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# RUNNING MUSHARAKAH: A COMPREHENSIVE ANALYSIS OF A VERSATILE ISLAMIC FINANCING TOOL

**Muhammad Faizan Khan**
Research scholar PhD, Repartment of Usool-ud-din, University of Karachi
faizanumar111@gmail.com
**Dr Muhammad Ismail Aarifi**
Assistant Professor department of Usool Uddin, Faculty of Islamic studies, University of Karachi
drismailaarifi@uok.edu.pk

## Abstract
*This article explores Running Musharakah (RM), a unique Shariah-compliant financing solution within Islamic banking, highlighting its historical development, operational features, merits, demerits, and practical applications in various business sectors. RM emerges as a versatile alternative to conventional financing, offering flexibility for both short-term and long-term needs while fostering a true partnership between banks and businesses. The article discusses RM's adaptability across multiple industries, simplified documentation processes, and potential for ongoing financial support. Despite its advantages, RM faces significant challenges, including high risk, compliance complexity, delayed profit distributions, and limited accessibility for startups. To maximize its potential, the article proposes targeted reforms focused on enhancing Shariah governance, establishing dedicated standards, promoting a documented economy, standardizing compliance protocols, and raising public awareness. This comprehensive analysis emphasizes the critical role of RM in the Islamic finance landscape and its alignment with contemporary economic needs.*

## Introduction
Running Musharakah (RM) is an asset side product of Islamic banking system. The product is structured as an alternative to conventional running finance. From Shariah perspective RM is based on Islamic concept of Shirka-tul-Aqd, in other wards we can say it is a joint partnership between the bank and the customer.

## What is Running Musharakah?
'Musharakah' is a word of Arabic origin which literally means sharing. In the context of business and trade it means a joint enterprise in which all the partners share the profit or loss of the joint venture. It is an ideal alternative for the interest-based financing with far reaching effects on both production and distribution. In the modern capitalist economy, interest is the sole instrument indiscriminately used in financing of every type. Since Islam has prohibited interest, this instrument cannot be used for providing funds of any kind. Therefore, Musharakah can play a vital role in an economy based on Islamic principles.[1]

In light of this, we can define Running Musharakah as a business arrangement where partners come together to invest in the ownership of a pool of assets belonging to a commercial or industrial company. The primary objective is to share in the profits generated from the Musharakah business's activities. The agreement allows for a flexible adjustment in the capital amount, granting the acting partner (the company) the liberty to withdraw capital from the investing partner (the bank) and return it as required.

From a Shariah perspective, this business model functions as Sharkat- tul- inaan between the Islamic bank and the client within the assets of the company.[2] The purpose is to collaboratively

[1] (Usmani, Muhammad Taqi (1998) An Introduction to Islamic Finance, Idaratul Ma'arif, Karachi, p. 17.)

[2] التمويل بالمشاركة المتغيرة، بين التأصيل الفقهي والتطبيق العملي ،بحث مقدم لمؤتمر أيوفي السنوي العشرين للهيئات الشرعية(14-15شوال 1443ه يوافقه 15-16مايو 2022م ) د. إرشاد أحمد إعجازرئيس اللجنة الاستشارية الشرعية، مصرف باكستان المركزي.

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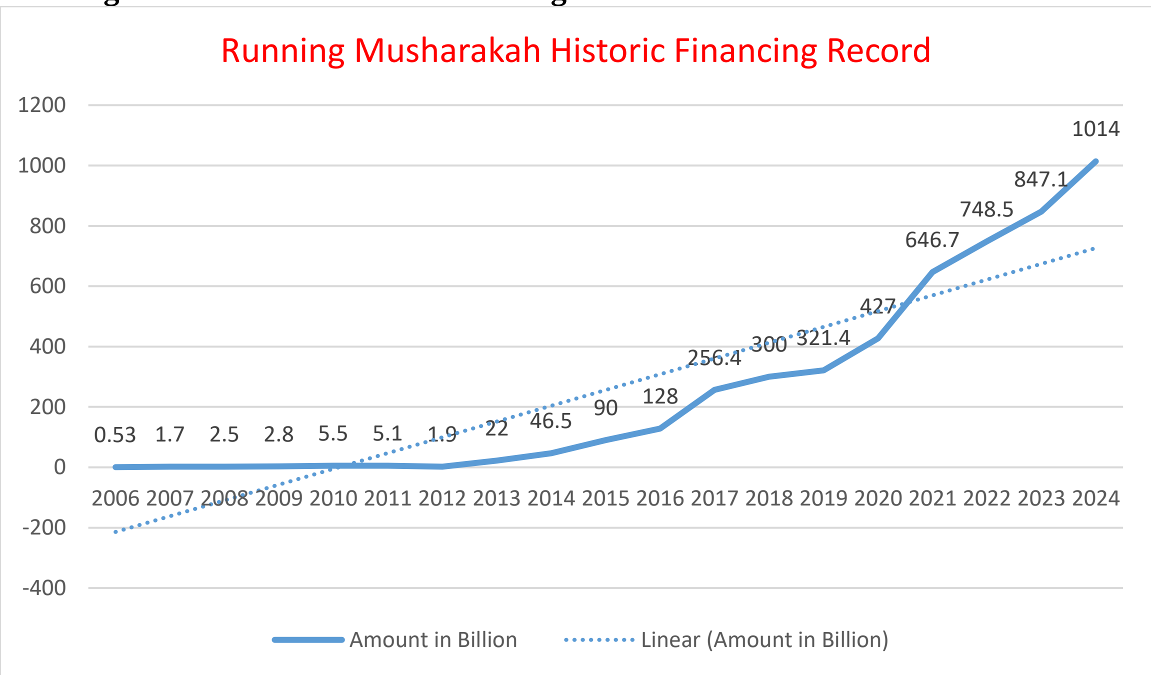
participate in the profits derived from the company's operations, based on pre-agreed-upon ratios between the bank and the client. The client, acting as the working partner in this arrangement, enjoys the freedom to either accept capital from the bank (the investing partner) or return it as needed for the capital requirements of the business

**Historical Background and Emergence of Running Musharakah**

In its early stages, Islamic banking mostly relied on Murabahah and Ijarah as key financing tools. As customer needs evolved, innovative products were introduced, yet a significant challenge persisted—how to cover overhead and working capital expenses of a running business through Islamic finance, given the asset-centric nature of existing products.

In response to this challenge, a concept of Musharakah as conceptualized by Mufti Muhammad Taqi Usmani[3] in 1998, was recalled, a pioneering solution that has since matured to fulfill a quarter of the industry's requirements. Below, you'll find the historic growth statistics detailing the journey of Running Musharakah:

**Running Musharakah Historic Financing Record**




Source: author's own calculation based on NBP Islamic banking Bulletins

**Running Musharakah Historic Share Growth**

[3] (Usmani, Muhammad Taqi (1998) An Introduction to Islamic Finance, Idaratul Ma'arif, Karachi, p. 43.)

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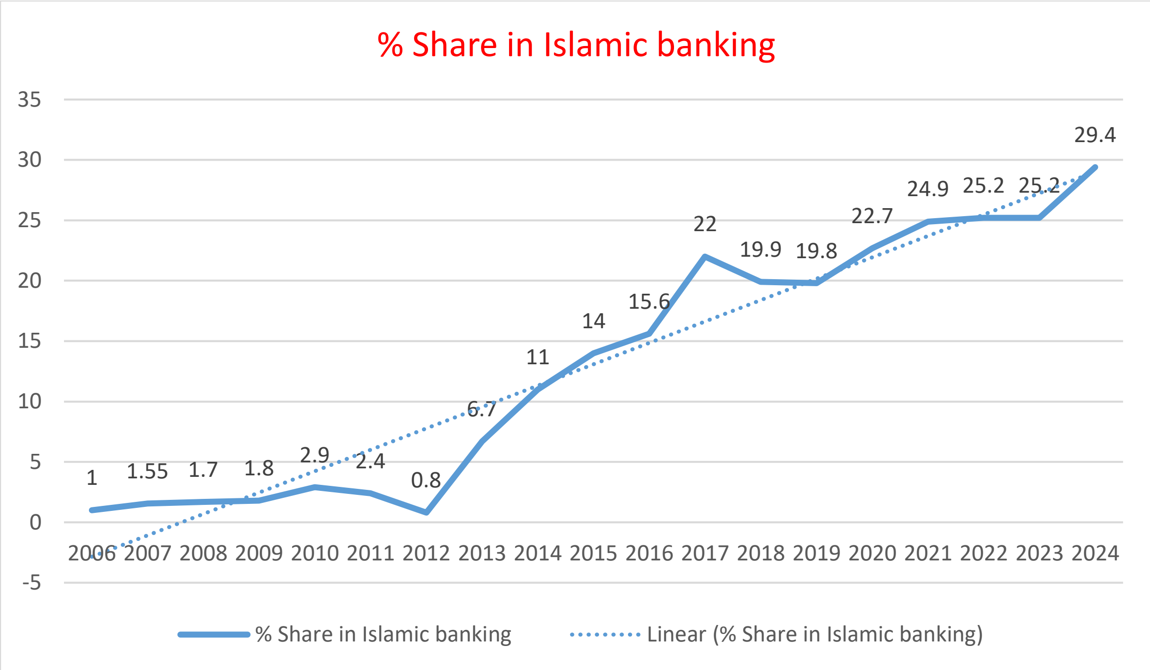
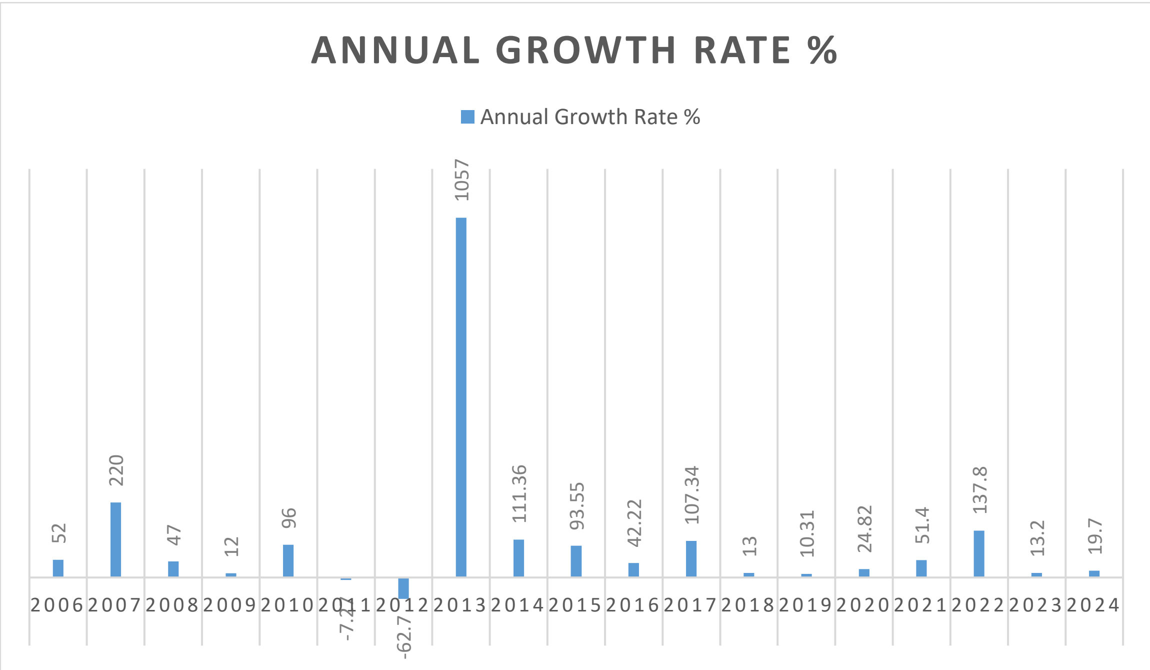



Source: author’s own calculation based on NBP Islamic banking Bulletins

**Annual growth rate history**




Source: Author’s own calculations based on SBP Islamic banking Bulletins (2006-2022)

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**Basic features of Running Musharakah product**

Running Musharakah serves as a Shariah-compliant substitute for the conventional Running Finance Facility found in traditional banking systems. This product is grounded in the Musharakah (Shirkat-al-Aqd) contract, and its key features are outlined below: [4]

1. RM offers a Shariah-compliant alternative to the widely favored conventional running finance facility among customers.
2. Running Musharakah empowers customers to access funds and make adjustments as needed, all without the requirement of submitting additional documents to the bank, a necessity in other Islamic financing methods.
3. This facility is extended to customers engaged in businesses declared as Halal and endorsed by Shariah.
4. Profit-sharing is determined based on the Gross Profit of the customer's business or any mutually agreed-upon profit-sharing ratio specified in the Musharakah agreement/contract, subject to periodic revisions.
5. RM cannot be utilized for financing or acquiring fixed assets.
6. The Musharakah agreement between the Bank and the Customer is established on the foundation of Shirkat-ul-Aqd.
7. Both the Bank and the Customer invest in the identified primary Operating Activities or any discernible segment thereof within the Customer's business.
8. Running Musharakah exclusively finances the Customer’s Operating Activities.
9. Profits/(losses) generated by the Musharakah are shared by the Bank and the Customer in proportion to their respective Profit-Sharing Ratios.
10. Client payments are provisional and temporary, settled at the end of each Musharakah period (monthly/quarterly/biannual/annual, as mutually agreed), subject to finalization.

**Expert Opinions and Industry Feedback on Running Musharakah**

Following an extensive review of the Islamic banking industry and a thorough examination of the literature, we can assert that the introduction of Islamic banking is motivated by two primary objectives. Firstly, it seeks to overhaul the processes and procedures involved in financing transactions to align with the Islamic principle of prohibiting riba (usury or interest). In Islamic finance, riba is considered unethical and is explicitly prohibited under Shariah principles.

Secondly, the establishment of Islamic banking seeks to realize the broader objectives of Shariah, the Islamic legal framework. This goal exceeds the mere prohibition of riba, extending into the socio-economic sphere. The aim is not only to establish a financial system devoid of interest but also to promote socio-economic benefits aligned with the ethical and moral values of Islamic law[5]. The most effective alternative to interest is the method of partnership and Mudarabah, which produces results far superior to those of interest. This approach is exceptionally fair and just, ensuring a more equitable distribution of wealth and leading to highly positive outcomes[6].

4 Dr. Muhammad Mushtaq Ahmed, Dr. Muhammad Farooq, Muhammad Arsalan, Running Musharakah Product of Islamic Banks, An Alternative of Running Finance, Al-Idah 33 (Dec, 2016).

5 Usmani, M. Taqi (2000); An Introduction to Islamic Finance, Karachi. (P24; also see P. 238-246)

6 Usmani, M. Taqi (1993); (اسلام اور جدید معیشت و تجارت) (see P137)

The majority of stakeholders in the Islamic banking industry believe that Running Musharakah offers a Shariah-compliant alternative to conventional running finance facilities.[7] The process is streamlined, making it easier and faster to obtain compared to other Shariah-compliant financing products[8]. In practice, Running Musharakah (RM) is increasingly viewed as the most desirable contract by corporate clients and Islamic banks in Pakistan. This preference is due to its fixed charges, flexibility in fund utilization, and minimal documentation requirements. Only the approval of the limit is necessary, making it a highly efficient and attractive financing option[9].

The corporate sector has increasingly shifted its preference toward Running Musharakah over traditional modes like Murabahah and Ijarah. This change is driven by the appeal of accessing substantial financing with the added benefit of only having to pay a fixed rate, making it more cost-effective. Unlike Murabahah and Ijarah, Running Musharakah does not involve the extensive juristic procedures or compliance requirements typically associated with these contracts. This streamlined approach offers greater flexibility and efficiency for corporate clients, positioning Running Musharakah as a more attractive option for their financial needs.[10]

Running Musharakah is highly favored by many companies due to its convenience and flexibility. Unlike Murabaha and Istisna, where Islamic banks required detailed understanding of the purchasing and manufacturing processes, RM offers a simpler experience. Under Murabaha or Istisna, banks often compelled companies to make direct payments to suppliers and perform physical inspections to verify real purchases, which created extra work for the customers. In contrast, with RM, companies can draw cash and use it as they see fit, with only a few restrictions.[11]

Most RM customers choose it primarily because the rates are competitive and it eliminates the operational hassles, they faced under Murabaha. Many of these clients, who were previously comfortable with Murabaha, are now insisting on RM due to its ease of use and reduced documentation

Running Musharakah is widely regarded as a highly flexible and viable financing solution for both trading and service industries, particularly for businesses with consistent operating profits. By functioning as a partnership in the customer's business activities, RM adapts seamlessly to various business models, offering significant flexibility. It is especially appealing to the service industry and travel agents, whose financing needs are often overlooked by traditional asset-backed products. This adaptability makes RM an attractive option for sectors requiring more fluid, cash-based financing structures, rather than being tied to specific assets.[12]

While the general sentiment among top industry stakeholders is positive regarding RM as a Shariah-compliant alternative to conventional running finance, there are industry reservations from a Shariah perspective. Specifically, critics point out that while RM is superior to Tawarruq, it does not fully align with the fiqh concept of Musharakah, as the profit-sharing ratio is often linked to KIBOR at a minimal rate. Additionally, RM is primarily offered to

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[7] Irshad Ahmad Aijaz, Islamic Economic Forum, 26/04/2017 - 04/05/2017
[8] Ahmad Ali Siddiqi, Group head Shariah compliance, Meezan Bank Running Musharakah slides
[9] Muhammad Akram, JOIFA, AAOIFI, Vol. 3, Issue 1 / 2019.
[10] Editorial – Journal of Islamic Business and Management, June 2016, Riphah Centre of Islamic Business (RCIB)
[11] Islamic Economic Forum Topic: Running Musharakah Compiled by: Khalid Hasani Date: 26/04/2017 - 04/05/2017)
[12] https://www.dibpak.com/index.php/differences-between-islamic-banking-and-conventional-banking-products/

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AAA-rated companies, leading Islamic banks to compete with conventional banks by lowering rates. This situation benefits companies by allowing them to pay conventional-equivalent rates while shifting the risk of loss onto Islamic banks.[13]

Some stakeholders argue that the true blessings of genuine Musharakah can only be realized if the profit-sharing mechanism is decoupled from KIBOR. Furthermore, concerns have been raised that RM compromises the distinctiveness of Islamic banking by reinforcing the use of artificial devices. This approach, now widespread among Islamic banks in Pakistan, has weakened the connection between finance and the real economy. In the market, RM functions as an alternative to overdraft-based borrowing, with banks earning a fixed profit rate and leaving the remainder for corporate clients. This has further damaged the reputation of the Islamic banking industry in Pakistan.[14]

Given the Shariah concerns and the influence of controlled Musharakah on the behavior of banks and the corporate sector, there is alarm that RM may ultimately be more detrimental than genuine Shariah-compliant products like Murabaha, Salam, and Ijarah.[15]

**Running Musharakah merits and demerits[16]:**

Running Musharakah offers a unique combination of features that make it a standout financing solution in the Islamic banking industry. Its most convincing advantage is its flexibility, as it can be utilized for both short-term and long-term financing, making it appropriate for businesses with varying financial needs. Whether a company requires immediate working capital or sustained long-term investment, RM provides the necessary flexibility to meet these demands.

Moreover, Running Musharakah is a multipurpose product, capable of being extended across a wide range of sectors, including trading, manufacturing, services, and travel agencies. This adaptability makes RM highly attractive to businesses operating in different industries, particularly those whose needs are not met by traditional asset-backed products like Murabahah or Ijarah. Its appeal lies in the fact that it is not tied to a specific asset or project, allowing businesses to use the financing in a way that best suits their operations.

One of the distinguishing features of RM is that the bank secures an ownership interest in the business proportional to its investment, establishing a true partnership between the bank and the business. This structure allows the bank to earn profits even during periods of default, provided the business continues to operate. Unlike other financing modes that may only earn profits through strict compliance with asset-related transactions, RM generates income as long as the partnership is active.

In terms of operational ease, RM stands out due to its simplified documentation process. Unlike other financing products that require repeated documentation and oversight for each disbursement, RM requires only a one-time setup, allowing for multiple disbursements without the need for repeated paperwork. This makes the process much more efficient and reduces the administrative burden for businesses, saving both time and resources.

Another key benefit of RM is its inherent flexibility. It is easy to restructure or extend the facility if a business's financial circumstances change, making it adaptable to evolving business

[13] Faisal Shaikh, Head, Product, Shariah Structuring & Organizational Transformation, (Islamic Economic Forum, 26/04/2017 - 04/05/2017)

[14] Muhammad Akram, JOIFA, AAOIFI, Vol. 3, Issue 1 / 2019.

[15] Muhammad Akram, JOIFA, AAOIFI, Vol. 3, Issue 1 / 2019.

[16] Websites of Islamic banks, industry surveys, and the author's own experience working in Islamic finance over the past seven years.

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needs. This ability to adjust and modify terms provides businesses with much-needed flexibility, enabling them to respond to new opportunities or challenges without the need for an entirely new financing agreement.

Furthermore, RM can be used as an ongoing financing arrangement, offering continuous support to businesses as they grow. Unlike one-off financing arrangements, RM can provide sustained financial backing, which is especially useful for businesses that need continuous access to funds over time.

Finally, RM offers competitive, market-matched returns, ensuring that the profit-sharing arrangement remains aligned with prevailing market conditions. This means that businesses benefit from rates that reflect the current economic climate, allowing them to stay competitive in their respective industries. The ability to offer market-aligned returns, combined with the product's flexibility and ease of use, makes RM an attractive financing solution for a wide range of businesses seeking Shariah-compliant options.

Despite its inherent flexibility and potential benefits, Running Musharakah has encountered several significant challenges that have slowed its broader adoption within the Islamic finance industry. One of the key concerns is the high level of risk associated with the product. Since the bank participates directly in the client's business operations as a silent partner, it becomes exposed to the business's performance risks, making RM less predictable and more volatile than other financing options. This increased risk is a major deterrent for banks.

Additionally, RM is complex from a compliance perspective, requiring strict adherence to Shariah principles and regulatory frameworks. This complexity adds an operational burden for both the bank and the client, making the product more demanding than other Shariah-compliant financing options. The need for constant supervision by both parties to ensure the partnership aligns with the agreed terms further increases administrative overhead, making RM less attractive for businesses looking for more streamlined financing solutions.

Concerns have also been raised by industry practitioners about RM's alignment with Shariah principles. Some question whether the structure of RM truly reflects the spirit of Musharakah, especially given its close ties to conventional profit benchmarks. These Shariah reservations have contributed to hesitancy among potential adopters.

Another significant drawback is the delay in profit distribution adjustments, which are dependent on audited financial statements. These statements are often not available until a quarter or more after the maturity of financing period, creating uncertainty for both the bank and the client regarding the final profit settlement. This delay complicates cash flow management for businesses and undermines the efficiency of RM.

Furthermore, RM is primarily geared toward corporate financing and is not suitable for consumer financing, limiting its applicability across various sectors. Its complexity in terms of calculation and compliance also makes it unsuitable for the undocumented sector, where simpler financing solutions are needed. Additionally, RM is typically offered only to businesses with a strong financial track record, often requiring three years of financial statements, which makes it inaccessible to startups and new enterprises. Lastly, RM cannot be extended to businesses that are operating at a loss, further narrowing its applicability to only profitable companies.

These limitations—high risk, compliance complexity, delayed profit settlements, and restricted access—have contributed to RM's slower growth and adoption, despite its potential as a flexible and Shariah-compliant financing tool. For RM to realize its full potential, these challenges will need to be addressed, especially in terms of reducing risk exposure and

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simplifying compliance to make it more accessible and appealing to a broader range of businesses.

**Usage of Running Musharakah**

Running Musharakah was introduced as a Shariah-compliant alternative to conventional running finance, designed to meet the same financial needs but within the Islamic finance framework. It allows banks and clients to form a partnership where the bank finances the operational activities of the business. This structure provides the customer with the flexibility to use the financing for day-to-day operations while freeing up their own equity for other strategic needs. Below are the key purposes for which Running Musharakah is commonly used[17]:

1. **Working Capital Management:** Running Musharakah is ideal for maintaining liquidity and covering essential day-to-day operational expenses like salaries, rent, utilities, and other administrative costs, ensuring smooth business operations.
2. **Inventory Purchase:** It provides a reliable source of funding for purchasing raw materials, inventory, or stock necessary for manufacturing or trading, enabling businesses to meet production demands without cash flow constraints.
3. **Bridging Cash Flow Gaps:** Running Musharakah is often utilized to bridge temporary cash flow gaps between receiving payments from customers and paying suppliers or vendors, helping businesses avoid disruptions in their supply chains.
4. **Seasonal Demand Management**: Businesses that experience fluctuating cash flow, particularly those with seasonal peaks, can benefit from Running Musharakah to finance their operations during high-demand periods, ensuring they can meet customer needs during these critical times.
5. **Timely Supplier Payments:** It helps businesses maintain strong supplier relationships by ensuring timely payments, especially when dealing with bulk orders or when taking advantage of supplier credit terms. This not only secures supply but may also lead to better negotiation terms with suppliers.
6. **Business Expansion:** Running Musharakah supports short-term business expansions or the fulfillment of large new orders that require immediate financing. This flexibility allows businesses to take advantage of growth opportunities without being constrained by lack of liquidity.
7. **Operational Flexibility:** One of the standout features of Running Musharakah is the ongoing line of credit it provides. Businesses can draw upon this credit as needed, offering a flexible financial solution without the need to apply for new loans every time funds are required. This flexibility reduces administrative burdens and ensures financing is readily available when needed.
8. Overall, Running Musharakah addresses a wide range of financing needs for businesses by providing operational flexibility and liquidity, all while adhering to Shariah principles. Its ability to meet working capital, cash flow, and expansion demands makes it an attractive financing solution for various industries.

**Conclusion:**

In light of the evidence presented, Running Musharakah (RM) emerges as a distinguished and adaptable product within Islamic banking. Its unique features—particularly the streamlined management of daily surplus and deficit funds without the need for additional documentation—

[17] Industry analyses

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provide it with a distinct competitive advantage. RM's versatility in fulfilling a wide range of financial needs has contributed to its steady, positive growth and its increasing share within Islamic banks' asset portfolios. This upward trajectory reflects the high level of acceptance and endorsement RM enjoys from Shariah scholars and industry practitioners alike. Significantly, all major Islamic banks now offer RM as a Shariah-compliant product, rigorously vetted and approved by their Shariah boards, underscoring its critical role in the industry.

While initial Shariah and technical concerns emerged, many have already been effectively addressed. Ongoing improvements are anticipated, and remaining challenges are expected to be resolved as Pakistan's Islamic banking sector advances toward greater maturity and refinement. Recent Shariah court rulings and constitutional changes aimed at eliminating Riba and advancing economic Islamization underscore RM's vital role in meeting industry demands due to its inherent flexibility and alignment with Islamic principles.

To further enhance RM's utility, address existing challenges, and ensure its effective implementation for future needs, the following targeted reforms are recommended:

**1. Enhancing Shariah Governance:**

The State Bank of Pakistan should consider strengthening Shariah governance for RM by conducting industry surveys to identify critical gaps and challenges, collaborating with stakeholders for effective solutions, and revisiting existing regulations. Updated or new dedicated regulations tailored to RM's unique characteristics would support its growth and secure greater compliance.

**2. Establishing Dedicated Shariah Standards:**

While Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) has developed over sixty Shariah standards to support the Islamic financial industry[18], a specific Shariah and accounting standard exclusively for RM would ensure comprehensive coverage of its operational aspects. This would facilitate greater consistency and encourage adoption across the industry, allowing RM's full potential to be realized.

**3. Advancing a Documented Economy:**

A key barrier to the expansion of Running Musharakah (RM) is Pakistan's extensive informal and undocumented economy, which is estimated to be 64% larger than the formal and documented sector[19]. Therefore, government agencies and influential industry players should promote a culture of documentation across business sectors. Increased documentation will widen RM's acceptance and foster greater transparency in transactions, expanding its relevance and utility.

**4. Standardizing Documentation and Compliance Protocols:**

Introducing standardized transactional documents and compliance frameworks for RM would streamline operations across the industry, making the product more accessible, transparent, and efficiently controlled.

**5. Raising Public Awareness and Engagement:**

Banks should actively engage with the public by offering educational initiatives to inform potential clients about RM's unique benefits. Such awareness programs will build client trust, allowing the target market to understand and appreciate RM's value, thus boosting its adoption and impact.

[18] Accounting and Auditing Organization for Islamic Financial Institutions

[19] Express, Tribune.com.pk October 24, 2024 | ePaper. https://tribune.com.pk/story/2466956/informal-economy-64-larger-than-formal-study