

ISSUES IN THE APPLICATION OF MURABAHAH SALE IN BANKING: FINANCING CONSUMER GOODS AND TRADE

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Abstract: *A study of the procedural aspects of Murabahah would reveal that its proper implementation in a financing context is challenging. Murabahah as practised in banking is a trading instrument in its original layout that has been adapted for financing purposes. Due to the forced nature of the application of Murabahah in banking, financing on the basis of Murabahah involves numerous conditions, laxity in the observance of which may make the transaction invalid from an Islamic legal perspective. In order to overcome issues arising in Murabahah based financing, implementation of equity-based modes such as Musharakah should be attempted where possible, such as in the context of trade financing. Murabahah is commonly used to finance the purchase of assets in a variety of forms, including financing consumer items as well as in trade financing, through local purchase as well as import. The current paper analyses important aspects involved in the application of Murabahah in the above areas, scrutinising practical aspects that are required to be carefully observed for the validity of the procedure in shari'ah.*

Keywords: *Islamic, Finance, Murabahah, Sale, Trade, Import, Consumer*

Introduction

Financing based on Murabahah sale can be used by Islamic financing institutions where the client is in need of funds for purchasing an asset or commodity. In Murabahah financing as practised by Islamic banks, instead of extending a loan facility to the client for purchasing the

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required commodity himself, the Islamic bank purchases the commodity from the supplier first and thereafter sells it to the client usually on deferred payment basis, at a fixed price comprising the cost incurred by the bank and an additional margin of profit. This differs from the conventional banking approach to financing, as conventional banks extend loan facilities to clients in all types of financing. Even where funds are needed by the client for acquiring commodities, a facility based on lending is used for this purpose, the loan being repaid together with interest thereafter. Due to the involvement of interest which is abhorred by Islam, availing of such loan facilities is prohibited. In lieu of interest-based loans, Islamic banks use Murabahah based structures for financing purposes, usually linked with some other contracts such as agency.

It is widely used in financing asset purchases of all types for consumption, utility or trading, in the local market or through import. Some perceived advantages in this format are: entitlement of the bank to a fixed amount of profit based on its cash outlay and the period required for settlement, asset risk being limited to the minimum duration the asset lies in the constructive possession of the bank, resemblance in outcome to conventional banking facilities, and credit risk being covered by a pledge or mortgage. Several bodies of contemporary shari'ah scholars have ruled it permissible in facilitating asset purchase, subject to observing the necessary conditions.² The Islamic Fiqh Academy Jeddah has permitted sales on Murabahah to the commissioner-to-purchase with regard to goods already in the physical possession of the seller as required by shari'ah, provided the seller carries the risk of loss before delivery, the consequences of returning the purchased goods because of concealed defects, etc., and provided the conditions of the sale are met, with the absence of any impediments.³

Problem statement

In the context of financing, Murabahah takes the form of a complex procedure comprising several transactions, reflecting several relationships between the parties involved. In this type of financing, the financial institution sells the commodity required by the client on deferred payment basis through a properly executed contract of Murabahah sale. This necessitates the financial institution having come into ownership of the necessary commodity beforehand, and having the item at its risk at the time of sale. However, since financial institutions typically do not own stocks, the article required by the client has to be purchased from elsewhere, usually from a source indicated by the client himself. This results in the introduction of several further intricacies to the Murabahah procedure. The bank appointing the client, who had sought the Murabahah facility, as its agent for purchasing the required asset on its behalf, while being correct in theory, invariably results in increasing the complexity of the transaction. The two transactions of sale where the bank purchases the commodity from the market first and sells it to the client second on cost plus mark-up basis, should both complete the relevant conditions for sales in shari'ah. The current paper seeks to analyse the important aspects involved in the application of Murabahah in consumer and trade financing, both local and import.

² E.g. First Islamic Banking Conference Dubai, 22-24 May 1979, held at Dubai Islamic Bank, in Dubai Islamic Bank, *al-Fatawa al-Shari'iyah fi al-A'mal al-Masrafiyyah*, vol. 1, p. 19, First Albaraka Seminar held in Madinah, June 1983, Resolution No. 8, in Dallah Albaraka, *Fatawa: Shariah Rulings on Economics*, p. 103.

³ See Islamic Fiqh Academy, resolution No. 40, 41, (2/5 & 3/5), 5th Session held in Kuwait in December 1988.

Theoretical framework of Murabahah in the context of financing

Murabahah in Islamic legal parlance refers to selling an item on cost plus profit basis, where the seller discloses to the buyer the cost incurred in procuring the article and the amount of profit earned by him through its sale. The buyer is assured about the exact profit made by the seller through the transaction, as the precise cost incurred by the seller is mentioned in the contract of sale and the profit component is fixed with the buyers consent. Due to the high degree of transparency that should prevail in Murābahah sales, they are classified by Muslim jurists under Buyu' al-Amānah or sales of trust, i.e. sale transactions which are based on trustworthiness in communicating the exact cost involved. This indicates that Murabahah not a financing mode as far as its basic structure is concerned. Being not the ideal instrument for financing, using Murabahah sale for financing purposes requires careful adherence to the necessary guidelines. It is clear that financing on Murabahah can never be as simple or uncomplicated as lending on interest. The very ease with which the lender provides loans and collects interest without undertaking any liability, or exposure to any risk or hardship, is one reason interest is prohibited in Islam. If such ease is desired, an ideal financing mode such as Musharakah or Mudharabah could be adopted, which however would necessitate undertaking the risk of the venture. Being a mode of sale, all rules and conditions that are relevant to sale transactions remain applicable in Murabahah even when it is used for financing purposes.

Financing on Murabahah can be employed only when a client genuinely requires procuring an asset from an outside source. The term 'financing' is used here to indicate purchasing the item required by the client from the indicated source and later selling it to the client. It does not mean extending a loan facility to the client so that he may purchase the item himself. Thus, when an asset such as a vehicle, land, building, raw material, merchandise, etc. is needed to be purchased, it may be financed on the basis of Murabahah. Instead of assets, if money is required for some purpose, Murabahah financing cannot be employed. This is because Murabahah is a genuine sale transaction where actual commodities are sold, and not a transaction of lending. Therefore, if cash is required for overhead expenses such as settlement of utility bills, payment of wages, transport, processing etc, or for purposes such as settlement of loans and payment for goods already purchased, Murabahah financing may not be employed. Similarly, if a service or usufruct is required, Murabahah may not be used for financing it.

In the context of financing, Murabahah takes the form of a complex procedure comprising several transactions, reflecting several relationships between the parties involved. In this type of financing, the financial institution sells the commodity required by the client on deferred payment basis through a properly executed contract of Murabahah sale. This necessitates the financial institution having come into ownership of the necessary commodity beforehand, and having the item at its risk at the time of sale. If the financial institution concerned happens to own stocks of the commodity required, this could be facilitated with ease, which would be welcome from a shari'ah point of view too as some questionable practices could be avoided. Indeed, in a proper Islamic set up, rather than being content with providing finance, Islamic financial institutions are expected to play an active role in trading as well, and currently there are Islamic banks that also maintain trading wings dealing in

vehicles etc. for providing Murabahahs. However, since financial institutions typically do not own stocks, the article required by the client has to be purchased from elsewhere, usually from a source indicated by the client himself. This results in the introduction of several further intricacies to the Murabahah procedure, resulting in the complex product known as “sale on Murabahah to the orderer-to-purchase”. (Bay‘al-Murabahah li-al-Amir bi-al-Shira’)

Major Phases in Murabahah Financing

The major phases in this procedure at the practical level involves the request made by the client to the financial institution to purchase a certain commodity from an external source for subsequent sale to him, purchase of the item by the financial institution, usually on cash terms, and its subsequent taking possession of the item, and lastly the client purchasing the commodity from the financial institution on deferred payment basis, later settling the price on the due date or in instalments as agreed. It would be seen that this procedure consists of an initial agreement by the financial institution to buy the item required by the client followed by two transactions of sale. If each of these steps takes place in a manner acceptable in shari‘ah, the transaction would be complete.

The Islamic shari‘ah does not recognise the validity of forward sales where an item currently not in the possession of the seller is sold through a sale transaction that becomes effective on a future date. Consequently, the financier in Murabahah may not enter into a forward transaction of sale when the client seeks a Murabahah facility. In this situation, the financier is compelled to purchase the required article from a third party, take possession of it, and thereafter sell it to the client on Murabahah. However, if the client refuses to purchase the article from the bank after the bank had purchased it from the supplier, this could possibly result in the bank being left with an item that cannot be disposed of without incurring a loss. To avoid this situation that would inhibit financiers from embarking on Murabahah transactions, especially when these involve consumer specific items, the client could be made to enter into a unilateral promise that he would purchase the asset when it is acquired by the financier. A bilateral contract where both the financier and the client bind themselves to enter into a contract of sale on a future date should be avoided, as it would be construed as a forward sale.

Thus, the initial request made by the client that the financial institution procures the required commodity from the market could, when necessary, take the form of a unilateral promise made by the client to the bank. Here the client promises that when the bank purchases the asset from the market, he would subsequently purchase it from them at a pre-agreed price calculated on cost plus mark-up basis. This is to eliminate the possibility of the client refusing to purchase the asset from the bank after the latter had procured it from the market. It is essential here that only the client binds himself to purchase the asset from the bank, while the bank does not promise to sell the asset to the client. This is to avoid entering into a bilateral promise binding both parties to contract a sale on a future date, resembling a forward sale which is prohibited in shari‘ah.

The two transactions of sale that follow this promise, where the bank purchases the commodity from the market first and sells it to the client second on cost plus mark-up basis, should both complete the relevant conditions for sales in shari‘ah. Thus, the bank should

unequivocally purchase the item preferably through its own channels and take possession of it, either physically or constructively. Here constructive possession means having the item in the bank's risk for a period of time, so that if the item is destroyed in that period the full responsibility devolves on the bank. The bank may procure the item from any supplier at its discretion, or purchase from a source indicated by the client. The subsequent sale to the client should take place after the bank had thus purchased it first and had borne its risk for some time. The bank transfers ownership of the asset to the client through a properly executed contract of sale, whereby the risk is transferred to the client for the first time.

The above illustrates the preferable procedure for Murabahah which should be adopted by financial institutions, and attempted to be implemented wherever possible. However in practice, an additional dimension is usually added to the above transaction that further complicates the matter and makes the procedure immensely vulnerable to abuse and foul play. This is the appointment of the client himself as the agent of the institution for purchasing the asset on latter's behalf. Due to the introduction of this element, the distinction between the two sales and therefore between the two distinct ownerships, i.e. the ownership of bank first and the ownership of the client second, becomes marginal, making the involvement of the bank in the transaction similar in appearance to that of a conventional financier who takes no part in the risk. We shall see below how this development affects the Murabahah transaction.

As stated above, the bank procuring the required asset through its own channels and keeping it in its own possession is preferable to getting the client involved in the process. There is no harm in purchasing from a supplier indicated by the client, as long as the client does not play any role in the purchase. This would make the bank's ownership of the goods more pronounced, and the subsequent sale to the client would appear more genuine. Any additional cost involved in the process could be added on to the cost of Murabahah for mark-up calculation.

However, due to various reasons, most financial institutions do not find this method convenient. Therefore, they prefer appointing the client himself who sought the Murabahah facility as the agent of the institution for purchasing the required asset on behalf of the institution. While this practice is correct in theory and therefore could be adopted when direct purchase from the supplier is not practicable due to some reason, it invariably results in increasing the complexity of the transaction, as now the bank and the client have to act in different capacities in different stages, and makes the point of transfer of the asset's ownership to the client become somewhat obscure.

In appointing the client himself as the purchasing agent of the bank, it is necessary to understand that when the client first purchases the asset from the supplier in this capacity, the asset enters into the ownership of the bank, and not the ownership of the client himself. When he takes possession of the asset as the bank's agent, it would be regarded as possession by the bank, and the risk of the asset is transferred to the bank. Any loss befalling the asset at this stage would be borne by the bank solely, provided the client had discharged the duties of agency diligently, as the client is only a trustee holding assets belonging to the bank. Consequently, the client is not permitted to consume or utilise the asset in anyway at this

stage, as this would amount to breach of trust. The asset would enter the ownership of the client only when the second contract of sale is finalised between the bank and the client, whereby the bank would sell the asset to the client on Murabahah terms as agreed. With this sale, the client would become owner of the asset, and start to bear the risk of the asset. Utilising the asset through any means such as consuming it or disposing of it through a contract becomes lawful for the client only after he purchases the asset thus from the bank through the second contract.

The agency given to the client by the bank may be for the purchase of a specific quantity of a specific item from a specified supplier, or for purchasing unspecified quantities of a type of commodity from unspecified suppliers. In the latter case, it would form a general agency, authorising the client to make several purchases on behalf of the bank. However, since what the client purchases on behalf of the bank remain at the risk of the bank, it should be ensured that the client exercises proper care in storing the commodities belonging to the bank separately, and duly purchases them from the bank on Murabahah before using them for his own purposes. Since general agency makes monitoring of the client's activities difficult and also is highly vulnerable to abuse, it should be granted only when necessary. Site visits should be undertaken regularly to ensure compliance.

Applications of Murabahah In Financing

Murabahah as described above could be used to finance the purchase of assets in a variety of forms. It could be employed wherever assets are needed to be purchased from a third party. From financing consumer items such as washing machines and vehicles, it could be used in corporate financing where building complexes, factories and real estate are to be purchased. Trade financing, both for local purchase as well as import, is widely done on Murabahah based structures. The procedure adopted in each of these is taken up for discussion in what follows.

Consumer Financing on Murabahah

Murabahah is popularly employed for financing the purchase of consumer items such as furniture, computers, vehicles, etc. Here, subsequent to approval of the facility and signing the overall agreement with the client, the client produces a quotation or pro forma invoice from the supplier indicating the price and other details of the item. Usually at this stage, the client makes an undertaking to purchase the asset from the bank, which, as described above, is a unilateral promise made by him, so as to protect the bank from being left with the goods if the client refuses to purchase them.

If the financial institution is satisfied with the genuineness of the request, it purchases the item from the supplier and takes possession using its own agents and means, prior to selling the item to the client on Murabahah. If this is not convenient, it appoints the client as its agent for purchasing the asset on its behalf. The payment is released directly to the supplier without the involvement of the client, through a medium such as bank transfer or a crossed account-payee cheque. After the client purchases the asset and takes possession on behalf of the bank, the bank is informed of this, and the bank preferably verifies the receipt of the goods through its own means. It is highly preferable that the bank requires the client to bring

the asset to the bank's own stores and lets it remain there for at least a day, so as to establish the risk of the bank beyond all doubt.

Subsequently, the bank sells the asset to the client on Murabahah terms through duly accepting a specific offer to purchase forwarded by the client, where the cost of the asset, the profit, the total Murabahah price, the due dates of payment for the full price or instalments etc. are clearly stated. The asset becomes the property of the client only upon the acceptance of the bank, until which the asset remains at the risk of the bank.

The credit period for the settlement of Murabahah price starts from the date the sale to the client is completed, i.e. the date when the bank accepts the offer to purchase forwarded by the client. The period does not start from the day the bank releases funds to the supplier of goods, as goods are purchased by the bank itself initially. The client becomes a debtor to the bank only after he purchases the goods from the bank on Murabahah. Due to this reason, when the profit margin of the Murabahah price is calculated on the basis of the period of credit, the time elapsed prior to the sale to the client in which the goods were in the possession of the bank may not be taken into consideration.

Murabahah In Trade Finance

Murabahah could be used for financing the purchase of trade goods, including both raw material as well as stock. The basic features of Murabahah are similar in essence to those of consumer financing. However, the payment periods are usually shorter here. The number of transactions carried out under a single facility is considerably higher than in consumer finance, as the purchase of each consignment constitutes a separate Murabahah transaction. Due to this, ensuring meticulous observance of all necessary conditions becomes a hard task, requiring the sincere intent both of the client as well as the financial institution.

In Trading Murabahah, usually a limit is approved for client, limiting the maximum amount that may become outstanding at a single time through entering in to a number of Murabahah transactions. After the overall agreement, whenever a consignment is to be purchased, the client submits the relevant quotation or pro forma invoice together with an undertaking to purchase, as described above in consumer financing. It is important to ensure that the client does not apply for Murabahah for goods that have already been purchased by him. This is of especial concern in Murabahah for trading, where consignments are purchased by clients on a daily basis. There is a possibility of an application for Murabahah being made by the client for consignments he had purchased directly from suppliers and had taken delivery, for the purpose of obtaining funds for payment to suppliers. Therefore, verifying the dates of quotations and making enquiry as to whether the goods have already been purchased is essential. Traders sometimes do so on the assumption that goods that have not yet been paid for still belong to the suppliers.

After verification, agency is granted to the client for purchase on behalf of the bank. Each undertaking to purchase requires a separate agency. When the client effects the purchase from the supplier on behalf of the bank and takes possession the goods enter the bank's risk. In this stage, the client is not allowed to sell or utilise the goods, as they still belong to the bank. If retaining the goods in the bank's own storing compounds prior to the sale to the

client is not feasible, the client should be emphatically required to store them separately, distinct from other merchandise belonging to him, until his purchase from the bank is complete. Site visits should be made periodically to ensure compliance in this respect, as sometimes traders hastily sell such consignments before purchasing them from the bank.

It is essential that the possibility of the funds being channelled to suppliers through the clients is prevented in Trade Murabahah as far as possible. This is for the purpose of ensuring that only genuine transactions take place. If funds are released to the client at the time of agency, this would result in the bank losing its control over the transaction, due to the possibility that the client could use the funds for other purposes, or negotiate credit terms with the supplier for partial or delayed payment. If due to some compelling reason funds are released to the client for payment to suppliers, it should be done only with clients whose sincerity in carrying out genuine Murabahah transactions is established. It is imperative that properly drawn receipts are obtained from the suppliers in this instance. If the bank knowingly approves Murabahah facilities for fictitious transactions, or the laxity of the system leads to such transactions being carried out, the profit earned may not be permissible.

When the offer to purchase from the bank is forwarded by the client, it should be promptly accepted, as the client may start using the goods for his own purposes only after this. It is essential that the Murabahah period starts from the date of acceptance. It is best that the bank arranges to complete the sale to the client after a site visit and verification of the goods purchased. Similarly, it is possible that after the initial agency is granted and the client effects the purchase on behalf of the bank, the bank may find that the client has reached the limit of his facility. However, as the bank has already become the owner of the goods, it may not refrain from payment to the supplier at this stage.

Murabahah For Import Purchase

A large portion of import transactions are financed by Islamic financial institutions on the basis of Murabahah. Instead of providing an interest based credit facility for imports as done by conventional banks, the Islamic bank is expected to import the consignment in its name first and thereafter sell it to the client on Murabahah. The procedure here is more complex as compared with Murabahah for local trade due the involvement of Letters of Credit, import documents such as Bills of Lading and Airway Bills as well as foreign exchange conversions. Ensuring the ownership of the bank over the consignment and bearing its risk prior to the sale to the client are points of concern in this procedure. Since there remains an amount of uncertainty over whether the shipping documents being in the name of the bank alone is enough to ensure complete ownership of the bank over the goods, Murabahah is not recommended for import transactions. The manner in which Murabahah is usually practised by Islamic banks in financing import purchases is analysed in what follows.

An overall agreement for providing Murabahah facilities for import purchases is signed between the bank and the client. When the client wishes to import a consignment of goods, he obtains the Pro Forma Invoice from the supplier and forwards it to the bank together with the undertaking to purchase. The undertaking to purchase only provides an approximate indication of the cost, mark up and the Murabahah price etc, as these are subject to change due to possible differences in shipping documents and exchange rate fluctuations.

The bank issues a Letter of Credit initiating the process of import. Upon receipt of the Letter of Credit through the negotiating bank, the supplier ships the goods and forwards the Bill of Lading, Invoice and other shipping documents to the L/C opening bank. The Bill of Lading and other documents are expected to be in the name of the L/C opening bank, thus purportedly establishing the bank's ownership over the consignment.

The bank releases the shipping documents to the client by endorsing them in his favour to facilitate port clearance, at the same time effecting a sale transaction to the client through offer and acceptance. From the point of time when the supplier surrenders the goods to the shipping company until the L/C opening bank sells the goods to the client, the goods purportedly are in the ownership of the bank (i.e. the L/C opening bank) and at its risk. If the consignment is damaged or is destroyed during this period, the bank may not claim any compensation from the client. Even if the consignment is insured through some Islamic arrangement such as Takaful or through conventional insurance, this would not change the party that bears the risk primarily, as insurance only facilitates compensation to the owner if a loss occurs, and does not eliminate possibility of loss.

Import On L/C Sight Terms

In the case of import on L/C sight or D/P (documents against payment) terms where no credit period is involved and remittance to the supplier is done immediately upon receipt of the documents, the Murabahah sale to the client could take place after the bank had remitted payment to the supplier. In this event, the amount of local currency spent by the bank for the purpose is known with certainty and the Murabahah sale could be carried out with ease on the basis of local currency.

Import On D/A Terms

When the import is on D/A (documents against acceptance) terms where the supplier himself extends a credit period, payment to the supplier is to be remitted at a future point of time. If the Murabahah sale to the client is planned to be carried out in the local currency, this would require knowledge of the exact amount to be remitted in the local currency, which is not possible due to fluctuation of exchange rates. Therefore, it is not possible to affect a Murabahah sale to the client in local currency in D/A imports. If remittance is to be done in foreign currency, the Murabahah sale also could be carried out in the same currency. On the due date of payment, the client could either settle the Murabahah price in the relevant foreign currency, or pay the equivalent in the local currency based on the exchange rate prevailing on the date of payment.

If the client is not willing to carry out the Murabahah purchase in foreign currency due to his apprehension that an unexpected rise in exchange rates could affect him adversely, there remains no possibility of a Murabahah transaction being carried out in this instance. The only option in this situation is to carry out a Musawamah sale where the bank sells the consignment to the client at a lump-sum price fixed through negotiation. The Musawamah contract does not provide any indication of the cost and profit elements. The sale in this instance could be carried out in the local currency. However, a sale on Musawamah basis requires the existence of a Musawamah agreement between the bank and the client

beforehand, where the nature of the Musawamah transactions to follow is clearly stated. Therefore, if imports are to be done on D/A basis, a Musawamah agreement should be in place, and the import could be financed on the understanding that the consignment will be sold to the client on Musawamah.

In Murabahah for imports, the bank may not charge the client anything other than the Murabahah profit mark-up calculated on cost. No separate charges such as L/C opening fee, handling charges etc could be levied from the client. This is because importing the consignment is expected to be done by the bank itself. These aspects could be kept in view when agreeing on the profit ratio for Murabahah. Apart from the Invoice amount remitted to the supplier, other actual costs incurred by the bank such as custom duty could be included in the cost of the consignment for mark-up calculation, provided the bank undertakes to pay these before the Murabahah sale to the client.

The Murabahah/Musawamah period should start from the date the consignment is sold to the client, i.e. the date the offer to sell forwarded by the bank is accepted by the client, and the shipping documents endorsed in his favour, as this is the point when the client becomes the owner of the goods. The period may not start from the date money is remitted to the supplier, nor could mark-up be calculated for the intervening period if there is any delay in the acceptance by the client.

Observations on The Application of Murabahah In Trade Financing

Careful consideration of the procedural aspects of Murabahah would reveal that its application in a financing context is prone to error and abuse in a number of ways, which makes its proper implementation challenging. In employing Murabahah for financing trade, due to the involvement of agency enabling the client to purchase the goods on behalf of the bank and take possession himself, the mechanism becomes vulnerable to abuse. Although such agency could be theoretically upheld as valid and may facilitate the bank's purchase especially when it may not purchase directly from the supplier for some reason, due to this element, the distinction between the two ownerships, i.e. the initial ownership of bank and that of the client afterwards, becomes marginal, as the transfer from one to the other takes place while the goods are in the custody of the client. The agency may also enable exploiting Murabahah for obtaining funds, without the involvement of an asset. If funds are released to the client under agency even in a genuine transaction, the client could delay forwarding them, by negotiating credit terms with the supplier. The asset sought to be financed may have already been purchased by the client and taken possession before the involvement of the bank. The client may even dispose of the goods before purchasing them from the bank, whereas doing so is lawful only after he purchases from the bank through an independent second contract.⁴

In order to overcome these and other similar issues arising in Murabahah, implementation of equity based modes such as Musharakah should be attempted in trade financing. Being

⁴ Client's purchase of the goods in his custody from the bank cannot be understood to take place automatically through a *ta'a'li* contract, i.e. an implicit contract indicated by the actions of the contractors, without the involvement of textual expression. Also, an agent for sale may not sell to himself assets belonging to the principal.

expressly designed for financing, these could replace in many instances debt based modes such as Murabahah that have been tailored to fit in artificially. Equity based structures for purchase of assets for trade, in addition to being distinctly advantageous through facilitating an equitable sharing of profit and loss, could significantly smoothen the process while avoiding negative aspects related to debt financing mechanisms such as Murabahah⁵.

Conclusion

In Murabahah financing practised by Islamic financial institutions, instead of extending a loan facility to the client for purchasing commodities required by him, the Islamic bank purchases the commodity from the supplier first and thereafter sells it to the client usually on deferred payment basis, at an agreed fixed price comprising the cost incurred by the bank and an additional margin of profit. In the context of financing, Murabahah takes the form of a complex procedure comprising several transactions, reflecting several relationships between the parties involved. Being a mode of sale, all rules and conditions that are relevant to sale transactions remain applicable in Murabahah even when it is used for financing purposes. When carried out correctly with due observance of all requirements, Murabahah provides a lawful means of fulfilling one's immediate financing requirements at a premium, without being constrained to borrow on interest.

Thus, the major positive aspect of Murabahah when carried out correctly is that it provides a lawful alternative to financing on the basis of interest, which is no meagre benefit. As far as those who avail of Murabahah facilities are concerned, their benefit is principally in the form of avoiding entanglement in the curse of riba, thus ensuring their spiritual and material wellbeing in this world as well as in the hereafter. This in itself is a major achievement of Murabahah based financing. Moreover, funds that were paid as interest to conventional banks previously and which served the purpose of furthering the interest based system are now channelled to Islamic banks and their depositors in the form of lawful profit, which is a tangible gain. However, when the necessary conditions are not fulfilled in the application of Murabahah, the process would be invalid from a Shari'ah perspective. This would result in the failure of the basic purpose for which Murabahah was adopted in the first place, which is avoiding violation of shari'ah.

It should not be forgotten that enjoying the fruits of the economic system propounded by Islam requires more than only evading direct violations of shari'ah. In fact, Islam has provided complete guidelines for establishing a just economic system that could eradicate social and economic oppression resulting from interest, monopoly, hoarding and speculation, ensuring an equitable distribution of wealth. A vital feature in this system would be the full-fledged adoption of the equity based financing mode of Musharakah. Utilising a debt based trading tool such as Murabahah in financing could never bring about the real benefits of the Islamic economic system. Therefore, employing modes such as Murabahah and Ijarah where the net result is not materially different from interest based transactions, should be restricted to instances where adopting Musharakah is not feasible. Widespread use of Murabahah in all

⁵ For a detailed discussion on the practical application of equity modes financing in trade, see Muhammad Abdurrahman Sadique (2015), Application of profit and loss sharing modes in trade financing for small-scale businesses: an alternative to debt based financing, in IIUM Law Journal, Vol. 23, pp. 175-189.

spheres of financing should be curtailed and means for widening the scope of application of Musharakah actively sought, facilitating the gradual transition from Murabahah based structures to full-fledged implementation of equity based modes for financing.

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