CHAPTER - IV

CONCEPT OF MURABAHAH
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4.1 Introduction:

Most of the Islamic banks and financial institutions are practicing "Murabahah" as an Islamic mode of financing that ranks highest in use, the majority of the financing operation carried out by them is based on this technique. They use the concept of Murabahah sale to satisfy the requirements of various types of financing, such as financing of raw materials, machinery, equipment and consumer durables as well as short-term trade financing etc. For this reason, this term is appreciated as a method of banking operations, whereas the original concept of “Murabahah” is different.

4.2 Meaning Of Murabahah :

**Lexical:** “Murabahah" an Arabic word has been derived from the root “r-b-h” meaning profit, gain or addition.¹

**Legal:** Murabahah is legally a particular sale of trust in which a commodity is sold at the original purchase price plus an agreed upon marked up profit. Alternatively it can be described as “a sale transaction on a cost-plus-profit basis”.²

4.3 Murabahah as defined by Classical Jurists:

1. **Hanafi School:**

Imam al-Kasani said: “Murabahah is a sale with the same (original) purchase price plus an amount of additional profit.”³

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Abdullah b. Mahmood al-Moosali said: “Murabahah is resale with a stated surcharge (add-on profit).”

Al-Marghinani defines Murabaha as “the sale of anything for the price at which it was purchased by the seller and an addition of a fixed sum by way of profit.”

2. Maliki School:

“Murabahah is a sale with the original purchase price and a declared extra amount of profit mutually agreed upon.”

Ibn Rushd says: “There is consensus among the majority of jurists upon that the sale is of two type: Murabahah & Musawamah; In Murabahah, the seller would disclose to the buyer the price he originally paid for the goods and state a surcharge in the form of dinar or dirham as condition that represents profit.”

Ibn Jazzi defined Murabahah that the seller would mention of how much he originally paid for the goods and what profit he would charge either in aggregate, (e.g. he would say that he purchased it for ten and would charge profit of one dinar or two dinar.) or in detailed statement, i.e. he would say to have the profit of one dirham for each dinar etc.

3. Shafi’ee School:

Sheerazi said: The seller would clearly state the original cost of the commodity (ras al-mal) and the rate of profit as he would say that its purchase

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price is 100 dinar and I sell it to you with its original price and a profit of one dirham in each ten (that is charging the ten percent profit).  

Ibn Hajr al-Haytami said: Murabahah is the profit i.e. an addition over the cost.

4. Hanbali School:

Ibn Qudamah has defined Murabaha as: “A sale of a commodity with its original cost plus a stated profit. The knowledge of capital cost (ras al-mal) is a precondition in it. Thus the seller should say: ‘My Capital involved in this deal is so much or this thing has cost me (Dirham) 100 and I sell it to you for this cost plus a profit of (Dm) 10.'”

Summation of the opinions:

Having gone through these definitions, we conclude the followings:

1. Disclosure of the original price and the cost incurred.

2. The surcharge, extra amount of profit must be known and mutually agreed upon.

Thus, the definition is based on three major elements; they are:

a) The commodity should be owned by the seller with possession that covers all the rights, liabilities and responsibilities pertaining to the commodity including the risk of loss, damage or its destruction.

b) Clear statement of both the price and the cost that the seller has originally paid for the commodity.

c) A stated agreed upon margin of added profit.

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Thus, by definition, it is basic for Murabahah that the buyer must know the original price, additional expenses if any and the amount of profit. Accordingly, it is a contract of trustworthiness.

4.4 Forms of Murabahah:

Classical jurists have mentioned different forms of Murabahah.

1. Saying of the seller: This commodity costs (Dinar) 100 and I add 10, as a profit thereupon. Be it known that the commodity is present at the time of sale contract. There is no divergence of opinion among the jurists upon this.

2. Another statement of the seller: I sell you the commodity with its capital cost of dinar 100 (ras-al mal), charging one dirham in each ten i.e. ten percent profit. The majority of the jurists have approved this form whereas some others have shown disapproval like Imam Ahmad, Ishaq b. Rahwaihe etc. As It has been narrated that Ibn Mas’ud (mAbpwh) ruled that there was no harm in declared lump-sum or percentage profit margins.

3. The commodity might not be present at the time of contract; the purchaser asks the seller to buy the specific commodity and he would purchase it with its purchase price plus a stated surcharge. This is called “Bay al-Murabahah li al-amir bi al-Shira” (Murabahah on purchase order). This form of Murabahah has been widely used and practiced by contemporary Islamic Banks and Financial Institutions.

Some relevant text may be found in “Kitab-al Umm” of Imam Al-Shafaee to deduce the conclusion that this specific form of Murabahah is not against the Shariah principles and thus corroborating its legitimacy. This issue will be later discussed in detail.

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However, being practiced dominantly by modern Islamic financial institutions, it has aroused a great deal of legal (fiqhi) discussion by contemporary Jurists.

During the last two decades, a number of research papers and books have been written that deals in detail the legal discussion of this specific form of Murabayah covering its various aspects.\(^\text{12}\)

### 4.5 The Rationale for Murabahah:

Murabahah sale performs a useful function in the sense that it provides a valuable service in economic markets since it allows those knowledgeable of market conditions to make a profit and those without such knowledge to obtain the goods at a good price. Thus, “Murabahah is a form of commission sale, where a buyer who is usually unable to obtain the commodity he requires except through a middleman, or is not interested in the difficulties of obtaining it by himself, seeks the services of that middle man.”\(^\text{13}\)

What must further be added, however, is the element of trust. The middleman performs a dual service, he facilitate the financing of a deal, and he does so in such a manner that even the most naive of consumers may rest easy with regard to the value he is receiving for his money.\(^\text{14}\)

De Lorenzo, Y. T. contends here thus:

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\(^{14}\) Professor Udovitch goes on to say, “Al-Marghinani suggests that their [sales of trust] purpose, particularly of the tawliyah and murabaha sales, was the protection of innocent general consumer lacking expertise in the various items of trade from the wiles and stratagems of sharp traders.” Op. Cit. p.220
“This last point is an intriguing one, and one that deserves further consideration. The classical jurists were careful to trace every transaction they described and regulated to a clearly Islamic origin, thereby to establish the transaction as one that had the approval of the Almighty. Thus the manuals of *fiqh* and their glosses are sure to begin their discussions of every new form of transaction by establishing Islamic authenticity, or justifying licitness or otherwise, through reference to the *Qur'an*, the *Sunnah*, consensus of the community, and/or the practice of the caliphs or early Companions. In a very few cases, however, the only sort of recourse available was to the practical grounds of its economic function in society. Apparently, and despite the best efforts of the jurists find a more sacred source for it, murabaha falls under this category.”

4.6 Legitimacy of Murabahah:

Murabahah is a legally permissible contract by the testimony of the majority of jurists. However, the legal evidences or indicators variously adduced by the classical jurists for the legitimacy of Murabahah contract are mainly general in nature and not at all specific to Murabahah. The proof of its permissibility is derived from the following:

1. There are many verses in the *Qur'an* that explicitly permit sales in general, e.g. “And Allah has permitted trade” [2:275], “But let there be among you traffic and trade by mutual good will” [4:29]. In this regard, Murabahah sales are clearly concluded by mutual consent.

“And when the prayer is ended, disperse freely on earth and seek to obtain [something] of Allah’s bounty” (62:10). This verse cited as evidence for the legitimacy of Murabahah is found in majority of the *fiqh* manuals. In a very general manner, the said verse establishes that it is lawful for people to go out in the world and earn their living. Such generalized permission may suffice as proof.

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15 De Lorenzo, Y.T., “Murabaha, Sales of trust, and the Money value of time”, *op. cit.* p. 147
16 De Lorenzo, Y.T., *op. cit.*, p.147
that trade and commerce are sanctioned by the Almighty; but there is clearly nothing in the verse about Murabahah. The same is true of other verses cited by the jurists in support of this transaction. For instance,

“He it is who has made the earth easy to live upon: go about, then, in all its regions, and partake of the sustenance that He provides” (67:15).

2. A valid narration reports that the Prophet (pbuh) while planning for emigration to Madinah, learned that “Abu Bakr had purchased two camels. He asked him to sell him one at the price at which he obtained it “wallini ahadahunna”.

Abu Bakr said: “It is yours at no price”, but the Prophet (pbuh) replied: “Not without a price”.17

3. This type of sale satisfies all the legal requirements for sale.

There are many hadith put forth by fuqaha for the permissibility of Murabahah such as the Hadith related by Tabarani: Seeking the lawful is the duty of every Muslimi. Or the Hadith related by Muslim, Abu Dawud, Tirmidhi, Nasa’i and Ibn Majah: If the two [counter values] are of different kinds, then sell as you like, provided that the deal is hand to hand. Or finally the Hadith related by Ibn Hibban and Ibn Majah: Varily, a sale is what takes place when there is mutual agreement.

Saeed Abdullah while investigating the specific references to murabahah permissibility concludes as:18

“The Qur'an, however, does not make any direct reference to murabahah, though there are several references therein to sale, profit, loss and trade. Similarly, there is apparently no hadith which has a direct reference to murabahah. Early

17 Narrated by Al-Bukhari on the authority of Ayesha (mAbpwh) and also by Imam Ahmad in his Musnad, Ibn Sa’d in Al-Tabaqat, and Ibn Ishaq in Al-Sirah.
scholars like Malik and Shafi‘i who specifically said that a murabahah sale was lawful, did not support their view with any hadith. Al-Kaff, a contemporary critic of murabahah, concluded that murabahah was “one of those sales which were not known during the era of the Prophet (peace be upon him) or his companions.”

According to him, prominent scholars began to express their view on murabahah in the first quarter of the second century AH, or even later. Since there is apparently no direct reference to it either in the Qur’an or in the generally accepted sound hadith, jurists had to justify murabahah on other grounds.

Yusuf Talal DeLorenzo, a Shariah consultant and Islamic financial advisor to the Dow Jones Islamic Market Index (New York) has rightly pointed out that the verses and Hadith literature presented by the jurist for the permissibility of Murabahah sale are not specific and inclusive rather unclear and imprecise. He further comments:

Several of the jurists appealed to ijma‘ as the justifying factor. An interesting twist to the same was claimed by Badr al Din al ‘Ayni, in his commentary on al Hidayah, in which he explained that Murabahah is lawful:

“...because the item for sale is known, and so is the price. People deal in it without anyone’s objecting to it. And when people deal in something without objecting to it, that is proof in itself of its validity because the prophet, upon him...”

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20 ibid.
21 Malik supported its validity by reference to the practice of the people of Madina: “There is consensus of opinion here (in Madina) on the lawfulness of a person’s purchasing cloth in a town, and taking it to another town for selling it on the basis of an agreed upon profit.” (al-Kaff; pp. 5-6). Whereas Shafi‘i without justifying his view by any shari‘ah text, said: “If a person shows a commodity to person and says, 'Purchase it for me, and I will give you such and such profit, and the person purchase it, the transaction is lawful.” (Shafi‘i, al-Umm, vol. III, p. 33) The Hanafi jurist, Marginian (d.593/1197), justified it on the ground that the conditions essential to the validity of a sale exist in it, and also because mankind stands in need of it.” (Marginian, ‘Hidayah, or Guide’, p. 282); The Shafi‘i jurist, Nawawi (d. 676/1277) simply said: “Murabahah sale is lawful without any repugnance.” (Nawawi, Rawdat al-Talibin, p. 526) see for the right references Saeed Abdullah, Islamic Banking & Interest, p. 77 as these references have been cited by him.
22 De Lorenzo, Yusuf Talal, op. cit. p.148
be peace, said, ‘what is considered becoming by the Muslims is considered becoming by Allah.”\textsuperscript{24}

In the Classical Islamic hierarchy of evidence, the indicators, \textit{adillah}, from the Qur’an, the Sunnah and the \textit{ijma’} are the ones that carry the most weight. It should be clear from the foregoing, however, that the proofs adduced from those resources are hardly specific to \textit{murabah}, and thus quite open to challenge. Clearly the jurists had to rely on other evidence from other sources in order to establish the lawfulness of this particular transaction. In other words, while the jurists did cite evidence from the Qur’an and the sunnah in support of Murabahah, the evidence itself is in no way specific to Murabahah. Moreover, no specific mention of the transaction is to be found in even the weaker Hadith literature. In other words, the most pertinent and substantial indicators for the legitimacy of the Murabahah transaction are the ones accorded the least weight of all by the jurists.\textsuperscript{25}

Dr. Yusuf al-Qaradawi, an eminent contemporary shari’ah expert contends that:

"The majority of scholars permit it [Murabahah] because the basic principle is the permissibility of things, and no clear text exists prohibiting such a transaction.

Furthermore there is no resemblance to interest in such a transaction, since the seller is free to increase the price as he deems proper, as long as it is not to the extent of blatant exploitation or clear injustice...."\textsuperscript{26}

\section*{4.6.1 Other Considerations in the Legitimacy of Murabahah:}

Burhan al Din al Marghinani (d. 593 AH), in his work \textit{al Hidayah fi Sharh al bidayah}\textsuperscript{27}, first has taken help to legal principle when explaining the legitimacy of Murabahah: “It is lawful owing to its meeting all the conditions for validity,”

\textsuperscript{24} Badr al Din al’Ayni, \textit{al Binayah fi Sharh al Hidayah} (Beirut: Dar al Fikr, 1982) vol. 6, p. 487.
\textsuperscript{25} De Lorenzo, Y. T., op. cit. p.148
\textsuperscript{27} The mainstay of latter Hanafi fiqh scholarship.
(ja'iz li istijma'i shara'it al jawaz). Thereafter, his commentator, Ibn al Humam noted,

“Since more than just the meeting of conditions is required to establish legitimacy, the author further mentioned the occasioning factor by saying, ‘There is a great need for this sort of dealing because one inexperienced in the ways of business will have to depend on those more experienced, and be satisfied with paying as much as the more experienced one has paid, plus an additional amount of profit. This is why it is essential to term these sales lawful.’ It should be clear that there is no need for proof of their legitimacy beyond the proof establishing the legitimacy of sales in general when there is mutual agreement and there is nothing to interfere with the conditions for a valid sale. Rather, the proof of the legitimacy of sales in general is the proof of the legitimacy of Murabahah and tawliyah.”

To explain the issue under discussion, De Lorenzo, Y. T. comments as follows:

Here, what the commentator means when he refers to “meeting the condition” is that it is not enough for a transaction to fulfill the prescribed legal formula of there being a buyer, a seller, an object of sale, an offer by the seller, and an acceptance by the buyer. These are the elements of a transaction deemed essential by the classical jurists. However, just because these elements are present, it does not automatically follow that the transaction will be lawful.

In addition, then, al Marghinani had to offer more convincing evidence for the legitimacy of this particular transaction, Murabahah. That is why he mentioned the occasioning factor, or illa. The classical jurists explained that while there are no occasioning factors in matters related to worship, ibadat, because these are related to the inscrutable will of the Almighty, there are always

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28 Ibn al Humam, Faith al Qaadeer (Bulaq: al matba'ah al Kubra al Amiriyah, 1316 AH) vol. 5, p. 254
29 He contended that the purpose of Murabaha (and Tawliyah) is the protection of innocent consumers lacking expertise in trade from the tricks and stratagems of cunning traders. (See al-Marghinani, 1957, p.282, as cited by Ayub.M.,(2007) Understanding Islamic Finance, p. 216)
to the worldly interests of humans occasioning factors in transactions, *mu‘amalat*, because these are related to the worldly interest of humans.\(^{30}\) They further explained that the benefit of occasioning factors is that they facilitate an understanding of Shariah rulings and categorizations by clarifying cause and effect relationships in the law. If a feature can be shown to constitute the occasioning factors behind a ruling in a principal case, then it becomes relatively easy to establish the same ruling in a novel case with the same feature.

What al Marghinani and his commentators, both Ibn Humam and Badr al Din al ‘Ayni, appear to be attempting, however, is to provide a rationale for the transaction, thereby establishing its ethical and Islamic legitimacy.\(^{31}\) Not all jurists, however, held that a rationale, or *hikmah*, could function as an ‘*illah* or occasioning factor.\(^{32}\)

He then concludes that it can be deduced that Murabahah, in its protecting the innocent consumer, actually assigns a money value of trust rather than to time. There is a value to knowing and to being able to trust that knowledge. Thus from this perspective, Murabahah holds nothing that could be considered grounds for prohibition or legal disapproval, *Karahah*. When dealing with the challenges of modern financial practice, it may be noted that consideration of such factors may well entail a new understanding for the *Shariah*.

Thus, a person who lacks skill in making purchases in the market on the basis of *Musawamah* is obliged to have recourse to a Murabahah dealer who is known for his honesty in this particular type of trade, and thus purchases the article from that person by paying him an agreed addition over the original purchase price. This leaves the actual buyer satisfied and secure from the fraud to which he was exposed for want of skill. Hence, it is evident that the main purpose

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\(^{30}\) *Kuwait Fiqh Encyclopedia*, vol. 12, p. 319

\(^{31}\) De Lorenzo, Y. T., *op. cit.* p. 148

of this form of bai is to protect innocent purchasers from exploitation by cunning traders.

Udovitch suggests that murabahah is a form of commission sale, where a buyer who is usually unable to obtain the commodity he requires except through a middleman, or is not interested in the difficulties of obtaining it by himself, seeks the services of that middleman.\footnote{Udovitch, p. 221}

\subsection*{4.7 Musawamah Sale:}

If the cost of the article sold is not disclosed to the buyer at the time of selling, it is called a Musawamah sale (i.e. sales based on negotiation).\footnote{Usmani, M.T. op. cit; p. 96} Here the sale takes place on a lump-sum price basis, without the contract having any mention of the cost and profit components. The buyer accepts to buy the article at the lump-sum price agreed, irrespective of the amount of profit earned by the seller through the sale. Mostly, sales take place on the basis of Musawamah, such as when purchasing a commodity from a shop without any enquiry as to what the cost of the item was.

For example, in selling a computer, if A tells B “I have sold this computer to you for USD 1000” without any mention of the cost incurred by him, it is a Musawamah sale.

It should be noted that the buyer happening to be aware of the cost of the item alone will not convert the sale into a Murabahah, as long as the contract of sale does not indicate the cost, relating it to the price.

Thus, the only feature distinguishing a Murabahah sale from other kinds of sale is that the seller in Murabahah expressly tells the purchaser how much cost he has incurred and how much profit he is going to charge in addition to the cost.
Here it is interesting to note that Imam Ahmad prefers ordinary sale (musawamah) over Murabahah in the following words:

“To me, Musawamah is easier than Murabahah, because Murabahah implies a trust (reposed in the seller) and seeking of ease on behalf of the buyer, and it also requires detailed description to the buyer, there is very likelihood that selfishness may overcome the seller, persuading him to give a false statement or that mistake may occur which makes it exploitation and fraud. Avoidance of such a situation is, therefore, much better and preferable”.

The same ideas have been expressed by a Jafari jurist on the authority of Imam Husain. After basing the sale price on the original cost of the goods to the seller, the purchaser is provided with a modicum against unjust exploitation by unscrupulous merchants.

It is important to observe, however, that modern Murabahah is conducted mainly by banks and financial institutions on a deferred payment basis. Upon execution of Murabahah, a receivable is created that becomes the liability of the customer. The aspect of disclosing details of the banks’ cost price, though a necessary condition of Murabahah, does not remain a serious issue between the parties, particularly in view of the fact that the customer himself is involved one way or the other in locating and purchasing the goods.

4.8 **Basic Features of Murabahah Sale:**

As pointed above that being a particular kind of sale, Murabahah is different from the common sale (Musawamah), therefore, it has some specific characteristics and conditions that are not related to others. In Murabahah, the profit may be determined by mutual consent, either in lump sum or through an agreed ratio of profit to be charged over the cost. All the expenses incurred by the

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36 Al-Kulayani, 1278 AH, p. 197 as cited by Ayub, op.cit, p.216
37 Udovitch, (1970) op. cit; p.220
38 Ayub, Muhammad G. (2007), Understanding Islamic Finance, op. cit., p. 217
seller in acquiring the merchandize like freight, custom duty etc. shall be included in the cost price and the mark-up can be applied on the aggregate cost. To sale an item on Murabahah, ascertaining the exact cost is a necessary condition. Otherwise, the item will be sold on Musawamah (bargaining) basis i.e. without any reference to the cost or to the ratio of profit.

For Example, “A purchased a ready-made suit with a pair of shoes in a single transaction, for a lump sum price of Rs. 500/-. A can sell the suit including shoes on Murabahah. But he cannot sell the shoes separately on Murabahah, because the individual cost of the shoes is unknown. If he wants to sell the shoes separately, he must sell it at a lump sum price without reference to the cost or to the mark-up.”^39

**Murabahah not always on Deferred Payment:**

It should be clear from the above that either Murabahah or Musawamah is not necessarily a sale on deferred payment basis. In both, the liability for payment could be instant, or deferred to a future date. Payment could even be spread out over a period of time in instalments. Therefore, Murabahah need not always be a credit sale where the payment falls due at a later point of time. Murabahah, similar to other types of sale such as Musawamah and Tawliyah (sale at cost), could take place either on cash basis or on deferred payment basis.

4.9 **Murabahah on Order and Promise** (*Murabahah lil amir bi al-shira/ lil-wa’ad bi al-Shira):**

If there are three parties, the buyer, the seller and the Bank as an intermediary trader between the buyer and the seller, where the Bank upon receipt of order from the buyer with specification and a prior outstanding promise to buy the goods from the Bank, purchases the ordered goods and sells those to the ordering buyer at a cost plus agreed profit, the sale is called "Bai-Murabahah on

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^39 Usmani, p. 103-104
Order or Promise", generally known as Murabahah. This type of Murabahah is dominantly being used by modern Islamic banks and financial institutions.

Thus it is a sale of goods on profit by which ownership of the goods is transferred by the Bank to the Client but the payment of the sale price (cost plus profit) by the Client is deferred for a fixed period.

Being a mode of sale, all rules, conditions and ingredients of a valid sale remain applicable in Murabahah even when the latter is used for financing purposes. Observance of these rules is essential for the validity of Murabahah.

Mr. Ayyub dilates upon this form of contemporary Murabahah thus:

This arrangement wherein bank, upon request by client, purchases an item from third party and sell the same to him on a deferred payment basis is being widely used by almost all Islamic banks and financial institutions operating in various part of the world and by the Islamic Development Bank (IDB) for its foreign trade-financing operations. The need for this alternative arises from the following factors:

1. Commercial banks, and likewise Islamic banks, do not normally undertake business where they might be maintaining inventories of various goods; they do not want to become traders because inventory storage, space and holding cost might be expensive.

2. It may not be possible for Islamic banks to purchase all items in advance for Murabahah to their clients because the list of goods could be very long and there could be continuous additions to the list.

3. The clients might be in need of specific quality goods and the banks might not be even aware of the source of their availability. If banks keep similar items in inventory, these might not be acceptable to the clients.

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40 ibid
4. Regulators/central banks normally do not allow the banks to undertake trading as their core business, with the dual purpose of keeping them liquid/saving them from the asset and market risks related to goods and to avoid cartels and monopolies in the commodity market. As such, most of the Islamic banks purchase only those goods for which they receive requisition from their clients.

On account of the above, Islamic banks have been allowed not necessarily to maintain inventory of goods to be sold through Murabahah. According to the AAOIFI shariah standard on Murabahah, it is permissible for IFIs to purchase items only in response to their customers’ wish and application. But this wish may not be considered a promise or commitment by the client to purchase the items, except when the promise has been made in the due form.\(^{41}\) For practical purpose, the promise can be incorporated into the requisition form to be submitted by the client.

The customer can also indicate the supplier from whom the items/goods are to be purchased by the bank. But the bank will have to ensure that the supplier is any third party and that the client has not already purchased the item from that supplier or made a firm commitment with him to purchase, otherwise it would be bai al-‘inah and the transaction would be non-shari‘ah compliant. The bank can obtain a performance bond from the client to ensure that the supplier identified by him will function in good faith and that the item provided by him will be acceptable to the client.\(^{42}\) Similarly, the bank is not allowed to enter into a Musharakah arrangement with the client with the promise that one of the parties will buy the other’s share through Murabahah on either a spot or deferred payment basis. However, the promise can be made by a partner to buy the other’s share at

\(^{41}\) AAOIFI, 2004-5, Shariah Standards p.113

\(^{42}\) AAOIFI, 2004-5, op. cit, Standard on Murabahah, clause 2/5/1, p.116
the market price or at a mutually agreed price at the time of sale by means of a separate contract.\textsuperscript{43}

However, it does not mean that IFIs can not be involved in the sale/purchase of goods or can not create their inventories. Purchasing an item, taking its possession and ownership along with risk and reward is a major requirement of Shari'ah, without which the transaction would not be valid. Murabahah can not be used as a substitute for running finance facility, which provides cash for fulfilling various needs of the client. If a bank does not keep inventory, it can purchase a commodity on a customer's request and sell it to him on a cost-plus basis, but it will have to fulfil all the necessary conditions of valid bai as well as as additional conditions applicable to Murabahah.

Merchant banking has become one of the functions of even conventional banks. Therefore, Islamic banks, in addition to conducting Murabahah on order, may like to establish specialized asset management and trading companies as non-bank financial subsidiaries to undertake active trading business by maintaining inventory of major items demanded by their clients. This way, their profit margin may be higher and customers may also be offered such items at cheaper rates.

Bank can purchase goods through any third person/agent and possess the goods before resale. If the bank appoints the customer its agent to buy the commodity on its behalf, the customer will first purchase the commodity on behalf of the bank and take its possession as such. But payment should be made by the bank directly to the supplier. Double agency, i.e. for making payment and for purchasing and taking delivery, should be avoided because it may become a cause of misuse, making Murabahah a back door to interest. At this stage, the commodity must remain at the risk of the financier, who is the seller in this

\textsuperscript{43} AAOIFI, 2004-5, Standard on Murabahah, p.113, 114, 116, 128; clause 2/2/1 to 2/2/5 and 2/5.
transaction. Thereafter, the client purchases the commodity from the financier for a deferred price.\textsuperscript{44}

It is clear from the above discussion that Murabahah is a lawful kind of sale but has its own limitations. The classical Murabahah was not a mode of financing, it was a kind of trade. Contemporary jurists have accepted it as a mode of business and an alternative to financing with certain limitations. These relate to the level of transparency and justice which \textit{shariah} ordains for commercial activities. It is in view of this requirement that Maliki \textit{fuqaha} consider this form of sale \textit{Naqis} (defective).\textsuperscript{45}

There is no doubt that jurists have justified Murabahah on the grounds that it provides protection to the innocent, unskilled and inexperienced buyers, but as we do not find any reference regarding its prohibition for experienced people or traders, it can therefore be adopted subject to the fulfilment of the juristic conditions, as an alternative to interest-bearing transactions for those activities which the contemporary \textit{shariah} scholars may allow.\textsuperscript{46}

De Lorenzo Y.T. opines thus:

"...In order to make the \textit{murabahah} contract effective in the business of inventory or short-term trade financing. It was necessary to depart somewhat from the classical model by combining a promise to buy on the part of a client with the actual purchase by the bank of goods from third part suppliers. Then, in addition to the actual murabahah contract, a further transaction is appended; the promise to

\textsuperscript{44} Usmani, 2000a, p. 106; for principal’s ownership during agency, see Zuhaili, 2003, p.674 (as cited by Ayub (2007), op. cit, p. 223)
\textsuperscript{45} Ayub, Muhammad G. (2007), \textit{Understanding Islamic Finance}, op. cit., p. 219
\textsuperscript{46} For details, see Council of Islamic Ideology, 1980, pp. 15, 16, 34, 35, 38, 42-46; the CII has described the detailed application of this mode in the chapter on “Commodities Banking”. According to the CII, it can be used both for “fixed investment financing” and “working capital requirements” of parties (pp. 34, 38). Farmers’ short term fund requirements, particularly for the purchase of inputs like seeds, fertilizer and pesticides and for plough cattle, tractors and tube wells can be met through Murabahah (pp. 34-45). The commerce sector can also be financed through this mode (pp. 45 and 46). As regards mining, quarrying, electricity, gas, water and consumption, consumer durables can be financed on a Murabahah- Mu’ajjal basis.
purchase that is made by the client or prospective buyer. This arrangement, however, innocent in appearance, actually brought up a host of issues for the early Shariah boards. Nonetheless, as the needs of modern trade were such that a Shariah-compliant alternative to trade financing by means of conventional interest-based financing was required, the classical murabahah was transformed into the modern Murabahah li’l-Amir bi al-Shira, murabahah with an order to purchase that has now become commonplace to Islamic banking.

‘Following the success of this experience, Shariah boards went on to engineer and approve a host of hybrid nominees, using a single nominate like murabaha in different configurations like parallel Murabahah, reverse Murabahah, back-to back Murabahah and reverse parallel Murabahah contracts:...’

4.9.1 Murabahah on Order: A Bunch of Contracts:

Contemporary Murabahah also involves an agency relationship between the bank and any third party or even the client. The Murabahah to Purchase Orderer in this form would compromise three distinct contracts:

1. A master contract which defines the overall facility to be availed by an agreement to purchase or promise by the client to buy the article when offered by the bank. Instead of being a bilateral contract of forward sale, the ‘agreement to buy’ is a unilateral promise from the client which binds him and not the bank.

2. An agency contract whereby the agent, who could be a client or any third party, has to purchase the item from the market or the supplier identified by the client and take its possession on behalf of the bank; this should be separate from the Murabahah agreement.

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48 AAOIFI, 2004-5, Standard on Murabahah, p.130
3. The actual Murabahah contract should be concluded when the bank owns the concerned commodity.

Murabahah transactions that involve other contracts like promise, agency (Wakalah) and credit along with an agreed rate of return for IFIs over the cost price lead to a number of issues that will be discussed in detail later.

4.10 Bay’ Mu‘ajjal & Murabahah:

All sales where the payment is deferred are known as Bay’ Mu‘ajjal (credit sale) or sale on deferred (price). According to Justice Taqi Usmani, deferred credit sale are governed by the following primary conditions:

- The time of payment must be agreed in advance;

- If there is an increase compared with the cash price, it must be agreed at the time of sale and the buyer must have the true option to pay the lower cash price or higher deferred sale price;

- The price may not be increased if there are delays in payment, but the remaining instalments may be accelerated if there are any defaults in paying the instalment on time.

Bunched with the Murabahah, Bai Mu‘ajjal would mean sale with an agreed profit margin over the cost price along with deferred payment. It may be termed as ‘Murabahah Muajjal’.

Postponement of the payment is one of the general features of lawful sales. In Hidayah, permission of credit sale has been described thus:

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49 Usmani, M.T. op.cit, pp.102-103
50 ibid, p. 117
"A sale is valid either for ready money or for a future payment provided the period be fixed, because of the words of the Holy Qur’an ‘Trading is lawful’ and also because there is a tradition of the holy prophet (peace be upon him) who purchased a garment from a jew, and promised to pay the price at a fixed future date by pledging his iron breast coat. It is indispensably a requisite of business but the period of payment should be fixed. Uncertainty in the period of repayment may occasion a dispute and jeopardize the execution of the transaction since the seller would naturally like to demand the payment of the price as soon as possible, and the buyer would desire to defer it."\(^{52}\)

Thus a valid sale may be concluded in which payment of the price is deferred and is made in instalments and in such a case, the period of instalment payment must be definitely ascertained and fixed.\(^{53}\)

When a Murabahah sale is carried out on deferred payment basis, all rules pertaining to sales on deferred payment become applicable. The due date of payment or the period at the lapse of which payment would fall due should be fixed in an unambiguous manner. If there remains any doubt as to when the payment would become due, the sale is void. The due time of payment can be fixed either with reference to a particular date, or by specifying a period, like three months, but it cannot be fixed with reference to a future event the exact date of which is unknown or is uncertain.

Similarly, the exact price must be clearly fixed at the time of sale. The price thus agreed may not be increased if the buyer fails to settle the amount on the due date. The deferred price may be more than the cash price,\(^{54}\) but it must be

\(^{52}\) Al-Marghini, 1957, p.242 as cited by Ayub (2007), op. cit; p. 219
\(^{53}\) Al-Zuhaili – El-Gamal, Vol 1, (3.2.1 & 3.2.2), pp 53, 63 (citing al-Sarakhsi (1\(^{st}\) edition), vol. 13, p.192), Al-Kasani, vol. 5, p.244, ‘Ibn al-Humam, vol. 5, p.109); and Ibn Abideen, vol. 4, p. 43 onwards), and 4.3.9, at pages 119-120 (noting that all four major schools of Islamic jurisprudence consider the installment sale a valid sale arrangement).
\(^{54}\) Delay in payment under Murabahah is also allowed in other schools of Fiqh, including Shiaites. (See, Al-Hilli, 1389 AH, p. 41, as cited by Ayub, op. cit., p. 220.) However, jurists slightly differ on the aspect of different cash and credit prices. The Hanafis, Shafi’es and Hanbalis permit the difference between cash and
fixed at the time of sale. The seller is entitled to demand a security in the form of mortgage or pledge, or a guarantee from a third party. If the payment is in installments, the seller may put a condition on the buyer that if he fails to pay any installment on its due date, the remaining installments will become due immediately. The buyer can also be asked to sign a promissory note or a bill of exchange, but the note or the bill cannot be sold to a third party at a price different from its face value.\(^{55}\)

However, it is not allowed to conduct Murabahah on a deferred payment basis in the case of gold, silver or currencies, because all monetary units are subject to the rules of Bai-al Sarf. Similarly, receivables or debt instruments cannot become the subject matter of Murabahah, as any profit over the principal of a debt is riba.\(^{56}\) However, Murabahah of shares of joint stock companies eligible on the basis of screening criteria is allowed.\(^{57}\)

### 4.11 Islamic Financing Techniques:

Before having a full discussion upon Murabahah financing method, it would be pertinent to discuss the various financing techniques used by Islamic Financial institutions in order to have a glimpse on their comparative advantages and applicabilities.

Keeping in view the Shariah considerations, Islamic banks around the world have devised many financial techniques that are basically derived from Islamic contract of partnerships, exchange, and the loans (Charity). For day-to-day banking activities, Islamic banks resort to these financial instruments that have been devised to satisfy the Islamic doctrine and provide acceptable financial returns to the investors. These are basic techniques, however, a certain degree of credit prices provided one price is settled at the finalization of contract. Although, imam Malik himself forbade it, some of the Malikis hold a different view and allow it. Contemporary jurists are almost unanimous on the legality of this difference.\(^{55}\) Usmani, M.T., op. cit, p. 102

\(^{56}\) AAOIFI, 2004-5, Murabahah Standard, clause 2/2/6; pp. 114, 128.

\(^{57}\) Ayub, op. cit., p. 220
variance in their practices may be observed from county to country and region-to-region. Sometimes the same techniques are called, pronounced or spelt differently in different regions as they all are derived from the Arabic sources. Following section gives a brief account of the Islamic financial techniques adopted by the Islamic banks worldwide. These can be grouped under three broad categories.

A: Contracts of Partnership

1. **Mudarabah (Capital Financing):** Also known as trust financing, this is an agreement between two parties one provides the capital and the other known as 'Mudarib' uses his entrepreneurial capabilities and manages the fund and the project. The profit arising from the project is distributed according to a predetermined formula. Any losses accruing are born by the provider of the capital. The provider of the capital has no control over the management of the project.

Under Islamic banking the bank acts as a manager of customers' funds. The depositors on the other hand are known as 'Rabb-al-Mal' meaning the owner of the fund. The bank on its own risk invests deposits accepted on savings under the profit sharing and loss absorbing agreement. Customers give authorization to the bank to invest funds and share profit or absorb loss on agreed proportions. Account holders of this type of account are required to maintain a minimum balance in the account.

Capital Trust financing is a contract between at least two parties in which the bank as the investor supplies the entire capital of the business forming a relationship between the supplier of capital and the user of capital. These two parties work together and share profits and bear the losses. A notable point of this agreement is attachment of the liability to loss to the financier only; the working party i.e. the user of the capital bears no part of the loss accruing to the capital extended by the financier. His only loss will be his labor, which will get no reward.
2. Musharakah (Partnership): This technique involves a partnership between two parties who both provide capital towards the financing of a project, both parties share profit on a pre agreed ratio, but losses are shared on the basis of equity participation. The both or any of the party may carry management of the project.

In this case the bank and the customer jointly contribute capital. They also contribute managerial expertise and other essential services at agreed proportions. Profits are shared according to the contract agreed upon while losses will be shared according to capital contribution. An individual partner does not become liable for the losses caused by others.

B: Contracts of Exchange

1. Murabahah (Cost plus profit): This is a contract sale between the bank and its client for the sale of goods at a price which includes a profit margin agreed by both the parties. As a financing technique it involves the purchase of goods by the bank as requested by its client. The goods are then resold to the client with a markup usually received in specified installments.

2. Ijarah (Leasing): A contract under which a bank buys and leases out for rental fee equipment required by its client. The duration of the lease and the rental fees are agreed in advance. Ownership of the equipment remains with the bank. This is similar to the conventional leasing. However, in the conventional leasing system the lessee pays specific rentals and a fixed rate of interest over a given period for the use of specific asset. But in the Islamic banking system of leasing the risk related to leasing has to be shared between the bank and the lessee, in case of any damage to the leased assets.

3. Ijara-wa-iqtina: Very similar to Ijarah except that there is commitment form the client to buy the equipment at a pre agreed price at the end of the lease. In this case rental also includes the costs of the equipment.
4. **Bay al-Salam:** A contract for sale of goods where the price of the said item is paid in advance. In this system a buyer pays in advance for a specified quantity and quality of a commodity, deliverable on a specific date, at an agreed price. This financing technique is similar to a future or forward-purchase contract and is particularly applicable to seasonal agricultural purchases. Under Islamic banking this technique is generally used to buy the goods particularly raw materials in cases where seller needs working capital before he could deliver.

5. **Bay Bithaman Ajil (BBA):** This contract refers to the sale of goods on deferred payment. In this system the Islamic bank buys the item requested by the client and sales it to the client on pre agreed installment including the cost of the equipment and the markup. This is very similar to *Murabahah* except the payment is made in installments some time after delivery of the underlying goods.

6. **Istisna:** A contract of acquisition of goods by specification or order, where the price is paid progressively in accordance with the progress of a job completion. This is practiced for purchase of an item that is yet to be completed or produced, for example, a house to be constructed where payments are made to the developer or the builder according to the stage of work completed. *Istisna* differs from *ijara* in that the manufacturer must procure his own raw materials. Otherwise the contract would amount to a hiring of the seller's wage labor as occurs under *ijara*. *Istisna* also differs from *bay salam* in a sense that (a) the subject matter of the contract is always a made-to-order item, (b) the delivery date need not be fixed in advance, (c) full advance payment is not required and (d) the *Istisna* contract can be canceled but only before the seller commences manufacture of the agreed item(s).

C: **Contracts of Charity**

1. **Qard Hasan (Interest free loan):** *Qard Hasan* means an interest-free loan, given by the Islamic bank to the needy people in a society. The practice of dealing with this sort of investment differs from bank to bank. *Qard Hasan* is
normally given to needy students, small producers, farmers, entrepreneurs and economically weaker sections of the society, who are not in a position to obtain loan or any financial assistance from any other institutional sources. The main aim of this loan is to help needy people in a society in order to make them self-sufficient and to raise their income and standards of living.

This principle is also practiced in case of Islamic banks accepting deposits from public. Depositors of this account do not receive any return, however, if Islamic bank wishes it might grant some financial or non-financial benefits to its depositors.

2. **Gifts:** This is actually a form of voluntary charity, encouraged under Islam. In Islamic banking this is used to oblige the depositors who have kept their money in Islamic bank without hoping any return. These cases are especially noticed in Malaysia and Iran where Islamic banks offer some gifts to the depositors to compensate for any losses they might have incurred by choosing to deposit in an Islamic bank. This is often commensurate with the conventional banks’ interest rate. In Malaysia, for example, ‘Government Investment Certificates’ (GIC’s), which do not carry any interest to the lender, is compensated by offering gift at the end of each loan period.