

# ISLAMIC FINANCE FOR MICRO AND MEDIUM ENTERPRISES

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**FINANCING MICRO AND MEDIUM SIZED ENTERPRISES  
THROUGH DECREASING PARTNERSHIP (*MUSHĀRAKAH  
MUTANĀQISAH*): REFINING SHARĪ'AH AND BANKING  
ASPECTS FOR ENHANCED APPLICABILITY**

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**ABSTRACT**

*Decreasing partnership as proposed by contemporary scholars could be effectively employed in financing MMEs, for procurement of assets as well as financing complete ventures. Its significance in financing MMEs could be enhanced through giving further prominence to the basis of equity participation, allowing the ancillary contracts of ijārah and sale to function independently. The paper argues that the reality of the underlying contracts should be effectively highlighted through pricing the units and ijārah rentals realistically, rather than as an apportionment of the profit element calculated on the capital outlay. In financing ventures on decreasing partnership, expenses of the venture should be shared proportionately; profit share of the bank should decline corresponding to the bank's stake, and unit price of the bank's share could be fixed based on a price negotiated at the time or professional valuation. The paper seeks to highlight many other conditions that are often violated in practice but that must be fulfilled in order to ensure full Sharī'ah compliance.*

**1. INTRODUCTION**

Financing micro and medium sized enterprises (MMEs) is a vital area that could be modelled based on equity participation, which could facilitate a more equitable sharing of returns as well as sustaining losses. Due to their inability to provide acceptable collateral and various other reasons, MMEs generally fail in meeting the stringent credit criteria of conventional banks, and rarely qualify for credit lines. Conventional banks consider the viability of the venture mainly for assessing the credit risk, which would determine the nature of collateral and other security to be sought. Conversely, in adopting equity participation as a medium for financing projects, the recovery of the capital along with realising a return is intrinsically related to the success of the venture. Demand for collateral would be practically relevant only in situations where the entrepreneur is liable for losses, due to reasons

such as negligence and fraud. As such, where the viability of the enterprise could be reasonably ascertained, lack of collateral alone need not deter Islamic banks from financing on the basis of equity participation, especially due to the fact that the bank gains ownership to a portion of the business assets, and the possible higher returns realisable as an equity partner.

Despite of an apparent reluctance on the part of Islamic banks to employ equity modes, especially so in the case of MMEs due to the perceived vulnerability and augmented risk, equity arrangements appear best suited for the purpose. In financing MMEs, unilateral funding modes such as *muḍārabah* as well as common equity participation based on *mushārah* could be adopted. However, in ventures of medium and long-term duration, termination of equity partnership cannot be done abruptly, and a gradual withdrawal may become necessary. Decreasing equity partnership (*mushārah mutanāqisah*), a combination mode widely adopted by Islamic banks presently for financing ventures and purchase of high-value assets such as houses, could be an ideal tool for financing MMEs. The possibility of equity participation while ensuring an exit mechanism offered by this structure provides an appropriate platform for the bank's involvement. Financing here could include both founding an enterprise jointly as well as joint purchase of an existing venture, until it gains sufficient financial strength to acquire total ownership. Decreasing partnership could also be employed in procuring assets needed by the enterprise. Thus, factories, buildings, machinery, equipment, tractors, boats, vehicles etc necessary for MMEs could be financed using the structure. However, decreasing partnership structures that are presently adopted could require further refinement and enhancement for achieving optimum performance in MMEs. They could be further upgraded in order to make the procedure more reflective of the basis of equity participation, thus ensuring bilateral justice and boosting the success and growth of MMEs, leading to a win-win situation.

This paper analyses the application of the decreasing partnership format in facilitating procurement of assets and financing complete ventures, and examines the currently adopted structure from an operational and Sharī'ah angle with a view to suggesting possible measures for enhancement in order to realise optimum suitability in a MME environment.

### **1.1. Essentials of Decreasing Partnership**

Prior to analysing aspects particularly relevant to financing MMEs, it is pertinent to examine the nature of decreasing partnership. Diminishing or decreasing partnership is a structure fundamentally based on equity participation that has been proposed for bank financing by a number of contemporary jurists. While some have restricted its use to financing assets such as real estate, others uphold its use in venture capital financing. The primary concept of decreasing

partnership involves the joint purchase of an asset or a venture by two parties, on the assurance given by one of them that the share of the other in the asset or the venture would be purchased by the former in stages. Due to the fact that the share of one party, usually that of the financial institution, declines gradually as a result of the consecutive purchases by the other, this structure has been referred to as *mushārah mutanāqisah* or decreasing partnership. Based on the common ownership of the parties, any revenue through the asset or the venture would be shared between them. When this structure is adopted for procurement and development of assets, the additional feature of *ijārah* is usually seen to be incorporated, however, as an independent contract. The share of one partner, usually that of the Islamic bank, is leased to the other at a fixed rental. With the progressive purchases of the client that result in the decline of the bank's share, the rental too is reduced, based on an undertaking given by the bank to this effect. With the client's purchase of the bank's share completely, the *ijārah* terminates and the relationship comes to an end. The structure differs from other asset financing modes such as *murābahah* due to features such as the co-ownership of the bank in the asset / venture with the resultant right of the bank to claim a proportionate share of any revenue through the asset / venture, and the possible incorporation of the rental element. Several variations to the above process have been suggested, all of which, while agreeing on the initial joint ownership, mainly differ on the process adopted for the gradual secession of one of the parties.<sup>1</sup>

Thus, decreasing partnership, while having an equity relationship as its base, also involves the concurrent application of other relationships such as agency, *ijārah*, sale etc, which, although not forming a condition to the validity of the basic partnership, are crucial ingredients for the viability of this mode, and necessarily adhered to as such. The component contracts, the synchronized application of which gives rise to the multifaceted relationship referred to as decreasing partnership, are recognised in Sharī'ah, on the basis of which advocates argue for the validity of the overall structure.

## **1.2. Basis of Decreasing Partnership**

Some proponents of decreasing partnership have identified the basic contract that forms its core as *shirkah al-'aqd*, on which basis they propose its application in a large variety of projects, extending from financing the purchase of assets such as machinery, factories, and houses to financing large-scale enterprises. Since the

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<sup>1</sup> See AAOIFI, Sharī'a Standards May 2002, p. 214; First Islamic Banking Conference Dubai, 22-24 May 1979, held at Dubai Islamic Bank, *Fatāwā Shar'īyyah fī al-'māl al-Masrafiyyah*, p. 22; Muhsin Ahmad al-Khudayri, *al-Bunūk al-Islāmiyyah*, Al-Qāhirah, Iytrak li al-Nashr, 1995, p. 133; Abd al-Sattār Abū Ghuddah, "al-Mushārahāt al-Mutanāqisah wa Dawābituhā al-Shar'īyyah", in *al-Iqtisād al-Islāmi*, No. 277, Rabī' al-Akhir 1425H, vol. 24, p. 217.



partnership is founded from the inception as a contractual partnership, they see no bar to utilising this structure for all sorts of financing that give rise to revenue.<sup>2</sup> AAOIFI Sharī'ah Standards seems to adopt this position. However, it does not bear any clear reference to utilising decreasing partnership structure in asset purchase.<sup>3</sup> Others have preferred to regard it as a structure based on *shirkah al-milk* when used for the purpose of acquiring assets such as real estate, however, allow its application in financing ventures that are based on assets, with some necessary guidelines to be observed due the structure taking the form of *shirkah al-'aqd* in this instance.<sup>4</sup> Where the relationship is categorised as *shirkah al-milk*, the partners could gain certain additional privileges that allow them to guarantee each other where necessary, and based on it, to pledge to purchase the other's share at a fixed price. Similarly, the partners' liability as well as right to any gain through the jointly held property would necessarily be proportionate to their ownership. However, when the relationship is identified as *shirkah al-'aqd* formed through investment with a view to sharing profits, purchase of the other's share at a fixed price may not be assured, as this would tantamount to guaranteeing a similar amount of the other's capital. The latter is not allowed in *shirkah al-'aqd*, as such an assurance would interfere with the mandatory requirement that liability should be shared strictly on the basis of capital participation.

## 2. DECREASING PARTNERSHIP FOR ASSET PURCHASE

An important area where decreasing partnership could be used in financing MMEs is facilitating the acquirement of assets. Various assets required by MMEs, where Islamic banks would be reluctant in providing debt-based modes such as *murābahah*, could be financed using this structure with a greater level of comfort for both the bank as well as the client partner. This is due to the usual incorporation of the *ijārah* contract that could accommodate delays in meeting periodical payments without loss of revenue for the bank, which would not be possible in fixed price mechanisms such as *murābahah*. This aspect also provides a greater level of ease to the MME partner, as he is granted more freedom in managing liquidity. However, the prevalent decreasing partnership mechanism requires several important adjustments in order to provide such benefits optimally.

### 2.1. Mechanism

Decreasing partnership, when applied in projects that involve the procurement or development of assets, consists of the joint purchase of an asset by the Islamic bank and the client initially. After the joint purchase of the asset, the client is

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<sup>2</sup> Abd al-Sattār Abū Ghuddah above.

<sup>3</sup> AAOIFI, Sharī'ah Standards May 2002, p. 214.

<sup>4</sup> Muhammad Taqī Usmāni, *An Introduction to Islamic Finance*, Karachi, Idaratul Ma'arif, 2000, p. 91.

required to purchase the share of the bank on a staggered basis based on a preceding promise made by the client to the effect, through purchasing a portion at equal intervals until the whole asset is owned by the client. The price of each unit of the bank's share is usually fixed beforehand. If the asset purchased is proposed for utility such as buildings and machinery, the client is allowed to commence using it soon after the joint purchase, where the share of the bank would be leased to him for the purpose, under a separate *ijārah* agreement, at a fixed rental. The share of the bank would successively decrease due to the periodic purchases by the client, as a result of which adjustment to the initial rental becomes necessary. This is achieved by a separate undertaking proffered by the bank that in the event the client purchase the share of the bank in units, the rental would be reduced accordingly, to reflect the reduced ownership of the bank. A rental schedule for the purpose usually accompanies the undertaking. With the purchase of the last unit by the client, the asset becomes wholly owned by him, terminating the *ijārah* contract simultaneously.

## 2.2. Major Shari'ah Issues

As far as creating common ownership over an asset through joint purchase is concerned, this is evidently recognised as valid in all schools of Islamic law.<sup>5</sup> When a partner appoints the other as his agent for the joint purchase of a specific asset, the latter becomes jointly owned by the partners upon purchase. In a jointly owned asset, a co-owner may sell his share or a part of it to the other without any objection.<sup>6</sup> Similarly, a co-owner of an undivided asset could lease his share to the other party under an *ijārah* agreement.<sup>7</sup> These being the basic constituent contracts found in decreasing partnership, when regarded independently, they are not understood to involve any aspect objected to in Shari'ah. Despite of this, various other aspects of Shari'ah relevance are found in the decreasing partnership mechanism as enumerated hereunder, some of which are also common to structures for financing ventures. All of these are pertinent to financing MMEs.

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<sup>5</sup> Shams al-Dīn al-Ramli, *Nihāyah al-Muhtāj*, Bayrūt, Dar al-Kutub al-Ilmiyyah, n.d., vol. 5, p. 8, Muwaffaq al-Dīn Ibn Qudāmah, *al-Mughni*, Bayrūt, Dar al-Fikr, 1992, vol. 5, p. 122, 'Alā al-Dīn al-Kāsāni, *al-Badā'i' al-Sanā'i'*, Bayrūt, Dar al-Ma'rifah, 2000, vol. 6, p. 90.

<sup>6</sup> Muhammad Amīn Ibn 'Ābidīn, *Radd al-Muhtār*, Bayrūt, Dar al-Fikr, 1979, vol. 4, pp. 300 – 304; Abd al-Rahmān al-Jazīri, *Kitab al-Fiqh 'ala al-Madhāhib al-Arba'ah*, Bayrūt, Dar al-Kutub al-Ilmiyyah, 1986, vol. 3, pp. 65, 69. al-Kāsāni, *al-Badā'i' al-Sanā'i'*, vol. 5, p. 168, Sulaymān ibn 'Umar al-Bujayrami, *Hāshiyah al-Bujayrami*, Diyār Bakr Turkiya, al-Makatabah al-Islāmiyyah, vol. 3, p. 107, Muhyī al-Dīn ibn Sharaf al-Nawawi, *al-Majmū'*, Bayrūt, Dar al-Fikr, 1996, vol. 9, p. 273.

<sup>7</sup> *Al-Majallah*, article 429, vol. 1, p. 83, Abū Ishāq ibn Muflih, *al-Mubdi'*, Bayrūt, al-Maktab al-Isāmi, 1400H, vol. 5, p. 79, 'Alī ibn Sulaymān al-Mardāwi, *al-Insāf*, Bayrūt, Dar Ihya al-Turāth al-'Arabi, n.d., vol. 6, p. 33, Mansūr ibn Yūnus al-Bahūti, *Kashshāf al-Qinā'*, Bayrūt, Dar al-Fikr, 1402H, vol. 3, p. 563.

A major Sharī‘ah concern that is not confined to decreasing partnership alone is the level of Sharī‘ah acceptability of amalgamating various contracts together in a single process with the connivance of the contracting parties. Whether contractual promises could be held enforceable, and whether an individual binding promise, offered by the client at the time of finalising the shirkah agreement or the joint purchase that the bank’s share would be purchased by him subsequently, is substantially different from an instance where two transactions are made conditional to each other, too are important Sharī‘ah aspects. Contemporary scholars recognise enforceability of contractual promises in certain situations, and regard that an individual promise that is not related to the text of a contract may not be compared to a condition for the validity of the latter. Therefore, it is necessary that the client’s agreement to purchase the bank’s share in units take the form of a unilateral promise made separately.<sup>8</sup>

In assets such as real estate and vehicles where registration with the relevant authority is mandatory in many jurisdictions, the legal title to the asset is usually transferred from the original owner, i.e. the housing development firm or the vehicle dealer, to the client directly. Thus, from a conventional legal standpoint, the bank’s involvement in the asset is limited to its financial interest, while the legal ownership rests on the client solely. To smoothen the issue from a Sharī‘ah angle, the client is appointed as the bank’s agent to carry out the purchase of the asset and to hold its legal title. Therefore, in spite of having the legal title to the asset, the client is considered the owner of only a part of it initially, i.e. to the extent of his participation in the cost of purchase, and would gain complete ownership only at the end of the tenure.

In order to secure the bank’s interest legally in this instance, a legal mortgage over the whole asset is usually drawn in favour of the bank. This document is not reflective of the true state pertaining to ownership of the asset, as it reflects the position of the bank as that of a mortgagee who is entitled to monetary dues from the mortgagor. Although not appearing on the deed of mortgage, its applicability is considered limited to the share owned by the client, mortgaged in favour of the bank for securing *ijarāh* rentals and actual damages to the bank due to possible non-adherence to the promise to purchase.

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<sup>8</sup> Islamic Fiqh Academy, 5th Session held in Kuwait, December 1988, Resolutions Nos. 40-41 (2/5 & 3/5); Muhammad Taqī Usmani, “al-Turuq al-Mashrū‘ah li al-Tamwīl al-‘Iqārī”, in *Buhūth fī Qadāyah Fiqhiyyah Mu‘āsirah*, Karachi, Maktabah Darul Ulūm, 1996, and *An Introduction to Islamic Finance*, pp. 120-126, 87-89; Wahbah al-Zuhayli, *al-Fiqh al-Islāmi wa Adillatuh*, Bayrūt, Dar al-Fikr, 2000, vol. 4, pp. 2928-2930. Enforceability of promises in the context of murābahah has also been upheld by other bodies such as the Second Conference of Islamic banks held in Kuwait, March 1983.

In the course of the decreasing partnership process, the client is expected to purchase the undivided share of the bank in units, usually at pre-agreed intervals. The purchase of each unit would form a separate transaction that should necessarily fulfil the requirements pertaining to sales. Thus, it is emphasised that the sale here take place through a proper offer and acceptance, accurately describing the nature of the unit purchase and the price, through which the ownership of the unit would transfer to the client.<sup>9</sup> This would allow the reality of the transaction to be manifested duly, in addition to rectifying the approach of the client as well as the bank towards the transaction.

In the event of any reluctance on the part of the client to purchase the units as promised, contemporary scholars regard the bank justified in demanding his performance. In the event of non-compliance, the bank may recover the actual damages suffered due to the client's failure to fulfil his promise. This could provide the bank with the necessary validation for commencing legal procedures for liquidation of the mortgage. However, it is clear that if the mortgage is liquidated, the bank would be justified only in recovering the actual damages suffered due the client's non-purchasing, together with the *ijārah* rentals for the bank's portion of the asset for the period. Any balance remaining of the sale price of the client's share should necessarily be given to him.

It could be seen from the above that obtaining legal title to the property in the name of the client solely, followed by a legal mortgage over the same, amounts to a misrepresentation of the underlying transaction of co-purchase. Registering both the bank and the client as co-owners is not generally favoured due to the involvement of multiple legal costs in transferring the bank's share to the client at the end. The long-term alternative would be to attempt to obtain legal recognition of the promises and other transactional documents executed in Islamic banking operations at least to a limited extent, with exemption from duties and other taxes normally involved.<sup>10</sup> Such a step could facilitate financing MMEs greatly. This could also result in an increased sense of responsibility in both the bank and the clients in carrying out such transactions. It should not be forgotten that irrespective of whether legal recognition is awarded, all transactions carried out by the bank, when found to fulfil the necessary criteria, are valid and enforceable in Shari'ah, and give rise to legal consequences such as transfer of ownership, liability for expenses and right to revenue.

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<sup>9</sup> Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, p. 90.

<sup>10</sup> The issue of double stamp duty had been solved in the context of Islamic mortgages in UK, which could set a precedent for other countries. However, the legal status of Islamic banking transactional documents is yet to be asserted.

### ***Implications of the bank's co-ownership in the asset***

As a result of the joint purchase, responsibilities pertaining to ownership would necessarily be attached to the bank, proportionate to its ownership. Similarly, a proportionate share of any increase or revenue generated by the asset could be claimed by the bank. The latter aspect is discussed below under decreasing partnership in ventures. Consequently, liabilities pertaining to ownership such as major repairs, risk of loss or destruction etc should be shared by the bank proportionately. These liabilities may not be transferred to the client even though the bank's share is leased to him, because they fall on the lessor even in *ijārah*. Minor repairs and upkeep necessary for usage could be assigned to the client as a lessee is required to bear them. Therefore, in spite of any reference to the bank in the legal documents as a mortgagee, liabilities inherent to ownership would necessarily fall on the bank proportionately. Such sharing of liability, if genuinely undertaken, could be a major boost to MMEs, and could serve as a key differentiator between *mushārahah mutanāqisah* and interest based facilities.

On the other hand, due to the fact that decreasing partnership involves co-owning the asset for a relatively long duration, the bank exercising due care in the co-purchase of the asset becomes necessary. Although the client could be made responsible for the selection of the asset, if the latter is unable to provide the usufruct expected there would be no justification for charging *ijārah* rentals. If the client refuses to purchase the bank's share as a result and the asset has to be liquidated, recovery of the bank's capital outlay may prove difficult unless if additional security is available. Even when the asset fetches a higher price, recovery of rentals may not be justified if the asset had been unusable. Thus, co-purchase dictates that these aspects that are necessary features of ownership and *ijārah* be kept in view at the time.

### ***Lease of bank's share to the client***

Decreasing partnership in asset purchases usually involves lease of the bank's share of the asset to the client through an *ijārah* agreement. A separate undertaking to reduce the rental in the event of the client purchasing units of the bank's share is made concurrently by the bank. This undertaking, made unilaterally by the bank without forming part of the *ijārah* agreement or the joint purchase, mentions the reductions in rental that would take place periodically according to the decline in the bank's share, subject to the client's purchase of units. Being separate unrelated transactions carried out individually that are not conditional to each other, these are not understood to impair the validity of the procedure.

If this procedure is held valid, it is necessary to observe Sharī'ah rulings pertaining to the lessor / lessee relationship. Thus, although expenses related to

minor wear and tear could be assigned to the client, major repairs and overhauls would necessarily have to be borne by the bank proportionate to its ownership. This is also necessary for stressing the bank's role as a co-owner and *ijārah* lessor, instead of that of a lender or financial lessor whose interest in the asset is limited to his financial dues. In addition, the danger of *ijārah* rentals being misunderstood as interest on the bank's remaining capital exposure should not be underestimated. To mitigate this possibility, suggestions offered below regarding the pricing of units and rentals as well as the obligation on the client to purchase could be considered.

### ***Fixing unit prices and ijārah rentals***

Subsequent to the bank's becoming a co-owner of the asset in a Sharī'ah perspective through joint purchase, while the bank's share is leased out to the client based on an *ijārah* agreement, at periodic intervals, the bank's share is sold to the client in units. The recovery of the capital involved in the facility along with a profit is realised in the form of sale prices of units and *ijārah* rentals. While the *ijārah* rental for the whole of the bank's share is fixed at the outset to be reduced gradually based on the undertaking to do so, whether the sale price of units could be thus fixed at the inception is a matter of difference among contemporary scholars. Contemporary scholars who regard decreasing partnership to consist of *shirkah al-milk* when utilised for asset purchases, while encouraging the price of units be fixed based on market value, have also allowed prior agreement between the bank and client regarding it.<sup>11</sup> Thus, the promise to purchase offered by the client could indicate the prices to be paid for the units. This is justified based on the fact that the partners here are mere joint owners in an asset, who have not entered into a joint venture for investing their capitals or to realise a gain through the sale of the asset to a third party. As such, the question of a partner guaranteeing the other's capital, which would occur had the partnership been based on *shirkah al-'aqd*, is not relevant here. Others who uphold *shirkah al-'aqd* as the universal basis of the procedure, consider such prior agreement impermissible.<sup>12</sup> This ruling also aims at safeguarding decreasing partnership from becoming a mere interest-based financing transaction in which a client undertakes to pay another party for his finance, in addition to a share in the partnership income.<sup>13</sup>

### ***Issues on fixing unit price and rental***

If the *mushārahah mutanāqisah* structure is to be employed for financing MMEs with any measure of success, an aspect of paramount importance would be the pricing mechanism adopted for fixing unit prices and *ijārah* rental. A

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<sup>11</sup> Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, p. 83.

<sup>12</sup> See section above on basis of decreasing partnership.

<sup>13</sup> AAOIFI, *Sharī'ah Standards* May 2002, p. 225.

drawback that is found in the practical application of the current structure for asset purchases is that the purchase prices of the units and the *ijārah* rentals are not found to have any relationship with the market value of the asset or its utility. The bank's intent is seen limited to recovering its capital together with an amount of return relative to the period of exposure, calculated based on the rate of return applicable to such facilities. Thus, considering the fact that the bank's share is divided into equal units, while the nature of the equity relationship could call for the unit prices to be similar and the rentals to decrease according to consecutive purchases effected by the client reflective of the portion remaining in the ownership of the bank after each purchase, the usual practice of banks is found to be different. The periodical purchase and payment of rental by the client are taken as a single payment, which is usually fixed as a uniform figure throughout the tenure of the facility. The components of unit price and rental comprising each payment are fixed with the aid of discounted cash flow technique, where the unit price is seen to increase while the rental amount diminishes progressively, without much relation to the number of units owned by the bank at each stage. While a perceived benefit here is that the client is required to pay a fixed total sum throughout, this method defeats a proper appreciation of the nature of decreasing partnership to a great extent, in that the client is made to understand from the process that a simple repayment of the bank's capital outlay is effected monthly with a margin of profit. This lack of appreciation is seen to manifest in the reluctance to carry out the offer and acceptance procedure for each unit purchase, as mere payment of the total 'instalment' is considered enough.

Treating the unit price and rental as a single payment could lead to another aspect that downplays the equity relationship. When units are not purchased at intervals as agreed, the terms of the *ijārah* agreement and the undertaking would require that no change take place in the rental. This is because the rental would be subject to adjustment only when the ownership of the bank is reduced due to the purchase of units. At any point of the tenure, if a unit is not purchased at the appointed interval, the share owned by the bank would remain unchanged. Thus, until another unit purchase is effected, the same amount of rental as was due earlier would remain payable periodically. However, if the unit price and the rental are taken as a lump sum payment regardless of its composition, the client could be understood only to have defaulted in meeting an instalment. Due to treating the amount thus as any instalment outstanding through other modes such as *murābahah*, its payment within the tenure could be considered sufficient. Thus, the *ijārah* rental would be taken to reduce automatically irrespective of whether a unit purchase was done at the right time or not. While this could be advantageous to the client, the reality and the significance of the underlying contracts of sale and *ijārah* are brought into question here through their apparent inefficacy.

*Illustration*

The following example could illustrate this point. Let us imagine the joint purchase of a property on decreasing partnership where the client’s purchase of the bank’s share is planned to take place in ten months in ten equal units. The unit price is fixed as P while the monthly rental for each unit is R. The rental due for the whole share of the bank being 10R, at the end of the first month, the total sum payable by the client, for purchase of one unit together with the rental, is (P + 10R). (As explained above, mere payment here would not be sufficient. The purchase should be concluded properly through the exchange of an offer and acceptance. If this is not done, the unit price paid would remain as an advance paid on account for a future purchase.) If a unit was purchased at the end of the first month, the rental is payable at the end of the second month only for nine units. Thus, the sum payable at the end of the second month would be (P + 9R). Let us imagine that the client did not purchase a unit at the end of the second month, i.e. the rental too was not paid, as both are usually paid together. In this instance, the rental would not decrease at the end of the second month, due to the share of the bank remaining the same. Thus, at the end of the third month, if the client were to pay both ‘instalments’ together through the purchase of two units at once, the sums payable would be (P + 9R) + (P + 9R). Thereafter, at the end of the fourth month, the total sum payable would be (P + 7R). A table illustrating an asset divided into ten units with deferment of purchase in the 2<sup>nd</sup>, 7<sup>th</sup> and 8<sup>th</sup> months is given below.

**Table 1. Unit Price and Rental in Decreasing Partnership in the Event of Irregular Payments**

	1 <sup>st</sup> month	2 <sup>nd</sup> month	3 <sup>rd</sup> month	4 <sup>th</sup> month	5 <sup>th</sup> month	6 <sup>th</sup> month	7 <sup>th</sup> month	8 <sup>th</sup> month	9 <sup>th</sup> month	10 <sup>th</sup> month
Units owned by client during month	-	1	1	3	4	5	6	6	6	9
Units owned by bank during month	10	9	9	7	6	5	4	4	4	1
Total rental due at end of month	10R	9R	2(9R)	7R	6R	5R	4R	2(4R)	3(4R)	R
New units purchased at end of month	1	-	2	1	1	1	-	-	3	1
Total Amount paid at end of month	P + 10R	-	2P + 2(9R)	P + 7R	P + 6R	P + 5R	-	-	3P + 3(4R)	P + R

Nevertheless, in the current scenario, when the unit prices and rentals are fixed with the aid of discounted cash flow method where a major part of the initial ‘instalments’ are treated to consist of the profit element, i.e. rental, while the



capital element, i.e. unit price, therein is negligible, it is not seen practicable to alter the rentals only based on unit purchases even when these are delayed, as dictated by the reality of the transaction. This is because, in the case of a non-purchase occurring during the initial months, an unrealistically large amount would be payable as additional rental, as the rental component is substantial during the early period. However, when the rental component is not regarded in its proper perspective and is made payable thus with little consideration for purchase of units or the remaining share of the bank, the function of the basic contracts comprising decreasing partnership could become neglected.

### 2.3. Suggestions for Enhancement

The decreasing partnership mechanism as endorsed by a number of contemporary scholars could be a highly viable tool in facilitating MMEs to procure necessary assets. Its potential in enhancing the revenue of Islamic banks and their depositors through the operation of the *ijārah* is a noteworthy feature that differentiates it from fixed price mechanisms such as *murābahah*. By means of the *ijārah* contract, a great amount of flexibility could be created in the operation, which, in addition to bringing in additional revenue for the bank in an acceptable manner thus compensating for the delay, could provide MMEs with an additional measure of ease in meeting payments. This would facilitate MMEs more freedom in deciding the duration of the bank's involvement in the asset. However, in order to avoid issues such as outlined above and improve efficiency of the mechanism, some suggestions are offered hereunder.

A primary measure needed in this respect is to effectively highlight the reality of the underlying contracts, through pricing the units as well as the rentals more realistically. Unit prices and rentals could be fixed in a manner that is more reflective of the gradual decrease of the bank's share. Adopting the discounted cash flow technique in a direct fashion for this purpose could result in misrepresenting the essence of the structure seriously, while making its application unrealistic in instances of delay in unit purchase. Therefore, it is necessary that the core contracts comprising decreasing partnership be given a higher level of visibility by allowing their smooth operation independently. This is all the more important for avoiding treatment of the structure as an interest-based scheme.

For this purpose, it appears that the purchase of units should be dissociated from payment of *ijārah* rentals, thus thwarting the possibility of misunderstanding the simultaneous payment of both as an 'instalment'. The bank's share could preferably be divided into equal units, priced evenly.<sup>14</sup> The client may be allowed

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<sup>14</sup> As mentioned above, the basis of decreasing partnership in assets, i.e. whether it forms *shirkah al-milk* or *shirkah al-'aqd* would determine pricing of the units largely. See section above on basis of decreasing partnership.

the facility of depositing a portion of the purchase price when convenient, the sale of the unit only taking place when the complete price for a unit is paid. This could be especially welcome in the case of MMEs, where management of cash flow could be a serious issue. The sale, formally finalised through proper offer and acceptance, would result in the transfer of the unit's ownership to the client, while resulting in the reduction of the rental based on the undertaking provided by the bank.

Instead of making the unit purchase mandatory at defined intervals, the procedure could provide more choice to the client on the issue, by allowing him to complete purchase of the bank's share within a defined period. For instance, if the bank's share was divided into thirty-six units, instead of scheduling the purchase to take place in three years, a duration of five years could be allowed for the purpose. The client would be permitted to purchase units during the period whenever his cash position allows him to do so, singly or several units together. The delay in purchase of the units would not create a loss for the bank as rentals would keep accruing for the unpurchased units.

Payment of *ijārah* rentals could be carried out as a process that is separate from that of unit purchases. *Ijārah* rentals should be fixed in a manner that defines the rental for each unit of the bank's share, where an equal amount of rental is fixed for every unit. Thus, the amount of rental to be paid would depend directly on the number of units owned by the bank at the time. If the client puts off purchase of units for several months, the previous rental would remain applicable during period, as the bank's share would remain unreduced. As mentioned before, this would call for the rentals to be fixed in a more realistic and uniform manner than by a direct application of the discounted cash flow method. Thus, the amount of rental on the remaining units throughout the tenure should be priced in such a way that the client could afford to pay additional rentals when postponing the purchase of an instalment becomes necessary, while discouraging undue delay in this regard resulting in the unnecessary prolongation of the *ijārah*. Although a strict application of market rates may not be necessary as this could defeat the purpose of the client in opting for the facility, the rentals should be fixed in a reasonable manner that is reflective of the bank's co-ownership. When the client needs to extend the *ijārah* beyond the stipulated period, this could be accommodated based on the previous rental structure or a new one, as agreed beforehand.

It is clear that when the units are equal and the rental is directly proportionate to the number of units, a higher rental would be payable initially, that would gradually decrease according to the unit purchases effected by the client. Despite of the fact that here the total amount payable by the client differs from month to month, thus resulting in the variation of the total amount payable by the client every month, it may be preferable to adopt this method as it serves the purpose of differentiating decreasing partnership from instalment payments. However, if the

client desires to pay an equal amount monthly, this could be done through fixing the total payable as an equal amount every month, where a part would consist of the complete purchase price of a unit while the balance goes towards settling the rental. It is evident that here the amount paid for rental would not be sufficient for covering the total rental in the initial months, which would be matched by the amount exceeding the rentals towards the end of the tenure. Allowing the client to pay part of the rental in the initial months is preferable to recovering the rental in full from the fixed amount while leaving the unit price incomplete, as the balance in this instance not being sufficient for the purchase of a unit, the client would be obliged to pay additional rental until its purchase through the subsequent payment. It may not be practicable to allow purchase of units on credit.

A necessary practical measure for removing the inherent danger of rentals on units being perceived as interest on capital is to emphasise the co-ownership of the bank in the asset. The contracts of sale, lease as well as the equity relationship could only be held real when the obligations attached to these capacities are effectively discharged. Thus, in each venture financed, ways of strengthening the bank's function in these capacities should be ascertained. It should be noted that as the legal mortgage over the asset could weaken this image through projecting the bank as a lender, an alternative method for asserting the bank's ownership should be explored. As stated earlier, obtaining legal recognition for transactional documents could rectify the situation greatly. Educating clients as well as staff on the concept of decreasing partnership would be essential in the initial stages.

#### ***Allowing client the option to purchase units or continue the lease***

Finally, if the provision that the promise to purchase extended by the client be legally enforceable could be dispensed with, it could result in some additional flexibility in the procedure for MMEs. Instead of the mandatory purchase of the share of the bank, the client could be given the choice to continue the *ijārah* through extending it with the bank's agreement. The objection of making diverse contracts conditional to each other may be substantially eliminated through this measure, thereby making the structure further acceptable from a Sharī'ah perspective. It should be noted that when the promise to purchase is made legally binding, the materialisation of the contract as planned is assured for all intents and purposes. Thus, there remains little more than a dialectical justification for not considering the promise to be a full-fledged contract mutually concluded, as any possibility of a refusal on the bank's part to conclude the contract is only a remote theoretical possibility. This is because the insistence on the legal enforcement of the promise comes from the bank itself. Therefore, although such measures could be adopted with the sanction of Sharī'ah experts where necessary, the delicate reasoning employed in the process should not be lost sight of. Some of the critical

observations made in this regard by analysts seem not to be devoid of merit.<sup>15</sup> Another option that could be availed of is that instead of the client, the bank should provide a promise to the effect that it would sell its share to the client, as has been proposed by some contemporary scholars.<sup>16</sup> It is noteworthy in this regard that the first ruling issued by a body of contemporary scholars on the decreasing partnership structure envisaged that both the client as well as the bank be given the freedom to sell their shares to each other or to outside parties.<sup>17</sup>

If the client were to be given a choice between purchasing the bank's share and continuing the *ijārah*, this could call for several important adjustments. A possibly beneficial measure is that the bank would be required to scrutinise the nature of the asset more thoroughly, in order to verify its worth and suitability for *ijārah*. Although this aspect was incumbent on the bank due to its gaining co-ownership as explained above, the possibility of a long-term *ijārah* would require the bank to be even more earnest in this respect. Another vital requirement in this event is that the *ijārah* rentals be fixed in a realistic manner, rather than as an apportionment of the profit element expected on the capital outlay. In addition, as stated above, such a rental arrangement that is more correlated to the nature of the asset rather than merely to the capital, would enhance the equity aspect of the relationship greatly.

### 3. DECREASING PARTNERSHIP FOR FINANCING VENTURES

Some contemporary scholars hold decreasing partnership the best suited structure for all types of project financing in the modern context.<sup>18</sup> The structure as validated by contemporary scholars could be effectively utilised in financing MMEs, with distinct advantages for both the financier and the entrepreneur. In addition to the prospect of sharing in unlimited profits due to all profits being divided proportionately, if the venture becomes successful, the bank could expect to earn a sizable profit through the sale of its share to the client, as the price for such sales would be based on market value. Being a co-partner who is able to contribute towards the venture, the bank may also consider specialised services it may carry out towards the project, and where worthwhile, hire staff and expertise necessary for the purpose. Thus, major advantages to the bank lie in the possibility

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<sup>15</sup> See Frank E Vogel and Samuel L Hayes III, *Islamic Law and Finance*, p. 126-128. Discussing some examples, the authors maintain that acknowledging future promises as binding risks subverting a basic principle of the Islamic contractual scheme as it has been known upto now, and that this risk persists even if the promise is seen as merely unilateral or is enforced only by damages awards.

<sup>16</sup> Abd al-Sattār Abū Ghuddah, p. 26.

<sup>17</sup> First Conference of Islamic banking held in Dubai, May 1979, Resolution on decreasing partnership structure, in Dubai Islamic Bank, *Fatāwā Shar'iyah fī al-A'māl al-Masrafiyyah*, p. 21.

<sup>18</sup> Abd al-Sattār Abū Ghuddah, p. 24.

of contributing effectively in the management of the venture and monitoring its progress as enabled by the joint equity participation, as well as the ability to carry out a smooth withdrawal while making a gain through both dividends and the sale of its share to the client partner. The MME could benefit through the profit / loss sharing structure that facilitates enhancing the capital base and the cash position without placing an undue burden on the enterprise in the form of interest payments, the expertise and supervision extended by the bank, and the possibility of gradually redeeming total ownership by purchasing the bank's share through profits realised.

### 3.1. Mechanism

The basic ingredients of the decreasing partnership structures advocated by contemporary scholars for financing ventures, for the most part, are found to be similar to those for asset financing. The mechanism here involves joint investment by the bank and the client towards a venture, the share of the bank in which would be later purchased by the client in stages, until the client becomes the sole owner of the project. Although similar in these fundamental ingredients, decreasing partnership for ventures embodies several major differences. Among these is the identity of the partnership, which, as explained before, is based on *shirkah al-'aqd*. As a result, rules pertaining to *shirkah al-'aqd* would become applicable in such ventures. Division of profits realised through the venture could be agreed to take place on a proportion other than that of ownership, based on the position of the Hanafi and Hanbali schools.<sup>19</sup> However, loss would necessarily be divided on the ratio of ownership. In addition, the share of the bank could be sold to the client at a price negotiated by them at the point of sale, if necessary based on a valuation of the business done by a party chosen mutually. Prior agreement regarding the price of the bank's share or indicating the price payable in a promise to purchase / sell provided by either of them is not admissible, in order to avoid guaranteeing the capital of the other party to that extent. Within this broad framework, diverse formats have been proposed by contemporary scholars.<sup>20</sup> Through these structures, financing for a large variety of MMEs of different types and durations could be facilitated.

### 3.2. Major Sharī'ah Issues

While, some of the Sharī'ah issues outlined above under asset financing are also applicable to structures for financing ventures, certain additional issues more pertinent to the latter are delineated hereunder. It could be seen the all of these issues are greatly relevant to financing MMEs, and being aspects that are reflective of equity participation, could play an important role in boosting their success.

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<sup>19</sup> Al-Kāsānī, *Badā'i' al-Sanā'i'*, vol. 6, p. 94, Ibn Qudāmah, *al-Mughni*, vol. 5, p. 140.

<sup>20</sup> See note under asset financing for references.

Although decreasing partnership for ventures involves inception of a partnership for generating income, some scholars have pointed out certain instances where such partnership could be established based on shirkah al-milk. These pertain to joint purchase of assets that provide an income such as purchase of buildings, machinery or vehicles for lease or hire. In such instances, decreasing partnership could be based on shirkah al-milk.<sup>21</sup> As such, the division of revenue should be on the proportion of ownership. Therefore, when the proportion of ownership becomes altered upon the MME partner purchasing a part of the bank's share, the ratio or profit division too would change accordingly. With the gradual decline of the bank's stake in the MME, its profit share too would be subject to reduction.

The profit sharing ratio for division of final profits would be agreed at the inception. Some contemporary scholars allow the partners to agree on a ratio different from that of capital participation, which could remain static throughout the tenure of partnership or be pre-agreed to vary at stipulated intervals, based on the client's purchase of the bank share or otherwise. Along with such agreement, they could arrive at an understanding on the amount of profit that should be set aside from the client's share of profits for purchasing the bank's share in the enterprise. Either the whole of the client's share of profits or a specific portion at every profit division would be agreed to be set aside. AAOIFI Shari'a Standards suggests that the client could promise to set aside a portion of the profit of the return he may earn from the partnership for this purpose.<sup>22</sup>

Mobilising the funds and investment will be undertaken jointly by the bank and the MME client. Where the bank does not have the expertise or capability of undertaking its share of management and other duties, the client may be entrusted with representing the bank in operating the project. However, the bank would be entitled to monitor the progress of the enterprise as well as taking an active role in auditing financial and other aspects. It may reserve for itself such tasks as receipt of income through the venture and managing finances. All income through the venture would be credited to the common funds of the venture, and a partner would not be given exclusive rights to any income. Expenses would be undertaken from the joint capital, i.e. common funds of the enterprise, so that a partner is not obliged with bearing them to the exclusion of the other.

After the commencement of the enterprise, the client could start to purchase the share of the bank in units, based on a price negotiated at that time or professional valuation, as agreed. The price for the bank's share would depend to a great extent on the performance of the enterprise at the points of time its units are purchased by the client. Purchase of shares could be agreed to commence when the project

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<sup>21</sup> Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, p. 90.

<sup>22</sup> AAOIFI, *Shari'ah Standards* May 2002, p. 215.

becomes functional and starts generating revenue. When all the units of the bank's share have been completely purchased by the MME partner, he becomes the sole owner of the venture, and would be entitled to all revenue generated. All functions carried out by the bank for the venture will be transferred to the client, and any existent mortgage in favour of the bank will be cancelled at the exit of the bank from the partnership.

### **3.3. Observations on Decreasing Participation for Ventures**

Observations made earlier on the decreasing partnership structure for asset purchases would, in a number of instances, be applicable to structures for financing ventures as well.<sup>23</sup> Some additional aspects are explored hereunder.

#### ***Issues pertaining to promise to purchase / sell***

Similar to asset financing, an important aspect relevant to MMEs in structures for venture financing is the promise extended by the bank or the client regarding the sale of the bank's share in units. AAOIFI Shari'ah Standards rules that a binding promise could be given by one partner, which entitles the other partner to acquire his equity share gradually.<sup>24</sup> This implies that the promise is made by the bank. In a number of formats adopted, the client's portion of the profits is retained, either partly or in full, in order to facilitate the purchase of units. With regard to MMEs, it appears that such purchase could largely depend on the profitability of the enterprise. If the enterprise has not been able to generate sufficient profits, the client may not be able to purchase as agreed. In this event, if the promise to purchase had been extended by him, it is important to resolve whether the client could be required to purchase using his personal funds. It appears that if the legally binding promise had stipulated the intervals at which the client is bound to purchase, he may be required to adhere to the schedule in spite of the performance of the venture. However, as pointed out earlier<sup>25</sup>, since the legal enforceability of the promise could usually materialise only in the form of liquidating the mortgage, it is improbable that this measure would be resorted to except at the end of the tenure. Similarly, the bank's commitment to sell also could be important. This is because, in a situation where the client offer to purchase a unit when the enterprise is generating low profits and is valued low, if it is expected to give higher levels of income in the near future, in spite of the client's offer, the bank could be induced to put off the sale until the value of the business rises. On the other hand, if the bank had provided a promise to sell, the client could offer to purchase when the value of

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<sup>23</sup> See 'major Shari'ah issues relevant to decreasing partnership' and 'suggestions for enhancement' above.

<sup>24</sup> AAOIFI, Shari'ah Standards May 2002, p. 214.

<sup>25</sup> See 'major Shari'ah issues relevant to decreasing partnership' above.

the business is at its lowest or when the business is undergoing a spell of losses, which the bank would still be bound to honour.

Possibly as a response to such issues, some contemporary scholars have put forth the novel suggestion that the sale of the bank's share may take place based on mutually binding promises made by both the bank and the client.<sup>26</sup> This is based on the argument that a binding mutual promise to sell and purchase in the future, although similar to a future sale as far as the outcome is concerned, is essentially different from the latter. Thus, a mutual promise for the purpose may not be ruled prohibited per se. Consequently, this suggestion considers that although mutual promise is objectionable in the context of *murābahah*, it may be allowed in decreasing partnership.<sup>27</sup> Accordingly, the bank and the client could execute mutual promises regarding the sale of the bank's share, and depending on the terms of the promises, when an offer is made by one party, the other would be bound to accept it. Therefore, although the price of the units are left to be determined based on valuation or mutual agreement at the point of sale, the ownership change according to the agreed schedule and terms would be certain for all intents and purposes, thus providing some assurance of the nature and extent of the bank's involvement prior to embarking on the project.

In a different approach to the above issues, some scholars appear to have indicated that, although prior determination of the price of units is unacceptable in decreasing partnership for ventures, this would be the case only where the sale is envisaged to take place between the bank and the client only. If the bank had reserved the right to sell its share either to the client or to another party at its discretion, thus leaving the possibility of transaction open ended, in this event, a price could be fixed at the outset for its sale to the client without objection.<sup>28</sup> Accordingly, due to the sale not being arranged to take place exclusively between the bank and the client, it seems that the client's promise to purchase could spell out the intended price. This is not construed as a guarantee of the bank's capital.

However, in view of the conventional banking theory dominating the practice of Islamic banking currently, it appears prudent that all possibility of a prior fixing of

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<sup>26</sup> Abd al-Sattār Abū Ghuddah, vol. 24, p. 298.

<sup>27</sup> Imām al-Shāfi'i has ascribed the necessity for choice in such unilateral or mutual promises to the possibility of the promise becoming a sale of what is not owned by the seller or a contingent sale, such as in a promise to purchase on *murābahah*. See Muhammad ibn Idrīs al-Shāfi'i, *al-Umm*, Bayrūt, Dar al-Ma'rifah, 1393H, vol. 3, p. 39. The Islamic Fiqh Academy, in its resolution on discharging promise and *murābahah*, has referred to the first reason. See Islamic Fiqh Academy, resolution No. 40, 41, (2/5 & 3/5), 5<sup>th</sup> Session held in Kuwait in December 1988.

<sup>28</sup> Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, p. 92. There remains some ambiguity on this issue, as the promise here is offered by the client.



the sale price be curtailed, and the promise, as mentioned above in the context of decreasing partnership for asset purchases, not be held legally binding.<sup>29</sup> Through this measure, the sale of units taking place with the choice of the parties at a price suitable to both of them could be ensured. Thus, the spirit of equity participation could be retained in the decreasing partnership arrangement, disallowing any compulsion on either party to sell his share to the other or to purchase the other's share except on the basis of free will at the time of such transaction. With regard to MMEs that operate amidst various financial constraints, such freedom in deciding the time of purchase could be crucial in managing the finances of the enterprise. A business enterprise being a prospect naturally subject to various phases and ups and downs, inflexible restrictions pertaining to the price or time of sale could lead to a violation of the rights of either party, as well as being alien to the basic concept of equity partnership based on sharing of gains and losses. Although the parties could have an understanding or even proffer promises that are of a non-binding nature on how unit sales should take place, they would be allowed complete choice on the issue at the time of carrying out the transaction, based on the prevailing state of affairs. While ensuring participation in the venture with an enhanced sense of responsibility and entrepreneurship on the part of both the bank and the client, this method would effectively remove any resemblance to interest based financing.

Regarding the prospect that if the promise not be held binding, in the event the client refuses to purchase the bank's share, the bank would be burdened with prolonged participation in a venture that may not be performing up to expectations thus affecting its liquidity, a closer analysis could reveal this apprehension to be groundless. According to all schools of Islamic law, the partners in *shirkah al-'aqd* are entitled to terminate the partnership at any stage.<sup>30</sup> Thus, unless if the parties had altered this default provision through agreeing on any other terms at the inception<sup>31</sup>, the right to liquidate the partnership thereby recovering whatever that is possible to be recovered is available to every partner. This has been provided precisely in order to prevent any party being compelled to continue involvement in a venture against his will, and appears especially suitable with regard to MMEs.

<sup>29</sup> It was noted above that an early resolution on the subject called for complete choice to both partners in the sale of their shares. (First Conference of Islamic banking held in Dubai, May 1979, Resolution on decreasing partnership structure, in Dubai Islamic Bank, *Fatāwā Shar'īyah fī al-A'māl al-Masrafiyah*, p. 21.) See section above on allowing client the option to purchase or continue lease.

<sup>30</sup> Abu Zakariyya Al-Nawawi, *Rawdah al-Tālibīn*, Bayrūt, Dar al-Kutub al-Ilmiyyah, n.d., vol. 4, p. 515, Ibn 'Ābidīn, *Radd al-Muhtār*, vol. 4, p. 328, Abu Bakr al-Sarkhasi, *al-Mabsūt*, Bayrūt, Dar al-Ma'rifah, 1406H, vol. 16, p. 194, Ibn Rushd al-Qurtubi, *Bidāyah al-Mujtahid*, al-Qāhirah, Maktabah al-Kulliyāt al-Azhariyyah, 1969, vol. 2, p. 277, Ibn Qudāmah, *al-Mughni*, vol. 5, p. 133.

<sup>31</sup> To prevent the secession of a partner resulting in the termination of the *mushārahah*, some agreements stipulate that a partner who wishes to resign should do so through selling his share to the remaining partners.

Therefore, if the MME partner refuses to purchase the bank's share on favourable terms, the latter could resort to the ultimate measure of liquidating the venture, so that the parties could exit from the partnership dividing the assets equitably among them. It could be observed that, if this right is maintained unaltered in decreasing partnership in ventures, the need for a legally binding promise or prior fixing of the price in order to sell one's share on reasonable terms could be dispensed with to a great extent.

### ***Participation of the bank in the enterprise***

Contrary to a conventional bank, the Islamic bank need not restrict its involvement in the enterprise to that of a financier, except in *muḍārabah*-financed projects. Even in the latter, the bank may appoint its staff in a monitoring capacity, without executive power.<sup>32</sup> In *mushārahah*, as an equity partner entitled to play an active role in management, decision-making and operations, the bank may fully participate in and contribute towards the successful performance of the enterprise. In larger projects, it may assign staff of its own solely working for the enterprise providing various services. By calling on its market awareness, business connections, management expertise etc, the bank may become vigorously involved, progressively eliminating the inherited identity as a lending institution, to that of a commercial associate indispensable for the successful operation of the project, worthy of a sizable share of profits. With regard to MMEs, such effective participation may lead to twin-fold benefit: it will enable the bank to monitor the performance of the venture in a factual and up-to-date manner, rather than depend on information provided by the client partner; in addition, the bank may take timely action in preventing unhealthy developments and avoiding complications inexperienced MMEs may encounter. An area banks may provide an invaluable service to budding MMEs is that of financial management. It is known that a significant percentage of MMEs fail during the early period itself due to incompetence in managing their finances and lack of adequate planning. An Islamic bank coming as a business partner with reserves of expertise in these fields could reduce such avoidable failures greatly, and help enhance the success rate of its clients, also gaining credence for itself in the process.

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<sup>32</sup> Al-Māwardi has narrated two positions regarding appointing such an overseer, one of which indicates permissibility. (Abu al-Hasan al-Māwardi, *al-Hāwi al-Kabīr*, Bayrūt, Dar al-Kutub al-Ilmiyyah, 1999, vol. 7, p. 312) However, when the overseer appointed by the investor is expressly precluded from any executive role, there does not seem to be any reason for impermissibility.