



CONTEMPORARY APPLICATIONS OF
MUDARABAH INVESTMENT ACCOUNT

BY

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A research paper submitted in partial fulfillment of the
requirement for the degree of Master of Science in
Islamic Banking and Finance

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ABSTRACT

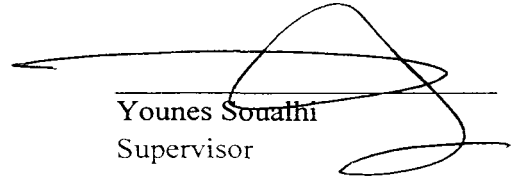
This research will discuss about one of the most important modes of Islamic equity financing which is Mudarabah by Islamic financial institutions from a shari'ah perspective and which is rarely practiced. To give the Islamic banks a complete shape, there is no other alternative but to implement, practice and popularize the Mudarabah concept specifically for the purpose of mobilizing funds from the surplus sector and to use them for investing activities in the Islamic institutions. This research attempts to suggest possible measures for promoting and eliminating the challenges related to the practice of Mudarabah in order to strengthen the shari'ah basis and realize the socio-economic objectives of this Shari'ah contract. The research consists of brief information and regulations of Mudarabah, and analysis of selected aspects related to Mudarabah such as legality, current applications of Mudarabah, and to highlight the current applications and structures of Mudarabah in Islamic financial institutions as well as the Shari'ah risk associated with Islamic deposit account and modes of mitigation. The research will also address the modes of risks mitigation in Mudarabah transactions.

خلاصة البحث

سوف يناقش هذا البحث واحدة من أهم أدوات الاستثمار في المالية الإسلامية، ألا وهي المضاربة في المؤسسات المالية الإسلامية من منظور الشريعة الإسلامية، وكيفية ممارستها . ولا يوجد بديل عن تفعيل دور المؤسسات المالية الإسلامية سوى تنفيذ وممارسة وتعميم مفهوم المضاربة على وجه التحديد ؛ لغرض تداول الأموال و عدم تركها في أيدي أغنياء المجتمع ، واستخدامها لأنشطة الاستثمار في المؤسسات المالية الإسلامية. بداية كانت المضاربة تمارس إلا أن ذلك لم يستمر لظهور بعض المشاكل. وفي هذا البحث سيتم اقتراح التدابير الممكنة لتعزيز ممارسة المضاربة، والقضاء على التحديات التي تواجهها من أجل تحقيق الأهداف الاجتماعية والاقتصادية المرجوة من هذا العقد ؛ كي تتوافق مع أحكام الشريعة الإسلامية. يشمل هذا البحث معلومات موجزة عن عقد المضاربة، وتحليل جوانب مختارة تتعلق بالمضاربة ، وتسلط الضوء على التطبيقات الحالية وهاكل المضاربة في المؤسسات المالية الإسلامية . وكذلك سيتعرض البحث للمخاطر المرتبطة بحساب الوديعة الإسلامية ووسائل تقليل تلك المخاطر.

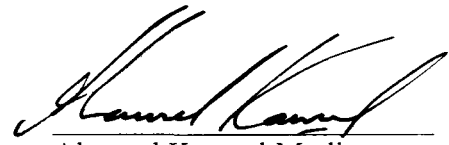
APPROVAL PAGE

I certify that I have supervised and read this study and that in my opinion; it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a research paper for the degree of Master of Science in Islamic Banking and Finance.



Younes Soualhi
Supervisor

This research was submitted to the IIUM Institute of Islamic Banking and Finance and is accepted as a fulfilment of the requirement for the degree of Master of Science in Islamic Banking and Finance.

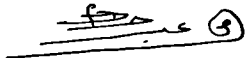


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DECLARATION

I hereby declare that this research paper is the result of my own investigation, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degree at IIUM or other institutions.

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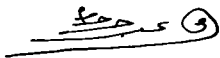
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**CONTEMPORARY APPLICATIONS OF MUDARABAH
INVESTMENT ACCOUNT**

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CHAPTER ONE

INTRODUCTION

1.1 BACKGROUND OF THE STUDY

Islam is a complete religion that contains principles revealed by Allah *Subhanahu Wa Ta'ala* (S.W.T.) for human guidance. It is a social system, a composite code, a civilization of which the rituals are part of it. The rules of Islam are meant to ensure prosperity and peace on earth and in the hereafter. The basic principles of Islamic ideology or Islamic system are contained in The Holy Quran, and the traditions of the Prophet Mohammad Peace Be Upon Him (P.B.U.H.).

Islam covers every facet of a human's life. One must understand Islam, its rulings and its spiritual needs required of its subject. Thus, the need to have an Islamic bank will be understood. Islam has duly encouraged the use of profit-sharing principle in business that will ensure fairness for all involved parties. Therefore, the alternative of conventional debt financing relies on the profit-loss-sharing principle of *Mudarabah*. *Mudarabah* as a profit-sharing instrument constitutes a vital place in Islamic finance. It has been used throughout the Islamic World between merchants and money changers since the time of the Prophet Mohammad (P.B.U.H.). However, its widest application has been in trade, as it was used in all known forms productive enterprise during various periods of Islamic history.

The early theoretical model of Islamic banking was based on the concept of profit and loss sharing (PLS) through *Mudarabah* and *Musharakah*. In practice, the liabilities side of Islamic banks replaced the term 'interest' by PLS. On the other hand, the assets side, which is the alternative mode of financing being used by these banks is

dominated by fixed–return modes such as *Mudarabah* and Leasing. Siddiqi¹ warned the Islamic finance industry as quoted in the following statement: "we cannot claim, for an interest-free alternative not based on sharing, the superiority which could be claimed on the basis of profit-sharing. What is worse, if the alternative in practice is built around predetermined rates of return to investible funds, it would be exposed to the same criticism which was directed at interest as a fixed charge on capital. It so happens that the returns to finance provided in the modes of finance based on *murabahah*, *bay' salam* (a forward sale, whereby payment is made at time of contract and item is delivered at later), leasing and lending with a service charge, are all predetermined as in the case of interest. Some of these modes of finance are said to contain some elements of risk, but all these risks are insurable and are actually insured against. The uncertainty or risk to which the business being so financed is exposed is fully passed over to the other party. A financial system built solely around these modes of financing can hardly claim superiority over an interest-based system on grounds of equity, efficiency, stability and growth."

However, this problem is the main problem of contemporary Islamic banking, so much so that it can be characterized as a crisis of identity of Islamic financial movement. Therefore, for the growth and popularity of Islamic banking system, *Mudarabah* is a very important mode of Islamic investment and it should be more practiced in the financial institutions to give the Islamic bank a complete shape as an Islamic banking system.

Economic ideals propounded by Islam as alternatives to debt financing could be broadly categorized as *Qard Hasan* and equity financing. Furthermore, a large

¹ Mohammed Nejatullah Siddiqi (1983) *Issues in Islamic Banking*, (Leicester: The Islamic Foundation), p.52.

proportion of all business financing in an Islamic economy would be based on equity financing, whereby the financier shares in the profit and loss of the business financed.²

In profit sharing arrangements, only shares of expected profit are determined at the outset. While, the actual rate of Return On Investment (ROI) is to be determined in the end, on the basis of realized profits. On the other hand, debt requires predetermined interest payments, and business difficulties may create pressures on the firm's cash flow. As a consequence, forcing it to forgo lucrative business ventures, borrow further, or sell its existing assets. As equity finance does not create such mandatory payment, the cost of adjustment to any contingency is lower. Therefore, proponents argue that in an advanced economy, equity financing should be the rule and not the last resort. Profit sharing provides more flexibility in meeting contingencies through facilitating a balanced distribution of gains as well as risks among the participants. Conversely, debt is restrictive and unforgiving, hence less stable.³

The idea of an Islamic financial system was developed from the fifties onwards. According to the majority of *Fuqaha'*, the prohibition of interest is the first essential feature of the Islamic financial system. Therefore, Islamic finance has been based on PLS, which should serve as a substitute for conventional financial instruments and should help to achieve the objectives of the Islamic concept for socio-economic development.⁴

However, in order to fortify Islamic banking institutions, a lot of issues need to be addressed, and equity financing based on *Mudarabah* and *Musharakah* are very

² Muhammad Umer Chapra (1990) *Towards a Just Monetary System: A Discussion of Money, Banking and Monetary Policy in the Light of Islamic Teaching*, 2nd edition, Translated by Sayyid Muhammad Sukkar and Revised by Rafiq Al-Misri, (Leicester, UK: The Islamic Foundation), p. 91.

³ Usamah A Othman (1994) "*Debt and Equity Contracts in the Theory of Social Economy*", *Review of Islamic Economics* 5, vol.1, no.1.

⁴Sami Tamer (2005) *The Islamic Financial System*, (Frankfurt: Peter Lang), p.7.

important to be used in the Islamic financial institutions in a wide range not to limit their usage.

1.2 STATEMENT OF PROBLEM

Not only Islamic finance tends to achieve the socio-economic benefits, but also a full-fledged implementation of Shari'ah ideals can be achieved. However, in Islamic banking institutions there are many issues related to profit distribution that guarantee allocation of some provisions as a reserve for the *Mudarib*. Since the essence of Islamic finance is PLS, there are various complexities noticed in the case of *Mudarabah* investment account. For instance, Islamic banks are entitled to go through and adhere to various provisions when maintaining Profit Equalization Reserves (PER). Clarification of Shari'ah issues related to the operational aspects of *Mudarabah* investment account are diminished, possibly due to engrossment with debt based instruments.

Customers of conventional systems -in the case of deposit accounts- deposit their surplus funds with the banks for an agreed percentage of interest. Moreover, the banks use these funds for the financing and lending purposes as well as attaining huge profits. However, the real owner of the funds gets relatively less returns according to the interest rate specified in the contract. Since, this is not the case in Islamic finance; it received an enormous popularity. Unfortunately, over the period of one decade, Islamic financial institutions are getting influenced by the conventional counterparts. Furthermore, they have started to focus on debt based products, whereby they can pay a fixed income to the customers on a monthly basis.

1.3 RESEARCH QUESTIONS

1. What is *Mudarabah*? What are the types of *Mudarabah*? What is the legality of *Mudarabah*?
2. What are the current applications and structures of *Mudarabah* in Islamic financial institutions?
3. What are the main operational issues of Islamic deposit accounts?
4. What are the Shari'ah risks associated with Islamic deposit account and what are the possible modes of mitigation?

1.4 OBJECTIVES OF RESEARCH

The main objectives of this research work are as follows:

1. To explain the meaning of *Mudarabah*, its types, the legality of *Mudarabah* and the rational of making this contract important and permissible from Shari'ah perspective.
2. To highlight the current applications and structures of *Mudarabah* in Islamic financial institutions.
3. To address the main operational and Shari'ah issues of Islamic investment account.
4. To highlight the Shari'ah risks associated with Islamic investment account and modes of mitigation.

1.5 IMPORTANCE OF THE STUDY

There are many factors that motivated the researcher to conduct this study as follows:

1. The main motivating factor is the inadequacy use of this kind of contract in the Islamic banking institutions as a whole. Hence, the researcher will

attempt to show the efficiency of this kind of contract as a mode of financing investment.

2. The existence of certain practices of *Mudarabah* that raise Shari'ah concerns causing a reputation risk to Islamic deposit account.
3. *Mudarabah* as one of the Islamic investment transactions has a vast field for the practical application, as it meets the needs of the people.
4. *Mudarabah* is the basis of Islamic banking institutions and it contributes to solve many economic problems, such as unemployment.
5. The steady growth of banks and Islamic financial institutions that rely on *Mudarabah*, which urges the need and necessity to study the practical applications of *Mudarabah* investment account, and some ways to develop it.

1.6 SCOPE OF THE RESEARCH

The scope of this research paper is to suggest the preferred structure and its juristic justification. In addition, some modes of mitigation to increase the use of *Mudarabah* as a mode of financing in the Islamic banking institutions. Hence, the researcher attempts to express the efficiency of this kind of contract as an investment account.

The researcher also analyzes the most relevant articles, journals, books, internet resources and reports of International Islamic Banking and Finance regulation such as International Islamic Fiqh Academy, Dallah Albaraka, The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), Islamic Financial Services Board (IFSB), and Shari'ah Resolution in Islamic Finance by Central Bank of Malaysia.

1.7 LIMITATION OF THE RESEARCH

There are some limitations to this research work. The main limitations are the time and space in conducting the study. Since the preferable modes of Islamic finance (*Mudarabah* and *Musharakah*) are not really used by Islamic financial institutions, empirical analysis of performance is not possible since they are not widely used. However, since they are the preferable modes by Islamic scholars and are well suited to Islamic egalitarian philosophy, a study on how *Mudarabah* investment account can be applied is mandatory.

1.8 RESEARCH METHODOLOGY

This study comprises of library based literatures and academic textbooks on *Mudarabah* as a mode of financing. Hence, it is theoretical in nature. This literature comprises of published journals, books, theses, articles, in either English or Arabic languages. This research involves the following methods:

I. Analytical Method

This method is used to analyze the procedures involved in the *Mudarabah* as a mode of financing with regard to the PLS, as well as suggest some modes of mitigation to reduce the risks in *Mudarabah*.

II. Inductive Method

The researcher applies the inductive method tracing the views and evidences of the contemporary and traditional Muslim scholars on the issues related to ruling on investment deposits and its structuring, profit distribution, and allocated some provisions as reserves in the Islamic banking institutions.

1.9 LITERATURE REVIEW

A number of scholars have done pioneering work in the field of Islamic economy as well as Islamic banking and some topics such as fund management; existent Shari'ah studies that largely deal with popular transactions modes such as *Mudarabah*, *Salam*, and *Ijarah*...etc. Although a number of scholars and writers have dealt with theoretical aspects of equity financing by Islamic banking and institutions in general manner, they did not really shed much light on facets relating to operation. Therefore, the researcher in his topic focuses on all related aspects to the *Mudarabah* investment account in specific. Furthermore, the researcher attempts to suggest possible measures for promoting and eliminating the challenges related to the practices of *Mudarabah*. Thus, strengthening the Shari'ah basis and realizing the socio-economic objectives of this Shari'ah contract based on his reading and understanding.

A major source of immense import for verifying the contemporary Shari'ah position on various banking aspects related to *Mudarabah* are the *Fatawa* issued by the Shari'ah supervisory boards of various Islamic financial institutions and individual scholars. A number of "Resolutions Made by the Jeddah Based Islamic Fiqh Academy" that comprises of a large number of Islamic scholars from various parts of the world pertaining to the topic of the research. Resolutions of this Academy are arrived after analyzing a fair amount of ground work undertaken by several selected scholars on each issue, and merit serious considerations.⁵

"*Fatawa: Shari'ah Ruling on Economic and Fatawa Nadwat Al-Barakah*", summarized the findings of the conferences held periodically by *Al-Barakah*, attended by prominent contemporary experts in the field.⁶

⁵ *Resolutions and Recommendations of the Council of Islamic Fiqh Academy (1985-2000)*, (Islamic Fiqh Academy: Saudi Arabia- Jeddah).

⁶ Dallah Al-Barakah (2000) "*Fatawa: Shari'ah Ruling on Economic*", (Jeddah: Author).

“*The Accounting and Auditing Organization for Islamic Financial Institutions*” (AAOIFI) based in Bahrain and their Shari’ah Standards for Islamic financial institutions, is a good reference for this research work as in the Shari’ah Standard Number (13). However, it aims to explain the Shari’ah ruling for restricted and unrestricted *Mudarabah*, in order to verify whether the Islamic financial Institution is acting in the capacity of either a *Mudarib* or an investor. The guarantees in a *Mudarabah* contract, the requirements, and the ruling related to the capital and profit are verified. In addition, the researcher considers the Shari’ah Standard Number (5) in order to list down the forms of guarantees that are permissible and related to the *Mudarabah* investment account.⁷

An important study by Usmani in 2008 discussed the concept of *Mudarabah*, business of the *Mudarabah* and the distribution of profit.⁸ However, this study is limited as it lacks information about the issues related to investment deposits and to the operational of *Mudarabah* investment account. Thus, the researcher attempts to cover those issues.

A study conducted by Sadique in 2007 analyzes major areas related to implementation of the Islamic equity financing modes of *Musharakah* and *Mudarabah* by Islamic financial institutions from Shari’ah perspective. Nonetheless, it highlighted important principles and aspects to *Musharakah* and *Mudarabah*. Moreover, it discussed the theoretical framework of equity modes, the Islamic fund management, the definition and legitimacy, the conditions for the validity, and some important rules of *Mudarabah*. In addition, the PLS in equity financing in *Mudarabah* and investment in equity accounts is discussed. Nevertheless, the study only mentioned some Shari’ah

⁷ Accounting and Auditing Organization for Islamic Financial Institutions (2010) *Shari’ah Standards*, (Bahrain: AAOIFI), p. 181.

⁸ Muhammad Taqi Usmani (2008) “*An Introduction to Islamic Finance*”, (New Delhi: Idara Isha’at-E Diniyat (p) I.TD).

issues relevant to decreasing partnership without looking at *Mudarabah* investment account in specific. Therefore, this research work covers the contemporary Shari'ah issues on *Mudarabah* investment account in specific.⁹

Engku Rabiah Adawiah conducted a study in 1992, which discussed the meaning, fundamentals, types and condition of *Mudarabah* as well as profit and losses.¹⁰

Another study conducted by Asiah in 1995 discussed the concept of *Mudarabah* and *Musharakah* principles in accordance to Shari'ah. However, it compared the principles of partnership under modern law: throughout the discussion it explained the importance of partnership and how it plays a role in the modern life. Moreover, the study compared between the principles contained in Islamic partnership as well as those that exist in English and Malaysian laws. In essence, the study looked at it from law perspectives and lacked the contemporary issues related to *Mudarabah* investment account. However, the study shed the light on the legal part of Islamic law, definition of *Mudarabah* and partnership. It also went through the right of partnership in *Mudarabah* and *Musharakah* as well as the duties of partner in *Mudarabah*.¹¹

Himesadeja conducted a study in Brunei Darussalam in 2008, which discussed the definition of *Mudarabah* and its legality from Shari'ah perspective. In addition, the need for the *Mudarabah* in the society, the pillars of *Mudarabah* and its types, the practical part of *Mudarabah* in the Islamic institutions with a brief history of Islamic banks in addition to the way the banks get their deposits are discussed. On the other

⁹ Muhammad Abdurrahman Sadique (2007) "*A Study of Equity Financing Modes for Islamic Financial Institutions in a Shari'ah Perspective*", (Ph.d Thesis, At Ahmad Ibrahim Kulliyah of Laws: IIUM).

¹⁰ Engku Rabiah Adawiah Engku Ali (1991/1992) "*Islamic Banking in Practice; an Evaluation*", (Master Thesis, At Kulliyah of Laws: IIUM).

¹¹ Asiah Bt. Bidin (1994/1995) "*Mudarabah and Musharakah Principles Under Shari'ah: A Comparative Study of Partnership Under English and Malaysian Law*", (Master Thesis, At Kulliyah of Laws: IIUM).

hand, it shed the light on the applications of *Mudarabah* in Brunei Darussalam. The researcher believes that the study lacked critical issues facing the *Mudarabah* in the Islamic banking institutions. Moreover, the study did not show how to reduce these risks to increase the usage of *Mudarabah* investment account.¹²

A study conducted by Nazmi Ghazali in 1994 discussed the Islamic principles of *Musharakah* and *Mudarabah* related to *Mudarabah* and the government's *Mudarabah* and *Musharakah* shares scheme. However, this study was limited by looking at the issues and risks related to *Mudarabah* investment account and the views of *Fiqh* ruling on investment deposits. Moreover, this study discussed the definition and the principles of *Mudarabah* and its related rules.¹³

Al-Zuhayli in 2007 conducted a study that investigated *Mudarabah* and its definition, legality, types, and characteristics. In addition, it discussed the conditions pertaining to partners, capital, and profits. However, this study was limited in discussing the concept of banking deposit investment, the concept of investment, and the *Fiqh* ruling on the investment deposits based on *Mudarabah*. Thus, this research work includes discussion on the concept of deposits and investment based on *Mudarabah* as well as the preferred structure and its juristic justifications.¹⁴

During the “4th *Fiqh Conference for Islamic Finance Institution*”, which was held in Kuwait in 2011, Hassan discussed the provisions of the allocations in the Islamic financial institutions. However, he explained the definition of the provisions, types and the reserves. At the same conference, Al-Kassar shed the light on allocation

¹² Himesadeja Binti Adenan (2008) “*Mudarabah and its Work in the Contemporary Islamic Institutions’ and their Applications Brunei Darussalam*”, (Master Thesis, At Faculty of Islamic Studies: University of Brunei Darussalam).

¹³ Nazmi Ghazali Azmi (1994) “*Government Mudarabah and Musharakah*”, (A Dissertation for Master, At Kulliyyah of Laws: IIUM).

¹⁴ Wahbah Al-Zuhayli (2003) *Islamic Jurisprudence and its Proofs*, 2nd edition, Translated by Mahmoud A El- Gamal and Revised by Muhammad S. Eissa, (Damascus- Syria: Dar Al-Fikir, vol.1).

in the provisions of Islamic banks and their impact on the distribution of profit. He explained the meaning of provisions, and their types and importance. The meaning of reserves and the most important differences between the provisions and reserves, the provisions and their relationships with Jurisprudence and profit in *Mudarabah* are discussed in his work.¹⁵

In the Kingdom of Bahrain, the 4th conference of the legitimacy bodies for Islamic Financial Institutions (2004), Ahmed presented the advantages of using *Mudarabah* and *Musharakah* as a mode of financing in Islamic banking institutions. Moreover, he discussed some Shari'ah risks in *Mudarabah* and modes of mitigation. However, the risks and modes of mitigation need further classification and studies.¹⁶

A study conducted by Al-Sayfi and Al-Saleem in 2010 discussed the assessment of utilization and profit allocation. In addition, it discussed the parties covered by the contract and showed the effect of Islamic banks business thereon. The study reviews the opinions of contemporary scholars in terms of structuring the agency contract and *Mudarabah* contract. Moreover, the paper discussed the practical structuring of investment deposits.¹⁷

¹⁵ 4th Fiqh Conference for Islamic Finance Institutions, (Kuwait, 21-22/12/2011).

¹⁶ Ahmed Mohiuddin Ahmed, "Application of *Mudarabah* and *Musharakah* Funds in banking", Paper Presented at the 4th Conference of the legitimacy bodies for Islamic Financial Institutions, (Kingdom of Bahrain, 3-4/10/2004).

¹⁷ Abdullah Al-Sayfi and Bader Al-Saleem (2010) "Investment Deposits in Islamic Banks: Assessment Of Utilization and Profit Allocation", A Paper was published in the Journal: Studies, Shari'ah and Law Sciences, vol. 37, Issue 1, (Jordan: University of Jordan).

CHAPTER TWO

MUDARABAH INVESTMENT ACCOUNT

2.1 DEFINITION OF MUDARABAH

Mudarabah is a special kind of partnership, whereby one partner gives money to another for investing it in a commercial enterprise. The investment comes from the first partner who is called “*Rabb-Ul-Mal*” (رب المال), whereas the management and work are an exclusive responsibility of the other, who is called “*Mudarib*” (مضارب).¹

It is a silent partnership contract; the *Rabb-Ul-Mal* gives it to a worker to trade on his behalf, and profits are shared according to an agreement upon formula.²

In Arabic language, *Mudarabah* indicates an arrangement between two parties, whereby the capital of one is given to another for involvement in trade on the agreement that the profit is to be shared between them, or that the latter is entitled to a defined share of the profit.³

In the Islamic legal sense, *Mudarabah* is defined as a contract between two parties, whereby one of them surrenders his capital to the other making the latter its owner for investment in trade by the latter against a defined undivided share in the profit subject to specific conditions. However, the legal meaning is in conformity with the literal meaning, except for the fact that it is restricted by conditions that decide its validity or otherwise in law.⁴

¹ Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, p.47.

² Wahbah Al-Zuhayli, *Islamic Jurisprudence and its Proofs*, vol.1, p.487.

³ Muhammad Bin Makram Ibn Manzur (1414H) *Lisan Al-'Arab*, 3rd edition, (Bayrut: Dar Sader, vol. 1), p.544.

⁴ Abd Al-Rahman Al-Jaziri (1986) *Kitab Al-Fiqh 'Ala Al-Madhahib Al-Arba'ah*, (Bayrut: Dar Al-Fikir, vol.3), p.34.

According to Al-Kasani, the term *Muqaradah* (مقارضة) and *Mu'amalah* (معامله) are used to indicate *Mudarabah* (مضاربة).⁵

According to the definition of Al-Nawawi, *Qirad* (قراض) and *Mudarabah* mean to relinquish a (sum of) capital to another so that the latter may employ it in trading for the profit to be shared.⁶

As discussed above, there are similarities among scholars in defining the meaning of *Mudarabah*. However, as a conclusion, *Mudarabah* is a partnership in profit whereby one party provides capital “*Rabb-Ul-Mal*” and the other party provides labour “*Mudarib*”.

2.2 THE ISLAMIC LEGAL STATUS OF MUDARABAH

Mudarabah contract derives its permissibility from the following:

2.2.1 The Holy Quran

The Holy Quran included a verse of the saying of the Almighty Allah S.W.T “**Others travelling through the land, seeking of Allah’s bounty**”⁷.

يقول تعالى: " وأخرون يضربون في الأرض يبتغون من فضل الله."

This verse is interpreted to mean those who travel for the purpose of trading and seeking permissible income in order to provide for themselves and their families.⁸

Another verse in The Holy Quran is “**And when the prayer is finished, then you may disperse through the land, and seek of the bounty of Allah**”.⁹

⁵ ‘Ala Al-Din Al-Kasani (1986 *Badai’ Al-sana’i Fi Tartib Al-Shara’i*, 2nd edition, (Dar Al- Kutub Al- ‘Ilmiyyah, vol. 6), p.79.

⁶ Abu Zakariyya Yahya Ibn Sharaf Al-Nawawi (1991) *Rawdah Al-Talibin*, 3rd edition, Edit Author by Zuhir Al-Shawish, (Bayrut: Al-Maktab Al-Islami, vol.5), p.117.

⁷ Surah, *Al-Muzammil*, verse: 20.

⁸ Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), *Shari’ah Standards*, p.190.

⁹ Surah, *Al-Jum’ah*, verse:10.

يقول تعالى: "فإذا قضيت الصلاة فانتشروا في الأرض وابتغوا من فضل الله".

2.2.2 The Sunnah of the Prophet Mohammad (P.B.U.H.)

The Sunnah is our sacred tradition. It says that Al-‘Abbas Ibn ‘Abd Al-Muttalib used to pay money for *Mudarabah*. However, he used to stipulate to the *Mudarib* who should not travel by sea, pass by valleys or trade in livestock. Moreover, the *Mudarib* would be liable for any losses if any. These conditions were found before revelation of Prophet Mohammad (P.B.U.H.) and were approved by him.¹⁰

However, Al-Ramli supported that the possibility of the legality of *Mudarabah* is referred to a fact that Prophet Mohammad (P.B.U.H.) used to trade for Khadijah Radia Allahu Anha (R.A.A.) on the basis of *Mudarabah* prior to Islam.¹¹

2.2.3 Ijma’

The Muslim jurists have reached *Ijma’* among them upon conducting *Ijihad* on the permissibility of the *Mudarabah* contract.¹²

Ijma’ of the prophetic companions including ‘Umar, ‘Uthman, ‘Ali, ‘Aishah and ‘Abdullah ibn Mas’ud Radia Allahu Anhum (R.A.A.) had invested property of orphans through *Mudarabah* without any objection being raised by the other companions.¹³ Yet, Al-Sharbini stated that the basis of the legality of *Mudarabah* is *Ijma’* and need *Hajah* (حاجة).¹⁴

¹⁰ Al-Baihaqi, Abu Bakr (2003) *Al-Sunan Al-Kubra*, 3rd edition, Edit by Muhammad Abd Qadir Ata, (Bayrut: Dar Al-Kutub Al-‘Ilmiyyah, vol.6), p. 184.

¹¹ Shams Al-Din Al-Ramli (N.D) *Nihayah Al-Muhtaj*, (Bayrut: Dar Al-Kutub Al-‘Ilmiyyah, vol.5), p.13.

¹² Central Bank Of Malaysia (2009) *Shai’ah Parameter Reference 3: Mudarabah Contract*, p.4.

¹³ Muhammad Abdurrahman Sadique (2009) *Essentials of Musharakah and Mudarabah*, (Malaysia: IIUM press). p.63.

¹⁴ Muhammad Bin Al-Khatib Al-Shirbini (N.D) *Al-Iqna’ Fi Hall Alfaz Abi Shuja’*, (Bayrut: Dar Al-Fikr. vol.2). p.341.