

Business Dynamics of Islamic Bank Mudharabah Contracts: An Islamic Economics Perspective

Dinamika Bisnis Akad Mudharabah Bank Syariah: Perspektif Ekonomi Islam

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ABSTRACT

This research examines how the concept of mudharabah in classical Islamic theory is implemented in Islamic monetary institutions, especially Islamic banking. Using literature research, this study shows that there are differences between the concept of mudharabah in classical fiqh books and its implementation in Islamic banking. The difference indicates that the door to ijtihad is still wide open in contemporary Islamic law. The principle of prudence requires Islamic banking to contextualise the classical concept of mudharabah in contemporary socio-cultural situations.

Keywords : *Mudharabah, Fiqh, Islamic Bank*

ABSTRAK

Penelitian ini mengkaji bagaimana konsep mudharabah dalam teori Islam klasik diimplementasikan dalam lembaga moneter Islam, khususnya perbankan syariah. Dengan menggunakan studi literatur, penelitian ini menunjukkan bahwa terdapat perbedaan antara konsep mudharabah dalam kitab-kitab fikih klasik dengan implementasinya di perbankan syariah. Perbedaan tersebut mengindikasikan bahwa pintu ijtihad masih terbuka lebar dalam hukum Islam kontemporer. Prinsip kehati-hatian mengharuskan perbankan syariah untuk mengkontekstualisasikan konsep klasik mudharabah dalam situasi sosio-kultural kontemporer.

Kata Kunci: Mudharabah, Fiqh, Bank Syariah

1. Introduction

Banks are critical financial institutions that facilitate economic activities and resource mobilization in any country. These institutions are broadly categorized into conventional banks and Islamic banks, each operating under distinct principles. Islamic banks hold a unique position as they operate based on Shariah (Islamic law), emphasizing equity, partnership, and justice through profit-and-loss sharing mechanisms, distinguishing them from interest-based conventional banks (Khan, 2010). Among the various financing schemes in Islamic banking, the Mudharabah contract is particularly significant as it represents a partnership where one party provides the capital (Shahibul Maal) and the other manages it (Mudharib). Profits are shared according to a pre-agreed ratio, while losses are borne solely by the capital provider unless caused by managerial negligence (Ahmed, 2002; Dusuki, 2008). This principle reflects the Islamic values of fairness and mutual benefit and has the potential to drive inclusive economic growth (Al-Ali & Al-Kandari, 2018).

Despite its potential, the implementation of Mudharabah contracts in Islamic banking faces significant challenges. Empirical evidence shows that Mudharabah financing is less utilized

compared to other Islamic banking products due to its relatively higher risk (Chong & Liu, 2009). This issue has become more pronounced during the COVID-19 pandemic, as the demand for effective financing mechanisms to support small businesses and economic recovery has grown significantly (Al-Suwailem, 2006). Although previous studies have explored the theoretical foundations of Mudharabah contracts and their compliance with Islamic jurisprudence (Iqbal & Mirakhor, 2011), there remains a lack of research addressing their practical application in modern Islamic banking systems. Specifically, there is a gap in understanding how Mudharabah contracts can be leveraged to foster economic resilience, particularly in supporting small businesses during and after periods of economic crisis (Siddiqi, 2006; Ariff & Safari, 2012).

This study aims to fill this research gap by conducting a comprehensive analysis of the Mudharabah contract from the perspective of Islamic economics. While existing studies have examined Mudharabah's theoretical aspects, limited research has been conducted on optimizing its application to balance risks and returns in contemporary Islamic banking. This study contributes novel insights into the operational efficiency and strategic potential of Mudharabah in promoting financial inclusion and equitable wealth distribution, in addition to adhering to Shariah principles (El-Gamal, 2006; Warde, 2010).

The primary objectives of this study are to analyze the theoretical principles of the Mudharabah contract, evaluate its operational challenges and associated risks, and explore its potential in enhancing financial inclusion and supporting small businesses. Furthermore, this study aims to propose strategic recommendations for optimizing Mudharabah implementation in Islamic banks, ensuring alignment with Islamic economic principles while addressing current financial needs. By addressing these objectives, this research not only advances academic discourse on Islamic finance but also provides actionable insights for policymakers and financial institutions to leverage Mudharabah contracts effectively. This is particularly relevant in the post-pandemic era, where economic recovery and sustainable growth are paramount (Obaidullah, 2005; Saeed, 1996).

2. Literature Review

The Mudharabah contract is a cornerstone of Islamic banking, representing a partnership where one party provides capital (Shahibul Maal) and the other manages it (Mudharib), with profits shared according to a pre-agreed ratio while losses are borne solely by the capital provider unless caused by negligence (Ahmed, 2002). This principle underscores equity and mutual benefit, aligning with the ethical foundations of Islamic economics (Dusuki, 2008). The contract is deeply rooted in Islamic jurisprudence and has been adapted for modern financial practices, offering a unique alternative to the interest-based systems of conventional banking (Iqbal & Mirakhor, 2011).

Theoretical Foundations and Operational Principles

Mudharabah contracts are grounded in classical Islamic legal texts and interpreted by contemporary Islamic economists to suit the needs of modern finance (El-Gamal, 2006). These contracts are distinctive because they emphasize profit-and-loss sharing rather than fixed returns, encouraging risk-sharing and fostering trust between the parties involved (Khan, 2010). The agreement stipulates that the fund provider shoulders any financial loss, except in cases of managerial negligence, which makes this contract inherently fair and ethical (Ariff & Safari, 2012).

Despite its theoretical appeal, the practical application of Mudharabah contracts in Islamic banking faces challenges. Research shows that Mudharabah financing constitutes a smaller proportion of total Islamic banking operations compared to other instruments like Murabahah, due

to its perceived high risk (Chong & Liu, 2009). The asymmetric information and moral hazard associated with Mudharabah can lead to adverse selection and agency problems, deterring financial institutions from adopting this mechanism widely (Dusuki, 2008). Additionally, operational inefficiencies and lack of robust monitoring mechanisms exacerbate these challenges, limiting its broader application (Warde, 2010).

Mudharabah's Role in Economic Development

Mudharabah contracts have significant potential for fostering financial inclusion and supporting small businesses, especially in developing economies (Al-Suwailem, 2006). By providing equitable financing options, Mudharabah can empower entrepreneurs who lack access to conventional credit facilities, thereby contributing to economic resilience (Obaidullah, 2005). During the COVID-19 pandemic, the relevance of Mudharabah contracts has been highlighted as an alternative financing model that aligns with ethical and socially responsible principles while addressing economic hardships (Al-Ali & Al-Kandari, 2018).

While existing literature provides a strong foundation for understanding the principles and challenges of Mudharabah contracts, gaps remain in exploring strategies to optimize their implementation. Limited research has addressed the practical integration of Mudharabah in contemporary financial systems to balance risks and returns effectively (Siddiqi, 2006). Furthermore, the potential of Mudharabah to contribute to sustainable economic development and recovery in post-crisis contexts has not been sufficiently explored (Ariff & Safari, 2012).

Contribution to Islamic Banking

This study seeks to bridge these gaps by examining the operational aspects of Mudharabah contracts within the framework of Islamic economics. It aims to propose strategies for enhancing their applicability and relevance in modern Islamic banking while ensuring compliance with Shariah principles. By addressing both theoretical and practical dimensions, this research contributes to a more comprehensive understanding of Mudharabah as a tool for ethical finance and economic development (El-Gamal, 2006; Warde, 2010).

Through this literature review, the study positions itself as a critical analysis of Mudharabah contracts, advancing both academic and practical knowledge in Islamic finance. It provides a basis for policymakers and financial institutions to leverage this unique financial mechanism to achieve equitable growth and financial inclusion.

3. Methods

This research was conducted using a qualitative approach and description method. The type of research used is library research, namely by looking through journals, notes, and news analyses sourced from previously published research. Observations on the concept of mudharabah contracts in Islamic banking were used as secondary data sources. The author uses journals, theses from previous research, websites/materials raised from other information related to the topic of this research to identify themes or discourses and examine the same events such as notes, newspapers, and others related to the subject matter. The information collected was then subjected to qualitative and descriptive analysis.

4. Results and Discussion

Concept of Mudharabah in Fiqh

Mudharabah in fiqh is someone handing over capital to entrepreneurs / workers to be worked on with the condition that the profits are divided according to the agreement stipulated in the contract. The loss is fully borne by the owner of the capital. Mudharib (entrepreneur) in this case will contribute work, time, thought and energy in managing the business according to the terms reached in the contract, namely to get business profits which will be divided based on agreement. There are several provisions stipulated in fiqh related to the mudharabah system, among them are as follows:

1. Capital

Capital in fiqh discourse is termed 'ra'sul maal'. The scholars require that the capital must fulfil the requirements: Consist of currency that is in circulation or in force. This requirement is put forward to avoid disputes in the future. Therefore, it is not permissible to use assets in the form of receivables, because it is difficult to measure the profit from it, and it can lead to disputes in the distribution of profits. The capital must be fully handed over to the entrepreneur. The capital must be handed over in full at the time of contracting. The amount and type of capital must be clear.

2. Management

Mudharabah contracts in fiqh are divided into two categories, namely: (1) Mudharabah Mutlaqah, where the fund owner (shahibul maal) gives full discretion to the manager (mudharib) in determining the type of business and management pattern that he considers good and profitable, as long as it does not conflict with sharia provisions. (2) Mudharabah Muqayyadah, in which the fund owner provides certain restrictions to the business manager by determining the type of business that must be managed, the period of management, the location of the business etc.

3. Guarantee

The essence of the mudharabah contract is the co-operation and mutual help between capital owners or people with surplus capital and people who only have expertise and skills, so that the gap between rich and poor can be eroded. Property in the Islamic perspective is only a trust from God that should be managed for the common good and to realise common welfare. Therefore, Islam recommends that wealth not only rotate in certain groups, but must be developed and endeavoured in real economic activities. On that basis, the mudharabah contract does not require any guarantee of the amount of capital given to the entrepreneur (mudharib). The benchmark for the guarantee of capital is only honesty, so that mudharabah activities must be accompanied by a high level of honesty from the mudharib.

4. Time period

Regarding the limitation of the term of mudharabah is debated by fiqh experts. Some scholars are of the opinion that the limitation of the period of validity of the contract will make the contract void, because it can deprive the entrepreneur of the opportunity to develop his business, so that the maximum profit from the activity is difficult to achieve. Others are of the view that it is permissible for the financier and the entrepreneur to agree on the term of the mudharabah, provided that if one party wishes to resign from the contract, the other party must first inform the other party.

5. Profit ratio

The profit ratio is a unique pillar of the mudharabah contract, which is what distinguishes it from other contracts. This ratio is the share that will be obtained by each contracting party. The determination of the ratio is made at the beginning and stated in the contract. In the process, there may be bargaining and negotiation on the distribution of the ratio. Negotiations are conducted with the principles of deliberation and antaradin minkum (mutual consent).

6. Forms of Mudharabah

In classical fiqh studies, the form of mudharabah carried out in the contract is carried out in the mode of direct financing/investment (direct financing), where shahibul maal acts as a surplus unit to invest directly in mudharib who acts as a deficit unit. The characteristic of this mudharabah model is that usually the relationship between shahibul maal and mudharib is personal and direct and the transaction is based on mutual trust (amanah).

Sharia Foundation

In general, the basic sharia foundation of mudharabah reflects more of an encouragement to do business. This is found in the following verses and hadiths. Karim, Adiwarmarman (2022)

1. Qur'an

Surah Al-Muzzammil: 20) Meaning: '... and of those who walk the earth seeking some of the bounty of Allah SWT. The wajhud-dilalah or argument of surah al-Muzammil: is the word 'yadhribun' which is the same as the root word mudharabah which means travelling on a business trip.

2. Al-Hadith

It was narrated from Ibn Abbas that Sayyidina Abbas bin Abdul Muthal, when giving funds to his business partners on a mudharabah basis, required that the funds not be taken across the sea, down a dangerous valley, or buy livestock. If he violates these rules, he is responsible for the funds. These conditions were brought to the attention of the Messenger of Allah (peace and blessings of Allah be upon him) and he allowed it.' (HR. Thabrani). The Prophet said, there are three things that contain blessings: deferred sale, qiradh (giving capital to others), and mixing good quality wheat with low quality wheat for household use, not for sale (HR Ibn Majah). Abbas bin Abdul Muthalib, when handing over property as mudharabah, stipulated that his mudharib should not sail the seas and not go down the valleys, and not buy livestock, if the conditions are violated, he (mudharib) must bear the risk. When the conditions set by Abbas were heard by the Prophet, he confirmed them (HR. Ad-Darulquthni)

3. Ijma'

Imam Zailai has stated that the Companions have consented to the legitimacy of processing orphaned assets on a mudharabah basis. The agreement of the Companions is in line with the spirit of the hadith quoted by Abu Ubaid'.

Mudharabah Laws and Conditions

In mu'amalah interactions between one person and another, entering into a mudharabah agreement is permissible (mubah). This law is taken from the hadith of the Prophet narrated by Ibn Majah from Shuhaib r.a. The Prophet said: Al-Jaziry, Abd. Rahman, Al-Fiqh al Madzahib al-Arba'ah (2020)

The Prophet Muhammad (peace and blessings of Allaah be upon him) said: "There are three things that are blessed: a deferred sale, providing capital, and mixing wheat with barley. for the family, not for sale".

As for the pillars of mudharah according to the Syafi'iyah scholars, there are six pillars of qiradh:

1. The owner of the goods who hands over his goods.
2. The person who works, namely the manager of the goods received from the owner of the goods.
3. Mudharabah agreement, carried out by the owner with the manager
4. Maal, namely the principal or capital
5. Amal, namely the field of work (project) management that can generate profit.
6. Profit. While the valid conditions for mudharabah are closely related to the pillars of mudharabah.

Discussion

Implementation System of Mudharabah Concept in Islamic Banking

The history of the establishment of banking with a profit-sharing system is based on 2 (two) main reasons, namely: (1) the view that interest in conventional banks is haram because it is included in the category of usury which is prohibited in religion, not only in Islam, but also by other religions. (2) from an economic aspect, the transfer of business risk to one party is considered to violate the norms of justice. In the long run, the conventional banking system will cause the accumulation of wealth in a handful of people who have large capital.

Islamic financial institutions apply a profit-sharing system as the basis of its operations with a profit-sharing mechanism applicable to participation products, both full and partial participation as a form of corporate business (cooperation). Parties involved in business interests must carry out transparency and partnership in a good and ideal manner. This is because all regular expenses and income related to the participation business are not for the personal benefit of the person running the project. That is why, most business financing in an Islamic economy will be in the form of equity participation where the financier/finance provider will share in the loss or profit of the business activity it is financing. Such financing will not only distribute the returns on the total investment between the financier and the entrepreneur/finance user fairly, but will also transfer a fair share of investment risk to the financier rather than placing the entire burden on the shoulders of the entrepreneur. The forms of mudharabah business in sharia banks are: Al-Sayyid, M. F. (2020)

a. In Commercial Banks Based on Shari'ah Principles:

Collecting funds from the community in the form of deposits in the form of savings, deposits, or other forms in the form of mudharabah. - Channelling funds in the form of business financing. - Perform other business activities that are common for banks as long as approved by the National Shari'ah Council.

b. In Rural Banks (BPR) based on Shari'ah Principles:

To collect funds from the community in the form of savings or deposits or other forms that use the form of mudharabah - To distribute funds in the form of profit sharing financing. - Performing other activities or businesses that are common to BPR as long as approved by the National Shari'ah Council.

The mudharabah theory as stated in fiqh studies has undergone changes and modifications when applied to the Islamic financial system. The position of mudharib (entrepreneur) acts as a customer and partner of the bank, so that more or less the bank will interfere in business management, mudharib does not have full freedom in running his business, but still gets supervision

from the bank, even though the mudharabah contract is mudharabah mutlaqah. The business capital provided is also disbursed in stages with the aim that the bank easily supervises and controls business management. The determination of risk sharing is not applied by the bank, so it seems that the loss is fully borne by the mudharib (entrepreneur), because the bank has participated in controlling and supervising the business, which if the business is stuck or loses, then it is entirely the fault of the entrepreneur Edwin, Mustafa Nasution (2016).

Mudharabah contracts are generally used for short-term commercial purposes where it is easy to determine the expiry of the contract. By knowing the expiry date of the contract, the profit rate can be calculated and the results known. Islamic banks in implementing mudharabah contracts make an agreement with customers regarding the level of profit ratio (profitratio) specified in the contract. The profit ratio is influenced by several factors, including: agreement from the customer (mudharib), prediction of profits to be obtained, market response, ability to market goods, and also the validity period of the contract.

There are two forms of mudharabah contracts applied in Islamic banking, namely mudharabah muqayyadah on balance-sheet and mudharabah muqayyadah off balancesheet. In the first form, the flow of funds is from one investor customer to a group of business operators in a limited number of sectors, such as agriculture and manufacturing. In the second form, the flow of funds is from an investor customer to a single financing customer. The Islamic bank only acts as a manager and the transaction is through an off-balancesheet mechanism, which is a transaction that is not recorded on the bank's balance sheet. The characteristic of the mudharabah contract is that it requires mutual trust between the customer and the bank, so that financing with the mudharabah scheme is considered a high-risk financing, because the bank will face the problem of asymmetric information, where the manager (mudharib) knows information that is not known by the bank. At the same time, moral hazard arises from the mudharib, i.e. the mudharib will do things that only benefit the mudharib and harm the shahib al-mal. (Islamic bank).

For this reason, the mudharib's duties in running the business include management, storage, and marketing, so that the mudharib must manage properly and carefully the capital entrusted to him. Mudharib guarantees to manage the goods in accordance with the terms agreed upon in the mudharabah financing. He is responsible for bearing all losses caused by his own mistakes that deviate from the procedures specified in the contract. The bank does not bear any losses caused by the fault of the mudharib. In short, the mudharib must comply with all the requirements specified in the contract relating to the management of the business. The implementation is generally supervised by the bank.

If the mudharabah contract does not result in profit, the mudharib does not get paid for his work. And the bank bears the loss as long as it is not proven that the mudharib did not misappropriate funds and not due to managerial errors. But if it is proven to be due to carelessness on the part of the mudharib, then he must bear the loss. In such cases, the collateral used as a means of accountability must be given to the bank.

The profit ratio between the shahi-bul maal and the mudharib is determined by percentage not by the nominal value of a currency. The ratio is determined by agreement before the contract and after a process of negotiation and bargaining. This ratio is the indicator in determining the distribution of profits for each contracting party. However, if the business carried out under the mudharabah contract suffers a loss, then the division of losses is based on the portion of each capital. Because the shahibul maal bears the full capital, it will automatically lose capital, while the mudharib provides a portion of labour, time, and thought, it will automatically experience losses on

that matter. The difference in measuring the distribution of profits and losses is due to differences in the ability to bear losses between the two parties.

The reality shows that the process of bargaining and negotiating the distribution of the ratio is only done to depositors/investors with large amounts of funds, because they have relatively high bargaining power, so they can be given a special ratio. As for small depositors, usually bargaining does not occur, but the bank offers a ready-made ratio, so that depositors may agree or not. Mollah, M. S., & Lipy, M. (2021). Meanwhile, the application of mudharabah contracts in banking uses the mode of indirect financing, in this case the bank will act as a third party who becomes an intermediary between the shahibul maal and mudharib. The working process is that the bank receives funds from depositors (shahibul maal) as a source of funds. The funds are packaged in the form of savings and deposits with varying terms. Furthermore, these funds are channelled back to the mudharib in the form of financing that produces (earning assets). The profit from the utilisation of this distribution of funds will be shared between the bank and shahibul maal.

There are several reasons why banks do not apply the form of mudharabah with direct financing mode:

1. The working system at the bank is a congregated investment, where they do not know each other, so there is little chance of a direct and personal relationship.
2. Investment in today's modern era requires large amounts of funds, so tens or even hundreds of shahibul maal are needed to become funders.
3. Weak practice of religious teachings, especially those related to honesty, so that banks find it difficult to guarantee that the funds channeled are safe and without risk

4. Conclusions

From the explanation above, it can be concluded that there is a fundamental difference between the concept of mudharabah as stated in classical fiqh studies and that practiced in Islamic financial institutions. The difference can be seen in the provision of working capital, business management, limitation of the period of mudharabah, the pattern of mudharabah applied, and the guarantee of mudharabah assets. The principle of prudence is something that must be considered by banks in providing financing or funding, this prudential principle requires Islamic banking to modify the concept of mudharabah, so that it can be applied and developed in the banking world. The fundamental difference that occurs does not cause a dwarfing of the concept of classical fiqh, but the concept is applied in accordance with current socio-cultural conditions. What is developed by the banking world regarding the concepts of muamalah in classical fiqh is an application of the principle of ijtihad which must indeed continue to be revived.

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