

## CONVERGENCE AND DIVERGENCE ANALYSIS IN ISLAMIC FINANCING

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### ABSTRACT

This study aims to determine the convergence and divergence between the theory and practice of *Mudaraba* and *Musyaraka* financing in Islamic Banking. The method used in this study is a literature review of the existing references related the convergence or divergence between the theory and practice of *Mudaraba* and *Musyaraka* financing in Islamic Banking. The findings show that the divergence in the financing of *Mudaraba* and *Musyaraka* contracts tends to be less than the convergence. This can be caused by the times and the different needs of these developments, so there is a need for innovation and diversification of *Mudaraba* and *Musyaraka* financing which makes it slightly different between practice and theory.

**Keywords:** *Islamic Banking, Sharia Financing, Profit-loss Sharing, Mudaraba, Musharaka.*

### 1. INTRODUCTION

Islam has a very broad scope, its teachings cover all aspects of human life in which there are aspects of muamalah. This aspect of muamalah is used by humans to organize their lives in socializing, because basically humans are social creatures who need help to maintain, protect and sustain life. In the aspect of muamalah, it has various activities, including financial transactions, commerce, trading and buying and selling which are the activities most often carried out by humans.

Along with the times, commercial activities have progressed very rapidly in their transactions. This is due to the large number of financial institutions that provide a stimulus to the community, namely by providing convenience in obtaining loans or financing for both business and personal needs. However, the loan installment payments are accompanied by a predetermined interest. This is certainly not in line with the Islamic view because in Islam interest is usury and usury is an act that is hated by Allah SWT, so it must be shunned. The strict prohibition related to usury is explained in the Qur'an, surah Al-Baqarah, verse: 275.

*Those who eat usury cannot stand but are like a person who has been possessed by a demon because he is mad. That is because they say that buying and selling is the same as usury. Even though Allah has made buying and selling legal and forbidden busury.*

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*Whoever gets a warning from his Lord, then he stops, then what he has obtained before becomes his and his business (up to) Allah. Whoever repeats, then they are residents of hell, they are eternal in it.*

Apart from this verse, the hadith of the Prophet was also mentioned regarding the strict prohibition against the practice of usury. From Abdullah bin Mas'ud ra from the Prophet SAW he said:

*From Abu Hurairah R. A said: The Prophet said: "Riba is seventy sins, the lightest sin is (the same as) the sin of a person who commits adultery with his own biological mother." (HR. Muslim)*

Therefore, in order for financing activities to be avoided from usury due to installment payments accompanied by predetermined interest, a Sharia Financial Institution has emerged which provides a breath of fresh air for Muslims. One of the sub-Islamic financial institutions is Sharia Banking. This Islamic banking strives for all financial transaction activities in it to be free from usury practices by providing products according to the sharia contract, thus providing security for mankind to avoid the grave sin of usury.

There are three types of financing based on a contract in Islamic Banking, namely a profit sharing contract, buying and selling and leasing (Peraturan Otoritas Jasa Keuangan, 2014). The profit sharing contract is the main contract in Islamic Banking financing because it reflects the essence of Islamic Banking to encourage the smooth running of productive businesses in the real sector and is a differentiator from financing in conventional financial institutions. There are various financing products based on profit sharing contracts, namely Mudharabah and Musyarakah financing (Muhammad, 2016).

This revenue-sharing contract financing is iconic for Islamic Banking with principles that are very different from conventional financing. For this reason, the authors are interested in conducting research on the concepts and practices of financing based on the Mudharabah and Musyarakah agreement on Islamic Banking to explore and present the convergence and divergence of financing between concepts and practices.

Based on the above background, problems that will be used as research objects can be formulated, namely: What are the concepts and practices of financing based on the Mudharabah and Musyarakah contracts in Islamic Banking and where is the convergence and divergence?

## **2. LITERATURE REVIEW**

### **2.1 Financing in an Islamic Perspective**

Financing in an Islamic perspective is the provision of funds from a bank with another party (borrower), which requires the borrower to share the results of his business in accordance with a predetermined agreement (Muhammad, 2016). This financing differs from conventional financing in several ways. Interest which is strictly prohibited

## CONVERGENCE AND DIVERGENCE ANALYSIS IN ISLAMIC FINANCING

by Islam is reimbursed using several financing schemes. The financing scheme is divided into 3 types based on the contract or principle that is the basis for Sharia Banking operations, namely: Profit-loss sharing financing in the form of *mudharabah* and *musyarakah* contracts, buying and selling financing in the form of *murabahah*, *salam* and *istishna* contracts, and lease financing in the form of *ijarah* and *ijarah muhtahiyya bittamlak* contracts (IMBT). Of the three principles of financing, financing based on a profit sharing agreement is an iconic financing for Islamic Banking.

### 2.2 Financing Based on Profit-loss Sharing

Profit-loss sharing is financing that is characteristic of Islamic Banking because of its contribution to improving the economic activities of the community. This is because an increase in profit sharing means an increase in the profits obtained by the company, when the company's profits increase in aggregate, this increase will encourage economic expansion in the form of increased investment, production, supply demand and a decrease in unemployment (Herianingrum, Ratnasari, Widiastuti, Mawardi, Rachmi, & Fadhlillah, 2019). According to Abdul Rahman and Nor (Rahman & Nor, 2016) said that the concept of profit-loss sharing financing is the spirit of Islamic Banking to increase economic activity and improve people's lives by increasing opportunities in the business sector for businesses that lack capital. The financing of profit-loss sharing will also encourage economic growth through industrial development and creating new entrepreneurs (Afkar, 2017).

### 2.3 Laws Governing Profit-loss Sharing Financing

The practice or implementation of *mudharabah* and *musyarakah* contracts in the Indonesian economy has been regulated and implementation in statutory regulations. Among them are Undang-undang Nomor 21 tahun 2008 concerning Sharia Banking which explains in general terms the general provisions to the specifics of Sharia Banks covering definitions, duties, authorities, obligations, scope of financial services activities, to products and contracts contained in Sharia Banks. Other laws and regulations that also regulate the practice of *mudharabah* and *musyarakah* contracts are Peraturan Otoritas Jasa Keuangan Nomor 10/POJK.03/2019 concerning Business Control of Sharia Financing Companies and Sharia Business Units of Financing Companies, Sharia Financing is the distribution of financing which is carried out based on the sharia principles distributed by Sharia Companies. As for the contracts is profit-loss sharing, buying and selling and leasing.

### 2.4 Products from Profit-loss Sharing Financing

In practice, *mudharabah* and *musyarakah* contracts are widely used in the financing made by Islamic financial institutions such as Islamic banking and Islamic financing institutions. Based on Undang-undang Nomor 21 tahun 2008 concerning Sharia Banking, financing is the provision or provision of funds in profit sharing transactions based on an agreement or contract between Islamic financial institutions such as Sharia Commercial Banks, Sharia Business Units, Sharia Financing Institutions and other parties and parties provided with the provision of funds to return the funds given within a certain period of

time with an agreed rate of return/profit sharing/*ujrah*/reward (Undang-Undang Republik Indonesia, 2008).

**a. Mudharabah Financing**

*Mudaraba* comes from the word *adh-dharbu fil ardhi* which means walking on the face of the earth. Travel on earth is generally carried out in the context of conducting a business or jihad in the path of Allah. Etymologically, *Mudharabah* is also called *qiraadh* which means *al-qath'u* (piece/piece), because the owners of the capital set aside part of their assets to be traded and they are entitled to a part of the profits from the trade.

In terms of the *mudharabah* contract, it is a form of agreement between *shahibul maal* (the owner of the capital) who contributes to giving 100% of the capital with the *mudharib* (fund manager), then the funds are used for productive activities where the benefits of the activity are shared between the two parties according to the agreement at the beginning of the agreement. . When there is a loss and it is not the result of *mudharib* mistakes, then the loss is borne entirely by the *shahibul maal*. (Muhammad, 2016). The legal *mudharabah* agreement may be based on the verses of the Al-Qur'an surah Al-Baqarah, verse: 283.

*But, if some of you believe some of the others, let the one who is believed to fulfill his mandate (debt) and let him fear Allah, his Lord.*

In addition, in Shuhaib *radhiyallahu anhum* said: Rasulullah said: "*There are three things that contain blessings: buying and selling not in cash, muqaradhah (mudaraba) and mixing wheat with barley for household needs, not for sale.*" (HR. Ibn Majah)

This contract brings together some people who have assets but do not have expertise in managing them and some people who do not have assets but have the expertise to manage and develop them. So Islam allows this *mudharabah* contract because this contract contains elements of *ihstisan* to realize benefit, namely by taking advantage of both *mudharib* and *shahibul maal*.

**b. Musyarakah Financing**

*Musharakah* comes from the word *al-syirka* which means alliance (*ikhtilath/mixing*) of two or more parties. This contract is usually used for a business association or partnership of property rights (Mas'adi, 2002). Etymologically, *musharaka* is mixing, merging or unions, so it means partnership. (Mardani, 2014). Whereas in terms of the *musyarakah* contract, it is a form of cooperation between two or more parties, where each party contributes funds provided that the profit sharing is divided based on the agreement, while the losses are based on the contribution of funds. (Muhammad, 2016). Partners (providers of funds) together provide funds to fund a business, whether a new business wants to start or an existing business. The law of the *musharaka* contract may be based on the verses of the Al-Qur'an Surah Sad, verse: 24.

*In fact, most of those who have fellowship commit wrongdoing to others, except those who believe and do good; and only a few of them are like that. "*

## CONVERGENCE AND DIVERGENCE ANALYSIS IN ISLAMIC FINANCING

In addition, in the hadith narrated by Abu Hurairah: The Messenger of Allah said: "Verily Allah Azza wa Jalla said," *I am the third party of two people who unite as long as one of them does not betray the other* "(H.R Abu Dawud).

This qudsi hadith shows Allah's love for his servants who practice association as long as they uphold the common trust and Allah curses those who commit treason. So, this makes it clear that even though this contract is allowed, the parties must be trustworthy and cannot as long as cancel the agreement that has been agreed upon.

### 2.5 Prohibition of *Maisyir*, *Gharar* and *Riba*

Islamic economics upholds the nature of justice and balance, which places something in its place and gives something only to those who have the right to receive it and treat things according to their position. There are several elements that are prohibited in the transaction rules in Islamic economics, among others (Mursal, 2015):

#### a. *Maisyir*

*Maisyir* has the same meaning as qimar, namely gambling. *Maisyir* is all forms of transactions or actions that have a speculative nature (chance) that are destined to gain material gain.

#### b. *Gharar*

*Gharar* has the meaning of danger or risk, then the word *gharar* is also formed from the word *taghrir* which means to give an opportunity for danger to occur. Meanwhile, based on fiqh muamalah, *gharar* means that there is ambiguity when carrying out a transaction that can harm or endanger other parties.

#### c. *Riba*

Islam strictly prohibits transactions that contain elements of usury. *Riba* has the meaning of *zada wa nama* which means to grow and increase. Meanwhile, according to Al-Syirbashi said that usury is an addition given through the payment of something, where the additional is required when two parties make a transaction (contract).

## 3. RESEARCH METHODOLOGY

The method used in this study is a combination of reviewing the existing literature and critical analysis of the results of several relevant studies to analyze the convergence or divergence between the theory and practice of *Mudaraba* and *Musyaraka* financing in Islamic Banking.

## 4. RESULT AND DISCUSSION

### 4.1 *Mudharabah* Financing Practices

*Mudharabah* financing has been applied by the Arabs since the arrival of Islam. Rich merchant who have more wealth can give part of their assets to be managed productively by other traders who need financial assistance in running or developing their business, based on the original contract and agreement in determining the margin or profit sharing rate, and are willing to take part in the losses that arise. (Rammal, 2003). One of the conditions contained in the *mudharabah* contract is that the owner of the capital (*mudharib*) does not have the authority to determine the level of margin or fixed profit sharing and any additional to the principal he gives. (Rammal, 2003). This is in

accordance with the rule of *Al-Ghunmu bil Ghurni*, which means that risk always follows the yield or rate of return. And the rule of *Al-Kharaj bid Dhaman*, where effort/result/return goes hand in hand with cost.

In terms of the concept of *mudharabah* and *musyarakah* contract financing, it is similar to the profit lost sharing principle used. The main difference between the two is the operational or implementation aspects, where in the *mudharabah* contract financing, only one party contributes to the capital and the other party contributes to the business. Meanwhile, the financing of the *musyarakah* contract requires both parties to contribute to capital and energy so that the relationship that exists is not a debtor-creditor but a partnership relationship.

**a. Convergence of Theory and Practices of *Mudharabah* Financing**

Interest-free financing carried out by Islamic Banking with a *mudharabah* profit sharing agreement is in theory and practice appropriate, that is, it is directed at the real sector and may not be used in investment activities that contain interest and speculation. Herianingrum, et al. (2019) in their research entitled "The Impact of Islamic Bank Financing on Business" found that in general, in the long term, Islamic bank financing with *mudharabah*, *musyarakah* and *murabahah* contracts was found to have a significant positive relationship with business trends in Indonesia. The results of this study indicate empirical evidence that not only in theory, but in practice, Islamic banking can improve the banking sector through financing the real sector which can then also improve the economy of a country in general. Sulayma (2015) also states that Sharia Banking profit sharing financing can create new investment opportunities and encourage people to do business. Furthermore Herianingrum, et al. (2019) explain that increasing Islamic banking financing in Indonesia can provide benefits to business development which in the long run can develop people's welfare.

Sharia financing with *mudharabah* and *musyarakah* contracts in theory and practice divides the nature or purpose of its use into two, namely productive financing such as business financing, capital procurement, trade financing, investment financing, and consumer financing for both primary and secondary needs. (Supriyadi, 2003).

Abbas & Arizah (2019) analyze marketability which is compiled from market share and concentration in it, and to test its effect on profitability mediated by production sharing financing with *mudharabah* and *musyarakah* contracts. The results show that the selling power of Islamic banking in Indonesia tends to be low. The ability to control the market (marketability) was found to have a positive effect on the level of profitability as measured by ROA and ROE. *Musharaka* contract financing has a competitive effect on the relationship between market share and profitability, while the financing for a *mudharabah* contract has a partial effect. The results of this study also show the suitability of the practice and theory of *mudharabah* financing which has an influence on profitability through its relationship with the market share of Islamic banking.

The pillars and terms of *mudharabah* financing are also in practice in line with the theory, among others:

## CONVERGENCE AND DIVERGENCE ANALYSIS IN ISLAMIC FINANCING

- 1) The parties who carry out the contract, namely the owner of funds (*shahibul maal*) and the capital manager (*mudharib*). Those who are required to be legally competent (*mukallaf*).
- 2) Capital (*Ra'sul maal*), which must meet the provisions (1) in the form of a medium of exchange (money), (2) it is known so that it is easy to record, (3) in cash, (4) can be transferred from the owner of the capital to the capital manager.
- 3) Business run (*al-amal*).
- 4) Profit (*ribh*).
- 5) Statement of consent and kabul (*sighat akad*).

These pillars and conditions have been implemented by financial institutions that provide financing services such as Sharia Banking and other Islamic financing institutions. Because basically without these pillars and conditions, the financing of the *mudharabah* contract is not valid and cannot be accounted for later.

### **b. Divergence of Theory and Practices of *Mudharabah* Financing**

Funding for *mudharabah* contracts has basically been implemented in accordance with the theory and principles of sharia. However, there are several things that need special attention in the practice of financing a *mudharabah* contract, such as the suitability of a customer profile with the actual situation. Because Islamic Banking in the financing of *mudharabah* contracts is not directly involved in the business or business run by the customer, it is necessary to analyze a profile and business that is truly in accordance with actual field conditions in order to minimize the risk of future financing.

### **4.2 *Musyarakah Akad* Financing Practices**

In practice, *musyarakah* contracts are mostly found in financing schemes carried out by Sharia Banking and other Sharia Financial Institutions which also provide sharia financing services. Currently, Islamic banking is a developing industry. More than fifty countries spread throughout the world have and apply this sharia system in their economic activities, especially in countries where the majority of their citizens are Muslim, such as Pakistan, Malaysia, and Indonesia. (Sugema, Bakhtiar, & Effendi, 2010).

*Musyarakah* contract financing is the most important model in influencing Islamic economic activity (Adela, 2018). This is due to the financing of the *musyarakah* contract which is engaged in the productive sector with a profit sharing principle that replaces interest and with a more flexible scheme that benefits both parties in a certain proportion according to the agreement in advance. Financing with a *musyarakah* contract can reduce risk, inefficiency, and effectiveness of capital management, because capital is fully used in one business. (Almutairi, 2016). All parties share the profits according to the proportion agreed at the beginning of the contract and share the losses according to the amount of participation in the distribution of capital.

Rahman & Nor (2016) explore the strategies used by Venture Capital (VC) and evaluate whether these strategies are in accordance with the concept of *Musyarakah* contract financing. The results of the study found that Islamic banking in Malaysia has the potential to provide financing for *musyarakah* contracts including risk mitigation activities by adopting five strategies, namely, (1) selection methods; (2) distribution of funds; (3) monitoring; (4) non-capital assistance; and (5) investment period. Sharia

banking can channel CSR funds to finance *musyarakah* contracts as an initial step in implementing the VC strategy (Almutairi, 2016).

**a. Convergence of Theory and Practices of *Musharaka* Financing**

Convergence or similarities between the theory and practice of *musyarakah* contract financing can be seen through the terms and conditions that must be met, among others:

- 1) Ijab qabul (*sighat*), is an agreement between the two parties in cooperation.
- 2) Two parties who have contracts and have the ability or ability to manage assets.
- 3) The object of aqad (*ma'qud alaihi*) which includes capital and involvement in business. Where capital must be in the form of cash, gold, silver of the same value (patent rights and so on).

The practice of financing the *musyarakah* contract is also in accordance with the theory used in productive activities or activities which can be found in two forms of financing, as follows (Maruta, 2016):

1) Project financing

*Musyarakah* contract financing can be applied to finance projects in which the customer and the Sharia Bank each contribute and/or their capital. After the project is completed, the customer will return the funds and share the profit proportion to the Sharia Bank according to the agreement

2) Venture Capital

This financing is only carried out by specialized financial institutions that have the authority to invest in company ownership. The *Musyarakah* contract financing will be used as the invested capital for a certain period of time and the financial institution will then sell its share.

**b. Divergence of Theory and Practices of *Musharaka* Financing**

Currently, the practice of financing for *musyarakah* contracts is much the same as conventional financing, which requires or promises a certain amount of profit in advance (Rammal, 2004). This is of course different and not in accordance with the procedure for financing the *musyarakah* contract in theory, where the advantages and disadvantages of both parties must be borne jointly. Sharia banking, which determines and guarantees the level of profit of the *musharaka*, makes these profits resemble interest and deviates from the rules of *Al-Ghunmu bil Ghurni* and *Al Kharaj bi Dhaman*.

Based on the Islamic economic system, providers of capital as well as entrepreneurs or managers are an inseparable unit of production factors. Both parties who contribute money and energy are entitled and obliged to share the profits proportionally at the beginning of the agreement based on the contract. (Rammal, 2004). This will be different if the benefits have been determined, promised and guaranteed from the beginning, because basically the determination of profits in advance is not in accordance with the principles of Islamic economics.

Another thing that is not in accordance with the theory in practice is the lack of knowledge and ability of Islamic Banking in analyzing the profile and conditions of the project to be financed. Ahmed (2008) evaluates the performance of *musyarakah* financing

## CONVERGENCE AND DIVERGENCE ANALYSIS IN ISLAMIC FINANCING

against profitability and risk. *Musyarakah* contract financing was found to have a higher preference than other financial models. Lack of knowledge of bank employees in analyzing, evaluating, and managing projects is the main cause of the lack of profit that can be obtained or the incidence of losses in financing for results. The results of this study are also in line with the statement "high risk high return".

Another practice that also needs to be considered because it is not in accordance with the concept of *Musyarakah* contract financing is the commitment of Sharia Banking which tends to be minimal for small entrepreneurs. The distribution of *musyarakah* contract financing tends to lead to businesses or businesses that are already large and stable. Meanwhile, MSMEs are not given enough attention and are not given access or similar facilities (Kayed, 2012).

### 5. CONCLUSION

The financing of *mudharabah* and *musyarakah* contracts has convergence and divergence in terms of theory and practice. Based on the findings, the divergence in the financing of *mudharabah* and *musyarakah* contracts tends to be less than the convergence. This can be caused by the times and the different needs of these developments, so there is a need for innovation and diversification of *mudharabah* and *musyarakah* financing which make it slightly different between practice and theory. This research is only limited to the convergence and divergence of the *mudharabah* and *musyarakah* financing contracts in general. Future research can focus on certain aspects such as juridical aspects, sanctions if there are parties who commit an achievement, historical aspects, aspects of legal sources and so on.

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