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Murabaha contract for the purchase orderer between Sharia controls and field applications

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Abstract---In this research paper, we addressed one of the most important Islamic financing contracts used by most Islamic banks, namely the Murabaha contract for the buyer's order. We clarified the difference between the Sharia-compliant Murabaha and the Murabaha for the buyer's order as practiced by Islamic banks today. We also highlighted the main criticisms of this contract and outlined the regulations that must be adhered to in order to avoid all the Sharia violations identified by scholars and jurisprudential assemblies, which in turn pose a risk that prevents clients from accepting and relying on it in their transactions.

Keywords---Simple Murabaha, Murabaha for the purchaser, Binding promise.

1. Introduction

Islamic banks rely on a method that contrasts with conventional interest-based banks, which depend on loans with interest. They use Islamic financing formulas inspired by Islamic law, which are divided into two main categories: participation-based formulas, which include Mudarabah (profit-sharing) and Musharakah (partnership), and fixed-return formulas, where the return is predetermined. One of the basic Islamic financing formulas in this category is sale contracts, including Murabaha, Salam, and Istisna, as well as Ijarah contracts, which are based on a fixed return and are considered a type of sale where the transaction is on the benefit rather than the asset. Murabaha sales are among the most widely used formulas in Islamic banks due to their widespread acceptance and the high level of security they offer to the bank itself.

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Based on the above, and in order to detail and clarify the structure of the Murabaha contract for the orderer and the violations that Islamic banks encounter, the following question arises:
What are the Shariah guidelines governing the Murabaha contract for the orderer to ensure that the contract is free from Shariah violations?
This study aims to clarify the Murabaha contract for the orderer as practiced by Islamic banks. It will outline the main doubts raised about this contract and address the Shariah guidelines governing it to ensure that it is free from Shariah violations that could make it invalid from a Shariah perspective. On one hand, and on the other hand, the lack of Shariah compliance is one of the risks that prevent clients from engaging in it.
In order to study and elaborate on this topic, the research has been divided into the following points:

- First: Murabaha and Murabaha to the purchase orderer, and the essential differences between them.
- Second: Forms of the Murabaha contract to the purchase orderer and the Shariah regulations governing them.
- Third: The main risks arising from this contract and the methods of managing them.

2. Murabaha and Murabaha to the Purchase Orderer, and the Essential Differences Between Them

Sale in Islamic jurisprudence is divided into two types:
First: Sale without consideration of the original cost of the commodity. This is subdivided into two categories:

- **Bargaining sale (Bay‘ al-Musawama):** In which the two parties agree on the sale price without reference to the original price paid by the seller.
- **Auction sale (Bay‘ al-Muzayada):** In which the sale occurs through bidding, starting from a minimum price set for the commodity.

Second: Sale with reference to the original cost of the commodity, which is known as Trust Sale (Bay‘ al-Amanah) and is of three types (Bakr bin Abdullah Abu Zayd, 1988, p. 968)

- **Murabaha sale:** a sale at a price higher than the original cost.
- **Loss sale:** a sale at a price lower than the original cost.
- **Equivalent sale:** a sale at the same price as the original cost.

These sales are called Trust Sales due to the trust between the two parties in the accuracy of the seller's report about the amount of the original cost.

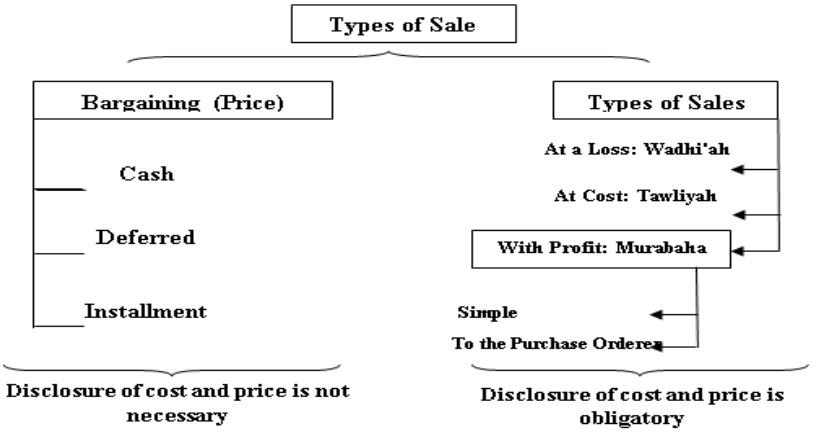

Figure No. 1: Types of Sales
Source: Samer Mazhar Kantakji, The Essential Differences Between Murabaha and Usurious Loans, available at the link:
www.kantakji.com/media/165264/The fundamental differences between Murabaha and usurious loans.pdf

2.1 Murabaha Contract (Simple Murabaha)

Linguistically, Murabaha is derived from ribh (with the first letter either kasrah or fathah), which means profit in trade. It is said: "He gave him money as Murabaha," meaning with profit shared between them. And it is said: "I sold him the commodity as Murabaha at the rate of one dirham profit for every ten dirhams."(Manẓūr, 1993, p. 442).

In terminology, it is a sale at the same price as the original with a known profit(Al-Kāsānī, 1986, p. 173) Volume Seven

The Murabaha contract may occur between two parties: the seller and the buyerthis is referred to as simple Murabaha. This form (simple Murabaha) is unanimously permitted by scholars (Al-Masri, 1988, p. 1113)**.** Murabaha may also involve three parties, which is common in Islamic banking transactions: the original seller, the bank (as intermediary), and the buyer (the bank's client), and is referred to as Murabaha to the purchase order.

2.2 Murabaha is a purchase order

This occurs when a person wishing to purchase a commodity approaches the bank because they do not have sufficient funds to pay its price in cash, and because the seller refuses to sell it on crediteither due to not dealing in deferred sales, not knowing the buyer, or needing immediate cash. The bank purchases the commodity for a cash price and sells it to its client for a higher deferred price. This process takes place in two stages:

The first is the promise stage regarding the Murabaha, and the second is the execution of the Murabaha contract. This arrangement is binding on both parties (the bank and the client) in some Islamic banks, while in others, it is not binding on the client. If the bank purchases the commodity, the client then has the option—either to buy it or not.

From this, it is understood that the bank is not obligated to purchase the commodity, but if it does, it is committed to selling it to the client if the client chooses to buy it. However, the bank is keen to purchase the commodity in order to preserve its reputation.(Al-Masri, 1988, p. 1133).

The basic elements of the Murabaha to the Purchase Orderer contract:

- **Three parties**:
  - **The purchase orderer**: The person who requests the bank to purchase the commodity they want.
  - **The seller of the commodity to the bank**.
  - **The bank**: The entity that buys the commodity from the seller and then sells it to the purchase orderer.
- **Two contracts**:
  - A contract between the seller and the bank.
  - A contract between the bank and the purchase orderer.
- **Three promises**:
  - A promise from the bank to purchase the commodity.
  - A promise from the bank to sell it to the purchase orderer.
  - A promise from the purchase orderer to buy the commodity from the bank.

3. Forms of Murabaha to the Purchase Orderer and Their Regulations

3.1 Forms of Murabaha to the Purchase Orderer as Practiced by Islamic Banks

The forms of Murabaha to the Purchase Orderer as practiced by Islamic banks can be limited to the following types:(Bakr bin Abdullah Abu Zayd, 1988, p. 984،983)

- **First Form:** This is based on a non-binding promise between the two parties, without prior specification of the profit amount. In this form, the client approaches the bank and says: "Buy this merchandise for yourselves; I am interested in purchasing it later for a deferred or immediate price with a profit," or "I will give you profit on it." The ruling on this form is permissibility, because the bank takes the risk of purchasing the commodity for itself without being certain that the client

will buy it with profit. If either party withdraws from their intention, there is no obligation and no legal consequence. It is this level of risk that renders the transaction permissible.

- **Second Form:** This is based on a non-binding promise between the two parties, with a specified profit amount. Its form is that the client desires to purchase a specific commodity or one of its kind, and goes to the bank saying: "Buy this commodity for yourselves; I am interested in purchasing it later for a deferred or immediate price, and I will give you a profit above the capital." Scholars have differed on this form with two opinions:
  - ✓ **First Opinion:** The absolute prohibition of this sale. This is the view of the Malikiyyah, and among contemporary scholars, Shaykhs Al-Albani and Ibn 'Uthaymin(Al-Dusuqi, p. 89)Volume Three).Their evidence is that stipulating profit before the bank purchases the commodity makes the transaction effectively an exchange of money for money with a delay, with a lawful commodity in between (Al-Barr, 1980, p. 812،811). This constitutes a prohibited 'inah transaction, as it is essentially an increase on a loan. The orderer here compels the bank to purchase the commodity for him at a fixed profit, and his statement "I will buy it from you" is meaningless.
  - ✓ **Second Opinion:** The permissibility of this sale. This is the view of the Ḥanafis(Al-Sarakhsi, No Date, p. 238،237), the Shāfi'is (Al-Shafi'i, 2001, p. 75), and the Ḥanbalis (Al-Jawziyyah, 2014, p. 430), and among contemporary scholars, Shaykh Ibn Bāz, and it has been approved by the Islamic Fiqh Academy. Their evidence (Al-Dayban, p. 348) includes:
    - The transaction has moved from being a loan with interest to being a sale and a commercial transaction, and from the bank being merely a financier to being a true buyer.
    - The seller at that point has sold what he owns, since the contract is not concluded except after the bank has owned the commodity. The offer and acceptance take place after realnot symbolicownership.
    - If the bank profits afterward, it profits from something under its liability, as the commodity, if it perishes, does so while still owned by the seller (the bank).

  However, those who permitted this method of Murabaha to the purchase orderer stipulated two conditions:
  - **First condition:** The initial agreement between them must be merely a promise to sell and a promise to buy. This promise is non-binding, and each of them has the choice to complete the sale or not.
  - **Second condition:** The contract between them must not be concluded until the party being promised (the bank) has taken full ownership and possession of the commodity.
- Third Form**:** This is based on the obligation of the promise to one of the parties (either the bank or the client). In this form, the client may be given the option while the bank is obligated, or vice versa. The rationale for this distinction in this form is not clear. The correct view is that the option must be available to both parties, as considering the interest of the client is not more important than considering the interest of the bank, and the same holds true in reverse.
- Fourth Form**:** This is based on a binding promise between the two parties with the profit amount specified. In this form, the client wishes to purchase a specific commodity or one of its kind, and they go to the bank to agree that the bank will be committed to purchasing the commodity, and the client will commit to buying it from the bank afterward. The bank will commit to selling it to the client at a price and a deferred term agreed upon by both parties, with a specified profit.

Ruling: Nullity and prohibition. This is the view of the Ḥanafis, Mālikis, Shāfi'is, and Ḥanbalis. This form is considered unanimously prohibited, and the opinion of its permissibility is only found among some contemporary scholars, based on the following evidence(Al-Dayban, p. 376،349)**:**

- The binding promise between both parties turns the promise into a contract, as obligation is one of the main characteristics of a contract. If this is the case, the following points apply:
- Its essence is a sale on a commodity whose ownership by the bank is not established before the bank actually owns the commodity.

- The generality of the prophetic hadiths that indicate the prohibition of selling what a person does not own.
- The generality of the prophetic hadiths that prohibit a person from selling what they have purchased unless they have taken possession of it. The reasoning here is that the texts are clear and authentic, stating that selling something before taking possession is prohibited, and the reason is that possession and stability in the buyer's ownership are incomplete. How, then, is it permissible for the bank to sell something it does not own and make a profit from it?
- The prohibition by Shariah of earning profit from something not guaranteed, as the bank profits from a specific commodity before it is under its guarantee.
- There is no difference between selling something one does not own or promising someone a binding commitment to sell something one does not own.
- This sale involves two issues:
  - Selling something one does not own, which applies to the bank.
  - Coercion to sell and the absence of consent, which applies to the client.
- The essence of this contract is a sale of cash for a higher amount to be paid later, with a lawful commodity in between, ultimately resembling a loan with interest.
- Analogizing the sale contract to other contracts, since contracts like divorce or marriage do not take effect with just a promise, neither should a sale based solely on a promise.

Table No. 1: The Difference Between Simple Murabaha and Murabaha to the Purchase Orderer

Simple Murabaha	Murabaha to the Purchase Orderer
The commodity is available and present. The contract is concluded in one session. The price is known at the time of the contract. The seller buys the commodity for themselves. It can be either immediate or deferred. It involves two parties and one contract. The profit is in exchange for effort and risk.	The commodity is not available and not present. It involves two stages: the promise stage and the contract stage. The promise may be binding, and the price is still unknown because the bank has not purchased the commodity yet and does not know its cost. The bank purchases the commodity based on the client's request and promise to buy it. It is generally a deferred payment transaction, involving three parties and two contracts. The profit is typically for the deferred payment term.

Source: Prepared by the researchers based on:

Rafiq Younis Al-Masri, Murabaha to the Purchase Orderer as Practiced by Islamic Banks, Journal of the Islamic Fiqh Academy, Jeddah, Fifth Session, Volume Two, 1988, p. 1138.

3.2 Regulations of Murabaha to the Purchase Orderer

The following are the general regulations that make Murabaha to the Purchase Orderer permissible:(Bakr bin Abdullah Abu Zayd, 1988, p. 989)

a. It must be free from any commitment to complete the sale, either in writing or verbally, before obtaining ownership or possession of the commodity.
b. It must be free from any commitment to guarantee the loss or damage of the commodity by either party (the client or the bank); rather, the bank is responsible for guaranteeing the commodity.
c. The contract for the sale of the commodity must not be concluded until the bank has taken possession of the commodity and it is firmly in its ownership.

4. Risks of Murabaha to the Purchase Orderer and Ways to Manage Them

4.1 Risks of Murabaha to the Purchase Ordere

The nature of the risks in Murabaha contracts differs from those in participation and profit-sharing contracts in terms of their level and the likelihood of occurrence, which is lower. The Murabaha contract involves market risks, credit risks, operational risks, and liquidity risks. Below, we will outline the potential risks at each stage of this sale as follows:(Al-Tijani, 16 April 2016, p. 09) **:**(Al-'Abbadi, 2015, p. 98،97)

- When the bank owns a commodity based on the client's request, and before delivering it to the client, the bank faces operational risks. This means that the bank is responsible for any damage, loss, or deterioration of the commodity until the actual delivery to the buyer. Additionally, it is exposed to risks from fluctuations in commodity prices.
- In the case of non-binding Murabaha contracts for the client, where the client has the right to reject the commodity, the financial institution faces market risks due to price fluctuations of the goods. This is because the institution sells the commodity to a third party. If it is sold at the same price, the risk is eliminated, but if sold at a lower price, this constitutes the expected risk.
- The risk here arises when the client receives the commodity but delays in paying the installment due on the due date. At this point, the institution is exposed to credit risks, in addition to liquidity risks, because the institution expects to receive cash flows, which it intends to use to cover its other obligations.
- The financial institution purchases the goods at the current price and receives payment for the commodity price plus profit at a future date. Therefore, if the profit does not cover the actual or real market rate, the institution is exposed to price increase risks, i.e., market risks.

The following diagram illustrates the risks of Murabaha to the Purchase Orderer at each stage of the sale.

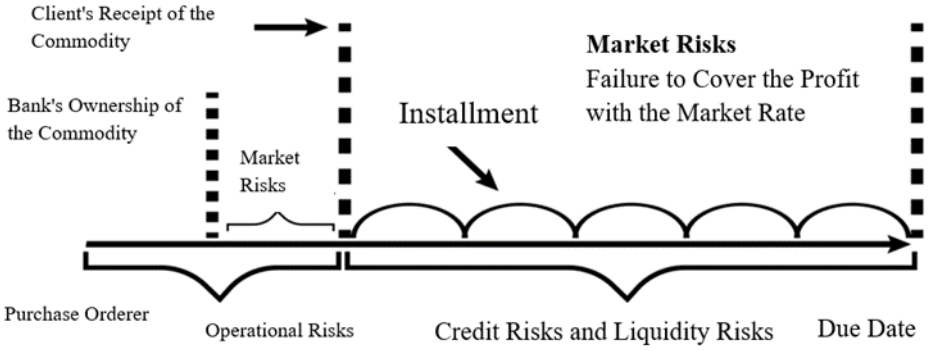

Figure No. **2**: Risks in the Murabaha Contract
Source: Prepared by the researchers based on:

Lwanis Akizidis, translated by Abir Fawzan Al-Abadi, Financial Risk Management in Banking and Islamic Finance, Jordan, Dar al-Fikr, 2015, p. 95.

4.2 Risk Management in Murabaha Contracts

As previously mentioned, Murabaha contracts are subject to various types of risks (operational risks, credit risks, liquidity risks, etc.).

- Managing Operational Risks in Murabaha Contracts

Regarding exposure to operational risks this occurs when the client fulfills their promise to purchase the product the financial institution allows for taking guarantees to enforce the promise or to compensate for any losses that may arise.

- Managing Credit Risks in Murabaha Contracts
  Financial institutions accept guarantees from clients who wish to enter into Murabaha contracts for goods and other assets in preparation for credit risks. These risks arise in the event of a payment default. Therefore, appropriate documentation for debts resulting from Murabaha contracts should be documented with a guarantor or collateral, or both, just like any other debt. The mortgage or the presence of a guarantor or cash collateral may precede the signing of the agreement or be required at the time of signing the agreement.
- **Managing Commodity Risks and Price Increases in Murabaha Contracts**
  When offering Murabaha contracts, financial institutions face the risk of price increases (profit margin) due to changes in the price increase rate and the reference rate used for commercial pricing. In Murabaha contracts, the price is fixed throughout the contract period. During this period, the reference rate may change. If the price increase rate or the prevailing profit margin exceeds the reference rate, the financial institution does not benefit from the increase in that rate. In Murabaha contracts, the total payments must be greater than the sum of the payments for the commodity price, taking into account price fluctuations, as shown in the following equation: $\mathbf{R} \geq \mu . \sum_{i=1}^{n} \mathbf{r_i}$
  Financial institutions must apply the reference rate and price the price increase or profit margin related to the commodity being traded through Murabaha contracts. Moreover, various scenarios driven by market behavior simulations can be used to estimate future commodity prices.
- **Managing Liquidity Risks in Murabaha Contracts**
  Liquidity risks in Murabaha contracts arise from other risks and may cause significant impact and additional losses. Therefore, financial institutions should invest efforts in managing other types of risks and thus reduce their exposure to liquidity risks.

Conclusion

Islamic banks have relied almost entirely on debt-based financing formats, foremost among them the Murabaha contract, especially Murabaha to the purchase orderer, due to its advantages such as providing goods and benefiting from them, facilitating repayment while preserving client privacy and account confidentiality, enabling the acquisition of appropriate guarantees, relatively low risk, and achieving considerable profits with rapid capital turnover.

However, these advantages have nearly turned into a curse on Islamic finance, as the reliance on Murabaha to the purchase orderera contract fabricated from three agreements: a binding promise and two sales in onehas led to the disappearance of what Islamic economic theorists dedicated themselves to highlighting and promoting, namely the reliance of the Islamic economic structure on participation in and encouragement of investment activity. This issue alone is sufficient to warrant reconsideration of this type of financing. Even more so considering that, as has become evident in this paper, the Murabaha to the purchase orderer contract, as currently practiced by banks, is prohibited by Shariah based on the evidence previously presented in the body of the study.

Therefore, if Islamic banks wish to restore their good reputation, which researchers have long worked to demonstrate, they must reduce their use of this format and give way to participation- and investment-based contracts. Similarly, official regulatory bodies overseeing the operations of these banks must establish sufficient guidelines to help correct the course of these formats, limit reliance on them, and replace them with participatory investment contracts.

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