

Comparison study of Murabaha and Istisnaa in Islamic banking in Jordan

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Abstract:

This paper aims to compare between two Islamic Investments "Istisna" and Murabaha in Islamic banking in Jordan. At the beginning there are some definitions of the Islamic investments "Istisna" and Murabaha. the research discussed if Islamic banks in Jordan applying these investment tools, at last the results show that on average 42% of the investments, the Islamic Banks in Jordan offer, are Islamic Investments. On the other hand, the majority of the Islamic investments attributed to Murabaha and ignores the other Islamic investment "Istisna".

Keywords: Islamic banking, Islamic investments, murabaha, Istisna, Industries

1.Introduction

Islamic banking is an exciting chapter in the religious, cultural, and intellectual life of Muslims is opening. While Islamic banking may not be a totally new concept, the widespread expansion of this form of banking is certainly a fairly recent phenomenon.

The most pronounced difference between Islamic financing and existing equivalent products is the prohibition of interest. This is based on the principle that it is unacceptable in and of itself for same commodity, including money, to increase in value merely by being lent to another person. However, Shari'ah does not prohibit the making of a return on capital if the provider is willing to share in the risks of a productive Enterprise.

In terms of products and services, Jordan Islamic Bank offers a wide range of financial products and services to both individuals and corporations. The services include Murabahah and Ijarah Muntahia Bithamleek as well as some investment products such as Musharakah, Mudarabah and Istisna.

Murabaha is one of the most common modes used by Islamic Banks. It refers to a sale where the seller discloses the cost of the commodity and amount of profit charged. Therefore, Murabaha is not a loan given on interest rather it is a sale of a commodity at profit. The mechanism of Murabaha is that the bank purchases the commodity as per requisition of the client and sells him on cost-plus-profit basis. Under this arrangement, the bank is bound to disclose cost and profit margin to the client. Therefore, the bank, rather than advancing money to a borrower, buys the goods from a third party and sell those goods to the customer on profit. A question may be raised that selling goods on profit under Murabaha and charging interest on the loan (as per the practice of conventional banks) appears to be one of the same

things and also produces the same results. The basic difference lies in the contract being used. Murabaha is a sale contract whereas the conventional finance overdraft facility is an interest based lending agreement and transaction. In case of Murabaha, the bank sells an asset and charges profit which is a trade activity declared halal (valid) in the Islamic Shariah. Whereas giving loan and charging interest thereupon is pure interest-based transaction declared haram(prohibited) by Islamic Shariah.

On the other hand Istisna is a contract whereby a party undertakes to produce a specific thing which is possible to be made according to certain agreed-upon specifications at a determined price and for a fixed date of delivery. This undertaking of production includes any process of manufacturing, construction, assembling or packaging.

In Istisna, the work is not conditioned to be accomplished by the undertaking party and this work or part of it can be done by others under his control and responsibility. Istisna, an instrument of pre-shipment financing and it is a contract where the deal can be referred to something not in existence at the time of concluding the contract, while Murabaha is an order to buy goods or commodities which are in existence in hand or possible to be found in the market.

The main objective of the Istisna mode of financing is to promote manufacturing capability. This may relate to manufacturing of complete assets in the form of capital goods. These goods may benefit the industrial, agricultural or infrastructure sector.

Istisna provides medium term financing to meet financing requirement for manufacturing/supplying/sale of identified goods, such as industrial/construction equipment, machinery, cargo vessels, oil tankers, trawlers, dredgers, locomotives, etc., transport equipment, pipelines for water and oil distribution, gas and electricity and their transmission/distribution lines, electric generators and transformers, telecommunication equipment, oil rigs, hospital equipment, etc. Under this mode of financing, it is possible to finance intangible assets like gas, electricity, etc. It is also possible, unlike under leasing and installment sale, to finance working capital. Istisna financing period is determined by the time required for procurement of necessary materials and manufacturing of the goods according to the agreed contract.

The study is carried out to answer the question whether murabaha nor Istisna as an Islamic finance policies are widely used in Islamic banks in Jordan. To achieve this, the study is structured into 4 sections: section (1) deals with the literature review; section (2) discusses methodology and data; section (3) describes Islamic bank in Jordan while analysis of results, conclusion are presented in section (4).

2. Literature Review:

A lot of studies exist on the Murabaha and Istisnaa. We summarize some studies that addressed this issue as follows:

Zaki (2011) wrote huge chapters about the Islamic finance as a mean of minimizing the risk. Data collected for the study through primary and secondary sources. Primary data they collected during the interviews of professional Islamic finance including the Islamic banks. Results showed that the three major policies which are the variables of the study provide the foundation for efficient mitigating risks and designed a model by after achieve a regulatory framework of suitable mitigate risks, perpetuate long term stability. So as illustrated earlier that Islamic Finance and rules are used a Risk mitigate and minimize if applied appropriately. Alsayyed, (2010) studied the uses of Commodity Murabaha, and found that Murabaha is clearly the Islamic treasurer's funding product of choice, as it is flexible enough to facilitate many structures for financing, hedging, and currency exchanging.

Abdo, (2009), examined if Islamic banks in Jordan depend on Islamic Investments? At the beginning there are some definitions of the Islamic investments that the Islamic banks should offer, like Mudaraba, Musharaka, Murabaha, Ijara, Istisna and Build operate transfer, the research discussed if Islamic banks in Jordan apply these investments, at last the results will show that an average of more than 58% of the investments of the Islamic banks in Jordan are non-Islamic such as (cash and deposits in other banks, investing in marketable securities, letters of credits, letters of guarantees, commercial papers, and other assets). These investments forms more than the half of the whole investments, and what remains about 42% of the investments, the Islamic Banks in Jordan offer, are Islamic Investments. On the other hand, the majority of the Islamic investments attributed to Murabaha lel Amer beshera'a and ignores all other Islamic investments.

Ariffin, Archer and Karim, (2009) attempted to ascertain the perceptions of Islamic Bankers about the nature of risks, risk measurement and risk management techniques in their banks. It covered 28 Islamic banks in 14 countries using a questionnaire survey. It concluded that the Islamic banks are mostly exposed to similar types of risks to those in conventional banks, but there are differences in the level of the risks. The findings of the study showed both theoretical and policy implications for the issue of transparency, with particular references to risk reporting in Islamic banks.

Cihak and Hesse, (2008) discussed the connection between size and stability of Islamic financial institutions worldwide. An International Monetary Fund (IMF) study found that large Islamic banks are less stable than small Islamic banks or large conventional banks, suggesting that a thorough look at credit risk management in large Islamic Banks is needed,

the features of Islamic financial contracts, such as profit and loss-sharing financing, and fewer risk-hedging methods, give rise to unique risks.

Saleh & Zeitun (2006) tried to study and analyze the Jordan experience with Islamic finance, and in particular the experience of the Islamic Bank first and second in the country, Jordan Islamic Bank for Finance and Investment (JIBFI), and the Islamic International Arab Bank (Arab Bank) in order to evaluate the performance of Islamic banks in the country. This paper used the assessment methodology performance by making a maximize profit, capital structure, and cash tests.

Altaleb (2005), in his study, which aimed to assess the financial performance of Jordan "Islamic Bank for Finance and Investment", has been analyzing the financial position of the banks access to its financial investment, and the fields of capital investment during the period 1998-2000. The study recommends that the banks should review all investment bank lines and associated budgets, and then search for instruments for expansion in Islamic banking in the Arab region.

Taylor, (2003) investigated the banking practices in compliance with the religion of Islam in the US American regulatory framework affecting the establishment and operation of an Islamic Banking Institutions; Rules and practices in Islamic Banks are derived from religious sources, that's why the Islamic Banking truly is in a developmental stage pertaining to the interaction between: 1) Western financial practices which are based on the role of interest and 2) the dictates of shari'ah law which forbid interest (riba) . The prohibition of riba does not mean that money may not be lent under Islamic law; the prohibition simply forbids unearned profit or any form of gain or profit which was unearned in the sense that they resulted from speculative or risky transactions and could not be precisely calculated in advance by the contraction parties. The author concluded that it was a matter of time until an Islamic banking institution, compliant with shari'ah law will be established in the United States, and it will have great potential for success and profitability.

Zaman and Ithaca,(2001) reviewed the growth of Islamic banking since its inception nearly four decades ago. They examined the major products/services offered by various Islamic banking institutions as well as analyzed such institutions' financial performance based on the latest data available. They concluded that some of the practices and the financial instruments used by the Islamic banks do not seem to conform to the traditional Islamic principles, and it offers suggestions for improvements.

Haron, (1998) examined the practices of Islamic banks from eleven Muslim countries. The selected areas included the usage of Sharia principles and the uses and sources of funds. Disparity exists especially in areas such as number of Sharia principles employed and its usage in banking activities. There are also differences in the sources and uses of funds among

the sample banks. In the case of the sources of funds, the differences are due to the types of accounts available and Sharia principles adopted by banks in delivering those services. For the usage of funds, all banks tend to concentrate in mark-up financing activities. Variations also appear in the area of sectoral financing. These differences are largely influenced by the economic development of the country in which the Islamic bank operates.

3. Islamic bank in Jordan

Islamic banking system has been in Jordan for roughly two decades, where it played a significant role in funding and contributing to several economic and social activities in the country, where it complies with the principles of Shari'a Law in the area of Islamic banking practices. The assets of the four Islamic banks operating in Jordan are \$4.6 billion and forms 5 percent of total banking assets. They achieve annual growth of 13 percent and are better than traditional banks in growth of deposits and financing. This reflects high demand for transactions; especially that they offer various unique services and products.

The history of Islamic financial institutions in Jordan is not that old. Jordan Islamic Bank (JIB) for Finance and Investment was established in 1979 with a capital of JD (4) Million divided into (4) Million shares. The Bank's capital increased over the years to reach JD (125) Million in the year 2012. The Bank aims at accommodating the diversified economical and social needs of citizens in the fields of banking, financing and investment on a non- usurious basis. This is realized through the Bank (64) branches and (15) offices, widespread all over the kingdom in 2012. The Jordan Islamic Bank has been growing rapidly; the number of clients as well as the volume of funds mobilized and invested reflects this rapid growth.

The success made by Jordan Islamic Bank, however, encouraged the Arab Bank Corporation (the largest financial institution in Jordan), to establish The International Arab Islamic Bank in 1996: started work in 1998 to meet the increasing demand, locally and in the Arab and Islamic markets, for banking services and products that are in accordance with the Islamic Sharia

In addition to the Islamic banks mentioned above, two other Islamic banks operating in Jordan are Jordan Dubai Islamic Bank which was established in 2010 and Al Rajhi Bank which set up its branch in 2011.

4. Research Methodology:

This paper aims to compare between Istisna and Murabaha by using in Jordanian Islamic bank, secondary data have been used depend on annual reports for the period (2004 – 2010).

The Research will use the descriptive analysis of the data collected and calculated from the annual reports of the two Islamic Banks working in Jordan, the Jordan Islamic Bank for Finance and Investment (JIB) and the Islamic International Arab

Bank (IAB). We excluded Dubai Islamic bank and Al Rajhi Bank from our sample because of the short period time .

For the period from 2004 to 2011, since those years are the most recent times of Islamic banks activities and it could be enough periods to test the study hypothesis.

The table (1) and (2) show the Islamic instruments of financing such as Murabaha and Istisna for Jordan Islamic Bank and Islamic International Arab Bank. The amount of money invested in each of these methods represented by the time series from 2004-2011. Where it is noted that the volume of funds invested through methods of financing investment style was Murabaha. It acquired the largest share of these funds invested during the time period 2004 - 2011, followed by Mudaraba then Istisna. The table 3 and 4 indicate that the ratio of Murabaha has increased from only 42% in 2004, to 53% in 2011 in Jordan Islamic Bank and in Islamic International Arab Bank ratio of Murabaha has increased from 26% in 2004, to 43% in 2011, on the other hand the ratio of Istisna equals zero in Jordan Islamic Bank and 2% in Islamic International Arab Bank for the period 2004-2011.

5. Descriptive analysis of the variables of the study

Table (6) and (7) show descriptive statistics for the variables of the study, the tables show that the Mudaraba data and the Istisna does not far from the normal distribution using the test (Jarque-Bera), and to accept the null hypothesis that the data follow a normal distribution

As shown us from the results of the sprain values and through review of mean and median values, we find its close, so this indicating the absence of sharp fluctuations in the fluctuation of these variables.

Conclusion

By examining tables, the study concludes that in the Islamic banks working in Jordan the majority of the Islamic investments attributed to Murabaha and ignores the other Islamic investment "Istisna", Istesna's percentage are very low, less than 3% for each.

Theoretically, Islamic banks should offer " Istisna" to support industries. This research finds that the Islamic Banks in Jordan do not offer " Istisna" services at all. So they do not have any effective role in supporting industries in Jordan.

As a result this study recommend Islamic banks in Jordan to increase depending on the Islamic form "Istisna", because this kind of Islamic investment tools plays an important role in supporting small and medium industries, and to find an effective ways to deal with other banks all over the world.

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Table (1) Jordan Islamic Bank for Finance and Investment (in J.D)

Year	Murabaha	Istesna'a
2004	227754230	0
2005	294966288	0
2006	319079764	0
2007	247,485,620	0
2008	363,653,953	0
2009	425,190,691	0
2010	282,752,606	0
2011	315,038,378	0

Table (2) Islamic International Arab Bank (in J.D)

Year	Murabaha	Istisna
2004	103,569,132	1361747
2005	114,580,672	2953912
2006	146,774,915	3196225
2007	230,282,173	4999636
2008	215,760,540	7041469
2009	209,069,266	5561435
2010	235,090,632	6726972
2011	260,665,931	7184531

Table (3) the ratio of Murabaha and Istisna per the total of investments for the Jordan Islamic Bank for Finance and Investment

Year	Murabaha	Istisna
2004	42%	0%
2005	46%	0%
2006	22%	0%
2007	35%	0%
2008	31%	0%
2009	35%	0%
2010	56%	0%
2011	53%	0%

Table (4) ratio of Murabaha and Istisna per the total of investments for the Islamic International Arab Bank

Year	Murabaha	Istisna
2004	26%	1%
2005	29%	1%
2006	36%	1%
2007	75%	2%
2008	74%	2%
2009	70%	2%
2010	64%	2%
2011	56%	2%

Table (5) averages of both banks data as a sector of Islamic Banks in Jordan

Bank	Murabaha	Istisna
Average		
Jordan Islamic Bank	40%	0%
Islamic International Arab Bank	54%	2%

Table (6): Descriptive analysis for Islamic International Arab Bank data

Murabaha	Istisna	
179303904	4548771	Mean
209069266	4999636	Median
235090632	7041469	Maximum
103569132	1361747	Minimum
56138212	2110172	Std. Dev.
-0.365307	-0.228924	Skewness
1.381356	1.718095	Kurtosis
0.91986	0.540431	Jarque-Bera
0.63132	0.763215	Probability
7	7	Observations

Table (7): Descriptive analysis for Jordan Islamic Bank data

Murabaha	Istisna	
308697593	0	Mean
294966288	0	Median
425190691	0	Maximum
227754230	0	Minimum
68140856	0	Std. Dev.
0.5509169	0	Skewness
2.2615495	0	Kurtosis
	0	
0.513142	0	Jarque-Bera
0.773699	0	Probability
7	7	Observations