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The Basis for the Legitimate Entitlement to Profit in Islamic Law

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Abstract. This paper is aimed at investigating the basis for legitimate profit in Islamic law thoroughly and providing a concise summary of the theories found in modern conventional economics regarding the cause of profit. Among the Islamic schools of law, the Hanafis have proposed the most comprehensive theory of profit. They have recognized money (*māl*), work (*'amal*) and assuming liability (*damān*) as three factors for profit entitlement. The employment of one or more of these three factors is the condition for permissible revenue. While money and work are independent sources of profit, *damān* is applicable in connection with either money or work. It is also applicable to fixed revenue and profit-generating enterprises if understood in a broader sense. On the other hand, risk as a separate source for gain is impermissible since it leads either to *qimār* or *gharar*. This study shall use the broader theoretical framework of the Hanafi concept of *damān* (liability, guarantee) and apply it to the cases of fixed revenue and profit. Eventually, this paper aims at exploring how the Hanafi formulation of *damān*, along with capital and labour, can be useful in explaining and determining the basis for a legitimate profit in Islamic law.

Keywords: Islamic law, Profit, Legitimate, *Damān*, Partnership

JEL Codes: P40, A12, D31, D33

Introduction

Profit is the objective and focus of entrepreneurial activity. Therefore, revenue in general and profit in particular should be understood in terms of their causes and legal entitlement. Islam prohibits interest, yet allows making profit. The Quranic prohibition of usury is accompanied with permission for trade (Qur'an 2:275). Is-

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lam advises being moderate in the quest for profit and to take only that which is legitimate. The urge for profit maximization must be tamed by the Islamic moral discipline. Islam encourages its believers to engage in trade and business (Qur'an, 62:10, 73:20). It, however, at the same time draws attention to man's extreme love for material gains (Qur'an, 100:8, 9:76, 3:14), urging them to follow the principle of moderation and get only that which is legitimate. A number of Qur'anic verses and Prophetic traditions put the pursuit of profit within the limits of Islamic morality (Qur'an, 4:29, 2:168, 28:77). Muslims should prefer virtue to wealth and be content with whatever they can earn lawfully. It directs men to establish and carry on all exchange relations on the principles of mutual consent, fair play and cooperation. (Hasan, 1983, p. 8)

The notion of profit is one of the core issues of mainstream economics as the price theory is backed by the assumption of 'profit maximization'. Conventional economists such as Clark, Schumpeter and Knight have investigated the causes of profit. They have explained the source of profit as dynamic changes triggered by various factors or elements in a society. Yet, the problem of legal entitlement has been only addressed by Islamic jurisprudence.

In this paper, I shall attempt to identify the underlying reason and basis for legitimate profit in Islamic law. With this in mind, I will focus on the concept of *damān* and the comprehensive theory developed by the Hanafi school of law in this regard. The paper shall also try to show the relevance of the concept of *damān* to profit and all kinds of revenue. It is not, nevertheless, limited to the Hanafi approach; on contrary, it will endeavour to make comparisons between the Islamic legal schools. It will begin with a short review of the literature in the field and provide a summary of the theories of profit in conventional economics. Then, it will provide a framework for legitimate profit and show its practical consequences in different commercial transactions. The paper will then end with some conclusive remarks.

A Review of the Literature

Earlier economists used to discuss the factors that are related to the rate or share of profit rather than its cause. They associated it very closely with the notion and practice of interest. Major attempts to understand the cause of profit have been made by such economists as J. B. Clark (1908), Schumpeter (1912) and Frank H. Knight (1921). Knight, for example, has established a relationship between profit and uncertainty. Knight's theory has been further developed by Burton S. Keirstead in line with the Keynesian approach, but the relationship between profit and

uncertainty has remained the same. No exhaustive study has been published after Knight, except in the form of some book chapters and articles (Hasan, 2008, p. 1; Obrinsky, 1983, p. 86). Questions about what makes a profit legal and ethical and who owns it rightfully are yet to be sufficiently addressed (Hasan, 1983, p. 4). Such normative issues are nowadays considered to not lie within the scope of economics.

The studies in Islamic economics in the specific field of distribution tend to focus on such issues as interest, rent and wages, mostly ignoring those topics, which are related to building a comprehensive framework regarding revenue and profit. The English literature on this topic is scarce, and the one present focuses on the economic rather than *shariah*, i.e. religious-legal aspects: Two papers by Zubair Hasan (1983, updated 2008) and M. Imran Ismail (2007) and a recently published brief book by Zubair Hasan (2017). The shariah aspect has not yet been fully explored in the English literature. On the other hand, there is a vast amount of literature in Arabic regarding the notion of profit including dozens of books and dissertations on the topic. They provide more details and lay more emphasis on the shariah aspect of the issue. Due to the time limitations of my project, I have only consulted the studies by Khattāb (2001), Muhaymid (2005), Qaisi (2008) and Haqīl (2011) on the topic.

Profit in Secular Economics

The concept of profit is atomic. Many definitions have been proposed for it. Yet to simply put it, profit is the amount left when total cost is deducted from the total revenue. While one may call income 'gross revenue', the term profit corresponds to 'net revenue' (Hasan, 2008, p. 2). Since these definitions do not affect the core of the issue in terms of its legitimacy, we do not need to go into further details.

Mainstream economics, since the physiocrats, regards profit as a functional return for the entrepreneur. Economists have tried to explain the origin and nature of profit, offering several theories of profit. In attempt to present their theory of profit, economists generally start with the 'no-profit' models. In these models, the total revenue product of the firm is exhausted by the remunerations to factor services, and the economic profit is therefore zero. They describe profit as a result of dynamic changes that occur in these models. Changes in different fields like society, technology or organization result in disequilibrium in an economy hence constituting reasonable opportunity for profit (Hasan, 2008, p. 2).

Economists have adopted different reflections of change in their theories (Hasan, 2008, p. 3; Ismail, 2007, p. 67; Muhaymid, 2005, p. 129).

a) Clark regards the cause of profit as the *'risk of losing capital'* that is inherent to change.

b) Schumpeter identifies *innovation* that creates change as the premise for profit. Innovations involve risk; gaining an advantage over competitors and generating a surplus over costs, i.e. profit. While the innovators were major figures in his theory, the role of innovating has passed from individuals to research centres and teams over time.

c) Knight, in his book *Risk Uncertainty and Profit* (1921), complemented Schumpeter's theory by providing some more detail. He suggested that the factor of *uncertainty* which arises in the process of innovation is the real cause of profit. According to Knight, this is also the distinguishing factor between the fixed revenue (i.e. interest, wage and rent) and the real profit-generating economies. In this context, he makes a distinction between the *measurable risks* that can be insured against on one hand and the *immeasurable risks* on the other. Hence, profit is the reward for making decisions and bearing "uncertainties" that cannot be measured and insured against. Knight also identified that *sound judgment* and *liability to loss* are two essential qualifications for entrepreneurship. While the former could be delegated to competent managers, the latter is inevitably bound to the person i.e. the entrepreneur. His explanation shows that *liability* has a fundamental role in gaining profit.

The main reason for proposing different theories of profit seems to be lying in determining the proper function of the entrepreneur. Economists describe the role of an entrepreneur in different ways; while some of them describe it as a risk bearer or coordinator and organizer of the factors of production, the others view profits as a non-functional income.

Today, corporations are owned by stockholders and the decision-making process is shared by a large number of independent functionaries. These developments in the realm of business have shifted the focus of study and analysis of profit from the entrepreneur to the firm (Hasan, 2008, p. 3).

The Islamic Framework for Profit and Gain

Although there are different definitions of profit, it is simply the net income after the deduction of expenses and allocations involved (AAOIFI Shari'ah Standard No. 22/10.2.1).

Islamic legal schools provide a juristic inquiry into the legal basis for entitlement to revenue and profit. Islamic law has put a scheme of distribution that emer-

ges from the Islamic notion of economic justice. Therefore, it is rather normative than positive. The key element here is the legal/ethical entitlement to revenue or profit.

Causes for Gain and Profit

Jurists are unanimous on the idea that the quest for profit is permissible. Once this is established, Islamic legal schools have tried to determine the basis (*mabda'*) for earning profit. Since they have differed in their analytical methods, they have developed theories of different scopes.

a) The Shafii and Zahiri jurists limit enterprises to those which are based on capital. With a somewhat literal approach to the textual evidences, they have concluded that only *wealth* constitutes the basis for profit in enterprises. Accordingly, entrepreneurial activity is only possible on the basis of capital ownership.

The Islamic legal term that the classical Muslim jurists employ to express the notion of capital is '*māl*' (money and goods). Some contemporary scholars like Hasan Khattāb have interpreted the word as 'milk' (ownership) because the capital and goods, to his opinion, deserve profit when they are in the possession of its owner (Khattāb, 2001, p. 74).

Money and goods are the foundation of growth and the principal elements that are traded in commercial transactions. They are the essential elements of joint venture (*sharikah*) and one of the founding sides of a limited partnership (*mudārabah*). Thus, real estate, fields and plantation can be a source of rent or partnerships.

b) The Malikis have adopted a more flexible approach. Accordingly, partnership can be established on the contribution of either *wealth* or labour input. Therefore, they allow for the kind of partnerships that is based solely on labour, like *sharikat al-abdān*, i.e. partnership between the labourers or the artisans.

It is clear that work and labour play an indispensable role in the process of production and in increasing profits. The effect of work and labour can be clearly seen in industrial (such as the conversion of raw materials into products), agricultural, and commercial activities as well as in services.

Work has two types of returns: either a fixed wage or a proportionate share of profit (like in *mushārakah* or *mudārabah*).

c) The broadest approach, however, has been displayed by the Hanafi jurists who also permit different types of non-monetary partnerships. Accordingly, the-

re are three reasons for making legitimate profit: investing capital (*māl*), working (*'amal*; as a proxy for wages), and assuming liability for damages (*damān*) (Zuhayli, 2003, p. 465; Haqīl, 2011, p. 91; Qaisi, 2008, p. 58).

Contemporary rulings, including the AAOIFI Shariah Standards, have adopted the Hanafi view since it allows a broader space for business and commercial transactions (cf. AAOIFI Shari'ah Standard No. 12/2.1).

The key concept offered by Hanafis is *damān*. They have given a central position to the concept of *damān* in the whole contract law.

The Hanafis apply this concept in varying forms, depending on the nature of partnership. This approach allows developing a comprehensive theory of profit and revenue that is effective in designating rights and liabilities and that can be used today in distinguishing between the permissible and impermissible kinds of contracts. It is also quite possible to suggest a link between the Hanafi School's view and Knight's approach.

In this context, one may mention another Islamic legal concept that is of a broader meaning than *damān*: *mukhātara*. There are two types of *mukhātara*, viz. the permissible and impermissible. The former is the bearing of risks related to loss or damage in permissible contracts. For instance, in *mudārabah* the *rab al-māl*, i.e. the owner of the capital risks his money while the *mudārib* risks his labour. In trade, the businessman invests in goods hoping to make profit by selling them with higher prices. *The non-permissible mukhātara*, however, does not rely on any permissible kinds of transaction or business. Those transactions that contain *gharar*, gambling/betting or *ribā* are of this kind of *mukhātara* (Ibn al-Qayyim, 1994, v. 5, p. 81; Muhaymid, 2005, pp. 129-130; Qaisi, 2008, pp. 50, 63-64; Haqīl, 2011, pp. 92-93).

The Hanafi Theory of Damān

Damān is bearing/taking the responsibility of damage and loss (Kāsāni, 1986, v. 6, p. 62; Muhaymid, 2005, p. 129; Haqīl, 2011, p. 91). The Hanafis have developed a holistic theory regarding the profit and legitimate gain on the grounds of this term.

The theory is based on those *hadīth*s that link revenue/profit to contractual liability (*damān*). One of such *hadīth*s reads as (الخراج بالضمان); literally meaning, "Revenue is earned in return for a liability to loss (*damān*)." An alternative translation may be, "The output belongs to the one who assumes the liability" (Ibn Mājah, n.d. v. 2, p. 754). Another important source for the theory is the information that the

Prophet (pbuh) prohibited (ربح ما لم يضمن) "making profit without assuming liability" (Ibn Mājah, n.d. v. 2, p. 738).

From all this discussion, one may conclude that the benefits derived from the object of transaction are a compensation for the liability borne by the buyer regarding the loss or diminution potential in the object of sale. Income is only justified by the taking of risk. The profit that a person collects is a compensation of taking the liability for the object (Zuhayli, 2003, pp. 210, 247).

Although there is a close relationship between profit and risk (Elgari, 2003, p. 17), the *damān* that is implied here is not the bearing of a "pure" responsibility or warranty which is isolated from the real economy. The *damān* that qualifies for profit must be related either to capital/ownership or to labour. This arises either from the ownership (*damān al-milk*) or from the labour that the person guarantees to do or even from the creditworthiness for buying goods on credit. Otherwise, profits made by taking/trading risks that have no productivity in them are tantamount to *gharar* and gambling [Loans with interest (credit risk), index trading etc.] (Muhaymid, 2005, pp. 128-9; Haqīl, 2011, p. 90; Qaisi, 2008, p. 72).

Reflections of «Damān» in Financial Transactions

In this part, I am going to discuss the reflections of the theory of *damān* in different business transactions, including trade, rent, labour contract and all kinds of partnerships.

Capital Revenue: Profit vs. Interest

In the business framework, both interest and profit are payments originating from capital. Islam recognizes the productive nature of capital. Nevertheless, it prohibits the guaranteed return of capital whereas it encourages the kind of profit made through the capital investment.

In Islamic law, the notion of *damān* is crucial to the fixed revenue generation. One of the Scriptural bases for this ruling is the Prophetic tradition that a man bought a young slave from another. After a time, the buyer discovered a defect in the slave, disputing the validity of the sale. The Prophet (pbuh) ruled that he has the right to return the slave to the seller. The seller said, "O Messenger of Allah, he used my slave (during this time)" to hear the response of the Prophet (pbuh): *al-Kharaj bi al-damān* "The benefit is in return for the liability". Here, if the slave died in the hand of the new owner, he could not return him back. Therefore, during

that time also the owner had the right to benefit from him (Ibn Mājah, n.d. v. 2, p. 754).

Various explanations have been offered by Muslim economists with regards to the prohibition of interest. *Damān* can also be used to show the difference between interest and profit. Permissible fixed returns like rent have the element of the *damān*, i.e. liability [rights & responsibilities] that originates from ownership. In contrast to this, loans are given by advancing the ownership of the principal amount from the lender to the borrower. Since this is a transfer of liability, the lender has no right to make revenue from his capital; but in an interest based system, the principal amount plus interest will be due (Muhaymid, 2005, p. 108; cf. Qaradāwi, 1994, p. 31 ff.).

The lack of *damān* in charging interest from productive loans is against the principles of distributive justice. A business that has a loan-equity mix in its capital structure is supposed to do different payments to capital for identical functions. Interest rates are determined in bond markets and affected by monetary policies of the central banks. The amount of interest for a productive loan does not correspond to its productivity. This division of profit and interest is a source of injustice. Generally, the lenders suffer injustice at times of unexpected inflation and the equity holders face injustice when the economy is going down. Islam offers justice by inviting all capital to participate in the production with a proportionate sharing of profit or loss (Hasan 1983, pp. 9-10; Hasan 2008, p. 5).

Partnership contracts like *mudārabah* or *mushārakah* must be solely based on a proportionate sharing of profit. It is not permissible to determine a certain amount of money for any of the parties involved. Asking for a guarantee for the capital or a promise for any guaranteed profit is absolutely impermissible. These contracts may not also be marketed or operated as guaranteed investments (Sarakhsi, 1993, v. 22, p. 25; Muhaymid, 2005, pp. 115-117; Haqīl, 2011, pp. 94-95; AAOIFI Shari'ah Standard No. 5/2.2.1). Commitment of one party to safeguard the other party against exchange rate fluctuations or an agreement beforehand on exit at nominal value is prohibited since such conditions are against the rules of profit-loss and entail *ribā* suspicion (AAOIFI Shari'ah Standard No. 24/9.3 and 24/10.2).

Trade and Business

Trading wares and goods involve ownership as well as a certain kind of *damān* rising from this ownership. Accordingly, if the sold item is under the ownership of

the seller, the profit belongs also to the seller as he/she bears any potential loss. The buyer may not claim the benefits and profits of the sale before he/she receives the goods because the sold item is still in the seller's possession and guarantee. If the buyer of an asset receives it and takes responsibility for the damage or loss then he will also be entitled to the benefits and profits of the item (Qaisi, 2008, p. 52).

The *damān* in question here is called by Hanafis *damān al-milk*. There is no disagreement among the jurists over this type of *damān* because it is clearly explained in the *Sunnah* of the Prophet (Muhaymid, 2005, p. 124).

This rule also effects modern *murābaha*, also a type of deferred sale, resulting in one of the important requirements. The AAOIFI Shariah standard No. 8 regarding *murābaha* has categorized the requirement of ownership and *damān* among the requirements of a valid *murābaha*: "It is obligatory that the Institution's actual or constructive possession of the item be ascertained before its sale to the customer on the basis of *murābaha*" (3/2/1).

"The condition that possession of the item must be taken by the Institution (before its onward sale to the customer) has a specific purpose: that the Institution must assume the risk of the item it intends to sell. This means that the item must move from the responsibility of the supplier to the responsibility of the Institution. (...)" (3/2/2).

Ijārah of Land or Property

Ijārah of land or property means "to transfer the usufruct of a particular property to another person in exchange for a rent claimed from him". This type of *ijārah* relates to the usufructs of assets and properties. Corpus of the leased item remains in the ownership of the lesser, while its usufruct is transferred to the lessee. The *damān* arises here out of ownership since the owner is fully responsible for maintenance of the property so that it continues to present its usufruct. When this fails, the *ijārah* contract is terminated by itself (Usmāni, n.d., pp. 109-110; Ismail, 2007, p. 64).

Some Muslim scholars have objected to the *ijārah* of land because of *damān*. They have considered charging rent for land to be identical to charging interest for money lending (Hasan, 1983, p. 10). Accordingly, profit arises from bearing the risk of loss whereas land does not incur any loss. Again, the usufruct of a land is not in the owner's control since it is linked to external conditions like climate, common parasites, etc. (Nyazee, 1999, p. 280; Ismail, 2007, p. 65).

This claim is contrary to the view of the four major Islamic schools of law because majority of them have generally regarded it permissible. There are a few opposing narrations from the Prophet (pbuh) and the companions whereas most of the related material is positive about renting of the cultivable lands. (Shawkāni, n.d., v. 5, p. 309)

Considering the land-rent same as interest is also logically unacceptable since there are at least two substantial differences between the land-rent and the money-lending on interest. The latter, as has been already pointed out, is a transfer of ownership while the former is a transfer of usufruct only. Money is a medium of exchange while land is a real factor of production. Although there are some other aspects to this topic that beg further elaboration. I will not go into more details since it is beyond the scope of this paper.

Ijārah of Labour

The term in the title means, "to employ the services of a person on wages given to him as a consideration for his hired services". The *labourer* sells his service in ways of either performing a set of tasks or making his services available for a specific time (Usmāni, n.d., p. 109).

The question of compensating for the labour on a fair basis has been a significant issue in economics yet lacks a definite answer. Hasan (1983) proposed that wages should be made in one way or another variable with the results of enterprise. He argues that, in the area of mass production where business outcome is not known in advance, justice can only be provided if all factors of production get a share from the profit. Since interest is prohibited and land has a little role in industry, the distribution problem is essentially a matter of sharing of the value product between the labour and the capital. At the same time, he accepts that to sustain workers, the wages cannot fall to zero or be negative. Therefore, he offers a provision of minimum wage accompanied by some sort of participatory system that gives the workers a share from the profit. Otherwise, wages, if determined by the market, cannot be determined in proportion to the contribution of labour to the output (Hasan, 1983, pp. 11-13; Hasan, 2008, p. 7).

Partnerships

Sharikat al-'Aqd (contractual partnership) means an agreement between two or more parties to combine their assets, *labour* or liabilities for the purpose of making profits (AAOIFI Shari'ah Standard No. 12/2.1).

Mudārabah (Silent Partnership)

Mudārabah is a contract in which the capital and the labour come together. "*Mudārabah* is a partnership in profit whereby one party (*Rab al-māl*) provides the capital and the other party (*Mudārib*) the *labour*" (AAOIFI Shari'ah Standard No. 13/2).

In *mudārabah*, one partner (*Rab al-māl*) subscribes the funds while the other (*mudārib*) subscribes the work and performs the managerial duties. The capital owner is entitled to his share in profit, due to his liability to a loss. The entrepreneur, although providing no capital, provides work (the management of the funds) without bearing any responsibility (AAOIFI Shari'ah Standard No. 37/3.2.2.).

Rab al-Māl

Since *māl* (capital/ownership) is regarded as an essential element of profit, it always gets its share of profit or loss in a partnership. (Kāsāni, 1986, v. 6, p. 80)

It is very important for the capital owner to bear the *damān* (risk) of the capital. During those instances when he does not bear the loss of his capital, the *mudārib* is not entitled to profit (Māwardi, 1999, v. 7, p. 332; Haqīl, 2011, pp. 88-89).

Here are two potential instances linked to such a situation:

a) Transfer of *damān* (warranty) that is stipulated in the partnership contract

In *mudārabah*, the capital owner is entitled to his/her share of profit in return for bearing the risks. This is similar to the type of *damān* in trading, i.e. *damān al-milk*. If the *mudārib* would be made to bear the loss, what would be the effect of this stipulation on the contract and on the distribution of profit? The majority of the jurists see such a stipulation impermissible for *mudārabah* contract (Ibn Qudāmah, 1968, v. 5, p. 49; Muhaymid, 2005, p. 125; Haqīl, 2011, pp. 104-100).

As for its effect on the contract, there are different views:

- The *mudārabah* contract itself is valid whereas the stipulation is regarded void. Therefore, a standard *mudārabah* contract is established (Hanafis and Hanbalis).

- The *mudārabah* contract becomes *bātil* (void). Hence, if there is any profit, it belongs to the *rab al-māl*. According to the Shafiis, the *mudārib* is entitled to the *ujra mithl* which is an average salary for the work he/she has done. The Malikis on the other hand, propose the *qirād mithl* which is an average share from the profit if there is any profit (Kāsāni, 1986, v. 6 p. 80; Ibn Qudāmah, 1968, v. 5, pp. 49-50).

b) Transfer of *damān* due to the negligence in protecting the capital.

When the *mudārib* transgresses his authority over the capital that is specified in the contract or neglects the protection of the capital in a proper way, the warranty of the capital passes over to the *mudārib*.

If a loss occurred as a result of the *mudārib*'s misconduct, negligence or breach of contract, the *mudārib* may be held liable for the loss of capital but not the profit, unless the investment accrues profit after liquidation, but then suffers loss due to the *mudārib*'s actions (Haqīl, 2011, pp. 98-103; AAOIFI Shari'ah Standard No. 45/3.7).

Despite the *Mudārib*'s wilful misconduct, negligence or breach of contract, if there is a profit, there are three different views regarding its treatment. These different views go back to how the jurists have analyzed this situation (Muhaymid, 2005, pp. 102-105):

- According to the Malikis and one report from the Shafiis, the profit is shared according to the initial contract. They see the situation still similar to a valid *mudārabah* contract.

- According to the Hanafis and the later view of Imam Shafii, the profit belongs to the *mudārib*. They compared this situation to the act of a *ghāsib* (usurper).

- According to the more popular legal opinion of the Hanbalis, the older view of Imam Shafii, the profit belongs to the *rab al-māl*. They consider the situation similar to a *wakālah* agreement (contract of agency).

While the AAOIFI Shariah Standards do not address this instance, the Maliki view can be regarded as closer to justice for all parties.

Mudārib

Work gets its share from profit in *mudārabah* by clearly stipulating it in the contract. That is different from *māl* (capital/ownership) which has a direct connection with profit and loss. According to the Maliki, Shafii and Hanbali schools, if the *rab al-māl*'s share is mentioned, but the *mudārib*'s share is not clearly mentioned in a *mudārabah* agreement, the contract is invalid. The Hanafis view it still valid since the share of the *mudārib* can be easily deducted in such a contract.

The contribution of labour to the *mudārabah* is mostly in the field of trade. Most of the definitions of *mudārabah* mention trade in it. Trading creates revenue

profit. There is another type of profit which is called 'capital profit'. The Shafii and Hanbali schools of law also see a share for the *mudārib* in this kind of profit, whereas the Hanafis and Malikis regard it as the right of the *rab al-māl* (Muhaymid, 2005, p. 110).

The Shafiis have limited the *mudārib* with the field of trade whereas the Hanafis and Hanbalis allow also for *mudārabah* in other fields of production including agriculture and industry (Muhaymid, 2005, p. 112). This latter view is also the position of the AAOIFI since no field limitation is mentioned (AAOIFI Shari'ah Standard No. 13/2).

If a *mudārabah* contract is void (*fāsid*), the compensation of work is an issue of debate among the schools of law. There are three views on the topic (Ibn Qudāmah, 1968, v. 5, pp. 52-53; Ibn Rushd, 2004, v. 4, pp. 26-27; Qaisi, 2008, p. 53):

- The *mudārib* receives a standard wage (Hanafi, Shafii, Hanbali and a view in the Maliki school).

- The *mudārib* receives a standard wage if the partnership has produced any profit (a view in the Shafiis and Malikis).

- The *mudārib* receives *qirād al-mithl* if it is less than the mentioned profit rate (Malikis).

Muzāra'ah and Musāqāt

Sharecropping and irrigation partnerships are profit-generating partnerships based on land. In sharecropping, the share of the landowner is settled as some reasonable proportion of the crop. As in the *mudārabah*, work and capital are brought together with a proportionate share of the profit i.e. the outcome of cultivation. This model can be considered closer to economic justice. On the other hand, fixing a wage or rent renders these contracts void.

The validity of these kinds of contracts is a matter of dispute. There are different narrations from the Prophet (pbuh) and the Companions about it. The majority views them permissible. They compare it to the *mudārabah* contract. Abu Hanifa considers these two contracts to be of the category of "labour contract (*ijārah*) with an unknown wage" and therefore regards them impermissible. Nevertheless, the relied-upon-view of the Hanafi School is taken to be the one produced by his two pupils, Abu Yusuf and Imam Muhammad who see it permissible. The objection of the minority to sharecropping is based on the fact that the outcome of this cont-

ract is not known at the beginning (Zuhayli, 2003, p. 522; Ismail, 2007, pp. 64-65; Nyazee, 1999, p. 285).

Mushārakah (Contractual Partnership)

Musharakah is a contract between two or more partners to combine their assets based on sharing profits and losses. Joining the client as a shareholder in the capital of a certain project or operation is a modern version of *mushārakah*. Here the two parties share the profits and losses according to a predetermined rate of profit sharing (AAOIFI Shari'ah Standard No. 37/3.2.3).

The conditions or modes of profit allocation in a *sharikah* contract must be in accordance with the Islamic principle of sharing profit. It is impermissible for a contract to include any clause or condition that may result in the violation of this principle (AAOIFI Shari'ah Standard No. 12/3.1.5.7).

The proportions of losses must always commensurate with the proportions of their contributions to the *Sharikah* capital (Qaisi, 2008, p. 49). Therefore, it is not permissible for one of the partners in a *sharikah* contract to guarantee the capital of another partner (AAOIFI Shari'ah Standard No. 12/3.1.4.1).

Some of the partners can outperform the others by being smart in managing the company's affairs and ways to bring in profits. A partner may also be contributing more in managing the funds or providing other services like accounting. Still, it is not permissible to specify a fixed remuneration for any of the partners. As mentioned by the AAOIFI Shariah Standards, "if a predetermined amount of profit or a specific percentage of capital is assigned to one of the partners, this assignment will be rendered void" (AAOIFI Shari'ah Standard No. 12/3.1.5.7).

However, it is permissible to give this partner a greater share as compared to his/her share in the capital. The schools of law differ regarding the distribution of profit in a *mushārakah* contract. The Hanafis and Hanbalis say that the partner's share of profit can be determined flexibly on the condition that it is mentioned proportionately at the conclusion of the contract. Whereas the Malikis and Shafiis see that it must be in accordance with the capital every partner puts into the partnership. The second group sees only 'capital/ownership' as the source of profit, while the first group sees another potential reason which is work. Some of the partners may contribute to the partnership better with their work (Ibn Rushd, 2004, v. 4, pp. 36-37; Kāsāni, 1986, v. 6 p. 63; Muhaymid, 2005, p. 120; AAOIFI Shari'ah Standard No. 12/3.1.3.4).

The AAOIFI has chosen the view of the Hanafis and Hanbalis, provided that "the additional percentage of profit over the percentage of contribution to the capital is not in favour of a sleeping partner" (AAOIFI Shari'ah Standard No. 12/3.1.5.3; Qaisi, 2008, pp. 56-57).

It is also permissible to allocate some funds to any of the partners provided that the final actual settlement takes place at a later stage. After actual or constructive valuation, if it comes out that the partner received in excess of his/her share of profit, he/she has to reimburse for the disparity (AAOIFI Shari'ah Standard No. 12/3.1.5.11).

Sharikat al-A'māl (Vocational Partnership or Partnership of Services)

This contract is also referred to as *sharikat al-taqabbul*, *sharikat al-abdān* or *sharikat al-sanāi'*. It is a partnership of two or more workers/professionals who agree to contribute their *labour*/service to a joint enterprise and share the earnings. Partners do not contribute any capital but only their labour and skills (Saleem, 2013, p. 101).

While most of the schools of law have accepted this type of partnership, the Shafiis and Zahiris have opposed it since they do not view labour as a legal basis for gaining profit in partnerships. The Malikis have accepted this partnership, though they see work as subservient to wealth (Zuhayli, 2003, p. 449; Ismail, 2007, p. 63).

The partners in this partnership assume a liability to perform (*damān al-amal*). Each partner is liable and bound to the performance of the work the other partner has agreed to. Sometimes one of the partners is responsible for indirect issues like bringing in customers or supervising workers. The entitlement to compensation is linked both to the liability to perform a specific work (*damān al-'amal*) and the work done by the partners. Therefore, partners have the right to share the revenue even if they have not worked in a specific order (Marghināni, (n.d.), v. 3, p. 12; Nasafi, 2001, v. 5, p. 64; Ibn Qudāmah, 1968, v. 5, p. 6; Ismail, 2007, p. 65; Muhaymid, 2005, pp. 121, 125).

The Hanafis and a view in the Hanbalis see *damān al-'amal* as the reason for entitlement to profit, whereas the Malikis and the Hanbalis see the work itself as the reason. The result of this disagreement is that, according to the first group the profit can be shared according to the condition in the partnership agreement whereas the latter argues that it should be shared according to the work performed by the partners (Ibn Nujaym, n.d., v. 5, p. 196; Muhaymid, 2005, pp. 121, 131). The AAOIFI Shariah Standards have not addressed this aspect of the topic.

Sharikat al-Wujūh (Partnership of Creditworthiness or Reputation)

This contract is also known as *sharikat al-dhimam*. In this contract, partners do not contribute any capital, but agree to purchase goods upon their personal credit and to sell them through their joint efforts (Sarakhsi, 1993, v. 11, p. 152; Saleem, 2013, p. 102; Qaisi, 2008, p. 59).

The Hanafis and the Hanbalis have accepted this type of partnership. The other schools of law oppose it since they do not see *damān* as a legal basis for gaining profit in partnerships (Zuhayli, 2003, p. 449; Ismail, 2007, p. 63). They claim that profits can be earned either by capital or by work. *Damān* is something that does not exist during the contract, therefore *wujūh* contract is invalid. The Hanafis have referred to the Prophetic Tradition about *damān*, comparing this contract to the partnerships of *mudārabah* and *sharikat al-a'mal* (Muhaymid, 2005, pp. 125-126; Haqīl, 2011, p. 89).

The Hanafis opine that the percentage of profit and loss must be equal, based on the agreement. The Hanbalis see that the percentage of profit may be different from that of loss, if stipulated in the agreement (Muhaymid, 2005, p. 131).

Conclusion

Islamic rulings encourage freedom of enterprise and gaining profit. Profit, to put shortly, is a surplus over cost. Scholars of Islamic law derived the possible basis for the profit entitlement from the standard transactions mentioned in and approved of by the Sunnah. The Hanafis, who have proposed the most comprehensive theory of legitimate profit, have determined the causes or factors for the profit entitlement as three: money (*māl*), work (*amal*) and assuming liability (*damān*).

The term *damān* means assuming the risk of loss and all responsibilities regarding an asset or capital. Money and work are independent sources of profit whereas *damān* (warranty) is a dependent source that creates its effect always in connection with money or work. On the other hand, risk itself is not an independent factor for profit and is prohibited due to either *qimār* or *gharar*. The employment of these three causes or factors in legitimate transactions such as agriculture, trade and industry result in permissibility of revenue.

The quoted hadīth in question has made the profit dependent or conditional upon *damān*. Therefore, the element of *damān* is essential to all permissible profit-making transactions. The concept of *damān*, if understood in a broader sense,

is applicable to both the fixed revenue and the profit-generating enterprises. In trade and partnerships, the owner holds the *damān* and therefore is entitled to the profit. The *damān* in other types of partnerships is linked to the commitment of the partners. In *sharikat al-a'māl* it is to accept the work and in *sharikat al-wujuh*, it is to bear the debt of his/her share in the partnership.

The notion of economic justice requires a situation/regulation wherein each factor of production receives a remuneration that is proportionate with its contribution to the total output. Therefore, rewarding the factors of production according to their contribution to the business outcome is the essence of distributive justice. It shall be more possible to achieve distributive justice if labour participates in the fruits of business by putting a performance incentive in addition to its fixed wage. Accordingly, the resulting profit should be shared between capital and labour in addition to a fixed minimum wage.

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