

INCLUSION OF ASSETS AS CAPITAL IN MODARABAH CONTRACT IN PERSPECTIVE OF CLASSICAL MUSLIM JURISTS

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Abstract: During the mediaeval period gold and silver coins were used as a medium of exchange. There was no question of fluctuation in the value of currencies at that time as the intrinsic value of draham and dnanir remains consistent in all places being that they are based on gold and silver metal. The expansion of economic activities and growing business needs not only resulted towards expansion of Modarabah rulings but also expand the nature of capital to be invested as form of investment in Modarabah. The study aims to discuss the nature of capital acceptable to be invested as a form of investment in Modarabah business. Thus it includes the analysis of medieval period of gold and silver coins as well as currency notes, fixed assets/finished consumer products, Debt and deposit and Hawalla (transfer of debt contract) as a form of Modarabah capital.

Keywords: urud (tangible property), draham (silver coins), dananir(gold coins), Modarabah, Abd ar-Rahman bin al Qasim, Fixed assets, Debt and deposit, Hawala.

Introduction

Wealth/Capital is a basic matter of Modarabah contract which must be handed over to the work manager by the owner. The capital may be in form of goods or money. The business manager will not provide any capital in form of money or goods, his contribution will be in form of non-money capital i.e. management skills or expertise to run the venture. In accordance to the conditions, there could be several types of Modarabah. It may be multipurpose or specific purpose, perpetual or for a fixed period, restricted or unrestricted Modarabah. All these classifications are extracted from the traditional text of Fiqh literature. The basic forms of Modarabah are two

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however the nature and conditions of Modarabah contract may classify it into several types. Yet the availability of capital as a condition of Modarabah remains consistent in all the forms of Modarabah. All the forms of investment which are acceptable and known to become the capital in all other forms of partnerships are valid to be invested in Modarabah. The distinguished characteristics of Modarabah capital are categorized as under.

Modarabah capital must be in form of money/currency.

The jurists of all the schools preferred the capital in form of absolute currencies not in form of urud (tangible property). Investment in forms of coins of gold and silver as capital in Modarabah is valid among all the jurists. Allama Shirbini states in this regard¹.

“For the validity of al-qirad it is required, the amount of capital (mal) must be in the form of silver coins (drahim) or gold coins (dananir).”

Whereas Ibn-Qudama states²:

“Jurists are unanimously agreed in accepting darahim and dananir as capital in the contract”

During the mediaeval period the gold and silver coins were used as a medium of exchange. The intrinsic value of draham and dananir remains consistent in all places being that they were based on gold and silver metal. There was no question of fluctuation in the value of currencies at that time. Due to this, it was very simple for investor and agent manager to distinguish the capital and identify the surplus as profit. The consistent value of currencies is of much importance in determining the profit of Modarabah because if there will a fluctuation in the value of capital, it will certainly affect the share of profit for both parties of the Modarabah. For this reason, the jurists are of the view that for the validity of the Modarabah contract the capital is either to be pure gold or silver coins or both gold and silver coins. The usage of gold and silver nuggets, jewelry and debased gold and silver coins are not permitted prior to minting.

Fixed assets or Finished consumer products

Based on the above discussion the capital in form of fixed assets or finished consumer products is not acceptable in Modarabah. In Modarabah contract, the capital may not be merchandise because the fluctuation in the value of Modarabah will affect the share of the investor and the agent manager. The form of investment should have its own intrinsic value that remains

constant as in the case of gold and silver whereas merchandise do not have its own intrinsic value, and their value depends on external factors of demand and supply. Even a Modarabah contract cannot be formed with the tijariyah dirhams. Al-Kasani states³:

“It has been related by Ibn Samaah *سماة* fromm Abu Yusuf in concern to the tijariyah dirhams (commercial dirhams) that Modarabah is not permissible in them, because they have been demonetized and have become more like goods. According to him if it had been declared permissible in them, its permissibility would also have been in Mecca with wheat, because they used to buy with wheat in the same manner others used to do so with copper coins.”

On the basis of this justification, to avoid uncertainty in determining the profit of Modarabah goods or merchandises whatever fungible or no fungible are not accepted as a capital of Modarabah investment and if an investor holds investment in form of finished consumer products and supplies it to agent manager, it will render the Modarabah contract as invalid because unlike gold and silver the price of goods fluctuated normally and ultimately makes the amount of Modarabah profit indefinite. For example at the inception of the contract, the goods were valued at 2 Million rupees. At the end of the Modarabah period the agent manager earns a profit of five hundred thousand. The agent manager wants to return the goods to the investor as the contract period has been ended. Substantially, the prices of the good turns higher that served as capital in the initial investment and now he has to return them as a capital of the investor. The agent manager will obviously in need to use some portion of the profit in returning the goods to the investor. As a result, his share of profit will decrease than he deserved and his work will be turned in vain as the major portion of his profit has been served to cover the investment. In contrast, if the value of goods drops, the agent manager would pay much less money and he would earn profit without really doing anything. For example the goods were valued at Rs. 2 million at the inception of the contract; the agent manager sells them in Rs. 2 million without making any effort. At the time of dissolution of the contract he buys goods from open market in Rs. 1.5 million and thus gains profit at the expense of the investor’s share⁴.

Above discussion reflects two main criteria opted by the classical jurists in concern to accept or reject particular goods or merchandises as modarabah

capital. 1. Constant value of the commodity 2. Legal tendency and function in the society. Commodities like copper coins, un-minted gold (tibr), fulus particularly rejected in applying the second criterion as these commodities keep little or no intrinsic value. Their circulation as medium of exchange is not universal. Upon this it is indicated that modarabah capital may be varied in accordance to the time and place (societies). As there is a possibility in changing the acceptance of a legal tender by a society with the passage of time and does not necessarily bound to be in gold and silver coins. Due to this manifest classical jurists in Mecca and Bukhara used to accept eatables and wheat/barley as capital in Modarabah because people of those cities habitually used these commodities as a medium of exchange.⁵

For the formation of Modarabah contract describing the ineligibility of goods and services Kasani says⁶:

“At the time of the division of the amount of profit, the Modarabah in form of goods cause to uncertainty. And uncertainty in turn leads to dispute...”

As we have illustrated with the help of an example that uncertainty in recognizing the value of goods, and possible fluctuation in their value may cause dispute and disharmony. There is also a chance of inequitable enrichment of one party at the expense of the other party and thus loss to the other party. In Mudawanna of Maliki this consideration has been argued, Sahnun asks’Abd ar-Rahman bin al Qasim⁷:

“What’s the reason of your disapproval of it? He said: “Considering his danger (the agent’s) possessing the wheat or barley and its value on that day will be one hundred dirhams, and after having trade with it, its value on the day when he is returning it will be one thousand dirhams. Thus his entire profit swallowed up. Or, its value on the day he returns will be one thousand dirhams. His entire profit is there by swallowed up or, its value on the day he returns it may be fifty dirhams and he will have profited from it.”

Thus a closer look on Maliki major works reveals that Malik clearly disallow goods as capital in forming a Modarabah contract.

Malik states⁸:

“Modarabah is valid only if the investment is in the form of cash of either gold or silver. It may not be consisted on goods and merchandise”

However, it is permissible according to Shia Zaidia to accept goods/merchandises as an investment (capital) in Modarabah contract⁹.

Economic needs of society have its worth and value and jurists recognized and addressed it very well. The trick of (Hiyal) legal stratagem may be seen as an example of the response of the classical jurists. Traders generate their profit by purchasing goods at low price in a market and selling them in other market at high price. Thus the difference in prices at both markets results in to profit. But it does not happen always and sometimes traders are found in a position of having a lot of unsold goods. Offently in such a cases traders face a situation when they are not in a position due to several reasons to sell their good by their own and to pursue their business by own. In such a situation an itinerant trader makes it convenient and profitable and a modarabah contract is arranged with him by entrusting unsold goods to the itinerant trader. This could possible only by the legal stratagem that further allowed the agent manager to return the value of the goods instead of actual goods.

Considering the economic need of society when it was argued that in carrying out a long-distance trade the traders are in need of more flexible law according to which goods could be accepted as capital in Modarabah contract. A legal stratagem was proposed to circumvent this prohibition. This legal trick (Hiyal) was approved by all school of thoughts including Malki, Hanafi, Hanbli except to Shafi'i jurists. Shafi'i jurists rejected the legal trick in this regard.

Recognizing the legal stratagem, an investor in order to accommodate a dire need may entrust goods to an agent manager and instruct him to sell them, and use the realized amount of sale as investment in Modarabah. Hanafis consider this form of transaction as a parallel combination of wakalah (agency) and Modarabah contract, where agent manager will be regarded as a representative (wakil) of the investor and after converting goods in cash immediately, he will invest the money in contract of Modarabah as per agreed terms and conditions.

Udovitch regarding this legal trick writes with reference to Khassaf as he suggests¹⁰:

“The investor can sell his goods for cash to a party whom he trusts, then handover the proceeds to the agent who can immediately repurchase them for the commenda.”

Rejection of such a legal stratagem by Shafi’i jurists is on the basis of some technicalities arises due to such arrangements. According to them, exact value of the goods, accepted as a capital in modarabah must be known as modarabah begins once the goods are handed over to the agent manager as capital. They emphasize on the definite value of the goods and in this case neither the Rabbul Mall (investor) knows the exact value of the goods nor it is known by the agent manager as the value of the goods will be known only once these goods are sold in the market. Due to this, modarabah agreement made on the basis of legal stratagem based on unknown value of capital. It contradicts with the fundamental condition of the agreement which requires that capital must be clearly known and identifiable by the parties of the modarabah agreement.

Debt and deposit as a form of Modarabah Capital.

Inclusion of debt and deposit as a modarabah capital has also been discussed by the classical jurists. As it is crystal clear from the earlier discussion that amount of capital must be handed over to Mudarib (Agent Manager) because Modarabah contract becomes effective only when agent manager is entitled to receive and use the capital. This clause provides a total control to agent manager in making business decision. Therefore, it is not permitted to use the debt owed by the mudarib, or by another party. When capital amount is in form of debt owed by the mudarib it cannot be converted into Modarabah capital. It happens when a creditor makes an offer to his debtor to use the debt money in a Modarabah contract and serve as an agent manager (Mudarib). All the classical jurists disapproved this case unanimously because a Modarabah contract cannot be formed by the amount by which mudarib has some liability. So, the origin of the capital absolutely be free of liability. Another reason of this rejection is explicitly offered by the Malikis as a fear of abuse of usurious loan which may happen by the conversion of debt money into Modarabah contract under the cover of false agreement, by which a creditor not only ensure the recovery of debt money but is also entitled to get an illegal return as a form of his share in Modarabah’s profit. There is also a possibility that the debtor (Agent manager) not be able to settle his debt money during the period of

Modarabah contract, thus the failure of a business plan would possibly result to a usurious loan. In this concern it is stated in al-Mudawwanah¹¹:

“[Sahnun] what do you think if I ask someone who owed me money to invest in Modarabah, is it permissible or not? [Ibn al-Qasim] the transaction is not permissible according to Malik. [Sahnun] Why? [Ibn al-Qasim] I am afraid of late payment and increase in debt.”

In concern to it Udovitch writes¹²:

“Maliki law consistently disqualifies any extraneous operations and procedures in the formation of a commenda agreement. Thus it also rules out the conversion of a deposit in to a commenda investment, or the collection of a debt owed to the investor in order to use the collected funds as the basis for a commenda”

Above discussion demonstrates that disapproval of debt money as a form of modaraba capital is because of the consideration of debt money as unsecured asset. It remains unsecured because of the possibility of delay or the unsettlement of debt payment.

Hawalah (Transfer of Debt Contract)

It happens when Investors capital is not in own possession but owed to him by another party or he has deposited with someone. All the jurists permit such a case in Modarabah contract. In real sense, it employs a hybrid arrangements parallel to transfer of debt contract (Hawala) with that of Modarabah. Describing Hawala Ibn Qudamah states an example¹³:

“When an investor says to an agent manager; take the debt which the person owed me and work with it as Modarabah. Then the agent manager took it and worked with it. The act is permissible according to all of the jurists.”

Commenting on the advantages of Hawala and its acceptability by the classical jurists Udovitch writes¹⁴:

“The advantages of such a combination would have been especially important in long distance trade, facilitating the flow of capital and investment. For example, if merchant A is leaving with goods or capital for some distant point at which merchant B has an unpaid debt from C, A can be empowered to collect from C and invest in goods on a commenda basis for the return trip”

The permissibility of Hawala is because of the secured asset of the debt money. The debt money is considered an asset (Account receivables) on the part of the investors who empowered the agent manager to collect the debt money on his behalf and use it as a Modarabah investment. As soon as the agent manager ensures the possession of debt money the contract of Modarabah becomes effective.

Wadi'a

The term wadi'a is used to refer 'deposit'. It is derived from the verb wada'a, expresses the meanings to leave, deposit, lodge¹⁵.

Expressing Wadi'a Encyclopedia of Islam states¹⁶:

“wadi'a (A, pl. *wadā'i*) : in law, the legal contract that regulates depositing an object with another p...”

Thus wadia is a mode used to empower someone in order to keep ones owned property/wealth explicitly and implicitly. Like mudarabah it is classified in two forms wadiah yad amanah (safe custody based on trust) and wadiah yad damanah (Safe custody based on guaranty). Basically wadiah yad amanah (safe custody based on trust) is a trust which is managed by the custodian. On explicit or implicit terms custodian/trustee will be authorized / responsible to keep and manage the wealth / property of the depositor as his own keeping and handling of his own property. Custodian would not be liable for any loss or damage occurred without his negligence. Custodian position is of a 'trustee' and does entitle for any profit from the contract. Explicit permission would be required to utilize the depositor wealth or property. Custodian would be liable to return the wealth or property of the depositor at any time on demand.

Wadiah yad damanah (Safe custody based on guaranty)

Wadiah refers to safe custody whereas damanah refers to guarantee thus it is an arrangement of combinations between wadiah and daman. This form enables the custodian to utilize the deposited money or property as per his own discretion i.e. for trading or as he may deem fit. Thus it gives a right to custodian to gain profit by the utilization of money or property that holds him responsible for any loss or damage. The attachment of guaranteed element with wadiah yad amanah contract modifies its original concept based on trust to “custody based on guarantee”. This element of guarantee

enables financial institutions to utilize the funds based on wadiah at their own risk.

Classical jurists differ in determining the legality of wadiah money to be utilized as capital in Modarabah. Hanafi and Hanabli jurists' permits to utilize wadiah money as capital in Modarabah even they permit its usage without the prior permission of the depositor¹⁷. They treat position of trustee similar to the original owner. However trustee is bound to guarantee the wadiah money. Thus trustee held's liable to return the wadiah money to the original owner irrespective of this trustee earns profit from the investment or suffers loss.

Shafi jurists also agreed on this rule, they just impose an additional condition for the trustee to seek permission of the original owner before utilizing wadiah money as investment in Modarabah¹⁸. Imposition of such a condition is to minimize the possibility of dispute during Modarabah business. Where as Maliki jurists are deny recognizing the acceptability of wadiah money as form of capital in Modarabah. They consider it an extra burden on the trustee especially in a case when loss is suffered by the Modarabah¹⁹.

Conclusion:

Our discussion on the nature of Modarabah Capital concludes that:

1. Modarabah capital should preferably be in the form of legal tender money.
2. The value of assets, in form of goods/merchandise must be clearly determined in terms of money and there should be no uncertainty or ambiguity remains in the value of goods at the time of entering into Modarabah contract.
3. Debt owed by the Mudarib cannot be treated as capital in Modarabah investment.

It is permissible to use the money not in hand of investor but owed to him by another party (Hawala) as an investment in Modarabah contract.

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