

# MUSYARAKAH: FROM A PRACTITIONER'S PERSPECTIVES

Positioning Musyarakah as a Shariah Based Business

Musyarakah – Discipline vs Products

The Need to Promote Musyarakah & Why We Must Not Rely  
on Islamic Banks to Spearhead Musyarakah as a Full-Fledged  
Discipline

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# SCOPE

- ❖ Musyarakah- Benefits for Ummah & Society
- ❖ Introduction to Musyarakah
- ❖ Positioning Musyarakah as a Syariah Based Business
- ❖ Concept of Musyarakah
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- ❖ Musyarakah vs Conventional VC/PE
- ❖ Potential of Musyarakah in Malaysia



# MUSYARAKAH- Benefits for the Ummah & greater Society

NEW STRAITS TIMES TUESDAY, MAY 29, 2007

## PM: Venture capital fund can drive Muslims ahead

■ By V. Vasudevan  
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**KUALA LUMPUR:** The prime minister has proposed a venture capital fund to boost business and innovation in a Muslim world beset by economic stagnation.

Datuk Seri Abdullah Ahmad Badawi urged delegates at the third World Islamic Economic Forum yesterday to use the occasion to think about the establishment of a Muslim venture capital industry, which he described as a pillar of modern enterprise.

"For the Muslim *ummah*, the lesson is clear: We need to unleash innovation by ensuring that our entrepreneurs have access to the capital they need to succeed," he said in his opening address to the forum.

He said the Muslim world need-

ed to pool its resources and that the interaction and networking afforded by the forum had, in the past, shown results, such as in the formation of various working groups.

Abdullah outlined a way forward for the global Islamic community to emerge from the doldrums by making the most out of its untapped potential.

"Firstly, we need to build the foundation for innovation by rebuilding our understanding of Islam. Secondly, we need to promote innovation by creating an ecosystem for knowledge and enterprise.

"Finally, we need to sustain innovation by building and developing platforms for co-operation and sharing ideas among the *ummah*," he said.

Abdullah, who is also finance

minister, said innovation was central to the future of Muslims.

"The world is becoming more globalised and more knowledge-based, and Muslims must learn to innovate or be left behind."

He said the level of innovation among the *ummah* was low. Of the top 15 countries which have submitted international applications under the Patent Co-operation Treaty, none were Muslim countries.

Abdullah said a mindset change was the necessary first step if the *ummah* was to progress and develop.

"We must break the rigidity and dogma that currently shackle Islam. We must go beyond rituals and ceremonies in Islam."

Abdullah said if Muslims adopted the principles of Islam Hadhari and became more open and pro-

gressive, the fortunes of the *ummah* could be turned around, and the structures of Muslim innovation rebuilt.

"In order to create an ecosystem that promotes innovation, we also need to create a business environment that provides the resources for innovation."

Abdullah also called on Muslim countries to step up investments in education and human capital development.

He said that while the Organisation of the Islamic Conference counted many oil-rich countries as members, only 3.7 per cent of gross domestic product was devoted to education between 2002 and 2004, compared with an average of five per cent invested by the Organisation for Economic Co-operation and Development countries in 2004.

# IDEAS MOOTED BY THE EX-PM

- ❖ Prime Minister proposed VC Fund/s to boost Business & Innovations throughout Muslim society.
- ❖ VC recognized as a pillar of modern enterprises.
- ❖ To unleash innovations – entrepreneurs must have access to capital
- ❖ Build foundation for innovations.
- ❖ Promote innovation – create ecosystem for knowledge & enterprises.
- ❖ Sustain innovations – create platforms to share ideas among ummah.

# INTRODUCTION TO MUSYARAKAH

- ❖ A joint enterprise or partnership, where  $>2$  persons agree to employ skills & capital to derive benefits from the enterprise with profit/loss sharing implications.
- ❖ Each party is involved in the business to a certain degree, either at management and/or at board of directors level.
- ❖ Unlike creditors, ie. interest, the capital partner/s will achieve a return in the form of a portion of the actual profits earned, according to a predetermined ratio.
- ❖ Unlike creditor, the capital provider/s may suffers losses.

# POSITIONING MUSYARAKAH AS A SHARIAH BASED BUSINESS

- ❖ Musyarakah, synonym to Syariah based instead of just Syariah compliant
- ❖ Syariah based more straightforward & unambiguous.
- ❖ Many Syariah compliant activities ie. banking/fund management/PE.....relabelling??
- ❖ Must understand concept of Musyarakah, profit & loss sharing, risks/rewards
- ❖ Not for the fainthearted.....could lose all your capital.

# MUSYARAKAH – DISCIPLINE vs PRODUCT

- ❖ Some Islamic bankers labelled Musyarakah as one of the products in Islamic banking??
- ❖ Musyarakah Mutanaqisah, Musyarakah Sukuk, etc –essentially still banking/lending products
- ❖ But Musyarakah is NOT about lending??
- ❖ We propagate Musyarakah as a Discipline....NOT a product, ie. Objective Long Term to bear fruition, hence should not be hampered by short term hiccups.
- ❖ Must believe in Providence & Law of Average applies widely in this business.

# CONCEPT OF MUSYARAKAH

- ❖ Musyarakah derived from the word ‘Shirkah’, means ‘Sharing’.
- ❖ Types of Musyarakah
  - ❖ a. Shirkat al-Aqad (Contract Partnership)
  - ❖ b. Shirkat al-Milk (Co-Own)
  - ❖ c. Musyarakah Mutanaqisah (Diminishing JV)
- ❖ Shirkat al Aqad leans toward Syariah Based as it is riskier than just credit risk, ie. no certainty of capital repayment or profit.
- ❖ Shirkat al Milk & Musyarakah Mutanaqisah however leans more towards Syariah Compliant as purchase undertaking guarantees repayment of capital + profit.

# MUSYARAKAH vs ISLAMIC BANKING

## Musyarakah

- ❖ Most authentic & most ideal in Islamic Finance.
- ❖ Unlike lenders, ie. only lending money, musyarakah means participation in the business to a certain degree.
- ❖ Not only participate in profit but loss suffered by each partner must be exactly in proportion of the investment.

## Islamic Banking

- ❖ Profits are guaranteed, the risk factor is almost eliminated, ie. collateralized. Short-term gains but the long-run raise doubt about authenticity of Islamic banking & may affect reputation, ie. relabelling??

## MUSYARAKAH vs ISLAMIC BANKING (cont')

- ❖ Islamic Banks, ie. Lenders, hence profits from lending activities, NOT investment activities.
- ❖ Lending a portion of the value of collaterals & charge Base rate + profit spread. Hence, no risk on the part of the banks. If borrowers business/projects spiral downwards, banks can threaten to dispose off collaterals & if shortfalls, come after the borrowers.
- ❖ After years of such practice, bankers lost risk taking instincts.....why take risk, when they pay negligible profit rate to depositors but charge BFR+ spread.
- ❖ So, if you ask them to go into Direct Musyarakah/PE/VC, it is virtually unattainable.

## **The Need to Promote Musyarakah & Why We Must Not Rely on Islamic Banks to Spearhead Musyarakah as a Full-Fledge Discipline**

- ❖ Islamic banking been around for 26 years in Msia.
- ❖ Direct Musyarakah activities almost none, hence about time for change.
- ❖ How the Govt promoted Islamic banking, VC & PE, Musyarakah could be promoted along the same line.
- ❖ SWFs/LT mutual funds/Takaful companies, cash flush foundations/private companies/cooperatives, high net worth individuals may go into Musyarakah investments.
- ❖ Market waited the last 26 years for Musyarakah to be given push forward by Islamic banks but to no avail, so why keep going the same route?

## MUSYARAKAH vs CONVENTIONAL VC/PE

### Musyarakah

- ❖ A partner/s who contribute capital/resources admitted to the business entitled to receive a portion of profits from the venture, if any.
- ❖ Returns/profits shared by partner/s is determined by the fortunes of the business.
- ❖ No reason to compute an interest rate (ie.coupon) and no fixed costs of debt, the partner/s receive his profits only if result +ve.

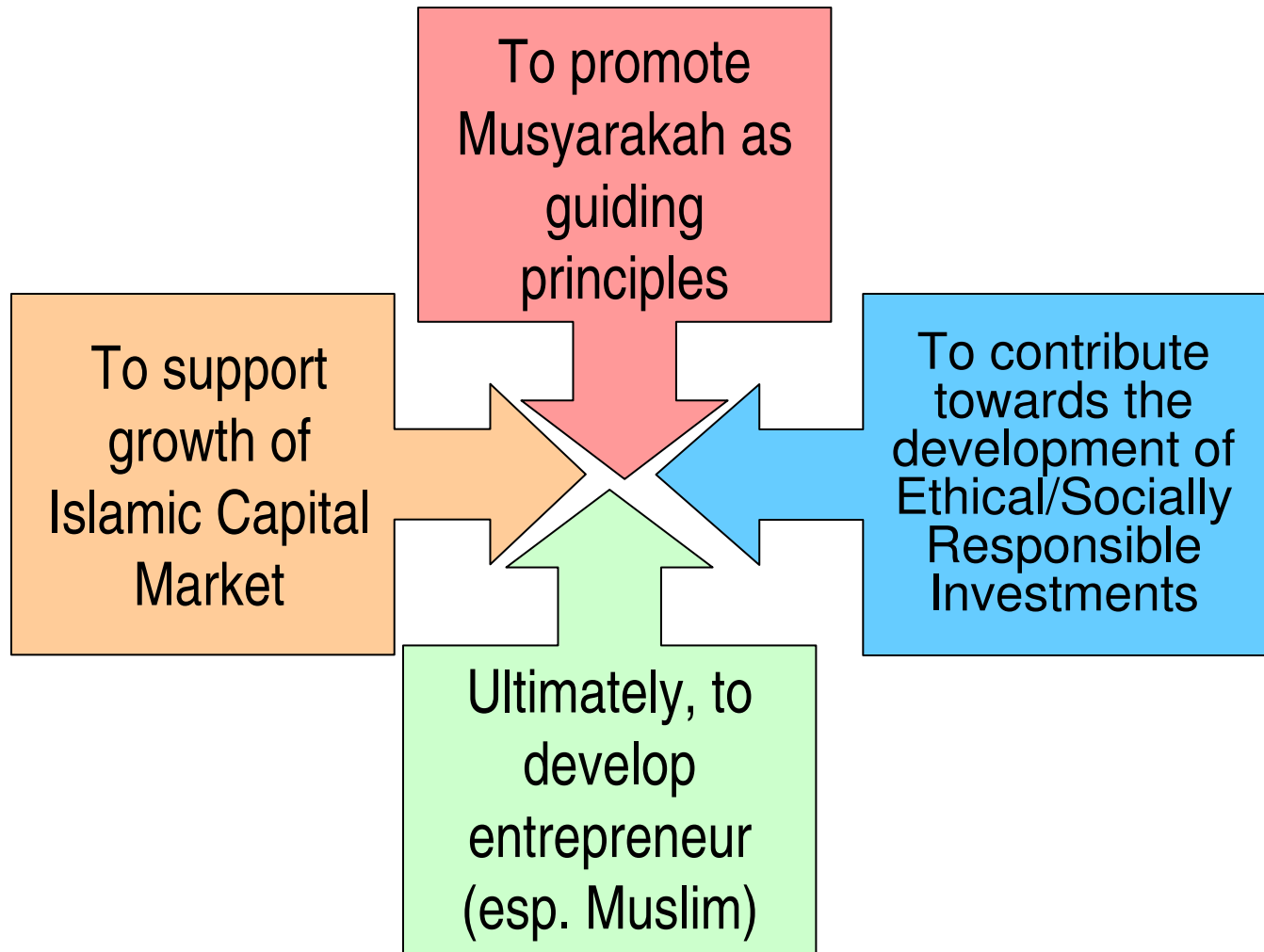
### Conventional

- ❖ High interest, plus amortization, will impose heavy fixed costs on the venture from the outset and increase the danger of failure, and in turn the interest payment also jeopardized.
- ❖ Venture's prospects can not be predicted with reasonable confidence, it will be very difficult even to calculate an appropriate interest rate.

# POTENTIAL OF MUSYARAKAH IN MALAYSIA

- ❖ Musyarakah as a product accepted by market
- ❖ Direct Musyarakah still viewed skeptically
- ❖ Many companies/entrepreneurs prefer direct Musyarakah vis-a-vis conventional VC/PE
- ❖ Various tax incentives provided by Msian Govt.
- ❖ First mover advantages.
- ❖ M'sia provides a good platform for players to expand regionally.

# Musyarakah/Islamic VC Objectives



## CONCLUSION

- ❖ Musyarakah is a discipline, NOT mere product
- ❖ Musyarakah needed to be elevated as a mainstream activity.
- ❖ Futile to get Islamic banks to go into Musyarakah.
- ❖ Hence, turn to other agencies/companies/fund providers.
- ❖ Musyarakah is Long Term discipline & more direct participation. Perseverance & know how are required.
- ❖ Lots of opportunities in Musyarakah in Msia & Regionally

# Thank You & Wasalam



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