THESIS REPORT ON

ISLAMIC MODE OF FINANCING
“MURABAHA”

IN THE NAME OF ALLAH
Most Gracious, Most Merciful
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# LIST OF ACRONYMS

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<th>Acronym</th>
<th>Description</th>
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<tr>
<td>BMA</td>
<td>Bahrain Monetary Agency</td>
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<tr>
<td>LMC</td>
<td>Liquidity Management Center</td>
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<tr>
<td>IIFM</td>
<td>International Islamic Financial Market</td>
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<td>PIRI</td>
<td>Prudential Information and Regulatory Framework for Islamic Banks</td>
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<tr>
<td>AAOIFI</td>
<td>Auditing Organization for Islamic Financial Institutions</td>
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<td>LME</td>
<td>London Metal Exchange</td>
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<td>NCB</td>
<td>National Commercial Bank</td>
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<td>House Building Finance Corporation</td>
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<td>National Investment Trust</td>
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<td>Participation Term Certificate</td>
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<td>BCO</td>
<td>Banking Company Ordinance</td>
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<td>Profit and Loss Sharing</td>
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<td>CTFS</td>
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<td>TFC</td>
<td>Term Finance Certificate</td>
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<td>ICAP</td>
<td>Institute of Chartered Accountants, Pakistan</td>
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<td>SBP</td>
<td>State Bank of Pakistan</td>
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<td>MBL</td>
<td>Meezan Bank Limited</td>
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<td>IBB</td>
<td>Islamic Bank Branch</td>
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LIST OF DIAGRAMS

1. Client and bank sign an agreement to enter into Murabaha
2. Client appointed as agent to purchase goods on bank’s behalf.
4. Client makes an offer to purchase the goods from bank.
5. Bank accepts the offer and sale is concluded.
EXECUTIVE SUMMARY

A strong economy can be identified by its banking system, because the more banking operation the more transaction takes place, the more transaction the more money circulation and circulation of money in market is one indicator of the stable economy.

The above paragraph shows that banking is important for economy for fast and safe transaction, keeping in mind the interest factor, while transacting with bank leads customer away from the bank, in Muslims countries particularly in Pakistan, because interest is not permissible in Islamic Shariah. Interest in known as second major sin after shirk.

What should a Muslim community needs to do to avoid interest? Answering this question we find solution of Islamic mode of financing, which is done both by Islamic banks and financial institutions.

These modes of financing are based on profit and loss sharing (PLS) basis, because Islam allow us to earn permissible (Halal) profit and permissible income comes with risk. If some one keep money in bank for particular period of time and withdraw it with surplus amount, so this amount is not permissible and forbade by Islamic shariah, but if some one invest money with chance of loss along with profit, so it is permissible in Islamic shariah.

According to Islamic shariah transaction must contain both elements i-e profit and risk of loss. Islamic banking not exist on the basis of lending money as conventional banks do, because Islamic bank can lend money but as Qard-e-Hasana , no extra money on principle amount, therefore, Islamic banks are on the basis of profit/loss sharing. While any return on capital in the form of interest is completely prohibited in Islam. The fundamental features of a profit/loss sharing arrangement which are in tune with the ethos of the value system of Islam are available in the
literature on Fiqh Muamlat-ul-malia these are usually found under the head of Mudarbah or Qirad or Muqaradah in Fiqh literature.

Murabaha is a particular kind of sale where bank disclose cost price plus profit to customer where in ordinary sale cost price is hidden and such transaction is known as “Musawamaha.”

Most of the people can not differentiate between interest and profit. They believe both are the same and avoid Islamic banks to transact with banks.

Many scholars os islamci shariah is permissible on the basis of

• its not lending and accepting transaction with bank, but a sale transaction.

• Islam forbade that money not permissible which comes charging as penalty on late payment of principle amount where in Murabaha no penalty or extra amount charge to customer but enjoy graces days for late payment.

• The risk remains with banks till the possession of goods not handed over to customer, even though customer paid fully to bank.

• In case, customer denay the transaction bank can not bound him to buy the product, and loss will be handle by banks.

Beside this the well known scholars of Islamic shariah “Mufti Taqi Usmani” and “Dr. Muhammad Imaran Ashraf Usmani” put a lot research and work on Islamic banking, they suggest that if banking transaction are based on PLS basis so that is permissible.
CHAPTER 1

INTRODUCTION

This chapter is basically a brief explanation of pre proposal. It contains information regarding,

- Introduction to report
- Problem definition
- Background of the study
- Purpose of the study
- Type of the study
- Scope of work
- Objective
- Methodology
- Scheme of report

1.1 INTRODUCTION

Banking play a vital role in the economy of the country, but Muslim countries where people don’t like interest and feel hesitation to transact with banks, therefore the Islamic banking has been introduced which provides its services to society where no interest will be charged on any deposit or withdrawal, that’s why I have taken the topic “Islamic Mode of Financing” which include Modaraba, Musharakah (active partnership), diminishings Musharakah, Salam, Istisna, Murabaha, Ijarah and Ijarah wa iqtina Focusing mode of the report is Murabaha.

Murabaha is a particular kind of sale; where the transaction is done on a “cost plus profit” basis i-e the seller disclose the cost to the buyer and adds a certain profit to it to arrive at the final selling price.
1.2 PROBLEM DEFINITION

Islamic banking and mode of financing of an Islamic bank is not a shorter term one can cover it from each angle and explain the whole concept of Islamic banking in just 60 or 80 pages, it needs a lot of struggle and time to cover all modes of financing and operation of an Islamic bank, therefore this report surrounds specifically to Murabaha which is one of the main financing mode of an Islamic bank which 70% contribute to a bank, this report will explain the process of Murabaha. Most of the people today are switching off from conventional banks to Islamic bank and majority of them transact with banks on the basis of Murabaha.

1.3 BACKGROUND OF THE STUDY

A strategy of Institute of Management Sciences of Peshawar is giving more exposure to an MBA student, one way is to do an internship in any organization, during the internship student learn things practically and then write report what ever he observed in organization. As we have come to know that this internship is not compulsory but student have to write a thesis report on specific topic. In internship report it was difficult to capture all the angle of an organization, so the best way is to write a thesis report on specific topic to explore it more precisely, and enable a student to come up with new and innovative ideas and giving him a chance to exercising the theory practically.

1.4 PURPOSE

Purpose of this report is basic, as aim is to increase existing knowledge on the specific topic “Islamic Mode of Financing.”

1.5 TYPE OF STUDY

Type of study is secondary which is based on secondary data.
1.6 SCOPE OF WORK

We live in Islamic country and believe in Islam, as a complete religion consist of all the principals in which one is “interest”, forbidden in Islam and not permissible for Muslims,

No one can deny the role of banks in the development of the economy but our religion do not allow us to exercise banks operation in our economy as not permissible (Halal), but now Islamic banks has been introduce with aim to help in development of the economy and catch those customer which do not transact with other banks and persuading them to transact with Islamic banks, therefore this report will look for the banks how they can attract the people toward Islamic banks on the basis of mode of financing especially Murabaha, and also concentrating the contribution of Murabaha to an Islamic bank.

1.7 OBJECTIVE

Objective of this report is as follow:

- Exploring idea about Islamic banking.
- Role of Islamic banks in the development of the economy.
- Explaining the clear idea of Murabaha financing.
- What Murabaha is all about.
- Basic rules/principles of Murabaha financing.
- Murabaha financing step wise
- Documents involve in Murabaha
- Profit calculation
- Issues in Murabaha financing
1.8 METHODOLOGY

This report needs secondary data, which have collected from different books, wrote by well known writers like “Dr. Muhammad Imran Ashraf Usmani”. Beside this data is collected through net to make it more accurate and up to date.

Visiting banks i-e Bank Of Khyber and Meezan Bank (pure Islamic banking) and interviewing different employees is also done for compiling the report, this topic was mostly covered on Meezan bank. Data of Meezan bank is selected for analysis and recommendation and for the report writing. All the data is collected from authentic employees especially from operational manager of Meezan bank.

1.9 SCHEME OF REPORT

This report is consist of four sections.

In section one Introduction to report, problem definition, background of study, purpose of study, type of study, scope of work and methodology is discussed in one chapter.

In section two literature review of the report is given, which enable a reader to understand what Islamic banking is, it’s philosophy, then report comes to the global scenario of Islamic banking and gradually comes to Pakistan that how much Islamic banking are working in Pakistan according to Islamic shariah, where one pure Islamic bank seems i-e Meezan bank limited, in this section two a little bit is discuss about Meezan bank as well.

In section three the idea of Islamic banking is explored concisely and also the role of Islamic banking in the development of the economy, beside this some mode of financing has been discussed and in this section the murabaha mode of financing is explained from every angle to help understand the reader easily.
Section four is based on section three mean analyzing the murabaha in section three, based on that some recommendation is given

SECTION TWO
CHAPTER 2

REVIEW

2.1 ISLAMIC BANKING

Islamic banking has been defined as banking in consonance with the ethos and value system of Islam and governed, in addition to the conventional good governance and risk management rules, by the principles laid down by Islamic Shariah. Interest free banking is a narrow concept denoting a number of banking instruments or operations, which avoid interest. Islamic banking, the more general term is expected not only to avoid interest-based transactions, prohibited in the Islamic Shariah, but also to avoid unethical practices and participate actively in achieving the goals and objectives of an Islamic economy.

2.2 PHILOSOPHY OF ISLAMIC BANKING

Islamic Shariah prohibits ‘interest’ but it does not prohibit all gains on capital. It is only the increase stipulated or sought over the principal of a loan or debt that is prohibited. Islamic principles simply require that performance of capital should also be considered while rewarding the capital. The prohibition of a risk free return and permission of trading, as enshrined in the Verse 2:275 of the Holy Quran, makes the financial activities in an Islamic set-up real asset-backed with ability to cause ‘value addition’.

Islamic banking system is based on risk-sharing, owning and handling of physical goods, involvement in the process of trading, leasing and construction contracts using various Islamic modes of finance. As such, Islamic banks deal with asset management for the purpose of income generation. They will have to prudently handle the unique risks involved in management of assets by adherence to best practices of corporate governance. Once the banks have stable stream of Halal income, depositors will also receive stable and Halal income.
The forms of businesses allowed by Islam at the time the Holy Quran was revealed included joint ventures based on sharing of risks & profits and provision of services through trading, both cash and credit, and leasing activities. In the Verse 2:275, Allah the Almighty did not deny the apparent similarity between trade profit in credit sale and Riba in loaning, but resolutely informed that Allah has permitted trade and prohibited Riba.

Profit has been recognized as ‘reward’ for (use of) capital and Islam permits gainful deployment of surplus resources for enhancement of their value. However, alongwith the entitlement of profit, the liability of risk of loss on capital rests with the capital itself; no other factor can be made to bear the burden of the risk of loss. Financial transactions, in order to be permissible, should be associated with goods, services or benefits. At macro level, this feature of Islamic finance can be helpful in creating better discipline in conduct of fiscal and monetary policies.

Besides trading, Islam allows leasing of assets and getting rentals against the usufruct taken by the lessee. All such things/assets corpus of which is not consumed with their use can be leased out against fixed rentals. The ownership in leased assets remains with the lessor who assumes risks and gets rewards of his ownership.

2.3 GLOBAL SCENARIO OF ISLAMIC BANKING

Over the last three decades Islamic banking and finance has developed into a full-fledged system and discipline reportedly growing at the rate of 15 percent per annum. Today, Islamic financial institutions, in one form or the other, are working in about 75 countries of the world. Besides individual financial institutions operating in many countries, efforts have been underway to implement Islamic banking on a country wide and comprehensive basis in a number of countries. The instruments used by them, both on assets and liabilities sides, have developed significantly and therefore, they are also participating in the money and
capital market transactions. In Malaysia, Bahrain and a few other countries of the Gulf, Islamic banks and financial institutions are working parallel with the conventional system.

Bahrain with the largest concentration of Islamic financial institutions in the Middle East region, is hosting 26 Islamic financial institutions dealing in diversified activities including commercial banking, investment banking, offshore banking and funds management. It pursues a dual banking system, where Islamic banks operate in the environment in which Bahrain Monetary Agency (BMA) affords equal opportunities and treatment for Islamic banks as for conventional banks. Bahrain also hosts the newly created Liquidity Management Centre (LMC) and the International Islamic Financial Market (IIFM) to coordinate the operations of Islamic banks in the world. To provide appropriate regulatory set up, the BMA has introduced a comprehensive prudential and reporting framework that is industry-specific to the concept of Islamic banking and finance. Further, the BMA has pioneered a range of innovations designed to broaden the depth of Islamic financial markets and to provide Islamic institutions with wider opportunities to manage their liquidity.

Another country that has a visible existence of Islamic banking at comprehensive level is Malaysia where both conventional and Islamic banking systems are working in a competitive environment. The share of Islamic banking operations in Malaysia has grown from a nil in 1983 to above 8 percent of total financial system in 2003. They have a plan to enhance this share to 20 percent by the year 2010. However, there are some conceptual differences in interpretation and Shariah position of various contracts like sale and purchase of debt instruments and grant of gifts on savings and financial papers.

In Sudan, a system of Islamic banking and finance is in operation at national level. Like other Islamic banks around the world the banks in
Sudan have been relying in the past on Murabaha financing. However, the share of Musharaka and Mudaraba operations is on increase and presently constitutes about 40 percent of total bank financing. Although the Islamic financial system has taken a good start in Sudan, significant problems still remain to be addressed.

Like Sudan, Iran also switched over to Usury Free Banking at national level in March 1984. However, there are some conceptual differences between Islamic banking in Iran and the mainstream movement of Islamic banking and finance.

Owing to the growing amount of capital availability with Islamic banks, the refining of Islamic financing techniques and the huge requirement of infrastructure development in Muslim countries there has been a large number of project finance deals particularly in the Middle East region. Islamic banks now participate in a wide financing domain stretching from simple Shariah-compliant retail products to highly complex structured finance and large-scale project lending. These projects, inter alia, include power stations, water plants, roads, bridges and other infrastructure projects. Bahrain is the leading centre for Islamic finance in the Middle East region. The establishment of the Prudential Information and Regulatory Framework for Islamic Banks (PIRI) by the BMA in conjunction with AAOIFI has gone a long way towards establishing a legal and regulatory framework to meet the specific risks inherent in Islamic financing structures.

The BMA has quite recently signed MoU with the London Metal Exchange (LME) to pool assets to develop and promote Shariah compliant tradable instruments for Islamic banking industry. The arrangement is seen as a major boost for industry’s integration in the global financial system and should set the pace for commodity-trading environment in Bahrain. BMA has also finalized draft guidelines for issuance of Islamic bonds and securities from Bahrain. In May 03, the
Liquidity Management Centre (LMC) launched its debut US$ 250 million Sukuk on behalf of the Government of Bahrain.

National Commercial Bank (NCB) of Saudi Arabia has introduced an Advance Card that has all the benefits of a regular credit card. The card does not have a credit line and instead has a prepaid line. As such, it does not incur any interest. Added benefits are purchase protection, travel accident insurance, etc and no interest, no extra fees with no conditions, the card is fully Shariah compliant. It is more secure than cash, easy to load up and has worldwide acceptance. This prepaid card facility is especially attractive to women, youth, self employed and small establishment employees who sometimes do not meet the strict requirements of a regular credit card facility. Saudi Government has also endorsed an Islamic-based law to regulate the kingdom's lucrative Takaful sector and opened it for foreign investors.

Islamic banks have also built a strong presence in Malaysia, Bank Negara Malaysia (BNM) has announced to issue new Islamic Bank licenses to foreign players. The Financial Sector Master plan maps out the liberalization of Malaysia's banking and insurance industry in three phases during the next decade. It lists incentives to develop the Islamic financial sector and enlarge its market share to 20 percent, from under 10 percent now. A dedicated high court has been set up to handle Islamic banking and finance cases.

In United Kingdom, the Financial Services Authority is in final stages of issuing its first ever Islamic banking license to the proposed Islamic Bank of Britain, which has been sponsored by Gulf and UK investors. The United States of America has appointed Dr. Mahmoud El Gamal, an eminent economist/expert on Islamic banking to advise the US Treasury and Government departments on Islamic finance.
2.4 ISLAMIC BANKING IN PAKISTAN

Steps for Islamization of banking and financial system of Pakistan were started in 1977-78. Pakistan was among the three countries in the world that had been trying to implement interest free banking at comprehensive/national level. But as it was a mammoth task, the switchover plan was implemented in phases. The Islamization measures included the elimination of interest from the operations of specialized financial institutions including HBFC, ICP and NIT in July 1979 and that of the commercial banks during January 1981 to June 1985. The legal framework of Pakistan's financial and corporate system was amended on June 26, 1980 to permit issuance of a new interest-free instrument of corporate financing named Participation Term Certificate (PTC). An Ordinance was promulgated to allow the establishment of Mudaraba companies and floatation of Mudaraba certificates for raising risk based capital. Amendments were also made in the Banking Companies Ordinance, 1962 (The BCO, 1962) and related laws to include provision of bank finance through PLS, mark-up in prices, leasing and hire purchase.

Separate Interest-free counters started operating in all the nationalized commercial banks, and one foreign bank (Bank of Oman) on January 1, 1981 to mobilize deposits on profit and loss sharing basis. Regarding investment of these funds, bankers were instructed to provide financial accommodation for Government commodity operations on the basis of sale on deferred payment with a mark-up on purchase price. Export bills were to be accommodated on exchange rate differential basis. In March, 1981 financing of import and inland bills and that of the Rice Export Corporation of Pakistan, Cotton Export Corporation and the Trading Corporation of Pakistan were shifted to mark-up basis. Simultaneously, necessary amendments were made in the related laws permitting the State Bank to provide finance against Participation Term
Certificates and also extend advances against promissory notes supported by PTCs and Mudaraba Certificates. From July 1, 1982 banks were allowed to provide finance for meeting the working capital needs of trade and industry on a selective basis under the technique of Musharaka.

As from April 1, 1985 all finances to all entities including individuals began to be made in one of the specified interest-free modes. From July 1, 1985, all commercial banking in Pak Rupees was made interest-free. From that date, no bank in Pakistan was allowed to accept any interest-bearing deposits and all existing deposits in a bank were treated to be on the basis of profit and loss sharing. Deposits in current accounts continued to be accepted but no interest or share in profit or loss was allowed to these accounts. However, foreign currency deposits in Pakistan and on-lending of foreign loans continued as before. The State Bank of Pakistan had specified 12 modes of non-interest financing classified in three broad categories. However, in any particular case, the mode of financing to be adopted was left to the mutual option of the banks and their clients.

The procedure adopted by banks in Pakistan since July 1 1985, based largely on ‘mark-up’ technique with or without ‘buy-back arrangement’, was, however, declared un-Islamic by the Federal Shariat Court (FSC) in November 1991. However, appeals were made in the Shariat Appellate Bench (SAB) of the Supreme Court of Pakistan. The SAB delivered its judgment on December 23, 1999 rejecting the appeals and directing that laws involving interest would cease to have effect finally by June 30, 2001. In the judgment, the Court concluded that the present financial system had to be subjected to radical changes to bring it into conformity with the Shariah. It also directed the Government to set up, within specified time frame, a Commission for Transformation of the financial system and two Task Forces to plan and implement the process of the transformation.
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System for distribution of profit among various kinds of liabilities/deposits. The Report also contained recommendation for forestalling willful default and safeguarding interest of the banks, depositors and the clients.

According to the Commission, prior/preparatory works for introduction of Shariah compliant financial system briefly included creating legal infrastructure conducive for working of Islamic financial system, launching a massive education and training program for bankers and their clients and an effective campaign through media for the general public to create awareness about the Islamic financial system.

The Finance Minister of Pakistan in his budget speech declared the following:

“Government is committed to eliminate Riba and promote Islamic banking in the country”. For this purpose a number of steps are under way which are:
1. A legal framework is designed to encourage practice of Islamic banking by banks and financial institutions as subsidiary operations of their main operations;

2. Consultations and exchanges are undertaken with brother Islamic countries and renowned institutions of Islamic learning such as middle eastern countries and Al-Azhar University of Egypt, to learn more about their experiences and practices;

3. Amendments in HBFC Act are being made in line with the directive of the Supreme Court. With these changes, HBFC would be fully Shariah compliant institution, which will play an effective role both in promotion of Islamic financing method but also in the development of the important housing sector;

4. Shariah compliant modes of financing like Musharaka and Mudaraba will be encouraged so that familiarity and use of such products is enhanced and their adoption at a wider scale made possible.

It is government’s intention to promote Islamic banking in the country while keeping in view its linkages with the global economy and existing commitments to local and foreign investors.

The House Building Finance Corporation had shifted its rent sharing operations to interest based system in 1989. The Task Force of the M/O Law proposed amendments in the HBFC Act to make it Shariah Compliant. Having vetted by the CTFS, the amended law has been promulgated by the Government. Accordingly, the HBFC launched in 2001 Asaan Ghar Scheme in the light of amended Ordinance based on the Diminishing Musharakah concept. A Committee was constituted in the Institute of Chartered Accountants, Pakistan (ICAP), wherein the SBP was also represented, for development of accounting and auditing standards for Islamic modes of financing. The Committee is reviewing
the standards prepared by the Bahrain based Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) with a view to adapt them to our circumstances and if considered necessary, to propose new accounting standards.

It was decided in September 2001 that the shift to interest free economy would be made in a gradual and phased manner and without causing any disruptions. It was also agreed that State Bank of Pakistan would consider for:

1. Setting up subsidiaries by the commercial banks for the purpose of conducting Shariah compliant transactions;
2. Specifying branches by the commercial banks exclusively dealing in Islamic products, and
3. Setting up new full-fledged commercial banks to carry out exclusively banking business based on proposed Islamic products.

Accordingly, the State Bank issued detailed criteria in December 2001 for establishment of full-fledged Islamic commercial banks in the private sector. Al Meezan Investment Bank received the first Islamic commercial banking license from SBP in January 2002 and the Meezan Bank Limited (MBL) commenced full-fledged commercial banking operation from March 20, 2002. Further, all formalities relating to the acquisition of Societe Generale, Pakistan by the MBL were completed, and by June, 2002 it had a network of 5 branches all over the country, three in Karachi, one in Islamabad and one in Lahore.

The Government as also the State Bank are mainly concerned with stability and efficiency of the banking system and safeguarding the interests, particularly, of small depositors. With this concern in mind it has been decided to operate Islamic banking side by side with traditional banking. The approach is to institute best practice legal, regulatory and accounting frameworks to support Islamic banks and investors alike. The
year 2002-2003 witnessed strengthening measures taken in the areas of banking, non-bank financial companies and the capital markets.

2.5 ISLAMIC BANKING SUBSIDIARIES

A new clause (aa) was inserted in sub-section (1) of Section 23 of the Banking Companies Ordinance 1962 by an amendment notified in the Gazette of Pakistan on November 4 2002, which provided that banks could form subsidiaries for “carrying on of banking business strictly in conformity with the Injunctions of Islam as laid down in the “Holy Quran and Sunnah.” In January, 2003 the State Bank issued BPD Circular No. 01 outlining detailed instructions on the remaining two parts of the strategy, viz. setting up of subsidiaries and Stand-alone branches for Islamic Banking by existing commercial banks. The criteria for subsidiaries are almost similar to the criteria for setting up scheduled Islamic commercial bank with emphasis on complete segregation of accounts of Islamic banking subsidiaries and the parent banks doing conventional banking. The subsidiaries shall have minimum paid up capital of Rs 1,000 million that is equal to the capital requirement for full-fledged commercial banks.

Islamic Banking through Stand-alone Branches for Part-III of the strategy, guidelines for opening of stand-alone branches for Islamic banking by existing commercial banks, enlisting eligibility criteria, licensing requirements and other operational details on the subject were issued on January 1 2003. The criteria pertain to financial strength of the applicant bank as evident from its capital base (net capital free of actual and potential losses), adequacy of its capital structure, record of earning capabilities, future earning prospects of the bank, managerial capabilities, bank’s liquidity position, track record of the bank’s adherence to prudential regulations, credit discipline, quality of customer services and the convenience and the needs of the population of the area to be served
by the proposed branches. The applying bank is required to submit proposal to the State Bank.

As regards the status of Islamic banking industry in the country (End Dec, 2005), Meezan Bank is operating with 29 branches in 12 cities as a full fledged Islamic bank. In addition to it, 5 banks (MCB, Bank of Khyber, Bank Alfalah, Habib Bank AG Zurich and Standard Chartered Bank) have been issued licenses for 12 dedicated Islamic Banking Branches (IBB) of which 10 branches are operating in Karachi, Islamabad, Peshawar, Lahore, Faisalabad and Multan. SBP has also given in principle approval for opening 10 more Islamic banking branches during 2004 by MCB and Bank Alfalah.

Habib Bank Limited and Bank Al Habib Limited have been granted in principle approval to open two Islamic banking branches. They started these branches during the year 2004. Applications for two new full-fledged Islamic banks are also under scrutiny while the license of a foreign Islamic bank is being converted to Islamic banking.

The premier Islamic banking in Pakistan is Meezan Bank with 29 branches in 12 different cities.

2.6 MEEZAN BANK LIMITED

Meezan bank is a publicly listed company first incorporated on January 27, 1997. It started operations as an investment bank in August of the same year. In January, 2002 in an historic initiative, Meezan Bank was granted the nation's first full-fledged commercial banking license dedicated to Islamic Banking, by the State Bank of Pakistan.

The Bank has made fundamental and significant progress forward, and in doing so has established a strong and credible management team comprised of experienced professionals, which have achieved a strong balance sheet with excellent operating profitability.
The Bank's main shareholders are leading local and international financial institutions, including Pak-Kuwait Investment Company, the Islamic Development Bank of Jeddah, and the renowned Shamil Bank of Bahrain, that in addition to their strength and stability, add significant value to the Bank through Board representation and applied synergies.

The Bank has an internationally renowned, very high caliber and pro-active Shariah Supervisory Board presided over by Justice (Retd.) Maulana Muhammad Taqi Usmani, a renowned figure in the field of Shariah, particularly Islamic Finance. He holds the position of Deputy Chairman at the Islamic Fiqh Academy, Jeddah and in his long and illustrious career has also served as a Judge in the Shariat Appellate Bench, Supreme Court of Pakistan. The Bank also has a resident Shariah advisor, Dr. Imran Usmani, who strictly monitors the regular transactions of the Bank. The board also includes Sheikh Essam M. Ishaq (Bahrain), and Dr. Abdul Sattar Abu Ghuddah (Saudi Arabia).
2.6.1 Bank’s Vision

Establish Islamic banking as banking of first choice to facilitate the implementation of an equitable economic system, providing a strong foundation for establishing a fair and just society for mankind.

2.6.2 Bank’s Mission

To be a premier Islamic bank, offering a one-stop shop for innovative value added products and services to customers within the bounds of Shariah, while optimizing the stakeholders' value through an organizational culture based on learning, fairness, respect for individual enterprise and performance.

2.6.3 Bank’s Service Mission

To develop a committed service culture which ensures the consistent delivery of bank products and services within the highest quality service parameters, promoting Islamic values and ensuring recognition and a quality banking experience to customers.

2.6.4 Shariah Board

The members of the Shariah Board of Meezan Bank are Internationally-renowned scholars serving on the boards of many Islamic banks operating in different countries.

The members of the Shariah Board are:

- Justice (Retd.) Muhammad Taqi Usmani
- Dr. Abdul Sattar Abu Ghuddah
- Sheikh Essam M. Ishaq
- Dr. Muhammad Imran Ashraf Usmani - Shariah Advisor
2.6.5 Network

Section three
CHAPTER 3

INTRODUCTION TO ISLAMIC BANKING

The guidance for all institutional developments in an Islamic society is to be derived from the principles of Shariah. The form and content of Islamic banking practices have therefore to be deduced from the teachings of Islam. There was no prototype of modern banks in the early history of Islam. Even in the Western countries.

The western banking system is primarily based on interest. The giving and taking of interest is strictly prohibited in Islam. Abstinence from interest is enjoined by the verses in the Holy Qur’an as well as the authentic sayings of the Holy Prophet (peace be upon him). The Arabic word used is riba and there is a consensus among Muslim scholars that interest in all forms and manifestations comes within the meaning of the word riba. Transactions based on interest are severely condemned in the Holy Qur’an and Sunnah.

The Qur’an says:

"Those who swallow ‘riba’ can not rise up save as he ariseth whom the devil has prostrated by (his) touch. That is, because they say: Trade is jus like ‘ribe’; whereas Allah permittech trading and forbidden ‘riba’. He unto whom an admonition from his Lord cometh, and (he) refraineth (in obedience thereto), he shall keep (the profits of) that which is past, and his affairs (henceforth) is with Allah. As for him who returneth to ‘riba’; such are rightful owners of the fire. They will abide therein. Allah hath blighteth ‘riba’ and made ‘sadaqat’ fruitful. Allah loveth not the impious and guilty.” (2:275-276)
“O ye believe! Devour not ‘riba’, doubling and quadrupling (the sum lent). Observe your duty to Allah that ye may be successful.” (3: 129-130)

The delineation in the Holy Qur’an of the practice of interest as an act of “war with Allah and His messenger” provides a clue to the philosophy behind the prohibition of interest in Islam. It is a clear pointer that the institution of interest is something which runs counter to the scheme of things which Islam stands for and which Allah wants to see established on earth. The words that “Allah has blighteth riba and made sadaqat fruitful” occurring in verse 276 of Surah Al-Baqara also point towards the fact that the practice of interest militates against the objectives of an Islamic society while sadaqat promotes these objectives. The call given in the same Surah “O ye who believe, observe your duty to Allah and give up what remineth (due to you) from riba if ye are (in truth) believers” shows that the practice of interest is incompatible with the spirit of Islam, and has no place in a society of true believers.¹

The rationale for the prohibition of interest on loans taken for consumption purposes is more or less invariant with regard to time. It is based on the ethical consideration that people living in an Islamic society should help each other in times of need by lending money without charging anything extra for it. Charging of interest on loans taken for consumption purposes amounts to taking advantage of a man’s inferior economic position and is repugnant to the spirit of Islam whose underlying philosophy is one of al-adl wal ahsan.

In the modern age, it is credit for production purposes rather than for personal consumption that dominates the scene. The western type

¹ Ahmad, Dr. Ziauddin, Interest free Banking, Intermedia Advertising Communication, 1994, pp 65
banks mobilize savings of the people by undertaking to pay a predetermined return on savings and time deposits while guaranteeing the safety of the principle amount of the deposit. They lend resources to the business enterprises and charge interest on the principle amount of the loan. On the face of it, this looks like an innocuous arrangement. However, such an arrangement has many undesirable features which militate against the ethical norms of Islam and also stand in the way of achievement of the socio-economic objectives of an Islamic economy. An understanding of these undesirable features is necessary not only for appreciating the rationale behind the prohibition of interest even in the case of loans for production purposes but also for fashioning an alternative system which may be in consonance with the spirit of Islam. The undesirable features of an interest-based banking system looked at in the context of the operative principles that currently underlie banking practice, may be listed as follows:

- Transactions based on interest violate the equity aspect of economic organization. The borrower is obliged to pay a predetermined rate of interest on the sum borrowed even though he may have incurred a loss.

- The inflexibility of an interest-based system in a loss situation leads to a number of bankruptcies resulting in loss of productive potential and unemployment. The dead weight of interest in terms of depressed economic activity characterized by low profitability, makes industries “sick” and makes their “recovery” extremely problematic which again has adverse consequences for the employment situation.

- The interest system dampens investment activity because it adds to the costs of investment.

- The interest based system is security oriented rather than growth oriented. Because of the commitment to pay a predetermined rate
of interest to depositors, banks in their lending operations are most concerned about the safe return of the principal lent along with the stipulated interest.

- The interest based system discourages innovation, particularly on the part of small-scale enterprises. Big industries firms and big landholders can afford to experiment with new techniques of production as they have reserves of their own to fall back upon in case the adoption of new practices does not yield a good dividend.  

The alternative to above is that banking should be conducted on the basis of profit/loss sharing. While any return on capital in the form of interest is completely prohibited in Islam.

The fundamental features of a profit/loss sharing arrangement which are in tune with the ethos of the value system of Islam are available in the literature on Fiqh Muamlat-ul-malia. These are usually found under the head of Mudarbah or Qirad or Muqaradah in Fiqh literature. These terms denote an arrangement by virtue of which money is given for trading purposes by one party to another on the principle of profit/loss sharing. When capital is provided entirely by one party and enterprise and/or labour entirely by another party, the profit earned can be divided between the parties in proportions agreed upon and stipulated in the agreement. However, in the event of a loss, the entire loss has to be borne by the provider of capital unless it is due to the negligence of the worker/entrepreneur. If there are more than one providers of capital, profit can be shared by them strictly in proportion to their respective capital contributions.

The Sharakah is another type of profit/loss sharing arrangement which is in consonance with the value system of Islam. Under this arrangement, all the parties contribute to the capital in equal or varying

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2 Ahmad, Dr. Ziauddin, Interest free Banking, Intermedia Advertising Communication, 1994, pp 67
proportions and all or some of them may participate in the work/management of the business. Profits are shared in pre-agreed proportions but the loss, if any, is borne strictly in proportion to the capital contributed by each party.

The requirement that loss has to be shared strictly in proportion to the capital contribution while profits can be shared in any agreed proportions is meant to ensure equity while providing sufficient flexibility in working out business-finance relationships. The basis of cooperation between capital and enterprise in Islam is the sharing of risks and gains between them.

The conduct of banking on the basis of a combination of interest free loans and profit/loss sharing is in tune with the Islamic norms of justice and is also capable of assisting the achievement of the socio-economic objectives of an Islamic society. The Islamic sense of justice demands that persons who are constrained to borrow to meet their essential consumption requirements should not be charged anything over and above the principal amount of money borrowed. Since all loan of a bank working in accordance with Islamic principles have to be free of interest, loans given by such bank for meeting essential consumption requirements will not saddle the borrowers with any additional burden beyond the repayment of principal amount of money borrowed. Provision of financial resources to business undertakings for productive purposes on the basis of profit/loss sharing will not militate against the Islamic norms of justice as Islam allows a return on capital provided the provider of capital funds shares in the risks of business. Apart from fulfilling the criterion of equity; a banking system based on profit/loss sharing can assist greatly in achieving the socio-economic objectives of an Islamic society. Islam favors full utilization of productive resources of an economy and lays great stress on an equitable distribution of income and wealth. A banking system based on profit/loss sharing is likely to provide
a tremendous boost to economic development by enlarging the supply of risk capital. Besides, such a system may be expected to quicken encouragement to innovation and experimentation with new techniques of production. It will also promote greater allocative efficiency as banks will join hands with business enterprises in maximizing productivity since the profit/loss sharing arrangement, unlike the lending arrangement, ties up the return on bank funds with the actual performance of an enterprise.

ROLE OF ISLAMIC BANK IN DEVELOPMENT OF ECONOMY

Islamic banks, while functioning within the framework of Shariah, can perform a crucial task of resource mobilization, their efficient allocation on the basis of both PLS (Musharaka and Mudaraba) and non-PLS (trading & leasing) based categories of modes and strengthening the payments systems to contribute significantly to economic growth and development. Sharing modes can be used for short, medium and long-term project financing, import financing, pre-shipment export financing, working capital financing and financing of all single transactions.

The non-PLS techniques, as acceptable in the Islamic Shariah, not only complement the PLS modes, but also provide flexibility of choice to meet the needs of different sectors and economic agents in the society. Trade-based techniques like Murabaha with lesser risk and better liquidity.

Ijarah related financing that would require Islamic banks to purchase and maintain the assets and afterwards dispose of them according to Shariah rules, require the banks to engage in activities beyond financial intermediation and can be very much conducive to the formation of fixed assets and medium and long-term investments.

On the basis of the above it can be said that supply and demand of capital would continue in an interest-free scenario with additional benefit of greater supply of risk-based capital along with more efficient allocation
of resources and active role of banks and financial institutions as required in asset based Islamic theory of finance. Islamic banks can not only survive without interest but also could be helpful in achieving the objective of development with distributive justice by increasing the supply of risk capital in the economy, facilitating capital formation, and growth of fixed assets and real sector business activities.

Salam has a vast potential in financing the productive activities in crucial sectors, particularly agriculture, agro-based industries and the rural economy as a whole. It also provides incentive to enhance production as the seller would spare no effort in producing, at least the quantity needed for settlement of the loan taken by him as advance price of the goods. Salam can also lead to creating a stable commodities market especially the seasonal commodities and therefore to stability of their prices. It would enable savers to direct their savings to investment outlets without waiting, for instance, until the harvesting time of agricultural products or the time when they actually need industrial goods and without being forced to spend their savings on consumption.

Banks might engage in fund and portfolio management through a number of asset management and leasing & trading companies. Such companies/entities can exist in the economy on their own or can be an integral part of some big companies or subsidiaries, as in the case of Universal Banking in Europe. They would manage Investors Schemes to mobilize resources on Mudarabah basis and to some extent on agency basis, and use the funds so collected on Murabaha, leasing or equity participation basis. Subsidiaries can be created for specific sectors/operations, which would enter into genuine trade and leasing transactions. Low-risk Funds based on short-term Murabaha and leasing operations of the banks in both local as well as foreign currencies would be best suited for risk-averse savers who cannot afford possible losses, in PLS based investments. Under equity based Funds, banks can offer a type
of equity exposure through specified investment accounts where they may identify possible investment opportunities from existing or new business clients and invite account-holder to subscribe. Instead of sharing in the bank’s profit, the investors would share the profits of the enterprise in which funds are placed with the bank taking a management fee for its work.
CHAPTER 4

PROHIBITION OF INTEREST

4.1 INTRODUCTION

On November 23, 1999, the Shari’ah Appellate Bench of the Supreme Court of Pakistan announced a historical judgement, disposing off a number of appeals against the Federal Shari’ah Court Judgment on Riba of November 1991. The Appellate Court endorsed the judgement of the Federal Shari’ah Court and declared that all types of interest fall in the purview of the Qur’anic prohibition of Riba. At the same time, the Appellate Court gave a deadline of 30 June 2001 to the government of Pakistan for enforcing a law to prohibit all transactions involving interest and also to introduce an alternative system of Islamic finance. The government has expressed its intention to comply with the court’s order.

The government of Pakistan had set up a commission for the transformation of the economy on Islamic lines. Reportedly, the commission has submitted its interim report. Besides, a number of subcommittees in the Ministries of law, religious affairs, and finance have made their contributions to the development of an alternative system based on Islamic principles.

The main conclusion of this chapter is that interest on loan finance is an economic phenomenon and if we want to eliminate it from the economy, we shall require economic solutions rather than legal solutions. The study argues that elimination of interest is not a state responsibility. It is an element of personal behavior and the Shari’ah has left it to individuals to decide whether they would like to abstain from it or indulge in it. It is like most of the Islamic Shari’ah in which an individual has the freedom to decide about his actions and omissions with responsibility for their consequences in the Hereafter.
4.2 THE DEBATE ON RIBA AND INTEREST:

The roots of debate over elimination of interest lie in the yearnings of the Muslim *Ummah* to create a homeland where it can practice its religion and way of life in its pristine form. Soon after the creation of Pakistan, the ulema raised a demand for transforming Pakistan into a modern Islamic state. Naturally, such a demand would present the most awkward situation where the financial institutions of the country were being run on the basis of interest. The popular demand was that since interest was prohibited by the *Shari‘ah*, therefore, the financial institutions should be reformed and based on some interest-free basis. The early day thinking was quite rudimentary and those who raised this slogan were not quite sure about the alternative basis of interest. However, they invoked two types of response. First, a sizeable number of people in Pakistan and other Islamic countries accepted their position and started thinking and suggesting alternative models of interest-free banks (as they were called in those days). The second response came from the western-educated modernist elite. They feared that the demand for creating an Islamic order may take the society to the seventh century days. They had the vision of making progress and treading with the currents of time. At the same time, they had a sincere affiliation with Islam’s broader vision life. They adopted a different route in discussing the prohibition of *Riba*. They argued that the *Qur’an* has prohibited *Riba*, which most probably, related to usury on consumption loans taken by the poor and the indigent. The main plank of their argument was that this type of *Riba* should, of course, be prohibited as had been done in other developed countries. However, the interest on commercial loans should remain intact, as it was neither unjust nor usurious. Instead, it helped in the development of trade and industry. This line of argument was led by such eminent scholars as Fazalur Rahman, Jafar Shah Phulwarwi and Abdullah Yusuf Ali, in Pakistan and Muhammad Abduhu and Rashid Rida in Egypt. While these
scholars were arguing their case on the above lines, scholars of the more conservative creed continued with their intellectual effort.

A turning point came when in 1975, the Islamic Development Bank came into being in Jeddah, asserting that it intended to operate on a basis other than interest. It was followed by the First International Conference on Islamic Economics in Makkah in 1976 in which a few hundred Muslim scholars and economists participated. The conference unequivocally declared that interest and riba were one and the same thing. Subsequent to that, scores of conferences and hundreds of documents consisting of thousands of pages have argued that interest and riba were one and the same thing. Beside, such authoritative bodies, the Council of Islamic Ideology of Pakistan, OIC Fiqh Academy, Fiqh Academy of India, the Azhar university, Shari‘ah Supervisory Board of International Association of Islamic Banks, Federal Shari‘ah Court of Pakistan, Shari‘ah Appellate Bench of the Supreme Court of Pakistan and hundreds of fatwas and rulings by individual ulema have argued that Riba and interest were one and the same thing. We think, the debate is finally settled in favor of the classical ulema. However, we still listen to some voices of disagreement here and there. We feel that the argument in favor of the classical position, which argues that interest and riba are one and the same thing, is conclusive and has been widely accepted by the Muslim ummah.

The first conclusion about the strategy for eliminating interest from the economy is that those who like to retain interest by re-interpreting the Qur’an are trying to fight a losing battle. The fact is that the Qur’an has prohibited riba and interest prevalent in conventional financial institutions is riba, which therefore, should be eliminated from the economy. The stance of retaining interest by providing a set of lame arguments does not have much intellectual support.
Chapter 2

After successfully arguing that interest and riba are one and the same thing, the religious lobby adopted a legal course of action. They approached the Federal Shari’ah Court of Pakistan, requesting it to issue an injunction against interest and to oblige the government of Pakistan for restructuring the entire financial system of the country on some alternative basis. At the same time, the Council of Islamic Ideology undertook a detailed exercise in studying all laws of Pakistan, clause by clause, and pointed out the sections or parts that should be deleted or modified because, they contained some reference to interest. The government of Nawaz Sharif, knuckling under the pressure of the religious lobby, appointed a committee headed by Raja Zafarul Haq for proposing changes in the financial system of the country. The main plank of that committee’s report (although not made public so far), was that the government should pass a law prohibiting interest.

4.3 IS THE ELIMINATION OF RIBA FROM THE ECONOMY A LEGAL ISSUE?

The idea that interest should be abolished by a legal decree has its roots in the contemporary interpretation of the religious text. In this section we shall examine the genesis of this idea and comment on its ability to provide a suitable strategy for elimination of interest from the economy.

The Qur’an has categorically declared interest as unlawful Verse 2:275 says:

Those who take Riba will not stand but as stands the one whom the demon has driven crazy by his touch. That is because they said: Trading is but like riba. And Allah has permitted trading and prohibited Riba. So, whoever receives an advice from his Lord and stops, he is allowed what has passed, and his matter is up to Allah. And the ones who revert back, those are the people of Fire. There they remain for ever.
From this verse, it is clear that *Riba* or interest is prohibited. The conventional interpretation is that since interest has been categorically prohibited, therefore, an Islamic state should decree its enforcement through a law and compel all financial institutions to restructure themselves on an alternative basis. If it is not done, the will of Allah will remain unfulfilled. We feel that it is an over-zealous interpretation of the verse. It is true that interest is prohibited but it does not suggest that its prohibition should be enforced by a law. As we shall show below that this is only a recent interpretation of this verse and has no support from the earlier days or sources of Islam. Even the text of the *Qur’an* talks of punishment in the Hell-fire and says that those who had taken interest in the past, their matter would be decided by Allah (in the Hereafter). The first part of the verse also refers to the state of interest-eater on the Day of Judgment. The whole slant of the verse is toward the Hereafter. Generally, in all those matters where reward in hereafter is referred to the individual is given the freedom to choose from good and evil and decide with his free will. It seems that the prohibition of interest on loans falls in this category of prohibitions where an individual is allowed the freedom to choose. It is not one of those things which are to be enforced by the state.

The *Qur’an* only allows return of the principal

Verse 2:278 says:

يَايَاكَانِيْلَنَّ أَمْتَعْنِؤُوا اللَّهَ وَزَرَّوْاً أَمَا بَقَى مِنَ الْرِّبوَةِ إِنَّكُمْ مُّهْمِيْنِ ٣٣

“O those who believe, fear Allah and give up what still remains of the ‘Riba’ if you are believers”. (2:278)

On the basis of this verse, the Prophet Muhammad (sws) declared during his last pilgrimage that he abolished all claims of interest and first of all abolished the claims of his own uncle *Abbas Ibn Abdu’l Muttalib*. 33
On the basis of this action of the Prophet (sws), it is argued that an Islamic state is supposed to enact prohibition of interest and courts shall not entertain any such claims in future⁴. It is possible to construe the above verse and the action of the Prophet (sws) in this sense. However, it seems that it is an over-ambitious interpretation. The Prophet (sws) declared all interest claims as void and first of all those of his own uncle, to set an example. However, he did not promulgate any law even then. The characteristic of the law is that it always has a bite so that if some one violates it, some sort of punishment or action is taken against him. In this case, the Prophet (sws) could easily announce some broad features of such a law. The fact is that neither the Prophet (sws) nor the Qur’an has announced any law relating to interest, as in the case of theft, adultery or murder. The attempts to convert these injunctions into a public law are very recent.

The Qur’an has given an ultimatum of war to those who take interest

Consider the following verse:

\[
\text{فَإِنَّنَّا نَفْتَعَلُونَ فَأَذَانُ بِحَرُبٍ مَّنَّا وَرَسُولُنَا وَإِنْ نَفْتَعِلُونَ فَلَكُمُ الرُّؤْفَةُ وَسُرُّ أَمَرَاءَ الْكُفَّارِ}
\]

“If you do not [desist from taking interest], then listen to the declaration of war from Allah and His Messenger”. (2:279)

This verse has been most vehemently quoted by the proponents of legal recourse against interest. The verse obviously says that those who deal in interest, should get ready for a war against them from Allah and his Messenger. An ultimatum of war from Allah and his Messenger naturally diverts the mind toward the worst type of state crime. Only a

person who revolts against the Islamic state can be considered worthy of such an ultimatum. Most of the ulema have, therefore, considered this verse as the most critical piece of evidence in their interpretation and in support of their insistence for a public law against dealings in interest.

This interpretation would be most plausible if we read the verse in isolation from the historical event which necessitated the revelation of this verse. Its historical context has been most clearly documented by Justice M. Taqi Usmani. He says:

Then the holy Prophet (sws) proceeded to Ta‘if which could not be conquered, but where, later on, the inhabitants of Ta‘if who belonged to the tribe of Thaqif came to him and after embracing Islam surrendered to the holy Prophet (sws) and entered into a treaty with him. One of the proposed clauses of this treaty was that the Banu Thaqif would not forego the amounts of interest due on their debtors but their creditors would forego the amount of interest. The holy Prophet (sws) instead of signing the treaty simply wrote a sentence on the proposed draft that the Banu Thaqif would have the same rights as the Muslims had. The Banu Thaqif having the impression that their proposed treaty was accepted by the holy Prophet (sws) claimed the amount of interest from Banu Amr Ibn al-Mughirah, but they declined to pay interest on the ground that Riba was prohibited after Islam. The matter was placed before ‘Attab Ibn Asid (raa), the governor of Makkah. The Banu Thaqif argued that according to the treaty they were not bound to forego the amounts of interest. ‘Attab Ibn Asid (rta) placed the matter before the holy Prophet (sws) on which the following verses of Surah Baqarah were revealed: O those who believe, fear Allah and give up what still remains of Riba if you are believers. But if you do not, then, listen to the declaration of war from Allah and His Messenger. And if you repent, yours is your principal. Neither you wrong nor be wronged. (2:278-79).4

4 Ibid., pp.24-25.
The above explanation shows that this ultimatum was a specific reference to the historical situation. Since the Banu Thaqif were intending to break the peace treaty they were given the ultimatum of war. It was not because, dealing in interest was by itself a crime requiring such an ultimatum. It was because, even after this verse, neither the holy Prophet (sws) himself, nor the first four caliphs nor any subsequent Islamic government ever enacted any law against the prohibition of interest. We come across several Ahadith where a companion of the Prophet (sws) transacted a deal and the other companion warned him that the deal involved Riba. In none of such cases do we note that any legal punishment was awarded to the person who dealt in such transactions. The only action was to undo the deal. Similarly, the books of Islamic jurisprudence deal in Riba. Nowhere do they prescribe any punishment for dealing in Riba. They define the limits of transactions and warn against entering into any deal that involves Riba. If we scan through any authentic book of Fiqh, produced throughout Islamic history, we do not find any law relating to Riba. The chapters dealing with Riba, of course, discuss its nature and what makes a transaction lawful or unlawful. But no where a public law, enforcing the prohibition of interest through legal action or through courts, is available in the whole of Islamic literature. It is only the contemporary move towards creating an Islamic state that has diverted the attention of the ulema to stress upon the creation and enforcement of such a law.

Past Attempts by Jews and Christians to Enforce Prohibition of Interest also did not Succeed. We think that one reason why our ancestors did not attempt to enforce prohibition of interest through a legal decree was their understanding of the history. The followers of earlier religions, especially Jews and Christians, did not succeed in eliminating interest through legal action.
Chapter 2

Review

- Hammurabi (2123-2081 BC), the ruler Babylonia, in his Code prescribed maximum rates of interest for various types of loans and also suggested profit-loss sharing to avoid interest. All great religions, and philosophers have opposed interest. But the idea had never been acceptable to wealth-owners and hence could not become a going concern\(^5\).

- Jews in Babylonia established the earliest interest-free bank in 700BC by the name of Agibi Bank on the basis of mortgage of productive assets to the bank for getting an interest-free loan. The bank was allowed to make use of the asset, like a house, a horse, land or slave etc. It did not work out as it did not provide an answer to very short-term loans and discounting of bills.\(^6\)

- The Christians evolved the concept of service charge. Soon the banks levying a service charge evolved into savings banks, where they started offering interest on deposits as well.\(^7\)

- Interest was first prescribed for all citizens by Christian legislature in 789 under Charlemagne.\(^8\)

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\(^5\) Ahmad, Shaikh, Mahmud, Towards Interest-Free Banking, Lahore: Institute of Islamic Culture, 1989, pp. 13-14

\(^6\) Ibid.

\(^7\) Ibid.

\(^8\) Ibid., pp.104
• In late eleventh century, Church reclassified it as a sin of injustice. In succeeding centuries, theologians and scholastics developed various arguments to prove interest as immoral. \(^9\)

\(^9\) Ibid.
CHAPTER 5

ISLAMIC MODE OF FINANCING

An Islamic bank is a financial institution which identifies itself with the spirit of Shariah, as laid down by the Holy Qur'an and Sunnah, as regards its objectives, principles, practices and operations. An Islamic bank does not normally lend money except interest-free loans which are termed as Qard Hasanah (Benevolent Loans) while loans on service charge, not exceeding the actual administrative cost of such loans, have also been permitted by Muslim Scholars.

To replace interest, the ideal mode of financing under the Islamic banking system is "Financing on Profit & Loss Sharing" (PLS) basis. The bulk of financing by Islamic banks has to be equity oriented. In this mode of financing, the losses are shared by the financier along with the entrepreneur in the ratio of their respective capitals. The profits are, however, shared in an agreed ratio.

MODE OF FINANCING

Hadees-e-Qudsi

Allah Subhan-o-Tallah has declared that, He will become a partner in a business between two Mushariks until they indulge in cheating or breach of trust (Khayanah).

5.1 MUSHARAKAH

The literal meaning of Musharakah is sharing. The root of the word “Musharakah” in Arabic is Shirkah, which means being a partner. It is used in the same context as the term “shirk” meaning partner to Allah. Under Islamic jurisprudence, Musharakah means a joint enterprise formed for conducting some business in which all partners share the profit according to a specific ratio while the loss is shared according to
the ratio of the contribution. It is an ideal alternative for the interest based financing with far reaching effects on both production and distribution. The connotation of this term is little limited than the term "Shirkah" more commonly used in the Islamic jurisprudence. For the purpose of clarity in the basic concepts, it will be pertinent at the outset to explain the meaning of each term, as distinguished from the other.

"Shirkah" means "Sharing" and in the terminology of Islamic Fiqh, it has been divided into two kinds:

### 5.1.1 Shirkat-ul-milk (Partnership by joint ownership)

It means joint ownership of two or more persons in a particular property.

### 5.1.2 Shirkat-ul-Aqd (Partnership by contract)

This is the second type of Shirkah, which means, "a partnership effected by a mutual contract". For the purpose of brevity it may also be translated as "joint commercial enterprise.

### 5.2 MUDARABA

This is a kind of partnership where one partner gives money to another for investing in a commercial enterprise. The investment comes from the first partner who is called "Rab-ul-Maal" while the management and work is an exclusive responsibility of the other, who is called "Mudarib" and the profits generated are shared in a predetermined ratio.

**Types of Mudarabah**

There are 2 types of Mudarabah namely:

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10 Usmani, Dr. M. Imran, Ashraf, Islamic Banking, Karachi, Darul Ishaat, 2002, pp 87
5.2.1 **Al Mudarabah Al Muqayyadah**

Rab-ul-Maal may specify a particular business or a particular place for the mudarib, in which case he shall invest the money in that particular business or place.

5.2.2 **Al Mudarabah Al Mutlaqah**

However if Rab-ul-maal gives full freedom to Mudarib to undertake whatever business he deems fit, this is called Al Mudarabah Al Mutlaqah (unrestricted Mudarabah).

5.3 **DIMINISHING MUSHARAKAH**

Another form of Musharakah, developed in the near past, is 'Diminishing Musharakah'. According to this concept, “a financier and his client participate either in the joint ownership of a property or an equipment, or in a joint commercial enterprise. The share of the financier is further divided into a number of units and it is understood that the client will purchase the units of the share of the financier one by one periodically, thus increasing his own share until all the units of the financier are purchased by him so as to make him the sole owner of the property, or the commercial enterprise, as the case may be.”

The Diminishing Murabaha based on the above concept has taken different shapes in different transactions. example is given below:

'A' wants to purchase a taxi to use it for offering transport services to passengers and to earn income through fares recovered from them, but he is short of funds. 'B' agrees to participate in the purchase of the taxi, therefore, both of them purchase a taxi jointly. 80% of the price is paid by 'B' and 20% is paid by 'A'. After the taxi is purchased, it is employed to provide transport to the passengers whereby the net income of Rs. 1000/-

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11 Usmani, Dr. M. Imran, Ashraf, Islamic Banking, Karachi, Darul Ishaat, 2002, pp 115-116
is earned on daily basis. Since 'B' has 80% share in the taxi, it is agreed that 80% of the fare will be given to him and the rest of 20% will be retained by 'A' who has a 20% share in the taxi. It means that Rs. 800/- is earned by 'B' and Rs. 200/- by 'A' on daily basis. At the same time the share of 'B' is further divided into eight units. After three months 'A' purchases one unit from the share of 'B'. Consequently the share of 'B' is reduced to 70% and share of 'A' is increased to 30% meaning thereby that as from that date 'A' will be entitled to Rs. 300/- from the daily income of the taxi and 'B' will earn Rs. 700/-. This process will go on until after the expiry of two years, the whole taxi will be owned by 'A' and 'B' will take back his original investment along with income distributed to him as aforesaid.

5.4 SALAM

This mode of financing can be used by the modern banks and financial institutions especially to finance the agricultural sector. In Salam, “the seller undertakes to supply specific goods to the buyer at a future date in exchange of an advanced price fully paid at spot. The price is in cash but the supply of purchased goods is deferred”

Purpose of use:

- To meet the need of small farmers who need money to grow their crops and to feed their family up to the time of harvest. When Allah declared Riba haram, the farmers could not take usurious loans. Therefore Holy Prophet allowed them to sell their agricultural products in advance.

- To meet the need of traders for import and export business. Under Salam, it is allowed for them that they sell the goods in advance so that after receiving their cash price, they can easily undertake the aforesaid business. Salam is beneficial to the seller because he received the price in advance and it was beneficial to the buyer
also because normally the price in Salam is lower than the price in spot sales.

5.5 ISTISNA

Istisna is a sale transaction where a commodity is transacted before it comes into existence. It is an order to a manufacturer to manufacture a specific commodity for the purchaser. The manufacturer uses his own material to manufacture the required goods.

In Istisna, price must be fixed with consent of all parties involved. All other necessary specifications of the commodity must also be fully settled.

5.5.1 Cancellation of contract

After giving prior notice, either party can cancel the contract before the manufacturing party has begun its work. Once the work starts, the contract cannot be cancelled unilaterally.

5.5.2 Istisna' as a mode of financing

Istisna may be used to provide financing for house financing. If the client owns a land and seeks financing for the construction of a house, the financier may undertake to construct the house on the basis of an Istisna. If the client does not own the land and wants to purchase that too, the financier can provide him with a constructed house on a specified piece of land. The financier does not have to construct the house himself. He can either enter into a parallel Istisna with a third party or hire the services of a contractor (other than the client). He must calculate his cost and fix the price of Istisna with his client that allows him to make a reasonable profit over his cost. The payment of installments by the client may start right from the day when the contract of Istisna is signed by the parties. In order to secure the payment of installments, the title deeds of the house or land, or any other property of the client may be kept by the financier as a security until the last installment is paid by the client. The financier will
be responsible to strictly conform to the specifications in the agreement for the construction of the house. The cost of correcting any discrepancy would have to be borne by him.

5.6 ISTIJRAR

Istijrar means purchasing goods time to time in different quantities. In Islamic jurisprudence Istijrar is an agreement where a buyer purchases something from time to time; each time there is no offer or acceptance or bargain. There is one master agreement where all terms and conditions are finalized. There are two types of Istijrar:

- Whereby the price is determined after all transactions of purchase are complete.

- Whereby the price is determined in advance but the purchase is executed from time to time.

The first kind is relevant with the Islamic mode of financing. This kind is permissible with certain conditions.

- In the case where the seller discloses the price of goods at the time of each transaction; the sale becomes valid only when the buyer possess the goods. The amount is paid after all transactions have been completed.

- If the seller does not disclose each and every time to the buyer the price of the subject matter, but the contractors know that it is being sold on market value and the market value is specified and determined in such a manner that it does not vary and it does not lead to differences of the contractors.

- If at the time of possession, the price of subject matter was unknown or contractors agree that whatever the price shall be, the sale will be executed. However, if there is significant difference in the market price and the agreed price, it may cause conflict. In
such a case, at the time of possession, the sale will not be valid. However, at the time of settlement of the payment, the sale will be valid.

As far as the use of Istijrar in Islamic banks is concerned, at present they are involved in four kinds of activities, namely Murabaha, Ijarah, Mudarabah and Musharakah.

5.7 IJARAH (LEASING)

5.7.1 Basic Rules

Transferring of usufruct not ownership. In leasing an owner transfers its usufruct to another person for an agreed period, at an agreed consideration.

5.7.2 Subject of lessee

Should be valuable, identified and quantified. All consumable things cannot be leased out the corpus of the leased property remains in the ownership of the seller, and only its usufruct is transferred to the lessee. Thus, anything, which cannot be used without consuming, cannot be leased out. For example money, wheat etc.

5.7.3 Lease as a mode of financing

Lease is not originally a mode of financing. It is simply a transaction meant to transfer the usufruct of a property from one person to another for an agreed period against an agreed consideration. However, certain financial institutions have adopted leasing as a mode of financing instead of long term lending on the basis of interest.

This transaction of financial lease may be used for Islamic financing, subject to certain conditions. It is not sufficient for this purpose to substitute the name of 'interest' by the name of 'rent' and replace the name of 'mortgage' by the name of 'leased asset'. There must be a
substantial difference between leasing and an interest-bearing loan. That will be possible only by following all the Islamic rules of leasing.

5.8 IJARAH WA IQTINA (LEASING AND PROMISE TO GIFT)

In Islamic Shariah, it is allowed that instead of sale, the lessor signs a separate promise to gift the leased asset to the lessee at the end of the lease period, subject to his payment of all amounts of rent. This arrangement is called 'Ijarah wa iqtina. It has been allowed by a large number of contemporary scholars and is widely acted upon by the Islamic banks and financial institutions. The validity of this arrangement is subject to two basic conditions:

- The agreement of Ijarah itself should not be subjected to signing this promise of sale or gift but the promise should be recorded in a separate document.

- The promise should be unilateral and binding on the promisor only. It should not be a bilateral promise binding on both parties because in this case it will be a full contract effected to a future date, which is not allowed in the case of sale or gift.
CHAPTER 6

INTRODUCTION TO MURABAHA

6.1 INTRODUCTION

Most of the Islamic banks and financial institutions are using "Murabaha" as an Islamic mode of financing, and most of their financing operations are based on "Murabaha". That is why this term has been taken in the economic circles today as a method of banking operations.

"Murabaha" is, in fact, a term of Islamic Fiqh and it refers to a particular kind of sale having nothing to do with financing in its original sense. If a seller agrees with his purchaser to provide him a specific commodity on a certain profit added to his cost, it is called a "murabahah" transaction. The basic ingredient of "murabahah" is that the seller discloses the actual cost he has incurred in acquiring the commodity, and then adds some profit thereon. This profit may be in lump sum or may be based on a percentage.

The payment in the case of murabahah may be at spot, and may be on a subsequent date agreed upon by the parties. Therefore, murabahah does not necessarily imply the concept of deferred payment, as generally believed by some people who are not acquainted with the Islamic jurisprudence and who have heard about murabahah only in relation with the banking transactions.

Murabahah, in its original Islamic connotation, is simply a sale. The only feature distinguishing it from other kinds of sale is that the seller in murabahah expressly tells the purchaser how much cost he has incurred and how much profit he is going to charge in addition to the cost.

If a person sells a commodity for a lump sum price without any reference to the cost, this is not a murabahah, even though he is earning
some profit on his cost because the sale is not based on a "cost-plus" concept. In this case, the sale is called "Musawamah".

This is the actual sense of the term "Murabahah" which is a sale, pure and simple. However, this kind of sale is being used by the Islamic banks and financial institutions by adding some other concepts to it as a mode of financing. But the validity of such transactions depends on some conditions which should be duly observed to make them acceptable in Shari‘ah.

In order to understand these conditions correctly, one should, in the first instance, appreciate that murabahah is a sale with all its implications, and that all the basic ingredients of a valid sale should be present in murabahah also. Therefore, this discussion will start with some fundamental rules of sale without which a sale cannot be held as valid in Shari‘ah. Then, we shall discuss some special rules governing the sale of Murabahah in particular, and in the end the correct procedure for using the murabahah as an acceptable mode of financing will be explained.

6.2 SOME BASIC RULES OF SALE

'Sale' is defined in Shariah as 'the exchange of a thing of value by another thing of value with mutual consent'.

Islamic jurisprudence has laid down enormous rules governing the contract of sale, and the Muslim jurists have written a large number of books, in a number of volumes, to elaborate them in detail. What is meant here is to give a summary of only those rules which are more relevant to the transactions of murabahah as carried out by the financial institutions:

[Online resource: http://www.darululoomkhi.edu.pk/fiqh/islamicfinance/murabaha.html#sale]
6.2.1 The subject of sale must be existing at the time of sale.

If a non-existent thing has been sold, though by mutual consent, the sale is void according to Shari‘ah.

Example:

A sells the unborn calf of his cow to B. The sale is void.

6.2.2 The subject of sale must be in the ownership of the seller at the time of sale.

If he sells something before acquiring its ownership, the sale is void.

Example:

A sells to B a car which is presently owned by C, but A is hopeful that he will buy it from C and shall deliver it to B subsequently. The sale is void, because the car was not owned by A at the time of sale.

6.2.3 The subject of sale must be in the physical or constructive possession of the seller when he sells it to another person.

Example:

A has purchased a car from B. B has not yet delivered it to A or to his agent. A cannot sell the car to C. If he sells it before taking its delivery from B, the sale is void.

6.2.4. The sale must be instant and absolute.

Thus a sale attributed to a future date or a sale contingent on a future event is void. If the parties wish to effect a valid sale, they will have to effect it afresh when the future date comes or the contingency actually occurs.
Example:

A says to B on the first of January: "I sell my car to you on the first of February". The sale is void, because it is attributed to a future date.

6.2.5. The subject of sale must be a property of value

Thus, a thing having no value according to the usage of trade cannot be sold or purchased.

6.2.6 The subject of sale should not be a thing which is not used except for a haram purpose, like pork, wine etc.

6.2.7 The subject of sale must be specifically known and identified to the buyer.

Example:

There is a building comprising a number of apartments built in the same pattern. A, the owner of the building says to B, "I sell one of these apartments to you"; B accepts. The sale is void unless the apartment intended to be sold is specifically identified or pointed out to the buyer.

6.2.8 The delivery of the sold commodity to the buyer must be certain and should not depend on a contingency or chance.

Example:

A sells his car stolen by some anonymous person and the buyer purchases it under the hope that he will manage to take it back. The sale is void.

6.2.9 The certainty of price is a necessary condition for the validity of a sale. If the price is uncertain, the sale is void.

Example:

A says to B, "If you pay within a month, the price is Rs. 50. But if you pay after two months, the price is Rs. 55". B agrees. The price is
uncertain and the sale is void, unless anyone of the two alternatives is agreed upon by the parties at the time of sale.

6.2.10 The sale must be unconditional. A conditional sale is invalid.

**Example:**

A buys a car from B with a condition that B will employ his son in his firm. The sale is conditional, hence invalid.

6.3 **MURABAHA AS A MODE OF FINANCING**

Originally, murabahah is a particular type of sale and not a mode of financing. The ideal mode of financing according to Shariah is mudarabah or musharakah. However, in the perspective of the current economic set up, there are certain practical difficulties in using mudarabah and musharakah instruments in some areas of financing. Therefore, the contemporary Shariah experts have allowed, subject to certain conditions, the use of the murabahah on deferred payment basis as a mode of financing. But there are two essential points which must be fully understood in this respect:

1. It should never be overlooked that, originally, murabahah is not a mode of financing. It is only a device to escape from "interest" and not an ideal instrument for carrying out the real economic objectives of Islam. Therefore, this instrument should be used as a transitory step taken in the process of the Islamization of the economy, and its use should be restricted only to those cases where mudarabah or musharakah are not practicable.

2. The second important point is that the murabahah transaction does not come into existence by merely replacing the word of "interest" by the words of "profit" or "mark-up". Actually, murabahah as a mode of finance, has been allowed by the Shariah scholars with some conditions. Unless these conditions are fully observed, murabahah is not permissible. In fact, it is the observance of these
conditions which can draw a clear line of distinction between an interest-bearing loan and a transaction of murabahah. If these conditions are neglected, the transaction becomes invalid according to Shariah.
FUNDAMENTALS OF MURABAHAH

Murabahah is a particular kind of sale where the seller expressly mentions the cost of the sold commodity he has incurred, and sells it to another person by adding some profit or mark-up thereon.

The profit in Murabahah can be determined by mutual consent, either in lump sum or through an agreed ratio of profit to be charged over the cost.

All the expenses incurred by the seller in acquiring the commodity like freight, custom duty etc. shall be included in the cost price and the mark-up can be applied on the aggregate cost. However, recurring expenses of the business like salaries of the staff, the rent of the premises etc. cannot be included in the cost of an individual transaction. In fact, the profit claimed over the cost takes care of these expenses.

Murabahah is valid only where the exact cost of a commodity can be ascertained. If the exact cost cannot be ascertained, the commodity cannot be sold on murabahah basis. In this case the commodity must be sold on musawamah (bargaining) basis i.e. without any reference to the cost or to the ratio of profit / mark-up. The price of the commodity in such cases shall be determined in lump sum by mutual consent.

Example (1)

A purchased a pair of shoes for Rs. 100/-. He wants to sell it on murabahah with 10% mark-up. The exact cost is known. The murabahah sale is valid.

Example (2)

"A purchased a ready - made suit with a pair of shoes in a single transaction, for a lump sum price of Rs. 500/-. A can sell the suit including shoes on murabahah. But he cannot sell the shoes separately on
Murabahah, because the individual cost of the shoes is unknown. If he wants to sell the shoes separately, he must sell it at a lump sum price without reference to the cost or to the mark-up.

Murabaha is available for financing local purchase or import of capital goods, consumer goods or raw material. Under the murabaha agreement, the client provides the bank with the specifications of goods. When the bank and the client have agreed on the terms of the deal, the bank purchases the goods from a third party, sells them to the client and delivers them physically or delivers their documents of title to the client on a deferred payment basis for their cost, plus its profit, which was mutually agreed. The bank has to give the client the breakdown of its cost along with expenses related to the transaction.

The profit is a certain agreed amount, not worked out on a combination, for on a combination of period and volume of funds involved. It can, however, differ according to the period alone, for example, If the payment is made in 3 months, the profit will be so much and if the payment is made in 6 months the profit will be so much, not necessarily double the amount of 3 months profit.

The bank is responsible for the goods until the client takes possession of them, and thus the bank undertakes a risk. To safeguard against subsequent rejection of the goods by the client, the murabaha contract should have a clause that the client will buy the goods on an “as is where is” basis. Moreover, when the client has approved the terms and conditions of the supply contract, the bank should assign to the client all its rights relating to warranties against the supplier. The bank also tries to minimize the gap between its purchase of the goods and their sale to the client.
Chapter 5
Financing

Islamic Mode of

7.1 FUNDAMENTAL PRINCIPLES OF MURABAHA

There are certain fundamental principles attached to murabaha, such as:

• There should be genuine purchase and sale of goods by the bank. Murabaha can not be created against existing goods of the client, nor against an abstract object.

• The goods must be clearly identified, place of delivery of goods and period of payment are pre-determined.

• The Islamic bank must have the ownership of the goods before selling them to the client. They may or may not be in its physical possession but the legal title of the goods must be in the name of the bank. The determining factor is whether the goods have become the bank’s risk or not in case of any mishap to the goods.

• Financing documents are signed by the client after the actual sale takes palace, not before.

• Between the bank and the client, the sale and purchase of particular goods can be done only once. Re-negotiation of price and roll over of murabaha are not allowed, if the installments are re-scheduled, no additional amount can be charged for re-scheduling.

• Discounting of a murabaha instrument is not permitted.

• The bank can ask for some collateral from the client to ensure payment on time.

The sale of goods by the bank to its customer may be:
7.2 BAI SALAM (ADVANCE PAYMENT SALE)

Bai Salam has been defined as advance payment for deferred delivery. In this case, the bank pays the agreed amount of the financing to the client in advance, and the goods are delivered to the bank at a specified future date and place. The agreed amount is paid in full at the time of the contract. This is a substitute for the “Packing Credit” (pre-shipment credit) allowed by the conventional banks. The quantity and quality of goods to be delivered are clearly specified in the contract. If the client fails to deliver the goods on time, he is liable to refund the amount advanced. The bank can ask for some collateral from the client to ensure delivery of the goods; the income from the collateral, if any, will however go to the pledger. The client is benefited by getting the funds required to prepare the goods, and the bank is benefited by the difference in price. Usually a salam purchase is cheaper than a spot purchase. The bank can dispose of the goods as it likes and keep the profit for itself. Salam is an exception to the general rule that the seller must possess the goods he is selling. A salam sale should not be undertaken if the client is not sure of being able to deliver the goods on time.

7.3 BAI’ MU’AJJAL: (DEFERRED PAYMENT SALE)

This is a trade deal in which the bank purchase the goods itself or through its agent, and sells them to the client at their cost plus profit, allowing him to pay the amount at a future date in a lump sum or in installments. In order to conform with the Shariah. It is necessary that the goods to be sold are owned by the bank before being sold to the client. The bank may take possession of the goods itself from the supplier or another person authorized by the bank in this behalf may do so. Sometimes the bank authorizes the client himself to buy goods on bank’s behalf. In this capacity the client is only a trustee, and ownership and risk remain with the bank, but when the clients purchase the goods from the bank, ownership and risk pass on to the client.
The promise to buy may not be legally binding on the client as long as the goods are not delivered, but if the promise has caused the bank to incur some liabilities, the promise becomes binding islamically. Islam strongly condemns non-fulfillment of a promise. Once the bank has purchased the goods, their physical possession by the bank is not always necessary since it is accepted that the bill of lading is the document of title in international trade. The transfer of title by the bank is effected by endorsing the bill of lading in favour of the client.

It is not uncommon for the bank to ask for a security deposit or some other collateral from the client to ensure payment on maturities of installments.

The basic principle of murabaha outlined above, particularly the purchase of goods by the bank and transfer of title to the client, apply to international as well as domestic trade.

**An Example of Murabaha Financing**

A textile mill is in need of some chemicals to dye their products and the chemicals are not available in the local market. They approach the Islamic bank and give a complete description of the goods required, along with the particulars of suppliers and some idea of the price. In most cases, the price is already settled between the suppliers and the mill, who needs a financing facility for the period in which these chemicals are used for finishing the product and its sale. The bank quotes an amount which it will charge as its profit, the list of goods is signed, and the bank. The bill is drawn on the Islamic bank and the bill of lading is made to the order of the bank. The export bill is negotiated, and the negotiating bank is reimbursed by the Islamic bank. The documents are received by the bank, and after a week the consignment is also received. The client approaches the bank for its purchase.
Now suppose the consignment has cost to the bank a sum of $120,000 and the profit agreed at the time of opening the Letter of Credit was $5,000. The Promissory Note Delivery Letter and other pertinent documents are signed for $125,000 payable after, six months. The bank draws an invoice of $125,000 on the mill showing its own cost plus profit, and endorses the Bill of Lading in favour of the mill.

If the financing is repaid on time, which usually happens, the transaction is closed. If there is delay in repayment, scholars are of the opinion that since the transaction is a sale and purchase, the seller can not claim anything over and above the agreed price. But in order to discourage willful delays by the client, most of the banks claim a penalty for non-fulfillment of promise equal to the average rate of return for the murabaha accounts of the bank, and Qard Hasan. There is, however, no penal interest which the conventional banks charge, nor is the penalty clause appearing in the Murabaha Agreement enforced if the delay is for reasons beyond the control of the client.

### 7.4 BASIC FEATURES OF MURABAHAH FINANCING

- Murabahah is not a loan given on interest. It is the sale of a commodity for a deferred price which includes an agreed profit added to the cost.

- Being a sale, and not a loan, the murabahah should fulfill all the conditions necessary for a valid sale, especially those enumerated earlier in this chapter.

- Murabahah cannot be used as a mode of financing except where the client needs funds to actually purchase some commodities. For example, if he wants funds to purchase cotton as a raw material for his ginning factory, the Bank can sell him the cotton on the basis of murabahah. But where the funds are required for some other purposes, like paying the price of commodities already purchased...
by him, or the bills of electricity or other utilities or for paying the salaries of his staff, murabahah cannot be effected, because murabahah requires a real sale of some commodities, and not merely advancing a loan.

- The financier must have owned the commodity before he sells it to his client. The commodity must come into the possession of the financier, whether physical or constructive, in the sense that the commodity must be in his risk, though for a short period.

- The best way for murabahah, according to Shariah, is that the financier himself purchases the commodity and keeps it in his own possession, or purchases the commodity through a third person appointed by him as agent, before he sells it to the customer. However, in exceptional cases, where direct purchase from the supplier is not practicable for some reason, it is also allowed that he makes the customer himself his agent to buy the commodity on his behalf. In this case the client first purchases the commodity on behalf of his financier and takes its possession as such. Thereafter, he purchases the commodity from the financier for a deferred price. His possession over the commodity in the first instance is in the capacity of an agent of his financier. In this capacity he is only a trustee, while the ownership vests in the financier and the risk of the commodity is also borne by him as a logical consequence of the ownership. But when the client purchases the commodity from his financier, the ownership, as well as the risk, is transferred to the client.

- As mentioned earlier, the sale cannot take place unless the commodity comes into the possession of the seller, but the seller can promise to sell even when the commodity is not in his possession. The same rule is applicable to Murabahah.
It is also a necessary condition for the validity of murabahah that the commodity is purchased from a third party. The purchase of the commodity from the client himself on 'buy back' agreement is not allowed in Shariah. Thus murabahah based on 'buy back' agreement is nothing more than an interest based transaction.

The above mentioned procedure of the murabahah financing is a complex transaction where the parties involved have different capacities at different stages.

a) At the first stage, the institution and the client promise to sell and purchase a commodity in future. This is not an actual sale. It is just a promise to effect a sale in future on murabahah basis. Thus at this stage the relation between the institution and the client is that of a promisor and a promise.

b) At the second stage, the relation between the parties is that of a principal and an agent.

c) At the third stage, the relation between the institution and the supplier is that of a buyer and seller.

d) At the fourth and fifth stage, the relation of buyer and seller comes into operation between the institution and the client, and since the sale is effected on deferred payment basis, the relation of a debtor and creditor also emerges between them simultaneously. All these capacities must be kept in mind and must come into operation with all their consequential effects, each at its relevant stage, and these different capacities should never be mixed up or confused with each other.

The institution may ask the client to furnish a security to its satisfaction for the prompt payment of the deferred price. He may also ask him to sign a promissory note or a bill of exchange, but it
must be after the actual sale takes place, i.e. at the fifth stage mentioned above. The reason is that the promissory note is signed by a debtor in favour of his creditor, but the relation of debtor and creditor between the institution and the client begins only at the fifth stage, whereupon the actual sale takes place between them.

- In the case of default by the buyer in the payment of price at the due date, the price cannot be increased. However, if he has undertaken, in the agreement to pay an amount for a charitable purpose, as mentioned in para 7 of the rules of Bai' Mu'ajjal, he shall be liable to pay the amount undertaken by him. But the amount so recovered from the buyer shall not form part of the income of the seller / the financier. He is bound to spend it for a charitable purpose on behalf of the buyer, as will be explained later in detail.
CHAPTER 8

STEP BY STEP MURABAHA FINANCING

In the light of the aforementioned principles, a financial institution can use the Murabahah as a mode of finance by adopting the following procedure:

8.1 CLIENT AND BANK SIGN AN AGREEMENT TO ENTER INTO MURABAHA

The client and the institution sign an over-all agreement whereby the institution promises to sell and the client promises to buy the commodities from time to time on an agreed ratio of profit added to the cost. This agreement may specify the limit upto which the facility may be availed.
8.2 CLIENT APPOINTED AS AGENT TO PURCHASE GOODS ON BANK’S BEHALF

When a specific commodity is required by the customer, the institution appoints the client as his agent for purchasing the commodity on its behalf, and an agreement of agency is signed by both the parties.
8.3 BANK GIVES MONEY TO AGENT FOR PURCHASE OF GOODS

The client purchases the commodity on behalf of the institution and takes its possession as an agent of the institution.
8.4 CLIENT MAKES AN OFFER TO PURCHASE THE GOODS FROM BANK

The client informs the institution that he has purchased the commodity on his behalf, and at the same time, makes an offer to purchase it from the institution.

8.5 BANK ACCEPTS THE OFFER AND SALE IS CONCLUDED

The institution accepts the offer and the sale is concluded whereby the ownership as well as the risk of the commodity is transferred to the client.

All these five stages are necessary to effect a valid murabahah. If the institution purchases the commodity directly from the supplier (which is preferable) it does not need any agency agreement. In this case, the second phase will be dropped and at the third stage the institution itself
will purchase the commodity from the supplier, and the fourth phase will be restricted to making an offer by the client.


This is the only feature of murabahah which can distinguish it from an interest-based transaction. Therefore, it must be observed with due diligence at all costs, otherwise the murabahah transaction becomes invalid according to Shariah.

8.6 MURABAHA DOCUMENTATION

There are a number of documents involved in a Murabaha financing transaction. The most essential of these documents are

- Master Murabaha Finance Agreement (MMFA)
- Agency Agreement
- Order Form
- Summary Payment Schedule
- Declaration

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12 http://www.darululoomkhi.edu.pk/fiqh/islamicfinance/murabaha.html#features
8.6.1 Master Murabaha Finance Agreement

It’s an agreement between the client and the bank whereby the client agrees to purchase goods from the bank from time to time as per the terms and conditions of this agreement.

MMFA is an overall facility agreement under which various Sub-murabaha may be executed from time to time. Hence it needs to be signed once at the time the facility is sanctioned.

8.6.2 Agency Agreement

The client is appointed by the bank as its agent to purchase goods. This agreement needs to be signed once between the client and the bank. The disbursement of funds is done under this agreement. Client needs to fill out the list of assets which it will purchase.

8.6.3 Order Form, Summary Payment Schedule

These documents are required for each disbursement/ Sub-murabah tranche.

8.6.4 Declaration

Declaration is to be signed by the customer immediately after it has purchased the goods. This document establishes the actual sale transaction, i.e., transfer of ownership of goods from the bank to the customer. At this stage the specific details of the assets must be known i.e., quantity, quality etc. Proper timing of declaration is extremely important.
### 8.7 PROFIT CALCULATION

#### 8.7.1 Bullet payment

<table>
<thead>
<tr>
<th>Financing amount</th>
<th>Rs. 100 million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit Rate</td>
<td>Rs. 16% per annum</td>
</tr>
<tr>
<td>Tenor</td>
<td>1 year</td>
</tr>
</tbody>
</table>

Payment of Murabaha price: Bullet payment

Amount due of First year: Rs. 116 million at the end

Contract price (Murabaha selling Price): Rs. 116 million

#### 8.7.2 Four unequal installments

<table>
<thead>
<tr>
<th>Financing amount</th>
<th>Rs. 100 million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit Rate</td>
<td>Rs. 16% per annum</td>
</tr>
<tr>
<td>Tenor</td>
<td>1 year</td>
</tr>
</tbody>
</table>

Payment of Murabaha price: four unequal installments

Amount due

- Rs. 4 million (= 0.16/4*100) at the end of first 3 quarters
- Rs. 104 million (= 100+4) at the end of the last quarter

Contract price: Rs. 116 million
### 8.7.3 Four equal installments

<table>
<thead>
<tr>
<th>Description</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financing amount</td>
<td>Rs. 100 million</td>
</tr>
<tr>
<td>Profit Rate</td>
<td>Rs. 16% per annum</td>
</tr>
<tr>
<td>Tenor</td>
<td>1 year</td>
</tr>
<tr>
<td>Payment of Murabaha price</td>
<td>four equal installments</td>
</tr>
<tr>
<td>Amount due</td>
<td>Rs. 27.55 million (based on n=4, r=4%, pv=100) at the end of each quarter</td>
</tr>
<tr>
<td>Contract price</td>
<td>Rs. 110.2 million</td>
</tr>
</tbody>
</table>

**SECTION FOUR**
CHAPTER 9

ISSUES IN MURABAHA

9.1 ISSUES

So far the basic concept of Murabaha has been explained. Now, it is proposed to discuss some relevant issues with reference to the underlying Islamic principles and their practical applicability in murabaha transaction, because without correct understanding of these issues, the concept may remain ambiguous and its practical application may be susceptible to errors and misconceptions.

Different pricing for cash and credit sales the first and foremost question about murabaha is that, when used as a mode of financing, it is always effected on the basis of deferred payment. The financier purchases the commodity on cash payment and sells it to the client on credit. While selling the commodity on credit, he takes into account the period in which the price is to be paid by the client and increases the price accordingly. The longer the maturity of the murabaha payment, the higher the price. Therefore the price in a murabaha transaction, as practiced by the Islamic banks, is always higher than the market price. If the client is able to purchase the same commodity from the market on cash payment, he will have to pay much less than he has to pay in a murabaha transaction on deferred payment basis. The question arises as to whether the price of a commodity in a credit sale may be increased from the price of a cash sale. Some people argue that the increase of price in a credit sale, being in consideration of the time given to the purchaser, should be treated analogous to the interest charged on a loan, because in both cases an additional amount is charged for the deferment of payment. On this basis they argue that the murabaha transactions, as practiced in the Islamic banks, are not different in essence from the interest-based loans advanced by the conventional banks.
This argument, which seems to be logical in appearance, is based on a misunderstanding about the principles of Shari‘ah regarding the prohibition of riba. For the correct comprehension of the concept the following points must be kept in view:

9.1.1 The modern capitalist

The modern capitalist theory does not differentiate between money and commodity in so far as commercial transactions are concerned. In the matter of exchange, money and commodity both are treated at par. Both can be traded in. Both can be sold at whatever price the parties agree upon. One can sell one dollar for two dollars on the spot as well as on credit, just as he can sell a commodity valuing one dollar for two dollars. The only condition is that it should be with mutual consent.

The Islamic principles, however, do not subscribe to this theory. According to Islamic principles, money and commodity have different characteristics and therefore, they are treated differently.

9.1.2 The use of Interest-Rate as Benchmark

Many institutions financing by way of murabaha determine their profit or mark-up on the basis of the current interest rate, mostly using LIBOR (Inter-bank offered rate in London) as the criterion. For example, if LIBOR is 6%, they determine their mark-up on murabaha equal to LIBOR or some percentage above LIBOR. This practice is often criticized on the ground that profit based on a rate of interest should be as prohibited as interest itself.

No doubt, the use of the rate of interest for determining a halal profit cannot be considered desirable. It certainly makes the transaction resemble an interest-based financing, at least in appearance, and keeping in view the severity of prohibition of interest, even this apparent resemblance should be avoided as far a possible. But one should not ignore the fact that the most important requirement for validity of
murabaha is that it is a genuine sale with all its ingredients and necessary consequences. If a murabaha transaction fulfils all the conditions merely using the interest rate as a benchmark for determining the profit of murabaha does not render the transaction as invalid, haram or prohibited, because the deal itself does not contain interest. The rate of interest has been used only as an indicator or as a benchmark

9.1.3 Promise to purchase

Another important issue in Murabaha financing which has been subject of debate between the contemporary Shari’ah Scholars is that the bank/financier cannot enter into an actual sale at the time when the client seeks murabaha financing from him, if the client is not bound to purchase the commodity after the financier has purchased it from the supplier, the financier may be confronted with a situation where he has incurred huge expenses to acquire the commodity, but the client refuses to purchase it. The commodity may be of such a nature that it has no common demand in the market and is very difficult to dispose of. In this case the financier may suffer unbearable loss.

9.1.4 Securities Against Murabaha Price

Another issue regarding murabaha financing is that the murabaha price is payable at a later date. The seller/financier naturally wants to make sure that the price will be paid at the due date. For this purpose, he may ask the client to furnish a security to his satisfaction. The security may be in the form of a mortgage or a hypothecation or some kind of lien or charge

9.1.5 Guaranteeing the Murabaha

The seller in a murabaha financing can also ask the purchaser/client to furnish a guarantee from a third party. In case of default in the payment of price at the due date, the seller may have recourse to the guarantor, who will be liable to pay the amount
guaranteed by him. The rules of Shari'ah regarding guarantee are fully discussed in the books of Islamic fiqh.

9.1.6 Penalty of Default

Another problem in murabaha financing is that if the client defaults in payment of the price at the due date, the price cannot be increased. In interest-based loans, the amount of loan keeps on increasing according to the period of default. But in murabaha financing, once the price is fixed, it cannot be increased. This restriction is sometimes exploited by dishonest clients who deliberately avoid to pay the price at its due date, because they know that they will not have to pay any additional amount on account of default.

This characteristic of murabaha should not create a big problem in a country where all the banks and financial institutions are run on Islamic principles, because the government or the central bank may develop a system where such defaultors may be penalized by depriving them from obtaining any facility from any financial institution. This system may serve a deterrent against deliberate defaults. However, in the countries where the Islamic banks and financial institutions are working in isolation from the majority of financial institutions run on the basis of interest, this system can hardly work, because even if the client is deprived to avail of a facility from an Islamic bank, he can approach the conventional institutions.

- The defaulter should be given a grace period of at least one month after the maturity date during which he must be given weekly notices warning him that he should pay the price, otherwise he will have to pay compensation.
- It is proved beyond doubt that the client is defaulting without valid excuse. If it appears that his default is due to poverty, no compensation can be claimed from him.
The compensation is allowed only if the investment account of the Islamic bank has earned some profit to be distributed to the depositors. If the investment account of the bank has not earned profit during the period of default, no compensation shall be claimed from the client.

This concept of compensation, however, is not accepted by the majority of the present day scholars. (including the author). It is the considered opinion of such scholars that this suggestion neither conforms to the principles of Shariah nor is it able to solve the problem of default. So far as grace period is concerned, it is a minor concession which is sometimes given by the conventional banks as well. Once again, in practical terms, there is no material difference between interest and the late payment charged as compensation.

**9.1.7 Rebate on earlier payment**

Sometimes the debtor wants to pay earlier than the specified date. In this case he wants to earn a discount on the agreed deferred price. Is it permissible to allow him a rebate for his earlier payment.

The issue is known in the Islamic legal literature as "Za wa tajal" (Give discount and receive soon). Some earlier jurists have held this arrangement as permissible, but the majority of the Muslim jurists, including the four recognized schools of Islamic jurisprudence do not allow it, if the discount is held to be a condition for earlier payment.

The majority of the jurists hold that if the earlier payment is conditioned with discount, it is not permissible. However, if this is not taken to be a condition for earlier payment, and the creditor gives a rebate voluntarily on his own, it is permissible.

The same view is taken by the Islamic Fiqh Academy in its annual session.
It means that in a murabaha transaction effected by an Islamic bank or financial institution, no such rebate can be stipulated in the agreement, nor can the client claim it as his right. However, if the bank or a financial institution gives him a rebate on its own, it is not objectionable.

9.1.8 Calculation of Cost in Murabaha

It is already mentioned that the transaction of murabaha contemplates the concept of cost-plus sale, therefore, it can be effected only where the seller can ascertain the exact cost he has incurred in acquiring the commodity he wants to sell. If the exact cost cannot be ascertained, no murabaha can be possible. In this case, the sale must be effected on the basis of musawamah (i.e. sale without reference to cost).

This principle leads to another rule: the murabaha transaction should be based on the same currency in which the seller has purchased the commodity from the original supplier. If the seller has purchased it for Pakistani rupees, the onward sale to the ultimate purchaser should also be based on Pakistani rupees, and if the first purchase has occurred in U.S. dollars, the price of murabaha should be based on dollars as well, so that the exact cost may be ascertained.

However, in the case of international trade, it may be difficult to base both purchases on the same currency. If the commodity intended to be sold to the customer is imported from a foreign country, while the ultimate purchaser is in Pakistan, the price of the original sale has to be paid in a foreign currency and the price of the second sale will be determined in Pak. Rupees.

9.1.9 Subject - matter of Murabaha

All commodities which may be subject matter of sale with profit can be subject matter of murabaha, because it is a particular kind of sale.
Therefore, the shares of a lawful company may be sold or purchased on murabaha basis, because according to the Islamic principles, the shares of a company represent the holder's proportionate ownership in the assets of the company. If the assets of a company can be sold with profit, its shares can also be sold by way of murabaha. But it goes without saying that the transaction must fulfill all the basic conditions, for the validity of a murabaha transaction. Therefore, the seller must first acquire the possession of the shares with all their rights and obligations, then sell them to his client. A buy back arrangement or selling the shares without taking their possession is not allowed at all.

9.1.10 Rescheduling of payments in murabaha

If the purchaser/client in murabaha financing is not able to pay according to the dates agreed upon in the murabaha agreement, he sometimes requests the seller / the bank for rescheduling the installments. In conventional banks, the loans are normally rescheduled on the basis of additional interest. This is not possible in murabaha payments. If the installments are rescheduled, no additional amount can be charged for rescheduling. The amount of the murabaha price will remain the same in the same currency.

Rescheduling must always be on the basis of the same amount in the same currency. At the time of payment however, the purchaser may pay with the consent of the seller, in a different currency on the basis of the exchange rate of that day (i.e. the day of payment) and not the rate of the date of transaction.

9.1.11 Securitization of murabaha

Murabaha is a transaction which cannot be securitized for creating a negotiable instrument to be sold and purchased in secondary market. The reason is obvious. If the purchaser/client in a murabaha transaction signs a paper to evidence his indebtedness towards the seller/financier,
the paper will represent a monetary debt receivable from him. In other words, it represents money payable by him. Therefore transfer of this paper to a third party will mean transfer of money. It has already been explained that where money is exchanged for money (in the same currency) the transfer must be at par value. It cannot be sold or purchased at a lower or a higher price. Therefore, the paper representing a monetary obligation arising out of a murabaha transaction cannot create a negotiable instrument.

9.2 SOME BASIC MISTAKES IN MURABAHA FINANCING

After explaining the concept of murabaha and its relevant issues, it will be pertinent to highlight some basic mistakes often committed by the financial institutions in the practical implementation of the concept.

9.2.1 The first and the most glaring mistake is to assume that murabaha is a universal instrument which can be used for every type of financing offered by conventional interest-based banks. Under this false assumption, some financial institutions are found using murabaha for financing overhead expenses of a firm or company like paying salaries of their staff, paying the bills of electricity etc. and setting off their debts payable to other parties. This practice is totally unacceptable, because murabaha can be used only where a commodity is intended to be purchased by the customer. If funds are required for some other purpose, murabaha cannot work. In such cases, some other suitable modes of financing, like musharakah, leasing etc. can be used according to the nature of the requirement.

9.2.2 In some cases, the clients sign the murabaha documents merely to obtain funds. They never intend to employ these funds to purchase a specific commodity. They just want funds for unspecified purpose, but to satisfy the requirement of the formal documents, they name a fictitiously
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**Fundamentals of Murabaha**

commodity. After receiving money, they use it for whatever purpose they wish.

Obviously this is a fictitious deal, and the Islamic financiers must be very careful about it. It is their duty to make sure that the client really intends to purchase a commodity which may be subject to murabaha. This assurance must be obtained by the authorities sanctioning the facility to the customer. Then, all necessary steps must be taken to confirm that the transaction is genuine.

**9.2.3** In some cases, sale of commodity to the client is effected before the commodity is acquired from the supplier. This mistake is invariably committed in transactions where all the documents of murabaha are signed at one time without taking into account various stages of the murabaha. Some institutions have only one murabaha agreement which is signed at the time of disbursement of money, or in some cases, at the time of approving the facility. This is totally against the basic principles of murabaha. It has already been explained that the murabaha arrangement practiced by the banks is a package of different contracts which come into play one after another at their respective stages. These stages have been fully highlighted earlier while discussing the concept of 'Murabaha Financing'. Without observing this basic feature of murabaha financing, the whole transaction turns into an interest-bearing loan. Merely changing the nomenclature does not make it lawful in the eyes of Shariah.

**9.2.4** It is observed in some financial institutions that they effect murabaha on commodities already purchased by their clients from a third party. This is again a practice never warranted by the Shariah. Once the commodity is purchased by the client himself, it cannot be purchased again from the same supplier. If it is purchased by the bank from the client himself and is sold to him, it is a buy-back technique which is not
allowed in Shariah, especially in murabaha. In fact, if the client has already purchased a commodity, and he approaches the bank for funds, he either wants to set-off his liability towards his supplier, or he wants to use the funds for some other purpose. In both cases an Islamic bank cannot finance him on the basis of murabaha. Murabaha can be effected only on commodities not yet purchased by the client.
CHAPTER 10

RECOMMENDATIONS

It is now time that Islamic banks and financial institutions resolve to gradually enhance their share of financing on PLS basis and reduce the share of financing on the basis of Murabaha, Bai Mu'ajjal and the like modes of financing.

If Islamic banks succeed in demonstrating a practical example of socio-economic justice by gradually enhancing their financing on PLS basis and also achieve further satisfactory operational results, there is no reason why more cooperation would not be extended to them by the European, American and other interest-based banks. Some of these conventional banks may even be tempted to adopt PLS system of financing in their subsidiaries & affiliates operating under the banner of Islamic banking.

The dawn of an era of justice can, therefore, be visualized where the fruits of the Islamic system would be available to a large number of people leading to over-all social and economic prosperity.

From the foregoing discussion on different aspects of murabahah financing, the following conclusions may be summarized as the basic points to remember:

1. Murabahah is not a mode of financing in its origin. It is a simple sale on cost-plus basis. However, after adding the concept of deferred payment, it has been devised to be used as a mode of financing only in cases where the client intends to purchase a commodity. Therefore, it should neither be taken as an ideal Islamic mode of financing, nor a universal instrument for all sorts of financing. It should be taken as a transitory step towards the ideal Islamic system of financing based on musharakah or
mudarabah. Otherwise its use should be restricted to areas where musharakah or mudarabah cannot work.

2. While approving a murabahah facility, the sanctioning authority must make sure that the client really intends to purchase commodities which may be subject-matter of murabahah. It should never be taken as merely a paper-work having no genuine basis.

3. No murabahah can be effected for overhead expenses, paying the bills or settling the debts of the client, nor can it be effected for purchase of currencies.

4. It is the foremost condition for the validity of murabahah that the commodity comes in the ownership and physical or constructive possession of the financier before he sells it to the customer on murabahah basis. There should be a time in which the risk of the commodity is borne by the financier. Without having its ownership or assuming the risk of the commodity, though for a short while, the transaction is not acceptable to Shariah and the profit accruing there from is not halal.

5. The best way to effect murabahah is that the financier himself purchases the commodity directly from the supplier and after taking its delivery sells it to the client on murabahah basis. Making the client agent to purchase on behalf of the financier renders the arrangement dubious. For this very reason some Shariah Boards have forbidden this technique, except in cases where direct purchase is not possible at all. Therefore, the agency concept should be avoided as far as possible.

6. If in cases of genuine need, the financier appoints the client his agent to purchase the commodity on his behalf, his different capacities (i.e. as agent and as ultimate purchaser) should be clearly distinguished. As an agent, he is a trustee, and unless he
commits negligence or fraud, he is not liable to any loss so far as the commodity is in his possession as agent of the financier. After he purchases the commodity in his capacity as agent, he must inform the financier that, in fulfilling his obligation as his agent, he has taken delivery of the purchased commodity and now he extends his offer to purchase it from him. When, in response to this offer, the financier conveys his acceptance to this offer, the sale will be deemed to be complete, and the risk of the property will be passed on to the client as purchaser. At this point, he will become a debtor and the consequences of indebtedness will follow. These are the necessary requirements of murabahah financing which can never be dispensed with. While describing the concept of "Murabahah as a mode of financing" we have already identified five stages of murabahah under agency agreement. Each and every step out of these five is necessary in its own right and neglecting any one of them renders the whole arrangement unacceptable. It should be noted with care that murabahah is a border-line transaction and a slight departure from the prescribed procedure makes it step in the prohibited area of interest-based financing. Therefore this transaction must be carried out with due diligence and no requirement of Shari‘ah should be taken lightly.

7. Two different prices for cash and credit sales are allowed on condition that either of the two options is specifically elected by the customer. Once the price is fixed, it can neither be increased because of late payment, nor decreased on earlier payment.

8. In order to assure that the purchaser will pay the price promptly, he may undertake that in case of default, he will pay a certain amount to the charitable fund maintained by the financing institution. This amount may be based on per cent per annum concept, but it must
invariably be spent for purely charitable purposes and should in no case form part of the income of the institution.

9. In case of earlier payment, no rebate can be claimed by the client. However, the institution may at its own option, forego some part of the price without making it a pre-condition in the agreement.
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LIST OF PERSONS INTERVIEWED

Mr. Muhammad Haroon Khan
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Meezan Bank.

Mr. Abid Ali Khan
Incharge Risk Management Deptt.
Meezan Bank

Mr. Ahmad Hussain
Incharge Risk Management Deptt.
Bank Of Khyber

Moulvi Lutfullah
Jamia Masjid Umar Bin Yasir

Moulvi Aziz-ur-Rehman
Masjid Ghufran Habib