

## **An analytical study of the issues of pricing Salam in the light of contemporary application**

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### **Abstract**

*The main purpose of this study is to addressing the issues of pricing in contemporary practice of Bai' Salam. Findings of the previous studies showed divergence opinions among the Muslims scholars regarding to this issues. In this research paper qualitative method will used in order to gather in-depth understanding of the pricing issues in Bai' Salam. The paper concludes with an academic discussion which could be used as a guide for future research.*

Key words: Bai' Salam, Pricing issues, Islamic Schools opinion

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## I. INTRODUCTION

Bai' Salam is an Islamic finance instrument used to provide working capital to the people who are seeking for financing in conditions compliant with Sharia. Literally, the word Salam is synonymous to the word Salaf'i (lending) in this content The Messenger of Allah (Blessings and prayers of Allah upon him) said: "whoever enters into Salaf, should stipulate a determined weight and measurement, and a determined date of delivery" the word Salaf in this Hadith refer to "Salam" which means a sale contract involved immediate payment of the price and delay of delivery of commodity (Masri, 2003). During the days of prophet (S.A.W) the caravans used to get interest based loans for purchasing the commodities. After prohibition of interest, they were allowed to purchase Salam contract. However, the meaning of Salam in Fiqh terminology indicates difference in wording among the various Fiqh schools, but the context is similar. The Maliki School, define Bai' Salam as a sale in which the capital (price) is paid in advance and the subject of sale is referred to specific time. Whereas, the Safi'i and Hanbali schools are defined the forward sale contract as a contract which described the commodity sold as a deferred liability (Chong, 2008).

Technically, Bai al salam transaction take place when a lender (Al-muslim) buys an asset from the party who seeking financing (the seller or Al-muslim Ileihi), pays the purchase price of the asset in advance and agrees to take delivery of the asset in specific period. Bai' Salam mostly used to finance sector such as agriculture, or the rural economy as a whole. It hence provides Shari'ah permissible, instead of interest based financing. The Bai' Salam satisfied the need of both parties of the contract to the extent that it has been named by the Scholars as Bay' Almahweej (sale practiced by the needy people). Although, there no conservers about the permissibly and the definition of forward sale but the current application of Salam records numbers of issues have been risen, the most debatably issue in Bai Salam is the price at the time of signing contract. According to Hanafi' , Shafi'i, and Hanbali' schools, price should not be delayed beyond the time when the contract is taking place their justification for this is that delay of both commodity and price could be categorized as sale of debt which is prohibited in Shari'ah (Umar, 1995). On the other hand, the Maliki jurists do not restrict the price in the time of signing the contract. In terms of delay in payment, according to Maliki jurists, it is permissible to delay the price up to three days (Chong, 2008). On the issue of payment of the price in installments, if only part of the principal amount is paid, the majority of scholars agreed that the contract is invalid. In addition, the determination of price according to floating price one of questionable issue raised by the contemporary researchers. However, purchasing against floating price does not allow the price to be known. The majority of scholars agreed that the Salam can be fixed according to market price only on the time of signing contract rather it is not permissible to agree in fixing price according to future market price.

The contemporary application of Bai'al Salam financing has brought numerous serious issues. One of these issues is the determination of price in Salam contract. Therefore, the study aims to shed light on the issues of pricing in Salam contract and addressing the various interpretations from different Islamic school.

## II. LITERATURE REVIEW

### *Conceptualization of Salam contract and its application with reference to Islamic law*

From a Sharia'h prospective, Salam contract is defined as "a forward sale for immediate payment. In other words, it is the selling of a specified commodity for exchange of a price paid in advance. Moreover, the definition varies among the Islamic scholars. According to the Hanafi School, "Salam is a contract which ensures the possession of the price paid in advance and the commodity delivered at a specified date in the future", while the Maliki school defined it as "the sale whereby the commodities are delivered at a specified date in the future for exchange of a price paid in advance". Concerning the purpose of Salam contract, it is strictly prohibited for Muslim to be involved in usurious loans. Therefore, farmers who need money to grow their crops and provide adequate provision to their family at the time of harvest cannot embrace this practice to fulfil their financial needs. This is where the Salam contract comes into picture, to allow them to sell their agriculture project in advance, in order to meet their financial need. In addition, it meets the need of traders for import and export business. Under Salam contract, it is allowed for a farmer to sell the goods in advance so that after receiving their cash price, they can easily undertake the aforesaid business. Salam is beneficial to the seller because he received the price in advance and it was beneficial to the buyer also because normally the price in Salam is lower than the price in spot sales. According to the Islamic Fiqh point of view, Salam contract is subject to certain conditions as follow. (Mahmor, 2002)

#### *Abu Hanifah*

- Must be précised fixed.
- Clearly Enumerated
- Not uniquely identified underlying asset
- Full payment at the conclusion of the contract

#### *Imam Malik*

- Must be précised fixed.
- Clearly Enumerated
- Not uniquely identified underlying asset
- Could be deferred to three days or even more.

#### *Imam Shafi'i*

- Must be précised fixed.
- Clearly Enumerated
- Not uniquely identified underlying asset
- Full payment at the conclusion of the contract

#### *Imam Ahmad*

- Must be précised fixed.
- Clearly Enumerated
- Not uniquely identified underlying asset
- Full payment at the conclusion of the contract

By analysing these conditions stated above one can observe that all the scholars agreed on the first three points, which concern analogically the quality and quantity to be fixed, the date and the place of delivery to be précised and the nature of the underlying asset must be pre-determined. In contrast to the fourth point, Imam Malik gives flexibility regarding the payment of price. But if we look in shari'ah framework, one can argue that it is necessary for the validity of Salam contract that the buyer pays the price in full to the seller at the time of affecting the sale. In the absence of full payment, it will be tantamount to sale of a debt against a debt, which is expressly prohibited by the Holy Prophet. Moreover the basic wisdom for allowing Salam contract is to fulfil the “instant need” of the seller. If it's not paid in full, the basic purpose will not be achieved. Moreover, only those goods can be sold through a Salam contract in which the quantity and quality can be exactly specified. For example, precious stones cannot be sold on the basis of Salam because each stone differ in quality, size, weight and their exact specification is not possible. Furthermore, let's look at the actual application of Salam contract in Sudan as an example. Referring to the Publications Series of Tadamon Islamic Bank titled “The Salam Sale Contract in Jurisprudence and Practice” case of Sudan. The following are observables;

***The Salam Contract practice by the banks in Sudan*** [Publications Series of Tadamon Islamic Bank (Salam Sale Contract in Jurisprudence and Practice), 1997]

The bank enters into a Salam contract as a buyer, with the farmer as the seller. The underlying assets are generally crops. During the contract, they specify the nature of the commodity for example: Sudanese wheat, breakaway or undelay (Sudanese date). The amount is specified by quantity and measure by determining the units exactly, the number and quality as prices range according to quality. The commodity shall be existing and can be delivered at the same date and place agreed upon the exact date shall also be specified according to the harvest of each crops. The two parties shall agree on place or site of delivery e.g. at Tadamon Islamic Banks warehouses located in the industrial area, Bahry (Khartoum North) and the price paid by the bank (the buyer) to the farmer (the seller). The price should be known in terms of sort or amount. It is usually the exchange currency as agreed upon by the two parties who shall determine that the amount is paid by the buyer as agreed upon and specify the quantity and quality of the commodity to be delivered at such and such place as the seller agreed with the bank.

The buyer must not undervalue the commodity, or crops of the seller. He has to pay the acceptable price and they have estimate the price in accordance with prices prevailing at signing of the contract and the price expected at the date and place of delivery in addition to expenses and costs related to the commodity and that the price should not be higher than expectation. In this case the buyer will lose accordingly. If the price agreed upon is unacceptable, the contract will be subject to amendment or repeal. The court has the right to enrage the agreed up on price at the seller's request, and if the buyer agree on the amendment, the contract will be amended, but if he doesn't accept amendment by the court the contract will also go cancelled by the buyer's retaining of the price according to Section (221) of the Sudanese Civil Transaction Law, 1984. Since the price paid in money by bank and the commodities are usually crops of different categories, the delay in delivery is possible. There are no other usurious reasons forbidding the Salam contract practice.

The practicing or refraining from the Salam contract sales by banks, depend on the recommendation and conclusion of the economic feasibility study conducted by investment section in this connection. Conditions of the Salam sale contract stating the duties and rights of the two parties to the price and commodity should expressly be written. Banks can get involved in this task along with other individuals. (Alzaabi, 2010)

***Benefit of Salam contract regarding to price***

The price determination plays an essential role in Salam contract for both bank (buyer) and seller (farmer). Surely, both parties will conclude the contract based on the offer and acceptance of the price. Therefore, the pricing factor gives advantage to both parties in order to conclude the contract.

Firstly, the bank can sell the commodity through a parallel Salam contract with higher price for the same date of delivery. The difference between the two prices shall be the profit earned by the institution. In this way institutions can manage their short term financing portfolios. Secondly, for the seller, the satisfaction of financial needs in order to realize his agriculture project is primordial. Therefore, he takes advantage to the advance price payment to maintain and develop the business.

***The issues of pricing in Bai' Salam from the different Islamic schools***

There are slight interesting differences among the four main schools of Fiqh on how they view terms and conditions related to the price in a Salam contract regarding the delivery of price. The payment and receipt of the price during the contract session prior to the parting of contractors is a condition. If the two parties separate prior to the receipt of the price, the contract is invalid and void. This follows since the objective of Salam, which is to give the seller the means to produce the object of sale, is no longer met. (Al-Zuhayl, 2002). Hanbali, Shafi'i and Hanafi are requiring that the price of Salam (capital) be known and specified to the seller, and transferred to him at the time of contract. If the price was a tangible and the parties separate without the seller receiving the price the very nature in Salam would not be met. Imam Malik, on the other hand, uniquely does not require the price (capital) to be handed over at the time of contract before the parties separate. Rather, they permit postponement for a maximum of three days. However, there is not perfect unanimity among Maliki scholars on this point. If the price is cash, some of them approve the delay of three days but others disapprove. If the price is in the form of tangible assets, transfer of which is postponed unconditionally for more than three days, some Malikis judge this to be permissible but discourage it, others that it is permissible without discouraging it, and still others judge that it invalidates the contract. (Al-Shanqiti, 2000)

In condition of tangible price it is permissible for the price (capital) to be in the form of tangible assets like machines and buildings because such utility is a form of value gained by owning the kind of assets that enable it, like buildings and machines. Hanbali, Shafi'i and Maliki, are in agreement on this view. In the Hanafi view, doing so deprives the seller of the flexibility that money (or other exchangeable form of the price) gives him.

Besides using debt capital as the price in Salam, the Malikis do not permit Salam by means of debt capital (owed by the seller or anyone else) unless the debt is due and made available to the seller at the time of the contract or within three days thereof. The Hanafi view is much the same as the Maliki, i.e. only debt due, produced and transferred to the seller at the time of contract (or very soon thereafter) is permissible. The Shafi'i is holding the same position as the Hanafis and the Malikis. On the use of debt capital to serve as the price, there are interesting variations within the Hanbali school of thought. Salam by means of debt capital owed by the seller is disapproved outright by Ibn Qudamah. But Ibn al-Qayyim and Ibn Taymiyyah hold it to be permissible provided the debt is due at the time of contract, i.e. provided that it does not result in selling one postponed debt for another, which is unanimously prohibited. Similarly, a debt owed to the buyer by a third party, due and produced at the time of contract; so that the seller takes possession of it is permissible. (Zaabi, 2010)

Finally, fixing the price of the sale object by reference to a particular market, the principle in a Salam contract is that the price must be fixed and known at the time of drawing up the contract. From the standpoint of Imam Malik the relevant value can be fixed in accordance with a particular market price at that time, or at that price plus or minus a certain percentage. What is not permissible is to fix the value at a future market price. The contracting parties can agree, at the time of Salam capital is transferred to fix the price of the sale object by reference to the price in a particular market on the date of delivery, plus or minus a certain amount (+10% or -10%, for example). This is permitted as it prevents unfair or exploitative transactions. This possibility of nominating a particular market price plus or minus 10% was the focus of inquiry at the second forum organized by Al Barakah. The forum agreed to the following principles:

- i. The basic rule in salam sales is the agreement of the parties on the price of the sale object at the time of drawing up the contract.
- ii. It is permissible to agree that the price is in accordance with the price of the sale object on a particular market at the time of the contract
- iii. It is permissible to agree that the price is in accordance with the price of a particular market at the time of the contract plus or minus an agreed percentage.
- iv. It is not permissible to fix the price in accordance with that of a particular market in the future, i.e. at the time of delivery of the sale object (Barakah, 1984)

### **III. CONCLUSION AND RECOMMENDATIONS**

The practices of Bai' al-Salam as a lawful financing instrument, seems to be a necessity due to the number of benefits it offers, main goal of Slam is to facilitate and finance the production process coupled with encouraging trade in the community by serving the interest of the buyer, 'profit' and to inject an economic value into the society due to the multiplier effect by supporting the existence of a particular economic activity. Moreover, it enhances and facilitates the operation process of the firms. This will secure a proportionate number of jobs to the needed labour force for the firms and generate income to the members of society, in addition to the economic value produced by the contract subject matter. This limitless value justifies the validity of Bai' al-Salam due to the maslah it offers. However, departing from the clear fact that a tremendous effort has been made by the majority of the Muslim scholars to come up with both definition and validity of Bai' Salam, there is the fact that Bai' al-Salam is not a joint venture or profit losses sharing contract. (Barakah, 1984). The most preferred financing instruments by the clients and widely practiced by the Islamic Intermediaries are Murabahah, Musharakah and Mudarabah because the contracts ruling them are reasonably understood compare to Bai al-Salam, which is less practiced and less preferred. Exploring the nature of the contract where the price of the subject matter is set to be less than the market price is not in favour of the seller because lower price rate enables the Buyer to have grater quantity from the good under the contract. To pursue the interest of the Buyer, reduction in price took place which justifies that Salam is not a profit-loss sharing contract. According to Haron (1996), the Islamic banking system will become an efficient model in mobilizing and allocating resources in the economy as a result of interest-elimination and profit sharing concepts.

Nonetheless, the contractual obligations of the farmer in a Salam contract will ensure the delivery of a particular agreed amount of the subject matter on a certain date. The financial intermediaries or the Buyer is also well protected in this contract, since the provision of guarantee or collateral is required. However, further specifications here are needed. Less well understood, are the terms and conditions of Salam contracts which Islamic banks also make use of, particularly because in the case of default, the farmer has to make up the reduced proportion of the price by buying the commodity from the market so as to fulfil the contract. (alzaabi, 2010).

One issue to note is the transaction cost, which encompasses the additional cost in terms of labour and transportation incurred by the farmer to deliver the good. Although there is a tendency of having low price of crops at the harvesting season due to the abundance of supply, at the delivery date the spot price is higher than the contract price. Even if the spot price is equal to the stated price, the delivery cost is also a burden to the farmer.

Another issue is the effect of an inflationary attack. The contemporary Islamic financial intermediaries are operating within a fiat money system which is inflationary, and the element of interest rate as a benchmark in determining the prices is not escapable due to the usage of discounting rate techniques for price determination. The proportion of the difference between the market price and the price of the contract is considered to be the profit rate out of this transaction. Another segment of the profit is the higher prices the Buyer will receive later when he sells the commodity a few months after the harvesting period.

There is also the question of whether the rabb al-salam will accept only his principle, in the case of default. Based on the discretionary efforts of the scholars on the justification of the lower price and the possibility of delaying the price for three days later, it is permissible. Still there is no such flexibility on the delivery period in addition to the absence of clear conditions on default, surrendering to the fact that agricultural production is in particular a venture which is surrounded with risk.

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