

MUDHARABAH FINANCING IN ISLAMIC BANKING

(CASE STUDY OF ISLAMIC BANKS IN INDONESIA)

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A. Foreword

Mudharabah is one of the most widely quoted operating principles in Islamic banking. For Islamic financial institutions, mudharabah is a partnership agreement between at least two parties, that are a lender (*sahib al-mal*) and an agent manager (*mudharib*). This contract has great benefits and play an important role for human life. Mudharabah role in the development of Islamic economics is very important because it can improve the economic welfare of the people by empowering them. Mudharabah also connect the surplus unit who act as financier with the deficit unit who act as the manager. The surplus unit is the parties excess funds but do not have the expertise to develop such funds, while deficit unit is the parties who need funding but has expertise or access to business development.

Mudharabah is not implemented yet optimally in the community because there are several obstacles in implementing it, for that it is necessary to optimize it through education and dissemination to the public of the benefits of mudharabah, improved regulation constantly by the authorities, and participation of any parties, such as financial institutions shari'ah, Shariah Supervisory Board (MUI), academics, and community leaders in an effort to improve the application of mudharabah, both individually and in syariah financial institutions.

B. Partnership contract in Business

Partnership is mutually beneficial cooperation between the two sides to achieve a common goal in the long term. Partnerships in Indonesia community is a matter that is no stranger to be applied, as has been known since centuries - ever though in scale modest. Partnership is not just purposed as a partnership, but the partnership has a pattern and

strategy in realizing the value of an institution's success in implementing modern management.

The partnership agreement is one of the new agreement were not stipulated in the Civil Code. This agreement forms emerged as one of the development of economic activities in the community. The partnership agreement is an agreement which is recognized in Act No. 9 of 1995 on Small Business and Government Regulation No. 44 of 1997 concerning the Partnership. Term partnership agreement comes from the English translation of "contract partner".

Partnership contract also applied in banking products, including the products of Islamic bank financing. One of banking products that implement a partnership is mudharabah financing. Mudharabah financing implemented profit and loss sharing system in financing based on two main reasons: first, the view that the interest¹ on a conventional bank is forbidden (haram) because it belongs to the category of usury that is forbidden in religion; and second, from the economic aspect, the delivery of business risks against one of the parties and it is violated the norms of justice.²

Financing agreement with mudharabah is a fair deal because the position between two parties who perform agreement is equal. This is because:

- a. Both sides have an equal position in determining the ratio of profits
- b. In case of loss, capital providers (*sahib al-mal*) will suffer the loss of money, while mudharib will lose profits, time, and effort
- c. Both sides agree on a balanced agreement that the agreement did not exist things that make the effort to fail.³

The basic philosophy of mudharabah is to bring together capital and labor (skill and entrepreneurs), which is always separated in conventional systems. In mudaraba will be apparent the nature and spirit of togetherness and justice. This is evident through

¹Technically, *riba* refers to "premium" to be paid by the borrower to the lender together with the principal amount of debt as a condition for a loan or extension of the loan period. See Zamir Iqbal and Abbas Mirakhor, *Pengantar Keuangan Islam Teori dan Praktik* (Introduction to Islamic Finance in Theory and Practice), (Jakarta: Kencana, 2008), p. 73.

²Muhammad Syafi'i Antonio, *Bank Syariah dari Teori ke Praktek* (Bank Shariah: From Theory to Practice), (Jakarta: Gema Insani Press, 2002), p. 118

³R.A Evita Isretno, *Pembiayaan Mudharabah dalam Sistem Perbankan Syariah* (Mudharabah Financing in The Islamic Banking System), (Jakarta: Cyntia Press, 2011), p. 71

togetherness bear the risk of losses to the project and share the profits when the economy is booming.

Advantages of financing with profit sharing principle can be stated as follows:

- a. Mudharabah financing will move the real sector due to the financing of productive, ie channeled for investment and working capital needs.
- b. An increase in the percentage of profit sharing financing will encourage the growth of entrepreneurs or investors who are willing to take risky business decisions.
- c. The pattern of mudharabah financing is productive financing patterns that provide added value for the economy and the real sector so that the possibility of a financial crisis can be minimized.
- d. Financing pattern for the results can lead to customer entrepreneurial spirit that can ultimately improve the distribution of income and economic empowerment of the community.⁴

C. *Mudharabah* in *Fiqh* literature

Mudharabah is derived from the word *wazan* on the scales (*wazan*). In the dictionary *Lisan al-'Arab*, said *dharaba* meaningful of *jalada* which means hitting.⁵ In the discourse of economic activity, the word of mudharabah refers to *adh-dharb fi al-ardhi*. According to Ibn Manzur, *dharaba fi al-ardhi* has meaning to search of the gift or sustenance.⁶

Mentioned in the Koran:

وَأَخْرُوجُونَ فِي الْأَرْضِ يَبْتَغُونَ مِنْ فَضْلِ اللَّهِ

It means: "... And another, they are traveling in the land seeking grace of God ...". (Q.S.Al-Muzzammil/73: 20).⁷

⁴*Ibid.*, p. 148.

⁵Ibnu Manzur, *Lisan al-'Arab*, Juz 8, Cet. III (Beirut: Dar Ihya al-Turas al-'Arabiyy, t.t), p. 35.

⁶*Ibid.* Understanding stomp or walk rather is a process of stomping their feet in running the business. See Antonio, Bank Syariah ..., p. 95

⁷Ministry of Religious Affairs, *Alquran dan Terjemahnya* (The Koran and Its Translation), cet. 12th (Bandung: Diponegoro, 2011), p. 575

In jurisprudence, the scholars provide diverse understanding of mudharabah. According to Hanafi, mudharabah is a partnership agreement in profits with a capital from one of the parties and the work (effort) of the other party. According to Maliki, mudharabah is a handover of money in advance by the owners of capital in the amount of money that is determined to someone who will run the business with the money in exchange for a portion of its profits. In view of Imam an-Nawawi (one of Shafi'ites scholar), mudharabah is delivery of a sum of money by the owners of capital to entrepreneurs to run it in a trading business with the advantage of being jointly owned between the two.⁸ In the opinion of the Hanbali, mudharabah is the delivery of an asset in a certain amount to the person working on it to get a certain portion of the profits.⁹

Some definitions described above can be understood globally but less obvious partially. According to Muhammad, Hanafi mention the division of profits but no detailed, Maliki regards mudharabah as surrender of power (tawkil) and not as an equal partner, Shafi'ites and Hanbali's do not mention mudharabah as a contract or tawkil but as giving or delivery in a broad meaning and unattached. Elaboration of profit and loss sharing need to be inserted as an integral part of a good definition, because mudharabah is a partnership activity that does not automatically bring profit.¹⁰ Muhammad offered a definition mudharabah pretty *jami'* and the *mani'*, ie a contract which includes the delivery of capital (or in the same of its meaning) of an owner of capital (*sahib al-mal*) to the manager (*mudharib*) in the number, type, and the specific character to be used in a business with the provision that if these efforts bring results then the result (profit) is shared to both the owner and the manager by the previous agreement while if these efforts do not bring results or bankrupt, the material losses are borne entirely by the capital owners with requirements and certain pillars.¹¹

⁸An-Nawawi, *Raudhatuh al-Thalibin*, Vol. IV, (Beirut: Dar Al-Fikr, t.t), p. 289

⁹Abdurrahman Muhammad bin Qasim al-Asi al-Najdiy, *Hasyiyah al-Raud al-Murbi' Syarh Zad al-Mustaqni'*, (Ttp: tp, 1992), p. 254

¹⁰Muhammad, *Konstruksi Mudharabah dalam Bisnis Syariah: Mudharabah dalam Wacana Fiqh dan Praktik Ekonomi Modern* (Construction Business Mudharabah in Sharia: Mudharabah in Fiqh Discourse and Practice of Modern Economics), (Yogyakarta: Center for the Study of Islamic Economics (PSEI), 2003), p. 56.

¹¹*Ibid.*, p. 57-58

According to Hasan al-Amin, mudharabah is an agreement of two parties, namely one party issuing his asset and other contribute labor and knowledge in a business and profits are shared between them in accordance with the agreement, a half, one third, one fourth, and so on.¹² In the language of Hijaz, mudharabah is also known as qiradh. *Al-qardh* meaningful *al-qat'u* (cut), because the asset owner cut off part of his asset and hand it over to the workers (managers).¹³

D. Mudharabah in the DSN, PBI, and FSA

Mudharabah financing has been stated by the National Sharia Board fatwa No.07/DSN-MUI/IV/2000 on Mudharabah. In addition to the fatwa, Bank Indonesia has made a standard contract of financing in Bank Indonesia Regulation No. 7/46/PBI /2005 on the Agreement of Funding and Financing for Banks Conducting Business Based on Sharia Principles. Furthermore, the Financial Services Authority (FSA), which now oversees financial institutions including Islamic banks also issued Regulation of the Financial Services Authority (FSA) number 31/POJK.05/2014 concerning the Implementation of Sharia Financing.

In Bank Indonesia Regulation No.7/46/PBI/2005, mudharabah is defined as the placement of funds from the financier (*sahib al-mal*) to the fund manager (*mudharib*) to conduct certain business activities, and profit distribution uses the method of profit and loss sharing or revenue sharing method between the two parties based on a ratio agreed in advance.

According to the Regulation of the Financial Services Authority (FSA) No. 31/POJK.05/2014 concerning the Implementation of Sharia Financing mentioned that mudaraba is a business cooperation contract between two parties where the first party (*sahib al-mal*) provides total capital, while the second party (*mudharib*) act as the manager,

¹²Hasan al-Amin, *Al-Mudharabah al-Syar'iyah wa Tatbiqatuha al-Hadisah*, Cet. III (Jeddah: Al-Ma'had al-Islamiy li at-Tanmiyah, 2000), p.19

¹³*Ibid.*

and business profits divided among them in accordance with the agreements between the parties.¹⁴

Mudharabah financing is arranged in Fatwa National Sharia Board (DSN) No. 07/DSN-MUI/IV/2000 on Mudharabah (Qiradh). Provisions stipulated:

First: Financing Terms

1. Mudharabah is financing provided by Sharia Financial Institutions (LKS) to other parties for productive business.
2. In this financing, LKS as *sahib al-mal* (the owner of the funds) finance 100% of the venture, while employers (customers) as mudharib.
3. Duration of business, procedures for refund, and the distribution of profit is determined based on the agreement of both parties.
4. Mudharib may perform a wide variety of businesses that have been agreed and in accordance with sharia, and LKS did not participate in business management but has the right for coaching and supervision.
5. The amount of financing must be clearly stated in the form of cash and not receivable.
6. LKS as fund providers bear all the losses due to mudharabah unless mudharib make mistakes intentional, negligent, or violate the agreement.
7. In principle, the mudharabah financing is no guarantees, but in order mudharib not to deviate, LKS can request a guarantee of mudharib or third parties. This guarantee can only be disbursed if mudharib proven violation of the things that have been agreed in contract.
8. Criteria for entrepreneurs, financing procedures, and the profit-sharing mechanism regulated by LKS with regard DSN fatwa.
9. Operating costs charged to mudharib.
10. In terms of financier (LKS) violation of the agreement, mudharib are entitled to compensation for costs incurred.

Second: Pillars and Terms of Financing

1. Providers of funds (*sahib al-mal*) and managers (*mudharib*) must be capable of law.

¹⁴Regulation of the Financial Services Authority (FSA) number 31 / POJK.05 / 2014 concerning the Implementation of Islamic Financing Chapter I on general provisions of Article 1, paragraph 14.

2. Statement of consent and qabul must be declared by the parties to demonstrate their will to hold the contract (*aqd*), with emphasized the following things:
 - a. Offer and acceptance should explicitly indicate the purpose of the contract.
 - b. Offer and acceptance at the time of the contract.
 - c. Contract put in writing, by correspondence or by using means of modern communication.
3. Capital is the amount of money and/or assets that given by fund provider to mudharib for business purposes with the following requirements:
 - a. Capital must be known its quantity and type.
 - b. The capital may take the form of money or goods are assessed. If the item is given in the form of an asset, the asset must be assessed at the time the contract.
 - c. Capital can not be in the form of accounts receivable and it is paid to mudharib both gradual and cash in accordance with the agreement when the contract.
4. Profit of mudharabah is obtained as an excess amount of capital. Terms of profits following must be met:
 - a. Profit should be reserved for both parties and should not be required only for one party.
 - b. The proportional of profit for each party must be known and stated at the time the contract was agreed and should be in the form of presentation (ratio) of profit according to agreement.
 - c. Providers of funds bear all losses resulting from the mudharabah, and managers should not bear the loss resulting from anything other than a deliberate error, omission, or violation of the agreement.
5. The efforts by the manager (*mudharib*) as equalization (*muqabil*) capital provided by the fund provider, must pay attention to the following points:
 - a. Business activities are mudharib exclusive rights without interference provider of fund, but he has the right to conduct surveillance.
 - b. Provider of fund should not restrict efforts of manager that can hinder the achievement of objectives mudharabah, which is profit.

- c. The manager must not violate the Islamic sharia law in his actions related to mudharabah, and must comply with the prevailing custom in this activity.

Third: Some Legal Provision Financing

1. Mudharabah can be limited to a certain period.
2. Contracts may not be linked (*mu'allaq*) with future events that may not necessarily occur.
3. Basically in mudharabah no compensation because mudharabah contract is mandate, except as a result of intentional error, omission, or violation of the agreement.
4. If one party does not fulfill its obligations or there is a dispute between two parties, the settlement through Arbitration Sharia after no agreement is reached by consensus.

E. Distribution of Profits and Losses

Every effort is made to gain a profit, as well as mudharabah. But in mudharabah, there are four conditions required to gain the profit, ie:

1. Special advantage for both parties who work together, they are the owners of capital (investors) and managers of capital. If the profit is required to a third party, for example by stating: 'mudharabah with the distribution of profits for you 1/3, 1/3 for me and 1/3 for my wife or anyone else, it is not legitimate unless otherwise specified third parties participate in managing the capital, so that be qiradh with two people. If it is said: 'half the profits for me and half for you, but half of my share to my wife', then this agreement is valid because it is promise to give his wife a gift.
2. Distribution of profit for both financier and manager and it not be legitimate only for one party. If it is said: 'I work together with you under mudharabah contract and the profit is fully for you' then this is invalid according to Shafi'ites scholars.
3. Profit should be known clearly.
4. In the contract, certain percentage for the owners of capital (investors) and managers is confirmed. So that the profit are evenly divided by the percentage, such as half, a third or a quarter. If the profit is determined by value, for example, it is said we cooperate mudharabah with profit sharing for you one million and the rest for me then this contract is invalid. Similarly, if the percentage is not clear, for

example: part of profit is for you and the other one is for me. This statement is invalid.

Scheme of distribution of profits and losses between the owner and manager of funds should be optimized so that managers are motivated to make the effort or the best act and suppress the occurrence of falsification. Through proper design, the expected profit-sharing scheme can provide optimal utility for fund owners and managers. There are several forms of profit-sharing scheme, namely: profit sharing, gross profit sharing, and revenue sharing. On profit sharing scheme, which serve as the basis for calculation is the profit earned from the financed business. Profit is the difference between the sales/revenues and expenses of business, either in the form of cost of sales/cost of production, cost of sales and general and administrative expenses. For financiers, profit sharing scheme has high-risk, but there is also the possibility of the fund owners can earn revenue for higher yields. For example when the volume and price of sales / revenue rises, raw material prices fell, increase of efficiency and productivity in product yield, and reduction the costs of business.¹⁵

On gross profit sharing, which is used as the basis for calculation is the gross profit, namely the sales/revenue minus cost of goods sold/cost of production. With this scheme, the contracting parties do not face uncertainty in the cost of sales and general and administrative expenses. Therefore, the risks that faced in gross profit sharing scheme are lower when compared to the profit sharing scheme. However, the potential for owners to enjoy a surplus of funds is also lower because they could not enjoy the benefits of the efficiency cost of sales and general and administrative expenses.¹⁶

On the revenue sharing scheme, the sales/revenue is used as the basis for calculating. Thus, the risk faced by the contracting parties is low. The owners of funds just face uncertainty over the high and low sales/revenues and not face uncertainty over the costs of business (cost of sales/cost of production, cost of sales and general and

¹⁵Tarsidin, *Bagi Hasil: Konsep dan Analisis* (Profit Sharing: Concepts and Analysis), (Jakarta: Issuing Faculty of Economics, University of Indonesia, 2010), p. 20-22

¹⁶*Ibid.*

administrative expenses). Among the three schemes, the Islamic banking in Indonesia more use revenue sharing scheme.¹⁷

Gains and losses in financing are regulated in Mudharabah Accounting Standards, SFAS No. 105. In SFAS No. 105 states that:

- 1) In a temporary syirkah that distributed by the owner of the funds recognized as Mudharabah investment upon payment of cash or delivery of non-cash assets to the fund manager.
- 2) Measurement of Mudharabah investments are as follows:
 - a) Mudharabah Investment in the form of cash are measured at the amount given at the time of payment;
 - b) Mudharabah Investment in the form of non-cash assets are measured at fair value of non-cash assets at the time of delivery:
 - (1) If the fair value is lower than its carrying value, recognized as a loss;
 - (2) If the fair value is higher than its carrying value is recognized as a gain deferred and amortized over the term of the contract of Mudharabah.
- 3) If the investment value of mudharabah down before business begins caused of damaged, lost, or other factors not negligence of fund managers, the impairment is recognized as a loss and reduced investment balances mudharabah.
- 4) If some mudharabah investment is lost after the start of business in the absence of negligence or error on the fund manager, the losses calculated when the results.
- 5) Business Mudharabah considered starts since Mudharabah fund or venture capital is received by the fund manager.
- 6) In the Mudharabah investment given in kind (non-cash) and the goods are impaired during or after the goods are used effectively in the activities of mudharabah, then the loss is not directly reduce the amount of investment, but taken into account at the time of the division of the proceeds.
- 7) Failure because errors of fund managers indicated by:
 - a) The requirements specified in the contract are not met;

¹⁷*Ibid.*, p.23

- b) There are no conditions beyond the capabilities of conventional and/or that have been specified in the contract; or
 - c) The results of the decision of the competent institution.
- 8) If the mudharabah contract expires before or when the contract matured and not been paid by the fund manager, the investment mudharabah is recognized as a receivable maturity.

Business income

- 1) If the mudharabah investment exceeds the reporting period, operating income recognized in the period of the rights for the results corresponding to the agreed ratio.
- 2) Losses incurred in a period before the contract of mudharabah ends is recognized as a loss and the allowance for investment losses. At the time of mudharabah contract expires, the difference between:
 - a) Mudharabah investment after minus the allowance for investment losses;
 - b) And mudharabah investment purchases, is recognized as a gain or loss.
- 3) Losses due to negligence or errors of fund manager charged to the fund managers and do not reduce mudharabah investment.
- 4) The results of efforts which have not been paid by the fund manager are recognized as receivable maturity from the fund manager.

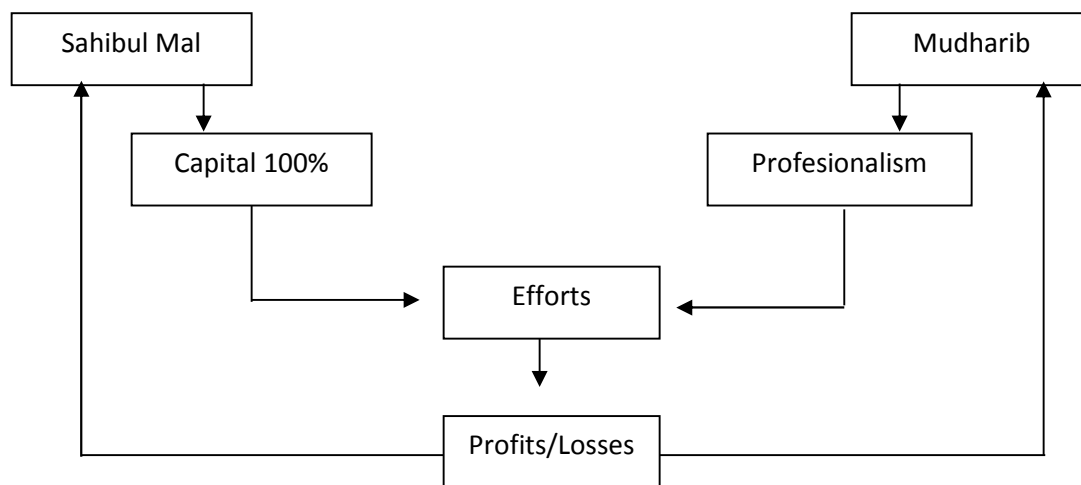
F. Application of Mudharabah in Islamic Financial Institutions and Islamic Business Institutions

In general, the system of mudharabah financing, capital lent by the bank in the efforts to be run by mudharib not given in cash. This is so that the banks can continue to oversee the management of the business. In mudharabah, purchase merchandise has been determined and the direct bank will be able to arrange payment to mudharib. Funds that have been loaned must not be corrupted and may not be used for other purposes. In project management, the bank handed over all the efforts to the debtor (mudharib) with the debtor must be subject to all the requirements specified in the contract.

According to Ali Hasan, banks and entrepreneurs are usually more cautious in carrying out their respective roles. The bank provides funds entirely for the purposes of a project. Entrepreneurs manage the project without the intervention of the bank, but the bank was authorized to oversee the project. The bank and entrepreneurs set together regarding distribution of profits. When there is a loss in the absence of the element of intent or losses that occur beyond human ability, then each party to bear the risk. The bank bears the risk of loss of capital, while the manager to bear the losses in the form of energy, thoughts, time, and managerial skills as well as the loss of profit for the results that should be obtained.¹⁸

Application of mudharabah financing in banking can be seen in the figure below:¹⁹

Figure 1: Schematic of Mudharabah



Schemes above illustrate that cooperation takes place between sahib al-mal and mudharib which sahib al-mal provide 100% capital and mudharib contribute to the professionalism in the business that became the object of mudharabah. From these efforts, either gains or losses divided among them according to mutual agreement. In general, the form of mudharabah is divided into two (2) types, namely mudharabah muthlaqah and mudharabah muqayyadah. Mudharabah muthlaqah or unrestricted investments is

¹⁸Ali Hasan, *Masail Fiqhiyah; Zakat, Pajak Asuransi dan Lembaga Keuangan* (Masail Fiqhiyah; Zakat, Tax Insurance and Financial Institutions), (Jakarta: RajaGrafindo Persada, 1997), p. 53.

¹⁹Sunarto Zulkifli, *Panduan Praktis Transaksi Perbankan Syariah* (Practical Guide to Islamic Banking Transactions), (Jakarta: Zikrul Hakim, 2003), p. 80.

submission of capital to entrepreneurs without special restrictions, such as saying, "I leave this money to you for investment, while profits will be shared between us, each one half or one third, and others." Mudharabah muqayyadah or restricted investment is submission of capital to the entrepreneurs with special restrictions, such as the requirement that employers must trade in Bandung area or must trade shoes, or buy goods from a particular person, etc.²⁰

G. Conclusion

Mudharabah is a partnership contract that can improve the society economy. Mudharabah has the characteristics of a fair, balanced, and emphasis on achievement in the form of work and risk borne. The higher performance of mudharib and the higher risk borne sahib al-mal, the higher the gains to be obtained. However, the application of this agreement on the financing in the bank was minimal because of the risks faced by banks is very large. Given the possibility of return on capital can not be ascertained, as they relate to the success of the project financed. Therefore, optimization of mudharabah financing needed in the financial institution of shariah by anticipating obstacles that exist in this contract.

²⁰Rachmat Syafei, *Fiqih Muamalah* (Bandung: Pustaka Setia, 2001), p. 227.

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