

*Islamic Banking and its Financing Methods**الصيرفة الإسلامية وطرق تمويلها*Yahiaoui Said ¹

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Abstract:

Islamic banking operates on the principles of Islamic Sharia, providing financial services that adhere to Sharia guidelines and strictly avoid usury and illegal risks. Islamic banks serve as intermediaries, facilitating innovative financing and investment operations such as participation, crowdfunding, leasing, and profit-sharing. Their primary objectives include promoting financial justice, social financing, and sustainable economic development in alignment with Islamic principles.

Keywords: Islamic banking; Principles of Islamic Sharia; Financial Intermediation; Islamic financing.

ملخص:

البنوك الإسلامية هي نظام مالي يعمل وفقاً لمبادئ الشريعة الإسلامية، حيث تقدم خدمات مالية وتمويلية تتماشى مع الشريعة وتتجنب بشكل صارم الربا والمخاطر الغير قانونية. تعد البنوك الإسلامية جزءاً أساسياً من هذا النظام وتلعب دور الوسيط المالي في تيسير العمليات التمويلية والاستثمارية المبتكرة، مثل التشارك، التمويل الجماعي، التأجير، والمشاركة في الأرباح.

كلمات مفتاحية: البنوك الإسلامية؛ مبادئ الشريعة الإسلامية؛ الوساطة المالية؛ الصيرفة الإسلامي.

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INTRODUCTION

Islamic banking and Islamic banks are part of the Islamic financial system, which is founded on principles and rules derived from Islamic Sharia. The objective of Islamic banking and Islamic banks is to provide financial and financing services that adhere to Islamic principles and laws.

In the Islamic financial system, usury (interest) is prohibited and considered religiously unacceptable. Consequently, Islamic banks serve as alternatives to conventional banks by conducting their financial operations in accordance with the principles and provisions of Islamic Sharia.

Islamic banks possess several key characteristics. One such characteristic is the utilization of the principles of participation and partnership, where the bank and the client share the profits and losses arising from business and financing projects. Additionally, Islamic banks embrace the concept of Islamic financing, which involves providing financial services through innovative methods such as cost plus financing, profit-sharing, leasing, Partnership and others.

1. Section one: Islamic Banking and Financial Intermediation

Islamic banking is a financial system based on the principles of Islamic law, also known as Shariah. It operates in accordance with the ethical and moral principles of Islam, which prohibit the charging or paying of interest (riba) and promote risk-sharing and fairness in financial transactions.

1.1 Chapter one: The Nature of Islamic Banking and Financial

Intermediation

1.1.1 Branch one: Concept of Financial Intermediation

Financial intermediation refers to the process through which financial intermediaries provide individuals and companies with financial services and solutions. Financial intermediation encompasses various activities such as trading in financial markets, investment management, provision of financial advice, arranging financing, insurance, financial analysis, and general financial consultancy.¹

1.1.2 Branch two: Islamic Banking

Islamic banking is a financial system that operates in accordance with Islamic Sharia laws and principles. Islamic banking is based on the concept of participation and avoids usury (unlawful interest) and prohibited risks. A selected range of Sharia-compliant financial instruments and products are applied in Islamic banking, such as profit and loss sharing, Murabaha (cost plus financing, Mudarabah profit-sharing, Partnership (partnership), and Islamic investment funds.

The objective of Islamic banking is to provide fair and Sharia-compliant financial solutions for individuals and companies, while promoting economic participation and enhancing social cohesion. Islamic banking is considered one of the pillars of the Islamic economy and is part of the comprehensive Islamic financial system that is based on Sharia principles and ethics.²

1.2 Chapter 2: The Role of Islamic Banks in Financial

Intermediation

In the world of economic competition, financial intermediation becomes a necessary aspect of the Islamic economy. A fast-growing economy cannot be imagined without financial intermediaries. It is not an exaggeration to say that a society that disregards financial intermediation is no better off than a society that abandons the use of money. Assuming the existence of a contemporary Islamic economy without financial intermediation, citizens would save, and Islamic banks would take those savings for investment purposes, either directly or through partnerships with businessmen. This would lead to two consequences:

The first one is that Islamic banks would be exposed to all commercial risks, and this exposure would be transferred to depositors in investment accounts. The division of labor and risk-sharing that can be undertaken by an institutional system to mitigate risk would not be possible due to direct transactions between Islamic banks on behalf of depositors and real sector producers, i.e., businessmen. Considering people's aversion to risk, savings would decline.

The second one is that it may become difficult for innovators and businessmen to finance their projects because the funders (Islamic banks) would seek to avoid significant risks. Moreover, Islamic banks would prefer exercising some control over projects through participation, for example. As a result, financing from Islamic banks to real businessmen would not flow easily and quickly, as it would with the presence of intermediaries.

Consequently, real investment would decline. If the economy is closed, business activities would contract, production would decline, and employment and income would decrease. However, there is no closed economy in today's world. Businessmen who do not secure deals with Islamic banks would seek alternative funders. Depositors, seeing increased risk in investment accounts, would also look for other options. At that point, non-Islamic banks would seize the opportunity, leading to the marginalization of Islamic banks, which would quickly be excluded from the market.³

Thus, financial intermediation is a necessity according to the various interpretations of the term in Islamic jurisprudence. If Islamic societies lack financial intermediaries, they will either become weak and isolated or non-Muslim opponents will take on the role of financial intermediation, leading to severe consequences for the financial and monetary system. Moreover, we see that Islamic banks are the most qualified institutions to perform financial intermediation. No other financial institution can fulfill this role, and no traditional institution (stock market, insurance companies, mutual funds) can perform it in an Islamic manner.

Therefore, Islamic banks have a duty to engage in financial intermediation. Islamic societies must build a sound economy that meets the needs of their Islamic citizens in order to protect themselves from internal deviation or external encroachment. A genuine and sound economy cannot exist without financial intermediation. "What is obligatory cannot be achieved except

through obligation," and the burden of this duty falls on those who are qualified to fulfill it. This, in itself, constitutes an obligation on Islamic banks. Furthermore, it supports our argument that financial intermediation was not a reprehensible practice in previous Islamic societies. There is no doubt that direct financing was prevalent, but the practice of one party providing financing based on profit-sharing to another party, who then delivers it to a third party, the actual beneficiary based on profit-sharing, was a known practice.

Financial intermediation through traditional Islamic contracts, such as deferred sale, installment sale, leasing, and partnership, plays a vital role. The essence of financial intermediation is the transfer of resources from savers to investors, involving the necessary transformation in terms of time horizon, resource volume, risk, etc., to tailor the offerings according to the users' needs. Those who facilitate this transfer and transformation are called intermediaries. However, the contracts mentioned earlier are originally direct contracts between the providers of capital and those who utilize it, with no room for intermediation. These four contracts, in their basic form, tell the story of direct financing.

Intermediation can enter these four contracts, as it has entered in the case of "speculator speculating." In this scenario, the intermediary "T" takes money from its owner "B" with the promise of putting it into productive use and sharing the profits. The speculator places the money at the disposal of the user "C," who utilizes it in their establishment or factory with the hope that

"T" will share in the profits resulting from the use of that money, i.e., the increase in value achieved from using the funds of "B" is divided between "C," "B," and "T." "C" receives their share due to their successful efforts in developing the capital, "B" receives their share due to the utilization of their funds, which were saved and exposed to risk, while "T" receives their share due to their proper selection of the appropriate use of "B's" funds, which is recognized as entrepreneurial activity.⁴

2. Section two: The first one is that

Islam has provided various forms for the utilization and investment of money through legitimate means, whether through capital collaboration or collaboration between capital and labor. These forms can be referred to as financing methods, and we will attempt to study these forms in detail, including their concepts, rulings, and implementation methods.

2.1 Chapter 1: Speculation, Partnership, and Profit-Sharing

2.1.1 Branch 1: Speculation

According to dictionary Al-Muhit: "And it has been said that a person speculates when he trades with his money, and it refers to borrowing."

In technical terms, Ibn Rushd defines speculation as follows: "It is when a person gives money to another person to trade with, with a known portion that the worker takes from the profit of the money, whether it is a third, a quarter, or half, as agreed upon."⁵

Financing projects through speculation can be divided into two categories:

- **Absolute Speculation:** It is not bound by specific conditions set by the capital provider in terms of time, place, nature of the activity, etc.
- **Restricted Speculation:** It is carried out in a specific operation or project, with specific conditions set by the capital provider on the speculator.

The speculation that used to take place in the past was a form of short-term financing because most financial and commercial transactions were conducted on a short-term basis at that time. However, nowadays speculation can be conducted on a short, medium, or long-term basis, which is the most prevalent in current speculation applications. With the development of economic activities and the emergence of large commercial and industrial projects, implementing speculation on a short-term basis has become difficult because the essence of speculation is that it continues until all offers are exhausted, as the profit measurement depends on the exhaustion of offers.

Regarding funds deposited during the year, their profits are calculated based on the proportion of months in which they were available for use by the owner.

2.1.2 Branch Two: partnership

In Language the term "participation" is derived from the concept of partnership.

In Islamic jurisprudence, scholars define "partnership" as an agreement between two or more individuals to engage in business activities, pooling their resources, skills, and personal

contributions, such as reputation. The profits are shared among the partners according to the agreed-upon terms.

The unique approach employed by Islamic banks to invest the deposited funds is as follows: The bank utilizes these funds in projects it undertakes itself within a limited scope or provides financing for projects undertaken by others through a partnership in financing and sharing returns, based on the principles established by Islamic law.⁶

The system of participation aims not only to adhere to Islamic teachings and principles but also to achieve justice, which is a fundamental objective of these teachings. Additionally, it brings about various long-term social and economic benefits within society. For example, the bank's involvement in its customers' productive activities allows the bank to utilize its technical expertise in identifying the best investment opportunities and methods, combining capital and expertise to contribute to national economic development.

2.1.3 Branch Three: Profit-Sharing Financing

In Language: The term "profit-sharing financing" is derived from the concept of obtaining profit, as if we say that the buyer has gained profit on their commodity.

In Islamic terminology, profit-sharing financing refers to a sale where the seller and buyer agree on the price of the commodity, with the addition of a profit margin. Islamic sales can be categorized as follows:

- Trust Sales: In this type, the seller and buyer agree on the

price of the commodity, with the option to choose the original cost. It includes the following variations:

- Sale at a Lower Price: The selling price is lower than the purchase price.
- Sale at the Same Price: The selling price is equal to the purchase price.
- Profit-Sharing Sale: The selling price is higher than the purchase price.
- Negotiated Sale: The price of the commodity is agreed upon without stipulating its original cost, allowing negotiation between the parties.

Profit-sharing financing has become a primary element for Islamic banks. Due to its guaranteed profit and short-term nature, these banks apply it to a significant portion, averaging at least 75% of their total operations. Some banks even apply it at a rate of 90%.

Islamic financing expenses in profit-sharing financing have proven to be an effective means of utilizing funds. This is because profit-sharing financing offers advantages over speculative and partnership arrangements in terms of swiftly mobilizing funds. Islamic financing expenses are still relatively new in productive investments. Furthermore, the environment in which these expenses operate has a significant impact on the transactions of these banks.

2.2 Rent, Slam, and Mugarasah

2.2.1 First Branch: Rent

In language, "rent" means leasing or hiring, which involves receiving wages in exchange for work.

In terminology, it refers to a contract for a lawful and known benefit, taken gradually over a specified period from a specific source.

The permissibility of rent is supported by the Quran, Sunnah (Prophetic traditions), and consensus.

2.2.2 Second Branch: Slam (السلم)

In language, "slam" means an advance payment. It can also refer to delivering the capital in a transaction, where the buyer pays in advance to the seller.

In terminology, it refers to delivering a known commodity for a deferred price.

Slam is the opposite of a regular sale, as it involves immediate payment and deferred delivery, whereas a regular sale involves immediate delivery and deferred payment. Slam is allowed for both parties because the sale price in slam is usually lower than the regular sale price. The seller benefits from receiving the advanced capital to meet their needs, while the buyer benefits from a reduced price.

Slam is a short-term financing method primarily used for agricultural products for one season, usually less than a year.

Islamic banks can widely apply this financing method, especially in the field of agriculture. The bank purchases the agricultural produce from the farmer before harvest, benefiting from a lower price, and later sells the produce after the harvest at a suitable profit margin. The farmer benefits from the advance

payment, which helps in agricultural expenses, making it more efficient. This also prevents the farmer from resorting to interest-based loans.

It is important for the bank not to exploit the farmer by reducing the price and to adhere to a fair price.⁷

2.2.3 Branch Three: Mugarasah (المغارسة)

In language, "mugarasah" is a derivative of the term "ghars" (planting).

In terminology, Ibn Rushd al-Hafid defined mugarasah as follows: It is when a landowner gives his land to another person on the condition that a certain number of fruits or crops are planted. When both partners fulfill their obligations, the planter is entitled to a portion of the land, as agreed upon.

The legitimacy of mugarasah is supported by evidence. Imam Ibn Hazm argued that mugarasah applies specifically to trees, where a worker plants a piece of land on behalf of its owner. Once the trees become productive, the worker receives a portion of both the land and the trees as compensation. Therefore, we consider it a form of rent, and it also has similarities with sharecropping.

If we consider different types of trees with permanent roots, we find that they require several years after planting to become productive. Therefore, mugarasah is a medium-term financing arrangement, with the duration varying slightly depending on the type of planted tree.

Islamic banks can apply this arrangement by purchasing lands using their own funds and then granting them to individuals

for cultivation through mugarasah. Alternatively, the Islamic bank can engage in land development for its owners through mugarasah, employing workers. This process allows the bank to provide the necessary financing, and after acquiring ownership, the bank can implement farming or agricultural projects, whether through the first method of land purchase or through ownership in mudarabah (profit-sharing) transactions.

CONCLUSION

In conclusion, Islamic banks follow different financing methods compared to traditional banks, based on the principles of Islamic law. These methods aim to provide financing solutions that are compliant with Shariah laws, avoiding interest and illegitimate risks.

Islamic banks utilize these methods to meet the needs of their customers and provide Shariah-compliant financial services. These methods ensure there is no unfair financial exploitation and promote the principle of fairness in financial transactions. They also contribute to enhancing economic stability and achieving sustainable development in the communities where Islamic banks operate.

¹ Ibn Taymia, "The Shari'a Policy in the Conditions of the Shepherd and the Flock," Cairo, Dar Al-Kutub Al-Arabi, 1955, p. 40..

² Ahmed Ibn Hasan Ibn Ahmad Al-Hasani, "Investment Funds: A Study and Analysis from the Perspective of Islamic Economics," Shabab Al-Jami'ah Foundation, Alexandria, 1999, p. 21.

³ Al-Arabi, Mohammad Abdullah, "Contemporary Banking Transactions and the View of Islam," Cairo, Al-Azhar Magazine, Second Conference of the Islamic Research Council, May 1965.

⁴ *ibid*, p. 24.

⁵ Al-Arabi, Muhammad Abdullah, p. 24.

⁶ Abdul Muniim Sayed Ali, Nizar Saad Al-Din Al-Issa, "Money, Banks, and Financial Markets," Dar Al-Hamid for Publishing and Distribution, Amman, Jordan, First Edition 2004, p. 67.

⁷ Program of Islamic Investment Methods in Banking and Commercial Sectors, p. 74, website www.Khartoumstock.com, dated 22/03/2024.

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