THE CONCEPT OF MURABAHA IN
A MODERN ISLAMIC CONTEXT

A thesis presented for
the degree of
Master of Philosophy.

by

MAHMOUD SALIH MAHMOUD

THE INTERNATIONAL STUDIES UNIT
UNIVERSITY OF SALFORD.

1990
ACKNOWLEDGEMENT

I would like to extend my thanks and gratitude to my supervisor Dr. Yousif N. Awad for his guidance and perseverance during the preparation of this work.

My thanks also go to Mr. M. Yaseen for his efforts and skills in typing this thesis so neatly and exquisitely.
CONTENTS

PROLOGUE

CHAPTER I  
THE CONCEPT OF ISLAMIC BANKING  
AND INVESTMENT SYSTEM

1. INTRODUCTION  7
2. ISLAMIC BANKS  8
3. WHAT IS RIBA?  11
4. WHY IS RIBA PROHIBITTED?  14
5. ISLAMIC INVESTMENT INSTRUMENTS  15
   A) MUSHARAKA  18
   B) MUSHARAKA MUTANAQISA  20
   C) LEASE PURCHASE  21
   D) MUDARABA  22
   E) SALAM SALE  25
   F) MURABAHA SALE  26
   G) WADEAH SALE  27
   H) TAWLIYAH SALE  27

CHAPTER II  
MURABAHA CONTRACT

1. THE MEANING OF MURABAHA  30
2. LEGALITY OF MURABAHA  31
3. CONDITIONS FOR A PROPER MURABAHA  36
4. THE ELEMENTS OF THE COST  38
5. MURABAHA CONTRACT IN ISLAMIC BANKS  42
6. COLLATERAL IN MURABAHA CONTRACTS  43
7. PROFIT IN MURABAHA SALE  53
8. IMPORTANCE OF MURABAHA IN ISLAMIC BANKS  59
CHAPTER III  CHALLENGE & PROBLEMS FACING MURABAHA CONTRACT
INTRODUCTION
1 - IS THE PROMISE OBLIGATORY?
2 - IS THE COMPENSATION FOR DELAYED PAYMENT PERMISSIBLE?
3 - IS MURABAHA A SALE OF WHAT ONE DOES NOT HAVE?
4 - IS THE MURABAHA SALE TO THE PURCHASE ORDERER PERMISSIBLE IN ISLAM?
5 - CAN THE BANK ESCAPE THE RISK?
6 - IS MURABAHA A FICTICIOUS SALE?
7 - IS IT POSSIBLE TO IMPORT THE GOODS IN THE NAME OF THE CLIENT?
8 - CAN THE CLIENT ACT AS AN AGENT FOR THE BANK?
9 - COULD THE SALE BE STARTED AS AN AMMANA SALE AND COMPLETED AS A MUSAWAMA SALE?
10 - IS IT ACCEPTABLE TO OFFER TWO PRICES TO THE CLIENT?

CHAPTER IV  SUMMARY & CONCLUSION
1 - SUMMARY

2 - FINDINGS & RECOMMENDATIONS
   2 - 1 DEVELOPMENT OF THE ISLAMIC BANKING SYSTEM
   2 - 2 DEVELOPMENT OF THE APPLICATIONS OF MURABAHA

APPENDIX  CONTRACT SAMPLES

BIBLIOGRAPHY
PROLOGUE
One of the main principles of Islamic Banking is to avoid interest (usury) in all forms of transactions because Muslims believe that they are not allowed to deal in usury and that they have to adopt an interest-free system. In order to achieve this, the Muslims have derived their guiding rules from the Islamic principles and used profit sharing mechanism rather than using the prevailing interest rate mechanism. The Muslim Economists have been trying to develop and present some successful real working examples of an interest-free economy.

The usury "interest" is called in Islam "RIBA" a term which literally means increase or addition but from the Islamic technical point of view it refers to the addition in the amount of the principal of the loan on the basis of time for which it is loaned and the amount of the loan.

The objective of the Islamic Banks and Investment Companies is to develop Islamic forms of transaction that do not involve interest which is prohibited in Islam. Islam has nothing against the modern banking operational techniques or against the cooperation or coordination with western investment and banking institutions unless they conflict with the Islamic rules.

The Quran, which is the fundamental source of the Islamic rules and principles has prohibited Riba. One of the implications of prohibition of Riba is that this prohibition eliminates all debt financing instruments as they exist in the traditional banking system. Islam has given some alternative transactions which do not involve Riba dealing. One of the important characteristics of the Islamic financial instruments is the Risk and Loss and Profit sharing.
The cause of the prohibition of Riba will be discussed in detail in this study. The study will also list and explain some of the main investment instruments and forms used in the Islamic Banking.

One of the most important forms of transaction developed in the Islamic Banks and Investment Companies is a form of sale called Murabaha. Murabaha is the most widely used form of transaction in the Islamic Banks and in the same time it is the most frequently subject to criticism. The Murabaha represents a special form of contracts for sale of goods. It is a Contract of Sale where the seller is obliged to disclose to the buyer the initial cost of the goods and the margin of profit he marked.

The objective of this study is to discuss this special form of transaction, make comments on how it is being practised in the Islamic Banks and Investment Companies.

Being a newly developed investment instrument, the Murabaha in its modern application has not been the subject of many books or researches. Many books and publications discussed the subject of the Islamic Banking System but few of them highlighted the issue of the modern Murabaha which is a different application of the old Islamic traditional form of Murabaha. The most important publications in this field are written recently after the Islamic Banks had adopted the Murabaha Sale Contract in its developed form. One of the books written in Murabaha is a book by DR. SAMI H. HOMOUD a distinguished Islamic Banker in the year 1976. The book is titled "DEVELOPMENT OF THE BANKING ACTIVITIES IN CONFORMITY WITH THE ISLAMIC SHARIA". The book discussed and highlighted all of the banking activities and was not devoted to Murabaha. Another writer in this field is DR. AHMAD A. ABDULLAH who, in the year 1987, wrote his book "MURABAHA, its principles, conditions and applications in the Islamic Banks". There are also some other Islamic Economists who wrote about the Murabaha sale such as Dr. Youssof Al Garadawi who wrote "Murabaha Sale to Purchase Orderer as applied in Islamic Banks", DR. ABDUL HAMEED AL BAALI, "The Jurisprudence of Murabaha" in addition to the "Scientific and Practical Islamic Banking Encyclopedia" issued by the International Institute of Islamic Banking & Economics.".
There are some of the recent publications which discussed the issue of Murabaha in the Islamic Banks and Investment Companies. There are old publications and books that referred to and explained this form of transaction. These are written by old Muslim Thinkers and Jurists but, of course, they did not discuss the modern applications of the Murabaha Contract as they were not known at those early days. The Murabaha Contract has been dealt with and discussed from different points of view which the writer intends to discuss and elaborate in this study which will be divided into four chapters.

The First Chapter will be concerned with explaining the concept of the Islamic Banks and Investment Companies showing their main characteristics and the points of difference between the Islamic Banks and the Conventional Banks. The chapter also describes some of the important islamic investment instruments which are being applied in the Islamic Banks.

The Second Chapter of the study will be devoted to explain the meaning of Murabaha both literally and in the Islamic Sharia and the stand of the different Muslim Jurists towards the definition of the Murabaha Contract. In the second part of this chapter, the author will explain how the Murabaha Sale used to be practiced in the early days of Islam and how it is being applied now a days in the modern Islamic Banks and Investment Companies.

A detailed description of the transaction will be given in this chapter showing how the transaction starts with a purchase order from the client to the Bank which purchases the required goods under its name, possesses them and then re-sells them to the client.

The Second Chapter also includes the general and the special conditions required to achieve a proper Murabaha Contract.
The general conditions are the conditions which apply to all contracts regardless of their type such as the legal capacity of the parties, offer and acceptance, valuable consideration and that the contract should not involve any usury. On the other hand, the special conditions are those which apply to the Murabaha Sale Contract as a special form of contract. These conditions include that the original purchase price should be disclosed to the buyer, the initial contract must be a valid one in accordance to the principles of the Islamic Sharia and that the goods should be owned by the seller at the time of the Sale Contract.

The third chapter of the study will contain the main problems facing the application of the Murabaha Contract in the Islamic Banks and Investment Companies showing that one of the main issues in this regard is in the execution of the contract in the Banks which, in many cases, affects the properness of the Murabaha. The chapter will also involve in the points of criticism which are raised against the application of this form of transaction. Some of the main points of criticism include that the Murabaha transaction involves usury, that it is a sale of what the seller does not own and that the transaction in its modern form was not known at the early days of Islam.

All criticisms will be discussed in detail and it will be shown that some of them are true and genuine and some actions need to be taken in order to rectify the transaction.

In the fourth chapter a summary of the findings of the study will be given stating the writers opinion and recommendations for the establishment of a proper application of the Islamic forms of transaction especially for the Murabaha Sale of Goods. The most important points relate to the qualifications, the concern and the seriousness of the officials and the executives of the Islamic Banks and Companies who should be always well trained in the business so that they can be able to face the challenge.
CHAPTER I
THE CONCEPT
OF ISLAMIC BANKING
AND INVESTMENT SYSTEM
1) **INTRODUCTION:**

Islam as understood by Muslim believers and as explained in the Quran is a complete system governing human life in its different aspects. These include prayers, human relations, social and family affairs as well as commercial transactions and mercantile dealings.

In this field of the economic and commercial transactions, Islam has its own system which differs from all other economics as stated by M. ARIF:

"It is interesting to see an Islamic economy being conceptualised by some in a highly idealised form which clearly portrays an economic behaviour based strictly on Islamic ethics and which boldly assumes that all Muslims behave puritanically." (1)

In order to have the tools which enable them to operate in a way compatible with the Islamic rules and thoughts, the Muslim Economists began to think about establishing Islamic Banks & Companies. The main objective was to find institutions through which they can develop investment instruments which conform with the Islamic Sharia without being forced to deal in usury, giving or taking.

---

(1) ARIF, MUHAMMAD - Monetary & Fiscal Economics of Islam, K.A. Aziz University 1982 Page 3.
In this connection, DR M.F. KHAN stated:-

"To the modern Western Economists who consider interest to have a pivotal role in the economic life of a society and even to many of the Muslims who believe in interest as an essential element for economic development and growth, the Islamization of an economy may seem to be a mission impossible. This belief may be due to the fact that no working model or blueprint exists to support its practicality or highlight its practical implications.

Muslim Economists have been trying to present the interest-free economy in theoretical models but unless some successful working example is presented to both the businessmen and economists their logic, no matter how convincing, will remain doubtful.

During 1970s, individual efforts were made in various Muslim countries to establish interest-free banks. These efforts present not only an excellent working example for those who did not believe in the practicality of the institution but also provide a spade-work over which the infrastructure of interest-free banking for a country could be built-up". (1)

2) **ISLAMIC BANKS:**

More than 20 years ago, the Muslims started the first practical steps towards establishing the Islamic financial and economic institutions. That was, as Muslims think, the only way to be able to apply and develop the Islamic economic and financial system.

(1) DR. KHAN, M.FAHIM, Money & Banking in Islamic Institute of Policy Studies, Islamabad 1983 - Page 259
That was never an easy task - but was never impossible because the interest (usury) is the pillar of the banking system while the Islamic Sharia prohibits it. The Quran says, prohibiting usury:-

"Those who devour usury
Will not stand except
As stands one whom
The Evil One by his touch
Hath driven to madness.
That is because they say:
"Trade is like usury",
But Allah hath permitted trade
And forbidden usury.
Those who after receiving
Direction from their Lord,
Desist, shall be pardoned
For the past; their case
Is for All (to judge);
But those who repeat
(The offence) are Companions
Of the Fire; they will
Abide therein (forever).

Allah will deprive
Usury of all blessing,
But will give increase
For deeds of charity-
For He loveth not
Creatures ungrateful
And wicked.

Those who believe,
And do deeds of righteousness
And establish regular prayers
And regular charity,
Will have their reward
With their Lord:
On them shall be no fear,
Nor shall they grieve.

-9-
ye who believe!
Fear Allah, and give up
What remains of your demand
For usury, if ye are
Indeed believers.

If ye do it not,
Take notice of war
From Allah and His Messenger:
But if ye turn back
Ye shall have
Your capital sums;
Deal not unjustly,
And ye shall not
Be dealt with unjustly." (1)

This is a clear Muslim stand against usury (Riba). Therefore the Islamic Banks had to operate in a different way because they are based on different philosophic and economic principles as described by Said Martan:-

"Commercial banks have become a vital part of the contemporary economic life of most societies. Their main function is the mobilization of the society's savings in order to channel them to economic and social uses. Through extending credits to worthy borrowers, commercial banks act to increase production, expand capital investments, and presumably achieve a higher standard of living. Other services include the convenient method of making payment through cheques and credit cards, the supply of foreign currencies and purchase and sale of securities. However, their main goal is the maximization of profit subject to a reasonable level of liquidity, safety, and soundness in performance. Their profits come from interest rates and the various fees and commissions charged by them from customers.

(1) HOLY QURAN - SURAT AL BAQARA 275-279
"Islamic banking institutions, on the other hand, are based on different philosophic and economic principles. Because Islam is a complete code of life, banking and financial institutions, like other institutions in an Islamic society, ought to derive their guiding principles from Islamic teachings. Islamic banks should therefore be viewed as a particular type of banks, operating without interest rate mechanism, and seeking to maximize an objective function which has social benefit, social welfare and profit as arguments (see Al-Hawary). In addition to their banking services, Islamic banks could be looked upon basically, as investment institutions, using profit-sharing mechanism rather than interest rate mechanism. (1)

So, the Islamic Banks were the only outlet for the Muslim economists who believed that this was the only alternative for the conventional banking system. It was never an easy job but a challenging exercise specially because the Islamic Banks and Investment Companies had to fight to have a foot in the modern investment markets and compete with the conventional commercial banks not only among the Muslims in the Muslim World but also among the non-muslims in the West and the East.

3. WHAT IS RIBA:

In Arabic language "RIBA" means "INCREASE" and in the Islamic Jurisprudence it means:-

"The Increase over the original wealth without trading". (2)


(2) The Scientific and Practical Encyclopedia of Islamic Banks International Association of Islamic Banks, Cairo - 1980 V-3, Page 123.
It is also defined as under:-

"The favour of wealth in return for no compensation in the exchange of wealth for wealth". (1)

There are two types of Riba:-

a) Riba Al Nasi'a (Delay Usury)
b) Riba Riba Al-Fad (Favour Usury)

a) **DELAY USURY:**

This is the Usury which was known to the people in the pre-Islamic period and it is a delayed loan with a conditional increase. This increase was in return for the delayed payment.

b) **FAVOUR USURY:**

This is usually practiced when one trades some goods for other goods of the same kind with an increase. An example for this is to sell gold for gold, wheat for wheat or silver for silver.

The famous Muslim Jurist IBNUL QAIYEM stated:-

*"The clear usury is the (delay) usury which was practised in the pre-Islamic era in the manner that one delays one's debt and adds on to it, and the more the debt is delayed the more it becomes until the hundred becomes thousands. No one-debtor-usually does this except the very needy, and if he finds that the creditor delays his claim of repayment in return for an increase he accepts it to avoid the humidity of claim and imprisonment."*

(1) The Scientific and Practical Encyclopedia of Islamic Banks International Association of Islamic Banking, Cairo, 1980. V-3, Page 123
From time to time it doubles the harm too, and the calamity becomes greater and the debtor is so deeply in debt that all his means are swallowed up. So the sum of money due by the needy becomes bigger with no benefit to him, and the usurer's money increases with no benefit derived therefrom for his brother, and so he devours his money by false pretences, with extreme harm to his brother. It is, therefore, by the great mercy of the Creator that He hath prohibited usury and cursed its devourer, devoureethe one who gives it to be devoured - writer and witnesses, and hath warned him who does not shun it of war from Him and His messenger. Such a threat has not been mentioned for another big sin. So this is the biggest.

Imam Ahmad, when asked about the undoubtful usury, said:

"(It is when man has a debt due to him and he says: (Would you repay or increase?). If he does not repay, he increases the money and the other prolongs the delay). Then Ibn Al-Qaiyam went on to say:-

(Allah hath made usury the opposite of almsgiving. The usurer is the opposite of the almsgiver. Allah sayeth: (Allah hath blighted usury and made almsgiving fruitful). And sayeth: (That which ye give in usury in order that it may increase on (other) people's property hath no increase with Allah- but that which ye give in charity, seeking Allah's countenance, hath increase manifold). An He sayeth: (O ye who believe! Devour not usury, doubling and quadrupling (the sum lent). Observe
your duty to Allah that he may be successful. And war off (from yourselves) the Fire prepared for disbelievers). Then He mentioneth paradise that is prepared for those who fear Him (Those who spend (of that which Allah hath given them.) in ease and adversity). Those are the opposite of the ususers. Allah hath ordered against usury which is an injustice to people and hath commanded almsgiving which is charity to them). (1)

4) WHY IS RIBA PROHIBITED:

This question has been the answered by Dr. Hassan Al INANI who wrote summarising the research he made in this regard:-

To sum up, the results have been as follows:-

a) The three Imams (Ahmad, Malik and Shafi) have agreed explicitly that the cause in the case of gold and silver is their being a kind of valuation.

b) The three Imams (Abu Hanifa, Ahmad and Shafi of old) have agreed that the cause in the case of wheat, barley, dates and salt is the weight or measure provided, according to Shafi and Ahmad, they are provisions.

IBNUL QAIYEM - A 'Lam Al Mowaqeen
Al Maktaba Al Kobra - Cairo 1955.
V.2 P. 99-100
c) Imam Abu Hanifa singly - apart from the three Imams - considers the cause in the case of gold and silver in the weight, not in valuation. He considers the cause in the case of wheat, barley, dates and salt the measurement together with unity of kind in all.

d) Imam Malik singly considers the cause in the case of wheat, barley, dates and salt their being provisions and can be saved up together with unity of kind.

Shaf'i of recent singly considers the cause in the case of wheat, barley, dates and salt their being provisions only with stipulation upon measurement or anything else except unity of kind." (1)

5) **ISLAMIC INVESTMENT INSTRUMENTS:**

Islam permits a wide freedom of commercial transactions and contracts. The rule in Islamic Sharia is that every transaction is permitted unless it clearly violates any of the Islamic Sharia principles. In other words we are not required to prove the legality of any commercial transaction because the Islamic Sharia permits any contract or dealing if the parties thereof concented unless such contract or dealing clearly violates the Islamic principles.

Let us read what Mohsin Khan says in this regard:-

(1) DR. ALINANI, HASSAN - The cause of prohibition of Usury and its relation to the function of Money & International Institute for Islamic Banks & Economcs. P.33-34.
"The sharing of risks and uncertainties of the enterprise is an extremely important characteristic of Islamic financial contracts, since the Sharia condemns even a guarantee by the working partner to restore the invested funds intact, not only because it removes the element of uncertainty needed to legitimize the agreed distribution of expected profits, but also because the lender will not be renumerated to the extent of the productivity of his financial capital in the resulting profit.

In the Islamic profit-sharing arrangements, while the profit is shared between the agent-entrepreneur and the financial capital owner, the loss is borne only by the owner of the funds and not by the entrepreneur. This fact affords human capital (as representative of present work and effort) a status on par with financial capital owner, the loss is borne only by the owner of the funds and not by the entrepreneur. This fact affords human capital (as representative of present work and effort) a status on par with financial capital (as representative of monetized past labor or inheritance). Thus, if the owner of funds risks the loss of his money, the agent-entrepreneur is recognized as risking his time and labor, but no more.

This Shariah as well permits a variety of modes of non-interest transactions in order to facilitate financing of projects where no additional property or assets are created, such as consumer loans. These include, inter alia, non-interest loans, lease and lease-purchase agreements, instalment sales, and special futures contracts, in which, even though some type of return is allowed, the return does not have the same characteristics as the conventional interest rate (1).

(1) KHAN, MOHSIN - Monetary Policy in an Islamic Economy A Research for the 6th Islamic Banking Meeting, Bahrain 1990 - Page 7-8.
Although the Islamic Banks are relatively new and are operating in different local conditions, yet there is a common pattern of their operations which are guided by the following basic principles:

a) Elimination of Usury (Riba)

b) Providing Social Services for the Muslim Society

The proposed Islamic Banking System which is meant to replace some of the conventional banking operations is a system of non-interest methods and forms of financing. It is worth mentioning that Islam is not at all against the western conventional banking system which is the pillar for the modern civilization and the economic development. The Muslim Economist did not delete all the conventional banking activities and operations and they are not required to do so. As stated before, according to the Islamic principles; all commercial transactions and dealings are permitted unless it is proved otherwise.

Therefore, the Islamic Banks have to operate and give finance to the bank clients using only the finance and investment instrument which do not conflict with the Islamic Sharia rules whether these instruments were used in the conventional banking system or developed and derived from the Islamic system. This is why we find many operations similar to the conventional banks operations which include both long term and short term finance.

The main investment instrument used by the Islamic Banks include the following:-
a) Musharakah (Participation)
b) Musharakah Mutanagisa (Redeemable Participation)
c) Lease Purchase
d) Mudarabah (Commendam)
e) Salam Sale
f) Murabaha Sale
g) Wadeah Sale
h) Tawliyah Sale

These are some of the Islamic investment instruments which are being used by the Islamic Banks as an alternative for the conventional banking operations which conflict with the Islamic principles. Where the normal banking practices do not conflict with the Islamic principles, they are usually adopted and used by the Islamic Banks.

In the following few pages we will give a brief description of each of the above-mentioned Islamic Investment Instruments:

a) **MUSHARAKA:**

Let us start with the statement written by DR. FAHIM KHAN, describing this form of investment.

The Banks and their clients agree to join in a temporary participation (not quite different from the joint venture concept) for effecting a certain operation within an agreed period of time. Both parties contribute to the capital of the operation (taken to mean, assets, technical and managerial expertise working
capital etc.) in varying degrees and agree to divide the net profit in proportions agreed upon in advance. There is no set formula for profit-sharing and each case is dealt with on its own merits. Operations carried, according to this mode, can vary from weeks to years. In medium- and long-term operations, a self-liquidating form of participation can be agreed upon; whereby the ownership of the whole project or operation may pass to the partner (customer). The bank would have retrieved, in the meantime, an agreed share of profits. (1)

While DR. A.A. EL NAJJAR explains the Musharaka form of investment as follows:-

**Musharaka** is a system whereby the banks enters into partnership with the clients for a limited period in a project. Both the bank and the clients contribute to the capital in varying degrees and agree upon a ratio of profit fixed in advance. It is also based on the principles of diminishing participation leading to ownership by clients at the end under which the bank gives the partner the right to pay back the bank's shares either at once or in instalment paid out of part of net income of the operations. The Islamic banks have adopted this method of participation particularly in real estate business. (2)


2) DR. AL NAJJAR, A. - One hundred questions and one hundred answers concerning Islamic Banks - International Association of Islamic Banks - Cairo - 1980 - P.73.
b) **Musharaka Mutnagisa:**

This is the form of a redeemable participation. It is similar to the form of participation which has been discussed in item "a" above. The only difference between the two is that in the redeemable participation form, the bank will be a temporarily participant promising to withdraw from the project by selling its shares to the client. At the time the client promises to buy the banks shares in the project by paying the banks amounts at once or on instalments basis as the parties may mutually agree.

Dr. M. Fahim Khan stated that such procedure is also being applied to a few activities other than the investment project some of these are:-

i) **Letter of Credit** - If the importer fails to pay the full amount of the letter of credit at the time of the delivery of goods, the bank will not charge him any interest on postponing the payment and will instead, share in the profits of the importer at a ratio agreed upon in advance. Some of the Islamic Banks, however, charge nothing if the amount is paid in full at the time of the delivery.
ii) Purchase of Property or Real Estate - The bank may provide loans for such purchases on the basis of musharkah. The bank will assess the rent or annual income from the property or real estate and will share it according to the extent to which he is financing and according to the terms agreed in advance. As the client pays up the instalments of the loan, the bank's share in the income will be reduced till the whole property is transferred to the client." (1)

c) LEASE PURCHASE:

This form of investment is usually used in case of financing a real estate project. It is similar in some aspects to the redeemable participation. Dr. Sami Homoud wrote about this transaction and stated that:-

"This newly introduced investment transaction reassembles the redeemable participation with only one difference between them. That is the client, here, is a tenant while in the redeemable participation form, the client is a partner. This means that in the lease purchase, the leased property will continue to be the property of the bank until all the conditions are fulfilled i.e. rent paid in full. But one weak point here is that the banks usually charge a rent higher than the current prevailing rents for similar properties". (2)

(1) DR. KHAN, FAHIM, Money & Banking in Islam, Institute of Policy Studies, Islamabad, 1983 P-263

(2) DR. HOMOUD, SAMI - Islamic Banks Journal International Association of Islamic Banks Volume 63 - Nov. 1988 - P-44.
d) **MUDARABAH (COMMENDAM):**

This is a form of Contract where the bank pays the financing while the client contributes his efforts to manage the project. This transaction is sometimes called Qiradh. The client gets an agreed portion of the profits but he will not be subject to losses because he does not contribute to the financing of the project. The bank will bear all the financial risks while the client will only lose his efforts.

DR. ALI H.A. GADIR says about the Mudarabah contract:

"In Mudarabah, one party pays the capital while the other performs the required work. The first is called RUBUL MAL (Financer) while the other is called AL-AMIL (The Worker). The financer gives the money to the worker so that the worker can start working on the project. It is a condition that the amount of money given to the worker is known and that each party's portion of the profit should be agreed upon. The financer will get his portion of the profit for the capital which he gives to the worker while the worker will get a portion of the profit for his efforts and management of the project." (1)

---

(1) DR. ABDUL GADIR A.H. - Jurisprudence of Mudarabah International Association of Islamic Banks, Cairo - 1980 - P-12.
The Mudarabah Contract is known to be one of the old forms of dealings. It was the usual form of transaction for the Arabs before the Islam and they continued to deal in it after Islam where it was common among the Hanafi and Hanbali Islamic schools of thought.

DR. SAMI HOMOUD in one of his most reputable books wrote about commendam detailing its types, conditions, suitability, elements and origin:

"The origin of dealings on this contract dates back to the Pre-Islamic era; it is reported in the biography of the Prophet, God's prayer and peace be upon him, that he left for Damascus carrying property belonging to Mrs. Khadigea which he took in commendam; that was before his mission. During the lifetime of Prophet God's prayer and peace be upon him, the Muslims used this kind of contract; the evidence being what has been narrated from Al Abbas ben Abdil Muttalib that when he used to give property in commendam, he stipulated on the recipient not to travel with the property by sea, nor to cross a valley or purchase with it live animals and if he did he shall be held liable. Al Abbas referred to God's Messenger, God's prayer and peace be upon him, seeking his opinion; the Prophet allowed it."
It would be also inferred from what Ash Shukani quoted that the dealing in commendam continued during the time of the Companions (Sahaba); he cited what Al Imam Ash Shafi'i reported in the book "The Difference of the Iraqia" quoting Omar ben Al Kattab as saying he had given the property of an orphan in commendam. As San'ani mentioned in Al Musannaf (literary work) what Imam Ali said in regard to commendam that "the loss will be suffered by the property and the profit shall be according to the agreement." (1)

DR. S. HOMOUD goes on to describe the scope of work covered by the Murabaha:-

The views of jurists differed about the nature of the commendam as much as regards its classification within the scope of contracts; some jurists considered it to be of the same kind as rent and on the strength of that argued that it is contrary to the criterion (measure), because the rental (wage, fee, remuneration) thereof is not definite; because the active partner of a commendam partnership does not know the wage (fee, rental) he will receive, not to say that he will not get any, due to the fact that a profit has not been realized - other Jurists considered commendam to be a kind of partnership and as such it is not contrary to the criterion (measure) Views differed also as to the coverage of the work of a commendam (active) partner: whether it is confined to trading and related activities only; or does it extend beyond that as to cover such activities which would realize the intended objective, even where the same is achieved through manufacturing of the commodities or otherwise. (2)

(1) DR. HOMOUD, SAMI - Islamic Banking - Cambridge University Press - 1986, Page 197.

(2) Ibid - Page 204.
e) **SALAM SALE (POST DELIVERY SALE):**

Although it is one of the most ancient types of sale, yet we can say that it still needs to be developed to suit the modern economic systems. The salam is a sale where the payment is made in advance but the delivery of the goods is delayed to a later time. The Bank approaches the client who is normally a farmer who grows certain types of Agricultural products, agrees with him to buy his products and pays the price in advance.

DR. M. FAHIM KHAN explains this sale transaction as follows:-

"The bank buys certain goods on post delivery and pays the cost immediately or sells certain goods on post delivery and receives its cost immediately. In this sale, cost of goods is fixed and paid in advance but the delivery of the sold item is postponed or delayed upto a certain period. Similarly, the place of delivery, its expenses and quantities of the sold goods should also be fixed and defined as they are conditions for such a sale." (1)

---

DR.KHAN, FAHIM - Money and Banking in Islam
Institute of Policy Studies Islamabad
1983 - P. 264.
The purpose of paying the sale price in advance is to help the client and enable him to finance the production of the goods. The most important conditions of the salam sale is that the quantity or the weight of the goods should be specified and the date of the delivery of the good should be known.

f) **MURABAHA SALE:**

This is the most common form of investment in the Islamic Banks and Investment Companies. It is normally defined as a sale for the cost plus an agreed upon mark up. In this form of transaction, the client orders the Bank to make available for him some goods. The Bank buys the required goods and resells them to the client for a pre-determined profit. DR. MUHAMMAD A. MANNAN elaborates saying:-

"In Murabaha the bank purchases commodity for the clients and resale at a fixed mark-up or rate of profit on the stated original cost. By basing the sale's price on the original cost of the item of the seller, the customer is provided a modicum of protection against unfair exploitation. The general rule is (that money expended directly on the goods or on services indispensable to their sale (e.g. brokerage fees) may be included, whereas the personal expenses of the merchant and other expenses not directly involved with the good are not to be figured into the stated original cost on which the murabaha transaction is based. As an additional protection to the customer, the lawyers insist that the seller avoid any misleading statements. He must be scrupulous in how he designates the sum serving as the basis of the Murabaha. If he includes various expenses in this sum, he may not, directly or indirectly, lead the buyer to believe that the Murabaha is based on the purchase price, but must use some expression indicating that this is what it cost him, and not that this is what he paid for it". (1)

This will be subject to detailed discussions in the following chapters of the study.

---

(1) DR. MUHAMMAD, ABDUL MANNAN - The Making of Islamic Economic Society - International Association of Islamic Banks - 1984 - P.473.
f) **WADEAH SALE:**

It is defined as a sale for the price less than the original purchase price.

This similar to the Murabaha sale but here the goods are sold out at a discount from the initial cost. It is a condition that the initial purchase price should be disclosed to the client.

g) **TAWLIYAH SALE:**

This is also a form similar to the Murabaha sale but the goods are sold out at the cost with no mark-up or discount.

These three forms, i.e. MURABAHA, WADEAH and TAWLIYAH are known as Amana (Trust) sales because the Bank is entrusted to disclose to the client the initial cost and the profit margin which the Bank marked-up.

About Wadeah and Tawliyah sales, DR. M.A. MANNAN stated:-

"In this connection it may be mentioned that in addition to the Murabaha sale, Islamic law also discusses in great detail other two forms of sale which have as their starting point the cost of the sale's object to the seller. There are: the tawliya, resale a the state original cost with no profit or loss to the sell; the wadeea, resale at
a discount from the original cost. In its true Islamic spirit, trade operations of Islamic Banks should be expanded and they should also involve in Tawliya and Wadeea sale operations in special cases particularly when a Muslim community or region is faced with natural calamities such as droughts, famines, earthquakes.

It appears that the current operations of the local banks are mainly concerned with the quick return and self-liquidating projects. In view of the competition from interest-based banks and limited experience, expertise and finance, it is quite clear why local Islamic Banks needed to be operationalised within shortest possible time. (1)

CHAPTER II
MURABAHA CONTRACT

— WHAT IS MURABAHA
— MODERN APPLICATIONS
THE MEANING OF "MURABAHA"

The Murabaha Contract is a special form of contracts for sale of goods. Its name is derived from the Arabic word "RABIHA" which literally means "to gain profit".

To sell some goods by Murabaha means to sell them for profit i.e. that the seller has gained profit.

In the Islamic jurisprudence, Murabaha is to sell some goods for the original cost plus a profit margin.

The different Muslim Jurists have defined Murabaha in different words:

Al-Kasani defines it as follows:-

"Murabaha is a sale for the original price plus a profit". (1)

While IBN RUSHD uses other words:-

"Murabaha is a sale where the seller discloses to the buyer the price for which he bought the goods and specifies his profit per dirham or dinar". (2)

---

Al-Sharwani defined Murabaha in these words:-

"It is a sale for the price or the cost incurred plus a profit" (1).

At the same time, the famous Hanbali Jurists IBN GUDAMA said defining Murabaha:-

"The meaning of Murabaha is the sale for the cost and a specified profit margin". (2)

M. Jawad Moghnia explained Murabaha in the following words:-

"Murabaha is the opposite of Wadeah i.e. it is the sale for the cost plus a fixed profit". (3)

Mr. ATfeesh uses the following wording:-

"It is (referring to Murabaha) sale where a seller discloses to buyer the price of the goods and stipulates a fixed profit." (4)

(1) AL SHARWANI - HAWASHI TOHFAT ALO MOHTAJ - ALBABLY PRESS V-4, Page 423.

(2) ABDULLAH IBN GUDAMA - AL MOGJNI - DAR AL MANAR, CAIRO V.4, Page 259.

(3) MOGHNIA, M. JAWAD - The Jurisprudence of Imam Jaffer Al Sadiq DAR AL ELM - Beirut 1965, V-3, Page 258.

From all these definition made by different reliable Muslim Jurists and Thinkers, we may notice the following:-

a) All the definitions contained an statement that the seller is obliged to disclose to the buyer the initial cost and the profit mark-up.

b) Some of the definitions mentioned the "initial" or "original" price and the others used the term "cost". It seems that those who used the term "price" meant the purchase price only while those who used "cost" referred to the purchase price and other cost elements such as insurance, transportation etc. whether the essential element is the "price" or the "cost" is a matter of dispute and will be discussed later.

c) The profit of the seller could either be a fixed amount of money or a percentage (per dirham or dinar).

To conclude and sum up the definitions we refer to DR. A.H. Al BAALI and DR. RAFEEQ AL MASRI. DR AL BAALI said:-

"It appears from the statements of the different Jurists, that they all agree to the following points:-
i) That the purchase price should be disclosed to the buyer although the Jurists differ in their understanding to what is meant by the "price" or "cost".

ii) That there must be a fixed and determined profit margin.

Therefore we can define the Murabaha sale as "the sale of goods for the cost as per the original contract in addition to a fixed profit which should be agreed upon.

This definition comprises of four points:-

a) That the goods should be owned by the Seller at the time the Sale Contract is concluded.

b) The cost or the price of the goods should be disclosed.

c) There should be a known mark-up.

d) That this mark-up should be agreed upon.

Elimination of any of these elements leads to render the Murabaha Contract void" (1).

DR. AL BAALI - ABDUL HAMEED - The Jurisprudence of Murabaha International Association for Islamic Banks, Cairo, P-11/12.
On the other hand, DR. R. AL MASRI stated:

There are two types of sale in Islam; the Trust (Amana) Sale and the bargaining (Mosawama) sale. In bargaining sale the parties agree on the price of the goods regardless of the purchase price which the seller originally paid for the goods while the amana sale is of three types:

- Murabaha - which is the sale for the original price plus a fixed mark-up.

Wadeah - which is the sale for the original price with a fixed discount.

Tawliyah - which is the sale for the original price without discount or mark-up.

DR. AL-MASRI, RAFEEQ - Murabaha Sale for Purchase Order
A research for the Islamic Conference 1987 - P-2.
2) **LEGALITY OF MURABAHA IN ISLAMIC SHARIA:**

An established Islamic rule says that "All contracts and commercial dealings are allowed unless they clearly violate or conflict with the Sharia principles". This is only true in case of commercial dealings and does not apply in case of prayers and "IBADAT". This is an important distinction between the prayers and the commercial activities. One may ask about the proof of the legality of any of the Ibadat (prayers) but he should not ask about the proof of a commercial dealing from the Prophets sayings or from the Holy Quran.

In this regard, let us read what IBN RUSHD said:-

"The permitted sales are those contracts which the Islamic Shari'a has not clearly prohibited because God has allowed people to deal in all types of transactions except those transaction which he has prohibited". (1)

---

IMAM AL SARKHASI, M. - Al Mogadimat- Al Saada Printers, Cairo, P-539-540.
All contracts and commercial dealings could be carried out by people unless there is a clear text from the Holy Quran or the Hadith (Prophet's sayings) prohibiting them. The people at the time of the Prophet used to lease and hire, buy and sell. (1)

Therefore if one wants to know whether a commercial transaction is permitted or prohibited, he has to trace all its steps to find out if any of them involves usury or any other prohibited action.

IBN GUDAMA confirmed the legality of Murabaha saying:-

"....It is permitted in Islam and do not know that anyone said it is prohibited". (2)

(1) AL-SARKHASI, SHAMS A. - Al Mabsout, Dar Al Maarifa, Beruit, V-15, Page 74.

(2) IBN GUDAMA, A. - Al-Moghni - Dar Al Manar, V-4, Page 259.
M. JAWAD MOGHNIA stated:–

"The four types of sale i.e. Musawama, Murabaha, Tawliyah and Wadeah are appropriate, acceptable and permitted". (1).

It is clear that the Jurists, who represent different schools of Islamic thought, have all agreed that the Murabaha sale is acceptable and permitted in Islam. Some of the Jurists said that it is permitted because there is no text from the Quran or Hadith prohibiting it. Some others said that it is an appropriate and acceptable contract.

Therefore, the Muslim Jurists have approved this form of transaction.

3) **CONDITIONS FOR A PROPER MURABAHA:**

For each contract there are some conditions necessary to achieve a proper transaction. The conditions necessary for a Murabaha Contract are of two types; General Conditions and special conditions.

i) The General conditions are those conditions which apply to all types of contract and which are required in all contracts, these include:–

---

(1) MOGHNIA, MUHAMMAD JAWAD - The Jurisprudence of Imam Jaffar Al Sadiq - Dar Al Elm, Beruit 1965 V.3, Page 258.
a) That the two parties should have the legal capacity to conclude contracts.

b) There should be an offer and an unconditional acceptance.

c) There should be a valuable consideration.

d) The transaction should not involve usury.

That the subject of the contract should be legal.

ii) The special conditions include those conditions which are required for a Murabaha sale to be a proper contract. These could be summarised as stated by DR. AL BAALI:

"The Jurists have set the following conditions as the requirement for a proper Murabaha sale contract:

a) That the buyer should know the original purchase price for which the goods have been purchased."
b) That the profit should be fixed and known. It will not be acceptable if the seller says: I sell you these goods for their purchase price plus some profit". In such a case the profit margin will not be known.

c) That the original purchase contract should be proper according to the Sharia rules. If the original contract is void, then the Murabaha will not be proper because it is based on the original contract". (1)

According to DR. ABDULLAH, the conditions required for a proper Murabaha are:-

"Murabaha sale is one of the (Trust) Amana sales and the main difference between the Amana and the Musawama sales is that in the Amana sale the original purchase price should be disclosed to the buyer.

The conditions required to achieve a proper Murabaha are:-

1) That the cost of the goods should be known to the parties because the sale is based on the original cost.

(1) DR. AL BAALI, A.H. - The Jurisprudence of Murabaha, International Association of Islamic Banks Cairo, Page 37 & 56.
2) That the initial purchase contract should be a proper valid contract according to the Sharia rules because the Murabaha contract is based on the initial purchase contract.

3) That the contract should not involve usury.

4) That the seller should disclose to the buyer the defects of the goods.

5) That the seller should inform the buyer about any increase or decrease growth or otherwise in the goods.

6) That the date of payment should be known and specified if payment is deferred.

7) The contract should not involve fraud or misrepresentation. (1)

4) **THE ELEMENTS OF THE "COST"**

We have defined the Murabaha sale as a sale for the original "cost" plus an agreed mark-up. On the other hand, it has been mentioned that one of the important conditions for a proper Murabaha Contract is to disclose the original price or the "cost" of the goods to the buyer. What is meant by the "cost"? What does the cost include? This question has been answered by different Jurists and Islamic Thinkers.

IMAM AL MIRGHINANI stated:–

"The cost will include what the traders are used to include in the cost and what the commercial customs include. Everything which increases the value of the goods should be added". (1)

While DR. AL BAALI elaborates saying:–

"It will include the cost of painting embroidery, transportation because these increase the value of the goods but should not include the cost of safeguarding or storage because these do not increase the value of goods."(2)

---

(1) AL MIRGHINANI, BURHANUDDIN, AL HIDAYA - AL BABLY, Cairo, Page 50.

(2) DR. AL BAALI, A.H. - The Jurisprudence of Murabaha International Association of Islamic Banks Cairo, Page 23.
DR. ABDULLAH's opinion in this connection is stated in the following words:-

"The cost comprises of the initial purchase price plus the necessary expenses required for the property. If the seller detailed the items of the cost for the buyer and informed him about them, he may include them in the cost and, then calculate his mark up accordingly. What should considered in this regard is the common commercial practice. Every item of the cost which the prevailing commercial customs consider a part thereof, should be so treated". (1)

5) MURABAHA CONTRACT IN ISLAMIC BANKS:

The application of Murabaha in the Islamic Banks and investment companies is slightly different from the traditional form which we have discussed. The Murabaha in the Islamic Banks is a newly developed form called "Murabaha Sale to The Purchase Orderer".

This means that the client who requires to buy certain goods, approaches the Bank showing the specifications and the description of the required goods. The client promises to buy the required goods from the Bank if the latter made them available for him.

The first who developed this form of Murabaha application is Dr. Sami H. Homoud who referred to it as the "Sale based on cost plus profit to he who orders a purchase". About this sale Dr. Homoud said:-

"Therefore in order to face the matter, we are inclined to consider opening the door to a non-usury bank to assist in enabling a person to obtain the commodity needed against payment of monthly instalments or other similar arrangements; however, this line begins from the consumer not the trader.

The interpretation of this is that such a person who wishes to buy medical equipment for his newly established surgery will approach the bank with a request to buy the required equipment according to the specifications given by the physician with a promise to buy such equipment actually needed by him on the basis of resale with specification of gain (according to the percentage agreed, i.e. 2% or 3% for instance,) and will pay the price in instalments commensurate with his income.

This operation is made up of a promise to purchase and resale with specification of gain, it is not a sale by a person of something which he does not have, because the bank would not in such case be offering to sell anything; it would be receiving an order to purchase; the bank would not sell until it has acquired title to what has been ordered and which must be shown to the person who placed the order to confirm that it conforms to the specifications of the item ordered; this operation does not involve profit without liability, because the bank, in purchasing the items becomes the
owner thereof and will bear the liability for their perishing: if the items purchased sustain a defect or breakage, prior to delivery to the physician who placed the order, such damage would be the liability of the bank and not of the physician. (1)

Such a transaction comprises of two parts; The first is a promise from the client to buy and a promise from the bank to sell the goods, and the other part is the sale contract.

DR. AL MASRI describes, the transaction in the following paragraph:-

"The Murabaha sale to the orderer is a form of contract where the client approaches the bank stating his desire to buy the named goods. This is because the client does not have the money to pay the cash price while the seller will not be ready to sell him on deferred payment basis". (2)

The bank will then purchase the goods for cash and resell them to his client for a higher price in instalments". (2)

One might ask why should the client go to the bank to conclude such a contract. The answer to this question is:-

(1) DR. HOMOUD, SAMI - Islamic Banking, Arabian Information 1986, P-244

i) The client might lack professional experience in the goods and needs somebody who is expert in this regard to purchase the goods for him because he is not confident that he will be able to check the specifications of the required goods. Therefore, he will need an expertise assistance.

ii) The client might not have the required amount of money to pay the purchase price. In this case the client approaches the bank in order to finance the purchase and he usually pays the price in instalments.

ISMAIL H. MUHAMMAD stresses on the point that the bank should possess the goods before selling them.

"In all cases, the Islamic bank should own and possess the goods before selling them to the client. Such possession may take one of two forms:

- Physical possession by acquiring the goods in its own warehouses, rented warehouses or in public warehouses under its name.
Legal possession by having the documents of ownership in its name, which gives the bank the right to dispose it, and without which no one else can acquire or dispose the goods. Examples for these are the shipment documents. The idea behind the possessing and owning the goods by the bank is that the bank carries a risk resulting from this, regardless the length of the period of carrying that risk. The client has the right after buying the Murabaha goods to return them back to the bank, should any hidden defaults-existing at the time of purchase-appear after that. The bank cannot argue that the goods were bought with such defaults. (1)

It is an important point that the Bank should own the purchased goods before it is sold to the client because the Islamic Sharia rule is that nobody is allowed to sell what he does not own.

One of the best description of the Murabaha transaction as being applied in the Islamic Banks is put by DR. AL GARADAWI:

"X goes to the Islamic Bank and says: I am the owner of a Hospital specialised in heart diseases. I want to buy some sophisticated equipment from the company 'Y' in Germany but I do not have even part of its price. I do not want to deal with the usurous banks to get a loan and pay interest which is prohibited in Islam. He asks the Bank official whether they can help him buy the required equipment and the bank will benefit by getting a profit margin".

The Bank official says: Yes we can buy the required equipment with the specifications which you want from the company "Y" as desired but you should pay us a certain amount or percentage of profit.

The two parties agree to that on condition that the sale contract will not be concluded until the goods have been bought by the bank and possessed by it or by its agent.

Then the client says: Therefore, the Bank will be responsible for acquiring the goods, payment of price and transportation. The Bank will also bear the risk for the damage of good and any defect which appears therein". (1)

This statement gives a good illustration for how the banks practice this transaction.

From these it could summarised that the important elements for this form of transaction are:-

i) When the client applies to the bank for a Murabaha operation, the bank conduct studies similar to credit studies conducted by conventional banks as the client will be a debtor of the bank.

ii) When the previous investigation has shown the credit worthiness of the client for a Murabaha transaction in principle, an agreement may take place with him on the following matters:

The amount of profit which the bank adds to the cost of acquiring and providing the goods.

The amount to be paid in advance as a guarantee that the client will buy the goods when made available by the bank.

The deferred amount of the sale price of the goods subject to the Murabaha, and the timing for future payment.

What the bank may require from the client as a collateral to recur deferred payment in the maturities agreed upon.

The action to be taken in case of delay in payment of instalments in due time.

iii) The following step is that the Islamic bank purchases the goods in the determined specification and agreed upon quantities.

iv) After the Islamic bank owns the required goods and possesses it actually, either physically or legally, and after its cost has been exactly determined including related expenses, a Murabaha sale contract is signed by the bank and its client. This contract includes all terms and conditions of the transaction.
This is the way the Islamic Banks and investment companies normally apply the Murabaha sale to the purchase orderer but one can not say that all the Islamic Banks follow exactly the same procedure and the same sequence. It is true that the different banks may execute the Murabaha Contract in slightly different ways without affecting the essence of the contract. For instance, some of the Banks consider that the promise of the bank to sell, and the promise of the client to buy is a mere invitation without any binding commitment, while other banks deal with this promise as a binding commitment which creates legal consequences. (1).

Another point of difference is that some banks fix the initial price and the profit margin at the time the promise is made while some other banks do not fix the price until the time of the contract. (2).

A third point of difference is that some of the banks purchase the required goods under their names and store them in their warehouses while some bank do not purchase the goods until the client orders them.

In some cases the banks might give the client an authorisation to buy the goods for himself as an agent for the bank while some banks do not believe that this is appropriate.

This shows that the Murabaha Contract could be applied in different ways keeping the essence of the sale unaffected. The reason for this is that the different muslim schools and Economists might think in a different way regarding the details of such a contract and the way it should be executed:

(1) & (2) See appendix "I" which includes samples of Murabaha Contracts from different Islamic Banks.
"As we have already said, banking operations have certain specified objectives to be achieved; such objectives may be achieved by certain means. Entrusting a depositary, for instance, with safekeeping of money is an act aimed at reassuring the owner against theft or loss. The means to achieve the safekeeping could be through delivery of the money to the clergy of the temple, as the Sumerians used to do, or through deposit with an honest man, as the Moslems used to do in ancient times, or still by opening an account with a bank or the post office savings fund, as is being practised by contemporaries.

Although the objectives, in all cases, are the same, the means are varied; hence the importance of differentiation between the objectives and the means, when we talk about weighing banking operations according to the Shari'a (Islamic Shari'a law) principles. Where all the objectives to be achieved are acceptable to the Shari'a, the conflict of the means used to achieve such objectives does not constitute an insurmountable problem because in most fields the means are varied although the objective is the same". (1)

(1) DR. HOMOUD, SAMI - Development of Banking Activities in conformity with Islamic Principles. Dar Al Fikr Amman - 1982, P-79/80
Having discussed the Murabaha Contract in its traditional form as well as its recent form which is being applied in the Islamic Banks and Investment Companies, we sum up by referring to Dr. Al Masri's comparison of the two modes of application of Murabaha Contract:

1) "In the traditional Murabaha the goods sold are usually owned and possessed by the seller while in the modern banking Murabaha (Murabaha sale to purchase orderer) the goods are neither possessed nor owned by the Bank.

2) The traditional Murabaha involves one transaction while the modern is composed of two transactions: the promise and the contract.

3) In the traditional Murabaha the buyer may not know the price at the beginning while in the modern form, the buyer knows the price from the beginning.

4) In the traditional form the seller usually purchases the good for himself but in the modern Murabaha he purchases them only upon the request of the client.

5) In the traditional Murabaha Contract, the price payment is either deferred or in advance while in the modern form the buyer usually pays by instalments". (1)

6) **COLLATERAL IN MURABAHA CONTRACTS:**

The question of the Collateral in the Banking transactions is an important issue. What type of collateral should the bank take from the Client? Should it be a personal guarantee or a mortgage?

This question was the subject of the discussion by DR. ISMAIL H. MUHAMMAD in the following words:-

The Murabaha sale is effected upon signing the contract between the seller (the bank), and the buyer (the bank's client). As a result of deferring the payment which will be paid on one payment or on instalments - a credit/debit relationship is created between the two parties. The debit is equal to deferred payment without any additions. At this stage the problem of guaranteeing the repayment of this amount arises, also a question of whether the bank has the right to ask for collateral arises.
First we should consider that the funds used in purchasing the goods belong to owners of investment accounts. These funds were deposited in the bank for investment and to play their role in the national economy, consequently, the bank should protect these funds from loss which might result from failure of users of these funds to pay. Therefore, the bank can ask for collateral if it feels that this is the way to guarantee the repayment of the deferred amounts.

While personal guarantee could be given from a credit worthy person or an entity other than the client himself, the physical guarantee can take one or more of the following forms:

a) Murabaha goods themselves, whether they are machines, cars, or others. They could be kept in the bank's stores and the client withdraws it gradually against paying part of the amount due on him; or the machines could be pledged to the bank while the client is using them.
b) Goods other than those of the subject sale which are owned by the client to be put in the bank's stores.

c) Real estate property owned by the client or others to be mortgaged to the bank.

d) Assignment of supply contracts to the bank, where the contract proceeds are paid directly to the bank.

Some argue that Islamic Banks by their nature should not ask for collateral as they work according to the principle of profit and loss sharing and they should carry the risk.

In fact, we should differentiate between Murabaha Sale and the debt resulting from deferring part of the payment, and other operations effected by Islamic Banks which do not create debt such as Mudaraba and Musharaka.

The risk involved in the Murabaha is in the purchase period and making the goods available to the client till selling it to him, then comes the risk of failure to pay the resulting obligations. Accordingly, the bank has to protect itself by asking for collateral, because the resulting obligations is a debt that has to be repaid on specific dates". (1)

7) **PROFIT IN MURABAHA SALE:**

In a Murabaha sale the profit is normally fixed from the beginning. At the time the mutual promise is made between the bank and the client, the parties agree and fix the margin of profit which will be added to the original purchase price. In such a case the profit will be known and fixed before the sale is concluded. This might raise a question about the difference between this transaction and the interest which is charged by the conventional commercial banks on the loans. It seems that there is a proportional relationship between the amount or percentage of profit and the time fixed for payment of the price.

In this respect we refer to DR. MUHAMMAD who believes that there is a big difference between the interest on loans on one hand and the profit in the Murabaha Sale Contract:

"Regarding this point, we state that there is a big difference between interest on loans and advances and profit in Murabaha Sale. In case of Murabaha, there is an actual sale operation with all its elements i.e. there is a seller, a buyer, and goods for sale that should be owned and possessed by the seller carrying all its risk before selling it. Also, there is a profit agreed upon between the seller and the buyer. Moreover, the the buyer is fully aware of the cost incurred by the buyer to provide the goods. It is not expected that a sale operation is transacted without profit for the seller."
With respect to the point that the amount of profit is positively proportionated to the period of repayment, this is natural too. In the beginning, the period of repayment is determined in the light of the expected period through which the client can sell the Murabaha goods directly, or the products which the Murabaha goods is a component of. It is known that the longer the selling period is, the more is the profitability. (Take as an example the case of the market profit margin on commodities like heavy equipments and furniture as compared to profit margin on commodities with high rate of turn over, like foodstuffs and cigarettes). If the profit margin is not affected with the length of repayment period, then Islamic Banks may hesitate to execute longer term operations, and this means they are not functioning properly.

When the Murabaha rule is effected and the deferred amount has been calculated and the maturities are determined, then we are before a fixed liability due on the client to the bank which is not subject to any increase provided the payment is made on time. (Notice that in case of conventional banks the interest rates accrued on loans and advances extended to their clients may be changed by the central bank, and the change applies on the outstanding which have been extended in previous periods).
Also to show the difference between interest on loans and advances and profit in the Murabaha transactions, in the former case interest is calculated on daily basis, and in case of arrears a higher interest rate is charged, regardless the period of delay or its causes.

While the situation is different in case of profit in Murabaha Sale. It is true that Islamic Banks may require the client to pay compensations for the delay, but this is done under completely different principles and guidelines (this will be discussed later). (1)

We believe that this clarification given by Dr. Muhammad Shows the difference between the profit charged in the Islamic Banks and the interest paid in the case of the conventional commercial banks:

DR. AL GARADAWI has devoted a complete chapter in his book about the Murabaha to discuss this point:

"They said that the intention is to give the loan and charge the interest and that the Islamic Bank gets the "Riba". The result is the same while the form and the title are changed.

They also said that such a transaction is not a sale because the buyer only approaches the bank for the sake of getting the money and the bank only purchases the goods for the sake of reselling it to the buyer on a deferred payment basis.

We say that this is not correct and it does not reflect the facts. The bank in reality purchases the goods and this is a proper purchase but the bank purchases with the intent of selling the goods to a third party as every trader would do. It is not necessary that everyone who purchases some goods intends to use them for himself". (2)

(1) DR. MUHAMMAD, I.H. - Islamic Banks Practices in Murabaha
   A Research for the Islamic Banking Meeting

(2) DR. AL GARADAWI, YOUSSEF - Murabaha Sale to the Orderer as practiced by Islamic Banks,
   Wahba, Cairo - 1987 - P.27.
The Murabaha Contracts are being used for almost all kinds of trade transactions especially in the local and import transactions. It is the most commonly used mode of investment in the Islamic Banks. The reason for this is the apparent simplicity of the application of this form of contract on one hand and the belief that it bears lower risks than the other instruments on the other. To confirm this point we refer to Dr. Al Masri who made a table showing the percentage of Murabaha Contracts compared to the differed bank's investments.

<table>
<thead>
<tr>
<th>Bank</th>
<th>Year</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jordan Islamic Bank</td>
<td>1986</td>
<td>80</td>
</tr>
<tr>
<td>Bangladesh Islamic Bank</td>
<td>1984</td>
<td>65</td>
</tr>
<tr>
<td>Faisal Financial Corporation, Turkey</td>
<td>1986</td>
<td>94</td>
</tr>
<tr>
<td>Islamic Bank for Western Sudan</td>
<td>1984</td>
<td>54</td>
</tr>
<tr>
<td>Al Tadamon Islamic Bank, Sudan</td>
<td>1984</td>
<td>61</td>
</tr>
<tr>
<td>Qatar Islamic Bank</td>
<td>1984</td>
<td>98</td>
</tr>
</tbody>
</table>

(1) DR. AL MESRI, RAFEEQ, Murabaha Sale to Purchase Orderer
A research for the Organization of Islamic Conference - 1987, Page 5.
DR. SHAHATA shares the same opinion:-

"After the evaluation of the Islamic Banks the role of the "Murabaha Sale to the Purchase Orderer" has become greater especially in cases of deferred payment. This type of sale has proved its suitability and significance." (1).

The wide usage of this sale contract in the different Islamic Banks has given the Murabaha a great importance and made it the subject of many discussions and criticism which we will discuss in detail in the following chapter.

(1) DR. SHAHATA, SHAQI - The Practice of FAISAL ISLAMIC BANK
Page 9.

-60-
CHAPTER  III
CHALLENGE AND PROBLEMS
FACING MURABAHA CONTRACT
CHALLENGE & PROBLEMS FACING THE MURABAHA CONTRACT

INTRODUCTION:

This Chapter will be devoted to the challenge, criticism and problems facing this form of sale contract. As the form of Murabaha which is being practiced in the Islamic Banks is the sale to the purchase orderer form, the discussion will be confined to this form of transaction rather than the traditional form of Murabaha.

The Murabaha Sale to the Purchase Orderer has been the subject for long discussions and debate and has faced many problems and challenges. As we have discussed earlier this transaction is a newly developed one and therefore it still - in the opinion of many Muslim Economists - needs more development and explanation.

Dr. Homoud believes that this form of transaction has been criticised many times and in different areas of application. Let us read what Dr. Homoud said:-

"This form of transaction was not safe from criticism which was genuine and justified and sometimes and unjustified most of the time.

The justified criticism is that which relates to the defects and errors in the execution and application of the Murabaha"
as some of the Islamic Banks do not practice this transaction in the proper form and sometimes use the sale transaction to undisclose the real intention. On the other hand the unjustified criticism is seen in the groundless accusations of the Islamic Banks for the intentions. This is similar to one who accuses a person for training people to grow grapes because grapes could be used to produce alcholatic drinks". (1)

It is true - as clearly stated by Dr. Homoud that some of the criticism are unjustified, this is either because the persons who make these criticisms are unaware of the facts and the activities of the Islamic Banks specially in the field of the Murabaha Sales or because they are biased against the Islamic Banking System.

The main problem and area of criticism facing the Islamic Bank in the field of Murabaha Contracts is the question of the promise and whether it is obligatory or a mene invitation to treat and if it is obligatory, is it so considered for both the seller and the buyer? One other important problem is that the Islamic Banks normally escape the risk by using clauses which eliminate the responsibility of the bank. These problems as well as others will be discussed in this Chapter in detail.

(1) DR. HOMOUD, SAMI - Islamic Financing Instruments
Islamic Banks Magazine - Nov. 1988 - Page 45.
1) IS THE PROMISE OBLIGATORY?

As we have discussed earlier, the Murabaha Sale Contract consists of two transactions as Dr. AL BAALI stated:

"This transaction is composed of a promise to buy and a Murabaha Sale". (1)

The question which is raised in this regard is whether the promise if mutually exchanged between the buyer (the Bank) and the seller (The Client), is obligatory or not i.e. is the promise to sell considered as a commitment which the Bank is obliged to fulfil or is it a mere expression of intent which is not binding? Are the parties obliged to conclude the contract?

This point has been thoroughly discussed by the different Muslim Jurists and Economists and accordingly the different Islamic Banks are dealing with the promise in the Murabaha sale differently.

The two main ideas in regards to the promise in the Murabaha Contract are being defended by many discussions and writings.

---

(1) DR. AL BAALI, ABDUL HAMEED - The Jurisprudence of Murabaha International Association of Islamic Banks, Cairo - P-58.
DR. S. AL DHAREER, DR. A.A. ABDULLAH and DR. H. AL AMEEN lead the group who believe that the promise given by the parties is a mere expression of an intention and should not constitute an obligatory commitment. On the other side stand DR. YOUSSEF AL GARADAWI, DR. SAMI HOMOUD and others.

Now, we will explain how each group defend their stand and try to reach a conclusion:

a) THOSE WHO THINK THE PROMISE IS OBLIGATORY:

The Muslim Jurists who believe that the promise should be considered as an obligatory commitment rely on verses from the Holy Quran such as:

"O ye who believe fulfil (all) obligations". (1)

AND

"O ye who believe, why say ye that which do not? Grievously odious is it in the sight of Allah, That ye say that which ye do not". (2)

(1) QURAN SURAH (5) - Verse (1)

(2) QURAN SURAH (61) - Verse 2-3.
The great Muslim Jurist IBN HAZM also stressed on that the promise in Islam is of significant importance, he said:-

"IBN SHUBREMA said that all promises are obligatory and their fulfilment is a must". (1)

The second conference of the Kuwait Islamic Bank adopted the same opinion:-

"The Conference decided that the promise in the Murabaha sale to the purchase orderer is acceptable from the Islamic Sharia point of view provided that the risk for damage and latent defects is on the Bank.

Regarding whether the promise is obligatory or not, it is in the best interest of both the bank and the client and for the stability of commercial dealings that the promise is considered as obligatory." (2)

(1) IBN HAZM - AL MOHALA - Commercial Printing Office, Beruit V-8, Page 1125.

(2) FATAWA & RECOMMENDATIONS OF ) Second Conference of Kuwait JURISTS COMMITTEE ) Islamic Bank, 1983.
DR. AL GARADAWI said:-

"I did not find a convincing evidence which challenges the numerous proofs that the promise should be obligatory". (1)

b) THOSE WHO THINK THAT THE PROMISE IS NOT OBLIGATORY:

IMAM AL SHAFIEE said:-

"If the buyer showed the seller the goods and asked him to buy them for him and promised him that he will buy them with a profit mark-up, then the purchase is permissible and the buyer has the option either to buy or abandon the goods" (2).

Professor Al Dhareer goes in the same direction and adopts the opinion that the promise should not be dealt with as an obligatory commitment.

---

(1) DR. AL GARADAWI, YOUSSEF - Murabaha Sale to the Purchase Orderer Wahba, Cairo, 1987, P-72.

(2) IMAM AL SHAFIEI, MUHAMMAD, Al-OMM, AZHAR, Cairo 1961, V-3, P-93.
"What is being practiced in Faisal Islamic Bank, Sudan, is that the transaction is obligatory to the Bank and optional for the client who is free to buy the goods or reject them when the bank offers them while the bank is committed to sell the goods to the client if he is interested in them.

What is being practiced in Faisal Islam Bank, Sudan is preferable because if we consider that both parties are obliged to conclude the transaction and that the promise is obligatory for both parties, then the transaction is turned into a sale contract which is concluded before the bank owns the goods. The situation is not changed by having the parties conclude a new sale contract after receiving the goods". (1)

The same opinion is shared by DR. AL AMEEN who stated that:

"In the Murabaha sale, the bank purchases the goods which are marketable according to the bank's market study or upon a request submitted by one of its clients who expresses his desire to buy the goods from the bank. If the bank is convinced that such goods are marketable, and purchases them, then the bank is free to sell them either to the original purchase orderer and or to anyone else". (2)

(1) PROFESSOR AL DHAREER, SEDDIQ - Islamic Banks Magazine

(2) DR. AL AMEEN, HASSAN - Bank Deposits and their Investment in Islam, Dar Al Shorooq, Jeddah 1983 P-325.
DR. AL ASHGAR also defended the idea that the promise should not be obligatory:

"The Murabaha Sale is being applied by the Islamic banks in two ways. In the first one, the Bank and the Client agree that the bank purchases the goods and that the Client will, then, buy it from the bank on deferred payment basis where the mark-up percentage is based on the purchase price and fixed in advance i.e. if he said: if you purchase it for 100 I will buy it from you for 120, deferred payment. If this is done, then this agreement is in reality a concluded contract, a sale contract. It constitutes a contract, no doubt, even if it is called a promise.

If it is so agreed, then it is a void contract prohibited in the Islamic Sharia". (1)

Another statement which defends the opinion that the promise should not be obligatory is made by DR. A.A. ABDULLAH:-

"If we say that the promise is Judicially obligatory in the non-gratuitous contracts, which include the Murabaha sale to the purchase orderer, then we are permitting what is prohibited by Sharia because the consequences of that are:-

i) Sale of what one doesn't have;
ii) To gain profit without having the risk.
iii) A loan with an increase.
iv) It is a gharar (ignorance) sale". (1)

DR. AL MASRI is also of the opinion that the promise should never be obligatory. He believes that this is the opinion of the four main Islamic Schools of thought:-

DR. AL MASRI stated that:-

"We have decided earlier that the Murabaha Sale to the Purchase Orderer is not a newly introduced form of transaction. All the four main schools of thought have rejected the obligatory purchase for orderer". (2)

DR. AL MASRI goes on saying:-

"It is not possible to oblige the Client to buy the goods since the cost will not normally known at the time of the promise. Knowledge of the price is imperative because the consent of the parties is an essential element of the contract and consent could not be given to something unknown". (3)

(1) DR. ABDULLAH, A.A. MURABABA, Its principles, conditions and applications, Sudan Book House 1987, Page 213.

(2) DR. A. MASRI, RAFFFEQ - Murabaha Sale to the Purchase Orderer A research submitted to the Islamic Fiqh Academy - The Organisation of the Islamic Conference 1987, P-14.

(3) The Same Reference - P-17.
As we have seen some of the Muslims Jurists believe that the promise in the Murabaha Sale Contract should be dealt with as an obligatory commitment and that both the bank and the client (who orders the purchase of the goods) are obliged to conclude the sale while some other Jurists think that the parties are left unbound by their exchanged promise.

The writer is of the opinion that it is true if the promise is considered obligatory, this might lead to stability in the commercial dealings and will probably be in the interest of the banks dealing in this transaction, but we should deal with the promise as something different from the contract. If the promise from the bank to sell and from the client to buy is obligatory, then what would be the difference between the promise and the contract? An established Islamic Sharia rule is that one can not sell what he does not have (own). This is similar to the common law rule "NEMO DAT QUI NON HABET" which means that "Nobody can give a better title than what he has" "He who has not cannot give".

On the other hand, if we say that the promise is an obligatory commitment, then we are faced by a situation of a sale contract where both the payment of price and the delivery of the goods are deferred and this violates and conflicts with the Islamic Sharia rule which bans the deferment of both payment and delivery.

It is worth mentioning that the Fatwa (opinion of Islamic Jurists) of the Islamic Fiqh Academy stated that:-
The promise is usually given from one party to the contract to the other. Such promise could be considered as obligatory if there is a cause for such a promise and if the other party incurred cost as a consequence of that promise. On the other hand, the bilateral promise (simultaneously given by the bank and the client) is permissible if both parties or either of them is given the option to conclude the contract. In case neither party is given such an option, then the transaction is not permissible because the obligatory bilateral promise will then be a concluded sale contract while the seller has not owned or possessed the goods. Therefore, if we say that a bilateral exchanged promise is obligatory, then we will be violating the Islamic Sharia rule which states that "Do not sell what you do not have". (1)

Therefore, we may conclude that the promise in the Murabaha Sale Contract should be considered as a mere invitation to transact and should never be a binding obligatory commitment.

2) **IS THE COMPENSATION FOR DELAYED PAYMENT PERMISSIBLE?**

One of the main criticisms which are being faced by the Murabaha Sale Contract is that when the client could not pay the deferred payments in time, the Islamic Banks usually charge a delay compensation which is similar to the interest being charged by the conventional commercial banks.

The questions raised in this area are concerned with the nature of the compensation charged by the Islamic Banks and the difference, if any, between the compensation and the interest, DR. MUHAMMAD believes that the two cases are different:-

"The question arises when the client is late in repayment. While in conventional banks delay interest is calculated, this is not the case with Islamic Banks which do not deal in interest. Therefore, some clients do not repay on due dates which is against the bank's interest as repayment on time will enable the bank to reinvest the money and consequently will affect return on investment accounts and shareholders equity. It is not expected that Islamic Banks will keep the situation as it is, they apply various systems to penalize clients for delay repayment."
It should be noted that the concept of compensation in Islamic Banks is completely different from delay interest charged by traditional banks.

In the Murabaha sale contract there is an item which states that in case of disputes in applying the contract an arbitration should be made. The arbitration committee should be formed of a representative of the bank, a representative of the client and headed by a third neutral person specified by name in the contract or the two arbitrators appoint him.

The delay in repayment on time is violation of the Murabaha contract. Accordingly, the arbitration committee determines the compensation unless the two parties have set it before. (1)

At the same time Professor Kaseem describes the point from the view point of the Islamic Sharia:

"In the case of delay for uncontrollable reason, he may be awaited until he is solvent as stated in the Holy Quran:-

"If the debtor is in a difficulty, Grant him time, till it is easy for him to repay".

(1) DR. MUHAMMAD, ISAMIL - Islamic Banks Practices in Murabaha
This means that if he is insolvent, then wait until he is solvent.

Some of the Islamic bank's clients delay the repayment relying on the fact that Islamic banks do not charge them interest and this causes them problems. Consequently, a meeting for a group of Sharia Supervisory Boards was held to discuss this matter. They reached the conclusion that they should follow the prophet's saying which means that if the client is solvent and still refuse to repay, the creditor could defame him and present a reason to the judge to punish him.

However, because legal action is time consuming, they decided that the client who delays repayment without a justifiable reason should compensate the Islamic Bank. This compensation is equal to the profit realized by the bank in the same period i.e. the amount of compensation should be related to the return of profit realized by the bank during the delay period." (1)

It is, therefore, obvious that the delay compensation is not charged in all cases but only in cases where the client is solvent and does not pay the debt. Even when it is decided to charge the compensation, the way it is calculated is quite different i.e. the basis for reaching the amount repayable as a delay compensation is different from the basis on which the interest is calculated.

(1) PROFESSOR KASEEM, YOUSEF - Comments on Islamic Banks Practices in Murabaha from Sharia point of view - A research for the Islamic Banking Meeting, U.A.E. 1989 - Page 4-5.
In this connection it is helpful to read what DR. MUHAMMAD said:-

Despite the fact that the basis of determining the compensation of the bank is the profit foregone as a result of late repayment and that each case is a separate one some general guidelines are followed which includes:

Compensation could be calculated based on the profitability of the Murabaha operation. A question usually arises here as the compensation ties between the profit and the time period.

Compensation could be calculated based on the profitability of the Islamic Bank, because had the client repaid in time, the banks could have reinvested the funds and made profits.

Compensation could be calculated based on the returns distributed to owners of investment accounts. Although return on investment accounts is usually less than the bank's profitability, it means that the bank, in the worst case, will not lose.
The above mentioned basis of calculating the compensation are accepted and applied by some Islamic Banks. However, they are guidelines and the most important issue is that the bank is compensated for the lost opportunity resulting from the delay. A very important point to be considered is that if the client delayed the repayment because of uncontrollable reasons, the bank may release him from the compensation, further more, it could release the client from a part of the obligation depending on the situation."(1)

These are the basis of calculating the compensation in case of delay of payment by the client. As Dr. Muhammad mentioned, they are guidelines because the most important thing is that no harm or injury should result from any action and if any injury happened to any part, the aggrieved party should be compensated and the said compensation should by no means exceed the injury which took place.

3) **IS MURABAHA A SALE OF WHAT ONE DOESN'T HAVE?**

One other criticism to the Murabaha sale contract as being applied in the Islamic Banks and investment companies is that it is a sale of goods where the seller does not have or own the sold goods.

---

As mentioned earlier in this study, the Islamic rule "Do not sell what you do not have" is similar to the common law rule "NEMO DAT QUI NON HABET" which means nobody can give a better title than what he has.

The question is whether the seller in the Murabaha Contract sells out goods without having the title to them.

Dr. Al-Garadawi thinks that Murabaha doesn't involve any violation to this rule, he said:

"The Jurists who participated in the first conference of the Islamic Bank in BUBAI and in the Second Conference in Kuwait have approved that the bank sells the goods to the purchase orderer if the bank has actually owned the goods. Everything which takes place between the bank and the purchase orderer before that is just a promise and not a sale or purchase." (1)

(1) DR. AL GARADAWI, YOUSSEF - The Murabaha Sale to the Purchase Orderer as practiced by Islamic Banks, Wahaba, Cairo, 1987, Page 60.
This takes us back to the question discussed earlier and that is whether the promise is in the Murabaha Contract is obligatory or not. If we say that the promise is not an obligatory commitment, then no question regarding a sale of one does not have could be raised, but if we adopt the opinion that the promise is obligatory, then the question is valid and might create some trouble to those who believe that the promise is obligatory.

4) IS THE MURABAHA SALE TO THE PURCHASE ORDERER PERMISSIBLE IN ISLAM?

The question of permissible and prohibited transactions in Islam sometimes seems to be complicated. Unlike the case in prayers, the rule is that all commercial transactions are permissible. Dr. Al Garadawi stresses on this point:

"The reply to this objection is:-

First that it is not important in the modern transactions that we find somebody from our preceding Jurists who said that such transaction is permissible. It is not necessary to do what some of our contemporary Jurists are doing trying to apply the old forms of transactions to the modern ones so that it could be judged in the light of the old forms.

As we have stated generally all commercial dealings, especially sale, are permissible and therefore no one should ask about its legality.

Second is that we find some of our Jurists who decided that such a transaction is generally permissible although that was different in some of the details. That is AL IMAM M. AL SHAFIEI in his book AL OMM where he said:
If a man showed another the goods and said:-

Buy this for me and I will give you a profit margin of so. Then if the man bought it, the purchase is permissible and the one who said that he will give the other a profit margin is at the option either to buy or to leave it." (1)

This is the reply of Dr. Al Garadawi and now let us see what Mohsen Khan says about this point:-

"Islam permits a wide freedom of contracts, assuming that the terms of the contract are not in violation of the rules of the Shariah; in particular, it permits any arrangement based on the consent of the parties involved so long as the shares of each care contingent upon uncertain gains and the parties have symmetric information regarding the project undertaken and its outcome. This flexibility makes possible a virtually open-ended menu of various modes of financial transactions and instruments.

(1) DR. AL-GARADAWI - The Murabaha Sale to the Purchase Orderer as practiced by Islamic Banks, Wahba, Cairo 1987 Page 33.
The Shariah as well permits a variety of modes of non-interest transactions in order to facilitate financing of projects where no additional property or assets are created, such as consumer loans. These include, inter alia, non-interest loans, lease and lease-purchase agreements, instalment sales, and special future contracts, in which, even though some type of return is allowed, the return does not have the same characteristics as the conventional interest rate."

It is an established Islamic principle that all the commercial transactions are permissible unless it is proved otherwise. Therefore, we are not required to look for a proof to prove that a certain transaction is permissible according to the Islamic Sharia.

5) CAN THE BANK ESCAPE THE RISK?

A criticism to some applications of the Murabaha sale contract is that the bank inserts a clause in the sale contract eliminating any risk or responsibility by the bank for any damage or defect which appears in the goods.

(1) KHAN, MOHSIN - Monetary Policy in an Islamic Economy
A Research for the Islamic Banking Meeting, Bahrain 1990, Page 7.
The following is a clause in an Islamic Bank's Contract:-

"As the second party (the client) has specified the source of the goods and their value, type, specifications and quantities. And as the first party (the Bank) would not have gone into this deal had he not received the clear information from the Second Party. Therefore, the Second Party shall be fully liable about all the information he has given and for the safety of the goods, their properness and conformity with the specifications and the quantities without the least responsibility whatsoever on the first party". (1)

Would such a clause be acceptable from the Sharia point of view. In other words could the bank put all the responsibility and the risk on the client. DR. AL-SHABANI answers:-

"After signing, the bank authorises the client to receive the goods from the port and gives him a limited period during which the client may return the goods if not in conformity with the specifications". (2)

As have been stated, one of the most important elements of a proper Murabaha Sale is that the goods should be owned by the bank before being sold to the client. This ownership necessarily means that the risk should be on the bank. Trials which have been made to escape the risk during the period of the "transit" ownership of the goods by the bank failed because this is not permissible in the Islamic Sharia and this is what has been stated by DR. ABDULLAH:-

(1) See the Appendix - Contract Forms
(2) DR. AL SHABANI, MUHAMMAD - Riba - Free Commercial Banks
Aalam A Kutub, Riyadh 1987 P-253

-83-
"This sale is not a sale without a risk because the risk during the period from time the goods are purchased till the time it is offered to the client falls on the Bank which owns the goods" (1).

The same opinion is confirmed by Dr. Homoud who stated:

"This operation is made up of a promise to purchase and a resale with specification of gain, it is not a sale by a person of something which he does not have, because the bank would not in such case be offering to sell anything; it would be receiving an order to purchase; the bank would not sell until it has acquired title to what has been ordered and which must be shown to the person who placed the order to confirm that it conforms to the specifications of the item ordered; this operation does not involve profit without liability, because the bank, in purchasing the items becomes the owner thereof and will bear the liability for their perishing; if the items purchased

(1) DR. ABDULLAH, A. ALI - Murabaha, Its principles, conditions and applications - Sudan Book House, 1987, P-175.
sustain a defect or breakage, prior to delivery to the physician who placed the order, such damage would be the liability of the bank and not of the physician (the client)." (1).

The same result was reached by the Muslim Jurists in the Islamic Fiqh Academy where it was found that:-

"The Murabaha Sale to the Purchase Orderer if concluded after the title to the goods is transferred to the Seller and possessed by him, it is a permissible sale provided that the seller is responsible for any damage before the delivery of the goods as well as being liable for latent defects and that all the conditions for proper sale are fulfilled". (2)

6) IS MURABAHA A FICTICIOUS SALE?

The Murabaha Sale Contract has been described as a contract where the sale is not the intention of the parties. The question has been put by DR. AL GARADAWI in the following words:-

(1) DR. HOMOUD, SAMI - Islamic Banking - Arabian Information 1984, Page 244.

"They said that the whole transaction is intended to get the money which the client used to get from the commercial usurious bank. The result is the same although the mode is different." (1)

In these words DR. AL GARADAWI explains the problem then he goes on to give the answer and said:

"We say that this is not true. The bank really buys the good but it is buying with the intention of selling them to a third party. This is exactly what traders do. It is not necessary for a sale to be permissible that one should buy goods only for his personal use". (2)

Could the Murabaha Sale Contract be considered not a genuine contract just because the bank does not intended buy the goods for its personal use?

It is not true that the intention of the bank to sell the goods to the client renders this contract to a usurious contract. What is essential is whether the "sale" is real or ficticious. It seems that this contract is a real sale contract, the goods are purchased by the bank and the title passes to the bank with all consequences and after that the bank sells the goods to the client.

(1) & (2) DR. AL GARADAWI, YOUSSEF - Murabaha Sale to Purchase Orderer as Practiced in Islamic Banks, Wahba, Cairo 1987, Page 27.
7) **IS IT POSSIBLE TO IMPORT THE GOODS IN THE NAME OF THE CLIENT?**

We have described the Murabaha Sale as being applied in the Islamic Banks and have seen that in many cases the bank imports the required goods from outside the country. The conditions set by the Muslim Jurists for a proper Murabaha Contract state that the goods should be purchased by the bank, owned and possessed by it before selling them to the client.

The question, now is that "Could the bank order the goods directly in the name of the client? Is it possible for the bank to make it short by directly transferring the title to the goods to the client instead of going a long way having the goods owned by the bank and then sold to the client?

This is another way which might be followed in some of the Islamic Banks to escape the responsibility and eliminate the risk.

We believe that such a practice is not acceptable from the Sharia point of view because the seller in such a case will be violating the Sharia rules which prohibits the interest. In case the goods are sold directly from their source to the client while the bank pays the cost without purchasing the goods, then this a mere usurious loan. No goods are involved, no risk is borne by the bank and at the same time the bank charges the client more than what the bank has paid to the source of the goods.
One of the Murabaha Contract contained the following clause:-

"As the goods have been already ordered from their sources to be shipped in the name of _________(the client) and as he is the only one entitled to receive the said goods and clear them from the customs, therefore, the client shall inform the bank immediately after the arrival of the goods so that the sale contract could be concluded." (1)

Such a clause should not be contained in any Contract of Sale and the banks and the investment companies should purchase the goods for themselves and under their names before selling them to the clients.

8) **CAN THE CLIENT ACT AS AN AGENT TO THE BANK?**

It has been discussed that the bank will not be able to purchase the goods in the name of the client because the goods must first be owned by the bank and then sold to the client, but can the client act as an agent for the bank to purchase the goods from their source and then resell them to himself or a third party? Some banks have followed such arrangements in order that the client will be responsible for the purchase of the goods and liable for any defects in them although the goods are purchased in the name of the bank.

(1) Company "B" - Contract Form - See Appendix
If the client acts as an agent for the bank to purchase the goods, this is permissible. If the client acts as an agent purchases the goods for the bank and sells them to a third party, it is also permissible. This is confirmed by AL SHEIKH BADR AL MOTWALI when he was asked about such a case.

**Question:**

What is the opinion in the case where we (the bank) purchase cars from somebody and appoint him as a paid agent to sell these cars to the public provided that the agent is held responsible, as a warrantor - for any possible defect in the goods during a certain period of time.

At the same time the agent will act as a surety for any third party who purchases the cases.

**Answer:**

Such cases have been the subject of dispute between the Muslim Jurists. The Hanafi School believes that this is a sale and a condition and therefore not permissible. In their opinion the sale is void and the condition is void as well.
On the other hand IBN SHUBERMA said that such a sale is 
permissible and the condition is permissible as well---
-------------. Therefore, if we look at the 
condition contained in the question independently, we 
will find that it a legal condition from the Islamic 
Sharia point of view, and as IBN SHUBREMA's opinion 
opens the door for some transactions which have 
prevailed among the people and because prohibiting such 
transactions might create troubles. Therefore, I am 
satisfied to the opinion that such a transaction is 
permissible". (1)

On the other hand it is not possible for the Bank to 
appoint the client as an agent to purchase the goods 
and sells them for himself because in this case, at the 
stage where the goods are being sold to the client, the 
client will be acting for both parties of the sale 
contract. i.e. for the bank being an agent and for 
himself being the buyer of the goods. This case seems 
to be a trial from the bank to escape the 
responsibility for the good during the period of the 
transit ownership.

9) **COULD THE SALE BE STARTED AS AN AMANA SALE** 
**AND COMPLETED AS A MUSAWAMA SALE?**

We have discussed and explained the two types of sale 
i.e. the Amana (trust) sale where the seller is 
obliged to disclose to the buyer the cost of the 
purchased goods and the Musawama (bargaining) sale 
where the seller is not obliged to disclose the 
purchase price for which he has bought the goods.

(1) SHEIKH AL MOTWALI, BADR - A Guide to the Legal Fatwa in Banking 
The Murabaha is an Amana (trust) sale and therefore the bank must inform the client about the purchase price of the goods.

It has been noticed in some Islamic Banks that the client orders the required goods describing their quantities and specifications and he promises the bank to buy them while the bank promises to sell them to the client. The parties adopt the opinion that the exchanged promise is obligatory and that both parties are obliged to conclude the sale contract when the goods arrive.

In the other part of the transaction, i.e. the Sale Contract, the parties forget about the promise and the Murabaha and start a new transaction which is a Musawama Sale. As a consequence for this, the bank will be under no obligation to disclose the goods purchase price to the buyer.

In such a case the parties will be taking a part of the Murabaha Sale (The promise to sell and buy) and another part from the Musawama Sale (The undisclosure of the purchase price). This is called in Islamic Sharia "Talfeeq" which literally means taking parts from one transaction and other parts from another transaction. Each part might be permissible within the frame of the concerned transaction but might not be permissible if put together.

This point is clearly explained by DR. AL MASRI:-

"If Talfeeq becomes common in a period and a place then controls should be put otherwise many prohibited acts will gradually turn into permissible acts."
It is known in the Islamic Sharia that it is possible that two acts could be combined where each of them is permissible if independently used but putting them together in one transaction will not be permissible. For instance the loan is permissible if independent from any other transaction and the sale is also permissible but it is not allowed to combine the sale and the loan in one transaction because this combination leads to a prohibited transaction which is to take the benefit of the loan from the profit of the sale" (1).

10) **IS IT ACCEPTABLE TO OFFER TWO PRICES FOR THE CLIENT, ONE FOR CASH PAYMENT AND THE OTHER FOR PAYMENT BY INSTALMENTS?**

This is one of the problems which arise in the Islamic Banks. The question is often raised because the banks usually sell the goods to the client who pays the price by instalments which is normally higher than the cash payment price.

Is it allowed in the Islamic Sharia to fix two prices for the same goods?

To answer this question we have to revert to the different Muslim Jurists and see what they say about this case.

AL KASANI reported that:-

"If the seller said, buy this item for 1,000 Derham and pay after one year OR for 2,500 Derham and pay after two years, the sale will not be permissible". (2)

---


(2) AL KASANI, A. - BADAI AL SANAYI- DAR AL KETAB AL ARABI, BERUIT. 1982, V-5, Page 157-158.
IBN RUSHD said in this regard:-

"If the seller said, I will sell you this Thobe (dress) for so much cash or so much in instalments, then the sale is prohibited". (1)

The same opinion is shared by IBN HAGAR who stated:-

"If he said I will sell you for 1000 cash or 2000 for one year and accept the price which you want or the price which I want, then the sale is not permissible." (2)

As we have seen, the Muslim Jurists have prohibited the form of sale where the seller offers two prices. The reason for this prohibition is that at the time of the contract, the price was not determined and agreed upon by the parties and consequently the buyer did not know how much he had to pay as a price for the purchased goods.

It is true that such sale is not permissible according to the Sharia principles, but is this the case in the modern applications of the Murabaha Sale Contract?

If we go back to check how the Islamic Banks apply this form of contract, we may be able to see that the difference between the two cases is clear.

(1) IBN RUSHD, M. - Bidayat Al Mujtahid - Al Bably, Cairo, V-2, P-111/116

(2) IBN HAGAR, A. - Tuhfatul Muhtaj, V-4, Page 294.
The prohibition is mainly because the price was unknown at the time the contract was concluded. This is what is called in Islamic Sharia "AL GHARAR" (which literally means ignorance) but the practice in the Islamic Banks is quite different because at the time the contract is concluded the two parties do agree on the purchase price. It is true that the bank usually fixes two prices one for the cash payment and the other for payment by instalments but at the time the client comes, and sits to discuss the terms of the contract, the two parties usually agree on either of the two prices. By doing so there will be no Gharar.

If the Bankers made their calculations and fixed a price for cash payment and another for instalments and sat with the client, explained to him the situation, offered the two price offers and the client agreed and took delivery of the goods without giving his acceptance to either of the price offers, then the contract of sale is not acceptable according to the Islamic Sharia rules.

But, if at the time of the conclusion of the sale contract, the client accepted one of the offers and received the goods then -in this case - the contract is not prohibited.

The Islamic Banks usually adopt the acceptable mode of transaction by having the client chose either to pay in instalments or in cash and the choice is left open for him to decide before concluding the contract but not after that.
The distinction between the two cases is made clear in the following statements by DR. AHMAD A. ABDULLAH:

"Some of the Economists asked about the reason that the Prophet prohibited this legal form of transaction. It is clear that if the buyer does not decide and accept one of the offers made by the seller at the time of the contract, then he might make his acceptance later. If the buyer accepts one of the offers later, then at that time, there will be no difference between the two cases (i.e. whether he conveyed his acceptance before or after the conclusion of the contract)........

The prohibition of this transaction is because of the general rule of Sharia that prohibits "Gharar" which is the ignorance of either or both contract parties of a material issue of the contract. This ignorance will probably lead to conflicts and disputes between the parties"(1).

To conclude, we state that the usual practice of the Islamic Bank does not amount to usury because the Banks, usually, have the client decides on the way he says the price before the conclusion of the sale contract and by so doing there will be no "Gharar".

— SUMMARY

— RECOMMENDATIONS & CONCLUSION
1) **SUMMARY:**

The Islamic Banking and Investment System is based on the elimination or usury (Riba). Therefore, the Islamic Banking System have to dispense with all interest (usury) related investment instruments and adopt other instruments which do not conflict with the Islamic Sharia principles.

The Islamic Banks have adopted some profit-sharing modes of investment.

We have discussed in this study the issue of Islamic Banking, how they were established, the purpose of such banks, how they operate and the difference between the Islamic Banks and the conventional banks.

In order to have the tools which enables them to operate in a way compatible with the Islamic Rules, the Muslim Economists and Jurists began to think about having institution through which they could develope investment instruments which conform with the Islamic Sharia Rules without dealing in usury. This mission seemed to be a very difficult and challanging one because the Islamic Banks and Investment Companies had to fight to have a foot in the modern investment markets and compete with the conventional commercial banks.
The Riba (Usury) was discussed in detail and defined as the Muslim Jurists did. It has been explained that there are two types of usury.

a) The Delay Usury - which is the type of the pre-islamic period. It is a delayed loan with a conditional increase in return for the delayed payment.

b) The favour usury which is usually practiced when one trades some goods for other goods of the same kind with an increase on one side.

Why is Riba prohibited in Islam is a question which many Muslim Jurists thought about but very few were able to state the reasons for this prohibition:-

The three Imams (Ahmad, Malik and Shaf'i) have agreed explicitly that the cause in the case of gold and silver is their being a kind of valuation.

The three Imams (Abu Hanifa, Ahmad and Shaf'i of old) have agreed that the cause in the case of wheat, barley, dates and salt is the weight or measure provided, according to Shaf'i and Ahmad, they are provisions.
Imam Abu Hanifa singly - apart from the three Imams - considers the cause in the case of gold and silver in the weight, not in valuation. He considers the cause in the case of wheat, barley, dates and salt the measurement together with unity of kind in all.

Imam Malik singly considers the cause in the case of wheat, barley, dates and salt their being provisions and can be saved up together with unity of kind.

Shaf'i of recent singly considers the cause in the case of wheat, barely, dates and salt their being provisions only without stipulation upon measurement or anything else, except unity of kind. (1)

The QURAN and the SUNA (Prophet's sayings) do not provide a detailed explanation and justification for the prohibition against interest beyond asserting, axiomatically, that charging interest is an act of injustice. Contemporary Muslim scholars, particularly the Economists among them, have provided various rationales for this prohibition by appealing to the supposedly adverse consequences of the existence of interest in modern societies, or by asserting that interest is exploitive, or by arguing that modern economic theory has not provided justification for the existence or even the necessity of interest rates. A further explanation can be based on the notion and concept of property rights in Islamic.

(1) DR. AL INANI, HASSAN - The Cause of Prohibition of Usury, International Institute for Islamic Banks Page-33-34.
At least four characteristics define the prohibited interest rate: (1) it is positive and fixed ex-ante; (2) it is tied to the time period and the amount of the loan; (3) its payment is guaranteed regardless of the outcome or the purposes for which the principle was borrowed; and (4) the state apparatus sanctions and enforces its collection. To understand the rationale for the prohibition against charging interest, one must consider Islam's position on property rights. Islam recognizes two types of individual claims to property: (a) the property rights that are a result of the combination of individual's labour and natural resources, and (b) the property that is obtained through exchange, remittances of what Islam recognizes as the rights of those less able to utilize the resources to which they are entitled, outrights grants, and inheritance.

Islam permits a wide freedom of contracts, assuming that the terms of the contract are not in violation of the rules of the Shariah; in particular, it permits any arrangement based on the consent of the parties involved so long as the shares of each are contingent upon uncertain gains and the parties have symmetric information regarding the project undertaken and its outcome. This flexibility makes possible a virtually open ended menu of various modes of financial transactions and instruments.

The sharing of risks and uncertainties of the enterprise is an extremely important characteristic of Islam financial contracts, since the Shariah condemns even a guarantee by the working partner to restore the invested funds intact, not only because it removes the element of uncertainty needed to legitimate the agreed distribution of expected profits, but also because the lender will not be renumerated to the extent of the productivity of his financial capital in the resulting profit. (1)

(1) KHAN, MOHSIN - Monetary Policy in an Islamic Economy, A Research for the Islamic Banking Meeting, Bahrain '90
The proposed Islamic Banking System which is meant to be used in the Islamic Banks, is a non-interest system. Therefore, the Islamic Economists had to develop instruments and modes of investment which conform with the Islamic principles whether such instruments were used in the conventional commercial banks or not. This is why it is apparent that some of the operations of the Islamic Bank look similar to those of the Conventional Banks.

The most common investment instruments in the Islamic Banks include:-

- MUSHARAKA
- LEASE PURCHASE
- MUDARABA
- SALAM SALE
- MURABAHA

These are some of the Islamic investment instruments which are being used by the Islamic Banks as an alternative for the Conventional Banking operations which conflict with the Islamic principles. Where the normal banking practices do not conflict with the Islamic principles, they are usually adopted and used by the Islamic Banks.
1) **Musharaka:**

This means equity participation and it is one of the widely used modes of transaction.

It is a system whereby the banks enter into partnership with the clients for a limited period in a project. Both the bank and the clients contribute to the capital in varying degrees and agree upon a ratio of profit fixed in advance. It is also based on the principles of diminishing participation leading to ownership by clients at the end under which the bank gives the partner the right to pay back the bank's shares either at once or in instalments paid out of a part of net income of the operations. The Islamic banks have adopted this method of participation particularly in real estate business.

There is another form of Musharaka called the redeemable participation (Musharaka Mutanagisa). It is similar to Musharaka but the difference between the two is that in the redeemable participation form the bank will be a temporarily participant promising to withdraw from the project by selling its shares to the client. At the time the client promises to buy the banks shares in the project by paying the banks amounts at once or on instalment basis as the parties may mutually agree.
2) **LEASE PURCHASE:**

Which is a newly developed form of transaction. It is a form normally being applied in the case of real estate investments. This form of transaction resembles the redeemable participation with only one difference between them. That is the client, here, is a tenant while in the redeemable participation from the client is a partner. This means that in the lease purchase, the leased property will continue to be the property of the bank until all the conditions are fulfilled i.e. rent paid in full. But one weak point here is that the banks usually charge a rent right than the current prevailing rents for similar properties.

3) **MUDARABA:**

This is a form of contract where the bank pays the financing while the client contributes his efforts to manage the project. This transaction is sometimes called Qiradh. The client gets an agreed portion of the profits but he will not be subject to losses because he does not contribute to the financing of the project. The bank will bear all the financial risks while the client will only lose his efforts.

4) **SALAM SALE:**

Although this is one of the most ancient types of sale, yet we can say that it still needs to be developed to suit the modern economic systems.
The Salam is a sale where the payment is made in advance but the delivery of the goods is delayed to a later time. The Bank approaches the client who is normally a farmer who grows certain types of Agricultural products, agrees with him to buy his products and pays the price in advance.

The purpose of paying the sale price in advance is to help the client and enable him to finance the production of the goods. The most important conditions of the salam sale is that the quantity or the weight of the goods should be specified and the date of the delivery of the goods should be known.

5) **MURABAHA:**

The Muslim Economists explain Murabaha as the sale where the Islamic Bank purchases commodity for the clients and resale at a fixed mark-up or rate of profit on the **stated original cost**. By basing the sale’s price on the original cost of the item of the seller, the customer is provided a modicum of protection against unfair exploitation. The general rule is (that money expended directly on the goods or on services indispensable to their sale (e.g., brokerage fees) may be included, whereas the personal expenses of the merchant and other expenses not directly involved with the goods are not to be figured into the stated original cost on which the Murabaha transaction is based.
There are of course other Islamic instruments being applied in the Islamic Banks and Investment Companies. The most common instruments have been discussed in detail in this research. We are mainly concerned in this study with the Murabaha Sale Contract which is one of the most popular modes of transaction in the Islamic Banks and Investment Companies. It is an Amana sale which is distinguished from the Musawama sale by that in the Amana Sale the buyer is under an obligation to disclose to the seller the cost of the goods. Amana Sales consist of the following main types:-

- MURABAHA
- TAWLIYAH
- WADEAH

The Murabaha is defined as a sale for the purchase price and a mark-up.

Tawliyah is the sale for the purchase price with no mark-up.

Wadeah is the sale for a price less than the original purchase price.

In all these cases of the Amana Sale the seller (the bank) is obliged to inform the buyer (the client) about the original purchase price and all other costs he had incurred and agree with the client about the profit margin he wants to mark. The case is not so in the Musawama Sale which literally means "Sale by bargaining. In this type of sale the seller is under no obligation to disclose to the buyer neither the original purchase price nor the other cost and expenses which he incurred.
Murabaha Sale as defined in Islamic Jurisprudence is a sale with a mark-up over the original purchase price.

There are some conditions which need to be fulfilled in order to have a proper form of Murabaha. The main conditions of Murabaha are:

1) The Purchase price and all related costs should be disclosed to the buyer.

2) The parties should agree on the profit.

3) The original purchase contract should be a genuine and proper contract.

4) The transaction should not involve usury.

For a Murabaha Sale of goods to be a proper contract according to the Islamic Sharia Rules, all these conditions must be fulfilled.

Is this the form normally applied in the Modern Islamic Banks and Investment Companies?

Is the Murabaha Contract being applied in the exact way which has been discussed and explained by the early Muslim Jurists and thinkers?

To have an answer to this question we have discussed in this research how Murabaha is being applied in the Islamic Banks of today and showed the difference between the old Murabaha and the Modern application which have been called "Murabaha Sale to the Purchase Orderer" or as DR. SAMI HOMOUD has called it "The Sale based on cost plus profit to he who renders a purchase".
The Murabaha Sale in Islamic Banks is made to the one who ordered the purchase of the goods. This means that the bank's client, who is in need of a certain commodity whether for trading in it or for use in the operations, applies to the bank stating the specifications and quantities of the commodity. He should also show his willingness to purchase the commodity, if the bank made it available for him in the same quantity and specifications he specified. It is clear that in such a case the payment of the price will be deferred and paid either at one payment or on instalments.

In fact, we are facing a compound operation that is composed of two parts:-

1) The Murabaha Sale at a specified price to be paid later.

2) The collection of the deferred payments resulting from the sale.

In other words, one can say that a debt on the buyer will result from the Murabaha Sale which should be settled on due dates. Therefore, the bank has to conduct credit studies before effecting the operation in order to examine the client's ability to repay on due dates. The bank has also to make sure that his client will buy the commodity when the bank makes it available.
The main differences between the traditional form of Murabaha and the modern form could be summarised as follows:-

1) In the traditional Murabaha the goods are normally owned and possessed by the seller but in the modern form the goods are not owned by the bank until the client orders them.

2) The traditional Murabaha consists of one transaction while the modern form consists of two transactions: a promise and a sale.

3) In the traditional form the price of the goods is known from the beginning but in the modern form the price might not be known at the beginning because the goods were not purchased at that time.

4) In the traditional form of Murabaha, the seller normally purchases the goods with the intention of using them for himself while in the modern Murabaha the goods are only purchased in order to be re-sold to the client who have ordered them.
5) In the traditional Murabaha the price is either cash or deferred while in the modern form the price is normally deferred.

6) The profit in the traditional form of Murabaha is usually paid in consideration for the seller's time, efforts and risk while in the modern form the profit is usually paid in consideration for the deferred payment.

This modern form of the Murabaha transaction is usually being applied in cases where the client lacks the experience in such dealings or where the client is looking for a deferred payment sale contract.

The Murabaha Sale Contract as being applied in the Islamic Banks has been the subject for criticism by many Muslim Jurists and Economists.

The main problem in this regard is the question of the obligatory promise.

This question has been discussed in detail in Chapter three of this study. After discussing the different opinions of the Muslim Jurists, it has been concluded that the promise should be dealt with as a mere expression of the intents of the parties and should never be considered as an obligatory commitment because in such case we will be faced by a concluded sale contract while the goods are not yet in the ownership of the buyer, a practice which is not permissible in the Islamic Sharia.
Some other problems facing the modern applications of Murabaha relate to the following points:

1) That Murabaha is a type of sale which was not known at the early days of Islam.

   It has been explained that it is a permissible type of contract and that it is not required to prove that a commercial transaction is permissible because the rule is that all commercial dealings are permissible unless the contrary is proved.

2) That the sale of Murabaha is a fictitious sale and that the transaction involves undisclosed usury.

3) The question of the bank escaping the risk has also been discussed and the opinion of the Muslim thinkers was explained showing that the bank being the seller, should own and possess them before selling them to the client.

In all cases, the islamic bank should own and possess the goods before selling them to the client. Such possession may take one of two forms:
4) The question relating to the deferred payment has been highlighted and the difference between the price in the Murabaha Sale and the interest in the Conventional Commercial Banks was discussed.

There is a lot of arguments about profit which is calculated in the Murabaha sale transactions. Some would like to link between this and the interests charged by the conventional banks on the loans and advances extended by them to their clients. They tend to make the link, as there is a proportional relationship between the amount of profit and the period of time through, or at the end of which, the deferred amount is to be paid. Some even say that the profit in case of Murabaha is in fact an interest but named differently.

Regarding this point, we have stated that there is a big difference between interest on loans and advances and profit in Murabaha sale. In case of Murabaha, there is an actual sale operation with all its elements.
Also to show the difference between interest on loans and advances and profit in the Murabaha transactions, in the former case interest is calculated on daily bases, and in case of arrears a higher interest rate is charged, regardless the period of delay or its causes. While the situation is different in case of profit in Murabaha sale. It is true that Islamic Banks may require the client to pay compensations for the delay, but this is done under completely different principles and guide lines.

The discussion of these questions and criticisms revealed that the Murabaha Sale Contract as being applied in the modern Islamic Banks and Investment Companies needs development and attention to the implementations of the basic principles. This will elaborated later when we make the recommendations.
2) FINDINGS & RECOMMENDATIONS:

As discussed in the Research the Islamic Banking and Investment System, although has become a reality, yet it still needs adaptation and development. Much work needs to be done in different areas of the Islamic System in general in the area of Murabaha in particular.

We will highlight the areas which in the opinion of the author - need attention in the course of developing the system of the Islamic Banking and the application of Murabaha Contract.

2.1 DEVELOPMENT OF THE ISLAMIC BANKING SYSTEM:

2.1.1 The officials who work in the Islamic Banks should be well acquainted with the banking activities. The Bank personnel are the tools which operate the system and if they are not high level personnel, then how would one expect to reach an acceptable performance level?

On the other hand, the Islamic Banks staff should also be aware of the Islamic Banking System and its investment instruments.

Having personnel who are well acquainted with the conventional banking system as well as the newly developed Islamic investment instruments is a must in order to achieve a proper application of the Islamic System. It is not enough for the Islamic Banks staff to be aware only about the Islamic Investment instruments because the Conventional Commercial Banking System is the base for any banking system.

2.1.2 It is necessary to have the personnel well acquainted with the banking system but they should also have the content in the Islamic instruments and modes of investment. Without such content the application of the Islamic modes and instruments will be a mission impossible.
2.1.3 The banking trade is always developing and the investment markets are continuously changing. Therefore, the Islamic Banks should continuously train their staff about all modern applications and systems. This training is deemed to be necessary for all the key staff in all times so that the staff will be aware about every development in the trade.

2.1.4 As we have discussed the Islamic investment forms of transaction are newly developed. Although some of them were known at the early days of Islam, yet some adaptations and modifications were made on them. This gives the indication that other investment instruments and forms of transaction could be introduced and developed. In the author's opinion the need is still there to develop other forms and the possibility is also there.

2.1.5 Some of the forms which need development are the Salam Sale and the Istisn'a Contract. These forms could be applied to finance the future production but in some cases they are not used in a proper way and are used by some banks to veil injustice which is caused to the farmers from whom the bank buys the future products for a cheap unfair price. The Salam Sale has a very important Role in the development of the Islamic Communities if it is used properly and if the proper conditions and controls are applied.
On the other hand the Istisn'a Contract is a form where somebody asks a Craftsman to make something for him e.g. the Carpenter to make a desk. The payment of the price could be in advance or deferred.

This is again a form of transaction which could be used to finance, future production and in the author's opinion, the Muslim Communities badly need such forms which make great contribution to the welfare of the community.

2.1.6 The Mudaraba Contract (Commendam) is a form not widely used. This form could be utilized in financing small investors such as Merchants, Carpenters, Physicians and Engineers. The Mudaraba mode of investment transaction could change the worker into a partner, therefore he might have a percentage of the profits of the project which he managed. Mudaraba is used in the Islamic Banks but cautiously it is a risky form unless the active partner is carefully chosen.

Mudaraba could certainly be a good addition to the efforts against unemployment because many of the craftsmen who could not afford to maintain their own workshops, could be financed by the Mudaraba form of contracts.
On the other hand, the Islamic Banks could use the "Collective Commdendâm" which involves three groups. The first group is the investors who provide the funds. These are not necessarily big funds providers but could be the small money depositors who deal with the bank. The second group is represented by the bank which acts as an intermediary between the investors and the active partners. The third group include all the active partners who receive the money from the bank and invest it. This form of investment requires development and needs to be widely used.

2.1.7 The application of the Islamic modes of investment always requires that experts look into it to check whether it conforms with the principles of the Islamic Sharia or not. This is the reason why almost all Islamic Banks have Boards of Control which review the bank's transaction and contracts to ensure that they are all proper from the Sharia point of view.

These Boards of Control play an active role in the activities of the Banks and it is thought that they need to be supported and strengthened by the the best experts and Jurists. The members of these Board might need to be trained on the banking operations so that they could be acquainted with the development in the banking practices.

2.1.8 The bank officials normally use forms of contracts which are approved by the Boards of Control but sometimes it is not enough to have an approved form of contract, but it also necessary to check every single transaction because it might happen that the contract form is proper but the application of the details are not proper.
Therefore, the bank officials and executives should refer to the Board of Control in all transactions and applications to eliminate the possibility of unpermissible dealings.

2.1.9 The Islamic Banking System could not be independent of the surrounding laws and monetary systems.

In some Islamic countries, the banking system and the monetary control regulations hinder the expansion and development of the Islamic Banking System. The author deems it necessary to amend some of the laws in order to make it possible for the banks to expand and use more Islamic investment tools. One example is that many Islamic countries do not have "transit ownership" arrangements which could have been used in cases of Murabaha Sale to the Purchase Orderer.

2.2. DEVELOPMENT OF THE APPLICATIONS OF MURABAHA:

2.2.1 In the author's opinion the promise in the Murabaha Contract should not be considered as a binding commitment. If it is treated as obligatory, then the transaction will involve a violation of the principles of the Islamic Sharia. Therefore, to eliminate this violation the exchanged promise should be dealt with as a mere epress of intentions.

2.2.2 If the promise is not obligatory, then the client can revoke his promise to buy the goods. In this case, the bank will have to look for another buyer for the goods. To avoid such a situation, which might be critical, the bank, before purchasing the goods should make thorough
studies for the markets to find out whether the concerned goods are marketable or not. The bank has to avoid purchasing goods which could not be sold out in the market easily such as the highly specialised equipment and products.

For those specialised equipment which are difficult to be marketed. The Murabaha is not the appropriate form of transaction. In such case Musharaka seems to be the most suitable form of contract.

2.2.3 Before financing any purchase for the client, the bank should study and question the creditability of the client especially in cases of deferred payment sale contracts. This could eliminate the risk of default in payment by the client.

2.2.4 Another guarantee for the client's payment of the contract value is that the bank should not deal with any new client in big amounts but should start with small contracts and when the bank is sure that the client is worthy of bigger amounts, then gradually the contracts value could be increased.

2.2.5 In deferred payment contracts, the bank may ask the client for a collateral as a guarantee for the repayment of the sale price. This collateral could be a personal guarantee if the client is credit worthy or it could be mortagage of a real estate property. The nature and value of the collateral vary from cases to case and depend on the evaluation of the bank for the client and his credit worthiness but in all cases the collateral given by the client should be enough to cover the contract value.
2.2.6 As Murabaha is a form where the bank purchases the goods and resells them to the client, therefore, the ownership of the goods by the bank should be real ownership with all its consequences. This means the risk should be on the bank and no clause in the sale contract should stipulate that the risk is on the client. Such clauses eliminating the Banks Risk violate the principles of the Islamic Sharia.

2.2.7 In case the client delays repayment of the sale price, the bank has to see whether the client is insolvent, then the bank has to wait and give him a chance to pay. If the client is solvent, then the bank should be compensated for the delay in payment. In calculating the compensation, the bank should consider the actual injury rather than applying a delay fine on the client. The idea of compensation is that it is a remedy for the injury which took place and therefore it should not be exaggerated. It should also be considered that a sale contract could never be renewed because it is a contract which causes the transfer of the property in the goods to the buyer. The attempt to renew a Murabaha Contract in case of the default of the client, is a plain attempt to involve usury.

2.2.8 In deciding the sale price, the bank should consider the real and actual cost of the goods and a reasonable profit margin. If the source of the goods offers the bank a discount on the original purchase price, this discount should be disclosed to the client and the client's purchase price should be based on the "actual" cost of the goods. On the other hand, the mark-up should be reasonable and should not cause injustice to either party.
To conclude, the Murabaha Sale Contract needs attention from the Muslim Jurists and the Bank's Executives to avoid any application which violates the Islamic Sharia principles. These recommendations which are stated above are thought to represent a step towards an improved Islamic Banking System especially in the area of the MURABAHA SALE CONTRACT.
APPENDIX
CONTRACT SAMPLES
MURABAHA CONTRACT

This contract is made and entered into this day of ___________ by and between:

1. __________________________________________________________________________
   (First Party)

and

2. __________________________________________________________________________
   (Second Party)

whereas the two parties have signed an agreement on _____________ stipulating the guidelines which govern the commercial relation between them, and whereas the First party, based on the Second party's order, has purchased the required goods.

Therefore, the two parties do agree as follows:

I. The Second Party admits that all the goods conform with the required quantities and specifications and that he has taken possession of the goods in due course.

II. The Second Party shall pay the purchase price in the following way:

   __________________________________________________________________________

III. For the part of the price the payment of which is postponed, the Second party shall issue and sign promissory notes to the First party.

IV. As the Second Party (the client) has specified the source of the goods and their value, type, specifications and quantities. And as the first party (the Bank) would not have gone into this deal had he not received the clear information from the Second Party. Therefore, the Second Party shall be fully liable about all the information he has given and for the safety of the goods, their properness and conformity with the specifications and the quantities without the least responsibility whatsoever on the first party". (1)

V. In case of the default of the Second party in any of the price instalments, all the remaining instalments shall fall due immediately and the Second party will be required to pay all the balance of the price.
VI. This contract shall be governed and construed according to the prevailing laws in ________________________________.

VII. This contract has been prepared in duplicate and each party has received a copy.

First Party

Second Party
SALE CONTRACT

On this day

It is hereby agreed, by and between:

a) First Party: ________________________________
   _____________________________ (The Seller).

b) Second Party: ________________________________
   _____________________________ (The Buyer).

1) The buyer has approached the Seller requesting the purchase of ____________________________ (The Goods). The Seller agrees to purchase the goods and re-Sell them to the buyer if the buyer so desires.

2) The Seller has purchased the goods and now offers them to the buyer who accepts to purchase them on the following conditions: -
   i) The price will be ______________________ and this includes the original purchase price for which the Seller has purchased the goods (__________________) + the other expenses (__________________) + the Seller's agreed markup (__________________).

   ii) The Buyer shall pay the price in ________ equal monthly instalments payable on the ______________ day of each month, i.e. _____________/month.
iii) The Parties shall be bound to fulfill their promise to sell and buy the goods and the party who violates this term of the contract shall compensate the other for any damages.

iv) "As the goods have already ordered from their sources to be shipped in the name of ______________________(the client) and as he is the only one entitled to receive the said goods and clear them from the customs, therefore, the client shall inform the bank immediately after the arrival of the goods so that the sale contract could be concluded."

v) The Buyer shall give adequate guarantees as a collateral for the unpaid part of the price.

vi) In case of dispute regarding the interpretation or execution of this contract, the two parties shall refer the matter to an arbitration committee which will be formed of three members.

The arbitration committee shall abide by the principles of the Islamic Sharia and its decisions shall be final.

In witness thereof the parties has signed.

__________________________  ____________________________
First Party                  Second Party
(The Seller)                (The Buyer)
BIBLIOGRAPHY
BIBLIOGRAPHY

I. ARABIC REFERENCES


4) DR. AL ASHGAR, M.S. - A PAPER SUBMITTED TO THE SECOND CONFERENCE OF THE ISLAMIC BANK, KUWAIT, 1983.

5) DR. AL BAALI, A. - JURISPRUDENCE OF MURABAHA - INTERNATIONAL ASSOCIATION OF ISLAMIC BANKS, CAIRO.

6) DR. AL GARADAWI, YOUSEF - MURABAHA SALE TO THE PURCHASE ORDERER AS BEING APPLIED BY ISLAMIC BANKS - WAHBA - CAIRO 1987.

7) AL KASANI - BADAI AL SANAYI - ZAKARIYA - CAIRO.


9) AL MOTWALI, BADR - A GUIDE TO THE FATWA IN BANKING ACTIVITIES - ISLAMIC ECONOMY CENTRE - 1989.


13) AL SHARWANI - HAWASHI TOHFAT AL MOHTAJ A BABLY - CAIRO.

14) HOLY QURAN

15) DR. HOMOUD, SAMI - DEVELOPMENT OF BANKING ACTIVITIES IN CONFORMITY WITH THE ISLAMIC SHARIA, DAR EL FIKR - AMMAN - 1978.
16) IBN ABDEEN, MUHAMMED - RAD AL MUHTAR - DAR SADAT.
17) IBN GUDAMA, ABDULLA - AL MOGHNI - DAR AL MANAR - CAIRO.
18) IBN HAZM, ALI - AL MUHALA - COMMERCIAL BUREAU - BEIRUT.
21) DR. JAMMAL, G. - BANKS AND BANKING - DAR AL ITIHAD - CAIRO 1972
22) MIRGHINANI, BURHAN - AL HIDAYCEH - AL MAKTABAAL KHAIIRYA - CAIRO.
26) SARKHASI, SHAMS - AL MABSOUT - AL SAADA - CAIRO.
27) THE SCIENTIFIC AND PRACTICAL ENCYCLOPEDIA OF ISLAMIC BANKS, INTERNATIONAL INSTITUTE OF ISLAMIC BANKING AND ECONOMICS - 1980

JOURNALS

II. **ENGLISH REFERENCES:**

1) **DR. ABDUL MANNAN M.** - *THE MAKING OF ISLAMIC ECONOMIC SOCIETY*  

2) **DR. ABDUL MANNAN** - *THE FRONTIERS OF ISLAMIC ECONOMICS*  

3) **DR. ABDUL MANNAN, M.** - *ISLAMIC ECONOMIC THEORY AND PRACTICE*  
   HODDER AND STOUGHTON.

4) **AHMED, ZIAUDDIN** - *FISCAL POLICY AND RESEARCH ALLOCATION IN ISLAM*  
   KING A. AZIZ UNIVERSITY - K.S.A.

5) **ALI, YUSUF** - *TRANSLATION OF QURAN* - ALOOM AL QURAN EST.  
   SAUDI ARABIA.


7) **ANWAR, M.** "MODELLING AND INTEREST FROM ISLAMIC ECONOMY,"  

8) **ARIFF, M.** - *MONETARY AND FISCAL ECONOMICS OF ISLAM* - CENTRE  
   FOR RESEARCH IN ISLAMIC ECONOMICS - K.S.A.

9) **DR. CHAPRA, M.U.** - *TOWARDS A JUST MONETARY SYSTEM* - ISLAMIC  

10) **CHAUDARY, M.A.** - *THEORETICAL CONTRIBUTIONS TO ISLAMIC ECONOMICS*  
    MAC MILLAN, LONDON - U.K.

11) **FATIMI, S.S.** - *ECONOMIC SURVEY FOR THE MUSLIM COUNTRIES*  

12) **DR. HOMOUD, SAMI** - *ISLAMIC BANKING* - ARABIAN INFORMATION -  
    LONDON - 1986.

13) **PROFESSOR KASSEM, YOUSEF** - *COMMENTS ON ISLAMIC BANKS PRACTICES IN MURABAHA FROM THE SHARIA POINT OF VIEW* - A  

14) **DR. KHAN, FAHIM** - *MONEY AND BANKING IN ISLAM* - INSTITUTE OF  
    POLICY STUDIES - ISLAMABAD - 1983.

15) **KHAN, MOHSIN AND MIRAHKAN ABBAS** - *THEORETICAL STUDIES IN ISLAMIC BANKING AND FINANCE* - HOUSTON - THE INSTITUTE FOR  

17. KHAN, WAGAR MASOOD - TOWARDS AN INTEREST FREE ISLAMIC ECONOMIC SYSTEM - ISLAMIC FOUNDATION - U.K.


19. POESLEY, JOHN - DIRECTORY AND ISLAMIC FINANCIAL INSTITUTIONS LONDON.

20. SIDDIQI, M.N. - BANKING WITHOUT INTEREST - ISLAMIC FOUNDATION - U.K.

21. SIDDIQI, M.N. - MUSLIM ECONOMIC THINKING - ISLAMIC FOUNDATION - U.K.

22. SIDDIQI, M.N. - PARTNERSHIP AND PROFIT SHARING IN ISLAMIC LAW - ISLAMIC FOUNDATION - U.K.

23. SIDDIQI, M.N. - ISSUE IN ISLAMIC BANKING - THE ISLAMIC FOUNDATION - LEICESTER.

24. SIDDIQI, M.N. - SOME ASPECTS OF THE ISLAMIC ECONOMY - MARKAZI MAKTABA ISLAMIC - DELHI.

25. ZIAUDDIN, A. - MONEY AND BANKING IN ISLAM - KING A. AZIZ UNIVERSITY - K.S.A.