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Comparison of theory and practice of Murabaha financing in Islamic banking

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Abstract: *Modes of financing in Islamic banking system are generally categorized as Shariah based financing like Musharakah, Mudarabah and Shariah compliant financing like Murabahah, Ijarah etc. Islamic banks should have implemented and promoted Shariah based financial tools but instead they have been frequently using Shariah compliant modes specifically Murabahah due to some valid reasons. The main objective of the paper is to compare the practical aspects, operations and procedures of the one of the financial product Murabahah with theory by inspecting the financing and operational records of Bank Islami Ltd and Bank of Khyber (Window Islamic) as Islamic banks are the representative of this product. The study has replied all the depths of the paper as questioned and has made known the procedure in executing such transaction. The study also explains clearly Islamic finance and Islamic banking and describes briefly the theoretical frame work of Murabahah transaction stated by some Islamic jurists like Mufti Taki Usmani. Murabahah is still a leading and widely used financing technique in comparison with other Islamic methods of finance. It has played a major role in the growth of Islamic banking and finance industry. The attitude of Islamic banks while practicing Murabahah is largely focused on to mitigate the risk as much as possible and make it a close alternative to conventional loans.*

Introduction

Over the last few eras, the Muslims have been trying to confine their lives on the basis of Islamic philosophies. They sturdily feel that the political economic ascendency of the west, during past centuries, has depressed them of the divine guidance, especially in the socio-economic fields. (Usmani M. T., 2002). Whereas conventional banking is believed to have begun in the middle of the twelfth century, Islamic finance is developing within global finance. In its contemporary form, Islamic banking started with innovative experiments in the early 1960s in Egypt. The formation of the Islamic development bank (IDB) in 1975 was a rotating point moment for Islamic banking, coming just after the founding of the first major Islamic commercial bank (Dubai Islamic bank) in U.A.E. The success of the later directed to the formation of a chain of similar banks comprising Faisal Islamic bank (Sudan) and Kuwait finance house (Kuwait) both in 1977. As early as the late 1970s, actions were taken in Pakistan for creating the financial system compliant with sharia codes. The permitted structure was then revised in 1980 to permit for the operation of sharia compliant profit-sharing financing corporations, and to start bank finance through Islamic tools. (Hussain, Shahmoradi, & Turk, 2015)

While the history of Islamic banking might not be entirely a new concept; the extensive development of this system of Islamic finance in Arab world is surely an honestly latest happening. Islamic finance is raising 10-15% per year (Bertillo & Salando) and with symbols of regular upcoming progress. Islamic bank have more than 300 institutions extent over 51 countries, containing the United States through companies such as the Michigan based University Bank, as well as an additional 250 mutual funds that follow with Islamic moralities. It is expected that over US$822 billion global Shariah-compliant assets are managed according to The Economist. Today, more than 260 Islamic financial bodies are working worldwide, which are claimed to managed assets worth no less than $300 billion, while the assets held Islamic financial bodies were only $5 billion in 1985. According to CIMB Group Holdings Islamic finance is the fastest-growing sector of the global financial system and sales of Sukuks may increase by 24 percent to $25 billion in 2010.

Islamic finance is well-defined as a financial facility regularly applied to follow the main creeds of Shariah (or Islamic law). In turn, the main cores of Shariah are the Holy Quran, Hadith, Sunna, Ijma, Qiyas and Ijtihad. The Holy Quran is the book of revelation given to the Prophet Muhammad; Hadith is the description relating the deeds and statements of Muhammad; Sunna refers to the habitual practice and behavior of Muhammad during his lifetime; Ijma is the consensus among religion scholars about specific issues not imagined in either the Holy Quran or the Sunna; Qiyas is the use of judgment by equivalence to provide an estimation on a case not discussed in the Quran or the Sunna in relationship with another case mentioned in the Quran and the Sunna; and Ijtihad represents a jurists‟ independent thinking linking to the applicability of certain Shariah rules on cases not mentioned in ether the Quran or the Sunna (Gait & Worthington, 2007).Islamic finance can be defined as:

All the objectives and actions of Islamic financial institution should be based on the ideologies of sharia i.e. Quran and Sunnah (Warde, 2000). From this definition we make known that Islamic finance is not just limited to Islamic banks only but also to those financial institutions which follow sharia. Iqbal says that Islamic finance is developing Islamic economic system by concentrating on equal and actual distribution of wealth among Muslims which is opposite to capitalistic economy where the wealth is in few hands (Iqbal, June 1997). Islamic banking system is a system which is formed on the basis of the philosophy of Islamic laws called sharia and directed by Islamic economics. A new model of Islamic banking appeared and has taken many viewers as surprise. The purpose of Islamic banking development is to remove the interest (Riba) from all the transactions and refine the financial system according to shariah (Islamic law). The prohibition of interest (Riba) in the Holy Quran is the main feature in the emergence of Islamic banking. The Islamic banking is centered on the profit and loss sharing (PLS) System in which the investors share the risk and reward. Fundamentally the main reason behind the system of Islamic banking was the wish of Muslims public to make organize their financial transactions according to ethics of shariah (Islamic Law) and without any connection of interest (Riba) to bring about their financial transactions. In fact, sharia forbids fixed return on investment and appreciates the investment in which the investor is rewarded in terms of risk sharing. Sharia also prohibits the trading in which financial risk is involved because it is seen as a form of gambling (Ashraf, 21st Aug, 2013). The Holy Prophet Muhammad (S.A.W) saying about Riba: ALLAH has prohibited you to take interest, therefore, all interest obligations shall henceforth be forego. Your capital is yours to retain. You will neither impose nor suffer any inequity. ALLAH has judged that there shall be no interest (Ahmed & Hassan, January 2007) .Sharia controls the Islamic banking and economic system, which firmly forbids interest (Riba) charges on loans (A.D, 1991).Under the Islamic laws Islamic banks are limited to give and take interest (Aggarwal, & Yousef, 2000). Sharia manages the Islamic banking: sources of sharia are Quran and the Sunnah, according to the Islamic rules, interest based transactions are not allowed and it is the major characteristics of Islamic banking. The primary sources of sharia are the Quran, Sunnah, Jurists and explainer of Islamic law.

Purpose of the Study

The purpose of this study is to explore the differences between theory and practice of murabahah financing carrying out by the Islamic banks in Pakistan

Research Problem

Murabahah financing is one of the key modes being used by Islamic banks in providing financing to its customers. Since, Islamic banking is evolving; therefore, its theory also needs to be updated for documenting the evolving practices. After going through its theory, researcher conducted a preliminary research for knowing the current practices murabahah financing and it was found that several new practices have emerged which are not yet been documented and made part of existing theory.

Objective of the Study

The objectives of this study are as under:

1. Exploring the existing theory of the murabahah financing.
2. Developing a pre – empirical theoretical framework
3. Finding new constructs from practice
4. Developing a post empirical framework through adding new constructs based on current practices of Murabaha financing.

Significances of the Study

From this study the three different people will get benefits:

I.e. Students and Practitioners directly and customers concerned to Islamic banking indirectly.

Students will get better know about true structure of Murabahah financing in Practice, after their graduation or post-graduation when they enter into Islamic financial institution. They will know better the procedures involved in operational level of Murabahah financing in banks. They will easily handle the cases faces to them about Murabahah financing. They will not mix up the different contracts of Islamic finance. They will not violate the shariah standards and will process according to shariah aspects.

Practitioners will also get better understanding of the theory about Murabahah financing. They will build up their bases by reading and review this paper. Most of practitioners in Islamic financial institutions are not aware from the basic concepts of shariah. They don’t know the necessary concepts of shariah and will lead to better understanding of these concepts especially Murabahah financing.

Most of the customers of Islamic banks researcher has seen in very short span of time don’t know about Islamic banking. They believe that Islamic banking pretend them. By getting proper information about Islamic banking one can believe that Islamic banking exists with the aim to get rid of interest. They will attract Islamic banking by knowing shariah concepts and procedure about Islamic financial contracts. Most of the commercial society will take benefits from Islamic banks by enter into interest free transaction Murabahah and their businesses will grow. So this paper is indirect impact on Islamic banks customers, because the specialized practitioners will deliver the basic knowledge of shariah and will take interest in one of the Islamic mode of finance Murabaha.

Literature Review

1. Islamic Finance

Islamic finance is defined as those financial services which follow the main sources of shariah. Shariah is Arabic term which represents Islamic law or the Law of Allah (swt). The main sources of Sharia are: The Holy Quran, Hadith of the Holy Prophet (P.B.U.H), Ijmah (Consensus of the Ummah), Qiyas & Ijtehad (Analogy). Sharia is a way which fulfills the divine guidance & laws given by the Holy Quran the Hadith (sayings) of the Holy Prophet Muhammad (P.B.U.H) & enhanced by the juristic interpretations by Islamic scholars. Sharia includes all the requirements of the Islamic faith, including beliefs and practices (Intelek, 2016).

Islamic Law is mainly deals with to fulfil the objectives of Sharia called Maqasid Sharia, these are five:

- Protection of life
- Protection of Al- Din (Islam)
- Protection of Posterity
- Protection of Intellect
- Protection of Material Wealth

Islamic finance refers to the establishment of financial services in accordance with Islamic Jurisprudence (shariah) Islamic finance main root is the prohibition of (Riba) interest. The prohibition of Riba also appears in Holy Quran at four different places. Riba Accurately means increase, expansion, addition or growth. In shariah, only the extra amount paid by the borrower to creditor along with principal amount as a condition prepared for the loan. (Chapra, 2008).

At IMF Staff Discussion Notes, it is also realized that Shariah does not allow for Riba, the products and transactions having uncertainties and ambiguities i.e. Gharar & Gambling, Short Sales and all the activities which are not beneficial for human society (Kammer, Norat, Pinon, Prasad, Towe, & Zeidene, 2015).

2. Islamic Banking

The current practice of Islamic banking and finance is now 30 years old. However, Islamic banking theory is still not very well developed. The practice has focused on a few credit-based instruments. The overriding concern in inventing or adapting new financial instruments has been meeting the Shariah requirements legalistically while the Maqasid al-Shariah (objectives of Islamic law) has not received appropriate attention. (Siddiqi, 2006)

Islamic banking system is a system which is based on the basic rules of shariah. This system is totally different from interest based conventional banking, Islamic banking not only endeavor to put into practice the interest free transactions but also trying to forbid unethical, unsocial and prohibited practices of conventional banking to promote Islamic economy and socially develop the society of the Islamic principles and ethics. It (IB) try to common the sale of commodities according to approved rules of shariah and prevent the interest based transactions (Ahmed, 2007).

Malaysia played a vital role in developing Islamic finance globally, the govt of Malaysia has sets the targets for achieving up to 2020 13% of Islamic finance assets. Other Arabic countries backed Malaysia by contributing their shares in Islamic finance assets. Lynette Cheng, Sue Lin Lim further concluded that Islamic banking system remains a nascent industry which has plenty of hurdles to be clear (Chong & Liu, 2009). Islamic banks are those institutions which have opened the doors for trade and prohibit Riba. They are providing opportunities for trade oriented customers to accept the deposits and making the way smooth for Islamic investment. Islamic banks operate actively according to the needs of the customers regarding deposits, investment as well as credit and financing facilities by following the prescribed rules of Shariah (Ahmed, 2011). The Prophet Muhammad (P.B.U.H) on the occasion of the last speech to pilgrimage declared and exemplified the people by referring various consecutive verses of the Holy Quran regarding. Prohibition of Riba in all its form in financial system (Ahmed, 2007).

3. The Principles of Islamic Banking and Finance

Islamic financial Institutions are based on Quranic principles. Therefore, their objectives and operations are spaced out from conventional banking system. Islamic Banking has no such Shariah and Islamic restrictions and limitations. Islamic banking worked on the prescribed rules of Shariah and Quran.

Quran has quoted some verses about Riba elimination of Riba. "Those who consumed interest cannot stand [on the day of Resurrection] except as one stands that is being beaten by Satan into insanity. That is because they say "Trade is [just] like interest". But Allah has forbidden interest. So whoever has received admonition from his Lord? And desists may have what is just, and his affairs rests with Allah. But whoever, returns [to dealing in interest or usury] – those are Champions of the Fire they will be abide eventually therein". (Al-Quran)

To have a strong faith in hereafter and on the Day of Judgment is the fundamental ideology 0f being a true Muslim. The above quoted verse of the Holy Quran states forwardly states that Allah has guided us as Muslim to prohibit Riba. Allah has described us that those people who believe that Riba is similar to trade are totally misguided and faulty. That who does not believe on these facts, their destiny is Hell and will be remaining here forever and will taste the fire of Jahanum. (Amjad, 2011).

One of the papers explained the response of the query about alternate of interest factor from Islamic Banking, he make clear that Profit and Loss Sharing (PLS) is the only mechanism that replaces interest and allot this reserve in financial body (Kahf & Khan, 1992).

4. Six Key Principles constraining the activities of Islamic Banks

(i) The Prohibition of Interest (Riba)

Quran explicitly prohibits riba and permits trade. This means that any amount over and above the principal amount charged is interest is ban in all types of transactions. By doing this Islam looks for just and light in society.

(ii) Risk Sharing

It is the basic principle of Islamic finance. This principle of sharing or partnership brings the investors and depositors to participate and share the risk. Any instrument bearing risk and have variable rate of return should be come in the circle of Shariah Law (Gait & Worthington, 2007).

(iii) All Financial Transactions Must Be Asset-Backed

Any transactions under the jurisdiction of Islamic Law should be asset backed. Shariah does not allow Islamic financial institutions to deal directly in money. To gain money over the money is prohibited by Islamic Shariah. (Kettel, 2011)

(iv) Prohibition of Gharar Uncertainty

The most significant prohibition in Islamic finance is Gharar (Uncertainty). It is the sale of probable items whose existence or characteristics are not certain, due to the risky nature which makes the trade similar to gambling. By doing sale both parties should be the full implications about the commodities and there will be no asymmetric information's. These kinds of transactions are harmful for the society. (Samad, Gardner, & Cook, 2005).

(v) Prohibition of Gambling

Only Shariah approved Contracts are Acceptable Conventional banking is secular in its orientation. In contrast, in the Islamic system, all economic agents have to work within the moral value system of Islam. Islamic banks are no exception. As such, they cannot finance any project that conflicts with the moral value system of Islam. For example, Islamic banks are not allowed to finance a distillery, a casino, a night club or any other activity prohibited by Islam or known to be harmful to society. (Buziek, 2011)

(vi) The Purity of Contracts

Many verses in the Holy Qur'an encourage trade and commerce, and the attitude of Islam is that there should be no impediment to honest and legitimate trade and business, in order that people earn a living, support their families and give charity to those less fortunate. Just as Islam regulates and influences all other spheres of life, so it also governs the conduct of business and commerce. Muslims have a moral obligation to conduct their business activities in accordance with the requirements of their religion. They should be fair, honest and just towards others. A special obligation exists upon vendors because there is no doctrine of caveat emptor in Islam. Monopolies and price-fixing are prohibited. The basic principles of the law are laid down in the four root transactions of (1) sales (bay), transfer of the ownership or corpus of property for a consideration; (2) hire (Ijara), transfer of the usufruct (right to use) of property for a consideration; (3) gift (hiba), gratuitous transfer of the corpus of property; and (4) loan (ariyah), gratuitous transfer of the usufruct of property. (Bertillo & Salando, 2013).

These basic principles are then applied to the various specific transactions of, for example, pledge, deposit, and guarantee, agency, assignment, land tenancy, waqf foundations (religious or charitable bodies) and partnerships. Islam upholds contractual obligations and the disclosure of information as a sacred duty. This feature is intended to reduce the risk of asymmetric information and moral hazard, potentially major problems for Islamic banks.

5. Products of Islamic Banks

As compared with conventional banking Islamic banks are motivated and provoked to catch a large number of customers by offering a series of Islamic products. Islamic banks operations and products are totally different from conventional banking system. To promote market shares by Islamic banks they are following the prescribed rules of Shariah keeping in view the needs of customers. Islamic banking is passing from challenging era since 2022 (Ahmad, Awan, & Malik, 2011).

(i) Murabahah Meaning & General Concept

Lexically Murabahah is an Arabic word which is derived from "Ribh" meaning profit, gain or addition (Hassan, Kayed, & Oseni, 2014). "Murabahah is a particular kind of shariah compliant sale transaction where the seller explicitly discloses the cost plus profit of the tangible sold goods to the buyer." (Ullah, Salma, & Latif, 2011) (Usmani, 2002) (Siddiqui, 2010) (Salman, 2014)

(ii) Basic Features of Murabahah Financing

Mufti Taqi Usmani explicitly describes the main features of the product Murabahah.

Murabahah is a particular kind of sale where the sellers explicitly mentions the cost of the sold commodity and mark up or profit there on.

Murabahah is not a loan given on interest but it is the sale of commodity for deferred price.

Being a sale Murabahah should be fulfilling all the requirements of the valid sale.

Murabahah will be valid only when the actual price of the commodity is known.

The profit in Murabahah can be determined by the mutual consent of both the parties.

All the expenses incurred by the seller acquiring the commodity like freight; custom duty etc. shall be included in the cost of the commodity (Usmani M. T., 2002). To explain the steps in Murabahah financing we will go through describing the basic conditions of Sale Transactions.

(iii) Conditions for Valid Sale Transaction

Sale can be defined in a Shariah as: the Exchange of something value with another thing of value by mutual consent of both the parties.

The following conditions must be followed during sale transaction:

According to shariah the Existence of subject matter is necessary.

3. The subject matter should be in the Ownership of the seller.
4. During sale transaction the Possession of subject matter should be in physical or constructive.
5. The subject matter of sale must be a property of Value.
6. The subject matter must be used for Halal Purpose not haram.
7. The characteristics of subject matter must be Known and Identified to the buyer.
8. The Delivery of subject matter must be on time and certain.
9. The sale transaction should be Unconditional; otherwise, it will remain invalid.
10. The sale must be Direct, Complete and on Spot. There will be no possibility of future date.

(Ethica Institutue of Islamic Finance, 2017)

Theoretical Framework/ Process Flow of Murabahah Financing

1. The client and the institution (Bank) enter into the agreement of promise, where the seller (Bank) agrees to sell and the buyer (client) agrees to buy the specific commodity.
2. The institution (Bank) appoints his client as an agent to buy the commodity on his behalf; here an agency agreement is signed between the bank and the client.
3. The bank gives money to agent/supplier for purchase of goods.
4. The client/agent takes possession of goods on bank's behalf.
5. The client makes an offer to purchase it from the bank.
6. The bank accepts an offer and the ownership as well as risk of the commodity is transferred to the client
7. The client made the periodic payment (Siddiqui, 2010).

I. Three Possible Structures of Murabahah Mode of Financing

There are three possible structure of Murabahah financing:

Two Party Structure

Two party structures is the buyer and seller or bank and client relation is the simplest structure of Murabahah sale purchase transaction.

Phase 1: The client approaches to a bank for the purchase of an asset assuming he/she has already collected full information about an asset to be purchased from the bank.

Phase 2: The bank offers the desired asset to the client on cost plus profit basis, transfer the ownership as well of the product to the client.

Phase 3: The client will pay the price on agreed dates in instalments or in lump sum as decided between them. This type of sale purchase agreement between the seller and the buyer is the most ideal one from the Islamic Shariah Point of view. The profit so earned by the bank is fully justified by the risk it assumes before the asset is delivered to the customer. It is the most transparent, unambiguous and riba-free possible structure of Murabahah transaction and non-existent in banking sector.

II. Three Party Structures

Three party structures involved the bank, the client and the supplier.

Phase 1: The client approaches to a bank for the purchase of an asset on the basis of Murabahah financing with all relevant information about an asset.

Phase 2: The bank then purchases the good directly from the supplier without involving the services of an agent.

Phase 3: The supplier delivers the good to the bank and the bank takes the physical or constructive possession of the good and become the sole owner of the good and makes payment.

Phase 4: The bank resells the same to the client on coat plus profit basis.

Phase 5: The client makes payment of the price to the bank in lump sum or instalments on agreed dates.

This structure contains two sales contracts. The first contract is made between the bank and the supplier of an asset, while the second takes place between the bank and the client.

III. Three Party Structures with Customer as Agent

This structure involves three parties, the bank, the client and the supplier. In this structure the client acts as an agent and purchases the good from supplier on behalf of the bank, and the bank does not deal directly with supplier.

Phase 1: At first the bank appoints client as its agent and purchases the goods on behalf of bank, so agency agreement took place between the bank and the client (Agent).

Phase 2: The client (Agent) purchases the good on behalf of the bank.

Phase 3: The supplier delivers the good to the bank and the bank takes the physical or constructive possession of the good.

Phase 4: The bank resells the same to the client on coat plus profit basis.

Phase 5: The client makes payment of the price to the bank in lump sum or instalments on agreed dates through an Agent.

Here various relations are formed between the bank, client and supplier.

At start the relationship between bank and the client is promissory and promises.

Principal-Agent Relationship between bank and the client.

Seller-Purchaser Relationship between bank and the customer.

Creditor/debtor relationship between bank and client

Research Methodology

1. Research Approach

The research is based on Philosophy of Social Constructivism. First of all researchers define and briefly explain the Social Constructivism Philosophy.

A focus of Social Constructivism is on human awareness or consciousness and its place in world affairs. (Jackson, Robert Sorensen, Georg, 2006).

According to Social Constructivism, knowledge is a human product, which is socially and culturally constructed in an active manner and not something which can be discovered. Knowledge is therefore neither tied to the external world nor does wholly to the working of the mind, but it exist as the outcomes of mental contradictions that result from ones interaction with other people in the environment. (Geary, 1995).

The strategy used in this research as phenomenology differs than most other research methodology because the goal is to describe a lived experience, rather than to explain or quantify it in any way. Phenomenology is only concerned with the study of the experience from the angle of the participants, therefore, the methodology does not include a hypothesis or any predetermined ideas about the data collected.

Phenomenology makes use of a variety of methods including interviews, conversations, participant observation etc. In general, the methodology is designed to be less structured and more open-ended to encourage the participant to share details regarding their experience. Surveys and questionnaires that are commonly used in other research methods to gather information from participants would be too structured and would not allow the participant to freely share. In other words, phenomenology emphasizes subjectivity. The goal of phenomenological research methods is to maximize the depth of the information collected and therefore, less structured interviews are most effective. (Center for Innovation in Research & Teaching)https://cirt.gcu.edu/research/developmentresources/research)

2. Data collection

Data collected for this study included secondary and primary data. Secondary data was collected from published documents while primary data was collected through in depth interviews. Interview respondents were selected through non - random purposive sampling. Since the topic of the study is highly specialized and only selected people working in the phenomenon of Murabaha financing could provide meaningful information. Therefore, six interviews were conducted from the experienced bankers working at the Bank of Khyber and Bank Islami who were practically engaged in Murabaha financing. Interviews were stopped when the process of new information came to an end and saturation point was reached. Collected data was manually analysed thematically and common themes were identified.

Findings and analysis

All the theoretical aspects of Murabahah financing has been explain explicitly, the views principles and procedure explain by various jurists and Islamic Scholars are addressed above. The first part of the thesis is completed and now the second part of the research are explained below, in this regard the practical implementation of Murabahah financing explain on behalf of two Banks One is Bank Islami and the other is Bank of Khyber.

Murabaha Financing by Bank of Khyber

Interview respondents of the bank of Khyber explained the Murabaha process as under:

1st Step:

a) Master Murabahah agreement and agency agreement shall be signed with the client
b) Branch will place a statement explaining the reason of using agency agreement. Agreement in file Form- M2 shall be signed.

2nd Step:

a) The client shall submit order form with all quotations or any other documents containing description of the requested assets.
b) Order form should be dated and signed only by the client.
c) The client shall write expected date of delivery in order form and in case of delay inform Shariah department and operation department of IBG.

3rd Step:

a) Client will purchase goods as an agent on bank behalf and will take their possession.
b) The invoice issued by the supplier shall be in the name of bank-account Client e.g. “1st
c) Islamic Bank- ABC Company” In case where obtaining invoice in the name of IBI is not possible, the invoice in the name of client may also be acceptable, subject to specific approval of the Shariah Advisor, for all such transitions.
d) The payment for Murabahah transactions shall be made directly to supplier.
e) After taking possession, agent will submit declaration to the bank with all dated invoices of purchases.
f) Murabahah transaction should be executed within two working days after delivery of the goods. However, it is responsibility of the branch manager to ensure the existence of assets with the agent at the time of booking of Murabahah.

4th Step:

a) Client will make an offer to purchase the goods from bank through a dated offer documents.

b) Bank will accept the offer and sale is concluded.

c) The quantities as per “Declaration” should be similar to that of invoices presented unless a transaction involves joint purchases with customer.

d) Where transaction involves joint purchases, the client must give a letter inducting clearly the amount purchased for him after booking of the transaction; repayment schedule shall be prepared and signed by the parties.

Murabahah Financing by Bank Islami

Interview respondents of the Bank Islami explained the Murabaha process as under:

1. After having necessary credit approvals, the Bank & Client will enter Master Murabahah Facility Agreement (MMFA) & Agency Agreement listing the assets i.e. x, y, z etc. to be procured from various suppliers.
2. Branch shall obtain Disbursements Authorization Certificate (DAC) for the entire Master Murabahah Facility (Limit Amount), only once.
3. Upon the requirement for purchase of asset, the customer will submit the order form, duly signed & stamp, to the bank branch.
4. Branch will forward the order form to RCAD through fax and obtain the authorization for the transaction i.e. for each sub-Murabahah anticipated under the Master Murabahah Facility.
5. After receiving the approval from RCAD, the branch will disburse funds for the purchase of listed assets through issuance of Pay Order/ Demand Draft favouring
   Suppliers by debiting „Advance against Murabahah‟.
6. The bank will make any payment to the supplier through the agent “client” in addition to direct payment by the bank to the supplier will be made.
7. The client shall purchase the assets on behalf of the bank.
8. After taking possession of the stock, the customer will inform the bank of the same through execution of the declaration (supported by invoices) and shall make an offer to purchase the stock from the bank.
9. After receiving customer’s offer, the bank will accept the customer’s offer and will execute the declaration and will be concluded.
10. The branch must ensure that the sub-Murabahah will be disbursed and created only during the applicable banking hours.
11. The Declaration shall be supported by the purchase invoice, Schedule of assets, payment Schedule and a D.P Note of contract price will be obtained from the customer for each sub- Murabahah transaction instead of one D.P Note for entire Murabahah Facility as per IBSD Circular # 21 dated 11.10.2010
12. As per SBP Shariah instructions, the invoice will be in the name of the bank or in joint names.
13. Branch will ensure compliance if IBSD “Policy Guidelines for Murabahah Monitoring Mechanism” dated 31.10.2006 and IBSD “Policy for Timelines for Murabahah Purchase Evidences (PE‟s) and declarations dated 31.10.2006.
14. The customer shall pay the agreed Murabahah Contract price, through own sources, to bank on the agreed date according to the agreed payment schedule and the sub-Murabahah shall be settled.
15. Branch shall obtain acceptance of the customer for this Process flow, confirming that he has been properly briefed about and understands the requirements of Murabahah Facility and its Process Flow.

Based on the research findings, theoretical framework based on literature is updated and revised as under:

Revised Theoretical Framework of Murabahah Financing

By comparing theory with practice researcher concluded thesis by comparing theory with practice; the following Structure of Murabahah Financing takes place.

1. The branch will approve the credit from RCAD (head office) & shall receive the Disbursement Authorization Certificate from RCAD (head office).
2. The bank & client will enter into Master Murabahah Facility Agreement (MMFA) & Agency Agreement. For Agency Agreement file M2 shall be signed by the client (an agent).
3. The customer shall submit order form, order form will be dated and signed by the customer & he will write expected date of delivery of goods, in case of delay, he will inform shariah as well as operation department of IBG.
4. Branch will forward the order form to RCAD (head office) & will approve the credit limit.
5. Branch will make payment to supplier directly or through agent. The invoices issued by the supplier shall be in the name of Bank client. Invoice in the name of bank only will not be acceptable. Invoices in the name of client will acceptable, however, the shariah department approval will be required.
6. The supplier will make delivery of goods to client; the bank will ensure the existence of goods by inspecting physically.
7. Client will make an offer to purchase the goods supported by all required invoices of goods. The bank will accept the offer.
8. The client will make deferred payment in instalments.

Conclusion

This study documented following knowledge which was in practice but was not yet added to the literature:

- There is no description in theory about Credit Approval from Regional Credit Administrative Division.
- There is no description of M-2 File in theory.
- There is no description about to inform Shariah Department in case of Delay in delivery of goods, delay in Time & Place.
- Two party relationships (Customer + Bank) are unpracticed at Islamic Banks in Pakistan.
- There is no description of Muqadam in theory, He is a person which defend and take care of the goods at Warehouse of the bank

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