THE PRACTICE OF MURABAHA:
A COMPARATIVE STUDY BETWEEN BANK MUAMALAT INDONESIA
AND ALBARAKA BANK IN SOUTH AFRICA

Thesis
Submitted to the Shari’a and Law Faculty in Partial Fulfillment of the
Requirements for the Degree of Strata 1

By:
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ISLAMIC ECONOMICS
SHARI’A AND LAW FACULTY
SYARIF HIDAYATULLAH STATE ISLAMIC UNIVERSITY
JAKARTA
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2011
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THE MOST BENEFICIENT THE MOST MERCIFUL
DECLARATION

I declare that the thesis “The Practice Of Murabaha: Comparative Study Between Bank Muamalat Indonesia and Albaraka Bank In South Africa” is hereby submitted to the Shari’ah and Law Faculty at UIN Syarif Hidayatullah State Islamic University of Jakarta in Partial Fulfillment of the Requirements for the Batchelors Degree. I also declare that, except where acknowledged, this work is my own, completed with the guidance and advice of my supervisors.

Signed by Shiraaj Buziek ........................................

Date ..................................................
In the name of Allah, most merciful, most gracious

I would like to dedicate this work to my dear beloved parents, Mogamat Taliep and Shamiema Buziek, whose love is boundless, for their support and encouragement throughout my studies, may Allah preserve them.

I would also like to dedicate this work to my beloved wife, Ferial Buziek who provides me with unlimited care, love, support and encouragement that I need to achieve my goal and success as well as my dearest children Farah and Mubashir, for giving me love, happiness and joy.

Lastly, I dedicate this work to my brothers Tofiq, Riyaan and Reza for their continuous love, encouragement and support.
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Finally to my parents and family who have always been very understanding and supportive both financially and emotionally.
ABSTRACT

It is indeed a tragedy, that for decades many Muslim governments and so-called Muslim scholars, imbued with western ideas, found serious weakness in Islamic principles dealing with trade and commerce. They believe that without the taking and giving of interest the whole economy will be paralyzed, since it is the pivot around which the banking system in our capitalistic economy revolves.

The failure of Muslims to implement the beautiful, sound, tested and proven economic principles, which are a combination of both material and spiritual values, gave ammunition to those who advocated and promoted un-Islamic economic plans. The architects to these capitalistic, communistic or socialistic systems boldly claimed that Islam does not have a solution to modern day problems in the complex world of trade and commerce.

Islam only prohibited interest, the sale of a limited number of such items which cause harm to an individual or society and certain types of transactions. Islam, however, encouraged trade and considered it the best of professions provided it is not propelled by greed and fuelled by exploitation like present day economics. Islam does not encourage an economy which causes the enrichment of a few and brings misery and destruction upon the majority.
OUTLINE

PREFACE ................................................................................................................

ACKNOWLEDGEMENT ......................................................................................

TABLE OF CONTENTS ........................................................................................

CHAPTER I        BACKGROUND

A. Background of Problem .................................................................................. 1
B. Focus of the Study ............................................................................................ 11
C. Research Questions .......................................................................................... 12
D. Objectives of the Study ................................................................................... 14
E. Significance of the Study .................................................................................. 15
F. Literature Review ............................................................................................. 15
F. Research Methodology ...................................................................................... 18
G. Process of Writing ............................................................................................ 20

CHAPTER II        DESCRIPTION: GENERAL CONCEPT OF MURABAHA

A. Meaning and Understanding of Murabaha .................................................... 24
B. Legal Foundations of Murabaha ..................................................................... 26
C. Various Types of Murabaha .......................................................................... 30
D. Essential Principles and Conditions of Murabaha ........................................ 31
CHAPTER III  
ISLAMIC BANKING IN INDONESIA  
(BANK MUAMALAT)  
A. General Overview of Bank Muamalat Indonesia.................  38  
B. The Implementation of Murabaha in Bank Muamalat Banking System in Indonesia................................................  43  
C. Determining the Profit-Margin .............................................  46  
D. Nominating an agent or representatives (Wakalah).............  51  
E. The Tax System applied on Murabaha.................................  52  

CHAPTER IV  
ISLAMIC BANKING IN SOUTH AFRICA  
(AL- BARAKAH BANK)  
A. General Overview of in Al Barakah Bank in South Africa .  56  
B. The Implementation of Murabaha in the Al Baraka Banking System in South Africa.................................  65  
C. Determining the Profit-Margin .............................................  70  
D. Nominating an agent or representative (Wakalah) ..........  71  
E. The Tax System applied on Murabaha.................................  72  

CHAPTER V  
OUTCOME OF RESEARCH  
A comparative analysis on the practice of Murabaha between Bank Muamalat in Indonesia and Al-Barakah bank in South African on:
A. The similarities and differences between the Islamic Banking systems on the practice and the implementation of Murabaha .......................................................... 74
B. Determining the profit margin .................................................. 75
C. Nominating a representative or agent (Wakalah).................... 77
D. The Tax system applied to Murabaha ..................................... 79

CHAPTER VI  CLOSING

A. Conclusion ............................................................................ 85
B. Recommendations .................................................................. 88

BIBLIOGRAPHY

APPENDIX
CHAPTER I
INTRODUCTION

A. Background

Over the last few decades, the Muslims have been trying to restructure their lives on the basis of Islamic principles. They strongly feel that the political economic dominance of the West, during past centuries, has deprived them of the divine guidance, especially in the socio-economic fields. Whilst conventional banking is believed to have begun in the middle of the twelfth century, Islamic banking first emerged only in the late seventies and early eighties although the history of Islamic banking activities can be tracked back to the birth of Islam.

While Islamic banking may not be a totally new concept, the widespread expansion of this form of banking is certainly a fairly recent phenomenon. Islamic Banking is growing at a rate of 10-15% per year and with signs of consistent future growth. Islamic banks have more than 300 institutions spread over 51 countries, including the United States through companies such as the Michigan-based University Bank, as well as an additional 250 mutual funds that comply with Islamic principles. It is estimated that over US$822 billion worldwide

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1 Muhammad Taqi Usmani, An Introduction To Islamic Finance (Maktaba MA’ARIF KARACHI 2002) pg 9
2 Mei Pheng, Islamic Banking and Finance Law (Pearson Malaysia Sdn. Bhd. 2007) pg 1-3
Sharia-compliant assets are managed according to The Economist. Today, more than 260 Islamic financial institutions are operating worldwide, which are claimed to manage assets worth no less than £300 billion, while the assets held Islamic financial institutions were only £5 billion in 1985. According to CIMB Group Holdings, Islamic finance is the fastest-growing segment of the global financial system and sales of Islamic bonds may rise by 24 percent to $25 billion in 2010. The term “Islamic banking” refers to a conduct of banking operation in consonance with Islamic teachings. The main principle of Islamic banking comprises prohibition of interest in all forms of transactions, business undertakings and trade activities.

The Holy Qur’an attaches great importance to every productive activity, which is the sole criterian set by the Holy Qur’an. The Quran not only considers it legitimate for people to transact in commercial transactions, it goes one step further to encourage them, and even persuades them to practice it.

Since Islamic banks are founded on the same Islamic business principles and are governed by the same law i.e. Sharia laws, there should be no differences in terms of operations and practices amongst them. In reality however, many differences in practices do occur among the Islamic banks in various Muslim countries.

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5 [http://www.dur.ac.uk/sgia/imedis/Islamicfinancesummerschool/summerschoolinfo/](http://www.dur.ac.uk/sgia/imedis/Islamicfinancesummerschool/summerschoolinfo/)
Islamic banking has the same purpose as conventional banking except that it operates in accordance with the rules of Shariah, known as Fiqh al-Muamalat (Islamic rules on transactions). The basic principle of Islamic banking is the sharing of profit and loss and the prohibition of riba (usury). Common terms used in Islamic banking include profit sharing (Mudharabah), safekeeping (Wadiah), joint venture (Musharakah), cost plus (Murabahah), and leasing (Ijarah).\(^9\)

Islamic banking theorists argue that Islamic banking should be based on profit and loss sharing (PLS) rather than interest.\(^10\) Most of the Islamic financial institutions, including the Islamic banks and the Mudarabas (joint profit/loss sharing Investment ventures) floated in Pakistan by a large number of Mudarabah companies, are working today on the basis of Murabaha and leasing. They are financing trade and industry by using these two instruments as Islamic modes of financing.

Most of the Islamic banks and financial institutions are using murabaha as an Islamic mode of financing, and most of their financing operations are based on murabaha. That is why this term has been taken in the economic circles today as a method of banking operations, while the original concept of murabaha is different from this assumption\(^11\)

Looking at the origin of Murabaha, it’s not a mode of financing in the strict sense of term as recognized in the contemporary usage of the business


\(^11\) Muhammad Taqi Usmani, *An Introduction to Islamic Finance* (Maktaba Ma’ariful Quran Karachi Pakistan 2002) pg 95
community. Originally, it was a transaction of general trade and not financing transactions. However, due to certain difficulties in applying the real Islamic modes of financing (Mudarabah and Musharaka), in present circumstances the contemporary scholars of Shari’ah have allowed the use of Murabaha as modes of finance, subject to certain conditions. These conditions are necessary for making these modes of finance acceptable to Shariah, and unless these conditions are fulfilled the transactions cannot be held as lawful in Shariah.¹²

This is a procedure where the partner approaches the bank certain items (be it a commodity or otherwise) be bought for him/her and he/she agrees to pay the bank later on, upon the fulfillment of the actual buying, an agreed percentage of profit. In order to avoid any riba element one of the banks provides that the agreement of the bank and the actual extension of buying do not contribute any legal obligation (according to Shariah) on the partner to buy.¹³ Hence the risk is still that of the bank’s. Untill the partner fulfilld his original promise of “rebuying” the commodity, the risk remains with the bank which justifies the profit.

Whether or not the present Islamic financial instruments are observing the prescribed conditions is a question of concern for every Muslim who transacts with them in the hope that he/she will not involve himself in an un-Islamic business activity. Despite the growing number of such institutions, no system has yet developed to examine in detail their activities from this point of view. The

¹³ Ahmed, Iqbal, Khan, *MONEY AND BANKING IN ISLAM* (Institute of Policy Studies Islamabad Pakistan 1983) pg 259
personnel employed in these institutions comprise mostly of persons educated and trained in the traditional financial system based on interest. They are not sufficiently familiar with the Islamic concepts and principles of business and despite their honesty, the possibility of mistakes and errors cannot be rules out.

Both legal and ethical dimensions of shariah are embodied into the rules and regulations governing the Islamic financial markets. These rules are:

1. Prohibition of riba (usury or interest).
2. Application of al-bay’ (trade and commerce)
3. Avoidance of gharar (ambiguities)
4. Prohibition of maysir (gambling)
5. Prohibition in engaging production of prohibited commodities such as liquor, pork, and pornography.

Although there are some religious boards which supervise the overall activities of some of these institutions, their function is limited to examining their model agreements and responding to specific questions referred to them by the management. They do not and perhaps cannot, examine the actual practice in individual transactions.

Therefore, the smooth functioning of Islamic financial institutions in accordance with the Shariah requires firstly the orientation of their personnel with

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a view to equipping them with the basic Islamic concepts of business and secondly a systematic method of auditing them from the Shariah point of view.

The Islamic law prohibits charging and paying of interest but allows earning profits. The Holy Quran has laid down rather strict injunctions with regard to interest on money which are repeated over and over with force and emphasis.\textsuperscript{16} This legal injunction has motivated the establishment and successful operation of a number of Islamic financial institutions. These institutions include Islamic banks, and non-banking Islamic financial intermediaries, namely, Islamic insurance companies.

South Africa is a new democratic state emerging as a powerful actor in the African continent and internationally it has been identified along with India, Brazil and China as the countries with the fastest growing economies amongst underdeveloped and developing countries. Islamic enterprises are firmly integrated in this developing process.\textsuperscript{17}

The Muslim population in South Africa is in the minority at an estimated 2 percent of the total population of 49,052,489 is Muslim.\textsuperscript{18} The strength of Muslim presence is manifesting in the establishment of Islamic Banking in a predominantly Western environment in sync with the trends in a global context. Though interest (riba), the primary reason for Islamic finance, is strictly

\textsuperscript{16} Muhammad Ahraf, \textit{Islam and the THEORY OF INTEREST} (Ahraf Publications Lahore 1991) pg 40
\textsuperscript{17} http://www.dfa.gov.za/department/stratplan05-08.pdf
\textsuperscript{18} http://www.factbook.net/muslim_pop.php
prohibited in the Qur'an, revealed over 1400 years ago, the obliging responsibility to refrain from interest (riba) is becoming increasingly conscious in the last decade. Muslims residing all over the Western world are increasingly looking for Shari'ah compliant financial institutions to deal with.

Al Baraka Bank, registered in South Africa since 1989, pioneered Islamic banking in this country in response to the need for a system of banking in line with Islamic economic principles. The bank is jointly owned by South African investors. DCD London & Mutual Plc, a company incorporated in England and Wales, and the Saudi Arabian-based Dallah Al Baraka Group, which - as part of its diversified business operations - has established one of the largest international Islamic banking groups in the world through the Al Baraka Banking Group, Al Baraka Bank's board comprises both local and international business people with individual professional and management abilities and collective expertise in the Islamic banking industry.

All of Al Baraka Bank's products and services promote the understanding and adoption of Islamic business principles and so contribute to the socio-economic development of the community. Since its inception, the bank has shown impressive growth. The bank's success may be attributed to its niche market's faith and confidence in its ability to implement and further develop a viable alternative to interest-based banking in South Africa. Al Baraka Bank's track-record to date is indicative of a growing market's increasing acceptance of an alternative system of banking in South Africa. The bank is well established in
South Africa as an institution striving to operate totally within the confines of Shari’ah compliance banking. The bank also has to abide by the South African Banking regulations.  

Islam is Indonesia's dominant religion and approximately 86%, or about 255 million, of its population identify as Muslims, making it the world's largest Muslim population.  

PT Bank Muamalat Indonesia Tbk was established in 24 Rabius Tsani 1412 H or November 1, 1991, endorsed by the Indonesian Council of Ulemas (MUI) and the Government of Indonesia, and commenced operations in 27 Syawwal 1412 H or May 1, 1992. Supported by the Indonesian Association of Moslem Intellectuals (ICMI) and a group of Moslem entrepreneurs, the founding of Bank Muamalat also won the support of the general public, evidenced by a Rp 84 billion pledge for the purchase of the Bank's shares on the date when the Articles of Association was signed. Thereafter, in a special meeting commemorating the founding at the Presidential Palace in Bogor, West Java, additional pledges from communities in West Java were raised to reach a total of Rp 106 billion. 

On October 27, 1994, barely two years from its founding, Bank Muamalat received its license to operate as a Foreign Exchange Bank. This recognition strengthened the Bank's position as the first and leading sharia (Islamic) bank in Indonesia with a growing array of products and services. 

In the late 90s, Indonesia was hit by a financial crisis which devastated most of the national economies in the Southeast Asia region. The national

19 http://www.albaraka.co.za/About_alBaraka/Corporate_Profile.aspx  
20 http://www.factbook.net/muslim_pop.php
banking sector collapsed under the burden of corporate debt overhang, which also impacted Bank Muamalat. In 1998, our Non-Performing Financing (NPF) ratio exceeded 60%. The Bank endured a loss of Rp 105 billion, which brought our equity to its lowest level ever of Rp 39.3 billion, less than a third of our original paid up capital.

In an effort to strengthen its capital base, Bank Muamalat solicited for a potential investor, which was responded positively by the Islamic Development Bank (IDB) based in Jeddah, Saudi Arabia. In the Annual General Meeting of Shareholders of Bank Muamalat on June 21, 1999, IDB officially became one of the shareholders of BMI. Thus, the period between 1999 and 2002 represents times of challenges as well as triumphs for Bank Muamalat. During this period, Bank Muamalat succeeded in reversing its financial fortunes from loss back into profitability. This is achieved through the dedicated hard work of the entire Muamalat Crew, supported by strong leadership, astute business strategy, and strict adherence to the principles of sharia in all aspects of its banking practice.

The characteristic of Islamic banking operation is based on partnership and mutual benefits principle provides an alternative banking system with mutual benefits both for the public and the bank. This system will give priorities to aspects related to fairness in transaction and ethical investment by underlining the values of togetherness and partnership in production, and by avoiding any speculative activity in financial transaction. By providing various products and banking services supported by a variety of financial schemes, Islamic banking
will be a credible alternative that can be benefited by all of Indonesian people without exception.

In the context of macroeconomic management, an extensive use of various Islamic financial products and instrument will help attaching financial sector and real sector and create harmonization between the two sectors. In addition to support financial and business the widely use of Islamic product and instrument will also reduce speculative transactions in thus the economy supports the stability of overall financial system. At the end, the Islamic banking will significantly contribute to the achievement of mid-long term price stability.

The enactment of Act no. 21 of 2008 issued on July 16, 2008 has provided a more adequate legal base to the development of Islamic banking in Indonesia, and consequently will accelerate the growth of the industry. With an impressive development progress reaching an annual average asset growth of more than 65% in the last five years, it is expected that Islamic banking industry will have a more significant role in supporting national economy.²¹

While in period 0f 1992-1998 only saw one unit of Islamic bank in Indonesia, in 2005 the number of Islamic banks has become 20 units, comprising 3 full-fledged Islamic banks and 7 Shariah business units.²² Meanwhile, the number of Shariah rural banks (BPRS) by the end of 2004 was 88. Data from Bank Indonesia show that the prospect of Islamic banking in five or ten years to

²¹ http://www.bi.go.id/web/en/Perbankan/Perbankan+Syariah/
the fore will be quite promising. The Islamic banking industry is predicted to continue to grow rapidly.

B. Focus of the Study

The focus of the study is the practice of Murabaha in two banks. The study would be conducted with the comparative method in order to compare the practice of Murabaha between two respected banks, one based in a population where the Muslim population is the majority and the other in minority.

The comparative method is often used in the early stages of the development of a branch of science. It can help the researcher to ascend from the initial level of exploratory case studies to a more advanced level of general theoretical models, invariances, such as causality or evolution.

The design of comparative research is simple. The objects are specimens or cases which are similar in some respects (otherwise, it would not be meaningful to compare them) but they differ in some respects. These differences become the focus of examination. The goal is to find out why the cases are different: to reveal the general underlying structure which generates or allows such a variation.

Comparison is one of the most efficient methods for explicating or utilizing tacit knowledge or tacit attitudes. This can be done, for example, by showing in parallel two slides of two slightly different objects or situations and by asking people to explain verbally their differences.
The method is also versatile: one can use it in detail work as a complement to other methods, or the entire structure of a research project can consist of the comparison of just a few cases.

C. Research Questions

The mode of Murabaha has been implemented by Islamic banking and institutions as a means of avoiding interest (riba). Yet the mode has not been shy of criticism by Islamic scholars, Muslims and non-Muslims alike and some referring to Murabaha merely as a change of name to the interest-lending loans offered by the conventional counterpart.

Although all the controversy, the mode of Murabaha has become the most popular mode of finance in Islamic banking. The study will focus on Murabaha used in Islamic banks in South Africa and Indonesia, its similarities and differences, and the main reason it has become the most popular financial instrument amongst all others.

On that basis, the principal problem of this research can be formulated on the comparative study between Muamalat bank in Indonesia and Al-Barakah Bank in South Africa on the following aspects:

1. What is the theoretical concept of murabaha?
2. Implementation of murabaha Muamalat bank in Indonesia and Al-Barakah Bank in South Africa
3. Analyzing the differences and similarities in the implementation of
4. The issue of nominating an agent or representative (Wakalah).

5. How is the profit-margins determined and are they contemporous with the interest rate?

6. The difference in the tax systems on Murabaha applied in the respective banks?

D. Objectives of Study

The objective of this study is to compare the use and practice of Murabaha in the Islamic banking system where Muslims are a majority (Indonesia) and where Muslims are a minority (South Africa).

The study will also investigate the challengers and problems faced by Indonesia and South Africa in implementing the modal of Murabaha in their respective Islamic Banking systems, its similarities and differences, and the main reason it has become the most popular financial instrument amongst all others.

It is indeed a tragedy, that for decades many Muslim governments and so called Muslim scholars, imbued with western ideas, found serious weakness in Islamic principles dealing with trade and commerce. They believe that without the taking and giving of interest the whole economy will be paralyzed, since it is the pivot around which the banking system in our capitalistic economy revolves.

The failure of Muslims to implement the beautiful, sound, tested and proven economic principles, which are a combination of both material and
spiritual values, gave ammunition to those who advocated and promoted un-Islamic economic plans. The architects to these capitalistic, communistic or socialistic systems boldly claimed that Islam does not have a solution to modern day problems in the complex world of trade and commerce.

Islam only prohibited interest, the sale of a limited number of such items which cause harm to an individual or society and certain types of transactions. Islam, however, encouraged trade and considered it the best of professions provided it is not propelled by greed and fuelled by exploitation like present day economics. Islam does not encourage an economy which causes the enrichment of a few and brings misery and destruction upon the majority.

E. Significances of the Study

The significances of this study are to obtain a better understanding of the financial mode of Murabaha. The mode has been met with lots of skepticism and doubts by Muslims and non-Muslims alike on whether there is a difference between Islamic banking and conventional western banking. These doubts have been brought about because of the misunderstanding of the mode of Murabaha, as the facility appear similar to conventional bank financing with the profit rate or mark-up being contemporaneous with the rate of interest.

Dr. Shahid Hasan Siddiqui an eminent Pakistani banker and economist explains in his paper Islamic Banking: True Modes of Financing
When the common people realize that the net result in the transaction of the Islamic banks is the same as was in the transactions of conventional banks, they become sceptical towards the function of Islamic banks. It therefore, becomes very difficult to argue for the case of Islamic banking before the common people, especially before the non-Muslims who feel that it is nothing but a matter of twisting documents only.”23

F. Literature Review

Islamic Banking in South Africa is a new phenomenon, and therefore there are only few books that are available relating to the topic of murabaha in South Africa. Hopefully as Islamic Banking and Finance develops in South Africa, more books and articles will emerge as a result of the phenomenon and its impact on the South African economy. The researcher will concentrate on a few articles that relate to the study, these few articles and research papers are mentioned below:

1. *The Importance of Islamic Banking for Muslim Minorities*, by Ahmed Faizel Ebrahim,

   This article by Ahmed Faizel Ebrahim ‘*The Importance of Islamic Banking for Muslim Minorities*’, concentrates on the importance of Islamic Banking, not only in Muslim majority but also Muslim minorities. It also highlights the role of Islamic Banking in a western society and its possible

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impacts on the economical system. Although the title suggests a broader study on Islamic Banking in Muslim minorities around the world, the articles mainly concentrates on Islamic Banking in South Africa where the Muslims are merely 2 percent of the population.

The article focuses on the importance of Islamic Banking in not only Muslim majorities but Muslim minorities as well. The author also discusses the importance of Halal earnings, Allah’s and the Prophet Muhammad’s attitude towards wealth.

This topic (A Comparative study of the practice of Murabaha) however will concentrate on the practice of Murabaha in both Islamic Banks in South Africa and Islamic Banks in Indonesia. How the mode of Murabaha competes in a minority and majority population of Muslims, its differences and similarities as well as the laws governing the practice of Murabaha, Legal Foundations of Murabaha, various types of Murabaha and the essential principles and conditions that governs the practice of Murabaha.

2. Islamic Banking in South Africa, Problems and Solutions, by Washfi Saal

This research study by the author Washfi Saal focuses on the Islamic Banking in South Africa and the problems and challengers faced by the Muslim minority when embarking on this venture. The author also highlights the South African Banking Act of 1990 which provides no legislation on Shari’ah complaint banking operations in South Africa and the issues
pertaining to Act as the main focus of the study. The study also suggests possible solutions to the problems and challengers faced by the Muslim minority in South Africa.

This study however will be more concise and concentrate only on the practice of Murabaha. The research study by Wasfi Saal provided much needed information on Islamic Banking in South Africa and its legislations governing the practice of Islamic Banking practices.

3. *Bank Syariah, Problem dan Prospek Berkembang di Indonesia*, by Prof. Dr. Thohir Luth, M.A

   Basically this book focuses on Islamic Banking in Indonesia and the problems in the development of Islamic Banking. The author focuses on the development of Islamic banking in Indonesia after the Islamic Banking regulations was established and the conditions of the Islamic Banks during this period.

   The difference of this study is that the above author Dr. Thohir concentrates only on Islamic Banking as well as the problems and developments in Indonesia, where the majority of the population is Muslim. This study however is a comparative study on the practice of Murabaha in both Islamic Banks in Indonesia and South Africa.
G. Research Methodology

1. Research Approach

The research is be based on qualitative data as the data captured is not numerical in nature. Viewed from the aspect of purpose, this study is a descriptive research, i.e. the data collected in the form of words, pictures and not the numbers.\(^{24}\) While in terms of data collection techniques, this study is a combination of library research, i.e. research that includes collecting data and information through the archives and documents the testing method used was analysis of documents or content analysis\(^{25}\) and field research\(^{26}\) by going out and conducting interviews with banking officials to obtain important information from the respective banks on the various issues on Murabaha.

2. Data Collection Techniques

The data collection technique consists of a combination of library research and field research. By using library research, the researcher has adopted documentary analysis to collect data from research papers, thesis's and articles pertaining to the title that has rendered tremendous help in achieving the goals of the researcher. Information from internet sources on the


establishment and growth of Islamic Banking and Finance in South Africa has also been studied.

By combining library research with field research the researcher has had the opportunity to collect valuable data and information by conducting interviews with officials from the respective banks. The interviews were semi-structured and the same questions were posed at both officials, one from Albaraka Bank South Africa and the other from Bank Muamalat in order to establish the different approaches in practice.

The interviews were performed face to face and conducted at Bank Muamalat Indonesia at the Muamalat Institute for research, training, consulting and publication, located at Gedung Dana Pensiun Telkom Lt 2 Jl. Letjend. S. Parman Kav. 56 Slipi, Jakarta Barat in the month November 2010 and Albarakah Bank branch situated in the city of Cape Town 42 Corner Klipfontein and Belgravia roads during the month of December 2010.

The interviewees Mr Nizaam Abdurahmaan is a senior consultant in Islamic finance at the Albaraka Bank Cape Town branch and Mr Ahmad Fauzi holds a position in the Financing Division Department at the Muamalat Institute.

3. Source of data

To be able to gather data that is relevant and accurate, the primary source for the study will be institution. Using the library research method and applying documentary analysis in capturing data. It should be noted that not
many books exist on Islamic banking in South Africa. The reason for this is that Islamic Banking in South Africa is a new phenomenon. Only few books on Islamic Banking in South Africa do exist. The data that do exist are mostly articles and essays that can be collected from the internet. Some sources that will be used are mentioned below:

a. http://www.albaraka.co.za
b. The Banks Act, 1990 (Act No. 94 1990 as amended)
c. http://www.acts.co.za
d. http://www.gbn.co.za/index.phd

4. Data Analysis Technique

In analyzing the data, the author will use content analysis techniques to analyze the method of comparative analysis of the contents of the material on Murabaha, concentrating with the implementation of Murabaha in the Islamic banking system in South Africa and Indonesia. The data obtained are derived from secondary data drawn from reading books and other literature which consists of:

a. Government regulation on banking.
c. Text Books about Murabaha which the data is still relevant to be used.
d. Results of research on Murabaha by previous researchers are still relevant.
5. Technical Writing

Being in the writing technique, this research is guided by the principles that have been regulated and standardized in the “Pedoman Penulisan Skripsi Fakultas Syariah Dan Hukum UIN Syarif Hidayatullah Jakarta 2005” (Guidelines for Thesis Writing, Thesis, and Dissertation Syarif Hidayatullah Jakarta UIN), with the following exceptions:

a. Quotations Verses of the Qur’an will not be referenced by footnotes because it is considered sufficient by the name of the chapter at the end of quotations.

b. The translations of the Qur’an will be taken from the english translation of the Qur’an by Saheeh International.\(^\text{27}\) Initially established to edit Islamic literature in English submitted by authors to Dar Abul-Qasim of Jeddah, Saudi Arabia, shortly thereafter the group began to produce material of its own as well. Their most notable work was published in 1997 – a translation of the Qur’an’s meanings. Numerous scholars now regard it as one of the most accurate Qur’an translations available.\(^\text{28}\)

c. Translations of the Qur’an and Hadith are typed single-spaced.

H. Writing System

\[^{27}\text{http://www.saheehinternational.com/}\]
\[^{28}\text{http://www.saheehinternational.com/}\]
The systematic writing of this paper will be divided into four chapters, namely:

CHAPTER I: Introduction, in which include: Background of Problem, Focus of the Study, Research Questions, Objectives of the Study, Significance of the Study, Literature Review and the Process of Writing.

CHAPTER II: Meaning and Understanding of Murabaha, Legal Foundations of Murabaha, Various Types of Murabaha, Various Types of Murabaha and the Essential Principles and Conditions of Murabaha

CHAPTER III: General Overview of the Islamic Banking System in South Africa, The Implementation of Murabaha in the Al Baraka Banking System in South Africa, Calculation of the Profit-Margin, Nominating an agent or representative (Wakalah), The Tax System applied on Murabaha

CHAPTER IV: General Overview of the Islamic Banking System in Indonesia, The Implementation of Murabaha in the Bank Muamalat Banking System in Indonesia, Calculation of the Profit-Margin, Nominating an agent or representative (Wakalah), The Tax System applied on Murabaha

CHAPTER V: A comparative analysis between Bank Muamalat in Indonesia and Al-Barakah bank in South African on the similarities and
differences between the Islamic Banking systems on the practice and the implementation of *Murabaha*, Analyzing the difference on the calculation of the profit-margin of *Murabaha* and establishing whether the profit-margin is contemporaneous to the interest rate, The issue of nominating a representative or agent (Wakalah), The differences on the issue of Tax applied to *Murabaha*

CHAPTER VI: Closing consisting of Conclusion Suggestions
CHAPTER II

DESCRIPTION: GENERAL CONCEPT OF MURABAHA

A. Meaning and understanding of Murabaha

_Murabahah_ or _murabaha_ (Arabic مرابحة, more accurately transliterated as murābahah) is a particular kind of sale, compliant with _shariah_ where the seller expressly mentions the cost he/she has incurred on the commodities for sale and sells it to another person by adding some profit or mark-up thereon which is known to the buyer.\(^\text{29}\) As the requirement includes an "honest declaration of cost".

The point behind such a transaction is that some people, while knowing about prices have mutual trust in each other. Thus an intending buyer comes to a person and says, “I am willing to buy this merchandise from you, and I will give you such and such profit”. Then the deal is confirmed on this basis.\(^\text{30}\)

Typically, there are three parties, _A_, _B_ and _C_, in a murabaha sale. _A_ request _B_ to buy some goods but promises to buy them from a third party, _C_. _B_ is a middleman/woman, and the murabaha contract is between _A_ and _B_.

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\(^{29}\) _Abdul Gafoor_, *Interest-Free Commercial Banking* (A.S NOORDIEN Malaysia 1996) pg 43

\(^{30}\) _Ala’ Eddin Kharofa_, *Transactions in Islamic Law* (A.S Noordien Kuala Lumpur 1997), pp162
murabaha contract is defined as a “sale of a commodity at the price which the seller (B) paid for it originally, plus a profit margin known to the seller (B) and (A).” \(^3^1\) Since its inception in Islamic law, the contract of murabaha appears to have been utilized purely for commercial purposes. Udovitch, as quoted by Saeed suggests that that murabaha is a form of commission sale, where a buyer who is usually unable to obtain the commodity he requires except through a middleman, or is not interested in the difficulties of obtaining it himself/herself, seeks the services of the middleman. \(^3^2\)

It is one of the most popular modes used by banks in Islamic countries to promote riba-free transactions. Different banks use this instrument in varying ratios. Typically, banks use Murabahah in asset financing, property, micro-finance and commodity import-export. \(^3^3\)

The seller may not use Murabahah if Mudarabah (profit sharing) or Musharakah (joint venture) is practicable. Since those profit-sharing modes of financing involve risks, they cannot guarantee banks any income. Murabahah, with its fixed margin, offers the seller (i.e. the bank) a more predictable income stream. A profit-sharing instrument, conversely, is preferable as it shares the risks more equitably between seller and buyer.

\(^{31}\) Jaziri, Kitab al-Fiqh ‘ala al-Mudhahib li al-Arba’a (Cairo : al-Maktabat al-Tijariyya al-Kubra n.d) pg 278-80

\(^{32}\) Abdullah Saeed, Islamic Banking and Interest, (E,J Brill, Leinden, The Netherlands 1996) pg 76

\(^{33}\) http://en.wikipedia.org/wiki/Murabaha
There are, however, practical guidelines in place which aim to ensure that the Murabahah transaction between the bank and the customer is one based on trade and not merely a financing transaction. For instance, the bank must take constructive or actual possession of the good before selling it to the customer. Whilst it can be justified to charge an additional margin to the customer to reflect the time value of money in terms of actual payment not being received from the customer at time zero, the bank can only impose penalties for late payment by agreeing to purify them by donating them to charity.34

The accounting treatment of Murabahah, and its disclosure and presentation in financial statements, vary from bank to bank.

In his book Ir. Adiwarman Karim explains Murabaha as an agreement in selling of goods by stating the cost and margins (profits), which is agreed by both the seller and buyer.35 The overall prices of goods that have been agreed are then paid by the buyer (customer) in installments. Ownership (ownership) of the assets is transferred to the customer (buyer) in proportion with the installment-payment being paid. Therefore, items purchased serves as collateral until the entire fee is paid.

B. Legal Foundations of Murabaha

The verses of the Koran used as a reference in support of murabaha transaction contract basis, are: Chapter-Nisa’: 29

34 http://en.wikipedia.org/wiki/Murabaha
35 Karim, Adiwarman, Islamic Banking Fiqh and Financial Analysis (PT RAJAGRAFINDO PERSADA 2004) p. 113
Sahih International

O you who have believed, do not consume one another's wealth unjustly but only [in lawful] business by mutual consent. And do not kill yourselves [or one another]. Indeed, Allah is to you ever Merciful.

Chapter Bakharoh, verse 275
2:275

Those who consume interest cannot stand [on the Day of Resurrection] except as one stands who is being beaten by Satan into insanity. That is because they say, "Trade is [just] like interest." But Allah has permitted trade and has forbidden interest. So whoever has received an admonition from his Lord and desists may have what is past, and his affair rests with Allah. But whoever returns to [dealing in interest or usury] - those are the companions of the Fire; they will abide eternally therein.

Hadiths

وَإِذَا مَسَّهُ سَمِّيَ الْبَيْعُ عَنْ تَرَاضٍ (رواة البهتري وابن ماجه)
Sa’ad al Khudri(ra) related that the prophet SAW said: “buying and selling should be done consensually.

(HR. al-Baihaqi and Ibnu Majah, and has been assessed as a shahih by Ibnu Hibban)

The Quran, however, does not make any direct reference to murabaha, though there are several references therein to sale, profit, loss, and trade. Similarly, there is apparently no hadith which has a direct reference to murabaha.

Early scholars like Malik and Shafi’I who specifically said that a murabaha sale was lawful, did not support their view with any hadith. Al-Kaff, a contemporary critic of murabaha, concluded that murabaha was “one of the sales which were not known during the era of the Prophet or his companions”36 According to him, prominent scholars began to express their views on murabaha in the first quarter of the second century AH, or even later.37 Since there is apparently no direct reference to it either in the Quran or in the generally accepted sound hadith, jurist had to justify murabah on other grounds.

Malik supported its validity by reference to the practice of the people of Madina:

There is consensus of opinion here (in Medina) on the lawfulness of a person’s purchasing cloth in a town, and taking it to another town for selling it on the basis of an agreed upon profit.38

Shafi’i, without justifying his view by any shari’a text, said:

If a person shows a commodity to a person and says, ‘Purchase it for me, and I will give you such and such a profit,’ and the person purchases it, the transaction is lawful.39

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36 Al-Kaff, Does Islam Assign Any Value, (Karachi: Islamic Research Academy. 1986) pg 8
37 Ibid.
38 Ibid.,pp.5-6
The Hanafi jurist, Marghinani (d.593/1193), justified it on the ground that
"The condition essential to the validity of a sale exist in it, and also because mankind stands in need of it."\textsuperscript{40}

The shaf‘i jurist, Nawawi (d.676/1277) simply said:
"Murabaha sale is lawful without any repungange."\textsuperscript{41}

The early scholars such as Imam Malik and Imam Shafi’i specifically stated the legitimacy of the sale based on Murabaha, although no clear reference is made to any. Distinguished scholars began to express their own views on Murabaha about the first quarter of the second century Hijra, or more. Because it seems there is no direct reference to Murabaha in the Qur’an or Hadith, legal experts have confirmed Murabaha based on other grounds.

The Fatwa of the second conference of the Islamic bank which took place in Damascus under the auspices of Qatar Islamic Bank: "The promise in the Murabaha sale to he who orders the purchase " is legally permissible after owning and possessing the commodity, only then it is permissible to sell it to the purchaser who requested it for the price specified and mentioned in the previous mutual promise agreement as long as the liability of damage before delivery and the consequences of a return for unseen defect is on the bank.\textsuperscript{42}

As to whether the promise is binding to the buyer, the bank or both, it better secures the interests of all parties, the bank and the customer, to have the

\textsuperscript{39} Shafi‘i, \textit{al-Umm}, III (Cairo:Dar al-Sha‘b. 1968) p.33
\textsuperscript{40} Marghina, \textit{Hedaya or Guide, A Commentary on the Mussulman Laws} (Delhi Islamic Book Trusat 1982) p.282
\textsuperscript{42} \url{http://www.ameinfo.com/113438.html}
promise as binding. It is legally acceptable and it is up to each Islamic bank to take either opinion according to what its committee of legal observers decides."

C. Various types of Murabaha

Murabaha is one of the most widely used modes of finance by the Islamic banks. It is suitable for partial financing to the investment activities of the customers, in industry, trade or others. It enables the customer/investor to obtain finished goods, raw material, machines or equipment from the local market or through import.

Payment for a murabaha may be done either in cash or installments. Under a murabaha, it is permissible for a seller to set different prices for different payment modes. Murabaha muajjal is characterized with the goods being delivered at the beginning of the contract and the payment being made at a later time (some time after the contract), either in a cash lump sum or installments.

Murabaha can be classified into three types, namely:43

1. Murabaha Taqsith - in installments

![Figure 1: Murabaha Taqsith](image)

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43 Karim, Adiwarman, *Islamic Banking Fiqh*, pg 117
2. Murabaha Mu’ajjal - lump sum at the end of the period

![Murabaha Mu’ajjal](image)

Figure 2: Murabaha Mu’ajjal

3. Murabaha Naqdan - in cash

![Murabaha Naqdan](image)

Figure 3: Murabaha Naqdan

**D. Essential Principles and conditions of murabaha**

**Murabahah as a mode of financing**

Originally, murabahah is a particular type of sale and not a mode of financing. The ideal mode of financing according to Shariah is mudarabah or musharakah; however, in the perspective of the current economic set up, there are certain practical difficulties in using mudarabah and musharakah instruments in some areas of financing. Therefore, the contemporary Shariah experts have allowed, subject to certain conditions, the use of the murabahah on deferred payment basis as a mode of financing. But there are two essential points which must be fully understood in this respect:

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44 Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, (Maktaba MA’ARIF KARACHI 2002) pg 104
1. It should never be overlooked that, originally, murabahah is not a mode of financing. It is only a device to escape from "interest" and not an ideal instrument for carrying out the real economic objectives of Islam. Therefore, this instrument should be used as a transitory step taken in the process of the Islamization of the economy, and its use should be restricted only to those cases where mudarabah or musharakah are not practicable.

2. The second important point is that the murabahah transaction does not come into existence by merely replacing the word of "interest" by the words of "profit" or "mark-up". Actually, murabahah as a mode of finance has been allowed by the Shariah scholars with some conditions. Unless these conditions are fully observed, murabahah is not permissible. In fact, it is the observance of these conditions which can draw a clear line of distinction between an interest-bearing loan and a transaction of murabahah. If these conditions are neglected, the transaction becomes invalid according to Shariah.

Basic features of Murabahah Financing: 45

1. Murabahah is not a loan given on interest. It is the sale of a commodity for a deferred price which includes an agreed profit added to the cost.

2. Being a sale, and not a loan, the murabahah should fulfil all the conditions necessary for a valid sale, especially those enumerated earlier in this chapter.

3. Murabahah cannot be used as a mode of financing except where the client needs funds to actually purchase some commodities. For example, if he wants

45 http://www.kantakji.com/fiqh/files/Finance/Murabaha.htm
funds to purchase cotton as a raw material for his ginning factory, the Bank can sell him the cotton on the basis of murabahah. But where the funds are required for some other purposes, like paying the price of commodities already purchased by him, or the bills of electricity or other utilities or for paying the salaries of his staff, murabahah cannot be effected, because murabahah requires a real sale of some commodities, and not merely advancing a loan.

4. The financier must have owned the commodity before he sells it to his client.

5. The commodity must come into the possession of the financier, whether physical or constructive, in the sense that the commodity must be in his risk, though for a short period.

6. The best way for murabahah, according to Shariah, is that the financier himself purchases the commodity and keeps it in his/she own possession, or purchases the commodity through a third person appointed by him/her as agent, before he/she sells it to the customer. However, in exceptional cases, where direct purchase from the supplier is not practicable for some reason, it is also allowed that he/she makes the customer himself/herself his/her agent to buy the commodity on his/her behalf. In this case the client first purchases the commodity on behalf of his financier and takes its possession as such. Thereafter, he/she purchases the commodity from the financier for a deferred price. His/her possession over the commodity in the first instance is in the capacity of an agent of his financier. In this capacity he/she is only a trustee,
while the ownership vests in the financier and the risk of the commodity is also borne by him as a logical consequence of the ownership. But when the client purchases the commodity from his financier, the ownership, as well as the risk, is transferred to the client.

7. As mentioned earlier, the sale cannot take place unless the commodity comes into the possession of the seller, but the seller can promise to sell even when the commodity is not in his possession. The same rule is applicable to Murabahah.

8. In the light of the aforementioned principles, a financial institution can use the Murabahah as a mode of finance by adopting the following procedure:

   **Firstly:** The client and the institution sign an over-all agreement whereby the institution promises to sell and the client promises to buy the commodities from time to time on an agreed ratio of profit added to the cost. This agreement may specify the limit upto which the facility may be availed.

   **Secondly:** When a specific commodity is required by the customer, the institution appoints the client as his agent for purchasing the commodity on its behalf, and an agreement of agency is signed by both the parties.

   **Thirdly:** The client purchases the commodity on behalf of the institution and takes its possession as an agent of the institution.

   **Fourthly:** The client informs the institution that he has purchased the commodity on his behalf, and at the same time, makes an offer to purchase it from the institution.
Fifthly: The institution accepts the offer and the sale is concluded whereby the ownership as well as the risk of the commodity is transferred to the client.

All these five stages are necessary to effect a valid murabahah. If the institution purchases the commodity directly from the supplier (which is preferable) it does not need any agency agreement. In this case, the second phase will be dropped and at the third stage the institution itself will purchase the commodity from the supplier, and the fourth phase will be restricted to making an offer by the client. The most essential element of the transaction is that the commodity must remain in the risk of the institution during the period between the third and the fifth stage. This is the only feature of murabahah which can distinguish it from an interest-based transaction. Therefore, it must be observed with due diligence at all costs, otherwise the murabahah transaction becomes invalid according to Shariah.

9. It is also a necessary condition for the validity of murabahah that the commodity is purchased from a third party. The purchase of the commodity from the client himself on 'buy back' agreement is not allowed in Shariah. Thus murabahah based on 'buy back' agreement is nothing more than an interest based transaction.

10. The above mentioned procedure of the murabahah financing is a complex transaction where the parties involved have different capacities at different stages.
(a) At the first stage, the institution and the client promise to sell and purchase a commodity in future. This is not an actual sale. It is just a promise to effect a sale in future on murabahah basis. Thus at this stage the relation between the institution and the client is that of a promisor and a promise.

(b) At the second stage, the relation between the parties is that of a principal and an agent.

(c) At the third stage, the relation between the institution and the supplier is that of a buyer and seller.

(d) At the fourth and fifth stage, the relation of buyer and seller comes into operation between the institution and the client, and since the sale is affected on deferred payment basis, the relation of a debtor and creditor also emerges between them simultaneously.

All these capacities must be kept in mind and must come into operation with all their consequential effects, each at its relevant stage, and these different capacities should never be mixed up or confused with each other.

11. The institution may ask the client to furnish a security to its satisfaction for the prompt payment of the deferred price. He may also ask him to sign a promissory note or a bill of exchange, but it must be after the actual sale takes place, i.e. at the fifth stage mentioned above. The reason is that the promissory note is signed by a debtor in favour of his creditor, but the relation of debtor
and creditor between the institution and the client begins only at the fifth stage, whereupon the actual sale takes place between them.

12. In the case of default by the buyer in the payment of price at the due date, the price cannot be increased. However, if he has undertaken, in the agreement to pay an amount for a charitable purpose, as mentioned in the rules of Bai’ Mu’ajjal, he shall be liable to pay the amount undertaken by him. But the amount so recovered from the buyer shall not form part of the income of the seller / the financier. He is bound to spend it for a charitable purpose on behalf of the buyer.

CHAPTER III

ISLAMIC BANKING IN INDONESIA

(BANK MUAMALAT)

A. General overview of Bank Muamalat Indonesia46

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46 www.muamalatbank.com
PT Bank Muamalat Indonesia Tbk was established in 24 Rabius Tsani 1412 H or November 1, 1991, endorsed by the Indonesian Council of Ulemas (MUI) and the Government of Indonesia, and commenced operations in 27 Syawwal 1412 H or May 1, 1992. Supported by the Indonesian Association of Moslem Intellectuals (ICMI) and a group of Moslem entrepreneurs, the founding of Bank Muamalat also won the support of the general public, evidenced by a Rp 84 billion pledge for the purchase of the Bank's shares on the date when the Articles of Association was signed. Thereafter, in a special meeting commemorating the founding at the Presidential Palace in Bogor, West Java, additional pledges from communities in West Java were raised to reach a total of Rp 106 Billion.

On October 27, 1994, barely two years from its founding, Bank Muamalat received its license to operate as a Foreign Exchange Bank. This recognition strengthened the Bank's position as the first and leading sharia (Islamic) bank in Indonesia with a growing array of products and services.

In the late 90s, Indonesia was hit by a financial crisis which devastated most of the national economies in the Southeast Asia region. The national banking sector collapsed under the burden of corporate debt overhang, which also impacted Bank Muamalat. In 1998, our Non-Performing Financing (NPF) ratio exceeded 60%. The Bank endured a loss of Rp 105 billion, which brought our
equity to its lowest level ever of Rp 39.3 billion, less than a third of our original paid up capital.

In an effort to strengthen its capital base, Bank Muamalat solicited for a potential investor, which was responded positively by the Islamic Development Bank (IDB) based in Jeddah, Saudi Arabia. In the Annual General Meeting of Shareholders of Bank Muamalat on June 21, 1999, IDB officially became one of the shareholders of BMI. Thus, the period between 1999 and 2002 represents times of challenges as well as triumphs for Bank Muamalat. During this period, Bank Muamalat succeeded in reversing its financial fortunes from loss back into profitability. This is achieved through the dedicated hard work of the entire Muamalat Crew, supported by strong leadership, astute business strategy, and strict adherence to the principles of sharia in all aspects of its banking practice.

Through these difficult times, however, Bank Muamalat persevered and was triumphant. Starting with the appointment of a new management board which was composed exclusively by personnel promoted from within the Bank’s own ranks, Bank Muamalat proceeded to deploy a five-year business plan which emphasizes on:

(i) non-reliance on further additional capital from shareholders,

(ii) not resorting to a cutback from the existing personnel of the Bank, while also ensuring that any cost-efficiency measures taken do not impinge on the rights of the Muamalat Crew,
(iii) recovery of employee self-confidence as the first-year priority for the new management of the Bank,

(iv) second-year priority on building a new foundation of business growth through the strengthening of work discipline within Bank Muamalat, and

(v) developing milestones in business achievements through the creation and pursuit of business opportunities in the third and succeeding years.

With the Grace of Allah Rabbul Izzati, this plan ultimately brought Bank Muamalat to a new era of growth entering 2004 and onwards.

Presently, Bank Muamalat provides services to excess of 2.5 million customers through 275 outlets spread across 33 provinces in Indonesia. The network is also supported by alliance, through more than 4000 Online Post Office/SOPP, 32,000 ATMs, as well 95,000 debit merchant across the country.

Besides, BMI is currently the first and only Indonesian bank running its full branch in Kuala Lumpur, Malaysia. To improve accessibility to customers in Malaysia, BMI works on cooperation with the Malaysian Electronic Payment System (MEPS) network, so that BMI can be accessed in more than 2,000 ATMs in Malaysia. As The First Purely Sharia Bank in Indonesia, Bank Muamalat committed to deliver banking services that not only comply to sharia, but also competitive and accessible to the public. The appreciation is continue to come from the government, mass media, national and international institutions through more than 70 prestigious awards received by BMI in the last 5 years including as
The Best Islamic Bank in Indonesia 2009 by Islamic Finance News (Kuala Lumpur), as The Best Islamic Financial Institution in Indonesia 2009 by Global Finance (New York) as well as The Best Islamic Finance House in Indonesia 2009 by Alpha South East Asia (Hong Kong).

Vision

To become the premier shariah bank in Indonesia, dominant in the spiritual market, admired in the rational market.

Mission

To become a ROLE MODEL among the world's sharia financial institutions, emphasizing in entrepreneurial spirit, managerial excellence, and innovative investment orientation to maximize value to stakeholders.

THE MANAGEMENT OF THE BANK MUAMALAT INDONESIA

Shariah Supervisory Board
Chairman: KH. Ma’ruf Amin
Members:
Prof. Dr. H. Umar Shihab
Prof. Dr. H. Muradi Chatib
B. The Implementation of Murabaha in Bank Muamalat Banking System in Indonesia

Murabaha is applied in Bank Muamalat Indonesia whereby the Bank will buy any halal goods that you need and then sell them to you to be paid periodically / installments according to their ability.\textsuperscript{47} This facility can be used to deal with your business needs (either working capital or investment: procurement of capital goods such as machinery, equipment, etc.) or private needs (e.g. purchase of motor vehicles, homes, etc.)\textsuperscript{48}

\textsuperscript{47} http://www.muamalatbank.com/index.php/home/produk/jualbeli_murabahah
\textsuperscript{48} Interview with Ahmad Fauzi, Financing Division, Bank Muamalat Indonesia, 05 November 2010
Murabahah mechanism can be used for procurement of goods, working capital, construction of houses and others. Here are some examples of applications of murabahah mechanism in Islamic banking:

1. Procurement of Goods

   This transaction is carried out by Islamic banks with the principle of buying and selling - murabaha, such as procurement of motorcycles, refrigerators, demand for investment goods for factories and the like. If a customer wants to buy a fridge, he can go to the Islamic bank and then apply for the bank to purchase it. If the customer qualifies for financing through murabaha, the bank will purchase the refrigerator and then resell it to the customer with an agreed profit margin. So if the refrigerator costs Rp. 4.000.000- and the banks profit margin is determined at RP. 800.000, the installment payments over two years will be set at Rp. 200.000,- per month. Other costs also borne by the customer is obliged insurance fees, notary fees or costs to third parties.49

2. Working Capital (Working Capital Goods)

   Provision of supplies for working capital can be done with the principle of buying and selling - murabahah. However, the transaction is valid for the purchase of goods for working capital and not cash or money.50

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49 Wiros, _Jual Beli Murabahah_, (Yogyakarta, UII Press, 2005), h.137
50 Ibid page 57
Because, if the working capital financing is in the form of money, using the murabaha mechanism, then the transaction is the same as consumer finance (consumer finance) in conventional bank which will consist of interest.

3. Home Improvement (Home Improvement Materials Procurement)

Any items needed for home renovations, such as red brick, tile, paint, wood etc. can be financed under the murabaha scheme.
Simulation of Murabahah

PT TERUS MAJU is a company doing printing business, needs a printing machine priced at IDR 100,000,000. PT TERUS MAJU subscribed to a machine

Simulasi of murabahah

http://www.muamalatbank.com/index.php/home/produk/jualbeli_simulasi_murabahah

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[^51]: http://www.muamalatbank.com/index.php/home/produk/jualbeli_simulasi_murabahah
supplier, namely PT. TRAKANTA. PT TERUS MAJU applies Murabaha facility to Bank Muamalat.

Following the review of balance sheets, financial reports and sources of repayments of PT. TERUS MAJU by our Account Manager, Bank will approve the Murabaha financing facility as follows:

1. COGS from Supplier is IDR 100,000,000
2. Margin for Bank Muamalat (Margin equals to 20% pa. effective) is IDR 22,149,950
3. Selling Price to PT TERUS MAJU (Selling Price = COGS + Margin) is IDR 122,149,950
4. Administration Fee is IDR 1,000,000
5. Appointed Supplier is PT. TRAKANTA
6. Term of Payment is 24 months
7. Installment / month is IDR 5,089,580/month

C. Determining the profit margin

An Islamic bank puts on a margin of profit to the financing products under natural certainty contracts (NCC), such as murabaha, ijarah, ijarah muntahia bit tamlik, salam and istishna. They are business contracts that provide payment certainty, both in terms of amount and timing.

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52 Cost that are directly related to the selling activities, such as cost of transport, packaging, and other elements normally categorised as costs of goods sold
53 Karim, Adiwarman, *Islamic Banking Fiqh and Financial Analysis* (PT RAJAGRAFINDO PERSADA) pg 276
Technically, a profit margin is a certain percentage that is fixed per one calculation year. Under a daily calculation, then the percentage is to be divided by number of the days within a year, which is set to be 360 days; under a monthly profit margin calculation, it is to be divided by the number of months in a year, or 12 months.

In general, clients repay their financing in instalment. Invoices that arise from the sale and purchase or lease transactions under murabaha, salam, and or ijarah are called as receivables. The total amount of receivables depends or each financing plafond given. A financing plafond is the total financing a bank provides a client with, which equals to the bank’s purchasing cost plus the profit margin, as mentioned in the financing agreement.

**Profit Margin Reference**\(^{54}\)

A profit margin reference is the profit margin determined by an Islamic bank at the ALCO\(^{55}\) meeting. The profit margin required for each financing is established on the basis of recommendations, suggestions, and proposals from an Islamic bank’s ALCO team, by taking into account the following aspects:\(^{56}\)

1. **Direct Competitor’s Market Rate (DCMR)**

A Direct Competitor’s Market Rate (DCMR) is the average profit margin in the Islamic banking industry; or the average profit margin of several

\(^{54}\) *Ibid*

\(^{55}\) Or an internal "Assets and Liabilities Committee," which is normally established in Bank Muamalat Indonesia.

\(^{56}\) Interview with Ahmad Fauzi, Financing Supporting Division, Bank Muamalat Indonesia, 05 November 2010
Islamic banks considered at the ALCO meeting as a group of direct competitors; or the average margin of a particular Islamic bank considered at the ALCO meeting as a closest, direct competitor.

2. *Indirect Competitor’s Market Rate (ICMR)*

    An *Indirect Competitor’s Market Rate* (ICMR) is the average interest rate in the conventional banking industry, or the average interest rate of some conventional banks considered at the ALCO meeting as a group of indirect competitors, or the average interest rate of a particular conventional bank considered at the ALCO meeting as a closest indirect competitor.

3. *Expected Competitors Return for Investors (ECRI)*

    An *Expected Competitors Return for Investors* (ECRI) is the competitive profit-sharing target that expected to be shared to a third party fund provider.

4. *Acquiring Cost*

    An acquiring cost is the additional cost expensed by the bank that is directly related to its effort in obtaining a third-party fund.

5. *Overhead Cost*

    An *overhead cost* is the cost expensed by the bank that is not directly related to its effort in obtaining a third-party fund.
Determining A Selling Price\textsuperscript{57}

Once the bank has made a profit margin reference available, it undertakes to set a selling price. A selling price is the total addition of the bank’s buying (or its acquiring cost) and its [required] profit margin.

Calculating the Instalment Rate for a Selling Price\textsuperscript{58}

Instalment of a selling price consists of a partial payment of the bank’s buying price (principal price) plus a partial payment of its profit margin. The instalment can be calculated by using any of the four methods as follow:

1. A Sliding Profit Margin Method;
2. A Profit Margin Average Method;
3. A Flat Profit Margin Method; and,
4. A Profit Margin as Annuity Method.

1. A Sliding Profit Margin Method

The \textit{sliding profit margin} method calculates a sliding profit margin along with the decreasing value of the principal price due to the instalment. The amount of the instalment (of the bank’s buying price plus its profit margin) that a client pays every month thus slides.

\textsuperscript{57} Karim, Adiwarman, \textit{Islamic Banking} pg 276
\textsuperscript{58} Ibid
2. A Profit Margin Average Method

A *Profit Margin Average* method calculates a sliding margin on a fixed basis. The amount of each instalment (of the principal price plus the profit margin) that client pays every month is fixed.

3. A Flat Margin Method

A *Flat Profit Margin* method calculates a fixed profit margin along with a fixed value of the principal price from one period to another, although the principal balance diminishes as a result of the instalment of the principal/buying price.

4. A Profit Margin as Annuity Method

A *Profit Margin as Annuity* method calculates a profit margin as annuity. An annuity calculation is a method calculating financing repayment by fixed instalments of the principal price and profit margin. This calculation produces a pattern of increasing instalment of the principal price, while the profit margin diminishes.

**Requirements for Calculating a Profit Margin**

A profit margin can be calculated only if the following components are available:

1. The type of profit margin calculation method.
2. The financing plafond according to type.

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59 Karim, Adiwarman, *Islamic Banking Fiqh*, pg276
3. The profit margin rate required from financing.

4. The collection mode of receivables or the duration of receivables (both the acquiring cost and profit margin)

A receivable collection date is excluded in the calculation of a daily profit margin.

D. Nominating an agent or representatives (Wakalah)

In context of banking, wakalah arises when a client authorises the bank to represent him or her in carrying out a certain job, such L/C book-balancing, bill collection, or money transfer.

Both the bank and the client subjected under the authorisation contract must be legally capable. Especially for the opening of an L/C, if the client’s funds are inadequate, the L/C settlement can be done through murabaha.\(^{60}\)

Usually in a murabaha scheme, the client would request financing for a certain commodity, the bank would then purchase the commodity and re-sell it to the customer at an agreed profit margin whereby the customer would settle the payment in instalments.

For example, the client wishes to purchase a house, the bank would nominated the client as an agent (wakalah agreement) to purchase the house on behalf of the bank from the third party (supplier). Once the bank is informed of the purchase, the bank draws up a murabaha contract whereby the bank re-sells the house to the client at an agreed profit margin.

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\(^{60}\) Karim, Adiwarman, *Islamic Banking Fiqh*, p. 107
MUI Fatwa No.04/DSN-MUI/IV/2000 April 1, 2000\(^1\) (26 Dzulhijjah H 1420) have established that if the Bank nominates the customer as an agent to buy goods from a third party, then the sale and purchase agreement (murabahah) should be done after the goods are owned by the Bank. In other words, granting authority (Wakalah) from the Bank to the Customer or any third party, must be done before the contract of sale and Murabahah happens.

Bank Indonesia (BI) seems pretty explicit in this regard. Bank Indonesia Regulation (PBI) No.7/46/PBI/2005 dated 14 November 2005\(^2\) on the standardization of contract, the central bank reiterates the use of Wakalah in the in article 9, paragraph 1, point d in the case of the Customer representing the bank (Wakalah) for buying of goods, then Murabahah should in principle be done after the goods become the property of the Bank. Then asserted, which is in principle the Bank's Articles of Agreement in Wakalah Murabaha is the flow of funds directed to suppliers of goods or evidenced by receipt of purchase.

E. The Tax System applied on Murabaha

Under the law, which came into effect in April, when a lender extends finance to a client through a murabaha scheme, it technically buys an item or product and then sells it to the client at a profit, thus avoiding charging interest.

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\(^1\) Bank Indonesia Regulation No. 7/46/PBI/2005 Funds Mobilization And Financing Agreements For Banks Conducting Business Based On Sharia Principles http://www.bi.go.id/web/en/Peraturan/Perbankan/pbi+74605+eng.htm

\(^2\) http://www.pspsyariah.com/index.php?ctn=produk
Previously tax was charged on both sales, that of the original vendor and then subsequently from the bank, though under the new legislation the sale and resale will be treated as a single transaction for tax purposes.\textsuperscript{63}

Up to now, there is only a handful of tax regulation that particularly covers Islamic finance, which are only high level tax regulation. In the past, no specific tax regulations were available to govern Islamic finance taxation. It resulted in some unfavourable situation for the Islamic banking industry, specifically in Murabahah transactions\textsuperscript{64}. In the latest Income Tax Law and Value Added Tax (VAT) Law, Islamic finance is accommodated to the extent that the tax authority is trying to create a level playing field between Islamic finance and conventional financial institutions. Under the new VAT Law, which came into effect in April 2010, VAT imposition on Syariah transactions will only be applicable on the delivery of goods from the VATable entrepreneur to the party that demanding the goods. The example set out in the Law is of a Murabahah transaction whereby a syariah bank is financing a purchase of a car for a customer. Under the Syariah financing, the bank will have to purchase the car from the car dealer (VATable entrepreneur) and later on sell it to the customer. In the new VAT Law, the VATable delivery of goods is considered to be directly from the car dealer to the customer. The interpretation would be that no sale and purchase has been conducted by the bank between the car dealer and the

\textsuperscript{63} Interview with Ahmad Fauzi, Financing Supporting Division, Bank Muamalat Indonesia, 05 November 2010
\textsuperscript{64} http://www.pwc.com/en_ID/id/publications/assets/FSNewsFlash-02-2010.pdf
customer, and thus no VAT is due on the legal transaction in which the bank purchases the car from the car dealer and sells it to the customer. The VATable event would only be on the initial sale from the car dealer (considered directly) to the customer. The above seems to resolve the VAT issue on Murabahah transactions. However, for the old market player, the VAT exposure on the past Murabahah transaction that was entered into prior to 1 April 2010 is still there. Based on the practice in the field, we have seen assessments imposed to several banks, even after the new VAT Law was launched. In addition, Islamic finance is not all about Murabahah. There are other underlying transactions which may involve other type of transaction (non-trading) such as rental which is also a VAT object in nature, and yet not covered under the Islamic finance part in the new VAT Law, although most of the financial services covered in the negative list of VAT is also applicable for Syariah-based activities. For example, Ijarah transaction that imitate finance lease or sale and lease back transaction. On the finance lease type, it needs to be considered whether it can fall under the finance lease with option right that is exempted from VAT under the new VAT Law. This is considering that the existing tax regulation has certain requirements for a transaction to be categorized as finance lease, one of which is that the lessor must be a financing or leasing company with license from Ministry of Finance and doing leasing activities. If the lessor in the Ijarah transaction does not fulfill this criterion, potentially, the VAT will not be exempted. Furthermore, there is still a dispute area in the conventional sale and lease back transaction whereby the tax
authority consider it as a true sale and thus subject to VAT. Therefore, Ijarah transaction that is imitating sale and lease back transaction may also end up with the same potential VAT exposure.\textsuperscript{65}

\textsuperscript{65} http://www.pwc.com/en_ID/id/publications/assets/FSNewsFlash-02-2010.pdf
A. General overview of Al Barakah bank in South Africa\textsuperscript{1}

Al Baraka Bank Limited was established in 1989 and its activities are directed mainly at the 2\% of Muslims in the population of South Africa. It has 135 employees covering its Durban head office and four branches in Durban, Johannesburg, Pretoria and Cape Town. The bank collects deposits and provides financial facilities – trade, asset based motor vehicle and property finance - mainly through murabaha and musharaka - to its customers.

The strength of Muslim presence is manifesting in the establishment of Islamic Banking in a predominantly Western environment in sync with the trends in a global context. Though interest (\textit{riba}), the primary reason for Islamic finance, is strictly prohibited in the Qur'an, revealed over 1400 years ago, the obliging responsibility to refrain from interest (\textit{riba}) is becoming increasingly conscious in the last decades. Muslims residing all over the Western world are increasingly looking for Shari'ah compliant financial institutions to deal with.

Al Baraka Bank is the leading Islamic bank in South Africa. The bank is owned by South African investors, DCD London and Mutual Plc, a company incorporated in London and Wales, and the Saudi Arabian based Dallah Al Baraka

\textsuperscript{1} http://www.barakaonline.com/default.asp?action=article&ID=143
group. The bank is well established in South Africa as an institution striving to operate totally within the confines of Shari'ah compliance banking. The bank also has to abide by the South African Banking regulations.

Al Baraka has its' headquarters in Durban, South Africa and six branches in different regions of the country. The addition of a corporate branch attached to the existing Cape Town branch will bring their corporate financing to two branches. The Board of Shari'ah Advisors consists of South African highly learned scholars who interact periodically with the international Board of Advisors of the Al Baraka group. In addition to the Board of Advisors, within the precincts of each branch a regulatory officer checks each transaction to exclude any misdemeanor that may have crept into a transaction. The bank has a both Muslim and non Muslim clientele. A senior official at the bank attribute this interest from non Muslims to the better proposition regarding asset financing. Conventional South African banks have the highest interest rates in the country. The prime interest rate on a residential home loan is at 15, 50 percent. Personal loans interest rates vary from 18 to 44 percent per annum. Al Baraka offers a fixed rate repayment scheme over a seven and ten year period. The bank however offers no credit cards and personal loans. The bank offers the services of:

*Murabaha* (Cost plus financing)

This is the financing scheme used for financing any fixed asset such as a residential property. The loan period is over seven years. An additional
percentage rate varying around 60 percent of the cost price is added to the price and spread over a repayment agreement of seven years.

*Musharakah* (Partnership Financing)

This is a fixed asset financing scheme between two parties. The bank finances the project and a pre-agreed arrangement regarding profit and loss sharing is between the concerned parties. Repayment to the bank is over a ten year period with a rate varying annually.

*Ijara & Ijara-wa-Iktina* (Leasing)

*Ijara* financing is a pioneering scheme for the bank. Inception is August 2008. Clients will have the option of choosing between *Murabaha* and *Ijara*.

*Takaful* (Insurance)

*Takaful*, South Africa is a subsidiary of the world wide Hanover Reinsurance group. *Takaful* provides cover to clients on goods ranging from fixed assets to moveable property.

The *Takaful Waqf* Fund operates in participation with *Takaful* and all excess funds are channeled to Shari’ah compliant projects. This fund has become an instrument in South Africa's much needed social upliftment and development.

The same principle that applies to Equity Investment companies is applicable to the *Takaful Waqf Fund*. All companies that are Shari’ah approved in their business practices are deemed allowed for *Takaful Waqf* Investment.

The *Waqf* Fund is interest (*riba*) free and this condition is governed by the Al Baraka Board of Shari’ah Advisors.
In line with common conventional banking practices the bank offers the usual banking services in addition to a Haj Investment scheme. This is a scheme for individuals and organizations who wish to proceed for the pilgrimage. A minimum fixed amount is deposited every month and a share of profits is earned monthly.

Major conventional banks in South Africa, First National Bank and Absa Bank have started incorporating Islamic windows along side conventional banking practices. Islamic bankers ascribe this to the strength of Muslims seeking Shari’ah compliance in Islamic banking. For the discerning Muslim the principle Institution remains entrenched in interest (riba) goal oriented practices.

Another concern of the minimal Islamic Bankers in the country is the allowance of conventional banks to borrow from the government controlled South African Reserve Bank. This of course would be an interest laden loan. The concern with conventional banks introducing Islamic windows is the overlap of the pool of finances available between the conventional section and Shari’ah compliant section.

INVESTMENT:

Al Baraka also offers investments. The Futuregrowth Al Baraka Equity Fund consists of shared investments on the South African Stock Exchange.

Albaraka offers an investment account, and Fraters and Stanlib are the other investment companies offering shared investment.
The best performing Asset Management in South Africa is the Oasis Group Holdings. The company has grown from its Cape Town regional offices to national and international occupation. It now has international offices in Dublin and Dubai. The company offers the best return on investments at present. The Oasis Crescent Equity Fund, which in June celebrated 10 years since inception, announced a return of 31.8 percent per annum. The company is also exclusive on offering a Shari'ah compliant Property Fund.

Internationally the company was the recipient of the Failaka Islamic Fund Award for two consecutive years. In 2006 the Oasis Asset Management received the Kuala Lumpur Islamic Finance Forum Award for outstanding Islamic Fund Manager.

The company has an international Board of Shari'ah Advisors of which Sheikh Yusuf de Lorenzo; the international renowned scholar is a member.

ETHICS

Interest (riba) is prohibited in explicit versus (Ibarat Al Nass) in the Qur'an. Therefore no consultation (Ijma) or analogy (qiyas) is entertained.

However, Public Interest (Maslahah Mursalat) has become a contentious issue in respect of interest (riba). Equity (Istihsan) is another element in Islamic Law some scholars have used to seek divergence from the explicit prohibition of interest (riba).

Equity is a term related to fairness and conscientiousness. Islam is sensitive to rigidity and unfairness. When personal reasoning (ijtihad) is
employed in order to arrive at equity, the instruments are the Qur’an, the practices of the Prophet Muhammed (Peace be upon him), analogy (qiyas) and consensus (ijma). The procedure prevents deviation from the framework of Islam.

Essential (darurah) requirements intrinsically get linked to economics. Changes in different aspirations have called for consensus to review or amend interest (riba) in view of essentials (darurah). The factor overlooked is consensus is only valid in the absence of clear direction in the Qur’an. Interest (riba) is clearly defined as prohibited and essentials inhibit too many variations. Different populations in different regions present different definitions of essentials (darurah). Globally Islam lacks a universal body to validate required components for issues qualifying essentials (darurah).

Corporate Profile

Albaraka Bank, registered in South Africa since 1989, pioneered Islamic banking in this country in response to the need for a system of banking in line with Islamic economic principles.

The bank is jointly owned by South African investors. DCD London & Mutual Plc, a company incorporated in England and Wales, and the Saudi Arabian-based Dallah Al Baraka Group, which - as part of its diversified business operations - has established one of the largest international Islamic banking groups in the world through the Albaraka Banking Group, Albaraka Bank’s board comprises both local and international business people with individual professional and management abilities and collective expertise in the Islamic banking industry.
All of Albaraka Bank's products and services promote the understanding and adoption of Islamic business principles and so contribute to the socio-economic development of the community. Since its inception, the bank has shown impressive growth.

The bank's success may be attributed to its niche market's faith and confidence in its ability to implement and further develop a viable alternative to interest-based banking in South Africa.

Albaraka Bank's track-record to date is indicative of a growing market's increasing acceptance of an alternative system of banking in South Africa.

**Mission**

We are dedicated to becoming the leader in the promotion of socio-economic development through the application of Islamic Economic Principles and Values, providing optimum returns to our shareholders and investors through partnership banking on a risk-reward sharing basis.

**Vision**

Albaraka Bank as an organisation endeavours to reflect the Islamic Economic System in all its operations. We desire to be an institution responsive to the socio-economic needs of the people of Southern Africa irrespective of religion, race or gender.

At Albaraka, through creativity and innovation, Albaraka strives to establish a stimulating and challenging environment equipped with the latest technology so as to develop products and services which will meet the needs of the people as well as provide optimum returns for our shareholders and investors.
Ultimately Albaraka envisage an economic order in which employees and clients will realise the opportunities presented to them for their economic growth and social well-being in accordance with Islamic Economic Principles.

THE MANAGEMENT OF ALBARAKA SOUTH AFRICA

Board of directors

During the 2009 financial year Al Baraka Bank’s board of directors comprised the following members:

**Non-executive**

AA Yousif, Chairman (Bahraini) MBA

SA Randeree, Vice Chairman (British) BA (Hons) MBA

OA Suleiman (Sudanese) BC Jon Economics

M Youssef Baker (Egyptian) B.Sc. Economics and Political Science

**Independent non-executive**

F Kassim (Sri Lankan) Executive Management Programme – Harvard Business School

A Lambat CA (SA)

Adv. AB Mahomed SC BA LLB Senior Counsel of the High Court of South Africa

MS Paruk CA (SA)

YM Paruk Director of companies

http://www.albaraka.co.za/Legal_Infomation/Company_Registration.aspx
Executive

SAE Chohan, Chief Executive CA (SA)

MG McLean, Deputy Chief Executive Advanced Executive Programme - UNISA

MJD Courtiade, Financial Director (French) CA (SA)

Advisor

Prof. S Cassim MCom; University Higher Diploma in Education

Company secretary

CT Breeds BA LLB

Shariah Supervisory Board

Dr AS Abu Ghudda, Chairman (Syrian)

Mufti SA Jakhura, Member

MS Omar, Member
B. The Implementation of Murabaha in Albaraka Bank banking system

Internationally, Islamic banks continue to develop economically sound financial packages to accommodate modern trends in the business world. Over the years financial products have been put in place very successfully in order to promote the growth and development of businesses.

Al Baraka Bank has kept pace with these developments and introduced financial products to suit local market conditions. These products now serve the
business community by providing them with structured packages for the purchase of equipment and machinery.

Al Baraka Bank has successfully implemented the Murabaha sale with repayments on an instalment basis as a method of financing for all assets, which includes business equipment, industrial machinery and commercial vehicles.

In a Murabaha sale transaction ownership of the asset is transferred to the client immediately. Both parties agree at the outset of the Murabaha contract on the profit mark-up and the period and terms of the repayment. These terms cannot be changed for the duration of the transaction.

Figure 5: Murabaha Module
Structured packages are advantageous as they allow a business to plan better for growth, development and the upgrading of equipment. Because the price and instalments are fixed, forecasts and profitability are easier to predict regardless of market volatility which could otherwise impact on the cash flow of the business.\(^3\)

Murabaha in its original Islamic connotation is simply a sale having nothing to do with financing in its original sense. The main feature distinguishing it from other kinds of sale is that the seller expressly tells the purchaser how much cost he has incurred and how much profit he is going to charge in addition to the cost. By simply selling a commodity without mentioning the cost plus the profit is not a murabaha sale but is called “musawamah”. The main feature of murabaha financing is that it is ASSET BASED and not a loan.

Albaraka bank uses the “Murabaha to the purchase orderer” transaction to satisfying the needs of Muslim consumers in South Africa who needs to purchase assets on a deferred payment basis and who are looking for alternative finance to the existing interest based loans offered by the conventional banks.

To give effect to the murabaha transaction the following procedure will be implemented;\(^4\)

1. The consumer submit an application to the Bank for the purchase of the asset on a “murabaha, to the purchase orderer”, basis.

\(^3\) http://www.albaraka.co.za/Finance/Asset_Based_Finance.aspx
\(^4\) Interview with Mr Nazeem Abdurahmaan, Senior Consultant at Albaraka Bank South Africa, 03 December 2010
2. The consumer promises to purchase the said asset.
3. The bank sends the consumer a reply, which may state, the following among other things:
   ✓ that it has approved or has not approved the consumer’s application for the purchase of the asset on a murabaha basis.
   ✓ That the bank appoints the consumer as its agent to conclude the first sale on its behalf
   ✓ The price at which the bank is prepared to sell the property to the consumer;
   ✓ Any other fact or matter which the bank in its sole discretion consider relevant, including the provision of security.
4. The bank appoints the consumer as its agent for the purpose of concluding the first sale and taking transfer of the asset under the first sale on the banks behalf.
5. The consumer enters into the first sale with the supplier on the banks behalf.
6. The first sale shall be deemed to be completed on registration of transfer of the asset.

Albaraka bank finances the following assets under “Murabaha to the purchase orderer”
3. Equipment finance
4. Trade finance
Murabaha, as previously stated, originally is a particular type of sale and not a mode of financing. The ideal mode of financing according to Shariah is Mudarabah OR Musharakah. However in the perspective of the current economic set up and demands from clients, there are certain practical difficulties in using mudarabah and musharakah instruments in some areas of financing. 5

South Africans are obsessed with home ownership and prefer to be the outright owner of their properties as opposed to being a joint partner with the bank in the ownership. Musharakah financing does not appeal to South Africans with regard to property finance, and is not practical in motor vehicle finance and equipment finance; therefore customers prefer murabaha transactions when purchasing movable and immovable assets.

The non Muslims are even more impressed with the fixed mark-up concept in murabaha transactions because of the cost saving compared to an interest based fluctuating loan. The contemporary Shariah experts such as Mufti Taqi Usmani have allowed, subject to certain conditions, the use of the murabaha on deferred payment basis as a mode of financing 6. It is only a device that is currently used as an alternative to interest based loans and not an ideal instrument for carrying out the real economic objectives of Islam. It is currently used as a transitory step in the Islamization of the economy, and it is therefore restricted only to those cases where mudarabah or musharakah are not practicable.

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5 Interview with Mr Nazeem Abdurahmaan, Senior Consultant at Albaraka Bank South Africa, 03 December 2010
6 Muhammad Taqi Usmani, *An Introduction To Islamic Finance* (Maktaba MA’ARIF KARACHI 2002) pg 9
C. Determining the Profit-Margin

Albaraka bank uses the “Albaraka Profit Mark-up” as its benchmark. This benchmark is reviewed quarterly by the Board Credit Committee and the decision is communicated to all stakeholders. The benchmark does not only follow the fluctuation of the interest prime rate but will be determined by internal and external factors affecting Albaraka bank. Some of the factors will be:

1. Laws and regulations of South Africa
2. The cash flows of Albaraka bank as well as external stakeholders.
3. The market conditions
4. Stability at Albaraka bank
5. Competition
6. Uncertain future circumstances
7. Supply and demand for funds.
8. Inflation
9. Domestic and national savings
10. The return the bank wishes for its depositors as well for itself

The responsibility of determining the benchmark is entrusted upon the Assets and Liability committee (ALCO) of Albaraka Bank.

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7 Interview with Mr Nazeem Abdurahmaan, Senior Consultant at Albaraka Bank South Africa, 03 December 2010
8 Or an internal “Assets and Liabilities Committee,” which is normally established in most banks.
The Albaraka Profit Mark-up benchmark once determined for implementation is publicized for the benefit of internal use as well as for the public.

Clients requesting that Albaraka bank follows the prime rate will be educated on the nature of an Islamic transaction and the benefits thereof.

D. Nominating an agent or representatives (*Wakalah*)

Albaraka bank and the consumer will firstly enter into an overall agreement whereby the bank promises to sell and the client promises to buy the asset at an agreed profit mark-up. This agreement is to provide assurance that the customer will complete the transaction after the item has been acquired by the bank

1. Albaraka bank then appoints the client as his agent for purchasing the asset on its behalf and an agency agreement is signed by both parties.

2. The client purchases the commodity on behalf of the bank as an agent of the bank.

3. The client informs the bank that he has purchased the asset on the bank’s behalf and at the same time makes an offer to purchase it from the bank.

4. Albaraka bank accepts the offer and the sale is concluded whereby the ownership as well as the risk of the commodity is transferred to the client.

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9 Interview with Mr Nazeem Abdurahmaan, Senior Islamic Financial Consultant at Albaraka Bank South Africa on the 03 December 2010
E. The Tax applied on murabaha

One of the major challenges facing the industry internationally is that tax laws generally cater for conventional banking products. This may lead to differences in tax treatment that may potentially place Islamic banks and their customers at a disadvantage compared to banks with conventional products.\(^\text{10}\)

In a Murabaha property finance transaction there is a double stamp duty (property transfer tax) which is implicit in the Islamic contract because it involves the transfer of title at the front and back end of the transaction because of the two sales. The first sale being when the bank purchases the asset from the seller and thereafter the second sale when the bank sells the asset to the customer at a cost plus profit mark-up.\(^\text{11}\)

Since Albaraka Bank is a member of AAOIFI (Accounting and Auditing Organization for Islamic Financial Institutions, the interpretations of the proposed new tax laws will be if not already referred to the Shariah Board of AAOIFI for a ruling who will give the Shariah opinion in matters requiring collective Ijtihad (reasoning) or to settle divergent points of view, or to act as an arbitrator.\(^\text{12}\)

The tax system does not currently cater for Islamic financing, thereby hindering the growth of South African financial service activities

\(^{10}\) Interview with Mr Nazeem Abdurahmaan, Senior Islamic Financial Consultant at Albaraka Bank South Africa on the 03 December 2010

\(^{11}\) Interview with Mr Nazeem Abdurahmaan, Senior Islamic Financial Consultant at Albaraka Bank South Africa on the 03 December 2010

\(^{12}\) http://www.aaoifi.com/members.html
in this regard. A proposed amendment seeks to place certain *Shari’a* compliant products (Mudarabah, Murabaha and Diminishing Musharaka) on an equal tax footing with conventional finance products. One benefit of the proposal is to provide Islamic savings products with the R22 300/R32 000 exemption for interest available to traditional savings products.\(^\text{13}\)

\(^{13}\) National Treasury releases for public comment a draft of the 2010 Taxation Laws Amendment Bills which give effect to the 2010 Budget tax proposals. The draft legislation and explanatory memorandum can be found on the National Treasury (www.treasury.gov.za) and (www.sars.gov.za) websites.
CHAPTER V
OUTCOME OF RESEARCH

A comparative analysis on the practice of Murabaha between Bank Muamalat in Indonesia and Al-Barakah bank in South African on:

A. The similarities and differences between the Islamic Banking systems on the practice and the implementation of Murabaha

Bank Muamalat Indonesia

It is a financing facility using trading system. Bank will buy any halal goods that you need and then sell them to you to be paid periodically / installments according to your ability. This facility can be used to deal with:

1. business needs (either working capital or investment: procurement of capital goods such as machinery, equipment, etc.) or

2. private needs (e.g. purchase of motor vehicles, homes, etc.)

Albaraka Bank South Africa

In South Africa, Al Baraka Bank has effectively provided trade finance based on these Islamic financing principles. Al Baraka can purchase a commodity at the request of the client and sell the commodity to the client on a Murabaha basis. The selling price which includes a profit and the repayment terms are agreed upon on the date of the Murabaha transaction.
Typically the Bank grants a revolving trade finance facility to the client within this facility. The murabaha facility is utilized for:

3. Equipment finance
4. Trade finance

B. Determining the profit margin

Bank Muamalat Indonesia

A profit margin reference is the profit margin determined by an Islamic bank at the ALCO meeting. The profit margin required for each financing is established on the basis of recommendations, suggestions, and proposals from an Islamic bank’s ALCO team, by taking into account the following aspects:

1. Direct Competitor’s Market Rate (DCMR)
2. Indirect Competitor’s Market Rate (ICMR)
3. Expected Competitors Return for Investors (ECRI)
4. Acquiring Cost
5. Overhead Cost

Requirements for Calculating a Profit Margin

A profit margin can be calculated only if the following components are available:
1. The type of profit margin calculation method.

2. The financing plafond according to type.

3. The profit margin rate required from financing.

4. The collection mode of receivables or the duration of receivables (both the acquiring cost and profit margin)

A receivable collection date is excluded in the calculation of a daily profit margin.

**Al Baraka Bank South Africa**

Albaraka bank uses the “Albaraka Profit Mark-up” as its benchmark. This benchmark is reviewed quarterly by the Board Credit Committee and the decision is communicated to all stakeholders. The benchmark does not only follow the fluctuation of the interest prime rate but will be determined by internal and external factors affecting Albaraka bank. Some of the factors will be:

1. Laws and regulations of South Africa

2. The cash flows of Albaraka bank as well as external stakeholders.

3. The market conditions

4. Stability at Albaraka bank

5. Competition

6. Uncertain future circumstances

7. Supply and demand for funds.

8. Inflation

9. Domestic and national savings
10. The return the bank wishes for its depositors as well for itself

The responsibility of determining the benchmark is entrusted upon the Assets and Liability committee (ALCO) of Albaraka Bank.

The Albaraka Profit Mark-up benchmark once determined for implementation is publicized for the benefit of internal use as well as for the public.

Clients requesting that Albaraka bank follows the prime rate will be educated on the nature of an Islamic transaction and the benefits thereof.

C. Nominating a representative or agent (Wakalah)

Bank Muamalat

The client wishes to purchase a house, the bank would nominated the client as an agent (wakalah agreement) to purchase the house on behalf of the bank from the third party (supplier). Once the bank is informed of the purchase, the bank draws up a murabaha contract whereby the bank re-sells the house to the client at an agreed profit margin.

MUI Fatwa No.04/DSN-MUI/IV/2000 April 1, 2000 (26 Dzulhijah H 1420) have established that if the Bank nominates the customer as an agent to buy goods from a third party, then the sale and purchase agreement (murabahah) should be done after the goods are owned by the Bank. In other words, granting authority (Wakalah) from the Bank to the Customer or any third party must be done before the contract of sale and Murabahah happens.
Bank Indonesia (BI) seems pretty explicit in this regard. Bank Indonesia Regulation (PBI) No.7/46/PBI/2005 dated 14 November 2005 on the standardization of contract, the central bank reiterates the use of Wakalah in the in article 9, paragraph 1, point d in the case of the Customer representing the bank (Wakalah) for buying of goods, then Murabahah should in principle be done after the goods become the property of the Bank. Then asserted, which is in principle the Bank's Articles of Agreement in Wakalah Murabaha is the flow of funds directed to suppliers of goods or evidenced by receipt of purchase.

**Albaraka Bank South Africa**

Albaraka bank and the consumer will firstly enter into an overall agreement whereby the bank promises to sell and the client promises to buy the asset at an agreed profit mark-up. This agreement is to provide assurance that the customer will complete the transaction after the item has been acquired by the bank

1. Albaraka bank then appoints the client as his agent for purchasing the asset on its behalf and an agency agreement is signed by both parties.

2. The client purchases the commodity on behalf of the bank as an agent of the bank.

3. The client informs the bank that he has purchased the asset on the bank’s behalf and at the same time makes an offer to purchase it from the bank.
4. Albaraka bank accepts the offer and the sale is concluded whereby the ownership as well as the risk of the commodity is transferred to the client.

D. The Tax system applied to Murabaha

Bank Muamalat Indonesia

Under the law, which came into effect in April, when a lender extends finance to a client through a murabaha scheme, it technically buys an item or product and then sells it to the client at a profit, thus avoiding charging interest. Previously tax was charged on both sales, that of the original vendor and then subsequently from the bank, though under the new legislation the sale and resale will be treated as a single transaction for tax purposes.

Up to now, there is only a handful of tax regulation that particularly covers Islamic finance, which are only high level tax regulation. In the past, no specific tax regulations were available to govern Islamic finance taxation. It resulted in some unfavourable situation for the Islamic banking industry, specifically in Murabahah transactions. In the latest Income Tax Law and Value Added Tax (VAT) Law, Islamic finance is accommodated to the extent that the tax authority is trying to create a level playing field between Islamic finance and conventional financial institutions. Under the new VAT Law, which came into effect in April 2010, VAT imposition on Syariah transactions will only be applicable on the delivery of goods from the VATable entrepreneur to the party
that demanding the goods. The example set out in the Law is of a Murabahah transaction whereby a syariah bank is financing a purchase of a car for a customer. Under the Syariah financing, the bank will have to purchase the car from the car dealer (VATable entrepreneur) and later on sell it to the customer. In the new VAT Law, the VATable delivery of goods is considered to be directly from the car dealer to the customer. The interpretation would be that no sale and purchase has been conducted by the bank between the car dealer and the customer, and thus no VAT is due on the legal transaction in which the bank purchases the car from the car dealer and sells it to the customer. The VATable event would only be on the initial sale from the car dealer (considered directly) to the customer. The above seems to resolve the VAT issue on Murabahah transactions.

**Albaraka Bank South Africa**

One of the major challenges facing the industry internationally is that tax laws generally cater for conventional banking products. This may lead to differences in tax treatment that may potentially place Islamic banks and their customers at a disadvantage compared to banks with conventional products.

In a Murabaha property finance transaction there is a double stamp duty (property transfer tax) which is implicit in the Islamic contract because it involves the transfer of title at the front and back end of the transaction because of the two sales. The first sale being when the bank purchases the asset from the seller and
thereafter the second sale when the bank sells the asset to the customer at a cost plus profit mark-up.

### Table of comparison

<table>
<thead>
<tr>
<th>Murabaha in the banking system</th>
<th>Bank Muamalat Indonesia</th>
<th>Albaraka Bank South Africa</th>
</tr>
</thead>
<tbody>
<tr>
<td>It is a financing facility using trading system Utilized for:</td>
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<tr>
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</tr>
</tbody>
</table>

### Calculating of the profit margin

The profit margin required for each financing is established on the basis of recommendations, suggestions, and proposals from an Islamic bank’s ALCO team, by taking into account the following aspects:

1. Direct Competitor’s Market Rate (DCMR)
2. Indirect Competitor’s Market Rate (ICMR)
3. Market Rate (ECRI)
4. Expected Competitors Return for Investors (ECRI)
5. Acquiring Cost

The responsibility of determining the benchmark is entrusted upon the Assets and Liability committee (ALCO) of Albaraka Bank. Albaraka bank uses the “Albaraka Profit Mark-up” as its benchmark. This benchmark is reviewed quarterly by the Board Credit Committee and the decision is communicated to all stakeholders. The benchmark does
Overhead Cost

Requirements for Calculating a Profit Margin

A profit margin can be calculated only if the following components are available:

1. The type of profit margin calculation method.
2. The financing plafond according to type.
3. The profit margin rate required from financing.
4. The collection mode of receivables or the duration of receivables (both the acquiring cost and profit margin)

not only follow the fluctuation of the interest prime rate but will be determined by internal and external factors affecting Albaraka bank. Some of the factors will be:

- Laws and regulations of South Africa
- The cash flows of Albaraka bank as well as external stakeholders.
- The market conditions
- Stability at Albaraka bank
- Competition
- Uncertain future circumstances
- Supply and demand for funds.
- Inflation
- Domestic and national savings
- The return the bank wishes for its depositors as well for itself

Nominating a representative or agent (Wakahal)

MUI Fatwa No.04/DSN-MUI/IV/2000 April 1, 2000 (26 Dzulhijjah H 1420) have established that if the Bank nominates the customer as an agent to buy goods from a third

Albaraka bank and the consumer will firstly enter into an overall agreement whereby the bank promises to sell and the client
party, then the sale and purchase agreement (murabahah) should be done after the goods are owned by the Bank. In other words, granting authority (Wakalah) from the Bank to the Customer or any third party, must be done before the contract of sale and Murabahah happens. Bank Indonesia Regulation (PBI) No.7/46/PBI/2005 dated 14 November 2005 on the standardization of contract, the central bank reiterates the use of Wakalah in the in article 9, paragraph 1, point d in the case of the Customer representing the bank (Wakalah) for buying of goods, then Murabahah should in principle be done after the goods become the property of the Bank. Then asserted, which is in principle the Bank's Articles of Agreement in Wakalah Murabaha is the flow of funds directed to suppliers of goods or evidenced by receipt of purchase.

promises to buy the asset at an agreed profit mark-up. This agreement is to provide assurance that the customer will complete the transaction after the item has been acquired by the bank

- Albaraka bank then appoints the client as his agent for purchasing the asset on its behalf and an agency agreement is signed by both parties.
- The client purchases the commodity on behalf of the bank as an agent of the bank.
- The client informs the bank that he has purchased the asset on the bank’s behalf and at the same time makes an offer to purchase it from the bank.
- Albaraka bank accepts the offer and the sale is concluded whereby the ownership as well as the risk of the commodity is transferred to the client.

| The Tax system | Under the law, which came into | One of the major challenges facing the industry internationally |
| applied to Murabaha | effect in April, when a lender extends finance to a client through a murabaha scheme, it technically buys an item or product and then sells it to the client at a profit, thus avoiding charging interest. Previously tax was charged on both sales, that of the original vendor and then subsequently from the bank, though under the new legislation the sale and resale will be treated as a single transaction for tax purposes. | is that tax laws generally cater for conventional banking products. This may lead to differences in tax treatment that may potentially place Islamic banks and their customers at a disadvantage compared to banks with conventional products. In a Murabaha property finance transaction there is a double stamp duty (property transfer tax) which is implicit in the Islamic contract because it involves the transfer of title at the front and back end of the transaction because of the two sales. The first sale being when the bank purchases the asset from the seller and thereafter the second sale when the bank sells the asset to the customer at a cost plus profit mark-up. |
CHAPTER V
CLOSING

A. Conclusion

This study was exclusively for understanding and comparing of the practice of murabaha in Indonesia and South Africa, between Bank Muamalat Indonesia and Albaraka Bank South Africa respectively.

In this comparative analysis on the practice of Murabaha between Bank Muamalat in Indonesia and Al-Barakah bank in South African on, we defined four objectives on the similarities and differences between the Islamic Banking systems on:

1. What is the theoretical concept of murabaha?

2. Implementation of murabaha Muamalat bank in Indonesia and Al-Barakah Bank in South Africa

3. Analyzing the differences and similarities in the implementation of Murabaha?

4. The issue of nominating an agent or representative (Wakalah).

5. How is the profit-margins determined and are they contemporous with the interest rate?

6. The difference in the tax systems on Murabaha applied in the respective banks?
And found some noteworthy observations. Many of the practices on murabaha between the two respective banks appear similar except for the tax regulation.

This indicates that interest-free banks agree on the basic principles. However, individual banks differ in their application. These differences are due to several reasons including the laws of the country, objectives of the different banks, individual bank’s circumstances and experiences, the need to interact with other interest-based banks etc.

The Indonesian government has recently leveled the playing field with the conventional counterpart by issuing a new law that eradicates the double tax payment on murabaha. Besides this law, Indonesia has many other government laws in place regulating Islamic banking. Indonesia has the potential to grow due to the Muslim majority of nearly 80%, their need for an alternative to the conventional banking system and the interest of foreign investors.

Compared to South Africa, with a minority of 2,5% muslims, in a Murabaha finance transaction there is a double stamp duty (property transfer tax) which is implicit in the Islamic contract because it involves the transfer of title at the front and back end of the transaction because of the two sales. The first sale being when the bank purchases the asset from the seller and thereafter the second sale when the bank sells the asset to the customer at a cost plus profit mark-up.

Until South Africa can pressurise the government to set in place laws to regulate not only the double tax payment on murabaha transactions, but other
Islamic banking issues, it may hinder the growth of Islamic banking in South Africa.

From the research findings, the following is concluded:

- The practice of murabaha was used originally only as a general trade mechanism, but today Islamic banks has transformed murabaha into a financing transaction.
- The implementation of murabaha in both banks are similar and both Bank Muamalat Indonesia and Albaraka Bank in South Africa applies the murabaha mechanism on house, car and equipment financing.
- Bank Muamalat Indonesia and Albaraka Bank in South Africa nominates the customer as the agent when procuring the object in the murabaha transaction.
- Bank Muamalat Indonesia’s profit margin on the murabaha transaction is calculated by the ALCO and takes into account the Direct and Indirect Competitor’s Market Rate, Expected Competitors Return for Investors, acquiring and overhead cost.
- Albaraka Bank in South Africa’s profit margin on the murabaha transaction is calculated by the ALCO and uses the “Albaraka Profit Mark-up”, which takes into account the laws and regulations of South Africa, the cash flows of Albaraka bank as well as external stakeholders, the market conditions, stability at Albaraka bank, competition, uncertain future
circumstances, supply and demand for funds, inflation, domestic and national savings and the return the bank wishes for its depositors as well for itself.

- Bank Muamalat has a single tax charge on murabaha
- Albaraka Bank has a double tax fee, at the front and back end of the transaction in murabaha.

B. Recommendations

It is obvious that the Islamic banks and Islamic window banks in South Africa are currently operating under constraints from the central bank and tax legislations. Despite this there is a strong influence from the role players in Islamic financing to revolutionise Islamic banking in South Africa.

1. Theoretical recommendation

Banking and Tax analysts are commenting in local and international media that the new tax laws in South Africa will spur investment from foreign investors and will level the playing field between Islamic banks and conventional banks. Some are even saying that the proposed tax laws could increase the tax base and bolster the country’s gross domestic product (GDP).

South Africa joins Australia, Hong Kong, the United Kingdom and a growing number of other non-Muslim countries developing their Islamic finance sector by
changing regulations to attract investors who can only put their money in Shariah compliant assets.

According to some analyst “Islamic finance is likely to become a permanent feature of South African economic landscape”.

2. Practical recommendations

With all the positive hype and lobbying to recognize Islamic banking globally as the only solution to the world economic crises, the question to be asked is that are these Islamic financial institutions only presenting theoretical alternatives to the interest based banking system and whether the practical implementation of the actual transactions are adhered to in their day-to-day activities.

By merely having “Shariah Compliant Certificates” does not render the transactions permissible. The Islamic transaction does not come into existence by merely replacing the word of “interest” by the word of “profit” or “mark-up”. Actually all the modes of financing have been allowed by Shariah scholars with some conditions. In fact it is the observance of the conditions which can draw a clear line of distinction between an interest bearing loan and a transaction of murabaha etc If these conditions are neglected, the transaction becomes invalid according to Shariah. Provided that an institution offering Islamic finance has a competent and reputable internal Shariah supervisory that adheres to internationally accepted standards of Shariah compliance, it is difficult to conceive that an approved Islamic product would necessary be different. It is for
this reason that Islamic financial institutions have had to approach regulatory authorities like AAOIFI in order to obtain specific dispensations that relate to them.

More focus should be given on practical implementation and auditing the Shariah compliance of all finance transactions to ensure that all the relaxed rules are adhered to stringently.

As for now the Islamic modes of financing in vogue is purely based on the ‘lesser of the two evils’.

3. University

The Faculty of Shariah and Law of UIN Syarif Hidayatullah University of Jakarta has a well structured Islamic Banking degree program that combines both the theoretical and practical aspects of Islamic Banking. My recommendation for the faculty would be a comparative course study on Islamic Banks locally and internationally in order that students may learn the differences in the practice of Islamic Banking such as murabaha, mudharabah, ijarah and musharakah etc, because although Islamic banks base their practices on the same fundamental principles, it would be interesting to analyse external factors affecting Islamic banks their operations and practices. This will also broaden their perspective on the study of Islamic economics.

4. Bank Muamalat Indonesia
Bank Muamalat Indonesia is a well established bank in Indonesia and is growing at a consistent rate. Most of the financial transactions is based on murabaha and this one of the reasons of the development and growth of the bank. Murabaha is probably the best suited module in this economic setup, as problems have arisen when trying to implement other financing tools such as mudharabah and musharakah. I think its essential for Bank Muamalat Indonesia to be more innovative and create more financial tools and products in order that the bank do not rely heavily on the murabaha financial module.

5. Al Baraka Bank South Africa

Al Baraka Bank South Africa is the only fully established Islamic bank in South Africa. Although it has recorded good growth over the last decade, I feel as long as their are no laws in place to regulate not only the double tax payment on murabaha but other Islamic banking issues, Islamic banks will not be able to compete with other banks whether it be Islamic banks or the conventional counterpart and thus may hinder the growth of the bank.
INTERVIEW

Name : Mr Ahmad Fauzi
Position : Financing, Supporting Division
Company : Bank Muamalat Indonesia
Time/Place : 05 November 2010, Bank Muamalat

1. What is your understanding of Murabaha?

Murabaha is a type of financing provided for customers who wish to purchase an item which will allow them to pay the price in instalments over a period of time. In the case of a bank, the customer would approach the bank, the bank would purchase the item wanted by the customer, and then resell it to the customer at an agreed mark-up. The customer would then pay the amount owed to the bank in instalments. And this is basically the common or universal understanding of murabaha.

2. How is Murabaha implemented Bank Muamalat Indonesia’s banking system?

Murabaha is applied in Bank Muamalat Indonesia whereby the Bank will buy any halal goods that you need and then sell them to the client to be paid periodically / installments according to their ability. This facility can be used to deal with business needs (either working capital or investment: procurement of
capital goods such as machinery, equipment, etc.) or private needs (e.g. purchase of motor vehicles, homes, etc.)

3. **What products are financed on the murabaha facility?**

We provide two types of murabaha financing facilities, namely investment murabaha product and murabaha for working capital. The investment murabaha product is utilised for consumable products such as purchasing a car, house or even for the purchase of products and materials for renovation. In the case of working capital, say a person wants to expand his business, we provide murabaha facility in assisting the person in developing his business. But we can only provide the materials on a murababa facility and not cash, or labour.

4. **Murabaha is deemed by many scholars as not a true mode of Islamic finance, and has drawn a lot of criticism from muslims and non muslims alike, yet Murabaha is the most popular mode of Islamic finance, why is that?**

Well if you want to check clearly you can download and check the bank muamalat financial statement for 2007, 2008 and 2009. You will be able to compare all the Islamic financial products such as murabaha, mudharabah, musharaka and ijarah etc. As for the popularity of murabaha, I think it’s the easiest way in catering for the people’s needs without getting involved in interest/riba.

5. **Can you explain the method used in nominating an agent or representative (Wakalah) in the practice of Murabaha?**

There are two ways in which we use or nominate a representative (wakalah) in the murabaha financing facility. In most cases we nominate the customer or client...
as the wakalah in purchasing the item he needs on behalf of the bank. And in other cases we may nominate a 3rd person as a representative in purchasing an item or product because of the expertise and experience he may have in the financing industry as well as the knowledge of the product which is required. For example if a customer wishes to buy a ship from abroad, we as the bank as well as the customer may not have access to the ship so we nominate a 3rd person with the proper expertise as a representative to acquire the ship on behalf of the bank in order that we may resell the ship to the customer. In this practice the L/C (letter of credit) is used to gain the ship. In drawing up the agreement and contract, bank muamalat firstly draws up a wakalah agreement. And then thereafter a murabaha contract is created and agreed upon between the customer and bank.

6. What technique is used in determining the profit margin? Is the profit margin contemporaneous with the interest rate?

In Indonesia there is good competition between conventional and Islamic banks. Many people compare the rates between the different banks and therefore the interest is taken into consideration when determining the profit margin. In Bank Muamalat, the profit margin is determined by the Assets and Liabilities Committee (ALCO) which is bank muamalats internal board. Many factors are taken into consideration when determining the profit margin such as the:

*Direct Competitor’s Market Rate (DCMR)*- A Direct Competitor’s Market Rate (DCMR) is the average profit margin in the Islamic banking industry; or the average profit margin of several Islamic banks considered at the ALCO meeting.
as a group of direct competitors; or the average margin of a particular Islamic bank considered at the ALCO meeting as a closest, direct competitor.

*Indirect Competitor’s Market Rate (ICMR)*- An *Indirect Competitor’s Market Rate* (ICMR) is the average interest rate in the conventional banking industry, or the average interest rate of some conventional banks considered at the ALCO meeting as a group of indirect competitors, or the average interest rate of a particular conventional bank considered at the ALCO meeting as a closest indirect competitor.

*Expected Competitors Return for Investors (ECRI)*- An *Expected Competitors Return for Investors* (ECRI) is the competitive profit-sharing target that expected to be shared to a third party fund provider.

*Acquiring Cost*- An acquiring cost is the additional cost expensed by the bank that is directly related to its effort in obtaining a third-party fund.

*Overhead Cost*- An *overhead cost* is the cost expensed by the bank that is not directly related to its effort in obtaining a third-party fund.

7. **How is the tax system applied to the practice of Murabaha?**

The tax on murabaha at bank muamalat is included in the profit margin when determined by the Assets and Liabilities Committee (ALCO) management. Due to the nature of murabaha, it is a selling and buying financial facility, therefore tax is usually applied twice on murabaha. The first when purchasing the item from the manufacturer or distributor, and then taxed again when reselling it to the customer. But since the establishment, Bank Muamalat has made an agreement with the government on the taxing on murabaha. Bank muamalat only
pays tax once when the bank purchases the item from the manufacturer and because of that, bank muamalat is able to compete with conventional banks in the market.

3. What is your understanding of Murabaha?

Murabaha in its original Islamic connotation is simply a sale having nothing to do with financing in its original sense. The main feature distinguishing it from other kinds of sale is that the seller expressly tells the purchaser how much cost he has incurred and how much profit he is going to charge in addition to the cost. By simply selling a commodity without mentioning the cost plus the profit is not a murabaha sale but is called “musawamah”. The main feature of murabaha financing is that it is ASSET BASED and not a loan.

4. How is Murabaha implemented in Albaraka bank’s banking system?

Albaraka bank uses the “Murabaha to the purchase orderer” transaction to satisfying the needs of Muslim consumers in South Africa who needs to purchase
assets on a deferred payment basis and who are looking for alternative finance to the existing interest based loans offered by the conventional banks.

To give effect to the murabaha transaction the following procedure will be implemented:

- The consumer submit an application to the Bank for the purchase of the asset on a “murabaha, to the purchase orderer”, basis.
- The consumer promises to purchase the said asset.
- The bank sends the consumer a reply, which may state, the following among other things:
  - that it has approved or has not approved the consumer’s application for the purchase of the asset on a murabaha basis.
  - That the bank appoints the consumer as its agent to conclude the first sale on its behalf
  - The price at which the bank is prepared to sell the property to the consumer;
  - Any other fact or matter which the bank in its sole discretion consider relevant, including the provision of security.
- The bank appoints the consumer as its agent for the purpose of concluding the first sale and taking transfer of the asset under the first sale on the banks behalf.
- The consumer enters into the first sale with the supplier on the banks behalf.
The first sale shall be deemed to be completed on registration of transfer of the asset.

5. **What products are financed on the murabaha module?**

   Albaraka bank finances the following assets under “Murabaha to the purchase orderer”
   - Commercial and Residential property finance.
   - Motor vehicle finance.
   - Equipment finance
   - Trade finance

6. **Murabaha is deemed by many scholars as not a true mode of Islamic finance, and has drawn a lot of criticism from muslims and non muslims alike, yet Murabaha is the most popular mode of Islamic finance, why is that?**

   Murabaha, as previously stated, originally is a particular type of sale and not a mode of financing. The ideal mode of financing according to Shariah is Mudarabah OR Musharakah. However in the perspective of the current economic set up and demands from clients, there are certain practical difficulties in using mudarabah and musharakah instruments in some areas of financing.

   South Africans are obsessed with home ownership and prefer to be the outright owner of their properties as opposed to being a joint partner with the bank in the ownership. Musharakah financing does not appeal to South Africans with regard to property finance, and is not practical in motor vehicle finance and equipment finance,
therefore customers prefer murabaha transactions when purchasing movable and immovable assets.

The non Muslims are even more impressed with the fixed mark-up concept in murabaha transactions because of the cost saving compared to an interest based fluctuating loan. The contemporary Shariah experts have allowed, subject to certain conditions, the use of the murabaha on deferred payment basis as a mode of financing. It is only a device that is currently used as an alternative to interest based loans and not an ideal instrument for carrying out the real economic objectives of Islam. It is currently used as a transitory step in the Islamization of the economy, and it is therefore restricted only to those cases where mudarabah or musharakah are not practicable.

7. Can you explain the method used in nominating an agent or representative (Wakalah) in the practice of Murabaha?

- Albaraka bank and the consumer will firstly enter into an overall agreement whereby the bank promises to sell and the client promises to buy the asset at an agreed profit mark-up. This agreement is to provide assurance that the customer will complete the transaction after the item has been acquired by the bank.

- Albaraka bank then appoints the client as his agent for purchasing the asset on its behalf and an agency agreement is signed by both parties.

- The client purchases the commodity on behalf of the bank as an agent of the bank.
The client informs the bank that he has purchased the asset on the bank’s behalf and at the same time makes an offer to purchase it from the bank.

Albaraka bank accepts the offer and the sale is concluded whereby the ownership as well as the risk of the commodity is transferred to the client.

8. What technique is used in determining the profit margin? Is the profit margin contemporous with the interest rate?

Albaraka bank uses the “Albaraka Profit Mark-up” as its benchmark. This benchmark is reviewed quarterly by the Board Credit Committee and the decision is communicated to all stakeholders. The benchmark does not only follow the fluctuation of the interest prime rate but will be determined by internal and external factors affecting Albaraka bank. Some of the factors will be:

- Laws and regulations of South Africa
- The cash flows of Albaraka bank as well as external stakeholders.
- The market conditions
- Stability at Albaraka bank
- Competition
- Uncertain future circumstances
- Supply and demand for funds.
- Inflation
- Domestic and national savings
- The return the bank wishes for its depositors as well for itself
The responsibility of determining the benchmark is entrusted upon the Assets and Liability committee (ALCO) of Albaraka Bank.

The Albaraka Profit Mark-up benchmark once determined for implementation is publicized for the benefit of internal use as well as for the public. Clients requesting that Albaraka bank follows the prime rate will be educated on the nature of an Islamic transaction and the benefits thereof.

9. How is the tax system applied to the practice of Murabaha?

One of the major challenges facing the industry internationally is that tax laws generally cater for conventional banking products. This may lead to differences in tax treatment that may potentially place Islamic banks and their customers at a disadvantage compared to banks with conventional products.

In a Murabaha property finance transaction there is a double stamp duty (property transfer tax) which is implicit in the Islamic contract because it involves the transfer of title at the front and back end of the transaction because of the two sales. The first sale being when the bank purchases the asset from the seller and thereafter the second sale when the bank sells the asset to the customer at a cost plus profit mark-up.

10. A new law, that will soon come into effect, would state that the sale and resale in murabaha transaction will be treated as one transaction for tax purposes, what does this mean for Albaraka bank and Islamic banking industry of South Africa?
Since Albaraka Bank is a member of AAOIFI (Accounting and Auditing Organization for Islamic Financial Institutions, the interpretations of the proposed new tax laws will be if not already referred to the Shariah Board of AAOIFI for a ruling who will give the Shariah opinion in matters requiring collective Ijtihad (reasoning) or to settle divergent points of view, or to act as an arbitrator.

**Glossary of Terms**

**Amanah**
This refers to deposits in trust. A person can hold a property in trust for another, sometimes by express contract and sometimes by implication of a contract. Amanah entails an absence of liability for loss except in breach of duty. Current Accounts are regarded as Amanah (trust). If the bank gets authority to use Current Account funds in its business, Amanah transforms into a loan. As every loan has to be repaid, banks are liable to repay the full amount of the Current Accounts.

**Arbun**
Down payment; a non-refundable deposit paid by a buyer retaining a right to confirm or cancel a sale.

**Al-‘Aariyah**
(Gratuitous loan of non-fungible objects) (Al-‘Aariyah means the loan of a particular piece of property, the substance of which is not consumed by its use, without anything taken in exchange, In other words, it is the gift of usufruct of a property or commodity that is
not consumed on use. It is different from Qard in that it is the loan of fungible objects which are consumed on use and in which the similar and not the same commodity has to be returned. It is also a virtuous act like Qard. The borrowed commodity is treated as liability of the borrower who is bound to return it to its owner.

Bai’ Muajjal  Literally this means a credit sale. Technically it is a financing technique adopted by Islamic banks that takes the form of Murabaha Muajjal. It is a contract in which the seller earns a profit margin on his purchase price and allows the buyer to pay the price of the commodity at a future date in a lump sum or in installments. The bank has to expressly mention the cost of the commodity and the margin of profit is mutually agreed. The price fixed for the commodity in such a transaction can be the same as the spot price or higher or lower than the spot price.

Bai’ Salam  Salam means a contract in which advance payment is made for goods to be delivered later. The seller undertakes to supply some specific goods to the buyer at a future date in exchange for being paid in advance a price fully paid at the time of contract. According to the normal rules of the Sharia’a, no sale can be effected unless the goods are in existence at the time of the bargain, but Salam sale forms an exception given by the Prophet himself to the general rule
provided the goods are defined and the date of delivery is fixed. It is necessary that the quality of the commodity intended to be purchased is fully specified leaving no ambiguity leading to potential disputes. The objects of this sale are goods and cannot be gold, silver or currencies because these are regarded as monetary values exchange of which is covered under rules of Bai al Sarf, i.e. mutual exchange which must be hand to hand without delay.

Barring this, Bai’ Salam covers almost everything which is capable of being definitely described as to quantity, quality and workmanship.

Bai’ bil Wafa Sale with a right in the seller, having the effect of a condition, to repurchase (redeem) the property by refunding the purchase price. According to the majority of Fuqaha this is not permissible.

Daman
1) Contract of guarantee, security or collateral; 2) Responsibility of entrepreneur/manager of a business; one of two basic relationships toward property, entailing bearing the risk of its loss.

Dayn means Debt. A Dayn comes into existence as a result of any contract or credit transaction. It is incurred either by way of rent or sale or purchase or in any other way which leaves it as a debt to another.

Duyun (debts) ought to be returned without any profit since they are
advanced to help the needy and meet their demands and, therefore, the lender should not impose on the borrower more than what he had given on credit.

Falah  Falah means to thrive, to become happy or to have luck and success. Technically it implies success both in this world and in the Akhirah (Hereafter). The Falah presumes belief in one God, the apostlehood of Prophet Muhammad, Akhirah and conformity to the Sharia'a in behaviour.

Fiqh  Islamic law. The science of the Sharia'a

Gharar  This means any element of absolute or excessive uncertainty in any business or a contract about the subject of contract or its price, or mere speculative risk. It has the potential to lead to undue loss to a party and unjustified enrichment of the other, which is prohibited.

Al Ghunm bil This provides the rationale and the principle of profit sharing in Ghurm  Shirkah arrangements. Earning a profit is legitimized only by engaging in an economic venture, applying risk sharing principles and thereby contributing to the economy.

Hadith  (see Sunnah)

Halal  Anything permitted by the Sharia'a.

Haram  Anything prohibited by the Sharia'a. Examples are wine and pork.

Hawalah  Literally, this means a transfer. Legally, it is an agreement by which
a debtor is freed from a debt by another becoming responsible for it, or the transfer of a claim of a debt by shifting the responsibility from one person to another – contract of assignment of debt. It also refers to the document by which the transfer takes place.

Hibah
Gift.

Ijara
Means letting on a lease. It refers to the sale of a definite usufruct of any asset in exchange for a definite reward. It refers to a contract of land leased at a fixed rent payable in cash and also to a mode of financing adopted by Islamic banks. It is an arrangement under which the Islamic banks lease equipment, buildings or other facilities to a client, against an agreed rental.

Ijarah-wal-Iqtina‘
means a mode of financing, by way of hire-purchase, adopted by Islamic banks. It is a contract under which the Islamic bank finances equipment, building or other facilities for the client against an agreed rental together with a unilateral undertaking by the bank or the client that at the end of the lease period, the ownership in the asset would be transferred to the lessee. The undertaking or the promise does not become an integral part of the lease contract to make it conditional. The rental as well as the purchase price are fixed in such a manner that the bank gets back its principal sum alongwith with some profit, which is usually
determined in advance.

**Ijtihad**
Refers to the endeavour of a qualified jurist to derive or formulate a rule of law to determine the true ruling of the divine law in a matter on which the revelation is not explicit or certain, on the basis of Nass or evidence found in the Holy Qur’an and the Sunnah. Express injunctions have no room for Ijtihad. Implied injunctions can be interpreted in different ways by way of inference from the accepted principles of the Sharia'a

**‘Illah**
this is the attribute of an event that entails a particular Divine ruling in all cases possessing that attribute. ‘Illah is the basis for applying analogy for determining permissibility or otherwise of any act or transaction.

**Ijma‘**
Consensus of all or a majority of the leading qualified jurists on a certain Sharia'a matter in a certain age.

**‘Inah**
(A kind of Bai): this is a double sale by which the borrower and the lender sell and then resell an object between them, once for cash and once for a higher price on credit, with the net result being a loan with interest.

**‘Inan**
(A type of Shrikah): this is a form of partnership in which each partner contributes capital and has a right to work for the business, not necessarily in equal shares.
Istihsan

this is a doctrine of Islamic law that allows exception to strict legal reasoning, or guiding choice among possible legal outcomes, when considerations of human welfare so demand.

Israf:

this refers to immoderateness, exaggeration and waste and covers spending on lawful objects but exceeding moderation in quantity or quality; spending on superfluous objects while necessities are unmet; spending on objects which are incompatible with the economic standard of the majority of the population. See also Tabzir

Istisna’a

this is a contractual agreement for manufacturing goods and commodities, allowing cash payment in advance and future delivery or a future payment and future delivery. A manufacturer or builder agrees to produce or build a well described good or building at a given price on a given date in the future. Price can be paid in installments, step by step as agreed between the parties. Istisna’a can be used for financing the manufacture or construction of houses, plant, projects, and the building of bridges, roads and highways.

Jahala

Ignorance, lack of knowledge; indefiniteness in a contract, sometime leading to Gharar.

Kali bil-Kali

this is a doctrine of Islamic law that allows exception to strict legal
reasoning, or guiding choice among possible legal outcomes, when
considerations of human welfare so demand.

Al-Kafalah (Suretyship) Literally, Kafalah means responsibility, amenability
or suretyship. Legally in Kafalah a third party become surety for
the payment of a debt. It is a pledge given to a creditor that the
debtor will pay the debt, fine etc. Suretyship in Islamic law is the
creation of an additional liability with regard to the claim, not to
the debt or assumption only of the liability and not of the debt.

Kharaj bi-al- Daman Gain accompanies liability for loss. This is a Hadith forming a
legal maxim and is a basic principle of Islamic finance– see also
Al-Ghunm bil Ghurm.

Khiyar means an option or the power to annul or cancel a contract.

Khiyar al- means the power to annul a contract possessed by both contracting
Majlis parties as long as they do not separate.

Khiyar al- A right, stipulated by one or both of the parties to a contract, to
Shart cancel the contract for any reason for a fixed period of time.

Mal-e- Things the use of which is lawful under the Sharia'a; or wealth that
Mutaqawam has a commercial value. Legal tender of the modern age that carry
monetary value are included in Mal-e-Mutaqawam. It is possible
that certain wealth has no commercial value for Muslims.

Examples would be pork or wine.
Mithli  (Fungible goods): Goods that can be returned in kind, i.e. gold for gold, silver for silver, US $ for US $, wheat for wheat, etc.

Mubah  means an object that is lawful (i.e. something which is permissible to use or trade in).

Mudarabah  a form of partnership where one party provides the funds while the other provides expertise and management. The latter is referred to as the Mudarib. Any profits accrued are shared between the two parties on a pre-agreed basis, while loss is borne by the provider(s) of the capital.

Murabaha  Literally this means a sale on mutually agreed profit. Technically, it is a contract of sale in which the seller declares his cost and the profit. Murabaha has been adopted by Islamic banks as a mode of financing. As a financing technique, it can involve a request by the client to the bank to purchase a certain item for him. The bank does that for a definite profit over the cost which is stipulated in advance.

Musawamah  Musawamah is a general kind of sale in which the price of the commodity to be traded is bargained between seller and the purchaser without any reference to the price paid or cost incurred by the former.

Maisir  An ancient Arabian game of chance played with arrows without
heads and feathering, for stakes of slaughtered and quartered camels. It came to be identified with all types of hazard and gambling.

**Musharakah** Musharakah means a relationship established under a contract by the mutual consent of the parties for sharing of profits and losses in a joint business. It is an agreement under which the Islamic bank provides funds which are mixed with the funds of the business enterprise and others. All providers of capital are entitled to participate in management, but not necessarily required to do so. The profit is distributed among the partners in pre-agreed ratios, while the loss is borne by every partner strictly in proportion to respective capital contributions.

**Qimar** Qimar means gambling. Technically, it is an arrangement in which possession of a property is contingent upon the happening of an uncertain event. By implication it applies to a situation in which there is a loss for one party and a gain for the other without specifying which party will lose and which will gain.

**Qiyas** Literally this means measure, example, comparison or analogy. Technically, it means a derivation of the law on the analogy of an existing law if the basis (‘illah) of the two is the same. It is one of the sources of Islamic law.
Riba means an excess or increase. Technically, it means an increase over the principal in a loan transaction or in exchange for a commodity accrued to the owner (lender) without giving an equivalent counter-value or recompense (‘iwad) in return to the other party; every increase which is without an ‘iwad or equal counter-value.

Riba Al-Fadl Riba Al-Fadl (excess) is the quality premium in exchanging low quality with better quality goods e.g. dates for dates, wheat for wheat, etc. – an excess in the exchange of Ribawi goods within a single genus. The Concept of Riba Al-Fadl refers to sale transactions while Riba Al-Nasiah refers to loan transactions.

Qabul Acceptance, in a contract; see also Ijab.

Qard (Loan of fungible objects): The literal meaning of Qard is ‘to cut’. It is so called because the property is really cut off when it is given to the borrower. Legally, Qard means to give anything having value in the ownership of the other by way of virtue so that the latter could avail of the same for his benefit with the condition that same or similar amount of that thing would be paid back on demand or at the settled time. It is a loan which a person gives to another as a help, charity or advance for a certain time. The repayment of the loan is obligatory. The Holy Prophet is reported to have said Every loan must be paid?. But if a debtor is in
difficulty, the creditor is expected to extend time or even to voluntarily remit the whole or a part of the principal. Qard is, in fact, a particular kind of Salaf. Loans under Islamic law can be classified into Salaf and Qard, the former being loan for a fixed time and the latter payable on demand. (see Salaf)

| Riba Al-Nasiah | Riba Al-Nasiah or riba of delay is due to an exchange not being immediate with or without excess in one of the counter values. It is an increment on principal of a loan or debt payable. It refers to the practice of lending money for any length of time on the understanding that the borrower would return to the lender at the end of the period the amount originally lent together with an increase on it, in consideration of the lender having granted him time to pay. Interest, in all modern banking transactions, falls under the purview of Riba Al-Nasiah. As money in the present banking system is exchanged for money with excess and delay, it falls, under the definition of riba. |
| Ribawi | Goods subject to Fiqh rules on Riba in sales, variously defined by the schools of Islamic Law: items sold by weight and by measure, foods, etc. |
| Al-Rahn | means pledge or collateral; legally, Rahn means to pledge or lodge a real or corporeal property of material value, in accordance with |
the law, as security, for a debt or pecuniary obligation so as to
make it possible for the creditor to recover the debt or some portion
of the goods or property. In the pre-Islamic contracts, Rahn implied
a type of earnest money which was lodged as a guarantee and
material evidence or proof of a contract, especially when there was
no scribe available to put it into writing. The institution of earnest
money was not accepted in Islamic law and the common Islamic
doctrine recognized Rahn only as a security for the payment of a
debt.

Salaf means loan/debt. The word Salaf literally means a loan which
draws forth no profit for the creditor. In wider sense, it includes
loans for specified periods, i.e. short, intermediate and long-term
loans. Salaf is another name for Salam as well wherein the price of
the commodity is paid in advance while the commodity or the
counter value is supplied in future; thus the contract creates a
liability for the seller. Amount given as Salaf cannot be called
back, unlike Qard, before it is due. (see Qard)

Al-Sarf Basically, in pre-Islamic times this was the exchange of gold for
gold, silver for silver and gold for silver or vice versa. In Islamic
law such an exchange is regarded as ‘sale of price for price’ (Bai al
Thaman bil Thaman), and each price is consideration of the other.
It also means sale of monetary value for monetary value – currency exchange.

**Sharia'a**

The term Sharia'a refers to divine guidance as given by the Holy Qur’an and the Sunnah of the Prophet Muhammad and embodies all aspects of the Islamic faith, including beliefs and practice.

**Sunnah**

Basically, in pre-Islamic times this was the exchange of gold for gold, silver for silver and gold for silver or vice versa. In Islamic law such an exchange is regarded as ‘sale of price for price’ (Bai al Thaman bil Thaman), and each price is consideration of the other. It also means sale of monetary value for monetary value – currency exchange.

**Tabarru’**

means a donation/gift the purpose of which is not commercial but is done to seek the pleasure of Allah. Any benefit that is given by a person to other without getting anything in exchange is called Tabarru’ It is absolutely at the lender’s own discretion and without any prior condition or inducement for reward.

**Tabzir**

Spending wastefully on objects which have been explicitly prohibited by the Sharia'a irrespective of the quantum of expenditure. See also Israf.

**Ujrah**

A contract of agency in which one person appoints someone else to perform a certain task on his behalf, usually against a certain fee.
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