



Issues in Contemporary Implementation of Murabaha

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Abstract: This research intended to explore issues in the contemporary implementation of Murabaha in Pakistan. For this purpose, the model agreements of Murabaha, obtained from the State Bank of Pakistan (SBP) and two Islamic banks (IB-I and IB-II), were analysed through content analysis. Resultantly 7 misgivings/issues were identified in form of open-ended questions. These issues were discussed with 30 Shari'ah scholars through semi-structured interviews in order to verify them as Shari'ah issues or clarify them as no Shari'ah issues. The findings confirmed no Shari'ah issue in appointing the customer as agent by the bank but shifting the supplier's risk to the agent was a practical Shari'ah issue. Further, filling and signing all the documents of Murabaha at the same time was confirmed as a serious Shari'ah issue equivalent to selling a commodity without assuming the ownership risk creating another Shari'ah issue. Shifting all types of risks to the customer either as agent or as ultimate consumer reflected the whole Murabaha as heela.

Keywords: Murabaha, Risk, Agent, Shari'ah scholars, Shari'ah issue

JEL Codes: Z12

Introduction

The State Banks of Pakistan's (SBP) efforts to promote Islamic banking in parallel with the conventional banking gave a new impetus to the growth of Islamic banking (Shah & Niazi, 2009) making Islamic banking available in almost every corner of the country. Nonetheless, the issue of it being *Shari'ah* complaint or otherwise is still controversial (Tahir, 2004; Ghias, 2011; Meezan Bank, 2008), as is of who can give the final verdict in the absence of an "ultimate authority" or "rules and guide-

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© Research Center for Islamic Economics
DOI: 10.26414/A052
TUJISE, 6(2), 2019, 1-24
tujise.org



Submitted : 25.01.2019
Revised : 25.04.2019
Accepted : 18.05.2019
Published : 15.08.2019



lines". The diversity of opinions and interpretations offered by various schools of thought "on *Shari'ah* issues makes things more complicated", which sometimes lead to controversies about the acceptance or disapproval of a "product" offered by Islamic banks (Malik, Malik, & Mustafa, 2011). Further, a group of *Ulema* declared that the prevailing Islamic banking was similar to conventional banking and contrary to the principles of *Shari'ah*, though certain other *Ulema* appreciated the concurrent Islamic banking practices (Ghias, 2011, pp. 5, 21-22). It is probably due to the lack of a "well developed Islamic banking theory" (Tahir, 2004; Siddiqi, 2006), i.e. giving a comprehensive picture of the "rationale, role, nature, and working", etc., in totality that can be achieved by conducting imperative research (Tahir, 2004).

This situation creates significant room for fresh research which may explore the contemporary Islamic banking practices in the light of the primary requirements of *Shari'ah*. Hence, the current research initially explores the issues in the contemporary implementation of Murabaha, on the basis of the model agreements applied by Islamic banks in Pakistan. Further this research brings to light the expert opinion of *Shari'ah* scholars regarding the issues identified in the contemporary implementation of Murabaha in the light of the *Shari'ah* requirements in order to verify them as real *Shari'ah* issues or clarify them as no issues related to *Shari'ah*. Precisely, this research intends to realize the following objectives.

- To study the contemporary implementation of Murabaha by the Islamic banks in Pakistan and identify the *Shari'ah* issues in the contemporary implementation of Murabaha on the basis of the model agreements.
- To explore the opinion of contemporary *Shari'ah* scholars regarding the issues identified in the contemporary implementation of Murabaha on the basis of the model agreements after their proper analysis.

Significance of the Study

Ever since their introduction in year 2002, for last 17 years, the contemporary Islamic modes of financing have not been examined in the light of the principles of *Shari'ah* in order to verify their compliance with them. Lack of such a study creates an essential gap for fresh research in this important area of Islamic banking. The present study is a thoughtful academic endeavour to fill up this vacuum and provide a lead to further research.

Though considerable amount of literature is found dealing with different "theoretical" facets of Islamic banking and finance but rare attempts have been made

to explore and investigate “empirical and operational aspects” of Islamic banking (Ahmad, 1993; Yousef, 2004; Ullah, 2012, p.4). There is a critical need of academic research to investigate the actual application of *Shari’ah* principles in Islamic banking (Ullah, 2012, p.4).

The current study is unique in the sense that previously no research has been undertaken to analyze the contemporary implementation of Murabaha on the basis of the model agreements. Thus, this is the first study of its kind that analyzes the model agreements of Islamic banks. This research explores the expert opinion of *Shari’ah* scholars regarding the issues identified in the contemporary implementation of Murabaha. Therefore, this research attempts to present an up to date knowledge regarding the issues related to the practice of Murabaha through inviting the expert opinion of contemporary *Shari’ah* scholars directly.

The findings of this research may prove a step forward towards creating consensus among a diverse group of contemporary *Shari’ah* scholars by reaching upon an agreement or may reflect the difference of opinion regarding the issues in the contemporary practice of Murabaha.

Literature Review

Murabaha contract has been “one of the most widely used” modes of Islamic finance which significantly “contributed to the recent growth” of “Islamic finance” in the global market (Hart & Childs, 2011; Haron et al., 2015). Islamic banks in Pakistan are also significantly relying on “Murabaha as a mode of financing” (Farooq and Ahmed, 2015). The massive use and growth of Murabaha has been referred to as “Murabaha syndrome” (Yousef, 2004).

Murabaha originally is a form of sale in which the cost of the subject of sale along with the profit added there on are disclosed to the buyer. The amount of profit can be determined as percentage of the cost or as an absolute amount. The sale may be on cash or deferred payment basis (Sairally, 2002; Usmani, 2007; Guney, 2015). Murabaha was adopted by Islamic banks as a means to facilitate customers by providing goods on deferred payment basis instead of advancing money. Thus, Murabaha is a type of sale in which an Islamic “bank, at the request of its client, purchases the specified goods from a third party”. Immediately after obtaining the “ownership” as well as the “physical or constructive possession” of the goods, “the bank sells these goods to the client at cost plus a fixed profit margin”. Hence, Murabaha in its true form is not a mode of financing (El-Gamal, 2000, pp.10-11;

Siddiqui, 2001; Sairally, 2002; Khan, 2003, p.26; Usmani, 2007, p.95; Ayub, 2007, p. 219; Alsayyed 2010; Hart & Childs, 2011; Farooq & Ahmed, 2015; Guney, 2015; Haron et al., 2015). Thus, the modern Murabaha as practiced in contemporary banking is quite different from its traditional spirit (Guney, 2015). However, the AAOIFI (2010) declared the application of Murabaha in its current form permissible. Nevertheless, if Murabaha is used as a financing mode, then all essential conditions defined by *Shari'ah* for a valid sale must be fulfilled (Usmani, 2007, p.105; Ayub, 2007, p. 214; Farooq & Ahmed, 2015). In such a sale, the seller discloses the cost of the goods to the buyer and the buyer “agrees to pay a premium over that initial price”. Further, the bank needs to own the goods at the time of selling them to the customer (El-Gamal, 2000, p. 10-11; Usmani, 2007, p.106). However, Usmani (2007, p.243) observed an “increase in the price of *Murabaha*” by financial institutions “for late payment” by the customers, which is against the spirit of Murabaha. In Murabaha, the price once fixed cannot be increased or decreased.

Hasan (2009) observed that the ill organized and uncontrolled practice of Murabaha warranting a “fixed profit rate” reflected “interest in an Islamic cloak”. Similarly, Gundogdu (2014) argued that the “simultaneous purchase and sale by Islamic” banks and the immediate transfer of “the ownership to the borrower in exchange of fixed return” in Murabaha indicated that the “ownership does not stay with the” bank. Gundogdu (2014) declared Murabaha as “debt creation” equivalent to conventional finance committing a “pre-determined” rate of return and essentially passing all risks associated with the Murabaha transaction to the loan seeker against the fundamental PLS principles.

The “excessive use” of Murabaha “has often led to doubtful practices” reflecting it “closer to interest bearing debt” (Tabet, 2015). The bank initially appoints the customer as agent to purchase/acquire i.e. “take possession” of the goods on behalf of the bank and deliver them to himself. The risk is in fact transferred to the customer particularly if the goods are purchased in the name of “customer from the beginning” guaranteeing a fixed return to the bank “without any risks”. In case of “constructive possession” by the bank and physical possession by the customer, the Murabaha may be undertaken before the actual “procurement of the commodity” by the bank as a cloak for financing instead of trading (Tabet, 2015).

It is observed that Murabaha has been the most frequently used financing mode by Islamic banks since its acceptance as *Shari'ah* compliant mode of finance. However, it has been criticised for securing fixed rate of return without carrying risk hence creating resemblance to conventional interest based financing (Sairally, 2002).

Moreover, previous research has not investigated the issues related to contemporary implementation of Murabaha. Yousef (2004) empirically examined the use of Murabaha and other mark-up based financing in comparison with the total financing extended by the Islamic banks. Similarly, previous research (Ahmad, 1993; Shah & Niazi) examined Islamic banking practices on the basis of annual reports, account opening forms, and promotional brochures of Islamic banks. No research is found to have examined the issues in the contemporary implementation of Murabaha on the basis of any primary reliable data including the legal documents and agreements which contains all the necessary terms and conditions sufficient to prove the *Shari'ah* compatibility or otherwise of the contemporary Islamic modes of financing.

Methodology

This research is premeditated as a qualitative research intending to explore the contemporary implementation of Murabaha followed by the expert opinion of a diverse group of *Shari'ah* scholars regarding the issues related to its contemporary implementation.

This research may be categorized as exploratory for discovering (Kothari, 2004, p.36) and better understanding (Neuman, 2014, p.38) the issues in contemporary practice of Murabaha and obtaining the expert opinion of *Shari'ah* scholars regarding its compliance with *Shari'ah* principles (Sekaran, 2006, p.120; Ullah, 2012, p.37). The structure of this research incorporates the essential features of both exploratory and descriptive research paradigm (Eid, 2012, p.244) due to the practically jumbling nature of exploratory and descriptive research (Neuman, 2014, p.38). The lack of a unanimous position of *Shari'ah* scholars (Alomar, 2006) on contemporary Islamic banking practices which developed particularly after 2002 and absence of an established theory of Islamic banking (Tahir, 2004; Siddiqi, 2006), are the two reasons making this an exploratory study suitable for applying qualitative methods. Zamil (2014, p. 382) undertook exploratory research in order to discover the “theoretical and practical aspects of problems and challenges” facing the Islamic banks.

Population

This study intended to explore issues in the contemporary implementation of Murabaha, hence all the full-fledged Islamic banks as well as conventional banks which operate Islamic banking branches in Pakistan apparently constituted the population of this study. Currently they all are 21 in number including 5 full-fledged Islamic banks and 16 conventional banks having Islamic banking branches in opera-

tion (SBP, Islamic Banking Bulletin July-September 2017; Zamil, 2014, p.192). The research comprised two phases, therefore a separate population was defined for each phase of this research.

In the first phase of this research, the contemporary implementation of Murabaha was examined on the basis of data collected from the model agreements/documents in order to identify issues in the contemporary implementation of Murabaha. Therefore, the group of model agreements of all the Islamic banks actually constituted the population in the first phase of this study. The model documents were selected as source of information on the basis of their authenticity, credibility, representativeness and meaningfulness (Scott, 1990, p. 6, cited by Flick, 2009, p.257).

Subsequent to identifying the issues in the contemporary implementation of Murabaha on the basis of content analysis of the model agreements, a list of open-ended questions was developed for soliciting the expert opinion of *Shari'ah* scholars through semi-structured interviews. Thus, the *Shari'ah* scholars having expertise in banking and finance, working in Islamic banks or serving in *Dar ul Uloom*, and academic researchers, constituted the population for the second stage of this study.

Sample and Sampling Techniques

In the first stage of the study, the model agreements developed by SBP and principal documents from all the five Islamic banks working in Pakistan were required. Therefore, theoretically the purposive sampling technique was used. Purposive or judgmental sampling is meant for "special situations" and is appropriate for "exploratory research". It is applicable to "content analysis" to examine agreements/documents in order to identify the issues (Neuman, 2014, pp. 273-274) in the contemporary implementation of Murabaha.

The researcher made full efforts to collect the model documents from SBP and all the five Islamic banks working in Pakistan. However, the model agreements could only be collected from the SBP website and two Islamic banks, coded as IB-I and IB-II for the purpose of this research in order to keep their confidentiality. Samad, Gardner, and Cook, (2005) also collected information from only two Islamic banks.

After analyzing the model agreements used for the contemporary implementation of Murabaha, a list of open ended questions was developed about the issues identified on the basis of information collected through the content analysis. It was intended to investigate that whether the issues identified in the contemporary practices of Islamic modes of financing, were significant from *Shari'ah* point of view or not.

Therefore, a sample was required to be selected from the *Shari'ah* scholars of the country for this purpose. Purposive sampling was again applied. Ahmed (2006) adopted “purposive random sampling” using “file study and questionnaire survey” in order to identify and comprehend “the problems and prospects of implementation and practice of Mudaraba and Musharaka”. Accordingly data were collected from a sample of 30 respondents including banks’ *Shari'ah* advisors, *Shari'ah* board members, *muftis* associated with Darul uloom and madrassas, and academician and researchers. Previous research used a sample of 31 (Zamil, 2014, p.207) and even a smaller sample of only 23 (Ahmed, 2006) for collecting primary data.

Data Collection and Analysis

In the first phase of this research, the SBP model agreements were downloaded from the SBP website and copies of principal documents/agreements of Murabaha were collected from two Islamic banks (IB-I, IB-II). It is worth mentioning that the model agreements of Islamic banks were used for the first time in an academic research in this study. Previous research (Ahmed, 1993; Shah & Niazi, 2009) collected information from annual reports, brochures, accounting opening forms and other promotional booklets of different Islamic banks for appraising the practices of Islamic banks.

The model agreements of Murabaha were analysed through qualitative content analysis (Saunders et al., 2009, p.117) in order to point out the issues in the contemporary implementation of Murabaha. The model documents were read and re-read iteratively in order to identify the clauses/sections that created misgivings about their *Shari'ah* acceptability. The initial misgivings identified in the model agreements were coded as questions making a list of 7 open-ended questions (Erlingsson & Brysiewicz, 2017) for soliciting the expert opinion of *Shari'ah* scholars through semi-structured interviews making the whole “process inductive” (White & Marsh, 2006).

These open-ended questions were used for interviewing a diverse group of *Shari'ah* scholars including *Shari'ah* advisors and *Shari'ah* board members, *muftis*, and academic researchers with specialization in Islamic banking and finance. Practically semi-structured interviews were conducted in this phase of the research. Previous researchers also conducted “semi-structured interviews” (Ullah, 2012, p.5; Zamil, 2014).

The interviews were properly transcribed and then analysed through content analysis. NVivo (version 12), the software for qualitative data was used for analysis of the transcribed data. In the next step codes were created in NVivo (version 12) rep-

resented by Q.1, Q.2, ... Q.7, on the basis of the open ended questions used for interviewing the *Shari'ah* scholars regarding the issues identified in the model agreements. The responses obtained from the *Shari'ah* scholars were then sent to the respective codes for further analysis. The software was run to examine the sentiments of the respondents with respect to each code (question). The NVivo initially composed the summary of responses to a code (question) and categorized the total respondents in four groups including mixed, negative, neutral, and positive categories. The results are discussed in section 5 of this paper. However, transcribed data were thoroughly analysed and interpreted by the researcher. Figure 1, presents the schematic diagram of the data collection and analysis followed in this research.

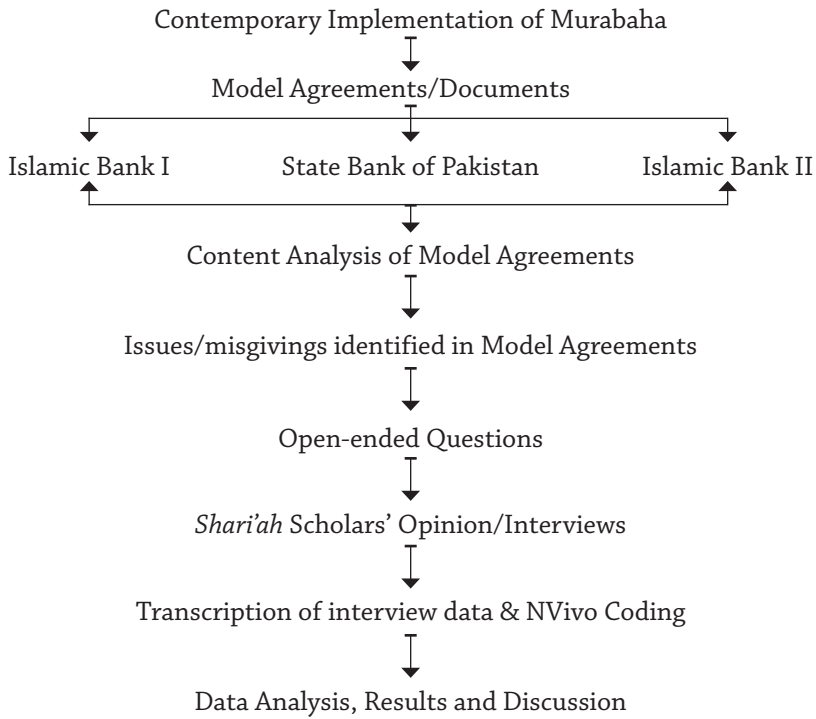


Figure 1. Data Collection and Analysis

Analysis of the Model Agreements

From the analysis of the model agreements it is observed that Murabaha is primarily described as a 'financing facility' and is defined as "financial accommodation within the meaning of the term 'finance' under the Financial Institutions (Recovery of Finances)

Ordinance 2001". For instance, it is stated that "the customer wishes to obtain finances (as defined in Financial Institutions (Recovery of Finances) Ordinance 2001) in accordance with the principles of Islamic modes of financing from the Bank for the purchase of the goods on Murabaha basis" (IB-II, MMFA). It is further clarified that the bank purchases the desired goods from the suppliers and sells the same goods to the customer by way of 'Murabaha facility' (SBP, MMFA, Clause, 1.01, 2.01; IB-II, MMFA, Clause, 1.1), whereas the 'Murabaha facility' is defined as "the total facility amount to be made available to the customer by the bank which may be paid to the supplier of the goods/asset directly as cost price or drawn down by the agent pursuant to a series of Murabaha transactions (IB-I, MMFA, Clause, 1). Each Murabaha transaction constitutes provision of "finance" as defined in the Ordinance (IB-I, MMFA, Clause, 5.04).

Literally, Murabaha is a sale transaction on cash or deferred payment basis in which the cost of goods sold is disclosed by the seller and a profit margin is included in the sale price (SBP, 2004; Usmani, 2007, p.95). Theoretically the bank (seller) purchases the assets as per requirements of a customer and sells the same to the customer (buyer) on deferred payment basis. It is stated that the bank purchases the desired goods from the supplier and sells the same goods to the customer by way of 'Murabaha facility' for up to a total aggregate of cost price of Rs. _____, at any given time (SBP, MMFA, Clause, 1.01, 2.01; IB-II, MMFA, Clause, 1.1).

However, practically the customer is appointed as agent by the bank to purchase the required asset on behalf of the bank taking its possession as an agent. At such moment of time the risk of ownership needs to be assumed by the bank. Subsequently the customer makes an offer to purchase the same from the bank as buyer, on deferred payment basis (Ayub, 2009, p.225; Usmani, 2007, pp. 106, 107). It implies that the risk of ownership lies with the bank during the period starting from the time of purchase of the asset by the agent till its subsequent sale to the customer (changing the status of customer from agent to buyer).

However, practically the customer as an agent receives the "pay order/cross cheque, in the name of supplier" from the bank for the desired goods to be purchased (SBP, MMFA, Clause, 2.01). In case of "failure of the supplier to supply the said goods within the period specified in the Purchase Requisition", the customer (agent) is liable to "refund the full amount and all cost and consequences in light of the Agency Agreement" (SBP, MMFA, *Murabaha* Document#4, Receipt). Similarly, the customer as an agent collects "the goods directly from the supplier in terms of Purchase Requisition duly endorsed by the bank and provides a declaration to the bank confirming the acquisition of the goods along with relevant details" (SBP, MMFA, Agency Agreement). Further,

the bank confirms “that the said assets are available with the ‘client’ and have not been consumed /resold at the time of signing of the acceptance” of the purchase offer made by the agent/customer (IBB-II, MMFA, Appendix C-Contract Form).

It is observed that the subject assets are practically in possession/control and use of the customer/agent with an explicit understanding of exchange of a theoretical offer and acceptance of purchase and sale between the customer and the bank. All associated risk, particularly the ownership risk appears to be only theoretically transferred to the bank for zero duration of time.

It is further stated that the bank (seller) sells the goods “without any responsibility on the part of the bank for any defect therein and without any warranty relating to the condition or suitability or efficacy of the goods whether such warranty be expressed or implied by law or recognized by custom” (IBB-II, MMFA, Clause 3.1; IBB-I, MMFA, Clause, 6).

In short, the overall Murabaha arrangement consists of three stages including (i) purchase of the goods by the bank directly or through the customer as agent, (ii) offer by the customer to purchase the goods from the bank, and (iii) acceptance of the offer by the bank to sell the goods to the customer. However, all the three stages are practically combined in one ‘Declaration’ comprising three parts for the three stages respectively included in the same document (SBP, Murabaha Document#5). It means that the ‘Declaration’ should at least be exchanged three times between the two parties. However, practically all the steps may be completed at once just to meet the *Shari’ah* requirements notionally and avoid audit objections.

After analysing the terms and conditions incorporated in the model agreement of Murabaha, the following issues are identified for further analysis.

1. It is observed that Islamic banks in fact extend financing facility in the name of ‘Murabaha facility’ defined as “financial accommodation within the meaning of the term ‘finance’ under the Financial Institutions (Recovery of Finances) Ordinance 2001”. Can such financing facility be called an Islamic mode of financing?
2. Do the *Shari’ah* principles allow appointing the customer (buyer) as agent for purchasing the desired asset on behalf of the bank and subsequently buying the same from the bank as customer/buyer, on deferred payment basis?
3. Do the *Shari’ah* principles allow completing the three stages of Murabaha at the same time i.e. signing all the requisite documents by the bank and the customer at once?

4. Do the *Shari'ah* principles allow a sale/purchase transaction in which the bank does not assume any ownership risk?
5. Do the *Shari'ah* principles allow any sale “without any responsibility on the part of the bank for any defect and without any warranty relating to the condition or suitability or efficacy of the goods whether such warranty be expressed or implied by law or recognized by custom”?
6. Do the *Shari'ah* principles allow binding the agent for the refund of “the full amount and all cost and consequences” to the principal, if the supplier fails to supply the goods in the required time?
7. Who should bear the risk of supplier failure in a sale transaction, according to *Shari'ah* principles?

Analysis of Interviews' Data and Discussion

The issues (questions) identified in the previous section were discussed with a diverse group of experts in Islamic banking representing various schools of thought. They included *muftis*, *Shari'ah* scholars, *Shari'ah* advisors, *Shari'ah* board members, and academic researchers. The list of these respondents is attached as appendix A at the end of this paper.

The detailed summary of responses to the 7 questions (codes) is given in table 1.

Table 1. Result Sheet of NVivo Showing Summary of Responses

| Category | A: Mixed | B: Negative | C: Neutral | D: Positive |
|----------|----------|-------------|------------|-------------|
| Q.1 | 7 | 5 | 14 | 4 |
| Q.2 | 5 | 5 | 16 | 4 |
| Q.3 | 5 | 7 | 13 | 5 |
| Q.4 | 10 | 8 | 12 | 0 |
| Q.5 | 2 | 6 | 21 | 1 |
| Q.6 | 11 | 11 | 6 | 2 |
| Q.7 | 12 | 8 | 8 | 2 |

Further, the NVivo sentiment analysis classified the respondents' sentiments into four categories including very negative, moderately negative, moderately positive and very positive. The NVivo claims to detect “what people like or dislike” on the basis of “opinions, emotions and attitudes” from the data sources including “open-ended survey responses”. It classifies the feedback in four categories (NVivo,

website) on the basis of sentiments derived by the software from the expression (words) in the text. The results are therefore unauthenticated quantitative form of the qualitative data, which may not necessarily support the findings/interpretation of the researcher. The use of various synonyms may influence the retrieval of information (Zamawe, 2015) and possible placements in categories against the real message the data conveys. Table 2 presents complete result of sentiment analysis of the 7 questions (codes).

Table 2. Result Sheet of NVivo Sentiment Analysis

| Category | A: Very negative | B: Moderately negative | C: Moderately positive | D: Very positive |
|----------|------------------|------------------------|------------------------|------------------|
| Q.1 | 5 | 8 | 9 | 3 |
| Q.2 | 3 | 7 | 8 | 1 |
| Q.3 | 5 | 7 | 7 | 4 |
| Q.4 | 17 | 9 | 9 | 4 |
| Q.5 | 3 | 5 | 0 | 3 |
| Q.6 | 5 | 19 | 12 | 2 |
| Q.7 | 17 | 6 | 15 | 1 |

The crux of the interviews and discussion held with the respective experts is summarized below on issue to issue basis followed by the NVivo result with respect to each code (question).

Regarding question 1, whether defining Islamic modes of financing on the basis of Financial Institutions (Recovery of Finances) Ordinance 2001 as “financial accommodation” creates a *Shari’ah* issue or not, a difference of opinion was observed. One group of respondents did not like defining Islamic modes of financing according to the said ordinance and proposed an independent legal framework for the Islamic banks in order to promote Islamic banking in its true letter and spirit. The second group of respondents indicated that the nature of the Islamic modes of financing should be considered on the basis of practice, and not on the basis of definition, whatever law might define it. Some respondents of this group justified that Islamic modes of financing actually used to result in creation of credit and might be collected like conventional credit on the basis of the said ordinance in case any such problem arose. So according to them, it was not an issue indeed.

However, a relatively smaller number of respondents, reflected indifference about the impact of such a definition on the Islamic modes of financing and opted to remain neutral regarding this issue.

The NVivo composed the summary of responses to Q.1 with 7 respondents categorized in mixed category, 5 respondents in negative, 14 respondents in neutral and 4 respondents in positive category. However, the sentiment analysis of the interviews' text, shown in table 2, classified 5 expressions in very negative category, 8 in moderately negative, 9 in moderately positive and 3 expressions in very positive category.

Question 2 inquired about the appointment of customer as agent by the banks in Murabaha. Almost all the respondents were unanimous in accepting the appointment of the customer as agent by the bank to purchase the required asset on behalf of the bank though some of the respondents explained that appointment of the customer was the least preferred option available to the Islamic banks. However, it was due to certain practical reasons that Islamic banks preferred to appoint the customer as agent. For instance, banks usually do not have expertise in purchasing the desired goods/quality for the customers so a customer is appointed as agent to purchase the goods according to his/her requirements/choice.

The NVivo summary of responses to Q.2 included 5 respondents in mixed category, 5 respondents in negative, 16 respondents in neutral and 4 respondents in positive category. However, the sentiment analysis of the interviews' text, shown in table 2, classified 3 expressions in very negative category, 7 in moderately negative, 8 in moderately positive and 1 expression in very positive category. Nevertheless, this division of respondents' opinion may better be attributed to the limitation of the software (NVivo).

In response to the question 3, the respondents unanimously agreed that for a genuine Murabaha transaction, it is necessary that all the requisite steps must be followed in letter and spirit indicating that filling and signing all the documents of Murabaha at the same time is not allowed in *Shari'ah*, in any case. It was explained that such a practice would make the Murabaha transaction void and equivalent to interest based conventional lending. However, two respondents explained that documents are not required in *Shari'ah* and a verbal understanding is sufficient if the proper steps are followed in the Murabaha transaction. An Islamic banker explained that all documents are filled/obtained at the same in order to facilitate the customer, who may otherwise get irritated if asked time and time again for

fulfilling the Murabaha process. However, the documents remain blank till the purchase of goods by the customer as agent which he/she might communicate through telephonic call or email or physical visit.

The NVivo summary of responses to Q.3 placed 5 respondents in mixed category, 7 respondents in negative, 13 respondents in neutral and 5 respondents in positive category. However, the sentiment analysis of the interviews' text, shown in table 2, classified 5 expressions in very negative category, 7 in moderately negative, 7 in moderately positive and 4 expressions in very positive category. Nevertheless, this division of respondents' opinion may better be attributed to the limitation of the software (NVivo).

In response to the question 4, the respondents unanimously agreed that the bank was not allowed to sell any goods without assuming the ownership risk in any case.

The summary of responses to Q.4 categorized 10 respondents in mixed category, 8 respondents in negative, 12 respondents in neutral and 0 respondent in positive categories. However, it is important to notice that even in this case, NVivo classified only 17 sentiments in very negative category, 9 in moderately negative category, 9 in moderately positive category and 4 in very positive category, on the basis of their expression in words. It is in fact the limitation of the software to classify such expression as 'very positive'. For instance, the following responses do not support any sale without assuming ownership risk. However, the software classified these responses as 'very positive'.

Respondent No. 10:

It is not allowed. The bank must assume the ownership risk. Otherwise it is like conventional interest based lending. Give money and do what you like. If such things are happening, they need to be rectified. We have heard from our teacher, Mufti Taqi Usmani that "we are guiding the banks in right directions but if they are doing something wrong then they need to be rectified".

Respondent No. 25:

It violates the hadith "*alkhiraj u bizamman*", i.e. no pain, no gain. Entitlement of profit is linked with taking risk. But if no ownership is taken, no risk is assumed.

Respondent No. 8:

It is usually not allowed. But practically speaking, bank is a specialized type of organization which always deals in credit and therefore such type of things happen. However, it is *makroh*.

In response to the question 5, a mixed opinion was observed. However, majority of the respondents were of the opinion that if the customer (buyer) agrees to such condition then there is no *Shari'ah* issue in imposing such condition on the customer. Nevertheless, a difference of opinion emerged on whether *khiyar e aib* could be vanished or not, through imposing such condition. Some scholars contended that *khiyar e aib* would remain in vogue despite incorporating such condition in the agreement. Nonetheless, certain other scholars said that if the bank divulged that it would not be responsible for any defect and the customer agreed to such terms, *khiyar e aib* would no more exist.

The NVivo summary of responses to Q.5 included 2 respondents in mixed category, 6 respondents in negative, 21 respondents in neutral and 1 respondent in positive category. However, the sentiment analysis of the interviews' text, shown in table 2, classified 3 expressions in very negative category, 5 in moderately negative, 0 in moderately positive and 3 expressions in very positive categories.

In response to the question 6, a difference of opinion was observed regarding the responsibility of the agent to "refund the full amount and all cost and consequences" in case of "failure of the supplier to supply the said goods within the specified period" (SBP, MMFA, *Murabaha* Document#4, Receipt). Some of the respondents, mostly bankers and *Shari'ah* advisors/board members justified this condition on the pretext that the agent would in fact purchase the goods for his/her own use and might delay the delivery of goods for using the money for other purposes if not made responsible in such a manner. However, most of the respondents expressed their concern rejecting this condition and explained that the agent would only be responsible if he/she was found guilty of negligence or misconduct, etc. Generally it is not the responsibility of the agent to refund the amount to the bank if it has already been paid to the supplier and the supplier fails to deliver the goods in the requisite time.

The summary of responses to Q.6 included 11 respondents in mixed category, 11 respondents in negative, 6 respondents in neutral and 2 respondents in positive categories. However, the sentiment analysis of the interviews' text, shown in table 2, classified 5 expressions in very negative category, 19 in moderately negative, 12 in moderately positive and 2 expressions in very positive categories.

In response to the question 7 regarding the supplier's (third party) risk, the respondents almost unanimously clarified that supplier's risk was the responsibility of the bank and bank should bear such risk in case the supplier fails to provide the

desired goods in time. However, some of the respondents explained that in case of Murabaha, such risk was rightly shifted to the agent because the same agent would be the ultimate buyer/customer. Thus, if he is exempted from such risk then the chances of possible manipulation between the supplier and the agent increase and the bank may face more of supplier failure risk.

The NVivo summary of responses to Q.7 included 12 respondents in mixed category, 8 respondents in negative, 8 respondents in neutral and 2 respondents in positive categories. However, the sentiment analysis of the interviews' text, shown in table 2, classified 17 expressions in very negative category, 6 in moderately negative, 15 in moderately positive and 1 expression in very positive category, on the basis of the sentiments observed from words.

Summary of Findings

The overall findings are summarized and discussed below.

As far as the issue of 'definition' of the contemporary Islamic modes of financing, is concerned, a difference of opinion has been observed, though an independent legal framework for Islamic banking was supported by the respondents.

In case of Murabaha, there is no *Shari'ah* issue in appointing the customer as agent by the bank. However, it is considered the least preferred option, at least theoretically. Nevertheless, practically Islamic banks prefer to appoint the customer as agent in almost all Murabaha dealings.

The filling and signing all the documents of Murabaha at the same time is a serious violation of *Shari'ah* requirements making the whole Murabaha transaction void and equivalent to interest based conventional lending. It is therefore declared a serious *Shari'ah* issue in the contemporary practices of Islamic modes of financing. It is equivalent to selling a commodity without assuming the ownership risk against the principles of *Shari'ah* creating another serious *Shari'ah* issue in the contemporary implementation of Murabaha by Islamic banks.

Regarding the observation on selling of good to the customer without taking any post sale responsibilities by the bank, a unanimous opinion cannot be formulated. A difference of opinion was observed with respect to exemption from '*khiyar e aib*'. Thus, an explicit *Shari'ah* position cannot be defined with respect to the existence or otherwise of *khiyar e aib* in case of Murabaha transactions.

The third party (supplier's) risk is the responsibility of the bank and shifting such risk to the agent, on the basis of whatever plea is a practical *Shari'ah* issue in

the contemporary practices of Murabaha. The agent is only responsible if he/she is found guilty of negligence or misconduct. Generally it is not the responsibility of the agent to refund the amount to the bank if already paid to the supplier and the supplier fails to deliver the goods in the requisite time. In principle, the third party (supplier) risk belongs to the principal (bank), not to the agent according to the principles of *Shari'ah*. Thus, the bank should bear such risk in case supplier fails to provide the desired goods in time.

Conclusion and Recommendations

Islamic banks were found operating under the same conventional legal framework including the Financial Institutions (Recovery of Finances) Ordinance 2001, and BCO, 1962, besides others, technically preventing the application of Islamic banking in its true spirit.

Similarly, Islamic banks were observed shifting all types of risks to the customers either as agents or as ultimate consumers in the contemporary implementation of Murabaha. Previous studies (Ahmed, 2006; Dusuki & Abozaid, 2007; Gundogdu 2014) also pointed out that Islamic banks used to shift “all risks and liabilities to the customer” in a sale transaction in contravention to *Shari'ah* requirements. Appointing the loan seeker as agent to purchase the desired goods and for assurance of quality and safety essentially passing all risks associated with the Murabaha transaction to the loan seeker reflects the conventional behavior of Islamic banks (Gundogdu, 2014). In fact, appointing the customer as agent is preferred by banks for being secure from bank's point of view but such mechanism makes “Murabaha a back door to interest” (Ayub, 2009, p.222) and creates doubts on its *Shari'ah* acceptability. At times, all the documents are signed at the same time without creating any gap between the two transactions of buying and selling of goods by the bank. Hence, the bank assumes no risk of ownership or whatsoever, even for a short while. This in any case, does not appear to be in conformity with the requirements of *Shari'ah* (Siddiqui, 2001).

Likewise the third party (supplier) risk belongs to the principal (bank). Thus, the bank should bear such risk in case supplier fails to provide the desired goods in time. However, practically the Islamic banks shift all such risk to the agent/consumer. The bank absolves itself of all responsibilities including the *khiyar e aib*, in undertaking the Murabaha sale transaction on the pretext that the subject goods are purchased by the agent for his/her (the agent) use ultimately. Therefore, all the risks including the ownership risk are transferred to the agent (customer) even if

he/she is working as agent for the bank. Thus, the bank does not accept any ownership or related risks, physical or constructive in any ways in Murabaha but only uses it as a *heela* working only as financial intermediary like conventional banks but with a different set of documents/agreements.

In order to establish true Islamic banking in the country, Islamic banks are required to work according to the *Shari'ah* principles in letter and spirit. For instance, in order to take a step forward to the true application of Murabaha, the banks need to avoid appointing the customers as agents any more. The bank should first purchase the requisite goods as per order of the customer and then should sell/deliver to the customer itself. The old fashioned argument that the bank does not have the requisite expertise in selecting and buying the desired goods is no more worth considering. Even the current form of Islamic banking is in existence for more than 15 years since 2002, whereas overall it is more than 50 years old since it came into being in 1963 in Mit Ghamr (Mirakhor, 1997). However, the government needs to amend the relevant sections of the Banking Companies Ordinance 1962, which prevents Islamic banks from undertaking actual trading.

The Islamic banks can establish a partnership arrangement with the manufacturer/supplier of some of the goods/commodities commonly used by the banks' customers. The banks can easily work out such goods/commodities from their historical records. This approach can be made more practical if the Islamic banks choose a specific industry as an area of specialization for their operations, i.e. each Islamic bank may focus on a specific industry and develop the relevant expertise in that industry. Siddiqui (2001) also suggested creating an independent "merchant banking division" by Islamic banks for undertaking real time buying and selling of goods. Islamic banks may also form special purpose entities (SPE) staffed with personnel having relevant education and skills to carry out real time "trading and leasing" transactions (Ayub, 2007, p.220). On the other hand Ahmed (2005) proposed independent financial institutions with expertise in Murabaha to purchase and possess goods and have "separate trading and financing activities" as an important remedy to eliminate "the current malpractices".

Islamic banking is primarily based on trading modes whether it is Murabaha, Salam, Istisna or even Ijara against the fundamental nature of banking, which only deals in money or documents. Therefore, the structure of Islamic banks needs to be drastically changed. They must work on the basis of fundamental principles of trading. For this purpose, the relevant statutes including BCO, 1962, Financial In-

stitutions Recovery of Finance Ordinance, 2001, and others need to be properly amended allowing the Islamic banks to deal in trading of commodities/goods.

In order to address the issue of expertise, the Islamic banks would need to hire specialists in the respective areas including procurement, supply chain, marketing, sales, and of course finance and banking. It means the Islamic banks need to work like conglomerates, which is not a hypothetical (unreal) model. All the big corporate organizations already work in a similar way with many unrelated businesses in one group.

It is worthwhile to mention that the analysis in this study is based on and limited to the information available in the SBP model agreements and principal documents/agreements collected from the two Islamic banks, which may limit the scope of the findings of this research up to some extent. Documents from more banks providing a wider content might have resulted in a larger pool of information making a more generalized analysis possible. Further, there are certain other areas in the field of Islamic banking which are still unexplored. The SBP formulates the monetary policy on the basis of an interest based system but also works as a regulator for Islamic banks. Therefore, future researches may focus on exploring the practical aspects of the monetary system currently in vogue and compare them with the *Shari'ah* requirements. Such investigations may also extend their scope to examine the money market operations of Islamic banks in the light of the teachings of Islam.

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Appendix- A

List of Shari'ah Scholars (Respondents)

| S.No. | Name¹ | Designation/Position and Address | Date of Interview |
|-----------------|-----------------------------|---|--------------------------|
| 1 | Dr. A. A. C. | Professor Islamic Studies and Arabic | August, 16, 2017 |
| 2 | Mufti A. G. | Mufti and Bank Sharia Auditor | August, 26, 2017 |
| 3 | S. M. A. | Member Sharia Supervisory Board and Professor | September 5, 2017 |
| 4 | A. S. Q | Bank Sharia Advisor | September 6, 2017 |
| 5 | Mufti Z. H. | Mufti Ex- Sharia Advisor of Bank | September 6 & 22, 2017 |
| 6 | Dr. M. A. | Bank Sharia Advisor and Assistant Professor | September 8 & 14, 2017 |
| 7 | Mufti H. | Mufti, Darul Afta | September 11, 2017 |
| 8 | Dr. S. U. H. H. | Member Sharia Supervisory Board, and Professor of Islamic Studies | September 12, 2017 |
| 9 | Mufti S. A. | Mufti Jamia/madrassa | September 13, 2017 |
| 10 | Mufti I. U. H | Mufti, Darul Afta | September 16, 2017 |
| 11 ² | Maulana K. Maulana A. R. | Naib Muhtamim, Dar ul Uloom Nazim, Dar ul Uloom | September 16, 2017 |
| 12 | M. A. | Member Sharia Board, Researcher and Editor | September 19, 2017 |
| 13 | M. S. G. | Sharia Auditor | September 25, 2017 |
| 14 | Dr. A-u-Z. | Professor of Islamic Economics | September 26 & 29, 2017 |
| 15 | Mufti M. I. B. | Resident Sharia Board Member | October 6, 2017 |
| 16 | Maulana M. A. R. | Muhtamim | October 11, 2017 |
| 17 | Dr. N. Z. | Assistant Professor; Chairman Sharia Advisory Board, and Sharia Board Member of Foreign Companies | October 12, 2017 |
| 18 | Maulana S. U. J. | Mufti and Raees ul Afta, Dar uloom | October 14, 2017 |
| 19 | Dr. S. J. | Assistant Professor | October 16, 2017 |
| 20 | Dr. M. M. R. | Senior Advisor, Federal Shariat Court | October 21, 2017 |
| 21 | Mufti A. N. | Mufti and Raees ul Afta, Jamia/Madrassa | October 22, 2017 |
| 22 | M. A. S. | Lecturer in University | October 23, 2017 |

1 Names have been abbreviated for keeping the respondents' identity confidential as per desire of some respondents.

2 These two scholars were interviewed in group and is treated one for the purpose of analysis.

| | | | |
|----|-------------------------------|---|-------------------|
| 23 | <i>Professor Dr. M. T. M.</i> | Sharia Advisor and Professor of Shari'ah | October 23, 2017 |
| 24 | <i>Mufti M. Z.</i> | Chairman Shariah Board of two Banks & Senior Teacher in Dar ul Uloom | October 24, 2017 |
| 25 | <i>S. A. R. S.</i> | Lecturer in University | October 31, 2017 |
| 26 | <i>M. A. S.</i> | Lecturer in University. | October 31, 2017 |
| 27 | <i>Professor Dr. H. M. Y.</i> | Professor and HOD of Economics Department | November 3, 2017 |
| 28 | <i>Mufti A. S.</i> | Mufti and Raes ul Afta | November 6, 2017 |
| 29 | <i>Mufti S. S. H.</i> | SVP/Resident Sharia Board Member, Head Sharia Compliance and Sharia Training Department | November 13, 2017 |
| 30 | <i>Mufti M. A.</i> | Sharia Board Member of two Banks, Lecturer & Mufti in Jamia/Madrassa | November 13, 2017 |