

ACHIEVING GLOBAL SUSTAINABLE ECONOMIC DEVELOPMENT THROUGH MUDARABAH PRODUCTS OF ISLAMIC BANKING AND FINANCE INSTITUTIONS

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Abstract

The best way to acquire wealth and strive for material improvement is through Mudarabah products as one of the Islamic lawful business means. This paper aims to observe the development of Mudarabah products, contract and practice under the Islamic banking institutions. It focuses to re-direct the man's attention towards useful ethical principles of Shariah on business transactions. The paper stresses that Mudarabah products of Islamic banking institutions is a financial intermediate that brings together the providers of capital with the users of the capital in accordance with the principles of Islamic law. Islamic banks are very unique therefore, their activities are regulated by concepts of Shariah. It further explains the system used by Islamic banks in generating liquidity which they use to perform their investment processes through Mudarabah contract which is a profit sharing and loss bearing contract. The paper presents literature on Mudarabah as the products of Islamic banking and finance institutions. The study contributes in uphold integrity among the rabul maal and amil in order to strengthen Mudarabah contract of Islamic banks. The study discovers that with Mudarabah contract, Islamic banks are able to provide necessary financing to support building successful individual and corporate customers, which are the engine of growth and development in many developing and developed countries. It is also sacrifice needed to reduce poverty, restore normalcy in the society and prepare the people for the challenges ahead.

Keywords: Islamic banks, mudarabah products, rabul maal and amil, Shariah principles

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1. Introduction

Mudarabah is a financial intermediate that brings together the providers of capital with the users of the capital in accordance with the principles of Shariah. Mudarabah has been in existence and is as old as Islamic religion itself (Adamu, 2014). It is clear that, inhabitants of the Middle East and the Arabian Peninsula in particular, have for centuries conducted trade and business partnerships which can be traced back to the pre-Islamic times, and in so doing, they followed certain customary commercial practices and traditions, some of which did not have any conflict with the principles of Islam for example Mudarabah partnership (Adeyemo, 2022).

Mudarabah is a unique product of Islamic bank. It was reported that Prophet Muhammad (peace be upon Him) used the Mudarabah contract to trade with Khadijah's capital which involved the Prophet trading to Syria. From the evidence, it appears that, this form of commercial transaction was practiced in pre-Islamic times and continued to be practiced throughout the early centuries of Islamic history, when operating large commercial enterprises under profit and loss sharing principle. As such Shariah is a base of innovation of the new Islamic products where Mudarabah product is included (Adeyemo, 2022).

2. Norms and Ethics of the Islamic Banking System

The businesses of Islamic banks based on the tenets of Shariah. Therefore, it is incumbent upon them to abide by the rules, norms and ethics of Islam in all their activities in business and financial transactions. This is because Shariah has provided many regulations in respect of the freedom to engage in business and financial transactions. The regulations are made up of a number of prohibitions, ethics and norms. It is only through Shariah compliance that the system can ensure sustainable basis and fairness to the investors, the banks and the customers of the bank (Ayub, 2007). On this premise, Islamic banks, through the principles of Shariah governance, ensure compliance with the Shariah tenets as regards the prohibition of certain practices. Among the practices are interest (*riba*), uncertainty (*gharar*) and gambling (*maisir*) (Obaidullahi, 2005).

Though *Riba* simply means interest, is the amount paid by the borrower to the lender as compensation for the latter's parting with his money for the duration of the loan (Nasiru, 2014). Furthermore, it is also the premium, regardless of how small or large, which must be paid by a borrower above the principal borrowed from the lender as a condition attached to the loans, regardless of their purpose (Menan, 2016).

The basic Shariah norms on the general operations in Islamic banking system cover the avoidance of interest (*riba*) as Allah forbids it. Allah says that "... whereas Allah has permitted trading and forbidden *riba* (usury)..." Allah says in Suratul Baqarah (Al-Quran 2:275). The significance of this is that it is forbidden for any Islamic bank to act as a creditor and make any increase simply because the debtor becomes insolvent and is eventually unable to settle the debt (El-Gamal, 2003).

Riba is prohibited both in forms of payment and receipt and it is considered to be a sin under Shariah (Adeyemo, 2022).

The prohibition of riba as spelled out in the *Quran* is a command from Allah to establish an Islamic economic system that would be devoid of all forms of injustice or exploitation as Allah says: “O you who believe! Eat not Riba (usury) doubled and multiplied, but fear Allah that you may be successful” (Al-Quran. Al-Imran 3:130). It is tantamount to error to be taking money as synonymous with capital. However, the former can only be a potential capital, when it requires the service of the entrepreneur to transform it into an actual productive use (Zulikfli, 2012).

In addition to the position of Shariah on the prohibition of riba, certain International Instruments concerned with the provision and protection of the so-called modern human rights are not silent on the issue. For instance, Article 21(3) of the American Convention on Human Right, 1969 provides: “Usury and any other form of exploitation of man by man shall be prohibited by law” (Adeyemo, 2022). Apart from the prohibition of riba, Islamic banking institutions do not allow any transaction that contradicts the principles of Shariah. The target here is to protect the parties involved in the particular transaction and the entire Muslim community at large (Obaidullahi, 2005).

The rules of Shariah emphasize equal bargaining power as against unequal bargaining power (Menan, 2016). Islamic banks comply with the prohibition of riba. They must therefore completely eradicate, keep away from and not brook any dealings and transactions that are characterized by any element of *riba*. Islamic banks must not allow riba to appear in their general operations and also in the course of providing services and products to the public (Abikan, 2012). Similarly, the banks must not structure any of their products in such a manner that will give room for any element of interest practices (Oladimeji, 2016).

2.1 Prohibition of Gharar (Uncertainty)

Islamic banking institutions stress the prohibition of any transaction involving risk (gharar) (Zulikfli, 2012). The term Gharar refers to uncertainty or hazard caused as a result of absence of clarity in respect of the subject-matter of the contract- the price of the contract or in respect of the delivery of the quality of the subject-matter (Ayub, 2007). The insistence is also for the benefit of the buyer to make sure that what he is purchasing is in tandem with the required standard. Hence, whether or not the goods are of good quality must be within the knowledge of the buyer before the contract is concluded (Obaidullahi, 2005).

The terms “uncertainty” and “risk” are, therefore, central to all the meanings attached to the concept of gharar by the Muslim jurists. That is to say that “uncertainty” and “risk” cannot be completely removed in any business transaction. This is so because one of the fundamental features of business is risk taking to the extent that is rabal maal exposes his capital to business risk and normal uncertainties with the hope that the final outcome will be beneficial to himself and mudarib (Ahmed, 2014). The fundamental thing is for the Islamic financial

institution to furnish its client with sufficient value and relevant information, try to avoid any information that may mislead or deceive the client, and to maintain certainty in respect of the subject-matter of the contract, time of delivery, delivery date, time and place, if the transaction involve Istisna' contract.

In fact, risk taking is a *sine qua non* for the entitlement to profit. Based on this, the jurists have divided gharar into Gharar-e-Kathir and Gharar Qalil, which mean too much and nominal uncertainty respectively; and that a particular transaction can only be declared invalid when its undertaking involves too much or excessive uncertainty (Obaidullahi, 2005). Non-excessive and minor gharar is tolerable in many contracts. Any commercial business in Islamic bank under minor gharar must be simple and trivial, and must not bring any kind of uncertainty into the contract. Such business also affects the ancillary or appendages of the contract and not the principal or the main essence of the business. The requirement of Islamic Bank is to avoid uncertainty gharar in business and transactions is only secured when the bank makes the other contracting parties to have the perfect knowledge of the counter values intended to be exchanged.

2.3 Prohibition of Maisir or Qimar (Games of Chance)

The requisite of justice and fair play in Islamic banking institutions extend to the prohibition of games of chance (Maisir). The games of chance involve any type of transaction where one party to the transaction only gains while the other party loses. It is forbidden by Shariah because there is no counterpart of an exchange of commodity as where one party exchanges its asset for its counter value in the form of cash or its equivalence (Balala, 2018). Therefore, all forms of gambling like lotteries, all schemes based on luck, dicing, betting and draws come under the categories of games of chance and are all forbidden outright in Islamic law (Al-Quran. Al-Imran 3: 90). It is outlawed by Shariah for the Islamic banks to structure any product which allows a participating customer to enjoy or acquire any benefit or gain at the expense of the other participating customers. Similarly, Islamic banks are banned by Shariah from financing such activity (Nasiru & Mansur, 2015).

3. Principles of Islamic Banking Institutions

The principles of Islamic banking institutions are based on set up of concepts linked to Shariah, ethical, moral, social and economic standards, most important of which are; the financial transaction of Islamic banks should be the one permitted under Shariah, if not it is null and void (Abikan, 2012).

The banks are not allowed to trade in (haram) prohibited products and services that against the principles of Islamic law. Such as investing in the company producing alcoholic substance. or involving in distributing or promoting the alcoholic substances products (Adeyemo, 2022).

The bank should be adopted of the risk-sharing principle in contracts for the sales and sharing of profits and losses in Mudarabah contracts and other Islamic banking products (Nasiru & Mansur, 2015). The seller is prohibited of selling the

commodities that is not actually acquired except only on the exceptional cases such as Bai' salaam and Istisna'.

4.1. Islamic Banking Products and Services

Muslim jurists came up with some alternative products that Islamic banks may offer to their customers, in order to run away from any transaction that contravenes the Shariah standards. The alternative products gained the support from the Qur'an and the Sunnah of the prophet and other sources (Adeyemo, 2022). Such products include Mudarabah, Musharakah, Murabahah, Ijarah etc. However, all Islamic business arrangements where two or more people will pool their resources together by way of money or money worth or skill, entrepreneurship or trustworthiness fall under Mudarabah and Musharakah (Musa, 2014).

4. 2. Mudarabah

This is a kind of partnership where one partner gives money to another for investing in a commercial enterprise. The investment comes from the first partner who is called "Rab-ul-Maal" while the management and work is an exclusive responsibility of the other, who is called "Mudarib" and the profits generated are shared in a predetermined ratio. Mudarabah is also known as "Qirad" or "Muqarada". The words are derived from the Arabic word alqard and the financier is called "muqarid". Meanwhile, the word Qirad or Muqarada means 'splitting' or 'cutting off'. Splitting or cutting off here is in the sense that the rabbul mal cuts off some of his property to be invested in lieu of a defined share of the profit on one hand, and on the other, the amil cuts off some of the profit he may procure from his investment to the Rabul mal (Ayub, 2005).

4. 3. Types of Mudarabah

There are two (2) types of Mudarabah namely:

1) Al Mudarabah Al Muqayyadah (Restricted Mudarabah)

The Rab-ul-Maal may specify a particular business or a particular place for the mudarib to carry out the business, in which case, he shall invest the money in that particular business or place. This is called "Al Mudarabah Al Muqayyadah" (Restricted Mudarabah).

2) Al Mudarabah Al Mutlaqah (Unrestricted Mudaraba)

However, if Rab-ul-maal gives full freedom to the Mudarib to undertake whatever business he deems fit; this is called "Al Mudarabah Al Mutlaqah" (Unrestricted Mudarabah). However, the Mudarib cannot, without the consent of Rab-ul-Maal, lend money to anyone (Abu Ghuddah, 2009). The Mudarib is authorized to do anything which is normally done in the course of business. However, if Mudarib wants to have extraordinary work, which is beyond the normal routine of the traders, he cannot do so without express permission of Rab-ul-Maal. He is also not authorized to:

a) Appoint another Mudarib or a partner

b) Mix his own investment in that particular Mudarabah without the consent of the Rab-ul Maal.

All conditions of offer and acceptance are applicable to both the parties. The Rab-ul-Maal can execute a Mudarabah contract with more than one person through a single transaction. This means that the Rab -ul- Maal can offer his money to 'A' and 'B' both, so that each one of them can act for him as Mudarib and the capital of the Mudarabah shall be utilized by both of them jointly.

4.4 Mudarabah Investment

Rab-ul-maal provides the capital investment and the Mudarib looks after the management. Therefore, Rab-ul-maal should hand over the agreed investment to the Mudarib and leaves everything to the Mudarib with no interference from his side, but he may:

a) Oversee the Mudarib's activities and

b) Work with the Mudarib if the Mudarib consents (Abu Ghuddah, 2009).

4.5 The Capital of Mudarabah

The capital of the Mudarabah can be cash, non-liquid assets like equipment, land are also accepted according to Hanafi fiqh should be in liquid form. But, according to other scholars, equipment and land etc. can also be included as capital Investment. The basic principle is that the capital in Mudarabah is valid just the way it is in Shirkah, which. However, all the scholars are unanimous on the following:

“Assets other than cash can be used as an intermediate step. However, this is subject to the determination of the exact value of the assets before they are used for Mudarabah. If the assets are not correctly evaluated, the Mudarabah is not valid” (Adeyemo, 2022).

4.6 Mudarabah Product of Islamic Banks

Mudarabah is regarded as a very significant mode of Islamic financial investment under Islamic banking and finance. It usually applies to an investment that involves the Islamic bank and another partner. The Islamic bank can take the position of mudarib, rabbul mal, or muqarib by providing the capital to the Amil for the execution of investment, while the latter manages the investment. The profit realized, if any, will be shared between the bank and Amil on the bases of the earlier mutually agreed percentage. In case there is a loss, the Islamic bank bears all the liabilities. Alternatively, the bank can take the position of Amil (investor) while the other partner will finance the investment, and the profit realized from the investment is shared between the bank as the Amil and the Rabbul-mal on the agreed sharing percentage. In this regard, Rabbul-mal (the owner of the capital) will bear any loss incurred instead of the bank that only serves as the Amil.

4.7 Mudarabah Expenses

The Mudarib shares profit of the Mudarabah as per the agreed rate with the Rab-ul-Maal, but his expenses like meals, clothing, conveyance and medical are not borne

by Mudarabah. However, if he is traveling on a business trip and is overstaying the night, then the aforementioned expenses shall be covered from the capital of Mudarabah. If the Mudarib goes for a journey which constitutes Safar-e-Sharai (more than 48 miles), but does not overstay the night, his expenses will not be borne by Mudarabah (Amin et al, 2009).

All expenses which are incidental to the Mudarabah's function like wages of employees/workers or commissions in buying/selling etc have to be paid by the Mudarabah. However, all the expenses can be included in the cost of commodities which the Mudarib sells in the market. For example, if the Mudarib is selling ready-made garments then the stitching, dyeing, washing expenses etc. can be included by the Mudarib in the total cost of the garments (Dogarawa, 2013). If the Mudarib manages the Mudarabah within his city, he will not be allowed any expenses, but only his due profit share. Similarly, if he keeps an employee, this employee will not be allowed any expenses, but his salary.

If the Mudarabah agreement becomes invalid (Fasid) due to any reason, the Mudarib's status will be that of an employee, meaning:

- a) Whether he is traveling or doing business in his city, he will not be entitled to any expenses such as meal, conveyance, clothing, medicine etc.
- b) He will not be sharing any profit and will just get Ujrat-e-Misl (prevalent remuneration) for his job (Dogarawa, 2013).

4.8 Distribution of Profit & Loss

It is necessary for the validity of Mudarabah that the contracting parties agree, right at the beginning, on a definite proportion of the actual profit to which each one of them is entitled. The Shariah has prescribed no particular proportion; rather it has been left to the partners' mutual consent (Obaidullahi, 2005).

They can share the profit in equal proportions and they can also allocate different proportions for the Rab-ul- Maal and Mudarib. However, in such cases where the parties have not predetermined the ratio of profit, the profit will be shared at the ratio of 50:50 (Adeyemo, 2022)

The Mudarib and the Rab-ul-Maal cannot allocate a lump sum amount of profit for any party nor can they determine the share of any party at a specific rate tied up with the capital. For example, if the capital is Rs. 100,000/-, they cannot agree on a condition that Rs.10,000/- out of the profit will be the share of the Mudarib, nor can they say that 20% of the capital will be given to the Rab-ul- Maal. However, they can agree that 40% of the actual profit will go to the Mudarib and 60% to the Rab-ul-Maal or vice versa.

It is also allowed that different proportions could be agreed for different situations. For example, the Rab-ul-Maal can say to the Mudarib "If you trade in wheat, you will get 50% of the profit and if you trade in flour, you will have 33% of the profit". Similarly, he can say "If you do the business in your own town, you will be entitled

to 30% of the profit and if you do it in another town, your profit share will be 50%". (Adeyemo, 2022).

Apart from the agreed proportion of the profit (as determined in the above-mentioned manner), the Mudarib cannot claim any periodical salary or a fee or remuneration for the work done by him for the Mudarabah (Ogunbado & Umar, 2015). All schools of Islamic schools are unanimous on this point. However, Imam Ahmad has allowed for the Mudarib to draw his daily expenses for food only from the Mudarabah Account. The Hanafi jurists restrict this right of the Mudarib only to a situation where the Mudarib is on a business trip outside his own city. In this case, he can claim his personal expenses for accommodation and food, etc. but he is not entitled to get anything as daily allowances when he is in his own city (Amin *et al*, 2009).

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

The Mudarabah becomes void (Fasid) if the profit is fixed in any way. In this case, the entire amount (Profit + Capital) will be the Rab-ul-Maal's. The Mudarib will just be an employee earning Ujrat-e- Misl (market equivalent salary/wages). The remaining amount will be called Profit. This profit will be shared in the agreed ratio.

4.9 Roles of the Mudarib

Ameen (Trustee): Responsible for safeguarding the investments, except in the case of natural calamities.

Wakeel (Agent): To make purchases from the funds provided by the Rab-ul-Maal.

Shareek (Partner): Sharing in any profit from the business.

Dhamin (Liable): To provide for the loss suffered by the Mudarabah due to any act of negligence on his part.

Ajeer (Employee): When the Mudarabah is Fasid for some reasons, the Mudarib is entitled to only the salary, Ujrat-e-Misl (Aznan, 2011).

4.10 Termination of Mudarabah

The Mudarabah will stand terminated when the period specified in the contract expires. It can also be terminated any time by either of the two parties by giving notice. In case the Rab-ul-Maal has terminated the services of the Mudarib, the latter continues to act as Mudarib until he is informed of the termination and all his previous acts will remain a part of the Mudarabah (Asutay & Harningtyas, 2015).

If all assets of the Mudarabah are in cash form at the time of termination, and some profit has been earned on the principal amount, it shall be distributed between the parties according to the pre-agreed ratio. However, if the assets of the Mudarabah are not in cash form, they will then be sold and liquidated so that the actual profit may be determined (Aznan, 2011).

All loans and payables of the Mudarabah will be recovered. Before termination the provisional profit earned by the Mudarib and the Rab-ul-Maal will also be taken into account and when the total capital is drawn, the principal amount invested by the Rab-ul-Maal will be given to him and the balance will be called profit which will be distributed between the Mudarib and the Rab-ul-Maal at the agreed ratio. If no balance is left, then the Mudarib will not get anything. If the principal amount is not recovered fully, then the profit shared by the Mudarib and the Rab-ul-Maal during the term of the Mudarabah will be withdrawn to pay the principal amount to the Rab-ul-Maal. The balance will be profit, which will be distributed between the Mudarib and the Rab-ul-Maal. In this case, if no balance is left, the Mudarib will not get anything (Zulikfli, 2012).

5. Recommendations

Mudarabah products of Islamic banks service as one of the basic of source of revenue for the Islamic banks, customers of the banks and community. Presently, both the investors and individual want to associated with profitable investment. It is also noted that both government and individuals shifted their focus from haram to halal products which has been approved by Shariah. Mudarabah products and investment can be depending upon to boast the business of the both the bank, customers and the government. Many countries have joined and operating Islamic banking system in which Mudarabah has popular to be part of their products and services because of its uniqueness in the Islamic banking services. It is hoping that if the bankers, financial brokers, an individual invest their money through Mudarabah products both the parties will be benefited.

The bank management should develop more investment products that the customers can have access to improve their businesses. There should be an increased public enlightenment on the various products of the bank, the benefits of the products and also its preferences above conventional bank's products. However, many corporate and individual will be interested in knowing sustainability of the products and available facility they can access in Islamic bank.

Since the products and services of Mudarabah of the Islamic banks are meant for sharing the profit and loss instead of depending on lending and borrowing. There is no denying the fact that the main factors responsible for the wide range of acceptability and vigorous patronage of Islamic banks' products and services are the absence of interest (*riba*), gambling (*maysir*) and uncertainty (*gharar*), and adherence to the Islamic ethico-legal guidelines.

6. Conclusion

It is strongly believed that if the recommendations are considered and adopted by the relevant authorities, customers and investors, the integrity of the Islamic banking institutions will be enhanced, and the sector will be making significant contributions to economic global sustainability and productivity. This in, addition, will enhance the attraction of foreign developed countries investors to invest in the

developing countries, with the potentialities of increasing job creation and societal satisfaction in that regard.

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