"MURABAHAH"

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An online publication by

MURABAHAH

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

"Murabahah" 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 *"murabaha"* 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 his 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.

An attempt has been made to reduce the detailed principles into concise notes in the shortest possible sentences, so that the basic points of the subject may be grasped at in one glance, and may be preserved for easy reference.

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 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 financial institutions:

1. The subject of sale must be existing at the time of sale. Thus, a thing which has not yet come into existence cannot be sold. If a nonexistent 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.

2. The subject of sale must be in the ownership of the seller at the time of the sale. Thus, what is not owned by the seller cannot be sold. 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.

3. The subject of sale must be in the physical or constructive possession of the seller when he sells it to another person. "Constructive possession" means a situation where the possessor has not taken the physical delivery of the commodity, yet the commodity has come into his control, and all the rights and liabilities of the commodity are passed on to him, including the risk of its destruction. Examples: (i) 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.

(ii) A has purchased a car from B. B, after identifying the car has placed it in a garage to which A has free access and B has allowed him to take the delivery from that place whenever he wishes. Thus the risk of the Car has passed on to A. The car is in the constructive possession of A. If A sells the car to C without acquiring physical possession, the sale is valid.

Explanation 1: The gist of the rules mentioned in paragraphs 1 to 3 is that a person cannot sell a commodity unless:

(a) It has come into existence.
(b) It is owned by the seller.
(c) It is in the physical pr constructive possession of the seller.

Explanation 2: There is a big difference between an actual sale and a mere promise to sell. The actual sale cannot be effected unless the above three conditions are fulfilled. However one can promise to sell something which is not yet owned or possessed by him. This promise initially creates only a moral obligation on the promisor to fulfil his promise, which is normally not justiciable.

Nevertheless, in certain situations, where such promise has burdened the promisee with some liability, it can be enforceable through the courts of law. In such cases the court may force the promisor to fulfil his promise, i.e. to effect the sale, and if he fails

to do so, the court may order him to pay the promise the actual damages he has incurred due to the default of the promisor.

But the actual sale will have to be effected after the commodity comes into the possession of the seller. This will require separate offer and acceptance, and unless the sale is effected in this manner, the legal consequences of the sale shall not follow.

Exception: The rules mentioned in paragraphs 1 to 3 are relaxed with respect to two types of sale, namely:

(a) Bai' Salam
(b) Istisna'

The rules of these two types will be discussed later in a separate chapter.

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 dates comes or the contingency actually occurs.

Examples: (i) 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.

(ii) A says to B, "If party X wins the elections, my car stands sold to you". The sale is void because it is contingent on a future event.

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

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

Explanation: The subject of sale may be identified either by pointation or by detailed specification which can distinguish it from other things not sold.

Example: There is a building comprising of 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.

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.

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.

10.The sale must be unconditional. A conditional sale is invalid, unless the condition is recognized as a part of the transaction according to the usage of trade.

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

(ii) A buys a refrigerator from B, with a condition that B undertakes its free service for two years. The condition, being recognized as part of the transaction, is valid and the sale is lawful.

Bai' Mu'ajjal (Sale on Deferred Payment Basis):

1. A sale in which the parties agree that the payment of price shall be deferred is called a "Bai'Mu'jjal."

2. Bai' Mu'ajjal is valid if the due date of payment is fixed in an unambiguous manner.

3. The due time of payment can be fixed either with reference to a particular date, or by specifying a period, like three months, but it cannot be fixed with reference to a future event the exact date of which is unknown or is uncertain. If the time of payment is unknown or uncertain, the sale is void.

4. If a particular period is fixed for payment, like one month, it will be deemed to commence from the time of delivery, unless the parties have agreed otherwise.

5. The deferred price may be more than the cash price, but it must be fixed at the time of sale.

6. Once the price is fixed, it cannot be decreased in case of earlier payment, nor can it be increased in case of default.

7. In order to pressurize the buyer to pay the installments promptly, the buyer may be asked to promise that in case of default, he will donate some specified amount for a charitable purpose. In this case the seller may receive such amount from the buyer, not to make it part of his income, but to use it for a charitable purpose on behalf of the buyer.

8. If the commodity is sold on installments, the seller may put a condition on the buyer that if he fails to pay any installment on its due date, the remaining installments will become due immediately.

9. In order to secure the payment of price, the seller may ask the buyer to furnish a security whether in the form of a mortgage or in the form of lien or a charge on any of his existing assets.

10. The buyer can also be asked to sign a promissory note or a bill of exchange, but the note or the bill cannot be sold to a third party at a price different from its face value.

Murabahah:

1. *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.

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

3. 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.

4. *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.

Murabahah 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* which have been discussed in the first chapter. 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 *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 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.

Basic Features of *Murabahah* Financing:

1. *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.

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

3. *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.

4. The financier must have owned the commodity before he sells it to his client.

5. 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.

6. 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.

7. 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*.

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

(i) The client and the institution sign an overall 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.

(ii) 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.

(iii) The client purchases the commodity on behalf of the institution and takes its possession as an agent of the institution.

(iv) 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.

(v) 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.

The most essential element of the transaction is that the commodity must remain in the risk of the institution during the period between the third and fifth stage.

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.

9. 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.

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

(i) 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

the future on *murabahah* basis. Thus at this stage the relation between the institution and the client is that of a promisor and a promisee.

(ii) At the second stage, the relation between the parties is that of a principle and an agent.

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

(iv) At the fourth and fifth stage, the relation between the institution and supplier is that 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.

11. 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 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.

12. 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 agreement to pay an amount for a charitable purpose, as mentioned in paragraph 7 of the rules of Bai' Mu'jjal, 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.

Some Issues Involved in Murabahah:

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

1. Different Pricing for Cash and Credit Sales:

The first and foremost question about *murabahah* 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 increase the price accordingly. The longer the maturity of the *murabahah* payment, the higher the price. Therefore the price in a murabahah 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 *murabahah* 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 the 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 *murabahah* transactions, as practiced in the Islamic banks, are not different in essence from the interest-based loans advanced by conventional banks.

This argument, which seems to be logical in appearance, is based on a misunderstanding about the principles of Shariah regarding the prohibition of *riba*. For the correct comprehension of the concept the following points must be kept in view:

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. The basic points of difference between money and commodity are the following:

(i) Money has no intrinsic utility. It cannot be utilized for fulfilling human needs directly. It can only be used for acquiring some goods or services. The commodities, on the other hand, have intrinsic utility. They can be utilized directly without exchanging them for some other thing.

(ii) The commodities can be of different qualities, while money has no quality except that it is a measure of value or the medium of exchange. Therefore, all the units of money, of same denomination, are 100% equal to each other. An old and dirty note of Rs. 1000/- has the same value as a brand new note of Rs. 1000/-, unlike the commodities which may have different qualities, and obviously an old and used car may be much less in value than a brand new car.

(iii) In commodities the transaction of sale and purchase is effected on a particular individual commodity, or at least, on the commodities having particular specifications. If A has purchased a particular car by pinpointing it and seller has agreed, he deserves to receive the same car. The seller cannot compel him to take the delivery of another car, though of the same type or quality. This can only be done if the purchaser agrees to it which implies that the earlier transaction is cancelled and a new transaction on the new car is effected by mutual consent.

Money, on the contrary, cannot be pinpointed in a transaction of exchange. If A has purchased a commodity from B by showing him a particular note of Rs. 1000/- he can

still pay him another note of the same denomination, while B cannot insist that he will take the same note as was shown to him.

Keeping these differences in view, Islam has treated money and commodities differently. Since money has no intrinsic utility, but is only a medium of exchange which has no different qualities, the exchange of a unit of money for another unit of the same denomination cannot be effected except at par value. If a currency note of Rs. 1000/- is exchanged for another note of Pakistani Rupees, it must be of the value of Rs. 1000/-. The price of the former note can neither be increased nor decreased from Rs. 1000/- even in a spot transaction, because the currency note has no intrinsic utility nor a different quality (recognized legally), therefore any excess on either side is without consideration, hence not allowed in Shariah. As this is true in a spot exchange transaction, it is also true in a credit transaction where there is money on both sides, because if some excess is claimed in a credit transaction (where money is exchanged for money) it will be against nothing but time.

The case of the normal commodities is different. Since they have intrinsic utility and have different qualities, the owner is at liberty to sell them at whatever price he wants, subject to the forces of supply and demand. If the seller does not commit a fraud or a misrepresentation, he can sell a commodity at a price higher than the market rate with the consent of the purchaser. If the purchaser accepts to buy it at that increased price, the excess charged from him is quite permissible for the seller. When he can sell his commodity at a higher price in a cash transaction, he can also charge a higher price in a credit sale, subject only to the condition that he neither deceives the purchaser, nor compels him to purchase, and the buyer agrees to pay the price with his free will.
It is sometimes argued that the increase of price in a cash transaction is not based on the deferred payment, therefore it is permissible while in a sale based on deferred payment, the increase is purely against time which makes it analogous to interest. This argument is again based on the misconception that whenever price is increased taking the time of payment into consideration, the transaction comes within the ambit of interest. This presumption is not correct.

Any excess amount charged against late payment is riba only where the subject matter is money on both sides. But if a commodity is sold in exchange of money, the seller, when fixing the price, may take into consideration different factors, including the time of payment. A seller, being the owner of a commodity which has intrinsic utility may charge a higher price and the purchaser may agree to pay it due to various reasons, for example:

(i) his shop is nearer to the buyer who does not want to go to the market which is not so near.
(ii) The seller is more trust-worthy for the purchaser than others, and the purchaser has more confidence in him that he will give him the required thing without any defect.
(iii) The seller gives him priority in selling commodities having more demand.
(iv) The atmosphere of the shop of the seller is cleaner and more comfortable than other shops.
(v) The seller is more courteous in his dealings than others.

These and similar other considerations play their role in charging a higher price from the customer. In the same way, if a seller increases the price because he allows credit to his client, it is not prohibited by Shariah if there is no cheating and the purchaser accepts it with open eyes, because whatever the reason of increase, the whole price against a commodity and not against money. It is true that, while increasing the price of the commodity, the seller has kept in view the time of its payment, but once the price is fixed, it relates to the commodity, and not to the time. That is why if the purchaser fails to pay at a stipulated time, the price will remain the same and can never be increased by the seller. Had it been against time, it might have been increased, if the seller allows him more time after the maturity.

To put it another way since money can only be traded in at par value, as explained earlier, any excess claimed in a credit transaction (of money exchange of money) is against nothing but time. That is why if the debtor is allowed more time at maturity, some more money is claimed from him. Conversely, in a credit sale of a commodity, time is not the exclusive consideration while fixing the price.

The price is fixed for the commodity, not for time. However, time may act as an ancillary factor to determine the price of the commodity, like any other factor from those mentioned above, but once this factor has played its role, every part of the price is attributed to the commodity.

The upshot of this discussion is that when the money is exchanged for money, no excess is allowed, neither in cash transaction, nor in credit, but where a commodity is sold for money, the price agreed upon by the parties may be higher than the market price, both in cash and credit transactions. Time of payment may act as an ancillary factor to determine the price of a commodity, but it cannot act as an exclusive basis for and the sole consideration of an excess claimed in exchange of money for money.

This position is accepted unanimously by all the four schools of Islamic law and the majority of the Muslim jurists. They say that if a seller determines two different prices for cash and credit sales, the price of the credit sale being higher than the cash price, it is allowed in Shariah. The only condition is that at the time of the actual sale, one of the two options must be determined, leaving no ambiguity in the nature of the transaction. For example, it is allowed for the seller, at the time of bargaining, to say to purchaser, “If you purchase the commodity on cash payment, the price would be Rs. 100/- and if you purchase it on credit if six months, the price would be Rs. 110/-." But the purchaser shall have to select either of the two options. He should say that he would purchase it on credit for Rs. 110/-. Thus, at the time of the actual sale, the price will be known to both parties.

However, if either of the two options is not determined in specific terms, the sale will not be valid. This may happen in those installment sales in which different prices are claimed for different maturities. In this case the seller draws a schedule of prices according to schedule of payment. For example, Rs. 1000/- are charged for the credit of 3months, Rs. 1100/- for the credit of 6 months, Rs. 1200/- for 9 months and so on. The purchaser takes the commodity without specifying the option he will exercise, on the assumption that he will pay the price in future according to his convenience. This transaction is not valid, because the time of payment, as well as the price, is not determined. But if he chooses one of these options specifically and says, for example,

that he purchases the commodity on 6 months credit with a price of 1100/- the sale will be valid.

Another point must be noted here. What has been allowed above is that the price of the commodity in a credit sale is fixed at more than the cash price. But if the sale has taken place at cash price, and the seller has imposed a condition that in case of late payment, he will charge 10% per annum as a penalty or as interest, this is totally prohibited; because what is being charged is not a part of the price; it its an interest charged on a debt.

The practical difference between the two situations is that where the additional amount is a part of the price, it may be charged on a one time basis only. If the purchaser fails to pay it on time, the seller cannot charge another additional amount. The price will remain the same without any addition. Conversely, where the additional amount is not a part of the price it will keep increasing with the period of default.

2. The Use of Interest-Rate as a Benchmark:

Many institutions financing by way of murbahah 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 murabahah 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 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 as possible. But one should not ignore the fact that the most important requirement for validity of *murabahah* is that it is a genuine sale with all its ingredients and necessary consequences. If a *murabahah* transaction fulfils all the conditioned enumerated in this chapter, merely using the interest rate as a benchmark for determining the profit of *murabahah* does not render the transaction 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. In order to explain the point, let me give an example.

A and B are two brothers. A trades in liquor which is totally prohibited in Shariah. B, being a practicing Muslim dislikes the business of A and starts the business of soft drinks, but he wants his business to earn as much profit as A earns through trading in liquor, therefore he resolves that he will charge the same rate of profit from his customers as A charges over the sale of liquor. Thus he has tied up his rate of profit with the rate used by A in his prohibited business. One may question the propriety of his approach in determining the rate of his profit, but obviously no one can say that the profit charged by him in his *hala*l business is *haram*, because he used the rate of profit of the business of liquor as a benchmark.

Similarly, so far as the transaction of murabahah is based on Islamic principles and fulfils all its necessary requirements, the rate of profit determined on the basis of the rate of interest will not render the transaction as *haram*.

It is, however true that the Islamic banks and financial institutions should get rid of this practice as soon as possible, because, firstly, it takes the rate of interest as an ideal for *halal* business which is not desirable, and secondly because it does not advance the basic philosophy of Islamic economy having no impact on the system of distribution.

Therefore, the Islamic banks and financial institutions should strive for developing their own benchmark. This can be done by creating their own inter-bank market based on Islamic principles. The purpose can be achieved by creating a common pool which invests in asset-backed instruments like *musharakah, ijarah*, etc. If majority of the assets of the pool is in tangible form, like leased property or equipment, shares in business concerns etc. its units can be sold and purchased on the basis of their net asset value determined on periodical basis. These units may be negotiable and may be used for overnight financing as well. The banks having surplus liquidity can purchase these units and when they need liquidity, they can sell them. This arrangement may create inter-bank market and the value of the units may serve as an indicator for determining the profit in murabahah and leasing also.

3. Promise to Purchase:

Another important issue in murabahah financing which has been subject of debate between the contemporary Shariah scholars is that the bank / financier cannot enter into an actual sale at a time when the client seeks murabahah financing from him, because the required commodity is not owned by the bank at this stage and, as explained earlier, one cannot sell a commodity not owned by him, nor can he effect a forward sale. He is, therefore, bound to purchase the commodity from the supplier, then he can sell it to the client after having its physical or constructive possession.

On the other hand, 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.

Solution to this problem is sought in the *murabahah* arrangement by asking the client to sign a promise to purchase the commodity when it is acquired by the financier. Instead of being a bilateral contract of forward sale, it is a unilateral promise from the client which binds himself and not the financier. Being a onesided promise, it is distinguishable from the bilateral forward contract.

This solution is subjected to the objection that a unilateral promise creates a moral obligation but it cannot be enforced, according to Shariah, by the courts of law. This leads us to the question whether or not a one-sided promise is enforceable in Shariah. The general impression is that it is not, but before accepting this impression at its face value, we will have to examine it in the light of the original sources of Shariah.

A thorough study of the relevant material in the books of Islamic jurisprudence would show that the *fuqahah* (the Muslim jurists) have different views on the subject. Their views may be summarized as follows:

(i) Many of them are of the opinion that 'fulfilling a promise' is a noble quality and it is advisable for the promisor to observe it, and its violation is reproachable, but it is neither mandatory (*wajib*), nor enforceable through courts. This view is attributed to Imam Abu Hanifah, Imam al-Shafii, Imam Ahmad and to some Maliki jurists. However, as will be shown later, many Hanafis and Malikis and some Shafii jurists do not subscribe to this view.

(ii) A number of the Muslim jurists are of the view that fulfilling a promise is mandatory and a promisor is under moral as well as legal obligation to fulfil his promise. According to them, promise can be enforced through courts of law. This view is ascribed to Samurah b. Jungdub, the well known companion of the Holy Prophet (SW) Umar b. Abdul Aziz, Hasan al Basri, Sa'id b. al-Ashwa, Ishaq b. Rahwaih and Imam al-Bukhari. The same is the view of some Maliki jurists, and it is preferred by Ibn-al-'Arabi and Ibnal-Shat, and endorsed by al-Ghazzali, the famous Shafii jurist, who says the promise is binding, if it is made in absolute terms. The same is the view of Ibn Shubrumah. The third view is presented by some Maliki jurists.

They say that in normal conditions, promise is not binding, but if the promisor has caused the promisee to incur some expenses or undertake some labour or liability on the basis of promise, it is mandatory on him to fulfil his promise for which he may be compelled by the courts.

Some contemporary scholars have claimed that the jurists who have accepted the binding nature of a promise have done so only with regard to unilateral gifts or other voluntary payments, but none of them has accepted the binding nature of a promise to effect a bilateral commercial or monetary transaction. However, based on a close study, this notion does not seem to be correct, because the Maliki and Hanafi jurists have allowed 'Bai ' bil wafa' on the basis of binding promise. Bai'bil wafa' is a special kind of sale whereby the purchaser of an immovable property undertakes that whenever the seller will give him the price back, he will sell the house to him. The question of validity of Bai'bil wafa' has already been discussed in detail in the first chapter while explaining the concept of house financing on the basis of 'diminishing musharakah'. The gist of the discussion is that if repurchase by the seller is made a condition for the original sale, it is not a valid transaction, but if the parties have entered into the original sale unconditionally, but the seller has signed a separate and independent promise to repurchase the sold property, this promise will be binding on the promisor and enforceable through the courts.

The binding nature of the promise in this case has been admitted by both Maliki and Hanafi jurists. Obviously, this promise does not relate to a gift. It is a promise to affect a sale in future. Still, the Maliki and Hanafi jurists have accepted it as binding on the promisor and enforceable through the courts. It is a clear proof of the fact that the jurists who hold the promises to be binding to not restrict it to the promises of gifts etc. The same principle is applicable, according to them, to the promises whereby the promisor undertakes to enter into a bilateral contract in future.

In fact, the Holy Qur'an and the Sunnah of the Holy Prophet (SW) are very particular about fulfilling promises. The Holy Qur'an says:

"And fulfil the covenant. Surely, the covenant will be asked about (in the Hereafter)." (Bani Isra'il :34)

"O those who believe, why do you say what you not do. It invites Allah's anger that you say what you not do." (Al-Saf:2 to 3)

Imam Abu Bakr al-Jassas has said that this verse of the Holy Qur'an indicates that if one undertakes to do something, no matter whether it is a worship or a contract, it is obligatory on him to do it.

The Holy Prophet (SW) is reported to have said:
"There are three distinguishing features of a hypocrite: when he speaks, tells a lie, when he promises, he backs out and when he is given something in trust, he breaches the trust."

This is only one example. There is a large number of injunctions in the ahadith of the Holy Prophet (SW) where it is ordained to fulfil the promises and it is clearly prohibited to back out, except for a valid reason.

Therefore, it is evident from these injunctions that fulfilling promise is obligatory. However, the question whether or not a promise is enforceable in courts depends on the nature of the promise. There are certainly some sorts of promises which cannot be enforced through courts. For example, at the time of engagement the parties promise to go through the marriage. These promises create a moral obligation, but obviously they cannot be enforced through courts of law. But in commercial dealings, where a party has given an absolute promise to sell or purchase something and the other party has incurred liabilities on that basis, there is no reason why such a promise should not be enforced. Therefore, on the basis of the clear injunctions of Islam, if the parties have agreed that this particular promise will be binding on the promisor, it will be enforceable.

This is not a question pertaining to Murabahah alone. If promises are not enforceable in the commercial transactions, it may seriously jeopardize commercial activities. If somebody orders a trader to bring from him a certain commodity and promises to purchase it from him, on the basis of which the trader imports it from abroad by incurring huge expenses, how can it be allowed for the former to refuse to purchase it? There is nothing in the Holy Qur'an or Sunnah which prohibits the making of such promises enforceable.

It is only on these grounds that the Islamic Fiqh Academy Jeddah has made the promises in commercial dealings binding on the promisor with the following conditions:

(i) it should be one-sided promise.
(ii) The promise must have caused the promisee to incur some liabilities
(iii) If the promise is to purchase something, the actual sale must take place at the appointed time by the exchange of offer and acceptance. Mere promise itself should not be taken as the concluded sale.

(iv) If the promisor backs out of his promise, the court may force him either to purchase the commodity or pay actual damages to the seller. The actual damages will include the actual monetary loss suffered by him, but will not include the opportunity cost.

On this basis, it is allowed that the client promises to the financier that he will purchase the commodity after the latter acquires it from the supplier. This promise will be binding on him and may be enforced through courts in the manner explained above. This promise does not amount to the actual sale. It will be simply a promise and the actual sale will take place after the commodity is acquired by the financier for which exchange of offer and acceptance will be necessary.

4. Securities Against *Murabahah* Price:

Another issue regarding murabahah financing is that the murabahah 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. Some basic rules about this security must, therefore, be kept in mind.

(i) The security can be claimed rightfully where the transaction has created a liability or a debt. No security can be asked from a person who has no incurred a liability or debt. As explained earlier, the procedure of murabahah financing comprises of different transactions carried out at different stages. In the earlier stages of the procedure, the client does not incur a debt. It is only after the commodity is sold to him by the financier on credit that the relationship of a creditor and a debtor comes into existence.

Therefore, the proper way in a transaction of *murabahah* would be that the financier asks for a security after he has actually sold the commodity to the client and the price has become due on him, because at this stage the client incurs a debt. However, it is also permissible that the client furnishes a security at earlier stages, but after the *murabahah* price is determined. In this case, if the security is possessed by the financier, it will remain at his risk meaning thereby that if it is destroyed before the actual sale to the client, he will have either to pay the market price of the mortgaged asset, and cancel the agreement of *murabahah*, or sell the commodity required by the client and deduct the market price of the mortgaged asset from the price of the sold property.

(ii) It is also permissible that the sold commodity itself is given to the seller as a security. Some scholars are of the opinion that this can only be done after the purchaser has taken its delivery and not before. It means that the purchaser shall take its delivery, either physical or constructive, from the seller, then give it back to him as mortgage, so that the transaction of mortgage is distinguished from the transaction of sale. However, after studying the relevant material, it can be concluded that the earlier jurists have put this condition in cash sales only and not in credit sales.

Therefore, it is not necessary that the purchaser takes the delivery of the sold property before he surrenders it as mortgage to the seller. The only requirement would be that

the point of time whereby the property is held to be mortgaged should necessarily be specified, because from that point of time, the property will be held by the seller in a different capacity which should be clearly earmarked. For example, A sold a car to B on first of January for a price of Rs. 500,000/- to be paid on 30th June. A asked B to give a security for payment at the due date. B has not yet taken delivery of the car and he offered to A that he should keep the car as mortgage from 2nd January. If the car is destroyed before 2nd January the sale will be terminated and nothing will be payable by B. But if the car is destroyed after the second of January, sale is not terminated, but it will be subject to the rules prescribed for the destruction of a mortgage. According to Hanafi jurists, in this case, the seller will have to bear the loss of the car, to the extent of its market price or its agreed sale price, whichever is lesser. Therefore, if the market price of the car was 450,000/- he can claim only the remaining part of the agreed sale price (i.e.Rs.50,000/-in the above example) . If the market price of the car is Rs. 500,000/- or higher, nothing can be claimed from the purchaser.

This is the view of the Hanafi school. The Shafii and Hanbali jurists hold that if the car is destroyed by the negligence of the mortgagee, he will have to bear the loss, according to its market price, but if the car is destroyed without any fault on his part, he will not be liable to anything, and the purchaser will bear the loss and will have to pay the full price.

It is clear from the above example that the possession of A over the car as a seller carries effects and consequences different from his possession as a mortgagee and therefore it is necessary that the point of time on which the car is held by him as a mortgagee should clearly be defined. Otherwise different capacities will be mixed up giving rise to dispute and rendering the security invalid.

5. Guaranteeing the *Murabahah*:

The seller in a *murabahah* financing can a so 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 Shariah regarding guarantee are fully discussed in the books of Islamic fiqh. However, I would point out to two burning issues in the context of Islamic banking.

(i) The guarantor in the contemporary commercial atmosphere does not normally guarantee a payment without a fee charged from the original debtor. The classical Fiqh literature is almost unanimous on the point that the guarantee is a voluntary transaction and no fee can be charged on a guarantee. The most the guarantor can do is to claim his actual secretarial expenses incurred in offering the guarantee, but the guarantee itself should be free of charge. The reason for this prohibition is that the person who advances money to another person as a loan cannot charge a fee for advancing a loan, because it falls under the definition of riba, or interest which is prohibited. The guarantor should be subject to this prohibition all the more, because he does not advance money. He only undertakes to pay a certain amount on behalf of the original debtor in case he defaults in payment. If the person who actually pays money cannot charge a fee, how can fee be charged by a person who has merely undertaken to pay and did not pay anything in actual terms?

Suppose, A has borrowed 100 US dollars from B who asked him to produce a guarantor. C says to A, "I pay off your debt to B right now, but you will have to pay me 110 dollars at a later date." Obviously 10 dollars charged from A are not allowed, being interest. Then D comes to A and says, "I stand as a guarantor to you, but you will have to pay me 10 dollars for this service."

If we allow to charge a fee for guarantee, it will mean that C cannot charge 10 dollars despite the fact that he has actually paid the amount, and D can charge 10 dollars, despite the fact that he has merely committed to pay only when A fails to pay. This being unfair apparently, the Muslim jurists have forbidden the charging of a fee for guarantee, so that both C and D, in the above example, may stand on equal footing.

(ii) However, some contemporary scholars are considering the problem from a different angle. They feel that guarantee has become a necessity, especially in international trade where the sellers and the buyers do not know each other, and the payment of the price by the purchaser cannot be simultaneous with the supply of the goods. There has to be an intermediary who can guarantee the payment. It is utterly difficult to find the guarantors who can provide this service free of charge in required numbers. Keeping these realities in view, some Shariah scholars of our time are adopting a different approach. They say the prohibition of guarantee fee is not based on any specific injunction of the Holy Qur'an or the Sunnah of the Holy Prophet (SW). It has been deducted from the prohibition of *riba* as one of its ancillary consequences. Moreover, guarantees in the past were of a simple nature. In today's commercial activities, the guarantor sometimes needs a number of studies and a lot of secretarial work. Therefore, they opine, the prohibition of the guarantee fee should be reviewed in this perspective. The question still needs further research and should be placed before a larger forum of scholars.

However, unless a definite ruling is given by such a forum, no guarantee fee should be charged or paid by an Islamic financial institution. Instead they can charge or pay a fee to cover expenses incurred in the process of issuing a guarantee.

6. Penalty of Default:

Another problem in *murabaha* financing is that if a 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 *murabahah* 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 *murabahah* should not create a big problem in a country where all banks and financial institutions are run on Islamic principles, because the government or the central bank may develop a system where such defaulters may be penalized by depriving them from obtaining any facility from any financial institution. This system may serve as 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.

In order to solve this problem, some contemporary scholars have suggested that the dishonest clients who default in payment deliberately should be made liable to pay compensation to the Islamic bank for the loss it may have suffered on account of default. They suggest that the amount of this compensation may be equal to the profit given by that bank to its depositors during the period of default. For example, the defaulter has paid the price three months after the due date. If the bank has given to its depositors a profit at the rate of 5%, the client has to pay 5% more as compensation for the loss of the bank. However, the scholars who allow this compensation make it subject to the following conditions.

(i) 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.

(ii) 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. Indeed, he must be given respite until he is able to pay, because the Holy Qur'an has expressly said:

"And if he (the debtor) is short of funds, then he must be given respite until he is well off." (2:280)

(iii) 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.

First of all, any additional amount charged from a debtor is *riba*. In the days of *jahiliyyah* (before Islam) the people used to charge additional amounts from their debtors when they were not able to pay at the due date. They used to say: "Either you pay off your debt or you increase the payable amount."

The aforementioned suggestion of paying compensation to the credit/seller resembles the same attitude. It can be argued that the above suggestion is theoretically different from the practice of *jahilliyah* in that the suggestion is to grant the debtor a grace period of one month to make sure that he is avoiding payment without a valid cause and to exempt him from compensation if it appears that his non-payment is due to poverty or hardship. But in practical application of the concept, these conditions are hardly fulfilled, because every debtor may claim that his default is due to his financial inability at the due date, and it is very difficult for a financial institution to hold an inquiry about the final acquisition of each client and to verify whether or not he was able to pay.

What the banks normally do is that they presume that every client was able to pay unless he has been declared as bankrupt or insolvent. It means that the concession allowed in the suggestion can be enjoyed by the insolvent people. Obviously, insolvency is a rare phenomenon, and in this rare situation, even the interest-based banks cannot normally recover interest from the borrower. Therefore, the suggestion leaves no practical and meaningful difference between an interest based financing and an Islamic financing.

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.

It is argued in favour of charging compensation that the Holy Prophet (PBUH) has condemned the person who delays the payment of his dues without a valid cause. According to the well-known hadith he has said:

"The well off person who delays the payment of his debt, subjects himself to punishment and disgrace."

The argument runs that the Holy Prophet (PBUH) has permitted to inflict a punishment on such a person. The punishments may be of different kinds, including the imposition of a monetary penalty. But this argument overlooks the fact that even if it is assumed that imposing fine or a monetary penalty is allowed in the Shar'iah, it is imposed by a court of law and is normally paid to the government. Nobody has allowed a situation where an aggrieved party imposes a fine on its own (and for its own benefit) without a judgement of a court, competent to decide the matter.

Moreover, had it been a recognized punishment, it should have been imposed even if the investment account has earned no profit during that period, because the guilt of the defaulter is established and it has no nexus with the profit of the investment account of the bank.

In fact, the suggestion of the compensation equal to the rate of profit of the investment account is based on the concept of opportunity cost of money. This concept is foreign to the principles of Shar'iah. Islam does not recognize opportunity cost of money, because after the elimination of interest from the economy, money has no definite return. It is always exposed to loss as well as it has the ability to earn a profit. And it is the risk of loss which makes it entitled to gain a return.

Another point is worth the attention. The one who defaults in the payment of debt is, at the most, like a thief or a usurper. But the study of the rules prescribed for theft and usurpation would show that a thief has been subjected to a very severe punishment of amputating his hands, but he was never asked to pay an additional amount to compensate the victim of theft. Similarly, if a person has usurped the money of another person, he may be punished by the way of *ta'zier,* but no Muslim jurist has ever imposed on him a financial penalty to compensate the owner.

Imam al-Shafi'i is of the view that if someone usurps the land of another person, he will have to pay the rent of the land according to the market rate. But if he has

usurped the money, he will return the equal amount of money and not more. All these rules go a long way to prove that the opportunity cost of money is never recognized by the Islamic Shar'iah, because, as explained above, money has no definite return or any intrinsic utility.

On the basis of what is stated above, the idea of compensation to be charged from a defaulter is not approved by most of the contemporary scholars. The question was thoroughly discussed in the annual session of the Islamic Fiqh Academy, Jeddah, and it was resolved that no such compensation is allowed in Shar'iah.

All this discussion relates to the impermissibility of the proposed compensation in Shar'iah. Now it is to be noted that this proposal does not solve the problem of default at all. To the contrary, it may encourage the debtors to commit as much default as they wish. The reason is that, according to this suggestion, the defaulter is asked to pay compensation equal to the return earned by the depositors during the period of default. It is evident that the rate of return earned by the depositors is always less than the rate of profit paid by the customer in a *Murabahah* transaction. Therefore, the customer will be paying after default, much less than he was paying before the default. Therefore, he would willingly accept to pay this amount and not pay the amount of price which he will invest in a more profitable activity. Suppose the rate of profit agreed in a *murabahah* transaction of six months is 15% p.a. and the rate of profit declared to the depositors is 10% p.a. It means that if the client withholds the price of *murabahah* after its maturity date and keeps it for another six months, he will have to pay the compensation at the rate of 10% p.a. which is much less than the rate of original *murabahah* (i.e. 15%). As such he will default and enjoy another facility for the next six months at a lesser rate.

This proposal, therefore, is not only against *Sha'riah,* but also deficient in meeting the problem of default.

The Alternative Suggestion:

The question now arises as to how the banks and financial institutions may solve this problem. If nothing is charged from the defaulters, it may be a greater incentive for a dishonest person to default continuously. Here is the answer to this question:

We have already mentioned that the real solution to this problem is to develop a system where the defaulters are duly punished by depriving them from enjoying a financial facility in future. However, as commented earlier, this may be only where the whole banking system is based on Islamic principles, or the Islamic banks are given due protection against defaulters. Therefore, a time when this goal is reached, we may need some other alternative. For this purpose it was suggested that the client, when entering into a *murabahah* transaction, should undertake that incase he defaults in payment at the due date, he will pay a specified amount to a charitable fund maintained by the bank. It must be ensured that no part of this amount shall form part of the income of the bank.

However, the bank may establish a charitable fund for this purpose and all amounts credited therein shall be exclusively used for purely charitable purpose approved by the Shar'iah. The bank may also advance interest-free loans to the needy persons from this charitable fund.

This purpose is based on a ruling given by some Maliki jurists who say that if a debtor is asked to pay an additional amount in case of default, it is not allowed by Shar'iah, because it amounts to charging interest. However, in order to assure the creditor of prompt payment, the debtor may undertake to give some amount in charity incase of default. This is, in fact, a sort of *Yamin* (vow) which is self-imposed penalty to keep oneself away from default. Normally, such 'vows' create a moral or religious obligation and are not enforceable through courts. However, some Maliki jurists allow can be made it justiceable, and there is nothing in the Holy Qur'an or the Sunnah of the Holy Prophet (PBUH) which forbids making this 'vow' enforceable through the courts of law.

Therefore, in cases of genuine need, this view can be acted upon. But, while implementing this proposal, the following points must be kept in mind.

i. The proposal is meant only to pressurize the debtors on paying their dues promptly and not to increase the income of the creditor/financier, nor to compensate him for his opportunity cost. Therefore, it must be ensured that no part of the penalty forms part of the income of the bank in any case, nor can it be used to pay taxes or set-off any liability of the financier.

ii. Since the amount of penalty is not deserved by the financier as his income, but it goes to charity, it may be any amount willfully undertaken by the debtor. It can also be determined on percent per annum basis. Therefore, it may serve as a real deterrent against deliberate default, unlike the former suggestion of compensation which, as explained earlier, may tend to encourage the defaults.

iii. Since the penalty undertaken by the client is originally a self-undertaken vow, and not the penalty charged by the financier, the agreement should reflect this concept. Therefore, the proper wording of the penalty clause would be on the following pattern:

"The client hereby undertakes that if he defaults in payment of any of his dues under this agreement, he shall pay to the charitable account/fund maintained by the Bank/Financier a sum calculated on the basis of …% per annum for each day of the default unless he establishes through the evidence satisfactory to the Bank/Financier that his nonpayment
at the due date was caused due to poverty or some other factors beyond his control".

iv. Give the stipulated amount to any charity of his own choice, but in order to ensure that he will pay, the charitable account or fund maintained by the financier/bank is specified in the proposed undertaking. This specific undertaking does not violate any principle of the Shar'iah. However, it is necessary that the bank or the financial institution maintains a separate fund, or at least, a separate account for this purpose and the amounts credited to that account must be spent in well-defined charities known to the client/debtor. This proposal has now been implemented successfully in a large number of Islamic financial institutions.

7. No Roll-Over in *Murabahah*:

Another rule which must be remembered and fully compiled with is that the murabahah transaction cannot be rolled over for a further period. In an interest-based financing, if a customer of the bank cannot pay at the due date for any reason, he may request the bank to extend the facility for another term. If the bank agrees, the facility is rolled over on the terms and conditions mutually agreed at that point of time, whereby the newly agreed rate of interest is applied to the new term. It actually means that another loan of the same amount is readvanced to the borrower.

Some Islamic banks or financial institutions, who misunderstood the concept of *murabahah* and took it as merely a mode of financing analogous to an interestbased loan, started using the concept of roll-over to *murabahah* also. If the client requests them to extend the maturity date of the *murabahah*, they roll it over and extend the period of payment on an additional mark-up charged from the client which practically means that another separate *murabahah* is booked on the same commodity. This practice is totally against the well-settled principles of Shar'iah. It should be clearly understood that *murabahah* is not a loan. It is the sale of a commodity the price of which is deferred to a specific date. Once the commodity is sold, its ownership is passed onto the client. It is no more the property of the seller. What the seller can legitimately claim is the agreed price which has become a debt payable by a buyer. Therefore, there is no question of affecting another sale on the same commodity between the same parties. The roll-over in
murabahah is nothing but interest-pure and simple-because it is an agreement to charge an additional amount on the debt created by the *murabahah* sale.

8. 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? This question has been discussed by the classical jurists in detail . The issue is known in the Islamic legal literature as (Give the discount and recieve 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 view of those who allow this arrangement is based on a *hadith* in which Abdullah ibn 'Abbas is reported to have said that when the Jews belonging to the tribe of Banu Nadir were banished from Madinah (because of their conspiracies) some people came to the Holy Prophet (PBUH) and said , " You have ordered them to been expelled, but some people owe them some debts which have not matured". Thereupon the Holy Prophet (PBUH) said to them (i.e., the Jews who were the creditors):

"Give discount and receive (your debts) soon."

The majority of the Muslim jurists, however, do not accept this hadith as authentic. Even Imam al-Baihaqi, who has reported this hadith in his book, has expressly admitted that this is a weak narration. Even if the hadith is held to be authentic, the exile of Banu Nadir was in the second year after hijrah, when *riba* was not yet prohibited.

Moreover, al-Waqidi has mentioned that Banu Nadir used to advance usurious loans. Therefore, the arrangement allowed by the Holy Prophet (SW) was that the creditors forego the interest and the debtors pay the principle sooner. Al-Waqidi has narrated that Sallam b. Abu Huqaiq, a Jew of Banu Nadir, is had advanced eighty dinars to Usaid ibn Hudayr payable after one year with an addition of 40 dinars. Thus, Usaid owed him 120 dinars after one year. After this arrangement, he paid the principle amount of 80 dinars and Sallam withdrew from the rest. For these reasons, 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 *murabahah* 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, especially where the client is a needy person. For example, if a poor farm has purchased a tractor or agricultural inputs on the basis of *murabahah*, the bank should give him a voluntarily discount.

9. Calculation of Cost in *Murabahah*:

It is already mentioned that the transaction of *murabahah* 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 *murabahah* 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 *murabahah* 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 has occurred in U.S. dollars, the price of *murabahah* 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.

This situation may be met with in two ways. Firstly, if the ultimate purchaser agrees and the laws of the country allow, the price of the second sale may also be determined in dollars.

Secondly, if the seller has purchased the commodity by converting Pakistani Rupees into dollars, the exact amount of Pak rupees paid by the seller to convert them into dollars can be taken as the cost price and the profit of *murabahah* can be added thereon.

In some cases, the bank purchases the commodity from abroad at a price payable after three months or in different installments, and sells the commodity to his client before he pays the full price to the supplier. Since he pays the price in dollars, its equivalent

in Pakistani Rupees are not known at the time when the commodity is sold to the client. Due to fluctuation in the price dollars in Pak Rupees, the bank may have to pay more than anticipated at the time of *murabahah* sale. For example, the rate of U.S. dollars at the time of *murabahah* was Rs. 40/- for one dollar. The price of *murabahah* was settled according to this rate, but when the bank paid the price to the supplier, the dollar rate increased to Rs. 41/- for one dollar, meaning thereby that the cost of the bank increased by 2.5%. In order to meet this situation, some financial institutions put a condition in the *murabahah* agreement that in case of such fluctuation in currency rates, the client shall bear the additional cost. According to the classical Muslim jurists, *murabahah* based on this condition is not valid because it leads to uncertainty of the price at the time of sale. Such uncertainty continues upto a date after three months when the buyer actually pays the price to the supplier. Such uncertainty renders the transaction invalid. Therefore, there are following options open to the bank in this issue:

i. The bank should purchase that commodity on the basis of L/C at sight and should pay the price to the supplier before effecting sale with the customer. In this case no question of fluctuation in currency rates will be involved. The *murabahah* price can be determined on the basis of the market rate of dollars on the date when the bank has paid the price to the supplier.

ii. The bank determines the *murabahah* price in US dollars rather than in Pak rupees, so that the deferred *murabahah* price is paid by the customer in dollars. In this case the bank will be entitled to receive dollars from the customer and the risk of the fluctuation in dollar's price will be borne by the purchaser.

iii. Instead of *murabahah,* the deal may be on the basis of *musawamah* (a sale without reference to the cost of the seller) and the price may be fixed as to cover the anticipated fluctuation in the currency rates.

10. Subject-Matter of *Murabahah*:

All commodities which may be subject matter of sale with profit can be subject matter of *murabahah*, because it is a particular kind of sale. Therefore, the shares of a lawful company may be sold or purchased on *murabahah* 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 *murabahah*. But it goes without saying that the transaction must fulfill all the basic conditions, already discussed, for the validity of a *murabahah* transaction.

Therefore, the seller must first acquire the possession of the shares with all their rights and obligations, and then sell them to his client. A buy back arrangement or selling the shares without taking their possession is not allowed at all. Conversely, no *murabahah* can be effected on things which cannot be subject matter of sale, For example *murabahah* is not possible in exchange of currencies, because it must be spontaneous or, if deferred, on the marginal rate prevalent on the date of transaction. Similarly, the commercial papers representing a debt receivable by the holder cannot be sold or purchased except at par value, and therefore no *murabahah* can be effected in respect of such papers. Similarly, any paper entitling the holder to receive a

specified amount of money from the issuer cannot be negotiated. The only way of its sale is to transfer if for its face value.
Therefore, they cannot be sold on *murabahah* basis.

11. Rescheduling of the Payments in *Murabahah*:

If the purchaser/client in *murabahah* financing is not able to pay according to the dates agreed upon in the *murabahah* 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 *murabahah* payments. If the installments are rescheduled, no additional amount can be charged for rescheduling. The amount of *murabahah* price will remain the same in the same currency.

Some Islamic banks proposed to reschedule the *murabahah* price in a hard currency different from the one in which the original sale took place. This was proposed to compensate the bank through appreciation of the value of the hard currency. Since this benefit was proposed to be drawn from rescheduling, it is not permissible. 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.

12. Securitization of the *Murabahah*:

Murabahah is a transaction which cannot be securitized for creating a negotiable instrument to be sold and purchased in the secondary market. The reason is obvious. If the purchaser/client in a *murabahah* 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 the transfer of this paper to a third party will mean the transfer of money. It has already been explained that where money is exchanged for money (in the same currency) the transfer may be at par value. It cannot be sold or purchased at a lower or higher price. Therefore, the paper representing a monetary obligation arising out of a *murabahah* transaction cannot create a negotiable instrument . If the paper is transferred, it must be at par value.

However, if there is a mixed portfolio consisting of a number of transactions like *musharakah*, leasing and *murabahah*, then this portfolio may issue negotiable certificates subject to certain conditions more fully discussed in the chapter of "Islamic funds".

Some Basic Mistakes in *Murabahah* Financing:

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

i. The first and the most glaring mistake is to assume that *murabahah* is a universal instrument which can be used for every type of financing offered by conventional interest based-banks and NBFIs. Under this false assumption, some financial institutions are found using *murabahah* 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 *murabahah* can be used only where a commodity is intended to be purchased by the customer. If funds are required for some other purpose, *murabahah* 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.

ii. In some cases, the clients sign the *murabahah* 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 commodity, after receiving the 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*h. 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 for example:

a. Instead of giving funds to the customer, the purchase price should be paid directly to the supplier.
b. If it becomes necessary that the client is entrusted with funds to purchase the commodity on behalf of the financier, his purchase should be evidenced by invoices or similar other documents which he should present to the financier.
c. Where either one of the above two requirements is not possible to be fulfilled, the financing institution should arrange for physical inspection of the purchased commodities.

Anyhow, the Islamic financial institutions are under an obligation to make sure that the *murabahah* is a real and genuine transaction of actual sale and is not being misused to camouflage an interest-based loan.

iii. In some cases, sale of commodity to the client is affected before the commodity is acquired from the supplier. This mistake is invariably committed in transactions where all the documents of *murabahah* are signed at one time without taking into account the various stages of the *murabahah*. Some institutions have only one *murabahah* 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 *murabahah*. It has already been explained in this article that the *murabahah* arrangement practiced by the banks is a package of different contracts which come into plat one after another at their respective stages. These stages have been fully highlighted earlier while discussing the concept of '*Murabahah* Financing'. Without observing this basic feature of *murabahah* financing, the whole transaction turns into an interest-bearing loan. Merely changing the nomenclature does not make it lawful in the eyes of Shariah.
The representatives of the Shariah Boards of the Islamic banks, when they check the transactions of the bank with regard to their compliance with Shariah, must make sure that all these stages have been really observed, and every transaction is effected at its due time.

iv. International commodity transactions are often resorted for liquidity management. Some Islamic banks feel that these transactions, being asset-based, can easily be

entered into on *murabahah* basis, and they enter the field ignoring the fact that the commodity operations as in vogue in the international markets, do not conform to the principles of Shariah. In many cases, they are fictitious transactions where no delivery takes place. The parties end up paying differences. In some cases, there are real commodities but they are subject to forward sales or short sales which are not allowed in Shariah. Even if the transactions are restricted to spot sales, they should be formulated on the basis of Islamic principles of *Murabahah* by fulfilling all the necessary conditions already mentioned.

v. It is observed in some financial institutions that they effect *murabahah* 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 *murabahah*. 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 the *murabahah. Murabahah* can be effected only on commodities not yet purchased by the client.

Conclusions:

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

i. *Murabahah* is not a mode of financing in its origin. It is a simple sale on a 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 the commodity. Therefore, it should neither be taken as a ideal slamic 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.

ii. 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.

iii. 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.

iv. 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 therefrom is not *halal*.

iv. 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.

v. If in cases of genuine need, the financier appoints the client his purchase to 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 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 indebtness 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 Shariah should be taken lightly.

vi. Two different prices for cash and credit sales are allowed on condition that ither 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.

vii. 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.

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