

***A critical analysis of Murabaha transaction in the
banking sector of Pakistan***

Dr. Rashid Ahmad¹

Abstract

Islamic Economic system has its unique features and characteristics, and in the modern era Islamic banking, is gaining more and more attention of people throughout the world in general and in Pakistan in particular owing to its usefulness. There has been a time when Islamic banking was just a dream, but today Muslim scholars have, after long deliberations, succeeded in their efforts to present a workable framework for it. Although they have recommended that Islamic banking should be based on Musharakah and Mudharabah transactions as these are the ideal modes, people in Pakistan are inclined towards Murabaha instead. Although Murabaha transaction is a simple form of sale and purchase, however, when it takes the shape of transaction in banking sector it becomes a combination of several other transactions. The State Bank of Pakistan has specified a corner for Islamic banking, the details of which are available on its website. This paper will focus on a critical analysis of the documents and rules and regulations of Murabaha transaction presented by the State Bank of Pakistan and present suggestions to make it in consonance with the teachings of Islam.

Key words: *Islamic Economic, Islamic Banking, Musharakah, Mudharabah*

An important aspect of individual and collective human life is economic. The economic system of Islam has its unique features. Islam has permitted earning by lawful means while unequivocally prohibited all unlawful means like bribery, deceit etc. However, it has laid great emphasis on the prohibition of usury (interest) as it is the worst form of earning and is a major source of exploitation.

The Holy Quran Says.:

“Those who eat usury will not stand (on the Day of Resurrection) except like the standing of a person beaten by the Satan leading him to insanity. That is because they say: "Trading is only like usury," whereas Allah has

¹ Associate Professor in Islamic Studies, Shaykh Zayed Islamic Centre, University of Peshawar

permitted trading and forbidden usury. So whosoever receives an admonition from his Lord and stops eating usury shall not be punished for the past; his case is for Allah (to judge); but whoever returns (to usury), such are the dwellers of the Fire - they will abide therein¹.”

The Holy prophet (PBUH) prohibited usury at many occasions:

عَنْ جَابِرٍ، قَالَ: «لَعَنَ رَسُولُ اللَّهِ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ آكِلَ الرِّبَا، وَمُؤَكِّلَهُ، وَكَاتِبَهُ، وَشَاهِدَيْهِ»،
وَقَالَ: «هُمْ سَوَاءٌ»

Jabir reported that Allah's Messenger (peace be upon him) cursed the persons who ate usury, gave usury, documented a usury deal or stood witness to it. According to Jabir, the Holy Prophet (peace be upon him) further said that all of the said persons were on equal footing².

عَنْ أَبِي هُرَيْرَةَ، قَالَ: قَالَ رَسُولُ اللَّهِ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ: «الرِّبَا سَبْعُونَ حُوتًا، أَيْسَرُهَا أَنْ يَنْكِحَ الرَّجُلُ أُمَّهُ»

Abu Hurairah reported that the Holy Prophet (peace be upon him) said that the sin of usury equaled seventy sins with the slightest of them being equal, in despicability, to incest with one's own mother³.

عَنْ أَبِي هُرَيْرَةَ، قَالَ: قَالَ رَسُولُ اللَّهِ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ: "رَأَيْتُ لَيْلَةَ أُسْرِي بِِي، " فَأَتَيْتُ عَلَى قَوْمٍ يُطَوِّئُهُمْ كَالْبُيُوتِ فِيهَا الْحَيَاتُ تُرَى مِنْ خَارِجٍ يُطَوِّجُهُمْ، فُلْتُ: مَنْ هَؤُلَاءِ يَا جِبْرِيْلُ؟
قَالَ: هَؤُلَاءِ أَكَلَةُ الرِّبَا

Abu Hurairah reported that the Holy Prophet (peace be upon him) said: "On the Night of Ascendance to the Heavens I passed a group of people who had tummies as big as houses, filled with snakes that could be seen from outside. I asked the Arch-Angel Jibrael who were they. Jibrael said that they were the people who ate usury⁴.

It is ironic that although Islam has clearly prohibited usury in all its forms and manifestations, the whole edifice of modern banking system stands on interest-based transactions. Some Muslim scholars started reflecting upon how to eliminate usury from this sector, and after a long endeavor succeeded in presenting a workable framework for interest-free banking. They based their deliberations on the principle that the mere act of advancing money is not prohibited in Islam subject to the condition that it is invested on the basis of profit-and-loss-sharing. Islamic commercial law presents alternative modes of financing based on this concept, and in most cases it has been proved more productive and beneficial than interest-based transactions.

This was the cause of resurgence of fundamental Islamic values in many parts of the world which manifested itself on the economic front as well, with a number of Muslim countries stepping forward to transform their economic system, especially the banking system, to conform more closely to the precepts of Islam⁵.

Muslim scholars have also presented other modes of financing where financing on the basis of sharing of profit and loss is difficult, like leasing, salam and *murabaha* etc. But most people showed their interest in *murabaha* transaction owing to its simple procedure as compared to other modes. The Stat Bank of Pakistan has prepared a document for this purpose, a critical analysis of which is needed as there are some important issues which have been ignored in it. In this article, the said issues will be discussed and their solutions will be suggested.

Definition

Murabaha is an Arabic word and its root is *ribh* which means to earn profit⁶ while technically speaking it is a sale of goods at a price covering the purchase price with profit margin agreed upon between the contracting parties.⁷

Difference between Murabaha and Sale

In Islamic Law the contract of sale with respect to the cost is of three kinds:

1. *Tawliyyah*

The resale of the object to the seller at the original cost without any profit or loss is called Tawliyyah.

2. *Wadi'ah*

Resale of the object at a discount rate from the original rate is called Wadi'ah.

3. *Murabaha*

Resale of the subject with profit on the original cost while the buyer knows the original cost⁸.

Then, if a client purchases a commodity and payment is done through cash, it is a simple form of *murabaha*, and if he purchases it on deferred payment then this type is called

Tahdhīb al Afkār A critical analysis of Murabaha..... Jan-June. 2015
murabaha mua'jjal. In Pakistani banking sector, most transactions are carried out on the basis of *murabaha mua'jjal*. Although this is not an ideal choice for a transaction, it can be practiced on a limited scale in industrial and agricultural sector very easily⁹.

In the light of the above discussion it is clear that in simple sale the cost price is not disclosed at the time of bargaining while in *murabaha* transaction the buyer must disclose the cost price.

Rules for validity of Murabaha Transaction

Each *murabaha* transaction must comply with the following rules:

- A. Existence of the subject at the time of sale: Islamic law does not allow the sale of a subject that does not exist at the time of transaction.
- B. Ownership of the subject: The seller must be the legal owner of the object at the time of transaction or else the transaction will become void.
- C. Possession of the Subject: The subject must be in physical or constructive possession of the seller. Physical possession means tangible control over the subject while constructive possession is a situation where the seller has not taken delivery of the subject physically and it yet has to come in to his control while bearing all liabilities, risk as well as related rights with the commodity.
- D. No sale on future date: It means that the transaction must be instant as well as absolute. Thus, if a seller says that he will sell his subject in future, the transaction will be void.
- E. Selling of valuable goods: The commodity that is being sold must be a good having value. Any goods with no value in the market are not allowed to be sold.
- F. Use of commodity in un-Islamic ways: If a commodity is used in un-Islamic ways, its sale and purchase is prohibited.
- G. Specification/identification of the commodity to the buyer: The commodity must be identified and known to the buyer. There should be no ambiguity.

- H. Delivery to the buyer: The delivery of the sold commodity should not depend on any contingency or chance. It should be certain.
- I. Certainty of price: The price must be certain and any uncertainty in it will make the transaction void.
- J. Condition(s) in the sale: Principally, the transaction should be without any condition. However, Islamic jurists allow any such condition that is recognized as part of the transaction according to custom of the traders.¹⁰

The following procedure is adopted for carrying out the murabaha transaction

1. Agreement

First of all, an agreement is made between the client and the bank according to which the bank promises to purchase the commodity from the market while the client promises to purchase it from the bank. Profit is determined at this stage.

2. Agreement of Agency

The bank may appoint the same client as its agent to purchase the commodity as agreed upon.

3. Possession

The client purchases the commodity and takes it in his possession on behalf of the bank.

4. Information

The client informs the bank about the purchase and then gives offer for the purchase of the commodity.

5. Acceptance of the offer

The bank accepts this offer and agreement of sale is concluded. Now the ownership and risk of the sold commodity is also transferred to the client¹¹.

The document of *murabaha* presented by the State Bank of Pakistan needs further improvement. The following discussion will be helpful in its reformulation in order to achieve consonance with the teachings of Islam. It is required that the following material should be made part of the document.

1. *Murabaha* is a transaction which is totally different from an interest-based loan transaction, therefore it is essential for all the concerned parties to keep this point in mind, thus the transaction of *murabaha* would be valid only if it is carried

out according to the rules and principles of sale as enunciated by Islamic jurists¹².

2. To achieve this goal the State Bank of Pakistan must appoint such experts of the Islamic Banking in its every branch in order to supervise the whole process and guide the concerned parties in the right direction.
3. Specification of duration: Specification of duration of the purchased commodity and the period of its utilization is essential as failing to do so may render the transaction ineffective. For example, if the client purchases the commodity before the agreement with the bank, or starts using it before completion of the transaction, the transaction will become invalid¹³. To achieve this goal the State Bank of Pakistan must issue clear instructions to the concerned banks that in no case the client or the agent would purchase the commodity before the completion of the transaction.
4. Security: When the agreement of murabaha comes in to existence, the bank is concerned with the risk of default on behalf of the client. Therefore, the bank seeks collaterals in this regard. These collaterals are of three types.

The first type is general guarantee where directors of the institution offer their personal guarantee, that is, in case of default, loss of the bank is covered from their assets.¹⁴ In Islamic jurisprudence, it falls under the category of *Kafalah* (surety ship) and, therefore, all conditions of *Kafalah* as laid down by Islamic jurists must be fulfilled. There are rules about the surety (*dhamin*), creditor (*makfool-lahu*) and subject-matter (*makfool-bihi*). Therefore, it would be appreciated if a complete charter of these rules becomes part of the *murabaha* transaction. The second type of collateral is hypothecation, that is, a guarantee related to moveable assets of the client. In case of default, the bank is authorized to take possession of the guaranteed asset.

The third type is pledge with possession. In this kind, the bank takes custody of the sold item or its documents until payment is done. In fact, this pledge is a contract of *rahn* in Islamic jurisprudence which is a security that can be employed lawfully for satisfaction of a claim in respect of a debt.¹⁵ The contact of *rahn* has conditions for pledged property, and for

claim or debt for which pledge is given. Also, there are related issues such as the issue of maintenance of pledged property and benefiting from pledged property by pledger etc . All these issues must be clearly mentioned in the contract of murabaha.

5. Risk of delay in payment is another issue. In conventional banking, interest on certain ratio is imposed in case the client delays to make payment, but in Islamic banking, it is not permitted to make transaction based on interest. To resolve this issue, Muslim scholars presented an alternate solution according to which if the client fails to pay on time without a valid excuse, he will be bound to pay a certain amount as penalty, but the bank will not use this amount for personal benefits rather this amount will be used for charity purposes. In essence, it is a pledge and the client is bound to fulfill it otherwise he may be brought to court in order to compel him for fulfillment of pledge.
6. Sometimes the bank seeks guarantee of a third person in order to ensure timely payments, and in case of delay or default, the bank will recourse to the guarantor¹⁶. This type of guarantee falls under the category of *Kafalah bil-mal*. According to Islamic Jurisprudence it is surety ship for the satisfaction of claim whereby the surety may be called upon to perform the obligation of the principal debtor if he makes default in payment of his debt¹⁷.

The present document does not provide clear injunctions in this regard, while it should be made part of the agreement in order to avoid any dispute in the future.

7. Rollover in *murabaha*: As it is made clear from the very outset that *murabaha* is a transaction which is totally different from a loan deal. Therefore, all rules of sale and purchase are implemented on this transaction. However, some cases have been reported that some time the client requests the bank to extend the maturity date of *murabaha* on the basis of rollover. The bank agrees with this request and the date is extended with addition of some amount. This is totally prohibited as it becomes purely an interest-based transaction. The reason is that once the commodity is sold, its ownership is transferred to the client and now the bank has nothing to do with it except the claim of its amount

which it has spent for the purchase of the commodity with the profit which has been specified at the time of transaction¹⁸.

8. Rebate in the case of early payment: Sometimes the client wants to rebate the money before the stated time of the agreement with the hope of discount from the bank. Today's scholars like Taqi Usmani has discussed this issue at length. According to him, rebate is permissible but there should be no condition of discount at the time of the agreement of *murabaha* transaction. However, if the bank makes discount on its own without any precondition then it is not only allowed but it is appreciated particularly when the client is needy¹⁹.
9. Calculation of cost in *murabaha*: In *murabaha* transaction it is essential that the client must know the actual cost and profit at the time of transaction. However, sometimes certain problems arise in this regard. For instance, if the bank purchases a commodity in foreign currency then due to the fluctuation of currency the bank may suffer loss. To cope up with this situation, Taqi Usmani has suggested three solutions:

In order to avoid the risk of currency fluctuation the bank should purchase the item first while price should be determined at the time of transaction and not before.

The bank may carry out the whole transaction in dollars and thus the client will pay in dollars.

The bank may also carry out this transaction without letting knowing to the client the actual cost and hence this transaction will become a simple sale instead of *murabaha* transaction.

10. Subject-matter of *murabaha*: While carrying out *murabaha* transaction it is important to know that all commodities are not allowed to be transacted. For example, *murabaha* is permissible in shares of a company while not permissible in exchange of currencies because it must be spontaneous or, if deferred, on the market rate prevalent at the time of transaction²⁰.
11. Rescheduling of payments: It is also a common observation that sometimes the client requests for rescheduling the installments. In conventional banking it is a matter of

routine as they do so by adding some amount over and above the stated amount in the basic contract. But in Islamic banking, rescheduling is allowed only if it is done without charging any additional amount because any additional amount would be an interest-based transaction which is prohibited in Islam²¹.

12. *Murabaha* is a transaction where actual sale and purchase of a commodity is essential. If that does not take place and *murabaha* is used for other purposes like, for example, payment of staff salary, then this will be totally un-Islamic. In such situations, other modes of financing like lease and *Musharakah* etc. can be used²².
13. It has been observed that sometimes the client does not intend to purchase the commodity at all, but he signs the *murabaha* document only to acquire money and use it for purposes other than for which the *murabaha* transaction has been carried out. In this respect it is the duty of the bank to ensure that the money has been spent for the purpose for which the contract has been signed. The bank can do it either by paying the amount directly to the supplier or by checking the invoices and other documents or by the physical inspection of the commodity²³.
14. It has been also observed that sometimes all documents of *murabaha* transaction are signed at one time without taking care of sequential signing of the contract. This practice is totally un-Islamic. It is obvious that *murabaha* transaction is a collection of several other transactions which need time to be effected. Without taking care of this, the whole transaction will be of no weight in the eyes of Shariah²⁴.
15. One common mistake which takes place while carrying out *murabaha* transaction is that sometimes the client has in their possession the commodity as owner and he draws amount on the purchased commodity. This is also un-Islamic as it falls under the category of buy-back sale which is not permitted particularly in *murabaha* transaction²⁵.
16. It is also essential that the purchased commodity must come in the actual or constructive possession of the bank before its ownership is transferred to the client. If risk of the

commodity is not borne by the bank, even for a while, this transaction would be null and void²⁶.

17. It has been strongly recommended by modern day Islamic scholars that the bank should purchase the commodity on its own and then should be handed over to the client. However, in some cases the bank authorizes the client to purchase the commodity on its behalf. It means that a new contract of agency is taking place between the bank and the client. Therefore all rules of agency should be clearly mentioned and implemented. There are conditions related to the principal(*muwakkil/asil*)and some conditions are related to the agent (*Wakil*), while there are some conditions related to the subject matter as well (*muwakkal bihi*).It would be more desirable that a form should be prepared stating all these conditions with describing duties of the agent towards his principal and vice versa.
18. The process of *murabaha* is simple when it takes place locally. However, when the client wants to import the commodity, he cannot import by its own. Rather, he has to contact the bank for this purpose. The reason for this is that the exporter wants some guarantee to ensure receiving the price of the goods. In this regard the bank of the importer gives surety to that exporter for the payment. This surety is called Letter of Credit (L/C) and it is widely used in local business as well²⁷.

In conventional banking the bank of importer provides two-fold services. In case of Full Margin L/C it provides services as agent or guarantor of the importer while the bank of the exporter provides services in the form of agency or in the form of creditor. In providing all these facilities the relevant bank charges the client, but in Islamic banking the bank can charge the client for playing the role of agent only while he cannot be charged in other cases, therefore it is essential to keep this point in mind while preparing documents of *murabaha*.

19. It is a general perception in Pakistan that *murabaha* transaction is used as credit vehicle. They think that usury is involved in this transaction as it provides finance for the purchase of commodity with pre-determined profit and does not bear any risk also ²⁸. This is a serious allegation

and all those banks and financial institutions which are involved with Islamic modes of transactions must address this issue otherwise it would be a very difficult situation for scholars who advocate Islamic banking and promote it among the masses.

20. One common misconception is that many people are not aware about the actual difference between conventional and Islamic banking and they consider both similar in essence. It is the need of the hour to clarify to the customer differences between the two systems so that the implementation of Islamic banking in its letter and spirit becomes possible.

Conclusion and suggestions

The topic under discussion is in fact very detailed and it is not possible for a single researcher to cover all transactions and aspects of *murabaha* transaction carried out in each and every bank of Pakistan. A wide field of study and research is available for the new researchers to choose some banks where *murabaha* transaction is carried out and critically analyze it in the light of the research presented by this researcher.

It is also obvious from the above discussion that that the present-day Islamic banks do not fulfill their duties while carrying out *murabaha* transaction. It is high time that trust of common man on Islamic banking gets restored as it is feared that if the system continues to fail, it will be too difficult to restart it in future. On the other hand, many banks in non-Muslim countries are seriously taking measures to introduce Islamic banking. Therefore, it is the foremost duty of all banks and financial institutions to reconsider and re-evaluate their documents and fulfill all deficiencies related to different modes of transactions.

References

- 1: (*al-Quran*, 2:275)
- 2: *Al-Qushairy, Muslim bn al-Hajjaj,(n.d.) al-Sahih3/1219 Kitab al Musaqqat, Bab Laan al- aakil al-Riba, Beirut, Dar Ihya al-Turath al-Arabi.*
- 3: *Al-Qazwini, Muhammad bn Yazid ,(n.d.) (2/764). al-Sunan, Kitab al-Tijarat, Bab al-Taghliz fi al-Riba Beirut, Dar Ihya al-Turath al-Arabi.*
- 4: *Ahmad bn Hanbal, al-Imam,(2001) al-Musnad 14/285) (2001), Beirut, Muassasa al Risala*
- 5: *Mohsin, Khan and Abbas Mirakhor, (1987), Theoretical Studies in Islamic Banking and Finance, p.1 Texas, The Institute for Research and Islamic Studies.*
- 6: *Al-Afriqi, Ibn al-Manzoor, 11/234) (1987), Lisan al Arab, Beirut, Dar al-Sadir*
- 7: *Mansoori, Muhammad Tahir, (2009), Islamic Law of Contracts and Business Transactions, p. 213 Islamabad, Shariah Academy*
- 8: *Mansoori, Muhammad Tahir, p. 214*
- 9: *Report on Belasood Bankari, p.107 (1988),Islamic Ideology Council Islamabad*
- 10:) *Ashraf, Muhammad Usmani, (2002), Islamic Banking, p. 126 Karachi, Dar al Ishaat.*
- 11: *Usmani, Muhammad Taqi (2002), An Introduction to Islamic Finance, p. 107, Karachi, Maktaba Ma'ariful Quran.*
- 12: *Ibid*
- 13: *Samadani, Ejaz Ahmad, : (2008), Islamic Banking and Murabaha, p. 49 Karachi ,Dar al Ishaat.*
- 14: *Ibid*
- 15: *Mansoori, Muhammad Tahir, p.319*
- 16: *Ashraf, Muhammad Usmani,p.127*
- 17: *Mansoori,2009,p.293*
- 18: *Usmani, Muhammad Taqi p. 140*
- 19: *Ibid*
- 20: *Ashraf, Muhammad Usmani, p.130*
- 21: *Usmani, Muhammad Taqi,p.146*
- 22:*Ibid*
- 23:*Ibid p.149*
- 24:*Ibid p.151*
- 25: *Ibid*
- 26: *Ibid p.162*
- 27: *Samadani, Ejaz Ahmad, p. 49*
- 28: *Mansoori, Muhammad Tahir, p.230*