Murabaha

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- Murabaha is selling a commodity as per the purchasing price with a defined and agreed profit mark-up.

- ‘Banking Murabaha’, *i.e* ‘Murabaha to the Purchase Orderer’

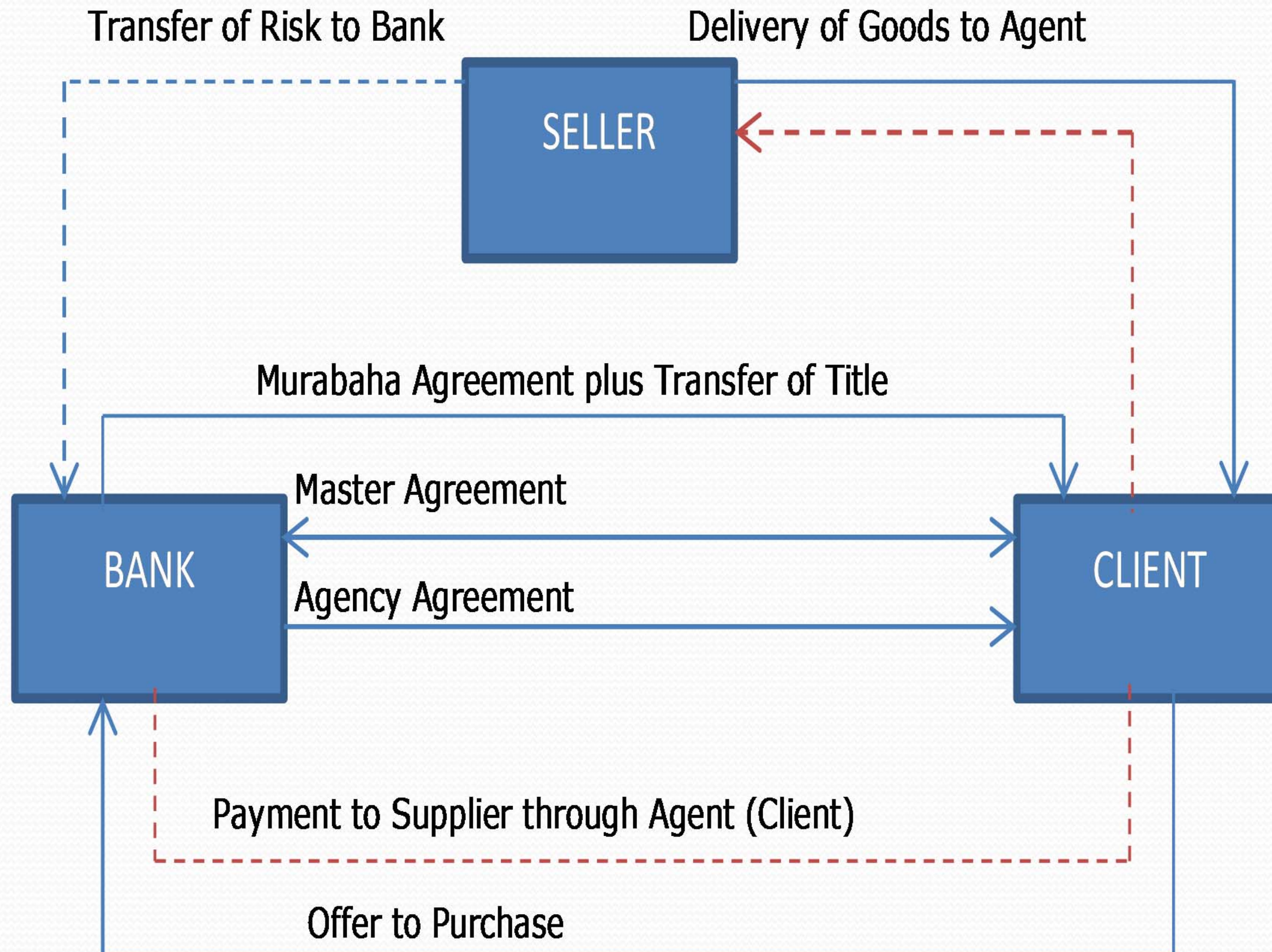
Conditions for a valid Murabaha

- **A person cannot sell a commodity unless:**
  - It has come into existence,
  - The asset has value,
  - It is owned by the seller,
  - The offer & acceptance is on a specific commodity for a specific price
  - It is in the physical or *constructive possession* of the seller;
    - Possession is not the same as custody. Possession implies ownership
- The buyer has the option to inspect and reject the offer or even renegotiate the terms

Salient features of Murabaha To The Purchase Orderer (MTPO)

- Three parties are involved-the Bank, the customer and the supplier of goods
- The bank as a financial intermediary facilitates the purchase of goods, takes possession or constructive possession of the goods, becomes the owner, and then sells the goods to the customer on spot or deferred payment basis subject to certain terms and conditions
- Sometimes the Bank appoints the customer as agent to purchase and collect the goods on its behalf
- The cost of goods is known both to the bank and the customer
- Usually the bank will require a deposit (hamish jiddiya) from the customer
- The bank and the customer agrees on a fixed profit mark up
- The sale price remains fixed during the period of the contract

MTPO PROCESS FLOW



Set Procedure for MTPO

- The customer signs a Purchase Order for the asset
- The customer promises to buy the asset on an agreed ratio of profit added to the cost and the bank promises to sell the asset to the customer
- The bank may appoint the customer as his agent for purchasing the commodity on its behalf, and an agreement of agency is signed by both parties.
- The customer purchases the commodity on behalf of the bank and takes possession as an agent of the bank. At this stage the bank has constructive possession of the commodity and bears the risk of the commodity
- The customer informs the bank that he has purchased the commodity on its behalf
- The customer and the bank then enter into a Murabaha Agreement whereby the ownership as well as the risk of the commodity is transferred to the customer
- Normally the sale will be on deferred payment basis. The Bank will take a security on this asset or other assets or may even require Takaful cover on the asset
- All these stages are necessary to affect a valid *murabaha*.

Parties acting in different capacities

- Initially the bank and the customer promise to sell and purchase a commodity in future. This is not an actual sale. It is just a promise to affect a sale in future on *murabaha* basis. It is a unilateral promise on both sides
- If the agency agreement is in place the relationship between the bank and the customer is that of a principal and an agent
- At the time of signing the Murabaha Agreement the relationship of buyer and seller comes into operation between the bank and the customer. Ownership is transferred from the bank to the customer
- Since the sale is effected on a deferred payment basis, the relation of a debtor and creditor also emerges between them simultaneously

- What happens if the customer does not purchase the asset after the bank has acquired it?
- Underlying asset or other assets usually taken as collateral/security
- Is roll over permissible?
- Penalty for delayed repayment
- Early payment discounts
- Fixed mark-up over the period : does not fluctuate
- Is the word ‘interest’ replaced with ‘profit’ in a Murabaha ?