



COMMODITY MURĀBAḤAH AS PRACTICED BY
ISLAMIC FINANCIAL INSTITUTIONS; A CRITICAL
ANALYSIS FROM FIQH PERSPECTIVE

BY

NUR FARHAH BT. MAHADI

A dissertation submitted in partial fulfilment of the requirement for
the degree of Master of Islamic Revealed Knowledge and Heritage
(Fiqh and Uṣūl al-Fiqh)

Kulliyyah of Islamic Revealed Knowledge and Human Sciences
International Islamic University Malaysia

NOVEMBER 2010

ABSTRACT

Commodity *Murābahah* is an example of product innovation in Islamic banking and finance which is based on *Murābahah* and *Tawarruq* transactions. Both traditional and contemporary Islamic jurists hold different opinions on its legality in the light of *Fiqh*. This study explains the nature of Commodity *Murābahah* as practiced by Islamic Financial Institutions from the *Sharī'ah* perspective and outlines the justifications for its permissibility and impermissibility. This study is aimed at understanding Commodity *Murābahah* trading especially the current practical operations and describing its preferred structures to facilitate Islamic financing products, Islamic investment and deposit services products, liquidity management products, Islamic hedging products, and Capital market products. This study presents a number of identified controversial *Sharī'ah* issues and how the Bursa resolves those issues. This study attempts to illustrate in detail the business operational model of Commodity *Murābahah* as introduced by *Bursa Sūq Al-Sila'* operated by Bursa Malaysia. The illustration of 20 different diagrams portray the pith and marrow of the entire discussion on Commodity *Murābahah* trading which forms the current practical observation. This research evaluates the *Sharī'ah* compliance status of the whole operation.

ملخص البحث

مراجعة السلع مثال لمنتج مبتكر في المصرفية والتمويل الإسلامي، والذي يقوم على عقدي المراجعة والتورق. وقد اختلف كل من العلماء المتقدمين والمعاصرين حول جوازها على ضوء معطيات الفقه، وتهدف هذه البحث إلى بيان حقيقة مراجعة السلعة كما تجربها مؤسسات المالية الإسلامية من منظور إسلامي مع إيجاز المبررات حول جوازها أو منعها، كما تهدف إلى البحث عن مفهوم مراجعة السلع وخاصة التطبيقات المعاصرة لها لدى بورصة ماليزية سوق السلع، وبيان الهيكلية المفضلة لمراجعة السلعة لتسهيل منتجات كل من: التمويل الإسلامي، خدمة الإيداع والاستثمار الإسلامي، إدارة السيولة، والتحوط الإسلامي، وسوق الرأسمال. وقد بينت هذه البحث المسائل الفقهية المثيرة للجدل في هذه العملية وكيفية معالجتها لدى البورصة. وحاولت أن تبين بالتفصيل نموذج التعاملات لمراجعة السلع كما أوضحتها سوق السلع التي تجربها بورصة ماليزيا. توضح المخططات العشرون المختلفة، زبدة ولب كافة المناقشات المطروحة حول مراجعة السلع والتي تشكل التطبيقات المعاصرة. وقد قامت هذه البحث بتقييم هذه العملية بأسرها ومدى موافقتها للشريعة الإسلامية.

APPROVAL PAGE

I certify that I have supervised and read this study and that, in my opinion, it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a dissertation for the degree of Master of Islamic Revealed Knowledge and Heritage (Fiqh and Uşūl al-Fiqh).

.....
Azman Mohd Noor
Supervisor

I certify that I have examined and read this study and that, in my opinion, it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a dissertation for the degree of Master of Islamic Revealed Knowledge and Heritage (Fiqh and Uşūl al-Fiqh).

.....
Mohd Afandi Awang Hamat
Examiner

This dissertation was submitted to the department of Fiqh and Uşūl al-Fiqh and is accepted as a partial fulfilment of the requirements for the degree of Master of Islamic Revealed Knowledge and Heritage (Fiqh and Uşūl al-Fiqh).

.....
Ahmad Basri Bin Ibrahim
Head Department of Fiqh and
Uşūl al-Fiqh

This dissertation was submitted to the Kulliyah of Islamic Revealed Knowledge and Human Sciences and is accepted as partial fulfilment of the requirements for the degree of Master of Islamic Revealed Knowledge and Heritage (Fiqh and Uşūl al-Fiqh).

.....
Badri Najib Bin Zubir
Dean,
Kuliyah of Islamic Revealed
Knowledge and Human Sciences

DECLARATION

I hereby declare that this dissertation is the result of my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any degrees at IIUM or other institutions.

Nur Farhah Binti Mahadi

Signature.....

Date.....

INTERNATIONAL ISLAMIC UNIVERSITY MALAYSIA

**DECLARATION OF COPYRIGHT AND
AFFIRMATION OF FOR USE OF UNPUBLISHED
RESEARCH**

Copyright © 2010 by Nur Farhah Binti Mahadi. All rights reserved.

**COMMODITY *MURĀBAĤAH* AS PRACTICED BY ISLAMIC FINANCIAL
INSTITUTIONS; A CRITICAL ANALYSIS FROM FIQH PERSPECTIVE**

No part of this unpublished research may be produced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording or otherwise without any prior written permission of the copyright holder except as provided below.

1. Any material contained in or derived from this unpublished research may only be used by others in their writing with due acknowledgment.
2. IIUM or its library will have the right to make and transmit copies (print or electronic) for institutional and academic purposes.
3. The IIUM library will have the right to make, store in retrieval system and supply copies of this unpublished research if requested by other universities and research libraries.

Affirmed by Nur Farhah Binti Mahadi.

.....
Signature

.....
Date

Dedicated exclusively to whom I owe a vote of gratitude,

Mr. Mahadi Ismail & Mdm. Jamaliah Ipar.

Who brought me up and motivated me to learn as much as possible.

And

My fiancé,

Mohamed Lutfi Bin Dato' Mohamed Nasir

*Whose constant love and support have given me the confidence I needed to complete
this dissertation.*

ACKNOWLEDGEMENTS

In the name of Allah (^{'azza}_{wa jalla}), the Most Gracious, the Most Merciful. All praises be to Him, the Lord of the universe, who has bestowed upon human being the enlightenment of knowledge. Prayer to Him and Peace bestowed upon Prophet Muḥammad (^{sallāluhu}_{'alayhi wa sallam}). I am grateful to Him for the blessings granted upon me, and for honouring me His aid to complete this paper.

First of all, I would like to express my special heartfelt gratitude to Dr. Azman Mohd Noor, my dedicated supervisor, for many hours that he has devoted towards improving this dissertation. His insight, feedback, advice, and experience have all played important roles in shaping my research. Although he faced numerous other demands on his time, he was still willing to give me the prompt attention on short notice that I demanded when time was of the essence and deadlines were near. Therefore, I consider myself fortunate to have had him both as an instructor and a friend as his excellence is reflected in my work. Credits to Dr. Azman, for service above and beyond the call of duty.

My deepest appreciation is credited deliberately to Dr. Mohd Afandi Awang Hamat, whose ideas, criticism and advice portray as a backbone for the perfection of this dissertation. His sincere efforts of examination and correction have etched indelibly in my mind, beholden.

Furthermore, I would like to convey my heartfelt thanks to the man I interviewed, Mr. Norfadelizan Abdul Rahman, the Vice President and Head of Bursa Malaysia Islamic Services, for respect the public's right to explore the current practice

of Commodity *Murābahah* market. Thank you for being a channel of information to the public.

Indispensably, I would like to thank my family, especially to my dedicated father, Mr. Mahadi Bin Ismail and lovely mother, Mdm. Jamaliah Binti Ipar, without whose continuous support, encouragement, assistance and love this dissertation might have been so improbable as well as Sr. Nur Fatin Binti Mahadi, who helps me much in the context of typing irrespective of tiredness, sleepiness and her precious time spent.

Friends, for the support that they have extended to me throughout the entire dissertation process and the assistance to cover of the odds and ends of things. Little things mean a lot. I fear that my prolonged exposure to dissertation research may have adversely affected my personality during this time, and for this I apologize. I thank all of you, especially my dear Mohamed Lutfi Bin Dato' Mohamed Nasir, for the love and support he has given me these past years. Someday if I should reach the stars, I shall remember that it was him who said I could.

Suffice to say, I believe all talents come and grant from Allah (^{'azza}_{wa jalla}) and it is to Him that I shall credits above all. May Allah (^{'azza}_{wa jalla}) guide us to and along His way and crown our efforts with success.

TABLE OF CONTENTS

Abstract	ii
Abstract in Arabic	iii
Approval Page	iv
Declaration Page	v
Copyright Page	vi
Dedication.....	vii
Acknowledgments.....	viii
List of Figures	xiii
CHAPTER ONE: INTRODUCTION.....	1
1.0 Introduction	1
1.1 Problem Statement.....	4
1.2 Research Questions.....	6
1.3 Objectives of the Research.....	7
1.4 Limitation of Study.....	9
1.5 Justifications of the Problem.....	9
1.6 Research Methodology.....	10
1.7 Literature Review	12
CHAPTER TWO: COMMODITY <i>MURĀBAḤAH</i>	30
2.0 The Definition and Nature of Commodity <i>Murābahah</i>	30
2.1 The Polemics of Commodity <i>Murābahah</i>	39
2.2 <i>Tawarruq</i> Definition	40
2.3 Justifications of <i>Tawarruq</i> in Commodity <i>Murābahah</i>	44
2.3.1 Permissibility of <i>Tawarruq</i> in Commodity <i>Murābahah</i>	46
2.3.2 Impermissibility of <i>Tawarruq</i> in Commodity <i>Murābahah</i>	50
2.4 The Concept of Commodity <i>Murābahah</i> in the current Islamic financial transactions	55
2.4.1 Current <i>Tawarruq</i> transaction in Commodity <i>Murābahah</i>	56
2.4.2 Sources of the permissibility of the said transaction	57
2.4.2.1 Al-Qur’ān	58
2.4.2.2 <i>Al-Sunnah</i>	59
2.4.2.3 The Saying and Practice of Companions.....	61
2.4.2.4 Legal Maxims.....	62
2.5 Closing	63

CHAPTER THREE: APPLICATION OF COMMODITY <i>MURĀBAĤAH</i> IN BANKING PRODUCT	65
3.0 Liquidity Management / Inter Bank Placement.....	66
3.0.1 The Objective of Liquidity Management.....	67
3.0.2 Elaboration on Liquidity Risk.....	68
3.0.3 Islamic Approach to Liquidity Management	74
3.0.4 Use of <i>Tawarruq</i> for Liquidity Management.....	77
3.1 Corporate Financing and its Operational Flow in Commodity <i>Murābahah</i>	79
3.2 Home Financing and Refinancing	81
3.2.1 Operational Concept of <i>Tawarruq</i> Home Financing.....	83
3.2.2 Elucidation from <i>Sharī'ah</i> point of view	86
3.3 Closing	88
CHAPTER FOUR: THE STRUCTURES OF COMMODITY <i>MURĀBAĤAH</i>	90
4.0 Islamic Financing Products	91
4.0.1 Elaboration on Islamic Financing Products	91
4.0.2 Model of suggested structure	92
4.1 Islamic Investment and Deposit Services Products	93
4.1.1 Amplification of Islamic Investment and Deposit Services Products	94
4.1.2 Instance of suggested structure.....	94
4.2 Islamic Hedging Products	96
4.2.1 Illustration of various diagrams on the related issue	96
4.3 Commodity Sale Agreement (CDSA)	98
4.3.1 Operational Flow of CDSA.....	98
4.3.2 Possible <i>Sharī'ah</i> compliant solution	100
4.4 Commodity Direct Investment (CMDI)	103
4.4.1 Transactional Flow of CMDI	103
4.4.2 Possible <i>Sharī'ah</i> compliant solution	104
4.5 Closing	106
CHAPTER FIVE: COMMODITIES <i>MURĀBAĤAH</i> MARKET	110
5.0 BURSA SAHAM KUALA LUMPUR (BSKL).....	110
5.0.1 Review on Crude Palm Oil (CPO)	113
5.0.1.1 Contract Specification of CPO.....	114
5.0.1.1.1 Contract Unit and Contract Value of CPO	115
5.0.1.1.2 Minimum Fluctuation and Contract Months.....	116
5.0.1.1.3 Final Trading Day and Maturity Date	116
5.0.1.1.4 Final Settlement Day	116
5.0.1.1.5 Validity of Certification of Quality and Appraisal Cost	117
5.0.1.1.6 Publication of Delivered CPO.....	117
5.0.1.1.7 Undertaking by Port Tank Installation	117
5.1 Outline of Commodity <i>Murābahah</i> and <i>Tawarruq</i> concepts in BSKL.....	118
5.1.1 Model of Commodity <i>Murābahah</i> in Financing	119

5.1.2 Model of Commodity <i>Murābahah</i> in Deposit.....	120
5.1.3 Model of Commodity <i>Murābahah</i> in <i>Sukūk</i>	122
5.2 Summary on Bursa <i>Sūq Al-Sila'</i>	124
5.2.1 Market Features of Bursa <i>Sūq Al-Sila'</i>	125
5.2.2 Transactional Flow of Bursa <i>Sūq Al-Sila'</i>	127
5.2.3 Analysis on the Permissibility of Bursa <i>Sūq Al-Sila'</i>	131
5.3 <i>Sharī'ah</i> Issues for Bursa Commodity Transaction.....	132
5.3.1 Identification of the Commodity	133
5.3.1.1 <i>Gharar</i> in CPO	134
5.3.1.2 Commodity's Price	139
5.3.1.2.1 Commodity's price seems equivalent to <i>ribā'</i>	139
5.3.1.2.2 <i>Murābahah</i> rate as benchmark to LIBOR	140
5.3.1.3 Dilemma in CPO	141
5.3.1.3.1 CPO derivative turns to be food products.....	141
5.3.1.3.2 Reselling non-possessed merchandise.....	142
5.3.1.4 Expensive fee charged for delivery of the commodity...	144
5.3.2 Execution of Contracts.....	144
5.3.2.1 Being <i>Tawarruq Munazzam</i> (Organized <i>Tawarruq</i>) which is synthetic and fictitious as <i>Bay' al-Īnah</i>	145
5.3.2.2 <i>Wakālah</i> Issue in Commodity <i>Murābahah</i> trading	147
5.3.2.2.1 The Appointment of the bank as an Agent	147
5.3.2.2.2 The trading is exposed to exploitation and fraud .	148
5.3.2.2.3 A Sale and Purchase Contract is concluded by one party for itself and on behalf of the counter party at once	151
5.3.2.2.4 Dissolution of a contract	152
5.3.2.3 Tri-partite <i>al-Īnah</i> which circumvents the prohibition of <i>ribā'</i>	155
5.3.2.4 <i>Murābahah</i> and <i>Bay' al-Mu'ajjal</i> contracts are deemed to continue the present <i>ribā'</i> -based transaction	156
5.4 Closing	157
CHAPTER SIX: CONCLUSION AND RECOMMENDED SOLUTION....	159
6.0 Conclusion.....	159
6.1 Findings in Commodity <i>Murābahah</i> issues	165
6.2 Recommended Solution from Islamic <i>Sharī'ah</i> point of view.....	168
6.3 Closing	172
BIBLIOGRAPHY	174
APPENDIX I: BURSA SŪQ AL-SILA' OPERATED BY BURSA MALAYSIA ISLAMIC SERVICES SDN BHD	187
APPENDIX II: SHARĪ'AH STANDARD NO. (20): SALE OF COMMODITIES IN ORGANISED MARKET.....	188
APPENDIX III: SHARĪ'AH STANDARD NO. (30): MONETIZATION (TAWARRUQ)	189

LIST OF FIGURES

<u>Figure No.</u>		<u>Page No.</u>
2.1	Traditional Definition of Commodity	31
2.2	Contemporary Definition of Commodity	31
2.3	Tawarruq Transaction	43
2.4	<i>Tawarruq</i> as practiced by Islamic Financial Institutions	44
2.5	The Permissibility of <i>Tawarruq</i> Transaction	47
2.6	The Rejection of Organized <i>Tawarruq</i> (<i>Tawarruq Maşraft</i>)	51
2.7	Commodity <i>Murābahah</i> Operation in Financing	55
2.8	Commodity <i>Murābahah</i> Operation in deposit mobilization	56
3.1	Commodity <i>Murābahah</i> in Corporate Financing	80
3.2	<i>Tawarruq</i> Home Financing	85
4.1	Islamic Credit Card using <i>Tawarruq</i>	92
4.2	Commodity <i>Murābahah</i> Deposit-i	95
4.3	The Desired Effect of Islamic Profit Rate Swap	97
4.4	Commodity Sale Agreement (CDSA): Bank as Investor	99
4.5	Commodity Direct Investment (CMDI): Bank as Investee	103
5.1	Model of How Corporate Customer is financed by Islamic Bank	119
5.2	Transactional flow of How Corporate Customer place <i>Murābahah</i> deposit with Islamic Bank	121
5.3	Structure of How <i>Sukūk Murābahah</i> is issued by Corporate Customer	123
5.4	Transactional Flow of Bursa <i>Sūq Al-Sila</i> ^c	128
5.5	Issues in Commodity <i>Murābahah</i> Market	133

CHAPTER ONE: INTRODUCTION

1.0 INTRODUCTION

This paper evaluates the nature of Commodity *Murābahah* as practiced by Islamic Financial Institutions from the *Sharī'ah*¹ perspective and outlines the reason for its permissibility and impermissibility. In general, commodity can be defined as anything that the land can produce either soft (for human consumption) or hard (for industrial usage) by means of raising on the land, extracting from the land, or growing on the land.² Economically, raising on the land refers to the live-stock based commodity such as live cattle and sheep, while extracting from the land refers to the mineral-based commodity like gold and petroleum, and growing on the land refers to agricultural-based commodity for instance rubber and cocoa. All these refer to the traditional definition of commodity. As for today, commodity is best defined as anything that can be traded on the land either physical commodity such as currency and bond futures, or fictitious commodities as they could not be seen or held for example index and interest rate futures.³

Murābahah is one of several Islamically permissible contracts of sale and purchase which are increasingly being used in the financial sector by various Islamic financial institutions. *Murābahah* can be defined as selling and purchasing an existing

¹ *Sharī'ah* is an Arabic word that literally means “the road to take” or “the line to follow”. As a terminology, *Sharī'ah* can be defined as “a set of divinely presanctioned laws and rulings, or prescribed principles, by which Muslims should abide themselves so they can relate to Allah as well as other human beings.” See Shaltūt, Sheikh Maḥmūd, *al-Islām: 'aqīdah wal Sharī'ah*, (n.p., 1959, 1st edn.), 68. In brief, *Sharī'ah* is considered as an intrinsic law which is practiced by each and every Muslim in his daily life.

² Ho Soke Fun, Noryati Ahmad, and Rosalan Ali, *Introduction to Malaysian Derivatives*, (Shah Alam: University Publication Centre (UPENA), 2007), 49.

³ *Ibid.*, 50.

commodity owned by the seller whereby the costs and profit margin (mark-up) are made known and agreed by all parties involved.⁴ The settlement of the purchase price is done normally on deferred payment basis or instalments.

As we noticed Islamic Financial Institutions or Islamic Bankings in general aim to promote and develop the application of Islamic principles, law and traditions to transaction of financial, banking and related business affairs as acceptable and consistent with Islamic principles. These forbid interest (*ribā'*), gambling and all un-Islamic activities. By doing so, Islamic banking will safeguard and protect Islamic communities and societies from activities which are considered bad from Islamic viewpoint. It helps to remove the contradiction in Islamic societies, between belief in the illegality of interest, and the existence of banks which deal with interest.⁵ Thus, the main goal of Islamic Banking is to deal without interest. There is complete unanimity among all schools of thought in Islam that the term *ribā'* stands for interest in all its types and forms.

Islamic Jurisprudence imposes a number of conditions on the validity of sale and purchase contracts. These conditions mainly pertain to the parties of the contract as well as to the goods which are being bought and sold.⁶ For instance, it is required that buyers and sellers must be adult and sane. In order for the goods to be sold, they must be pure, useful, in the ownership and possession of the seller, etc. As these and other conditions of a valid sale contract can be found in any standard book of Islamic Jurisprudence.

⁴ Awṣaf Aḥmad, *Contemporary Practices of Islamic Financing Techniques*, (Jeddah: Islamic Research and Training Institute, 1993), 34.

⁵ Elteganī, 'Abdelgader Aḥmed, *Islamic Banking: Distribution of Profit (Case Study)*, (United Kingdom: The British Library, 1990), 47-48.

⁶ Awṣaf Aḥmad, *op.cit.*, 65.

As part of Bank Negara Malaysia's initiative to support Islamic banking and finance development in Malaysia, Commodity *Murābahah* which is based on principle of *Tawarruq* was introduced to facilitate liquidity⁷ management and investment purpose. It is designed to be the first ever commodity-based transaction that utilizes the Crude Palm Oil (CPO) based contract as the underlying assets.⁸ Commodity *Murābahah* transaction with Bank Negara Malaysia was first auctioned competitively in the Islamic Inter-bank Money Market (IIMM)⁹ on 14th March 2007 and marked an extensive effort by the country to become a significant player in Islamic financial market globally.¹⁰

Commodity *Murābahah* enables the customer to buy a specific commodity on the basis of deferred payment, then, he has the right to keep it, or resell it for cash. Islamic financial institutions use the concept of *Murābahah* sale to satisfy the requirements of various types of financing such as the financing of raw materials, machinery, equipment, metals, CPO, oil and gas, foods, bonds, shares, consumer durables as well as short-term trade financing and etc.

As Islamic banks cannot earn interest by lending money, they have to undertake investment based on Islamic principles, i.e. *Mushārahah*, *Mudārabah* or *Qiraḍ*, *Murābahah*, Leasing or Renting the Physical Capital etc. However, the researcher will focus more on *Murābahah*.

⁷ Liquidity means the degree to which an asset or security can be bought or sold in the market without affecting the asset's price. Liquidity is characterized by a high level of trading activity. Assets that can easily bought or sold, are known as liquid assets. Liquidity is the ability to convert an asset to cash quickly which known as "marketability", Liquidity, *Investopedia*, <www.investopedia.com/terms/l/liquidity.asp>, (accessed 10 May 2009).

⁸ Asyraf, Wajdi Dusuki, *Commodity Murābahah Programme (CMP): An Innovative Approach to Liquidity Management*. Paper published in Journal of Islamic Economics, Banking and Finance, vol.3, No.1; 2007, 4.

⁹ In Malaysia, the establishment of Islamic Inter-bank Money Market (IIMM) on 3rd January 1994 was designed to provide avenue for Islamic banks to manage liquidity more effectively without underpinning the principles of *Sharī'ah*.

¹⁰ Bank Negara Malaysia, Commodity *Murābahah* Programme. <<http://iimm.bnm.gov.my/index.php?ch=4>>, (accessed 9 August 2007).

In this procedure (*Murābaḥah*), the client requests the bank to buy certain items on his behalf and he agrees to pay the bank later on, upon the fulfilment of the purchase, the purchase price plus an agreed percentage of profit.¹¹ *Murābaḥah* is essentially a form of trade credit, in which the bank actually purchases and becomes legal owner of whatever the client has ordered and then resells it to the client on delivery, at a previously agreed, higher price. However, opinions differ as to whether the client has a legal obligation to buy what the bank has purchased on his/her behalf. Nonetheless, if the client has no legal obligation to buy or, in other words, can apply the option (*khiyār*) to reject the goods, then *Murābaḥah* would be commonly acceptable.¹²

This paper discusses in details the polemics of Commodity *Murābaḥah* in the light of *Sharī'ah* and the concept of Commodity *Murābaḥah* in the current Islamic financial transaction. Later the researcher elaborates on the application of Commodity *Murābaḥah* in banking products, e.g. Liquidity Management, Corporate Financing, and Home Financing. Both structures of Commodity *Murābaḥah* and Commodity *Murābaḥah* markets such as Bursa Kuala Lumpur and London Metal Exchange are discussed in this paper. Finally the researcher comes up with her own idea on the recommended and possible solutions towards this issue.

1.1 PROBLEM STATEMENT

Recently, Commodity *Murābaḥah* concept has been extensively used in Islamic financial banking along with other *Sharī'ah* contracts such as *Mushāarakah*, *Murābaḥah* and etc. This project paper is proposed to discuss some relevant issues with reference to underlying Islamic principles and their practical applicability in Commodity *Murābaḥah*, because without correct understanding of these issues, the

¹¹ Elteganī, 'Abdelgader Aḥmed, *Islamic Banking: Distribution of Profit (Case Study)*, 21.

¹² Ibid.

concept may remain ambiguous and continue confusing. Thus, its practical application may be susceptible to errors, inaccuracies and misconceptions.

Even though the application of Commodity *Murābahah* with pre-determined profit rate or pre-agreed “mark-up” is permissible in *Shari‘ah* compliant financing, but the disputation between the Islamic jurists saying that Commodity *Murābahah* resembles to *ribā*’-based transaction may render the transaction invalid.

As far as the researcher concerned, when *Murābahah* is used as a mode of financing, it is always affected on the basis of deferred payment. The financier purchases the commodity on cash payment and sells it to the client on credit. While selling the commodity on credit, he takes into account the period in which the period is to be paid by the client. The longer the maturity of *Murābahah* payment, the higher the price would be. If the client purchases the same commodity on cash, he will pay much less compared he has to pay in a *Murābahah* transactions on deferred payment basis. Obviously, the commodity’s price in a credit sale may be increased from the price of a cash sale. Therefore, it is argued that the increase of price in a credit sale should be treated equivalent to the interest (*ribā*’) charged on a loan, because in both cases an additional amount is charged for the deferment of payment.¹³

However, it is argued that Commodity *Murābahah* which applied the form of Organised *Tawarruq* resembles to tri-partite *Bay‘ al-‘Īnah*¹⁴, which is frowned upon by some as a form of *hīlah* (legal trick) and it circumvents the prohibition of *ribā*’¹⁵.

¹³ Elteganī, ‘Abdelgader Aḥmed, *Islamic Banking: Distribution of Profit (Case Study)*, 21-30.

¹⁴ *Bay‘ al-‘Īnah* according to Islamic legal literature is described as an arrangement whereby a person sells an asset to another for deferred payment. Subsequently, the seller buys back the asset from the buyer before the full payment of the deferred price and for cash payment which is of a lesser amount than the deferred price. Imām Mālik and Aḥmad ibn Ḥanbal prohibited this transaction because it is a legal devise for dealing in *ribā*’. Refer to Ibn Manẓūr, Muḥammad b. Mukarram, *Lisān al-‘Arab al-muḥīṭ*, (Bayrūt: Dār Lisān al-‘Arab, n.d), vol.13, 306, Ibn Qudāmah, Muwaffāq Al-Dīn, *al-Mughnī*, (Bayrūt: Dār Al-Fikr, 1985), vol.4, 158, Ibid., vol.6, 260 and Ibn Qayyīm, *I‘lām al-muwaqqi‘īn*, (Egypt: Idārah al-Uibaniyyah al-Muniriyyah, n.d.), vol.3, 96. See also Abū Zayd, ‘Abd al-‘Azīm, *Bay‘ al-murābahah wa taṭbīqatuhu al-mu‘āshirah fī al-maṣārif al-Islāmīyah*, (Dimashq: Dār al-Fikr, 1st edn.,

This is because, the practice of *Murābahah* transaction is seen as something analogous to *ribā'* based on financing through Organised *Tawarruq*. This will certainly pose a great challenge to the Islamic financial institutions and for Malaysia to be the centre of Islamic finance. Furthermore, *Murābahah* transactions as practiced in the Islamic banks are not different in essence from the interest-based loans advanced by the conventional banks.

Therefore, with positive approach, this paper tries to investigate the *Sharī'ah* view on Commodity *Murābahah* from its various modes and tries to propose possible recommendations for greater application of Commodity *Murābahah* which is appropriately applied by Islamic financial institutions.

1.2 RESEARCH QUESTIONS

This study is attempted to answer these questions:

- 1- What is the best application of Commodity *Murābahah* as practiced by Islamic Financial Institution in the light of *Fiqh*¹⁶ Perspective?
- 2- Are Commodity *Murābahah* transactions, as practiced by Islamic financial institutions different in essence from the interest-based loans advanced by the conventional banks?

2004), 103-105 and Al-Rashīdī, Aḥmad Fahd, *ʿAmaliyāt al-tawarruq wa-taṭbīqātuha al-iqtisādīyah fī al-maṣārifi al-Islāmiyyah*, (Jordan: Dār al-Nafaʿīs, 1st edn. 2005), 39-42, Rabiah Ali, *Bayʿ al-ʿĪnah and Tawarruq: Mechanisms and Solutions. In Bank Negara Malaysia (Ed.), Mudhākarah Cendekiawan Sharīʿah Nusantara 2006: Bayʿ al-ʿĪnah and Tawarruq: Isu-isu dan Penyelesaiannya Dalam Konteks Kewangan Islām*, (Kuala Lumpur: Central Bank of Malaysia, 2007), 139; Al-Zuhayli, Wahbah, *al-Fiqh al-Islāmī wa-adillatuhu*, (Dimashq: Dār al-Fikr, 3rd edn., 1989), vol.4, 466-467.

¹⁵ Al-Qurān Al-Karīm, Al-Rūm (30):39, Al-Nisāʿ (4):161, Al-ʿImrān (3):130-132 and Al-Baqarah (2):275-281.

¹⁶ *Fiqh* (“فقه” means understanding) is Islamic jurisprudence. In brief, *Fiqh* is ‘ulamā’s interpretation on *Sharīʿah*. *Fiqh* is an expansion of the *Sharīʿah* Islamic law (based directly on the Qurʿān and Sunnah) that complements *Sharīʿah* with evolving rulings or interpretations of Islamic jurists. *Fiqh*, *Wikipedia*, <<http://en.wikipedia.org/wiki/Fiqh>>, (accessed 15 June 2009).

- 3- What are the difficulties and problems facing Islamic banks in the legality of Commodity *Murābahah*, the important issue of *Tawarruq*, its main objections and the implications of the recent ruling from the Islamic Fiqh Academy of OIC?
- 4- What are the methods of investment used in Islamic financial institutions and how these banks are operating Commodities *Murābahah* in the absence of interest as well as the approaches in *Fiqh* when determining whether the contract is valid and permissible from *Sharī'ah* perspectives?
- 5- Whilst being an increasingly popular and accessible liquidity management tool, do Commodity *Murābahah* and its associated structures bring any challenge to market practitioners?
- 6- What are the rational outlooks of the application of Commodity *Murābahah* in banking products such as Liquidity Management, Corporate Financing and Home Financing and its suggested structures as practiced in Islamic banks and its clarification from *Sharī'ah* point of view?
- 7- What are the Commodity *Murābahah* and *Tawarruq* concepts in Bursa Saham Kuala Lumpur, transactional Flow of Bursa *Sūq Al-Sila'* and *Sharī'ah* permissibility on its market?

Of these, the last three are the primary objectives of the research.

1.3 OBJECTIVES OF THE RESEARCH

This paper intends to discuss some of the pertinent issues on Commodity *Murābahah* as implemented by Islamic financial institutions. If this finding can help influence or convince Malaysian jurists to practise Commodity *Murābahah* as a legitimate contract to raise capital, the supply of Islamic global Islamic funds can indeed become the much needed source of capital for Malaysia's economic recovery.

Basically, Islamic banks stand on two principles from Islamic Law (*Shari'ah*). The first principle is the abolition of interest (usury / *riba'*). The second is the replacement of interest by a profit sharing system whenever possible. However, this may not be the case as the argument against the trading of Commodity *Murābaḥah* in the current Islamic financial transaction is popularly discussed such as the application of Commodity *Murābaḥah* in banking products, e.g. Liquidity Management, Corporate Financing, and Home Financing, the structures of Commodity *Murābaḥah* and Commodity *Murābaḥah* Markets such as Bursa Saham Kuala Lumpur (Kuala Lumpur Stock Exchange) and London Metal Exchange. The application of Commodity *Murābaḥah* is restricted to a handful of financing products, e.g. working capital, personal financing and credit cards whereby the financing is used for the purpose of providing cash to customers. In the light of these, the most important objectives for the study were formulated:

1. To study the application of Commodity *Murābaḥah* as practiced by Islamic Financial Institution in the light of *Fiqh* Perspective
2. To argue that the *Murābaḥah* transactions, as practiced by Islamic financial institutions are different in essence from the interest-based loans advanced by the conventional banks.
3. To clarify and illustrate the difficulties and problems facing by Islamic banks in the legality of Commodity *Murābaḥah*, the important issue of *Tawarruq*, its main objections and the implications of the recent ruling from the Islamic *Fiqh* Academy of OIC.
4. To show and illustrate methods of investment used in Islamic financial institutions and how these banks are operating in the absence of interest especially when it comes to Commodity *Murābaḥah* as well as discover the approaches in

Fiqh when determining whether the contract is valid and permissible from *Sharī'ah* perspectives.

5. To clarify whether Commodity *Murābahah* and its associated structures bring any challenge to market practitioners or otherwise.
6. To explore the rational outlooks of the application of Commodity *Murābahah* in banking products such as Liquidity Management, Corporate Financing and Home Financing along with its suggested structures as practiced in Islamic banks and its clarification from *Sharī'ah* point of view.
7. To study the Commodity *Murābahah* and *Tawarruq* concepts in Bursa Saham Kuala Lumpur, transactional Flow of Bursa *Sūq Al-Sila'* and *Sharī'ah* permissibility on its market.

In order to put the above objectives in the right context, it was felt necessary to examine the legitimacy of Commodity *Murābahah* in Malaysian financial institutions; the definition, the concept and the nature of Commodity *Murābahah*, and analyse on its related products, markets, and operations in Malaysian financial institutions.

1.4 LIMITATION OF STUDY

As the topic discussed in this paper is vast, the researcher limits her study particularly on the issue of Commodity *Murābahah* as being practiced by Islamic Financial Institutions in Malaysia such as in Al-Rajhi Bank and other Islamic banks, as well as Commodity *Murābahah* which is offered by Bursa Malaysia in Bursa *Sūq al-Sila'*.

1.5 JUSTIFICATIONS OF THE PROBLEM

Recently, Commodity *Murābahah* has been widely applied in Islamic finance, along with other *Sharī'ah* contracts such as *Muḍārabah*, *Mushārahah* and *Bay' Murābahah*

where all transactions in an Islamic system must be governed by norms of Islamic ethics as enunciated by the *Sharī'ah*. At a fundamental level, an Islamic financial system may be described as a "fair" system and a "free" system. The objective of ensuring "fairness", however, is primary and it circumscribes the "freedom" of the participants in the system. While Islam provides a basic freedom to enter into transactions, this basic norm does not imply unbridled freedom to contract and is constrained by other norms, such as, the prohibition of *ribā'* and *gharar*.

However, confrontation still exists from some critics saying that Commodity *Murābaḥah* based financial products bear a striking resemblance to interest-based products. Thus, considering their overwhelming importance, the researcher explores for a further and lucid discussion of the more important ones in this research, which is "Commodity *Murābaḥah* as practiced by Islamic financial institution". Therefore without hesitation the researcher believes that there is a great necessity to have a critical look at Muslim Jurists' opinions and evidences in order to determine and select a preferable and appropriate opinion for contemporary time. Hence, the researcher begins with a comprehensive explanation on the nature of Commodity *Murābaḥah* and *Sharī'ah* perspective then proceeds to a discussion pertaining to *Fiqh* issues in Commodity *Murābaḥah*. Next, she continues with a brief explanation on challenges and issues in Commodities *Murābaḥah* followed by the applications of Commodity *Murābaḥah* in related products and markets. Eventually, the researcher provides some suggested recommendation concerning to this issue.

1.6 RESEARCH METHODOLOGY

The methodology of this research will be descriptive, which describes and studies the definition and chronology of Commodity *Murābaḥah* and analyzes on its practice as

implemented by Islamic financial institutions and explores various Islamic jurists' views on its permissibility and impermissibility.

Instead of being descriptive, the methodology of this study will be qualitative, reading classical Arabic texts in *Fiqh* and *Uṣūl al-Fiqh* as well as contemporary Arabic, English and Malay texts in the field.

Based on the above objectives, the study is conducted in six chapters. Chapter One, in the introductory preface stresses the permissible contract of sale and purchase which is increasingly being used in the financial sector by various Islamic financial institutions, that is Commodity *Murābaḥah*. In Commodity *Murābaḥah*, people tend to practice Organise *Tawarruq* which is a trick or artificial transaction to cover *ribā'*. The commodities are not well identified or tagged. These problems form the focus of the research. Thus the research questions, objectives of the research, methodology of the research and literature review are outlined. Chapter Two evaluates in brief the nature of Commodity *Murābaḥah* from the *Sharī'ah* perspective and outlines its polemics as well as delineates the various *Fiqh* views for its permissibility and impermissibility. The concept of Commodity *Murābaḥah* in the current Islamic financial transaction is also reviewed. It also identifies the sources of the permissibility of the said transaction such as from the sanctions of Al-Qur'ān, *Al-Sunnah*, the saying and practice of companions and legal maxims. Chapter Three will analyze in greater detail the *Fiqh* issues in the application of Commodities *Murābaḥah* in banking products. In this chapter, the researcher tries to find out what are the justifications and arguments against Commodities *Murābaḥah* when it is practiced in Liquidity Management, Corporate Financing, Home Financing and Refinancing. Therefore, the researcher is obliged to prepare the most suitable Islamic approaches to Liquidity Management, Islamic Corporate Financing and the rational outlook of the