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# Partnership, Equity-Financing and Islamic Finance: Whither Profit-Loss Sharing?

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## Abstract

Proponents of Islamic financial institutions (IFIs) regard their conventional counterparts as Islamically unacceptable, because the latter are interest-based, not based on fair profit-loss sharing (PLS) and risk sharing. Idealization of the PLS mode is questionable as it is not explicitly mandated in Islam's primary texts. The preference for PLS is based on juristic interpretation that evolved in response to the prohibition of riba, commonly equated with interest. Contrary to theory, IFIs in practice have marginalized PLS modes and instead adopted mark-up type, interest-substituting, risk-avoiding modes of finance. In this paper it is argued that despite the theoretical idealization, IFIs as businesses are rational in avoiding PLS modes. Partnership is the least common form of business organization for practical reasons. In this context these reasons also cover equity-financing. IFIs are organized as banks, but rather than being financial intermediaries, they are primarily merchant banks. Accordingly, this paper contends that legally restricting or religiously idealizing PLS modes is untenable. The conclusion is that, while paying lip service to PLS modes to define themselves as interest-free aka Islamic entities, IFIs continue to marginalize PLS, packaging conventional banking products under Islamic labels.

**Keywords:** Islamic economics, Islamic finance, Islamic banking, Islamic banking and finance, riba, partnership, equity-financing, mudaraba, mudarabah, musharaka, musharakah, Profit-loss sharing modes, PLS modes, Islamic financial institutions, interest, usury, risk-sharing

**JEL Classification:** A13, B11, B19, B29, G21, G32

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