

SHARIAH ISSUES ON THE MODERN APPLICATIONS OF MURABAHA IN ISLAMIC FINANCIAL INSTITUTIONS (IFIS)

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Abstract

Murabaha is one of the Islamic banking product widely used by the IFIs. Due to several reasons the modern applications of Murabah at IFIs has brought many Shariah issues. This study intended to identify the Shariah issues that are been criticized by the expert and to explain the basis behind those issues. This study has employed qualit methods where by the date were collected through primary and secondary sources. As per the objectives of this study, the researchers have found the some Shariah issues. The issues found are common for all the IFIs in the world. All of the issues highlighted in this study are serious and challengeable to the stability of the IFIs. Among the issues some have been discussed for which the suggestions for the rectification have been recommended while some are ongoing unsolved issues among the scholars

Key Word: Murabaha, sharia issues, Islamic Financial institution

1.1 Background of the study

Islamic Banking throughout the World is increasing day by day. This has become the means of an increase in the establishment of new Islamic Banks as well as Islamic Banking Units or windows being established by conventional banks. In present scenario, most of the Islamic Banks and financial institutions are using Murabaha as a mode of finance, while the original concept of Murabaha is a kind of sale. It has been implemented as a mode of finance after doing financial engineering to process. This research would focus on few arguments from Shariah compliancy of modern application of Murabaha financing which is considered and believed to be the ideal forms of financing in the Islamic financial industry. However, Murabaha is basically a type of Islamic financial transaction involving offer and acceptance from the contracting parties. The distngush feartures of Murabha from the other sale is the seller will disclose the actual price of the goods along with the profit added on it. By making the payment of Murabah as deferment either installments or lumpsum at any future date, IFIs provide financing for their customers. It is defined as a “mode of Islamic finance that refers to the sale of goods with a pre-agreed profit mark-up on the cost. The word Murabaha, which actually means ‘profit’, is ultimately derived from the Arabic term *‘rihb’*. It is essentially a contract of sale in which a commodity is sold for profit. The seller is required to inform the buyer of the cost price of products and services, along with the selling price and the profit margin or mark-up.

Murabaha is the most common and popular mode of Islamic financing in the industry as a technique widely used by Islamic banks across the globe. It has been calculated that as much as 80% of the financial operations of Islamic banks belong to the category of Murabaha. The following analysis explains the overwhelming predominance of this particular mode of finance. Imagine that a client approaches a bank to seek the finance required for purchasing a particular product or service. (Source)

The money could be loaned to this customer with interest by a conventional, interest based bank. The customer would then use the loan to purchase the commodity or product in the open market. Due to the prohibition of riba, Islamic banks do not have this option open to them, so their operations and functions are not based on interest. In short, they cannot lend money to a client who is required to pay interest on the loan. The bank nevertheless has to make money from its operations to ensure its survival in the market. Thus, it cannot normally lend money to its clients at a zero interest rate, even if the provision of liquidity in the form of interest-free loans may represent some small proportion of total finance. Murabaha is prevented interest based transactions by serving zero interest based loan to the client for buying assets.

The alternative mechanism of Murabaha was therefore developed to allow banks to make money from providing finance to their clients without violating the Sharia prohibition of riba. Rather than lending money to an interest-paying borrower, the bank itself purchases the asset or commodity for cash, and then sells it at a fixed profit to the prospective customer. Unlike a straightforward purchase and resale trade, however, the bank allows the client to defer payment, as the client would not have entered into the transaction if he had the necessary liquidity available to purchase the goods outright. Thus, the client enjoys immediate use of the asset without having to pay for it in full at once, while the Islamic bank is able to make a profit in exchange for its services in acquiring the commodity on behalf of the client. In order to ensure this transaction meets the Islamic standards of a legal sale, many requirements must be met. Murabaha thus follows the principle of interest prohibition, allowing participants to enjoy profits and fees from the sale of assets or property without interest.

Murabaha Many people have questioned the legality of Murabaha financing under Sharia law, due to the similarity of the profit or mark-up to interest or riba. The bank purchases the goods for the client at an agreed price, and then sells them to the client at cost plus a reasonable profit. Repayment of this sale price including mark-up is usually made in instalments, which the client pays to the bank at agreed intervals.

Sri Lanka as a country with a rapid growth in Islamic finance Murabaha is practiced by most of its Islamic Financial Institution.

This study would also identify the issues related to Murabaha in few Islamic Financial Institution.

1.2 Brief Literature Review

There are numerous articles and conference paper dealing specifically sharia issues of Murabaha financing such as legal aspect, risk default in payment, viability for short, medium & long terms finance, practical aspects, problems & difficulties and controversial issues relating to Murabaha, time value of money in deferred Murabaha etc

Dr. Abdul Hameed al- Ba'ali" in his book dilates upon Murabaha contract from legal (fiqhi) perspective covering the opinions of all four famous schools of Classical Jurisprudence viz. Hanafi, Maliki, Shafi'I and Hanbali including Zahiri. The work has a good discourse on different aspects and issues of Murabahah with all possible fiqhi discussion. While concluding the debate, the author does the comparative analysis among different opinions and thereby establishes a favouring opinion. There is also juristic analysis on contemporary issues of Murabahah.(Al- Ba'ali, Abdul Hameed (n.d.) 'Fiqh al-Murabahahfi al-Tatbeeqat al-Iqtisadal-Ma'asir\ Cairo, Maktabah al-Salam al-AIamiyah)

Dr. Yusuf al-Qaradawi (1984) in his writing, has successfully dealt with the critique & arguments put forth against contemporary Murabaha and tried to remove the objections with legal evidences deduced from Qur'anic verses, Sunnah & other sources of shariah including logical reasoning. He first presented the opponent views and their arguments then did the critical appraisal of their viewpoints and pointed out the underlying weakness in their standpoint and thereafter clarified the confusion that led to misconception related to contemporary Murabaha. He is very clear in his argument. His work discusses the nature and form of Murabaha contract and its peculiarities and elaborately deals with one of the most important issues of contemporary Murabaha i.e. whether the promise is binding or non-binding on the part of promisor (client). Dr. Qaradawi argues in favour of binding nature of promise by putting forth the arguments of both earlier scholars and later ones. Dr. Rafiq al Misri had strong reservation in this behalf and hence put a rebuttal to binding Murabaha and argued for non-binding Murabaha. He critically examined the arguments and points put forth by Yusuf al-Qaradawi. then clarified more the issue in question and tried to spell out the picture on the matter referring to the objections of al-Misri.(Al-Qaradawi Yusuf(1404 A.H./ 1984), ' Bai al-Murabahah HI 'Amir bi'l Shim kama Tujreehi al Masarif alIslamiyah iDirasah fi Dau'i al-Nusus wa'l Qawaid al-Shar'iyah', Kuwait, Dar al-Qalam)

Ahmad Ali Abdullah (1987) in his work has tried to touch all concerning issues of Murabaha and its contemporary application & practices and analyse them in fiqhi perspective taking into account the opinions of various schools of jurisprudence including Zahiri & Shi'ites. The author also critically analyses the legal opinions and argues for convincing one. The second chapter of the book is very significant in the sense that it deals at length with contemporary Murabaha, its concerns and important aspects. The various misconceptions and objections raised against Murabaha have been dealt in the light of legal opinions of classical Fuqaha(Abdullah, Ahmad Ali (1407 A.H./1987), 'al-Murabaha: Usuluha

wa Ahkamuha wa Tatbeeqatuha fi'l Masarif al-Islamiyah' al-Khurtum, al-Dar al-Sudaniyah HI Kutub, 1st ed., (a Ph.D. dissertation under the supervision of Dr. Sadiq M. al-Ameen al-Dareer).

Jamal Attieh (1990) in his work highlights legal problems that arise in implementing Murabaha (mark-up) contract as a financing tool that is widely used by Islamic banks. He argues that major problem is the question of bank ownership of the financed commodity. This ownership is required by shari'ah but prohibited by banking laws in many countries. Exempting Islamic banks from such laws-as has often been the case-and referring them to fiqh leaves important legal gaps, because fiqh encompasses several and occasionally opposite views. He also discusses a bank's rights and obligations in case of traditional letter of credit as compared to Murabaha and concludes with suggested solutions to the problems raised. Some suggestions require specific changes in laws, while others may be adopted by individual banks.(Attieh Jamal (1990), 'Legal Aspect of Applying the Murabaha Financing Contract', Islamic Economics Journal, King Abdul Aziz University (KAU),

Jeddah, Vol.2,No.1http://www.kau.edu.sa/Show_Res.aspx?Site_ID=320&LNG=EN&RN=27915)

Dr. Attieh Fayyaz (1999) deals rather much in detail with the subject of Murabaha. He has elaborately discussed ordinary and contemporary Murabaha with pros and cons in the light of Islamic law (fiqh). His work covers various important issues related to Murabaha like promise to purchase & its bindingness, conditions for validity of the specific form of contemporary Murabaha, expenses in relation to Murabaha, increased price due to deferred payment, rebate on earlier payment, the issue of providing securities and guaranteeing, financial discount in the case of paying installment on time etc. In short, his work provides a full discourse on each aspect of the subject.(Faiyyaz, Attieh (1419 A.H.I 1999), 'al-Tatbeeqat al-Masrafiyah li bai al-Murabaha fi dau al-fiqh alIslamV, Egypt, Cairo, Dar al-Nashr iil Jamiaat, 1st Ed.)

Yusuf Talal DeLorenzo (1997) has compiled a useful compendium of legal opinions (fatwa) on the operations of Islamic banks based on the Arabic fatwa having English translation with original Arabic text. Its chapter on Murabaha classifies the questions and answers in terms of contract components, contract provisions, and the contract itself and the prohibited cases. In view of Murabaha being prevalent and termed as a suspect contract, this chapter includes about 70 percent of the questions and fatwas of the compendium. However, different and opposing opinions were not presented on the issues in question, if it is so, it would prove to be very useful and valuable in order to appreciate the matter in depth.(DeLorenzo, Y. Talal (1997), 'A Compendium oj Murabaha, Mudaraba and Musharaka', UK, London, Institute of Islamic Banking & Insurance.)

M. Taqi Usmani, (2000) in his work has analysed various important issues of contemporary Murabaha from legal, logical and economic point of view in clear, simple and convincing way. Being a shariah advisor of a number of Islamic Banks with substantial experience of their working, he provides a thoughtful and pertinent analysis on the subject taking cognizance of the realities of present times. For

proper understanding the issues, he discusses them in the light of the authoritative texts of Shariah sources and the lessons learnt from Islamic Banking experiment. He has more innovative approach to ijtihadi matters without disregarding the traditional juristic opinions but he does not follow the unambitious approach often adopted by Muslim scholars with regard to the prohibition set by shah'ah concerning financial matters. He gives the reasons which justify these prohibitions, instead of merely raising them and shielding behind them without providing an explanation. He does not also hesitate to warn where necessary, e.g. he points out that that using Murabaha and Ijarah as modes of financing is not what these two concept were meant for and therefore, when they are applied outside their original purpose, additional requirements must be fulfilled. His work relies substantially on classical Arabic sources with logical interpretation and thus it is one of the best reference on the subject available in English language. (Usmani, Muhammad Taqi, 'An Introduction to Islamic Finance', Idaratul Ma'arif, Karachi May 2000.)

Sami Hasan Hamoud (1976) in his Ph. D. thesis first introduced the concept of Murabaha HI 'Amir bil Shira" in contemporary Islamic finance, based on a fatwa by Sheikh Faraj al-Sanhuri. Banking finance based on the classical Mudarabah principle has been challenged by Hamoud & others. He pointed out some limitations of classical Mudarabah principle in its application to the modern needs of financing and suggested a proposal as other alternatives to them. In his work, he invited attention to the cases where Mudarabah is incapable to provide financing e.g. consumer's goods, (durable or non durables), goods supplied to government and industry etc. He was in search of an Islamically acceptable financial instrument capable of competing with conventional consumer-finance product. Thus since the publication of Hamoud (1982) Murabahah emerged as a principle distinct from sharing one (PLSP) and became the backbone of contemporary Islamic Finance. Islamic banks welcomed this new addition from fiqh that allowed them to replace a significant part of their practice of high risk amanah financing such as Mudarabah & Musharakah. Sami developed this concept on the basis of Imam Shafi'i's concept of al-Murabaha. (Hamoud Sami Hasan (1396 AH/ 1976), 'Tatweer al-a 'amal al-Masrifiyah bimayuttafiq wa 'I Sahariah al-Islamiyah\ Cairo, 1st ed. (a Ph.D. dissertation))

1.3 Problem Statement

Murabaha—the most used Islamic financing tool by the Islamic banks and financial institutes around the world is a vital Islamic finance concept. However, the over reliance on murabaha has created doubts about the degree of Shariah compliance. The utilization of murabaha finance is not questionable but it is actually the over utilization of this financing method that arises reservations. By evaluating the perceptions of Customers, Islamic Bankers and assessing their opinions regarding murabaha, the negative view points can be obliterated to promote better understanding of the concept and to enhance applicability of this vital Islamic financing mechanism. And the study focuses on Sharia Perspective to evaluate whether these doubts are well based or not and what are the possible options which can be considered in order to dispel these negative opinions about Murabaha.

1.4 Research Questions

What are the sharia issues faced by IFIs while practicing Murabaha in its modern application?

1.5 Research Objective

This paper aimed to identify the sharia issues related to contemporary applications of Murabaha in IFIs.

1.6 Methodology

This study has employed qualit methods where by the date were collected through primary and secondary sources.

1.7 Finding and Discussion

This paper has find some sharia issues along with the arguments and explanations given through Islamic scholars it clearly defines in which point it contradicts with sharia.from the discussions with sharia scholars of a particular Islamic Financial Institution of srilanka this study have found that all the above issues are faced by these Institution in practic of Murabaha Financing.They do financing through murabaha for nearly 5% of there total financing activities. this is done in two ways as vehicle murabaha and commodity murabaha is limited for one year.there prices differ when it comes to cash and credit sale. and they also charge penalty for late payments. they do give rebate for early payments they says that small amount of discounts would bring goodwill to their Institutions.Along with these they two have another challenge in pricing benchmark which they follow the conventional benchmarking but offering the fixed price avoiding the rate.

➤ **Difference in Pricing for Cash and Credit Sales**

Since, Murabahah is usually used on differed payment basis i.e. the sellerbuys the commodity on cash and sells it on credit, while deciding the price, he alsoconsiders the period of payment. The longer the maturity of the *Murabahah* payment, the higher the price. Thus the price in Murabahah contract is normallyhigher than the market price. Now the question arises as to whether price of creditsale may be higher than that of cash sale or not. Opinions differ. Some approveand others disapprove.'Those who do not hold that price of a commodity in cash & credit contract may differ, argue that the increase of price in a credit sale being in consideration of the time given to the buyer, should be regarded tantamount 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 contracts are no longer different in essence from the interest bearing loans.

➤ **Rebate in Case of Early Payment:**

Sometimes the debtors want to pay early to get discounts as in the case of conventional banking. Can an Islamic bank allow rebate on early payment of Murabaha? This issue has been examined by the classical jurists in detail, and it was concluded that since Murabaha represents the sale of a specific commodity -the price of which is a settled issue - there can be no rebate or discount on voluntary eary payment by the buyer. The issue is known in the Islamic legal literature as "*Da' wa ta 'ajjal*" (Give discount and receive soon). Some earier jurists (from Shafi'is, Hanbalis and 'Ibadis) have held to its

permissibility, but the majority of the Muslim jurists, including the four schools of Islamic jurisprudence esp. Malikis sternly disapprove it and do not allow remission (for earlier payment in murabaha operation by banks). Some jurists opine that if the early payment is tied to a discount, it is not permissible. However, if the rebate is not an attraction for pre-payment and is not taken to be a condition for earlier payment and the bank gives an allowance voluntarily, it may be permissible under Sharia.

➤ **Rescheduling for Additional Payment:**

Some times customer is not able to pay according to the dates agreed upon in the murabahah agreement, so he requests the seller/ the bank for rescheduling the installments. At times, rescheduling of installments is seen as a way out in the face of default. In conventional banking, loan rescheduling is accompanied by additional interest charge for the timing differences. This is not possible in murabahah payments. In Murabahah such rescheduling is not allowed as no additional amount can be charged for the same. But if the installments are rescheduled, no additional amount can be charged for rescheduling. The amount of the murabaha price will remains unchanged." Some banks attempt to circumvent this by changing the unit of currency. Needless to say, this is not permissible. They proposed to reschedule the murabahah price in other than a currency in which initial transaction effected. Usmani Says:

"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."

➤ **Imposing penalty on default payment:**

In credit facilities extended by conventional banks, the loan is invariably tied up with interest that continues to grow with the passage of time. If the client fails to settle the loan upon maturity, this results into the interest burden becoming even larger, and if the delay is unacceptable, sometimes high penal rates of interest are applied. In addition to increasing the income of the lender, this process also acts as a deterrent to defaulting.

In the Islamic system where the Murabahah price is fixed at the outset, no increase may take place in the liability of the client due to delay in settlement. The financier is entitled to claim only the original Murabahah price, irrespective of when it is paid. This could result in some clients purposely delaying settlement in order to avail of free credit period.

This situation could be easily overcome in a place where all financial institutions provide only Islamic facilities, as clients who habitually default could be blacklisted and deprived of further facilities. However, this could be done only with the cooperation of all banks.

When this is not the case, can the financial institution require compensation from defaulting clients after providing sufficient warning, when it is assured that defaulting was deliberate and was not due to poverty? The majority of the contemporary scholars answer in the negative, based on the clear Shari'ah principle that any additional amount charged from the debtor is Riba. Such compensation has no parallel in Islamic Shari'ah.

➤ **Use of Interest-Rate as Benchmark.**

Many banks settle on 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.

The critics have recourse to disapprove Murabahah on this ground. Contemporary shari'ah scholars though not advise or encourage to use such benchmark but in the absence of viable Islamic benchmark they not see wrong in using LIBOR as it is merely mean to have a complete market price and does not involve interest transaction at all.

1.8 Conclusion

As per the objectives of this study, the researchers have found the some Shariah issues. Murabaha is a permissible kind of sale but it brings out Shariah compliant issues when it is altered to operate as financing mode. The issues found are common for all the IFIs in the world as it is found from number of literature. All of the issues highlighted in this study are serious and challengeable to the stability of the IFIs. Issues like penalty and rescheduling have discussed many articles and have been recommended alternative suggestions. However, issue of benchmarking is still faced on going arguments among the scholars as unsolved issues.

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