

MODARABA IN SHARI'AH AND ITS APPLICATION IN PAKISTAN



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By

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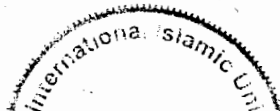
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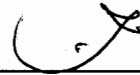
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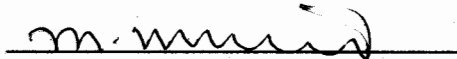
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DEDICATION

I dedicate this thesis to both of my dear daughters, Ayesha Hassan and Anoushey Hassan. Ayesha, a student of "O" Levels, has helped me a lot to accomplish this task. I also dedicate it to my wife, who encouraged me for admission in LL.M (Corporate Law) and co-operated with me on every step in the completion of this degree programme.

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ABSTRACT

Modaraba is an Islamic form of limited partnership wherein the first party (*Rab-al-mal*) may be the person who provides investment, the second party is either a bank or a *Modaraba* company who works for the first party as *Mudarib* or an agent and may either hand over the first party's investment to a third party or to start business itself for the first party. The parties to *Modaraba* business execute *Modaraba* agreements with each other in order to specify the terms and conditions relating to running of *Modaraba* business and profit sharing. This ancient concept has been proved through the Hadith and practice of the Holy Prophet (SAS) and his companions.

This old concept of *Modaraba* encouraged the people of Pakistan in the private sector to launch *Modaraba*. After the introduction of *Modaraba* laws (*Modaraba Companies & Modaraba* (Floatation & Control) Ordinance, 1980 and Rules framed there under in Pakistan, a number of *Modarabas* were formed. The enactment and promulgation of *Modaraba* laws, was the first important step towards the introduction of *Modaraba* business in Pakistan. The experience of first *Modaraba* in Pakistan has encouraged a number of persons in the private sector to launch new *Modarabas*. After the success of first *Modaraba*, perpetual *Modarabas* for multi-purpose floated successfully.

Modaraba is an ideal alternate to *Riba'* (interest or usury), is regulated by a number of government bodies in Pakistan in order to run it in accordance with the Injunctions of Islam. The Registrar of *Modaraba* closely watches the business of *Modaraba* after its certification (that it is according to the Injunctions of Islam) by the Religious Board constituted under the *Modaraba* Ordinance. A number of reports and returns are required to be submitted to different authorities by *Modaraba* companies on regular basis.

Although *Modaraba* sector has been facing a number of problems and difficulties even then it proved to be a successful mode of Islamic financial system. The misconception prevailing in the society that the experience of *Modaraba* in Pakistan has a history of failure can be ruled out from the fact that the *Modaraba* sector is a growing sector having total assets of Rs.30 billion with Rs.10 billion of equity as on June 30, 2008. *Modaraba* being a

Shari'ah compliant business activity has been able to recognize itself as an Islamic Financial Institution to be practiced by the Muslim *Ummah* in the times to come.

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INTRODUCTION

Pakistan was created in 1947 on the basis of ideology of Islam and the basic purpose was to introduce Islamic systems in all walks of life. Soon after independence, it was felt that the country's economic structure should be in conformity with the Injunctions of Islam. In December, 1948 the founder of Pakistan Quaid-e-Azam Muhammad Ali Jinnah while inaugurating the State Bank of Pakistan, said that the economists of the country must search such opportunities through which the national economy should get rid of Interest. However, in this regard no serious efforts had been made.

The Objectives Resolution passed by the Constitutional Assembly in 1948 (which is part and parcel of the current Constitution of 1973) reveals that it is the basic duty of the State to help the Muslims of Pakistan individually and collectively to live their lives in accordance with the injunctions of Islam. In this way, structuring of the Interest free economy of the country becomes one of the basic duties of the State.

In Article 38 of the 1973 Constitution of the Islamic Republic of Pakistan, importance of Interest free economy has been highlighted and it is stressed upon the government to abolish the Interest as soon as possible.

In 1977 first time any government in the history of Pakistan started a process to Islamize the economy of the country. A committee of financial experts and renowned religious scholars was constituted in order to recommend proposals for Islamization of country's economic system. The committee submitted its proposals to Council of Islamic Ideology and the government decided the stepwise eradication of Interest from the country's economy. In 1980 the three financial institutions House Building Finance Corporation, National Investment Trust and Investment Corporation of Pakistan had decided to abolish Interest from these institutions. The government then started implementing the recommended proposals and introduced the systems of Profit and loss Sharing, Equity Participation, Leasing, Higher Purchase and *Modaraba* etc in the financial sector of the country.

In Pakistan, *Modaraba* business was introduced in financial institutions after the promulgation of the *Modaraba Companies & Modaraba (Floatation & Control) Ordinance, 1980*. This Ordinance speaks about the Registration of *Modaraba* companies, Floatation of *Modaraba* companies' Certificates in the Capital Market (Stock Exchange) and the laws relating thereto have been laid down and elaborated in Rules framed under the Ordinance.

After introduction of above referred ordinance, the *Modaraba* has been considered the best alternate of Interest. Banks and the business institutions/ companies had started introducing *Modaraba* in their businesses. Most of the companies successfully handled *Modaraba* business and some of the leading banks such as National Bank of Pakistan, Bank of Punjab, Grindlays Bank, Habib Bank etc. had also floated their *Modarabas*.

The methodology which I adopted in compilation of this research work is that in the first chapter of this thesis I tried to explain/ define *Modaraba*, its background, meanings, essential features in the light of Holy Quran, *Hadith* of the Holy Prophet (SAS), practice of the companions of the Holy Prophet (SAS) and viewpoints of different schools of thoughts. In the second chapter I focused on the laws applicable to *Modaraba* business. I elaborated the salient features of *Modaraba Companies and Modaraba (Floatation & Control) Ordinance, 1980* and then the comparative study of this law with the Companies Ordinance, 1984. Thereafter, an analysis of these laws has been given keeping in view the practical approach/ aspects of these laws. In the third chapter I explained what types of *Modarabas* are allowed to be floated in Pakistan and how the *Modaraba* companies are incorporated and what are the main objects which are generally incorporated in their Memorandum of Association. Also the brief description of certain conditions which are applicable to *Modaraba* companies has been given and finally in this chapter, case study of few *Modaraba* companies has been made part of it. In the last and Fourth chapter I presented the analysis and conclusion on the basis of the study and research work conducted by me.

The purpose of this study is to investigate, examine and prove that *Modaraba* is an Islamic mode of contract. As to why this ideal alternative to Riba' and one of the popular

tools of commercial activity could not achieve its objectives, either due to prevailing *Modaraba* laws, their non-conformity to Shari'ah principles or due to mishandling of this business and non-profitability.

In this regard in order to compile this research work, I had to go through the Holy Quran, books of Hadith and of different Islamic scholars. Further, to understand how *Modaraba* is being practiced, I studied the prevailing laws of Pakistan on *Modaraba*, prospectuses and annual reports of different *Modaraba* companies. On the basis of these studies, conclusion was drawn that under such and such conditions *Modaraba* is allowed to be practiced and how investment is made under this mode of Islamic contract, and as to whether all this is being run in accordance with the Injunctions of Islam.

To achieve this target I had to face few difficulties while I was collecting study material on this topic. In this regard I visited libraries of different universities and government institutions such as International Islamic University, Allama Iqbal Open University, Islamic Research Institute, Council of Islamic Ideology, Federal Ministry of Law, Justice and Human Rights, SECP, Few Islamic Banks etc. In all this process of completion of thesis, availability of time remained the main problem for me since I have been practicing as a corporate lawyer and even till the last moments of its completion I am facing this issue badly.

CHAPTER ONE

THE LAW OF *MODARABA* IN ISLAM

1.1 INTRODUCTION

The process of Islamization of financial system in the Islamic world can be successful only if we seek to identify and evolve instruments which, on the one hand, reconcile the freedom of the individual with the optimal use of resources, and on the other, do not conflict with the Islamic tenets of equity and justice. The basis of relationship between capital and enterprise in the Islamic context is the equitable sharing of the risks and gains between the provider and user of capital. One of the instruments of finance which has been identified for switching over from interest to non-interest basis is *Modaraba* a pre-Islamic institution which was legalized by the Holy Prophet (SAS) in order to bring about a marriage between surplus resources of individuals and skilled manpower for carrying out economic activity in an Islamic society.

1.2 DEFINITION, MEANING AND BACKGROUND OF *MODARABA*

Modaraba can be defined as an arrangement in which an investor or group of investors entrusts capital to an agent or manager, who is to trade with it and then return to the investor the principal amount together with the agreed share of the profit. The agent receives the remaining share of the profit as a reward for his labour. The loss, however, is exclusively borne by the investor. The loss of the agent is only by way of expended time and effort. Thus, *Modaraba* means a business in which a subscriber (Rabb-ul-Mal) participates with his capital (mal) and the manager, (Modarib or Muqarid) participates with his efforts and skill, and profits are shared between the two according to clearly defined proportions agreed upon beforehand.

The term *Modaraba* is derived from the expression “addarb fil-ard” , that is, journeying in the land for the purpose of earning. It is so called because the agent (al-modarib) is entitled to the profit in his capacity as a partner by virtue of his effort

and work. **Imam Sarakhsi**, one of eminent jurists of Islam, in his celebrated work **Mabsut** has explained the nature of *Modaraba* as follows:

"The term *Modaraba* is derived from the expression 'making a journey' (*ad-darb fil-ard*), and it is called this because the agent (*al-modarib*) is entitled to the profit by virtue of his effort and work. And he is the investor's partner in the profit and in the capital used on the journey and in its dispositions.

The people of Madina call this contract *muqarada*, and that is based on a tradition concerning "Uthman, may God look favorably upon him, who entrusted funds to a man in the form of a *muqarada*. This is derived from *al-qardh* which signifies cutting; for in this contract the investor cuts off the disposition of this sum of money from himself and transfers its disposition to the agent. It is therefore designated by that name (*muqarada*). We, however, have preferred the first term (*modaraba*) because it corresponds to that which is found in the book of God, may He be exalted. God, may he be exalted, said: "While others travel in the land (*yadribuna fil-ard*) in search of Allah's bounty," that is to say, travel for the purposes of trade." ¹

Another Muslim theologian Al-Marghinani elaborates the meanings of *Modaraba* in his book "Al-Hidaya" as follows:

"*Modarba* is derived from the word *Darb* (striving and journeying) on earth. It has been so named because the *Modarib* (user of capital) deserves the profit on account of his efforts and work. It has been allowed (in Shariah) because of its necessity, as there are several kinds of people. There are some rich in wealth but without talents to use it, and others capable of using it but empty handed. There occurs thus a necessity for such utilization. It reconciles the welfare for all the unskilled and the resourceful, the poor and the rich. People practiced it in days of the Prophet

¹ Shams ud din al-Sarakhsi, *Al-Mabsut* (Beirut: Dar-ul-Marifah, 1989), 22:18.

(SAS) who confirmed the legality. The companions of Prophet also entered into similar contracts. The capital then is a trust in the hands of the user and he is authorized to use it (with his own discretion) as he gets the possession with the sanction of actual owner, not on account of exchange or pawn. He is an agent as he uses it with the sanction of the owner. He shares the profit when it accrues on account of his authority over it and his work. When the contract is violated (on account of the owner) it will be treated as employment on wages till the user gets a wage equivalent of similar work anywhere else. When (the user) violates, he becomes a usurper on account of misuse of other's wealth. Quduri says '*Modaraba* is a contract based on the combination of capital from one of the two parties and it means participation in profit. This is feasible with capital from one of the two parties and work from the other party. There is no *Modaraba* except with this condition. If, however, the whole of profit would go to the owner of capital, it (the contract) becomes *Bidaa'h* (simple investment); and if it is agreed that the worker enjoys the whole of it, the contract is a *Qard* (loan).'²

The term "*Modaraba*" is interchangeably used with *Qirad* and *Muqarada*. It is presumed that the latter two originated in the Arabian Peninsula, while *Modaraba* was of Iraqi origin. Subsequently the difference appears to have been perpetuated by the legal schools, the Malikis and Shafi'is adopting the term '*qirad*' and '*muqarada*' and the Hanafi the term '*modaraba*.'³

Although not mentioned in the Holy Quran, *Modaraba* was a tradition sanctioned and practised by the Muslims and this form of commercial association continued throughout the early period of Islamic era as the mainstay of caravan and long distance trade. Indeed, not only in law, but in practice also, *Modaraba* constituted to be one of the most widespread tools of commercial activity.

². Al-Marghinani, *Al-Hidayah*, Chapter 3 p. 241

³. Abraham L. Udevitich, *Partnership and profit in Medieval Islam*, p. 174.

Modaraba is an ancient concept and it was in existence in Babylonia and several other countries in the olden times. It was known as *Commenda* in the Italian Law and was prevalent in Arabia long before the advent of Islam.

Explaining the meaning of *Qirad*, Al-Marghinani states:

"And there is no difference of opinion among the Muslims about the legality of *Qirad*. It was an institution in pre-Islamic period and Islam confirmed it. They all agree that its form is that a person gives to another person some capital that he uses it in business. The user gets according to conditions, some specified proportion of the profit, i.e. any proportion they agree one-third, one fourth or even one-half."⁴

The Holy Prophet (SAS) endorsed the practice of *modaraba*. Indeed, numerous traditions attribute the practice of *modaraba* to the Holy Prophet (SAS) and his leading companions. The Holy Prophet (SAS) acted as an agent in a *modaraba* contract with an investment by Hazrat Khadija. Hazrat Umar, Hazrat Usman and Abu Musa Ashaari were also parties to *Modaraba* contracts. Hazrat Umar used to invest the money of the orphans of which he was the guardian with merchants who traded between Madina and Mecca. Similarly Ibn Masud, a prominent companion of Holy Prophet (SAS), and Abbas-bin-Abdul Muttalib, the uncle of the Holy Prophet (SAS), engaged in *Modaraba* trading. In this context, Kasani, the author of "Badai" States:

"It is narrated on behalf of Ibne Abbas (God bless them both) that Abbas-bin-Abdul Muttalib, when he provided finance on *Modaraba*, made it a condition that he (the user) would not take the capital to the oceans nor would he enter a valley, nor would he trade with it in the sick cattle. If, however, he did any of these things, he (the user) shall be responsible (for the loss). When the Prophet (SAS) knew of these conditions, he allowed the same. Similar was the convention when the Prophet (SAS) lived and this was confirmed by him. Confirmation (by the Prophet "SAS") of a practice

⁴ *Al-Hidaya*.

means a kind of Sunnah (The practice of the Prophet "SAS")" ⁵

The endorsement of *Modaraba* as a technique of business finance is also found in two Hadiths quoted by Imam Malik in *Muwata*, 'Kitab-ul-Qirad'.

"It is reported on the authority of Zaid bin Aslam from his father that Abdullah and Obaidullah, the two sons of Hazrat Umar Ebn El Khattab that they accompanied the army which was going to Iraq. Upon arrival, they went to visit Abu Musa Al Ashaari, the Emir of Basra, who bade them welcome and told them:

"If I can be of any help to you, I will not fail to do so." He then added: "I have some money in trust which I wish to deliver to the Caliph; I will lend it to you, and you may buy with it some goods from Iraq which you may sell for profit in Madina. You will give the capital (*Raas-ul-Mal*) to the Caliph and keep the profits unto yourselves." They accepted and acted upon his advice. Meanwhile, Abu Musa wrote to the Caliph Umar explaining to him that he was entitled to the capital entrusted to his sons.

When the sons of Umar reached Madina, they sold the goods for a profit and then went to their father and apprised him about the agreement with Abu Musa. Umar asked: "Did he render the same service for the supply of the army?" When they replied in the negative, the Caliph said: "He did you, this favour, because you are the sons of the Caliph. Deliver unto me the capital as well the profits." Abdullah remained silent but Obaidullah said: "This is not appropriate, O Emir of the Faithful, if some of the money had been spent or had it been totally wiped out, we would have reimbursed it." But Umar insisted that they deliver the entire amount, capital as well as profits. Abdullah again remained silent, but Obaidullah objected. One of the men sitting with the Caliph then said: "What if you looked at it as qirad." Consequently, Umar took the capital and half the profits and his sons divided the other half between themselves." ⁶

Similarly, **Hazrat Ayesha also practised *Modaraba*. Imam Sarakhsi states:**

⁵. Ala ud Din Al-Kasani, *Badai-us-Sanai Fi Tarteeb Ashrahaia*, 79.

⁶. Malik b. Anas, *Muwata*, Chapter on *Qirad*,

"On the authority of Qasim bin Muhammad who said we had some money (as deposit) in the hands of Ayesha (God bless her). She used to invest it on *Modaraba*. God blessed us and gave profit through her efforts."⁷

The Holy Prophet (SAS) is also reported to have said "Whoever is a trustee over the money of orphans, let him trade with it, lest it be eroded by Zakat."

The sayings and the practice of the Holy Prophet (SAS) and his companions clearly point to the fact that there is a consensus among the Muslim polity on the legitimacy of the *Modaraba*. At the time of advent of Islam, the tribe of Quraish earned their livelihood primarily from trading. Since many persons were old or represented women, children and the sick and could not undertake long journey for the purpose of trade, they used to give their money to the agents under *Modaraba* contract in return for a share in profits in a certain specified ratio. The Holy Prophet (SAS) allowed this practice and his companions followed it. As argued by Imam Sarakhsi, *Modaraba* was allowed:

"Because people have a need for this contract. For the owner of capital may not find his way to profitable trading activity and the person who can find his way to such activity may not have the capital. And profit cannot be attained except by means of both of these, that is, capital and trading activity. By permitting this contract, the goal of both parties is attained."⁸

Thus the practice of *Modaraba* was allowed because of the good it rendered to the community. It fulfilled an important economic function of the Islamic community through encouraging "the hiring of capital" and the "hiring of trading skills." This is not surprising because Islam being a religion of humanity could not have ignored the use of an institution which added to the economic betterment of mankind.

⁷. *Al-Mabsut*, 22:18-19

⁸. *Al-Mabsut*, 22:19

1.3 ESSENTIAL FEATURES OF *MODARABA*

The Muslim Jurists in the earlier period of Islamic era focused their attention on elaborating the essential features of *Modaraba* and placed certain limitations on its use in order to safeguard against its misuse in situations where the agent was to be reduced to the position of a borrower or a wage earner. It is, however, significant to note that there were no hard and fast rules defining the terms and conditions of *Modaraba* other than the Prophet's (SAS) approval to what was being practiced in his time. The Muslim jurists, therefore, have differed widely on certain features. Their differences, however, stem from the interpretation put to *Modaraba* in different economic conditions prevailing in their time. Nevertheless, the legal treatment of the *Modaraba* in the three major schools of early Muslim Law (Hanafi, Maliki and Shafi) is sufficiently uniform, and the basic structural features of *Modaraba* and the character of relationship between the principal parties are similar in the three schools of thought. The essential features of *Modaraba* as elaborated by various scholars in the earlier period of Islam are summarized below:

1. *Modaraba* can be formed with any legal tender money. The criteria for the eligibility of various types of property in a *Modaraba* are the same as those for partnership. Goods were not considered admissible for the *Modaraba* contract because uncertainty relating to their value could lead to dispute and inequitable advantage and enrichment of one party over the other. In explaining the ineligibility of commodities for the formation of *Modaraba*, Kasani says:

"The *Modaraba* in goods leads to uncertainty concerning the amount of profit at the time of division. This is so because the value of goods is known only by estimation, chance and conjecture, and will differ with the approach of those who do the estimating. And uncertainty in turn leads to dispute, and dispute leads to discord."⁹

However, according to Al-Hidaya, it is permissible for *Rabb-ul-Mal* to give certain goods to the agent with instructions to sell these and use the proceeds for the purpose of

⁹ Ala ud Din Al-Kasani, *Badai-us-Sanai Fi Tarteeb Ashrahaa*, 6:82.

Modaraba. Like a *Shiraka* contract, *Modaraba* also calls for a lawful item of trade. Thus, an agent is not allowed to trade in wine or swine or any other unlawful item.

2. The amount of investment should be determined (*malum*) so that there is no dispute in this respect at a later stage. In case the investor's capital is not on hand but is owed to him by another party, the investor may empower the agent to collect the deposit or the debt on his behalf and use it for *Modaraba*.

However, it would not be permissible for a creditor to ask the debtor to use the debt for *Modaraba* because money for this purpose should be completely free from all liabilities. The conversion of debt into a *Modaraba* is prohibited to safeguard against the abuse of usurious loan being camouflaged as a *Modaraba* where in essence the creditor would possibly ensure for himself not only the recovery of his debt but also an illegal return on his loan under the cover of his share in *Modaraba* profits. For this reason, Maliki law rules out the conversion of a deposit into *Mudaraba* investment, or collection of a debt owed to the investor for its use for the *Modaraba* operations.

3. Another condition of valid *Modaraba* is that the capital (*Raas-ulMal*) should be transferred to the agent (*Modarib*). The money may be physically handed over, or authority over its disposition may be transferred to the agent. In any case, there should be a complete alienation of money on the part of the investor. This would ensure independence of the agent and also the anonymity of the investor vis-a-vis third parties. This does not, however, imply that ownership is also passed on to the agent. In fact, ownership of the property remains with the investor, while control over it is passed on to the agent. Nevertheless, the investor may impose restrictions on the agent in terms of place, object and method of trade. The investor may want to have a quick and direct access of his capital and may, for instance, stipulate that the agent may trade within a certain marketing zone, According to Shaybani, such a restrictions would be interpreted on the basis of 'istihsan' to include the adjacent areas outside the zone. This is elaborated by Sarakhsi in "Mabsut" as follows:

"If the investor entrusts with a *Modaraba* on the condition that he works with it in the market of Kufa, and the agent works with it in Kufa but not in that place, that, according to analogy, he is a violator and liable because he violated a stipulation imposed upon him by the investor. But by *Istihsan* his transactions are effective in the *Modaraba* and he is not liable. Because a stipulation which is not beneficial is not taken into consideration and there is no benefit in confining his transactions to the market. For the investor's intention applies to the price level of Kufa, not the market itself; in any place in Kufa in which he transacts business, his transactions conform to that which the investor stipulated. Do you think that if the investor instructs him to work with the investment in another market and he works in a different market, or if he instructs him to work in the house of so and so, and he works in some other place that he will be liable? He will not be liable for anything in this connection by reason of the unity of the city."¹⁰

The investor may also restrict the use of *Modaraba* to a particular commodity. This would enable the investor to take advantage of the knowledge, skill or specialization of the agent. Such a restriction would not, however, "preclude incidental expenses such as transportation, storage and help obtained by hiring persons to do certain assignments. The agent is permitted to do anything which the merchants engaged in that branch of trade would normally do. Similarly, the investor may restrict the agent in the matter of trade policy and designate parties from whom he is to buy and to whom he is to sell.' He may also forbid the agent to give goods on 'ibda' and may restrict his transactions to cash only. Again he may compel the agent to sell the goods if the bargain is profitable.

4. The profit earned out of *Modaraba* contract is to be divided in strict proportion already agreed at the time of the contract. The sharing of profit must be proportionate and not in specified amounts. The actual proportion of sharing profits is left to the discretion of the parties. Al-Marghinani lays down this principle in Al-Hidaya as follows:

¹⁰. *Al-Mabsut*, 22:48

"An important condition is that the profit between them will be proportionate and none of the two can claim a specified amount out of the profit, as this condition violates the partnership between them; and this is an indispensable condition in the contract of participation."¹¹

The share of the agent is strictly out of the profit and in no case out of capital (Raas-ul-Mal). Any violation of the proportional division of profit would make the *Modaraba* invalid and would convert it into an irregular employment (ijara) contract. In the case of loss, the entire liability is to be borne by the investor. Moreover, the proportionate division of profit should be clearly known to both the parties.

5. There may be more than one agent or investor in a *Modaraba*. So long as their share in the profit is proportionally determined and the object of the *Modaraba* is clearly stated the contract is valid. In the case of a bilateral *Modaraba*, where the share capital is contributed both by the investor and the agent, the share of the profit of the investor must be limited only to its contribution to the total capital.¹²

6. A *Modaraba* is invalid if the profit stipulation is ambiguous or the distribution of profit is not stated but is left to the discretion of one of the parties. Similarly, an arrangement where all the profit is assigned to the agent or the investor is not a valid *Modaraba*. The *Modaraba* is essentially a "partnership of profit", and its fundamental components are the association of work and capital. The profit for either party is on the basis of these two components. The range of profit-sharing within this framework is practically limitless.

7. The agent is allowed to incur legitimate business expenses in the course of *Modaraba* transactions. The limits of these expenses would be determined by the prevalent commercial practice in the branch of trade and the location. Both Shaybani and Sarakhsi have elaborated on the matter of expenses of the agent as follows:

"If a man entrusts to another ten thousand Dirhams as a *modaraba*

¹¹. *Al-Hidaya*, 3:242

¹². Muhammad bin Hassan al-Shaibani, *Asl*, Chapter on *Modaraba*,

investment on the basis of one-half or one-third or one-fourth of the profit or more, or less and the agent trades with it while in his own town or while remaining with his family, then the agent's expenses for his food, clothing and all his needs are to be borne by himself. None of his expenses are to be borne by the investor or the *Modaraba* if he does not travel."

"If, however, he departs with the capital to any other town in order to make purchase with it, or to sell some of the merchandise he has already purchased, then his expenses while travelling and while in the town to which he is heading are to be borne by the capital. This includes his clothing, food, ointment, the cost of his mount while travelling and during his sojourn in the city to which he has come in the customary manner commensurate with the expenses of somebody of his status." ¹³

"If the agent travels to another place for carrying out the business of *Modaraba*, then his expenses on travel and boarding and lodging during the stay in another city can be met out of the *Modaraba* capital. This is so because of custom; for his departure and travel are on behalf of the *Modaraba* capital. A person does not normally undertake this kind of hardship for the sake of an uncertain profit which he may or may not achieve and then pay his expenses from his own money. However, he is willing to undertake such hardship with a view to the benefit that might accrue to him; and this will not come about except by taking the expenses sufficient for his upkeep from the money at hand (i.e. the *modaraba* investment)." ¹⁴

8. *Modaraba* is a contract of fidelity and the agent is considered a trustworthy and faithful party with respect to capital entrusted to him. He is, therefore, not liable for the loss incurred in the normal course of business activities. As a corollary, he is liable for the property in his care as a result of violation of his fidelity. His actions must, therefore, be in consonance with the overall purpose of the

¹³. *Al-Asl*, chapter on *Modaraba*, 76a 1.10 76 b 1.1

¹⁴. *Al-Mabsut*, 22:62-63.

contract and within the recognized and customary commercial practice.

9. The rights of the agent implied in contract would be as follows:
 - i. Buy and sell commodities to earn some profit.
 - ii. Buy or sell for cash or credit.
 - iii. Give goods as '*bida*' or leave them as deposit or pledge.
 - iv. Hire helpers as needed.
 - v. Authorize another person as an agent for purchase and sale of goods.
 - vi. Travel for the promotion of business.
 - vii. Mingle the *Modaraba* funds with its own resources.
 - viii. Give it as a *Modaraba* to a third party.
 - ix. Invest it in a partnership with a third party.

1.4 MODARABA IN MODERN ECONOMY

It would be observed from the foregoing discussion that *Modaraba* is a form of contract in which a subscriber or an investor (*Rabb-ul-Mal*) participates with his money and the manager (*Modarib*) with his efforts and skills. In other words, it is a concept adopted in Islamic finance under which one partner (or more) participates with his funds and another with his skill and efforts in some trade business and industry permitted by Islam. The one who participates with his efforts assumes the role of manager, while the provider of funds becomes the beneficial owner.

It is also the characteristic of *modaraba* that the liability of the *rabb-ul-mal* is

restricted to his capital; the *Modarib* can also be a *rabb-ul-mal* in a bilateral *modaraba*; the loss is entirely borne by the *rabb-ul-mal*; the *Modarib* has a total control of business; the *Modaraba* has to function within the parameters of the contract; all business expenses are a charge on *Modaraba* income; the basis of profit sharing has to be defined without any pre-emptive right to any one party and *Modaraba* business can encompass any field of economic activity provided it does not conflict with Quran and Sunnah.

In modern terminology, a '*Modaraba*' is akin to a mutual fund minus its un-Islamic features. The concept of mutual funds has gained widespread acceptance in several countries. The success of NIT units and the ICP Mutual Funds is a measure of its popularity in Pakistan. The ICP has so far floated some closed-end mutual funds with a capital of certain millions. The mutual funds are actively traded on the stock market and their dividend record has been fairly satisfactory. Similarly, NIT units, which are in the nature of open-end mutual funds, have successfully mobilized household savings. These mutual funds have been Islamized by weeding out all interest-bearing investments from their portfolio. The introduction of *Modaraba* under the Islamic framework has given a new dimension to business management and mobilization of savings by opening all types of business activity to the fold of *Modaraba* which represents mutual fund practiced the present day world in an Islamic mould.

The requirement of capital funds for the establishment, maintenance and expansion of trade and industry is too obvious to need any emphasis. These funds are generally needed to finance the acquisition and replacement of plant, machinery and acquire other capital assets. Sometimes funds are required to finance the acquisition and control over other business.

A business may also need-funds to refinance or refund maturing long-term obligations. A productive unit in an economy raises the requisite funds either internally through reinvestment of retained profits and contribution by equity holders, or externally through obtaining term finance. It could be argued that the funds should be raised entirely through own sources in the form of equity so that there would be no dependence on outside funds. It is, however, observed that during the early stages of development industrial and

business units tend to be small and family financed. Their capital needs are accordingly small.

As the economy grows, the size of the business also tends to grow. A substantial and geographically scattered class with surplus savings also emerges. Self-finance is found to be too restricted to meet the capital needs of businesses and resort has, therefore, to be made to other sources. The modern process of production involves round-about methods, which has necessitated huge outlays of capital involving gestation periods which may at time spread over a number of years. It would be retrograde to go back to direct methods of production in place of present technology. It is also to be borne in mind that capital usually is not invested in infinitely small increments, but also in indivisible lumps. Nor is capital supplied continuously. Rather it is secured in discrete amounts.

Keeping these factors in mind, the basic task of evolving a new system for financing based on the Islamic principle is to transform the early techniques of Islamic finance and evolve new techniques which, on the one hand, meet the peculiar needs of entrepreneurs for capital, and on the other hand, overcome investors' resistance to part with their hard earned savings in favour of those who can utilize them fruitfully without any serious risk of loss.

Modaraba, altered and adjusted to meet the requirements of modern business without in any way sacrificing its essential elements, that is, the association of entrepreneurial skill with capital, the limited liability of the investors, a clear-cut basis of profit-sharing and total command on the use of resources by the *modaraba* within the parameters of the contract laid down in the prospectus making an offer for sale, presents a medium of finance which holds unlimited potential for mobilization of savings and their channelization into productive uses.

With this end in view, the Government of Pakistan has promulgated a *Modaraba* Law in 1980 to regulate the floatation and operation of *Modarabas* in the country.

CHAPTER TWO

THE LAW OF *MODARABA* IN PAKISTAN

2.1 SALIENT FEATURES OF *MODARABA* COMPANIES AND *MODARABA* (FLOATATION AND CONTROL) ORDINANCE, 1980

In 1980 the Government of Pakistan decided to convert the country's economy into an Islamic Economic System. Firstly, the government started implementing different modes of Islamic financial transactions such as Profit and Loss Sharing, buying and selling of shares, leasing, hire purchase and *Modaraba* etc. Except some, the rest of the modes were approved by the government. It is pertinent to mention that in all the banks in the Islamic Countries, the Islamic financial transaction system was already introduced whereas in Pakistan the mark-up system was in operation in banks. The religious scholars of Pakistan unanimously decided that *Modaraba* is the only true source of Islamic financial transactions. It is the best replacement of *Riba* (usury) which can be implemented in banks, financial institutions and trading companies.

In Pakistan *Modaraba* business was introduced in financial institutions after the promulgation of the *Modaraba Companies & Modaraba (Floatation & Control) Ordinance, 1980*. This Ordinance speaks about the Registration of *Modaraba* companies, Floatation of *Modaraba* companies' Certificates in the Capital Market (Stock Exchange) and the laws relating thereto have been laid down and elaborated in Rules framed under the Ordinance. There are three main steps starting from the incorporation/ registration of *Modaraba* companies to their enlistment with the Stock Exchanges and sale and purchase of their Certificates, which are required to be followed in accordance with the provisions of *Modaraba Ordinance*.¹

¹ *Journal of Islamic Banking & Finance*- January-March 2006

2.1.1 REGISTRATION²

A *Modaraba* management company cannot start its business/ operations unless it is registered with the Registrar of *Modaraba* who is appointed by the Government of Pakistan under the *Modaraba* Ordinance. Some of the main requirements of registration of a *Modaraba* management company are as under:

If a *Modaraba* company confines itself to the business of Floatation and Management of *Modaraba* then the company shall have to show its Paid up Capital to an amount of not less than two and a half million rupees and if it also engaged in business other than Floatation and Management of *Modaraba*, then its Paid up Capital shall not be less than seven and a half million rupees.

The directors of the company must have a good repute in honesty and integrity as well as well known businessmen of their community.

In order to permit the floatation of *Modaraba*, the Registrar office takes some time to investigate the matters of proposed *Modaraba* and its management company, its documentation, and characters and financial position of its financiers/ sponsors.

2.1.2 FLOATATION OF MODARABA³

In order to obtain permission to float a *Modaraba*, the company submits an application to the Registrar of *Modaraba* along with a prospectus accompanying the following details:

- The name and type of the *Modaraba*;
- The conditions and amounts to be floated and its division into *Modaraba* Certificates of fixed amount;

². *Modaraba Companies & Modaraba (Floatation & Control) Ordinance, 1980*

³. *Modaraba Companies & Modaraba (Floatation & Control) Ordinance, 1980*

- The business scheme and mode of distribution of profits;
- The amount to be subscribed by the *Modaraba* company;
- The form of the *Modaraba* Certificate and such other matters as may be prescribed from time to time.

The Registrar carefully examines the details containing in the application and prospectus before its onward submission to the Religious Board.

2.1.3 RELIGIOUS BOARD⁴

Under the *Modaraba* Ordinance, a Religious Board has been constituted comprising of three members. One of the three members is the Chairman of the Board, who is or has been or is qualified to be a Judge of a High Court. The remaining two members of the Board are appointed from amongst the religious scholars of Pakistan.

After a thorough scrutiny of prospectus relating to floatation of *Modaraba* by the Registrar office it is then submitted to the Board for its approval. The Board is empowered to review and give its final approval of the prospectus of *Modaraba* submitted before it. The Board while granting its approval, basically determines the Shari' status of *Modaraba*, as to whether it is not a business opposed to the Injunctions of Islam. The permission for floatation of *Modaraba* depends upon the fulfillment of basic requirements and information contained in both, the application and prospectus.

The Registrar shall not permit the floatation of a *Modaraba* unless the Religious Board certifies that the *Modaraba* is not a business opposed to the Injunctions of Islam. The Registrar after an approval by the Religious Board to this effect, may ask the *Modaraba* company to make such modification, additions or omissions in the prospectus as the Religious Board may have indicated or the Registrar may deems fit. After final approval by the Board, the prospectus is required to be published in the leading daily news papers.

⁴. "*Modaraba Companies & Modaraba (Floatation & Control) Ordinance, 1980.*

2.1.4 REGULATORY AUTHORITIES⁵

To regulate the day to day affairs/ matters of *Modarabas* and their companies, certain authorities/ bodies have been vested with the regulatory powers which are as under:

2.1.4.1 SECP (Securities & Exchange Commission of Pakistan)

The Registrar of *Modaraba* functioning under this Commission (SECP), after a thorough scrutiny of *Modaraba*, its management company, its documentation, financiers/ sponsors etc. gives approval for registration of *Modaraba* company. The Registrar may on his own motion or on an application made by the holders of *Modaraba* Certificates (whose certificates' value is not less than ten percent of the total subscribed amount of the *modaraba*) investigates the mismanagement of affairs of the *Modaraba* company or *Modaraba* through an enquiry. In case *Modaraba* or its company contravenes/ violates any provisions of the *Modaraba* Ordinance, 1980 the Registrar is empowered to cancel the registration of *Modaraba* company, remove the company from the management of *Modaraba* floated by it and can initiate legal proceedings or impose penalty against the *Modaraba* company.

2.1.4.2 RELIGIOUS BOARD

The permission to float Certificates of a proposed *Modaraba* business rests with the Religious Board who gives final approval of the prospectus of *Modaraba* followed by a certificate to this effect that the *Modaraba* is not a business opposed to the Injunctions of Islam.

⁵. *Ibid & Modaraba Excessive Control Stunts Development*, Economic Review (March-1995), 21.

2.1.4.3 STATE BANK OF PAKISTAN

It is binding on the management of a *Modaraba* company to regularly submit its reports regarding its business affairs, with the State Bank of Pakistan so that the bank should get in touch with the matters relating to *Modaraba* business for its smooth running. State Bank's monitoring can be judged from the fact that quite a number of returns are annually filed with it by *Modarabas*.

2.1.4.4 CHARTERED ACCOUNTANT

In order to look after the matters relating to profits and distribution thereof of a *Modaraba* business, the Government of Pakistan has made it mandatory for *Modaraba* companies under the provisions of the *Modaraba* Ordinance, 1980 to get their accounts audited by a renowned auditor who is a Chartered Accountant within the meaning of the Chartered Accountants Ordinance, 1961. The Auditor shall be appointed with the approval of the Registrar. In addition to other matters, the auditors' report shall state as to whether in their opinion the business conducted, investments made and expenditures incurred by the *Modaraba* are in accordance with the objects, terms and conditions of the *Modaraba*.

2.1.4.5 TRIBUNAL⁶

For the purpose of *Modaraba* Ordinance, 1980 the government of Pakistan may by a notification constitutes one or more Tribunals in order to provide speedy and effective justice. A Tribunal so constituted shall consist of such person who is or has been or is qualified to be a Judge of a High Court. The Tribunal while deciding claims filed by either holder of *Modaraba* Certificates or a *Modaraba* company, or on an application by the Registrar for winding up of a *Modaraba* company, shall exercise its powers as vested in a civil court under the Code of Civil Procedure. Similarly, in exercise of its criminal

⁶. *Modaraba Companies & Modaraba (Floatation & Control) Ordinance, 1980.*

jurisdiction it shall have the same powers as are vested in the Court of a Sessions Judge under the Code of Criminal Procedure. All proceedings before a Tribunal shall be deemed judicial proceedings before a court. The matters before the Tribunal shall be decided expeditiously and in exercise of its civil jurisdiction it shall follow the summary procedure provided in Order 37 of the Code of Civil Procedure. Any party aggrieved by any order, judgement, decree or sentence of the Tribunal may within thirty days prefer an appeal to the relevant High Court whose Bench shall be comprising of two Judges. Presently the Banking Tribunals of the three main cities Karachi, Lahore and Peshawar have been vested with the additional powers of the Tribunal under the *Modaraba* Ordinance of 1980.

2.1.5 PUNISHMENTS⁷

If a *Modaraba* company violates and/ or commits any of the following faults, the Tribunal can punish such faults with imprisonment of either description of a term which may extend to 3 years and with fine which may extend up to five hundred thousand rupees:

- If any *Modaraba* company operates without registration.
- Any *Modaraba* engages in a business opposed to the injunctions of Islam.
- A *Modaraba* company violates any of the conditions applicable to a *Modaraba* or fails to furnish accounts, etc. to its certificate holders.
- A *Modaraba* company, director, officer, employee or agent or auditor makes any statement or gives any information which he knows to be false or incorrect or omits any material fact from any document, prospectus, report, return, accounts or information or explanation required in pursuance to the Ordinance or Rules framed thereunder.

⁷. *Modaraba Companies & Modaraba (Floatation & Control) Ordinance, 1980.*

- A *Modaraba* company;
 - (a) engages in a business which competes with that for which a *Modaraba* is floated; or
 - (b) the company or any of its directors, officers or relatives obtain loan, advance or credit from the *Modaraba* funds on security of its assets; or
 - (c) Subscribe less than 10% of the total amount of the *Modaraba* Certificates offered for subscription.

2.1.6 PENALTIES

If a person refuses or fails to furnish any information called for under the Ordinance or refuses to comply with the conditions imposed by Federal Government or directive issued under the Ordinance or contravenes or fails to comply with any provision, the Registrar may, after satisfying himself, and after having given the person an opportunity of being heard, impose a penalty up to one hundred thousand rupees and, in case of continuing default, a further sum calculated at the rate of Rs.1,000/- per day after the issue of the order.

2.1.7 APPEAL⁸

In case of an order passed by the Registrar, an appeal shall lie with the Commission (SECP) and in case of the order of Tribunal, the appeal shall lie with the bench of two judges of the High Court of the competent jurisdiction.

⁸. *Modaraba Companies & Modaraba (Floatation & Control) Ordinance, 1980.*

2.1.8 INCOME TAX⁹

If 90% of the profits of a year of a *Modaraba* are distributed to the Certificate holders, no income tax will be payable by the *Modaraba*. If profits are not distributed at the specified ratio then the income tax will be levied and deducted at such rates which is payable by the other corporate concerns.

2.1.9 WINDING UP OF MODARABA

A *Modaraba* floated for a fixed period or for a specific purpose shall be wound up by the *Modaraba* company on the expiry of the period fixed for the *Modaraba* or upon the accomplishment of the purpose of *Modaraba*. A *Modaraba* under this Ordinance shall also be wound up by the Tribunal on an application made by the Registrar of *Modaraba* if:

(a) the *Modaraba* is unable to discharge its liabilities;

(b) the accumulated losses wipe out more than 50% of the total amount subscribed;

(c) the business of the *Modaraba* is being conducted or has been conducted for a fraudulent purpose or with intent to defraud the certificate holders, creditors or other persons; and

(d) the Tribunal is of the opinion that it is just equitable to wind it up.

⁹. *Ibid.*

2.2 THE COMPARATIVE STUDY OF *MODARABA* COMPANIES AND *MODARABA* (FLOATATION AND CONTROL) ORDINANCE, 1980 AND COMPANIES ORDINANCE, 1984

2.2.1 SPECIAL LAW AND GENERAL LAW

Before going into detailed discussion of comparative study of both the laws; first we should distinguish between the special law and general law. Special law is that law which is enacted/ promulgated to cover a specific subject and/ or topic. This law does not discuss any other subject but confines itself only to that particular topic. Whereas, general law is that law which covers many subjects and topics at the same time and this term is used/ applied in a broader/ wider sense. The law of *Modaraba* Companies and *Modaraba* (Floatation and Control) Ordinance, 1980 is a special law and it has been enacted/ framed and introduced keeping in view the specific subject or purpose to cover under it i-e, the matters relating only to *Modarabas* and *Modaraba* companies. Whereas, the Companies Ordinance, 1984 is a general law and it has been enacted/ framed and promulgated in order to cover matters relating to all types of companies even including *Modaraba* management companies. It is a well settled principle of law that special law over rules the general law in case of any conflict, confusion/ dispute relating to applicability, as to whether which of these two laws (special and general laws) shall prevail.

2.2.2 REGISTRATION¹

Like all other companies, a private or a public limited *Modaraba* management company is incorporated/ registered under the Companies Ordinance, 1984 in the CRO (Companies Registration Office) of that area where the registered office of the company will situate. The detailed procedure for registration of such companies has been explained in the Chapter "Incorporation of *Modaraba* Management Companies". Similarly under the *Modaraba* Ordinance, 1980 these management companies are registered with the

¹. *Modaraba Companies & Modaraba (Floatation & Control) Ordinance, 1980 and Companies Ordinance, 1984.*

Registrar of *Modaraba* as *Modaraba* companies and a certificate to this effect is issued by the Registrar.

2.2.3 FLOATATION²

In order to enlist/ register a company with Stock Exchange for the purpose of floating of its shares, it is mandatory that the company must be a public limited by shares whereas, under the *Modaraba* laws there is no such condition for a *Modaraba* company regarding its floatation of *Modaraba*. Similarly other conditions such as announcement of annual dividend not less than 90 percent is restricted to *Modaraba* companies only, otherwise these companies shall be levied income tax at the ratio charged to other corporate concerns

2.2.4 REPORTS AND RETURNS³

The *Modaraba* management companies are governed under the Companies Ordinance, 1984 and these companies submit their Forms regarding change of address of registered office etc. with the concerned CRO but in case of change of any Director(s), the company before its submission of Form-29 obtains approval of the name of new Director(s) from the Registrar *Modaraba*. Moreover, annual return (Form-A) is submitted by these companies with the CRO regularly under the Companies Ordinance. Annual audited accounts are also filed under the Companies Ordinance and *Modaraba* Ordinance with the concerned CRO and Registrar *Modaraba* respectively.

2.2.5 MEETINGS

Modaraba companies are required to regularly hold their Annual General Meeting and/ or an Extra Ordinary General Meeting as the case may be and Board of Directors'

². *Ibid*

³. *Ibid*

meetings under the Companies Ordinance whereas, *Modaraba* Certificates holders' annual general meeting is convened under the *Modaraba* Ordinance and a report to this effect is submitted to Registrar of *Modaraba*.

2.2.6 PUNISHMENTS AND PENALTIES

There are certain restrictions and requirements which like all other public and private limited by share companies must be fulfilled by the *Modaraba* management companies under the Companies Ordinance and in case of default thereof, penalties can be imposed by the concerned CRO on these companies. The *Modaraba* Ordinance being a special law on the subject of *Modaraba* contains therein certain provisions relating to punishments and penalties which may be inflicted upon the *Modaraba* companies such as if a *modaraba* company violates or commits any faults, the Tribunal can punish such faults with imprisonment of either description of a term which may extend to 3 years and with fine which may extend up to five hundred thousand rupees (as explained in preceding chapter). Similarly, If a person refuses or fails to furnish any information called for under the *Modaraba* Ordinance or refuses to comply with the conditions imposed and/ or contravenes or fails to comply with any provision, the Registrar may, after satisfying himself, and after having given the person an opportunity of being heard, impose a penalty up to one hundred thousand rupees and, in case of continuing default, a further sum calculated at the rate of Rs.1,000/- per day after the issuance of the order.

2.2.7 COURT JURISDICTION

Under the Companies Ordinance, the original jurisdiction of companies legal matters rests with the High Court of competent jurisdiction whereas, under the *Modaraba* Ordinance, Tribunals have been constituted and vested with special powers to handle the matters relating to *Modaraba* companies and an appeal against an order of Tribunal shall lie with the bench of two judges of the High Court.

2.2.8 REGULATORS

SECP is the regulator of companies incorporated under the Companies Ordinance whereas, there are certain authorities including SECP (as explained in the preceding chapter) have been vested with the powers to regulate the affairs of the *Modaraba* companies under the *Modaraba* Ordinance.

In general the *Modaraba* companies are governed and regulated under the *Modaraba* Ordinance, 1980 and major penalties/ punishments are awarded thereunder. Since it is a special law on a specific subject therefore, the affairs of *Modaraba* companies are very minutely looked into by the Registrar of *Modaraba* and Religious Board in order to keep it strictly a *Shari'ah* compliant business activity.

2.3 ANALYSIS OF THE EXISTING MODARABA LAWS IN PAKISTAN

Promulgation of *Modaraba* Companies & *Modaraba* (Floatation & Control) Ordinance, 1980 was the first important step towards the introduction of *Modaraba* business in Pakistan. *Modarabas* were created by the Ordinance whose intent it was to provide a legal framework for formation and regulation of *Modaraba* as a recognized legal entity as well as providing a framework for *Modaraba* management through a *Modaraba* management company.

Modaraba is an Islamic form of limited partnership in which a managing firm agrees to invest the funds of a fairly large number of passive investors. Shares of the management company (in case of listed public limited company) as well as those of their *Modaraba* funds subscribed by the private investors are traded on the stock exchange. As long as the *Modarabas'* activities are sanctioned by the Religious Board, it can engage in almost any line of permissible business. A number of private and public sector companies whether registered under the Companies Act, 1913 and/ or presently incorporated under the Companies Ordinance, 1984 started undertaking the business of *Modaraba* and

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floated it in the Capital Market in Pakistan.³

Presently public or a private limited by shares *Modaraba* management company is incorporated under the Companies Ordinance, 1984. It has to fulfill the minimum requirement of paid-up capital. Like all other companies, a *modaraba* management company has to submit certain documents at the time of its incorporation such as Memorandum and Articles of Association along with certain Forms which we will discuss in detail under the title of Incorporation of *Modaraba* Management Companies.⁴

For the purpose of registration of a *Modaraba* company an application is made to the Registrar of *Modaraba* accompanied by certain documents which we will discuss in detail in the next chapter. The Registrar on being satisfied that the company is eligible to be registered shall issue a Certificate of Registration on such conditions as may be specified. Thereafter, for the purpose of floatation of *Modaraba*, the company submits an application to the Registrar of *Modaraba* (appointed by the Government of Pakistan under the *Modaraba* Ordinance, 1980) along with a prospectus accompanying certain details as explained in the preceding chapter “The Law of *Modaraba* in Pakistan”. Registrar carefully examines the details containing in the application and prospectus before its submission to the Religious Board for its examination.⁵

In order to run *Modaraba* business in accordance with the injunctions of Islam a Religious Board has been constituted under the *Modaraba* Ordinance. This Board scrutinizes the prospectus of floatation of *Modaraba* submitted before it by the Registrar, in the light of Shari’ah and finally gives certification if nothing is found in it against the injunctions of Islam. Only then *Modaraba* company is allowed to start its operations of *Modaraba* business in Pakistan.

For the purpose of raising *Modaraba* funds, *Modaraba* companies float/ issue *Modaraba* certificates of a certain value like the sale of shares of public limited

³. Shabbir H. Kazmi, *Modaraba: A Viable Alternative*, *Pakistan & Gulf Economist* (March-April, 2005).

⁴. *Companies Ordinance, 1984*

⁵. *Modaraba Companies & Modaraba (Floatation & Control) Ordinance, 1980 and The Modaraba Companies and Modaraba Rules, 1981.*

companies listed in the Stock Exchanges. Each *Modaraba* company who floats *Modaraba*, is required to invest at least ten percent of its total investment of *Modaraba*. *Modaraba* business starts with the sale of *Modaraba* certificates. *Modaraba* company's business is very closely watched by the Registrar of *Modaraba*. Annual accounts, Auditors' report, *Modaraba* business activities and copies of prospectus are regularly sent to each holder of *Modaraba* certificates.

Modaraba company is allowed to receive service charges or remuneration only to the extent of not more than ten percent of the total annual profits. The *Modaraba* company is not allowed to raise funds from any other source except through the process of floatation. In case of loss in *Modaraba* business there shall be no liability of *Modaraba* company.⁶

Briefly, we can say that *Modaraba* is a fund which is utilized/ invested by the *Modaraba* company in different modes of Islamic investment. This fund basically contains ten percent of company's investment and the remaining ninety percent is invested by the general public. The *Modaraba* company takes ten percent of the total annual profits and apart from this it takes ten percent of the total annual profits as management fee.

It is pertinent to mention here that in the ancient concept of *modaraba* generally there are two parties, Investor (*Rab-al-mal*) and the Agent (*Mudarib*). The distribution of profit and loss sharing is done between these two. This view is held and supported by the majority of Muslim Jurists.

Whereas, *Modaraba* practiced and allowed under the prevailing laws of Pakistan contains a slightly different concept. Under the existing laws of *Modaraba* there are three parties who participate in the business of *Modaraba*, first party (*Rab-al-mal*) may be the persons who provide investment, the second party is either a bank or a *Modaraba* company who works for the first party as *Mudarib* (agent) and hands over the first party's invested amounts to a third party to start business with these amounts. Here the bank or *Modaraba* company shall have the status of *Rab-al-mal* in their relation with the third

⁶. *Ibid*

party. All the three parties execute separately *Modaraba* agreements with each other. First agreement is executed between the first party (*Rab-al-mal*) and the bank or *Modaraba* Company (*Mudarib*) whereas; the second agreement is executed between the bank or *Modaraba* Company (*Rab-al-mal* and the third party/ businessman (*Mudarib*). This view/ concept is held and supported by the Jurists of *Hanafi* Fiqh. According to them, since the second party hands over the first party's investment to the third party keeping in mind the element of risk (*Daman*) involving therein therefore, the second party is entitled for sharing in profits.⁷

The *Modaraba* business in Pakistan contains transparency therein due to the existing *Modaraba* laws. Certain authorities have been vested with the powers of regulators under these laws and they have checks over the business activities of *Modaraba* companies. *Modaraba* companies are registered after a thorough investigation and scrutiny of their documentation submitted before the Registrar and thereafter at the time of its floatation, its Shari' status is verified by the Religious Board constituted under these laws. If a *modaraba* company violates any of the provisions of the *Modaraba* laws, the penalty to that effect shall be imposed on it after being first heard the matter by the Registrar, the Commission (SECP) and/ or the Tribunal as the case may be. The business of *Modaraba* companies is closely watched and governed in accordance with the provisions of *Modaraba* Companies and *Modaraba* (Floatation and Control) Ordinance, 1980 and the Companies Ordinance, 1984 in order to make sure that these companies are running their business strictly in accordance with the injunctions of Islam.

⁷. Ghulam Rasool, *A Review on Modaraba System in Pakistan*, 5-6.

CHAPTER THREE

THE *MODARABA* BUSINESS IN PAKISTAN

In Pakistan a company wishing to float a *Modaraba* will have to get it registered with the Registrar of *Modaraba* appointed by the Government of Pakistan under the *Modaraba* Ordinance, 1980 and fulfills the conditions laid down in the *Modaraba* laws. The permission requested for shall be granted by the Registrar for the floatation of *Modaraba* after scrutiny of necessary documentation if found correct and in accordance with the provisions of the *Modaraba* laws and the injunctions of Islam.

3.1 TYPES AND FLOATATION OF *MODARABA* IN PAKISTAN¹

3.1.1 Types of *Modarabas*

There are two types of *Modaraba* applicable in Pakistan, Multipurpose and Specific purpose *Modarabas*:

(a) **Multipurpose *Modaraba*** It means a *modaraba* having more than one specific purpose or objective. For instance, a company may float a *Modaraba* for running a transport service, operating an automobile workshop and providing services as packers.

(b) **Specific purpose *Modaraba*** It means a *Modaraba* for a specific purpose or objective, for instance to set up and run a cement plant.

These *Modarabas* can be for a fixed period or for a specific purpose and or for a perpetual/ indefinite period. The fixed period *Modarabas* will terminate at the end of the fixed period while a specific purpose *Modaraba* will be wound up when the specified

¹. *Modaraba Companies & Modaraba (Floatation & Control) Ordinance, 1980 & Modaraba Companies & Modaraba Rules 1981.*

purpose has been achieved or upon the accomplishment of the purpose of the *Modaraba*. In this regard all the directors of *Modaraba* company shall make a declaration to this effect supported by a report of the auditor on the affairs of *Modaraba* and file the same with the Registrar. The declaration shall have no effect unless approved by the Registrar. The aggrieved party may file an appeal to the Commission (Securities & Exchange Commission of Pakistan) who shall dispose off the same after giving the appellant an opportunity of being heard. Under the *Modaraba* Ordinance, 1980 the Tribunal is also empowered to wind up the *Modaraba* under certain circumstances upon filing of an application by the Registrar with the Tribunal. Similarly a perpetual-*Modaraba* would continue indefinitely unless wound up specifically under the *Modaraba* Law.

3.1.2 Floatation of Modaraba

Any company registered under the Companies Act, 1913 or presently under the Companies Ordinance, 1984 or a body corporate formed under any law in force, owned or controlled, whether directly or through another company or corporation by the Federal Government or Provincial Government can undertake *Modaraba* business. However, there are certain pre-requisites which must be fulfilled before any company undertakes the business of management of *Modarabas*. Main among these are:

- i) If a company is formed solely for the purpose of floating and managing a *Modaraba*, it must have a paid-up capital to an amount of not less than two and a half million rupees. In the case of companies which are engaged in other business and want to float a *Modaraba*, the minimum amount of paid up capital exclusively set aside for management of *Modarabas* will have to be presented separately;
- ii) No director, officer or employee of the company has been convicted of fraud, breach of trust or an offence involving moral turpitude;

iii) No director, officer or employee of such a company has been adjudged an insolvent or has suspended payment or compounded with his creditors;

iv) The promoters, in the opinion of the Registrar, are persons of means and integrity and have knowledge of matters with which the *Modaraba* company will deal;

v) The company is registered with the Registrar as *Modaraba* company and has obtained permission of the competent authority of Capital Issues and Registrar for floatation of *Modaraba*; and

vi) A clearance is obtained from the Religious Board (constituted under the *Modaraba* Ordinance) to the effect that the business proposed to be carried on by the *Modaraba* is not opposed to the injunctions of Islam.

For the purpose of registration of a *Modaraba* company an application is made to the Registrar accompanied by the following documents:

- Five copies of the Memorandum and Articles of Association;
- Five copies of Certificate of incorporation;
- Receipted treasury challan in respect of the fees paid for the application;
- Five copies of the latest audited accounts, if the company has already been in business; and
- A precise description of the business being done, if it is already engaged in business other than floatation of *Modaraba* or if it is proposes to undertake such business in addition to floatation and management of *Modarabas*.

The Registrar on being satisfied that the company is eligible to be registered shall issue a Certificate of Registration in Form-X on such conditions as may be specified. Thereafter, for the purpose of floatation of *Modaraba*, the Registrar shall submit the prospectus along with other documentation of *Modaraba* Fund with the Religious Board who gives final approval of the prospectus of *Modaraba* and a certificate to this effect that the *Modaraba* is not opposed to the Injunctions of Islam will be issued by the Board.

3.2 INCORPORATION OF *MODARABA* MANAGEMENT COMPANIES²

The *modaraba* management company is a legal entity; presently it is formed under the Companies Ordinance, 1984. It has a certain minimum limit of share capital and it can not be formed without share capital. Liability of its members is limited to the extent of their share in the paid-up capital of the company.

These companies may further be classified as public (listed or non-listed) or private companies limited by shares. Non listed public limited companies can be formed by at least three persons and in case of listed companies by at least seven persons by subscribing their names to the Memorandum and Articles of Association of the company. A private limited *Modaraba* management company may be formed even by a single person by subscribing his or her name to the Memorandum and Articles of Association of the company.

A private limited company, by its Articles of Association:

- i) restricts the right to transfer its shares;
- ii) limits the number of its members to fifty; and
- iii) prohibits any invitation to the public to subscribe for shares or debenture of the company.

². *The Companies Ordinance, 1984.*

There are certain steps which are required to be followed under the Companies Ordinance, 1984 for the incorporation of a *Modaraba* management company which are as under:

1. The first step with regard to incorporation of a *Modaraba* management company is to seek availability of name of the proposed company from the concerned Companies Registration Office on payment of a prescribed fee. The name should not be inappropriate, deceptive or designed to offend the religious susceptibilities of the people and it should neither be identical nor have close resemblance with the name of any existing company.

2. In case of incorporation of private limited companies, the following documents are required to be submitted to the concerned Companies Registration Office:

i) Four copies of Memorandum and Articles of Association signed by the promoters;

ii) Declaration on the prescribed Form-1 regarding compliance with the requirements of the Companies Ordinance, 1984 signed by any proposed director or an authorized person;

iii) Address of the registered office of the company on Form-21; and

iv) Particulars of Chief Executive, Director(s) and other officers on Form-29.

3. In case of incorporation of public limited companies, in addition to the documents required for registration of a private limited company, the following documents are also required to be filed with the concerned Companies Registration Office:

i) List of persons consenting to act as Chief Executive/ Directors on Form-27; and

- ii) Consent of Chief Executive and Directors on Form-28.

3.2.1 MAIN OBJECTS OF A MODARABA MANAGEMENT COMPANY³

The objects for which the *Modaraba* management company is established are governed by the *Modaraba* Companies and *Modaraba* (Floatation and Control) Ordinance, 1980 and generally the following main objects are incorporated in clause III of the Memorandum of-Association of such company:

- To engage in *Modarabas*, *Musharakas*, *Murabahas* and all other forms of Islamic business and to initiate, sponsor, promote, float, organize, manage, administer and operate *Modaraba* companies, *Modaraba* funds and *Modarabas*, *Musharakas* and *Murabahas* of all types and descriptions.
- To assist, invest or participate in and to collaborate or co-operate under any financial management, joint venture or other arrangement with any *Modaraba* company, *Modaraba* fund, *Modaraba*, *Musharaka*, *Murabaha*, *Mutual* fund and other similar concerns.
- To arrange, procure and raise finance through *Modaraba* companies, *Modaraba* funds and *Modarabas* of all types and descriptions, mutual funds and other similar concerns.
- To amalgamate or merge with or to absorb, takeover or manage any other company having any of the objects primarily similar to those of this company.
- To purchase, sell, dispose off, divest, exchange, transfer or terminate, acquire or takeover directly or indirectly, wholly or partially either for the purpose of retaining or re-sale any other *Modaraba* company, *Modaraba* fund, *Modaraba*, *Mutual* fund, *Investment* company or any other similar concern.

³. A number of companies' Memorandum & Articles of Associations

The *modarabas* are wholly engaged in the business of:⁴

- *Modaraba*
- *Musharaka*
- *Murabaha*
- *Ijarah*
- *Salam*
- *Istisna'a*

3.2.1.1 MODARABA

A form of partnership where one party provides the funds while the other provides expertise and management. The latter is referred to as the *Mudarib*. Any profits accrued are shared between the two parties on a pre-agreed basis, while loss is borne only by the provider of the capital (*Rab-ul-Maal*).

3.2.1.2 MUSHARAKA

Musharaka means a relationship established under a contract by the mutual consent of the parties for sharing of profits and losses in the joint business. It is an agreement under which an Islamic bank provides funds, which are mixed with the funds of the business enterprise and others. All providers of capital are entitled to participate in the management, but not necessarily to do so. The profit is distributed among the partners in pre-agreed ratios, while the loss is borne by each partner strictly in proportion to respective capital contributions.

⁴ . Khaile Niaz Khawaja, *Islamic Concept of Banking*.

3.2.1.3 MURABAHA

Literally it means a sale on mutually agreed profit. Technically, it is a contract of sale in which the seller declares his cost and profit. Islamic banks have adopted this as a mode of financing. As a financing technique, it involves a request by the client to the bank to purchase certain goods for him. The bank does that for a definite profit over the cost, which is stipulated in advance.

3.2.1.4 IJARAH

Ijarah is a contract of a known and proposed usufruct against a specified and lawful return or consideration for the service or return for the benefit proposed to be taken, or for the effort or work proposed to be expended. In other words, Ijarah or leasing is the transfer of usufruct for a consideration which is rent in case of hiring of assets or things, and wage in case of hiring of persons.

3.2.1.5 SALAM

Salam means a contract in which advance payment is made for goods to be delivered later on. The seller undertakes to supply some specific goods to the buyer at a future date in exchange of an advance price fully paid at the time of contract. It is necessary that the quality of the commodity intended to be purchased is fully specified leaving no ambiguity leading to dispute. The objects of this sale are goods and cannot be gold, silver or currencies. Barring this, Salam covers almost everything, which is capable of being definitely described as to quantity, quality and workmanship.

3.2.1.5 ISTISNA'A

It is a contractual agreement for manufacturing goods and commodities, allowing cash payment in advance and future delivery or a future payment and future delivery. Istisna'a can be used for providing the facility of financing the manufacture or construction of houses, plants, projects and building of bridges, roads and highways.

3.2.2 Registration with Registrar of Modaraba⁵

The following are the requirements which must be fulfilled by the *Modaraba* Management Company for its registration as *Modaraba* Company with the Registrar of *Modaraba* and thereafter its floatation of *Modaraba*:

- It is a registered company under the Companies Act, 1913 (VII of 1913);
- Presently the company is incorporated/ registered under the Companies Ordinance, 1984;
- It is a body corporate formed under any law in force and owned or controlled, whether directly or through a company or corporation, by the Federal or a Provincial Government;
- If being a company solely engaged in the floatation and management of *Modaraba*, it should have a paid up capital of not less than two and a half million rupees;
- If being a company also engaged in business other than floatation and management of *Modaraba*, it has a paid up capital not less than seven and a half million rupees;

An application for registration of a *Modaraba* company shall be made to the Registrar

⁵. *Modaraba Companies & Modaraba (Floatation & Control) Ordinance, 1980 & Rules of 1981.*

in Form IX and it shall be accompanied by the following documents:

1. Five copies of the Memorandum and Articles of Association;
2. Five copies of Certificate of incorporation;
3. Receipted treasury challan in respect of the fees paid for the application;
4. Five copies of the latest audited accounts, if the company has already been in business; and
5. A precise description of the business being done, if it is already engaged in business other than floatation of *Modaraba* or if it is proposes to undertake such business in addition to floatation and management of *Modarabas*.

The Registrar on being satisfied that the company is eligible to be registered shall issue a Certificate of Registration in Form-X on such conditions as may be specified. Thereafter, for the purpose of floatation of *Modaraba* the Registrar shall submit the prospectus along with other documentation of *Modaraba* Fund with the Religious Board who gives final approval of the prospectus of *Modaraba* and a certificate to this effect that the *Modaraba* is not opposed to the Injunctions of Islam shall be issued by the Board.

3.3 CONDITIONS APPLICABLE TO *MODARABA* AND

A *MODARABA* COMPANY⁶

There are certain conditions which are required to be fulfilled by *Modaraba* and its Management Company in order to run the business of *Modaraba* in accordance with the injunctions of Islam. Chief among these conditions are as under:

- It must be a registered company either under the Companies Act, 1913 or

⁶. *Modaraba Companies & Modaraba (Floatation & Control) Ordinance, 1980 & Rules of 1981.*

presently under the Companies Ordinance, 1984;

- It must be a body corporate formed under any law in force and owned or controlled, whether directly or through a company or corporation, by the Federal or a Provincial Government;

- If a company is solely engaged in the floatation and management of *Modaraba*, it must show a paid up capital of not less than two and a half million rupees;

- If a company is also engaged in business other than floatation and management of *Modaraba*, then its paid up capital must not be less than seven and a half million rupees;

- For the purpose of floatation, an approval of *Modaraba* must be obtained from the Registrar and the Religious Board who gives final approval of the prospectus of *Modaraba*.

- The allotment of *Modaraba* Certificates shall not be made by the company unless the prospectus approved by the Registrar has been issued and the minimum amount stated in the prospectus to be the amount which must be raised in order to provide for the business operations and expenses has been subscribed.

- All moneys received from the applicants for *Modaraba* Certificates of a *Modaraba* shall be deposited and kept in a separate account in a scheduled bank.

- If the subscription amount has not been received by the date specified in the prospectus, all moneys received from the applicants shall be refunded to them within fifteen days of the said date and the *Modaraba* company and its directors shall be jointly and severally liable to repay the money which is not so refunded.

- The *Modaraba* company shall issue *Modaraba* Certificates within thirty days from the date of allotment of these certificates.

- The *Modaraba* company shall maintain a register of holders of *Modaraba* Certificates in such form and in such manner as may be prescribed under the *Modaraba* Rules.

- The *Modaraba* company shall maintain separate bank account, funds, assets and liabilities of each *Modaraba*.

- No *Modaraba* shall be liable for the liabilities, or be entitled to benefit from the assets, of any other *Modaraba* or of the *Modaraba* company.

- A *Modaraba* Certificate shall be transferable in the manner provided for in the prospectus of the *Modaraba*.

- No *Modaraba* company shall engage in any business which is of the same nature and competes with the business carried out by a *Modaraba* floated or controlled by it.

- No *Modaraba* company or any of its directors or officers or their relatives (spouse, brother or sister or any of the lineal ascendants or descendants) shall obtain loan, advance or credit from the funds of the *Modaraba* or on the security of the assets of the *Modaraba*,

- A *Modaraba* company shall subscribe in each *Modaraba* floated by it not less than ten percent of the total amount of *Modaraba* Certificates offered for subscription. Thus the *Modaraba* company is also financially involved in the *Modaraba* bilateral in character.

- The Registrar can call for special reports, information, etc. from time to time and ask the *Modaraba* company to make them available to the certificate holders and in default thereof a penalty can be imposed.

- The remuneration of a *Modaraba* company in respect of a *Modaraba* firm floated by it shall be a fixed percentage of the net annual profits of the *Modaraba* and shall not exceed ten percent of such net annual profits computed in the

manner to be prescribed.

- The *Modaraba* being a legal person can sue and be sued in its own name and the assets and liabilities of each *Modaraba* will be separate and distinct from each other as well as from those of the *Modaraba* company. Moreover, no *Modaraba* shall be liable for the liabilities of or be entitled to benefit from the assets of any other *Modaraba* or of the *Modaraba* company.

In order to ensure that the interest of the investors are safeguarded, the *Modaraba* companies have to follow certain statutory obligations/ requirements (already explained in preceding chapter) relating to matters such as issue of capital, issuance of certificates, appointment of auditors, winding up; and in case of any refusal/ failure or violation on the part of *Modaraba* company, punishments/ penalties are inflicted or imposed as the case may be.

3.4 CASE STUDY OF FEW MODARABA COMPANIES IN PAKISTAN¹

The *Modaraba* Ordinance of 1980 provides a legal framework for formation and regulation of *Modaraba* as well as a framework for a *Modaraba* company. Soon after the sanction/ approval by the Religious Board constituted under the Ordinance, the *Modarabas* are engaged in their business activities.

The first *Modaraba* i-e, Twin Tower *Modaraba* was formed in 1981. The first multi-purpose *Modarabas*, BRR *Modaraba* and First Habib *Modaraba* were floated in 1985. In 1987, First Grindlays *Modaraba* and *Modaraba* Al-Mali were floated. The success of these *Modarabas* attracted others and by 1990, 14 and by December 1991 total 36 *Modarabas* had been floated.

This growth was partially due to the relatively good profits earned by the *Modarabas*. The fact that the *Modarabas* were also managed within the injunctions of Islam made

¹. Based on *Modaraba Companies'* old and current reviews

them attractive investments. Perhaps more important, section 37 of the *Modaraba* Ordinance provided for tax exemptions if not less than ninety percent of its profits were distributed to the holders of *Modaraba* Certificates. These factors led to a rapid expansion of *Modarabas* with 19 new ones floated in 1991 alone and by the end of 1999 there were 60 *Modarabas* in existence.

Another factor responsible for the expansion of *Modarabas* has been the incentives given to banks to get into this type of business. The floatation of *Modarabas* allows banks to: (a) acquire funds at relatively low cost; (b) save income tax; (c) improve their liquidity position of banks; and (d) leverage on maximum exposure to one organization. Specifically, through their *Modarabas*, banks can partially extend funds from their banking operations and partly through leasing plant and machinery. This enables the banks to extend larger amounts to good clients without running up against the credit limit per party.

Currently in Pakistan the following are the *Modaraba* Management Companies and the *Modarabas* floated and managed by them as shown in the table below:

<i>Modaraba</i> Companies & <i>Modaraba</i> as on 31.12.2008			
Sr.No	List of <i>Modaraba</i> Management Companies	List of <i>Modarabas</i>	Status
1	A.R. Management Services (Pvt) Ltd.	Imrooz <i>Modaraba</i>	Active <i>Modaraba</i>
2	A.R.T. <i>Modaraba</i> Management (Pvt) Ltd.	Tri-Star <i>Modaraba</i>	Active <i>Modaraba</i>
3	Allied Engineering Management Company (Pvt) Ltd.	Allied Rental <i>Modaraba</i>	Active <i>Modaraba</i>
4	Al-Noor <i>Modaraba</i> Management (Pvt) Ltd.	Al-Noor <i>Modaraba</i>	Active <i>Modaraba</i>

5	Al-Zamin <i>Modaraba</i> Management (Pvt) Ltd.	1. Al-Zamin Leasing <i>Modaraba</i>	Active <i>Modaraba</i>
		2. Unicap <i>Modaraba</i>	Active <i>Modaraba</i>
6	B.R.R. Guardian Investment (Pvt) Ltd.	1. B.R.R. Guardian <i>Modaraba</i>	Active <i>Modaraba</i>
		2. Crescent Standard <i>Modaraba</i>	Active <i>Modaraba</i>
7	Bank Islamic Investment (Pvt) Ltd.	<i>Modaraba</i> Al-Mali	Active <i>Modaraba</i>
8	Constellation Management Company (Pvt) Ltd.	Constellation <i>Modaraba</i>	Active <i>Modaraba</i>
9	Crescent Standard Business Management (Pvt) Ltd.		Dormant
10	Crescent <i>Modaraba</i> Company Ltd.	Elite Capital <i>Modaraba</i>	Active <i>Modaraba</i>
11	Dadabhoy <i>Modaraba</i> Management Ltd.	Dadabhoy <i>Modaraba</i>	<i>Modarabas</i> under Winding up
12	Dewan Mushtaq Financial Services (Pvt) Ltd.		Dormant
13	E.A. Management (Pvt) Ltd.	B.F. <i>Modaraba</i>	Active <i>Modaraba</i>
14	Faysal Management Services (Pvt) Ltd.		No <i>Modaraba</i> yet floated
15	Fidelity Capital Management	Fidelity Leasing <i>Modaraba</i>	Active <i>Modaraba</i>

16	First Investec Management Services Ltd.	First Investec <i>Modaraba</i>	<i>Modarabas</i> under Winding up
17	First <i>Modaraba</i> Management (Pvt) Ltd.		No <i>Modaraba</i> yet floated
18	Global Econo Trade (Pvt) Ltd.	Treet Manufacturing <i>Modaraba</i>	Active <i>Modaraba</i>
19	Habib Bank Management Services (Pvt) Ltd.	Habib Bank <i>Modaraba</i>	Active <i>Modaraba</i>
20	Habib <i>Modaraba</i> Management (Pvt) Ltd.	Habib <i>Modaraba</i>	Active <i>Modaraba</i>
21	I.B.L. <i>Modaraba</i> Management (Pvt) Ltd.	I.B.L. <i>Modaraba</i>	Active <i>Modaraba</i>
22	Islamic Investment Bank Ltd.	Islamic <i>Modaraba</i>	<i>Modarabas</i> under Winding up
23	National Bank <i>Modaraba</i> Management Company Ltd.	National Bank <i>Modaraba</i>	Active <i>Modaraba</i>
24	National Technology Development Corporation Ltd.	Long Term Venture Capital <i>Modaraba</i>	<i>Modarabas</i> under Winding up
25	Pakistan Industrial Development Financial Services Ltd.		Dormant
26	Paramount Investments Ltd.	Paramount <i>Modaraba</i>	Active <i>Modaraba</i>
27	Premier Financial Services (Pvt) Ltd.	Equity <i>Modaraba</i>	Active <i>Modaraba</i>
28	Premier <i>Modaraba</i> Management Company (Pvt) Ltd.		Dormant

29	Prudential Capital Management Ltd.	Prudential <i>Modaraba</i>	Active <i>Modaraba</i>
30	Punjab <i>Modaraba</i> Services (Pvt) Ltd.	Punjab <i>Modaraba</i>	Active <i>Modaraba</i>
31	Royal Management Services (Pvt) Ltd.	Pak <i>Modaraba</i>	Active <i>Modaraba</i>
32	Schon <i>Modaraba</i> Management (Pvt) Ltd.	Schon <i>Modaraba</i>	<i>Modarabas</i> under Winding up
33	Standard Chartered Services of Pakistan (Pvt) Ltd.	Standard Chartered <i>Modaraba</i>	Active <i>Modaraba</i>
34	Tawakkal <i>Modaraba</i> Management (Pvt) Ltd.		Dormant
35	Technology Venture (Pvt) Ltd.	KASB <i>Modaraba</i>	Active <i>Modaraba</i>
36	Total Hospitality (Pvt) Ltd.		No <i>Modaraba</i> yet floated
37	UDL <i>Modaraba</i> Management (Pvt) Ltd.	UDL <i>Modaraba</i>	Active <i>Modaraba</i>
38	Unity <i>Modaraba</i> Management (Pvt) Ltd.	Unity <i>Modaraba</i>	<i>Modaraba</i> has been wounded up in 08
39	Universal Management Services (Pvt) Ltd.		
40	Vanguard <i>Modaraba</i> Management (Pvt) Ltd.		Dormant
41	SFT <i>Modaraba</i> Management (Pvt) Ltd.		MMC newly registered (Dec 08)

42	<i>Modaraba</i> Managed by the Administrator	Trust <i>Modaraba</i>	Active <i>Modaraba</i>
	Number of <i>Modaraba</i> management companies	41	
	Number of <i>Modaraba</i> Funds floated	27	
	<i>Modaraba</i> managed by administrator	1	
	<i>Modarabas</i> under Floatation	3	
	<i>Modarabas</i> under winding up	6	

3.4.1 Twin Tower *Modaraba*

As a pioneering effort, Bankers Equity Limited launched the first ever *Modaraba* in Pakistan operated by the name and style of Twin Tower *Modaraba*. Naturally, the first *Modaraba* was more a concept and a new product rather than a simple commercial proposition. The first *Modaraba* had all the ingredients of a pioneering and path breaking venture. It was aimed at testing three hypotheses:

- Is *Modaraba* an appropriate medium for resource mobilization?
- Can *Modaraba* be relied upon as a proper mechanism for business management?
- Can *Modaraba* measure up to the expectation of the stock market as good performer of returns on investment?

It is necessary to correct a widespread misconception which continues to haunt the floatation of the first *Modaraba* even today long after its winding up in March, 1983. The Twin-Tower *Modaraba*, which was the first *Modaraba*, was not the outcome of a choice. In early 1981, after the promulgation of *Modaraba* Law and Rules framed thereunder, it

was expected that persons from the private sector will take the initiative to use *Modaraba* a device for fund mobilization. When no one came forward, Bankers Equity Limited in its eagerness to promote Islamic products of finance took the initiative of promoting *Modaraba*. After a great deal of scouting, only one person volunteered to go through the *Modaraba* route for completing an apartment structure project which was lying incomplete for quite sometime. In other words, if a choice was there, it was more between testing the concept of *Modaraba* or not having a *Modaraba* at all. Bankers Equity obviously took the bold step of testing the concept and a lot of insight has been obtained which would be valuable for floating any new *Modaraba* in future.

The first *Modaraba* can be rated as among the successful new issues floated on the stock exchange. As against the original offer of Rs.15 Million, the total subscription of the Twin Tower *Modaraba* amounted to nearly Rs.40 Million, or 2.7 times, over the original offer. In all 3,899 applications were received, of this, 116 applications involving total subscription of over Rs.3.137 Million were received from overseas Pakistanis. The local applications for subscription numbered at 3,783 involving Rs.37.842 Million. Out of the total applications, 2,531 applications were received for the minimum subscription of Rs.1,000 by one applicant involving Rs.2.531 Million, leaving a balance of 1,252 applications received for amounts exceeding the minimum subscription of Rs.1,000 per applicant aggregating to Rs.34.311 Million.

As regards the success or failure of the first *Modaraba* as an instrument of business management, this particular *Modaraba* had two facets to it. In its relationship to the subscribers, the Bankers Equity acted as the "Modarib" but in its turn, in its relationship with the user of funds Bankers Equity assumed the role of "Rabb-ul-Mal" while the user of funds acted as the "Modarib" for the application of *Modaraba* funds in the completion of the apartment structure. The implementation of the project was closely supervised. The apartment structure built under the umbrella of Twin Tower *Modaraba* can legitimately claim to be the only structure built by any property developer in Pakistan which had the benefit of high standards of overseeing, supervision and rigorous control on the quality of construction by an independent agency such as Bankers Equity Limited. Similarly, ever

since the induction of Bankers Equity Limited in the project through the *Modaraba*, every element of cost and input was subjected to a very thorough scrutiny not only by Bankers Equity, but also by its project implementation specialist arm, namely Real Estate Management Corporation of Pakistan.

As regards the performance of the first *Modaraba* as a medium measuring up to the expectation of the saver for giving a good return, judged from this viewpoint, the first *Modaraba* gave a return of 30.5% for investment made in a project of 18 months duration, or a return of 20% per annum. This was a good enough return for any investor to channelize his savings in an Islamic instrument of finance.

3.4.2 First Al-Noor Modaraba

First Al-Noor *Modaraba* managed by Al-Noor *Modaraba* Management (Pvt.) Limited was floated on 19th October 1992. The company's objective was to engage in domestic and international trading activities as a trading house prevalent mercantile practices that are not in violation of the injunctions of Islam. The *Modaraba* has been specifically trading in the following commodities and products:

- Agriculture and Food Products
- Chemical & Petro-chemical Products;
- Construction Materials and Capital Goods;
- Jute & Jute Products;
- Leather & Leather Products; and
- Textile Products and Fiber.

3.4.2.1 Capital Structure

The authorized capital of the company initially was Rs. 400.00 million (later on increased) divided into ordinary shares of Rs.10 each, against which the paid-up capital stood at Rs. 200.00 million and currently its paid up capital is Rs.210 million. The company has made investments in various industrial sectors including: banking and investment, construction, fertilizer, fiber board, insurance, sugar and trading. The company belongs to a well-known Al-Noor Industrial Group.

3.4.2.2 Resource Mobilization

The company mobilizes additional resources without the element of Riba (interest) using the modes of Musharaka, Morabaha, *Modaraba* (and all other permissible Islamic modes approved by the Religious Board).

3.4.2.3 Concepts of Trading Transactions

The Company abides by the following trading concepts:

- *Modaraba* does not enter into any transactions, business, sale or purchase dealing which violates the injunctions of Islam. In all its dealings and transactions the *Modaraba* observes the principles of Shari'ah.
- *Modaraba* only transact sale of the products and commodities which it owns as principal or when acting as agent, product/ commodity is owned by its principal.
- The products/ commodities sold or purchased are in the physical or constructive possession of the seller who also bears the risk corresponding to the possession.

- The sale price on credit is disclosed before an offer of sale.
- The contract of sale is not contingent.
- The delivery of goods or the payment of price is also not contingent on an event that may or may not occur in future.

3.4.3 LTV (Long Term Venture) Modaraba:

From a position of near bankruptcy in November 1992 (at the time of change in management), since then LTV has become one of the leaders in the financial services sector. In August 1994, before the announcement of the results for the year ended June 30, 1994, LTV had a paid-up capital of Rs.200 million. This amounted to about 2.7 percent of the *Modaraba* sector paid-up capital and about 8.5 percent of the sector's market capitalization. Before its winding up process LTV's paid up capital was Rs.395.911 million. It was not only the most traded *Modaraba* share but it also earned the distinction of being one of the highest traded shares on the Karachi Stock Exchange.

In 1994 the company produced a return on capital to Certificate holders of 66.6% and a dividend of 50%. At that time it was a record for the *Modaraba* sector. Since then LTV *Modaraba* has been distributing its profits among its Certificate holders at relatively better rates compared to other *Modarabas*. In the continuing quest for solving the resource mobilization problem for the *Modaraba* sector, the management of LTV believes that it has achieved a major break through in the proposed LTV Redeemable Certificate. The proposed instrument is basically an interest free bond with warrants attached to it and it has been offered to LTV's Certificate holders. Its approval was obtained from both, the Registrar and the Religious Board. Not only was the instrument provided LTV with 0 interest financing, it dramatically increased the earnings of the *Modaraba*, which was paid out to the Redeemable Certificate holders.

In view of the excellent results in the last few years and even management's ambitious business expansion plans, the board of directors has been regularly deciding to announce dividend to its certificate holders after deduction of board's management fee at a maximum allowable rate of ten percent. The management of LTV *Modaraba* strongly believes that it is their corporate obligation to contribute towards building a well-balanced society and a better environment. The management pledges to make LTV a professional run financial institution of international standards.

In sum, the management of LTV *Modaraba* believes that Pakistan today offers unique opportunities for entrepreneurs. The success story of LTV itself is one of the most prominent examples of effective use of entrepreneurial skills. Based on their optimism for Pakistan's future growth, LTV *Modaraba* had set up a Strategic Investment department. The function of this department was to identify viable projects and local entrepreneurs and to invest in projects, including venture capital projects which encourage technology transfer and international joint ventures. After introduction of this department, LTV *Modaraba* successfully handled different projects including setting up of a 108 MW power plant in Pakistan, under LTV Power Generation Limited, having majority holding in this company. Presently LTV *Modaraba* is being wound up by its management.

3.4.4 First Interfund Modaraba:

First Interfund *Modaraba* (FIM) is a multi-purpose *modaraba* listed on all three stock exchanges of Pakistan. It is a member of the Interfund Group which includes Long Term Venture Capital *Modaraba*, Inter Asia Leasing Company Limited and Inter Fund Housing Finance Limited.

FIM was launched in May 1991 by a group of professionals dedicated to their mission of positive contribution to the economy. Initially it had a paid-up capital of Rs.35 million which was increased to Rs.60 million in 1993 and currently its paid up capital is Rs.77.558 million.

The reason for this successful track record is development of innovative services supported by extensive research. The company offers the following services:

- Stock Market Investment Advisory Services
- Client Fund Management
- Corporate Research
- Stock market brokerage and placement of stocks, underwriting of public issues of shares and development and placement of corporate bonds.

The company feels that the capital market in Pakistan is mainly confined to shares, whereas the secondary markets for banks' certificates, treasury bills and other instruments is still in a very rudimentary state. Even in the stock exchanges, major buying and selling decisions are made by brokers who mostly depend on their hunch rather than detailed analysis of a company. The company feels that to gain advantage in today's market it will have to increasingly rely on its leadership in security analysis and advisory services.

The overwhelming importance of *Modaraba* and their significant contribution to the national economy in the areas of leasing, stock market investments, short and long-term financing, trading and, in some cases, even manufacturing, cannot be overestimated. Most of the *Modarbas* listed on the Karachi Stock Exchange are perpetual, multi-purpose and multi-dimensional. Plain readings of the prospectuses of the *Modarabas* reveal their scope of business and lines of activity which include:

3.4.4.1 Finance

These provide working capital finance on profit and loss sharing basis using *Musharaka* (joint venture partnership) and by supplying materials, products and capital goods on cash and deferred mode of payment.

3.4.4.2 Advisory and Investment Management Services

The *Modarabas* often give professional analysis of non-interest bearing securities to institutional and individual investors. In addition, they can:

- Provide expert financial and investment advice pertaining to Islamic modes of investment.
- Manage investment portfolios in Halal (as approved by the Religious Board) shares and stocks, non-interest bearing securities and bonds, *Morabaha*, *Musharakas*, public floatation and private placement of approved equity securities.
- Act as advisors to companies in corporate or financial restructuring as well as in the preparation of resource mobilization plans.

3.4.4.3 Underwriting

Underwriting of shares of joint stock companies means that when the shares of a new joint stock company could not be sold, and any financial institution takes the responsibility of their buying.

3.4.4.4 Venture Capital

These activities include:

- Providing seed capital to private companies with exceptional potential for growth and capital restructuring with the ultimate aim of floating shares and securities of the company to the general public.
- Co-sponsoring the companies being floated.

- Providing funds through Musharakas and Morabaha arrangements.
- Acting as financial intermediary, raising venture capital and equity capital for existing and new companies.
- Rehabilitating potentially viable, but sick or near sick companies.

3.4.4.5 Leasing

Subject to the approval of Registrar of *Modaraba*, they engage in the business of leasing for which the funds are generated through Certificate floatation or Musharaka arrangement and other lawful resources.

3.4.4.6 Investment

They invest in equity and non-interest bearing securities listed and traded at the various stock exchanges.

3.4.4.7 Resource Mobilization

They mobilize substantial resources through Musharaka, *Modaraba*, Morabaha and other permissible Islamic modes.

In the decade of 90s *Modarabas* had obtained around 70 percent of their revenues from leases, 16 percent from trading and other sources, 9 percent from Morabaha and Musharaka, with income from equity investments comprising the rest. On the asset side, around 51 percent had consisted of assets leased out; Morabaha and Musharaka Finance accounting for 18 percent investment equity securities; 8 percent, with cash and other assets comprising the remainder.

The business of *Modaraba* companies can be judged by the two main aspects; one is that the value of *Modaraba* Certificates depends upon the fluctuations of Stock Market. If the market trend is rising or bullish then the value of *Modaraba* Certificates will definitely rise and attractive otherwise the situation will be depressing but comparatively better than the other stocks floated in the market. The second aspect covers the area of net work of *Modaraba*, such as annual reports, audited accounts, annual announcement of maximum profits and financially a strong group backing *Modaraba*, are the main sources of its success. Moreover, those *Modarabas* which have been floated by the banks are successful due to the reason that they are directly financed by the banks themselves such as Habib Bank *Modaraba*, National Bank *Modaraba*, Punjab *Modaraba* etc.

CHAPTER FOUR

ANALYSIS AND CONCLUSION

Modaraba is a partnership in profit whereby one party provides capital (*Rab al-maal*) and the other party provides labour (*Mudarib*). The capital provider is permitted to obtain guarantees from the *Mudarib* that are adequate and enforceable. This is circumscribed with a condition that the capital provider will not enforce these guarantees except in cases of misconduct, negligence or breach of contract on the part of *Mudarib*.¹

Modaraba is basically an ancient concept and it has been proved through the Hadith and practice of the Holy Prophet (SAS) and his companions. This old experience encouraged a large number of people in the private sector to launch *Modaraba*. After the introduction of *Modaraba* laws in Pakistan, the *Modaraba* business started functioning and a number of *Modarabas* were formed. The experience gained by the first *Modaraba* in Pakistan has encouraged a number of persons in the private sector to launch new *Modarabas*. After the success of first *Modaraba*, perpetual *Modarabas* for multi-purpose business were introduced and approved. To carry out the business of leasing of transport vehicles and industrial plants and buildings, *Modaraba* has played a successful role in the past few years.

The law of *mudaraba* differs banking as the business in the former is conducted on the will of the *rabb-ul-maal* while banks in their ordinary business do not ask for the consent of the customer/investor. In addition, the amount of profit to be paid to the customer is fixed at the time of contract while in *mudaraba* business, the amount of profit is not fixed, even the investor is supposed to bear the loss if it incurs.

Modaraba companies are regulated by a number of authorities/ bodies such as:

- Registrar of *Modaraba*;

¹. *Shari'a Standards for Islamic Financial Institutions* (1429 H – 2008), 235-236

- Religious Board;
- SECP (Securities and Exchange Commission of Pakistan);
- Auditors;
- Competition Commission of Pakistan;
- Stock Exchange; and
- The State Bank of Pakistan.

In part, the large number of regulators reflects the Government's concern over the increasing number of financial mishandlings. The scope of regulations covers the capital structure of the *Modarabas*, creation of reserves, and per party exposure. Some of the more salient features of these rules are:

- *Modarabas* will maintain both for funded and non-funded financing in each case for the first two years of operation, a ratio of equity to liabilities not less than 1:7 and thereafter the ratio may be increased for each to 1:10.
- Not less than 20 percent of after tax profit of *Modarabas* shall be credited to a reserve fund till such time as the reserve fund equals the amount of paid-up capital of the *Modaraba*. Thereafter a sum of not less than 5 percent of the after tax profit will be credited to a reserve fund.
- Not less than 15 percent of the *Modarabas* liabilities excluding paid-up capital, borrowings from financial institutions, and the lease key money will be invested in NIT (National Investment Trust) units or any other investment permitted by the Religious Board.
- Total exposure of the *Modaraba* to a single borrower will not exceed 20 percent of the equity. In the case of listed companies, total exposure will not exceed 20 percent of the total assets of *Modaraba*.

- While granting a credit facility, every *Modaraba* will ensure that the total facilities availed by the borrower do not exceed 10 times the capital and reserves (free of losses) of the borrower.
- Every *Modaraba* will have at least 70 percent of its assets in the principle line of business.

With regard to regulation it is clear that certain controls are unnecessary:

- Until late 1994, *Modarabas* were not allowed to mobilize resources through offering deposits. As such, the regulatory role of the Central Bank of *Modarabas* was unjustified.
- The State Bank monitoring is excessive. The Bank procedures require the (often understaffed) *Modarabas* to file over 150 returns annually.
- Changes in regulations had been occurring frequently and were unpredictable. The result has been to undermine the confidence of *Modaraba* Certificate holders and the general public.

Another problem faced by the *Modarabas* is their changing tax status. In the 1992 budget the government proposed initiating a 25 percent tax on the income of the *Modarabas* (after their first three years of tax exemption). This action created considerable uncertainty, as the *Modarabas* were assumed to be permanently tax-free. In addition, the tax removed the obligation of payment of 90 percent dividends to *Modaraba* Certificate holders, thus creating uncertainty over future dividends. The change in taxation not only applied tax on income but to a number of other taxes as well, Turn Over Tax of half a percentage and Withholding Tax of 2.5 percent.

After considerable bargaining between the *Modaraba* Association of Pakistan and the Ministry of Finance, the Turn Over tax was withdrawn from *Modaraba* Sector. The Withholding Tax of 2.5 percent on transactions of the *Modarabas* was reduced to 1 percent. Further concessions were allowed in the budget of 1993 with two years lower

taxation of 12.5 percent, after three years' exemption, and thereafter 25 percent tax.

However, the tax problems of *Modarabas* have not been completely resolved. The application of Capital Value Tax on purchase of commodities by *Modarabas* (which were tax exempt and were, therefore, unable to show an assessment of tax for the Assessment Year 1993) has badly hurt the *Modarabas* doing Leasing business. They had to pay a 5 percent Capital Value Tax on purchase of any vehicle or machinery for leasing and were therefore, losing business to Leasing Companies (unaffected by this tax). The Withholding tax of 2 percent on imports of goods and 2.5 percent on sales was also adversely affecting the trading of the *Modarabas*.

These problems have to one extent or another affected the growth and development of the *Modarabas* in Pakistan. The result had been that:

- While most of *Modarabas* listed on the Karachi Stock Exchange, were quoted below par.
- While most *Modarabas* declared stock dividends, local banks were often reluctant to extend funds to them on a Musharaka basis.

One explanation for these patterns is that the *Modarabas* were over regulated. Another explanation focuses on the changing tax liabilities and differential controls and access to credit faced by the *Modarabas*.

The *Modaraba* sector in general has been facing liquidity problems and operating in an environment that essentially restricted their resource mobilization capacity. This has kept the *Modaraba* Certificates under-priced in spite of the presence of quite a few well managed *Modaraba* companies. Since the commercial banks have limited availability of funds due to some reasons such as pressure on them to buy Treasury Bills offered by the government etc. Therefore, the larger *Modarabas* few years ago started receiving funds from international agencies like IFC (International Finance Corporation) and others. However, a large portion of these funds is in the form of equity, not as in the form of a more flexible line of credit.

In addition, the government offers such excellent returns on their securities that people who want a safe, stable guaranteed return and securities of investment prefer to invest in these securities, for example, "the Defense Saving Certificates". But these problems have been mitigated by allowing *Modarabas* to issue Musharaka certificates and introduce Redeemable Certificates.

Modarabas have come to fill an important niche in the Pakistan's evolving capital markets. While commercial banks provide short-term finances and non-bank financial intermediaries are involved in project financing, the *Modarabas* occupy an important slot for providing short and medium term finance.

The attractiveness of the *Modarabas* lies in their versatility. They can engage in leasing and contribute to capital formation directly. They can provide short-term funds for seasonal inventory and trade and thus support the marketing of commodities and exportable surpluses. Or, they can invest in capital market and contribute to its development. *Modarabas* can be established for the specific purpose of taking over and rehabilitating sick industries, or those being privatized. Venture capital *Modarabas* could be the financing solution to the funding problems of many small enterprises with the potential for growth.

Yet it is clear that *Modarabas* have yet to reach their true potential in the financial intermediation market. In the more developed financial system of the West and South-East Asia, mutual funds are playing a far greater role in the mobilization and investment of funds for economic development than in Pakistan.

In short we can say that *Modaraba* could not flourish as could have, due to a number of serious problems:

- In 1990's decade too many *Modarabas* were floated in too short a time. The result had been excessive competition and falling rates of profit.
- They are controlled and regulated by too many agencies and face too many arbitrary restrictions.

- The basic problem is financial. *Modarabas* have to obtain Shari'ah-based finance that is Musharaka-based finance from institutions or Morabaha-based. Normally commercial banks are not inclined to finance the *Modarabas* because they operate on more or less a mark-up which is Riba' or Interest.

- The same applies to international agencies like the World Bank, IFC, and the Islamic Development Bank who would normally finance and allocate lines of credit. However, few years ago these organizations had indicated a willingness to consider taking shares in the *Modarabas*. Had that trend continued, a valuable source of finance would have become available to the *Modarabas*.

If we assume that changes in government policy toward the *Modarabas* will enable them to better compete for resources and that willingness of international agencies to lend to the *Modarabas* will increase:

- With increased competition, there would likely to be a series of mergers involving the smaller *Modarabas*.

- With the passage of time, the international agencies will understand the working of *Modarabas* and also develop faith in this Islamic mode of financing and will participate more readily.

- The allowing of COIs (Certificates of Investments) on Musharika basis will provide a major stimulus to the *Modarabas* by enabling them to raise adequate funds to expand their operations.

Pakistan can claim to have blazed the trail of *Modaraba* business by codifying it and launching *Modarabas* for mobilizing savings and using them in an Islamic financial mode. But this ideal alternate to Riba' and one of the popular tools of commercial activity could not flourish itself the way it was successful in its beginning when it was introduced and launched after the promulgation of *Modaraba* laws.

However, the main criticism on *Modaraba* business in Pakistan is that it is not being

practiced in its true sense in accordance with the Injunctions of Islam. As according to the prevailing *Modaraba* laws, the *Modaraba* companies are required to invest minimum 10% of the total investment and they are also entitled to share in profits as against their shareholding. Moreover, these companies are also allowed under the law to create reserve funds out of the net annual profits which is not in accordance with the Injunctions of Islam and what would be the use of these funds and in case of winding up of *Modaraba* where would these funds be utilized. To resolve these issues, the learned Muslim Scholars of Islamic world has given their *Fatwas* which are reproduced below:

“It is lawful for an agent-manager in a *Modaraba* operation to invest in that operation such that he/she will be legally termed a partner in the operation through the capital which he/she puts into it. At the same time, he/she will still be legally considered an agent-manager in the *Modaraba* owing to his/her work, and for the percentage agreed upon. Thus, he/she will have two legal roles in the operation: that of an investor and that of an agent-manager”.

“There is no legal impediment to the establishment of a reserve fund with which to confront the various risks and dangers facing investment operations, including bad debts and the sorts of things that usually put projects at risk and threaten investors with losses. The legality of doing so, however, will depend upon the agreement of the investor to have a percentage (proportionate to the risk involved) of his/ her profits deducted, while nothing is to be deducted from the agent-manager, so that only the investors will share in financing the reserve fund”. It was further explained that the purpose of the reserve fund is to reduce the risk of losses; than to guarantee the capital investment which would then amount to a sort of Riba’. “Since each investor agreed in writing to have a share of his/ her profits deducted and deposited as a gift to the fund, therefore, when the bank/ company ceases to function the contents of the fund may be donated as a charity, including the category of charitable spending approved for Zakah”.²

². Institute of Islamic Banking and Insurance, a Compendium of Legal opinions on the operations of Islamic Banks Ijara, Sarf and Riba edited and translated by Yousuf Talal Deloreno Vol: 1, Edition II.

Apart from the difficulties explained above faced by *Modarabas*; on the whole it proved to be a successful mode of Islamic financial system. What required is, only the sincere efforts on the part of government by giving incentives to *Modaraba* companies. It is incorrect to say that the experience of *Modaraba* in Pakistan has a history of failure. In fact, the *Modaraba* sector is a growing sector having total assets of Rs.30 billion with Rs.10 billion of equity as on June 30, 2008. The sector has been regularly paying dividends to its certificates holders. The market price of *Modaraba* Certificates has also witnessed a growing trend. As a Shari'ah compliant business activity, the *Modaraba* has been able to recognize itself as an Islamic Financial Institution and has been providing the investment opportunities to the masses that are desirous of investing their savings in the Shari'ah compliant business activities. In the economies of the Muslim world *Modaraba* can play a very vital role and there is every hope that *Modaraba* will become an effective and a popular medium of corporate finance in the economies of the Muslim world.

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