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MA'AM FAKHRA MUBARAK

SUBJECT # LAW OF BUSINESS ORGANIZATION

Definition of *mudarabah*

INTRODUCTION

Literally, the word *mudarabah* is derived from the Arabic "*daraba*" which means travelling for business. Technically, *mudarabah* is a type of partnership where one party provides capital and the other party provides labour and management skills. So, there are two parties: capital provider and manager. The one who provides capital is called "*Rabbul Mal*" / Capital provider. And the working partner is called "*Mudarib*" or Manager. The practice of *mudarabah* was common in the Arab society before the advent of Islam. The Prophet Muhammad (peace be upon him) himself entered into a *Mudarabah* contract with Khadijah (May Allah be pleased with her) in pre-Islamic period.

DEFINITION

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

- It is a kind of partnership, wherein one party provides finance to the other, having skill, to carry out any business.
- The party which provides the finance is called the "*Rabb-ul-Mal*" (the Investor), whereas the other party who puts its management skills and efforts for the Mudaraba is called the "*Modarib*" (the Manager)

Mudarabah Example:

In Mudarabah, the profit distribution must be pre-determined by both the parties and will be solely dependent on the profit accrued, which is independent of the capital invested in the commercial entity. The Shariah law does not indicate the percentage distribution of profit and will be at the discretion of both parties. Either party, in accordance with the terms and conditions given, can terminate a Mudarabah contract at any time.

Business Model of Mudarabah

- The Mudarabas are allowed to offer any financial product or conduct any business based on Islamic concept provided it is Shariah compliant and approved by the Religious Board.
- Mudarabas can invest in stock markets, trading of halal commodities, project financing activities etc.
- The Mudaraba can raise funds in the form of Certificates of Mudaraba and Certificate of Musharaka. Mudarabas can also issue Sukuk and Musharaka based TFCs.
- Prospectus of the Mudaraba should be approved by the Registrar Mudaraba, Securities and Exchange Commission of Pakistan, after obtaining a certificate from the Religious Board to the business of the Mudaraba.
- Mudaraba certificates shall be listed on the stock exchange for trading purpose.

Classification of *mudarabah* contract from the perspective of work limitations

The *mudarabah* contract can be divided into two categories from the perspective of work limitations: unrestricted and restricted.

Unrestricted *mudarabah* (*Al-Mudarabah al-Mutlaqah*)

It is a form of *mudarabah* contract where the capital provider doesn't restrict manager and give him full freedom in terms of capital administration. In this case, the manager has no restriction in business type or location etc. He has a luxury to invest the money and do whatever he wants based on his expertise and experience. In other words, he is authorized to do anything which is done in normal course of business. But if he wants to do some extraordinary activity which is not in the normal routine of traders, then he has

to get prior permission from capital provider.

Unrestrictive Mudarabahs mean that the investor has granted the working partner the left to undertake any lawful investment. The working partner has the left to invest in any suitable investment that is reasonably expected to yield profits. It is the responsibility of the working partner to avoid unlawful and high-risk investments, and the working partner is liable for any losses suffered from such investments

Restricted mudarabah (Al-Mudarabah al-Muqayyadah)

It is a form of *mudarabah* contract where the capital provider restricts manager to a particular type of business or to a particular location. In this case, the manager has to work or invest capital within the given boundaries. The capital provider has a right to put any condition which he thinks appropriate as long as that would not constrain manager from his basic operations.

Restrictive Mudarabah means that the investor has specified investment details in the Mudarabah contract and has restricted the working partner within the scope of such specifications. Due care and precaution must be taken by the working partner to honor the restrictions imposed by the investor.

Benefits of Investing in Modaraba

Following are the advantages of Modaraba:

1. Halal Business

Modaraba is the business model in the financial sector which is based on true Islamic practices duly scrutinized and approved by the members of the Religious Board appointed by the Federal Government. It provides profitable investment opportunities to the stakeholders who are looking for Halal profits on their investments according to Islamic Shariah.

2. Diversified Business

The diversity of the Modaraba concept provides a unique universe of business opportunities to the sector, including financing, trading, manufacturing, equipment-rental, participation in property development, project management, portfolio management, imports and exports and distribution business. Such a diverse canvas of activities is not available to any other entity in the Islamic financial regime.

3. Tax Benefit

The income earned by the Modarabas, other than the trading modarabas, is fully exempted from income tax provided they distribute 90% of their profits amongst the certificate holders. For trading modarabas, the maximum tax rate is 25 percent.

4. Maximum Distributuion of Profits

As an investor of a Modaraba one may expect getting maximum dividends as 90% of the income/profits of the Modaraba are distributed to the certificate holders in order to avail the benefit of tax exemption.

5. Funding and Financial Facilities under Shariah Compliant

Funding and financial facilities under the Shariah compliant modes are provided by Modarabas, on the pattern similar to Islamic banks to the clients.