Murabaha Transactions of Islamic Banking

Shariah Issues

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Abstract

It is indeed very encouraging and a means of great joy that the inclination towards Islamic Banking throughout the World is increasing day by day. This has become the means of an increase in the establishment of new Islamic Banks as well as Islamic Banking departments or windows being established by conventional banks. These developments not only indicate towards the truth of Islam in that it is the only religion that has the ability to guide humanity in contemporary issues even after 1400 years, but also are a great sign of encouragement in that they indicate towards the fact that Muslims have extended their commitment to the teachings Islam from being restricted merely to the mosque to other branches of their lives. In present scenario, most of the Islamic Banks and financial institutions are using Murabah as a mode of finance, while the original concept of Murabaha is that this is a kind of sale. It has been implemented as a mode of finance after doing financial engineering to process. That is why, it faces a few arguments from different sides.In this research article in short these arguments has been discussed and has been tried to prove if murabaha, is implemented within the principles of the Sharia then this would be acceptable and there is no reason to make this a target of criticism. Although, musharaka and mudharaba are considered and believed to be the ideal forms of financing from Shariah point of view.

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1. Introduction

1.1. Definition

In fact, Murabaha is kind of sale, where the seller clearly mentions to the purchaser the actual cost of sold commodity he has incurred and sells it with some fix profit thereon.[1]

1.2. Difference between Murabaha & simple sale

The difference between a simple contract of sale and a murbaha is that in a common contract of sale, the seller pronounces a fix price of the commodity, meaning by that he is not obliged to disclose actual cost of things and the sum of profit charged against it. This type of sale is known as *Musawama*, while in murabah, the seller informs the purchaser with the cost of commodity as well as the profit he intends to get.[2]

2. Murabaha in Islamic Banking System

2.1. Murabaha as Short Term Finance (STF)

In major asset side operations of conventional banking system, the advances are booked on the basis of loan against which the bank earns a profit. On the other hand, an Islamic Bank offers different kinds of products to finance its customers. Usually, for short term finance (STF), an Islamic Bank use Murabaha as a mode of finance. This is known as "Murabaha to the Purchase orderer[3] as it occurs upon the request of the purchaser (client). In this transaction an Islamic Bank purchases an item and after taking its possession by disclosing the actual cost and rate of profit charged over it[4]. By taking the possession of subject matter, the bank assumes the risk of that item.

3. Permissibility of Murabaha

As for as, general permissibility of Murabaha is concerned, it is a lawful transaction from Shariah point of view. A verse of the Holy Quraan narrates:

و احل الله البيع و حرم الربوا

"And Allah has permitted sale and prohibited interest."[5]

As Murabaha is also a type of sale and the Holy Quraan has permitted sale transactions (buying and selling), murabaha transactions are also permitted provided that the required conditions are adhered to.

> The logical reasoning for the permissibility of murabaha is that the Islamic Bank assumes the risk of the subject matter of the sale and it is a law of the Sharia that the one who assumes the risk of an item is eligible to earn a profit from that item. This is known as " Reward is against the Risk" [6]

It should be kept in mind that "risk" refers to the risk associated with the subject matter of the sale and not the risk of the client defaulting. The risk of client defaulting is found in every deffered transaction but no expert of Sharia has permitted any transaction based on this risk to date.

As Murabaha in reality is a type of sale in which the seller informs the buyer of the cost at which he acquired the goods and the amount of profit that is selling the goods at. So, in Murabaha, together with all the other conditions of a valid sale, the seller is obliged to fulfil one more condition which is to disclose his cost and thereby disclose the amount of profit he is making on the transaction.[7]

4. Procedure Murabah as Mode of Finance

As mentioned earlier, Basically, Muarabaha is not a mode of finance, rather it is a kind of sale, but after applying financial engineering, now it is being used as a mode of finance in Islamic Banking sector. This

transaction is concluded in the following stages.[8]

4.1. Facility Agreement

In the first stage the client and the bank arrive at the understanding of the transactions that are to be concluded and sign a general agreement or facility agreement. The limit of the amount at which the client will purchase goods from the bank, the profit that the bank will make on these goods, the method of payment of these goods etc. are amongst those aspects that are agreed upon in this agreement. (It should be noted that this is not the murabaha transaction. It is merely a memorandum of understanding or a general framework for the transactions that are to pursue.)

4.2. Purchasing the desired goods

Thereafter the bank purchases the goods from the market that it would later sell to the customer.

At this point, the Islamic Banks have been advised that either they themselves purchase the desired goods from the market or they appoint an agent other than their client to purchase these goods. However, in cases of necessity the client himself may be appointed as an agent of the bank to purchase the goods from the market on behalf of the bank.

Taking possession of the purchased goods and informing the Islamic Bank

If the client himself is appointed as the agent of the Bank to purchase on their behalf then, after purchasing the required goods he would take possession of the subject matter and inform the Bank that he has, in his capacity as agent of the Bank purchased the goods and taken possession of them.

According to the Sharia the possession taken by an agent is considered as possession taken by the principal.[9] So we can say that these goods are now in the possession of the principal, which is the Bank. As such, at this point all the rules pertaining to possession would take effect,

especially the fact that, if these goods are destroyed without any negligence on the part of the client, then the Bank would have to bear this loss. The client could not be held responsible for such loss.[10] Similarly if the goods are being imported from a foreign country, the risk of the goods being destroyed lies with the Islamic Bank until the goods reach the country of import and are sold to the client. In the case of destruction the Bank would have to bear the loss.

It is absolutely clear that none of the transactions entered into until this stage, are against the principles of the Sharia.

4.3. Execution of Murbaha

After this, the client offers to purchase these goods from the Bank at a certain price which includes the cost of the Bank and its profit and agrees to pay for the goods either immediately or according to a particular schedule. When the bank accepts this offer, the murbaha transaction is concluded and the client becomes responsible to pay the amount agreed upon to the Bank. The Bank acquires some collateral from the clients as a guarantee for the payment of this amount. Taking of collateral is also permissible from Shariah point of view.[11]

5. Shariah Issues

This is the glance review of the stages that has been named murabaha in the Islamic Banks. The aspects that are related to the different forms of Islamic Finance jointly are as follows;

1. Before the Islamic Bank purchases the property or vehicle required by the client, the Bank acquires a unilateral undertaking from the client in which he undertakes to purchase the asset or lease the asset from the Bank if the Bank purchases it.
   In other words this promise is only from the side of the client, and not from the side of the Bank. Further, this promise is binding? Is it permissible to take such a promise from the client?

2. When transacting with the Islamic Bank the client undertakes that if he does not make his payments on time, he shall give a certain amount of money in charity. The Bank is obliged to use these funds in charitable avenues? Is it permissible for the Islamic Bank to take such an undertaking from the client?

3. Islamic Banks use interest based benchmarks in determining their profits in Murabaha. What is the ruling regarding this?

Below we shall discuss these issues in a fair amount of detail.

5.1. The First Issue: Taking a promise from the Client

The first issue pertains to the Islamic Bank acquiring an undertaking from the client when he expresses his desire to acquire finance, before the Bank even purchases the required asset, that he (the client) would purchase the asset/commodity through a murabaha transaction or that he would lease the asset from the Bank once the Bank acquires it. The question is that, is it permissible for the Bank to acquire such an undertaking from the client? Further, if it is permissible, then can this undertaking be regarded as binding?

As far as the making of such an undertaking is concerned there is no difference of opinion regarding its permissibility.[12] An example that aptly portrays the permissibility of such an undertaking is as follows; Khalid has a bookshop. Zaid comes to his bookshop and requests a specific book. Khalid does not have that particular book at present. Khalid tells Zaid that he does not have the book presently but he can purchase it from somewhere and make it available for Zaid. Zaid is keen on acquiring the book in this manner from Khalid. Khalid fears that possibility of Zaid refusing to purchase the book after he has purchased it. He therefore asks Zaid to promise that after he has purchased the book, Zaid will purchase it from him. It is clear that it is permissible for Khalid to ask Zaid to make this promise, as it does not go against any principle of the Sharia. In a similar manner it is permissible for the Islamic Bank to take a such a promise from their client.

And as far as the question of a promise being binding or not is concerned, the answer is that there is a difference of opinion between the jurists. However, the latter Hanafi jurists have allowed the making of a promise binding in cases of necessity. Hence Allaamah Shaami (R.A.) mentions:

المواعيد قد تكون لازمة فتجعل لازمة عند حاجة الناس

Sometimes bilateral promises are binding. As such,

With the view of the requirements of the people,

They could be made binding.[13]

Practical experience also shows us that promises are considered to be binding in many day to day activities. e.g. big hotels and caterers have agreements with different suppliers in which the suppliers agree to deliver different commodities to the hotel or caterers at different times. Many a times the caterers need to prepare food for weddings and other important functions and have the food delivered to their clients. If the suppliers excuse themselves (fail to) from delivering the commodities at the right time it is certain that the caterers will have to face a lot of inconvenience and loss. The caterers have already made arrangements with different suppliers. For example, an agreement would have been signed for the rental of a tent. Another arrangement for the delivery of the food on time may have been entered into, etc. If all of these suppliers fail to deliver their services on time and alternatively merely excuse themselves from the fulfillment of their promises, and separate themselves from the contracts the inconvenience that will be caused to the caterer and his clients can well be imagined. Exactly in a similar manner, if the Islamic Bank spends hundreds of thousands of Rands, and in certain instances millions of Rands to purchase items that their client has promised to purchase from them, and later on the client refuses to fulfill his promise, the Bank will have to suffer substantial financial loss.

Hence, adopting the view of the latter Hanafi jurists and declaring promises to be binding will not be against the Sharia.

5.2. The Second Issue: Collecting of Charity

The second issue for clarification is with regards to taking a sum of money from the client in the case of his defaulting or delaying in payment, for distribution to charity. If one ponders, then in reality three questions arise here. Each of these questions together with their answers are mentioned hereunder.

1. The client of the Islamic Bank making this undertaking that he would give a certain amount of money to the charity fund of the Bank in the case of delay in payment is his personal matter. No person or institution can compel him to make such an undertaking. (Just as taking a vow to do something is every person's personal

matter. No one can force the other to take a vow). In Islamic Banks, the client does not have the choice of not making this undertaking. Rather, making this undertaking is incumbent upon him. If he wishes to transact with the Islamic Bank he has to make this undertaking. Is it permissible in the Sharia to make a person take such a promise?

2. The condition is made that this charity will be given through the medium of the Bank. Is this correct?
3. If the client does not fulfill this promise, the Bank can fulfill it by resolving the matter at court level. Is it permissible to make the client fulfill such an undertaking by taking him to court?

The answers to these three questions are mentioned in the same sequence hereunder;

1. Imposing charity upon oneself if one were to make a mistake is of two types.
    a. The mistake is related to violating a right of Allah (حقوق الله). E.g. one says, "If I miss my Fajr Salaah I shall give a certain amount of money in charity."
    b. The mistake is related to the violation of the rights of people(حقوق العباد) . In other words by committing this mistake another person suffers a loss. E.g. two people embark on a journey. One undertakes not to cause any type of harm to the other and that if he does so he shall give a certain amount of money in charity.

As far as the first type is concerned it is totally the choice of the person making the promise. He has the choice of imposing something upon himself. No one else has the right to make him take such a promise. On the other hand in the second type mentioned above, (حقوق العباد) there are certain situations in which one can make a person bound to take such a promise. E.g. Zaid has a vehicle. Both Zaid and Bakar which to travel together in this vehicle. Bakar enjoys driving. He tells Zaid that he will drive. Zaid says that he may drive on this condition that he would drive very cautiously. Bakar makes this promise. For further security Zaid says

that you are allowed to drive my vehicle on this condition that you make a further promise that if you are incautious you will give a certain amount of money in charity. Bakar accepts this condition as well and makes the promise.

It is clear that just as it is permissible for Zaid to make Bakar take the first promise, it is also acceptable that Zaid make Bakar take the second promise, as the object of both promises is to protect oneself from potential loss under the Sharih ruling.

الضرر يزال

Loss must be compensated[14]

So in this case, Zaid has imposed necessarily upon Bakar from this angle, that if Bakar wishes to use Zaid's car then he will be forced to make the promise, that if he drives incautiously he would donate a sum of money to charity. On the other hand, he is not compelled to make this undertaking considering the fact that he has the choice of not accepting this condition and thus not using Zaid's vehicle.

An Islamic Bank is part of the banking industry. A fair amount of the funds it has, are of those depositors that have deposited their lifetime savings with them. The Bank uses these funds to finance their clients. If the Bank does not impose an effective method to avoid delayed payments there would be a very strong chance that its clients would keep on delaying their payments. If this becomes the case, Islamic Banks would face numerous economic problems. In fact, there would also be the danger of the Bank becoming bankrupt.

> Hence, one can understand that it is necessary for the Islamic Bank to take an effective stand whilst remaining within the boundaries of the Sharia to protect themselves and the depositors from this possible loss. One method that has been suggested is that when a client approaches the Islamic Bank in order to conclude a transaction, the Bank could get a promise from the client stating that he would pay on time and together with this the client is also made to take this undertaking that if

does not make his payment on time he would give a certain sum of money in charity.[15]

Making this undertaking is necessary from this point of view that if a person wishes to transact with the Islamic Bank he would have to make this promise. However, considering that one is not obliged to transact with the Islamic Bank, and that one has the option of trying to fulfill ones requirements from other permissible avenues, making such a promise is not at all necessary (i.e. one is not forced to make this promise). Hence, just as it is correct for Zaid that he get a promise out of Bakr stating that if he drives Zaid's vehicle recklessly he would donate a certain sum of money, it is also permissible for the Islamic bank that it acquire a promise from its client stating that if he does not pay on time he shall donate a certain sum of money.

2. The client is compelled to give these funds to charity by depositing them into the Banks charity account just so that the Bank is satisfied that the client has indeed donated this money. This is the reason that after receiving this donation, the Bank cannot include these funds as part of its income. Rather, it is obliged to spend the money in the correct avenues of charity. This condition merely satisfies the Bank that the client has paid the charity. It is like a condition that further emphasizes the transaction. And the inclusion of a condition that emphasizes the transaction or a condition that conforms to the nature of the transaction is permissible.
3. Although, according to the Hanafi School of jurists this promise cannot be enforced by a court of law[16], however according to some Maaliki Jurists this promise enforceable through a court of law . As Banks have the requirement and need that they can only enforce their transactions through a court of law, there seems to be room for the Maaliki opinion to be adopted in this situation. Especially when the matter under discussion falls under the category of commercial dealings, regarding which Hazrat Thaanwi (R.A.) has allowed one to adopt the Maaliki view in some commercial transactions in Imdaad-ul-Fataawa.[17]

5.3. The Third Issue: Using the interest rate as a benchmark

The third issue pertains to the fact that presently Islamic Banks generally use the inter-bank interest rates as a benchmark to determine the profit or rental that they should charge. For example, in Pakistan KIBOR (Karachi Inter Bank Offer Rate) is a benchmark.

Of course there is absolutely no doubt that making an interest rate a benchmark to determine permissible profits is indeed not liked. However, if an Islamic Bank fulfills all the other conditions of a Muraba contract then to say that the transaction is invalid just because an interest rate was used to determine the profit is not correct.

This could be understood by the following example. Khalid requires R100.00. He comes to Zaid to request him for a loan. Zaid says that I will give you this loan on condition that you repay me R110.00. This transaction is clearly an interest based loan which is haraam and prohibited. Khalid leaves Zaid and goes to Ahmad. Ahmad asks Khalid why he requires the loan. Khalid says that he has got visitors and I would like to purchase some fruit for them. Instead of giving him a loan, Ahmad purchases fruit to the value of R100.00 and after taking possession of them, sells them to Khalid for R110.00. The transaction the Ahmad has concluded with Khalid is one of a sale and purchase agreement in that he first purchased fruit for R100.00 from the market place, took possession of them and thereafter sold them to Khalid. If one has to analyze both the situations above then indeed there is a similarity between Ahmad and Zaid's transactions from this point of view that Ahmad has earned the same amount of profit by selling the fruit that Zaid was demanding in the form of interest. Despite this resemblance, no person who is acquainted with the principles of Sharia can ever say that the profit that Ahmad has earned is Haraam and impure because he has earned the same amount of profit that Zaid would have earned (in the form of interest) by giving a loan. Rather it will be said that since Ahmad has upheld all the principles of Sharia and concluded a valid sale then just because of this outer resemblance one cannot deem his sale impermissible. Hence, if Islamic Banks uphold the principles of Sharia in their murabaha, ijara and diminishing musharaka transactions then just because of their using an interest based benchmark to determine their profit or rental their transaction will not be impermissible.

5.4. There should be Search for an Alternative!

However, because making an interest rate a benchmark to determine permissible profits does resemble an interest based transaction apparently therefore it would be preferable that Islamic Banks exert their efforts to strive and avoid even such apparent resemblance. However, we should also analyze why Islamic Banks currently use interest based benchmarks in determining their profits and what difficulties are they facing in searching for an alternative.

If the Islamic Banks in Pakistan desire to stop using KIBOR as a benchmark and start using some other Islamic benchmark then it is clear that this would require that a big market of Islamic Banking exist. Alhamdulillah, this market is slowly slowly progressing in Pakistan. Some contemporary Ulama have suggested that Islamic Banks should form transferable instruments that are backed by physical assets such as property or assets that have been leased out. Whichever Bank has given assets out on lease they should formulate shares of these assets. Thereafter those Islamic Banks that have surplus funds would purchase these shares on the basis of net asset value. (The net asset value of these shares could be determined at different intervals.) Similarly those Islamic Banks that have more shares than they require would sell their shares. In this manner an Islamic Inter Bank market would come into existence. Islamic Banks could then use the net asset value of these shares as a benchmark to determine their profit in the different forms of financing that they provide. In this manner a sharia compliant alternative to KIBOR will be formed.

6. Conclusion

- Murabaha is kind of sale, where the seller clearly mentions to the purchaser the actual cost of sold commodity he has incurred and sells it with some fix profit thereon.
- It has been implemented as a mode of finance in Islamic Banking System after doing financial engineering to process.
- The process of Murabaha completes in four steps.
- A few arguments from different sides have been raised to discuss the Shariah status of this transaction.
- After detail discuss, we reached at the conclusion that murabaha can be used as an mode of finance in Islamic banking and it is permissible if all the regarding conditions are fullfileed during its implementation.

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