Master 1: Islamic Finance and Banking

The Sixth lecture

1. Text:

- Read the text and do the following activities:

❖ Musharakah Meaning

Musharakah refers to a type of Islamic banking where two or more partners contribute their labor or capital to a business to share the profit in a pre-decided ratio and bear the losses as per the share of their contribution. Therefore, the purpose is to promote participants' cooperation, risk-sharing and ethical business practices.

All the partners can participate in the business's management, but it is not mandatory. Musharakah is used for long-term financing, making working with a loan easy due to the absence of interest. Furthermore, it is not legally binding, so any partner can quit the agreement. Moreover, it is based on equity, sharing, and cooperation principles

❖ How Does Musharakah Work؟

Musharakah is an arrangement in Islamic finance where the profits and losses are shared. The word means sharing in Arabic, and its concept is used as a framework of partnership between two or more individuals in a business. Under this method of financing, partners get profits as per their share of investment and share the loss equally occurring in the company. Islamic economists and jurists widely advocate and accept musharakah as the best Islamic financing because it avoids interest-based banking and abides by the shariah law.

❖ Types of Musharakah

There are different types of Musharakah in Islamic finance. Here are three common types .:

1. **Shirkah Al-Milk Or Partnership In Joint Ownership**: It relates to shared ownership of a property or asset between more than two persons.
2. **Shirkah Al-Aqd Or Contractual Partnership**: It means a type of mutual contract leading to a partnership between more than two persons for business-related financing. They are further divided into three types:

- **Shirkat-ul-amwal or contractual partnership**: It is the most common form of shirk, which partners use to invest jointly in a commercial project.
- **Shirkat-ul-A'mal or liability partnership**: It refers offering of services to customers jointly by the partners at specific fees from the customers. Hence, the partners distribute the total costs collected among themselves.
- **Shirkat-ul-wujooh or vocational partnership**: It is based on the goodwill of partners. Here partners invest their goodwill and not through any capital. As a result, they equally share the profit between themselves.

3. **Permanent Musharakah**: Under this type of Islamic financing, Islamic banks participating in a project's equity get their share of the profit on a pro-rata basis. Moreover, it goes on for a long time till the partners want it. Therefore, it is suitable for long-term financing of projects having long gestation periods.
4. **Diminishing Musharakah**: Although it resembles permanent musharakah, Islamic banks' equity in a project progressively decreases until the ownership of the asset transfers to the partner owners. Here the investor bank gets dividends over their equity in the project while the investor keeps purchasing a small part of the asset. As a result, the project progressively reduces the bank's equity to zero, rendering the bank a non-partner in the project.