

## EVALUATING MURĀBAḤAH FINANCING IN SRI LANKA: PRACTITIONER PERCEPTION

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### ABSTRACT

The most popular service offered by Islamic financial institutions is *Murābaḥah* financing. Thus, the purpose of this research is to investigate the historical roots of the *Murābaḥah* contract and its modern financial derivatives. The legal stratagems (LS) used to create these derivatives are themselves a source of criticism. Hence, the validity of these legal stratagems is analyzed through classical and contemporary literature. In addition, an investigation on the use of *Murābaḥah* instruments in Sri Lanka is carried out by conducting thematic analysis on interviews with nine respondents who are both practitioners and scholars of *Sharī'ah*. Based on the findings, it was determined that the mere presence of LS does not render a contract void. However, there should be some standards and limitations placed on the application of LS. In addition, there is a disconnect between the theory and practice of *Murābaḥah* in IFIs, in which practitioners frequently tend to conflate *Murābaḥah* financing with conventional loans due to a lack of understanding of the concept of LS. In order to ensure the legality and feasibility of using *Murābaḥah* financing and other products, this study suggests that IFIs not only educate their employees on the basics of Islamic finance, but also have *Sharī'ah* review and audit systems in place on a regular basis.

**Keywords:** *Murābahah*, *Sharī'ah*, Legal Stratagem, Islamic Financial Institutions (IFIs), Sri Lanka

### Introduction

A nation's surplus and deficit can be smoothed over with the help of its financial infrastructure. Ingenious innovations and discoveries have been made possible by the

cooperative phenomenon that has allowed humans to advance in their history. Conscious Muslims, on the other hand, are denied access to these finances. Hence, Islamic banking and finance were developed to help those who aspire to progress within the permissibility of *Sharī'ah*. Furthermore, Islamic finance is also gaining ground, even in countries where Muslims are in the majority, as a result of a demand for more moral forms of financing (Thabith, 2014).

Over the years, the most complex financing needs have been met by conventional financing products. This has burdened *Sharī'ah* scholars with imitating conventional products. Nevertheless, it is essential to investigate the repercussions that those goods will have on society and the economy in order to determine whether they fulfil the purpose of *Sharī'ah*. This is why, especially for *Murābahah* (cost plus profit sale) contracts, there has been a recent push to diversify product offerings beyond the traditional. The flexibility of this contract makes it suitable for use in any state-of-the-art financial engineering scheme.

Currently, the predominant utilization of Islamic financing products by Islamic banks and financial institutions is observed in the context of the *Murābahah* contract. The popularity of the *Murābahah* contract can be attributed to several factors, including its relative simplicity and the ease with which staff can be trained to handle various products based on this contract.

Islamic banks, similar to conventional banks, exhibit a risk-averse behavior, as they are governed by the same Basel accords. Hence, profit-sharing agreements like *Mudhārabah* and *Mushārahah* transactions are not very common among Islamic financial institutions., though it was advocated ardently by early Islamic economists (Mansoori, 2011) The transfer of risk has received extensive criticism due to its similarity in substance to conventional products, with the only discernible difference being the utilization of an Arabic nomenclature for the products.

*Murābahah* is a term for the fundamental principles of Islamic jurisprudence.

*It is a kind of sale-purchase transaction in which the seller has to reveal the total cost of the good(s) to the client/buyer plus the profit the seller wants to earn over and above the cost of the product. Murābahah is a type of sale contract in which the client/purchaser orders the seller to purchase the commodities, and the seller then sells the commodities to the client with an additional amount as a profit paid at the same time. When a seller agrees with his client to provide him with a specific good for a certain fixed amount of profit in addition to the cost of the good, this is known as the Murābahah contract (Farooq & Ahmed, Vol. 31 Dec 2015).*

However, *Murābahah* is currently used as a financing model. The financing method in question involves the procurement of goods on behalf of customers, followed by the subsequent resale of a portion of said goods to the same customers on a deferred payment basis, with a mutually agreed upon profit margin being upheld. Upon the expiration of the predetermined contractual duration, the client has the option to either settle the outstanding balance in a lump sum or through periodic payments. Therefore, the utilization of this agreement differs from its conventional interpretation. Furthermore, it is noteworthy that the supplementary earnings generated by means of the *Murābahah* transaction do not contravene the principles of *Sharī'ah*. As per the consensus among the scholarly community, (Usmani, 2013), there is also an opinion that this contract is not valid as the transaction is a legal stratagem to mimic usury (Al-Ifta', 2008).

As a result, for the purpose of this investigation, we will investigate the scholarly discussion surrounding *Murābahah* transactions to determine whether or not there are any aspects of legal stratagems and to analyse the various points of view concerning this theme. Furthermore, an analysis is attempted on the *Murābahah* transactions executed by Islamic Financial Institutions (IFIs) in Sri Lanka, with an investigation into the extent to which legal stratagems may compromise the original intention of this contract.

### ***Murābahah* Contract in the Literature**

The word "*Murābahah*" is conveyed by the term "*Rabaḥa*" or "*Ribḥ*" respectively which comes from the Arabic word, and its means profit (Ibn Manzūr, 1993). In Islamic commercial law, A *Murābahah* sale is one in which both the purchase price of the goods and the seller's anticipated profit are mentioned at the time the agreement is made. (Daly & Frikha, 2014). Al-Ansārīyy defined the sale of *Murābahah* as an amount of profit in excess of the capital invested. (al-Ansārīyy, 2001).

*Murābahah* is not a form of financing but rather an agreement to sell something. On the other hand, it is currently being utilized as a method of Islamic financing, albeit with a few restrictions attached. (Gait & Worthington, 2007). *Murābahah* as a sale contract has no controversy, but rather the financing contract has many disputes about its validity.

The proponents of *Murābahah* as practiced today acknowledge the shift from modern jurists to classical jurists. Cattelan indicated a change in mindset in *Ijtihād* from the classical jurists to the present-day jurists (Cattelan, 2010). The mentality of classical *Ijtihād* was God-oriented. Nevertheless, the present-day *Ijtihād* has made significant strides toward becoming more practice oriented. In this regard, *Murābahah* is being used as a part of Islamic business exercises in order to avoid problematic situations such as usury. (Rakaan Kayali, 2015).

On the other hand, Mansoori was critical of imitating conventional products. He observed that Islamic finance sticks to the restrictions of *Ribā*, *Gharar*, and *Qimār* in general, nevertheless, organized Tawarruq and *Murābahah* financing does not produce any actual financial outcome other than that of interest, and scholars have overlooked the motivations behind the prohibitions in *Shari'ah* (Mansoori, 2011). In other words, the scholars have given importance to the form and ignored the substance of contracts.

The following critique is on the risk-taking behavior of IFIs (Waemustafa & Sukri, 2013); (Rosly, Naim, & Lahsasna, 2017). The International Financial Institutions (IFIs) are observed to be shifting the risks onto the customers rather than engaging in risk-sharing practises. In this context, International Financial Institutions (IFIs) do not prioritise a higher quantity of Profit and Loss Sharing (PLS) products over mark-up products within their framework. The authors mentioned above have failed to acknowledge that International Financial Institutions (IFIs) are also subject to both international regulations and regulations set by local central banks. PLS products have higher costs to banks as it increases the capital adequacy ratio as PLS products increase the risk assets ratio. Hence, banks, whether Islamic or not, are designed to transfer risk. Consequently, the *Murābahah* contract should not be invalidated based on this argument. However, if *Murābahah* makes people financially miserable, an interest-based contract, though admissible, should be regarded as undesirable.

*Murābahah* in itself is a sales contract, and to make it a financing product and to mimic the conventional products, scholars are using Legal Stratagem (LS) (*Ḥiyal*). The rationale is that there is a necessity. This way, both the financier (IFIs) and the financed

(borrower) can benefit without going out of the prohibitions of Islamic law. Using legal stratagem to make the contract more applicable in the modern day has brought criticism. Hence, it is vital to understand the validity and applicability of the LS.

### **Legal Stratagem (LS) or *Hiyal* and its influence on *Murābahah***

Some scholars said that the practices of modern IFIs are not really Islamic because they rely heavily on LS or *Hiyal*, like in *Murābahah* and *Ijārah* (al-Ifta', 2008), which are not real Islamic alternatives to conventional banking and finance (Mansoori, 2011).

According to the Sharī'ah perspective, the initial Hanafi scholars suggested that the prohibition of LS does not extend to all instances. Certain items are deemed acceptable. According to Usmani (2013), individuals who employ the LS as a means of extricating themselves from a difficult circumstance and circumventing engagement in activities that contravene the proscribed (*ḥarām*) provisions of a contract will be rewarded by Allah. As a result, there is a range of opinions concerning the issue.

The Arabic expression *Hiyal* is the plural of *Hilah*, which can be translated as a legitimate tool, lawful ingenuity, lawful trap, tricks, and legal stratagems (Tawfiq, 2012). As per the Arabic dialect, the term *Hilah* and its different terms, for example, *Hiyal*, *Tahayyul*, and *Ihtiyal*, all indicate the meaning of imagination, the sharpness of intelligence, and skill in the management of affairs (Ibn Manzūr, 1993). The cause of *Hilah* is *Hāwla*, which means change (*Tahawwul*) beginning with one state and then moving on to the next, possibly through some expertly executed plan that assists in concealing the reality. The term *Hilah* is utilised to denote the methods by which specific objectives, typically those that require confidentiality, can be achieved or acquired. Despite the common usage of the term to refer to a tactic that involves at least one unfavorable perspective, it is also employed to exemplify a method that is both judicious and pragmatic. (Sadique, 2008) (Ministry of Awqāf) (Ministry of Awqāf, 1983).

Another such definition provided by the commentator of Sahih al-Bukhari, Ibn Hajar al-‘Asqalāniyy, is *Hiyal* is stratagems that lead one to his goal through concealed means (al-‘Asqalāniyy, 1993). Here, the definition does not attempt to scrutinize *Hiyal* based on any criteria except that it is an indirect mean, leading to the desired objective.

Ibn Taymīyyah explained similarly that *Hiyal* is intended to stifle an obligation or allow and permit a prohibition (*Ḥarām*) by activities that are not initially implied or *Sharī'ah* legislated for it. (Ibn Taymīyyah, 1987). In addition, Ibn Qaiyīm considered that the definition of *Hiyal* is one form of lead in which the practitioner strives to change a condition from one state to another through it (Ibn Qaiyīm al-Jawziyyah S. a.-D., 1991). To put it another way, the effort of the *Hiyal* ought to bring about a change in either the decision or the condition.

In sum, the aforementioned definitions present a clear and straightforward explanation of the elements that constitute *Hiyal* and the necessary conditions for acknowledging it.. Because of this, it can be used to find solutions to difficult issues, exactly as the Prophet Muhammad (SAW) advised his *Sahāba* to do in the instance of the sale of dates (*al-tamr*) after the battle of *Khayber*. This study of *Ḥadīth* shows that there is proof for the application of LS in Islamic transactions to save from *Ribā'* and *Ḥarām*.

The prevailing perception regarding LS is that it is not entirely prohibited from the standpoint of Sharī'ah. It is feasible to employ it as a means of safeguarding oneself and others from the repercussions of *Ribā'* and *Ḥarām* transactions, even in precarious

circumstances. The truth is that the LS is mentioned by the *Qur'ān* and *Sunnah* in two types of situations: first is that it is valid and acceptable, and second is that it is invalid and prohibited. According to these categories, Prophet Muhammad said that: "*Allah cursed and unblest on the Jews because they had deprived and been forbidden of grease (fat), but they made by the beauty and sold it*",<sup>1</sup> showing that there is a ban on the Legal Stratagem (LS) in Islam.

Further, Almighty Allah cursed the society of "*al-Sabut*" in the Holy *Qur'ān*: Almighty Allah did ban (*Ḥarām*) fishing on Saturday (*Sabbath*), but they had broken the prohibition by utilizing LS in an improper manner, which is why Allah brought the wrath upon the society. Based on this history, a number of academics have proposed that the punishment was inflicted upon them as a result of the deceitful actions that they engaged in.

Meanwhile, the following verse of the *Qur'ān* explains the history of Prophet Yusuf:

"So, he began [the search] with their bags before the bag of his brother; then he extracted it from the bag of his brother. Thus, did We plan for Joseph. He could not have taken his brother within the religion of the king except that Allah willed. We raise in degrees whom We will, but over every possessor of knowledge is one [more] knowing" (al-Yusuf-76).<sup>2</sup>

This verse said that the Prophet Yusuf used the element of LS to keep his brother with him. According to this verse, "*Thus did We plan for Yusuf*," Almighty Allah reportedly revealed that he instructed Prophet Yusuf to model his strategy after his own (Allah). In the situation of Prophet Ayoub, who made a promise and took an oath before Allah regarding the matter of his wife, Almighty Allah declared the following:

"(We said), "And take in your hand a bunch [of grass] and strike with it and do not break your oath." Indeed, we found him patient, an excellent servant. Indeed, he was one repeatedly turning back (to Allah)" (Sād:44).

This part of the verse, "*take in your hand thousands of grass and strike and beat for your wife*," teaches us the result of breaking our oaths. This proves beyond a doubt that Allah educated Prophet Ayoub to perform the LS prior to Prophet Ayoub breaking his promise, which he did on his wife. In light of these examples, the appropriateness of LS applications depends on their specific contexts.

Hence. We can understand from the history of Prophet Ayoub that applying a legal stratagem is permissible when we face necessity and save himself and others from being prohibited by the *Sharī'ah*. Islamic banks have resorted to utilizing the Legal Stratagem (LS) in Islamic transactions by imitating conventional *Ribā'* bearing products as a means of financial engineering, when there exists a greater economic and social benefit (*Maslahāh*).

The LS is often applied to bring in a benefit. Hence these are closely related to engaging a *Maslahāh*. In every LS, there are certainly some *Maslahāh*, which may render the LS valid and acceptable. For example, a floating rate in the *Murābahah-Sukuk* is often considered unacceptable, as the originator can only claim a fixed rate based on the agreed-upon rate. Nevertheless, the fixed-rate *Sukuk* are prone to many market risks, especially when the *Sukuk* are for longer terms, for instance, 20 years or so. The market rate changes with time, marking a vast difference between the fixed profit and the market rate. To follow the *Sharī'ah* requirements of fixed-rate return and at the same time attempt to mitigate the market

<sup>1</sup>Ahmad Ibn Hajar al-‘Asqalāniyy, *Fathūl al-Bāri Sharḥu Sahīhū al-Bukhari*.

<sup>2</sup> Translated by Quran.Com (Also Known as The Noble Quran, Al Quran, Holy Quran, Koran) Is A Pro Bono Project. © 2016 Quran.Com. All Rights Reserved.

risks with a floating rate return, the *Murābahah-Sukukis* based on a master *Murābahah* agreement with several subordinate *Murābahah* agreements therein. In the subordinate *Murābahah* agreements, which are shorter-term than the master *Murābahah* agreement, the profit was set based on the market rate of that specific time frame. Hence, the market risk was mitigated, while *Sharī'ah* compliance is also maintained. It is a pleasant LS that opened the gateway to greater *Maslahāh* (Tawfique, 2014).

The elevated expenses associated with the production of PLS products constitute an additional factor contributing to this phenomenon. Despite the numerous favorable impacts of PLS products on the macroeconomic landscape, individual banks neither incur the expenses associated with these intricate processes nor utilize them. The utilization of LS in Islamic banking and finance during its inception is imperative for the sustained prosperity and longevity of the business. The support of regulatory bodies, coupled with a heightened comprehension of Islamic finance, would facilitate the sector's transition away from structures based on interest rates. (al-Jarhi, 2016).

Certain scholars in the past sanctioned the utilization of LS within Islamic transactions as a means of financial engineering, provided that the economic benefit derived from it was deemed to be of greater significance, as per the concept of *Maslahāh*. LS can be employed as a means of extricating oneself from a precarious situation, if deemed necessary. This approach not only proves to be effective but also results in the reward of Almighty Allah for the action.

Thus, disregarding the LS due to its perceived lack of alignment with the essence of Islam would result in the denial of an alternative financial management approach to both Muslims and non-Muslims. Moreover, achieving complete detachment from the LS, despite its unpleasantness, poses a significant challenge. Given the need for ongoing modifications, it is advisable to restrict the utilization of the LS to specific situations and solely when it is deemed indispensable. The controllers are expected to play a crucial role in facilitating the transformation of the business from imitating the practices of traditional banks to generating innovative products that will establish the Islamic finance sector as self-sufficient and distinctive.

### **Examining the Practice of *Murābahah* in IFIs in Sri Lanka**

The establishment of Amāna Investment Limited in 1997 marked the beginning of the entrance of Islamic financial institutions (IFIs) into the economy of Sri Lanka. Soon after that, in 1999, Amāna Takaful Company began conducting business under its current name. As a direct result of this, the Sri Lankan Banking and Finance Act No.30 of 1988 has been revised, and the resulting "(Act No. 02 of 2005)" was approved on the 10th of December 2005 in order to make it possible for IFIs to engage in business (Farook, 2012). Amāna Bank was renamed subsequent to being granted a banking license by the Central Bank of Sri Lanka, as Amāna Investment Company obtained the aforementioned license. As of present, it stands as the sole Islamic bank in the nation that is fully functional. In contrast, the provision of Islamic financial products and services by commercial banks in Sri Lanka was delayed by over ten years.

According to the statistics provided by the Islamic Finance News, there are currently 44 participants working within the *Sharī'ah* financial industry in the local area. Among the individuals in question, 16 are employed in the banking and finance sector, four are employed in the Islamic insurance industry, and nine are employed in the consultancy industry. In terms

of quantity, the activities of Islamic banking windows exhibit a notable superiority over their conventional counterparts within the banking and finance industry. In 2015, the Islamic Financial Services Board (IFSB) welcomed on board only a single fully-fledged Islamic banking institution in the form of Amāna bank ((IFN), 2016).

For this research, structured interview questions were distributed among practitioners in IFIs (*Sharī'ah* scholars and IFIs professionals) to find the gaps in the theory and application of *Murābahah* transactions. The methodology employed in this specific research study involved the utilization of thematic content analysis to examine the collected data. The responses were subjected to coding procedures aimed at identifying recurrent concepts among the participants, which were subsequently categorized into distinct themes. The aforementioned approach proved to be effective in attaining its intended objectives.

Upon conducting a comprehensive inquiry and a subsequent reevaluation of the gathered information, recurring themes were identified. Table 1 displays that the themes that were identified through the analysis of the questions were assigned a concise title that accurately represented a brief overview of the theme. The results pertaining to each inquiry have been presented and classified according to their respective themes. The inclusion of interview quotations serves to enhance the credibility and reliability of the research findings. In the end, the *Murābahah* contracts of IFIs are evaluated alongside other literature in Islamic finance in order to identify the areas of weakness in both the conceptualization and practical implementation of *Murābahah* deals in Sri Lanka. In-depth interviews were conducted with a large sample of people, and the results are presented in Table 1 below, organized by a number of different criteria. Each theme has a brief name that can be used to identify it. The method of "thematic content analysis" was used to organize these topics.

Questions		Themes
Q1	Thoughts about Legal stratagems	<i>Sharī'ah</i> Compliance
		Criticism
		Necessity
Q2	<i>Murābahah</i> Transaction a Legal stratagem	<i>Sharī'ah</i> Compliance
		Deferred Payment
		Knowledge
Q3A	Client as Agent	<i>Sharī'ah</i> Compliance
		Lack of Facility
		Criticism
Q3B	Client Repaying in Instalments	Consent
		Deferred Payment
		Credit Price
Q3C	Collateral	Risk Management
		<i>Sharī'ah</i> Compliance
Q4	Satisfaction	Very Satisfied
		Satisfied
		Neutral
Q5	Practical Issues in the Day-to-Day Operations	Unsatisfied
		Default
		Awareness

		Process
		Exchange Rate Risk
		Operational Risk
		Well, Being
		No Issues
		Awareness
		Penalty
		Regulations
Q6	Solving the Practical Issues	Follow-Up
		<i>Sharī'ah</i> Audit
		Commodity Money
		Islamization
		Yes
Q7	PLS Models	No
		Not Always
		Risk Management
Q8	Practical Issues in PLS	Fraud
		Implementation
		Islamization

Table 1 shows the common themes identified and categorized for each question from the interviewees.

### Thoughts about Legal stratagems

The first questioning during the interview pertained to the candidates' level of familiarity with diverse legal tactics and strategies. The notion of adhering to Shariah was the most commonly expressed idea among the respondents. According to the respondents, legal stratagems are effective instruments for creating Islamic financial products that are compliant with *Sharī'ah* principles and for mitigating any unlawful implications that may have arisen from the transaction. The operational complexities of Islamic Financial Institutions (IFIs) may impede their ability to carry out transactions involving original Islamic finance goods. Consequently, the implementation of legal tactics becomes vitally important. The majority of respondents agreed with the following quote, which was provided by respondent 5, "*Hiyal* is a term for "legalistic trickery" in Islamic jurisprudence. The primary purpose of *Hiyal* is to avoid exact observance of Islamic law in difficult situations while still obeying the letter of the law."

Respondents 1 and 8 indicated criticisms directed towards legal stratagems. Respondent 1 thought that legal stratagems appear to be *Sharī'ah* non-compliant, whereas respondent 8 believed it opposes Islamic jurisprudence.

The utilization of legal stratagems by *Sharī'ah* scholars to compete with conventional banking and finance was also noted by Respondent 1. In Sri Lanka, International Financial Institutions (IFIs) face competition from traditional financial institutions, and legal tactics are imperative for ensuring the sustainability of financial operations. Therefore, the concept of necessity was referenced.



The participants exhibit an in-depth understanding of legal stratagems, and it is heartening to note that the majority of them are aware of the fact that it ought to be employed solely in critical situations. Nonetheless, it is inaccurate to completely dismiss lawful tactics or to generally accept them. Even though *Sharī'ah* scholars have taken legal stratagems, the conditions for the acceptance need to be understood clearly by practitioners, and it should be used only during unavoidable situations. The point of legal actions is not to undermine conventional banking. If an IFI can maximize profits through a simple contract, they should use that contract instead of one that employs complex legal maneuvers. The application of legal strategies does not emphasize this caution at IFIs.

### **Is *Murābahah* Transaction a Legal Stratagem?**

Five respondents commented on whether or not *Murābahah* is a legal stratagem, while the other three did not comment on it. Among the five who commented, three of them agreed that it is a legal stratagem, and one disagreed while another responded that it depends on the situation.

Out of those who agreed, only one of them mentioned that it is a legal stratagem because it uses deferred payment, which is not in the actual practice of *Murābahah*. Others who agreed responded that it is *Sharī'ah* compliant as it does not have any illegal clauses.

There was one disagreeing opinion of respondents, and that person pointed out that current *Murābahah* transactions fulfill every component of a valid sale contract. Hence, there is no legal stratagem used in *Murābahah* products.

After analyzing the responses, it is clear that the practitioners do not fully comprehend the current *Murābahah* contract. The scholars of *Sharī'ah* who have approved the present *Murābahah* agreement have established clear procedures regarding the appropriate circumstances for its implementation, acknowledging that it is a lawful tactic. Only one out of all respondents mentioned that it is a legal stratagem because of the deferred payment. Others who agreed and disagreed do not have a clear understanding of the contract. Hence, in practice, the processes and conditions laid out by *Sharī'ah* scholars are ignored, and there is a clear gap between the theory and practice of *Murābahah* transactions. This is why *Murābahah* has received so many criticisms because the critics only look at the procedure, and this contract is widely used without caution.

### **Legal stratagems in *Murābahah* Contract**

This question activated the three legal stratagems used in *Murābahah* transactions: client as an agent, deferred payment, and collateral.

Using a client as an agent is a legal strategy, according to all respondents. The reasons why, however, vary widely among the respondents. Two respondents defended this method, arguing that customers should be treated as agents because they know more about the product than the company,

"Clients know the quality and the type of goods they need."

Meanwhile, one respondent commented that institutions do not have the facility to act as agents to all the transactions due to the difficulties in operations:

"Many institutions do not have the facility to visit and write the merchandise."

Another respondent mentioned that this is a clear legal stratagem. According to the original contract, the seller has to sell directly to the purchaser, which is not observed in

practice. Also, another point mentioned by a respondent is that making clients as the agents do not breach any *Sharī'ah* principles:

"There is no prohibition in *Sharī'ah*. The agency agreement is not a condition to invalidate the contract."

All of the respondents understood that using clients as agents is a legal stratagem. However, they do not have a deeper understanding of it. *Sharī'ah* scholars have accepted this practice when all other options are not available to the institution. This legal stratagem cannot merely be used because it does not breach any law. Moreover, the absence of adequate resources and expertise cannot serve as a valid rationale for the widespread utilization of the agreement. It is advisable to explore all possible alternatives in each case before resorting to this legal stratagem, which should only be employed as a last resort. There is a deficiency in comprehension of this concept among practitioners.

It can be inferred that the IFI designates the agent as the LS element due to the existence of multiple contracts, as per analysis. Nonetheless, several transactions occur with different customers at the same time, and they sometimes lack the experience to purchase the specific goods that the client has requested. As the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) said about the purchase order of the subject matter:

*3/1/3 The original principle is that the institution itself purchases the item directly from the supplier. However, it is permissible for the institution to carry out the purchase by authorizing an agent, other than purchase orderer, to execute the purchase; and the customer (the purchase orderer) should not be appointed to act as an agent except in case of a dire need. Furthermore, the agent must not sell the item to himself. Instead, the institution must first acquire the title of the item and then sell it to the agent (AAOIFI), 2015).*

According to the AAOIFI's own statement above, there are various purchasing methods that are allowed from a *Sharī'ah* perspective, including the institution purchasing an item through a customer acting as an agent.

When questioned regarding the legality of deferred payment as a strategic approach, seven participants agreed, whereas one disagreed. The respondent who held a differing viewpoint argued that financing can only occur through mutual agreement and in the absence of deferred payment, it cannot be facilitated:

"If there is no deferred payment, there is no point in financing."

The ones who agreed gave two reasons: mutual consent and also *Murābahah* price is higher than the cash price.

The deferred payment is not a legal strategy in and of itself. Combining the *Murābahah* contract with deferred payment, on the other hand, modifies the original *Murābahah* contract, making this a legal stratagem. The majority of respondents agreed. Furthermore, it is permissible in this situation due to mutual consent, which has been a recurring theme.

In practice, deferred payment is a crucial component of *Murābahah* financing. It's important to remember, though, that this is all a legal stratagem. Most practitioners agree on this point, so there is no gap between theory and practice.

Taking collaterals (al-*Zamānah*) in *Murābahah* financing was also cited as a legal stratagem by the majority of the respondents, while two of them disagreed with it. It is a legal stratagem because it ensures repayment, minimizes the risk, and fulfills its responsibility

toward its investors. It has been disputed as a legal stratagem based on the permissibility of taking collaterals in *Sharī'ah*.

The act of taking collateral is frequently interpreted incorrectly as a viable legal tactic by people in general. In addition to the rationales provided by the participants, safeguarding the institution against fraudulent behavior by clients is a crucial aspect of the collateral. Once again, the respondents' understanding of the legal stratagem concept is lacking.

### **Satisfaction with the Practice of *Murābahah* Transaction in IFIs**

Four out of the nine respondents were very satisfied with the practice of *Murābahah* transactions in IFIs, while three were satisfied, one was neutral, and the other was unsatisfied.

It is clear from the responses that most respondents are satisfied with the operations of IFIs on the *Murābahah* contract.

### **Practical Issues in the Day-to-Day Operation of *Murābahah***

Only one respondent stated that there are no problems. Others raised various practical issues. The most consistent idea is that when a client defaults, the institution loses the opportunity cost and cannot increase rates. Besides, the clients do not know the workings of *Murābahah*, and the clients have to wait longer for approval compared to conventional loans. The contract is also subject to operational risk and exchange rate risk. The need for several agreements to be signed by the client and the institution is a source of operational risk. The institution will be unable to use the funds if the procedure is not carried out properly. In addition, one of the respondents stated that the organization is only concerned about making money, and that the well-being of its customers is not taken into consideration.:

"The main problem faced in the *Murābahah* contract is that the Institution completely becomes money-oriented without any caring for society's welfare."

The most significant misunderstanding among the practitioners is the mindset of equating *Murābahah* financing with conventional loans. It is standard practice to thoroughly investigate a client before extending credit, but default is always a possibility. In Islam, business is encouraged but *Ribā* (interest on debt) is forbidden because it is unethical. Inherently unfair situations include those in which a client cannot pay the amount owed to the institution and the institution will be burdened as a result of the default. If this is how practitioners think, they have a fundamental misunderstanding of how Islamic financial institutions work.

The second issue is that the clients do not understand the *Murābahah* transaction because it is not communicated in layman's terms. The institution's staff did not express the contract in plain language because it was drafted by legal counsel. The institution is responsible for ensuring that the contract is fully communicated.

In addition, if there is a lag and delay in the process, the organization is obligated to come up with a method or system to make it more efficient and effective. This is a problem with the operations, and the organization is responsible for coming up with a solution for it.

Islamic products have a higher operational risk because the institution cannot profit if the contract is not fulfilled. As a result, it is imperative to provide the staff with the education and training they need to reduce these risks.

In conclusion, the bank does, in fact, operate with a profit motive, and the welfare of the customers is not given the highest priority. The bank's staff should be familiar with other contracts in order to provide clients with options other than the *Murābahah*.

## **Solving the Practical Issues**

Many different solutions have been proposed by respondents as a potential remedy for the problems that have been outlined above. The solution to the problem of default is offered in the form of tightening regulations and closely following up for recovery. A correct *Sharī'ah* audit is recommended for the mitigation of operational risk. It is recommended that seminars and meetings be held in order to raise the customers' level of product awareness.

As previously stated, the key was to make the system more efficient and effective. Furthermore, the *Sharī'ah* audit occurs post-contract; therefore, the institution would not be able to recoup any losses incurred as a result of an audit finding. Hence, this suggestion is not a solution to the operational risk mentioned earlier. It is essential that the process be overseen by a qualified individual possessing expertise in Islamic finance to ensure that the contract adheres to *Sharī'ah* principles.

## **Profit and Loss Models**

Respondents were asked about their opinion of moving away from the *Murābahah* contract and toward PLS transactions such as *Muḍārabah* and *Mushārahah*. The majority of respondents disagreed, claiming that products are developed in response to customer needs. To completely move away from *Murābahah* is unnecessary. Also, the PLS products in practice have their weaknesses and challenges:

"Complete deviation from *Murābahah* to PLS model is not necessary as every aspect has its lapses."

Only one respondent agreed that PLS products should be given importance.

Because Islamic institutions lack specific regulations, IFIs in Sri Lanka are regulated similarly to conventional institutions. Furthermore, the nature of institutions is risk aversion. As a result, *Murābahah* contracts are more commonly used than PLS products. According to the respondents, the institution should cater to the needs of the clients, and thus completely abandoning *Murābahah* products is also unwise. Nonetheless, practitioners should promote PLS products over *Murābahah* when the opportunity arises, and a thorough understanding of PLS products is essential.

## **Conclusion**

This study has brightened the gaps that exist between theoretical principles and practical implementation in *Murābahah* transactions within Islamic Financial Institutions (IFIs) operating in Sri Lanka. The predominant concern among practitioners pertains to the alignment of their mindset with Islamic banking and financing vis-à-vis conventional banking and financing. The expeditious and comprehensive resolution of this matter necessitates the provision of adequate training to the personnel of Banks and Institutions, with respect to the Bank's mission and vision, as well as Islamic finance in its entirety.

Furthermore, there appears to be a deficiency in practitioners' comprehension of the notion of legal stratagems, the prerequisites for employing legal stratagems, and the implementation of legal stratagems in *Murābahah* agreements. The insufficiency in question has the potential to expose the institution to operational risks, which may result in reputational and financial losses over an extended period.

Ultimately, it is advisable to incentivize practitioners to provide PLS models to their clients, as these models are shown to generate greater social welfare in comparison to

Murābaḥah products. A comprehensive understanding of the various products within the realm of Islamic finance is of the utmost importance for practitioners working in Islamic financial institutions.

A consensus among classical scholars has been reached to approve the Murābaḥah transaction, which is grounded on a traditional form of sale. The present transaction can be classified as a cost-plus-profit (CPP) sale. This agreement does not entail any instances of discordance. In the context of Islamic banking, there is a transformation of the sale-based Murābaḥah contract into Murābaḥah financing (*Murābaḥah al-Banki*). This practice has been subject to varying interpretations among contemporary scholars. Critics of Murābaḥah financing frequently highlight the utilization of diverse legal tactics to substantiate its legitimacy. In the meantime, advocates of *Murābaḥah* finance sanctioned this agreement, though believing it undesirable. The implication of this statement is that it would be advisable for International Financial Institutions (IFIs) to employ PLS models whenever feasible, while refraining from utilizing the *Murābaḥah* mode of financing.

As a result, this study holds that the other school of thought among academics should be respected and that *Murābaḥah* financing is permissible. This is because we can't ignore the alternative funding options provided by Islamic banking and finance. We would be cut off from this potential revenue stream if we stopped all *Murābaḥah* transactions, leaving Muslims with no choice but to rely on Ribā'-based financing as their only option. Although it is possible that it does not comply with the *Sharī'ah* in terms of its spirit, *Murābaḥah* does comply with the *Sharī'ah* in terms of the letter of the law. As a result, it cannot be completely ignored. This contract may not be ideal, but breaking the law is not an option.

We prefer a gradual changeover, so contracts like *Murābaḥah* should be used sparingly and only when absolutely necessary. The role of regulators is crucial if the industry is to make the leap from mere institutional replication to the development of truly innovative products and the attainment of economic independence. The Islamic financial sector must undergo this shift in order to become sustainable on its own.

The investigation's results suggest that a noteworthy disparity exists between the theoretical foundation of *Murābaḥah* financing and its actual execution. The primary reason for the significant difference can be attributed to the mindset of practitioners who perceive *Murābaḥah* transactions to be comparable to traditional loans. The professionals hold the perspective that the *Murābaḥah* contract's distinct characteristic of being singular in nature represents a vulnerability within the system. Furthermore, while practitioners recognize the concept of legal stratagems, they do not fully comprehend it.

The present study endeavors to address this disparity and proposes that Islamic financial institutions (IFIs) undertake the task of imparting knowledge on the fundamentals of Islamic finance to their personnel, in addition to appointing a member of the *Sharī'ah* committee at each branch to monitor and scrutinize the legitimacy and indispensability of employing *Murābaḥah* financing and other similar products. The findings of this study suggest that it would be beneficial for Islamic financial institutions (IFIs) to provide their employees with training on the fundamental principles of Islamic finance.

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