee for their approval. The *sharī'ah* committee members will examine the *modus operandi* of the proposed product and decide on its legality. If the *sharī'ah* committee members are not satisfied with the proposed product, it will be returned back to the bank management for further improvement. It is unknown however how frequent a particular new product is rejected by the *sharī'ah* committees. Nevertheless, the report of BIMB's *sharī'ah* advisory council indicates that their discussions are brief. The *sharī'ah* committees seem rely heavily on the information presented by the bank's *sharī'ah* officers. Strictly speaking, the *sharī'ah* committees merely act as 'rubberstamp' who endorses proposal from bank's management.

In addition to this, BNM has also founded the National *Sharī'ah* Advisory Council (NSAC). The NSAC is regarded as the most authoritative body relating to the *sharī'ah* issues of the Islamic banking in the country. The NSAC is responsible to make final decision whenever different interpretations between the *sharī'ah* committees in Islamic banks occur. The resolutions made by the NSAC are binding and should be applied by all *sharī'ah* committees of the Islamic banks. For example if the NSAC decide to abandon the use of a disputed contract, the *sharī'ah* committees can not overrule the decision and allow them to be use in their respective banks. Hence, it is obvious that the main reason for establishing the NSAC is to ensure the standardisation of Islamic banking rulings.

It is important to note however, the authority of the NSAC is currently limited within the Islamic banking institutions. The NSAC' resolutions do not have any

influence in the civil court where disputes between the Islamic banks and their customers are decided. Judges of the civil courts are free to adhere to the NSAC's resolutions or not. This situation has created confusion with regard to the legality of the *bay' bithamanin ājil* (BBA) home financing offered by BIMB. A judge of High Court has dismissed the NSAC's resolution on the *sharī'ah* compliance of the product, claiming that the product is merely a duplication of conventional housing loan²⁸⁹. As a result, the customer has been awarded win in a court in his battle against BIMB over default payment issue. After the incident, BNM has proposed a new rule to be passed by members of the Malaysian parliament, requiring the judges of civil court to consult the NSAC members before giving verdict in the Islamic banking matters²⁹⁰. As such, the Central Bank of Malaysia Act 2009 has been passed on recently. The Act affirms the authority of the NSAC as the sole authoritative body on *sharī'ah* matters pertaining to Islamic banking and finance. The Act also makes mandatory for the court or arbitrator to refer the NSAC for deliberation on any *sharī'ah* issues.

Although the framework of the Malaysian *sharī'ah* governance looks comprehensive²⁹¹, the current practice is argued concentrating only on the ex-ante compliance process. What are meant by ex-ante compliance process are the reviewing, monitoring and controlling tasks before the product is approved (i.e. during the designing of the contracts and agreement). Very few Islamic banks undertake ex-post *sharī'ah* compliance process which requires the *sharī'ah* committee members or the *sharī'ah* internal officers to check the transactions that took place after the execution of the contracts. As the ex-post *sharī'ah* compliance process is viewed as equally important, the current situation is considered as a serious loophole in the Malaysian *sharī'ah* governance system. Hence, suggestion has been made by researchers to introduce a *sharī'ah* audit. The *sharī'ah* auditors will check random samples of

²⁸⁹ Detail of the case is explained in the following chapter.

²⁹⁰ Lee Cheng Wee, High Court to Consult SAC in Islamic Finance Cases, *The Malaysian Reserve*, Kuala Lumpur, 22 April 2009.

²⁹¹ As it consists of three level of supervision; internal *sharī'ah* officer, *sharī'ah* committee, the NSAC.

completed transactions to ensure that they are confirm to the *sharī'ah* rules and guidelines²⁹².

After this discussion of the framework of the *sharī'ah* governance, the practice of *ijtihād* particularly among the *sharī'ah* committee and the NSAC levels becomes the most pertinent focus of our attention. Since the central qualification of members of both entities is indicated as their ability to make *ijtihād*, it is interesting to examine the methodology and principles adopted in solving current banking and financial problems. The discussion is pertinent because Malaysian *sharī'ah* scholars are viewed as adopting a more lenient or relaxed approach when compared to their Middle East counterparts. One of the controversial issues in this matter is the decision to legalise *bay' al-īnah* contract by the NSAC. Understanding the methodology and approach employed by the *sharī'ah* scholars will help us understand their framework in making rulings pertaining to *mudārabah* products. The discussion in the next section is divided into three sub-topics. Firstly, I will explain the classical jurists' assessment on the legality of *bay' al-īnah*. Secondly, I will show how the contract has been applied (despite the majority jurists' opposition) to create the Islamic credit card of BIMB. Thirdly, based on the justifications in accepting the practice of *bay' al-īnah*, I formulate the Malaysians *sharī'ah* scholars' methodology and approach in determining the legality of other banking products.

The Classical Jurists' Rules on *Bay' al-īnah*

Undeniably, Islamic banking institutions operate in a very competitive and demanding industry. In order to survive, they must be able to meet their customers' sophisticated financial needs. Product innovation is seen as the key success to maintain current business growth. Interestingly, the development of new products happens more extensively in the banking institutions of South-East Asia when compared to innovation within the Middle East. Malaysia is

²⁹² Abdul Rahim Abdul Rahman, *Sharī'ah Audit for Islamic Financial Services: The Needs and Challenges*, ISRA Islamic Finance Seminar, Kuala Lumpur, November 2008.

one of the countries where new products are regularly developed. The country became the first to establish the Islamic Inter-bank Money Market (IIMM), the full-fledged Islamic Stockbroking Company, the corporate *sukūk* (Islamic bond) and the Islamic unit trust²⁹³. However, the advancement of Malaysian Islamic banking industry has raised controversial issues. This is because the advancement is based on the application of the *bay' al-ṭinah* contract which has been much criticised by most of the Middle East *sharī'ah* scholars.

Bay' al-ṭinah is a sale contract with immediate repurchase. The term *bay' al-ṭinah* was normally used by the Ḥanbalī and Mālikī jurists. According to some Mālikīs, *al-ṭinah* was derived from the root word of *al-ʿaunu* which means assistance. It is called *bay' al-ṭinah* because the seller assists the buyer in obtaining his need. Other Mālikīs jurists were of the opinion that *al-ṭinah* was derived from the word *al-ʿain* which refers to cash. According to this view, it was called *bay' al-ṭinah* since the main purpose of executing the contract is to obtain cash²⁹⁴. In *Kitāb al-Umm*, al-Shāfi'ī did not use the term *bay' al-ṭinah* but he explained the contract as one of the problems of deferred sale (*bay' al-ʿājal*)²⁹⁵. Similarly, al-Marghinānī for the Ḥanafīs discussed the contract under the sub-topic of void sale (*bay' al-fāsid*)²⁹⁶. Although the jurists adopted different approach in discussing the contract, they had similar understanding on its basic concept. According to them, the contract takes place when a person sells an asset in credit and immediately buys back the asset in cash at different price.

The classical jurists differed in determining the assessment of *bay' al-ṭinah*. The Ḥanafīs²⁹⁷, Mālikīs²⁹⁸ and Ḥanbalīs²⁹⁹ were of the opinion that the contract was unlawful (*ḥarām*). On the other hand, the Shāfi'īs had two rules in this matter.

²⁹³ The Islamic Capital Market Brochure, Kuala Lumpur: Bursa Malaysia, pp.3.

²⁹⁴ Abū ʿAbdallah Muhammad al-Ḥaṭāb, *Mawāhib al-Jalīl fī Sharh Mukhtaṣar al-Khalīl*, Beirut: Dar al-Fikr, 1992, vol. 4, pp.404

²⁹⁵ Shāfi'ī, *Kitāb al-Umm: bāb bay' al-ʿājal*, vol. 3 &4, pp.78.

²⁹⁶ Muhammad al-Bābartī, *al-ʿInāyah ʿAla al-Hidāyah*, Beirut: Dār al-Fikr, (n.d), vol. 7, pp. 433

²⁹⁷ Ibid.

²⁹⁸ Abū ʿAbdallah Muhammad al-Ḥaṭāb, *Mawāhib al-Jalīl fī Sharh Mukhtaṣar al-Khalīl*, vol. 4, pp.404.

²⁹⁹ Ibn Qudāmah, *al-Mughni*, vol. 6, pp.260.

According to al-Shāfi‘ī, the contract was permissible (*mubāh*)³⁰⁰. However, some later Shāfi‘īs such as al-Nawāwī contradicted the eponym's rule and viewed the contract as discouraged (*makrūh*)³⁰¹. Generally, the jurists who ruled against *bay‘ al-‘īnah* justified their assessment on two main explanations. Firstly, the prohibition is indicated in *athār* and *ḥadīth* and secondly, the practice of the contract was seen merely as *ḥīlah* (legal artifice) to legalise *ribā*.

The most commonly quoted legal evidence (*dalīl*) in this matter was an *athār* narrated from ‘Ā’ishah. The *athār* was used by the Ḥanafīs, Mālikīs and Ḥanbalīs as the main legal evidence to rule the impermissibility of *bay‘ al-‘īnah*. It was reported that ‘Ā’ishah was asked about a transaction conducted by the *umm walad* of Zaid bin Arqam. Acting on behalf of her master, the *umm walad* sold one of Zaid’s slave at 800 dirham in credit to ‘Aṭā’ and bought back the slave at 600 dirham in cash. Ruling the transaction, ‘Ā’ishah said, "*it was very bad sale and inform Zaid that his conduct has eliminated all his rewards for participating in jihad with the Prophet if he does not repent*". According to the majority of jurists, ‘Ā’ishah assertion clearly indicated that *bay‘ al-‘īnah* was unlawful contract.

In addition to the *athār*, the Ḥanbalīs justified their ruling based on a *ḥadīth* which showed the condemnation of the contract by the Prophet. Narrated by Ibn Ḥanbal on the authority of ‘Ibn ‘Umar, the Prophet was reported as saying:

*‘If people are busy with counting every single dinar and dirham, trading based on al-‘īnah, following behind cows (i.e. farming activities), and abandoning the duty of jihad for the sake of Allah, Allah will make misfortune befall them, and will not remove it from until they return to their religion’*³⁰²

It should be noted however, the *ḥadīth* was only used by the Ḥanbalīs to support their ruling regarding *bay‘ al-‘īnah*. On the other hand, the Ḥanafīs and Mālikīs did not use the *ḥadīth* as a *dalīl*, probably because its chain of narrators

³⁰⁰ Shāfi‘ī, *Kitāb al-Umm: bāb bay‘ al-‘ājāl*, vol. 3 &4, pp.78.

³⁰¹ Muḥammad al-Ramlī, *Nihāyah al-Muḥtāj Ilā Sharḥ Alfāz al-Minhāj*, Beirut: Dār al-Fikr, 1984, vol. 3, pp. 477.

³⁰² Ibn Qudāmah, *al-Mughni*, vol.6, pp.261

(*isnād*) was weak. One of the narrators, namely al-‘Amāsh, was considered to be a less than well-qualified narrator. The traditionists doubted that al-‘Amāsh had heard the *ḥadīth* from the previous narrator, named as ‘Aṭā’. Despite admitting the weakness, the Ḥanbalīs accept the legality of the *ḥadīth* by supporting it with another *isnād* (chain of narrators) narrated by Abū Dāwūd. Abū Dāwūd's *isnād* included Ḥaiwah bin Shuraiḥ, Ishāq bin ‘Abd Raḥmān, ‘Aṭā’, Ibn Nāfi‘ and Ibn ‘Umar. According to Ibn al-Qayyīm of the Ḥanbalīs, Ishāq bin ‘Abd Raḥmān was viewed as a better qualified narrator whom scholars of Egyptian school relied on as compared to al-‘Amāsh. In addition, the *isnād* of Abū Dāwūd also confirmed that the *ḥadīth* was transmitted through ‘Aṭā’. It testified that ‘Aṭā’ heard the *ḥadīth* from Ibn Nāfi‘, the most reliable narrator and the life-long servant of Ibn ‘Umar. Hence, considering the two chains of narrators, the stipulated *ḥadīth* is categorised as “fine” (*ḥasan*) and valid to be used as *dalīl*³⁰³. The *ḥadīth* clearly indicates that the practice of *bay‘ al-‘īnah* was staunchly condemned and thus prohibited.

In justifying his rule, al-Shāfi‘ī did not cite the above *ḥadīth* but only mentioned the *athār* of ‘Ā’ishah. However, he did not accept the legality of the *athār* since for him it was a case of the Companions in disagreement. In this matter, al-Shāfi‘ī considered ‘Ā’ishah and Zaid bin Arqam to have differed in determining the legality of the “double sale” contract. From the Shāfi‘ī point of view, since both of them were Companions, no opinion can overrule the other. In contrast to the majority of jurists, al-Shāfi‘ī viewed that Zaid bin Arqam's opinion as more accurate. Al-Shāfi‘ī presumed that ‘Ā’ishah prohibited the contract not because of the double sale contract rather because the credit transaction was agreed with unknown period (when the slave was sold in credit).

The majority of jurists followed the ‘Ā’ishah hadith as they viewed the application of *bay‘ al-‘īnah* to be a *ḥilāh* to legalise *ribā*. Ibn Rushd for the Mālikīs contended that the contract was manipulated to make *ribā al-nasī‘ah* seem legal. For instance, a person said to another person, "I lend you 10 *dīnār*

³⁰³ Abī ‘Abdullāh Muḥammad bin Abī Bakr Ibn Qayyim al-Jūziyyah, *Ilām al-Muwāqī‘īn*, Beirut: Dār al-Jail, 1973, vol. 3, pp.166.

for a month and I want 20 *dinār* (in return)". "That is not permissible", said the other person. "But you can sell to me this donkey for 20 *dinār* in credit for a month then buy back the donkey for 10 *dinār* in cash"³⁰⁴. Based on the transaction, the buyer will get 10 *dinār* in cash and the seller will receive 20 *dinār* in a month. The sale asset was just a trick since neither of the contracting parties actually intended to sell or buy the donkey. Hence, the contract was similar to a 10 *dinār* loan with 100 percent interest.

Indeed the application of *hīlah* in Islamic law has become topic of debate among the classical jurists. The Ḥanafīs were known as the jurists most willing to employ the *hīlahs* as one of principles in deducing rules. For example, they permitted the marriage of *muḥallil* based on the principle of the *hīlah*³⁰⁵. Marriage of *muḥallil* refers to a temporary marriage contract executed to allow a husband who had divorced his wife three times (termed as *bā'in kubrā*) to re-marry the wife. In a marriage of a *muḥallil*, usually it was agreed that the temporary husband will not sleep with the wife and will divorce her as soon as possible. Interestingly however, in the case of *bay' al-ṭinah* the Ḥanafīs admitted that the contract was a kind of deception that can not be compromised. Al-Shaybānī said, "In my heart, the contract was such a hill of blameworthy which created by those who eat *riba*"³⁰⁶.

In contrast, al-Shāfi'ī did not consider the practice of *bay' al-ṭinah* as *hīlah*. He treated *bay' al-ṭinah* as two separate contracts in which each of them comply with all the essential elements (*arkān*) of a sale contract. In the case of Zaid bin Arqam, both sales were agreed with fixed prices, valid subject of sale and qualified contracting parties. Hence, al-Shāfi'ī questioned the basis on which one would forbid someone from selling his asset in cash in which the asset was obtained from credit purchase. He also made an analogy with the similar case which the jurists unanimously agreed on its permissibility. The jurists ruled that

³⁰⁴ Ibn Rushd, *Bidāyah al-Mujtahid wa Nihāyah al-Muqtasid*, vol.3, pp.1596.

³⁰⁵ Sarakshi, *al-Mabsūt: bab al-hīlah*, vol. 15, pp. 345.

³⁰⁶ Ibn 'Ābidin, Muḥammad Amīn ibn 'Umar, *Rad al-Mukhtar fir Dar al-Mukhtar*, Beirut: Dār al-Kutub al-'Ilmiyyah, 1992, vol. 5, pp.274. It should be noted that other Ḥanafīs master, Abū Yūsuf had permitted the *bay' al-ṭinah*. He argued that the contract was practiced by some early Muslim scholars.

it is allowed for a person who purchased a slave with 100 dinar in credit to sell the slave with 200 *ḍinār* in cash. Therefore, for al-Shāfi'ī, *bay' al-ṭinah* should be permitted on the same basis. Al-Shāfi'ī clearly considered *bay' al-ṭinah* as a genuine sale contract that was distinct from *ribā*³⁰⁷.

Al-Shāfi'ī's rule in *bay' al-ṭinah* was consistent with his rule in *bay' al-mu'āṭāh*. He established a principle that the validity of any type of sale contract is examined based on its compliance with the essential elements which are identified as the contracting parties, the subject of sale and the language of offer and acceptance (*ṣiḡḡah*). Briefly speaking, *bay' al-mu'āṭāh* is a sale contract without the utterance of offer and acceptance between the seller and the buyer. A modern example of this type of contract would be purchasing via vendor machine. Contrary to the majority jurists, al-Shāfi'ī ruled that *bay' al-mu'āṭāh* was void. His main argument was because the contract did not comply with the condition of the language of offer and acceptance. For him, the offer and acceptance must be spelling out verbally and can not be replaced by an action³⁰⁸.

However, his rule to legalise *bay' al-ṭinah* contradicted to his rule on marriage of *al-muḥallil*. Applying the principle of analogy, al-Shāfi'ī should reach to conclusion that both contracts are prohibited. This is because *bay' al-ṭinah* and marriage of *al-muḥallil* are similar: neither of the contracting parties have a genuine intention to execute the contracts. In the case of *bay' al-ṭinah* the main purpose is to obtain cash whereas in the marriage of *al-muḥallil*, the motive is to allow the former husband to re-marry the wife. However, al-Shāfi'ī abandoned the analogy and ruled the permissibility of the former and the prohibition of the latter. Interestingly, in deducing the rule of marriage of *al-muḥallil*, al-Shāfi'ī made an analogy with the marriage of *al-mut'ah*. Based on the Prophet's prohibition of *al-mut'ah* marriage, al-Shāfi'ī ruled that any kind of marriage contract which was executed on temporary basis was forbidden. The rule indicated that al-Shāfi'ī in this matter gave emphasis on the genuine

³⁰⁷ Shāfi'ī, *Kitāb al-Umm: bāb bay' al-ʿajal*, vol. 3 & 4, pp.78.

³⁰⁸ Sharbinī al-Khaṭīb, *Mughnī al-Muḥtāj Ila Maʿrifah Maʿānī al-Alfāz al-Minhāj*, vol.2, pp. 325

intention of the contracting parties. Even though the marriage of *al-muḥallil* complies with all the essential elements (*arkān*) of the marriage contract, it was forbidden since the intention of the contracting parties contradicts with the concept of a marriage in Islamic law (i.e. establish permanent relationship between a husband and wife).

As indicated earlier, the Malaysian *sharī'ah* scholars had favoured the opinion of al-Shāfi'ī in accepting the *bay' al-īnah* contract in creating a number of Islamic banking products. The following statements are the resolutions by the NSAC pertaining to the acceptability of the contract in Islamic money market products and Islamic credit card:

A. Resolution on Money Market Transaction

The Council in its 8th meeting held on 12th December 1998 / 23rd Syaaban 1419 resolved that *bay' al-īnah* transaction in the Islamic Inter-bank Money Market is permissible based the following conditions: i. *bay' al-īnah* transaction must strictly follow the mechanism which is accepted by the Shāfi'ī school; and ii. the transacted asset is not a *ribawī* item.

B. Resolution on Credit Card

The Council in its 18th meeting held on 12th April 2001 / 22nd Muharram 1422 resolved that the mechanism of Islamic credit card which applies *bay' al-īnah* concept to generate funds for credit purposes by a customer who requests for the Islamic credit card is permissible³⁰⁹.

In the following section, we will examine how the *bay' al-īnah* contract has been applied to create the so-called Islamic credit card. Understanding the *modus operandi* of the Islamic credit card would give us a clear indication regarding the methodology and approach adopted by the Malaysian *sharī'ah* committees members in solving current banking and finance problems.

³⁰⁹ Resolution of Shari'ah Advisory Council of Bank Negara Malaysia, Kuala Lumpur, pp.14-18, http://www.bnm.gov.my/guidelines/01_banking/04_prudential_stds/07_shariah_resolution.pdf. Accessed on 20th of January 2010.

The Application of *Bay' al-ṭinah* in BIMB Islamic Card (BIC)

Credit card is a well-known product in the conventional banking system. It refers to 'plastic money' that grants credit facility to card credit holder. By obtaining a credit card, one can spend the extended credit up to a pre-arranged ceiling level. However, the cardholder must pay back the amount that has been borrowed within a given period, or else interest will be charged on the remaining balance of the unpaid debt³¹⁰. Due to two main factors (convenience and safety), the credit card has become an indispensable banking facility for majority of people. The credit card provides a convenient way of making payment as one does not have to bring a bundle of cash to make large purchases. It is also a safety way of shopping since carrying lot of cash will expose us to the risk of robbery. Furthermore, in certain cases the need for a credit card is obvious because the card is a pre-requisite for online transactions i.e. in hotel booking or car rental payment. As far as the bank is concerned, credit card business is able to generate huge profit for the institution. By issuing credit card, the bank will earn revenue from (1) annual fees charged to the cardholders and from (2) interest for the late settlement. It is reported that the credit card market in Malaysia has witnessed a 50 percent of increase in profit between 2005 and 2007. This significant growth is attributed to a 32 percent in the number of new card issued and a 44 percent growth in the outstanding debt³¹¹.

Contemporary jurists had differed in determining the legality of conventional credit card. There are some jurists who permit its usage with conditions that Muslims customers must (1) pay the full outstanding balance every month, (2) never roll over any balance to next statement period and (3) avoid cash withdrawals³¹². It is argued that by adhering to these conditions *ribā* could be avoided, thus using a credit card in this way is legitimate. However, the majority of jurists are of the view that the conventional credit card is absolutely

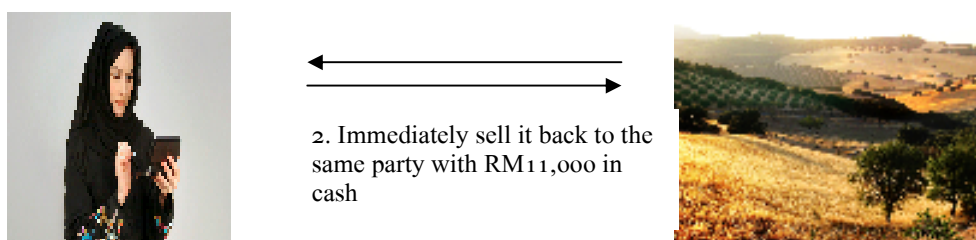
³¹⁰ Paxson, D., & Wood, D, *Encyclopedic Dictionary of Finance*. Oxford: Blackwell. 1998.

³¹¹ The Paypers-Malaysia credit card market. www.lafferty.com/pdffiles/. Accessed on 4 of July 2009.

³¹² Adil Manzoor Bakshi, *Developing a Financial Model for Islamic Credit Card for the UK*, Masters Dissertation, University of Salford, 2006.

forbidden. Its underlying concept is based on *ribā al-nasī'ah*. A card credit holder is obliged to pay interest if he fails to settle his outstanding debt within a given period. Thus by signing a credit card contract, a Muslim is perceived as having agreed to commit a major sin (*ribā*). This majority view apparently becomes the most accepted ruling in this matter. Nevertheless, although a credit card is regarded as unlawful product, its potential profit seems hard for the Islamic bankers to ignore. Therefore, they tried to develop a credit card system which confirms the rules and guidelines of Islamic commercial law. In their quest to invent an 'Islamic' credit card, BIMB with the help of their *sharī'ah* committees have come out with the BIC card model. The *modus operandi* of the transaction is illustrated in figure 2 below.

Figure 2: The *modus operandi* of BIC card



Suppose Aminah intends to obtain a BIC card from BIMB. Firstly, she will be asked to fill in an application form, notifying her annual income to the bank. Based on Aminah' financial conditions, the bank will offer different types of BIC card. Premium card (gold or platinum) usually will be offered if her annual income is quite high. Let us assume that Aminah qualifies to have a gold BIC card with credit facility up to RM11,000. In granting the said amount to Aminah, the bank will execute a *bay' al-ṭinah* transaction.

BIMB will identify a specific asset, for example a piece of land which will then be sold to Aminah, say for RM15,000 in deferred sale. Immediately, the bank will buy back the land from Aminah for RM11,000 in cash. When the second transaction is executed, Aminah who formerly came to the bank with empty pocket now will have a substantial amount of cash to spend. The bank will disburse the cash (RM11,000) which is the proceeds of the second agreement into Aminah's BIC *wadī'ah* account. Having the money, Aminah now can use

her BIC card for various commercial transactions similar to the conventional credit card. She is required to pay back the money she had used from the account within a given period. Otherwise, the bank will impose additional payment for the late settlement.

BIMB contends that its additional payment for the late settlement is legitimate since it is regarded as profit not interest. The profit is referred to the difference between the sell and the buy back prices (RM15,000 – RM11,00) in the *bay' al-ʿinah* transaction executed earlier. In other words, through the act of selling land to Aminah, BIMB is actually entitled to RM4000 profit. However, the profit is only claimed on her when she struggles to pay her debt on time. The maximum additional payment however is fixed (RM4000 in our example). According to BIMB, the fixed maximum profit demonstrates BIC card main advantage over its conventional counterparts. This is because in the conventional credit card system, interest is charged compounded and indefinitely until cardholders' outstanding debts are been settled.

The Justification and Methodology of Malaysian *Shari'ah* Scholars

The Malaysian *shari'ah* scholars legalise the practice of *bay' al-ʿinah* based on two main justifications. Firstly, they argue that the contract was not clearly prohibited either in the Qur'an or in the *sunnah*. They do not accept the validity (*hujjiyah*) of the *athār* and the *ḥadīth* which indicate the prohibition of the contract. For them, the *athār* of ʿĀ'ishah is considered as weak evidence due to unreliable narrator in its *isnād*. Even if the *athār* is accepted in terms of its *isnād*, it still regarded as invalid evident because its textual content (*matan*) appears to contradict the general principle of Islamic law. This is because ʿĀ'ishah was reported to have invalidated the reward of *jihād* that Zaid bin Arqam had involved together with the Prophet. In the *athār*, she was reported saying that '*inform Zaid that his conduct has eliminated all his rewards for participating in jihad with the Prophet if he does not repent*'. Such a statement could not be taken into consideration since ʿĀ'ishah was not in capacity to do so.

Secondly, the Malaysian scholars argue on the basis of *maṣlahah*, in which refers to the need or interest of Muslims contemporary society. The scholars accept the argument that credit card has become an important banking facility for majority of Muslims. In today's world, the card is crucial for daily business dealings and commercial transactions. Considering this need, the scholars support the bank's initiative to create a credit card that is *sharī'ah* compatible. In this regard, *bay' al-ṭinah* is viewed as a key contract since it provides a *makhraj* (mode of problem solving). The contract can help the society as well as the Islamic banks achieve their respective goals. Although admitting *bay' al-ṭinah* resembles *ḥīlah*, the contract is accepted for the sake of majority interest³¹³.

These two justifications signify the crux of methodology adopted by the local *sharī'ah* scholars in assessing the legality of other Islamic banking products. The first justification indicates that the *sharī'ah* scholars practice independent *ijtihād*. In solving *fiqh* problems of the Islamic banking, they will refer directly to the primary and the secondary sources of Islamic law. As generally known, the primary sources refer to the verses of the Qur'an and the sunnah of the Prophet (pubh), while the secondary sources refer to *ijmā'* (consensus), *qiyās* (analogy), *istiḥsān* (legal preferences), *urf* (custom) and others³¹⁴. They will also examine the prominent classical jurists' opinions but will not blindly be restricted by them. This method contradicts their approach when judging the matrimonial, inheritance, administration of mosque and *waqf* (endowment) cases where decisions are usually confined to the rulings of the Shāfi'ī's school.

In practising the *ijtihād*, the local *sharī'ah* scholars uphold a legal maxim stipulating that '*the original ruling of mu'āmalat (business transaction) is permissible*'. It implies that a new business transaction is regard as lawful unless there is legal evidence prove otherwise. In the case of *bay' al-ṭinah*, the contract is viewed as legal since evidences indicating its prohibition has created doubt in the minds of the local *sharī'ah* scholars. The legal maxim was

³¹³ Resolution of the Securities Commission Sharī'ah Advisory Council, Kuala Lumpur: Malaysian International Islamic Financial Center, 2006, pp.22.

³¹⁴ Resolution of the Securities Commission Sharī'ah Advisory Council, pp.8 & Interview with Dr. Engku Rabiah

commonly practiced by the classical jurists when deciding new rules for commercial dealings and business transactions³¹⁵. It certainly enables the Malaysian *sharī'ah* scholars to adopt pragmatic orientation when assessing the compliance of Islamic banking products. Thus, the local *sharī'ah* scholars are not fixed rigidly within the classical jurists' rulings but admit changes and modifications. They accept creativity and innovation in the field of Islamic commercial transaction³¹⁶. It should be noted however, the scholars embrace a different orientation when judging unprecedented *'ibādah* (worship) matters. They are of the opinion that the original ruling of *'ibādah* is forbidden until they find out a divine text which states otherwise.

The second justification (*maṣlaḥah*) shows that the Malaysian *sharī'ah* scholars deliberate at length the practical aspect of the current banking business. Through direct involvement in the banking practices, they seem to admit that sticking with *muḍārabah* contract has significant problems in terms of feasibility and practicality from the perspectives of the Islamic banks and their clients. The impediments faced by the Islamic banks in implementing profit sharing business are acknowledged by the local *sharī'ah* scholars. It appears that there are significantly higher costs of placing funds on *muḍārabah* venture. In identifying the right investment project, Islamic bankers need to impose parameters, risk control measures, accounting and monitoring system that are costly and time-consuming³¹⁷. The additional cost of monitoring entrepreneurs' activities is as a result of the moral hazard hypothesis. The present economic condition is generally thought to be contributing to dishonest behaviour among business people. In the *muḍārabah* arrangement, these types of entrepreneurs are likely to under-report or artificially reduce declared profit by increasing business operational expenses³¹⁸. Considering the settings in which Islamic

³¹⁵ 'Umar 'Abd Allah Kāmil, *ar-Rukhṣah al-Shar'īah fī Usul wal Qawā'id al-Fiqhiyyah*, Mecca: Maktabah al-Makiyyah, 1999, pp. 327.

³¹⁶ Interviewed with Dr. Shamsiah Mohammed, 13 August 2008, University of Malaya, Kuala Lumpur.

³¹⁷ Munawar Iqbal, Ausaf Ahmad & Tariqullah Khan, *Challenges Facing Islamic Banking*, Occasional Paper no. 1, Jeddah: Islamic Research Training Institute, 1998, pp. 50.

³¹⁸ Md. Abdul Awal Sarker, Islamic Business Contracts, Agency Problems and the Theory of Islamic Firms, *International Journal of Islamic Financial Services*, vol.1 no.2.

banks are operating, the local *sharī'ah* scholars try to balance between the ideal and the practice of Islamic banking industry.

In view of the practical issue of *muḍārabah* investment, the local *sharī'ah* scholars adopt a '*form over substance*' approach in developing Islamic banking instruments. The approach focuses on changing the legal terminology rather than the essence of the conventional banking products. As is evident in the case of *bay' al-īnah*, the contract is analogous to a usurious transaction. Financing products created through *bay' al-īnah* economically has similar effects to the conventional banking loans. Perhaps the local scholars' primary concern in adopting such an approach is to demonstrate the usefulness of various medieval Islamic commercial contracts in today's modern world. In other words, knowing the various risks in implementing the *muḍārabah*, they shift to less risky medieval commercial contracts. Hence, by adopting the contracts of *bay' al-īnah*, *bay' murābaḥah*, *bay' bithamanin 'ajil* and others, at least they have proven that Islamic commercial law has solution to the *ribā* problem even in the sophisticated banking environment³¹⁹.

However, critics of the Islamic banking disagree with the approach. Its implementation is seen as a kind of deception which manipulates the religious notion of Muslims for banks' economic profit. This is evident in the case of Islamic credit card created through the application of dubious *bay' al-īnah* contract. The legal trick in legalising *ribā* in the product is obvious as Islamic banks repeatedly use the same piece of land to create thousands of credit cards. As a result banking products created through this approach look 'Islamic' in their appearance but maintain the element of *ribā* in their fundamental nature. Therefore, the objectives (*maqāṣid*) of Islamic banking will never be achieved if *sharī'ah* experts continually evaluate new Islamic banking products on this basis.

³¹⁹ Muhammad Anwar, Islamicity of Banking and Modes of Islamic Banking, *Arab Law Quarterly*, vol. 18, No. 1, 2003, pp.62-80.

Conclusion

The pioneer scholars of Islamic banking clearly set forth the application of *muḍārabah* contract as the primary basis of the establishment and the operation of interest-free banking institutions. Since interest in conventional banking is prohibited for being a guaranteed return on capital, it is only logical for Islamic alternative to base on profit and loss sharing principle. *Muḍārabah* is chosen as the alternative because the contract certainly comply with this essential Islamic economic rule. As Islamic banks were established rapidly in the late 1970's, the pioneer scholars hoped to see the emergence of distinctive financial institutions which predominantly operate on *muḍārabah* contract. However, their wish was not realised as the proportion of *muḍārabah* business in the existing Islamic banks has remained negligible. Hence, the dichotomy between the theory and practice has become a major issue in this subject.

Malaysian Islamic banking experience unfortunately has been a good example with which to illustrate this "dichotomy" problem. There is no doubt that through numerous incentives and encouragement from the government (through the Central Bank), Islamic banking industry in the country has grown tremendously. Its target to capture 20 percent of total banking market share by 2010 is on track. The framework of Malaysian *shārī'ah* governance is arguably one of the most advanced as compared to other Muslims countries. Besides, with the assistance from local *shārī'ah* scholars, Islamic bankers have managed to offer various complex banking and financial products. However, most of the advancements made in particular at the operational level have been critically argued as insufficiently different from the conventional banking practices. This is partly due to the over reliance on the duplication and the 'form over substance' approaches undertaken by the Islamic bankers and banks' *shārī'ah* advisors. The latter party appear to have an over emphasis on the consideration of actual banking problems in supervising *shārī'ah* compliance matters. They interpret Islamic commercial law according to bankers' needs and present business demands.

As we will demonstrate in the next chapter, the ‘market-driven’ approach is clearly adopted by the Malaysian *shārī‘ah* scholars in issuing *ijtihād* related to *muḍārabah* products. Some of the *ijtihād* rulings are controversial as they contradict the prevalent rules of the contract.

CHAPTER FOUR: ANALYSIS OF THE APPLICATION OF *MUḌĀRABAH* IN MALAYSIAN ISLAMIC BANKS

Introduction

As indicated in the previous chapter, BIMB is the pioneer of Islamic banking institution in Malaysia. Being a pioneer, the bank has become focus of many empirical studies. The issues most often studied at the operational level are related to bank's financial performance³²⁰ and selection criteria³²¹. With regard to the first issue, researchers are keen to examine whether BIMB is capable of offering a viable alternative for conventional banking system. Studies on the selection criteria observe customers' patronage factors in choosing BIMB banking products. There is no doubt that the findings of these studies have in a way enhanced the financial and marketing aspects of the bank. However, from my personal observation, research that critically analyses the *sharī'ah* compliance of bank's products has not been given adequate consideration. It is appear that the decisions made by BIMB's *sharī'ah* advisors are accepted without much analytical deliberation.

The present chapter attempts to challenge the prevalent assumption by examining BIMB current practice of *muḌārabah* contract. It tries to evaluate the extent in which the current practices comply with the rules of *muḌārabah* as described by the classical jurists. As a case study, the chapter analyses the *modus operandi* of deposit and wealth management products offered by the bank. The focus of the discussion is to point out some critical issues arising from *ijtihād* made by the local *sharī'ah* scholars in modifying *muḌārabah* contract into modern banking practices. The *ijtihād* is broadly examined under two main subjects; (1) the utilisation of *muḌārabah* capital and (2) the profit distribution method. Under the first subject, we will analyse how far the financing, Islamic bonds (*sukūk*) and Islamic money market products uphold

³²⁰ See for example Abdus Samad & M. Kabir Hasan, The Performance of Malaysian Islamic Bank During 1984-1997: An Exploratory Study, *International Journal of Islamic Financial Services*, vol. 1 no. 3.

³²¹ See for example, Haron S, Ahmad, N, Planisek, S.L, Bank Patronage Factors of Muslim and non-Muslim Customers, *International Journal of Bank Marketing*, vol.12, no.1, pp.33-40.

the profit and loss sharing principles. Meanwhile, in the second subject we will examine the *ijtihād* on profit equalisation reserve (PER), indicative profit rate, interim profit payment and capital guarantee.

The Milestones, Vision and Core Values of BIMB

BIMB has been in operation for more than a quarter of century. Since its inception, the bank has chartered various milestones establishing a feasible Islamic banking system that operates in parallel with conventional banking. Besides Islamic banking industry, BIMB also plays pivotal role in developing other complementary sectors such as Islamic insurance (*takāful*), Islamic unit trust and Islamic securities. A subsidiary company was set up in 1984, 1993 and 1994 respectively to undertake these distinctive businesses. As each subsidiary experienced accelerated growth, BIMB Holding Berhad was formed in 2000 to consolidate and further strengthen the group's businesses³²².

As far as the capital is concerned, BIMB has recorded tremendous growth. From only RM80 million initially, the bank's paid up capital rose to RM1.73 billion in June 2009³²³. The figure however is considered as a moderate success as compared to the total capital of Malaysian Islamic banking which reported at RM16.8 billion in the same period³²⁴. In terms of product offering, it is claimed that the bank has developed more than 150 sophisticated banking products and services. These products do not only created to meet the traditional banking needs such as financing, saving and basic investment accounts but also to satisfy the needs of micro financing, wealth management and capital market. The latest innovative products are *al-Awfar* saving and investment accounts as well as cross-currency swap transaction. Driven by a comprehensive strategic business plan, the bank recorded the highest ever profit of RM308.27 million in 2008.

³²² Bank Islam Malaysia Berhad Annual Report, Kuala Lumpur, 2008, pp. 3.

³²³ Bank Islamic Malaysia Berhad, Who are we?, www.bankislam.com.my, Accessed on 24th December 2009.

³²⁴ Monthly Statistical Bulletin November 2009, Bank Negara Malaysia, Kuala Lumpur, www.bnm.gov.my/files/publication/msb/2009, Accessed on 1st January 2010.

The achievement however has not succeeded without encountering challenges. In 2006, BIMB shocked the nation by announcing a massive loss of RM479.8 million. The losses were largely due to the unexpected provision of non-performing loan (NPL) which totalled at RM2.2 billion. Out of the total NPL, 35 percent was contributed by the poor credit management of its offshore branch in Labuan³²⁵, 30 percent from the bank's commercial units and the remaining came from consumers and corporate clients. Commenting on the Labuan case, BIMB admitted that the financing was given generously without sufficient understanding of the risks involved including country and project risks³²⁶. As response to these substantial losses, the ownership structure of BIMB group has gone through a major revamp. In order to raise cash injection, 40 percent of the group's stakes were sold to foreign shareholder namely Dubai Investment Group (DIG) of United Arab Emirates. And another 9 percent stakes were sold to a local Islamic financial institution, Lembaga Tabung Haji (LTH). The initial shareholders maintain a marginal control of the group with 51 percent stakes. In addition, the revamp course brings in a new management team, led by Datuk Zukri Samat.

The new management team is committed to make BIMB as a global leader in Islamic banking. The vision aims to establish BIMB as the ultimate guidance and source of reference for innovative *sharī'ah*-based products and services. The new management team proudly claims that the strength of the bank lies in the word 'Islam'. According to them, the word expresses the bank's commitment to uphold *shārī'ah* principles in all values, activities and transactions³²⁷. Hence, banking products offered by BIMB are assured as 100 percent *shārī'ah* compliant. A comprehensive list of the products is presented in figure 3.

As shown in the figure, BIMB's banking products are generally divided into two groups; consumer and business. The first group is created to satisfy the needs of individual customers whereas the second is designed to meet the

³²⁵ One of BIMB investment branch located in West Malaysia.

³²⁶ Anil Netto, Islamic bank's woes highlight problems, Asia Times Online, 5 November 2005, www.atimes.com/atimes/Southeast_Asia/ Accessed on 27 December 2009.

³²⁷ Bank Islam Malaysia Berhad, *Our Logo Rationale*, www.bankislam.com.my, Accessed on 24 December 2009.

requirements of corporate clients. Consumer banking products are further organised into three types; deposit, financing and wealth management. Deposit products comprise of typical or basic banking facilities which are saving, current and investment accounts. Similar to conventional banking, these accounts function as the main sources of funds to support bank's operations. One of the core operations is to provide financing. For individual customers, the financing products offered include home financing, vehicle financing, personal financing and Bank Islam Card-i. Meanwhile, the wealth management products are recently introduced by BIMB as response to the increasing demand of *sharī'ah* compliant asset management products. The wealth management products aim to draw more funds from institutions and individuals of high net worth. At present, two types of products are being offered under this category; unit trust and structured investment instruments.

As for business and corporate clients, the banking products offered are classified into three groups; trade financing, asset-based financing and treasury services. Trade financing products focus on providing short-term financial assistance to businesses that require additional working capital i.e. to fund cost of imported raw materials. BIMB will offer financing facility to these clients and help them accomplish their business projects. This types of products include letter of credit, trade working capital financing, accepted bills, bills of exchange purchased, export credit refinancing, shipping guarantee, bank guarantee, bilateral payment arrangement and cash line. On the other hand, asset-based financing products are offered to fund commercial property acquisition, purchase of equipments or refinancing assets. Financing facilities provided under this category normally are executed over a long-term period. The current products of asset-based financing are hire purchase, leasing, equipment & commercial property financing, project bridging and business financing. Treasury services are the most sophisticated Islamic banking products created. It offers liquidity management products for corporate clients such as Islamic bonds (*sukūk*), foreign exchange (Islamic FX forward), derivatives/hedging and money market instruments.

Despite numerous innovative banking facilities offered by BIMB, in this study, we shall concentrate only on the deposit and wealth management products. These products become the focus of this study because they are the main BIMB's banking facilities that apply the *muḍārabah* contract. In contrast, products of consumer financing, trade financing, asset-based financing and treasury services are mainly operated on debt-like contracts such as *bay' al-murābahah*, *bay' bithaman 'ajil* (BBA), *bay' al-īnah*, *wakālah* and *ijārah*. The classification of the products based on Islamic commercial contracts applied is presented in table 8.

Figure 3: List of Banking Products Offered by BIMB

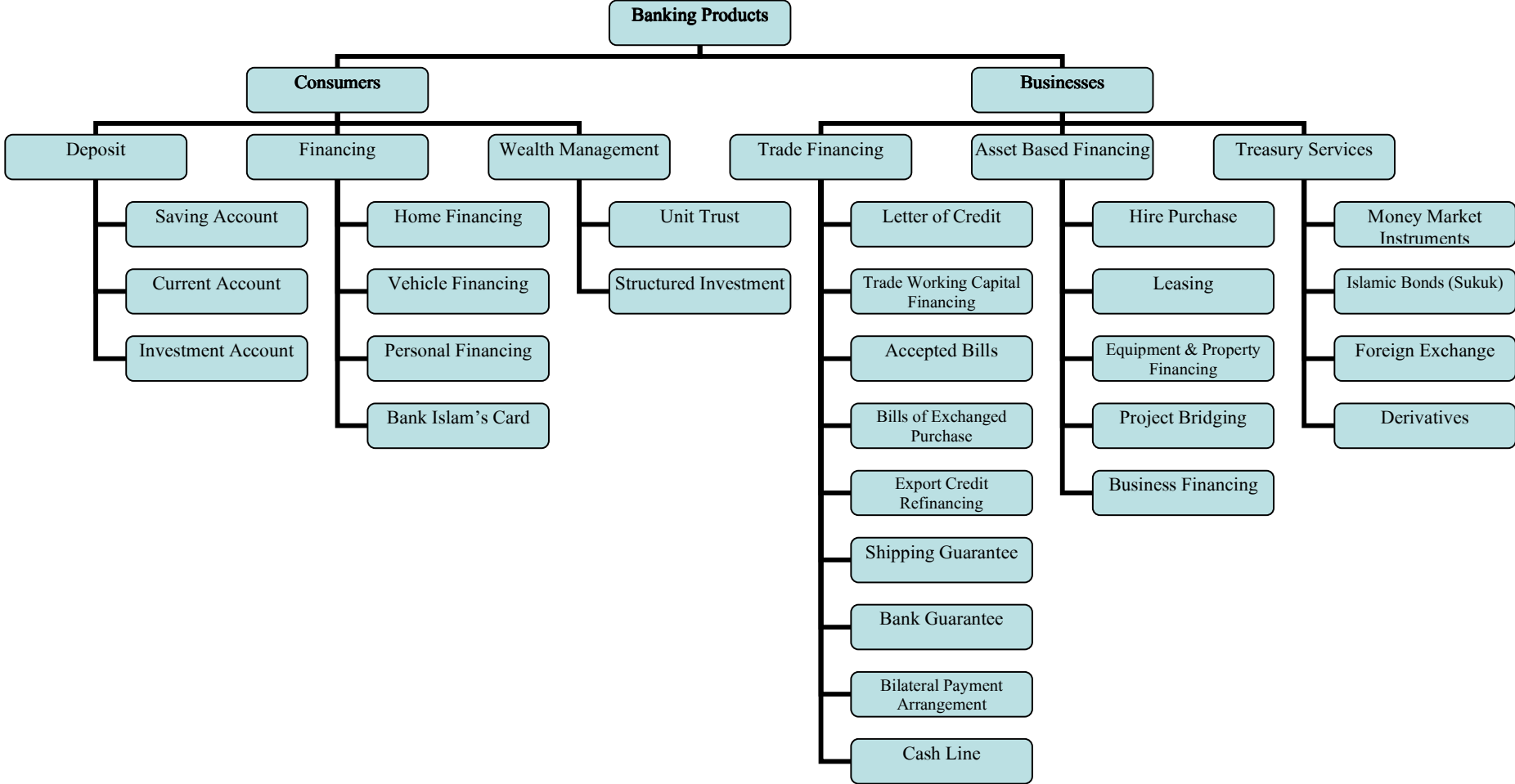


Table 8: Classification of BIMB products based on Islamic commercial contracts applied

No.	<i>Muḍārabah</i>	<i>Murābahah</i>	<i>BBA</i>	<i>Wakālah</i>	<i>al-Ḥīnah</i>	<i>Ijārah</i>	<i>Bay' al-Dayn</i>	<i>Kafālah</i>	<i>Istiṣna'</i>	<i>Wadī'ah</i>
1.	Saving account	Letter of credit*	Home financing	Letter of credit*	Personal financing	Hire-purchase	Bills of exchanged purchase	Shipping guarantee	Project bridging	Current account
2.	Investment account	Trade working capital financing	Vehicle financing		Bank Islam Card	Leasing	Export credit refinancing*	Bank guarantee		
3.	Unit trust	Accepted bills	Equipment & property financing		Cash line			Bilateral payment arrangement		
4.	Structured investment	Export credit refinancing*	Business financing							

* Applied hybrid contracts

As clearly shown in table 1 above, BIMB implements 10 Islamic medieval commercial contracts in devising its banking products. Noticeably however, out of the ten contracts, *muḍārabah* is the only contract that advocates profit and loss sharing principles. The rest of the contracts are based on debt-like transactions. The current practices obviously deviate from the theory of Islamic banking as expounded by early Muslim economists. This due to the fact that *muḍārabah* contract is only implemented to draw funds from depositors and investors. In theory, these funds should be invested in viable business projects also on profit and loss sharing basis. However, as evident in the case of BIMB these funds are utilised in banking transactions of minimal risks which identical to conventional banking instruments. The virtually 'risk-free' banking products are created by adopting the debt-like contracts such as *murābahah*, *BBA*, *wakālah* and etc.

BIMB's Deposits and Wealth Management Products

This section discusses the salient features of deposit and wealth management products of BIMB. In general, BIMB adopts Siddiqi's model of interest-free bank in running both types of products. Depositors or investors are regarded as *rabb al-māl* (capital providers) while the bank is considered as *muḍārib* (agent-manager). The bank will invest the deposited money by providing financing to appropriate clients. As part of the bank's marketing strategies, the products are categorised as follows:

Table 9: The categorisation of BIMB deposit and wealth management products

No	Deposit		Wealth Management	
	Saving Account	Investment Account	Unit Trust	Structured Product
	Muḍārabah	General	al-Fakhim	an-Najah
	Wadi	Sakīnah	al-Munsif	Ziyad
	Ijraa	Al-Awfar	al-Falah	
	Pewani		al-Mubin	
	al-Awfar			

Saving Accounts

BIMB creates four types of saving accounts to capture different segments of consumer deposit market. There are called as *muḍārabah*, *wadi*, *ijraa*, *pewani* and *al-awfar* saving accounts. *Muḍārabah*, *wadi* and *ijraa* accounts are differentiated mainly on the basis of age requirement. *Muḍārabah* saving account is the most basic account intended for general savers aged 12 years old and above. Meanwhile, *wadi* saving account is created to encourage saving among children of below 12 years old and *ijraa* for teenagers between 13 and 18 years old. *Pewani* saving account is a unique deposit product designed to help women aged 18 years and above prepare for their future.

In terms of benefit, the *muḍārabah* saving account holders perhaps are the most advantageous. They are entitled bankcard facilities that enable them to access to ATM withdrawal, fund transfer, statement request, internet banking and other uses. In contrast, due to age factor, holders of *wadi* and *ijraa* accounts are not entitled to such benefits. Depositors of these accounts depend on their guardians to make any transaction such as withdrawing their money. *Pewani* account holders are not also offered the bankcard facilities but they have the right of *takāful* (Islamic insurance) coverage. However the coverage is not automatically granted. In order to be entitled the coverage of up to RM25,000, *pewani* account holders should maintain the monthly average balance of RM50,000. All depositors will share profit from their

savings based on pre-determined ratio. Normally the profit ratio agreed is 25:75, in which the former ratio belongs to customers³²⁸.

Al-Awfar saving account is recently launched to further promote saving among the public. The account is distinctive as it gives depositors opportunity to win cash prize draws in every quarter as follows:

Table 10: Cash prizes draw in *al-Awfar* saving and investment accounts

No.	Cash Prize	No. of Quarterly Prize
1.	RM100,000	1
2.	RM10,000	1
3.	RM5,000	1
4.	RM1,000	3
5.	RM5,00	5
6.	RM250	18
7.	RM100	500

Source: www.bankislam.com.my

In *al-Awfar* account, every RM100 deposit entitles one unit of draw entry. This means the more deposits put in the account the larger chance for depositors to win the prize. It also implies that a minimum balance of RM100 should be maintained at all times to be eligible for the draw. It should be noted that for some conscious Muslims the *modus operandi* of *al-Awfar* account appeared to be surrounded with contentious *fiqh* issues. They view that the quarterly prize draw involves the element of gambling. This is due to the thought that *muḍārabah* profit is distributed only to a few draw winners whereas the losers will get nothing from their investment. If this is truly happens, *al-Awfar* saving accounts clearly exemplifies unfairness type of profit distribution.

Replying to this scepticism, BIMB asserts that the cash prizes are not taken from profit of *al-Awfar* funds but are derived from bank's own money. In other words, all depositors of *al-Awfar* saving account are assured to earn their respective shares of profit if any. The cash prizes are just additional incentives given by the bank from external financial sources as a marketing strategy to attract more funds from the general public. Since the original profits are shared between all depositors, the questions of gambling and unfairness distribution of profit do not arise. On this basis,

³²⁸ Bank Islam Malaysia Berhad, *Pewani Accounts*, www.bankislam.com.my, Accessed on 25 February 2010.

the *Shari'ah* Supervisory Council of BIMB approved this product in its 102nd meeting dated 7th April 2008³²⁹.

Despite this clarification, I am still wondering how BIMB could afford to give such commitment in paying the cash prizes drawn in every quarter. My suspicion becomes a bit clearer when I look at the profit ratio agreed between depositors and the bank. For the purpose of comparison, I reproduce the profit ratios and the indicative profit rates of all types of deposit accounts as advertised in the bank's website.

Table 11: Profit rates of BIMB deposit accounts from 16 November to 15 December 2009.

Deposit Products	Profit Sharing Ratio Customer : Bank	Profit Rate % p.a.
Mudarabah saving account	25:75	1.11
Wadi saving account	25:75	1.11
Ijraa saving account	25:75	1.11
Al-Awfar saving account	2:98	0.04
Pewani saving account		
Exceeding RM5,000	30:70	1.33
Below RM5,000	25:75	1.11

*This is indicative rate of return based on the previous month's performance.

The actual rate can be higher or lower than the indicative rate.

Source: www.bankislam.com.my

Information on the profit ratio and the indicative profit rate of *al-Awfar* saving account give us some clues regarding the trick of how the draw mechanism is actually worked out. As clearly shown in the table above, the profit ratio of customer is somehow unreasonable; 2 ratios against 98 enjoyed by the bank. The profit ratio is notably lower comparing to the other types of deposit products. What is the explanation for this significance variance? Why the bank could offer relatively higher customer profit ratio in other deposit accounts but not *al-Awfar* account? There must be solid justification for this condition. I personally think that the enormous share of profit enjoyed by the bank is used to maintain the cash prizes draw. Having 98 percent of profit sharing ratio, the bank will use some of them to pay what they claim as an 'additional incentive' to depositors. There is no doubt that all depositors will earn their respective shares. However, given the 2 percent ratio which equal 0.04 percent of indicative annual profit rates³³⁰, their shares are virtually nothing. Therefore, the bank's claim that it uses its own money to pay the cash prizes could be thought of as a

³²⁹ Bank Islam Malaysia Berhad, *Al-Awfar Accounts*, www.bankislam.com.my, Accessed on 25 February 2010.

³³⁰ A detailed discussion concerning the indicative profit rate will follow in the next section.

misleading statement. The bank artificially attains almost all the profits from saving funds and then reallocates them to certain lucky depositors.

Furthermore, the fact concerning the division of profit sharing ratio is not highlighted by the bank when promoting *al-Awfar* account to potential customers. Unless carefully studied, customers will not aware of their negligible share of profit. The most important elements presented to the customers are the chance to win the grand cash prizes. In addition, the bank’s personnel will stress that the draw is free from gambling activity and the product is *sharī’ah* compliant.

Investment Accounts

An investment account is one of the most basic accounts through which one can establish a relationship with a particular bank. The main advantage of having an investment account is the opportunity to maximise profit from our idle funds. This is because normally an investment account offers higher rates of return as compared to saving account. In BIMB, the investment accounts are divided into three types (1) general investment account (2) special investment account called *sakīnah* and *al-Awfar* investment account.

Table 12: The salient features of general investment account.

Product	Salient Features
General Investment Account	Investment term: 1, 3, 6, 9, 12, 18, 24, 36, 48 or 60 months
	Minimum investment: RM500 for 3 months and above tenure RM1000 for 1 month tenure
	Age requirement: Open to all aged 18 years and above
	Types of accounts: Individual account Trusted account Joint account Partnership account Private company account

Source: www.bankislam.com.my

In order to open the general investment account, depositors have to fulfil certain requirements, imposed by the bank as investment contract guidelines. Firstly, the depositors are required to deposit their money for a specific term, ranging from 1 to 60 months. The term is determined by depositors at the beginning of the contract. They must keep their money within the agreed term to be eligible for any potential

profit. Premature withdrawal will cause them to lose the chance to share the profit. In addition to the investment terms, BIMB requires certain amount of minimum deposit. Depositors who wish to invest for only 1 month are required to deposit at least RM1000. Whereas those who wish to invest 3 months and above tenure, the minimum deposit is RM500.

The bank creates four types of general investment account to satisfy different needs of investors. Basically, the accounts are open to all Malaysians aged 18 years and above. Adult of 18 years and above can open and own an individual account. Children under 18 years old can open trusted account with the condition that they name an individual adult as a trustee. Besides this, depositors who jointly share a sum of money (i.e. husband and wife) can open joint or partnership accounts. In order to cater the needs of businesses, BIMB also creates private company account. The account is designed for a private company who wishes to invest its idle funds in the bank.

The *Sakīnah* investment account is specially created for retirees. As claimed by the bank, the *sakīnah* account holders will have an opportunity to enjoy higher profit sharing ratio and obtain special rates of Bank Islam card and other financing facilities. This however comes with conditions. The minimum investment is stipulated at RM50,000 and the money should be kept in the bank at least for one whole year. Meanwhile, *al-Awfar* investment account has similar salient features to those of other general investment accounts except for the ‘additional’ cash draw prizes. In tandem with the minimum investment requirement, *al-Awfar*’s account holders are required to maintain a minimum of RM1000 for 1 month investment tenure and RM500 for 3 months tenure and above to be eligible for the draw³³¹. The following table shows the profit sharing ratios and the indicative profit rates of all investment accounts discussed earlier.

Table 13: Profit sharing ratio and indicative profit rate of BIMB’s investment accounts

Profit rate for general investment account maturing from 1st June 2009 onwards		
Period	Profit Sharing Ratio Customer: Bank	Indicative Rate % p.a.
1 month	45:55	1.99
3 months	45:55	2.04
6 months	45:55	2.04
9 months	45:55	2.04

³³¹ Bank Islam Malaysia Berhad, *Al-Awfar Accounts*, www.bankislam.com.my.

12 months	50:50	2.27
15 months	52:48	2.36
18 months	52:48	2.36
24 months	54: 46	2.45
36 months	56:44	2.54
48 months	58:42	2.63
60 months & above	60:40	2.72
Profit rate for <i>sakinah</i> investment account maturing from 1st June 2009		
Period	Profit Sharing Ratio Customer: Bank	Indicative Rate % p.a.
12 months	50:50	2.27
24 months	54:46	2.45
36 months	56:44	2.54
48 months	58:42	2.63
60 months	60:40	2.72
Profit rate for <i>al-Awfar</i> investment account maturing from 16 November to 15 December 2009		
Period	Profit Sharing Ratio Customer: Bank	Indicative Rate % p.a.
1 month	30:70	0.49
3 months	30:70	0.51
6 months	30:70	0.54
9 months	30:70	0.58
12 months	30:70	0.62
15 months	30:70	0.63
18 months	30:70	0.64
24 months	30:70	0.65
36 months	30:70	0.69
48 months	30:70	0.73
60 months	30:70	0.76

Source: www.bankislam.com.my

Information shown in table 13 above reveals two arguments. Firstly, for the same period of investment tenure (12 months onwards), the profit ratio offered to general investors and retirees of *sakinah* investment is indistinctively varied. As a result, both types of investors attain similar indicative rates of profit from their investment. Thus, the bank's claim that the *sakinah* investment account offers a higher rate of profit is debatable. From the retirees' point of view there is no significant advantage to put their money in *sakinah* investment account as compared to the general investment account. Secondly, as pointed out in the previous discussion, the profit sharing ratio as well as the indicative profit rate of *al-Awfar* account is much lower comparing to the others. Thus, similar argument could be suggested here. Investors of *al-Awfar* account receive lower rates of profit not because their money was invested in non-profitable business but to maintain the cash prizes draw which take place in every quarter.

Wealth management products

BIMB offers two types of wealth management products to investors - unit trust and structured investment instrument. To date, there are four funds of unit trusts - *al-Fakhīm*, *al-Munṣif*, *al-Falāh* and *al-Mubīn* and two of structured investment - *an-Najāh* and *Ziyād* had been created.

In general, unit trust is sometimes referred to as mutual funds, and is a collective investment product which pool investors' capital in a fund managed by professional managers. A unit trust is considered as a relatively safe investment tool for investors to participate indirectly in equity market. As investors are always advised not to put all their 'eggs in one basket', investment in unit trust offers diversification opportunities. Unit trusts facilitate this by taking advantage of the pooled funds to purchase diversified portfolios of authorised investments. The diversification spreads the investments around a variety of assets in a portfolio to produce a better yield, more consistent return and reduced risks. The majority of unit trust investors are typically those with relatively small amount to invest, who neither have the expertise nor the inclination to hold portfolios on direct investments or shares. The ownership of unit trust fund is divided into units of entitlement, which will increase or decrease in net asset value (NAV) as the fund's value fluctuates. In our case, the institutional fund manager who is responsible in investing the investors' money is BIMB Unit Trust Management Berhad (a subsidiary of BIMB group).

Al-Fakhīm, *al-Munṣif*, *al-Falāh* and *al-Mubīn* funds are mainly distinguished based on the trade off between risk and return. According to the bank, *al-Fakhīm* fund is suitable for investors who prefer a regular annual income with a relatively low risk to principle capital. This is due to the fact that 70-90 percent of the funds would be invested in fixed income securities i.e. government bonds and corporate Islamic debt securities which are relatively secure and reasonable risk tolerance. Only a small fraction of funds would be invested in risky types of investment instruments such as in the money market. In addition, to secure the stability and security of the funds, BIMB would adopt a defensive strategy. This means, instead of taking an active trading approach the bank will hold the bonds for long term until it matures. As investment risks of the *al-Fakhīm* fund are low, the investors would also earn just reasonable return.

Meanwhile, *al-Munṣif* funds attempt to attract investors who seek a steady and consistent income over the medium to long term period. To achieve these goals, the funds would be invested equally in two sectors, equity and fixed income securities. Investment in equity market aims to generate high dividend yields. For *al-Munṣif* fund, the investment in equity market is primarily made to purchase blue chip stocks—the stocks of well-established companies having stable earning and no extensive liabilities. Investment in fixed income securities is made to generate the recurring income from expected regular annual dividend payment. Given the nature of stocks in which the fund is invested, the risk profile of *al-Munṣif* fund is considered between low to moderate. Hence, the fund is expected to generate an average return.

Al-Falāḥ is designed for investors who have long term investment plan and ready to bear a higher degree of investment risks. In line with this objective, up to 70 percent of the fund would be used to purchase stocks of companies that could offer potential increase in value rather than steady incomes. Contrary to *al-Munṣif*, the focus of stocks selection is the future earning growth. Thus, the fund may be used to purchase stock of small and mid-size companies that are undervalued which normally could generate higher than the average return. Since the focus of the fund is investment in growth stock, *al-Falāḥ* unit trust carries moderate to high risks. Nevertheless, the higher risks imply higher expected returns.

Al-Mubīn fund shares similar characteristic of *al-Falāḥ* fund except in the portfolio of equity investment. In the former, between 70-90 percent of the funds would be allocated to purchase stocks whereas in the latter, the allocated funds are only between 30-70 percent. Besides, BIMB would adopt active trading approach in which more funds would be utilised to purchase *shārī'ah* compliant stock if the equity market outlook is expected to be positive. Only a small fraction of the funds would be used in the investment of money market especially in the event of a severe downturn of equity market. Since *al-Mubīn* fund bears a high risk of investment, its expected return is also anticipated to be high.

As the basic characteristic that distinguishes Islamic unit trust from its conventional counterparts lies in the investment in portfolios of a *shārī'ah* compliant stock, the process of stock selection as pursued by BIMB *shārī'ah* committees become the most pertinent to our investigation here.

Islamic Stocks Screening Method

A company that undergoes a selection process has to pass two stages of screening process. The first stage is to scrutinise the core activities of the company. If the core activities are *sharī'ah* compliant then, the company passes the first test. The core activities are considered as *sharī'ah* compliant if they do not involve any of the four main criteria below:

1. Operation based on *ribā* i.e. commercial banks, merchant banks and other types of conventional banking institutions. This is based on the prohibition of *ribā* in the Qur'ān (2:275).
2. Operation that involves gambling which is defined as any game where the winning party takes all profits/benefits at the expense of the losing party. Gambling activities are clearly prohibited in the Qur'ān as stated in (3:90).
3. Operation that involves the production of or sale of prohibited commodities such as liquor and non-*ḥalāl* meat. This is based on the verse 3:90 of the Qur'ān.
4. Operation that involves activities based on *gharār* (uncertainties) i.e. conventional insurance business. This is based on *ḥadīth* on the prohibition of *gharār* transaction.

The next stage is to scrutinise the other side activities of the company i.e. subsidiaries and other business activities. In cases where a subsidiary's revenues are mixed with unlawful elements (for example, the core activity of the parent company is lawful i.e. engaging in real property sector but the subsidiary company operates a hotel which sells liquor), then the company can still be recognised as *sharī'ah* compliant provided that the unlawful revenue is minimal. The *sharī'ah* committee of Securities Commission³³² had ruled that the percentage of unlawful income must be negligible compared to that of company's core business activities. They determine that the income derived from unlawful activities should not be more than 5 percent of the total income of the company. In addition to that, it is emphasised that the unlawful income should go through a 'cleansing' process by being removed, which is normally done

³³² *Sharī'ah* committee of Securities Commission is another body set up at national level which function as the most authoritative institution in the *sharī'ah* compliant stock screening process matter. The role of the committee is very much similar to that of National *Sharī'ah* Advisory Council of Islamic banking.

through donation to charities. BIMB *sharī'ah* committee members agreed to this particular *ijtihād*.

However, there is a possible objection to it. One may argue that the *ijtihād* is contradictory to the understanding of the word *ḥarām* (unlawful) as stated in the Qur'ān (see for example 16:116). According to the understanding of the verse, what is unlawful in large quantity is also unlawful in small quantity. Scholars who criticise this *ijtihād* demand that the revenues of *sharī'ah* compliant stocks should be 100 percent derived from lawful sources. In addition, the basis of determination of 5 percent of the unlawful income is also unknown. It is understood that the 5 percent is determined to represent insignificant amount of unlawful income. However, the question is why 5 percent is chosen as the determining level. Can the percentage increase or decrease in the future?

According to Dr. Engku Rabiah, the decision for allowing 'mixed-companies' to be included as *sharī'ah* compliant is made for temporary period. She views the *ijtihād* is based on the *maṣlahah* principle. This is because, in reality it is hard to find public listed companies which completely free from unlawful income. Because of the ever changing business circumstances, there are certain unlawful situations that are unavoidable or difficult to avoid (termed in *fiqh* as *'umūm al-balwā*). For instance, due to the acquisition and merging activities, a *sharī'ah* compliant company may become non-compliant when it acquired/merged with company that involves in unlawful activity. Besides, the unlawful income commonly derived from interest paid by conventional banks. This is due to the fact that the majority of public listed companies still do not place their idle funds or make investments through Islamic banks³³³.

I personally can accept the temporary justification as an excuse to allow the insignificant amount of unlawful income. However being a temporary excuse, there must be a time framework established (e.g. 10 year transitory period) to allow 'mixed-companies' to adapt into strict *sharī'ah* requirement. Furthermore over the 10 years, the percentage allowed should be reduced gradually from 5 to 4 and so forth.

³³³ Interview with Dr. Engku Rabiah Engku Ali, 11 August 2008, International Islamic University of Malaysia, Kuala Lumpur.

However, this has not happen in the Malaysian Islamic capital industry. In the absence of any indication that the percentage will be removed from the Islamic stock screening process, it is strongly felt that the temporary excuse would become permanent resolution. This would continuously allow companies to conduct unlawful transactions though in small division.

The task to ensure the *sharī'ah* compliance of unit trust funds is under the responsibility of the same *sharī'ah* committee of BIMB bank. This means the *sharī'ah* committee members are not only responsible for authenticating the compliance of Islamic banking products to the classical commercial contract rules, but are also answerable for monitoring the investment of unit trust funds. As different skills and experience are required to conduct both tasks, such a practice is viewed as insufficient to some scholars³³⁴. Although BIMB's *sharī'ah* committees could argue that they do not need to go through the detailed stock screening process, as the list of *sharī'ah* approved companies is produced by the Malaysian Securities Commission³³⁵, I still think that they have to observe the operation of existing funds especially those of active trading category. Every investment transaction must be audited to ensure that investors' money has been utilised in lawful business. In order to carry out such a meticulous task, full time *sharī'ah* scholars need to be employed. An external *sharī'ah* committee who just meet several times during a year arguably could perform the audit process efficiently.

Structured Investment Instruments

The second product created under the category of wealth management is the structured investment instrument. This product is designed in the form of Islamic Negotiable Deposit (NID-*ī*). It refers to a sum of money deposited with the bank and repayable to the investors on a specified future date at the nominal value of the NID-*ī* plus declared dividend. Contrary to the deposit and investment accounts, the NID-*ī* is based on the application of restricted *muḍārabah* (*muḍārabah muqayyadah*). Under

³³⁴ Rodney Wilson, Islamic Asset Management, SGIA Research Working Papers Series, No.1, June 2007, University of Durham, pp. 3.

³³⁵ The list is produced by Securities Commission for free to assist public and institutional investors to invest in *sharī'ah* compliant companies. The stock screening process is undertaken its own *sharī'ah* committee.

this contract, the scope and the nature of business in which NID-*ī* funds would be utilised is identified at front. To date, BIMB has launched two NID-*īs* called as *an-Najāh* and *Ziyād*. The former focus on investments in the health care industry whereas the latter concentrate on the Asian equity market.

NID-*ī* instrument is distinct from a unit trust product since it offers capital protection when held to maturity. This means investors of NID-*ī* are assured that they will not lose their money regardless of the outcome of investment. The capital is guaranteed provided that the investors do not redeem their NID-*ī* instruments prior to maturity. If the instruments are redeemed prior to maturity, the investors may face fees or costs which could result in the investor losing part of, or the entire initial capital. How can *muḍārabah* capital been protected? Is this something against the established rule of the contract? We shall discuss this issue in detail in the following sections. At present, our focus of attention will be the salient features of both *an-Najāh* and *Ziyād* NID-*ī* instruments.

An- Najah NID-*ī*

An-Najāh NID-*ī* was officially launched in August 2008. It aims to attract RM300 million from institutional, corporate and individual investors. As indicated earlier, the fund would be allocated to purchase stocks of companies that specialise in health care products and services. The investment would be made for 3 years duration. The health care and its sub sectors (i.e. biotechnology) are chosen as the mediums of investment because they are expected to bring in good returns. This is as a result of the growing number of people over the age of 65 and above worldwide. The income and consumption pattern of the aging group is significantly different from those of the younger group. The aging group tends to spend more time in life-prolonging treatment and hence consume more health-based products³³⁶. This would benefit the pharmaceutical, medical equipment and biotechnology product suppliers as well as retailers. Even material companies are expected to benefit given the interest retirees often have in recreational activities such as gardening³³⁷. The growing demand for these products is not limited within the developed countries but also spread to the

³³⁶ An-Najāh NID-*ī* Pamphlet, Bank Islam Malaysia Berhad, Kuala Lumpur.

³³⁷ Playing the baby-boomer trade: J. P Morgan Aging Population Index, 7th November 2008, <http://seekingalpha.com/article/104772>, Accessed on 10 January 2010.

developing economies. As such, the health care industry is believed to be a good place to invest the *An-Najah* NID-*i* funds.

BIMB would invest the funds on companies which listed in the Baraka Aging Population Index. It comprises 30 stocks, carefully selected from a basket of 2,400 stocks from the Dow Jones Islamic Market World Index. The following information shows portfolio investment of *an-Najāh* NID-*ī* fund as at 30th October 2009.

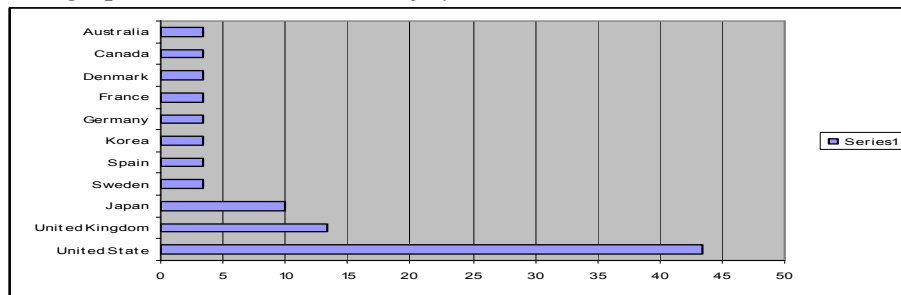
Table 14: Stocks within Baraka Aging Population Index as at 30th October 2009.

Sub Sector	Names
Biotechnology (6.67%)	Amgen Inc
	Grisols S.A
Drug Retailer (3.33%)	Shoppers Drug Mart Corp.
Health Care Providers (3.33%)	Rhoen-Klinikum AG
Medical Equipment (23.33%)	Beckman Coulter Inc.
	Covidien PLC
	Elekta AB Series B
	Medtronic Inc.
	Smith and Nephew PLC
	Synthes Inc.
Medical Supplies (6.67%)	Thermo Fisher Scientific Inc.
	Baxter International Inc.
Pharmaceuticals (56.7%)	Owens and Minor Inc
	Astellas Pharma Inc
	Astrazeneca PLC
	Bristol-Myers Squibb Co.
	CSL Ltd.
	Endo Pharmaceutical Holdings Inc.
	GlaxoSmithKline PLC
	Johnson & Johnson
	Merck & Co. Inc
	Novartis AG
	Novo Nordisk A/S Series B
	Pfizer Inc
	Roche Holding AG Part Cert.
	Sanofi Aventis S.A
	Shire PLC
	Takeda Pharmaceutical Co. Ltd.
Valeant Pharmaceutical International	
Yuhan Corp.	

Source: www.bankislam.com.my

In terms of geographic allocation, the companies within the Baraka Aging Population Index are as follow:

Figure 4: Geographic allocation of *an-Najāh* NID-ī fund investment



As clearly shown in table 7, 56.7 percent of *an-Najāh* funds is invested in the pharmaceutical companies. The remainder of the funds is used to buy stock of companies that produce medical equipments (23.33%), biotechnology (6.67%), medical supplies (6.67%), health care (3.33%) and drug (3.33%) products. Most of the companies are based in the United State which represents 43.33 percent. The next largest invested countries are United Kingdom (3.33%), Switzerland (10.00 %) and Japan (6.67%). The funds are also used to purchase stocks of companies from Sweden, Spain, Korea, Germany, France, Denmark, Canada and Australia (3.33 percent each respectively). The financial performance of the instrument however can not yet be evaluated since its maturity will only end by October 2011.

Ziyād NID-ī

After the introduction of *an-Najāh* NID-ī, BIMB came out with the second structured investment instrument called *Ziyād*. Basically, *Ziyād* NID-ī has similar features that of *an-Najāh* NID-ī. Both instruments offer capital-protected investment products with the opportunity to share high yields dividend. In the latter product, the minimum investment is determined at RM65,000 and subsequent investments are in multiples of RM5,000. Contrary to the global strategy adopted in *an-Najāh* NID-ī, *Ziyād* NID-ī fund focus exclusively on the Asian equity market. According to BIMB, the strategy is taken to take advantage from the massive stimulus plans embarked on by various Asian governments. The stimulus plans is expected to recover the Asian equity market within the medium to long term. Hence, *Ziyād* NID-ī funds would be used to purchase selected stocks at low prices today and sell them at higher prices after 5 years. The selection of stocks would also be based on a particular Index which pools together

high performance companies in a basket. Since at the time this thesis is prepared, *Ziyād NID-ī* is still accumulating its funds, no investment transaction can be reported. However, BIMB has hinted that the deposited funds would be utilised to purchase stock of companies such as China Mobile Ltd and CNOOC Ltd. of China, Panasonic Corp. and Canon Inc. of Japan as well as BHP Billiton Ltd. of Australia³³⁸.

Our discussions on structured investment instrument raise an important *fiqh* enquiry. What are the justifications relied on by BIMB *sharī'ah* committee members in allowing such capital-protected investment instruments? How do the products confirm to the principle of *muḍārabah* which advocates the loss sharing principle? The subsequent section is devoted to examine this issue in detail.

Capital Guarantee in *Muḍārabah* Banking Products

As we may recall from our discussion in chapter 2, one of the basic elements in a *muḍārabah* contract is the risk taking/sharing concept. The concept implies that a capital provider (*rabb māl*) and an agent-manager (*muḍārib*) must be willing to bear a certain degree of risk to ensure the validity of a *muḍārabah* contract. A capital provider must be willing to accept the possibility of losing his capital partly or entirely in the event of business loss unless it is caused by gross negligence of agent-manager. An agent-manager, though not accountable for the monetary loss, must be ready to accept the risk of wasting his expended time and effort. The risk-taking concept is derived from the two classical legal maxims which become the fundamental of Islamic commercial law. The legal maxims state that (1) *al-kharāj bi-dhamān* - gain comes with the liability for loss and (2) *al-ghunmu bi al-ghurmi* - gain is the result of risk taking.

Based on the concept of risk sharing, earlier jurists and Muslim economists advocated the *muḍārabah* contract as the ideal basis for Islamic banking operations. Under the contract, depositors are expected to share the risk-return with the Islamic banks as well as the entrepreneurs. Hence, in the event of financial difficulty, depositors in Islamic banks theoretically will not only face the possibility of obtaining zero return

³³⁸ Bank Islam Malaysia Berhad, *Ziyād NID-I*, www.bankislam.com.my, Accessed on 25 February 2010.

from their investment but also face the possibility of losing their initial deposit. The concept of guaranteed return in the conventional investment products is arguably contrary to the spirit of Islamic commercial law. As borrowers are obliged to repay the lenders (depositors) regardless of whether their businesses succeed or fail, the guaranteed return mechanism is viewed as an unjust economic system. Hence, the establishment of interest-free banks among other things is to establish the risk taking/sharing principle between depositors, banks and the fund users.

However, the concept remains entirely in the theoretical writings of the early jurists and the Muslims economists. In reality, all deposits in Islamic banks (all types of deposit accounts, investment accounts, *an-Najāḥ* and *Ziyād NID-īs*) are guaranteed and protected. This means depositors and investors of these accounts/instruments are assured that they will not lose their money in the event of a bank's business failure or even bankruptcy. In Malaysia, the deposited money is guaranteed by a special institution set up for this purpose namely the Malaysian Deposit Insurance Corporation (MDIC). Islamic banks in the country are obliged by the Central Bank (BNM) to pay an annual premium based on their total deposits to the institution which will then provides depositors with coverage and ensures payout in the event of banking failure³³⁹. The coverage limit provided by the MIDC is up to RM60,000 for each depositor. However, depositors with deposits in more than one Islamic bank will be insured separately for their deposits in each bank. Besides, various types of account such as joint, trust, sole proprietorship and partnership will also be separately insured.

It is noteworthy that the idea of deposit guarantee has been put forward by many scholars prior to its implementation in the Malaysian Islamic banks. Among prominent scholars who advocated this idea include Muḥammad Baqer al-Ṣadr, Sami Hamud, Abdullah Saeed, Al-Teghānī and Fahim Khan ³⁴⁰. The scholars generally argue that there is a genuine need for deposit guarantee even in the PLS-based banking system. They come to the conclusion after considering the actual behaviour of the majority of depositors in the present economic system. Islamic banks are

³³⁹ International Association of Deposit Insurers, vol. 1 issue 3, 18 July 2006.

³⁴⁰ Rafiq Yunus al-Misri, *Hal Yajuz fi al-Muḍārabah an Yadmana al-ʿAmil Raʿsu al-Māl?*, *Journal of Islamic Economics*, University of King Abdul Aziz, 2003, pp.73-78 and Mahmoud A. El-Gamal, *Islamic Bank Corporate Governance and Regulation: A Call for Mutualisation*, www.ruf.rice.edu/elgamal/files/IBCGR.pdf, Accessed on 26 Jun 2009.

operating in the environment where the number of risk-averse depositors is much more than the risk-taker depositors. Even though, up till now there is no statistic which could prove the argument, the common belief indicates that not many depositors are willing to take risks with their investments. This is true particularly among depositors of the lower income population. The majority of them are not ready to take any risk at all when investing their hard earned savings. Hence, if Islamic banks do not provide a deposit protection scheme, this group of depositors will walk away from the Islamic banking system. Hence, in order to attract these depositors, Islamic banks should be allowed to provide deposit guarantee scheme similar to the conventional banks³⁴¹.

In the early discussion of this issue, al-Teghānī proposed that Islamic banks should voluntarily provide the guarantee of deposit. He was of the opinion that his *ijtihād* does not contradict with any prevalent classical *muḍārabah* rules. According to him, the prominent classical jurists never ruled on the impermissibility of such an action (where an agent-manager himself pledges guarantee of capital entrusted to him). The case in which Abū Ḥanīfa, Mālik, al-Shāfi‘ī had given their judgments was when a capital provider make a condition compelling an agent-manager to guaranty *muḍārabah* capital. Al-Teghānī argued that the guarantee enforced by a capital provider is dissimilar from voluntarily guarantee made by an agent-manager. The former is considered as an unfair deal whereas the latter is regarded as an admirable decision³⁴². Since the matter was not clearly discussed by the classical jurists; it leaves rooms for contemporary interpretation. Al-Teghānī disagreed with the argument, claiming that the implementation of deposit guarantee scheme will make investment in Islamic banks comparable to their conventional counterparts. He contended that the distinction which differentiate the two banking system remains on the fact that return in the former is not guaranteed while return in the latter is secured. He asserted that the deposit guarantee is just to assure the depositors that they held a very minimal risk when investing in the Islamic banks³⁴³.

³⁴¹ Muhammad Fahim Khan, Guaranteeing Investment Deposit in Islamic Banking System, *Journal of Islamic Economics*, University of King Abdul Aziz, 2003, pp.45-52.

³⁴² Al-Teghānī ‘Abd al-Qādir Ahmad, Ḍamān al-Muḍārib lil Ra’ Sul al-Māl fi al-Wadā‘ī al-Maṣrafiyyah, *Journal of Islamic Economics*, University of King Abdul Aziz, 2003, pp.61-72

³⁴³ Ibid.

Al-Teghānī's idea regarding this matter was criticised by many jurists including Rafiq Yunus al-Misri. The implementation of deposit guarantee indicates that the Islamic banks and depositors will share any profit made if their venture is successful. However, in the event of business failure only Islamic banks will be responsible for the losses incurred. As argued by Rafiq, such a condition tried to combine between loan (*al-qarḍ*) and *muḍārabah* contracts. This cannot be done since both contracts are contradictory (*mutaḍāḍāni*). *Al-qarḍ* is a contract executed and based on a charity (*tabarru'*) basis, whereas *muḍārabah* is implemented and based on monetary exchange (*mu'āwāḍah*) premise. Rafiq refuted al-Teghānī, claiming that the classical jurists never rule on the agent-manager's guarantee. Quoting a case from *al-Mudawwanah* as an example, Rafiq proved that Mālik had disapproved of such a deal. Based on the classical jurists' rules against the practice of capital guarantee, Rafiq asserted that *muḍārabah* deposit in Islamic banks should be implemented in its purest form by applying the risk taking/sharing concept³⁴⁴.

As already noticed, the deposit guarantee scheme practised in Malaysia is quite different from the suggestion made by al-Teghānī. The deposit guarantee is not provided by the Islamic banks, but by a third party institution set up for this special purpose. Since the guarantor is neither the capital provider nor the agent-manager, the Malaysian *sharī'ah* scholars believe that the scheme does not contravene with any classical jurists' rules³⁴⁵. Hence, there is no issue whether the agent-manager provides the capital guarantee voluntarily or as a result of forced influence from a capital provider. The deposit guarantee scheme as proposed by al-Teghānī may be viewed as an unfair dealing particularly for the Islamic banks. This is because during a financial crisis, although the Islamic banks suffer huge losses, they are still obliged to compensate depositors' initial deposit. However, such phenomenon will not happen in Malaysia as MIDC will provide the guarantee and protect the Islamic banks from banking collapse. As the deposit insurance mechanism does not cause harm to any party in the *muḍārabah*, therefore the *sharī'ah* scholars in the country have approved its practice. In addition to that, the Islamic deposit insurance is permitted because its mechanism is based on the *kafālah* concept. It refers to the mutual guarantee among

³⁴⁴ Rafiq Yunus al-Misri, *Hal Yajuz fī al-Muḍārabah an Yadmana al-ʿAmil Raʿsu al-Māl?*, *Journal of Islamic Economics*.

³⁴⁵ The decision to approve the deposit guarantee scheme is decided on the 26th NSAC meeting held on 26th Jun 2002.

the Islamic banks agreeing to contribute to the *kafālah* funds which will be used whenever any participants of the scheme faces fearful of banking collapse. The contribution to the funds is considered part of the Islamic banks' obligation to preserve the stability of the Islamic banking industry as a whole³⁴⁶.

In my personal opinion, ideally speaking *muḍārabah* investment in Islamic banks should be carried out without a deposit guarantee scheme. Depositors should be aware of the risk taking/sharing principle when deposit their money in the Islamic banks. However, considering the reality of depositors' behaviour (being usually risk-averse) plus the pressure from the conventional banks (which are able to provide the capital protection scheme), perhaps the concept is too idealistic. In order to ensure the competitiveness of Islamic deposit products, I could argue the deposit insurance scheme should be in place. The deposit insurance scheme is a better alternative when compared to with al-Teghāni's recommendation. The scheme is free from the classical jurists' objection since neither one of the contracting parties is involved in guaranteeing the deposit.

The Utilisation of *Muḍārabah* Funds

Malaysian *sharī'ah* scholars are of the opinion that the unrestricted *muḍārabah* agreed at the beginning of the contract has given absolute power to the bank in investing the deposited money in saving and investment accounts³⁴⁷. According to them, once depositors agreed to entrust their money under the terms of an unrestricted *muḍārabah* (*muḍārabah muṭlaqah*), the bank is considered to have obtained full authority in making any investment decision. After meeting the statutory reserve requirement and holding the required liquid asset, BIMB is free to invest the remainder of the depositors' funds based on its experience and skill³⁴⁸. It is obvious that in this regard the Malaysian *sharī'ah* scholars adapt the Ḥanafīs framework of *muḍārabah* contract. As can be recalled from chapter two, the Ḥanafīs, in determining the scope of empowerment of a *muḍārib* (agent-manager), had classified it into three categories, depending on the expression (*ṣīghah*) used by the investor at the beginning of the

³⁴⁶ Bank Negara of Malaysia, *Sharī'ah* Resolutions, http://www.bnm.gov.my/microsites/financial/pdf/resolutions/o8_kafalah.pdf, Accessed on 29 Jun 2009.

³⁴⁷ Interview with Dr. Shamsiah Mohammed, University of Malaya Kuala Lumpur, 9 August 2008.

³⁴⁸ Guidelines of *Muḍārabah* Deposit, Bank Islam Malaysia Berhad, Kuala Lumpur.

contract. If the investor used a general expression (*ṣīghah muṭlaqah*) such as "start a business with my initial capital of 1000 and we will share equally the profit", absolute power is given to the agent-manager to execute various types of business transactions provided that they are beneficial and customary practised by traders³⁴⁹. Thus, in running the both accounts, BIMB neither seeks depositors/investors' approval nor consults their opinion before investing the money. The only source of information for depositors/investors to know where their money had been invested is through the bank's financial statements published annually. However, it can be observed that the information given in the annual report is far from adequate and the terms used are too complicated for most of the general public to understand.

Let us examine BIMB's annual report in 2008 as an example. During that year, the total *muḍārabah* deposits were recorded as RM6,878,049. The division of the deposits is as follows:

Table 15: *Muḍārabah* funds by type of deposits

No.	Type of Deposit	Amount (RM)
1.	Savings Deposit	536,629
2.	General Investment Deposit	2,411,039
3.	Special Investment Deposit	3,930,146
4.	Others	235
	Total	6,878,049

Source: BIMB Annual Report 2008

From the deposits, the bank managed to generate a total of RM919,496 of profit. RM112,086 of the profit is derived from investment of general investment deposits whereas other deposits contribute RM807,495.

Table 16: Income derived from investment of depositors' funds

No.	Type of Deposit	Profit (RM)
1.	General Investment Deposit	112,001
2.	Other Deposits	807,495
	Total	919,496

Source: BIMB Annual Report 2008

³⁴⁹Sarakhsī, *al-Mabṣuṭ*, vol. 22, pp. 20.

Profit derived from investment of general investment and other types of deposits are further elaborated in table below:

Table 17: Profit from General Investment Deposit

Profit Derived from Investment of General Investment Deposit		
<i>No.</i>	<i>Source of Income</i>	<i>Profit (RM)</i>
1.	Financing, advances and other	79,067
2.	Securities:	
	i. Held for trading	314
	ii. Available for sale	6,331
	iii. Held to maturity	262
3.	Deposit with other financial institutions	23,593
4.	Accretion of discount less amortisation of premium	2,519
5.	Net loss from sale of securities held-for-trading	(109)
6.	Net (loss)/gain on revaluation of securities held-for-trading	(26)
7.	Net gain from sale of securities available-for-sale	7
8.	Gross dividend income from quoted securities in Malaysia	43
		112,086
Profit Derived from Investment of Other Types of Deposits		
<i>No.</i>	<i>Source of Income</i>	<i>Profit (RM)</i>
1.	Financing, advances and other	570,075
2.	Securities:	
	i. Held for trading	2,263
	ii. Available for sale	45,646
	iii. Held to maturity	1,869
3.	Deposit with other financial institutions	170,233
4.	Accretion of discount less amortisation of premium	18,130
6.	Net (loss)/gain on revaluation of securities held-for-trading	(781)
7.	Net gain from sale of securities available-for-sale	239
		807,495
	Total	919,496

Source: BIMB Annual Report 2008

Based on the information in table 10 above, we can safely assume that the *muḍārabah* funds were invested in three main activities; (1) financing activities (2) securities (Islamic bonds) and (3) inter-bank money market instruments. The financing activities contributed approximately RM649,142 of profit while the securities and money market investments generated RM56,874 and RM193,826 respectively. A question arises then, of how these activities (financing, securities and inter-bank money market) are carried out by BIMB? Do they support profit and loss sharing principles

as emphasised by the classical jurists when formulating the theory of *muḍārabah*? The following discussion attempts to answer the questions by studying some applications of Islamic commercial contracts in the financing, securities and inter-bank money market products.

Financing Facilities of BIMB

Financing activities are the main source of profit not only for *muḍārabah* fund depositors/investors but also for BIMB shareholders. In 2008, the total net financing advanced to customers was recorded as RM10,458,831. The largest component of financing extended by the bank was for the purchase of individual property which accounted for 56.2 percent of the total financing. This is followed by personal financing (23.1 percent) and trade bills discounted financing (16.1 percent). Table 18 below gives detailed information on this matter, though it is not clear what the exact amount of *muḍārabah* funds invested in each type of financing were.

Table 18: BIMB financing by type

No.	Type of Financing	Amount (RM)
1.	Cash line	175,463
2.	House financing	5,878,379
3.	Syndicated financing	107,339
4.	Leasing receivables	208,234
5.	Bridging financing	242,504
6.	Personal financing	2,425,401
7.	Other term financing	3,951,604
8.	Staff financing	295,785
9.	Credit cards	340,100
10.	Trade bills discounted	1,684,209
11.	Trust receipts	175,518
12.	Less: Unearned income	(5,025,705)
	Total	10,458,831

Source: BIMB Annual Report 2008

These financing products are created through the application of several Islamic medieval commercial contracts. As indicated by table 19, the most widely applied contract was *bay' bithaman ājil* (52.8 percent), *bay' al- ʿinah* (21.9 percent) and *bay' murābahah* (17.6 percent). As the contract of *bay' al- ʿinah* was already discussed in chapter three, we shall focus in this section on the application of *bay' bithaman ājil* (hereafter termed as BBA) and *bay' murābahah* as the core principles in utilising the *muḍārabah* deposit. In chapter three, we found that the application of *bay' al- ʿinah* is surrounded by many *fiqh* controversies. The financing products based on the contract

were shown to be insignificantly different from the conventional banking loan. Thus, in this section we will try to assess whether the application of BBA and *murābahah* contracts is free from such controversy. If both contracts are applied in tandem to the spirit of profit and loss sharing principle, therefore we would conclude that the *muḍārabah* deposit was utilised in legally right manner.

Table 19: BIMB financing by contract

No.	Type of Financing	Amount (RM)
1.	<i>Bay' bithaman ājil</i>	5,526,409
2.	<i>Ijārah</i>	243,063
3.	<i>Ijārah Muntahia bi al-Tamlīk</i>	30,334
4.	Muḍārabah	9,249
5.	Murābahah	1,848,075
6.	<i>bay' al- īnah</i>	2,291,713
7.	Iṣṭisna'	509,988
	Total	10,458,831

Source: BIMB Annual Report 2008

The contract of BBA is applied largely by BIMB to create Islamic home financing. Since its inception, the product has been criticised by many scholars. The legality of the product has not only been disputed amongst the academics (*sharī'ah* and economic background) but also involved judges of Malaysian civil courts³⁵⁰. In September 2008, the Malaysian High Court Judge, Datuk Abdul Wahab Patail ruled that the application of BBA contract in the Malaysian Islamic home financing is contrary to the Islamic Banking Act 1983. He was of the opinion that the sale contract in the BBA is not a *bona fide* sale. In other words, from the judge's point of view, the so called Islamic home financing is just a duplication of conventional housing loan. Since the contract was structurally faulty, the judge ruled that the defaulters of Islamic home financing need not to pay more than the original financing amount that they received³⁵¹.

Following the High Court ruling, the Central Bank of Malaysia (BNM) has urged all 17 Malaysian Islamic banks to review their BBA contract application. In response to the advice of BNM, several Islamic banks such as Maybank Islamic and RHB Islamic have shown interest in replacing the BBA contract. In December 2008, both Islamic banks launched a new version of Islamic home financing, based on the contract of

³⁵⁰ Note that in Malaysia, the shari'ah court does not have authority to judge dispute between Islamic banks and their customer. Therefore, such cases are brought to conventional courts which have superior authority.

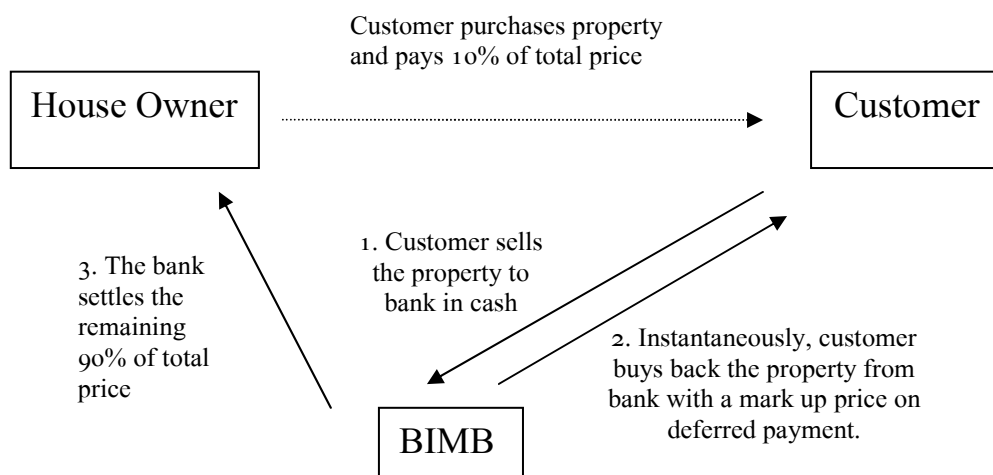
³⁵¹ Habhajan Singh, *Time for Bank to Study BBA Further*, <http://Islamicfinanceupdates.wordpress.com>, Accessed on 21 April 2009.

mushārahah mutanāqīshah (diminishing partnership) which is claimed to be more able to comply with the profit and loss sharing principle. At that time, it is felt that the Islamic banks in the country will gradually introduce more "authentic" Islamic products which not only focus on the changes of products' terminologies but their inner or substance.

However, in April 2009, the Court of Appeal (a higher level of court) revoked the earlier judgement of the High Court. Datuk Md Raus Sharif, Datuk Abdul Hamid Embong and Datuk Ahmad Maarop, the judges of the Court of Appeal, unanimously agreed that the application of BBA contract in the Islamic home financing is valid and binding. Therefore, according to them, the Islamic home financing product must not be compared to the conventional loan agreement³⁵². It is not certain whether the recent ruling brings adverse implications to the transformation of Islamic banking products in Malaysia. However, what is certainly the case is that the BBA contract remains the dominant concept of Islamic home financing in the country.

What is the basis of this disagreement? Why did the judge of High Court deny the legality of the product while others admitted it? In order to analyse this issue, it is pertinent to understand how the BBA contract is applied in the said product. Figure 5 below shows the *modus operandi* of Islamic home financing offered by BIMB:

Figure 5: The *modus operandi* of BIMB's home financing



³⁵² Association of Islamic Banking Institution Malaysia, Court of Appeal Reverse High Court BBA Ruling <http://aibim.com/content/view/>, Accessed on 22 April 2009.

Suppose Ahmad wants to buy a house valued at £100,000. Firstly, he needs to sign the Sale and Purchase Agreement (SPA) and pays 10 percent (£10,000) of the selling price to the house owner. The SPA is necessary to confer a beneficial right of the property to Ahmad. After signing the SPA, Ahmad becomes the owner of the house. Then he will go to BIMB seeking financing of the remaining £90,000. In doing so, Ahmad sells the house to BIMB in cash for £90,000 and buys back the house on deferred payment with mark up price, say £120,000. At this juncture, the concept of *bay' al-ṭinah* is applied. Now, Ahmad is considered as buying the house from BIMB on deferred payment (*bay' bithaman ājil*) and will pay instalments to the bank for an agreed period. Ahmad will settle the remaining £90,000 to the initial house owner while the bank will make £30,000 profit from the transaction.

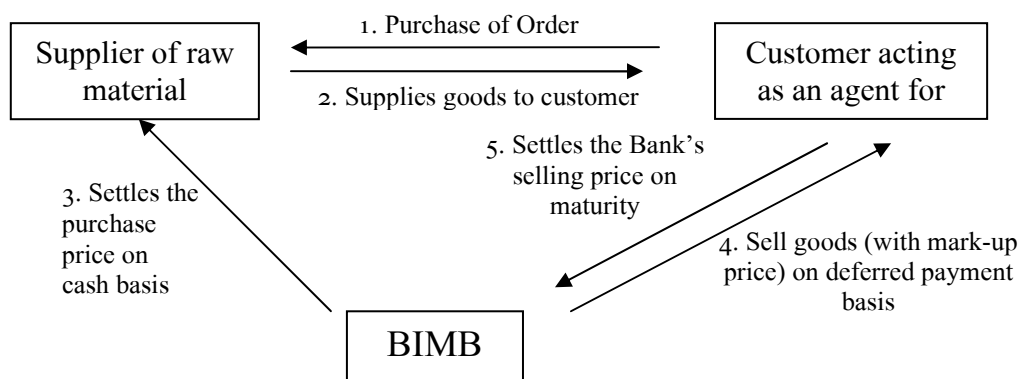
BIMB contends that the distinguishing feature between the Islamic home financing and the conventional housing loan lies in the fact that the former is based on a sale (*bay'*) transaction whereas the latter is based on a loan (*qarḍ*) contract. According to them, the transaction of *bay' al-ṭinah* and BBA clearly demonstrate the sale contract. However, not everyone agrees to this claim. The critics, including the judge of High Court, view the transaction as no more a legal trick rather than a true sale contract. They are of the opinion that the bank in the Islamic home financing transaction, merely act as a financier rather than a seller/trader. They argue that if the bank wishes to act as a seller/trader, in the first place, it should actually buy the house from the owner and then sells it to customer with a mark-up price. By doing so, profit (mark-up price) earned by the bank is justifiable from the *sharī'ah* perspective. This is because the bank has borne certain degree of business risk i.e. the possibility of loss should the house is unsold.

However, in this transaction the bank seems to become a risk-free party which is too much similar to a lender. On the other hand, the buyer bears all risk associated with a borrower. Perhaps, the problem of a delayed housing project is a good example to highlight this point. In Malaysia, developers are legally permitted to sell house entirely under construction. The developers can just set up property development company and launch new housing project; promise potential house buyers to build houses based on the agreed specifications in specific duration. This rule has led to serious problem of incompleteness housing projects especially during the economic

recession. When a housing project is abandoned, the buyers will suffer; they must pay the home mortgage to the bank despite their incomplete house. Unfortunately, the buyer under the Islamic home financing also faces similar problem. Should BIMB truly apply the sale contract the buyer will not have to pay for an incomplete house. As a seller, it is the bank's responsibility to bear the risk of an incomplete house. As such, the problem of abandoned housing project proves that the Islamic bank generally acts as a financier not seller/trader.

The other most popular contract adopted in creating BIMB's financing products is *bay' murābahah*. Basically, it is a sale contract whereby the seller will inform explicitly the cost and the mark-up price to the buyer. Contrary to the BBA contract which is used to create long term financing products of individual customers, *bay' murābahah* is applied to structure short-term financing products of business customers. In BIMB, the *murābahah* short term financing products include letters of credit, trade working capital financing, accepted bills and export credit refinancing. Although the products have different names they have something in common; they are meant for traders who are in need of capital to purchase raw material, machinery, stock or inventories. Through the combination of *wakālah* and *bay' murābahah* contracts, these products are created to assist business customers in obtaining their needs. Let us examine the *modus operandi* of BIMB's working capital financing in figure 6 below³⁵³.

Figure 6: The *modus operandi* of BIMB's working capital financing



³⁵³ Islamic Banking Practice from the Practitioner's Perspective, Kuala Lumpur: Bank Islam Malaysia Berhad, 1994, pp.113.

Suppose a manufacturer needs money to purchase raw material in the course of his business. He may approach BIMB to provide financing through the working capital financing product. Using this facility, firstly BIMB will appoint the manufacturer to purchase the required raw material on its behalf. From a *fiqh* point of view, at this stage the relationship between the bank and the manufacturer involves a *wakālah* (agency) contract. When the supplier delivers the raw material to the manufacturer, the bank will pay the supplier its cost on a cash basis based on the invoice value. Then, the bank will sell the raw material to the customer comprising its purchase price and a profit margin, and allow the manufacturer to settle it on deferred terms of 30, 60 or 90 days (or, indeed, any other period).

The reason for the criticism of *murābahah* product is essentially due to the similarity between the mark-up rate charged by Islamic bank and the interest rate of the conventional bank³⁵⁴. Often an Islamic bank uses the conventional benchmark such as the LIBOR (London Inter-Bank Offer-Rate) to determine the mark up rate for its *murābahah* product. As a result, by the maturity date, customer of both banks will pay about similar price for their purchases. This has led to the conclusion that there is no difference between the *murābahah* financing products and the conventional interest-based loans. It is also argued that by referring to LIBOR, Islamic bank faces a similar rate of return risk as the conventional banks. As the LIBOR rate always fluctuates, every contract benchmarked with it will inherit the interest-rate risk, albeit indirectly.

To conclude, our analysis on the BIMB financing activities has shown that they are not operated on the basis of profit and loss sharing principles. The bank adopts a risk adverse approach in creating its financing products. All the products seem very much similar to debt-like products of the conventional bank. In other words, looking at it from the economic perspective, the effect of Islamic financing products is similar to that of conventional interest-based loan. Therefore, I think it is inappropriate to invest the *muḍārabah* deposit into this kind of investment.

³⁵⁴ Nagoaka Shinsuke, Beyond The Theoretical Dichotomy in Islamic Finance, Analytical Reflection on *Murābahah* Contract and Islamic Debt Securities, *Kyoto Bulletin of Islamic Area Studies*, 2007, pp. 72-91.

In the following discussion, we will investigate the other two investment activities that generate income for the *muḍārabah* deposit. They are the so called Islamic securities and Islamic inter-bank money market instrument.

Islamic Securities

Securities are referred to as investment certificates representing evidence of ownership of debt issued by a corporation or government. They could be in the form of bonds, stocks, shares, options and futures. The main reason for a corporation or government to issue securities is to raise additional capital to fund business expansion, specific development projects, repay business debt and finance government deficit. Investors purchase securities with the understanding that the issuers will pay back their original principal plus any interest at a maturity date. As far as investors are concerned, investment in securities has two main advantages. First, it offers the most secure types of investment, particularly securities issued by a government. It rarely happens that a government fails to honour its debt obligation issued in its own currency. Second, securities are marketable and liquid as they can easily be bought and sold in the secondary market. Perhaps because of these two factors, investment in securities has become a popular choice among commercial banks. By purchasing securities, the banks can invest their surplus funds in the most secure manner and if necessary, they can sell back the securities to supplement the cash resources³⁵⁵.

However, Islamic banks are prevented from investing in the conventional securities since they are based on *ribā* transaction. Investors who purchase conventional securities are considered as lending their money to the issuers (corporation or government). From the *sharī'ah* point of view, as lenders, the securities holders can not receive any additional payment from their initial investment as it will be regarded as *ribā*. However, such a restriction causes liquidity problem to Islamic banks. This is because generally Islamic banks have 50 percent excess of liquid asset as compared to their conventional counterparts³⁵⁶. The abundance of liquid assets implies that the structure of Islamic banking business is less competitive. It demonstrates the failure of

³⁵⁵ Ali Arsalan Tariq & Humayon Dar, Risk of Sukuk Structure: Implication for Resource Mobilisation, *Thunderbird International Business Review*, vol. 49(2) 203–223, March–April 2007.

³⁵⁶ Abdul Rais Abdul Majid, Development of Liquidity Management Instrument: Challenges and Opportunities, paper presented at the *International Conference on Islamic Banking: Risk Management, Regulation and Supervision*, Jakarta: September 30–October, 3.

the banks in maximising returns from their idle funds. According to Islamic banks, this problem occurs due to the limited availability of *sharī'ah* compatible liquidity management instruments. Hence, Islamic bankers in Malaysia have taken the initiative to develop 'Islamic' securities known as *sukūk* which are claimed to be interest-free investment tool and more importantly capable to produce competitive rate of return for depositors.

In 2008, BIMB in particular had invested more than RM3 million in the Islamic securities. It is not declared however, the total deposit of *muḍārabah* general account invested in the securities but over nearly RM200,000 of profit was allocated to the account from the investment³⁵⁷. Generally there are three types of Islamic securities purchased by BIMB; (1) securities held for trading (2) securities available for sale and (3) securities held to maturity. The first and the second types of securities are purchased mainly as liquidity management measures. The bank held these securities temporarily to gain profit for a certain period. They will be sold in the secondary market after sometime. Meanwhile, the third type of securities is purchased with the intention of holding them to maturity. Normally, the securities are held between 3 to 5 years and potentially bringing higher rate of profit as compared to the other two types of securities.

A prompt question arises then, how the Malaysian Islamic bankers structure the Islamic securities which comply with the principle of *sharī'ah*. Are they really distinctive from the conventional securities or just like any other Islamic banking products; appear to be 'Islamic' in their form and legal technicalities but indifferent in its economic substance? To begin our analysis of the said product let us have look at the answers given by the Malaysian Inter-bank Money Market (hereafter termed as IMM) to such similar question³⁵⁸.

1. What is the difference between Islamic bonds (securities) and conventional bonds?

Islamic bonds are similar to conventional bonds in Malaysia. It always has a fix term maturity, can bear a coupon, and trades on the normal yields price relationship. For conventional investors, the structuring of the bonds by the

³⁵⁷ Annual Report of Bank Islam Malaysia Berhad, Kuala Lumpur, 2008.

³⁵⁸ Bank Negara Malaysia, *Islamic Inter-bank Money Market*, <http://iimm.bnm.gov.my/>, Accessed on 5 May 2009.

issuer is immaterial. The difference lies in the way the issuer structure the bonds.

An Islamic bonds is structured such as that the issuance is not an exchange of paper for money consideration with the imposition of an interest as per conventional. It is based on an exchange of approved asset for some financial consideration that allows the investor to earn profit from the transaction. Approval of the assets and the contract of exchange would be based on *sharī'ah* principles, which is necessary to meet the Islamic requirement.

The various types of Islamic-based transaction structures used for the creation of Islamic bonds are sale and purchase of an asset based on deferred payment, leasing of specific assets or participation in joint venture businesses.

2. Is there any difference in term of investors' protection against default?

The Islamic bonds share the same criteria as the conventional bond in the matter of non-payment/late payment of the profit portion and the principal amount.

Table 20: Comparison between Islamic and conventional bonds

Items	Islamic	Conventional
Issuance Process	Must be approved by <i>sharī'ah</i> scholars and Securities Commission	Must be approved by Securities Commission only
Structure Types	leasing, equity and debt based contracts	Debt based contract only
Issuers	Government, semi-government and private sectors	Government, semi-government and private sectors
Investors	Both conventional and Islamic Investors	Only conventional Investor

The IMM openly admits that there is no distinctive difference between the Islamic and the conventional securities traded in Malaysia. Both securities have similar characteristics; (1) offering investors a stable income and (2) are tradable in the secondary market. The only thing which differentiates between the two, as claimed by the IMM is the way they are structured or securitised. Conventional securities are structured based on a loan (*qard*) contract. They are merely debt certificates in which the holders have no relationship to the issuers' business or property. Upon the maturity date, the issuers are contractually obliged to pay the money they owed to the securities holders plus the interest, regardless whether the business venture was profitable or otherwise.

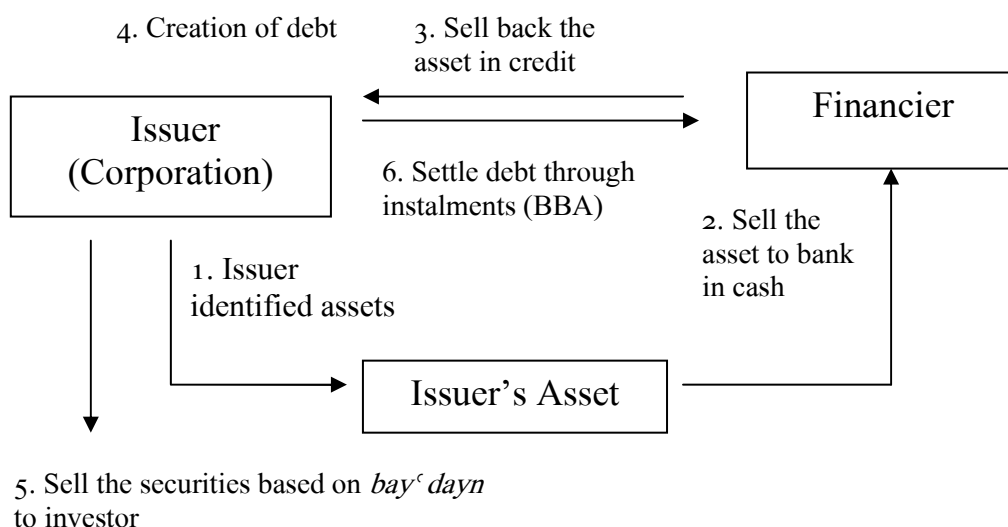
In contrast, the Islamic securities are structured on the basis of an asset-backed principle. The principle means Islamic securities are back up by physical assets

that have real monetary values. The Islamic securities represent ownership of issuer identified assets. In other words, investors who purchase Islamic securities are actually buying issuer identified assets in a collective manner³⁵⁹. Theoretically, there are three types of contracts applied in the Islamic securitisation process. There are leasing (*ijārah*), partnership (*muḍārabah/mushārahah*) and debt based contracts (*murābahah/BBA*). Compared to the debt based contract, the leasing and the partnership based contracts are viewed as the most accurate contracts in meeting with the spirit of Islamic commercial law. Leasing and partnership based contracts are widely used by securities issuers in the Middle East.

However in Malaysia, although there is growing tendency to adopt both types of contracts (in order to attract Middle East funds), debt-based contract remains the favourite concept among the Malaysian securities issuers. Hence, due to the over-reliance on the debt-based contract, we will once more see the similarity between the Malaysian version of Islamic securities and the conventional bonds. It is noteworthy to mention that the securities issuers in Malaysia commonly claim that their Islamic securities are based on the contract of *murābahah*. But, in my opinion a detail analysis of the securitisation process reveals that the claim is misleading. The main contracts applied in the process are actually *bay' al-ʿinah* and *bay' al-dayn* (debt trading contract). Example of the securitisation process is shown in the figure 7.

³⁵⁹ Muhammad Taqi Uthmani, *Sukuk and Their Contemporary Application*, www.muftitaqiusmani.com/Downloads/Publications/Articles/Sukuk.pdf, Accessed on 25 February 2010.

Figure 7: The *modus operandi* of Malaysian *sukūk*



Suppose a corporation intends to issue Islamic securities to finance its business growth. In doing so, firstly, the corporation must identify its properties to be used as securities (the underlying assets). These assets could be the corporation's factory, stocks or inventories. Then, the underlying assets will be sold to financier (normally a bank) and bought back from the same party at a credit price. This buy-back agreement (*bay' al-ṭinah*) will ensure that the corporation will receive the money in cash while the financier will be paid a prefixed or contracted amount in a future date. The payment for the buy-back transaction is delayed through the instalment mechanism known as *bay' bithaman ājil* or deferred payment. The securitisation process occurs when the corporation issues its certificates known as securities representing its debt to the bank/financier. These securities are sold to investors, based on the application of *bay' al-dayn* as part of the corporation's plan to settle its debt.

Because of these two controversial contracts, the Islamic securities introduced by the Malaysian government (Government Investment Issue-GII) in 2001 have failed to attract fund from the Middle-Eastern investors³⁶⁰. As generally known, *sharī'ah* scholars in the region oppose the application of *bay' al-ṭinah* as they view it as camouflaged *ribā*. In the above case, although the issuer had identified specific assets as back up to the securities, they become insignificant due to the buy-back agreement

³⁶⁰ Saiful Azhar Rosly & Mahmud M. Sanusi, The Application of Bay' al-ṭinah and Bay' al-Dayn in Malaysian Islamic Bond: An Islamic Analysis, *International Journal of Islamic Financial Services*, vol.1 no.2.

(*bay' al-ṭinah*). At the end of the process, the Islamic securities appear to be similar to conventional bonds. Both types of securities denote debt certificates.

In addition to *bay' al-ṭinah*, the Malaysian version of Islamic securities are criticised because of *bay' al-dayn* issues. When debt certificates are securitised, they become objects of sale. A juristic question arises then; can a corporation (as debtor) sell its debt to investors from the *sharī'ah* perspective? Did classical jurists consider debt as legal commodity or *māl mutaqaawwam*? It is found that the issue happened to be subject of disagreement among the classical jurists. Sarakshī of the Ḥanafīs was the opinion that debt was not regarded as *māl mutaqaawwam*. The reason was because debt is an undeliverable item³⁶¹. As the deliverability of debt can not be guaranteed, its sale to other party will lead to uncertainty (*gharār*). Hence, the sale of debt to a third party (like in our case to the investors) is not permissible from the Ḥanafī point of view. The majority of the Ḥanbalīs also agreed to the ruling. They had issued ruling on the problem of *bay' as-ṣikāk* which is in modern time very much similar to the sale of cheques. According to them, debt documented in a piece of paper (termed as *as-ṣikāk*) can not be traded because if otherwise will lead to *ribā al-nasī'ah*³⁶².

Meanwhile, the Shāfi'ī jurists had two different views in this matter. The most prevalence view, according to al-Nawawī was that it was impermissible. Their justification is similar to the Ḥanafīs and Ḥanabalīs that debt is not *māl mutaqaawwam*. However, the other group of Shāfi'īs jurists including al-Shirāzī and al-Subkī differentiate between secured debts (*al-dayn al-mustaqir*) and unsecured debt (*al-dayn ghair al-mustaqir*)³⁶³. They allowed the sale of the former and prohibited the latter. As explained by al-Shirāzī, secured debt refers to debt that is likely to be delivered or paid. Since, the payment of secured debt is almost certain, it can be recognised as a commodity for sale. The Mālikīs, generally allowed the sale of debt. They outlined several conditions before a sale of debt could take place such as (1) debtor is aware of

³⁶¹ Sarakshī, *al-Mabsut*, Kitāb al-Sarf, vol.14, pp. 35.

³⁶² 'Alā' al-Din Abū Ḥasan Sulaymān al-Mardāwī, *al-Inṣāf fī Ma'rifat al-Rājih min al-Khilāf*, Dār Iḥyā' al-Turath al-'Arabī, vol. 5, pp. 84.

³⁶³ Muḥammad ibn Aḥmad al-Ramlī, *Nihāyah al-Muḥtāj ilā Sharḥ al-Minhāj*, Cairo, Muṣṭafā al-Bābī al-Ḥalabī, 1967, vol.3, pp. 92.

the sale and assure the settlement of debt (2) debt is sold for cash and (3) the sale is not intended to cause harm to any contracting parties³⁶⁴.

The contemporary *sharī'ah* scholars of the Middle East largely support the rulings against sale of debt. The Islamic Fiqh Academy (*Majma' Fiqh Islāmī*) discussed the issue in its 16th convention in Mecca on January 2002 and decided on the impermissibility of the said contract. On the other hand, the Malaysian *sharī'ah* scholars approve the application of the sale of debt in the issuance of Islamic securities. Their main argument lies in the view that Islamic securities are secured debt. Since they are issued by government or corporations with high credit rating, the likelihood of default payment of the securities is very minimal. Hence, *gharar* is not an issue in the securities trading as their payments are almost certain³⁶⁵.

The Malaysian *sharī'ah* authority went further by allowing discounted debt trading. It takes place for example when a corporation issues security at discount, say RM800. The security is redeemable at par value of RM1000 after one year. This means an investor who purchases the security will obtain RM200 of return when he/she sells back the security to the issuer. The Malaysian *sharī'ah* scholars recognise the RM200 as profit deriving from a valid sale of debt contract. According to them, the sale is valid since the security is not currency; rather it is a paper worth RM800 now and is sold for RM1000 in a year's time³⁶⁶. The element of *ribā* in the transaction does not exist because it is similar to any other commodity trading; bought as a commodity at RM800 and sold it for RM1000 in the future. However, the justification is rejected by the Middle East *sharī'ah* scholars. They do not consider the return as profit but a 20 percent of interest like the practice of conventional bond.

Obviously, the issue of *bay' al-dayn* again demonstrates the divergent interpretations of the classical jurists' ruling between Malaysians and the Middle East *sharī'ah* scholars. I personally think the argument to accept the legality of securities trading on

³⁶⁴ Abū 'Abd Allah Muḥammad bin Muḥammad bin 'Abd Rahman al-Ra'īnī, *Mawāhib al-Jalīl Sharh Mukhtaṣar al-Khalīl*, Beirut: Dār al-Fikr, vol.4, pp. 369

³⁶⁵ Umer Chapra and Tariqullah Khan, *Regulation and Supervision of Islamic Banks*, Islamic Research Training Institute, Occasional Paper 3, Jeddah, 2000.

³⁶⁶ Ishak, Dato Othman Hj, *Developing Dha' wa Ta 'ajjal in Structuring Islamic Instruments*, Paper presented at the *International Capital Market Conference* held at Kuala Lumpur on 15-16 July, 1997.

the ground that they are secured debt is not convincing. No matter how big a corporation or how strong a government is, they are still exposed to default payment risk. The current credit crunch in the United States and the European countries; as a result of the bankruptcy of their giant financial institutions, is an obvious example to this situation. Hence, Islamic securities issuers in the Muslim country are also face similar possibility. As security of the debt is questionable, Islamic securities can not be regarded as *māl mutaḳawwam* and be traded in the secondary market.

In addition to the justification of secured debt, the Malaysian *sharī'ah* authority allows the practice of *bay' al-dayn* based on the *maṣlaḥah* (public interest) principle. In this case, the *maṣlaḥah* is referred to the *maṣlaḥah* of Islamic banks. Islamic bankers always argue that they need such securities instruments to manage their liquidity problem. As securities are tradable in the secondary market, they provide flexible investment instruments for any banking institutions. The banks could invest in the securities when they have surplus funds and sell them back to the issuers when in need of liquidity (i.e. to supplement their cash resources). Moreover, as argued by the Islamic bankers, failure to create such investment instrument may lead to banking collapse and by extension the instability of the Islamic banking system³⁶⁷. Considering this *maṣlaḥah*, the Malaysian *sharī'ah* scholars had taken *ra'fah* and *takhfif* (lenient and relaxed) approaches, to permit the *bay' al-dayn* contract in creating the Islamic version of securities. Although their decision may be viewed as adopting the weaker juristic opinion, it was taken as promoting the Islamic banking industry which is more important. However, the decision poses crucial questions. Is the *maṣlaḥah* justifiable in adopting the lenient and relaxed approaches? Can we possibly contravene the Islamic commercial law rulings for the sake of the Islamic banks' interest? We shall discuss these questions in the following chapter.

However, at this point, we shall come back to our initial investigation in this section; does the investment of *muḍārabah* deposit in the Islamic securities comply with the principle of profit and loss sharing? Based on our preceding discussion, it is clear that the Malaysian version of Islamic securities is a replication of conventional bonds.

³⁶⁷ Abdul Rais Abdul Majid, Development of Liquidity Management Instrument: Challenges and Opportunities, paper presented at the *International Conference on Islamic Banking: Risk Management, Regulation and Supervision*, Jakarta, September 30-October.

Despite the Islamic contract modification, the element of guaranteed return still prevails in the Islamic securities. Therefore in my opinion, the said product has failed to uphold the profit and loss sharing principle as it should be in a *muḍārabah* contract.

Next, we will examine the activities carried out by the Malaysian Islamic Inter-bank Money Market in which has generated considerable income for the *muḍārabah* general investment account.

The Malaysian Islamic Inter bank Money Market (IIMM)

Islamic Inter bank Money Market (IIMM) is one of the renowned innovations of the Malaysian government in Islamic banking sector. The IIMM was established to facilitate the local Islamic banks in managing their liquidity. As explained earlier, for bankers, managing liquidity is essential if banks are to maximise their earnings and control their risks. In the conventional banking system, the banks' liquidity is managed through investment in the inter bank money market. The investment is made through various short and medium termed liquidity instruments. The instruments allow banks to borrow and lend among themselves, through which banks with surplus funds can invest with those with liquidity deficit. Such an investment mechanism has been beneficial in maintaining the balanced liquidity of the commercial banks in which is the key factor in promoting the stability of the banking system. However, since the investment instruments are operated on the basis of interest (*ribā*), Islamic banks are forbidden from utilising them.

Hence, during the first decade of the Islamic banking industry in Malaysia, the local Islamic banks had to rely on the Central Bank (BNM) to resolve their liquidity problem. At that time, the only *sharī'ah* compatible liquidity instrument available was the Government Investment Certificate (GIC). The Islamic banks would purchase the GIC when they have surplus capital and sell them back to the BNM when they have asset-liability mismatches. However, the option has proven insufficient to facilitate the rapid growth of the industry. The need for wider range of liquidity investment instruments that comply with the *sharī'ah* principles was clear. Therefore, in January 1994 the Malaysian government established the IIMM to function similar role of the conventional inter bank money market.

The IIMM was set up with three main components; (1) Inter-bank deposit product (2) Islamic money market instruments and (3) Islamic Cheque Clearing System (ICCS)³⁶⁸. For the purpose of this thesis, we will concentrate only on the *muḍārabah* inter bank investment (MII) product. The product is relevant to our preceding discussion since it has generated considerable amount of profit for the *muḍārabah* general investment account. The MII refers to a mechanism whereby a deficit Islamic bank can obtain investment from a surplus Islamic banks based on a *muḍārabah* contract. The minimum amount of investment in the MII is RM50,000, while the period of investment can vary from overnight to 12 months. The profit sharing ratio is negotiable among both contracting banks. The investor bank at the time of negotiation would not know what the return would be, as the actual return will be crystallised towards the end of the investment period. The principal invested shall be repaid at the end of the period, together with a share of the profit arising from the used of the fund by the deficit (receiving) bank³⁶⁹.

The rate of return for the MII is based on the rate of gross profit before distribution for investment of 1-year of the surplus (investing) bank. To see how an MII transaction would be settled at the end of the investment period, let us study an example illustrated by Obiyathullah. Suppose, Ambank Islamic has a surplus of RM5 million that it wishes to place out for 3 months in the IIMM. Bank Muamalat on the other hand is in need of liquidity. Assume it needs the same amount of fund for similar period. Both banks then agree to embark on the MII product. Let say they agree on a profit sharing ratio of 75:25, which means Ambank Islamic as the investing bank will receive 75 percent of Bank Muamalat's declared gross profit before distribution of 1 year investment that it has had. Based on this agreement, Ambank Islamic will place a RM 5 million deposit with Bank Muamalat. 90 days later, Bank Muamalat will have to return the principal of RM 5 million plus a profit amount. Let us say, Bank Muamalat declares a gross profit of 6 percent before distribution on its 1 year

³⁶⁸ Obiyathullah Isma Batcha, The Islamic Inter bank Money Market and a Dual Banking System: The Malaysia Experience, *International Journal of Islamic and Middle Eastern Finance and Management*, vol. 1, no. 3, 2008, pp. 210-226.

³⁶⁹ Bank Negara Malaysia, *Islamic Inter-bank Money Market*, <http://iimm.bnm.gov.my/index>, Accessed on 7 May 2009.

investment. Thus, the profit amount to be paid by Bank Muamalat to Ambank Islamic would be³⁷⁰:

$$\begin{aligned}
 X &= \frac{[\text{RM } 5,000,000 (6\%) (90)][.75]}{365,000} \\
 &= \frac{2,700,000,000 \times [.75]}{365,000} \\
 &= \frac{2,025,000,000}{365,000} \\
 &= \text{RM } 55,479.45
 \end{aligned}$$

So, on day 91, Bank Muamalat would have to return an amount of RM 5,055,479.45 to Ambank Islamic, being the principal plus profit due.

Having reviewed the method of the MII product, we will then try to answer our basic analysis question; does this type of investment suit the principle of profit and loss sharing (PLS) as embedded in the classical *muḍārabah* contract. In other words, it is appropriate to invest the *muḍārabah* general deposit into the MII product? The proponents of Islamic banking surely agree with the investment decision. They would argue that the investment fulfil the salient features of a *muḍārabah* contract since BIMB as *muḍārib* (agent-manager) had invested the *muḍārabah* deposit into a *muḍārabah* investment. In fact, the investment in MII product is closer to meeting the PLS principle when compared with the investment in financing activities and Islamic securities.

Looking from the legal contract perspective, at least on paper, the investment in the MII product can be viewed as in accordance to the principles of Islamic commercial law. Both, the general investment account and the MII product are operated on the basis of a permissible contract (*muḍārabah*). However, if we analyses deeply this sort of investment, it can be argued that it lacks of risk sharing element. The MII product is such a passive investment. BIMB who is expected to role as an active *muḍārib* (agent-manager) has preferred not to expose itself in the risky business but to place the deposit money in a secured place while waiting for return. In my opinion, this action is against the core value of the *muḍārabah* contract which emphasises on the

³⁷⁰ Obiyathullah Isma Batcha, The Islamic Inter bank Money Market and a Dual Banking System: The Malaysia Experience, *International Journal of Islamic and Middle Eastern Finance and Management*.

risk taking element. As we have pointed out in chapter three, it is the risk taking element embedded in the *muḍārabah* which made the earlier jurists and Muslim economists thought that the contract was the ideal basis on which to replace the interest-based transactions. As recalled, Islamic commercial law always emphasises on the principle of ‘*al-ghunm bil ghurm*’ which means one is entitled to a gain if one agrees to bear responsibility for loss. Therefore, if one analyses the issue of MII product within a confined legalistic paradigm, he/she will have no objection to the legalisation of the investment. However, if one analyses the issue within the framework of *maqāsid* (objective) of the contract, the MII product would appear fail to uphold the profit and loss sharing principle.

In conclusion, BIMB adopts the concept of unrestricted *muḍārabah* (*muḍārabah muṭlaqah*) in investing the *muḍārabah* funds. Based on this concept, the bank is given absolute power in managing the depositors’ money. It is totally under the bank’s discretion to make the investment decision. On the other hand, the depositors are fairly ignored. The only means for the depositors to know where their money had been invested is through the bank’s financial report published annually. Unfortunately, we notice that the information given is inadequate and difficult for the general public to understand. Despite the lack of information circulated to the depositors, the current practise appears to be an accepted standard among all Islamic banking institutions in the country. Islamic banks argue that the practice confirms with the behaviour of most of the depositors. This is because generally depositors of Islamic banks are not significantly different from those in conventional banks. They are also profit oriented investors. In other words, the main concern of the Islamic banks’ depositors is not ‘where’ the investment has been made rather ‘how’ much profit could they earn.

Given this type of depositors, therefore the Islamic banks investment portfolio is found to be very similar to their conventional counterparts. The Islamic banks have invested most of the *muḍārabah* deposit into debt-like products. In our case, for instance BIMB has invested the general investment deposit mainly into three types of investment; (1) to provide funds for bank’s financing products, (2) to purchase Islamic securities and (3) investing in MII product. The problem with these investments is that they contradict to the theory of interest-free bank expounded by earlier jurists and

Muslims economist. This is because the investments do not uphold the profit and loss sharing principle. Even worse, some of the investment products are carried out based on dubious Islamic commercial contracts namely the *bay' al-ʿinah* and *bay' al-dayn*. The application of these contracts only changes the legal technicality of the conventional loan but maintains its interest (*ribā*) consequences. Therefore, I personally think that the current practice of the Malaysian Islamic banks and their utilisation of the *muḍārabah* deposit beset with confusion and ambiguities. The Islamic banks did not genuinely comply with the *muḍārabah* principles as described by the classical jurists.

After explaining the ways BIMB utilises the *muḍārabah* deposit, I would now explain how the bank distributes the *muḍārabah* investment profit to the depositors.

Profit Distribution of the *Muḍārabah* General Investment Account

A few studies have been conducted by researchers to examine the practice of profit distribution in Islamic banks. Their main purpose in examining the subject is to assess the ability of Islamic banks to establish a more equitable wealth distribution system. Perhaps, the earliest empirical study in this subject was conducted by Norhayati Ahmad and Sudin Haron³⁷¹. Based on the analysis of 10 years financial statements of 15 Islamic banks from various Muslim countries including Bahrain, Bangladesh, Iran, Jordan, Kuwait, Malaysia, Sudan, Tunisia, Turkey and the United Arab Emirates, they found that there was a positive relationship between the interest rate of the conventional banks and the profit rate of the Islamic banks. Their study shows that the former influences the latter. Besides, Obiyathullah also found similar findings³⁷². Studying the Malaysian commercial banks (conventional and Islamic) rate of returns for a period of 13 months, Obiyathullah again proved that the changes in conventional banks' interest rate had influenced the profit rate of the Islamic banks.

³⁷¹ Norhayati Ahmad & Sudin Haron, The Existence of Conventional Banking Profitability Theories In The Islamic Banking System, *Journal Analisis, School of Management University of Utara Malaysia*, vol 5 (1 & 2), pp. 89-97, 1998.

³⁷² Obiyathullah Ismath Bacha, Dual Banking System and Interest Rate Risk for Islamic Banks, *The Journal of Accounting, Commerce and Finance: Islamic Perspective*, 1 8 (2004), pp. 1-42.

Our understanding of the *muḍārabah* rules indicates that this phenomenon should not be the case of Islamic banks. The rate of profit received by Islamic banks' depositors should be totally independent of the interest rate offered by the conventional banks. The logic is simple. As the relationship between depositors and Islamic banks is based on *muḍārabah* ventures, any potential profit is greatly depends on the business skill of the Islamic bankers as agent-managers (*muḍārib*). If bankers in the Islamic banking institutions perform well in the course of their business, there is a possibility for depositors to receive higher rates of profit far exceeding the conventional interest rate. On other hand, there is possibly a time when the *muḍārabah* or banking business suffers losses. During such financial difficulty, the depositors will not be expected to receive any return from their deposit.

The pegging of profit rate to the interest rate implies another issue. Since the former is always tied up to the latter, depositors are arguably received lower rate as compared to the actual profit generated by the Islamic banks³⁷³. The matter seems more problematic when researchers found that there was significant variance between profit paid to the depositors and shareholders even though their money was invested in similar *muḍārabah* investments³⁷⁴. As mentioned earlier, the *muḍārabah* capital in Islamic bank comprises of depositors' money and shareholders' fund. Combining together the capital, Islamic bank put them in various kinds of investments to generate profit. In principle, profit generated from the investments should be distributed between the Islamic bank and the capital providers according to a pre-determined ratio. In this case, the capital providers are the depositors and the shareholders. Both parties should be treated equally by receiving similar rate of profit for their capital contribution. However, analysis of the return received by the depositors and the shareholders of the Islamic banks in Malaysia reveals a different situation. It was found that the return on equity (ROE) given to shareholders was higher than the return on *muḍārabah* deposit (ROMD) given to depositors. On average the variance between the ROE and the

³⁷³ Zubair Hasan, *Islamic Banks: Profit Sharing, Equity, Leverage Lure and Credit Control*, Forthcoming in *Symposium on Islamic Banking and Finance Melbourne University*, Australia, 2009.

³⁷⁴ Saiful Azhar Rosly and Mohammad Ashadi Mohd. Zaini, Risk-return Analysis of Islamic Banks' Investment Deposit and Shareholders' Fund, *Journal of Managerial Finance*, vol.34, no.10, 2008, pp.695-707.

ROMD was 3.69 percent³⁷⁵. Why is there a distinction between the two rates? By right the depositors should get higher profit rate since they collectively contribute larger sum of money as compared to the shareholders.

Considering the above issues, I think it is pertinent to look back how *muḍārabah* profit is distributed by the Islamic banks. Based on the earlier findings; (1) the existence of conventional banking theories in determining the profit rate of Islamic banks and (2) the unequal treatment to the depositors, the current practice of profit distribution in Islamic banks appears to be surrounded with *fiqh* issues. This section intends to discuss these issues by highlighting the Malaysian *sharī'ah* scholars' decisions to permit the practices of Weighted Method (WM), Profit Equalisation Reserve (PER), indicative profit rate and interim profit payment.

However, before we embark further into the discussions, it is necessary to note an important point. From the outline proposed by earlier jurists such as Muḥammad Baqer as-Sadr, we notice that the profit distribution in an interest-free bank was viewed as a complex issue. The complexity exists as a result of dissimilar business environment in which *muḍārabah* contract was implemented. During the classical period, *muḍārabah* was applied in circumstance where a capital provider (*rabb al-māl*) will provide the entire capital to an empty handed entrepreneur. Using the capital, the entrepreneur will buy saleable items and try to sell them for profit. The classical jurists defined profit as any surplus from the capital. Hence, in order to identify the surplus, the agent-manager (*muḍārib*) was required to return the capital to the investor when the business is about to be liquidated. Anything exceeding the capital would be considered profit and would be shared between the two parties based on a pre-agreed ratio. All these procedure are straightforward because the *muḍārabah* was implemented in a simple business setting.

However, the way a *muḍārabah* deposit is managed nowadays is quite different. The differences lie on two main points. Firstly, Islamic banks receive deposit from their customers at different times through out a year. The deposit is then placed collectively and invested in various types of investments which vary in their completion period. For example, money deposited in June and July in a particular year was commingled

³⁷⁵ Ibid.

together and invested to buy short-term Islamic securities, one matures in December and the other in April³⁷⁶. Considering this dissimilarity, one will wonder how Islamic bank determines profit rate for every single depositor in such a *muḍārabah* arrangement. Secondly, normally Islamic banks do not invest the *muḍārabah* deposits into small businesses of empty handed entrepreneur. Through the Islamic securities and MII investment product, the *muḍārabah* deposits are channelled to large corporations that have long eclipsed small proprietary businesses. In other words, the *muḍārabah* deposits are used to provide additional funds for ongoing business. So, how profit is calculated in this business situation?

Weighted Method (WM)

The most common profit distribution method adopted by Islamic banks in Malaysia is known as the Weighted Method (WM). Table 21 below shows an example of its application in which an Islamic bank is supposed to distribute RM5800 of profit from total deposit of RM900,000 to depositors based on 50:50 profit sharing ratio³⁷⁷.

Table 21: An Example of Weighted Method in Islamic Bank

Deposit Placement Tenure	Monthly Average Balance	Weighted Average Ratio (WAR)	Weighted Proportion of Profit	Distributable Profit		Depositors' Portion			Bank's Portion		
				Actual Gross Profit Allocated	Actual Gross Rate of Return	PSR	Profit Amount	%	PSR	Profit Amount	%
(i)	(ii)	(iii)	(iv)	(v)	(vi)	(vii)	(viii)	(ix)	(x)	(xi)	(xii)
1	100,000	0.80	80,000	515.56	6.74	0.50	257.78	3.37	0.50	257.78	3.37
3	100,000	0.85	85,000	547.78	7.16	0.50	273.89	3.58	0.50	273.89	3.58
6	100,000	0.90	90,000	580.00	7.58	0.50	290.00	3.79	0.50	290.00	3.79
9	100,000	0.95	95,000	612.22	8.00	0.50	306.11	4.00	0.50	306.11	4.00
12	100,000	1.00	100,000	644.44	8.43	0.50	322.22	4.21	0.50	322.22	4.21
15	100,000	1.05	105,000	676.67	8.85	0.50	338.34	4.42	0.50	338.34	4.42
18	100,000	1.10	110,000	708.89	9.27	0.50	354.44	4.63	0.50	354.44	4.63
24	100,000	1.15	115,000	741.11	9.69	0.50	370.55	4.84	0.50	370.55	4.84
36	100,000	1.20	120,000	773.33	10.11	0.50	386.66	5.05	0.50	386.66	5.05
	900,000		900,000	5800.00			2900.00			2900.00	

The underlying principle of the WM is the use of Weighted Average Ratio (WAR). The WAR ratios are applied based on the assumption that long term deposit placement gives more opportunity for the bank to generate bigger profit. For example a 12-month deposit could be invested in various profitable investments with higher returns as compared to a 1-month deposit. Based on this premise, as indicated in column iii, a higher ratio is assigned to longer deposit tenure. The WAR ratios are

³⁷⁶ Assuming in this example, the financial year of the Islamic bank is from April to April each year.

³⁷⁷ <http://www.money3.com.my/Profit> Distribution, Retrieved on 8 Jun 2009

then multiplied by monthly average balance (column ii) to determine the weighted proportion of profit in column iv. In order to calculate the actual gross profit (column v) of each deposit, the following formula is applied; balance in column iv divided by total in column iv multiplied by RM5800 of profit. This means the gross profit allocated for 12-month deposit, for instance is:

$$\frac{100,000}{900,000} \times 5,800 = \text{RM}644.44$$

After that, the gross percentages in column vi are computed by dividing the profit of RM644.44 over the original deposit amount in column ii, multiply 100, multiply 365 days in a year and divide by number of days in the month, say 31. Hence, the rate of return of the 12-month deposit is:

$$\frac{644.44}{900,000} \times 100 \times \frac{365}{31} = 8.43$$

Having determined both the actual gross profit (column v) and their percentages (column vi), the profit portion of depositors and the bank can now be calculated. Since in our example, the profit sharing ratio (PSR) is agreed at 50:50, the depositors and the bank's portion is calculated by dividing the gross profit into two (RM644.44 ÷ 2 = RM322.22). The same formula is applied in computing the effective rate of return for both parties (8.43 ÷ 2 = 4.21).

Based on the above example, perhaps we now have a clear idea on how the Islamic banks could come out with the so-called indicative profit rate. It refers to the rate of return described in percentages (as in column ix) which give indication to the depositors regarding the return they may receive from their *muḍārabah* general deposit investment. For instance, a person who opens a *muḍārabah* general account may expect to receive profit rate of 3.79% for his 12-month deposit. The Islamic banks claim that the indicative profit rate is just a reference of the expected return that would be received by the depositors. The profit rate is quoted based on the regular rates paid to the depositors. The actual profit rate paid to the depositors will be the real profit earned from the banks' business operations. This practice is approved by the Malaysian National Shari'ah Advisory Committee (NSAC) in their 9th meeting on 25 February 1998³⁷⁸. In addition to the indicate profit rate, the Islamic banks in

³⁷⁸ *Muḍārabah* (Deposit) Contract Guidelines, Bank Islam Malaysia Berhad, Kuala Lumpur, 2007

Malaysia apply monthly interim profit payment. This means preliminary profit is paid to the account holder each month before the actual term of the contract is due. This practice is permitted by the Shari'ah Committee of the Islamic banks, for example by the Shari'ah Committee of BIMB during their 14th meeting on 7th Jun 1985³⁷⁹.

Beginning in 2004, the Islamic banks in the country introduced another new mechanism in distributing profit for the *muḍārabah* investment. The new mechanism is known as Profit Equalisation Reserve (PER). The PER is introduced to stabilise the rate of return paid to the depositors³⁸⁰. In the real banking business, the monthly rate of return recorded by Islamic banks through out a year is inconsistent. This is because an Islamic bank tends to generate a huge profit at the end of its financial year due to the flux of bad debt income, provisioning and total deposit. The pressure of the closure of bank' financial account makes bankers work harder during that time to generate high profit. Meanwhile, during the middle of the year such a pressure eases during which a fairly low profit is produced from the bank's businesses³⁸¹. Hence, in order to mitigate the fluctuation of the rate of return, the Central Bank of Malaysia has demanded that all the Islamic banks in the country to implement the PER mechanism. The PER allows the Islamic banks to save up to 15 percent of the total gross income in a separate provision. This provision/reserve will be used whenever Islamic banks record a low profit. As such PER is viewed as a reserve that is built up in good times to cater for need in bad times³⁸². As argued by the Islamic banks, the PER is essential to ensure a stable and competitive rate of return for the depositors.

Analysis of the Current Practice of Profit Distribution in Malaysian Islamic Banks

It is clear that the present practice of profit distribution method in the Islamic banks is different from the rules explained by the classical jurists. The application of the WM method emphasises the investment period rather than the nature/activity of the investment. The amount of profit which depositors may receive is determined by their deposit placement tenure. The longer the investment period the higher rate of return

³⁷⁹ Ibid

³⁸⁰ The Framework of The Rate of Return, Bank Negara Malaysia, Kuala Lumpur, 2004.

³⁸¹ Interviewed with Nazri Chik, Bank Islam Malaysia Berhad, Kuala Lumpur, 10 August 2008.

³⁸² Abdul Ghafar Ismail & Shahida Shahimi, *Profit Equalisation Reserve Decision: An Empirical Analysis of Islamic Banks in Malaysia*, working paper in Islamic Economics and Finance no. 0605, National University of Malaysia, 2006.

will be offered. This explains why the rate of return of the *muḍārabah* general investment of the same investment tenure³⁸³ is similar despite the fact that the funds were invested in various types of investments. In principle, the rate of return should vary as different investments carry dissimilar degree of business risks. Nonetheless, for the Islamic bank, the issue of whether one investment is more profitable from another is insignificant. This is because the bank will pool together all the profit made during each year and distribute them based on the weighted average method. As far as the Malaysian *sharī'ah* scholars are concerned, the method does not contravene the *muḍārabah* rules since all depositors had given consent to share the profit on a weighted basis. Their approach in solving this problem is similar to the solution suggested by Muḥammad Baqer al-Sadr³⁸⁴.

However, although significant effort have been made to design the WM method in which an attempt is made to distribute profit in the most equitable manner (given the sophisticated banking business circumstances), in my opinion there still a number of *fiqh* issues need to be addressed. As duration becomes the crucial factor in determining depositors' share of profit, *muḍārabah* investment appears to be indifferent from the conventional deposit investment. In principle, the *muḍārabah* profit should be measured by the nature/activity of the investment rather than its duration. The assumption that long term investment always generates more profit is debatable. If investment is made in a correct business manner, it may generate more profit in a short period. The problem with the current system is that it may not distribute the actual profit to the depositors. This is because by mingling together all the profit and distributing it based on the investment duration; the bank may deny some depositors the chance to earn a bigger share of profit which was made with their money.

In this regard, I am inclined to agree with the model of an interest-free bank proposed by the earlier scholars. Instead of receiving deposits through out a year, Siddiqi for instance had proposed that the Islamic banks take the deposit in a specific time i.e. quarterly. The suggestion was made to distinguish one investment from another, so any potential profit could be distribute in a more accurate manner. However, the

³⁸³ For example, all 12-months deposit is given 3.79% rate of return

³⁸⁴ Sadr, Muḥammad Bāqir, *al-Bank al-lā ribawī fī al-Islām*

model does not attract the attention of Islamic bankers presumably because it restricts the bank's opportunity in maximising its capital/fund. Open deposit taking is preferred and viewed as more practical because it would bring more funds to the Islamic bank as opposed to having a specific deposit time limit.

In addition to that, the argument regarding "depositors' consent" needs further clarification. An important question needs to be asked before one wishes to accept the argument. Do depositors have any negotiating power in determining the profit distribution matters within the Islamic banks? In other words, do they have choice not to give their consent? Based on the implementation of *standard form contract*, the present practice seems to be a 'take it or leave it' affair. The negotiating process as advocated by the classical jurists does not take place between the depositors and the Islamic banks. All decisions regarding the profit sharing ratio and the rate of return are decided by the Islamic banks. Depositors, on the other hand look like a neglected party. Clearly, the present practice contradicts the situation in which *muḍārabah* was originally implemented. During the classical period, the capital provider (*rabb al-māl*) seemed to have more negotiating power. This fact was expressed by the jurists when illustrating the commencement of a *muḍārabah* contract. A capital provider frequently quoted as saying to an agent-manager (*muḍārib*) '*I entrust you 1000 dinar as a muḍārabah contract with 50:50 profit ratio*'. The sentence indicates that the profit ratio was suggested first by the capital provider. As an empty handed entrepreneur, the *muḍārib* may accept the offer or negotiate the profit ratio. However, in the current banking practices, the situation has turned the other way around. The Islamic banks will offer the probable rate of return, and it is down to depositors to make investment decision.

Although the implementation of the indicative rate of return is viewed as *sharī'ah* compliant³⁸⁵, I personally think it could mislead the true application of a *muḍārabah* contract. This is obvious when the Islamic banks regularly use the indicative rates in their advertising to attract new depositors. The matter seems no better because Islamic bankers while promoting the *muḍārabah* investment normally do not clearly explained the issue of 'indication' unless critically asked by a potential depositor. Hence, from

³⁸⁵ Since it is just 'indication' and the profit which will be distributed depend on the actual profit made.

my personal observation, the majority of the depositors commonly expect to receive the indicative rates of return from the Islamic banks. The indicative rates have led the general public to think that Islamic banks offer a guaranteed return from their investment. Such a perception clearly contradicts the underlying concept of a *muḍārabah* contract in particular and the objective of the establishment of Islamic banking institutions in general.

The practices of interim profit payment and the PER are undoubtedly controversial. They appear to contravene the principles of the *muḍārabah* contract as elaborated by the classical jurists. As discussed earlier, the classical jurists unanimously disallowed neither the capital provider nor the agent-manager to take an accrued profit before *muḍārabah* business is to be liquidated. They stressed that the profit distribution procedure is only completed when the capital is handed over to the *rabb al-māl*. The justification of this rule is to avoid any ambiguity in the profit determination. Even if one of the contracting parties receives the profit while the business is still in progress, he/she is obliged to return the profit in case the business suffers losses. Perhaps, the main reason why the Malaysian Islamic banks practice interim profit payment is to match with the conventional banks practices.

This replication policy is clearly seen when they introduce the PER. The practice of having a certain amount of profit as a reserve for bad business periods is totally alien to the classical *muḍārabah* concept. To the best of my knowledge, none of the classical jurists had allowed such practice. As argued by the Islamic banks, the PER is introduced to enable them to offer a stable and competitive rate of return to the depositors. Although the purpose of PER is undeniably important, its implementation however causes more confusion. The PER may provide steady return to depositors but it also brings a *fiqh* problem. Let us consider an illustrative case as an example. Suppose a depositor put his money in a *muḍārabah* general investment account for 3-months, commencing from January an ending in March. During these months, the actual profit generated by the Islamic banks is substantially high. However due to the PER practice, some of the profit is taken as a reserve for the bad business period. What is the bank's justification in taking this action? The Islamic banks may argue that they obtain the depositor's permission based on the standard form signed at the beginning of the contract. But, as I highlighted earlier the level of transparency

pertaining to this matter is very low. The Islamic banks do not explain the PER mechanism clearly to the depositors. The negotiating element as emphasised by the classical jurists apparently does not take place between both parties.

To conclude, the present practice of profit distribution in Malaysian Islamic banks is not without *fiqh* issues. Given the sophistication of the modern banking business, Islamic bankers and local shari'ah advisors face challenges in applying the classical theory of *muḍārabah* contract. Some of their decisions differ from the established rules founded by the classical jurists. The practice of WM method is arguably indetical to the conventional method which emphasises the duration of the investment rather than the investment activity itself. The indicative profit rate has led to the public assumption that the Islamic banks also offer a fixed return on investment. Meanwhile, the interim profit payment clearly contravenes the classical rules which disallowed profit distribution before liquidation of *muḍārabah* business. On the other hand, the PER policy bring injustice to some depositors. In addition to that, the profit distribution matters has become exclusively in the hands of the Islamic banks. They make decisions and determine the profit ratio and the amount of profit to be distributed. The level of transparency in providing adequate information to depositors regarding the profit earned is far from satisfactory.

Conclusion

Muḍārabah contract is adopted primarily by BIMB to create deposits and wealth management products. For strategic marketing purpose, the products are named with different Arabic terminologies such as *sakīnah*, *al-awfār*, *al-falaḥ*, *al-mubīn* etc. However in terms of their roles, all products function as the main sources of fund in support of bank's operations. Theoretically, the *muḍārabah* funds should be invested in profit and loss sharing business. BIMB supposes to grant the funds to trustworthy entrepreneurs to run various profitable projects. Profit generated from the business will be shared between the three parties (depositors, bank and entrepreneurs) according to pre-determined ratio. Due to some practical concerns however, BIMB prefer to invest the funds in virtually risk-free investment instruments. Most of the funds are used to advance financing for the bank's clients; individual as well as corporate. These include financing in purchasing house, vehicle and numerous businesses' needs i.e. letter of credit and working capital financing. A large part of the

muḍārabah funds are also invested in securities and inter-bank money market products. From the bank's *sharī'ah* committee perspective, all transactions conducted by BIMB are legitimate. They view that the way *muḍārabah* funds is been utilised is undisputedly in accordance to the principles of *sharī'ah*.

However, my analysis of the current practices suggests different conclusion. The philosophy of *muḍārabah* contract has not been comprehended fully by the Islamic bankers. *Muḍārabah* funds are utilised in investment instruments which are not supporting the notion of profit and loss sharing. Moreover, I find out that some of the *ijtihāds* made by BIMB *sharī'ah* committee contradict the prevalence principles of *muḍārabah* contract expounded by the classical jurists. The local *sharī'ah* scholars in general can not be considered to be applying either the Ḥanafīs or the Shafī'īs *muḍārabah* ethical framework as discussed in chapter 2. As we may recall, the Ḥanafīs despite being lenient in empowering the agent manager did not violate the principle of profit and loss sharing embedded in the contract. However, the *sharī'ah* committee's approval concerning *al-Awfār* accounts, indicative profit rate and profit equalisation reserve (PER) suggest that they had gone beyond the classical boundaries in accommodating bankers' needs. They are driven by market demands in modifying *muḍārabah* rules to suit modern banking practices. The market driven approach is pursued by emphasising the change of terminologies rather than the ethical framework underlying behind the *muḍārabah* contract. A new banking product is recognised as *sharī'ah* compliant as long as it fulfils the legal technicalities though indistinct and identical to the interest-based banking products in its substance.

In relation to this, I personally think that the issue of the independency of *sharī'ah* committees in the Islamic banks is still relevant and valid despite been denied by a few local *sharī'ah* scholars. I argue that the enhancement of the regulatory framework of *sharī'ah* governance undertaken recently by the Central Bank of Malaysia is inadequate to assure a greater confidence regarding the lawfulness of Islamic banking products offered in the country. In my opinion, the main problem does not lie on the structure of *sharī'ah* governance system but rather on the legal orientation advocate by the local *sharī'ah* scholars appointed. The controversy of *ijtihād* in Malaysian Islamic banking is not a result of disorganised chain of authority within the *sharī'ah* advisory committees but it lies in the market driven approach adopted by their members.

The local *sharī'ah* scholars appear to be inconsistent when assessing the compliance of Islamic banking products. They are very liberal in the sense that they would remove many restrictions in Islamic commercial contracts on the basis of *maṣlaḥah* (public interest). Sometimes, they also can be too rigid by advocating the implementation of controversial medieval contracts ignoring their consequences to the Muslims economic affairs at large. Such inconsistency in the methodology is been criticised because it leads to the problem of lack of authenticity in the current practice of Islamic banking. It is strongly viewed that the approach is taken just to accommodate the Islamic bankers. Since most of Islamic banking products have similar economics effects as the conventional banks, the objective of abolishing *ribā* is doubtful and remains the main concern of the *sharī'ah* scholars. In view of this issue, I personally think that there is need to develop a comprehensive guideline to assist the scholars in achieving more precise decisions which in line with the objectives of the *sharī'ah*.

CHAPTER FIVE: MAŞLAḤAH-MAFSADAH CALCULUS IN ASSESSING THE COMPLIANCE OF ISLAMIC BANKING PRODUCTS

Introduction

Figure 8: Inter-relationships between *Fiqh* Doctrine, *Shārī'ah* Advisors and Islamic Banking Sector



The establishment of Islamic banks provides a platform for Muslims to implement some aspects of the *sharī'ah* in their daily life. By having these institutions, Muslims have the opportunity to demonstrate the actual workings of an equitable financial system based on the application of Islamic legal traditions which have long been advocated by Muslims economists. In realising the project of Islamic banking, the vital role played by the *sharī'ah* advisors is of significance. As illustrated in figure 8 above, they function as mediators between the classical *fiqh* doctrine and the real operation of the Islamic banking sector. The Islamic bankers rely on them to authenticate the conformity of proposed products to the principle of *sharī'ah* and subsequently make the products saleable in the market.

However, our previous analyses on the *muḍārabah* products indicate the incoherent orientation adopted by *sharī'ah* advisors of Malaysian Islamic banks. It is found that the local *sharī'ah* scholars are highly driven by the banking market in modifying the classical rulings. The ethical framework of the *muḍārabah* contract and the objective of the *sharī'ah* are often neglected in the need to satisfy the demand of sophisticated financial requirements. They inconsistently apply the principle of *sharī'ah* when assessing the compliance of Islamic banking products.

The scholars can be very rigid by concentrating solely on the technical aspect of the medieval commercial contract. A proposed product is legally recognised when it

merely satisfies the salient features (*arkān*) and conditions (*shurūṭ*) of a particular contract. The creation of *al-Awfār* accounts provides a good illustration of this matter. If one analyses the accounts from a purely technical contractual perspective, no *fiqh* issues arise. The accounts do not contravene any core rules of a *muḍārabah* contract. As the quarterly cash draw prizes are claimed to be derived from the bank's own resources (not from the profit of the deposited money), the *modus operandi* of the account is viewed as free from any gambling element. However, a closer look at the profit ratio offered by the bank to depositors reveals the trick. The unreasonable profit ratio (2 for depositors against 98 enjoyed by the bank) clearly suggests that the bank's claim is deceptive. Nonetheless, the trick is beyond the observation of the *sharī'ah* scholars as their emphasis is on the technicality of the contract not the overall picture of the product.

However, sometimes the local *sharī'ah* scholars can be too liberal in the sense they would remove the classical boundaries of medieval contracts simply by using the *maṣlahah* excuse. They are much more liberal than even the Ḥanafīs in pleasing the Islamic bankers. Their acceptance on Profit Equalisation Reserve (PER) method is a case in point. PER empowers Islamic banks to take certain amount of *muḍārabah* profit as reserve for bad business time. This implies that depositors do not necessarily obtain the full amount of profit generated from their funds. Such a practice is totally alien to the *muḍārabah* doctrines propounded by the classical jurists. It contradicts the prevalent ruling which emphasises the distribution of exact amount of profit earned from a *muḍārabah* venture. However, the Malaysian *sharī'ah* scholars ignore the classical ruling as they give priority to the present *maṣlahah* of Islamic bankers. As argued by the bankers, the PER method is crucial to maintain the competitiveness of Islamic banks in facing stiff competition from conventional banks.

In view of both flawed orientations, I strongly feel that there is genuine need to develop comprehensive parameters (*dawābiṭ*) in assisting the *sharī'ah* scholars reaching more appropriate *ijtihād* in the banking and finance areas. I personally think that the rigid approach is unsuitable because its outcomes usually overlook the objectives (*maqāṣid*) of *sharī'ah*. As evident in the case of *bay' al-ṭinah*, the contract fails to abolish the element of *ribā* in its transaction. Meanwhile, the application of *maṣlahah* theory can not be completely ignored. The problem of the current

application of *maṣlaḥah* theory lies in the absence of a well-defined doctrine. The *sharī'ah* advisors seem to manipulate the concept of *maṣlaḥah* in the interest of Islamic banks.

The rest of this chapter explains briefly why the *maṣlaḥah* approach is worth considering in overcoming the "authenticity" problem of the Islamic banking. Firstly, I begin with a discussion regarding what is happening within the Islamic banking sector after the sign of a recovery in the recent financial crisis. The discussion describes the orientations of Islamic bankers and *sharī'ah* advisors who maintain their duplication and market-driven approaches despite the obvious failure of giant Western financial institutions. As the current approaches prolong the authenticity issue, I incline to support Siddiqi's idea concerning the adaptation of *maṣlaḥah-mafsadah* calculus in assessing the *sharī'ah* compliance of Islamic banking products. Hence, I will present historical sketches of the *maṣlaḥah* theory in Islamic law. It should be noted however, the section is only a preliminary discussion concerning the juristic debate in recognising *maṣlaḥah* as an independent source of Islamic law. It shows the tendency of contemporary jurists to apply the theory based on the Mālikī and Ḥanbalī schools' arguments. In addition to that, the section also highlights Shāfi'ī's concern over the possibility of manipulating the *maṣlaḥah* principle for the sake of human interest. Lastly, I explain my position in rejecting the application of *bay' al-tawarruq*. The analysis regarding *bay' al-tawarruq* is relevant in our discussion because it is a good example of how the *maṣlaḥah* theory can be applied as a tool to attain more appropriate *ijtihād* in the banking and finance matters.

Have Islamic Banks Learnt from the Recent Financial Crisis?

The market-driven orientation adopted by the *sharī'ah* advisors is likely to continue despite the recent global financial crisis. The severity of the crisis clearly shows the catastrophe of excessive debt financing. As the practice of charging interest is viewed as the crux of the problem, the crisis proves that the capitalist financial system is a fallacy. Although factors contributing to the crisis are still debated, one can not deny the major role played by credit-default swap (CDS). CDS is a credit derivative instrument purchased by investors to insure against default on corporate bonds. The instrument guarantees the repayment of investment in bond plus its bearing interest to

its holders when the issuer company goes bankrupt. However, the CDS is different from a typical insurance instrument in the sense that it allows investors who do not own a corporate bond to purchase it. This means the insurance company or banks which sells the CDS is not necessarily insuring against real assets. If a person thinks that a particular issuer bond company is going to default, he can buy CDS to seize profits.

As a result of this practice, CDS has turned into a pure speculation instrument departing from its primary hedging purpose³⁸⁶. The ability to sell risk of default to a third party makes the banking institutions reckless. They tend to offer more CDS instruments to less creditworthy clients and fail to monitor their behaviour in ensuring payment³⁸⁷. As time passes, the volume of CDS in the financial system increases in which create interdependency situation between all major insurance companies and banks. They are all caught in CDS's web. Everyone is counting on others to meet payment obligations. With so much debt floating in the market, the financial system becomes so vulnerable. It lastly explodes and affects the entire financial institutions.

Islamic banking industry is considered lucky because at the time the crisis occurs, the so-called Islamic credit-default swap instruments were yet been introduced in the market. The validity and permissibility of the derivatives instruments were under discussion among *sharī'ah* scholars when the crisis struck the conventional financial institutions. This explains why the impact of the crisis is considered manageable within the Islamic banking industry. However, it is noteworthy that Islamic bankers have long argued that they need such hedge funds instruments in order to remain competitive. Their demand was supported by the fact that in 2009, there were 10 defaults reported in Islamic bonds (*sukūk*). This call for the creation of a similar mechanism of credit-default swaps to protect investors against *sukūk* risk. The magazine of *al-Iqtisādiyyah wa al-maṣrifiah* published an interesting article in this matter. The translation of the article was produced by Mahmoud el-Gamal as follows:

³⁸⁶ Edib Smolo, *Financial Derivatives from Islamic Perspective*, Islamic Finance Bulletin, Kuala Lumpur: IBFIM, Issue 24, June 2009, pp. 18.

³⁸⁷ Muḥammad Nejatullah Siddiqi, *Dealing with the Financial Crisis: an Islamic Approach*, April 2009. <http://siddiqi.com/mns/>. Accessed on 28 February 2010.

A group of informed experts on the Islamic finance industry called for a "partnership" between Islamic *takāful* (insurance) industry and *sukūk*, toward the end of assisting the latter in providing "protection" for investors against losing their funds that they invested in these Islamic instruments. Those calls became louder after the recent registration of the Pakistani cement company Maple Leaf as the last company with defaults on its Rupis 8 billion Islamic bonds. The experts suggested during their interview with "*al-iqtisādiyyah*" that Takāful (Islamic insurance) companies should find a new insurance instrument for *sukūk*, which can protect the *sukūk* holders from the risk of default, by providing "partial" compensation in the case of default³⁸⁸.

The new development in the industry indicates that the Islamic banking institutions are aiming to offer derivatives instruments. As we may anticipate, Malaysia has become the leader in such 'innovative' financial engineering. Dr. Mohd. Daud Bakar, the chairman of National *Shari'ah* Advisory Council (NSAC) is one the proponents of the instruments³⁸⁹. Speaking at the 5th International Islamic Finance Forum Asia 2009 in Kuala Lumpur, he asserted that:

"We can not ban Islamic derivatives. They are required. Some speakers tend to give extreme example of CDS as one of the reasons that brought down some large financial institutions in the US (in arguing against allowing derivatives instruments in Islamic finance). But CDS is a remote example. It is not reflective of derivatives on the whole³⁹⁰".

He suggested the application of *bay' al-'urbūn* (deposit payment), *bay' al-salām* (forward sale), *al-wa'd* (unilateral binding promise) and *tawarrūq* contracts as the underlying principles of the Islamic derivatives mechanism. The main argument in support of such an instrument is to protect investors' interest. It is claimed that the Islamic legal traditions never prohibit the act of managing risk in investment. In fact, it is essentially acceptable from the Islamic legal perspective to prevent investors from suffering huge losses.

³⁸⁸ Maḥmod el-Gamal, *Have we learned nothing? Here come the 'Islamic Credit Default Swaps'*, 3rd January 2010. <http://elgamal.blogspot.com/>, Accessed on 29 February 2010.

³⁸⁹ Mohd. Daud Bakar, *Islamic Hedging Mechanism: The Emergence Trend*, www.bnm.gov.my/microsites/giff2007/pdf/iif/Session4_c3.pdf, Accessed on 1st February 2010.

³⁹⁰ Habhajan Singh, *Hedging permissible in Islamic Finance*, Malaysian Reserve, Kuala Lumpur, 6th July 2009.

Although the claim that the Islamic legal traditions never prohibit the risk management is right, many wonder how the Islamic derivatives instruments would depart from speculative gain. This is because, without speculators the derivatives market is impaired³⁹¹. According to the proponents of the instruments, the speculation issue would be simply resolved by applying the said Islamic medieval commercial contracts. However, as duplication and market-driven orientations become the basis of the instruments, I strongly suspect that they would not carry any significant economic substance. The instruments may look 'Islamic' as they apply various classical commercial contracts but are indifferent in their underlying mechanism compared to the conventional derivatives products. Thus in the future, it would not be surprising if the Islamic banking institutions encounter similar crisis of the current conventional financial institutions.

To overcome the authenticity issue, I support Siddiqi's recommendation that the *sharī'ah* scholars should adopt a *maṣlaḥah-mafsadah* calculus. It advocates the use of well-defined *maṣlaḥah* principle as the basis in determining the *sharī'ah* compliance of Islamic banking products. It should be noted however, the description of well-defined *maṣlaḥah* principle is beyond the scope of this research. Nevertheless, I shall elaborate briefly the classical discussion concerning the principle and then discuss the issue of *bay' al-tawarrūq* as its practical example.

Historical Sketch on *Maṣlaḥah* Theory in Islamic Law

Literally, the word *maṣlaḥah* is derived from the verb *ṣaluḥa*, which denotes a good, right, just or honest person or thing. Legally, Shāṭibī defined it as:

*'all concerns that promote the subsistence of human life, the completion of man's livelihood and the acquisition of all his physical and intellectual qualities which are required for him'*³⁹².

Its antonym, *mafsadah* indicates anything that is harmful and destructive. The use of *maṣlaḥah* as an independent legal source has been advocated by many contemporary jurists and reformists such as Muḥammad 'Abduh (d.1905), Rashid Riḍā (d.1935), Ibn

³⁹¹ Saadiyah Mohamad, *Islamic Hedge Funds: Hedging or Speculating?* Islamic Finance Bulletin, Kuala Lumpur: AIBIM, issue 23, March 2009, pp.8.

³⁹² Abū Ishāq al-Shāṭibī, *Al-Muwāfaqāt Fī Uṣūl al-Āḥkām*, Beirut: Dār al-Fikr, 1990, vol.2, pp.15.

‘Ashur (d.1973) and Muḥammad Sa‘īd Ramaḍān al-Būṭī. They support the principle based on the notion that Islamic law was revealed to serve, *inter alia*, human welfare³⁹³. Hence, all matters which preserve the well being of the society are in line with the objectives of the *sharī‘ah* and therefore should be pursued and legally recognised.

However, there was disagreement among the classical jurists in adapting the *maṣlaḥah* principle as the determining factor in Islamic law. Due to the ambiguity in defining its limit (how far human welfare justification could be used to determine law), the classical jurists had differed in recognising the validity of *maṣlaḥah* as a source of law. Some scholars claim that Shāfi‘ī did not employ the *maṣlaḥah* as independent legal evidence (*dalīl*) because he strictly confined the use of personal opinion (*ra‘y*) to *qiyās*. To Shāfi‘ī, applying the concept of *maṣlaḥah* would exceed the limitations of permitted use of human legal reasoning in deducing a new *hukm*³⁹⁴. Perhaps, Shāfi‘ī attempted to portray his legal methodology (the Qur‘ān, *sunnah*, *qiyās* and *ijmā‘*) explained in *al-Risālah* as the perfect sources of law which are able to answer all questions in Muslim life. Shāfi‘ī believed that these sources of law are sufficient to cover the *maṣlaḥah* of human being. He felt the *sharī‘ah* takes full cognisance of all *maṣlaḥah* and there is no *maṣlaḥah* outside its framework.

In the sixth century Hijri, al-Ghāzalī refined the Shāfi‘ī’s concept of *maṣlaḥah* by defining its parameters. Al-Ghāzalī acknowledged the validity of *maṣlaḥah* as independent legal evidence with the condition that it fulfilled three elements; *ḍarūrah* (necessity), *qaṭ‘iyyah* (absolute certainty) and *kuliyyah* (universality). In elucidating the parameters, al-Ghāzalī illustrated a classical example from the law of war whereby Muslim soldiers encounter predicament whether to attack unbelievers' army who were shielding themselves with a group of Muslim captives or to refrain from attacking. The first course of action would kill the innocent Muslims whereas the second would give opportunity to the unbelievers to conquer more Muslim territory. In such a situation, al-Ghāzalī thought that the Muslim soldiers should attack the unbelievers in view that the action would preserve a more important *maṣlaḥah*. In addition, the attack

³⁹³Nazly Hanum Lubis, *al-Tūfi's Concept of Maṣlaḥah: A Study of Islamic Legal Theory*, Master Dissertation, University of McGill, 1995, pp.10.

³⁹⁴ Ibid, pp.32.

is considered *ḍarūrī* because it protects Muslim life, *qaṭʿī* as it the only method of saving Muslims and *kullī* because it takes consideration of the whole community³⁹⁵.

In the other schools of Islamic law, the principle of *maṣlaḥah* was generally received a wider acceptance. Although, there is no textual evidence indicating Abū Ḥanīfah's consent to *maṣlaḥah* being one of the sources of law, his whole legal theory supports the pursuit of *maṣlaḥah* in solving new legal problem³⁹⁶. Being the leading rationalists (*aṣḥāb al-raʾy*) of his time, Abū Ḥanīfah appeared to be inevitably employing the *maṣlaḥah* principle in developing his *fiqh* doctrine. The adaptation of *ʿurf* (custom) and *istiḥsān* (legal preference) strongly suggests the inclusion of *maṣlaḥah* in the Ḥanafī legal paradigm³⁹⁷.

In contrast, the adaptation of the *maṣlaḥah* principle in Mālik's doctrine is much more explicit. In fact, some scholars had accused him of over reliance on the principle which to a certain extent had prioritised *maṣlaḥah* over the textual sources. Cases in point are Mālik's approval of killing a *zindīq* who had declared the commitment to convert to Islam and his *fatwā* permitting a woman to abstain from breast-feeding her baby without any reasonable cause. The first case appears to contradict the saying of the Prophet; *'I have been ordered to fight against people, until they testify that there is no God but Allāh, and believe in me (that) I am the Messenger and in all that I have brought. And when they do it, their blood and riches are guaranteed protection on my behalf except where it is justified by law, and their affairs rest with Allāh'*³⁹⁸. Meanwhile, the second case opposes the verse 2:233; *'And the mothers should breast-feed their babies for a period of two years'*.

Supporting Mālik's approach to the *maṣlaḥah*, al-Būṭī contends that none of the two cases was ruled as abusing the principle. Al-Būṭī argues that the *zindīq* group was excluded from the meaning of unbelievers stipulated in the *ḥadīth*. He was of the opinion that the *ḥadīth* indicates unbelievers who lived during the Prophet's time

³⁹⁵ Muḥammad bin Muḥammad al-Ghazālī, *al-Mustaṣfā*, Beirut: Dār al-Kutūb al-ʿIlmiyyah, 1993, pp.177.

³⁹⁶ Muḥammad Saʿīd Ramaḍān al-Būṭī, *Ḍawābiḥ al-Maṣlaḥah Fī al-Sharīʿah al-Islamiyyah*, Damascus: Dār al-Fikr, 2005, pp. 391.

³⁹⁷ Wahbah Zuhailī, *Uṣūl Fiqh al-Islāmī*, Damascus: Dār al-Fikr, 2005, vol. 2, pp.775.

³⁹⁸ Saḥīḥ al-Muṣlīm, 1:31 [see also 1:130, 1:32, 1:33]

which include *al-mushrikūn*, the people of Holy books; Jews and Christians and *al-munāfiqūn* (hypocrites). Although these unbelievers differed in their manifestation of God, they still believe in religion. However, the *zindīq* were distinct from these groups of unbelievers since they did not have faith in religion at all. Therefore, the rule to allow killing the *zindīq* did not contravene with the *ḥadīth* but was made on the basis of the principle of *maṣāliḥ al-mursalāh* (*maṣlaḥah* which has no basis either in the Qur'ān or the sunnah)³⁹⁹. On the other hand, Mālik's *fatwā* regarding the breast-feeding is based on his understanding that the verse does not imply any obligation on behalf of a mother. Hence, there is no issue which arises over whether the *fatwā* contradicts the verse or otherwise. In the classical Muslim society, the perception that a mother is obliged to breast-feed her baby is merely based on *urf*(custom) and is not derived from textual evidence⁴⁰⁰.

The above discussion clearly illustrates Mālik's adaptation of the *maṣlaḥah* principle in developing his *fiqh* doctrine. Subsequently, the theory of *maṣlaḥah* was enhanced further by the later Mālikīs notably Shāṭibī (d.790/1388) in his masterpiece *al-Muwāfaqāt*. Shāṭibī emphasised that the concept of *maṣlaḥah* applied by the Māliki jurists is not just a matter of consideration of human interest in determining the law. Rather it is a practice of *ijtihād* in understanding the Lawgiver's intentions (*maqāsid*)⁴⁰¹. In relation to this, it is noteworthy that the *maṣlaḥah* which is referred to by the Mālikīs is the *maṣlaḥah* which has a basis in the textual sources. In other words, in considering a human interest as *maṣlaḥah* the Mālikīs did not rely solely on opinion (*al-'aql*) but tied it to the Qur'ān and sunnah. Based on this fact, the contemporary Muslim jurists depict the *maṣlaḥah* as an undisputed source of law acknowledged by all classical jurists (including Shāfi'ī)⁴⁰².

However, al-Tūfī (d.716/1316) of the Ḥanbalīs emerged with a more liberal concept. The controversy of al-Tūfī's concept of *maṣlaḥah* lies on several ideas which depart from the general theory of the majority jurists. In this study however, I would mention

³⁹⁹ Muḥammad Sa'īd Ramaḍān al-Būṭī, *Dawābiṭ al-Maṣlaḥah Fī al-Sharī'ah al-Islāmiyyah*, pp.360.

⁴⁰⁰ Ibid, pp. 353.

⁴⁰¹ Ahmad al-Raysuni, *Imām al-Shāṭibī's Theory of the Higher Objectives and Intents of Islamic Law*, London: The International Institute of Islamic Thought, 2005, pp.45-50.

⁴⁰² See for example Muḥammad Sa'īd Ramaḍān al-Būṭī, *Dawābiṭ al-Maṣlaḥah Fī al-Sharī'ah al-Islāmiyyah*.

only two of them. Firstly, he recognised opinion as the sole determining factor in judging human interest as *maṣlaḥah*. Secondly, al-Tūfī propounded a view which prioritised *maṣlaḥah* over the textual sources in deducing a new *hukm*⁴⁰³. Because of these controversies, al-Tūfī's idea was not welcomed and received severe criticism from his contemporaries. The concept of *maṣlaḥah* articulated by al-Tūfī went beyond the accepted standard of the majority jurists. Despite the criticism, one can not deny al-Tūfī's contribution in augmenting the idea that *maṣlaḥah* principle should be applied only in the *mu'āmalat* (man-man relationships) and not *ʿibādāt* (God-man relationships). While the latter is the prerogative of God, the former is down to the discretion of mankind.

The previous discussions clearly indicate that the majority of classical jurists upheld a middle position in adapting the *maṣlaḥah* principle in solving new *fiqh* problem. They chose to be in between the strict rejection of Shāfi'ī and the liberal opinion of al-Tūfī. Certainly, the works of al-Ghāzalī and al-Shāṭibī provide grounds on how to apply the principle. However, such classical works are considered to be general without outlining a specific method in solving real Muslim affairs. Hence, to apply the principle in Islamic banking matters, contemporary scholars have to develop a distinctive method. For instance, the question on how to deduce an accurate ruling when there is a contradiction between the two *maṣlaḥah* should be clarified clearly. The controversy of *bay' al-tawarruq* contract is an interesting example with which to address this issue. As the proponents and opponents of the contract argue for using the *maṣlaḥah* principle, the *sharī'ah* scholars have to have a sound understanding of the theory in order to make correct judgement.

Adapting *Maṣlaḥah* Principle in Assessing *Bay' al-Tawarruq* Issue

Basically, the salient features of *bay' al-tawarruq* are very much similar to *bay' al-ṭinah*. Both contracts are identical in the sense that they are executed to attain liquidity. The contracting parties in the contracts have no intention to own the purchased assets but use the sales technicalities as a means in obtaining cash. The distinctive feature between the two is that the *modus operandi* of the former involves

⁴⁰³ Wahbah Zuhailī, *Uṣūl Fiqh al-Islāmī*, pp.817-818.

three parties whereas the latter includes two parties. Hence, the classical form of *bay' al-tawarruq* is described when a person who buys merchandise at a deferred price sells it in cash at lower price to a third party. As we may re-call in chapter three, *bay' al-ṭinah* is strongly viewed by the majority of classical jurists as a contract which analogous to *ribā* transaction. With the exception of the Ḥanbalis, all other jurists did not discuss the rule of *bay' al-tawarruq* separately from *bay' al-ṭinah*⁴⁰⁴. The majority of Ḥanbalī jurists approved *bay' al-tawarruq* as they did not notice any element of *ribā* embedded in the contract⁴⁰⁵. Since *bay' al-tawarruq* is less controversy among the classical jurists, the Malaysian Islamic bankers and *sharī'ah* scholars are keen to promote the contract as alternative to *bay' al-ṭinah* in creating cash financing products. In fact, they had introduced commodity *murābaḥah* programme (CMP) which deemed to be an innovative approach in solving liquidity problems among Islamic banks.

However, the application of *bay' al-tawarruq* has been slammed by a recent declaration of the Organisation of Islamic Conference (OIC) Fiqh Academy. In April 2009, the Academy had passed a resolution that ruled against the practise of what they called 'organised' *tawarruq* implemented by most Islamic banks. The Academy *sharī'ah* members differentiate between the classical form of *bay' al-tawarruq* and its contemporary practices⁴⁰⁶. They are of the opinion that the cash obtained from the classical *bay' al-tawarruq* is determined purely by market forces. There is no prior arrangement between *al-mustawriq* who first buy merchandise with deferred price and the third party who buy back the merchandise at lower spot price. In contrast, the contemporary *tawarruq* is organised whereby the transaction involving the three parties (client, banks and third party company) are previously set up to provide cash. While the former is allowed according to the Ḥanbalī jurists, the latter is viewed to be analogous to *bay' al-ṭinah* and hence impermissible. In many cases, this arranged transaction would result in non-satisfaction of receipt condition (*al-qabḍ*) that is required in Islamic commercial law⁴⁰⁷.

⁴⁰⁴ Al-Mausu'ah al-Fiqhiyyah, Kuwait: Wizārah al-Awqaf, n.d, vol.14, pp. 147.

⁴⁰⁵ Mansūr bin Yunus al-Buhūtī, *Kashāf al-Qinā' 'an-Matn al-'Iqnā'*, Beirut: Dār al-Fikr, 1982, vol. 3, pp.182.

⁴⁰⁶ OIC Fiqh Academy Ruled on Organised Tawarruq Impermissible, ISRA Portal, Kuala Lumpur, <http://www.isra.my/index.php:oic-fiqh-academy-ruled-tawwaruq-impermissible>. Accessed on 4th Febuary 2010.

⁴⁰⁷ Asyraf Wajdi Dusuki, Commodity Murābaḥah Programme (CMP): An Innovative Approach to Liquidity Management, 5th International Islamic Finance Conference, Monash University Kuala Lumpur, 3rd – 4th September 2007.

In assessing the compliance of *bay' al-tawarruq* in Islamic banking practices, Siddiqi applies the *maṣlahah-mafsadah* calculus. He is of the opinion that the harmful consequences of *bay' al-tawarruq* are much greater than the benefits generally cited by its proponents. Arguing from the macroeconomic perspective, he contends that the application of *bay' al-tawarruq* will support an economic system based on debt creation. This is based on the fact that *bay' al-tawarruq* is manipulated by Islamic banks to create debt instruments. As one of the founders of Islamic economic discipline, Siddiqi opposes the excessive of debt creation instruments in governing Muslim financial affairs. He warns against the creation of debt market instruments under the banner of Islam. This is because the market of debt instruments created through the adaptation of *bay' al-tawarruq* will inherit similar problems of the capitalist economic system i.e. speculation activity, inefficient allocation of funds and inequitable wealth distribution. He contends that the application of *bay' al-tawarruq* will broaden the dichotomy between the theory and practice of Islamic economic, therefore should be avoided⁴⁰⁸.

However, the proponents of *bay' al-tawarruq* argue that Islamic banks and their clients need the contract to solve the problems of liquidity and cash financing. By adopting *bay' al-tawarruq*, Islamic banks could develop various liquidity management products which are essential in ensuring their survival. Failure to manage the liquidity risk efficiently will probably cause the collapse of the entire banking system. As for the clients, the contract of *bay' al-tawarruq* is important as a *makhraj* (mode of problem solving) in creating financing products to meet their basic needs i.e. to purchase houses, vehicles and etc. Hence, the proponents claim that there are prudent needs (*al-ḥājiyyat*) to adopt some controversial contract like *bay' al-tawarruq* without having resort to *ribā*-based transaction⁴⁰⁹. Hence, the adaptation of *bay' al-tawarruq* is seen as the act of choosing between the lesser of two evils; between *ribā* which is absolutely prohibited and *bay' al-tawarruq* which is disputed. The decision to take a lesser harm action is supported by a legal maxim in Islamic jurisprudence; *yuzal ad-ḍarar al-ashaddu bid-ḍarar al-akhaff* a greater harm is eliminated by means of a lesser harm.

⁴⁰⁸ Mohammad Nejatullah Siddiqi, *Economics of Tawarruq, how its mafāsīd overwhelm the maṣāliḥ*, Workshop on Tawarruq and its methodological issues, London School of Economics, February 2007.

⁴⁰⁹ Asyraf Wajdi Dusuki, *Commodity Murābahah Programme (CMP): An Innovative Approach to Liquidity Management*.

Having reviewed the arguments of opponents and proponents of *bay' al-tawarruq*, it is clear that both parties have justified their opinions using the *maṣlaḥah* concept. The opponents agree with the application of the contract considering the *maṣlaḥah* of Islamic banks and their clients. Meanwhile, Siddiqi and others rule against the contract in view of the *maṣlaḥah* of Islamic economic system as a whole. So which *maṣlaḥah* is more justifiable?

In view of the theory of *maṣlaḥah* propounded by the classical jurists, I think the resolution of OIC *Fiqh* Academy and its supporters is more correct. The justifications put forward by Siddiqi are more convincing in achieving the objectives of *sharī'ah* and the original aims of the establishment of Islamic banks. The harmful consequences of *bay' al-tawarruq* to the whole Islamic economic system are much more important and to be avoided than its temporary benefits. The acceptance of *bay' al-tawarruq* will prolong the debate regarding the authenticity issue in the Islamic banking system. Therefore, I think the time has come for Islamic bankers and their *sharī'ah* advisors to re-think their approach in carrying out the Islamic banking operations. Semantic modification is no longer viewed as an appropriate orientation. Instead, the 'Islamic' alterations are required to encompass genuine economic substance. By abandoning the legal artifice of *bay' al-tawarruq*, it is hoped that the Islamic banks will be able to create investment instruments that truly uphold the notion of profit and loss sharing as embedded in *muḍārabah* contract. It is strongly believed that the notion of profit and loss sharing is the only principle representing the true spirit behind any effort to circumvent *ribā* in the current financial system.

Conclusion

This chapter recommends the use of a well-defined *maṣlaḥah* doctrine in assisting the *sharī'ah* scholars producing more precise *ijtihād* in Islamic banking and finance matters. The recommendation is made after considering the incoherent orientation adopted by the current *sharī'ah* advisors in Malaysian Islamic banks. They can be too rigid by emphasising solely on the technicality aspect of medieval contract as well as be too liberal by using unregulated *maṣlaḥah* principle. Such incoherent legal methodology has resulted in authenticity issues within the Islamic banking sector. Islamic banking products created through this approach do not really exhibit the Islamic ethical framework and the objectives of *sharī'ah*.

The need of a well-defined *maṣlaḥah* theory is obvious when examining the state of Islamic banking sector after the episode of global financial crisis. Despite the massive impact of the crisis towards the Western financial institutions, the Islamic bankers and *sharī'ah* advisors maintain their duplication and market-driven approaches. Their tendency to introduce the so-called Islamic derivatives instruments clearly suggests that they do not learn anything from the catastrophe of a financial system which is based on excessive debt creation. As the incoherent legal methodology becomes the basis for approving the Islamic derivative instruments, the present chapter doubts any significant economic substance carried out by the products. The instruments may look 'Islamic' in appearance but are indifferent in their underlying mechanic when compared to the conventional derivatives products.

Meanwhile, the discussion regarding the *maṣlaḥah* theory in this chapter is preliminary in nature. It only sketches the historical discussions among the classical jurists in recognising *maṣlaḥah* as independent source of Islamic law. The majority of classical jurists including the Mālikīs, Ḥanbalīs and Ḥanafīs supported its application in resolving contemporary Muslim problems. However, Shāfi'ī was reported as rejecting the application of *maṣlaḥah* due to the possibility of human manipulation. The historical sketch of the *maṣlaḥah* theory indicates good grounds for philosophical discussions laid down by the classical jurists such as al-Ghāzalī and al-Shāṭibī. However, to apply the theory in Islamic banking and finance matters there is a need to develop a distinctive method to ensure its application does not deviate from the

original concept. As an example, the chapter also discusses the issue of *bay' al-tawarruq*. It illustrates the importance of having a sound understanding of the *maṣlaḥah* theory when judging the contradiction of two interests.

CONCLUSION CHAPTER

The Islamic legal traditions prohibit *ribā* in loans for consumption and production purposes. The wisdom behind the prohibition is to advocate an economic system based on the notions of equality and fairness. This is because *ribā* has been viewed by the classical jurists as the root cause of economic exploitation. It allows the rich creditors to manipulate the poor debtors. To solve the problem of consumption loans, Muslims are encouraged to offer benevolence advances to those who in need of financial assistance. The advance is offered purely based on the spirit of kindness and brotherhood. Lenders of such advances are forbidden from receiving any compensation. They are only promised huge rewards in the Hereafter. Meanwhile, to avoid the injustice of production loans, the Islamic legal traditions recommend risk-sharing principle in mobilising Muslim financial resources. Money (capital) is not recognised as the factor of production within an Islamic economic framework. The classical jurists rejected the notion that ‘money could yield money’ without bearing any risk. For money to generate money, the lenders and entrepreneurs are required to bear certain degree of probability of loss.

The risk-taking principle is strongly embedded in a *muḍārabah* contract. The contract promotes an equity partnership between investors and entrepreneurs in venturing business projects. *Muḍārabah* takes place when investors provide capital while agent managers contribute work. Any realised profit will be shared between the two parties based on a profit ratio agreed at the beginning of the contract. Monetary loss will be borne solely by the investors. The agent managers will only lose their expended times and effort. Inspired by the notion of risk sharing, the early modern Muslim economists proposed *muḍārabah* as the basis in establishing Islamic banks. Its practical model is based on the triangular relationship between depositors, Islamic banks and entrepreneurs. According to the model, Islamic banks act as middle-parties between depositors as capital providers (*rabb māl*) and entrepreneurs as agent managers (*muḍārib*).

The founders of Islamic banking theory are determined with regard to the ability of *muḍārabah* in running the Islamic banking operations. Their belief in the contract is

based on the successful implementation of the contract during Muslim economic glory of the medieval period. This is evident in the works of the classical jurists. All major schools of Islamic law contain comprehensive doctrines of the *muḍārabah* contract. The jurists developed the doctrines throughout a few centuries in response to the changes of business and economic context. Influenced by different methodologies in interpreting the *sharī'ah*, the detailed outlines of practical conduct of *muḍārabah* vary between the schools notably between the Shāfi'īs and the Ḥanafīs.

The former school appeared to be more rigid as it upheld 'law determines market' approach. For the Shāfi'īs, the contract of *muḍārabah* should be implemented according to strict observance of the original rules in order to achieve its desired objective. In contrast, the Ḥanafīs were more flexible and lenient. They paid considerable attention to market forces in deciding the scope of empowerment to the agent manager. In many cases, the customary practices of traders (*'urf al-tujjār*) were used as the determining factor. It should be noted however, despite the relaxed and lenient approach, the Ḥanafī jurists were consistent in maintaining the spirit of the contract.

Analyses the *muḍārabah* banking products in Malaysian Islamic banks confirms the previous allegations that the current practices have deviated from its original theory. *Muḍārabah* contract has not become predominant in the daily Islamic banking transactions. Through the creation of deposits accounts and wealth management products, the contract is mainly applied to accumulate funds for the Islamic banks. In investing the funds however, the Islamic bank prefers to invest them by adopting debt-based contracts such as *bay' al-ʿīnah*, *bay' al-murābaḥah*, *wakālah* and *ijārah*. The problem with this investment method is that it does not truly exhibit the spirit of risk sharing. Financing products, Islamic money market instruments and Islamic securities where the *muḍārabah* funds are invested, are designed by mimicking the conventional banking facilities. They do not genuinely encompass significant economic substance.

In the so-called Islamic home financing, the relationship between the Islamic banks and the clients is very similar to the lenders-borrowers connection rather than traders-buyers arrangement. Islamic banks appear to be risk-free parties similar to lenders

whereas the house buyer bears all the risk associated with borrowers. The use of Arabic term in representing the product i.e. *bay' bithamanin 'ajil* is just a 'cosmetic' modification. On the other hand, the Islamic money market instrument is such a passive investment. Investing in the money market means *muḍārabah* funds are placed in the deficit banks for guaranteed returns. The investment strategy contradicts the philosophy of the *muḍārabah* contract which emphasizes the risk-taking element. Meanwhile, the Malaysian version of Islamic securities is surrounded with *fiqh* controversies. This is a result of the local *sharī'ah* scholars' acceptance of *bay' al-īnah* and *bay' al-dayn* as the underlying contracts of the products. The application of both contracts receives much criticism because it demonstrates the obvious example of manipulating the *sharī'ah* for the sake of Islamic bankers' interest.

The Malaysian *sharī'ah* scholars adopt incoherent legal methodology in modifying *muḍārabah* classical doctrine to suit into modern banking practices. They can not be considered as applying either the Shāfi'ī or the Ḥanafī approaches. They are much more liberal than even the Ḥanafīs by justifying certain actions of Islamic banks based on unregulated definition of *maṣlahah*. At the same time, the *sharī'ah* scholars also are very rigid and fail to look at the appalling consequences of proposed banking products from wider perspective. It is strongly viewed that the incoherent legal methodology is undertaken to accommodate the requirements of Islamic bankers.

In view of the increasing awareness regarding the authenticity of the Islamic banking operations, such incoherent orientation is no longer justifiable. As the question regarding the controversy of Islamic banking resolutions is becoming more obvious among researchers and concerned Muslims, the credibility of Islamic banks' *sharī'ah* advisors will be slowly decline if they continue to favour the Islamic bankers. Hence, the time has come for the *sharī'ah* scholars to re-consider their approach when analysing the compliance of Islamic banking products. This study proposes the implementation of a well-defined *maṣlahah* doctrine as a guideline in assisting them attaining more precise *ijtihād* in this matter.

BIBLIOGRAPHY

Primary Sources

- Abū Dāwūd, Sulaymān ibn al-Ash‘ath, *Sunan Abū Dāwūd*, Cairo: Dār Ihyā’ al-Sunnah al-Nabawīyah, vol. 3, 1950.
- Abū Layth al-Samarqandī, Naṣr ibn Muḥammad, *Khizānat al-Fiqh*, Beirut: Dār al-Kutub al-‘Ilmiyyah, 2005.
- Aḥmad ibn Ḥanbal, *Masā’il al-Imām Aḥmad Ibn Ḥanbal wa Ishāq bin Ruwaiyah* narrated by Ishāq b. Mansūr al-Marūzī, Medina: Saudi Arabia, 2004.
- ‘Alī‘Abdullah Yūsuf (trans.), *The Meaning of the Holy Qur’ān*. Bretwood, Md.: Amana, 1991.
- Al- Shāfi‘ī, Muḥammad ibn Idrīs, *Kitāb al-Umm*, Beirut: Dār al-Ma‘rifah, vol. 4, 1973.
- Al- Shāfi‘ī, Muḥammad ibn Idrīs, *Risalāt al-Shāfi‘ī*, Cairo: Maktabah ‘Isā al-Bābī al-Ḥalabī, 1969.
- Al-Bābartī, Muḥammad ibn Muḥammad ibn Maḥmūd, *al-Ināyah ‘Ala al-Hidāyah*, Beirut: Dār al-Fikr, vol. 7, n.d.
- Al-Bāji, Sulaymān ibn Khalāf, *al-Muntaqā sharḥ Muwaṭṭa’ Malik*, Beirut: Dār al-Kutub al-‘Ilmiyyah, vol. 7, 1999.
- Al-Buhūti, Mansūr bin Yunus, *Kashāf al-Qinā‘ an-Matn al-‘Iqnā‘*, Beirut: Dār al-Fikr, vol. 3, 1982.
- Al-Dhahabī, Muḥammad ibn Aḥmad, *Kitāb Tadhkirat al-ḥufāz*, Beirut: Dār Ihyā’ al-Turāth al-‘Arabī, vol. 1&2, n.d.
- Al-Dusūqī, Muḥammad ibn Aḥmad ibn ‘Arafah, *Hāshiyat al-Dusūqī ‘alā al-Sharḥ al-kabīr (‘alā Mukhtaṣar Khalīl) li Aḥmad al-Dardīr ma‘a taqrīrāt li Muḥammad Ullaysh*. Cairo: Maktabah ‘Isā al-Bābī al-Ḥalabī, n.d.
- Al-Ghazālī, Muḥammad Abū Ḥamīd, *al-Wajīz fī Fiqh Madhhab al-Imām al-Shāfi‘ī*, Beirut : Dār al-Ma‘rifah, vol.1, 1997.
- Al-Ghazālī Muḥammad Abū Ḥamīd, *al-Mustaṣfā*, Beirut: Dr al-Kutūb al-‘Ilmiyyah, 1993.
- Al-Ḥaṭāb, Abū ‘Abdallah Muḥammad, *Mawāhib al-Jalīl fī Sharḥ Mukhtaṣar al-Khalīl*, Beirut: Dār al-Fikr, vol. 4, 1992.
- Al-Maqdisī, ‘Abdullah Muḥammad bin Muflaḥ al-Maqdisī, *al-Furū‘* Beirut: Dār ‘Āllam al-Kutūb, vol. 4, 1985.
- Al-Mardāwī ‘Alā’ al-Din Abū Ḥasan Sulaymān, *al-Inṣāf fī Ma‘rifat al-Rājih min al-Khilāf*, Dār Ihyā’ al-Turath al-‘Arabī, vol. 5, n.d.
- Al-Nawāwī, Yaḥya ibn Sharaf, *al-Majmū‘ sharḥ al-Muhadhdhab lil Shīrāzī*. Cairo: Zakarīyā ‘Alī Yūsuf, vol. 1 and 14, 1966-69.
- Al-Qarāfī, Aḥmad bin Idris, *Dhakhīrah*, Beirut: Dār al-Gharb al-Islāmī, vol.6, 1994.
- Al-Ramlī, Muḥammad ibn Aḥmad, *Nihāyah al-Muḥtāj Ilā Sharḥ Alfāz al-Minhāj*, Beirut: Dār al-Fikr, vol. 3, 1984.
- Al-Ramlī, Muḥammad ibn Aḥmad, *Nihāyah al-Muḥtāj ilā Sharḥ Alfāz al-Minhāj*, Cairo: Muṣṭafā al-Bābī al-Ḥalabī, vol. 4, 1967.
- Al-Sharbīnī, Muḥammad ibn Muḥammad. *Mughnī al-Muḥtāj ma‘āni al-fāz al-Minhāj/ sharḥ Muḥammad al-Shibīnī al-Khatīb ‘ala matn al-Minhāj li-Abī Zakariyā Yaḥya ibn Sharaf al-Nawawī*. Misr: Sharikat wa Maṭba‘at Mustafā al-Bābī al-Ḥalabī, vol. 2, 1958.

- Al-Shaybānī, Muḥammad ibn al-Ḥasan, *Jāmi' al-ṣaghīr*, Beirut: Dār 'Ālam al-Kutub, 1986.
- Al-Tanukhī, Saḥnūn ibn Sa'īd, *al-Mudawwanah al-Kubrā li al-Imām Mālik bin Anas*, Baghdad: Maktabah al-Muthannā, vol. 5, 1970.
- Dāraquṭnī, 'Alī ibn 'Umar, *Sunan al-Dāraquṭnī. Kitāb al-Buyū'*, Cairo: Dār al-Maḥāsin, vol. 3-4, 1980.
- Ibn Hazm, Aḥmad ibn Sa'īd, *al-Muḥallā bi al-Āthār*, Beirut: Dār al-Fikr, vol. 7, n.d.
- Ibn Ḥajar al-'Asqalānī, *al-Maṭālib al-'Aliyah bi-Zawā'id al-Thamāniyah/ taḥqiq Abī Bilāl Ghunaym ibn 'Abbas ibn Ghunaym, Abī Tamim ibn Ibrahīm Muḥammad*. Al-Riyāḍ: Dār al-Waṭar, vol. 2, 1997.
- Ibn Ḥajar al-'Asqalānī, *Bulūgh al-Marām min Adillat al-Aḥkām; Kitāb al-Buyū'*, Mecca: Maktabah an-Nahḍah al-Ḥadīthah, 1979.
- Ibn Ḥajar al-'Asqalānī, *Fathul al-Bārī bi sharḥ Ṣaḥīḥ al-Bukhārī*, Beirut: Dār Iḥyā' al-Turāth al-'Arabī, vol. 4, 1981.
- Ibn Khaldūn, 'Abd al-Raḥmān ibn Muḥammad, *the Muqaddimah, an Introduction to History*, Franz Rosenthal (trans), London: Routledge & Kegan Paul, vol. 3, 1986.
- Ibn Mājah, Muḥammad ibn Yazīd, *Sunan Ibn Mājah, Kitāb al-Tijārāt, Bāb al-Sharikah wa al-Muḍārabah*, Stuttgart: Thesaurus Islamicus Foundation, 2000.
- Ibn Qayyim al-Jūziyyah, Abī 'Abdullāh Muḥammad bin Abī Bakr, *Ilām al-Muwāqī'in*, Beirut: Dār al-Jail, vol. 3, 1973.
- Ibn Qudāmah, 'Abd Allāh ibn Aḥmad, Muwaffaq al-Din. *Al-Mughnī/ taḥqiq 'Abd Allāh ibn al-Muḥsin al-Turkī, 'Abd al-Fattāḥ Muḥammad al-Ḥulw*. Al-Riyāḍ: Dār 'Ālam al-Kutub, vol. 7, 1999.
- Ibn Rushd, Muḥammad ibn Aḥmad, *Bidāyatul Mujtahid wa Nihāyah al-Muqtasid*, Cairo: Dār al-Salām, vol. 4, 1995.
- Ibn Taymīyah 'Abd Salām ibn 'Abd Allāh, *al-Muḥarrar fī al-Fiqh 'alā Madhhab al-Imām Ahmad ibn Ḥanbal*, Beirut: Dār al-Kutūb al-'Ilmiyah, vol. 2, 1999.
- Ibn 'Abd al-Barr, Yūsuf ibn 'Abd Allāh, *Kitāb al-Kāfī fī Fiqh ahlul Madīnah al-Mālikī*, Riyadh: Maktabah al-Riyadh al-Ḥadīthah, vol. 2, 1980.
- Ibn 'Ābidin, Muḥammad Amīn ibn 'Umar, *Rad al-Mukhtar fir Dar al-Mukhtar*, Beirut: Dār al-Kutub al-'Ilmiyyah, vol. 5, 1992.
- Khatīb al-Baghdādī, Aḥmad ibn 'Alī, *Tārīkh Baghdād*, Beirut: Dār al-Kitāb al-'Arabī, vol.6, 1966.
- Mālik bin Anas, *al-Muwatta'*, Beirut: Dār al-Gharb al-Islāmī, vol. 2, 1997.
- Muslim ibn Ḥajjāj, *Ṣaḥīḥ Muslim: Kitāb al-Musāqāt*, Beirut: Dār Iḥyā' al-Turāth al-'Arabī, vol. 3, 1985.
- Qinālīzādah, 'Alī Chalabī ibn Amr Allāh, *Ṭabaqāt al-Ḥanafīyyah*, Amman: Dār Ibn al-Jawzī, 2004.
- Sarakshī, Muḥammad ibn Ahmad. *Kitāb al-Mabsūṭ*, Cairo: Maṭba'at al-Sa'ādah, vol. 22, 1906-13.
- Shāṭibī, Ibrāhīm ibn Mūsā, *Al-Muwāfaqāt Fī Uṣūl al-Āḥkām*, Beirut: Dār al-Fikr, vol. 2, 1990.
- Shīrāzī, Ibrāhīm ibn 'Alī , *Kitāb al-Muhadhdhab fī al-Fiqh Madhhab al-Imām al-Shāfi'i*, Cairo: Maktabah al-Bābī al-Halabī, vol. 1, 1929.

Secondary Sources

- ‘Abd al-Qadīr bin Badrān, *al-Madkhal ilā Madhhab Ibn Ḥanbal*, ‘Abd Allāh bin Muḥsin (editor), Beirut: Mu’assasah al-Risālah, 1981.
- A.L.M. Abdul Gafoor, *Muḍārabah-based Investment and Finance*, *Journal of Islamic Banking and Finance*, vol 19. no 5, 2002.
- Abdul Ghafar Ismail & Shahida Shahimi, *Profit Equalisation Reserve Decision: An Empirical Analysis of Islamic Banks in Malaysia*, working paper in Islamic Economics and Finance no. 0605, National University of Malaysia, 2006.
- Abdul Ḥakim I. al-Matroudi, *The Ḥanbalī School of Law and Ibn Taymiyyah Conflict or Conciliation*, London: Routledge, 2006.
- Abdul Rahim Abdul Rahman, *Sharī‘ah Audit for Islamic Financial Services: The Needs and Challenges*, ISRA Islamic Finance Seminar, Kuala Lumpur, November 2008.
- Abdul Rais Abdul Majid, Development of Liquidity Management Instrument: Challenges and Opportunities, *International Conference on Islamic Banking: Risk Management, Regulation and Supervision*, Jakarta: September 30-October.
- Abdullah Saeed, *Ribā, Encyclopedia of Islam Second Edition*, Edited by: P. Bearman, Th. Bianquis, C.E. Bosworth, E. van Donzel and W.P. Heinrichs. Brill, 2008. Brill Online, EXETER UNIVERSITY. Accessed on 27 November 2008.
- Abdus Samad & M. Kabir Hasan, The Performance of Malaysian Islamic Bank During 1984-1997: An Exploratory Study, *International Journal of Islamic Financial Services*, vol. 1 no. 3.
- Abdus Samad & M. Kabir Hassan, The Performance of Malaysian Islamic Bank During 1984-1997, *International Journal of Islamic Financial Services*, vol.1, no.3.
- Abraham L Udovitch, *Partnership and Profit in Medieval Islam*, Princeton N.J: Princeton University Press, 1970.
- Abraham L. Udovitch, *At the Origins of Western Commenda: Islam, Israel, Byzantium?* *Speculum*, vol. 37 no.2, April 1962.
- Adil Manzoor Bakshi, *Developing a Financial Model for Islamic Credit Card for the UK*, Masters Dissertation, University of Salford, 2006.
- Ahmad al-Raysuni, *Imām al-Shāṭibī’s Theory of the Higher Objectives and Intents of Islamic Law*, London: The International Institute of Islamic Thought, 2005.
- ‘Ali Jum‘ah Muḥammad, *al-Madkhal ilā Dirāsāt -il- al-Madhāhib al-Fiqhiyyah*, Cairo: Dār al-Salām, 2007.
- Ali Arsalan Tariq & Humayon Dar, Risk of Sukuk Structure: Implication for Resource Mobilisation, *Thunderbird International Business Review*, vol. 49(2) 203–223, March–April 2007.
- Al-Mausu‘ah al-Fiqhiyyah, Kuwait: Wizārah al-Awqaf, vol.14, n.d.
- Al-Teghani ‘Abd al-Qādir Ahmad, *Ḍamān al-Muḍārib lil Ra’ Sul al-Māl fi al-Wadā‘ī al-Maṣrafiyyah*, *Journal of Islamic Economics*, University of King Abdul Aziz, 2003.
- Anil Netto, *Islamic bank’s woes highlight problems*, Asia Times Online, 5 November 2005, www.atimes.com/atimes/Southeast_Asia/ Accessed on 27 December 2009.
- Arnaldez, R. 'Ibn Ḥazm, Abū Muḥammad ‘Ali b. Aḥmad b. Sa‘īd'. *Encyclopedia of Islam, Second Edition*. Edited by P. Bearman, Th Bianquis, C.E. Bosworth, E.

- Van Donzel and W.P. heinrichs. Brill 2009. Brill Online. EXETER UNIVERSITY. Accessed on 24 August 2009.
- Association of Islamic Banking Institution Malaysia, Court of Appeal Reverse High Court BBA Ruling <http://aibim.com/content/view/>, Accessed on 22 April 2009.
- Asyraf Wajdi Dusuki, Commodity Murābahah Programme (CMP): An Innovative Approach to Liquidity Management, *5th International Islamic Finance Conference*, Monash University Kuala Lumpur, 3rd – 4th September 2007.
- Bank Islam Malaysia Berhad, An-Najah NID-*i* Pamphlet, Kuala Lumpur.
- Bank Islam Malaysia Berhad (BIMB) Financial Statement 2009, Kuala Lumpur, [http://www.bankislam.com.my/bimbpdf/AR09-Financial Staments.pdf](http://www.bankislam.com.my/bimbpdf/AR09-Financial%20Statements.pdf), Accessed on 30 December 2009.
- Bank Islam Malaysia Berhad, Annual Report 2008, Kuala Lumpur.
- Bank Islam Malaysia Berhad, Guidelines of *Muḍārabah* Deposit, Kuala Lumpur, n.d.
- Bank Islam Malaysia Berhad, *Al-Awfar Accounts*, www.bankislam.com.my, Accessed on 25 February 2010.
- Bank Islam Malaysia Berhad, *Our Logo Rationale*, www.bankislam.com.my, Accessed on 24 December 2009.
- Bank Islam Malaysia Berhad, *Pewani Accounts*, www.bankislam.com.my, Accessed on 25 February 2010.
- Bank Islam Malaysia Berhad, *Ziyād NID-I*, www.bankislam.com.my, Accessed on 25 February 2010.
- Bank Islamic Malaysia Berhad, *Who are we?* www.bankislam.com.my, Accessed on 24 December 2009.
- Bank Negara Malaysia, Guidelines on Skim Perbankan Islam, Kuala Lumpur, n.d.
- Bank Negara Malaysia, Guidelines on the Governance of *Shari'ah* Committee for the Islamic Financial Institutions, Kuala Lumpur, December 2004.
- Bank Negara Malaysia, The Framework of the Rate of Return, Kuala Lumpur, 2004.
- Bank Negara Malaysia, The History of Islamic Banking in Malaysia, www.bnm.gov.my/index. Accessed on 14 August 2008.
- Bank Negara Malaysia, Annual Report 2005, Kuala Lumpur.
- Bank Negara Malaysia, *Islamic Inter-bank Money Market*, <http://iimm.bnm.gov.my/>, Accessed on 5 May 2009.
- Bencheneb, M. "Khālil b. Ishāq b. Mūsā b. Shu'aib al-Djundi." *Encyclopedia of Islam Second Edition*. Edited by: P. Bearman, Th. Bianquis, C.E. Bosworth, E. van Donzel and W.P. Heirinchs. Brill Online, EXETER UNIVERSITY. Accessed on 28 November 2009.
- Borhan J.T. Bin, *The Doctrine and Application of Partnership in Islamic Commercial Law With Special Reference To Malaysia Experiments in Islamic Banking and Finance*, Phd Theses University of Edinburgh, 1997.
- Bursa Malaysia, The Islamic Capital Market Brochure, Kuala Lumpur, 2005.
- Christopher Melchert, *the Formation of the Sunni Schools of Law, 9th-10th Centuries*, Leiden: Brill, 1997.
- Christopher Melchert, Traditionist-Jurisprudents and the Framing of Islamic Law, *Islamic Law and Society*, Leiden: Brill. vol.8, no.3, 2001.
- Edib Smolo, *Financial Derivatives from Islamic Perspective*, Islamic Finance Bulletin, Kuala Lumpur: IBFIM, Issue 24, June 2009.

- El-Sharif B.B.K. *Law and Practice of Profit Sharing in Islamic Banking with Particular Reference to Muḍārabah and Murābahah*, Phd Theses University of Exeter, 1990.
- El-Tegani A. Ahmed, Distribution of Profit in Islamic Banking: A Case Study of Faisal Islamic Bank of Sudan (FISB), *J.KAU: Islamic Economic*, vol. 8, 1996.
- Eyyup Said Kaya, *Continuity and Change in Islam Law: The Concept of Madhhab and the Dimensions of Legal Disagreement in Ḥanafī Scholarship of the Tenth Century* in Peri Bearman, Rudolph Peters, Frank E. Vogel, *The Islamic School of Law, Evolution, Devolution and Progress*, Massachusetts; Harvard University Press, 2005.
- Engku Rabiah Adawiyah Engku Ali, Interview on 11th August 2008, International Islamic University of Malaysia, Kuala Lumpur.
- Financial Sector Master-plan, Kuala Lumpur: Central Bank of Malaysia, 2004.
- Frank E. Vogel and Samuel L. Hayes III, *Islamic Law and Finance, Religion, Risk and Return*, London: Kluwer Law International, 1998.
- Habhajan Singh, *Hedging permissible in Islamic Finance*, Malaysian Reserve, Kuala Lumpur, 6th July 2009.
- Habhajan Singh, *Time for Bank to Study BBA Further*, <http://Islamicfinanceupdates.wordpress.com>, Accessed on 21 April 2009.
- Hamed Hamoud Alajlan, *Usury, Moral Economy and Islamic Banking: A Critical Examination Ideal Notion and Business Practices with Reference to Kuwait*, Phd. Thesis University of Exeter, 2006.
- Haron S, Ahmad, N, Planisek, S.L, Bank Patronage Factors of Muslim and non-Muslim Customers, *International Journal of Bank Marketing*, vol.12, no.1, pp.33-40.
- Heffening, W. “al-Kasani, Ala’ al-din Abū Bakr b. Mas’ud, called Mālik al-ūlama’.” *Encyclopedia of Islam*. Edited by: P. Bearman, Th. Bianquis, C.E Bosworth, E. Van Donzel and W.P. Heinrichs. Brill, 2008. Brill Online. Exeter University. Accessed on 22 July 2008.
- Hiroyuki Yanagihashi, “Abū Hanīfa” *Encyclopaedia of Islam, THREE*. Edited by: Gudrun Kramer, Denis Matringe, John Nawas and Everett Rowson. Brill, 2008. Brill Online. Exeter University. Accessed on 2 July 2008.
- Hiroyuki Yanagihashi, *A History of the Early Islamic Law of Property, Reconstructing the Legal Development, 7th-9th Centuries*, Leiden: Brill, 2004.
- Homouyon A. Dar and John R. Presly, *Lack of Profit and Loss Sharing in Islamic Banking: Management and Control Imbalances*, Economic Research Paper No. 00/24, University of Loughborough.
- Ḥasan al-Amīn, *al-Muḍārabah al-Shar’iyyah wa-Taṭbīqāha al-Ḥadīthah*, Jeddah: al-Ma’had al-Islāmī lil-Tanmiyyah, 2000.
- Ḥasan al-Ma’naqash, *al-‘Ilāqāt al-Tarbawiyah min Khilāl Muqaddimah al-Majmū‘ al-Nawawī*, <http://attarbawya.maktoobblog.com/> Accessed on 1 December 2009.
- International Association of Deposit Insurers, vol. 1 issue 3, 18 July 2006.
- Ishak, Dato Othman Hj, Developing Dha’ wa Ta ‘ajjal in Structuring Islamic Instruments, Paper presented at the *International Capital Market Conference* held at Kuala Lumpur on 15-16 July ,1997.
- Islamic Banking Practice from the Practitioner’s Perspective, Kuala Lumpur: Bank Islam Malaysia Berhad, 1994.
- Jackson, S.A. “Shihāb al-Dīn al-Qarāfī.” *Encyclopedia of Islam Second Edition*. Edited by: P. Bearman, Th. Bianquis, C.E. Bosworth, E. van Donzel and W.P.

- Heirinchs. Brill 2009. EXETER UNIVERSITY. Accessed on 28 November 2009.
- Jonathan E. Brockopp, *Early Mālikī Law, Ibn Abd al-Ḥakām and his Major Compendium of Jurisprudence*, Leiden: Brill, 2000.
- Joni Tamkin Borhan, Interview on 14th August 2008, University of Malaya, Kuala Lumpur.
- Joseph Schacht, 'Mālik b. Anas'. *Encyclopaedia of Islam*. Edited by: P. Bearman, Th. Bianquis, C.E. Bosworth, E. van Donzel and W.P. Heinrichs. Brill, 2008. Brill Online Exeter University. Accessed on 26 August 2008.
- Joseph Schacht, *An Introduction to Islamic Law*, Oxford: Clarendon Press, 1964.
- Joseph Schacht, *The Origins of Muhammadan Jurisprudence*. Oxford: Clarendon Press, 1950.
- Laoust, H. "Aḥmad ibn Ḥanbal." *Encyclopaedia of Islam, Second Edition*. Edited by: P. Bearman, Th. Bianquis, C.E. Bosworth, E. van Donzel and W.P. Heinrichs. Brill, 2008. Brill Online. EXETER UNIVERSITY. Accessed on 18 December 2008.
- Lee Cheng Wee, High Court to Consult SAC in Islamic Finance Cases, *The Malaysian Reserve*, Kuala Lumpur, 22 April 2009.
- M. Umer Chapra, Innovation and Authenticity in Islamic Finance, paper presented at the *Eight Harvard Conference in Islamic Finance*, Massachusetts, April 2008.
- M. Umer Chapra, *Towards a Just Monetary System*, Leicester: The Islamic Foundation, 1985.
- Mahmoud A. El-Gamal, *An Economic Explication of the Prohibition of Ribā in Classical Islamic Jurisprudence*, 2001, www.ruf.rice.edu/~elgamal/files/riba. Accessed on 27 November 2008.
- Mahmoud A. El-Gamal, *Islamic Bank Corporate Governance and Regulation: A Call for Mutualisation*, www.ruf.rice.edu/elgamal/files/IBCGR.pdf, Accessed on 26 Jun 2009.
- Mahmoud El-Gamal, *Have we learned nothing? Here come the 'Islamic Credit Default Swaps'*, 3rd January 2010. <http://elgamal.blogspot.com/>, Accessed on 29 February 2010.
- Md. Abdul Awal Sarker, Islamic Business Contracts, Agency Problems and the Theory of Islamic Firms, *International Journal of Islamic Financial Services*, vol.1 no.2.
- Mehmet Asutay, 'Islamic Banking and Finance: Social Failure', *New Horizon* (169), October 2008.
- Mohammad Hashim Kamali, *Equity and Fairness in Islam*, Cambridge: The Islamic Text Society, 2005.
- Mohammad Nejatullah Siddiqi, *Economics of Tawarruq, how its mafāsīd overwhelm the maṣāliḥ*, Workshop on Tawarruq and its methodological issues, London School of Economics, February 2007.
- Mohammed al-Qorshi, *Islamic Finance & Development*, IMF Magazine, vol. 42, no. 4, December 2005.
- Mohd Faiz Hakimi & Ishak Sulaiman & Kamaruzzaman Nordin, *Muḍārabah Perkongsian Modal dan Untung*. Kuala Lumpur: Academy of Islamic Studies, University of Malaya, 2008.
- Mohd. Daud Bakar, Islamic Hedging Mechanism: The Emergence Trend, www.bnm.gov.my/microsites/giff2007/pdf/iif/Session4_c3.pdf, Accessed on 1st February 2010.

- Monthly Statistical Bulletin November 2009, Bank Negara Malaysia, Kuala Lumpur, www.bnm.gov.my/files/publication/msb/2009, Accessed on 1st January 2010.
- Muhammad Abu Zahra, *the Four Imam*, Aisha Bewley (trans). London; Dār al-Taqwā, 2001.
- Muhammad Anwar, Islamicity of Banking and Modes of Islamic Banking, *Arab Law Quarterly*, vol. 18, no. 1, 2003.
- Muhammad Fahim Khan, Guaranteeing Investment Deposit in Islamic Banking System, *Journal of Islamic Economics*, University of King Abdul Aziz, 2003.
- Muhammad Nejatullah Siddiqi, *Muslim Economic Thinking: A Survey of Contemporary Literature* in *Studies in Islamic Economics*, Khurshid Ahmad (ed.), Leicester: The Islamic Foundation, 1980.
- Muhammad Taqī Uthmani, *Sukuk and Their Contemporary Application*, www.muftitaqiusmani.com/Downloads/Publications/Articles/Sukuk.pdf, Accessed on 25 February 2010.
- Muhammad al-Mukhtār al-Māmī, *al-Madhab al-Mālikī, madārisuhu, mu'ālafatuhu, khaṣā'isuhu wa sammātuhu*, al-'Ayn: Markāz Zā'id li al-Turath wa al-Tārīkh, 2002.
- Muhammad Nejatullah Siddiqi, *Banking Without Interest*, Leicester: The Islamic Foundation, 1983.
- Muhammad Nejatullah Siddiqi, Dealing with the Financial Crisis: an Islamic Approach, April 2009. <http://siddiqi.com/mns/>. Accessed on 28 February 2010.
- Muhammad Sa'īd Ramaḍān al-Būṭī, *Dawābiṭ al-Maṣlaḥah Fī al-Sharī'ah al-Islamiyyah*, Damascus: Dār al-Fikr, 2005.
- Muhammad Taqī Usmani, *an Introduction to Islamic Finance*, Karachi, 1998.
- Munawar Iqbal, Ausaf Ahmad & Tariqullah Khan, *Challenges Facing Islamic Banking*, Occasional Paper no. 1, Jeddah: Islamic Research Training Institute, 1998.
- N.J Coulson, *A History of Islamic Law*, Edinburgh University Press, 1964.
- Nabil A. Saleh, *Unlawful Gain and Legitimate Profit in Islamic Law*, London: Cambridge University Press, 1986.
- Nagoaka Shinsuke, Beyond The Theoretical Dichotomy in Islamic Finance, Analytical Reflection on *Murābahah* Contract and Islamic Debt Securities, *Kyoto Bulletin of Islamic Area Studies*, 2007.
- Nazly Hanum Lubis, *al-Tūfī's Concept of Maṣlaḥah: A Study of Islamic Legal Theory*, Master Dissertation, University of McGill, 1995.
- Nazri Chik, Interview on 10th August 2008, University of Malaya, Kuala Lumpur.
- Norhayati Ahmad & Sudin Haron, The Existence of Conventional Banking Profitability Theories In The Islamic Banking System, *Journal Analisis*, School of Management University of Utara Malaysia, vol 5 (1& 2), 1998.
- Norma Md. Saad, *Macro Economic Application in South East Asian Countries*, Kuala Lumpur: International Islamic University of Malaysia Press, 2004.
- Norman Calder, *Studies in Early Muslim Jurisprudence*, Oxford: Clarendon Press, 1993.
- Norman Calder. "Sarakshī, Muhammad b. Aḥmad b. Abī Saḥl Abū Bakr, Sham al-A'imma". *Encyclopedia of Islam, Second Edition*. Edited by: P. Bearman, Th. Bionquis, C.E. Bosworth, E. Von Donvel, W.P. Heinrichs. Brill Online, Exeter University. Accessed on 11 February 2009.
- Nurit Tsafir, *the History of an Islamic school of law: the early spread of Ḥanafīsm*, Massachusetts: Harvard University Press, 2004.

- Obiyathullah Ismath Batcha, the Islamic Inter bank Money Market and a Dual Banking System: The Malaysia Experience, *International Journal of Islamic and Middle Eastern Finance and Management*, vol. 1, no. 3, 2008.
- Obiyathullah Ismath Bacha, Adapting *Muḍārabah* Financing to Contemporary Realities: A Proposed Financing Structure, *Journal of Accounting, Commerce and Finance*, vol. 1, no.1, 1997.
- Obiyathullah Ismath Bacha, Dual Banking System and Interest Rate Risk for Islamic Banks, *The Journal of Accounting, Commerce and Finance: Islamic Perspective*, 1 8 (2004).
- OIC Fiqh Academy Ruled on Organised Tawarruq Impermissible, ISRA Portal, Kuala Lumpur, <http://www.isra.my/index.php:oic-fiqh-academy-ruled-tawarruq-impermissible>. Accessed on 4th February 2010.
- Paxson, D., & Wood, D, *Encyclopedic Dictionary of Finance*. Oxford: Blackwell. 1998.
- Peri Bearman, Rudolph Peters, Frank E. Vogel, *The Islamic School of Law, Evolution, Devolution and Progress*, Massachusetts; Harvard University Press, 2005.
- Playing the baby-boomer trade: J. P Morgan Aging Population Index, 7th November 2008, <http://seekingalpha.com/article/104772>, Accessed on 10 January 2010.
- Quitān Wiktorowicz, 'the Salafī Movement in Jordan', *International Journal of Middle East Study*, issue 32, 2000.
- R. Kevin Jaques, *Authority, Conflict and the Transmission of Diversity in Medieval Islamic Law*, Leiden: Brill, 2006.
- Rafīq Yunus al-Misrī, *Hal Yajuz fī al-Muḍārabah an Yadmana al-ʿAmil Raʿsu al-Māl?*, *Journal of Islamic Economics*, University of King Abdul Aziz, 2003.
- Resolution 21(3/9), *al-Ahkām an-Nuqūd al-Waraqiah wa Taghyir Qīmah al-ʿUmlah*, Amman, 16 October 1986. www.fiqhacademy.org.sa/qyarat/3-9.htm. Accessed on 22 November 2009.
- Resolution of *Sharīʿah* Advisory Council of Bank Negara Malaysia, Kuala Lumpur, http://www.bnm.gov.my/guidelines/o1_banking/o4_prudential_stds/o7_sharia_h_resolution.pdf. Accessed on 20 of January 2010.
- Rodney Wilson, *Islamic Asset Management*, SGIA Research Working Papers Series, University of Durham, no.1, June 2007.
- Rodney Wilson, The Contribution of Muḥammad Bāqir al-Ṣadr to Contemporary Islamic Economic Thought, *Journal of Islamic Studies*, vol. 9 no.1, 1998.
- S.M. Hasanuz Zaman, *Muḍārabah* in non-trade operation, *JKAU: Islamic Economic*, vol. 2,
- Saʿadiah Mohamad, *Islamic Hedge Funds: Hedging or Speculating?* Islamic Finance Bulletin, Kuala Lumpur: AIBIM, issue 23, March 2009.
- Ṣadr, Muḥammad Bāqir, *al-Bank al-lā ribawī fī al-Islām*, Beirut: Dār al-Taʿāruf lil Maṭbuʿāt, 1977.
- Saiful Azhar Rosly & Mahmud M. Sanusi, The Application of Bayʿ al-ʿīnah and Bayʿ al-Dayn in Malaysian Islamic Bond: An Islamic Analysis, *International Journal of Islamic Financial Services*, vol.1 no.2.
- Saiful Azhar Rosly and Mohammad Ashadi Mohd. Zaini, Risk-return Analysis of Islamic Banks' Investment Deposit and Shareholders' Fund, *Journal of Managerial Finance*, vol.34, no.10, 2008.
- Sayyid Sābiq, *Fiqh al-Sunnah*, Beirut: Dār al-Kitāb al-ʿArabī, vol.3, 1985.
- Shamin Ahmad Sidiqi, 'Understanding and Eliminating *Ribā*: Can Islamic Financial Instruments be Meaningful Implemented'. *Journal of Management and Social Sciences*, vol.1, no.2, 2005.

- Shamsiah Mohammed, Interview on 9th August 2008, University of Malaya, Kuala Lumpur.
- Susan A. Spector, Ahmad ibn Ḥanbal's Fiqh, *Journal of The American Oriental Society*, vol. 102, no. 3, Jul-Oct 1982.
- Tariqullah Khan, *An Analysis of Risk Sharing in Islamic Finance with Special Reference to Pakistan*, Jeddah: Islamic Research Training Institute, 1996.
- The Paypers-Malaysia credit card market. www.lafferty.com/pdffiles/. Accessed on 4 of July 2009.
- Timur Kuran, *Islam and Mammon, the Economic Predicaments of Islamism*, Princeton: Princeton University Press, 2004.
- Umer Chapra and Tariqullah Khan, *Regulation and Supervision of Islamic Banks*, Islamic Research Training Institute, Occasional Paper 3, Jeddah, 2000.
- Wael B. Hallaq, *The Origins and Evolution of Islamic Law*, Cambridge: Cambridge University Press, 2005.
- Wahbah al-Zuhaylī, *al-Fiqh al-Islāmī wa Adillatuh*, Damascus: Dār al-Fikr, vol.5, 1997.
- Wahbah al-Zuhaylī, *al-Fiqh al-Islāmī wa Adillatuh, Financial Transactions in Islamic Jurisprudence* Maḥmūd A. El-Gamal (trans), Beirut: Dār al-Fikr, vol.1, 2003.
- Wahbah al-Zuhaylī, The Juridical Meaning of *Ribā*, Interest in Islamic Economic, *Understanding of Ribā*, (edited) AbdulKader Thomas, London: Rutledge Taylor & Francis, 2006.
- Ya'kov Meron, The Development of Legal Thought in Ḥanafī Texts, *Studia Islamica*, no. 30, Larose: Maisonneuve & Amp, 1969.
- ʿUmar Sulaimān al-ʿAshqar, *al-Madkhal ilā Dirāsat- il- al-Madhāhib wal al-Madāris al-Fiqhiyyah*, Amman: Dār al-Nafa'is, 2007.
- ʿUmar ʿAbd Allah Kāmil, *ar-Rukḥṣah al-Sharʿiah fī Usul wal Qawa'id al-Fiqhiyyah*, Mecca: Maktabah al-Makiyyah, 1999.
- Ziaul Haque, *Ribā the Moral Economy of Usury, Interest and Profit*, Kuala Lumpur: S. Abdul Majeed & Co, 1995.
- Zubair Hasan, Islamic Banks: Profit Sharing, Equity, Leverage Lure and Credit Control, Forthcoming in *Symposium on Islamic Banking and Finance Melbourne University*, Australia, 2009.

APPENDIX