

*EVALUATING THE SHARIAH COMPLIANCE
AND OPERATIONALISING MAQASID AL
SHARIAH: THE CASE FOR ISLAMIC PROJECT
FINANCE CONTRACTS*

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TAREQ HESHAM MOQBEL

EVALUATING THE *SHARIAH* COMPLIANCE AND OPERATIONALISING *MAQASID AL SHARIAH*: THE CASE FOR ISLAMIC PROJECT FINANCE CONTRACTS

ABSTRACT

While the Islamic financial industry has been growing rapidly and has become a significant sector in many countries, it is often criticised of not complying with *Shariah* (Islamic law) principles and not fulfilling the goals of Islamic law, *maqasid al Shariah*. Against the positive financial developments of Islamic finance and Islamic project finance (IPF) in particular, it is important to critically examine the underpinning aspects of IPF from the *Shariah* and *maqasid* perspectives. Hence, this study aims to explore the contracts used in IPF with the objective of examining their practice in Islamic financial institutions from two dimensions: the *Shariah* compliance and the adherence to *maqasid al Shariah*.

Regarding the *Shariah* component, the study commences with a critical explorative review of the main IPF contracts and their structures. The study then develops two frameworks for *Shariah* analysis. The first framework relates to compliance with the AAOIFI (2010) *Shariah* Standards and the second one relates to the overall compliance of the contracts with Islamic commercial law. Four real life contracts, as the case studies, are studied—*mudarabah*, *murabahah*, *ijarah* and *istisnaa*—and examined against these two *Shariah* compliance frameworks.

The second component of the research analyses *maqasid al Shariah* by examining the classical and contemporary discourses and establishes the relationship between Islamic commercial law and *maqasid*. In addition, the sampled contracts of *mudarabah*, *murabahah*, *ijarah* and *istisnaa* are deconstructed into their particular rulings and the rulings are linked to their appropriate *maqasid* through an inductive analysis. In addition, a framework is developed to examine and quantify the *maqasidic* compliance. In developing this framework, it was pertinent to assign weights to the *maqasid*. Therefore, the study first constructed an index—the *Maqasid al Shariah* Index (MSI)—to measure the relative weights of *maqasid* in general, and then applied the index to weigh the *maqasid* of economic activities. The conceptual frameworks developed were then applied to actual IPF contracts to examine their *maqasid* compliance.

The empirical results show relatively low compliance scores and do not reflect a positive status of Islamic finance when it comes to *Shariah* compliance and realisation of *maqasid*. Nevertheless, the study provides useful lessons and information that can be used to evaluate the current practice of IFIs. This initial step is necessary in order to reshape the industry towards the realisation of the social and developmental aspects of Islamic economics. More importantly, the study contributes towards the construction of a normative and ethical philosophical basis for the Islamic moral economy.

**EVALUATING THE *SHARIAH* COMPLIANCE AND
OPERATIONALISING *MAQASID AL SHARIAH*: THE CASE
FOR ISLAMIC PROJECT FINANCE CONTRACTS**

TAREQ HESHAM MOQBEL

Thesis Submitted in Fulfilment of the Requirements for the
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DEDICATION

TO ALLAH THE ALL MIGHTY

وَمَا بِكُمْ مِّن نِّعْمَةٍ فَمِنَ اللَّهِ ^{صلى}

and

To my great parents *Hesham* and *Eman* who were always my teachers and best friends

For all you have sacrificed for me ...

For all you have taught me ...

For all the love you represent ...

رَبِّ أَرْحَمُهُمَا كَمَا رَبَّيَانِي صَغِيرًا

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CHAPTER 1

INTRODUCTION

1.1 OVERVIEW AND BACKGROUND

Islamic finance, which was initiated in the 1970s, has emerged as one of the most rapidly growing industries in the 20th century. With financial assets totalling 1.54 trillion USD in 2012 and expected to reach 3.4 trillion USD by 2018 (Ernst and Young, 2014), the Islamic financial industry is increasingly establishing itself as a strong competitor in the global financial system. Already accounting for 1.5% of total global banking assets (Beck *et al.*, 2013) and operating in at least 105 countries (Warde, 2010), Islamic finance has been attracting increased attention in the wake of the global financial crisis.

Within the Islamic financial sector, a relatively new field is emerging—Islamic project finance (hereafter, IPF). IPF can be traced back to the early 1990s in the form of a 92 million USD Islamic tranche to finance the Hub River power project in Pakistan (Clifford Chance, 2013). In 1995, *Shariah* (Islamic law) compliant project financing schemes, particularly *istisnaa* (manufacturing contract) financing, were implemented in Malaysia to fund the PUTRA Light Railway Transit project (Wilson, 1998). The *Shariah*-compliant access to equity capital markets and the introduction of *sukuk* (Islamic bonds) in the late 1990s were additional developments in the IPF industry (McMillen, 2009). Since then, project financing involving Islamic techniques has occurred in the GCC region and beyond.

IPF holds significant promise for Islamic nations and others. The growing global population of Muslims is a substantial factor given the expected increase from 1.6 billion in 2010 to 2.2 billion in 2030 (Pew Research Center, 2011). This increase will affect project financing by boosting demand for infrastructure and development projects, such as electricity, water, roads and other services, all of which are capital

intensive. This situation has motivated multilateral organisations such as the Islamic Development Bank (hereafter, IDB) to establish infrastructure funds. The IDB established the IDB infrastructure fund in 2001 and another infrastructure fund in collaboration with the Asian Development Bank in 2009. Both funds aim to invest in infrastructure projects while promoting Islamic finance for similar projects (Islamic Development Bank, 2012). Liquidity is another factor that contributes to IPF development. The availability of funds in Muslim countries, particularly the GCC, is tremendous. Wealth management schemes have been established in banks and financial institutions, and these schemes are considered the main reason for the success of IPF (Clifford Chance, 2013). Against these positive financial developments, it is important to critically examine the underpinning aspects of IPF. One of the main motivations underpinning this study, therefore, is the remarkable growth of IPF.

At the core of Islamic finance is the issue of *Shariah* compliance, which is considered “the main justification of the existence of Islamic banking and finance” (Diaw and Febianto, 2014: 170). *Shariah* compliance denotes compliance with the Islamic religious precepts governing what is good and permitted versus what is harmful and forbidden (De Lorenzo, 2000). *Shariah* supervisory boards endeavour to ensure compliance (Graiss and Pellegrini, 2006) by certifying all financial products and contracts (Hayat *et al.*, 2013).

One of the most important areas that must be *Shariah* compliant is the chief component of Islamic finance—the contracts. The Islamic system of *muamalat* (transactions) defines several contracts that serve as the foundation for all transactions (De Lorenzo, 2000). Islamic commercial law specifies rules for various specific contracts (Vogel and Hayes, 1998). Hence, ensuring that contracts comply with *Shariah* is an essential requirement that legitimises Islamic financial institutions (hereafter, IFIs). Therefore, it is important to examine the *Shariah* compliance of contracts because the non-adherence of contracts to *Shariah* requirements exposes IFIs to *Shariah* compliance risks (De Lorenzo, 2000). This type of risk, which is unique to Islamic banks, requires attention because it can introduce reputational risk and damage customer confidence (Ahmed *et al.*, 2014).

In this context, a body of existing literature claims that Islamic finance does not comply with genuine *Shariah* requirements and, thus, differs from conventional financial institutions in form, but not in substance (El Gamal, 2006). This view contends that IFIs closely implement the techniques of their conventional counterparts (Kuran, 1993 cited in Khan, 2010). El Hawary et al (2004), in their analysis of the defining characteristics of IFIs—risk sharing, materiality, no exploitation, and no financing of sinful activities—show that IFIs do not differ incrementally from conventional banking. Zaman (2008: 10) concurs with this conclusion: “It appears that no matter how the transactions are structured by the Islamic bank, as long as these are made into ‘contract’ documents, these are termed as Islamic”. Similarly, Abu Zaid (2014) emphasises that Islamic financial products have failed to show differences from conventional financing products. The potential benefits of Islamic banking thus remain theoretical. Nevertheless, other scholars assert that IFIs are not required to reinvent products but can minimally modify conventional products to ensure compliance with *Shariah* (Farak *et al.*, 2014).

This study is therefore motivated by the centrality of *Shariah* compliance in Islamic finance and its importance in legitimising the practice of IFIs. Additionally, to the best of the knowledge of the researcher, no significant research has been conducted on the *Shariah* compliance of IPF contracts using deconstructive analysis, although IPF offers tremendous potential and significant applications in the Muslim world and beyond. This study addresses this gap in the literature. Analysing real-life Islamic contracts can also clarify the nature of *Shariah* compliance in IFIs generally and can provide evidence to verify or disverify the assertion that IFIs do not fully adhere to *Shariah* requirements.

However, Islamic finance does not only involve adherence to the legal *Shariah* requirements; it also involves broader ethical and moral issues (Khan, 2010). IFIs, as essential components of the wider Islamic order, must be aligned with the moral value system of Islam (Iqbal and Molyneux, 2005). The primary role of Islamic behavioural norms and the moral value system is to confer social responsibility on the individual (Kuran, 1986) and to transform the “selfish and acquisitive *homo economicus* into a paragon of virtue, *homo Islamicus*” (Kuran, 1995: 159).

According to Chapra (1985), the money and banking system in Islam should contribute to the realisation of the major socioeconomic goals of Islam, such as economic well-being and social justice. These notions have roots in the classical discourse on *Shariah* that emphasises that the objective of *Shariah* is to promote the welfare of the people (Al Ghazali¹, 1997). Collectively, the objectives and purposes of *Shariah* are known as *maqasid al Shariah* (Al Shatibi², 2004; Auda, 2008).

The practical implication of this value oriented system is that IFIs are expected to provide ethical financing that realises the objectives of *Shariah* and embeds social responsibility in business models (El Nahass *et al.*, 2013). Hence, embedding *maqasid al Shariah* in IPF projects and contracts is essential, particularly given that project finance offers a fertile ground to realise the social aspects of Islamic finance. This is because infrastructure projects serve a wide array of beneficiaries and engender considerable social impact.

However, the contemporary practices of IFIs have not been immune to criticism in terms of the moral and ethical perspectives. Islamic finance has been criticised for failing to achieve the ethical and social goals of the Islamic moral economy and failing to construct a human-centred development (Asutay, 2010). Essentially, it is suggested that Islamic finance has not fulfilled the goals, higher intents and purposes of Islamic law, *maqasid al Shariah* (Siddiqi, 2004; Hasan, 2005). This purported gap between ideals and reality is attributed to the mechanistic, non-consequentialist nature of the contemporary application of the Islamic law of financial transactions (Asutay and Zaman, 2009). It has been contended that the prevalent reductionist *fiqhi* approach to Islamic finance limits the wider implications of *Shariah*—the emphasis on contract forms and compliance at the micro level fails to realise the wider objectives of the Islamic moral economy (Barom, 2013).

The importance of *maqasid*, therefore, is a main motivator of this study. *Maqasid* and their ethical and moral implications cannot be severed from Islamic project financing. It is important to develop a systematic way to understand and to attempt to quantify the social aspect—the *maqasid*—of the different contracts, particularly given that all

¹ D. 1111 AD.

² D. 1388 AD.

Shariah rulings that constitute the contracts can be linked to their relevant *maqasid*, objectives (Al Shatibi, 2004).

Therefore, the focal point of this study is the intersection of three significant and relatively under-researched areas: *Shariah* compliance, Islamic project financing and *maqasid al Shariah*. IPF financing contracts, as part of the Islamic system of economics, should adhere to the requirements of *Shariah* while realising the social and ethical objectives of the Islamic moral economy. Hence, this study aims to explore the contracts used in IPF and to examine their practice in Islamic financial institutions in two dimensions, namely, *Shariah* compliance and adherence to *maqasid al Shariah*.

It is important to stress that this study investigates only the contractual aspect of IPF and the contract-related social and ethical issues. That is to say that the social and ethical aspects of IPF and their social consequences will not be addressed in this study because they constitute a wide topic, whereas focusing on the contractual and legal aspects enables a more in-depth analysis.

1.2 THEORETICAL FRAMEWORK

As this study analyses the *Shariah* and *maqasid* dimensions of IPF contracts, developing a theoretical frame of reference is necessary to guide the research methodology and interpretation of results. The overarching framework for this study rests on two main notions: intentionalism and consequentialism in terms of the construct and consequence of legal action or decision. This section, therefore, briefly explores both approaches from the perspective of normative ethical theory as well as classical Islamic discourses.

Normative ethical theory aims to provide answers to questions such as: What kinds of actions are right or wrong? What are the moral virtues? What does morality require? Such abstract questions arise when we attempt to make decisions (Copp, 2006). Put differently, normative ethics involves proposals concerning how to live and how to act (Kagan, 1998). Deontology—which is also known as intentionalism—and

consequentialism are two of the prominent types of normative ethical theory, which are relevant to Islamic finance in the context of project financing in terms of evaluating the process and measuring the consequences of decision-making.

Consequentialism, as its name suggests, is the view that the moral rightness of an act depends on the consequences of that act. Some versions of consequentialism hold that in any given choice situation, the agent is required to perform the act that has the best consequences. Therefore, according to this view, it is not sufficient that an act has good consequences. Rather, the act that has the best outcome—when compared to the alternatives—has to be performed (Kagan, 1998). Similarly, utilitarianism, the most famous consequentialist theory, holds that the moral rightness of an action depends on what would produce the greatest overall value (Darwall, 2003).

In contrast to consequentialism, deontology maintains that rightness is not justified by its consequences; rather, there are other considerations that make an act right or wrong (McNaughton and Rawling, 2006). Therefore, deontologists believe in other normative factors beyond the goodness of results (Kagan, 1998). One of the factors that may determine the goodness of an act is the intention. Hence, deontology may be regarded as an intentionalist theory implying that as long as the instrumental and procedural nature of decision-making is ‘good’ in itself, consequences do not make a difference; thus, it can be referred as instrumental or procedural morality.

As regards to Islamic ontology and epistemology, *Shariah* scholars in the post-*ijtihadi* closure period, adopted the intentionalism as part of the *usul* methodology. This is particularly an issue in the modern times with the emergence of Islamic finance; as the *Shariah* scholars focus on the ‘form’ or the ‘procedural’/‘instrumental’ nature of morality through a rational-legalistic methodology, through which they have defended the projects financings that they have approved. This implies that ‘substance’ related morality is ignored in the Islamic financing and financial transactions and therefore, the current debate has been around ‘form’ vs. ‘substance’ or ‘*Shariah* complicancy’ vs. ‘Islam-based financing’, respectively, referring to the ‘intentionalism’ and ‘consequentialism’ nature of the debate.

As opposed to the modern *Shariah* scholarship in Islamic finance, however, the notion of consequentialism can also be found in the Islamic core sources. The Quran, for instance, emphasises the notions of *eman* (belief) and *al amal al saleh* (doing righteous deeds) in a number of verses (see: 2: 277; 18: 107) and speaks about them almost invariably implying that they complement each other and go hand in hand. In the hermeneutics of the Quran, thus, *eman* can be understood to represent the intention whereas *al amal al saleh* can represent the consequentialist component; therefore, lack of either does not bring *falah* or salvation (happiness). Consequently, by essentialising both aspects of daily behaviour, Islam in essence brings a complementarity of morality—as opposed to modern Islamic scholarship, Islam essentialises also consequentialism; and as opposed to the Western thought, Islamic ontology enforces instrumental morality or intentionalism. Thus, Islamic methodology, in its origin, overcomes the divide between ‘contemplation’ and ‘action’ suggesting the complementarity of Islamic methodology as the articulation of *tawhid*.

Consequently, in reflecting on the notion and method of complementarity, Nasr (2002) illustrates this idea at different levels—the complementary function of the Islamic society; complementarity between the creation of humans and the creation of the cosmos; complementarity between Islam and other religions; and the complementarity of roles between males and females. Thus, it is considered that Islamic ontology essentialises complementarity. Therefore, in Islamic finance, ‘intentionalism’ has to be complemented with ‘consequentialism’ as a direct expectation of the Islamic *tawhidi* methodology.

On a more clearer note the idea of consequentialism can be deduced from the story of Khidr and prophet Moses in *surat al Kahf* (The Quran: 18: 65-82). The Khidr, in this narrative, conducted some acts that caused some damages, as a consequence, in order to achieve greater benefit. He, therefore, acted on the basis of the consequences of his actions.

Another example, which clearly manifests consequentialism, is the prevention of *hiyal*—legal means by which one can arrive at results otherwise prohibited by the law. The law prohibits these results because they may lead to the avoidance of obligatory

acts or may allow what is not permissible. The classical example of this type of stratagem is the combination of doctrines from more than one school in an arbitrary manner (Hallaq, 1997). Similarly, the doctrine of blocking the means, which states that a lawful action may be forbidden because it could be means that lead to unlawful actions (Kamali, 2003), is essentially a consequentialist notion. Analysing the jurisprudential discourse within Islamic methodology, hence, reveals the presence of consequentialism.

It should be noted that in particular, the *maqasid al Shariah* discourse is purely consequentialist³ as it gives priority to achieving the overall goals of *Shariah* and incorporates the substantial morality, while *Shariah* in its modern application, as an instrumental morality, focuses mainly on intentionalism. However, the complementarity of methodology within the *tawhidi* paradigm ties *Shariah* with *maqasid*; implying that lack of either would undermine the Islamic methodology. This is the main theoretical argument of this piece, which should be considered as an attempt in grounded theory.

In substantiating this methodology, scholars proclaim that a jurist who gives a judgement on a specific case should also be aware of the acumen and special circumstances of that specific case. Therefore, the jurist must investigate the *illah*, *ratio legis* in that case and consider the context (Hallaq, 1997). Thus, the same case can be given different rulings depending on different circumstances because issuing the same ruling in different cases can generate consequences that are inconsistent with the *maqasid*. This important aspect of outcome consideration illustrates the consequentialist component of Islamic law.

In this context, Al Shatibi (2004) argues that the intention of the person must be the same as the intention of the *Shariah* in all worship, actions, and transactions. Therefore, any act of worship or any transaction whose intended purpose departs from the purpose of the *Shariah* is deemed invalid, even if its form complies with the *Shariah* and even if all of the rules and stipulations are fulfilled. This directly explains the complementarity of Islamic methodology by suggesting that *Shariah* has to fulfil

³ *Maqasid al Shariah* will be explored in Chapter 4.

maqasid. The rationale for this argument is that in such a case, the person who performs the act does not fulfil its original purpose but instead performs the act to achieve another purpose that the *Shariah* has not intended. This maxim can be applied to all transactions in Islamic finance that superficially comply with the rules and stipulations but are meant to achieve goals other than those the *Shariah* has established. This reflects upon the current debate on the nature of Islamic finance operations in the sense of ‘form’ vs. ‘substance’.

In further exploring, a very important maxim that summarises the consequentialist component of Islamic law is the maxim stating that ends have priority over the means. This maxim is especially effective when means and purposes conflict. For example, if there is a conflict between a goal of a particular contract and one of the conditions or rulings stipulated in classical jurisprudence, then priority is given to achieving that goal, and the condition can be nullified.

In concluding, it can be said that the *maqasid al Shariah* approach which is consequentialist methodologically is more consistent with the Islamic core sources as well as jurisprudential theorizations than the reductionist literal *fiqhi* approach which is intentionalist. Therefore the practice of Islamic finance should essentialise consequential normative doctrine by prioritising substantial morality without denying that Islam through *Shariah* constructs also essentialises the intentionalist dimension. Thus, the Islamic stance of normative ethics reconciles both approaches, as the *tawhidi* methodological framework suggests.

As mentioned, this complementarity of the Islamic methodology of *tawhid* by combining intentionalism and consequentialism as the essential totality of methodology forms the theoretical framework of the study; which, as an attempt in the grounded theory, can be considered as a contribution towards the construction of the ‘Islamic normative ethical theory’.

1.3 AIMS, OBJECTIVES, AND RESEARCH QUESTIONS

This research aims to explore, analyse and examine the *Shariah* compliance of IPF contracts and their adherence to *maqasid al Shariah*. To accomplish these two aims, the following objectives are pursued:

- 1) To explore the nature and the structure of project financing generally and the nature and structure of IPF contracts specifically;
- 2) To develop a framework for assessing and evaluating the *Shariah* compliance of actual IPF contracts;
- 3) To identify the particular *maqasid* on which the specific rulings and injunctions of IPF are based;
- 4) To devise a methodology to quantify the *maqasid* and to measure their realisation in real-life IPF contracts;
- 5) To explore whether empirical analysis will be able to verify the prevailing philosophical methodology of Islamic financial contracts.

Consistent with these aims and objectives, the study attempts to answer the following questions:

1. What type of contracts and structures are implemented in IPF?
2. To what extent are the contracts compliant with *Shariah*?
3. What types of violations of *Shariah* are observed in IPF contracts, if any?
4. Can trends and generalisations be synthesised from the deconstruction and analysis of IPF contracts?
5. To what extent are *maqasid al Shariah* grounded in Islamic commercial law and finance?
6. What are the *maqasid* underlying the rulings in IPF contracts?
7. How do the distinct *maqasid* of economic activity rank in terms of importance?

8. To what extent does the current practice of IPF contracts comply with *maqasid al Shariah*?
9. Can the empirical results verify the intentionalist methodology followed by the *Shariah* scholars in the design of Islamic financial contracts?

1.4 SIGNIFICANCE OF THE STUDY

The significance of the study emerges from its response to an observed gap in the literature on the *Shariah* compliance of IPF contracts and their adherence to *maqasid al Shariah*. Although they are important areas of research, they have not been the focus of scholarship on Islamic finance.

The *Shariah* compliance dimension of the research is significant and important in numerous ways. First, the main contribution of the study is the empirical analysis of the real-life contracts of IPF and the examination of their *Shariah* compliance. Specifically, the framework developed to examine the *Shariah* compliance of the contracts represents another strength in terms of the originality of this study. In addition, not much work has been conducted to deconstruct Islamic financial contracts and infer generalisations. More broadly, this study contributes to existing efforts to improve perceptions and awareness of the current state of Islamic finance generally and IPF specifically and the compliance of both to *Shariah*.

This research is, therefore, expected to serve as a reference point for future *Shariah* scholars and researchers seeking to understand how contracts are structured and how the requirements of *Shariah* are realised in practice. The empirical findings will be useful to policymakers because they offer a clear understanding of the current state of IPF within a specific context.

Regarding the *maqasid* component, this research is one of the first studies to quantify the *maqasid* of contracts and to devise a methodology to measure the *maqasidic* compliance. This study also identifies the specific *maqasid* that form the basis for the

particular rulings of IPF contracts. Thus, this study offers a new perspective for considering the *Shariah* compliance of contracts. That is *maqasidic* compliance rather than the prevailing mechanistic, rule-based compliance approach. This notion, largely based on Ibn Ashur's argument that "valid contracts are those which meet the requirements of *maqasid al Shariah* and fulfil its true purpose in the creation thereof" (Ibn Ashur, 2011: 299), is novel and contributes to the realisation of the objectives of the Islamic moral economy.

The study also contributes by presenting *maqasid al Shariah* and its consequentialist nature at the heart of the philosophy of the Islamic law of financial transactions. Illustrating the central role of *maqasid al Shariah* in Islamic law, the study challenges the assumption that Islamic law is disconnected from *maqasid al Shariah* and instead contends that Islamic law and *maqasid* should be considered a coherent entity.

To construct a framework for measuring *maqasidic* compliance, the study develops an index for measuring the weights of the *maqasid* of economic activity. In fact, this study is the first, to the best of the researcher's knowledge, to construct a proxy indicator for measuring the relative weights of *maqasid*. Although the general theoretical basis for this approach has been outlined in the literature and researchers have encouraged the development of a process to measure *maqasid* (Najjar, 2006; Ibn Bayyah, 2010; Kamali, 2008a), the relevant discourse is extremely limited, and no significant attempts have responded to this research gap. In this regard, Kamali (2008b: 19) asserts that "the relative strength and weakness of the various *maqasid* in relationship to one another is a subject on which *maqasid* literature is still at its early stages of development". Therefore, the developed index can be considered a first step in this direction. This index is distinctive because although it is applied to Islamic finance, particularly Islamic project financing, the framework and index it develops are generic and thus can be used to examine any *maqasid*. Hence, the contribution of this study extends beyond Islamic economics and finance to the wider *maqasidic* discourse.

This study is also important because it consults the primary sources and texts of Islamic law, the Quran and *Sunnah* (Prophetic traditions), thereby enhancing the originality and credibility of this research.

1.5 RESEARCH METHODOLOGY

To achieve the aims and objectives of the study, a qualitative research methodology is used as the overarching framework. This methodology is appropriate because this study is mainly theoretical and involves the analysis of documents and texts. However, the study also quantifies the qualitative constructs and thus applies mixed methods.

Given the nature of the research and the absence of a well-formulated theory that accurately describes certain aspects of the area of inquiry, the study applies grounded theory. This approach enables the researcher to formulate theory by analysing data (Glaser and Strauss, 1967) and developing “a theoretical discussion that facilitates discussion of the general features of the topic under study” (Martin and Turner, 1986: 142). Grounded theory approach is highly useful for the topic under investigation because few detailed studies exist on IPF and the *Shariah* aspect of the contracts. The study also seeks to explore and identify the importance and rankings of the *maqasid* of economic activity. Consequently, grounded theory methods are adopted.

In terms of the research strategy, an inductive strategy is adopted. This approach, which also focuses on theory generation, is utilised because the study interprets and analyses data from various sources, such as the Quran, *Sunnah* and contracts. This data is used to formulate theory and synthesise general patterns and trends.

Furthermore, this research is designed as an exploratory case study. This design is selected because the study aims to dissect and explore the nature of IPF and the related *Shariah* and *maqasid* issues by analysing the available literature. Given that the literature on this topic is scant, the study also employs a case study approach because case studies assist in “exploration for those who search for explanatory laws” (Stake,

1978: 7). The multiple case study approach employed in the empirical investigation enhances the robustness of the study and enables the findings to be generalised.

Regarding the research methods, the study relies on secondary data. This takes the form of texts from the core sources of Islamic commercial law as well as actual contract documentation. These texts are critically analysed through textual analysis methods. Furthermore, the study utilises purposive judgemental sampling to ensure that the chosen sample is representative of IPF contracts in general.

This outline of the general methodological approach and the orientation of the research underpins the findings of this research. A detailed description of the research methodology and research process is presented in Chapter 5.

1.6 THESIS STRUCTURE

This thesis consists of three major sections: the theoretical and background section; the methodological and operational section; and the empirical investigation section. These main sections are organised into twelve chapters. The introduction chapter provides a background to the study, outlines the theoretical framework, states the research aims, objectives, and research questions, and highlights the significance of the research. The remaining chapters of this thesis are organised as follows.

Chapter 2 introduces conventional project financing with the objective of developing an understanding of the most important concepts underpinning project financing. It examines, in detail, the financing structures and relevant documentation employed in conventional project financing. This detailed investigation is essential because it will provide the conventional background for the subsequent chapters on Islamic project finance.

Chapter 3 investigates the underpinning principles of IPF with the objectives of analysing how Islamic financing principles are accommodated to project finance. It

discusses the contracts and structures of IPF, examines the literature on IPF and identifies research gaps.

Chapter 4 presents a genealogy of the *maqasidic* aspect of Islamic commercial law in order to analyse and evaluate the *maqasid al Shariah* discourse regarding Islamic finance contracts. This genealogy reveals a different side of Islamic commercial law than is typically covered in the standard texts on Islamic commercial law. It briefly introduces *maqasid al Shariah* and critically reviews the literature on the *maqasid* of economic activity. By unearthing the foundations of current research on *maqasid*, Chapter 4 analyses the literature and puts the current study into context.

Chapter 5 is the research methodology chapter. It focuses on the research methodology, the strategy, the design, the data collection, the sampling strategies, and the data analysis techniques implemented to answer the research questions.

Chapter 6 develops two analytical frameworks for the study. The first framework provides a model for assessing *Shariah* compliance, whereas the second framework is designed for *maqasid al Shariah*. The aims of the *maqasid al Shariah* framework are to deeply explore the *maqasid* of economic activity, to analyse how they function in different contracts and to establish the basis for measuring the realisation of *maqasid* in IPF contracts.

Chapter 7 follows logically from Chapter 6. It is devoted completely to the task of capturing the relative weights and the intrinsic value of the *maqasid* economic activity. To achieve this aim, the chapter first constructs an index—the *maqasid al Shariah* index (MSI)—to measure the relative weights of *maqasid* generally. Then, it applies the index to assign weights to the five *maqasid* of economic activity.

Chapters 8 to 11 form the empirical component of the study. Each chapter presents a case study for one of the four contracts—*mudarabah*, *murabahah*, *ijarah* and *istisnaa*—and analyses them using the analytical frameworks developed in Chapter 6 and Chapter 7 from both the *Shariah* and *maqasid* dimensions. For each case, the chapter commences with a description of the contract documentation. This description is followed by the results of the *Shariah* analysis and a detailed

justification of the derivation of the results. Where necessary, the analysis is extended to Islamic commercial law. Next, *maqasid al Shariah* analysis is presented. The relevant rulings of the contract—the case study—are assigned the appropriate *maqasid* through a systematic survey of the relevant literature. These are then quantified based on a methodical procedure. Finally, the actual results of the contract under investigation are computed.

Chapter 12 contextualises the findings from the three sources of analysis, namely, the literature review, the *Shariah* compliance and the *maqasid* analysis. Hence, an integrated analysis is provided. The discussion responds to the research questions and reflects on the wider issues of Islamic finance. It also outlines the policy implications, highlights the study's limitations and offers recommendations for future research.

CHAPTER 2

CONVENTIONAL PROJECT FINANCE

2.1 INTRODUCTION

Project financing has spread rapidly over the last thirty years from the established US and UK markets into emerging markets in Asia, the Middle East and Africa. Despite the credit crunch following the 2008 financial crisis, the demand for project finance has been remarkably resilient. However, although project finance is practiced on a broad scale internationally, the literature on project finance is limited when compared to that of corporate and direct financing.

The aim of this chapter is to offer an overview for the current practices of project finance, with the objective of developing an understanding of the most important concepts underpinning any project financing. In addition, the chapter examines in detail the financing structures employed in conventional project financing. This is essential since it provides the conventional background for the chapters on Islamic project finance.

In accomplishing this task, the chapter is organised as follows. Following this introduction, Sections 2.2 and 2.3 outline the current state of global project financing and provide the required definitions. Next, Section 2.4, on the financing structures, and Section 2.5, on project finance documentation, constitute the main body of the chapter. Section 2.6 concludes with the main findings.

2.2 THE CURRENT STATE OF PROJECT FINANCE

There is currently a large global demand for infrastructure in both developed and emerging economies. In general, emerging economies focus on building new infrastructure to cope with the increasing economic growth whilst developed economies need to upgrade or replace the existing infrastructure. More specifically, the World Bank Group (2008) identifies a number of reasons for the upsurge in the demand for infrastructure. First, the globalization of goods and services requires the availability of quality infrastructure to allow the required mobility. Second, the rapidly growing economies in the developing countries have to be accompanied with adequate infrastructure services. In addition, the changing climate has significant implications on the infrastructure demands. This may take the form of large greenhouse projects, as well as reconstruction after disasters such as tsunamis. Other reasons include rising energy prices, the changes in the global financial conditions, and the implementation of new technologies.

Estimates on infrastructure may differ but nevertheless highlight the importance of the sector. Regarding the scope of investments required in the infrastructure sector, the OECD estimates that the required investments will reach USD 71 trillion by 2030, not taking into account ports and social infrastructure (PricewaterhouseCoopers, 2008). Another estimate is that the global infrastructure requirements over the next 25 years will total to more than USD 50 trillion (Ernst and Young, 2011). Meanwhile, Ahmed (2010) estimates that in the decade starting 2008, USD 21 trillion will be needed in global infrastructure investment.

Estimates for countries and regions also show huge need for infrastructure investments in the shorter run. For example, the value of the infrastructure planned in India for the period 2008-2012 was valued close to USD 500 billion. In addition, the projects planned or under way in the Gulf Cooperation Council (GCC) are close to USD 2.9 trillion as of April 2011 (Saidi *et al.*, 2011). According to Ernst and Young (2011), the UK, a highly developed economy, was planning to spend USD 320 billion on infrastructure over the next five years. This clearly highlights the huge demand for infrastructure in the years to come.

2.3 DEFINING PROJECT AND INFRASTRUCTURE FINANCE

Infrastructure finance can be discussed under the general topic of project finance. Thus, the approach here will be to define project finance first and then move on to define infrastructure finance. When defining project finance, it is important to take into account that the term has been used in many contexts and over the years its meanings have evolved due to the nature of the practice.

There have been many attempts to define project finance. For instance, Finnerty (2007: 1) defines project finance as “the raising of funds on a limited recourse or non-recourse basis to finance an economically separable capital investment project in which the providers of the funds look primarily to the cash flow from the project as the source of funds”. Yescombe (2002: 1) highlights the debt financing feature of project finance when he defines project finance as “a method of raising long-term debt financing for major projects through financial engineering, based on lending against the cash flow generated by the project alone”. Meanwhile, Esty (2004: 1), who has written comprehensively on project finance, defines it as “the creation of a legally independent project company financed with equity from one or more sponsoring firms and non-recourse debt for the purpose of investing in a capital asset.” However, Dewar (2011: 1) argues it is difficult to define project finance and “perhaps not worth the exercise” since it can be recognised “when you see it”. Nevertheless, he asserts that the accepted definitions focus on “the financing of a specific asset in which the lenders look principally to the revenues generated by the operation of that asset for the source of funds from which loans will be repaid”.

Analysing the definitions indicates that project finance pivots around the creation of a special purpose vehicle to finance a relatively large or capital-intensive project by means of loans from a sponsor or sponsors to be repaid from the cash flow generated by the project itself. There is also another feature that is present in most project financings, which is the non-recourse or limited recourse nature of the finance (Fight, 2005: 1). Although this aspect is not mentioned in the majority of definitions, it is important since it is part of most project financing. Therefore, project finance can be

defined as limited recourse financing of a capital intensive project through the creation of a special purpose vehicle and borrowing funds from sponsors who consider the revenues generated by the operation of the asset. It is apparent from this definition that infrastructure finance can be considered a sub-set of project finance since any infrastructure project is technically a 'capital-intensive project' as well as a 'capital asset' and such projects are considered 'major projects'.

However, the term infrastructure needs to be defined in order to clarify the scope of this research. There are two approaches to define infrastructure. One way is to define it in terms of its characteristic and the other method is to define it in terms of the specific examples it entails such as transport, communications, energy, etc. (Fourie, 2006). An example of the first approach is "physical assets that provide services used in production and final consumption" (Grigg, 2010: 7) whereas an example of the second approach is "transportation (railways, roads and airports), utilities (energy generation and distribution, water and waste processing, and telecommunications), and social infrastructure (schools, hospitals and state housing)" (Grigg, 2010: 2).

However, it is useful to note that project finance and infrastructure finance are used interchangeably in the financial literature. Most studies use the term project finance when addressing this topic whilst a minority of studies use the term infrastructure finance (see for example: Fourie, 2006; Gramlich, 1994; Grigg, 2010). Although project finance is a broad subject which entails infrastructure finance and others, the majority of project finance academic books and articles tend to address the financing of infrastructure projects specifically rather than other type of financing (see for example: Dewar, 2011; Tan, 2007). From here onwards, the term project finance refers to the financing of infrastructure projects unless otherwise stated.

2.4 THE FINANCING STRUCTURES

Several different financing structures for project finance are identified in the literature. Although the main features of these structures are almost always considered as identical, there are differences in certain details. This study discusses the main financing structures of equity, debt, bonds and leasing. Although bonds can be considered a form of debt, as is normal in the literature, they are presented as a separate category due to their different characteristics. Almost all other models of financing structures come under these four groups.

2.4.1 Equity

Historically, equity has been an important source of financing. Equity, which is sometimes referred to as 'capital', consists of retained earnings and funds from issues of preference shares and common shares (Yescombe, 2002). Equity contributions compromise the share capital (Delmon, 2009) and can either be public or private. Public equity is manifested in stock markets whilst private funds are a common example of private equity. Although equity is not the prevalent form for financing large projects, it has an important role in any project financing. According to Hustedde and Pulver (1992), the availability of equity is a critical factor in the start-up and early expansion of high risk businesses such as infrastructure projects.

2.4.1.1 Equity investors

Equity investors are those who bring investment capital to the project and are, typically, those who would benefit from the operation of the project. This can have various forms; purchasing the projects' output; supplying products to the project; or

being owners of natural resource reserves the project would utilise (Finnerty, 2007). The equity involvement of the investors can take the form of limited or general partnership interests, or stock ownership of the project company (Hoffman, 2008). Equity providers include private corporations, investment bankers, governments, consultants, private investors, and institutional investors as well as venture capitalists (Delmon, 2009; Hustedde & Pulver, 1992).

2.4.1.2 Characteristics of equity

Equity capital is considered as carrying the highest risk in the capital structure. Equity providers are usually willing to take more risk than debt providers, since equity providers share the return on the money invested (Plenderleith, 2011). This level of risk means that equity financing is more expensive than debt financing (Fight, 2005).

Generally, equity investors will defer making contributions since the later the money is invested the higher the internal rate of return (Yescombe, 2002). Thus, the trend is to make the equity contribution as low and as late as possible. In addition, a pure equity contribution to a project is very rare. However, lenders prefer a low debt to equity ratio in order to obtain a greater investment from the shareholders and hence ensure the shareholder's commitment (Delmon, 2009). Therefore, there is a balance to be struck between the debt and equity in each project (Gatti, 2008; Plenderleith, 2011) and determining the correct ratio of equity and debt is important when designing the structure of the project finance. For example in energy projects, the total project investment usually comprises 20%-40% equity and 80%-60% debt (Blumental, 1998).

2.4.1.3 Methods for raising equity finance

This section discusses the different methods through which equity finance is raised. In addition, the methods discussed in this section reflect the phases for providing the equity for firms. Thus, methods are arranged in order; from basic angel financing to stock market offerings.

Angel financing

Angel financing is a method for financing new ventures and firms. It is considered an important source of start-up capital. Angel investors are affluent individuals providing equity capital for business start-ups. These are usually informal and relatively minor contributions. One of the main purposes of angel financing is to fill the gap between funding from family and friends, and institutional funding. Angel investors invest for three reasons: the opportunity for financial gain; participation in the entrepreneurial process; and the intention of supporting their communities which is why they are called angels (Robbie & Ken, 1998; Bhatia et. al, 2009).

There are certain differences between the nature of angel financing and venture capital. First, angel investors take on more risks than venture capitalists. Second, angel investors invest smaller amounts in younger firms. In addition, the managerial control mechanisms adopted by angel investors are different to those implemented by venture capitalists. Furthermore, angel investors usually invest their own money. However, it is more difficult to find angel investors than venture capitalists, as no public records of their investments exist (Bhatia et. al, 2009; Lerner, 1998).

Venture capital

Venture capital is an emerging field for providing equity project financing, albeit still not very common. It is a means of providing risk capital to companies that offer high potential returns (Barry *et al.*, 1990). It can be defined as “investment provided in the early stages of a company’s life and particularly in technology oriented sectors” (Ferran, 2008: 67) or “investment by specialised venture capital organisations (venture capital funds) in high growth, high risk, often high technology firms that need capital to finance product development or growth and must, by nature of their business obtain this capital largely in the form of equity rather than debt” (Black & Gilson, 1998: 245). Gompers and Lerner (2001) illustrate that the venture capital cycle starts with raising the venture fund; proceeding through the investment; adding value to the firm; returning capital to the investors; and raising additional funds.

In the context of project finance, venture capital is implemented at the early stages of the structuring of the project company and most often from pension fund contributions (Haislip, 2010). Venture capitalists may sometimes buy toll roads or large scale facilities, but so far, in the US at least, most concessions are for the operation rather than the ownership of the project assets (Grigg, 2010).

Private equity

Private equity is a critical component of modern finance. Despite the fact that angel financing and venture capital can be considered subsets of private equity, there are particular distinctions. Private equity denotes larger capital investment in more mature firms and usually implies a wider range of financing techniques (Robbie & Wright, 1998). However, it is useful to note that in the literature, angel financing, venture capital, and private equity are occasionally used interchangeably.

Private equity participation is an emerging source for financing infrastructure projects especially in developing countries. Private equity is considered to be riskier than public equity and thus, it is expected to offer risk premium above conventional equity (Marquez *et. al*, 2011). The risk premium is the principal motivation for private equity investments, along with it being a means of portfolio diversification for the private equity investors (Wingerd, 1997).

The findings of Gemson *et al.* (2012) show that projects funded with private equity are of a larger average size and have more sponsors but there was no significant difference in debt levels than projects without private equity funding. Moreover, they conclude that the participation of private equity in such projects has helped in achieving successful financial disclosure and has helped in the development of riskier projects. Furthermore, they assert that the role of private equity in developing countries is a risk sharing role, whilst it is a source of additional capital in developed countries.

Private investors will not usually invest in projects unless there are attractive risk return profiles. This can be achieved by introducing risk mitigation techniques and providing the necessary government intervention to reduce political and commercial risks (Ahmed, 2010).

Initial public offerings

Initial public offerings (IPOs) refer to the process through which a firm goes public by issuing stock to investors. An IPO is the first sale of shares to the public. There are various reasons for firms to go public. The most obvious reason is to raise new equity finance and facilitate liquidity. Second, this access to the capital markets reduces the dependence on internally generated equity and expands the range of financing sources. In addition, being quoted on the stock market may facilitate borrowing from banks. Furthermore, going public allows for a dispersed shareholder base. However, there are certain drawbacks to going public. For example, listing a company on the stock

exchange involves high costs due to listing fees and other costs (Ferran, 2008; Pagano & Roell, 1998; Roell, 1996).

The issuance of IPOs and going public is very beneficial for companies involved in project financing since the nature of project finance requires relatively intensive equity contributions due to the magnitude of funding required. More importantly, banks may favour companies listed on the stock exchange. Thus, being listed on the stock exchange may be very useful when it comes to borrowing (Ferran, 2008; Pagano & Roell, 1998; Roell, 1996).

Raising equity from stock markets

As IPOs are issued, companies become listed in the stock market. Once listed on the stock market, the issuer can return to the market for other issuances to raise further cash. Access to equity is usually achieved either through domestic or international capital markets. The domestic market is a good choice for local companies, although, in developing countries, domestic markets are still nascent and the available capital is constrained. On the other hand, international stock markets offer significant amounts of funds for infrastructure projects, but such markets are generally limited to multinational companies (Fight, 2004; Hoffman, 2008).

Stock markets are a very important tool in facilitating the large volume of funds required for project finance. The large numbers of investors and the availability of liquidity through such markets are critical factors for their involvement in project finance.

2.4.2 Debt

Debt is the most common form of project financing. There are several types of debt structures and various debt providers. Generally, debt instruments have advantages over equity. For example, debt can be secured; the interest, unlike dividends, can be tax deductible; and the borrowed amount as debt will be repaid eventually without tax consequences unlike the repayment of capital which may be more complex in terms of a corporate and tax standpoint (Plenderleith, 2011).

2.4.2.1 Types of debt

There are generally two approaches in the literature as to how to tackle the debt issue. The first is to categorize debts according to their type such as maturity (e.g., long-term, short-term, etc.) and seniority of claims (e.g., subordinated, mezzanine, etc.). The second approach is to categorize them according to the debt providers such as commercial banks, development banks, multilateral agencies, etc. The approach taken here is to categorize them according to a combination of type and provider.

Before presenting the debt types, it is useful to note that in general borrowers have two methods of debt-based financing for their projects; direct and indirect financing. Direct financing is facilitated through the issuance of debt securities to the investors whilst indirect financing is achieved through borrowing from financial intermediaries such as banks (Ferran, 2008). This section will focus on indirect financing (loans) while the Section 2.4.3 is devoted to the issuance of bonds.

Commercial bank loans

Commercial banks have been the traditional source for financing infrastructure projects, and are still the main source for project financing. This dominance is due to several factors. Commercial banks have a better ability to evaluate complex project financing requirements and to bear other non-credit related risks which other lenders would not undertake. In addition, commercial banks have substantial experience and greater funding flexibility which allows them to manage drawdown schedules and multi-currency lending. International commercial banks usually employ experienced staff and project financiers who understand the management and financing of complex projects (Finnerty, 2007; Plenderleith, 2011). Traditional bank loans also have the advantage of offering flexible drawdown schedules during the construction phase. Thus, sponsors do not face any negative cost of carry i.e. interest payments on funds that have not yet been spent on construction (McKeon, 1999). Bank loans also have benefits in terms of corporate governance. Bankers monitor performance and usually intervene effectively if non-performance is likely from the borrower (Diamond, 1991; Esty & Megginson, 2003).

The norm in loans for project finance is that they are either independent loans from a number of lenders or syndicated loans in which several lenders join to form a syndicate. Syndications can range from two to two hundred participants in a single syndicate (Esty & Megginson, 2003; Hoffman, 2008). There are two forms of loan syndicates: direct loan syndicates and participation syndicates. A direct loan syndicate is “a multilateral loan agreement in which participant banks, having signed a single (common) loan document, advance funds to the borrower” (Anant, 1989: 461) whilst a participation syndicate is one in which a “lead bank usually executes a loan agreement with the borrower and it then forms the syndicate by entering into a participation agreement with other banks” (Anant, 1989: 461). Therefore, in the participation syndication only the lead bank will execute the agreement with the borrower and the participation of the other banks may not be disclosed to the borrower. This type of syndication enables the lead bank to not compromise its business relationship with the borrower since the other participants will not be

disclosed. In addition, it enables the lead bank to transfer some of the loan risks to other banks. Moreover, the lead bank may not have sufficient funds to finance the loan, therefore enters into this type of syndication in order to go preserve the deal that could otherwise be refused by the borrower if the other participants were disclosed (Semkow, 1984).

Esty and Megginson (2003) show in their study on the relationship between legal risk and syndication, that there is a positive association between syndication concentration and the reliability of the legal enforcement or the strength of creditor rights. In countries where there is a strong legal environment, lenders tend to form smaller more concentrated syndicates in order to facilitate monitoring. In contrast, jurisdictions in which there is no strong legal enforcement, lenders tend to form larger syndicates to strategically defer the potential legal risk.

The commercial bank loans take a variety of forms. The forms identified in the literature include construction loans also called revolving credit loans, term loans, bridging loans and working capital loans. Term loans are loans for a specified period. They allow the project sponsors to drawdown during the construction period and can short term (up to one year), medium term (up to five years) or long term (up to ten years). Infrastructure projects usually require long term loans. Regarding revolving credit loans, the sponsors are allowed to draw down on the facility as funds are needed but subject to a maximum cap. Bridging loans are designed to cover the gap between the scheduled drawdowns of the long term funds and the timing of the expenditures. Commercial banks also provide working capital loans which are utilised to finance the everyday operations of the project company (Ferran, 2008; Finnerty, 2007; Plenderleith, 2011).

Subordinated debt

Subordinated debt is defined as “debt whose debt service comes after amounts due to senior lenders, but before distribution of dividends to investors” (Yescombe, 2002:

342). In terms of the type of financing, subordinated debt and its variants are similar to other types of financing except in terms of repayment rights (Hoffman, 2008).

Generally speaking, when a debt is subordinated, its terms include that the principal amount of the loan will not be repaid until all or some of the company's other debts have been paid in full. Thus, subordinated debts are riskier and attract higher interest rates (Ferran, 2008). Subordinated debt is similar to equity since it ranks below debt in seniority, and thus some studies define subordinated debt as "debt that serves as equity" (Everett, 1965: 954). Subordinated loans have the advantages of being fixed rate and long term. In addition, they may be considered as equity for purposes of computing debt to equity ratios (Fight, 2005).

There are a wide range of options for subordinated debt. At one end of the scale, there can be absolute subordination in which all payments of the principal loan and interest are precluded as long as there is outstanding senior debt. At the other end, there is subordination that functions solely on the bankruptcy of the company (Plenderleith, 2011).

The next section discusses in more detail a specific type of subordinated debt known as mezzanine debt.

Mezzanine debt

Mezzanine debt is subordinated debt provided by third-party investors at a higher rate of interest. It is usually provided by institutional lenders, such as pension funds and insurance companies (Akintoye *et al.*, 2001; Plenderleith, 2011).

Mezzanine debt can be considered a solution that falls between debt and equity; since debt is a low risk, low return approach whilst equity is high risk, high return approach. Mezzanine debt is an intermediate solution between the two (Bean, 2008) and thus carries higher margins than debt. Although there are many types of mezzanine financing, the common thread in all mezzanine financings is "is a capital structure

with debt that is senior to equity but junior to other more senior debt” (Berman, 2007: 998). Mezzanine finance serves as the central layer of a financing package that includes equity and debt (Pratt and Crowe, 1995).

It can attract lenders who can accept more risk but whose corporate guidelines do not allow them to contribute equity. In addition, it may be used by investors who aim to reduce their equity contribution (Gatti, 2008). Since mezzanine financing is of higher risk than debt, companies that wish to attract this type of financing, as well as subordinated financing, usually have to satisfy certain criteria. This includes an established reputation in the industry, a history of profitability and viable expansion plans.

Mezzanine financing has a number of disadvantages. The higher interest rate may affect a company’s financial position if the funding is not used efficiently. Moreover, some mezzanine structures may require a company to give rights to the mezzanine lenders such as a lender vote on the board of directors. In addition, the financing agreement may push some companies to invest in areas that are not part of their strategic plan (Bean, 2008). Furthermore, there are various types of securities that may be used by mezzanine lenders. This includes taking warrants and requiring a direct interest in the borrower’s capital stock (Gross & Amiri, 1990).

Mezzanine financing is used for project financing. For example, in the UK, mezzanine finance can have a large role to play in financing infrastructure projects within the Government’s Private Finance Initiative (Pratt & Crowe, 1995). Moreover, mezzanine financing facilities have been used in the Worsley multi-fuel cogen project in Western Australia, as well as a number of renewable energy project financings (Mpubani, 2011).

Equity bridge loans

Equity bridge loans are “provided by the lenders during the construction period for the amount of the equity investment” (Yescombe, 2002: 334). Equity bridge loans are usually short-term loans with a tenor of up to three years (Mpubani, 2011). The reason for using equity bridge loans is that the sponsors may want to delay their equity contribution into the project in order to maximise their returns as mentioned previously. Thus, this type of loan is used to cover the equity share of the project costs and when the construction period ends, the actual equity is used to repay the bridge facility (Yescombe, 2002). This type of loan is usually secured with corporate guarantees from sponsors with strong credit ratings (Mpubani, 2011).

Debt from official funding sources: multilateral agencies and development banks

Another substantial source for providing debt for project finance, especially in developing countries, is official funding sources, including multilateral institutions. There are several multilateral institutions. At the top of the list are the World Bank and the International Monetary Fund. Other similar institutions include regional multilateral development banks and international investment development institutions. Multilateral development banks are “bodies or agencies created by international agreement among multiple nations whose purpose is to promote development among all or certain member states” (Maizel & Borisoff, 2011: 218). The common thread in all such institutions is the promotion of economic growth and alleviation of poverty. In addition, infrastructure projects are a common point of interest among such organizations due to the importance of projects in contributing to economic growth.

Although the amount of financial support is limited, there are advantages for the involvement of a multilateral agency in project financing. First, the tenor may be longer than commercial banks. Second, fixed interest rates may be possible. In

addition, the involvement of multilateral organisations may limit government intervention. However, support from these organisations may not be always possible if the goals of a proposed project are not in line with the strategic policies of the organization. Moreover, funding from these organisations is often contingent on meeting strict environmental and social compliance regulations (Hoffman, 2008; Plenderleith, 2011).

Multilateral organizations usually play a major role in syndicated loans and co-financing with commercial banks. In addition to direct loans, some organisations such as the World Bank also offer risk guarantees and credit guarantees (Gatti, 2008). Political risk cover is another aspect of financing from these organisations.

Export credit agencies (ECAs) are another typical source of project finance from official organisations. An ECA is “an arm or agency of a national government created for the purpose of promoting or facilitating exports from that nation to other countries and by so well doing, contributing to national employment and overall national economic wellbeing in the ECAs home country” (Maizel & Borisoff, 2011: 214). ECAs normally provide low cost debt arrangements to the local manufacturers who aim to transport technology to foreign countries. On occasions they also provide political risk insurance. Examples of such agencies include the United States Import Export Bank, The Export Import Bank of Japan, and the UK’s Export Credits Guarantee Department (Fight, 2005).

2.4.3 Project Bonds

A bond is defined as a “note or certificate ... sold by one party, the issuer, to another, the investor, promising to repay the holder the face value of the bond plus interest at future dates” (Nevitt & Fabozzi, 2000: 380). Project bonds are bonds issued in international capital markets to raise finance for projects. The international capital market can be defined as the “market for medium term and long term securities that functions outside the national capital markets of the world” (Finnerty, 2007: 227).

The bond market has been a growing source of project finance since the 1980s although it is not as common as other traditional financing sources. In terms of geographical diversity, the US, Western Europe and Asia account for most of the bond issues. The capital markets financing of projects now covers a broad range of infrastructure related assets such as power, oil, and gas. In addition, it is now being utilised in green energy projects (Gatti, 2008; Siebens & Gasperow, 2011).

Bonds are very similar to bank debts in many ways especially from the borrowers' standpoint. The main difference in this context is that the project bond can count on a much wider base of parties who have an interest in financing (Gatti, 2008). This is important since a number of infrastructure projects need substantial funding which otherwise cannot be raised even through syndicated bank loans (Nevitt & Fabozzi, 2000). In addition, bonds are aimed mainly at the non-bank market and thus the main investors in bonds are pension funds, insurance companies and certain government agencies. Another important feature of bonds is that they are treated as tradable debt instruments (Gatti, 2008; Yescombe, 2002).

There are various economic benefits for the utilisation of bonds in project financing, which can be summarised as follows. Bonds play an important role in the diversification of funding, thus making the project less vulnerable to collapses in bank lending, while from the investor perspective bonds offer asset diversification and investment opportunities. Second, the bond market is a major source of long debt, in contrast to commercial banks due to the internal regulatory restrictions. Moreover, the bond market is a large and liquid market providing increased choice and flexibility. In the international capital market, large amounts of debt are raised in a short period of time. Another advantage of the bond market which attracts investors is the fixed interest rates. For example, in 2003 80% of the euro-dominated corporate bonds were fixed rate coupon bonds. The bond markets also allow less restrictive covenant packages. Furthermore, the terms of public bond deals are less onerous than private debt deals. Moreover, some laws such as the European and US securities law permit bond deals without a formal regulatory registration process (Dailami & Hauswald, 2003; Ferran, 2008; Hoffman, 2008; Plenderleith, 2011).

2.4.4 Leasing

In a general lease contract, one party (the lessee) is granted the right to use an asset which is owned by a second party (lessor) in exchange for a series of payments over a defined period of time (Esty, 2004). Leasing is an important source of funding even when compared to debt. Lemmon et al (1998) have reported that for the 1981-1992 Compustat data, operating leases, capital leases, and debt were 42%, 6%, and 52% of fixed claims, respectively.

There are two types of leases, operating leases and financial or capital leases. An operating lease is a “short term lease whereby a user can acquire use of an asset for a fraction of the useful life of the asset” (Nevitt and Fabozzi, 2000: 421). For financial accounting purposes, an operating lease appears on the lessee’s balance sheet as equivalent to debt. On the other hand, a financial lease is a source of financing. In this case a user acquires the use of an asset for the majority of its estimated economic life. The rental payments, over the life-span of the lease, allow the lessor to recover the cost plus an interest. In many cases, ownership of the asset is transferred to the lessee at the end of the lease period. Therefore, a financial lease is similar to borrowing (Brealey *et al.*, 2008; Nevitt & Fabozzi, 2000).

According to the Financial Accounting Standards Board (1980) a lease is considered a financial lease if it meets one of the following criteria. The first criterion is that the lease transfers ownership of the asset to the lessee at the end of the lease period. The second criterion states that the lease contains a purchase option. A lease is also considered to be a financial lease if the lease term is equal to 75% or more of the economic life of the leased asset. The fourth criterion is that the present value of the lease payments is at least 90% of the value of the asset. If a lease does not satisfy all four criteria it is considered an operating lease.

2.4.4.1 Characteristics of leases

There are a number of merits of leasing that give it advantage over debt. The main benefit of leasing over debt is its treatment in bankruptcy. Repossession of a leased asset is much easier than that of the collateral of a secured loan. Many statutes recognise this. In the US, for example, the bankruptcy code makes it much easier for a lessor to repossess an asset than a secured lender. This implies that a lessor is able to extend more credit against a leased asset in contrast to a lender (Eisfeldt & Rampini, 2009; Krishnan & Moyer 1994; Smith & Wakeman, 1985).

Leasing is also advantageous in terms of the tax benefits. A lease structure separates ownership from control of the asset, which can create value for both parties. This is done through transferring the tax benefits from the project company (lessee) to the equity investor (lessor). It is advantageous since the tax deductions are shifted from an entity that cannot fully utilise them to an entity that can (Hoffman, 2008; Yescombe, 2002). The tax deduction comes from treating the accrued rental payments as an expense. The lessor is eligible to claim the tax benefits of the leased asset and the residual value (Plenderleith, 2011). Lemmon *et al.* (1998) have shown in their empirical study of operating leases that corporate marginal tax is negatively related to the use of operating leases whilst it is positively related to debt usage.

Smith and Wakeman (1985) have also discussed other motives for lease financing such as resolving the asset substitution problem. This is because the lease commits the firm to use a particular set of assets over the lease period. Moreover, there are compensation related motives. This can be illustrated in the case of a manager whose bonus relies on the return on the invested capital. He will prefer to lease rather than purchase an asset since the purchase will increase the denominator of the performance measure. In addition, leases, especially short term ones, may reduce expenditure related to information quality. A lessee will be usually less concerned about detailed information than a potential purchaser. Nevertheless, a lease implies a separation of ownership and control since the asset is under the control of the user, and thus, agency problems arise (Eisfeldt & Rampini, 2009).

2.4.4.2 Application of lease in project finance

The general lease structure is modified and utilised in certain project financings. A typical project financing lease structure is as follows (Esty, 2004; Gatti, 2008; Hoffman, 2008; Plenderleith, 2011). An equity investor (sometimes called the lease finance company) acts as the lessor. This equity investor holds legal and tax ownership of the project. In other words, it is the owner of the project. This is most effectively done by creating a special purpose entity that holds the asset. To become the owner of the project, the lessor provides a minority percentage of the capital to purchase the assets of the project. Collectively, it borrows the remainder of the capital from a lender to enable it to finance the costs of the project acquisition. This financier (the lender) takes collateral security in the form of the lease rental repayments and all the underlying project assets.

After the equity investor (lessor) has secured the acquisition of the project's assets, it then leases the project to the project company (the lessee). The project company benefits from the residual cash flow of the project during the lease period. Accordingly, the project company pays the rentals, from the residual cash flow, to the lessor (equity investor) in instalments according to a pre-established timetable. At the end of the lease term, when the instalments are paid by the lessee and received by the lessor, the project assets return to the lessor (the equity investor). Thereafter, there are a number of choices for the equity investor. It may lease the project for a specific renewal period or it may sell the project to a different entity. Moreover, the lessee may negotiate a purchase option at the end of the lease term. This is the general cycle of the lease structure in project finance (Esty, 2004; Gatti, 2008; Hoffman, 2008; Plenderleith, 2011).

2.5 DOCUMENTATION OF THE FINANCING AGREEMENTS

The documentation of the financial contracts and agreements is paramount in project finance. Due to the complexity of project financing, various types of contracts and documentation are executed between the different parties. A complete system of contracts is engineered in order to provide an optimal organisation for the project finance deal.

The agreements include: shareholder agreements; implementation agreements; concession agreements; supply agreements; construction agreements; security agreements; financing agreements; and operation and maintenance agreements. In line with the objectives of the research, this section analyses the documentation of the financing agreements with the objective of clarifying how the financing structures discussed in the preceding sections are documented and implemented.

The financing documentation can be categorized into three main groups: preliminary financing documentation; principal financing documentation; and ancillary financing documentation (Dewar, 2011). The first group comprises the introductory contracts that are executed before the main body of financing contracts, which form the second group. This is followed by the third group which encompass the supporting contracts in the form of ancillary financing documentation.

It is useful to note, however, that there is no agreement on any classification of the project contracts since, as indicated previously, project finance varies from case-to-case, contingent on the particularities of the given project.

2.5.1 Preliminary Financing Documentation

2.5.1.1 The due diligence report

The due diligence report describes the legal context of the project and analyses the risks inherent in the project. This allows bankers to decide upon the viability of the project and, thus, to support or withdraw from the project. More specifically, it provides a risk analysis of the project and outlines its weaknesses. This allows the lenders to assess their expectations of the project's future revenues. The issues addressed in this report include feasibility of the project being constructed within the budget; whether the project company has the requisite skills and experience; and the social and environmental impact. In addition, this report gives a description of the regulatory and legislative framework in the sector in which the project is initiated. The report is usually assigned to a competent technical advisor who has experience in that specific field (Dewar & Irwin, 2011; Gatti, 2008).

2.5.1.2 Letter of intent, term sheet and commitment letter

A letter of intent (LOI), also referred to as a memorandum of understanding (MOU), is a non-binding written statement that provides the sponsor with an initial indication that the lender is interested in the project and that there is an intention to sign the formal agreement at a later date. The topics detailed in the LOI vary depending on the project itself and the host country. These may include: a description of the project; the expected performance; the deadlines; the expected governmental action; the acceptable amounts of debt and equity of the project company; and the basic terms of financing. Thus, the LOI can serve as a preliminary loan application and can help provide in-formal evidence to a state authority; for example, that financing will be available. Depending on the type and reputation of the lender, the issuance of the LOI

can give a very strong credible indication that financing will be available (Hoffman, 2008; Plenderleith, 2011).

The term sheet is the next documentation produced after the LOI. A term sheet provides the terms of financing, as well as the financial requirements and preferences of both the sponsors and lenders. It summarises the key aspects of the financing structure. The term sheet may be a stand-alone document or part of an attachment to a commitment letter. Although term sheets are not intended as legal commitments, they may be regarded so if stated. The term sheet may be comprehensive, including, for example, exhaustive lists of conditions, covenants and events of default. However, comprehensiveness of the term sheet is not a firm requirement (Gatti, 2008; Plenderleith, 2011).

As the negotiations between the project sponsor and the project financing provider (the lender) move forward, the next step is to sign a commitment letter. A commitment letter is the document under which the lender makes a binding offer to the customer to lend money. Thereupon, the borrower either accepts the offer and signs the letter or negotiations continue to structure an acceptable agreement. The principal role of the commitment letter is to provide legally binding documentation that the lender will provide a specified level of participation in a financing facility. The basic elements of the commitment letter are: the loan amount; a specification of how the borrower may use the proceeds; the repayment terms; the representations and warranties; and the events of default. Furthermore, this commitment is usually conditional. In the context of project finance, the lender may condition the commitment on the basis of further due diligence on the underlying project, since in project finance there is greater due diligence than in any other corporate finance transaction. Consequently, there will be a condition that the terms are subject to change based on that due diligence. The commitment letter will also contain a clause that the terms of the letter are required to be accepted by a specific date, otherwise, the letter will terminate and the lenders will have no further obligations. Nevertheless, the lender's managerial expenses will usually remain payable even though the commitment is cancelled (Hoffman, 2008; Plenderleith, 2011).

2.5.2 Principal Financing Documentation

The principal financing documentation encompasses the main body of financing contracts. These are the contracts that comprise the equity, debt and project bond arrangements.

2.5.2.1 Equity capital documentation

Equity contribution can either take the form of initial capital or equity rights to be sold in the capital markets at a later stage. Holmes and Robertson (2011) indicate that due to the different requirements of equity ownership structures in the different jurisdictions, it is difficult to give a specific contractual arrangement as to the structure of equity; instead, the contractual arrangement of equity should be discussed in general terms.

The equity contribution, generally, can be secured by one of three arrangements. The first is the shareholders' agreement. This agreement governs all matters related to shareholders in a given project. This includes their capital contributions, whether they are in cash or in-kind capital such as material and equipment, also known as sweat equity. The second type is the subscription agreement which, as its name indicates, governs the sponsor's subscription of shares. The third type is a separate equity contribution agreement that documents the obligations of a sponsor to contribute capital periodically if the equity was not required up front. These arrangements will also provide the procedure for the distribution of the cash flow (Buljevich & Park, 1999; Delmon, 2009; Gatti, 2008). An important consideration in this context is that in most jurisdictions the equity investors do not have complete freedom to choose the level of equity contribution in the overall transaction. There are usually minimum capitalization requirements that investors have to comply with when forming the company or creating the ownership structure (Holmes & Robertson, 2011).

2.5.2.2 Loan documentation

This section analyses, selectively, the key agreements typically present in any loan documentation.

Credit agreement

The credit agreement is the main legal document which formally records that the “lender will lend or agree to lend a sum of money to the borrower in return for the borrower’s promise to repay that sum either on demand or at the agreed time, usually with interest” (Mpubani, 2011: 168). The credit agreement will usually state that the loan is to be used exclusively for the purpose specified in the agreement. Regarding the loan maturity, the loan will be usually given a time span that allows the revenues needed for repayment to be generated. Project companies will be usually given an option of repayment (Gatti, 2008).

The key provisions of this agreement will include: the loan amount; the rate of interest; the debt service structure; the loan maturity; the penalties for late repayment; and specific restrictions (Tan, 2007). The credit agreement will provide the undertakings from the borrower such as the delivery of the accounts and financial statements on a regular basis and undertakings not to dispose of the project’s assets. The main aim of these measures is to guarantee that the borrower maintains the same status that made the lender decide the former was an acceptable credit risk in the first place (Vinter, 1998).

After the credit agreement has been signed, the lenders become committed to lend the agreed loan to the borrower, subject to the specified conditions. There will usually be two sets of conditions: those common to all debt tranches and those specific to the particular debt tranche. Furthermore, each set of conditions will be further divided into two parts: conditions applicable to the initial drawdown and conditions

applicable to each drawdown, initial and subsequent. The purpose of the conditions precedent to each drawdown is to ensure that certain milestones are being met, as well as to identify any potential problems (Mpubani, 2011).

Mezzanine, and equity bridge loans agreement

Mezzanine agreements have certain key features which distinguish them from ordinary loan agreements. First, the mezzanine agreement will be drafted after the senior facility has been produced. Second, the agreement may definitively express that the mezzanine lenders are given an exclusive security. Moreover, the mezzanine facility will usually reflect a higher interest rate for the mezzanine lender to compensate for subordination to the senior debt. Another important feature of mezzanine agreements is the option it gives the mezzanine lenders to convert part of the debt into equity in the event of the project being unable to service the debt, while still remaining viable in the long term (Mpubani, 2011).

An equity bridge loan agreement (EBL) agreement will usually have the following characteristics. First, the agreement will have a provision that the EBL will be drawn before the senior facilities. Second, equity bridge lenders will usually provide the loan without taking any security over the project's assets. However, EBL lenders may take certain measures to protect their position. This may take the form of a hedging programme as regards to any currency risk (Mpubani, 2011).

Inter-creditor agreement

The need for an inter-creditor agreement arises when there are more than two creditors or, in the case of syndication, when there is more than one syndicate of lenders, since each syndicate can act as a single block. An inter-creditor agreement can

be defined as an agreement between lenders regarding the rights of the different creditors in the event of default (Delmon, 2009).

As the number of creditors increases, so does the potential for conflict of interests between the different parties. At the core is the issue of creditor classes. It is commonplace in project finance to have a creditor class arrangement in which the creditors are either senior creditors or subordinated creditors. Senior creditors are those who are granted first priority in repayment and recovery. Subordinated creditors, or junior creditors, rank below the senior creditors in issues associated with repayment. Thus, the *raison d'être* of the inter-creditor agreement is to provide a prioritization structure for the creditors in terms of subordination of debt, in order that the claims of the senior creditors are discharged ahead of the claims of the lower ranking creditors. This ensures an equitable allocation of rights and, consequently, faster decision-making, especially in the case of default (Hoffman, 2008; Mpubani, 2011).

Another important function of the inter-creditor agreement is to structure the voting framework. The agreement determines the appropriate voting arrangement necessary for passing any creditor decisions such as waivers, consents, variations to the financing structure, changes to interest rates, and changes to the prioritization of debt tranches. The voting rights usually correspond to the creditor's exposure to the project and this will be clearly identified in the inter creditor agreement. (Mpubani, 2011; Yescombe, 2002).

2.5.2.3 Project bond documentation

The issuance of bonds in the capital markets is a complex task. As a consequence, the associated documentation is complex. Obviously, the documentation of each transaction will vary depending on the market and jurisdiction. This section covers the primary documentation underlying any project bond as demonstrated by Siebens and Gasperow (2011), Gatti (2008), and Ferran (2008).

The project bond issuance will start with an offering circular. This offering circular will serve as a prospectus. An offering circular will, almost always, have the following broad categories of information: a technical description of the project; and a description of all the construction agreements. It will also disclose the risk factors inherent in the project and will highlight the potential pitfalls. Moreover, it will give descriptions of the issuer's industry, management team, board of directors, and the shareholders. An important section in the offering circular will encompass a description of which aspects of the project the proceeds of the bond will be applied. The financial statements of the issuer will usually be attached at the end of the offering circular.

Following the offering circular is the subscription agreement, which is the principal agreement between the issuer and the underwriters. The main component of this agreement is the commitment from the underwriters to buy the project bonds from the issuer at a given price. Signing this agreement denotes there is an obligation on the underwriters to purchase. However, this obligation is contingent on the satisfaction of various conditions that are mentioned in the agreement. The subscription agreement will entail a plethora of warranties to ensure that the information in the offering circular is true.

In addition to signing the subscription agreement, the issuer will issue a certificate to the bond holder. This certificate, also known as a global note, is the physical evidence that the investor has been issued with a bond. The note may also contain the basic terms of the bonds such as the principal and interest rate although these details will be set forth in the offering circular. It will also be held in an electronic book-entry system which is useful particularly when the bonds are traded globally. In addition to the global note, there will also be a trust deed, also referred to as an indenture. It is a contract between the issuer and a trustee who represents the bondholders. The role of the trustee is basically to protect and represent the interests of the bondholders and to pursue the administrative work on their behalf. The trust deed is more detailed than the global note and entails, in addition to the basic terms of the bonds, covenants, events of default, and the indemnities of the trustee.

The project bond documentation will also include provisions on the security which is usually the underlying project assets. Moreover, and especially in large bond issuances where there are multiple underwriters, it is commonplace for a subset of underwriters to take the lead in managing and being responsible for a larger proportion of the overall transaction on behalf of the other underwriters. In such circumstances, a formal agreement among underwriters may be drawn up to establish the structure for the responsibilities under this delegation.

2.5.3 Ancillary Financing Documentation

Following the description of the main contracts associated with the financing transaction in the previous section, this section outlines the main aspects of the ancillary and supporting financing documentation, particularly the security agreement and the insurance agreement. Typically, every project finance contract will include both agreements. However, the structure of the agreements will vary between different jurisdictions.

2.5.3.1 Security agreement

As indicated previously, project finance contracts are structured on a case-by-case basis to cater for the specific requirements of the specific project and the prevailing jurisdiction. The security agreement is even more prone to this consideration because of the sensitivity of the security to the different legal systems. Civil and common laws approach the security issue differently.

English common law, for example, is very flexible and allows the creation of a large range of securities covering all the assets of the company. Under English common law, the cornerstones of a security agreement are the further assurances clause and the

power of attorney clause. The further assurances clause obliges the security issuer to take all necessary actions that are needed to execute the security agreement. The power of attorney clause, on the other hand, authorizes the secured party to execute any document which the security provider fails to execute to enforce the security. In addition to the lenders, other parties such as the contractors and suppliers may require to be secured. This is achieved through inter creditor arrangements with the secured lenders (Ferran, 2008; Holmes & Robertson, 2011).

In contrast to common law, civil law jurisdictions are very strict in terms of the granting of a security. The document that constitutes the security is commonly referred to as a pledge. There are certain restrictions on the assets that can be secured for business concerns. The specific assets are given in the governing regulations. For example, the assets that cannot be pledged for business concerns include the inventory, buildings, receivables and bank accounts. There are also other types of security under civil law jurisdictions known as mortgages (Cazali & Maffei, 2011).

2.5.3.2 Insurance agreement

Insurance policies form an integral part of a project finance transaction. Some of the aspects of an insurance contract outlined by Benatar and Fyfe (2011), Delmon (2009) and Vinter (1998) are summarised below.

An insurance contract that covers multiple parties, as is the case in project finance, can be either a joint insurance or a composite insurance. In a joint insurance there will be more than one party under the same contract, and they will all have the same insurable interests. Consequently they will all share the loss in the event of a peril, and they will all share the insurance proceeds. Any vitiating act by any of the co-insured will invalidate the insurance. A composite insurance, on the other hand, will include more than one party on the same policy, but the nature of each party's insurable interests differs. Each party will suffer the loss in a different way and thus the

insurance proceeds will not be shared; each party's entitlements are separate. Thus, the composite insurance is similar to separate contracts under one policy.

The subject matter of the insurance contract is the insurable interest. The relationship between the insured (the party insured) and the subject matter (the object insured) usually arises because of financial interest or ownership, which has to be clearly identified in the policy. The object insured has to be valued as the indemnity is based on this value. The insured will be allowed to recover up to a maximum agreed sum, which is included in the undertaking. There will be provisions to specify the mechanism for renewing the insurance as well as provisions for reinsurance.

It is common practice to have a broker acting as an intermediary between the insured and the insurer. This is achieved through a letter of undertaking from the broker. The broker will be in charge of providing the required information to both parties, ensuring the payments are made on time, and ensuring that the insurance proceeds, when applicable, are enforced.

2.6 CONCLUSION

This chapter analysed the main financing structures utilised in project financing. This was achieved through a descriptive and analytical approach as to the nature of the main types of financing mechanisms in the context of project finance. The structures studied were debt, equity, leasing, and bonds. Debt financing is the most common in the current practice. However, there is an emerging market for bond issuance in the project finance.

The chapter also outlined the main documentation of a project finance contract. It has been shown that the contracts in such transactions are complex and vary from case-to-case. In addition, the literature review has shown that there is an effect of the legal environment on the structuring of the contracts. Overall, this chapter provided a survey of the main aspects of project financing. This forms a starting point for discussing IPF in the following chapter.

CHAPTER 3

ISLAMIC PROJECT FINANCE: AN OVERVIEW

3.1 INTRODUCTION

This chapter investigates the underpinning principles of IPF with the objectives of analysing how Islamic financing principles are accommodated into project finance, as well as examining the structures and techniques of IPF. To achieve this, the chapter is organised into four main parts. Section 3.2 introduces the Islamic economic system and its main axioms and principles. Next, Section 3.3 gives a brief outline of *Shariah* and the main principles of Islamic finance. Section 3.4 provides a critical analysis of the literature on IPF in order to identify the vacuum in the existing body of literature. The structures and contracts of IPF are then discussed in Section 3.5. The chapter concludes with the main remarks in Section 3.6.

3.2 THE ISLAMIC ECONOMIC SYSTEM

The Islamic economic system is the foundational base underlying Islamic finance. Therefore, Islamic banking and finance is expected to conform to the foundational principles of Islamic economics. This section introduces Islamic economics and outlines briefly the philosophical and conceptual aspects of the Islamic moral economy.

The Islamic economic system is a value laden economic paradigm based on the value system of Islam (Asutay, 2007). It should be understood as “part of the general system of Islam which organises different aspects of life in the society” (Al Sadr, 2009: 64). The central idea that sets it apart from neoclassical economics is “its insistence on the

explicit inclusion of an ethics *based on religion* in a unified analytical framework” (Naqvi, 1994: 14). It derives its worldview, goals and strategy from the Islamic teachings (Chapra, 2003; Kuran, 1995) and particularly the value system embodied in the Quran and *Sunnah* (Ahmad, 1980a). Hence, Islamic economics is primarily normative although the positive aspect cannot be denied since the core sources—the Quran and *Sunnah*—are not devoid of positive economic related statements (Zarqa, 1980).

Based on this value-oriented proposition, the philosophical tenets and foundational axioms of Islamic economics are constructed. The leading Islamic economists (Ahmad, 1980b; Siddiqi, 1980; Naqvi, 1994; Chapra, 2003) have attempted—through social constructivism—to develop an axiomatic approach as to the treatment of the principles of Islamic economics. The main axioms are discussed below:

- i. *Tawhid* (oneness of God): The whole of the Islamic worldview and strategy rests on this concept—all Islamic teachings emanate from it (Chapra, 2003). *Tawhid* is, in essence, a total commitment to Allah’s will. The will of Allah is the end of all human endeavours and constitutes the source of all values (Siddiqi, 1980). *Tawhid* “particularly denotes the vertical dimension of Islam—linking the imperfect and finite social institutions with a Perfect and Infinite Being” (Naqvi, 1994: 26). The implication of the axiom of *tawhid* on the economic plane is that all individuals should be guaranteed equality of opportunity and social care since all are equal in their relationship with God (Siddiqi, 1980). In a nutshell, the concept of *tawhid* provides “the framework for economic activity to take place within Islamic norms” (Asutay, 2007: 5).
- ii. *Al Adl Wal Ihasn* (justice and beneficence): The twin concepts of *al adl wal ihsan* denote a “state of social equilibrium” (Naqvi, 1994, 27) emphasising that “all needs of all the least privileged members in Muslim society constitute the first charge on the real resources of the society” (Naqvi, 1994: 27-28). Both concepts imply that societies should establish a balance between the needs of present and future generations and develop policies for the equitable distribution of wealth (Asutay, 2007).

- iii. *Tazkiyah* (purification and growth): The axiom of *tazkiyah* is concerned with “growth and expansion towards perfection through purification of attitudes and relationships” (Ahmad, 1980b: 179). Hence, *tazkiyah* directs individuals towards the purification of all aspects of social and economic development (Asutay, 2007). The end result of *tazkiyah* is “*falah*, prosperity, in this world and the hereafter” (Ahmad, 1980b: 179).

- iv. *Khilafah* (man’s role as God’s vicegerent-on-earth): The axiom of *khilafah* defines the responsibility of human beings in being the vicegerents of God on earth. This implies the concepts of trusteeship, morality and social organisation (Ahmed, 1980b). Moreover, the implications of *khilafah* include universal brotherhood and human freedom (Chapra, 2003).

Following this introduction to the foundational axioms of the Islamic economic system, it is important to delineate the main objectives of the Islamic economic system stemming from the foundational axioms. According to Naqvi (1994), the key policy objectives of an Islamic economy are human freedom, distributive justice, universal education, economic growth, and maximum employment generation. Chapra (2003) confirms these objectives but adds, *inter alia*, stability, fulfilment of needs and universal brotherhood. The goals and objectives of the Islamic moral economy also include human resource development, expansion of useful production, and the improvement of the quality of life (Ahmad, 1980b). In summarising, the Islamic economic system “aims to guarantee individual liberty, freedom of choice, private property and enterprise” (Asutay, 2007: 9), and fulfil the objectives of *Shariah* which are “human well-being, economic development and social justice in the society” (Asutay, 2007: 9).

Thus, IPF is expected to conform to the teachings, general objectives and philosophical tenets of the Islamic moral economy. The rest of this chapter looks into *Shariah* issues related to IPF and the following chapter discusses—through *maqasid al Shariah*—the relevant ethical and social issues.

3.3 SHARIAH AND THE ISLAMIC ECONOMIC SYSTEM

Setting the context for IPF is paramount to achieving the aim of this chapter, and, thus, this section outlines the sources of Islamic law. In addition, the fundamental principles underpinning Islamic finance are briefly discussed so as to construct the conceptual framework within which IPF is located.

3.3.1 Sources Of The Islamic Economic System

Shariah, in its broad interpretation, entails all the commandments, values, and norms compiled in the divine sources of Islam, the Quran and *Sunnah*. In other words, *Shariah* contains legal and non-legal subjects that include theological and moral issues (Calder, 1993; Faruki, 1962; Kamali, 2008a; Schacht, 1964). Thus, *Shariah* “is not ‘law’ in the modern sense as it contains a comprehensive set of dogmas, legal and ethical doctrines” (Laldin, 2006: 3). The jurisprudential part of *Shariah* is known as *fiqh* (Islamic jurisprudence), which covers the Islamic law of transactions that is the focus of this study. *Fiqh* is the outcome of understanding and analysing the *Shariah* through specific normative legal methodologies known as *usul al fiqh* (the fundamental principles of *fiqh*)⁴ (Hallaq, 1997; Kamali, 2008a). However, the definition of *Shariah* is sometimes reduced and confined to Islamic law; the legal and jurisprudential aspect of *Shariah* (Hallaq, 2009). The term *Shariah* law is, thus, occasionally used (Coulson, 1964).

The first and most sacred source of Islamic law is the Holy Quran. Muslims believe that the Quran, the final and authentic word of God (SWT) manifested in the Quranic text, is the basic source for locating a particular norm of Islamic law. Embodying

⁴ This assertion, although very common in *usuli* treatises, is problematic since it was not until the tenth century that *usul al fiqh* reached its formation as an integrated methodology (Hallaq, 1997). Therefore, a significant part of Islamic law was justified *ex post facto* by the jurists.

knowledge about faith and belief, moralities and ethics, as well as human conduct and practice, the Quran is the complete compendium regarding the broad principles of human existence. Regarding Islamic jurisprudence, the Quran contains around 90 legal verses, of which few relate to the Islamic transaction law (see: Coulson, 1964), while Hallaq (2009) argues that there are 500 verses in the Quran with such implications.

The second major source after the Quran is the *Sunnah* which is the practices, deeds and sayings of the Prophet Muhammad (PBUH). Together with providing the best possible interpretation of the Quran, the *Sunnah* also adds new *ahkam* (injunctions), elaborates on Quranic topics, and addresses new issues. Thus, there is a strong hermeneutical relationship between the Quran and *Sunnah* (Duderija, 2007).

The third source of Islamic law is *ijmaa*, which is consensus or the agreement of highly learned jurists living in a certain age on a particular ruling. Although it is a separate source, consensus has to be articulated on the basis of Quran or *Sunnah*. However, the rulings upon which there is consensus are very limited (Hallaq, 2009) as it is very difficult to prove *ijmaa* on a particular issue due to the conditions required for an authoritative *ijmaa*. Following consensus in the hierarchy of Islamic law sources is *qiyas*, which denotes analogical deduction. Since the advent of Islam, *qiyas* has been employed to solve emerging cases and questions. Moreover, since *qiyas* equips the jurist with a set of methods allowing him to reach legal resolutions, this source is essential in deriving new rulings. However, the credibility of *qiyas* has been questioned by Rahman (1982) given that the texts—which are the basis of *qiyas*—can yield more than one opinion and consequently there is no uniformity in the outcome of *qiyas*. Nevertheless, *qiyas* remains very practical in the context of Islamic finance in which innovations are continually occurring (Hassan, 1982).

The foregoing sources of Islamic law constitute the tools of *ijtihad*; the reasoning process employed by the jurist to reach what he perceives is the *Shariah* ruling for a particular case. These sources can be considered to be the *corpus juris* of Islamic law (Hassan, 1982). Moreover, there are other methods of legal reasoning, sometimes

referred to as ‘subsidiary’ or ‘additional’ sources of Islamic law⁵ (Hassan, 1982; Weiss, 1998). However, there has been a trend in contemporary Islamic law, known as eclectic *ijtihad*, through which jurists do not follow the specific principles of *usul al fiqh* and the systematic procedures of *ijtihad*. Instead, the jurists select the texts that support their preconceived position (Saeed, 1997).

3.3.2 The Fundamental Principles Of Islamic Finance

Permissibility is the default position in Islamic law of transactions. It is permissible to undertake any economic activity as long as it is not forbidden explicitly or contains an element of prohibition (Balala, 2011; Nethercott & Eisenberg, 2012). There are two main prohibitions that should be avoided in any transaction or it will be deemed *haram* (prohibited). These are: *riba* (interest); and *gharar* (uncertainty). In addition, the *maqasid* (goals) of *Shariah* have to be taken into account since the spirit of the *Shariah* and its ultimate aim of promoting human welfare has always to be present. Thus, any transaction has to be assessed in terms of its legal validity, as well as its coherence with the broader *maqasid*. Due to the profound implications of the foregoing prohibitions, they are examined in further detail.

Riba is an Arabic word meaning increment or increase. Generally, *riba* is understood to be interest. It has been declared as prohibited on numerous occasions in the Quran and *Sunnah* (Ahmad & Hassan, 2007; Ayub, 2012; Rahman, 1964). There are many definitions of *riba* in the works of both of classical and contemporary jurists. One common definition related to *riba* in loan transactions is that it is an addition to the sum lent (Ariff, 2011). Dewar and Hussain (2011: 274) elaborate, defining *riba* as “any excess paid or received on the principal, or an additional return received on the principal derived by the mere passage of time”. The latter definition identifies the two types of *riba*: *riba al-fadl*, the excess compensation received by one party due to the exchange of goods; and *riba al-naseeyah*, the additional return received by the lender

⁵ The subsidiary sources include *istihsan* (the public interest), *istishab* (presumption of continuity) and local custom known as *urf* (Abdal Haqq, 2002).

due to the passage of time (El-Gamal, 2006). Based on the mainstream juristic interpretation of *riba*, interest paid on conventional loans, gains from trading bonds and other debts, and interest earned from deposit accounts are all prohibited.

However, expanding the interpretation of the Quranic prohibition of *riba* to cover all interest bearing loans is not universal. It has long been debated, albeit within narrow limits,⁶ that *riba* which does not include a time factor is not prohibited. Thus, according to this understanding, only *riba al-naseeyah* is prohibited (Balala, 2011; El-Gamal, 2009).⁷ Nevertheless, the practice of Islamic financial institutions does not allow for any type of *riba*, and thus, this discussion remains within the academic and scholarly circles.

After establishing the prohibition of *riba*, it is also important to briefly highlight the rationale for this prohibition. Jurists identify many reasons. The main justification is that the prohibition of *riba* maintains justice and eliminates all forms of exploitation (Ahmad & Hassan, 2007). In addition, the prohibition of interest leads to economic stability since one of the factors that cause economic instability is the excessive build-up of debt as a result of relatively easy access to credit, which is one of the features of an interest-based system (Chapra, 2006).

The second prohibition is *gharar*. Literally, *gharar* implies hazard or risk (Razali, 2012). The common factor in all categories of *gharar* is uncertainty and unquantifiable risk (El Gamal, 2006). However, it is also important to stress that *gharar* is wider than uncertainty, encompassing speculation, excessive risk and ignorance (Balala, 2011; El-Gamal, 2001). Al Dareer (1993) classifies *gharar* into two types: *gharar* in the essence (terms) of the contract; and *gharar* in the object of the contract. Examples of the first category include future and suspended sales, whilst examples of the latter include ignorance of the genus, species and attributes of the object of sale. This classification of *gharar* has to be taken into account when designing new contracts.

⁶ In this context Al Zuhayli (2003) states that all the followers of the Prophet (PBUH) reached a consensus of the prohibition of both types of *riba*, and no disagreement remains.

⁷ In addition, jurists have had differing opinions as to the *ribawi* items (Vogel and Hayes, 1998) as well as the types of transactions that constitute *riba* (El Gamal, 2006). Moreover, in contemporary times there has been a jurisprudential debate on *riba* primarily taking place in Egypt (Khalil and Thomas, 2006).

Although classical jurists have given various definitions as well as numerous examples of the forbidden *gharar*, Vogel and Hayes (1998) claim that the exact scope of *gharar* has not been identified. Balala (2011) agrees that there is little clarity as to what *gharar* is. This conclusion may be correct regarding the intermediate types of *gharar* but not the minor and major *gharar* since they are apparent and thus can be identified. Using analogy on the examples of *gharar* given in the *Sunnah* and juristic texts, a contemporary transaction can be examined to establish whether or not it contains *gharar*. A number of studies, such as that Al Suwailem (2012), attempt to quantify *gharar* through certain mechanisms in order to ease its measurement.

Regarding the basis of the prohibition of *gharar*, there is no verse in the Quran that explicitly forbids *gharar*. However, the Quran explicitly forbids *maisir* (gambling), which is an extreme form of *gharar*. Moreover, the Quran on more than one occasion forbids *batil* (vanity) (The Quran: 2:188; 4:161). Vanity has been interpreted as *gharar*. In line with the implicitness of the Quran, the *Sunnah* explicitly forbids *gharar* sale (Al-Saati, 2003). These elements, together with the juristic consensus, clarify the rationale for the proscription of *gharar* under the Islamic law of transactions.

On a practical level, *gharar* and uncertainty cannot be avoided completely. Thus, jurists distinguish between forbidden *gharar* and tolerated *gharar*, sometimes referred to as major and minor *gharar*. The AAOIFI (2010) provides four conditions under which *gharar* is not permissible. First, *gharar* must be excessive. Thus, minor uncertainty is permissible. Second, if it is not justified by a *Shariah*-recognisable necessity. This condition has the implication that if the need in the contract containing *gharar* can be met it is permissible, otherwise the contract is deemed invalid. Third, for *gharar* to be defective, the contract must be exchange-based or of that nature. Finally, *gharar* must relate to the principal component of the contract in order to invalidate a contract. A classic example for this is the sale of an unborn calf by itself.

The proscription of *gharar* has an important implication for speculation and derivative instruments. Thus, the presence of *gharar* in conventional options is one of the reasons behind its prohibition by contemporary scholars. In addition, future

contracts have been prohibited by the majority of contemporary scholars due to *gharar* along with other factors (Al Dossary, 2010).

Together with the ascertainment that a contract is free from prohibitions, *maqasid al Shariah* have to be fulfilled. The Islamic economic philosophy of providing social justice as well as economic prosperity can be derived from *maqasid al Shariah*. Thus achieving *maqasid al Shariah* is a very distinct axiom in the Islamic economic model as the ultimate goal of *Shariah* is to promote human welfare, or as according to Chapra (2008: 1), the “ultimate goal of all Islamic teachings is to be a blessing for mankind”. *Maqasid* will be discussed in detail in Chapter 4.

3.4 IPF LITERATURE: A CRITICAL APPRAISAL

3.4.1 Overview Of The Literature

Although the literature on Islamic banking and finance is extensive, there are only a limited number of studies on its application in IPF. The rapid proliferation of IPF has not been supplemented by the necessary corresponding discourse. Thus, IPF literature lags behind the practice resulting in a gap between the theory and practice. This section provides an outline of the relevant literature followed by an analytical review of the main research undertaken in this field.

Literature on IPF can be classified into three categories; two of which are academic and the third is practioner-based, non-academic literature. The first category entails research that has been conducted specifically on the topic of IPF. This embodies the majority of what has been written on IPF and is most relevant to this research. This category includes studies that can be considered the cornerstones of the theoretical discourse of IPF. Such studies include, *inter alia*: Khan (1997); Zarqa (1997); Babai (1998); Wilson (1998); Ebrahim (1999); Cox (2000); McMillen (2000, 2007, 2009 and 2011); Iqbal and Khan (2004); Camacho (2005); Hassan and Soumare (2007); Gabbani

(2009); Ahmed (2010); Alexander (2010); Dewar and Husain (2011); Elasrag (2011); and Sadikot (2012).

The second category embraces discussions of IPF within broader studies on either Islamic finance or conventional project finance. Examples of the former include: Justice Usmani's (2002) discussion of adapting *musharakah* (profit loss sharing) and *mudarabah* (partnership) into project financing in his classic *An Introduction to Islamic Finance*; Vogel and Hyes' (1998) highlighting of certain techniques which can be utilised in IPF in their scholarly work *Islamic Law and Finance Religion, Risk, and Return*; El Gamal's (2006) reference to project finance in the context of *salam* (forward contract) in his critique *Islamic Finance Law, Economics, and Practice*; and Al Amine's (2011) treatment of IPF in terms of *sukuk* (Islamic bonds) issuance in his compendium *Global Sukuk and Islamic Securitization Market*. In addition, examples of the discussion of IPF within conventional finance literature include: Yescombe (2002); Esty (2004); Hoffman (2008); and Delmon (2009). Such studies, with the exception of Esty (2004), lack depth and an analytical approach; they merely give a general outline of the nature of IPF.

The third category encompasses non-academic, industry-oriented publications and client briefings by market players, consultancies, and rating agencies. In addition, press releases can be considered under this category. Examples of this category include: Dar and Azmi (2010); Keenan (2010); Islamic Development Bank (2011); Clifford Chance (2013); and, most importantly, the AAOIFI (2010) *Shariah* Standards which include a standard on concession contracts. The majority of publications in this category are intended to give an overview on IPF to the different financial sectors and investors. In addition, such publications focus on the magnitude of IPF investments and their performance.

Having categorised the main types of literature, it is now useful to analyse the discourse in further detail in order to identify the focal points and gaps of IPF literature.

3.4.2 Analysis Of The Literature

In this analysis, the main academic studies and articles are examined to highlight the extent of the academic literature on IPF. It is important to note that this section surveys the main underpinning aspects of IPF, but excludes the financing structures as, due to their significance to the research, they are allocated a separate section.

The role of *istisnaa* as a financing tool in project finance is highlighted by various studies (see for example: El Gamal, 2006; Vogel & Hayes, 1998). Most, if not all, studies on IPF stress its substantial role and consider it to be a breakthrough in the IPF realm. Zarqa (1997) is one of the first scholars who highlighted in depth the role of *istisnaa* in project finance. In addition to providing a framework for *istisnaa* project financing, he argues that banks can play an important role in such financing in terms of investing their own funds in *istisnaa* as well as marketing such investments. More importantly, he asserts that long term investments can be encouraged by allowing for a higher rate of return to investors willing to accept longer dated certificates. This can be realized by splitting the total financing into tranches of different maturities. He also sheds light on the issue of indexation of loans. As payment of the deferred price extends over a long period of time, indexation is important in project finance. Thus, he forwards a *Shariah* compliant indexing tool.

Khan (1999) provides an extension and modification of Zarqa's (1997) proposals regarding the implementation of *istisnaa* in financing infrastructure projects. Since Islamic finance faces liquidity problems as Islamic debts are not tradable in secondary markets, Khan's (1999) main argument is how to make Islamic debts more liquid without violating *fiqh* rulings. In other words, he proposes an Islamic alternative for mezzanine financing which is very instrumental in conventional project finance. For this he proposes the utilisation of embedded options with the classical *istisnaa* contract due to its flexibility in terms of deferral of price and object. Owners issued with *istisnaa* debt certificates can be given, for example, the option of exchanging their *istisnaa* certificates with stocks of the franchise or a specified amount of output of the perpetual franchise. This is all legitimised under the *bay al dayn bil ayn* concept; the

sale of debts for real assets. In addition, the certificate holders can be given the option to rescind the certificate to the issuing authority during a certain period of time.⁸ Overall, his suggestions aim to effectively overcome the limitation regarding Islamic debt certificates.

The role of *mudarabah* in project finance particularly can be attributed to Khan (1997). He has provided a clear description for the utilisation of *mudarabah* in addition to the well-established *istisnaa* arrangement. He legitimises the creation of special purpose vehicles (SPVs) on the basis of a 'specific purpose' *mudarabah* which can be dissolved at the end of the financing term. Moreover, he illustrates the implementation of Islamic bonds as securities in project finance giving particular Jordanian bonds as an example.

Another pioneering study on IPF was conducted by Wilson (1998). Building up on the work of Khan (1997) and Zarqa (1997) he highlights the role of *istisnaa* but stresses that it is only one Islamic solution for project financing. Unlike previous studies that concentrated on the similarities between the build, operate and transfer (BOT) schemes and *istisnaa*, Wilson discusses the differences. For example, he has shown that in the case of *istisnaa*, the Islamic bank controls the project whilst in the case of BOT the contractor controls the project. Wilson suggests that other financing schemes such as those based on *musharakah* and *mudarabah* are likely to be more just and economically beneficial. Another important notion discussed in the paper is the issue of knowledge and uncertainty. Good information and financial reporting are perceived as vital components for the success of any project financing. Moreover, Wilson provides a well-balanced evaluation of the different views regarding the discounting and the calculation of NPV of a project. Furthermore, he touches upon the issue of developing full-fledged *Shariah* compliant bid bonds and performance bonds. Taking into account the state of IPF research at the time of his writing; Wilson's study provides a constructive contribution to the IPF discourse.

⁸ Zarqa (1997) also suggests that the certificate holder can be given the choice of transferring the debt certificate to a third party in return for property or merchandise, based on the classical *hawalah* (transfer contract) contract in *fiqh*. However, this may need, according to the position of some *fiqh* schools, the consent of the debtor. This can be resolved by the issuance of fully transferable certificates.

Ebrahim's (1999) study is another of the earliest academic attempts to address IPF. The main aim of the study is to analyse the basic traditional modes of IPF in light of modern financial engineering. In addition to offering a relatively brief description on how Islamic debt and equity instruments can be translated into security design packages, the author reflects on the main Islamic nominate contracts from the perspective of modern finance which distinguishes this study from others. For example, he shows, using equations, how *murabahah* is equivalent to an asset backed risky loan and how *khiyar* (option) can be synthesised as a European call option. Although the study can be interpreted as an analysis of Islamic financing instruments generally and not specifically IPF, the author touches on important issues in project finance. For example he discusses the legitimacy of transferring part of the risk of the *mudarabah* venture to the *mudarib* (labourer) in return for the *rab ul mal* (capital provider) acquiring a lower profit sharing ratio. He posits a proposal for this risk-return trade-off but then leaves it for the scholars of the *fiqh* academies to resolve. The study should be acknowledged for its distinct treatment of Islamic financial concepts from the perspective of modern finance.

Contractual and inter-creditor issues in IPF are raised by Cox (2000). The concerns she raises are very practical especially as it was a result of experience in a multi-tranche financing for the development of the holy sites at *Arafat* and *Muzdalifa* in Saudi Arabia. The title and contractual ownership issues are important in such arrangements. These include exposing the Islamic financier who holds the project assets for a given period (in the case of lease transaction for example) to the local legislation regarding liability of the owners in cases of damage. In addition, holding the title to the assets may expose the Islamic financier to payment of compensation to a third party who may be harmed by the asset. Moreover, as an owner of the project assets, the financier will also be held responsible for the maintenance and insurance issues and will have to deal with the taxation issues. The creation of a special purpose company can resolve a number of these concerns since it acquires title to the assets and thus the ownership liability. Regarding inter-creditor issues, Cox (2000) highlights the importance of separating the Islamic finance tranche from the core

financing tranche⁹ in order to ensure the rights of decision are not controlled by the majority of conventional financiers. In addition, she proposes that Islamic financiers, who cannot charge interest in case of default, can resolve this problem by offering beneficial terms for early and even prompt repayment.

In their seminal work, Iqbal and Khan (2004) laid the framework for an Islamic model for BOT projects especially, as well as other variants of infrastructure projects. They provide a critical review of the factors which make infrastructure investments unstable compared to investments in other areas of finance. Although most of the factors are discussed in mainstream project finance studies (see for example Vinter, 1998), the authors highlight some important considerations such as: the lack of macroeconomic policy coordination; ambiguity in the characterization of foreign investments; and the difficulties in forecasting correct revenues due to the complexity of contracts. In addition, they illustrate some of the experiences of Muslim countries with infrastructure financing projects. In a similar vein is Camacho's (2005) study which although contains little which is new, it provides a survey of projects financed with IPF such as the Thuraya satellite project and the Dolphin gas project.

Another strand in the literature which reflects a marked advancement in the theory of IPF is represented by McMillen (2000, 2007, 2009, 2011), Ahmed (2010), and Dewar and Hussain (2011). These studies approach IPF in more depth and are consequently more comprehensive. In addition, these studies are distinct from the previous studies as they integrate theory with practice. It is clear from the discussions that they are based on a firm appreciation of the IPF market and its practical issues.

With the aim of harmonizing principles from the disciplines of Islamic finance and conventional project finance, McMillen (2007) investigates the fundamental and conceptual differences between Islamic and conventional finance. Having discussed these differences, he stresses that due to the considerable Western participation in IPF, *Shariah*-compliant project financing has to use methodologies that are acceptable to Muslims as well as participants with a different set of principles. More importantly, McMillen (2007) gives a very detailed appraisal of the different financing and joint

⁹ This relates to cases in which the majority of the financiers are conventional, which was the prevailing state of IPF at the time of her article.

venture structures in a comprehensive and carefully argued coverage. His work is admirable both for its clarity and the sense of authority conveyed due to the concise integration between conventional finance, law and Islamic finance.

In addition to presenting a succinct explanation of the operation of IPF modes in his whitepaper on Islamic infrastructure finance, Ahmed (2010) discusses other issues regarding the complexity of structuring, legal issues, and government support. He asserts that the standardisation of contracts is essential for mitigating legal risks and lowering the transaction costs. Moreover, he stresses that in the case of multi-tranche financing, care should be taken regarding issues of pre-payments, non-payments and insolvency procedures due, for example, to the *Shariah* objections to charging default interest. In addition, he draws attention to the problem of enforceability of contracts and dispute resolution especially in jurisdictions which do not support Islamic law. This is particularly important in project finance since private sector participation is instrumental but could be curtailed if the law cannot protect the stakeholders. The study, unlike previous studies in IPF, also underlines concerns relating to the legitimacy of certain instruments in infrastructure finance such as forward lease and advanced rentals, the sale of assets and transfer of ownership in *ijarah* (lease) *sukuk*, and the smoothing of payments to *sukuk* holders in the cases of *mudarabah* and *musharakah*. The study then provides recommendations for the progress of IPF. For instance, it argues that government support is essential in terms of providing a stable regulatory environment and ensuring the appropriate investor risk-return profile. Enhancing the involvement of the private sector in infrastructure finance and increasing the involvement of non-bank entities such as *takaful* (Islamic insurance) companies are also perceived as important factors for the development of IPF.

The study of Dewar and Hussain (2011) is another important contribution to IPF literature. Their approach is more legally-oriented in terms of conventional law and Islamic law. In addition, they focus on the documentation and agreements, which is a new development in the IPF literature. In their proposition of integrating Islamic and conventional project finance they assert that it is important to resolve the complex inter-creditor agreements between conventional lenders and IFIs. They stress that harmonizing the events of defaults and exercise of remedies between the Islamic and

conventional tranches is paramount since the project, notwithstanding that there are different tranches, is an indivisible whole and it would be not acceptable that one tranche is accelerated whilst the other is hindered. Moreover, they highlight the issue of the applicable voting threshold should a consultation be needed especially that Islamic tranches are traditionally smaller than conventional tranches. The authors' objective approach is better than that of the Islamic finance protagonists who tend to be emotive rather than questioning or critical in their analysis.

Gabbani (2009) in her survey of IPF attempts to examine the parallels between traditional project finance and IPF. However, the study turns out to be a comparison between the more general Islamic finance and conventional finance. Nevertheless, she highlights using the notion of *maqasid al Shariah* that project finance is close to the economic philosophy of Islam, although she offers no elaboration on the link between project finance and *maqasid al Shariah*. She also gives an assessment of the risks inherent in IPF especially regulatory and inter-creditor issues although her treatment of these issues is limited.

The second category of IPF literature entails references to IPF within broader studies of Islamic finance as well as conventional project finance. In general, the themes discussed and issues raised by these studies are usually incorporated in studies in the first category; IPF specific studies. Nevertheless, there are some useful contributions. For example, Usmani (2002) provides a very clear and succinct rationale for the utilization of *mudarabah* and *musharakah* in project finance. He gives practical solutions for the continuation of a project based on *musharakah* if one of the parties wants to withdraw. In addition, he offers the rationale for the securitization of *musharakah*; the issuance of *musharakah* certificates to raise the required capital for project finance.

The growing strand of literature on conventional finance offers an important addition to the IPF literature. Esty (2000), for example, in his case study of the Equate Project illustrates how co-financed structures can be implemented in infrastructure financing.

The third category of the literature comprises the practitioner and industry-based publications. Such publications are primarily aimed at the customers in order to

convey IPF structures in a clear, uncomplicated way (for example: Keenan, 2010; Clifford Chance, 2013). Although they are not very instrumental for the main body of this research due to their generality, they are useful in terms of providing insights on the current state of the IPF market and its development.

However, the AAOIFI (2010) standard on concession contracts is central to IPF in terms of the theory and the practice given the authoritative body that publishes it. The AAOIFI (2010) standard number 22 on concession contracts discusses three types of concession contracts: utilization of minerals and water; construction; and management. The construction concession contracts are discussed here as this type relates to this research. Construction concession contracts have been defined by the AAOIFI (2010: 400) as a “contract between the State and another party according to which the latter constructs a specifically defined project usually related to public utilities”. The standard then identifies three forms of construction concession contracts. The first is one in which the state is the owner of the project and the licensee holds the title to the usufruct of the project; after completion the ownership of the usufruct is transferred to the state. The second scenario is one in which both the project and the usufructs become the property of the licensee for a period of time after which they are both transferred to the state. The third scenario is one in which the project remains the property of the state but the revenue is shared between both the state and the licensee and after a period of time it is transferred to the licensee. The standard declares that the IFIs can be involved in concession contracts either by entering as an intermediary party between the state and the licensee or through a direct relationship with the state. It should be noted that the AAOIFI confines concession contracts to contracts in which the state is a party. Although this is the usual arrangement, it does not discuss concession contracts in which the state is not involved. It then goes on to give an outline of the financing structures as discussed in standard IPF literature.

The standard provides a useful addition regarding the disposal of the concession license. As the concession license is considered to be a financial right, the owner has the right to dispose it of through leasing, selling, mortgaging, partnership or securitization, as long as this meets the *Shariah* rules and does not contradict the

conditions imposed by the licensor. Regarding the remuneration, the standard rules that it is permissible for the remuneration to be determined in terms of the right to utilize the project for a specific period. The rationale is that such an arrangement can be considered to be an *istisnaa* in which the price is the utilization of the facility; a viewpoint that has been confirmed by the 17th Al Baraka seminar (AAOIFI, 2010). Overall, the standard is authoritative, well presented and clearly structured.

Reviewing the IPF literature reveals important findings. The lack of academic studies is evident when compared with the cornucopia of literature on conventional project finance. It is apparent that there are very few studies that directly address IPF. The depth of discussion and the analytic approach varies between the different studies. Moreover, the IPF literature concentrates largely on a descriptive analysis of the general financing structures as opposed to specific *Shariah* compliance issues, empirical analysis, regulation and legislation, and performance. The survey of the literature also reveals that there is no exhaustive study on the contracts of IPF.

Although there is a relatively detailed discussion on the financing structures, one important idea is missing from the discussions; *maqasid al Shariah*. The implementation of *maqasid* is particularly important in project finance since project finance offers a fertile ground for the realisation of the social aspects of Islam due to the fact that infrastructure projects serve a large array of beneficiaries and can contribute to the prosper of ordinary people. Examining the corporate social responsibility of IFIs in project finance has not been thoroughly addressed although there have been attempts (Jalil, 2006) to devise an Islamic framework for project evaluation to ensure the coherence of a project with the *Shariah* objectives. In addition, and as is the case with the majority of Islamic financial products, an examination of *maqasid* at the project finance contract level is not present in the literature.

This state of IPF literature has had implications on the development of IPF. First, the current literature does not provide a comprehensive understanding of the process of IPF which, in turn, fails to satisfy the requirements of the project participants. Consequently, this may lead to reluctance towards the implementation of IPF

techniques since the rights and obligations of each party are not clearly identified. Second, the documentation of IPF arrangements is not clarified to the extent required for legal purposes. Moreover, the lack of empirical studies on IPF leads to shortcomings in terms of the assessment of the performance of IPF and, accordingly, deciding upon the commercial viability of utilising such techniques. Another important consideration is that limitations in the discourse regarding IPF can hinder its development since governments and policy-makers may be reluctant to endorse concepts which are not fully developed and thus do not offer a clear method of implementation. The notion of linking theory with policy needs to be taken into account when addressing IPF.

Nevertheless, it has to be acknowledged that the literature is constrained due to the state of the nature of IPF and the direction it is taking as a relatively new phenomenon evolving in the global financial order. In addition, the complex, interdisciplinary nature of IPF has to be taken into account when analysing the discourse.

3.5 ISLAMIC PROJECT FINANCING TECHNIQUES AND STRUCTURES

This section presents a structural analysis of the different techniques of IPF. It explains how nominate contracts are accommodated in order to cater for IPF. The underlying mechanism of most Islamic finance transactions is to synthesise classical nominate contracts and adapt them to cater for contemporary financial transactions. In practice, this can mean coming up with new innovative structures or simply replicating conventional financing tools. Hence, IPF structures will typically consist of one or more main contracts as well as supporting contracts. In addition, Islamic project financings either consist purely of Islamic contracts or are combined with conventional contracts in what is known as multi-tranche financing.

This section is primarily based on the writings of Khan (1997), Ebrahim (1999), McMillen (2000, 2007, 2009, 2011), Ahmed (2010), Dewar (2011), and Dewar and Hussein (2011). To standardise the discussion and for uniformity purposes, three

parties to each structure are identified: the funding company (FC); the project company (PC); and the engineering, procurement and construction company (EPC). For each structure, a brief outline of the contracts is given followed by the application and expansion of the foregoing contracts in Islamic project financing.

3.5.1 Simple *Istisnaa*

Istisnaa, also referred to as ‘commissioned manufacture’, occurs when “one party buys goods that the other party undertakes to manufacture according to specifications given in the contract” (Vogel and Hayes, 1998: 146). IFIs have also developed parallel *istisnaa* in which the buyer in the first contract enters into another contract with a third party in order to sell the item, with the same specification, in the capacity of the manufacturer. Thus, the buyer in the first contract is the seller in the second contract (AAOIFI, 2010).

In IPF, the FC is the seller (*sanea*) and the PC is the buyer (*mustasnea*). An *istisnaa* contract is initiated between the FC and the PC in which the FC takes responsibility for constructing the project and selling it to the PC. The delivery date is agreed upon and the price payable is fixed at the outset and can be paid by the PC to the FC either at the outset of the contract or in instalments. However, this structure is not usually employed since the FCs are not constructing companies and thus, subcontract the construction to EPCs (Ahmed, 2010).

3.5.2 Parallel *Istisnaa*

In this structure, the same arrangement followed in the simple *istisnaa* is applied in which an *istisnaa* contract is initiated between the FC and the PC. The difference is that the FC does not execute the construction; it delegates the construction by

subcontracting it to an EPC. A parallel *istisnaa* agreement is signed between the FC and the EPC in which the EPC undertakes to construct the project and sells it to the FC and, consecutively, the FC pays to the EPC either at the offset or in instalments as certain milestones of the project are reached. The specifications of the original *istisnaa* and the parallel *istisnaa* are the same. The important point is that the price paid by the FC to the EPC is lower than the price paid by the PC to the FC. Thus, this difference in price is the profit for the FC. Nevertheless, the FC remains liable to the PC for delivery and specifications (Ahmed, 2010).

This financing structure gives rise to a number of issues. First, the financing is made at fixed rates of return, which can be problematic due to market fluctuations and shifting risks. Second, the *istisnaa* financing receivables are debt receivables and thus cannot be traded in the secondary market; therefore, they are illiquid. Ebrahim and Khan (2002) tried to solve the problem of illiquidity with *istisnaa* certificates¹⁰ by embedding risk encountering options in the certificates. They propose that prior to maturity but after completion of the project, the certificates can be exchanged for a specified amount of the output of the infrastructure project or for other stocks of the franchise, if applicable. Thus, the *istisnaa* certificates, which are otherwise debt certificates and cannot be traded, are converted into real assets which can be traded. Thus, the classical concept of *bay al dayn* (the selling of debts) is developed into an asset securitization device. This embedding is achieved through a promise which is binding on either the buyer or the seller but not both. More importantly, this promise has no value on its own and cannot be separated from the original contract, or else it will fall under the prohibition of derivatives.

3.5.3 *Ijarah*

Ijarah corresponds to leasing in conventional finance. It is defined as a contract in which the owner of an asset transfers its usufruct to someone else for an agreed period,

¹⁰ The *istisnaa* financing receivables can be converted into certificates.

at an agreed consideration (Usmani, 2002). In the practice of IPF, this contract is supplemented by other *Shariah* compliant structures such as *istisnaa*. However, it may be used as a standalone structure. For example, if the project has been already constructed with a conventional tranche, *ijarah* can be utilised as a repayment mechanism after the completion of the construction of the project. In many cases, it is the core element of repayment.

Ijarah is utilised in IPF as follows. The FC holds the title to the assets possibly through *murabahah*. It then leases the assets to the PC under a lease contract. Next, the PC pays rental instalments to the FC. This can be structured in a way that it is equivalent to the debt service payable by the FC to the bank. In some cases, it has been structured in such a way that any default on the lease will also constitute an event of default on the loan. The agreement may also include a clause that the PC is to purchase the assets in whole or in part under certain defined circumstances. Forward lease (*ijarah mawsufash bil dima*) has also been introduced into IPF in which the FC can charge advance rent whilst the asset/project is being manufactured/constructed (McMillen, 2007).

An important issue related to this structure is that Islamic commercial law on *ijarah* does not allow for the maintenance obligations to be passed from the lessor to the lessee. However, to achieve this practice, which is common in conventional financial arrangements, a mechanism has been invoked to shift the maintenance obligations to the lessee. This has been realised, in certain cases, by the introduction of a manager contractor agreement in which the lessor hires the lessee to carry out the required maintenance. Moreover, some agreements also have provisions that result in removing the FC from the decision-making process (McMillen, 2007).

The collateral security structures are also considered very important elements of project financings. An outline of selected structures which are associated with *ijarah* financing structures is as follows. The PC enters into a series of security arrangements with the FC in which it pledges all its assets to the FC. The assets are essentially pledged to secure the obligations of the PC to the FC. Moreover, there are also similar

security arrangements between the loan provider and the FC. In this context, the FC may assign to the bank all of the rights it has in the PC collateral (McMillen, 2007).

3.5.4 *Wakalah Ijarah*

The *wakalah ijarah* arrangement—together with the *istisnaa ijarah* arrangement—is one of the most prevalent structures of IPF whether in pure Islamic structures or in Islamic tranches of multi-tranche financing. *Wakalah* is defined as the “act of one party delegating to the other to act on its behalf in what can be a subject matter of delegation and it is, thus, permissible” (AAOIFI, 2010: 413). *Istisnaa* and *ijarah* have been defined in the previous sections.

The *wakalah ijarah* arrangement consists of two main agreements: the *wakalah* agreement and the *ijarah* agreement. The role of the *wakalah* agreement is to provide financing for the construction phase. As depicted by Dewar and Hussein (2011) and Ahmed (2010) it is arranged as follows. The FC appoints the PC to act on its behalf as a *wakeel* (agent) in respect of the procurement of assets from the EPC contractor. Next, an *istisnaa* arrangement is established between the PC, which is the *wakeel* of the FC, and the EPC contractor. Thus, the PC takes responsibility for the project execution, completion and supervision. As long as the PC acts in accordance with the *wakalah* agreement, it maintains management of the project and there is little involvement from the FC. During the construction period, the PC draws payment from the FC equivalent to the EPC milestone payment under the EPC contract. Upon completion of the construction of the project, the PC accepts delivery of the project assets and the title to the project assets is passed directly to the FC. The agreement stipulates that the title is transferred from the EPC to the FC directly and not through the *wakeel*, particularly because certain *Shariah* scholars object to passing the ownership through the *wakeel*.

Upon completion, the project assets are leased back to the PC pursuant to a lease agreement as discussed below. Alternatively, albeit not common in IPF, the FC may

instead sell the project assets by way of a parallel *istisnaa* into which it entered at the time of the original *istisnaa*. However, it is not permitted for the FC to sell the project back, through *istisnaa*, to the PC since the *Shariah* prohibits a sale and buy back. Therefore, the FC can sell the project to a third party or an SPV owned by any other corporate entity that is not related to the PC. The *wakalah* agreement between the FC and the PC ends on the date when the project assets and title are transferred from the EPC contractor to the FC.

The second agreement is the lease agreement which is utilised once construction is completed. The FC leases the project assets to the PC and receives rental payments. Through this mechanism, the principal and profit are returned to the FC during the post-construction period. Thus, the rentals compromise the purchase price of the project assets as well as the profit margin which can be fixed and/or floating. It is usually benchmarked against LIBOR. The lease agreement can be renewed each time LIBOR is revised. Although, the commonplace arrangement is that the rentals are payable once the assets are able to be used for their intended purpose, the forward lease (*ijarah mawsufash bil dima*) can be used in *ijarah* financings. Under the forward lease, the PC pays rentals to the FC during the construction phase. However, if during the construction phase, an event of default results in a termination of the *wakalah* agreement between the FC and the PC and thus terminates the project, the FC is obliged to refund the advance rentals which have been paid by the PC.

It is useful to note that the FC usually appoints an Islamic facility agent to act on its behalf. This can be done through an asset agency agreement. Therefore, the FC can be replaced by the term 'Islamic facility agent'.

3.5.5 *Istisnaa Ijarah*

Akin to the *wakalah ijarah* arrangement, the *istisnaa ijarah* IPF arrangement comprises of two main agreements: the *istisnaa* agreement and the *ijarah* agreement. Regarding the *istisnaa* agreement, the FC appoints the PC to procure the

assets/project on the basis of an *istisnaa* agreement. Thus, the PC which is the *sanea* takes the necessary steps to construct the project and the FC which is the *mustasnea* agrees to purchase. The payments made by the FC to the PC can be phased. The PC can undertake the construction or it can delegate the construction to an EPC contractor through a parallel *istisnaa*. In certain projects, the FC will incorporate an SPV owned by the FC to manage the purchase of the project from the PC. This has the advantage that the FC will be shielded from liability regarding the project assets. Following the completion of the project, it is then leased back to the PC in return for the payment of rent for utilising the project. This is conducted through a lease agreement as depicted in the section on *wakalah ijarah*. Moreover, in certain projects, the *ijarah wa iqtina* (hire-purchase) is implemented allowing the PC to purchase the project/asset at the end of the lease period either at market price or a price specified in advance. This is particularly practical when the government is a party in concession contracts and requires the asset project to be under its ownership at maturity (Ahmed, 2010; Dewar & Hussein, 2011).

The main difference between the *istisnaa ijarah* agreement and the *wakalah ijarah* agreement is that in the former arrangement there is no agency contract between the FC and the PC. Instead, there is a direct *istisnaa* agreement between the two parties. The advantage of this arrangement for the FC is that the PC remains responsible for the project assets and thus the FC is not be held liable in case of any delays in the construction (Dewar & Hussein, 2011).

3.5.6 Musharakah

The contract that entails *musharakah* (sharing) is known more commonly referred to in Islamic law books as *sharikah* or *sharikat al aqd* (contractual partnership). This term, which signifies the mixing of two properties, was then generalized by the jurists to all partnership contracts (Al Zuhayli, 2003). The AAOIFI (2010: 203) provides a

practical definition of *sharikah* as “an agreement between two or more parties to combine their assets, labour or liabilities for the purpose of making profits”.

In the *musharakah* IPF structure, the FC and PC form a joint venture which jointly owns the project. The FC contributes funds on behalf of the investors and the PC contributes its share of capital and in-kind input. The construction of the project is then subcontracted to an EPC on behalf of the joint venture. Thus, the project is owned by both the FC and the PC whilst the EPC receives the price for the construction. Upon completion of the project, and in the operation phase, the FC may lease its share of assets to the PC and receive rental income. Moreover, diminishing *musharakah* may be utilised in which the ownership of the project assets are gradually transferred to the PC from the FC. This can be done through a *murabahah* contract where the FC sells its *hisas* (ownership units) to the PC and upon completion of payment, the project is owned by the PC (Ahmed, 2010; McMillen, 2007).

3.5.7 *Mudarabah*

The *mudarabah* contract corresponds to the sleeping partnership in conventional commercial law. It has been defined as “a partnership contract in profit in which one party provides capital and the other provides labor and work” (Ibn Abdeen¹¹, 2003: 430). The cornerstones of a *mudarabah* IPF structure are the *mudarib* (entrepreneur) and the *rab ul mal* (investor) as indicated previously. In IPF, the *mudarib* is the FC and the *rab ul mal* can either be the bank who provides the loan or the *sukuk* holders in the case of *sukuk* issuances. Then the FC enters into a second arrangement with the PC. This can be *istisnaa*, *ijarah* or any other complex structure. Thus, the FC will have more than one role simultaneously; for example: a *mudarib* and a *sanea* (McMillen, 2007).

¹¹ D: 1836 AD.

3.5.8 *Murabahah*

Murabahah is a very common mode of financing used by most, if not all, Islamic banking institutions in numerous transactions. It has been defined as selling at the principal plus cost in addition to a profit margin on the condition that the principal is known to both parties (Al Zuhayli, 2003).

Thus, *murabahah* is, in fact, a sale and the features that distinguish it from other types of sale are that the principal is disclosed, and profit is incurred. The composite form of *murabahah*, widely employed by IFI's, is known as *murabahah lil-amir-bil-shira*, (*murabahah* to purchase order). This is where a bank purchases a good at the request of a client and then re-sells the good to the client with an agreed mark-up. The transaction comprises two promises: a promise from the client to buy; and a promise from the bank to sell (Usmani, 2002; Vogel & Hayes, 1998).

The emergence of *murabahah* as a financing tool in IPF is noticeable especially with the onset of the 2007 financial crisis. Although the *murabahah* is most closely identified in the Islamic finance context with short-term finance, it is increasingly challenging the prevailing IPF structures such as *istisnaa* and *ijarah*. In a typical *murabahah* structure, the FC signs a contract with an EPC or a supplier to construct the project or to provide project assets. However, in practice the *murabahah* structure is not usually utilised for the construction phase; it is utilised for the financing of specific inputs or assets. Following or together with the *murabahah* contract, the PC promises to buy the assets and this promise is binding upon the promisor according to certain *fiqh* interpretations. In addition, the FC may request a letter of credit or a good faith down payment, such as *arbun*, from the PC. Then, the FC signs a further contract with the PC to sell the project/assets at a mark-up. However, the FC has to possess the asset and thus is responsible for any damage which happens to the assets before delivery. Regarding payment, the PC can pay the price to the FC in instalments with LIBOR usually taken as the benchmark. Moreover, the FC can take collateral (*rahn*) in case of delinquency but it cannot increase the outstanding debt or else it will be subject to the prohibition of *riba*. This summarises the typical *murabahah* structure

as utilised in IPF. It reflects a conventional sale and purchase agreement in conventional project finance (Ahmed, 2010; Dewar & Hussein, 2011; McMillen, 2009).

3.5.9 Organised *Tawarruq* (Commodity *Murabahah*)

The sole purpose of a commodity *murabahah* (*tawarruq*) in IPF is to provide cash for the PC. In many *tawarruq* transactions, organised *tawarruq* is utilised. The process is as follows. The FC buys commodities from the international or local market for a spot payment. Thereupon, the FC is provided with a certificate which proves ownership. Next, the FC offers the commodities to the PC who wants financing. The PC then buys the commodity from the FC on an instalment sale basis. Subsequently, the PC then sells the commodity to a third party on a spot basis. However, in this organised *tawarruq*, the PC does not sell the commodity to a third party; instead the FC sells the commodity on behalf of the client. In other words, the FC acts as an agent of the PC. Thus, the end result is that the PC gets cash immediately, while the FC gets its price back on a deferred instalment basis. In the context of IPF, *tawarruq* has been used to provide the equity contributions that a sponsor may be obliged to make as well as the working capital funds required by the PC. However, this practice of organised *tawarruq* has been prohibited by a number of scholars as it replicates an interest bearing transaction and thus, only differs from interest based transactions in form and not in substance (Ahmed, 2010; Al-Shalhoob, 2007; Dewar & Hussein, 2011).

3.5.10 *Sukuk* Structures In IPF

Sukuk are defined as “Islamic trust certificates representing an undivided beneficial ownership interest in an underlying asset where the return is based on the performance of that underlying asset” (Dewar & Hussain, 2011: 279). Various types of *sukuk* can be utilised in IPF whether they were asset based (*ijarah sukuk*), debt based

(*istisnaa sukuk*), equity based (*musharakah sukuk*), or agency based (*wakalah sukuk*). The *ijarah sukuk* is the most dominant in the current practice and has a number of different varieties (Al-Amine, 2011; Dewar & Hussein, 2011). *Ijarah sukuk* is analysed here in detail focusing on its structure in IPF. Moreover the application of another common *sukuk*, namely *musharakah sukuk*, is also presented in this section.

Under the *ijarah sukuk*, or *sukuk al ijarah*, the FC will typically be an SPV created for the purpose of this specific transaction. The SPV will buy a rent-generating described asset (to be constructed) from an originator which is the PC. Next, the SPV will issue *sukuk* certificates representing ownership entitlement in the asset to potential investors and the proceeds from the sale of the *sukuk* will be passed on to the PC as the price of the purchase of the described asset. In turn, the PC will utilise the payments in the construction of the asset, the project. The SPV will then lease the asset owned by the *sukuk* holders to the PC on the basis of forward *ijarah*. Upon completion of the construction of the asset, the PC will pay periodic rent to the *sukuk* holders via the SPV. The rentals can be fixed or variable, for example based on LIBOR. The generally accepted mechanism to achieve the variable *ijarah* is to have a number of individual lease periods within the general lease period. The lease period will correspond to the duration of the *sukuk* certificates and the lease payments will match the periodic payments due to the *sukuk* holders (Ahmed, 2010; Al-Amine, 2011; McMillen, 2007).

At the end of the term of the contract, the asset may be sold back to the PC for a bullet payment. In this case the periodic payments which have been made will have included rent only. Alternatively, the contract may take the form of *ijarah wa iqtina*. In this structure, a part of the amortised capital will be included in the periodic payments together with the rent. Thus, at the end of the contract, the asset will be returned to the PC as a gift or for a nominal value (Ahmed, 2010; Dewar and Hussein, 2011).

The second type of *sukuk* to be discussed is *musharakah sukuk* which is an equity based *sukuk*. Under this structure, the SPV, which represents the FC, will issue *musharakah sukuk* to investors. It will then enter into a *musharakah* agreement with the PC using the proceeds from the *sukuk* issuances. The PC will contribute cash or

in-kind capital into the *musharakah*. Profits may be distributed in proportion to the contributions or as agreed. The PC will undertake the management of the project under a separate agreement. In the case the PC would want to acquire possession of the project assets; it can purchase the units of the SPV through diminishing *musharakah*. Moreover, the PC can purchase the project assets at the end of the term of the contract at market value or at a time agreed upon at acquisition and not at the face value corresponding exactly to the principal provided by the shareholders (AAOIFI, 2010; Al-Amine, 2011).

3.6 CONCLUSION

This chapter provides a detailed introduction into IPF. In setting the context, a brief outline on *Shariah* and the Islamic economic system is provided. In addition, the literature on IPF is examined in detail. It is shown that there is a lack of studies on IPF when compared with the plethora of literature on conventional project finance. Moreover, the existing IPF literature concentrates largely on a descriptive analysis of the general financing structures as opposed to specific *Shariah* compliance issues, empirical analysis, regulation and legislation, and performance. The survey of the literature also reveals that there is no exhaustive study on the subject and especially on the *maqasid* related issues.

The third part of the chapter is devoted to examining the structures and contracts of IPF. The innovative structures of IPF are classical nominate contracts adapted for contemporary IPF financial transactions. It is also shown that IPF structures typically consist of one or more main contracts as well as supporting contracts. Hence, IPF structures are more complex than other Islamic finance products.

CHAPTER 4

MAQASID AL SHARIAH AND ISLAMIC COMMERCIAL LAW: A GENEALOGY

4.1 INTRODUCTION

Islamic project finance is based on the Islamic moral economy and is hence expected to conform to the high moral standards and the foundational principles of Islamic economics. Therefore, Islamic project finance has to comply with *maqasid al Shariah*, which aims, at the broadest level, to achieve human wellbeing and promote human-centred development.

Although there is a wealth of literature on *maqasid al Shariah* in Islamic finance in general, not much has been done to explore the link between Islamic commercial law and *maqasid al Shariah*. In addition, the grounding and endogenisation of *maqasid* within particular rulings of Islamic commercial law is another area where *maqasidic* research has been very limited. In response to these shortcomings, this chapter aims to present a genealogy of the *maqasidic* aspect of Islamic commercial law in an attempt to show a different side of Islamic commercial law than is usually covered in the standard texts on Islamic commercial law. It opens with a brief introduction to *maqasid al Shariah* and then provides a critical review to the literature on the *maqasid* of economic activity.

This critical review will benefit this study in a number of ways. Firstly, the survey will facilitate a gradual approach to the topic of Islamic project finance and *maqasid al Shariah* by serving as an introduction to the relatively technical analysis that is carried out in the empirical chapters. Secondly, the review sheds light on the development of the commercial *maqasidic* discourse and, thus, aids in putting these concepts into their proper perspective. Furthermore, the critical examination of the roots and

sources of the commercial *maqasid*, their development, and the state of the literature, illustrates the originality and contribution of this research. By examining the foundations of current research in *maqasid*, this section puts the present study—on the moral aspects of Islamic project finance—into context.

This chapter proceeds as follows: Section 4.2 gives a brief introduction to *maqasid al Shariah*. Section 4.3 analyses the *maqasid* of commercial transactions in classical discourse. Section 4.4 gives an analysis of the *maqasid* of contemporary transactions in contemporary discourse. The main remarks are set out in Section 4.5.

4.2 MAQASID AL SHARIAH: MEANING AND DIMENSIONS

Etymologically, the word *maqasid* is the plural of *maqasid* the root of which is *qasd*, denoting the straightness of a path, directive destination and balance and justice (Laldin and Furqani, 2013; Al Kaylani, 2009). Technically, *maqasid al Shariah* are the goals, higher intents and objectives of the *Shariah* (Auda, 2008; Kamali, 2008b; Chapra, 2008; Al Shatibi, 2004). *Maqasid al Shariah*, therefore, represent the foundational basis and rationale on which *fiqh* is constructed.

Two main sources are used to derive and identify *maqasid*. The most common and authoritative sources are explicit Quranic textual proofs whose meanings are clear. This category includes Quranic verses whose meanings are unlikely to be anything other than what is apparent, such as the verses that stress that Allah (SWT) does not like corruption (The Quran: 2: 205). It can be deduced from such verses that one of the goals of *Shariah* is to prevent corruption. The second source that is used to identify *maqasid* is the *Sunnah al mutawatira*—the contiguously transmitted Prophetic traditions and the thematically recurrent reports and practices of the Prophet (PBUH) that were witnessed by most of his companions in such a way that they acquired an inclusive knowledge of it (Ibn Ashur, 2011; Al Yubi, 2011). The method for deriving the *maqasid* from these sources is *istiqla*, inductive examination.

According to the different sources, *maqasid al Shariah* have been classified into two main categories. The first classification is based on the level of necessity and the second one relates to the comprehensiveness and scope. Both classifications are interrelated, and a particular *maqsid* can be classified within each of the different classifications.

The classical typology of classifying the *maqasid* according to the level of necessity is most prominent in *maqasid al Shariah* literature and was first introduced by Al Shatibi (2004) in his treatise *Al Muwafaqat*. In this typology, *maqasid* are divided into three hierarchical levels: necessities (*daruriyyat*), needs (*hajiyyat*) and luxuries or embellishments (*tahsiniyyat*). Necessities are crucial for success in this life and in the hereafter. They include the protection of faith, the soul, wealth, the mind and offspring, as articulated in classical literature on *maqasid*. These necessities are considered to be the essential components of human life.

Needs (*hajiyyat*) exist on a secondary level. They represent what is needed to eradicate hardships and to facilitate life (Al Shatibi, 2004). They are complementary requirements (Ahmed, 2011) and are of secondary importance to individuals. For example, some contracts are not completely free from *gharar* and *riba* but have been accepted to meet the needs of the people (Ibn Bayyah, 2010).

The third level in this classical typology is the beautifying purposes (*tahsiniyyat*). These aim to improve quality of life. Aspects of these types of *maqasid* include cleanliness, beautification and manners (Al Shatibi, 2004). This category of *maqasid* is complimentary to the *hajiyyat* and, similarly, the *hajiyyat* are complimentary to the *daruriyyat*. Al Shatibi (2004) has noted the logical hierarchical relationship between these categories. Each level shields and protects the level before it.

The *maqasid* are also classified in terms of the scope of the rulings that they cover. This classification process yielded three categories of *maqasid*: general *maqasid* (*amah*), specific *maqasid* (*khasah*), and partial *maqasid* (*juziyah*). General *maqasid* are those that are observed throughout the entire body of Islamic law. Examples from this category include the necessities, *daruriyyat*. The second entails specific *maqasid* that relate to a certain area of Islamic law, such as the *maqasid* of financial

transactions. The third category contains the partial *maqasid*: the wisdom behind specific rulings and commandments taken from divine rulings, such as, for example, the wisdom governing the prevention of *gharar* in commercial transactions (Ibn Ashur, 2011; Al Khadimi, 2001; Atiyah, 2007). Having given a brief outline of *maqasid al Shariah*, the next section turns to an analysis of the *maqasid* of financial transactions.

4.3 MAQASID IN THE CLASSICAL DISCOURSE ON ISLAMIC COMMERCIAL LAW

In the classical discourse on the *maqasid* of financial activity, the most dominant reference to *maqasid al Shariah* is the explicit mention of the *maqasid* of the preservation of wealth as given, *inter alia*, by Al Ghazali (1997), Al Razi¹² (1992) and Al Juwaini¹³ (1980). Although this strand of literature does not go much beyond these brief indications, it has laid the foundations over which the corpus of Islamic commercial law has been built.

What matters more is the application of this general notion of preservation of wealth in the discourse of Islamic commercial law. To illustrate this, a number of rulings and injunctions, scattered across the different topics of classical Islamic commercial law, will be analysed and discussed in order to explore their underlying *maqasidic* component. No specific order has been followed in presenting the rulings; the method followed was to collect different rulings from different schools of *fiqh* and from a variety of scholars from different backgrounds in order to enhance the analysis and enable a level of generalisation from the findings.

It may be worthwhile to mention Al Raysooni's assertion that, "in reality, the due consideration of *maqasid* and their application is uncontested and subject to the consensus of the *ulama* [scholars], classical or modern; except for an extremist

¹² D: 1209 AD.

¹³ D: 1085 AD.

minority” (2012: 19). Decades before him, when discussing some of the aspects of *maqasid*, Ibn Ashur (2011) asserts that the leading scholars were aware of *maqasid* and that their juristic reasoning was informed by *maqasid*. These two assertions from two of the leading *maqasid* scholars of this age clearly reveal that it has been common practice in jurisprudential discourse to take *maqasid* into consideration. This supports the examples and arguments to come.

Following are six rulings taken from classical *fiqh* that illustrate the *maqasid*-based nature of Islamic commercial law.

4.3.1 Price Fixing and Market Regulation

The first is the issue of price fixing and market regulation. This is based on the tradition that the Prophet (PBUH) abstained from fixing prices when asked to do so by the companions. Maliki jurists have explained this issue of price fixing in the light of *maqasid al Shariah* and that of public interest, which the scripture came to protect. The interest here is that of merchants who trade according to the law of supply and demand (Ihmeeto, 2012). As such, imposing a fixed price is an injustice to merchants. However, there is another opinion—based on *maqasid*—that permits the imposition of a fixed price when merchants raise the prices through creating a monopoly or by deceit (Ihmeeto, 2012).

4.3.2 *Al Ajeer Al Mushtarak*, The Common Labourer

According to Islamic commercial law, *al ajeer al mushtarak* (a service provider who offers his services to many and may thus be contracted by several clients at once) is essentially someone who is entrusted with providing a service. As such, he is not a guarantor except when a transgression is proven. Imam Malik, however, favoured the

position that considers *al ajeer al mushtarak* as a guarantor. This position was adopted after public ethics deteriorated and it became common for service providers to violate the rights of others and to be dishonest. This loss of ethics is the primary reason that Imam Malik placed the service provider in the guarantor position. This ruling shows how the principle of *maslahah*—which is, in essence, a *maqasidic* notion—can create an exception to the general rule (Hassan, 2008).

4.3.3 Obligatory Service Providing

Among the *fatwas* that are based on the *maqasid* of the *Shariah* is Ibn Al Qayem's (d. 1350 AD) opinion that if people need the service of a labourer—for activities such as farming, weaving and construction—the ruler may compel the provider to perform this service and may impose pricing commensurate with what is charged by others in the same profession. Ibn Al Qayem (2007: 226) states that, "... people's interests are only attained through this [previous ruling]". He also asserts, "what is intended is that if people needed the individuals of a certain profession, like farmers and the like, then the labourers of these professions are required to carry out the job in return for a commensurate salary. This forced price-fixing is obligatory." (Ibn Al Qayem 2007: 232).

Ibn Al Qayem argues that these *masalih* (benefits) can be traced back to the classical traditions. He says, "It is mentioned in prophetic traditions that a man owned a tree on land owned by another. The landlord was harmed by the tree owner's continuous entering [into the property]. He complained to the Prophet (PBUH). The Prophet (PBUH) commanded him to accept an equal tree or to donate it, but the tree owner refused. The Prophet (PBUH) then allowed the landlord to remove it." (Ibn Al Qayem 2007: 682). This is because the harm to the landlord is greater than the harm suffered by the tree owner from making him accept another tree. This clearly illustrates that *Shariah*—based on a *maqasidic* perspective—prevents the greater of two harms by allowing the lesser harm (Ibn Al Qayem, 2007).

4.3.4 Restricting the Use of Rights

Ibn Rajab (d. 1393 AD) a renowned *Hanbali* scholar, cites a number of edicts (*fatwas*) in *Hanbali fiqh* derived from *maqasid al Shariah*. The common thread across these *fatwas* is the establishment of *maqasid al Shariah*. Examples include the restrictions on the individual's own rights to prevent him causing harm to others. If the execution of a right that is permitted by the *Shariah* causes harm to others, the execution of this right is prohibited. Such a right must then be performed in a manner and under circumstances that do not harm others. Ibn Rajab (1996) affirms this *Shariah*-endorsed general rule on which such *fatawas* are based. For example, he asserts that whenever the dissolution of a lawful contract causes harm to one of the parties, or others who are connected to the contract, it is not permissible to dissolve the contract although in principle it is allowed. However, if the harm can be averted through giving something as collateral or the like, dissolution is permissible.

In this case, Ibn Rajab applies the principle that individuals may not exercise their right when its application violates the rights of other parties. He holds the opinion that, even if a person has the right to dissolve the contract, he may not terminate whenever and however he wills if the dissolution of the contract results in a missed opportunity for the other party. This follows from an examination of the texts of the *Shariah* indicating that the intention of *Shariah* is to prevent something that is lawful if it results in what is considered as unlawful. In the example given, the lawful party to the contract could have used its right in a way that would not harm the other party. However, it chose to exercise its right in a way that harms others. It is as if it intended harm, or at least failed to take the necessary precautions to prevent causing harm to others (Al Raysooni, 2012). The consequentialist component is also apparent from this *fatwa*.

4.3.5 Allowing a Margin of *Gharar* and Risk in Transactions

Ibn Ashur (2011) asserts that, especially in labour based transactions, *Shariah* allows a margin of risk and *gharar* in order to increase these types of transactions. *Shariah* has ignored a degree of *gharar* in these contracts since the benefits of these transactions greatly outweigh the harm caused by *gharar*. On this basis, the majority of scholars have allowed the contracts of *musaqah* and *mugharasah*¹⁴. A more particular example can be taken from the *musaqah* contract. There has been a divergence of opinion on restricting *musaqah* to date palms and vineyards. A number of scholars, however, were of the view that this transaction is lawful in all types of tree and crop cultivation and should not be limited to palms and vineyards (Ibn Rushd¹⁵, 2004). The basis for allowing this is the notion of allowing *gharar* to increase labour-based transactions (Ibn Ashur, 2011).

4.3.6 Providing the Worker with the Means Necessary to Complete the Work

One of the *maqasid* of labour-based transactions according to Ibn Ashur (2011) is to provide the worker with the necessary means to complete the work. Therefore, scholars have stated that in certain contracts, if the worker is unable to complete the work, another worker should be employed to help him. Even more, in the Maliki jurisprudence, the worker in *mugharasah* has the right to sell his right to work to another employee. This illustrates how jurists have considered the *maqasid* of providing the worker with the means for him to accomplish the work (Ibn Ashur, 2011).

The examples presented in this connection show the strong connection between Islamic law and *maqasid al Shariah*.

¹⁴ Both these contracts are crop sharing contracts.

¹⁵ D: 1198 AD.

4.4 MAQASID IN CONTEMPORARY ISLAMIC FINANCE DISCOURSE, FATAWAS AND RESOLUTIONS

In this section, the contemporary discourse on the *maqasidic* component of Islamic finance will be analysed. To achieve this, the academic discourse will be discussed first. Secondly, the institutional and industry based discourse will be analysed. It is not possible, given the scope for the study, to attempt to be comprehensive. Hence, a particular yet representative sample of institutional and industry based publications will be analysed.

Although there is an increasing interest in *maqasid al Shariah*, especially with the advent of the modern version of Islamic finance in the 1970's, much of the discourse remains narrowly focused on the previous literature on *maqasid* and, in many cases, the same debates are repeated over and over again. Al Raysooni (2012: 20) in this regard, says that:

“A few decades after the emergence of *fiqh* councils and experiments with Islamic banks and financial institutions, as well as the accompanying intensive *ijtihadi* jurisprudential movement that directed its scope to recent issues and domains, we are still researching and debating the place of *maqasid*; its imperativeness, applications, whether others rulings can be built on them, whether their function is limited to being a preference...”

It is important to clarify, before proceeding with the review, that this section addresses primarily the main contributions to the contemporary discourse on *maqasid*.

4.4.1 Academic Oriented Discourse

The erudite scholar Ibn Ashur (2011) was probably the first contemporary scholar who paid particular attention to the objectives of monetary transactions in his work *Maqasid Al Shariah*, which was published almost seven decades ago.

In this book, Ibn Ashur attempted to present *maqasid* as a methodological basis for the renewal of Islamic law asserting that the traditional *usul al fiqh* is inadequate as it mainly concentrates on the technicalities of the *fiqhi* process—*usul al fiqh* failed to serve the wisdom of *Shariah*. Therefore, his approach was to emphasise the rationales, purposes and common good in rulings in order to achieve certainty and conformity in the *fiqhi* process.

Ibn Ashur divided his book into three main parts. In the first part he established the underpinning theoretical foundations of *maqasid*. Next, the second part of the book discussed, *inter alia*, the general objectives of the Islamic legislation in achieving a solid and stable social order for the Islamic nation. The third part of the book can be described as an application of the theory that he developed. Here, he analysed the specific *maqasid* of family law, transactions as well as criminal law.

Three chapters of the book were dedicated to monetary transactions in which Ibn Ashur states that there are five *maqasid* of economic activity: circulation, clarity, preservation, persistence, and justice. He then proceeds to provide explanations and evidences for these five *maqasid*.¹⁶

Therefore, Ibn Ashur appears to have been the first to give a thorough and relatively comprehensive analysis of the notion of *maqasid* of commercial transactions. In making this observation, the intention is not to say that the scholars preceding Ibn Ashur lacked an awareness of the *maqasid* of economic activity. Rather, it is simply to say that there are significant differences between Ibn Ashur's (2011) approach and those preceding him. For instance, Ibn Ashur (2011) devised five novel *maqasid* for economic transactions and he formulated distinct

¹⁶ A detailed analysis of the five *maqasid* is given in Chapter 6.

maqasid for different categories of transactions; namely labour based transactions and donation based transactions.

In addition, the space devoted by the classical scholars to this topic is quite small when compared to Ibn Ashur's (2011) discussions. Hence, it can be claimed that Ibn Ashur's (2011) important contribution to and exposition of this topic is similar to that made by Al Shafee¹⁷ (1940) in *usul al fiqh* and Al Shatibi (2004) in *maqasid al Shariah* generally. Undoubtedly, it is one of the most important contributions for understanding *maqasid al Shariah*.

Ibn Ashur's work has stimulated follow-up research by other contemporary scholars, specialists and researchers, among them the erudite scholars Ibn Bayyah (2010) in his work *Maqasid al Mu'alamat Wa Marasid Al Waqiaat*, and Al Qaradawi (2010) in *Maqasid Al Shariah Al Mutaliqah Bel Mal*.

Ibn Bayyah (2010) presents the five *maqasid* identified by Ibn Ashur (2001), and verifies, explains, and comments on them. He then proceeds to rephrase and reorder them stating that, "if we wish to classify these *maqasid* according to *maqasidiyah* and based on the weight of the corresponding *maslahah* (interest), then the highest in order is making a livelihood and acquiring money; second, preserving fortune." (Ibn Bayyah 2010: 73). These *maqasid* include the *maqasid* of seeking justice, through which money is preserved against all forms of violations and injustices. He continues by saying, "third, clarity, which we can also call transparency; forth, the *maqasid* of exchange and circulation..." (Ibn Bayyah 2010: 77). This seminal book provides multiple jurisprudential applications and many cases of *ijtihad* and examinations of newly arising modern monetary issues based on *maqasid* and *usul al fiqh*. It provides a valuable resource for scholars looking for the application of the *maqasid* of economic activity in a contemporary context.

A more detailed approach to surveying and categorising monetary *maqasid* is provided by Al Qaradawi (2010). He identified 27 of these *maqasid* and divided them into six categories: Firstly, he proposed *maqasid al Shariah* that are related to the value of money and its position. These include those explaining the value of money and its

¹⁷ D: 820 AD.

importance. Secondly, the *maqasid* that connect money and the economy with faith and ethics. The third category pertains to the *maqasid* related to the generation of money such as encouraging the generation and acquisition of money through permissible means. Next are the *maqasid* related to the expenditure of money. This category includes moderating consumerism and expenditure and combating lavishness. The fifth category of *maqasid*, according to Al Qaradawi (2010), is related to monetary exchange issues such as the prevention of hoarding. The last category encompasses those *maqasid* related to the distribution of money. This includes achieving fair distribution of wealth among different groups and individuals and liberating individuals from the anguish of poverty.

The notion of *maqasid* is also present in the conceptual and foundational works of the contemporary Islamic economists. According to many of the founders of Islamic economics in its modern form, such as Chapra (2000), Ahmad (2000), Siddiqi (2004) and Naqvi (2003), the objectives of Islamic finance and banking are deeply informed and inscribed by the overall notions and objectives of *Shariah* such as creating a just society. The fulfilment of the socio-economic objectives embedded in *maqasid al Shariah* are a core requirement of Islamic finance and banking (Dusuki, 2008) and Islamic finance is governed by ethical norms and social commitments (Mirakhor, 2000; Warde, 2010). In addition, it is apparent from the literature that the classical notions of Al Ghazali (1997), Al Juwaini (1980) and Al Shatibi (2004) have evolved into socio-economic notions such as economic development, diminishing differences between economic levels and social assistance (Auda, 2008).

A number of current studies are founded upon these classical and contemporary contributions. Again, Al Juwaini (1980), Al Shatibi (2004), Al Ghazali (1997) and Ibn Ashur (2011) seem to be the most frequently cited and referred to (Dusuki and Abozaid, 2007; Zakaria, 2014; Cizakca, 2007 ; Seraji and Hassan , 2013). Al Raysooni (2012) also attests to the point that the contemporary discourse on the subject does not exceed, generally, what was previously mentioned.

4.4.2 Institutional And Professional Publications, Resolutions And *Fatawas*

The modern experience of Islamic banks has certainly caused a tremendous vibrancy in the *fiqh* of money and monetary transactions. It has caused a movement of *ijtihad* that is unmatched in any other domain of Islamic law (Al Raysooni, 2012). Despite the late start and shortcomings of the contemporary debate on economic *maqasid*, this renewed interest demonstrates growing awareness and belief in the importance of employing *maqasid* within professional and institutional circles. This section provides an outline of *maqasid al Shariah* in institutional publications as well as selected *fatawas* and resolutions.

One example of this mounting awareness and movement is the fact that the International Islamic *Fiqh* Academy dedicated one of its panels to *maqasid al Shariah* and their role in inferring rulings, during its 18th session in Malaysia in 2007. Resolution 167 (18/5) which the Academy dedicated to this subject states in article 8 that it affirms “the importance of the functions of the aims of *Shariah* in applying rules to contemporary financial transactions and to differentiate between Islamic forms of products and existing conventional ones...” (International Islamic *Fiqh* Academy, 2007: 385).

Concurrent with this session, and during the Al-Barakah 28th Symposium, September 2008, Dr. Hussein Hamid Hassan submitted his extensive research paper on the objectives of *Shariah* and the outcomes of the activities of Islamic banking. In addition, during this 28th session, a resolution regarding *maqasid al Shariah* was issued. The resolution stressed that *maqasid al Shariah* should be considered as a framework for *ijtihad* in order to realise the aims of *Shariah* (Al Raysooni, 2012).

Hassan (2008) in this seminal paper on *maqasid* has given examples of the endogenisation of *maqasid* in contemporary Islamic finance issues. Here are two examples related to the *mudarabah* contract. The first issue is the knowledge of the capital associated with *mudarabah*. It is common for a pre-knowledge of the capital of the *mudarabah* to be a prerequisite for the validity of the contract. In investment and

savings accounts that are based on *mudarabah* this condition of prior knowledge of the capital is not satisfied. This is because the account holder (who is, in this case, the capital provider) has the right to withdraw money from his account under certain conditions, especially from savings accounts. Therefore, the capital on the *mudarabah* will not be known until the profit distribution or the end of the account period.

Thus, in this case, the *maqsid* of preventing *gharar* through knowledge of the capital of *mudarabah* has been overlooked. However, the basis for overlooking this *maqsid* is also *maqsidic*. Hassan (2008) argues that the basis for this oversight is the *maqsid* of promoting wealth in addition to rechanneling investments from *riba*-based conventional banks to Islamic banks. According to Hassan (2008), this is a *darurah*, necessity. Thus, this *maqsid* supersedes the other *maqsid* of preventing *gharar*. In addition, this is minor *gharar* since the capital of *mudarabah* will be known at the end of the *mudarabah* contract.

The second example relates to the issue of multiple capital providers in a single *mudarabah*. In the practices of Islamic banks, it is common for capital providers, who are, in this case, the account holders, to enter and exit from the *mudarabah* at different times even though the main *mudarabah* is still functioning. In other words, a new person may open a new account and thus enter into the current *mudarabah*. Similarly, an old account holder may wish to withdraw from the *mudarabah*. This activity all takes place without actual or constructive evaluation (Hassan, 2008).

This is problematic with classical *fiqh* because in principle, in a multiple-party *mudarabah*, a new capital provider should not enter into the *mudarabah*, and an old capital provider should not leave the *mudarabah* until actual, constructive valuation takes place and the profits are distributed. The rationale for this stipulation is that each person involved should have precise knowledge of the capital of each *mudarabah*. Moreover, the new account holder who is entering into the *mudarabah* will not know the total amount of the *mudarabah* capital because he has no access to the details of the other accounts (Hassan, 2008).

Contemporary scholars, however, accept this arrangement although it entails *gharar* because it opens the doors for Islamic banks and thus counters *riba* in non-Islamic

banks. Hence, it promotes the *maqsid* of preservation of wealth through minimising *riba*. Thus, this prioritisation is another example of *maqasidic* based *ijtihad*. It should also be added that the jurists that allowed this transaction did not overlook any scripts because the provision of knowledge in *mudarabah* is not present in any text but is rather based on *maqsid*. In addition, the basis of this stipulation by classical jurists is the prevention of conflict and the preservation of the rights of the parties involved. Thus, if this is arranged by Islamic banks in a manner that prevents conflict and guarantees the rights of the parties, this *ijtihad* may be objective (Hassan, 2008).

Around the same time of Hassan's (2008) paper, the secretary of the European Council for *Fatwa* and Research addressed the issue of *maqsid*—especially its monetary components. The Council commissioned its chairman to conduct research on the topic of 'money-related *maqsid*', to be submitted to the Council's 18th annual session in July of that year. The research was published independently in a separate volume in 2010 (Al Raysooni, 2012).

Notwithstanding the practical problems and issues associated with *murabahah*, it remains, arguably, an early example of *maqasidic* based *ijtihad*. In theory, financing through *murabahah* is essentially different from interest based financing and realises the objective of *Shariah* in combining money making with beneficial and productive work. *Murabahah* is neither an advance loan nor a deferred payment loan, but it involves real buying and selling operations that result in the acquisition of the property by the party that actually needs it (Al Raysooni, 2012). Hence, in theory, *murabahah* is a product of *maqasidic ijtihad*. Whether it has been a successful application is another question.

There have also been cases where contemporary jurists considered the essence and substance of the transaction rather than the formalities and terminologies. An example that illustrates this is the diminishing partnership, which is a real corporation that is jointly financed by the two parties; the bank and client. However, in this case, one of the two parties guarantees that it will buy the shares of the other gradually, until the buyer owns the entire venture. With regard to financing estate and residential housing through diminishing partnership, the Al Baraka 6th Symposium

issued a *fatwa* that permits the registration of a residence under the name of the partner who will own the property based on trust. The latter partner can also incur the expenses of registering ownership and other subsequent costs, since he will be the owner at the end of the process. This is an example of the consideration *maqasid* and its outcomes and overlooking terminologies and formalities (Al Raysooni, 2012).

The presence of the *maqasidic* component, albeit superficially, cannot be missed even by a cursory examination of the different *Shariah* standards published by different IFI's and regulating bodies. The AAOIFI *Shariah* Standards (2010), for example, have stated the *maqasid* as the rationale for a number of their rulings. To illustrate this, a number of cases where the AAOIFI *Shariah* Standards (2010) provided justification based on *maqasid* are presented.

In Standard No. 5 on guarantees, the standard states that “the basis of the permissibility of stipulating guarantees in contracts is that it protects property, which is one of the objectives of *Shariah*” (2010: 72). Although not explicitly mentioning the *maqasid*, Standard 8 on *murabahah* states one *maqasidic* notion; that is the “fulfilment of obligation and undertaking” (2010: 129). Similarly, Standard 9 on *ijarah* provides the rationale for one of the rulings stating that it will “not lead to dispute” (2010: 154) and this, as discussed by Ibn Ashur (2011), is one of the elements of the *maqasid* of transparency. More specifically, Standard 12 on *sharika* refers to the *maqasid* of preservation when it states that the rationale of one of the rulings is the “protection of the remaining partners against any potential damage” (2010: 225). One of the elements of the *maqasid* of persistence is also stated in Standard 22 on concession contracts that read, “project construction contracts are permissible because they come under commitments that should be honoured” (2010: 407). Two things can be noticed. Firstly, it is not very common to find reference to *maqasid* in these standards. Secondly, the reference in most cases is not explicit but rather implicit.

Another potential area where one would expect reference to *maqasid* are The Bank Negara *Shariah* Resolutions (2010c) given it is the central bank of Malaysia which is a pioneer in Islamic finance and given the authoritative scholars sitting at its *Shariah* boards. In giving the basis for the assignment of liabilities in *al-ijarah thumma al-bai*

(lease and sale), the resolution states that “the assignment of rights or liabilities does not contradict the *Shariah* as Islam recognises transfer of rights and liabilities based on mutual agreement by the parties.” (2010c: 5). Although not very explicit on stating the *maqsid*, it sheds the light on the *maqsid* of persistence and gives evidence on the presence of the *maqasidic* component. Other resolutions include statements that indicate some sort of *maqasidic* consideration such as the “principle of freedom to contract” (2010c: 7) and the avoidance of “any element of *gharar* (uncertainty)” (2010c: 10) in addition to some developmental notions such as ensuring “the sustainability of [the] Islamic financial system and market stability” (2010c: 29) and fulfilling “the contemporary needs of Islamic *muamalah*” (2010c: 44). Moreover, in some cases reference is made to the general objectives of a given contract such as the resolution stating that the “practice is not contradictory to the objectives of *ijarah* contract (*muqtada al-aqd*)” (2010c: 13).

The Rajhi Bank *Shariah* Resolutions (2010) have also been examined in search of the *maqasidic* justification. Rare indications have been made to *maqasid* such as “the protection of capital” (2010: 2, 806). The subsidiary categories of *maqasid* such as *riba* and *gharar* are more common. Apparently the majority of the resolutions give little or no reference to *maqasid*. More surprising is the fact that not even a mere rationale or justification is given for the majority of *fatwas* except for a final comment saying that the product or transaction either satisfies or does not satisfy the *Shariah* requirements.

The previous discussions have shown that even though *maqasid* are present in the contemporary discourse and publications, a coherent methodological application of *maqasid*, in most cases, has not been formulated. In addition, it can be said that the role of *maqasid* it is still not very visible and is marginal when compared to hundreds of conditions, standards, cautions, and prohibitions stated in the texts and standards. Moreover, as the analysis of the different *Shariah* Standards has shown, *maqasid* are dealt with in a selective, superficial and an on-occasion way. In this regard, Al Raysooni (2012) maintains that despite there is a mounting interest in the topic of *maqasid al Shariah*, especially in the financial domain, their deployment and application in jurisprudential *ijtihad* still suffers from a short-sighted and reductionist perception.

Even more, there are some cases where, arguably, IFI's dismissed the consideration of *maqasid* in the issuance of resolutions. However, in certain cases the resolutions were overruled by other *fatawas* that took *maqasid* into consideration. The following example of organised *tawarruq* illustrates this.

Many individual and collective *fatawas* permitting this transaction were issued before it was consequently overruled. Among these *fatawas*, or rather chief among them is the *fatwa* of the Islamic *Fiqh* Council of The Muslim World League in its 15th Session in October 1998, which stated that *tawarruq* is permissible (Islamic *Fiqh* Academy, 2006). It can be seen from the resolution that it is absolute and did not prohibit organised *tawarruq*. However, after years of widespread dealings in *tawarruq* by a number of Islamic banks, jurists started to realise its transgression to the limits of *Shariah*. Consequently, the International Islamic *Fiqh* Academy, in its 19th session in April 2009, issued its resolution 179 (5/19) which prohibited organised *tawarruq* (International Islamic *Fiqh* Academy, 2007).

Another issue surrounding the realisation of *maqasid* is the fact that jurists may have different views as to which *maqsid* should be given priority. This is very important at the practical level since the outcome of *fatawas* can be determined by the *maqasid* being prioritised. The following example of inflation and debts illustrate this.

The majority of Muslim jurists still hold to their disregard for changes in inflation rates and their belief that they should not have an impact on the value of debts because otherwise this involves *riba* (Ibn Bayyah, 2010). As a result, whoever lends someone a certain amount of money, and then later the currency of this money decreases in value or purchasing power—say by a third of its value—the lender then still deserves only the extract amount lent, regardless of the degree of the loss.

In certain places in his book *Maqasid Al Muamalat*, Ibn Bayyah (2010) has successfully dealt with the issue of the impact of inflation and devaluation from a *maqasidic* perspective. He established a preference for the validity of considering the decrease in value and to take it into consideration when paying a debt. He asserted that the issue is connected to the notion of essential needs and based his opinion on two *maqasid*: establishing justice and negating harm. Moreover, Ibn Bayyah has

shown disapproval of the attitude of the *fiqh* councils on this, arguing that they are still pivoting around the general notion that debts must be paid back equally in order to prevent *riba*. Hence, it can be seen from this example that differences of opinion on identifying the *maqasid* has led to different *fatawas*.

In conclusion, it can be argued that the vast majority of the works echo Al Shatibi (2004) in general and Ibn Ashur (2011) in particular. Both have become standard texts and have stimulated further classical works as well as contemporary studies and research. The latter's contribution to the *maqasid* of economic activity cannot be missed in any standard text on the *maqasid* of financial transactions. Hence, this makes a strong case for using Ibn Ashur's (2011) theorizations for constructing a model to measure *maqasid* as will be shown in the following chapters.

Moreover, choosing Ibn Ashur's *maqasid* can be justified on the basis that it is more focused on financial transactions than, for example, Al Ghazali's model. Moreover, his approach allows for operationalizing the *maqasid* and hence measuring them as the broad notions are broken down into quantifiable concepts—a feature that is not present in other models such as Ibn Al Qayem's general welfare principle.

4.5 CONCLUSION

In general, the analysis of the classical discourse on Islamic commercial law has shown that *maqasid al Shariah* are present and considered in Islamic commercial law. Several examples have been analyzed giving ample evidence that various scholars from different jurisprudential backgrounds have considered *maqasid al Shariah*.

As for the contemporary discourse on Islamic commercial law, the study has found that Ibn Ashur (2011) has made the major contemporary contribution to *maqasid al Shariah* in his treatise, *Maqasid al Shariah*. This is not to deny the other contributions that have enriched the discourse but only to say that his work is one of the most important contemporary *maqasid* texts.

The institutional publications on Islamic finance have also been analysed and it has been shown that the presence of *maqasidic ijtihad* is superficial whether in the issuance of *fatawas*, the development of new products and the publication of standards. The role of *maqasid* is still not very visible and is marginal when compared to hundreds of conditions, rulings, and prohibitions stated in the texts and standards.

CHAPTER 5

RESEARCH METHODOLOGY

5.1 INTRODUCTION

To ensure the quality of a study, it is imperative to select an appropriate research methodology. This chapter presents the research methodology employed in this study for examining *Shariah* compliance and the realisation of *maqasid al Shariah* in IPF contracts. It first delineates the research methodology, strategy and design in Sections 5.2, 5.3 and 5.4 respectively. Next, Section 5.5 identifies the sampling process, data collection method and data analysis techniques. Finally, Section 5.6 provides the concluding remarks.

5.2 RESEARCH METHODOLOGY

Research methodology is the “study of the research process itself – the principles, procedures, and strategies for gathering information, analysing it, and interpreting it”(Gray, 2007: 14) or more simply stated, it is an examination of “the tools used to gather the data” (Dawson, 2009: 23). The purpose of methodology is to “enable researchers to plan and examine critically the logic, composition and protocols of research methods; to evaluate the performance of individual techniques; and to estimate the likelihood of particular research designs to contribute to knowledge” (Krippendorff, 2004a: xxi). The crucial issue in determining the research methodology is the extent to which the method contributes to a greater understanding of the research subject.

Research methodology is generally classified into qualitative and quantitative approaches. Qualitative research usually emphasises “words rather than quantification in the collection and analysis of data,” whereas quantitative research highlights “quantification in the collection and analysis of data” (Bryman, 2008: 21). The main characteristics of qualitative analysis include minimal quantitative measurement; data in the form of words; and qualitative data that can be interpreted in a rigorous and scholarly manner (Sarantakos, 2005). Conversely, quantitative research focuses on data in the form of numbers and the measurement of variables (Punch, 1998). According to Corbetta (2003), the main differences between the qualitative and quantitative approaches—notwithstanding their philosophical and epistemological premises—lie in their planning, data collection, data analysis and scope of findings.

This study adopts a qualitative research approach because it examines the conceptual and theoretical aspects of IPF as well as evaluates IPF contracts from the perspectives of both the *Shariah* compliance and *maqasid al Shariah*. In addition, it follows a case study approach, which satisfies the criteria of qualitative research and allows researchers to build a complex, holistic picture of the phenomenon (Creswell, 1998). Nevertheless, this study also includes elements of quantitative methodology since both *Shariah* compliance and the realisation of *maqasid al Shariah* are quantified to a certain degree. Bryman points out that this process of ‘quasi-quantification’ is known in qualitative research and that “qualitative researchers sometimes undertake a limited amount of quantification of their data” (2008: 624).

5.3 RESEARCH STRATEGY

Research strategy prescribes the relationship between the theory and the research. In addition, it identifies whether “theory guides research (known as deductive approach) or whether theory is an outcome of research (known as an inductive approach)” (Bryman, 2008: 4-5). Hence, there are two main types of research strategies: inductive and deductive. In the deductive approach, “the researcher, on the basis of what is

known about in a particular domain and of theoretical considerations in relation to that domain, deduces a hypothesis (or hypotheses) that must then be subjected to empirical scrutiny” (Bryman, 2008: 24), whereas the induction approach is defined as “an approach to the relationship between theory and research in which the former is generated out of the latter” (2008: 712). However, Strauss and Corbin (1998) admit that an interplay between induction and deduction exists.

Furthermore, Creswell (1998) asserts that the deductive approach is appropriate for topics that include an established theoretical framework and a wealth of literature. In contrast, it may be more suitable to follow an inductive approach for topics with limited research as such an approach will generate data and help develop theoretical themes.

Thus, this study utilises the inductive approach because it is qualitative in nature and the data has been collected from financial institutions in addition to the primary texts in order to generate a theoretical framework. Moreover, due to the exploratory nature of this study and the paucity of literature on the topic, an inductive approach has been employed to reveal the trends and general patterns in the *Shariah* compliance of contracts as well as to explore the nature of the *maqasid* underlying the contracts.

5.4 RESEARCH DESIGN

Research design is the science and art of creating specific procedures to obtain valid findings in research (Vogt 1993, cited in Collis and Hussey, 1997). Yin (2009: 26) defines research design as “the logical sequence that connects the empirical data to a study’s initial research questions and, ultimately, to its conclusions”. In addition, the research design “constitutes the blueprint for the collection, measurement, and analysis of data” as well as expresses “both the structure of the research problem and the plan of investigation used to obtain empirical evidence on relations of the problem” (Blumberg *et al.*, 2005: 127). Furthermore, the research design rationalises the

structure and the principles incorporated in the research methodology as well as focuses on how these elements are linked with the research questions (Jupp, 2006).

Bryman (2008) categorises research designs into five groups: experimental, cross-sectional, longitudinal, case study and comparative. Moreover, research designs are classified into exploratory, explanatory, descriptive and hypotheses testing (Saunders *et al.*, 2009). This study is exploratory in nature and follows a case study design as elaborated in the following paragraphs.

An exploratory study is initial research that aims to discover what is occurring and clarifies the nature of a problem (Zikmund, 2000). In addition, research is considered exploratory if it meets some or all of the following conditions: it is conducted on a new issue; there is limited extant literature and research regarding the topic; further information on the topic is required (which calls for preliminary work); and the goals of the required research are to inspire more rigorous and more conclusive studies in the future (Bryman, 2008; Neuman, 2011; Zikmund, 2000).

In light of the aforementioned, the present study investigates two particular dimensions: *Shariah* compliance and the realisation of *maqasid al Shariah* in IPF contracts. In regard to exploring the underlying nature of the *maqasid*, exploratory research is the most suitable research design, mainly because limited information exists on the topic and there is no ready conceptual framework that can be used as a reference. In addition, this study explores the nature of IPF contracts and how the practice adheres to the ideal *Shariah* requirements. In other words, it describes and explores the current practices of IPF and compares them against related theories. Hence, the study is exploratory.

As stated earlier, the present study also adopts a case study research design. Yin (2009: 18) defines a case study approach as “an empirical inquiry that investigates a contemporary phenomenon in depth and within its real life context especially when the boundaries between phenomenon and context are not clearly evident” while Bryman (1989: 173) states that the purpose of a case study “is not to infer the findings from a sample to a population, but to engender patterns and linkages of theoretical importance”. In addition, a case study approach “provides us with a greater

opportunity than other available methods to obtain a holistic view of a specific research project” (Valdelin, 1974, cited in Gummesson, 1991: 76). This approach is especially effective since it allows the use of various research methods and multiple sources of data, and aids in theory building and theory testing research. However, the disadvantages of this approach include the credibility of the generalised findings as well as issues of confidentiality and privacy regarding access to certain case study settings (Denscombe, 2010).

Regardless of such disadvantages, this study applies a case study approach since it deconstructs and analyses real-life IPF contracts from a leading Islamic finance institution to obtain a holistic view of the nature of these contracts and their designs as well as assessing the degree of their *Shariah* compliance. Considering the fact that this study analyses four different cases—*mudarabah*, *murabahah*, *ijarah* and *istisnaa*—it follows a multiple-case study design, also known as a collective case study or comparative case study (Punch, 1998). A multiple case study design is based on the concept that analytical conclusions arising from multiple cases are more significant than those arising from a single case. Furthermore, the use of different cases offers contrasting situations and thus enables comparability (Yin, 2009).

5.5 RESEARCH METHOD

A research method is a procedure and technique for gathering and analysing data (Strauss and Juliet, 1998). In addition, a research method reflects the nature of the adopted research methodology in terms of whether it is qualitative or quantitative or both. The following sub-sections discuss the data collection and the data analysis techniques.

5.5.1 Data Collection And Sampling

The data collection procedure includes setting the research boundaries and collecting information as well as establishing the protocol for recording the information (Creswell, 2003). Since this study analyses the compliance of contracts in terms of *Shariah* compliance and *maqasid*, the collected data is in the form of secondary data—contracts and related documentation. Four case studies are analysed and consequently, the contract documentation, the structure documents and structure diagrams for the *mudarabah*, *murabahah*, *ijarah* and *istisnaa* each serve as the primary data sources in this study. Nevertheless, this study also consults the Quran and *Sunnah* to analyse the five *maqasid* of economic activity and obtain quantitative measures by assigning relative weights. Secondary data for this study is also derived from the classical and contemporary treatises on Islamic commercial law and *maqasid al Shariah*.

Regarding the sampling approach, the purposive sampling method—also called the judgmental sampling method—is employed. This approach is a “non-probability sampling procedure in which the judgement of the researcher is used to select the cases that make up the sample” (Saunders *et al.*, 1999: 598). Purposive sampling also “allows us to choose a case because it illustrates some feature or process in which we are interested” and it “demands that we think critically about the parameters of the population we are interested in and choose our sample case carefully on this basis” (Silverman, 2001: 104). This type of sampling has been applied instead of statistical sampling methods because, according to Silverman (2001), statistical sampling procedures are unavailable in qualitative research as data are often derived in these studies from one or more cases. In addition, he asserts that these cases are frequently chosen because they can be easily accessed by researchers.

Since this is a subject of enormous complexity and variation, it is difficult to conduct a comprehensive investigation. Instead, a detailed examination is restricted to only four prevailing structures—*mudarabah*, *murabahah*, *ijarah*, and *istisnaa*—stated earlier. In choosing these contracts, a number of points have been taken into consideration. First, the choice was based on the IPF literature wherein these four contracts are among the

prevailing structures in current IPF practices, as previously discussed in Chapter 3. Secondly, a review of the financial statements of the major Islamic banks in the country of study—the UAE—reveals that these contracts are among the ones frequently used not only in the IPF of these banks but also in their general financing activities (Abu Dhabi Islamic Bank, 2013; Dubai Islamic Bank, 2013b; Emirates Islamic Bank, 2013; Sharjah Islamic Bank, 2013). Additionally, this study focuses on the UAE, particularly Dubai, since it is establishing itself as an Islamic finance hub (Bassens *et al.*, 2010) with the goal of becoming the capital of the Islamic economy (AbdulRab, 2013; Gulf News, 2013). Based on these aforementioned facts, the selection of this particular country is justified.

Another issue regarding the sampling is related to the institution from which the contracts have been shared. However, due to confidentiality requirements, the name of the institution will not be revealed by the researcher. Hence, only a description of the selected institution will be provided as follows.

The institution selected for this case study is a leading *Shariah* advisory firm—a subsidiary of a top Islamic bank—that provides other IFIs with guidance regarding the application of *Shariah* principles, and legally compatible, innovative and commercially viable solutions. The team working at this institution includes world-class experts in the field of Islamic finance, prominent lawyers, bankers, capital market and asset management experts as well as *Shariah* scholars, accountants, auditors and trainers. This particular institution has been involved in the development of many important pioneering structures and products in the Islamic financial market. In addition, a number of major Islamic banks in the UAE outsource their contracts and products to this institution and its consulting services even extend to IFIs in other countries. In fact, this IFI has been named the ‘Leading Advisory Group’ and the ‘Best *Shariah* Advisory Firm’ as well as receiving many other awards. Thus, by using it as a case study, a relative representation of the practice of IPF in the UAE by a reputable firm can be obtained.

A final issue concerning the sampling in this study is the representativeness and generalizability of the sample. The contracts chosen are representative since, as noted

above, they are the main contracts applied in the current practice of IPF. With regard to the generalizability, there are two purposes of this study. The first is to develop a theoretical framework for quantifying *Shariah* compliance and *maqasid* realisation while the second is to utilise this framework for examining different contracts—the empirical component. Since the framework is general (i.e. a generic model), it can be used to examine both the *Shariah* and *maqasid* perspectives in other contracts.

As for the empirical component of this study, the findings are relatively generalizable, based on the fact that the chosen transactions are templates of the contracts and not individual cases. In other words, they are frequently used by IFIs. In addition, the institution from which the contracts have been obtained was selected since it was most likely to provide an exemplar of practice. Notwithstanding these important facts, the literature on case study research demonstrates that “... the possibilities to generalise from one single case are founded in the comprehensiveness of the measurements which makes it possible to reach a fundamental understanding of the structure, process and driving forces rather than a superficial establishment of correlation or cause-effect relationships” (Normann, 1970: 53).

In addition, Punch (1998) shows that case studies can be generalised by focusing on conceptualisation; that is, new concepts can be developed to describe what is being studied and applied to other cases. Hence, the results of this case study are generalizable. Moreover, Maxwell (2005) argues that qualitative studies—such as case studies—are generalizable since there is no apparent reason to not believe that the results can be applied more generally. Furthermore, the theoretical basis can be extended to other cases as a single case can indicate a general conceptual category or property (Glaser & Strauss, 1967: 30). In sum, it can be asserted that although each case is somewhat unique, it is also a “single example of a broader class of things” (Denscombe, 2010).

5.5.2 Data Analysis Technique

The main forms of data analyses in the present study are content and textual analysis. Content analysis, which is the most common type of textual analysis (Carley, 1994), is defined as “a systematic reading of a body of texts, images, and symbolic matter” (Krippendorff, 2004a: 3). This type of analysis is widely used in qualitative research because it is a flexible method for analysing textual data (Hsieh & Shannon, 2005). Since content analysis is useful for explanatory studies (Mitchell, 1967) and it is becoming an increasingly common method in legal studies (Blackbourn *et al.*, 2012), it is appropriate to employ such analysis in the present study.

Content analysis has been applied in analysing the contracts—the case studies. The whole of the documentation for each contract has been scanned and analysed against the checklists developed. To ensure the objectivity of the procedure, it was necessary to read the whole contract, from beginning to end, to arrive at meanings in their proper context (CMG, 2003). The only units for interpretation are the written words in the contract—un-communicated intentions that might have been intended by the drafters of the contract were not taken into consideration. This is because intentions that are not expressed in the instrument, in this case the contract, could not in any opinion bind the other party (CMG, 2003).

There was an exception to this general rule, however, because some contracts were ambiguous on certain issues. Therefore, to have a better indication and to be fair in judging *Shariah* compliance, the process diagrams of the contracts—which are internal documents—were also consulted. This follows on from the point that in the area of contractual interpretation reference to materials extrinsic to a written document is justifiable (CMG, 2003). In addition, the aim of this analysis is not to be used in dispute resolutions but rather the aim was primarily to investigate the extent of *Shariah* compliancy of a certain product and thus all possible ways to reach this aim can be utilised.

Moreover, this study utilises textual analysis and hermeneutics, which is the interpretive analysis of texts (Bernard and Ryan, 2010) that enables readers to read and understand texts especially those written in another time or in a different context (Thiselton, 2009: 1). This method has been used because the primary texts—the *Quran* and *Sunnah*—are analysed and interpreted in order to devise weights for the *maqasid* underlying the contracts. Hermeneutics has been particularly important in deducing the *maqasid* from the verses and Prophetic traditions using classical *usul al fiqh* which is, in essence, a hermeneutic methodology that formulates the rules for interpreting the classical texts. More concisely, the notions of textual explicitness and implicitness—that are explained in Chapter 7—are important pillars of the classical Islamic hermeneutic theory.

As previously pointed out in Section 5.3, the present study employs an inductive research strategy. In addition to the appropriateness of this method from the contemporary research method perspective, induction has been historically associated with *maqasid* and its derivation in classical jurisprudence. Al Shatibi (2004) suggests a strong link between induction and the discovery of *maqasid* in the introduction of his *Al Muwafaqat*—he asserted that through induction he was able to elucidate *maqasid al Shariah*.

Although he—Al Shatibi (2004)—mentioned four methods for determining *maqasid al Shariah*, he mostly relied on induction and emphasised its importance as a legitimate method. In regard to such significance, Al Raysooni (2005: 282) states, “all the objectives of the Quran and the *Sunnah* rest on the notion of tracing the law and its rulings to the bases which give rise to them”. In addition, one of the main features of induction is to survey all of the analytical units to obtain a holistic perspective of the inner spirit of the law (Al Shatibi, 2004). Hence, induction is central to the approach applied in the present study since it can be used for analysing both the primary texts—the Quran and *Sunnah*—as well as the specific rulings in order to conduct a systematic and holistic analysis.

5.6 CONCLUSION

This chapter has provided a general overview of the research methodology and identified the most appropriate research strategy and design as follows. First, a qualitative research approach is adopted since it examines the conceptual and theoretical aspects of IPF as well as evaluates IPF contracts from both the *Shariah* and *maqasid al Shariah* perspectives. Secondly, this study utilises the inductive approach since it is qualitative in nature and the data includes primary texts as well as documentation from a reputable financial institution. Third, in regard to exploring the nature of the underlying *maqasid*, exploratory research is the most suitable research design, mainly because no existing conceptual framework can be used as a reference and limited information exists on this topic. Fourthly, the chapter outlines the sampling method and argues that the selected sample is representative of IPF contracts in general. Finally, it shows that the multiple case study approach is generalizable and that this orientation supports the findings of this research.

CHAPTER 6

ANALYTICAL FRAMEWORK

6.1 INTRODUCTION

In examining the *Shariah* compliancy of IPF contracts—the case studies—and their realisation of *maqasid al Shariah*, an analytical framework enables a deeper understanding and provides a more structured approach. This chapter develops two analytical frameworks. The first provides a model for assessing the degree and nature of *Shariah* compliance. The second is designed to assess *maqasid al Shariah* in depth and enable an analysis of how they function in different contracts. It sets the basis for measuring the realisation of *maqasid* in IPF contracts. Section 6.2 presents the framework for the *Shariah* compliance assessment and Section 6.3 considers the *maqasid al Shariah* framework. In Section 6.4 the main remarks are presented.

6.2 SHARIAH COMPLIANCE ASSESSMENT FRAMEWORK

The aim of this section is to develop a structured framework for analysing and deconstructing the real-life IPF contracts that are to be assessed in terms of their *Shariah* compliance. As discussed in Chapter 5, four of the prevailing contracts of IPF have been chosen as the case studies—these are the *mudarabah*, *murabahah*, *ijarah*, and *istisnaa* contracts. The rationale for choosing these contracts in particular has been given in Section 5.5.1 on sampling and data collection. The case studies will be examined against a particular benchmark in addition to a purpose-developed framework—entitled the ‘*Shariah* Compliance Approach’—for examining the nature

of *Shariah* compliance. This integrated approach to examining *Shariah* compliance makes an important contribution of this research.

Hence, this section is further divided into two sections. The first section delineates the chosen benchmark against which the chosen contracts will be examined to explore their degree of compliance. The second section proposes a framework for extending the analysis of *Shariah* compliance beyond the chosen benchmark—the ‘*Shariah* Compliance Approach’. Collectively, these two sections constitute the analytical frameworks for assessing *Shariah* compliance.

6.2.1 *Shariah* Benchmark

Selecting a benchmark for the *Shariah* rulings is important to ensure consistency through unifying the point of reference. The benchmark will act as the reference point against which all the contracts will be examined. Therefore, all the clauses of each case study will be examined in terms of their compliance with the chosen benchmark.

After extensive research and scrutiny of all the available options—including the Bank Negara *Shariah* Parameters (2010a; 2010b; 2012) and the Al Barakah *Shariah* Guidelines and *Fatawa* (Abu Ghuddah, n.d.; Ahmed and Abu Ghuddah, n.d.)—the AAOIFI *Shariah* Standards (2010) were chosen as the benchmark for the *Shariah* rulings. The rationale for this selection can be summarised as follows. First, the AAOIFI Standards are internationally recognised and have been implemented by leading IFIs (DeLorenzo, 2006) although they are not binding in many countries (Soualhi, 2012). Secondly, these standards are increasingly regarded the benchmark for the industry. Third, the AAOIFI Standards have been developed by a commission of prominent *Shariah* scholars from different countries (AAOIFI, 2010) that gives it authority and thus provides an important reason for choosing it as the reference for this model. In addition, it is apparent from the researcher’s understanding and experience with these *Shariah* standards that no single school of *fiqh* was taken as a reference; instead, an attempt was made to develop a common core of standards that

can be shared by all IFIs worldwide and thus establish a mutual, workable system. Moreover, the AAOIFI standards were specifically developed for contemporary financially transactions.

However, the chosen benchmark was not applied directly. It was subject to a screening process in order to identify the relevant rulings of each contract. This is an important step since it filters out the relevant rulings from the rulings that will not be subject to the analysis. The following methodology was applied.

The AAOIFI *Shariah* Standards (2010) are divided into standards each representing a contract or product. Therefore, for each contract, the whole standard was studied. The rulings constituting that standard were classified into two broad categories: required rulings and conditionally required rulings. The required rulings can be defined as those rulings that are essential in every contract. For example, they are required in every version of *mudarabah*. These can be negations or affirmations. Conditionally required injunctions, on the other hand, are the rulings that become required upon the presence of certain conditions. In other words, when certain conditions are present, then these stipulations or negations are required. Therefore, the various versions of the same genre of a contract will vary with regard to the conditionally required injunctions.

The basis for this classification is taken from the Islamic jurisprudential methodology, *usul al fiqh*. The required rulings would have words which make an obligation or which denote a prohibited or impermissible act. These fall under the *wajib* (obligatory) and *haram* (prohibited) categories in *usul al fiqh* (Hallaq, 1997). The conditionally required rulings are, in essence, the same as the required rulings; however, they are contingent on certain conditions.

Classifying the standard into these two broad categories is useful for analysing the *Shariah* rulings since it eliminates the non-relevant issues. These non-relevant issues include the definitions given in the contract, the explanations and elaborations as well as the permissible clauses where the standard states that it is permissible to do a specific action or undertake a specific measure in a contract. These permissible items were not included since the default in Islamic commercial law is permissibility (Ibn

Taimiyah¹⁸, 2004). Thus, it cannot be said that the *Shariah* intended and requires this particular item; it merely allowed it. Consequently, it will have been wrong to include such clauses and state that the *Shariah* intended them. However, it is important to clarify that not all clauses in the standard that have the word ‘permissible’ are considered to fall under the permissible items category. This is because an item stating that it is permissible to carry out an action on the condition that an action is satisfied is, in essence, a required ruling.

Hence, a checklist entailing the relevant rulings—both the required and conditionally required—has been developed for each contract. These checklists will serve as the main tool in examining the contracts. It should be noted in this context that the number of rulings vary from one contract to another. For example, the total number of rulings for the *mudarabah* contract is 30, while the total number of rulings for the *istisnaa* contract is 23. This reflects the rulings required by the AAOIFI (2010) in order to achieve compliance for each contract, rather than reflecting the relative importance of each contract. In other words, the number of rulings required for a contract is not an indication of its relative importance. Rather, it reflects the differing nature of contracts and demonstrates that some contracts have more complex characteristics than others. In short, the relative number of rulings for each contract should not be associated with the relative importance of a contract.

It is important to underscore, in this context, that when consulting the AAOIFI *Shariah* Standards (2010), the study does not imply in any sense that non-compliance with these standards indicates non-compliance with *Shariah* and Islamic commercial law. Any bank or institution working on *Shariah* compliancy can apply its own reference and still be *Shariah* compliant. This selection is by no means definitive.

Having discussed the theoretical rationale, it is important to delineate the examination procedure and scoring system for quantifying the degree of compliance. Prior to developing a scoring system for this study, the clauses of the contract were classified in terms of their relation with the chosen benchmark in order to enable a clear appraisal of the nature of the contracts to be investigated. In other words, this means locating

¹⁸ D: 1328 AD.

the clauses of the contracts within the AAOIFI (2010) requirements. Hence, a careful examination of the documentation has been undertaken and, consequently, the following typology has been identified in classifying the clauses against the chosen benchmark—the AAOIFI (2010) *Shariah* Standards. All the clauses in the contracts fall under one of these categories (see Figure 6.1).

a) Compliant

This category comprises those clauses that are compliant with the AAOIFI (2010) *Shariah* Standards. This denotes an article or clause that states one ruling or more, as required. It also includes the negations, that is, a clause that prohibits an action not permitted by the AAOIFI (2010) *Shariah* Standards.

b) Neutral

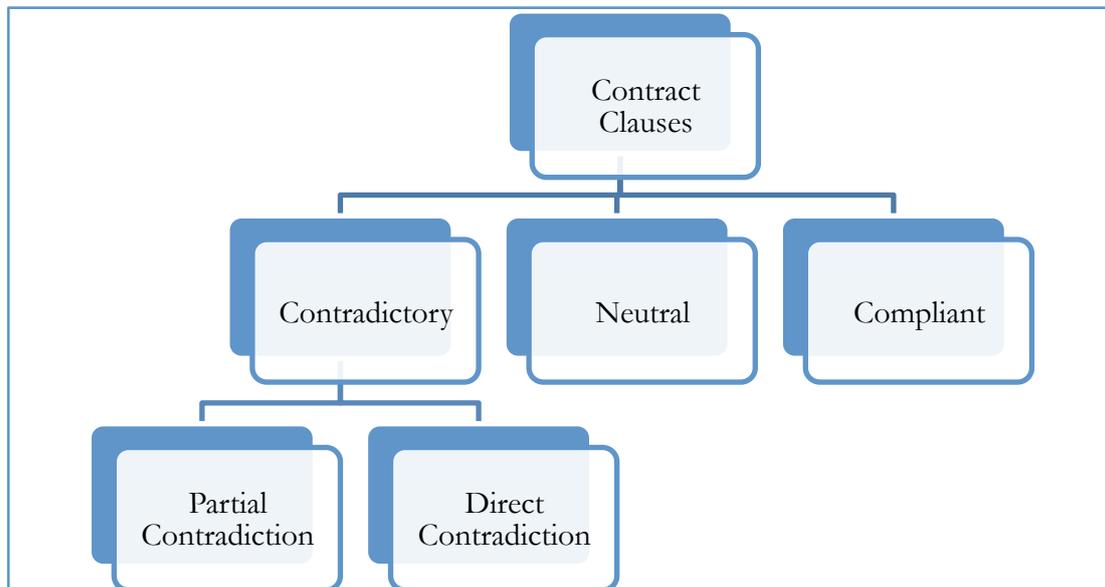
This category comprises those articles that can be described as neutral. That is, they do not state anything that is required by the AAOIFI (2010) *Shariah* Standards, nor do they have anything that is not permitted in the AAOIFI (2010) *Shariah* Standards or that contradicts them. In other words, these fall under the *mubah*, permissible, category of *usul al fiqh*. This constitutes the majority of the contract clauses articles since the majority are purely legal and administrative clauses.

c) Contradictory

This category is further classified into the following two sub-categories:

- i. **Direct Contradiction:** Clauses that directly contradict required rulings.
- ii. **Partial Contradiction:** Clauses that partially contradict required rulings.

Figure 6.1: Classification of Clauses



Having identified the nature of the clauses, it is important to identify the scoring scheme. Due to the lack of studies on the *Shariah* compliance of contracts, this study borrows, in developing the scoring scheme, from the literature on disclosure of annual reports in general as well as the studies on the compliance of Islamic banks with the reporting standards. In particular, the work on the compliance of banks with the AAOIFI reporting standards (Vinnicombe, 2010; Vinnicombe, 2012) has been very useful in this context.

One strand in the literature on annual reports disclosure typically applies a dichotomous scoring system—an item scores one if communicated, disclosed, and zero if not communicated (Haniffa and Cooke, 2002; Haniffa and Hudaib, 2007). Another strand in the literature follows a three-category approach. That is, a clearly disclosed item scores 1, an ambiguously disclosed item scores 0.5, and an undisclosed item scores 0 (Maali *et al.*, 2006; Inchausti, 1997; Vinnicombe, 2010). This study follows the threefold approach and adds two more categories relating to the direct contradiction and partial contradiction.

Therefore, five categories have been developed for the *Shariah* compliance index-scoring scheme as follows:

Category 1: the ruling is stated—disclosed—in the contract = **1**

Category 2: the ruling is stated in a less specific way, ambiguously disclosed or diluted in the contract = **0.5**

Category 3: the ruling is omitted—not disclosed—in the contract = **0**

Category 4: the ruling is partially contradicted in the contract = **- 0.5**

Category 5: the ruling is directly and explicitly contradicted in the contract = **-1**

It is pertinent to note here that the individual rulings were not weighted. Rather, they have been given equal weights. Although weighing the rulings according to their importance may have provided more insightful results, this has not been achieved since there is no clear method for assigning weights to rulings and no studies have attempted to allocate weights to the rulings. In addition, the approach of assigning weights has been criticised, in other contexts, for its subjectivity and bias (Barako *et al.*, 2006). In addition this approach of assigning equal weights to all items is not all new—a number of studies on annual report disclosure have applied equal weights to all items (Vinnicombe, 2012; Ghazali, 2007; Chau and Gray, 2002; Monteiro and Aibar Guzman, 2010; Maali *et al.*, 2006).

Following the content analysis of the contracts and scoring, the *Shariah* compliance index was calculated as follows: The scoring scheme discussed above was employed in examining the rulings developed in the checklists. A total score is awarded to each contract by adding the scores of all the rulings to derive an aggregate score for the contract. Then the *Shariah* compliance score is computed as a percentage of the actual score to the maximum possible value for each contract.

6.2.2 *Shariah* Compliance Approach

In addition to adopting the AAOIFI *Shariah* Standards (2010) as the main benchmark, the study also proposes another framework for *Shariah* compliance to supplement the analysis in conjunction with the chosen benchmark. This approach allows for extending the analysis beyond the AAOIFI *Shariah* Standards (2010) and thus enables an overall judgement of the contract and the nature of its compliance, if applicable. In addition, it is an attempt to develop a tentative framework for answering the existential question: What makes a contract *Shariah* compliant?

While there appear to be no previous studies on the contractual *Shariah* compliance approaches in the literature on Islamic commercial law, this model draws on the literature on *Shariah* screening practices. Hence, this study will borrow from the research on *Shariah* screening practices and apply it in a different context—the *Shariah* compliance of contracts.

Derigs and Marzban (2009) discuss a number of *Shariah* compliance strategies¹⁹ for *Shariah* screens, namely, the best-of strategy, the consensus (*ijmaa*) strategy, the liberal strategy, and the majority strategy. The last three strategies are applicable to this study. The consensus strategy “considers asset to be compliant if and only if all basic *Shariah* strategies consider the respective asset to be compliant” (Derigs and Marzban 2009: 1168). Under the majority strategy an asset is compliant “if and only if the majority of the basic *Shariah* strategies consider this asset to be compliant” (Derigs and Marzban 2009: 1168). The third strategy is the liberal strategy. According to this strategy, “an asset is considered to be compliant if at least one basic *Shariah* strategy considers the asset to be compliant” (Derigs and Marzban 2009: 1168).

This approach is applied in a different context and adapted as follows. For the purposes of this research, the *ijmaa* approach will denote that the contract is considered as *Shariah* compliant if, and only if, all the *Shariah* scholars consider the contract clauses to be compliant. That is, there is *ijmaa* on the legitimacy of the

¹⁹ Note that Derigs and Marzban (2009) use the phrase ‘*Shariah* Compliance Strategy’. This study, however, prefers to use the phrase: ‘*Shariah* Compliance Approach’.

contract. This implies that all the particular clauses of the contract are allowed and permissible under all scholarly views. Theoretically, it is not expected that this strategy is common since there are very few rulings upon which there is *ijmaa* in Islamic commercial law. However, it may be useful to test this strategy to explore empirically whether or not it is applied in practice. The point of reference for this is Abu Habib's (1997) *Encyclopaedia of Consensus in Islamic Law*, known as *Mawsuat Al Ijmaa Fil Fiqh Al Islami*. This scholarly work is reliable since it draws upon the major classical works of the leading Muslim jurists, such as Ibn Hazm (d. 1064), Ibn Al Mundhir (d. 930 AD), and Ibn Taimiyah.

The analysis is carried out as follows: All the rulings in each of the four contracts upon which there is *ijmaa*, consensus, have been identified. Then all clauses in each contract—the case study—are examined to ascertain that they are allowed and permissible according to all scholars of Islamic law. If all the clauses are allowed and permissible according to all scholars of Islamic law, then the contract is considered to be compliant according to the *ijmaa* strategy. Otherwise, if a single ruling on which there is a divergence of views is identified, then the whole contract is not compliant according to the *ijmaa* strategy / approach. If this is the case, then the contract will be further analysed according to the other two strategies as follows.

As for the majority approach, a contract is considered as *Shariah* compliant if, and only if, the contract is considered *Shariah* compliant according to the majority of scholars. In achieving this examination on the contracts studied, the rulings that are attributed to the majority of scholars have to be identified first. As such, the *Encyclopaedia of Majority Rulings in Islamic Law* authored by Saeed (2005) has been consulted as a reference point. Following this, the examination is to be conducted using the same method outlined above for the *ijmaa* approach. The rule is: if all the particular clauses in the contract are considered compliant and are submissive according to the majority of scholars, the contract is considered compliant according to the majority approach. Otherwise, if any single ruling that is not legitimate according to the majority of jurists is identified, then the whole contract is not compliant according to the majority approach. Consequently, the contract is eligible for further analysis according to the liberal approach.

Although the majority approach is adopted in this study, it should be acknowledged that a majority ruling would not imply a right decision in itself as a majority decision can be mistaken. Therefore, considering the *maqasidic* aspect is very important to resolve this methodological problem. *Maqasid al Shariah*, as argued by Ibn Ashur (2011) are definitive and thus should be considered as the main overarching framework that governs the classical *usuli* approach. This would mean that *maqasid* governs *ijma*.

The third approach is the liberal approach. This approach considers a contract to be *Shariah* compliant if at least one scholar or school of *fiqh* considers it to be compliant. This means that all the particular clauses in the contract under examination should be acceptable to at least according one scholar or school of *fiqh*. Therefore, the rule is: if all the particular clauses in the contract are considered compliant and are submissive according to at least one scholar—and they do not satisfy the criteria of the *ijmaa* and majority strategies—the contract is considered compliant according to the liberal strategy. Otherwise—if there is any clause in the contract that is not permissible under all *fiqh* jurisdictions—the contract is not compliant with the liberal strategy and, more importantly, cannot be considered as compliant with *Shariah* since it has, in essence, violated *ijmaa*.

In conclusion, the following procedural set of questions has been developed to operationalise the analysis for each contract. The process starts with question A:

A: Is there any clause in the contract that violates *ijmaa*?

If yes, the contract is not valid in *Shariah*.

If no, go on to B.

B: Is there any clause in the contract that is not acceptable according to the majority of scholars?

If yes, the contract is valid according to the liberal approach.

If no, go on to C.

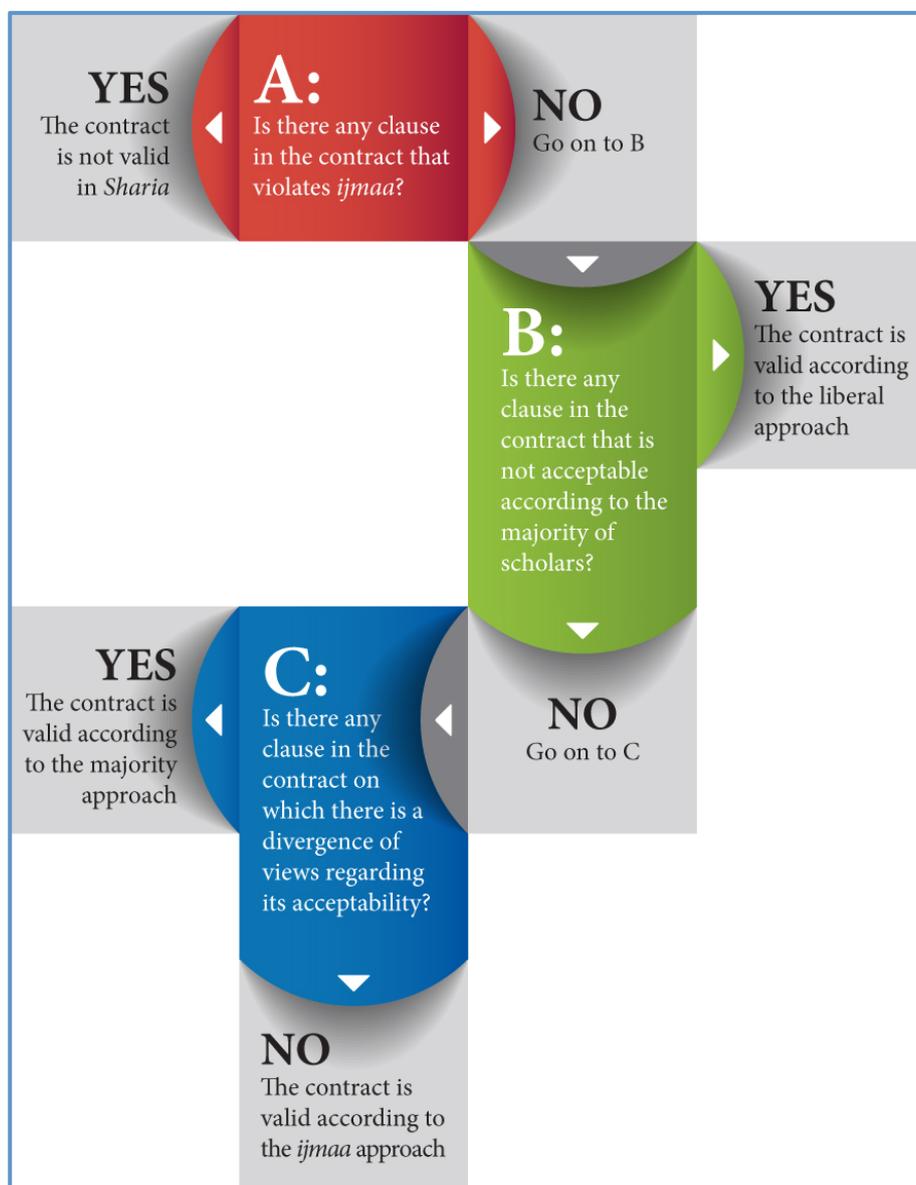
C: Is there any clause in the contract on which there is a divergence of views regarding its acceptability?

If yes, the contract is compliant according to the majority approach.

If no, the contract is valid according to the *ijmaa* approach.

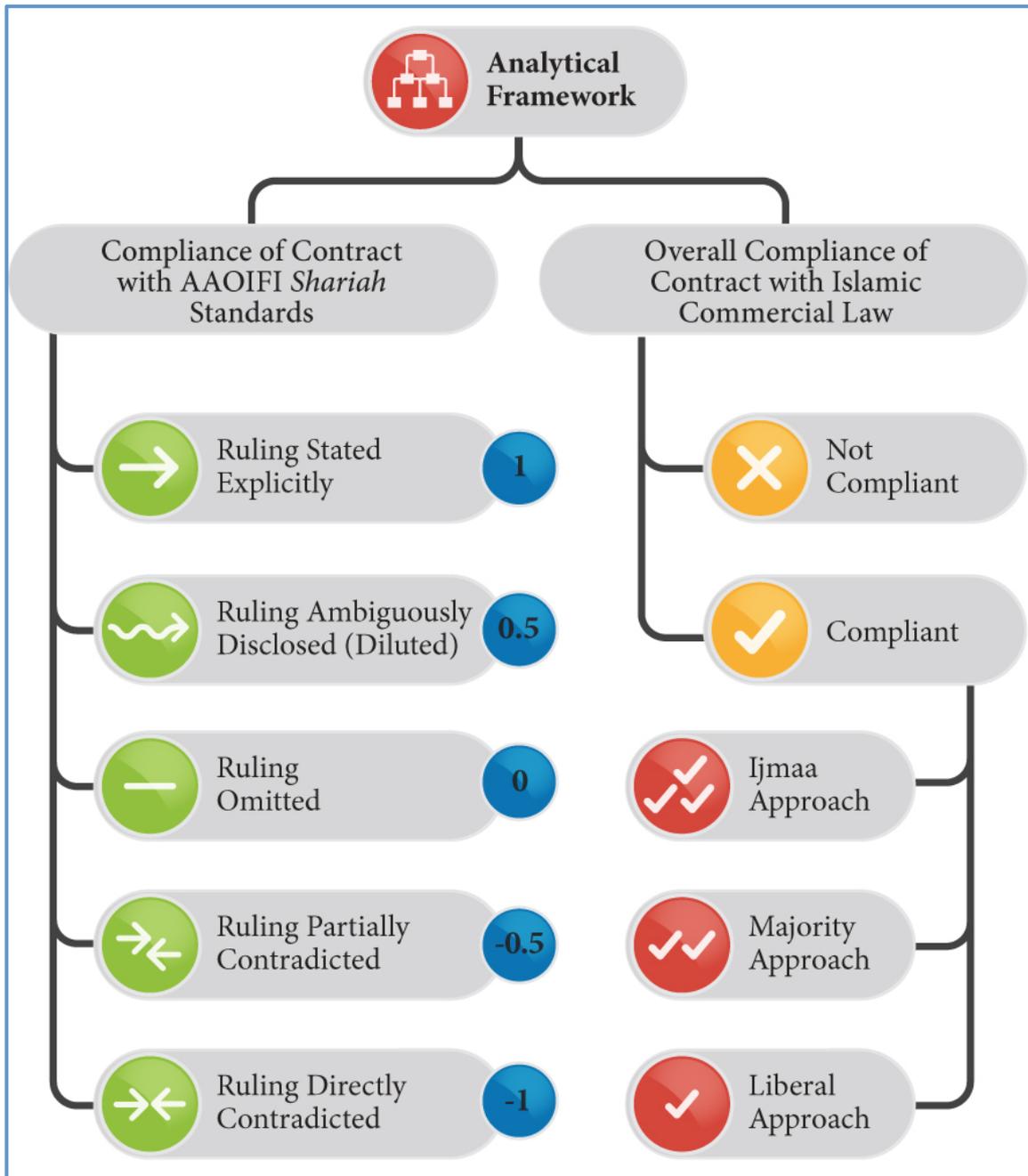
Figure 6.2 presents these questions.

Figure 6.2: Rules of Classification Questions for the *Shariah* Compliance Approach



This concludes the '*Shariah* Compliance Approach' framework. To sum, Figure 6.3 presents the overall structure of the both *Shariah* frameworks for this study:

Figure 6.3 : *Shariah* Analytical Frameworks



6.3 MAQASID AL SHARIAH ASSESSMENT FRAMEWORK

The second component of the study addresses *maqasid al Shariah* and their realisation in IPF contracts. This is achieved through assigning each ruling to the appropriate *maqasid* they fulfil. Once the *maqasid* have been associated with the relevant rulings, it becomes possible to measure the realisation of *maqasid* by assessing all the rulings in the contracts.

Developing this analytical framework involves five phases: 1) selecting the benchmark *maqasid*; 2) weighing the *maqasid*; 3) identifying criteria for linking the *maqasid* to the rulings; 4) linking rulings to the *maqasid* and 5) the development of a quantification procedure. The following sections are devoted to delineate these phases.

6.3.1 Selecting The *Maqasid*

Identifying the *maqasid* that form the basis of this framework is pertinent to this inquiry. As discussed in Chapter 4, there are a number of typologies for the *maqasid* of economic activity. Out of these models, Ibn Ashur's (2011) fivefold typology has been selected. This typology includes the *maqasid* of circulation, preservation, persistence, justice and transparency.

It has been selected since this classification was derived after a deep and careful reading of the core sources and texts by inductive inference (Ibn Ashur, 2001). In addition, Ibn Ashur is regarded as a pioneer in the contemporary discourse of *maqasid*, and his treatise—which proposes this classification—is regarded as a major contribution (Cizakca, 2007). Hence, there is a strong case for using Ibn Ashur's (2011) theorisations for constructing a model to measure *maqasid*, as will be shown in the sections to come.

6.3.2 Weighing The *Maqasid*

Each of the five *maqasid* has its own weight and importance. Therefore, weighing the *maqasid* according to their importance will provide more accurate and more objective results since it reflects the importance attributed to each *maqasid*. This is akin to assessing the quality of disclosure as in the literature on annual report disclosure (Beretta and Bozzolan, 2004). In addition, it will offer more interesting insights in analysing the *maqasid* and contracts. However, weighing the *maqasid* requires a systematic method and a completely devoted study. Therefore, Chapter 7 is devoted to devising a method for weighing the *maqasid*.²⁰

6.3.3 Setting The Criteria For Associating The *Maqasid* With Rulings

This section identifies the criteria for linking rulings to the particular *maqasid*. In order to formulate criteria for assigning the *maqasid* to the rulings, working definitions for the five *maqasid* will have to be devised. Ibn Ashur's (2011) definitions will be adopted and regarded as the operational definitions for this research since he is the first to suggest and develop these five *maqasid*. In addition to this, Ibn Ashur's (2011) explanations will be the first source for outlining the elements that go under the definitions for each *maqasid*. This is because some of the definitions provided are relatively wide. To overcome this methodological issue, it would be advisable to identify the elements that fall under each *maqasid* as is understood from Ibn Ashur (2011) mainly and from the scholars following him. This is essential in order to understand and operationalize the concepts. It is also important to stress that although these *maqasid* are distinct, they are obviously related, and so this is another methodological consideration here. The following sections discuss each *maqasid* and the concepts related to it.

²⁰ The method is then applied to the five aforementioned *maqasid* and weights are assigned.

Circulation

The *maqsid* of circulation of wealth has been defined by Ibn Ashur (2011: 36) as “the fair circulation of wealth in the hands of as many people as possible” and “the transfer of wealth in the community among as many hands as possible without causing any harm to those who have acquired it lawfully” (Ibn Ashur 2001: 288). According to the explanations given on this *maqsid*, it encompasses a number of concepts that can be considered as elements. This is of benefit to the operationalisation process since deconstructing the general concept into smaller elements enables the concept to be captured. Table 6.1 summarises the related concepts.

Table 6.1: Elements of The *Maqsid* of Circulation

<i>Maqsid</i>	Connoted Concepts
Circulation	Removing obstacles to trade.
	Instituting contracts to regulate the transfer of financial rights.
	The concept of bindingness of contracts.
	Allowing a certain measure of <i>gharar</i> in some contracts.
	Ensuring that real wealth is being distributed and thus maintaining that money is merely a mediator.
	Prohibition of <i>riba</i> ; since <i>riba</i> does not promote the circulation and distribution of wealth.
	Attesting the transfer of property through documentation.
	<i>Zakah</i> , wills and all types of legitimate spending of money such as giving money on relatives and family.
	Preventing hoarding.

A number of researchers have also confirmed that these concepts serve the *maqsid* of circulation of wealth (Ibn Zughaihah, 2010; Mustafa, 2013). Based on this theorization, it can be asserted that any ruling that promotes one of these elements promotes the *maqsid* of circulation.

Preservation

Ibn Ashur (2011) discussed the *maqsid* of preservation of wealth and illustrated the importance of the protection of property and public wealth. The *maqsid* of preservation is the most commonly prescribed *maqsid* in the literature on the *maqsid* of economic activity (Al Shatibi, 2004; Rosly, 2010; Meera and Larbani, 2006; Chapra, 2008; Ahmad, 2011). The concepts that manifest the dimension of preservation of wealth are presented in Table 6.2.

Table 6.2: Elements of the *Maqsid* of Preservation

<i>Maqsid</i>	Connoted Concepts
Preservation	Sanctity of money and property.
	The protection of property.
	Prescribing the compensation for damage.
	Prevention of gambling.
	Preventing the wasting of money.
	The concept of legal capacity.
	Guarantees, pledges, insurance and such preservative measures can be included in this category.

Persistence

According to Ibn Ashur (2011)—who is the first scholar to explicitly determine this *maqsid*—the *maqsid* of persistence ensures that an owner has the exclusive right to what has been earned lawfully and this right is not subject to any kind of delay. Table 6.3 presents the concepts manifesting the dimension of persistence:

Table 6.3: Elements of the *Maqsid* of Persistence

<i>Maqsid</i>	Connoted Concepts
Persistence	Rights should not be subject to any type of risk or delay.
	No one should be deprived from his right to his property.
	Fulfilment of stipulations is obligatory.
	The principle of revocation of contracts due to their conflict with <i>maqasid</i> or violation of someone else's right.
	Conditions are binding.
	Prevention of non-competent people from dealing with their property. This denotes the requirement for legal capacity.
	A Property owner has the right to dispose what he owns but without causing harm to other people.
	The principle of consent is considered in <i>Shariah</i> .
	The freedom of contract.

Justice

The *maqsid* of justice is the essence and core of Islamic economics and finance (Hassan and Kayed, 2009; Kuran, 2004; Khan, 1994; Ahmad, 1991; Kamla and Rammal, 2013). According to Ibn Ashur (2011: 299), it implies that “wealth and property should not be acquired wrongfully and unjustly. That is to say, wealth must be acquired by personal effort on the basis of a substitute given to the original owner – by donation or by inheritance”. Table 6.4 presents the concepts manifesting the *maqsid* of justice:

Table 6.4: Elements of the *Maqsid* of Justice

<i>Maqsid</i>	Connoted Concepts
Justice	Prevention of injustice in the distribution of wealth.
	Prevention of <i>riba</i>
	Prevention of public misfortune.
	Prevention of hoarding and raising prices unjustly.
	Acquiring wealth legally is a requirement.

Transparency

The aim of the *maqsid* of transparency, according to Ibn Ashur (2011: 295), is to “avoid harm and disputes as much as possible”. Table 6.5 summarises the concepts manifesting the *maqsid* of transparency:

Table 6.5: Elements of the *Maqsid* of Transparency

<i>Maqsid</i>	Connoted Concepts
Transparency	The prevention of <i>gharar</i> .
	Avoiding harm and disputes as much as possible.
	Prescribing pledges and documentation.

6.3.4 Associating *Maqasid* With The Rulings

Following the identification of the *maqasid* and the criteria for linking them with the rulings, this section delineates the process for linking the *maqasid* with the rulings. The important question is: How to judge that the ruling promotes and serves a specific *maqasid*?

There are three methods to identify the *maqasid*. Firstly, classical and contemporary jurists in specialised *fiqh* books occasionally make reference to the *maqasid* underlying the ruling when they discuss the rationale and evidence for the ruling. To clarify, they may state explicitly that a ruling is there to achieve a particular *maqasid* (Al Juwaini, 2011; Ibn Qudama²¹, 1999; Al Zuhayli, 2003). However, linking the ruling explicitly and directly to the *maqasid* is not very common in *fiqh* books.

The second method to detect the underlying *maqasid* of a particular ruling is through identifying the sub-categories of the *maqasid*. These are the concepts that fall under each particular *maqasid*. The jurists frequently justify the prescription of a particular ruling to, for example, the prohibition of *riba*, how binding contracts are, or the prevention of monopolisation of money (Al Juwaini, 2011; Ibn Qudama, 1999; Al Zuhayli, 2003). These, as shown in Section 6.3.3, are elements of the *maqasid* of circulation. This is the most frequently used method in this research as will become apparent in Chapters 8-11.

An alternative way to identify the *maqasid* is to use logical thinking to link the ruling to the *maqasid*. Rationality and reason are genuine sources for identifying *maslahah* as pointed out by Ibn Abd Al Salam²² (2010). In this study, this approach will only be applied in cases where no indications from the scholars can be inferred—it is dealt with as a last resort. When this method is used, the reasoning is provided.

To clarify the methodology, there follows two examples for rulings that have been assigned the *maqasid* of circulation.

²¹ D: 1223 AD.

²² D: 1262 AD.

In the *murabahah* contract, Ruling 2.2.3 states that the institution must ensure that the party from which the item is bought is a third party and not the customer or the agent (AAOIFI, 2010). The justification given is that this may lead to *riba*. Therefore this ruling was assigned the *maqsid* of circulation since the prevention of *riba*, as outlined in Section 6.3.3, is an element of the *maqsid* of circulation. Alternatively, it can be argued as follows: *Riba* stagnates circulation and hence its prohibition—through this ruling—promotes the *maqsid* of circulation.²³

Another example is taken from the *mudarabah* contract. Ruling 4.4 states that the *mudarib* is not liable except in cases of negligence and misconduct (AAOIFI, 2010). The scholars have stated, when addressing this issue in the agency contract (which is analogous to the *mubarabah* contract), that the rationale for this is to encourage people to engage in this transaction (Al Haitami²⁴, 1996). Therefore, the ruling was assigned the *maqsid* of circulation.

The body of knowledge that will be consulted in this exercise range from specialised works to more general ones as follows: Ibn Ashur's (2011) treatise, *Maqasid al Shariah*, is the primary source for the derivation of the criteria since Ibn Ashur is the founder of the five-fold classification and has provided an explanation for each one of them. Hence, the study draws heavily and primarily on his work. In addition, contemporary works on *maqasid*, which are based on Ibn Ashur (2011), have also been consulted. These can be regarded as extensions and elaborations on his contributions. This includes, *inter alia*, Ibn Bayyah (2010), Ibn Zughaibah (2010) and Mustafa (2013).

Moreover, the study refers to specialist research on Islamic commercial law and contracts. This includes mainly academic research—articles, Ph.D. theses and masters dissertations—specialising on a certain topic of Islamic commercial law. The significance of these works is that they provide the *maqasid* of the topic they are studying. Examples of this category include Al Huqail (2011) and Al Lahim (2012).

²³ It was also assigned another *maqsid*; justice (see: Chapter 9). However, it is intended in this section to show why it was linked to circulation and this does not imply at all that it hasn't been assigned another *maqsid*. The same also applies to the next example.

²⁴ D. 1566 AD.

6.3.5 Quantification Procedure

The last phase of the *maqasid al Shariah* framework is: how to quantify the findings? A straight forward procedure is followed based on the scoring system for the *Shariah* benchmark discussed in Section 6.2.1.

Since each *maqsid* is linked to a ruling, then the scores for the *maqsid* follow the scoring system for the rulings. The only difference is that the *maqsid*, unlike the rulings, are assigned weights²⁵. Therefore, each *maqsid* will be multiplied by its weight.

The following example illustrates the procedure for computing the *maqasid* achievement of the real life cases:

Ruling 4.4 of the *mudarabah* contract is assigned the *maqsid* of circulation. Hence, the first step is to examine the status of Ruling 4.4 according to the scoring scheme devised in Section 6.2.1. Say that for this particular example, ruling 4.4 has been stated explicitly and thus scores 1. Consequently the *maqsid* of circulation scores 1 multiplied by its weight which will be devised in Chapter 7. Accordingly, all the *maqasid* will be quantified using this procedure.

Therefore, computing the *maqasidic* achievement for each contract is achieved as follows. For each individual *maqsid*, the total score is generated by adding the scores of all the relevant rulings for that *maqsid*. Then a total score is awarded for the whole contract by adding the scores for all the individual *maqasid* to derive an aggregate. The final result is then calculated as the percentage of the awarded score to the maximum possible score.

²⁵ The weights are devised in Chapter 7.

6.4 CONCLUSION

This chapter developed the analytical framework for the theoretical and empirical analysis of the thesis. Two frameworks have been developed; the first one relates to the *Shariah* examination and the second one relates to *maqasid al Shariah*. The phases for developing these frameworks have been delineated and discussed. The frameworks enable quantifying the *Shariah* compliance as well as the realisation of *maqasid al Shariah*. Both model gains their importance in being one of the first attempts to provide a systematic framework for assessing the *Shariah* compliance as well as analysing the contracts in terms of their *maqasid* compliance. The methodology is distinct since it translates the often abstract and theoretical discussions on *maqasid* into real practical terms. In addition, the *Shariah* compliance model is useful because not only does it identify the framework for this study, but also contributes in general to the *Shariah* compliance literature by forwarding a generic model for *Shariah* assessment.

CHAPTER 7

MEASURING THE RELATIVE WEIGHTS AND INTRINSIC VALUE OF THE *MAQASID* OF ECONOMIC ACTIVITY: A MULTI-DIMENSIONAL FRAMEWORK

7.1 INTRODUCTION

The previous chapter indicated that in order to examine the realisation of *maqasid* in IPF contracts, it is pertinent to assign weights to the *maqasid*. This chapter is devoted to this complex task of identifying the relative weights and intrinsic value of the *maqasid* of economic activity. In achieving this aim, the chapter first constructs an index—the *Maqasid al Shariah* Index (MSI)—to measure the relative weights of *maqasid* in general and, secondly, to apply the index to assign weights to the five *maqasid* of economic activity.

One of the main contributions of this chapter is, thus, the framework it develops for measuring the weights of the various *maqasid*. To the best of the knowledge of the researcher, this study is the first to construct a proxy indicator for measuring the relative weights of *maqasid*. Although the general theoretical basis for this has been provided in the literature, and there have been calls for developing a procedure to measure *maqasid* (Najjar, 2006; Kamali, 2008b), the relevant discourse is very limited and no significant attempts have been made. According to Kamali, “the relative strength and weakness of the various *maqasid* in relationship to one another is a subject on which *maqasid* literature is still at its early stages of development” (2008b: 19).

This index is distinguished because although it is applied to Islamic finance and particularly Islamic project financing, the framework is generic and thus can be used to examine any *maqasid*. Hence, the contribution of this study extends beyond Islamic

economics and finance to the wider *maqasidic* discourse. This study is particularly important since it consults the primary sources and texts of Islamic law to construct the MSI; therefore, the study offers original work and augments the credibility of the research.

The remainder of this chapter proceeds as follows: Section 7.2 outlines the literature on quantifying and measuring *maqasid*. Section 7.3 describes the construction of the MSI, focusing on the normative selection of the dimensions, components, and indicators; the data sources used to derive the MSI; and the methodology for assigning weights and calculating the MSI. Section 7.4 applies the index to measure the weights of the five *maqasid*, undertakes key comparisons, and analyses the results. The chapter concludes with Section 7.5.

7.2 PRIOR ATTEMPTS TO QUANTIFY MAQASID

Literature on technical issues of *maqasid* remains limited and, as indicated above, no study has attempted to measure the weights of the *maqasid* of economic activity in a systematic and methodical manner. Nevertheless, this paper argues that existing research in the various fields of Islamic studies provides solid ground for the construction of this indicator.

Classic and contemporary scholars have attempted to arrange the general *maqasid* into a hierarchical order. In addition, a number of contemporary studies on *maqasid* have assigned weights to *maqasid*. This section provides a general outline of the studies that have contributed to the discourse and offered new insights.

As indicated in Chapter 4, classic literature classifies *maqasid* into three levels: *daruriyyat*, *hajiyyat*, and *tahseeniyyat* (Al Shatibi, 2004). There are five *daruriyyat* identified: human life, religion, progeny, intellect, and wealth (Al Shatibi, 2004; Al Ghazali, 1997). The classic scholars, however, do not agree on a particular order of importance for the five *maqasid*. Although the majority of scholars maintain that

religion is the most important *maqsid* (Al Shatibi, 2004; Al Ghazali, 1997); others maintain that the protection of human life should be given the foremost priority in the hierarchy (Al Razi, 1992; AL Suyooti²⁶, 2008; Al Qarafee, 1999). There is also a divergence of views regarding the order of the other three *maqasid*: progeny, intellect, and wealth (Al Mahasen, 2012). Moreover, classic scholars have discussed the implications of this ordering, and the proposed orders were used in devising *Shariah* rulings (Auda, 2013).

In the contemporary discourse on *maqasid*, there are a number of approaches to the ordering of *maqasid*. Whereas certain scholars prefer to follow the classic scholars (Buti, 1966), others propose their own order of the five *maqasid* (Juma, 2004). In the contemporary discourse, some scholars suggest a number of *maqasid* without any specific order, instead, merely listing them (Al Qaradawi, 2010; Rida, 1947). Another strand in the literature proposes specific *maqasid*, which are considered as essential. Ibn Ashur (2011), for instance, maintains that the overarching *maqsid* of *Shariah* is to maintain the overall system of the *ummah*, the nation. He also adds a number of subsidiary *maqasid*. Similarly, Al Alwani (2003) holds that there are three essential *maqasid*: *tawheed* (monotheism), *tazkiyah* (purification), and *emran* (development). Other attempts at reformulation include Atiyah (2007).

Rahman (1982) argues for developing a hierarchy of the values that can be interpreted from the Holy Quran, although not necessarily in the context of Islamic finance or even *maqasid al Shariah*. He emphasizes socio-historical context when interpreting the general values. However, he does not give clear mechanisms by which to develop this hierarchy. Saeed (2006) builds on Rahman's theory and provides a list of ordered values that reflects the emphasis of the Quran. The values are arranged in the following order: obligatory, fundamental, protectional, implementational, and instructional. Saeed indicates general guidelines for classifying the values under each category based on repeated emphasis in the Quran. However, he does not present a systematic methodology to enable the classification of the values under the different categories. The notion of the hierarchy of values in the Quranic discourse is also present in Izutsu's (2002) work. Although he was concerned with the semantic

²⁶ D: 1505 AD.

analysis of the ethico-religious concepts in the Quran, Izutsu (2002) indicates that the Quranic discourse varies in the level of importance. He asserts that “it is to be noticed that the materials [i.e. from the revealed texts] gathered are not all of equal value: they differ from one another in the degree of contextual relevance, and consequently they must be assessed and utilized each according to its worth” (Izutsu, 2002: 36).

It can be inferred from the outline of the literature presented above that there are two central issues. First, the literature focuses on the *maqasid* in general and not those particular to financial transactions. Second, the proposals provided by the scholars give an order but not any particular weights to the different elements. In other words, the *maqasid* are only arranged in an order of importance, but there is no indication of the intrinsic value of each *maqsid*.

In relation to the first issue, Ibn Bayyah (2010) in his seminal work on *maqasid* is an exception. He implemented the five *maqasid* of economic transactions proposed by Ibn Ashur (2011) and proposed the following order: the creation of wealth; the preservation of wealth; transparency; and finally circulation. However, there are limitations to his work. First, he only ordered four out of five *maqasid*—the *maqsid* of justice had been omitted. Second, he did not give any weights to the *maqasid* and, finally, he did not outline clearly the rationale for this order—no clear justification was provided.

Some contemporary studies have attempted to give weights to *maqasid al Shariah*. Antonio *et al.* (2012) in their study entitled *An Analysis of Islamic Banking Performance: Maqasid Index Implementation in Indonesia and Jordania* chose a three-dimensional classification of *maqasid*: education, justice, and *maslahah*. Each dimension was given a relative weight based on interviews. The relative weight for each component was defined by 16 experts. In fact, their study was informed and inspired by a previous study (Abdul Razak *et al.* (2008) in which 16 experts assigned weights to the *maqasid* using questionnaires. Although this consultative process for assigning weights is justified academically and has been used frequently, it still involves subjective decisions and personal judgments. Thus, there is an area of potential error (Njong and Ningaye, 2008). Another problem with this approach is

that there are very few experts on the topic of *maqasid al Shariah*, and so it is not always easy to have access to them. Finally, no rationales are provided to justify the choice of weights, which brings into question the rationality and objectivity of the methodology. Other similar attempts at classification and assigning weights were made by Bedoui (2012).

This study takes into account the existing literature and moves the discussion forward in several regards. First, it constructs an index to measure the relative weights of *maqasid* in a systematic and methodical manner. Second, it consults the original ontological sources of Islamic law and uses them as the basis for giving weights. Finally, it focuses on the *maqasid* of financial transactions although the framework can be applied to *maqasid* in general. Additionally, this study uniquely applies the results obtained to the context of IPF contracts.

It is worth emphasizing Auda's (2013) assertion that although *maqasid* need to be arranged into a systematic hierarchy, any proposed arrangement suggested by the scholars of *maqasid* will remain an *ijtihad*, which, like any other product of human intellect, remains open to improvement and is not necessarily the truth itself.

7.3 METHODOLOGY FOR INDEX CONSTRUCTION

There is a belief among some social scientists and philosophers that human values are not qualitatively commensurable (Martinez-Alier *et al.*, 1998). However, others argue with evidence that values are measurable (Catton, 1954; Lockwood, 1997). This study adopts this second view as it is in line with the Islamic legal scholarship as stated in the previous section.

Like other social constructs, the measurement of the relative weight of *maqasid* is a difficult task and the challenge for conceptualizing and measuring *maqasid* is daunting. Not only does the *maqasidic* phenomenon entail a multiplicity of aspects (such as the intrinsic value of the *maqasid* itself, the scope, and comprehensiveness of

the *maqsid*), but new complexities continue to be unravelled by the changing societal realities. Therefore, the index developed in this study can be regarded, at least, as a proxy indicator and an indirect measure of the intrinsic value and weight of *maqsid*.

The following sub-sections delineate this process in detail.

7.3.1 Constructing The Index

As *maqsid al Shariah* are conceptualized as a multi-dimensional construct, they should be measured through the aggregation of the different dimensions. Therefore, information provided from different sources is incorporated into a composite *maqsidic* index. The general procedure for the construction of the weighting index involves a number of steps (Njong and Ningaye, 2008):

- the choice of dimensions and indicators;
- the definition of a weighting scheme for each of the dimensions and indicators;
and
- the aggregation of the dimensions to arrive at the composite index.

Although this process involves a series of value judgments, each step is justified through giving a rationale. The margin of arbitrariness is acknowledged as this study is arguably the first step in this direction.

The procedural construction of the index draws mainly on the literature on social-oriented indices due to the scarcity of *maqsid* related indices. Therefore, the United Nations Human Development Index (UNDP, 2013), the Oxford Poverty and Human Development Initiative working papers (Alkire and Santos, 2011), and other related indices were consulted in the process of development. That is, the overall methodology of index construction was borrowed from these sources. This includes the method for choosing dimensions and indicators. Furthermore, defining the

weighting scheme benefited from the method adopted by United Nations Human Development Index. The calculation method in this study was also based on these indices although there have been some minor changes. For example, the normalization formula applied in this study is a less sophisticated version of the one used in the United Nations Human Development Index. Alkire and Santos's (2011) index was also helpful in understanding the process of operationalizing concepts for index construction. The theoretical rationale of the index, however, is based on the classic and contemporary works on *maqasid*, Islamic law, and related disciplines.

7.3.1.1 Selection of dimensions

At a conceptual level, Ibn Bayyah's (2010) seminal work represents an important contribution regarding the dimensions for measuring the strength or weakness for any particular prohibition in *Shariah*. He explicitly states that any prohibition has to be analysed from three perspectives: 1) the scriptural source; 2) the textual indication; and 3) the *maslahah* inherent in the prohibition. It can be asserted that he is, conceptually, the first to explicitly propose this model. Given the authoritativeness of Ibn Bayyah (2010) and his pioneering contributions to *maqasid* generally, this study endorses his framework, but instead of applying it to measure prohibitions in *Shariah*, it applies it to measure the intrinsic weight of *maqasid*. Furthermore, instead of his proposed three-level analysis, the study uses a binary model by merging the scriptural source dimension with the textual indication dimension. Consequently, the study proposes three dimensions for this index: 1) the Quran dimension; 2) the *Sunnah* dimension; and 3) the *maslahah* dimension. More precisely, the Quran and *Sunnah* dimensions denote the reference to the *maqsid* in the Quran and *Sunnah*. The *maslahah* dimension, on the other hand, denotes the impact and applications of the *maqsid*.

The Quran and *Sunnah* have been selected as two dimensions based on the following rationale: As indicated in Chapter 3, there are four principal sources of *Shariah*,

namely the Quran, *Sunnah*, consensus (*ijmaa*), and analogy (*qiyas*). However, consensus and analogy are not regarded as completely independent proofs or primary sources since they do not function in total isolation from the Quran and *Sunnah*. The *ijmaa* needs a basis in the Quran or the *Sunnah*, usually referred to as the *sanad*. Similarly, the analogy has to be founded on an established ruling in the Quran or *Sunnah* in order to be valid (Kamali, 2003; Hallaq, 1997). Therefore, it can be inferred that the Quran and *Sunnah* are the main sources of *Shariah* upon which all other sources are built.

However, the Quran and *Sunnah* are considered as two different dimensions as they are not at an equal level of authoritativeness and priority. The Quran is considered as the primary source of *Shariah* and the foremost authoritative guide. The *Sunnah*, on the other hand, although it stands on the same footing as the Quran in terms of being a source of *Shariah* which constitutes binding law, is considered as a secondary source (Kamali, 2003). Scholars of *usul al fiqh* state that if there happens to be a conflict between the Quran and *Sunnah*, priority is to be given to the ruling in the Quranic text. This is because the Quranic authenticity is not open to doubt; it is decisive, whereas some parts of *Sunnah* have relatively weaker authenticity. Second, the *Sunnah* is also considered to explain the Quran and, naturally, an explanation occupies a secondary place in relationship to the source (Shaltout, 1963; Kamali, 2003). Thus, it can be concluded that in terms of weight and importance, the Quran comes first.

Although Ibn Bayyah's (2010) proposals form the foundations for these two dimensions, this model is also informed by other classic and contemporary works on *maqasid al Shariah*. Ibn Ashur (2011), for example, states that the degree of certainty or probability of a *maqsid*, and hence its strength or weakness, depends on the quantity of available textual scripts from the sources of *Shariah* as well as the strength and clarity of their indication. Although not explicitly concerned with the topic of arranging *maqasid al Shariah* into a hierarchy, Al Shatibi's (2004) *Al Muwafaqat* contains relevant discourse. He states that commandments and prohibitions in *Shariah* are not of equal level. Therefore, the issue of priority is present in his seminal work. This classic material provides two perspectives: one relating to the thematic survey of the sources, and the other relating to the interpretation of the sources.

As for the *maslahah* dimension, Ibn Abd Al Salam (2010), the classic scholar of law and *maqasid*, has shown in his book *Al Qawaed* that the norm of *Shariah* is to prefer the *maslahah* with the higher benefit—the outweighing *maslahah*—over the *maslahah* with the lesser benefit. Therefore, *Shariah* gives more priority to the greater and most effective *maslahah*. In this connection also, Ibn Ashur (2011) discusses the methods of preference used by jurists in cases of conflicting benefits, *masalih*. He states that one of the ways of deciding preference is to compare the impact of one *maslahah* with another. The example he cites is giving priority to the preservation of life over the protection of property. Both are *masalih*, but priority is given to the *maqsid*, which has a greater inherent *maslahah*. Prior to Ibn Ashur (2011), the Hanbali scholar Ibn Al Qayem (2010) also attests to this point. Certain scholars go further with the issue of importance of *maslahah*. Al Tufi, for example, argues that *maslahah* should be the basis for the interpretation of the content of the Quran. He argued that in cases in which the text is in conflict with the *maslahah*, preference is to be given to the *maslahah* (Al Yubi, 2011; Saeed, 2006).

In addition, Najjar (2006) and Kamali (2008b) state that one of the indicators that may help with the appraisal of *maqasid* is to evaluate the likely *maslahah* (benefit) or the mischief they prevent. They propose that this can be achieved by ascertaining whether or not the *maslahah* promoted by the *maqsid* in question is comprehensive; whether it concerns a large or small number of people; and whether the *maslahah* relates to a vital aspect of life or is of partial benefit. This notion has roots in Al Shatibi's (2004) argument that the texts of the Quran and *Sunnah* cannot be determined by only referring to the linguistic and interpretative methods. He argues that the precise value of the texts of the Quran and *Sunnah* can only be determined by addressing the inherent *maslahah*. Hence, the intrinsic *maslahah* can be chosen as one of the dimensions for the MSI. This can be referred to as the 'impact' of the *maslahah*.

Overall, it can be contended that there is an enduring consensus regarding these three dimensions and their importance in determining the importance of any *Shariah* command. Therefore, applying them to measure *maqasid al Shariah* is justifiable. By choosing these three dimensions, this study is combining and reconciling the two

prevailing approaches for understanding and interpreting *Shariah*; the textualist approach and the context-based approach.

In addition to the theoretical rationale, there are other arguments in favour of the chosen dimensions. Alkire and Santos (2011) point out a number of reasons that make the choice of dimensions for an index favourable including, *inter alia*, recognisability, interpretability and the availability of data.

These three attributes apply to the MSI. First, the three chosen dimensions, in the wider general context of Islamic law, are widely recognised. Second, interpretability. There is substantial literature on interpreting the sources of *Shariah* and there are well established procedural mechanisms, which, in turn, make the analysis easier. The third reason is the presence of data—having the core sources of *Shariah*, which are easily accessible, as the main data sources is a further strength for the choice of dimensions.

7.3.1.2 Selection of indicators

The second stage of the construction of the index involves selecting the indicators pertaining to the dimensions. It is common practice to choose more than one indicator for the same dimension given the partial nature of indicators (Corbetta, 2003). The following sub-sections explain in detail the choice of indicators for the three dimensions.

7.3.1.2.1. Indicators for the first two dimensions: The Quran and Sunnah

Two identical indicators have been developed for each dimension; the first one relates to the frequency of occurrence, and the second one relates to the interpretation and hermeneutics.

Indicator 1: Frequency of occurrence

The first indicator for both dimensions relates to the frequency of occurrence of the *maqsid* in the ontological sources—it is a quantitative indicator. In this respect, Al Qaradawi (1997) in his book *Kaifa Nataamal Ma Al Quran* has stated that the emphasis of the Quran on a topic or issue, its frequency, and its repetition in different forms, denotes its importance and should, therefore, be given due consideration in proportion to its degree of repetition and mentioning in the Quran. He considers this as a legitimate indicator of the relative importance or non-importance of an issue. In addition, the scholars of *usul al fiqh* propose prioritizing an issue which is mentioned more frequently. Although they have not discussed this notion on this specific topic, their general discussions can be useful in this context. For example, when they discussed the topic of metaphorical and literal meanings of words (*majaz* and *haqiqaa*), they have stated that what occurs more frequently should be given priority (Amidi, 1968). The same conclusion was also stated in their discussions on the topic of *amm* and *khas*, the generality and specificity of words. Furthermore, certain scholars consider the notion that ‘what occurs more frequently should be given more priority’ as a methodological maxim in *usul al fiqh* (Al Owaid, 2009). Based on this rationale, a quantitative indicator can be introduced regarding the frequency of occurrence of the particular *maqsid* in the Quran and *Sunnah*. A *maqsid* that occurs more in the Quran and *Sunnah* will carry more weight than a *maqsid* that is mentioned less and has a lower frequency.

Indicator 2: Interpretation and hermeneutics

The topic of textual interpretation and textual linguistics is one of the most important branches of *usul al fiqh*, the theoretical basis of Islamic law. This topic includes the principles relating to the clarity and ambiguity of words and to the way in which words convey their meanings (Ramic, 2003). There is a myriad of literature on *usul al*

fiqh as it is a very established discipline within Islamic studies (Al Isnawee²⁷, 1999; Amidi²⁸, 1968; Al Subki²⁹, 2004). This feature facilitates the development of this indicator. This section draws mainly on the literature on textual interpretation. It also benefits from the literature on the conflict of evidence, another important branch of *usul al fiqh*. The indicator is concerned with the textual indications that are the cornerstone of interpretation and hermeneutics in *usul al fiqh*.

There are quite a number of classifications regarding the indications and inferences that can be deduced from the texts. Acknowledging this fact, this study will only make use of the relevant classifications and those that have a practical effect on interpreting the text and giving priority to one over the other. This departs from the notion that certain theorizations in *usul al fiqh* remain within theoretical boundaries and have no practical implications. Therefore, the classification that has been selected for this indicator is the “methods of textual indication” classification (*turuq dalat al alfaz ala al ahkam*). Concisely, this is the degree of textual explicitness (Kamali, 2003; Ramic, 2003).

It is important, before discussing the technicalities of this relatively complex area of *usul al fiqh*, to clarify an important issue—the *usuli* approach to be followed. It is common knowledge that there are two approaches to *usul al fiqh*: the deductive approach and the inductive approach. Although the first approach is attributed to the *Shafee* school, it is endorsed by the majority of scholars. The latter, however, is attributed mainly to the *Hanafi* school (Kamali, 2003). This study will not necessarily limit itself to either approach; rather, it will build on and benefit from both, although it mainly will follow the *Hanafi* approach.

The reason for this choice is that the *Hanafi* school explicitly arranges its categorization of the textual indication methods into levels of authoritativeness. In other words, the *Hanafi* scholars put the four types of textual indication into a hierarchy so that in case of conflict, the indication that is at a higher level takes precedence over the indication that is at a lower level (Ramic, 2003). This feature is

²⁷ D: 1306 AD.

²⁸ D: 1232 AD.

²⁹ D: 1355 AD.

very important for index construction since weights have to be assigned in terms of importance. The *Shafee* school, however, is not very explicit on giving a hierarchy for the levels of textual indications they propose. Nevertheless, indications can be found in some of their books, and thus, a hierarchy can be inferred from their discussions. For example, Al Razi (1992) states in *Al Mahsool* that the pronounced indication, *al mantooq*, is stronger than the implied. However, some followers of this school do not agree with him and in contrast give preference to the implied over the pronounced (Al Isnawee, 1999; Amidi, 1968). Therefore, arguably, the *Hanafi* school is more consistent in assigning hierarchies to the different textual indications. So, it is more useful to adopt, in the main, their classification for constructing the index.

Another reason for choosing the *Hanafi* classification rather than the *Shafee* classification is that there are discrepancies within the latter school regarding their own classification. For example, the *Shafee* methodologists differ over three sub-categories of indications—namely, the required meaning (*dalat al iqtida*), the gestured meaning (*dalat al ima*), and the alluded meaning (*dalalat al isharah*)—whether they belong to the pronounced or implied category (Al Subki, 2004). In addition to this divergence of views, no clear hierarchy is given for these sub-categories. Al Owaid (2009) in his comprehensive research on textual indications states that he did not find any mention of a hierarchy for the categories in the standard *usul* texts of this school. Furthermore, the *Hanafi* approach is more straightforward from the researcher's point of view since differences of views regarding the order of some categories are fewer in the *Hanafi* school. In addition, their approach is more clear-cut, unlike other approaches that involve many sub-categories and thus make the process more complicated.

As noted previously, the *Hanafi* model is not adopted completely; it is refined and some components of the *Shafee* school—particularly, the divergent meaning (*mafهوم al mukhalafah*)—are included. In conclusion, this study has developed an integrated and cohesive classification of the textual indications to develop the index. The following paragraphs explain in detail the classification endorsed.

The *Hanafi* scholars suggest four types of textual implications. This means that a ruling, and in our case a *maqsid*, can be derived from a textual script by one of four textual indications. These are: the explicit meaning (*ibarat al nass*); the alluded meaning (*isharat al nass*); the inferred meaning (*dalat al nass*); and finally the required meaning (*dalat al iqtidaa*) (Al Owaid, 2009; Ramic, 2003; Kamali, 2003; Saleh, 1993).

At the top of the hierarchy is the explicit meaning (*ibarat al nass*). It represents, usually, the principal theme and the immediate meaning of a text that is derived from its obvious words and sentences. (Kamali, 2003). It is, in essence, the ruling that the text and the context (*al siyaq*) intend to provide no matter whether it is the principal theme or a subsidiary theme (Saleh, 1993; Ramic, 2003). The major condition for this type is that the meaning derived should be apparent. An example of *ibarat al nass* lies in the verse of *Surat al Baqarah* “Allah has permitted trade and forbidden *riba*” (The Quran, 2: 275). The apparent and explicit ruling that can be deduced from the verse is that *riba* is forbidden. The explicit meaning, *ibarat al nass*, indicates this explicit ruling.

The second type of textual indication is the alluded meaning (*isharat al nass*). It is defined as the “word’s indication of a ruling which is not intended, and the text was not transmitted for this purpose” (Ramic, 2003: 11). It is a rationally concomitant meaning that is obtained through further investigation and an analysis of the signs given by the text (Kamali, 2003). Therefore, fundamentally, it is the meaning established through allusion and necessary inference. The following example illustrates the alluded meaning. The Quran (2: 233) states, in the context of providing maintenance for young children, that “It is his (father’s) duty to provide them with maintenance and clothing according to the custom.” Scholars have deduced, through the alluded meaning, from this verse that the child’s descent is solely attributed to the father (Abu Zahrah, 1958; Kamali, 2003).

The inferred meaning (*dalalat al nass*) is the third type of indication. It is the meaning derived from the rationale and spirit of the legal text and not indicated in the words and sentences of the text. The main difference between inferred meaning and both the

explicit and the alluded meanings is that the latter two are both indicated in the words of the text while the inferred meaning is identified through analogy. Therefore, this indication has been equated to analogical deduction (Kamali, 2003). For example, the verse in *Surat Al Esraa* on the obligation of respecting one's parents states that "and say not 'fie' to them" (The Quran, 17: 23). The explicit meaning of the verse is that it is forbidden to say any word of contempt to one's parents. In addition, it can be understood through the inferred meaning of the text that all forms of abuse towards the parents are forbidden, even though other forms of disrespect have not been mentioned in the text (Kamali, 2003).

The fourth type of textual indications is the required meaning (*iqtidaa al nass*). It is a "meaning which must be presumed in order to make the text correct and valid" (Ramic, 2003: 29). In other words, the text is silent on this meaning, yet it must be presumed in order for the text to fulfill its proper objective (Kamali, 2003). An example from the Quran illustrates this. The Quran (4: 23) states: "forbidden to you are your mothers, your daughters, your sisters". Although the verse is in the context of marriage, it does not mention the word marriage. Therefore, the word *marriage* has to be read to complete the meaning (Kamali, 2003) and is arrived at through the required meaning (*dalalat al iqtida*).

As discussed, the interpretation of legal texts, according to the *Hanafi* school, can take place through the application of one or more of the four aforementioned methods of legal construction. They are all valid and can be applied individually or in combination.

The focus now turns to the hierarchy between the four types of indications. The hierarchy is based on the literature which discusses the relationship between these four types (Saleh, 1993; Al Owaid, 2009). Table 7.1 presents a matrix highlighting the priority the *Hanafi* scholars give to each type when it is in conflict with another type.

Table 7.1: Matrix of Hierarchy of the Four Types of Textual Implications According to *Hanafi* Jurists

	Explicit	Alluded	Inferred	Required
Explicit		Priority to Explicit	Priority to Explicit	Priority to Explicit
Alluded	Priority to Explicit		Priority to Alluded (majority of <i>Hanafi</i> scholars)	Priority to Alluded
Inferred	Priority to Explicit	Priority to Alluded (majority of <i>Hanafi</i> scholars)		Priority to Inferred
Required	Priority to Explicit	Priority to Alluded	Priority to Inferred	

As can be seen from the matrix, the four types are placed in the following order:

1. the explicit meaning;
2. the alluded meaning;
3. the inferred meaning; and
4. the required meaning.

Therefore, for the MSI, the explicit meaning will carry more weight than the alluded and so on.

In addition, to these four types of legal interpretation methods, there is a fifth type of textual indication technique for deriving rulings: the divergent meaning (*mafhum al mukalafah*). Although not generally accepted in the *Hanafi* school, it has been accepted and endorsed by the majority of *usul al fiqh* scholars (Saleh, 1993). This study adopts divergent meaning in order to complement the other four types and thus complete the integrated model. The main reason why the divergent meaning is adopted in this study, rather than other types proposed by the *Shafee* school, is that the other types more or less fall under one of the four *Hanafi* school textual indications.

The divergent meaning is defined as an “implicit meaning which indicates that the ruling of the pronounced is opposite to the ruling of the pronounced” (Ramic, 2003: 55-56). For example, the Quran (515: 6) states that “if an evil person comes to you with news, verify it”. It can be understood from this verse through the divergent indication that if the person who carries the news is not an evil person, then the news the person carries need not be verified (Ramic, 2003).

However, the challenge is where to place this fifth type in the hierarchy given that the *Hanafi* school does not accept this type and, therefore, they do not propose any hierarchy for it. The *Shafee* scholars, on the other hand, accept this type, but they have their own classification of textual indications. The task is to incorporate a textual indication from the *Shafee* school into a hierarchy of textual indications from the *Hanafi* approach. This is akin to assimilating two different models. After an examination of this type of indication and reviewing the literature on conflict between the different types of indications, the divergent meaning is placed in fifth position, at the bottom of the hierarchy.

This conclusion was reached as follows. First, the divergent meaning is an implicit meaning that is not understood from the words in the text explicitly. Therefore, it is of a lower degree when compared to the explicit and alluded meanings. In addition, scholars have stated that in cases of conflict between the pronounced and implied, priority should be given to the pronounced. Needless to say, the divergent meaning is a type of pronounced indication (Al Owaid, 2009). Moreover, the majority of scholars maintain that in case of conflict between the agreed meaning and the divergent meaning, the agreed meaning has priority (Al Owaid, 2009) and since the inferred meaning (*dalalat al nass*), is equated with the agreed meaning, then it also precedes the divergent meaning. Furthermore, the scholars state that in case of conflict between the required meaning and the divergent meaning, priority is to be given to the required meaning (Al Owaid, 2009). Hence, the divergent meaning is to be placed at the bottom of the hierarchy.

In conclusion, the following order of indications will be applied in this study:

1. the explicit meaning;
2. the alluded meaning;
3. the inferred meaning;
4. the required meaning; and
5. the divergent meaning.

Note that the unit of analysis for these indicators are the Quranic verses and Prophetic traditions (the *Sunnah*). Table 7.2 summarizes the structure for the Quran and *Sunnah* dimensions.

Table 7.2: General Structure for the Quran and *Sunnah* Dimensions

DIMENSIONS	INDICATORS	OUTCOME
QURAN	Frequency Of Occurrence	Numerical Value
	Interpretation And Hermeneutics (Methods Of Textual Indication)	Explicit
		Alluded
		Inferred
		Required
Divergent		
SUNNAH	Frequency Of Occurrence	Numerical Value
	Interpretation And Hermeneutics (Methods Of Textual Indication)	Explicit
		Alluded
		Inferred
		Required
Divergent		

7.3.1.2.2. Indicator for the second dimension: The *maslahah*

In order to develop an indicator for the *maslahah* dimension, the classic *maqasidic* typologies present in the standard texts of *maqasid al Shariah* have been consulted (Al Shatibi, 2004; Ibn Ashur, 2001; Al Yubi, 2011; Kamali, 2008b; Auda, 2008). Two prevailing classifications have been examined in particular: 1) classifying the *maqasid*

in terms of the importance and essentiality; and 2) classifying the *maqasid* in terms of the comprehensiveness and generality.

The first classification—where *maqasid al Shariah* are classified into *daruriyat*, *hajiyat*, and *tahseeniyat*—has not been selected as an indicator for the following reasons. First, classifying a *maqasid* under one or the other of these categories is a relative exercise that involves value judgment (Kamali, 2008b). In addition, a particular *maqasid* can be placed under all three categories simultaneously depending on the context (Najjar, 2006). That is, this classification can be regarded as dynamic and dependant on the changing social, political, and economic contexts, unlike the previous indicators which are more or less static since they are based on divine sources that do not change.

Therefore, the other classification of *maqasid* in terms of comprehensiveness has been chosen as the indicator for the *maslahah* dimension since it can be quantified more objectively and methodically. This classification categorizes the *maqasid* into two types: general and particular. The general *maqasid* are those broad and comprehensive goals that characterize *Shariah* in its entirety and apply to all areas and subjects or, at least, most of them. Consequently, the general *maqasid* relate to a larger group of people and have wider applications and a greater impact. The particular goals, on the other hand, pertain to specific subjects such as the goals of financial transactions, and hence affect a smaller number of people (Al Shatibi, 2004; Ibn Ashur, 2011; Al Yubi, 2011). Therefore, the indicator for this dimension is the comprehensiveness of the *maqasid*; the greater the comprehensiveness, the greater intrinsic value. According to Al Najjar, “the *maslahah* that involves a greater number of people is stronger than the *maslahah* that involves a smaller number” (2006: 246). This indicator can also be understood as an indicator that measures the ‘impact’ of the *maqasid*.

7.3.1.3 MSI calculation procedure

The next stage following the identification of the dimensions and indicators is to define a procedure in order to arrive at quantified results. This entails defining a weighting scheme and outlining the calculation method.

7.3.1.3.1. Defining a weighting scheme

Dimensions

The choice of a weighting scheme is of major importance for a coherent evaluation of *maqasid al Shariah*. Weights represent the importance and priority of a dimension/indicator relative to other dimensions/indicators (Alkire and Santos, 2011). The weights are usually applied at three levels: 1) between dimensions (Quran, *Sunnah*, and *maslahah*); 2) within dimensions; that is between the indicators of each dimension; and 3) among the outcomes of each indicator. Regarding the MSI, weightings will be assigned to the three dimensions as follows.

Equal weighting is applied to each dimension (Quran, *Sunnah* and *maslahah*). Therefore, each dimension weighs 1/3. This follows a number of other indices, including the United Nations Human Development Index convention that applies equal weights to the dimensions (UNDP, 2013). Although facing increasing criticism for assigning arbitrary equal weights to each dimension (Njong and Ningaye, 2008; Chowdhury and Squire, 2006), this methodology is widely used and it is the most common weighting scheme³⁰ (Alkire and Santos, 2011; Hagerty and Land, 2007). Therefore, it is applied in constructing this index.

³⁰ Equal weighting has also been applied by Diener's (1995) Value Based Index of National Quality of Life, Land *et. al* (2001) Index of Child and Youth Well-Being as well as the (1979) Physical Quality of Life Index.

Admittedly, it is difficult to justify assigning equal weights for the dimensions since the Quran has a higher status than the *Sunnah*. However, the justification for this may be that, in the final analysis, the Quran and *Sunnah* are equal in conveying teachings. Nevertheless, assigning the *maslahah* dimension, a weight equal to the Quran and *Sunnah* dimensions, remains problematic. However, since no criterion has been previously developed for this and since there are no previous studies, it has been decided to apply the equal weights approach. Perhaps, future research can contribute to a more objective assignment of weights for the dimensions.

Regarding the indicators, no overall weights need to be assigned. This is because, for the Quran and *Sunnah* dimensions, both indicators—the frequency and the interpretation—are multiplied together and the composite score weighs $1/3^{31}$. As for the *maslahah* dimension, there is only one indicator and, correspondingly, it will weigh $1/3$.

Indicator outcomes

The next step is to assign the values and weights for the indicator outcomes. The first two dimensions each have two identical indicators, frequency and indication. The outcome of the frequency indicator is the number of occurrences, which is a numerical value. Therefore, no weighting is required for the frequency indicator. The maximum value is the highest observed value of occurrence and the minimum is the lowest observed value.

In relation to the second indicator, the interpretation, there are five possible outcomes for each unit of analysis. They have been assigned arbitrary weights, reflecting the priority of each outcome, as highlighted in Table 7.3.

³¹ A detailed explanation for the calculation procedure is provided in Section 7.3.1.3.2.

Table 7.3: Arbitrary Weights for Textual Indications

INDICATOR	OUTCOME	ARBITRARY WEIGHT
Methods of textual indication	Explicit	5
	Alluded	4
	Inferred	3
	Required	2
	Divergent	1

The rules of classification are established by the following sequence of questions:

A. Set A: The Explicit

1. Does the verse state the *maqsid* or one of its opposites?
2. Is the *maqsid* the principal theme or one of the main themes of the verse?

If the answer to any of these questions is "yes", then score = 5

If the answer to all of these questions is "no", then proceed to set B.

B. Set B: The Alluded Meaning

1. Is the *maqsid* indicated by reasonable allusion and inference?
2. Is the *maqsid* a rational concomitant meaning that is reached through further analysis of the text?

If the answer to any of these questions is "yes", then score = 4

If the answer to all of these questions is "no", then proceed to set C.

C. Set C: The Inferred Meaning

1. Is the *maqsid* an implicit meaning about which the text is silent, but it is nonetheless equivalent or superior to a pronounced *maqsid*

mentioned in the same verse? In other words, is the *maqsid* reached by superior or equivalent analogy on another *maqsid* in the same verse and they both share an effective cause?

If the answer to this question is “yes”, then score = 3.

If the answer to this question is “no”, then proceed to set D.

D. Set D: The Required Meaning

1. Does the correctness of the verse in one’s mind and its rational and legal validity depend on the presumption of the *maqsid*?
2. Is the *maqsid* an addition to the text without which the meaning of the text cannot be fulfilled?

If the answer to this question is “yes”, then score = 2.

If the answer to this question is “no”, then proceed to set E.

E. Set E: The Divergent Meaning

1. Is the *maqsid* understood through an implicit unpronounced indication which is opposite to a pronounced indication or *maqsid*?

If the answer to this question is “yes”, then score = 1.

If the answer is “no” at this point, then score = 0 for that *maqsid* for that particular unit of analysis. However, the unit of analysis is assumed to have at least one *maqsid* because only the units of analysis that encompass *maqsid* are selected. Hence, in practice no unit of analysis will score 0.

The assignment of these numerical values was to a large extent intuitive. Although the relative weightings were determined arbitrarily based on theoretical considerations, there is no scientific way in which, for example, the required indication can be said to be twice as strong as the divergent indication. This is one limitation of this study.

In relation to the second dimension, the inherent *maslahah*, there is only one indicator: the comprehensiveness of the *maslahah*. This is also a numerical value and, therefore, no weighting is required for this indicator.

Having identified the outcome of each indicator, the next section explains the calculation method.

7.3.1.3.2. Calculation method

In the following sub-sections, the calculation method will be outlined and explained in detail.

7.3.1.3.2.1 Assigning values to the indicators

The first step is to conduct the analysis and obtain the results which are then used in the quantification process.

The first two dimensions, the Quran and *Sunnah*, each have two indicators. Therefore, the same procedure is used to arrive at the calculation for all four indicators. This procedure is as follows: first, every unit of analysis (a verse or a *hadith*) that encompasses a *maqsid* is analysed and allocated to one of the five interpretation categories. Second, the frequency of occurrence of each category is recorded. Third, the weight of each category is multiplied by its frequency.

Table 7.4 is an example of the calculation process for the *maqsid* of justice, which is mentioned, for example, in 50 verses.

Table 7.4: Calculation Example (1)

Indicator	Frequency
Explicit	10
Alluded	10
Inferred	20
Required	5
Divergent	5
Total	50

After recording the data, the frequency of each indication is multiplied by its weight. Following this, the results of each indicator are summed. Therefore, the result of the first component is 165 because both are directly connected (see Table 7.5).

Table 7.5: Calculation Example (2)

Indicator	Weight	Frequency	Result (weight * frequency)
Explicit	5	10	50
Alluded	4	10	40
Inferred	3	20	60
Required	2	5	10
Divergent	1	5	5
Total			165

This process is repeated with the other component, the *Sunnah*. For example, the *Sunnah* dimension scores 120. The next stage is to obtain the results for the third dimension—the *masalahah*. This will be a numerical value, for example, 43. Table 7.6 summarises the results for this example in order to clarify the method.

Table 7.6: Calculation Example (3)

DIMENSION (WEIGHT)	INDICATORS	VALUE
Quran (1/3)	Frequency	165
	Interpretation	
<i>Sunnah</i> (1/3)	Frequency	120
	Interpretation	
<i>Maslahah</i> (1/3)	Comprehensiveness	43

7.3.1.3.2.2 Normalization and aggregation

The obtained scores then undergo a process of normalization. The aim of this step is to transform the outcome of the indicators into indices between 0 and 1. This allows comparability across the different indicators in order that each score can be interpreted relative to other scores (UNDP, 2013; Klugman *et al.*, 2011).

The following equation is applied:

$$\text{Normalized Index} = \text{Actual Value} / \text{Maximum Value}$$

Following from the previous example, the calculation method can be illustrated starting with the first dimension, the Quran. The actual value for the example given is 165. The question, then, is: what is the maximum value? The maximum value is the maximum observed value that has been scored by all the cases examined. Therefore, the normalization process for this component can only be achieved after analysing all the cases in order to come up with the maximum observed values. If the maximum observed score across all the cases for this component is 200, to normalize, the equation is applied as follows:

$$165 / 200 = 0.825$$

As for the second dimension, the *Sunnah*, this example scored 120. If this has been the highest observed score, it is normalized as follows:

$$120 / 120 = 1$$

The third dimension, the *maslahah*, has only one indicator. The actual value for this example is 43. If the maximum observed value that has been scored by all the cases examined is also 43, it is normalized as follows:

$$43 / 43 = 1$$

Table 7.7 summarizes the results of this example after normalization.

Table 7.7: Calculation Example (4)

DIMENSIONS (WEIGHT)	INDICATORS	VALUE
Quran (1/3)	Frequency	0.825
	Interpretation	
<i>Sunnah</i> (1/3)	Frequency	1
	Interpretation	
<i>Maslahah</i> (1/3)	Comprehensiveness	1

The next step is to compute the weight of each dimension. The Quran dimension has a maximum of 1/3. Hence, the result obtained after normalization is divided by 3.³² For this example, we have:

$$0.825 / 3 = 0.275$$

The second component, *Sunnah*, in this example scores:

$$0.333 = 0.333$$

The same process is repeated with the third dimension, the *maslahah*. In this example it obtains the maximum possible score since:

$$0.333 = 0.333$$

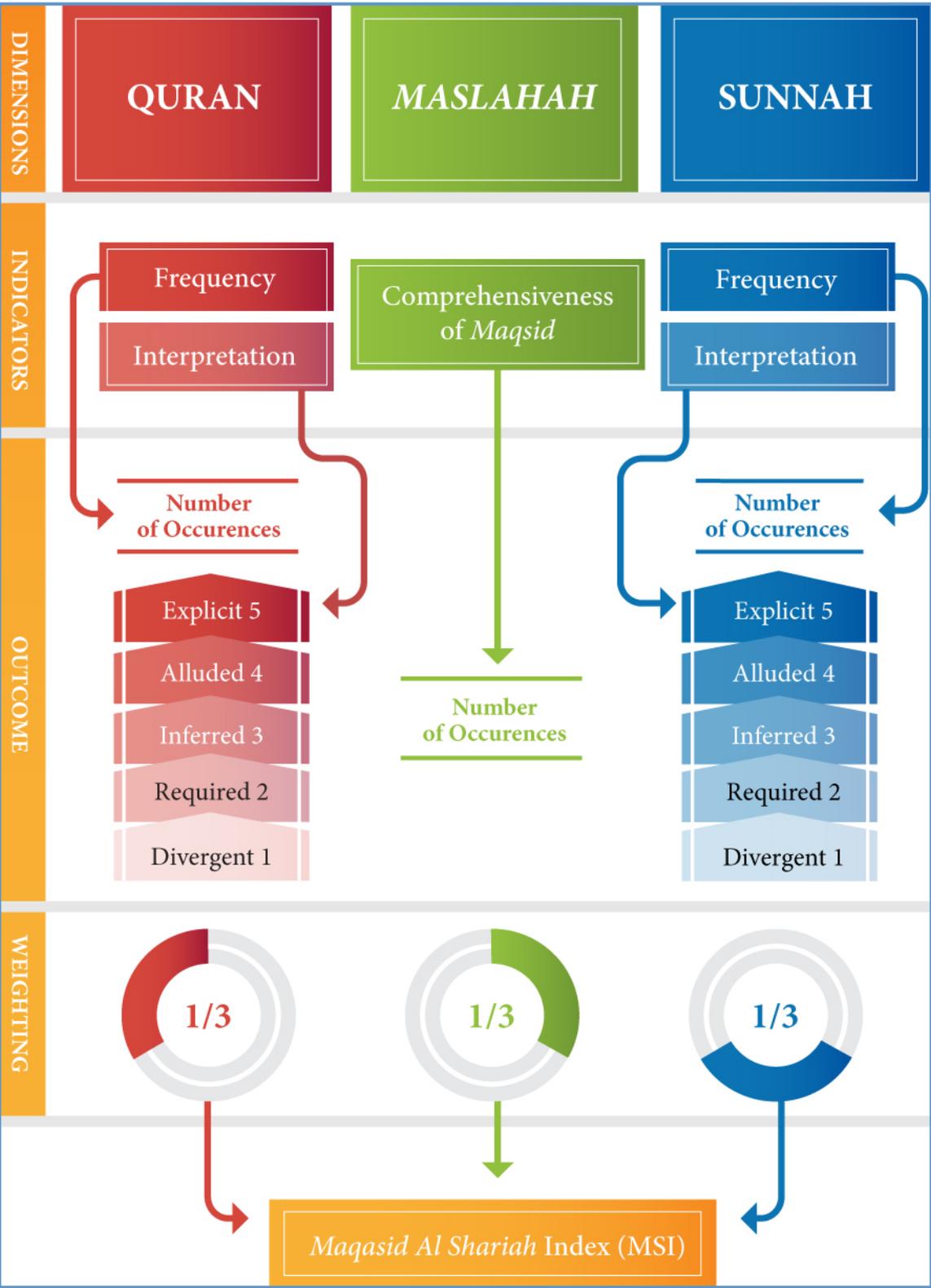
The final stage is to aggregate the scores of all three dimensions to get the final MSI:

$$0.275 + 0.333 + 0.333 = 0.941$$

The overall structure for the *Maqasid al Shariah* Index (MSI) is presented in Figure 7.1.

³² Alternatively, the normalised values can be added and then divided by 3.

Figure 7.1: Overall Structure for MSI Index



7.4 MEASURING THE WEIGHTS OF THE FIVE MAQASID OF ECONOMIC ACTIVITY: APPLYING THE INDEX

The MSI indicator developed is to be applied to measure the *maqasid* of economic activity. Prior to the examination, it is important to identify the units of analysis that are the subject of the examination. That is, the relevant Quranic verses and Prophetic traditions. This is presented in Section 7.4.1. Next, Section 7.4.2 reports the results of the examination and analysis of all the data sources for the MSI. The results for each dimension are reported together.

7.4.1 Identifying The Units Of Analysis

As indicated previously, there are three dimensions: 1) the Quran; 2) the *Sunnah*; and 3) *maslahah*. The following sections elaborate on the data sources and units of analysis for each dimension.

7.4.1.1 Identifying units of analysis for the Quran dimension

The examination of the Holy Quran is limited to the verses concerned with financial transactions. Therefore, the first step is to identify the verses related to wealth, monetary transactions, and economy. This task requires an inductive survey of the whole of the Quran to identify the relevant verses. In total there are 6236 verses to examine in the Quran. Each verse is considered as a unit of analysis.

After conducting the examination, 236 verses have been found to be relevant to economics and financial transactions. Each verse will be assigned to at least one of the five *maqasid*: circulation, preservation, justice, persistence, and transparency. The

working definitions for each of these *maqasid* have been given in Chapter 6. Therefore, these verses will be analysed using the developed indicators, and scores will be assigned correspondingly.

7.4.1.2 Identifying units of analysis for the *Sunnah* dimension

The *Sunnah*, the second source of *Shariah*, is also analysed since it is the source for the second and third dimensions. However, the *Sunnah* is not examined fully, rather a sample is used as the focus of this study. The chosen sample comprises the two most authoritative reference books of the *Sunnah*: *Al Saheehyan*, *Al Bukhari* and *Muslim*. These two books are widely considered as the most authoritative sources and all the traditions in these two books are considered as ‘sound’ by the great majority of scholars (Al Shami, 2007). Siddiqi (1993: 58) attests to the fact that *Al Bukhari* is “generally considered by the Muslims as an authority second only to the Quran” and that *Sahih Muslim* “has been considered its [*Al Bukhari*’s] superior by some, its equal by others, and second to it by most”. Moreover, the choice of these two books may be justified on the basis that they are considered authoritative sources of *Sunnah* in the country of study—the UAE. In addition, these texts were chosen because they include all the topics of Islam and are not limited to particular topics (Al Shami, 2007). The analysis is limited to these two books since it is beyond the scope of this study to be comprehensive and analyse all the Prophetic traditions.

The analysis of the Prophetic traditions in these two books is performed using a condensed version of *Al Saheehayn* compiled by Al Shami (2007) entitled *Al Wafee Be Ma Fe Al Saheehayn*. Although it is a condensed version, it contains all the core material of *Al Saheehayn*. The methodology followed by Al Shami (2007) was to eliminate the repetitions and choose the most comprehensive narration in case there is more than one narration of the same *hadith*. Therefore, all the main narrations have been included in this compilation. In total, there are 1929 *hadiths* in this book to be

examined to identify the *hadiths* that are relevant to economics and monetary transactions.

After conducting an analysis of the 1929 *hadiths*, 206 *hadiths* matched the selection criteria—that is they are on the topic of economics and monetary transactions. Each of these 206 *hadiths* is considered as a unit of analysis and will be subject to the *maqasidic* analysis.

7.4.1.3 Identifying units of analysis for the *maslahah* dimension

In addition to using the Prophetic traditions as a reference source for the *Sunnah* dimension, it will also be used as the data source for the *maslahah* dimension. This is because, as explained before, the indicator of the *maslahah* dimension relates to the comprehensiveness of the *maqsid*; the greater the comprehensiveness, the greater intrinsic value. One of the denotations of the comprehensiveness of a *maqsid* is its application in the different topics of Islamic law. That is, the more the topics the *maqsid* has applications in, the more comprehensive the *maqsid* is. Therefore, the *maqsid* will have more weight since it has a greater impact.

In order to measure the comprehensiveness of a *maqsid*, this study has proposed a mechanism based on the notion of comprehensiveness. To operationalize this idea, the *Saheehayn* were chosen, and more particularly, the condensed version of Al Shami (2007). That is because the *Saheehayn* are divided into sub-chapters known as *abwab* plural and singular *bab*. These chapters cover the different topics of *Shariah*. Therefore, in order to judge the comprehensiveness of a *maqsid*, the study proposes that the greater number of *abwab* in which a *maqsid* is present—that is the more frequently it occurs—the more comprehensive is the *maqsid*. So, the method is to count the number of sub-chapters in which the unit of analysis can be derived from—the greater the number of sub-chapters in which the *maqsid* is found, the more comprehensive is the *maqsid*. For this indicator, the analysis is not limited to the topics that are concerned with economic transactions but is extended to all topics

because the aim is to examine the spread and dispersion of *maqasid* over the different topics. It is pertinent to note here that for this indicator, the units of analysis are the sub-chapters.

7.4.2 Results For The Quran And *Sunnah* Dimensions

The first two dimensions each have two indicators, the frequency of occurrence of the particular *maqsid*, and the interpretation and hermeneutics indicator which essentially examines the strength of the indication to the *maqsid*. Although these are two distinct indicators, they are very connected to each other and so the results of both indicators are multiplied to come up with one set of results. In the following subsections, the results for each indicator will be reported individually first and then the composite results will be presented.

7.4.2.1 Frequency of occurrence

This indicator applies to two dimensions; the Quran and the *Sunnah*. Therefore, each one has a distinct set of results. As for the Quran, the results of the analysis for this indicator are presented in Table 7.8. Note a single verse can allude to more than one *maqsid*. The results are presented beginning with the highest score.

Table 7.8: Frequency of Occurrence of *Maqasid* in the Quran

<i>Maqsid</i>	Justice	Circulation	Preservation	Persistence	Transparency
No. of Verses	189	172	62	13	9

The results show that the *maqsid* of justice, mentioned in 189 verses, achieved the highest frequency, while the *maqsid* of transparency is mentioned least, with 9 occurrences only.

Table 7.9 presents the results for the *Sunnah*.

Table 7.9: Frequency of Occurrence of *Maqasid* in *Sunnah*

<i>Maqsid</i>	Circulation	Justice	Preservation	Transparency	Persistence
<i>No. of Hadiths</i>	155	52	41	17	6

The results obtained show that circulation is in the first position followed by the *maqsid* of justice. The *maqsid* of persistence is at the bottom of the list with only 6 occurrences.

7.4.2.2 Interpretation and hermeneutics

The interpretation and hermeneutics indicator examines the strength of the indication to the *maqsid* in the particular unit of analysis—the Quranic verse or the *hadith*. There are five possible indications: the explicit, the alluded, the inferred, the required, and the divergent. That is to say, each unit of analysis indicates the *maqsid* with a specific degree of explicitness. Table 7.10 summarizes the results for the Quran dimension.

Table 7.10: Frequency Results for the Textual Indications of the *Maqasid* in the Quran

<i>MAQSID</i>	<i>INDICATION</i>				
	<i>E</i>	<i>A</i>	<i>I</i>	<i>R</i>	<i>D</i>
Circulation	28	144	0	0	0
Preservation	33	29	0	0	0
Persistence	2	11	0	0	0
Justice	27	162	0	0	0
Transparency	4	5	0	0	0

To clarify the results of Table 7.10, the results of the *maqsid* of circulation are used as an example. The *maqsid* of circulation was indicated in 28 verses with an explicit indication, and indicated in 144 verses with an alluded indication. However, it was not indicated in any verse with an inferred, required, or divergent indication. The same applies to the other *maqsid*.

Table 7.11 presents the results regarding the *Sunnah*.

Table 7.11: Frequency Results for the Textual Indications of the *Maqsid* in the *Sunnah*

MAQSID	INDICATION				
	E	A	I	R	D
Circulation	0	146	6	0	3
Preservation	3	38	0	0	0
Persistence	0	6	0	0	0
Justice	5	47	0	0	0
Transparency	3	14	0	0	0

7.4.2.3 Composite results

The composite results are the most significant results for the MSI. They are the product of multiplying the number of occurrences of a particular indication with its weight and then summing up all the indications for that *maqsid*. Table 7.12 reports the results for the Quran and Table 7.13 presents the results for the *Sunnah* dimension.

Table 7.12: Composite Results for *Maqsid* in the Quran

<i>Maqsid</i>	Justice	Circulation	Preservation	Persistence	Transparency
Result	783	716	281	54	40

As shown in Table 7.12, the *maqsid* of justice scores highest followed by the *maqsid* of circulation. The *maqsid* of preservation follows whereas the *maqsid* of transparency and persistence both score very low results.

Table 7.13: Composite Results for *Maqasid* in the *Sunnah*

<i>Maqsid</i>	Circulation	Justice	Preservation	Transparency	Persistence
Result	605	213	167	71	24

Unlike the results of the Quran dimension, the *maqsid* of circulation scores highest with a considerable difference between it and the *maqsid* of justice. In addition the *maqsid* of preservation is relatively close to the *maqsid* of justice. Again, both the *maqsid* of transparency and persistence both score very low results.

7.4.3 Results for The *Maslahah* Dimension

The inherent *maslahah* dimension, which indicates the impact of the *maqsid*, has one indicator; the comprehensiveness of the *maqsid*. As indicated earlier, the comprehensiveness of a *maqsid* denotes the extent to which the *maqsid* is realized in the different topics of Islam. The more topics the *maqsid* has applications in, the more comprehensive is the *maqsid*. The results for this examination are in Table 7.14.

Table 7.14: Frequency of Occurrence of *Maqasid* in Different Topics

<i>Maqsid</i>	Circulation	Preservation	Persistence	Justice	Transparency
Number of Sub-Chapters	213	35	6	43	13

7.4.4 Normalization, Aggregation And Computation

In this section, the results obtained from the indicators will be normalized and aggregated in order to come up with the MSI. The process for calculating the results for the MSI includes four stages: 1) recording the original results; 2) normalizing the results by dividing the result by the highest value in order to obtain a number between 0 and 1; and 3) multiplying the normalized value with the weight of the indicator; and 4) aggregating the results from the indicators to compute the final MSI.

7.4.4.1 Circulation

Table 7.15 summarises the results for the *maqsid* of circulation.

Table 7.15: Calculations for The *Maqsid* of Circulation

Dimension	Indicators	Score	Normalized score	MSI
Quran (1/3)	Frequency * Interpretation	716	0.9144	0.3074
Sunnah (1/3)	Frequency * Interpretation	605	1	1/3
Maslahah (1/3)	Comprehensiveness	213	1	1/3

The calculation was carried as follows. The *maqsid* of circulation scored 716 for the Quran dimension. This was the product of multiplying the weight of each indication—explicit (5), alluded (4), inferred (3), required (2), divergent (1)—with the number of occurrences; its frequency. Then the results for all the indications were summed up—this gave a total of 716. The next step was to normalize this value. This was achieved by dividing it with the highest observed value, which is 783—scored by the *maqsid* of justice—as presented in Section 7.4.2.3. The result was 0.9144. This number was then multiplied by 1/3 in order to give a value between 0 and 1/3 which is

the maximum weight of the indicator. The resultant was 0.3074. The same process was repeated with the *Sunnah* dimension.

As for the *maslahah* dimension, there is one indicator, the comprehensiveness of the *maqsid*. The *maqsid* of circulation scored 213. Then this score was normalized by dividing it by the highest possible score, which is also 213 since the *maqsid* of circulation achieved the highest score. Therefore, $213/213= 1$. This was then multiplied with 1/3 in order to give a value between 0 and 1/3. The result was 1/3.

Following this, all the four scores from the three dimensions were aggregated. Therefore, the MSI for circulation = $(0.3074+ 1/3 + 1/3)= \mathbf{0.9740}$

The same procedure was repeated with the remaining *maqsid*.

7.4.4.2 Preservation

Table 7.16 summarises the results for the *maqsid* of circulation.

Table 7.16: Calculations for the *Maqsid* of Preservation

Dimension	Indicators	Score	Normalized score	MSI
Quran (1/3)	Frequency * Interpretation	281	0.3589	0.1196
Sunnah (1/3)	Frequency * Interpretation	167	0.2760	0.0920
Maslahah (1/3)	Comprehensiveness	35	0.1643	0.0548

Therefore, the MSI for preservation = $(0.1196+ 0.0920+0.0548)= \mathbf{0.2664}$

7.4.4.3 Persistence

Table 7.17 summarises the results for the *maqsid* of persistence.

Table 7.17: Calculations for the *Maqsid* of Persistence

Dimension	Indicators	Score	Normalized score	MSI
Quran (1/3)	Frequency * Interpretation	54	0.0690	0.0230
Sunnah (1/3)	Frequency * Interpretation	24	0.0397	0.0132
Maslahah (1/3)	Comprehensiveness	6	0.0282	0.0094

Therefore, the MSI for persistence = $(0.0230 + 0.0132 + 0.0094) = \mathbf{0.0456}$

7.4.4.4 Justice

Table 7.18 summarises the results for the *maqsid* of justice.

Table 7.18: Calculations for the *Maqsid* of Justice

Dimension	Indicators	Score	Normalized score	MSI
Quran (1/3)	Frequency * Interpretation	783	1	1/3
Sunnah (1/3)	Frequency * Interpretation	213	0.3521	0.1173
Maslahah (1/3)	Comprehensiveness	43	0.2019	0.0673

Therefore, the MSI for justice = $(1/3 + 0.1173 + 0.0673) = \mathbf{0.5179}$

7.4.4.5 Transparency

Table 7.19 summarises the results for the *maqsid* of transparency.

Table 7.19: Calculations for the *Maqsid* of Transparency

Dimension	Indicators	Score	Normalized score	MSI
Quran (1/3)	Frequency * Interpretation	40	0.0512	0.0171
Sunnah (1/3)	Frequency * Interpretation	71	0.1174	0.0391
Maslahah (1/3)	Comprehensiveness	13	0.0610	0.0203

Therefore, the MSI for justice = (0.0171+ 0.0391+ 0.0203) = **0.0765**

To sum, Table 7.20 presents the final MSI for the five *maqsid*.

Table 7.20: Comparative MSI Results

MAQSID	CIRCULATION	JUSTICE	PRESERVATION	TRANSPARENCY	PERSISTENCE
MSI	0.9740	0.5179	0.2664	0.0765	0.0456

The results in Table 7.20 show that the *maqsid* of circulation scored highest with 0.9740 out of 1. The *maqsid* of justice follows with 0.5179. Next is the *maqsid* of preservation. Finally, both the *maqsid* of transparency and persistence score 0.0765 and 0.0456 respectively.

7.5 CONCLUSION

The aim of this chapter was to weigh the five *maqasid* of economic activity. In achieving this, the chapter developed a generic index for measuring the intrinsic weights of the *maqasid*. The index followed a multi dimensional approach. The chosen dimensions were the ontological sources and benefit, *maslahah*. Each dimension was further split into indicators. A weighing scheme was identified and the calculation process delineated. The index was then applied to examine the five *maqasid*—circulation, preservation, persistence, justice, and transparency. The results showed that circulation is the most significant *maqsid*, followed by justice. On the bottom of the hierarchy was the *maqsid* of persistence. The results obtained are not only important for the examination of the realisation of *maqasid al Shariah*, but can also be benefited from in understanding the grounding of the *maqasid* in the core sources—the Quran and *Sunnah*.

Having identified the analytical framework for this study, the thesis now turns to the empirical investigation in the following chapters.

CHAPTER 8

CASE STUDY 1: THE *MUDARABAH* CONTRACT

8.1 INTRODUCTION

Following the critical literature review and the development of the analytical frameworks, this chapter commences the empirical part of the research. In this chapter, the *mudarabah* contract will be examined in detail from both the *Shariah* and *maqasid* perspectives using the frameworks developed in Chapters 6 and 7. There are four main components to this chapter:³³ 1) Examining the compliance of the contract with the AAOIFI (2010) *Shariah* Standards; 2) identifying the *Shariah* compliance of the contract. That is, judging the overall *Shariah* compliance of the contract and exploring the nature of that compliance if applicable;³⁴ 3) assigning the rulings to the *maqasid* they fulfil and providing a justification for this judgment; and 4) computing both the weighted and non-weighted scores of the *maqasid* achievement of the case study.

The chapter is organised as follows: Section 8.2 provides an outline of the transaction. Section 8.3 presents the *Shariah* examination, followed by Section 8.4 with the *maqasid* analysis. The chapter concludes with main remarks in Section 8.5.

8.2 OUTLINE OF THE TRANSACTION

The *mudarabah* contract to be studied consists of two main documents: the *Mudarabah* Agreement and the Purchase Undertaking.

³³ This will also be applied to the following case study chapters.

³⁴ The phrase 'if applicable' is used as the contract might not be compliant with *Shariah* in the first place.

The *Mudarabah* Agreement

The body of this agreement consists of three main sections after the title page, brief introduction, and identification of the parties. These sections are the Recitals; the Definitions, and Interpretation; and the main articles, which consist of article 2 (Nature and Scope of *Mubarabah*) through to article 26 (Settlement of Disputes and Jurisdictions). The main articles are followed by Schedule 1, the Investment Plan, and Schedule 2, the *Mudarabah* Termination Notice as well as the Execution Page.

The Purchase Undertaking

This is a secondary document since it is applicable only in cases where there is an Exercise Event that corresponds to an Event of Default as defined in the main *Mudarabah* Agreement.

The document consists of three sections after the title page and identification of the parties. These are the Recitals; Definitions, and Interpretation; and the main articles, which consist of article 2 (Undertaking) through to article 8 (The Settlement of Disputes and Jurisdiction). Schedule 1, the Form of Exercise Notice, and Schedule 2, the Form of Sale Agreement, and the Execution Page follow the main articles.

8.3 SHARIAH ANALYSIS

The first phase of the analysis is the *Shariah* compliance analysis. In examining the *Shariah* compliance of the contract, first, the necessary rulings have to be identified. Next, the contract is examined and scores allocated. This is then substantiated and discussed.

8.3.1 Identification Of Benchmark Rulings

According to the analytical framework developed in Chapter 6, the contracts will be subject to two levels of analysis. At one level, the contracts will be examined against the AAOIFI (2010) *Shariah* Standards. At the second level, the analysis is extended to the wider Islamic law and a *Shariah* compliance approach is identified. Hence, the relevant rulings—those that establish the benchmarks—have to be identified.

In the AAOIFI (2010) *Shariah* Standards, the standard on *mudarabah* had to be initially classified into required rulings, conditionally required rulings, and neutral rulings. The essential required rulings are presented in Appendix A1. All the required rulings are essential and should be present in or, in other words, satisfied, in the examined contract. The conditionally required rulings, on the other hand, differ from contract to contract and do not apply to every *mudarabah* transaction. Therefore, the essential step here was to examine the contract under investigation to ascertain which of the conditionally required rulings were applicable. The examination has been undertaken and the applicable rulings are set out in Appendix A2. It was found that the *mudarabah* transaction under study had to satisfy three conditionally required rulings in addition to 27 required rulings. Overall, it can be said that all those rulings are now required; the conditionally required rulings now become required because they apply to the contract. This procedure will be carried out for all case studies.

As for the second level of analysis, two categories of rulings had to be identified; the rulings on which there is a consensus, and the rulings on which there is a majority opinion. These will be discussed as appropriate in Section 8.3.2.2.

8.3.2 Results

8.3.2.1 Compliance with AAOIFI standards

The contract under investigation scored 81.7% in terms of compliance with the AAOIFI Standards as reported in Table 8.1.

Table 8.1: Mudarabah Contract Shariah Analysis Results

Number	Ruling Reference	Maximum Score	Actual Score
REQUIRED RULINGS			
1	4.1	1	1
2	4.2	1	1
3	4.3	1	-1
4	4.3 (a)	1	0.5
5	4.4	1	1
6	5	1	1
7	7.1 (1)	1	1
8	7.2	1	1
9	7.3	1	1
10	7.4	1	1
11	8.1 (1)	1	1
12	8.1 (2)	1	-0.5
13	8.2 (1)	1	1
14	8.3	1	1
15	8.6	1	1
16	8.7	1	1
17	8.8	1	1
18	9 (1)	1	1
19	9 (2)	1	1
20	9.3 (1)	1	1
21	9.3 (2)	1	1
22	9.5	1	1
23	9.6	1	1
24	10.1	1	1
25	10.1 (d)	1	0
26	10.1 (e)	1	1
27	10.2	1	1
APPLICABLE CONDITIONALLY REQUIRED RULINGS			
28	4.3 (b)	1	1
29	8.9	1	1
30	9.7	1	0.5
TOTAL		30	24.5
			81.7%

The score was calculated as follows: in total, there were 30 required rulings that had to be satisfied; 25 were satisfied in the contract while five were not. Out of these five, one ruling was contradicted and hence scored -1; one ruling was partially contradicted and so it scored -0.5; two rulings were diluted and therefore scored 0.5 each; and one ruling was omitted and hence scored 0.³⁵ Therefore, the contract scored 24.5 out of a possible maximum of 30. Consequently, the contract scored 81.7%. The results are explained in more detail and discussed in the following paragraphs under four headings: dilution, omission, partial contradiction, and direct contradiction.

Dilution

Regarding rulings 9.7 and 4.3 (a), the contract is not very specific on them and thus they have been placed in the diluted category.

Omission

Ruling 10.1 (d), which states that the *mudarabah* contract terminates when the funds of the contract have been exhausted completely, has not been stated in the contract, and, thus, falls under the omitted rulings category.

Partial Contradiction

Ruling 8.1 (2), which states that the distribution of profits must be on the basis of an agreed percentage of the profits and not on the basis of a lump sum or a

³⁵ This is based on the five-fold scoring scheme developed in Chapter 6.

percentage of the capital, has been partially contradicted. No clause in the contract explicitly violates this requirement and, moreover, there are clauses stating that the distribution of profits is on the basis of a percentage of the profits. However, the researcher maintains the position that this requirement has been at least partially, if not completely, contradicted. This is because there are certain clauses implying that the bank should receive a set amount of profit and this resembles the stipulation of a lump sum. For example, Clause 4.2 of the contract holds the *mudarib* responsible for properly executing the *mudarabah* to achieve the projected results:

...the mudarib shall be fully responsible for properly executing the mudarabah in order to achieve the financial results projected by it in the Investment Plan.

This can be considered an indirect contradiction since a *mudarib* cannot be held responsible for achieving the projected results and profits. He is only responsible for carrying out the *mudarabah* as would be expected from his peers in custom, *urf*, and *urf* will differ from time to time and place to place—it is relative.

On a clearer note, clause 8.3 of the contract provides a form of contradiction of ruling 8.1 (2). It states that

In respect of any Profit Distribution Date, if the net asset value of the Mudarabah shows that the Mudarabah Profit payable for such period is equal or more than the threshold... and Rab-ul-Maal share in the Mudarabah Profit... in respect of any Profit Distribution Date... is more than the Threshold, then Rab-ul-Maal shall be paid its share of the profit up to the Threshold and the surplus (the 'Surplus Profit') will be used as a reserve for the purpose of future Mudarabah Profit distributions and shall be credited into an Mudarabah Profit reserve account (the 'Profit Reserve Account').

Although the aforementioned clause does not directly contradict ruling 8.1 (2) since it does not stipulate the allocation of a lump sum, this issue can be looked at from a different perspective. That is, the distribution of profit is required to be a percentage of the profit and the word 'profit' here is absolute. According to this

clause, however, there is a certain threshold and cap on the profit distribution. Hence, the distribution of profit is not absolute. This does not necessarily violate *Shariah* requirements; on the contrary, some scholars approve it. Nonetheless, it is presented here to help build the whole picture, which turns out to be, as will be shown, essentially not *Shariah* compliant.

The essential issue in this clause is in the case where the net asset value of the *mudarabah* shows that the *rab ul mal* entitlement is less than the threshold. It states that:

...if the net asset value of the Mudarabah shows that the RM Entitlement is less than the Threshold (being the 'Shortfall'), then in respect of any Profit Distribution Date, the amounts standing to the credit of the Profit Reserve Account shall be utilised to meet the Shortfall so that the RM Entitlement is as per the Threshold.

The problem here is that it emphasises the fact that the *rab ul mal* is guaranteed a fixed return, so it is similar to requesting a lump sum and, in this sense, violates ruling 8.1 (2). In addition, it is apparent that this is to the benefit of the *rab ul mal*, which in this case is the financial institution. To make this clear, the clause only refers to a situation in which the *rab ul mal* entitlement is less than the threshold and does not make any reference to the *mudarib*. In other words, there is no clause stating that if the *mudarib*'s entitlement is below a certain threshold then he is entitled to compensation from the profit equalisation reserve.³⁶ This raises issues regarding equality in the contract and its structure that benefits one party over the other, in this case the *rab ul mal* (the IFI).

The issue becomes even more apparent in situations where there are insufficient funds available in the profit reserve account to ensure the payment to the *rab ul mal* as per the threshold. The clause states that, in this case,

³⁶ It may be argued here that the *mudarib* does not contribute any money and thus does not face any risk. However, the *mudarib*'s contribution is the labour and it is, in the final analysis, a type of contribution similar to that of the *rab ul mal*.

...then [the Customer] (in his personal capacity) shall utilise his own funds on an 'on-account basis' to meet the Shortfall.

Thus, according to the clause, the *mudarib* shall utilise his own funds to meet the shortfall on an 'on-account' basis. This means that at the end of the *mudarabah*, any on-account payments paid by the *mudarib* shall be repaid back to him.

However, if the *mudarabah* funds have been exhausted, or if the *mudarabah* suffers a total loss and there are no amounts payable to the *rab ul mal*, then how will the *mudarib* be compensated? The contract provides no answer for this issue. Therefore, it can be concluded that the contract is designed in such a way that the *rab ul mal* guarantees a certain amount, which is similar to stipulating a lump sum. In addition, the contract gives an advantage to one of the parties over the other. Hence, the clauses mentioned here fall under the partial contradiction category.

Direct Contradiction

Ruling 4.3 of AAOIFI standards, which states that a *mudarabah* contract is not binding unless the *mudarib* has already commenced the business as stated in ruling 4.3 (a), is contradicted by clause 14.6.2 of the contract, which states that

...the obligations existing and created under this Agreement and under the Investment Plan: ...14.6.2 shall constitute valid and binding obligations upon them shall, at all times, be validly enforceable against them

The main reason for non-compliance is that this clause states that the obligations are binding 'at all times'. This is clearly a contradiction and thus falls under the direct contradiction category.

In conclusion, it has to be noted that although the contract scored 81.7%, this does not suggest that it is absolutely valid. This is merely a measure to show the extent of compatibility with AAOIFI (2010) Standards, although, obviously, a contract scoring,

for example, 90% is ‘more acceptable’ than one scoring 60%. Thus, this represents a degree of compliance rather than the existential issue of legality.

8.3.2.2 Identifying the overall *Shariah* compliance

In Chapter 6, three *Shariah* compliance approaches were identified: the *ijmaa* approach; the majority approach; and the liberal approach. The aim of this section—following the examination of the compliance with the AAOIFI—is to explore under which approach, or strategy, the examined contract can be classified. To achieve this, the framework devised in Chapter 6 has to be applied. The rules of classification procedure developed previously includes a number of questions. The first question in the sequence is the following:

A: Is there any ruling in the contract that violates ijmaa?

If yes, the contract is not valid in Shariah.

If no, go on to B.

According to Abu Habib (1997), there are five rulings relevant to this transaction on which there is *ijmaa*:

- i) the distribution of profit must be on the basis of an agreed percentage of the profit and not on the basis of a lump sum or a percentage of the capital;
- ii) both parties should possess the legal capacity to appoint agents and accept agency;
- iii) the *mudarabah* contract becomes binding when the *mudarib* has commenced the business;
- iv) it is not permissible for the *mudarib* to make a loan, gift, or charitable donation out of the *mudarabah* funds; and
- v) the *mudarabah* contract is one of the trust-based contracts.

Therefore, an examination of the rulings that were not satisfied in the contract in question shows that there is consensus on one of them, ruling 8.1 (2). Violation of this ruling is not allowed under any doctrine of Islamic law.

Therefore, based on this, the answer to the following question is positive:

A: Is there any ruling in the contract that violates ijmaa?

This is because ruling 8.1 (2) is not satisfied and hence, the contract is not valid under Islamic commercial law.

In addition, there is one significant issue in this contract. It is that the whole transaction is similar in some ways to a conventional interest-bearing loan. This also stems from the violation of ruling 8.1 (2). This can be illustrated as follows. The bank is the *rab ul mal*; it is, therefore, akin to presenting the *mudarib* with a loan. The bank is expecting a fixed, guaranteed return on the money lent to the *mudarib*. Ultimately, then, it is as if the *rab ul mal* has provided the *mudarib* with a loan and wants the loan to be returned with a mark-up. This includes potential *riba*. Hence, all that is accomplished by this transaction is to replicate an interest-bearing loan under the title of *mudarabah*. This is a very important issue in this contract and it has to be taken into consideration.

The conclusion that this analysis has reached is that this contract does not satisfy all the AAOIFI requirements and, more importantly, it cannot be validated under Islamic commercial law since it is not possible to categorise it under any *Shariah* compliance strategy.

8.4 MAQASID ANALYSIS

The second part of the empirical investigation is the *maqasid al Shariah* analysis that aims to explore the *maqasid* underlying the rulings. This will enable the study to develop a more systematic understanding of the *maqasidic* component underlying the rulings and then apply this framework to examine the cases. The analysis involves two stages: identifying the *maqasid* and then assessing the *mudarabah* case study according to the criteria established.

8.4.1 Exploring The Underlying *Maqasid*: A Ratiocinative Approach

This section explores the *maqasid* underlying the *mudarabah* contract rulings in the AAOIFI (2010) *Shariah* Standard. The analysis is ratiocinative; it is based on rationales and justifications for assigning the rulings to the appropriate *maqsid/maqasid*.

The following format is used in presenting the analysis. The ruling is stated and then the relevant *maqsid/maqasid* is/are assigned along with the justification. The following codes are used for the *maqasid*: A= circulation; B=preservation; C= persistence; D= justice; and E= transparency.

8.4.1.1 Analysis

Required rulings

1. Ruling 4.1 *The contract formula must be stated. The Mudarabah contract may be concluded using terms such as Mudarabah, Qirad, or Muamala.*

C: An individual is entitled to what he owns and should not be deprived of his entitlements except with an expression that indicates his consent (Ibn Ashur, 2011; Al Mausily³⁷, 2002). Thus, stipulating a formula for the contract satisfies the *maqsid* of persistence of ownership by insuring that entitlements persist with their owners unless the owners express their intention of giving away their entitlements.

E: The formula indicates the individual's consent in a clear manner that leaves no place for disputes and thus eliminates *gharar* (Ibn Bayyah, 2010).

2. Ruling 4.2 *Both parties should possess the legal capacity to appoint agents and accept agency.*

B: Ibn Al Mundhir (1999) has stated in his book *Al Ijmaa* that jurists are unanimous on the ruling that an individual who cannot preserve his wealth should be prevented from access to his wealth in order to preserve his wealth for him. Therefore, the condition of legal capacity, which in essence ensures that an individual is capable of preserving and managing his wealth appropriately (Ibn Bayyah, 2010; Mustafa, 2013), fulfils the *maqsid* of preservation of wealth.

³⁷ D: 1203.

3. Ruling 4.3 *The general principle is that a mudarabah contract is not binding.*

C: *Mudarabah* is not binding by conclusion since this reverts to the notion of giving an option for the worker (Ibn Ashur, 2011). Giving the parties an option stems from the principle of freedom of contract, which manifests the *maqsid* of persistence (Ibn Zughaihah, 2010; Mustafa, 2013). This is because the principles of persistence of ownership and exclusiveness of property rights to the lawful owners of the property imply that owners should have the freedom to dispose what they have owned or earned, and entering into the *mudarabah* entails disposing capital (as in the case of the capital provider) and labour (as in the case of the *mudarib*).

4. Ruling 4.3 (a) *The mudarabah contract becomes binding when the mudarib has commenced the business.*

A: Bindingness in contracts promotes the circulation of wealth and encourages financial activity (Al Qarafee, 1994; Ibn Ashur, 2011). Therefore, terminating the contract after commencement frustrates the objective of making profits (AAOIFI, 2010) and circulation.

D: Terminating the *mudarabah* contract after the *mudarib* has commenced the work is not equitable for the *mudarib* and violates justice. This is because the *mudarabah* may not have achieved any profit yet and thus the *mudarib* will not receive any compensation for the work he has done (AAOIFI, 2010). Consequently, this ruling promotes the *maqsid* of justice.

5. Ruling 4.4 *A Mudarabah contract is one of the trust-based contracts.*

A: The fact that the *mudarib* is not liable except in the case of negligence satisfies the *maqsid* of circulation of wealth since it encourages people to engage in such contracts. This can be understood from Al Haitami (1996) when he stated that making an agent liable may lead to discouraging people from executing the agency contract. The same

applies to *mudarabah* since the *mudarib* is considered by scholars to be an agent of the *rab ul mal* (Al Buhooti³⁸, 1997; Haider, 2003).

B: The default in Islam is that money cannot be taken from someone without a legitimate and justified cause. Therefore, if the *mudarib* is held liable even if there was no negligence on his part, this will violate the *maqsid* of preservation of wealth since it involves taking someone's money without a just cause (Hamad, 2012).

D: Holding the *mudarib* liable in case of misconduct and negligence satisfies equity between both parties to the contract. This is because it is unjust and inequitable to hold the capital provider liable because of the *mudarib*'s misconduct and negligence.

6. Ruling 5 *The type of mudarabah must be stated.*

E: Identifying the type of *mudarabah* eliminates *gharar* and insures transparency.

7. Ruling 7.1 (1) *The nature of the mudarabah capital has to be mentioned in the contract. In principle, the capital of mudarabah must be provided in the form of cash or tangible assets.*

E: Identifying the type of *mudarabah* eliminates *gharar* and insures transparency.

8. Ruling 7.2 *The capital of mudarabah should be clearly known to the contracting parties and defined in terms of quality and quantity in a manner that eliminates any possibility of uncertainty or ambiguity.*

D: The profit is the surplus on the capital. Therefore, if the capital of the *mudarabah* is not known exactly, this may lead to an inequitable distribution of the profit since, consequently, the profit will not be identified exactly. Ibn Taimiyah (2004) asserted

³⁸ D. 1641 AD.

that there is a relationship between justice and the exact identification of the *mudarabah* capital.

E: Identifying the capital of *mudarabah* capital eliminates *gharar* and insures transparency.

9. Ruling 7.3 *It is not permitted to use a debt owed by the mudarib or another party to the capital provider as capital in a Mudarabah contract.*

A and D: The capital of *mudarabah* should not be a debt owed to the capital provider for two reasons. First of all, the *mudarabah* capital has to be available on the spot for the *mudarabah* operations and since a debt is a receivable, it fails to meet this requirement (AAOIFI, 2010). Thus, this may be an obstacle to achieving the objective of the *mudarabah* operations. Consequently, this ruling fulfils the *maqsid* of circulation of wealth, A, since it removes potential obstacles to economic activity.

The second reason for this ruling is that considering a debt to be the capital of *mudarabah* may involve potential *riba*. This is because the creditor may have extended the term of the debt in order to get additional consideration from the debtor (AAOIFI, 2010). Having identified that potential *riba* is the second rationale for this ruling, it is important to examine the *maqsid* for the prohibition of *riba*.

There is a plethora of literature on the rationale for this prohibition. However, one of the most frequently articulated rationales on the prohibition of *riba* is that *riba* violates the core Islamic *maqsid* of equity and justice through economic exploitation (Ibn Taimiyah 2004; El Gamal, 2006; Iqbal and Mirakhor, 2007). Therefore, prohibiting *riba* eliminates one of the main causes of inequalities and the unequal distribution of resources. In a nutshell, *riba* violates equity and justice since creditors would otherwise get credit for ultimately providing nothing in exchange. Therefore, this ruling leads to justice, D, through preventing *riba*.³⁹ In addition, *riba* stagnates the

³⁹ According to Al Huqail (2011), the basis for this ruling, as maintained by the majority of jurists, is that it violates the legal maxim of *al ghurm bil ghunm*, entitlement to gain requires taking the responsibility for any accompanied risks. This is because if the debt is owed by the *mudarib* to the capital provider, the debt is the responsibility of the *mudarib* (debtor) until it is returned to the capital

economy and hinders the circulation of wealth (Ibn Bayyah, 2010). Hence, the prohibition of *riba* promotes the circulation of wealth, A.

10. Ruling 7.4 *For a Mudarabah contract to be valid and for the mudarib to be considered as having control over the capital, the capital must be, wholly or partially, put at the disposal of the mudarib, or the mudarib must have free access to the capital.*

A: The *Shariah* aims at circulating wealth by removing all obstacles to trade (Ibn Ashur, 2011). Giving the *mudarib* free access to the capital enhances this *maqsid*.

11. Ruling 8.1 (1) *It is a requirement that the mechanism for distributing profits must be clearly known in a manner that eliminates uncertainty and any possibility of dispute.*

E: Identifying the mechanism for profit distribution eliminates *gharar* and disputes and ensures transparency.

12. Ruling 8.1 (2) *The distribution of profits must be on the basis of an agreed percentage of the profits and not on the basis of a lump sum or a percentage of the capital.*

A: The distribution of profits should not be on the basis of a lump sum since this is not “consistent with the sharing of profit. This is because the *mudarabah* operation may not realise a profit other than the lump sum which goes to one party, thus excluding the other party from partnership in profit” (AAOIFI, 2010: 246). Therefore, this arrangement does not allow the circulation of wealth in the hands of as many people as possible and thus it contradicts one of the features of the *maqsid* of

provider (creditor). Consequently, if the debt is used as the capital for the *mudarabah*, and profit is made, then the capital provider will be considered as being entitled to gain without taking responsibility for the accompanied risks.

circulation (Ibn Ashur, 2011). In addition, if the *mudarib* is entitled to a lump sum, then he may not be encouraged to employ all his efforts to turn a profit and thus the *maqsid* of circulation (Al Rafee⁴⁰, 1997), which implies the exertion of best efforts to promote wealth, would not be satisfied.

D: The distribution of profits on a lump-sum basis violates the *maqsid* of justice, since one of the parties may not be compensated for his work or capital contribution and this is not equitable (Al Rafee, 1997). Ibn Taimiyah (2004) has also stated in his *Fatawa* that allocating a lump sum violates justice.

Moreover, distributing profits on the basis of a lump sum has been considered by the International Islamic *Fiqh* Academy (2003) to contradict the maxim of ‘entitlement to gain requires taking the responsibility for any accompanied risks’. This is because allocating a lump sum means that the party who receives it will receive the agreed-upon amount irrespective of any risks.

It is important, therefore, to contemplate the *maqasid* of this maxim. Al Huqail (2011), in his detailed study of this maxim, asserts that the *maqasid* of this maxim are, *inter alia*, the promotion of wealth, A, and the achievement of justice, D. This legal maxim promotes wealth since it encourages the circulation of wealth because it implies that an asset has to be possessed by its trader before being sold and this insures that there is real economic activity and that real assets are being exchanged. The maxim also promotes justice since justice implies that he who benefits from the profit should be made liable for the accompanying risks. It is not equitable that one party receives the credit and profit whilst the other party is held liable for the risks.

E: Ibn Qudama (1999) has asserted that allocating a lump sum for one party leads to *gharar*. This is possibly because of the uncertainty accompanying the profit share of the other party that has not been allocated a lump sum. This can also be a source of disputes.

Hence, prescribing this ruling promotes A, D, and E.

⁴⁰ D: 1226 AD.

13. Ruling 8.2 (1) *In principle, it is not permissible to earn a share of profit in addition to a fee in a Mudarabah contract.*

A, D and E: Earning a share of profit in addition to a fee is similar to allocating a lump sum (AAOIFI, 2010). Thus, the same justification for ruling 8.1(2) applies here.

14. Ruling 8.3 *The parties should agree on the ratio of profit distribution when the contract is concluded.*

E: A prior agreement on the ratio of profit distribution eliminates *gharar* and insures transparency.

15. Ruling 8.6 *It is not permissible for the capital provider to give the mudarib two amounts of capital on condition that the profit earned on one of the two amounts would be taken by the mudarib while the capital provider would take the profit earned on the other amount. It is also not permissible for the capital provider to state that the profit of one financial period would be taken by the mudarib and the capital provider would take the profit of the following financial period. Similarly, it is not permissible to assign the profit from a particular transaction to the mudarib and the profit from another transaction to the capital provider.*

A and D: Giving the *mudarib* two amounts of capital on the condition that each party will gain the profit on one of the two amounts precludes “the sharing of profit and may potentially lead to one party being wrongfully deprived of his rights” (AAOIFI, 2010: 247). This is because a profit may be realised on one of the amounts and thus only one party will receive a profit. Therefore, this violates circulation since the capital will not be circulated and will be limited to one of the contracting parties.

In addition, the *maqsid* of justice is violated since the *mudarib* may not be compensated for his work and the capital provider may not be compensated even though he provided the capital. Thus, this ruling leads to the realization of A and D.

E: Al Qarafee (1994) has stated that this is prohibited since it leads to *gharar*. This can be attributed to the uncertainty regarding the profit distribution as well as the potential disputes.

16. Ruling 8.7 *No profit can be recognised or claimed unless the capital of the Mudarabah is maintained intact.*

B: The profit is considered by jurists as protecting the capital (Al Zuhayli, 1984) and therefore no profit is realised unless the capital is intact. Thus, this ruling protects the money of the *rab ul mal*.

17. Ruling 8.8 *The mudarib is entitled to a share of profit as soon as it is clear that the operations of the Mudarabah have led to the realization of a profit. However, this entitlement is not absolute, as it is subject to the retention of interim profits for the protection of the capital. It will be an absolute right only after distribution, i.e., when actual or constructive valuations take place.*

A: The *Shariah* aims at the circulation of wealth (Ibn Ashur, 2011) and thus the *mudarib* is entitled to his share as soon as the profits are realised.

B: In order to protect the capital, the entitlement of the *mudarib* to the profit is not absolute (AAOIFI, 2010). If it was absolute, then the *mudarib* would be able to exercise his entitlement to the profit without insuring that that the capital, which is the right of the capital provider, was kept intact.

D and E: Actual/constructive valuation eliminates *gharar* and leads to an equitable distribution.

18. Ruling 9 (1) *The mudarib should employ his best efforts to accomplish the objectives of the Mudarabah contract. The mudarib should assure the capital provider that his money is in good hands.*

A: The objective of *mudarabah* is wealth promotion (Al Juwaini, 2011) and thus the *mudarib* is obliged to employ best efforts to achieve this objective.

B: When the *mudarib* employs best efforts in accomplishing his duties, this ensures that the capital will be protected.

19. Ruling 9 (2) *The mudarib will act to find the best ways of investing in a permissible manner.*

D: Investment should be permissible and lawful since equity and justice imply acquiring wealth lawfully (Ibn Ashur, 2011).

20. Ruling 9.3 (1) *The capital provider is not permitted to stipulate that he has a right to work with the entrepreneur (mudarib) and to be involved in selling and buying activities, or supplying and ordering.*

A: Restricting the actions of the *mudarib* obstructs the achievement of the goals of *mudarabah* and hence contradicts the objective of wealth circulation.

21. Ruling 9.3 (2) *The capital provider is not entitled to lay down conditions that will restrict the movements or actions of the mudarib.*

E: Al Qarafee (1994) has stated in *Al Dakheerah* that if the capital provider stipulates that he has a right to work with the *mudarib* this may lead to *gharar* since it increases the uncertainty of the work to be done by the *mudarib*. In other words, the work of the *mudarib* has, by default, uncertainty and if the *rab ul mal* requires the *mudarib* to work with him, this may add to the uncertainty of the *mudarib*'s work.

22. Ruling 9.5 *The mudarib is not entitled to sell items for the Mudarabah operation at less than the common or market price, or to buy items for the Mudarabah operation at a price higher than common prices, unless such action in either case is intended to achieve an objective that is obviously in the interest of the Mudarabah.*

A: The *Shariah* aims at removing all obstacles to trade in order to promote circulation and thus the *mudarib* is permitted to undertake such actions, which are in principle prohibited, if they are in the interest of the *mudarabah*.

B: The *mudarib* is not entitled to sell at less or buy at higher than the common market prices since such actions may lead to the loss of the *mudarabah* capital. Therefore this ruling preserves the capital of the *rab ul mal*.

23. Ruling 9.6 *It is not permissible for the mudarib to make a loan, gift, or charitable donation out of the Mudarabah funds. Likewise, the mudarib is not entitled to waive a right associated with the Mudarabah operation unless the capital provider has consented to his doing so.*

B: Giving a loan or gift out of the *mudarabah* funds may involve potential loss to the capital provider (AAOIFI, 2010). Therefore, this ruling preserves the capital of the *rab ul mal*.

C: An individual has the exclusive right to what he owns (Ibn Ashur, 2011) and thus the *mudarib* needs the consent of the *rab ul mal* to waive rights associated with the *mudarabah*. Hence, the *maqsid* of persistence is achieved.

24. Ruling 10.1 *The way/mode for termination of the mudarabah must be mentioned in the contract.*

E: Stating the mode of termination ensures transparency.

25. Ruling 10.1 (d) *The contract terminates when the funds of the mudarabah contract have been exhausted completely.*

B: Terminating the contract when the *mudarabah* funds have been exhausted will urge the *mudarib* to be more careful with the *mudarabah* capital because if he does not preserve the capital then the *mudarabah* will be terminated. Therefore, from this perspective, B is satisfied.

26. Ruling 10.1 (e) *The contract terminates by death of the mudarib or liquidation of the institution that acts as the mudarib.*

B and C: According to Al Kasani⁴¹ (2000), Al Mirghinani⁴² (1999), Al Ramli⁴³ (1993), and Al Zuhayli (2003), death contradicts the required legal capacity. Therefore, terminating the contract by death and liquidation can be assigned the same *maqsid* as ruling 4.2—preservation. In addition, the *maqsid* of persistence, C, applies here.

27. Ruling 10.2 *On the maturity of a mudarabah operation, the assets shall be subject to the liquidation process.*

D and E: The liquidation process ensures an equitable and transparent mechanism for the distribution of wealth.

⁴¹ D: 1191 AD.

⁴² D: 1197 AD.

⁴³ D: 1596 AD.

Conditionally required rulings

28. Ruling 4.3 (b) *When the contracting parties agree to determine a duration for which the contract will remain in operation, the contract cannot be terminated prior to the end of the designated duration, except by mutual agreement.*

A: Terminating the contract before the agreed-upon duration frustrates the objective of promoting wealth. Thus, justification for 4.3 (a) applies here.

C: The contract cannot be terminated before the agreed-upon condition except with mutual agreement, since conditions are binding and parties to contracts must to fulfil their contractual obligation (Ibn Ashur, 2011). According to Al Kasani (2000), conditions set by the contracting parties are to be kept intact as much as possible. This satisfies the *maqsid* of persistence since the set period is an entitlement and a right for each party and this right cannot be withdrawn except with the consent of the right holder.

D: Justification for 4.3 (a) applies here since the *mudarabah* may have not realised any profit at the time of termination.

29. Ruling 8.9 *If the mudarib has commingled his own funds with the Mudarabah funds, the mudarib becomes a partner in respect of his funds and a mudarib in respect of the funds of the capital provider. The profit earned on the two commingled funds will be divided in proportion to the amounts of the two funds, in which case the mudarib takes the profit attributable to his own funds, while the remaining profit is to be distributed between the mudarib and the capital provider according to the provisions of the Mudarabah contract.*

B and D: The profit has to be divided in proportion to the amounts of the two funds in the case of a commingled *mudarabah* in order to ensure an equitable distribution of the profit of each fund. This satisfies the *maqsid* of justice since it ensures that the *mudarib*, for example, will not receive profits he is not entitled to receive. In addition,

this segregation of funds ensures that the rights of each party are protected and preserved, thus satisfying the *maqsid* of preservation of wealth.

E: The *mudarib* is given two distinct statuses to ensure transparency in roles and profit allocation.

30. Ruling 9.7 *If there is no agreement on the right of the mudarib to receive living expenses from the mudarabah capital, then the mudarib should take living expenses in accordance with custom and reason. The mudarib is also entitled to travel expenses in accordance with custom and reason.*

A: To promote circulation, the *mudarib* is entitled to living and travel expenses to provide him with the necessary means for achieving the objectives of the *mudarabah*.

B: The *mudarib* is entitled to living and travel expenses according to custom and reason since this ensures the sanctity of the capital provider's money and protects it from being taken without right.

8.4.1.2 Standard results

Based on the analysis in the previous section, the standard results are computed. These are the highest possible results that the *mudarabah* contract under investigation can achieve. The process is summarised in the following points:

- i. Each ruling is assigned its relevant *maqsid/maqasid*.
- ii. The score for each *maqsid* follows the score of the corresponding ruling according to the fivefold scoring scheme developed in Chapter 6. For example, if the ruling had scored 1, the *maqsid* also scores 1. If, however, the ruling scores 0.5, then the *maqsid* scores 0.5.
- iii. For each individual *maqsid*, the total score is generated by adding the scores of all the rulings fulfilling that *maqsid*.

- iv. A total score is awarded for the whole contract by adding the scores for all the individual *maqasid* to derive an aggregate.
- v. The final index is then calculated as the ratio of the awarded score to the maximum possible score.
- vi. To derive weighted results, the same process is repeated and the results of each *maqasid* are multiplied by its weight.

The following example illustrates this procedure: Ruling 4.4 of the *mudarabah* contract is assigned the *maqasid* of circulation. Hence, the first step is to examine the status of ruling 4.4 according to the scoring scheme devised in Chapter 6. For this particular example, ruling 4.4 has been stated explicitly and thus scores 1. Consequently, the *maqasid* of circulation scores one multiplied by its weight—i.e., the weight devised in Chapter 7. Accordingly, all the *maqasid* will be quantified using this procedure.

Table 8.2 provides the standard results in the form of a matrix.

Table 8.2: Matrix for The Standard *Mudarabah* Results

	MAQASID	CIRCULATION	PRESERVATION	PERSISTENCE	JUSTICE	TRANSPARENCY	TOTAL
	<i>Ruling Reference</i>	A	B	C	D	E	
Required Rulings							
1	4.1			1		1	2
2	4.2		1				1
3	4.3			1			1
4	4.3 (a)	1			1		2
5	4.4	1	1		1		3
6	5					1	1
7	7.1 (1)					1	1
8	7.2				1	1	2
9	7.3	1			1		2
10	7.4	1					1
11	8.1 (1)					1	1
12	8.1 (2)	1			1	1	3
13	8.2 (1)	1			1	1	3
14	8.3					1	1
15	8.6	1			1	1	3
16	8.7		1				1
17	8.8	1	1		1	1	4
18	9 (1)	1	1				2
19	9 (2)				1		1
20	9.3 (1)	1					1
21	9.3 (2)					1	1
22	9.5	1	1				2
23	9.6		1	1			2
24	10.1					1	1
25	10.1 (d)		1				1
26	10.1 (e)		1	1			2
27	10.2				1	1	2
Applicable Conditionally Required Rulings							
28	4.3 (b)	1		1	1		3
29	8.9		1		1	1	3
30	9.7	1	1				2
	TOTAL	13	11	5	12	14	55

The ideal weighted results, which are the product of the frequency of each *maqsid* and its weight, devised in Chapter 7, are presented in Table 8.3:

Table 8.3: Standard Weighted Results for *Mudarabah*

<i>Maqsid</i>	Circulation	Preservation	Persistence	Justice	Transparency	Total
Frequency	13	11	5	12	14	55
Weight	0.9740	0.2664	0.0456	0.5179	0.0765	1
Weighted Score	12.662	2.930	0.228	6.215	1.071	23.1062

The ideal weighted results show that the *maqsid* of circulation is the most significant *maqsid*, followed by the *maqsid* of justice with almost half the score. The *maqsid* of transparency and persistence have low scores of 1.071 and 0.228, respectively.

8.4.2 Examining The *Maqasidic* Achievement Of The *Mudarabah* Contract

This section reports the results of the actual *mudarabah* case study. Table 8.4 presents the results in a matrix form.

Table 8.4: Matrix for *Mudarabah* Case Study Results

	MAQASID	CIRCULATION	PRESERVATION	PERSISTENCE	JUSTICE	TRANSPARENCY	TOTAL
	Ruling Reference	A	B	C	D	E	
Required Rulings							
1	4.1			1		1	2
2	4.2		1				1
3	4.3			-1			-1
4	4.3 (a)	0.5			0.5		1
5	4.4	1	1		1		3
6	5					1	1
7	7.1 (1)					1	1
8	7.2				1	1	2
9	7.3	1			1		2
10	7.4	1					1
11	8.1 (1)					1	1
12	8.1 (2)	-0.5			-0.5	-0.5	-1.5
13	8.2 (1)	1			1	1	3
14	8.3					1	1
15	8.6	1			1	1	3
16	8.7		1				1
17	8.8	1	1		1	1	4
18	9 (1)	1	1				2
19	9 (2)				1		1
20	9.3 (1)	1					1
21	9.3 (2)					1	1
22	9.5	1	1				2
23	9.6		1	1			2
24	10.1					1	1
25	10.1 (d)		0				0
26	10.1 (e)		1	1			2
27	10.2				1	1	2
Applicable Conditionally Required Rulings							
28	4.3 (b)	1		1	1		3
29	8.9		1		1	1	3
30	9.7	0.5	0.5				1
	TOTAL	10.5	9.5	3	10	12.5	45.5

The actual, non-weighted scores—presented in Table 8.4—are then divided by the standard, non-weighted scores to obtain a percentage of compliance. Table 8.5 reports these results:

Table 8.5: *Mudarabah* Non-Weighted Percentage Compliance

<i>Maqsid</i>	Circulation	Preservation	Persistence	Justice	Transparency	
Actual	10.5	9.5	3	10	12.5	45.5
Standard	13	11	5	12	14	55
%	81%	86%	60%	83%	89%	82.7%

Next, the weighted results are computed. They are the product of the frequency of each *maqsid* and its weight (see Table 8.6).

Table 8.6: *Mudarabah* Weighted Results

<i>Maqsid</i>	Circulation	Preservation	Persistence	Justice	Transparency	Total
Frequency	10.5	9.5	3	10	12.5	45.5
Weight	0.9740	0.2664	0.0456	0.5179	0.0765	1
Weighted Score	10.227	2.5308	0.1368	5.179	0.9563	19.0

The final phase is to divide the actual weighted scores by the standard, weighted scores to obtain a percentage of compliance. Table 8.7 reports this.

Table 8.7: *Mudarabah* Weighted Percentage Compliance

<i>Maqsid</i>	Circulation	Preservation	Persistence	Justice	Transparency	
Actual	10.227	2.5308	0.1368	5.179	0.9563	19.0
Ideal	12.662	2.9304	0.228	6.2148	1.071	23.1
%	81%	86%	60%	83%	89%	82.3%

The actual weighted results show that the *maqsid* of transparency has been considered most in the *mudarabah* contract investigated scoring 89% followed by the *maqsid* of preservation. Both the *maqsid* of circulation and justice scored close results. The *maqsid* of persistence has been the least considered *maqsid* in this case study scoring 60%. The overall weighted *maqsidic* achievement is 82.3%.

8.5 CONCLUSION

This chapter has examined a real life *mudarabah* contract from two perspectives: *Shariah* compliance and *maqasid al Shariah*. The *Shariah* compliance analysis has been performed at two levels: compliance with the AAOIFI (2010) *Shariah* Standards in addition to identifying a *Shariah* compliance strategy. The contract under investigation scored 81.7% in compliance with the AAOIFI (2010) *Shariah* Standards. However, the analysis has shown that the contract is not valid since it contradicts *ijmaa* and hence it was not possible to classify it under any of the three *Shariah* compliance approaches.

The second part of the empirical investigation related to *maqasid al Shariah*. The contract scored 82.3% in terms of the achievement of *maqasid al Shariah*. The individual scores for the five *maqasid* were relatively close—between 80-89%—except for the *maqasid* of persistence, which scored 60%. This gives indications that the realisation of *maqasid* in the contract varies from one *maqasid* to the other.

In addition, the deconstruction of the *mudarabah* contract has revealed that all rulings are means to achieve certain *maqasid*. Thus, the rulings are not ends in themselves but are merely means to achieve higher goals and intents. This finding implies that *Shariah* scholars in the Islamic financial field should pay more attention to the *maqasid* rather than concentrating on rulings and on fulfilling the legalistic aspect of contracts. Such approaches are inadequate because fulfilling the legalistic component of contracts is insufficient unless their goals and purposes are also fulfilled. Therefore, this highlights the importance of analysing the contracts from the *maqasidic* perspective as it reveals the particular goals of the contract and presents consequentialism at the core of the Islamic law of transactions.

CHAPTER 9

CASE STUDY 2: THE *MURABAHAH* CONTRACT

9.1 INTRODUCTION

This chapter is devoted to a case study of the *murabahah* transaction. The *murabahah* transaction is analysed from the *Shariah* perspective as well as that of *maqasid al Shariah*. As explained in Chapter 8, there are four main components to this chapter: 1) examining the compliance of the contract with the AAOIFI (2010) *Shariah* standards; 2) identifying the *Shariah* compliance approach of the contract; 3) assigning the rulings to the *maqasid* they fulfil; and 4) computing both the non-weighted and weighted *maqasidic* scores of the case study.

The chapter proceeds as follows. Section 9.2 gives an outline of the transaction as well as the consolidated documentation. Next, the *Shariah* examination and the *maqasid* analysis are set out in Sections 9.3 and 9.4 respectively. Section 9.5 closes the chapter with the main concluding remarks.

9.2 OUTLINE OF THE TRANSACTION

The transaction is structured as follows. First of all, the customer issues the promise in favour of the bank to buy, on a *murabahah* basis, a specific asset. For example, in the case of project finance, this may be material for the project. Based on this promise, the bank thereafter purchases that asset from a supplier and acquires the title and possession of that asset. After acquiring that asset, the bank sends an exercise notice to the customer obliging him to enter into the *murabahah* agreement in relation to the asset that the bank had purchased. Thereupon, the customer and the bank execute the

murabahah agreement, whereby the bank sells the asset to the customer for a price that is calculated on a cost plus profit basis. Upon execution of this agreement, the ownership of the asset, including all associated rights and risks, passes on to the customer who takes actual or constructive possession of the asset. Thereupon, the customer pays the sale price to the bank on a deferred payment basis.

Two documents are required for this transaction: the 'Promise to Purchase' and the '*Murabahah* Agreement'.

The Promise To Purchase

The promise to purchase commences with an identification of the contracting parties followed by the recitals of the contract. Then there is the main part of the promise, beginning with article 1, Undertaking, to article 4, Governing Law and Jurisdiction. Following this are three schedules. Schedule 1 provides the relevant details of the asset to be purchased. This includes details of the price and profit calculation. Next is Schedule 2, the Exercise Notice, which is a letter issued to the customer obliging him to enter into the *murabahah* agreement. It is signed by the customer and returned on a named date. Schedule 3 is a template of the agreement. The agreement is concluded with the Execution Page, where the promisor is requested to sign.

The *Murabahah* Agreement

This is the main agreement in this transaction and is its cornerstone. After the identification of contracting parties and the recitals, article 1 consists of the definitions and interpretations. The main articles are from article 2, Sale, to article 7, Governing Law and Jurisdiction. Two schedules are then attached. Schedule 1, entitled 'Relevant Details', provides a description of the *murabahah* asset as well as the cost and account

details in addition to a payment schedule. Next, Schedule 2, entitled 'Security', contains details of the security that the customer provides to the bank. The final page in this agreement is the 'Execution Page' which the bank and the customer are both requested to sign.

9.3 SHARIAH ANALYSIS

To examine the *Shariah* compliance of the *murabahah* transaction, the relevant rulings have to be identified before performing the content analysis and allocation of scores. The following sub-sections cover this.

9.3.1 Identification Of Benchmark Rulings

As discussed in Chapter 6, the AAOIFI (2010) standard on *murabahah* rulings has been classified into required rulings and conditionally required rulings. Appendix B1 presents the required rulings for any generic *murabahah* contract. As for the specific *murabahah* transaction under investigation, the conditionally required rulings applicable to this contract have been identified in Appendix B2.

As for the second level of analysis, two categories of rulings had to be identified: the rulings on which there is a consensus, and the rulings attributed to the majority of scholars. These are discussed in Section 9.3.2.2.

Before turning to the results section, there is another issue which is unique to this contract. There are many rulings required by the AAOIFI Standards which are not directly connected to the core *murabahah* agreement but rather to the whole structuring of the transaction. These are mainly the rulings pertaining to: the relationship between the purchaser and the supplier, the relationship between the institution and the supplier and agency issues. It would not be possible to judge these

issues using the documentation of the *murabahah* agreement in the possession of the researcher. Therefore, these rulings will not be used in the examination of the *Shariah* compliancy because the documentation is not sufficient to judge these issues.

9.3.2 Results

9.3.2.1 Compliance with AAOIFI Standards

The contract under investigation scored 68.4 % in terms of compliance with the AAOIFI Standards. This was calculated as follows. In total, there were 19 rulings that had to be satisfied. Out of them, 14 were satisfied completely in the contract whilst 5 rulings were contradicted or not satisfied. The maximum possible score is, thus, 19 and the achieved score is 13. Consequently, the contract scored 68.4%. The results are presented in Table 9.1 and explained and discussed in the following paragraphs.

Table 9.1: Murabahah Contract Shariah Analysis Results

Number	Ruling Reference	Maximum Score	Actual Score
REQUIRED RULINGS			
1	2.2.6 (1)	1	1
2	2.3.1	1	1
3	2.4.1	1	1
4	2.5.2	1	1
5	3.1.1	1	1
6	3.2.1	1	1
7	3.2.2	1	1
8	4.1 (1)	1	1
9	4.1 (2)	1	1
10	4.3 (1)	1	0
11	4.4	1	0
12	4.6	1	1
13	4.7	1	1
14	5.4 (1)	1	1
APPLICABLE CONDITIONALLY REQUIRED RULINGS			
15	4.2	1	1
16	4.3 (3)	1	0
17	4.8	1	-1
18	4.10	1	0
19	5.6	1	1
TOTAL		19	13
			68.4%

The results of the analysis show that the problems in this contract have arisen because of the non-compliance with or non-satisfaction of five rulings. Out of the five non-compliances, there is only one direct contradiction whilst the rest are omitted required rulings.⁴⁴ The following is an elaboration of each of these non-compliances in detail.

Omission

Ruling 4.3 (1) states that the institution is obliged to disclose to the customer the details of any expenses that it would include in determining the selling price (AAOIFI, 2010).

⁴⁴ As discussed in Chapter 6 in detail, a direct contradiction scores -1 whilst an omitted ruling scores 0.

The contract under investigation does not provide such details. Schedule 1 of the *murabahah* agreement provides the cost price, the profit and the sale price only. Although Schedule 1 of the Promise to Purchase document presents the basis for the profit calculation, it does not provide the details of the expenses taken into consideration. Therefore, ruling 4.3 (1) can be considered to be one of the omitted rulings.

Similarly, ruling 4.4 follows on from the previous ruling 4.3 (1), and asserts that the institution is not entitled to include in the base cost of the item any amounts other than the direct expenses that are paid to a third party (AAOIFI, 2010). Building on the previous discussion on ruling 4.3 (1), and since no details are given by the bank on this issue, it can be said that this can be regarded as an omitted required ruling. The bank had to disclose this in the agreement but it failed to do so, and thus it receives a score of zero regarding this issue. The same argument applies to ruling 4.3 (3).

These three rulings—4.3 (1), 4.3 (3) and 4.4—are all based on the idea that the seller has to disclose details of the expenses to the customer, as well as detailing the expenses that can be included in the final cost. When we examine the material on *murabahah*, we find that in addition to the AAOIFI *Shariah* Standards (2010) there are a number of scholars who have mentioned that rulings such as 4.3 (1), 4.3 (3) and 4.4 are required. However, scholars such as Usmani (2002), Shubair (2007) and Al Shubaily (2005), in their discussions on *murabahah*, did not mention some or all of these rulings. More importantly the International Islamic *Fiqh* Academy in its resolutions (International Islamic *Fiqh* Academy, 1988) did not state that these rulings are requirements for the permissibility of *murabahah*. Thus, it can be seen that these issues have not been considered by a number of the contemporary scholars. Therefore, it can be argued that although according to the AAOIFI Standards (2010) these issues have not been complied with, there are enough reasons to say that these rulings should not be considered very essential for any *murabahah* contract.

Finally, ruling 4.10 states that the institution is responsible for any pre-existing hidden defects if it has not stipulated its exemption from such defects. However, the contract remains silent on this issue; the bank does not exempt itself from the hidden defects nor

is there any article or clause which states that the bank is responsible for such hidden defects should they be discovered. This is problematic, since if there is such a defect, there is nothing on paper which obliges the bank to be held responsible. Therefore, this required ruling is considered to be one of the omitted required rulings.

Direct Contradiction

Ruling 4.8 states that it is not permitted for the bank to demand any extra payment for delay in payment that may be for a reason or for no reason (AAOIFI, 2010). This is directly contradicted by article 3.4 of the *Murabahah* Agreement which states that:

If the Sale Price (including each of the Instalments in relation thereto) or other amounts due are not paid by Purchaser on its due date in accordance with this Agreement, the Purchaser irrevocably undertakes to pay the Seller a late payment amount in respect of the period from, and including, the due date for payment to, but excluding, the date of full payment, calculated on a daily basis, for the delay in payment on the outstanding amount at the rate of [] % per annum on such unpaid or delayed amount from the due date of the payment to the actual date of the payment.

However, ruling 5.6 states that it is permissible for the bank to take that amount of money, given that it is donated to charitable causes. The contract complies with this; clause 3.4 states that the bank shall

pay all amounts received towards the late payment charges to charitable foundations or Islamic scientific or medical institutions as it may select in its sole discretion and, if applicable, in accordance with the guidance from its Shariah Supervisory Board.

So it can be seen here that although one requirement has been violated, namely ruling 4.8, simultaneously another requirement, directly related to it, has been complied with. Therefore, in order to maintain consistency, the researcher has opted to consider one

ruling to be nullified and the other one to be satisfied. The main reason for maintaining this position is that this will ensure consistency in the procedure of contract analysis.

The International Islamic *Fiqh* Academy in a number of resolutions, such as resolution 85 (2/9) (International Islamic *Fiqh* Academy, 1995) has endorsed Ruling 4.8. Also, according to Usmani (2002), this practice is not accepted by the majority of present day scholars. Even more, Usmani (2002) asserts that the scholars who approved this issue have set certain conditions. These include, *inter alia*, that: a) the defaulter should be given a period of grace of at least one month after the maturity date, and b) it has to be clear without doubt that the client is defaulting without any valid excuse. However, the AAOIFI *Shariah* Standards (2010) allow for taking this payment given that the compensation is given to charitable causes only and it does not add any other stipulation.

9.3.2.2 Identifying the overall *Shariah* compliance

The aim of this section is to explore under which *Shariah* compliance approach the contract examined can be classified. To achieve this, the framework devised in Chapter 6 has to be applied. The first question in the sequence is the following:

A: Is there any clause in the contract that violates ijmaa?

If yes, the contract is not valid in Shariah.

If no, go on to B.

Hence, it is pertinent to explore the issues on which there is *ijmaa*. When doing so, it was found that there are very few *ijmaa*'s, or consensuses, on the *murabahah* contract. This stems from the fact that the *murabahah* for the purchaser is a contemporary contract which was not practised in the classical period in this particular form. Al Shubaily (2005) asserts that the only similarity between *murabahah* for the purchaser

and the classical *murabahah* discussed in *fiqh* books is the name. Therefore, it is very difficult to find consensus on *murabahah* rulings. Hence, and after an examination of the classical manuals on *ijmaa*, and especially the *Encyclopedia of Ijmaa*, it has been found that there are only two *murabahah* rulings on which there is *ijmaa*, namely:

- i) the base price of the item should be both fixed and known to both parties at the conclusion of the contract; and
- ii) the institution's profit mark-up should be both fixed and known to both parties at the conclusion of the contract; the mere mention of the total selling price is not sufficient.

As for the contract under investigation, the analysis has shown that the rulings that were not complied with in this contract are not based on any scholarly *ijmaa*. Thus, there is no violation of any *ijmaa*.

Hence, the answer to the question:

A: Is there any clause in the contract that violates ijmaa?

is: No clause in the examined contract violates *ijmaa*, and hence according to the devised method, the next question in the sequence applies:

B: Is there any ruling in the contract that is not acceptable according to the majority of scholars?

If yes, the contract is valid according to the liberal strategy.

If no, go on to C.

As discussed in the previous section, ruling 5.6 states that it is permissible for the bank to take that amount of money, given that it is donated to charitable causes. This ruling, which according to Usmani (2002) is not permitted by the majority of jurists, has been included in the contract in Clause 3.4. Consequently, the response to this question is: Yes, there is a ruling in the contract not acceptable to the majority of scholars. Hence, the contract can be classified under the liberal strategy.

There is also another crucial issue that might have a considerable impact on the *Shariah* compliancy of the contract. This is the problem of ambiguity. As mentioned before, there are a number of rulings which cannot be judged from the available documentation. These include rulings that govern the relationship between the purchaser and the supplier, as well as the appointing of the purchaser as the agent of the seller. These issues are very important in validating the contract. That is why any analysis of the discourse on *murabahah* shows us that scholars have emphasised these issues (Al Shubaily, 2005; Al Huqail, 2011). Many of these issues have the potential to change the outcome of the *Shariah* analysis.

In conclusion it can be stated that although the contract scored 68.4% in its compliancy with the AAOIFI *Shariah* Standards, the rulings that were not complied with are not very essential and pressing issues and on none of them is there *ijmaa*, consensus. Therefore, there are many possibilities for arguing that the contract can be validated. In fact, the analysis has shown that the contract is validated under the liberal strategy. However, there is a limitation of the analysis and examination. It is that there are many issues that cannot be judged from the available contract documentation. To give a judgement it is necessary to examine other documents that are not part of the contract package but rather are internal documents. Analysing them can give different and interesting results, which might be completely different from the ones obtained.

9.4 MAQASID ANALYSIS

The *maqasid* analysis involves two stages; first of all identifying the *maqasid* underlying the rulings in the AAOIFI (2010) *Shariah* standards and then examining the *murabahah* case study.

9.4.1 Exploring The Underlying *Maqasid*: A Ratiocinative Approach

This section explores the *maqasid* underlying the *murabahah* contract rulings. The following format is used in presenting the analysis. The ruling is stated and then the relevant *maqasid/maqasid* is/are given with the justification. The following codes are used for the *maqasid*: A= circulation; B=preservation; C= persistence; D= justice; and E= transparency.

9.4.1.1 Analysis

Required Rulings

1. **Ruling 2.2.6 (1)** *It is not permitted to carry out a Murabahah on deferred payment terms where the asset involved is gold or silver or currencies.*

A and D: Since this involves *riba*, this ruling is assigned the *maqasid* related to the prohibition of *riba* (see Ruling 7.3 of the *mudarabah* contract).

2. Ruling 2.3.1 *It is not permissible that the document of promise to buy (signed by the customer) should include a bilateral promise which is binding on both parties (the institution and the customer).*

C: A bilateral promise may imply selling an object that is not owned by the seller. Thus, the object will usually be under the ownership of another party. Therefore, concluding a promise on an object that is not owned by the seller violates the sanctity of property rights and the exclusiveness of rights to their owners.

E: A bilateral promise exemplifies a sale contract where the seller does not own the object he is going to sell (International Islamic *Fiqh* Academy, 1988; AAOIFI, 2010) and selling an object before possessing it is prohibited since it entails *gharar*.

3. Ruling 2.4.1 *It is not permissible for the institution to receive a commitment fee from the customer.*

A: Commitments are analogous to options and according to Ibn Bayyah (2010), options are prohibited since they prevent the circulation of real commodities. Thus, this ruling promotes the *maqsid* of circulation.

D: A commitment is essentially a “right to contract, which is a mere intention and wish that is not a subject of exchange” (AAOIFI, 2010). In addition, this commitment is similar to options that have been prohibited by the majority of contemporary jurists since they cannot be considered as tradable commodities (Al Dossary, 2010). Therefore, it is not equitable to take a fee for something that is not a commodity in itself—this violates the *maqsid* of justice.

4. Ruling 2.5.2 *It is not permitted to impose on a customer who is the purchase orderer a guarantee regarding hazards that may affect the item such as damage and destruction during period of shipment or storage.*

A and D: Imposing on the customer to guarantee the hazards during the period of shipment or storage has been considered as violating the maxim stating that the right to profit is associated with bearing risk, *al gurm bil gunm* (Al Rajhi, 2010; Al Shubaily, 2005; Al Huqail, 2011). This is because this is the responsibility of the owner; in this case the financial institution.

The maxim of *al gurm bil gunm* aims, as discussed previously, at promoting wealth and ensuring equity according to Al Huqail (2011). Therefore, this ruling is to be assigned A and D.

5. Ruling 3.1.1 *The institution is prohibited from selling any item in a Murabahah transaction before having acquired ownership the item. Hence, it is not valid for the institution to conclude a Murabahah sale with the customer before concluding the purchase, from the supplier of the item, of the subject matter of the Murabahah, and before actual or constructive possession of the item as a result of the supplier giving control over the item or presenting documents that represent possession.*

C and E: The basis for this prohibition is that such an action constitutes selling before acquiring ownership. Therefore, the justification for 2.3.1 applies here.

6. Ruling 3.2.1

It is obligatory that the institution's actual or constructive possession of the item be ascertained before its sale to the customer on the basis of Murabahah to the purchase order.

A and D: The basis for this requirement is to ensure that the institution takes responsibility and bears the risk for the commodity before selling it (AAOIFI, 2010). Therefore, the justification for 2.5.2 applies here.

7. Ruling 3.2.2

It is obligatory that the point when the risk of the item is passed on by the institution to the customer be clearly identified, with reference to the stages in which the item is transferred from one party to another.

E: Clear identification of the stages for the item transfer ensures transparency in the transaction.

8. Ruling 4.1 (1) *It is not permitted for the institution to consider that the contract of Murabahah to the purchase orderer is automatically concluded by its mere taking possession of the asset.*

A and D: Considering the contract automatically concluded by the institution's possession of the asset violates the maxim of *al gurm bil gunm*. Thus, the justification for 2.5.2 applies here.

9. Ruling 4.1 (2) *The institution may not force a customer who is the purchase orderer to take delivery of the asset and pay the Murabaha selling price, if the customer refuses to conclude the Murabahah transaction.*

C: Forcing the purchase orderer to purchase the asset contradicts the freedom of contracts which falls under the *maqsid* of persistence according to Ibn Zughaihah (2010).

10. Ruling 4.3 (1) *The institution has the obligation to disclose to the customer, when concluding the contract of sale, the details of any expenses that it would include in determining the selling price.*

E: Since this ensures transparency and eliminates *gharar*.

11. Ruling 4.4 *The institution is not entitled to include in the base cost of the item, for the purpose of calculating the Murabahah price, any amounts other than the direct expenses that are paid to a third party. It is not permissible, for example, for the institution to add the cost of the item payments made to its own staff for their work, and the like.*

B and D: It is not equitable to include in the base cost other amounts other than the direct expenses. This ruling, therefore, ensures justice and preserves the money of the customer.

12. Ruling 4.6 *The base price of the item should be both fixed and known to both parties at the conclusion of the contract.*

E: Knowledge of the base price is required to avoid uncertainty (AAOIFI, 2010). In addition, a floating benchmark entails *gharar* (Meerah, 2011).

13. Ruling 4.7 *The institution's profit mark-up should be both fixed and known to both parties at the conclusion of the contract; the mere mention of the total selling price is not sufficient.*

E: Knowledge of the profit is required to avoid uncertainty (AAOIFI, 2010). In addition, a floating benchmark entails *gharar* (Meerah, 2011).

14. Ruling 5.4 (1) *It is not permissible to stipulate that the ownership of the item will not be transferred to the customer until the full payment of the selling price.*

C: Stipulating that the ownership will not be transferred to the customer who is the legal owner until full payment violates the sanctity of property rights and the entitlement of owners to what they own as clarified by Ibn Ashur (2011).

Conditionally Required Rulings

15. Ruling 4.2 *The institution is entitled to receive compensation for any actual damage it has incurred as a result of the customer's breach of a binding promise. The compensation consists of the customer reimbursing the institution for any loss due to a difference between the price received by the institution in selling the asset to a third party and the original cost price paid by the institution to the supplier.*

B: The basis for this ruling is to protect the institution from the damage that may be inflicted on it because of the act of the customer (AAOIFI, 2010). Therefore this ruling promotes the preservation of wealth.

16. Ruling 4.3 (3) *If the institution failed to disclose any expenses, it is not entitled to include them unless they are customarily considered as normal expenses, such as transportation expenses, storage expenses, fees for letters of credit and insurance premiums.*

D and E: This satisfies transparency and maintains justice by ensuring that the customer will not be liable for expenses which are not customarily considered as normal expenses.

17. Ruling 4.8 *It is not permitted to demand any extra payment either in consideration of extra time given for payment or for delay in payment that may be for a reason or no reason. In case of rescheduling, it is not permissible to extend the date of payment of the debt in exchange for an additional payment.*

A and D: Since such an action is a form of *riba* (AAOIFI, 2010).

18. Ruling 4.10 *If the institution did not stipulate its exemption from pre-existing hidden defects whose effects appear after the conclusion of the contract, then it is responsible for pre-existing hidden defects excluding any new defects (recent defects).*

A, D and E: The institution is responsible for the pre-existing hidden defects since this may lead to conflict due to the inherent *gharar*. In addition, this ensures the rights of the customer are preserved (preservation). Moreover, the institution is not responsible for any new defects since it would be inequitable to hold the institution liable for such defects. Thus, the *maqsid* of justice is also promoted.

19. Ruling 5.6 *It is permissible that the contract of Murabahah consists of an undertaking from the customer to pay an amount of money or a percentage of the debt, to be donated to charitable causes in the event of a delay on his part in paying instalments on their due date.*

A and D: The amount of money has to be paid to charitable causes and not for the benefit of the institution since the latter is a form of *riba* (Usmani, 2002).

9.4.1.2 Standard Results

Based on the analysis of the literature conducted in the previous section, the ideal results are computed. Table 9.2 provides a matrix for the standard ideal results.

Table 9.2: Matrix for The Standard *Murabahah* Results

	MAQASID	CIRCULATION	PRESERVATION	PERSISTENCE	JUSTICE	TRANSPARENCY	TOTAL
	Ruling Reference	A	B	C	D	E	
Required Rulings							
1	2.2.6 (1)	1			1		2
2	2.3.1			1		1	2
3	2.4.1	1			1		2
4	2.5.2	1			1		2
5	3.1.1			1		1	2
6	3.2.1	1			1		2
7	3.2.2					1	1
8	4.1 (1)	1			1		2
9	4.1 (2)			1			1
10	4.3 (1)					1	1
11	4.4		1		1		2
12	4.6					1	1
13	4.7					1	1
14	5.4 (1)			1			1
Applicable Conditionally Required Rulings							
15	4.2		1				1
16	4.3 (3)				1	1	2
17	4.8	1			1		2
18	4.1	1			1	1	3
19	5.6	1			1		2
	TOTAL	8	2	4	10	8	32

Next, the standard weighted results, which are the product of the frequency of each *maqsid* and its weight are presented in Table 9.2:

Table 9.3: Standard Weighted Results for *Murabahah*

<i>Maqsid</i>	Circulation	Preservation	Persistence	Justice	Transparency	Total
Frequency	8	2	4	10	8	32
Weight	0.9740	0.2664	0.0456	0.5179	0.0765	1
Weighted Score	7.792	0.5328	0.1824	5.179	0.612	14.2982

The ideal weighted results show that the *maqsid* of circulation obtained the highest score followed by the *maqsid* of justice. The *maqsid* of persistence has the lowest score: 0.1824.

9.4.2 Examining The *Maqasidic* Achievement Of The *Murabahah* Contract

The results of the *murabahah* contract under investigation are presented in Table 9.4.

Table 9.4: Matrix for *Murabahah* Case Study Results

	MAQASID	CIRCULATION	PRESERVATION	PERSISTENCE	JUSTICE	TRANSPARENCY	TOTAL
	Ruling Reference	A	B	C	D	E	
Required Rulings							
1	2.2.6 (1)	1			1		2
2	2.3.1			1		1	2
3	2.4.1	1			1		2
4	2.5.2	1			1		2
5	3.1.1			1		1	2
6	3.2.1	1			1		2
7	3.2.2					1	1
8	4.1 (1)	1			1		2
9	4.1 (2)			1			1
10	4.3 (1)					0	0
11	4.4		0		0		0
12	4.6					1	1
13	4.7					1	1
14	5.4 (1)			1			1
Applicable Conditionally Required Rulings							
15	4.2		1				1
16	4.3 (3)				0	0	0
17	4.8	-1			-1		-2
18	4.1	0			0	0	0
19	5.6	1			1		2
	TOTAL	5	1	4	5	5	20

The actual non-weighted scores of the *murabahah* contract are then divided by the ideal non-weighted scores to obtain percentages of compliance. Table 9.5 reports these results:

Table 9.5: *Murabahah* Non-Weighted Percentage Compliance

<i>Maqsid</i>	Circulation	Preservation	Persistence	Justice	Transparency	
Actual	5	1	4	5	5	20
Standard	8	2	4	10	8	32
%	63%	50%	100%	50%	63%	63%

In order to compute the weighted results, the frequency of each *maqsid* is multiplied by its weight (see: Table 9.6).

Table 9.6: *Murabahah* Weighted Results

<i>Maqsid</i>	Circulation	Preservation	Persistence	Justice	Transparency	Total
Frequency	5	1	4	5	5	20
Weight	0.9740	0.2664	0.0456	0.5179	0.0765	1
Weighted Score	4.87	0.2664	0.1824	2.5895	0.3825	8.2908

Next, the actual weighted scores are divided by the ideal weighted scores to obtain percentage compliance. Table 9.7 reports these results:

Table 9.7: *Murabahah* Weighted Percentage Compliance

<i>Maqsid</i>	Circulation	Preservation	Persistence	Justice	Transparency	
Actual	4.87	0.2664	0.1824	2.5895	0.3825	8.2908
Standard	7.792	0.5328	0.1824	5.179	0.612	14.2982
%	63%	50%	100%	50%	63%	58%

The actual weighted results of the case study examined show that the *maqsid* of persistence has been considered the most, scoring 100%, followed by the *maqsid* of circulation and transparency, both with 63%. The overall weighted *maqasidic* achievement of this contract is 58%.

9.5 CONCLUSION

The aim of this chapter was to examine a *murabahah* transaction from the perspectives of both *Shariah* and *maqasid al Shariah*. Regarding the *Shariah* compliance, the case study achieved 68.4% compliance with the AAOIFI standards. However, this is not in the main due to major issues in the contract, but rather because of the dissatisfaction of rulings that are not the distinctive features and cornerstones of the *murabahah* contract. In other words, and for increased clarification, we find that out of the five non-satisfied rulings, three of them are related to one main issue, which is the disclosure of the details of the profit calculation—an issue not of central importance to the *murabahah* contract. Therefore, if the rulings had been weighted each one according to its worth, the contract might have achieved a higher compliance score.

As for the second part of the empirical investigation—*maqasid al Shariah*—the contract scored an overall *maqasidic* achievement of 58%. Hence, there is a considerable difference between the *Shariah* score and the *maqasid al Shariah* score. This fact highlights the importance of considering the *maqasidic* perspective as it has shown that *fiqhi* compliance does not necessarily denote fulfilment of the *maqasidic* component.

CHAPTER 10

CASE STUDY 3: THE *IJARAH* CONTRACT

10.1 INTRODUCTION

This chapter is devoted to a case study of the *ijarah* contract. The *ijarah* transaction is analysed from the *Shariah* perspective as well as that of *maqasid al Shariah*. The chapter is organised as follows. Section 10.2 gives an outline of the transaction as well as the consolidated documentation. Next, the *Shariah* examination and the *maqasid* analysis are presented in Sections 10.3 and 10.4 respectively. Section 10.5 concludes the chapter.

10.2 OUTLINE OF THE TRANSACTION

In this *ijarah* contract, the lessee (the customer) issues a promise to lease a specific asset from the lessor (the bank). Based on this promise, the lessor enters into the process of the procurement of the asset to be leased. Next, the lessor gains ownership and possession of the asset. Thereafter, the lease agreement is signed between the lessee and the lessor. At maturity, the asset is bought by the lessee through a sale contract. Thus, the lessor is both the seller of the asset as well as its lessor. There are seven documents for this transaction. An explanation of each one is given in the following sections.

Promise To Lease

The Promise to Lease is the document in which the customer is the promisor and the bank is the promisee. The customer promises to lease the asset from the bank after it acquires the asset. After the identification of the parties and the recitals, the document includes 13 articles and 3 schedules. Schedule 1 provides a description of the asset to be leased whereas Schedule 2 is a form of notification to the promisor notifying him that the asset is ready to be leased by him. The final schedule provides the full text of the lease agreement.

Lease Agreement

This is the main document in the *ijarah* package. It commences by identifying the contracting parties followed by the recitals, which is a short paragraph outlining a summary of the transaction. Next is article 1 which includes sub-clauses providing the definitions and interpretations. The main stipulations of the contract start from article 2 entitled Agreement to Lease and end with article 27 entitled Counterparts. Attached to the agreement are 6 appendices. Appendix 1 gives the specifications of the asset, while Appendix 2 presents an explanation of the event of default followed by Appendix 3 which gives a schedule for the rental payment dates. Then Appendix 4 provides a notice for the first rental payment. This is followed by Appendix 5 which is a notice to the lessee to notify him of the subsequent rental payments; it is in the form of a letter. Finally, Appendix 6 provides details of the security provided by the lessee.

Service Agency Agreement

In the *ijarah* package, the bank (the lessor) requests that the customer (the lessee) undertakes and carries out major maintenance of the asset. This is achieved through the document known as the Service Agency Agreement. As with the other documents, the Service Agency Agreement commences with an identification of the contracting parties, which is followed by a brief section on the background of the transaction and then a section on the definitions and interpretation. Then there are 11 articles. Article 2 provides details of the appointment and the fees whereas article 3 provides a description of the major maintenance obligations. The document ends with article 11.

Purchase Undertaking Document

Upon the occurrence of an event of default, the lessor has the right, according to the lease agreement, to require the lessee to purchase the leased asset. This is done by means of the Purchase Undertaking Document, the main idea of which is that the lessee undertakes by means of a promise to purchase the leased asset from the lessor if the lessor exercises its right to do so. Therefore, the lessee is a promisor in this regard.

In addition to the usual introductory articles, the document has 9 articles, starting with article 1 entitled Definitions and ending with article 9 entitled Governing Law and Jurisdiction.

Sale Undertaking Document

Since the *ijarah* package under investigation is an *ijarah mutahiyah betamleek*, in which the leased asset is sold by the lessor to the lessee on the maturity of the lease term, the Sale Undertaking Document is the legal basis for this operation. The

document is an agreement in which the bank (the lessor/promissor) undertakes that on the maturity date and upon the lessee paying the rental payments, it shall sell the asset to the lessee (who is also the promisee under this document).

The document, following the usual introductory and definition sections, has 8 main articles, beginning with article 2, entitled Sale Undertaking, and ending with article 8, entitled Governing Law and Jurisdiction. Thereafter, there are three schedules. Schedule 1 is the Sale Notice Letter and is to be sent from the lessee to the lessor informing him that he is willing to buy the asset. This is followed by Schedule 2 which is the reply from the lessor to the lessee. At the end of the document is Schedule 3 which is the Sale and Purchase Agreement and is signed by the two parties after they agree to go ahead with the sale undertaking. Fundamentally, it is this document which is the basis for the transfer of the asset from the ownership of the lessor to the ownership of the lessee. The schedule has 8 articles, as well as an execution page.

Asset Purchase Agreement

As outlined above, the bank (the lessor), before entering into the lease transaction, has to buy the asset because it does not own the asset beforehand. The bank only proceeds in the buying of the asset after the lessee (or more exactly, the future lessee) promises that he will lease the asset. This is done through the Asset Purchase Agreement.

The document has, in addition to the usual background information, 22 articles beginning with the definitions and interpretation and ending with the governing law and jurisdiction. At the end there is Schedule 1 which provides a description of the asset.

Title Nominee Declaration

The Title Nominee Declaration is tied to the Asset Purchase Agreement. After the bank gains possession of the asset, the title to the asset will not be registered in the bank's name. Rather, the title to the asset is recorded in the name of a trustee who is appointed by the bank. He is regarded as an agent who holds title to the asset on behalf of the bank. Upon demand by the bank, the trustee transfers the title to the asset to the bank.

The document commences with the identification of the parties followed by 17 articles beginning with the definitions and interpretation and ending with the governing law and jurisdiction. Attached to the document is Annexure 1, which provides a description of the asset.

10.3 SHARIAH ANALYSIS

To examine the *Shariah* compliance of the *ijarah* transaction, the relevant rulings have to be identified before performing the content analysis and allocating the scores. The following sub-sections cover this.

10.3.1 Identification Of Benchmark Rulings

An analysis of the (AAOIFI) Standards on *ijarah* classified the rulings into 13 required rulings (see: Appendix C1) and 12 applicable conditionally-required rulings (see: Appendix C2). Hence, in order to obtain 100% compliancy with the AAOIFI rulings, the *ijarah* package being analysed has to comply with 25 rulings in total.

As for the second level of analysis, two categories of rulings had to be identified: the rulings on which there is a consensus, and the rulings on which there is a majority opinion. These are discussed in Section 10.3.2.2.

10.3.2 Results

10.3.2.1 Compliance with AAOIFI Standards

An analysis was conducted of the seven documents that make up the *ijarah* package. The contract under investigation scored 36% in terms of compliancy with the AAOIFI Standards. This was calculated as follows. In total, there were 25 rulings that had to be satisfied. Out of them, 17 were satisfied completely in the contract whilst 8 rulings were contradicted or not satisfied. The maximum possible score is, thus, 25 and the achieved score is 9. Consequently, the contract scored 36%. The results are presented in Table 10.1 and explained and discussed in the following paragraphs.

Table 10.1: Ijarah Contract Shariah Analysis Results

Number	Ruling Reference	Maximum Score	Actual Score
REQUIRED RULINGS			
1	3.1	1	1
2	4.1.1	1	1
3	4.1.2	1	1
4	5.1.1 (1)	1	1
5	5.1.1 (2)	1	1
6	5.1.4	1	1
7	5.1.5	1	-1
8	5.1.7 (1)	1	1
9	5.1.7 (2)	1	1
10	5.1.8 (1)	1	-1
11	5.2.1	1	1
12	5.2.2	1	-1
13	6.3	1	-1
APPLICABLE CONDITIONALLY REQUIRED RULINGS			
14	2.3	1	1
15	3.1 (b)	1	1
16	3.3	1	1
17	5.1.8 (2)	1	0.5
18	5.2.3	1	-1
19	6.4	1	1
20	6.5	1	-1
21	7.1.3	1	-1
22	8.1	1	1
23	8.2	1	-0.5
24	8.3	1	1
25	8.7	1	1
TOTAL		25	9
			36%

The analysis has shown that the non-compliance of this contract with the AAOIFI Standards was due to the failure of nine rulings. The majority of these rulings, namely Rulings 5.1.5; 5.1.8 (1); 5.2.2; 5.2.3; 6.3; 6.5; 7.1.3, were directly contradicted. Only one ruling, namely Ruling 8.2, was partially contradicted. According to the analysis, one ruling has been diluted and there were no rulings omitted in this contract. The

following paragraphs provide an elaboration and justification of the researcher's stance regarding these rulings and the score obtained. In addition, the results are discussed in the context of the juristic differences found in classical *fiqh*.

Dilution

Ruling 5.1.8 (2) has not been stated clearly in the contract. Hence, it falls under the dilution category.

Partial Contradiction

Ruling 8.2, stating that the promise in the *ijarah* is binding on one party only, appears to be diluted rather than directly violated (AAOIFI, 2010). A superficial analysis of the Promise to Lease document indicates that Ruling 8.2 is satisfied, as shown, for example, by Article 5 and Article 6 of the Promise to Lease, which give the promisor the choice to withdraw from the promise. This clearly indicates that the promise is not binding upon the promisor. However, the ruling is diluted by Schedule 2 of the Promise to Lease. The schedule is a letter or form of notification that notifies the promisor that the asset he has promised to lease is ready to be leased by him. It therefore requires the promisor to sign the Lease Agreement and return it to the bank within a given time limit. The problematic issue is in the following statement:

If we do not receive any response from you upon expiry of the above period, we will assume that you have signed the Lease Agreement and the First Lease Period shall commence on such day and the Rental Payment for the First Lease Period shall become payable in accordance with the terms of the Lease Agreement.

Thus if the bank does not receive the signed lease agreement from the promisor, it will *assume* that he has signed the Lease Agreement although the promisor may *have not* signed it. There are two main problems. First, it is *as if* the lease agreement has been made binding on the promisor since the lease agreement has been initiated by his signing of the promise even though he did not sign the lease agreement—it is only *assumed* that he has signed the lease agreement. However, this is not a direct contradiction since there are articles in the Promise to Lease, such as Articles 5 and 6, which give the promisor the choice. Therefore, it can be argued that it partially contradicts Ruling 8.2.

Second, the bank considers that the customer is involved in a transaction by *assuming* that he has accepted and *not* obtaining his explicit consent. The issue is a major concern in Islamic commercial law which emphasises the importance of consent. In addition, the issue of binding promises is widely acknowledged as controversial in Islamic commercial law. Whereas the *Malikis* in their prevailing view and the *Hanafis* in certain cases *permit* the promise to be binding, the majority of the scholars disagree (Katooa, 2012). Therefore, there is a possibility of validating the ruling. However, the most important issue in relation to this ruling is when the contract says that in case the promisor does not respond either positively or negatively that he wishes to go ahead with the lease agreement, then the bank will *assume* that he has given permission and the contract of *ijarah* will be initiated. This can be understood to violate one of the cornerstones of Islamic commercial law which is the notion of consent. How can the bank assume that the customer has signed the lease agreement when he actually has not? What evidence of consent does the bank have to initiate the lease agreement? These questions remain unanswered after the analysis.

Direct Contradiction

Ruling 5.1.5 states that the lessor is responsible for all defects of the leased asset and may not exclude his liability for any impairment sustained by the leased asset even as a

result of events outside his control (AAOIFI, 2010). This ruling is directly contradicted by Clauses 3.2 and 3.5 as follows: Clause 3.1 of the Lease Agreement states that the lessee confirms that he has inspected the asset, and based on this, Clause 3.2 states that:

In light of the confirmation and acknowledgment by the Lessee in Clause 3.1, the Lessor expressly disclaims and makes no representation or warranty, either expressly or implied, caused by reason of:

3.2.1 the design or condition of the Asset or any part thereof; or

3.2.2 the durability, suitability or fitness for any particular purpose of the Asset or any part thereof; or

3.2.3 the quality of the material or workmanship of the Asset or any part thereof; or

3.2.4 the conformity of the Asset or any part of the Asset to the specifications set out in Appendix 1; or

3.2.5 any other matter concerning the Asset or any part of the Asset, and the Lessee acknowledges this disclaimer

This, it can be seen that the lessor disclaims itself and is not to be held liable for any defects or any reason that may affect the benefits intended to be available under the *ijarah* contract. Although the lessee acknowledges this disclaimer, this contradicts Ruling 5.1.5. Clause 3.5 makes this issue even more clear when it states that:

Without limiting the generality of Clause 3.4 and in light of the confirmation and acknowledgment by the Lessee in Clause 3.1, the Lessor shall not be liable or responsible for any defects, either patent or latent, in any item of the Asset, or for the direct or indirect damage to persons or Asset resulting from any such defects, or for the Lessee's loss of use of the Asset or for any interruption in the Lessee's business caused by the Lessee's inability to use the Asset for any reason, except if it is caused as a result of the wilful misconduct or negligence of the Lessor

Thus according to Clause 3.5, the lessor is not responsible for any defects unless it was caused as a result of his misconduct or negligence. This is problematic since we would normally expect in contracts of *amanah*, trust based contracts, that the *ameen* (the

entrusted), who is in this case the lessee, is only liable in case of *his* misconduct and negligence. Therefore, the correct wording should have been: 'except if it is caused as a result of the wilful misconduct or negligence of the lessee'. Hence, it appears that the wording in the contract is incorrect. Furthermore, the AAOIFI standard (2010) states that the lessor is responsible for any defects even if they were caused by reasons outside his own control. Therefore, there is clearly a violation of the AAOIFI standards in this case.

In addition, Clauses 3.2 and 3.5 of the *ijarah* contract violate AAOIFI Ruling 5.1.8 (1) which states that the leased asset is the responsibility of the lessor unless misconduct or negligence is committed by the lessee *not* 'only if negligence is caused by the lessor' as clause 3.5 asserts.

Reflecting on classical *fiqh*, it can be seen that traditional views in relation to Ruling 5.1.5, which requires the lessor to be responsible for any defects in the leased asset, highlight its controversial nature *if* the lessor stipulates that he is *not* responsible for the defects. This issue can be related to the sale of an object with the stipulation that the seller is not responsible for any defects which might be discovered later—a similar position is applied to the *ijarah* contract. Whereas some scholars maintain this is permissible, other scholars allow this *given* that the seller does not know beforehand about these defects (Ibn Qudama, 1999). Therefore, although this ruling is not applied in the AAOIFI Standards (2010), it is allowed by certain *fiqhi* schools. Therefore, although the contract under investigation violates the AAOIFI ruling, the contract can be validated through *fiqh*, especially because in this case the lessee checked the asset and acknowledged that the lessor was not responsible for any defects.

Ruling 5.1.8 (1) is also concerned with this issue. It states that the lessee is responsible for the leased asset only if he commits negligence or misconduct. This ruling, which is violated by the contract under investigation, is based on a consensus. Therefore, the contract violates a consensus-based ruling and cannot be approved by any school of *fiqh*. This is one of the main problems of the contract. A further point also needs clarification. It could be argued that the lessee has agreed to comply with this stipulation and therefore it should be permitted based on the consent of the lessee.

However, jurists have established that not all stipulations in a contract are allowed absolutely (Ibn Qudama, 1999). Stipulations which contradict the main form and arrangement of the contract are not permitted even if there is consent from both parties; consent from both parties does not imply permissibility. The scholars also give this issue of holding the lessee liable as an example of this maxim (Abu Sulayman, 1992).

The third ruling that is contradicted is Ruling 5.2.2 which states that the lessor is entitled to the rental from the time the lessee starts to benefit from the asset or from when the asset or the usufruct is made available to the lessee. Clause 4.9 directly contradicts this when it states that:

The Lessee's obligations to pay Rental Payments including the Rental Payment for the Last Lease Period and all other amounts hereunder and under any other Transaction Document is absolute and unconditional and shall not be affected by any circumstances

The main problem in the clause is the “absolute and unconditional” aspect of the lessee’s obligations to pay the rental payments. Payment should be conditional upon the lessee starting to benefit, or being in a position to benefit, from the leased asset in order for the clause to be compliant.

This issue is also subject to juristic differences of opinion. Whereas the *Shafees* and *Hanbalis* maintain that the lessor’s entitlement to the rental starts on the day when the contract is signed, the *Hanafis* and *Malikis* in principle do not permit entitlement to the rental on the signing of the contract, but *do allow it* if it is stipulated in the contract (Abu Sulayman, 1992). Therefore, it can be seen that the ruling which is violated in the contract is allowed by two of the major schools of *fiqh* and it is allowed by the other schools, namely the *Hanafis* and *Malikis*, if it is stipulated as a condition of the contract. Thus, it is possible to validate the contract based on the position of those jurists who allow the entitlement to start from the signing of the contract and also other jurists who allow this if it is stated in the contract. In the contract under investigation, this is stipulated in the contract. Thus, in conclusion, it can be argued

that although the contract violates AAOIFI rulings, it can be validated based on the four mainstream schools of *fiqh*.

The next contradicted ruling is Ruling 5.2.3. This ruling relates to the first rental payment and states that in the case of floating rental, then the rental for the first lease period should be specified. The contract under investigation does not adhere fully to this ruling since for the first lease period, the rental is both fixed *and* variable as Clause 4.2 of the Lease Agreement indicates:

The Rental Payment for the First Lease Period shall consist of the following and shall be payable by the Lessee on the relevant Rental Payment Date in accordance with the notice from the Lessor substantially in the form set out in Appendix 4:

4.2.1 Fixed Rental; and

4.2.2 Variable Rental.

Therefore, although the fixed rental complies with the requirement of Ruling 5.2.3, there is also a variable rental component which is non-compliant. Hence, in conclusion, the rental payment for the first lease period is not fixed and consequently it is a direct violation of ruling 5.2.3.

The fifth ruling that is contradicted is Ruling 6.3. This ruling prohibits any increase in the rental in the case that the lessee delays any payment (AAOIFI, 2010). This is directly violated by clause 4.5 of the Lease Agreement which states that:

If any sum due and payable by the Lessee under the terms of any Transaction Document (including, for the avoidance of doubt, Rental Payment) is not paid to the Lessor in full on its due date, the Lessee irrevocably undertakes to pay to the Lessor a late payment amount.

However, the clause adds:

Any late payment received by the Lessor (less any costs of recovering such payment) must be donated to such charity as the Lessor may choose in accordance with the principles of Sharia.

Nevertheless, in order to maintain consistency, it has been maintained that Clause 4.5 of the Lease Agreement directly contradicts Ruling 6.3 even though the proceeds are to be donated to charitable causes.

Ruling 6.5 is another ruling that has been violated. The ruling states that in the event of a foreclosure of the security, only amounts due in respect of the previous rental periods can be deducted (AAOIFI, 2010). This is directly contradicted by Clause 6.2 of the Lease Agreement which can be interpreted as allowing the lessor to claim amounts due in respect of both the previous and the future periods. Clause 6.2 states:

if the Lessee defaults in its obligations under this Agreement or any other Transaction Document, the Lessor shall be entitled to enforce the security ... against the Lessee in order to recover all amounts that are due and owing by the Lessee to the Lessor pursuant to the Transaction Documents (including for the avoidance of doubt the outstanding Rental Payment or any part thereof (in respect of which the default has occurred)) and any other leases entered into between the Lessee and the Lessor.

A further ruling that is violated is Ruling 7.1.3. This ruling states that the *ijarah* contract is terminated in case of total destruction of the leased asset and hence it may not be stipulated that the rest of the instalments are to be paid (AAOIFI, 2010). The ruling does not give any other condition. In other words, it does not state that this ruling holds given, for example, that the destruction has *not* been caused by the negligence and misconduct of the lessee. This is directly contradicted by Clause 4.9 when it states that:

The Lessee's obligations to pay Rental Payments including the Rental Payment for the Last Lease Period and all other amounts hereunder and under any other Transaction Document is absolute and unconditional and shall not be affected by any circumstances, including, but not limited to:...

4.9.7 any damage to, or destruction of, the Asset or any part of the Asset which has been caused by the negligence or wilful misconduct of the Lessee.

Therefore, the contract implies that if the destruction of the asset is caused by the negligence or misconduct of the lessee, then he is obliged to pay all the rental payments including that of the last lease period.

The AAOIFI's (2010) stance on this ruling has its basis in classical *fiqh*, in which the jurists are unanimous that if the asset has been destroyed, then the contract is terminated (Abu Sulayman, 1992; Ibn Rushd, 2004). Moreover, holding the lessor liable in the case of total destruction of the asset is not permitted because this would contradict the notion of trust-based contracts of which *ijarah* is one (Bank Al Bilad, 2013). In this case the contract violates a ruling that is not permitted by the majority of classical jurists and the AAOIFI.

10.3.2.2 Identifying the overall *Shariah* compliance

The aim of this section is to explore under which approach the contract examined can be classified. To achieve this, the framework devised in Chapter 6 has to be applied. The first question in addressing the *Shariah* compliance strategy is:

A: Is there any clause in the contract that violates ijmaa?

If yes, the contract is not valid in Shariah.

If no, go on to B.

In order to answer this question, it is necessary to collate all the rulings of the *ijarah* contract on which there is *ijmaa*, consensus. According to Abu Habib (1997), there are five rulings concerning the *ijarah* contract on which there is consensus between the jurists. These are the following:

- i) For the validity of an *ijarah* contract concerning a specified asset, the lease contract should be preceded by acquisition of either the asset to be leased or the usufruct of that asset;
- ii) the lease contract is a binding contract which neither party may terminate or alter without the other's consent;
- iii) the benefit from an *ijarah* must be lawful in *Shariah* and the asset should be used lawfully;
- iv) the leased asset is the responsibility of the lessor, including the insurance, throughout the duration of the *ijarah*, unless the lessee commits misconduct or negligence; and
- v) the rental must be specified.

The discussion in the previous section has shown that ruling 5.1.8 (1) has been violated and hence there is a violation of consensus. Therefore, the contract is not valid under Islamic commercial law.

In conclusion it can be argued that the *ijarah* contract under examination cannot be considered as valid since it has violated the *ijmaa* on one ruling. Moreover, in terms of compliance with the AAOIFI Standards, it achieves a very low score of 36%. Nevertheless, the discussion shows that a considerable number of the violated rulings are subject to legitimate juristic differences. In addition, in one area in which the contract violated the AAOIFI requirements it nevertheless complied with the view of the majority of jurists. However, this may not help justify the position of the institution which drafted this contract because it is stated in the Lease Agreement in Clause 26.1 that the agreement is governed by the AAOIFI Standards as interpreted by the *Fatwa* Board of that institution.

Importantly, the analysis reveals that the contract may conform with a particular ruling but then contradict it with other clauses which may be peripheral to the contract and not in the main body of the documentation. Overall, the contract under investigation has significant discrepancies and problems.

10.4 MAQASID ANALYSIS

The *maqasid* analysis involves two stages; first of all identifying the *maqasid* underlying the rulings and then examining the *murabahah* case study.

10.4.1 Exploring The Underlying *Maqasid*: A Ratiocinative Approach

This section explores the *maqasid* underlying the *ijarah* contract rulings. Each ruling is assigned its appropriate *maqasid/maqasid* and the justification is given, the ruling is stated and then the relevant *maqasid* are given with the justification. The following codes are used for the *maqasid*: A= circulation; B=preservation; C= persistence; D= justice; and E= transparency.

10.4.1.1 Analysis

Required Rulings

1. **Ruling 3.1** *For the validity of an Ijarah contract concerning a specified asset, the lease contract should be preceded by acquisition of either the asset to be leased or the usufruct of that asset.*

C and E: The lease contract should be preceded by acquisition of either the asset or the usufruct since if it is not this falls under the prohibition of selling what someone does not own.

This is because lease is considered a form of sale by classical jurists. For example, Ibn Qudama (1999) and Al Qarafee (1994) state that lease is the selling of usufructs. On an even clearer note, Al Qarafee (1994) states that the contract of lease is based on the sale contract—the rulings of lease are based on the rulings of the sale contract. Al Dareer (1967), a renowned contemporary scholar, also attests to this fact. Therefore, the *maqasid* of prohibiting the sale of what someone does not own apply here (refer to Ruling 2.3.1 of the *murabahah* contract).

2. Ruling 4.1.1 *The lease contract is a binding contract which neither party may terminate or alter without the other's consent except in case of force majeure.*

A, C and D: The majority of jurists maintain that the *ijarah* contract is binding upon both parties; the lessee and the lessor. They build this stance based on a number of rationales. One of them is that a lease contract is akin to a sale contract and, since there is a consensus on the bindingness of a sale contract, the lease contract is also binding (Al Jalood, 2007). Ibn Qudama (1999) asserts that in addition to it being an exchange contract, the lease is a type of sale and thus it is binding. He adds that the basis of this ruling is to prevent harm to any of the contracting parties.

Therefore, and since this is similar to ruling 4.3 (a) of the *mudarabah* contract, this ruling is allocated A and D. In addition, the stipulation of consent stems from the *maqsid* of persistence, C.

3. Ruling 4.1.2 *The duration of an Ijarah contract must be specified in the contract. The period of Ijarah should commence on the date of execution of the contract, unless the two parties agree on a specified future commencement date, resulting in a future Ijarah, that is, an Ijarah contract to be executed at a future date.*

E: Specifying the duration of the contract gives knowledge of the subject matter (Al Juwaini, 2011; Ibn Muflih⁴⁵, 1997) and thus it prevents *gharar* (Al Dareer; 1967) and

⁴⁵ D: 1362 AD.

potential disputes (Ibn Abdeen, 2003). Therefore, this ruling promotes the *maqsid* of transparency.

4. Ruling 5.1.1 (1) *The leased asset must be capable of being used while preserving the asset.*

E: It is a condition that the leased asset must be capable of being used while preserving the asset since the *ijarah* contract is in essence a contract on the usufruct, and if the asset is consumed whilst being used, then this means that the subject matter (the asset) perishes and thus no use can be made of the usufruct (Ibn Qudama, 1999).

In addition, if the asset is not preserved, but is rather consumed, then this is akin to a sale contract and not a lease contract which requires only the usufructs to be sold (Al Rafee, 1997; Al Dusooki⁴⁶, 1996). Consequently, the contract does not fall under the definition of lease. Therefore, prescribing this ruling promotes the *maqsid* of transparency since it ensures that both the name and substance of the contract are consistent. In other words, it does not allow the contract to be titled 'lease' while it is in essence a sale contract. This transparency allows allocating the correct rulings and thus prevents disputes.

5. Ruling 5.1.1 (2) *The benefit from an Ijarah must be lawful in Shari'a and the asset should be used lawfully.*

B: The benefit from the *ijarah* should be lawful in *Shariah*. In this regard, Ibn Muflih (1997: 416) asserts: "because the unlawful benefit is required to be eliminated in *Shariah* and thus money should not be spent in return for an unlawful object". Ibn Qudamah (1999), on a similar note, also states that this is not permissible since the benefit is unlawful and thus not recognized in *Shariah*. Therefore, paying money in return for a non-beneficial asset which is not recognized in *Shariah* is akin to taking people's money without right. Al Haitami (1996) also attests to this argument and agrees with it.

⁴⁶ D. 1815 AD.

D: Equity and justice imply earning and acquiring wealth lawfully (Ibn Ashur, 2011).

Therefore, this ruling promotes the preservation of wealth and justice.

6. Ruling 5.1.4 *The lessee must use the leased asset in a suitable manner or in conformity with common practice, and comply with conditions which are acceptable in Shariah.*

B: The leased asset has to be used in a suitable manner in order to reduce the harm and risk of harm that may fall on the asset as Al Juwaini (2011) proclaims. Therefore, this serves to protect wealth.

C: In addition, the benefit should not exceed what is allowed customarily as well as what is stated in the contract since it is not allowed to overcome what has been agreed in the contract (Ibn Muflih, 1997). Submitting to contractual obligations serves the *maqsid* of persistence according to Ibn Ashur (2011).

7. Ruling 5.1.5 *The lessor must accept responsibility for any defects of the leased asset which impair the intended use of the asset, and may not exclude his liability for any impairment that the leased asset may sustain, either by his own doing or as a result of events outside his control, which affect the benefits intended to be available under the Ijarah contract. (al baraa min al oyoob).*

A: The lessor may not exclude his liability for any impairment the leased asset may sustain since in principle there is a claimed consensus (Al Juwaini, 2011) that the leased asset is the responsibility of the lessor (Ibn Quadama, 1999). The rationale for this ruling, as Al Qarafee in *Al Dakheera* (1994) puts it, is that if the lessee was to be made responsible, then people may be reluctant to enter into such a contract and thus this contract will not be promoted. It can also be understood from Al Rafee's (1997) and Al Zuhayli's (1997) discussion that this ruling facilitates the *ijarah* contract. Therefore, this serves the *maqsid* of circulation of wealth.

B and D: In addition, it is not equitable to make the lessee pay the rental installments as well as being held responsible for any impairment. This violates justice and the protection of other people's wealth.

8. Ruling 5.1.7 (1) *The lessor may not stipulate that the lessee will undertake the major maintenance of the asset that is required to keep it in the condition necessary to provide the contractual benefits under the lease.*

A, B and D: The lessor should undertake the major maintenance since he is responsible for providing the lessee with all the means to facilitate his use and benefit of the asset (Al Zuhayly, 1997). The same reasoning as for ruling 5.1.5 applies here.

9. Ruling 5.1.7 (2) *The lessee should carry out operating or periodical (ordinary) maintenance.*

B and D: The lessee is required to carry out the ordinary maintenance since it is not just to hold the lessor responsible for all maintenance including the ordinary maintenance and doing so involves taking his money without right. This violates justice and the preservation of wealth.

10. Ruling 5.1.8 (1) *The leased asset is the responsibility of the lessor, including the insurance, throughout the duration of the Ijarah, unless the lessee commits misconduct or negligence. Therefore, if the benefit from the leased asset is impaired wholly or partially as a result of the lessee's misconduct, while the property remains under lease, the lessee is obliged to restore or repair the usufruct, and rent for the time during which the benefit is lost is not to be waived.*

A, B and D: The same reasoning as for ruling 5.1.5 applies here. In addition to that, it is not just to hold the lessor liable for defects that are a result of the lessee's misconduct.

11. Ruling 5.2.1 *The rental must be specified, either as a lump sum covering the duration of the Ijarah contract, or by installments for parts of the duration. It may also be for a fixed or variable amount, according to whatever designated method the two parties agree upon.*

E: The rental must be specified in order to ensure transparency and prevent conflict that may arise because of *gharar* (Al Dareer, 1967).

12. Ruling 5.2.2 *The rental is made obligatory by the contract and the lessor's entitlement to the rental runs from the time when the lessee starts to benefit from the asset or once the lessor makes the usufruct of the asset available to the lessee, and the entitlement to the rental does not necessarily commence on the date of signing the Ijarah contract.*

D: The lessor's entitlement to the rental runs from the time the lessee starts to benefit from the asset since this ensures that there is justice taking place in this exchange transaction. In other words, it will not be just and equitable for the lessor to claim the entitlement before the lessee starts benefiting from the asset (Al Ainee⁴⁷, 2000).

13. Ruling 6.3 *No increase in the rental due may be stipulated by the lessor in case of delay in payment by the lessee.*

A and D: This stipulation is not permissible since it entails potential *riba*.

⁴⁷ D. 1451 AD.

Conditionally Required Rulings

14. Ruling 2.3 *If the customer breaches his promise, in case a guarantee of the customer's commitment is taken, he is charged either the difference between the cost of the asset intended to be leased and the total lease rentals for the asset which is leased to a third party, or, if the asset is sold, the difference between its cost and the total selling price.*

B and D: This arrangement insures justice and the protection of money.

15. Ruling 3.1 (b) *If the asset is to be acquired from the customer or from a third party, the ijarah contract shall not be executed unless and until the institution has acquired that asset.*

C and E: It is a requirement that the asset is acquired by the institution or otherwise it will be like selling an asset which is not owned. This is not allowed in *Shariah*. Therefore, the rationale for ruling 3.1 applies here.

16. Ruling 3.3 *A lessee of an asset may enter into a sub-lease contract with a party other than the owner for a rental that is either the same, lower or higher, payable either currently or on a deferred basis, unless the owner stipulates that the lessee should not assign or sublet the property to third parties, or should not do so without his approval.*

C: The approval of the owner is required because the owner only has the exclusive right to the asset so his consent is required (Ibn Muflih, 1997). This serves the *maqsid* of persistence.

17. Ruling 5.1.8 (2) *If the lessor takes into account the insurance expenses implicitly when the lease rental is to be fixed, he may not, after the contract is signed, charge the lessee any cost in excess of the cost anticipated at the time of fixing the rent.*

B and D: The lessor may not charge the lessee any cost in excess of the cost anticipated at the time of fixing the rent since this is clearly inequitable and involves violation of people's rights and wealth.

18. Ruling 5.2.3 *In case the rental is subject to changes (floating rental), it is necessary that the amount of the rental of the first period of the ijarah contract be specified. It is then permissible that the rentals for subsequent periods be determined according to a certain benchmark.*

E: This is to ensure transparency and remove potential disputes.

19. Ruling 6.4 *It may be provided in the contract of ijarah or ijarah muntahia bittamleek that a lessee who delays payment for no good reason undertakes to donate a certain amount or percentage of the rental due in case of late payment. Such donation should be paid to charitable causes under the co-ordination of the Institution's Shariah Supervisory Board.*

A and D: The amount donated has to go to charitable causes since otherwise, if it goes for the benefit of the institution, then it is a form of *riba* (Usmani, 2002). Therefore, this ruling prevents *riba*.

20. Ruling 6.5 *In case of foreclosure of the security, the lessor may deduct from such amounts only what is due in respect of rental for previous periods.*

B and D: The lessor may deduct only what is due in respect of the previous rental periods since the contract has come to an end and hence, the lessor has no right to any

rent (Bank Negara Malaysia, 2010c). This ensures justice and protection of people's money and rights.

21. Ruling 7.1.3 *In case of total destruction of the leased asset, the ijarah contract is terminated if it is concluded on an identified asset. In such a case, it may not be stipulated that the rest of the instalments should be paid.*

B and D: This stipulation is prohibited since it violates justice and the *maqsid* of protection of wealth.

22. Ruling 8.1 *In ijarah muntahia bittamleek, the method of transferring the title in the leased asset to the lessee must be evidenced in a document separate from the ijarah contract document and cannot be taken as an integral part of the contract of ijarah.*

E: The transferring of the title document must be separate from the *ijarah* contract to ensure that the liabilities and obligations are not linked together (AAOIFI, 2010). This promotes the *maqsid* of transparency.

23. Ruling 8.2 *A promise to transfer the ownership by way of one of the specified methods is binding on one party only.*

B, C and E: The justification for ruling 2.3.1 of the *murabahah* contract applies here. In addition to that, since it is binding on the promisor, it protects the promisee (AAOIFI, 2010) and thus this serves the *maqsid* of preservation.

24. Ruling 8.3 *In all cases of transfer of ownership by way of gift or sale, it is necessary, when the promise is fulfilled, that a new contract be drawn up, since the ownership to the property is not automatically transferred by virtue of the original promise document that was drawn up earlier.*

C and E: The ownership of the property is not automatically transferred by virtue of the original promise document since it is merely a promise and the transfer of rights has to take place through a recognised contractual obligation. This eliminates any potential disputes and thus ensures transparency as well as ensuring fulfilment of the *maqsid* of persistence, which implies that rights should not be taken from the owner without consent (Ibn Ashur, 2011), and a promise does not denote consent.

25. Ruling 8.7 *Transfer of the ownership in the leased property cannot be made by executing, along with the ijarah, a sale contract that will become effective on a future date in the case of ijarah muntahia bittamleek.*

E: Ownership cannot be made contingent on a future date since in principle a sale contract, as the term ‘sale’ implies, has to have immediate effect, where the ownership is transferred immediately (AAOIFI, 2010). This can be understood to represent the *maqsid* of transparency since the substance of the contract has to match the name/title of the contract.

10.4.1.2 Standard results

The standard—benchmark—results are computed on the basis of the theoretical analysis in the previous section. Table 10.2 reports the results.

Table 10.2: Matrix for The Standard *Ijarah* Results

	MAQASID	CIRCULATION	PRESERVATION	PERSISTENCE	JUSTICE	TRANSPARENCY	TOTAL
	AAOIFI Ruling Reference	A	B	C	D	E	
Required Rulings							
1	3.1			1		1	2
2	4.1.1	1		1	1		3
3	4.1.2					1	1
4	5.1.1 (1)					1	1
5	5.1.1 (2)		1		1		2
6	5.1.4		1	1			2
7	5.1.5	1	1		1		3
8	5.1.7 (1)	1	1		1		3
9	5.1.7 (2)		1		1		2
10	5.1.8 (1)	1	1		1		3
11	5.2.1					1	1
12	5.2.2				1		1
13	6.3	1			1		2
Applicable Conditionally Required Rulings							
14	2.3		1		1		2
15	3.1 (b)			1		1	2
16	3.3			1			1
17	5.1.8 (2)		1		1		2
18	5.2.3					1	1
19	6.4	1			1		2
20	6.5		1		1		2
21	7.1.3		1		1		2
22	8.1					1	1
23	8.2		1	1		1	3
24	8.3			1		1	2
25	8.7					1	1
	TOTAL	6	11	7	13	10	47

Similar to the previous case studies, Table 10.3 presents the standard results with weighting.

Table 10.3: Standard Weighted Results for *Ijarah*

<i>Maqsid</i>	Circulation	Preservation	Persistence	Justice	Transparency	Total
Frequency	6	11	7	13	10	47
Weight	0.9740	0.2664	0.0456	0.5179	0.0765	1
Weighted Score	5.844	2.9304	0.3192	6.7327	0.7650	16.5913

The ideal weighted results show that the *maqsid* of justice is the highest observed *maqsid*, followed by the *maqsid* of circulation. The *maqsid* of preservation is third with 18% of the total distribution of *maqasid* in the contract. Both the *maqasid* of transparency and persistence obtained low scores.

10.4.2 Examining The *Maqasidic* Achievement Of The *Ijarah* Contract

The actual results of the *ijarah* case study are presented in Table 10.4.

Table 10.4: Matrix for *Ijarah* Case Study Results

	<i>MAQASID</i>	CIRCULATION	PRESERVATION	PERSISTENCE	JUSTICE	TRANSPARENCY	TOTAL
	AAOIFI Ruling Reference	A	B	C	D	E	
Required Rulings							
1	3.1			1		1	2
2	4.1.1	1		1	1		3
3	4.1.2					1	1
4	5.1.1 (1)					1	1
5	5.1.1 (2)		1		1		2
6	5.1.4		1	1			2
7	5.1.5	-1	-1		-1		-3
8	5.1.7 (1)	1	1		1		3
9	5.1.7 (2)		1		1		2
10	5.1.8 (1)	-1	-1		-1		-3
11	5.2.1					1	1
12	5.2.2				-1		-1
13	6.3	-1			-1		-2
Conditionally Required Rulings							
14	2.3		1		1		2
15	3.1 (b)			1		1	2
16	3.3			1			1
17	5.1.8 (2)		1		1		2
18	5.2.3					-1	-1
19	6.4	1			1		2
20	6.5		-1		-1		-2
21	7.1.3		-1		-1		-2
22	8.1					1	1
23	8.2		-0.5	-0.5		-0.5	-1.5
24	8.3			1		1	2
25	8.7					1	1
	TOTAL	0	1.5	5.5	1	6.5	14.5

Following on from Table 10.4, the actual non-weighted scores are divided by the ideal non-weighted scores—Table 10.5 reports these results:

Table 10.5: *Ijarah* Non-Weighted Percentage Compliance

<i>Maqsid</i>	Circulation	Preservation	Persistence	Justice	Transparency	
Actual	0	1.5	5.5	1	6.5	14.5
Standard	6	11	7	14	9	47
%	0%	14%	79%	8%	65%	31%

In addition, the weighted results, which are the product of the frequency of each *maqsid* and its weight, are presented in Table 10.6:

Table 10.6: *Ijarah* Weighted Results

<i>Maqsid</i>	Circulation	Preservation	Persistence	Justice	Transparency	Total
Frequency	0	1.5	5.5	1	6.5	14.5
Weight	0.9740	0.2664	0.0456	0.5179	0.0765	1
Weighted Score	0	0.3996	0.2508	0.5179	0.4973	1.6656

Finally, the actual weighted scores are divided by the ideal weighted scores to obtain percentage compliance. Table 10.7 reports these results:

Table 10.7: *Ijarah* Weighted Percentage Compliance

<i>Maqsid</i>	Circulation	Preservation	Persistence	Justice	Transparency	
Actual	0	0.3996	0.2508	0.5179	0.4973	1.6656
Standard	5.844	2.9304	0.3192	6.7327	0.7650	16.5913
%	0%	14%	79%	8%	65%	10%

The real life *ijarah* case study examined has obtained a very low score in terms of compliance with *maqasid al Shariah*—10%. Although the transaction scored relatively high on the persistence and transparency *maqasid*, it scored very low or no score at all on the *maqasid* that have more weight—preservation, justice and circulation—and hence the overall *maqasidic* achievement was low. In addition, the results show that there is a considerable difference between the overall weighted score (10%) and the overall non-weighted score (31%).

10.5 CONCLUSION

This chapter has conducted a comprehensive examination of the *Shariah* compliance and *maqasid al Shariah* achievement for a real life *ijarah* transaction. The transaction consisted of seven documents.

In terms of compliance with the AAOIFI Standards, the contract scored 36%. Non-compliance of this contract with the AAOIFI Standards was due to the failure to adhere to nine rulings. The majority of these rulings, namely Rulings 5.1.5; 5.1.8 (1); 5.2.2; 5.2.3; 6.3; 6.5; 7.1.3, were directly contradicted and one ruling, namely Ruling 8.2, was partially contradicted. In addition, one ruling was diluted. According to the analysis, there were no rulings omitted in this contract. In addition, the analysis revealed that the contract may agree with a particular ruling but then contradict it with other clauses which may be peripheral to the contract and not in the main body of the documentation. More importantly, the analysis has shown that ruling 5.1.8 (1) has been violated and hence there is a violation of consensus. Overall, the contract under investigation has significant discrepancies and due to the violation of consensus it does not fall under any of the *Shariah* compliance strategies and hence is not valid. The second part of this examination was assessing the *maqasidic* achievement of the contract. The results have shown that the transaction scored 10% in its overall *maqasid* achievement. The main reason for this was that the *maqasid* that were not satisfied were the ones that have greater weights and therefore the non-satisfaction of these *maqasid* has a considerable impact on the overall *maqasidic* achievement.

CHAPTER 11

CASE STUDY 4: THE *ISTISNA*A CONTRACT

11.1 INTRODUCTION

This chapter is devoted to the *istisnaa* contract case study; the *istisnaa* contract itself is analysed from both the *Shariah* and *maqasid al Shariah* perspectives as with the previous contracts. The chapter is divided as follows: Section 11.2 provides an outline of the transaction and the consolidated documentation. Sections 11.3 and 11.4 document the *Shariah* examination and the *maqasid* analysis, while Section 11.5 offers some concluding remarks.

11.2 OUTLINE OF THE TRANSACTION

With regard to the structure of the transaction, the bank enters into an *istisnaa* agreement with the customer in relation to the production of a specified asset. The bank is the *sanea* (manufacturer) and the customer is the *mustasnea* (buyer). Simultaneously, the bank also enters into a parallel *istisnaa* agreement with a manufacturer and developer to construct the same asset. The customer pays the bank and the bank, in turn, pays the manufacturer. On the delivery date, the manufacturer delivers the *istisnaa* asset to the bank, which it then delivers to the customer.

There are two *istisnaa* agreements in this structure. They are similar in format as one of them is between the bank and the customer and the other is between the bank and the manufacturer, yet they differ in details such as the date of delivery, although these do not affect the overall structure. Thus, this section describes the format, rather than the details, of the agreements.

The *Istisnaa* Agreement

The *istisnaa* agreement commences with an identification of the contracting parties, followed by the definitions and interpretation in article 1. The main section starts with article 2, which is termed ‘Basis of *Istisnaa* Arrangements’, and ends with article 19, ‘Governing Law and Jurisdiction’. There are three schedules attached to the document along with an execution page: Schedule 1 describes the asset; Schedule 2 details the purchase price; and Schedule 3 provides the construction phases. The document ends with the execution phase.

11.3 SHARIAH ANALYSIS

To examine the *Shariah* compliance of the *istisnaa* transaction, the relevant rulings have to be identified before performing the content analysis and allocating the scores. The following sub-sections cover these elements.

11.3.1 Identification Of Benchmark Rulings

The AAOIFI (2010) *istisnaa* standard rulings have been classified into fourteen required rulings (see Appendix D1) and nine conditionally required rulings (see Appendix D2). The contract was examined in the same manner as the previous contracts.

11.3.2 Results

11.3.2.1 Compliance with AAOIFI Standards

Given that both *istisnaa* contracts are similar, they achieved the same score of 76% compliancy with the AAOIFI Standards (2010). The score was calculated as follows: twenty-three rulings have to be satisfied in total; fourteen of them are from the required category; and nine are from the conditionally required category. Out of the twenty-three rulings, seventeen were satisfied, three were omitted, one was partially contradicted, and two were diluted. Therefore, the result is $17.5/23 = 0.761$, which when translated into a percentage becomes 76%. The results are presented in Table 11.1 and discussed in the following sections.

Table 11.1: *Istisnaa* Contract Shariah Analysis Results

Number	Ruling Reference	Maximum Score	Actual Score
REQUIRED RULINGS			
1	2.2.1 (1)	1	1
2	2.2.1 (2)	1	1
3	2.2.1 (3)	1	0
4	2.2.1 (5)	1	0
5	2.2.3	1	1
6	2.2.4	1	1
7	3.1.1	1	1
8	3.1.3 (1)	1	1
9	3.1.6 (1)	1	1
10	3.1.6 (2)	1	1
11	3.2.5	1	1
12	6.1	1	0
13	6.7 (2)	1	1
14	6.8	1	1
APPLICABLE CONDITIONALLY REQUIRED RULINGS			
15	2.2.1 (4)	1	1
16	3.1.2	1	1
17	3.2.2	1	1
18	4.1.1 (2)	1	1
19	4.2.4 (1)	1	1
20	6.3 (1)	1	1
21	6.7 (1)	1	-0.5
22	7.1	1	0.5
23	7.3	1	0.5
TOTAL		23	17.5
			76%

The analysis shows that six rulings were found to be non-compliant or not completely compliant, namely, rulings 2.2.1 (3), 2.2.1 (5), 6.1, 6.7 (1), 7.1, and 7.3. According to the devised non-compliance typology, rulings 2.2.1 (3), 2.2.1 (5), and 6.1 fall under the omitted rulings category, and ruling 6.7 (1) is in the partial contradiction category. Rulings 7.1 and 7.3 have been stated in an ambiguous format. It is also important to highlight that the *istisnaa* contract is only explicitly permitted under the *Hanafi* jurisprudence. The other schools of *fiqh* (the *Shafee*, the *Maliki*, and the *Hanbali* schools) do not recognise it as a separate contract; rather, they discuss the rulings of *istisnaa* under other contracts such as the general sale contract and the *salam* (advance payment) contract (Badran, 1968). For these schools of *fiqh*, the rulings of *istisnaa* are

therefore endogenised under other contracts. Thus, as Badran (1968) indicates, it is not an easy task to discuss the *istisnaa* rulings from a comparative jurisprudential perspective.

Dilution

Rulings 7.1 and 7.3 have been stated ambiguously, thereby falling under the dilution category.

Omission

Ruling 2.2.1 (3) states that the *istisnaa* contract is binding for both parties (AAOIFI, 2010). The contract under investigation is, however, explicit that it is binding for the seller. Sub-clause 4.1.3 states that regarding legal validity

each of the Documents to which the Seller is or will be a party constitutes (or when executed will constitute) legal, valid and binding obligations enforceable in accordance with its terms.

As there is no indication that it is also binding for the buyer, it is then one of the omitted rulings. Reflecting on classical *fiqh* and according to the *Hanafi* school, the *istisnaa* agreement is not binding for either party, the buyer or the manufacturer (Al Kasani, 2000), up to the stage when the asset has been manufactured but the buyer has not yet seen it (Ibn Al Humam⁴⁸, 1970). Once the asset has been manufactured and the buyer has seen it, there is, however, a disagreement among *Hanafi* scholars, with some arguing that in this case it is binding for the seller only or, in other words, the seller *has* to deliver the asset (Ibn Al Humam, 1970). A second view is that it is still not

⁴⁸ D: 1457 AD.

binding for either party. The third perspective, attributed to Abu Yusuf, is that it is binding for both parties (Al Kasani, 2000), yet the *Mejjelle* (Haider, 2003) maintains that the *istisnaa* is binding for both parties from the moment of signing the contract, a belief which is also held by some *Hanafi* scholars (Ibn Abdeen, 2003). Therefore, this shows that Ruling 2.2.1(3)—that has not been complied with—is subject to jurisprudential differences, even within the Hanafi school of *fiqh*. Thus, when the contract made it explicitly binding for the seller but not the buyer, they have followed one legitimate view. Nevertheless, it has been considered an omitted ruling since it is not in line with the benchmark selected for this study.

Ruling 2.2.1 (5), which gives the customer the option to refuse the asset if it does not conform to the specifications (AAOIFI, 2010), has also not been complied with here. Clause 3.1.1 of the *istisnaa* contract states that

The Seller shall at all times pay promptly or, as the case may be, indemnify and hold harmless the Buyer, its employees, directors and officers from and against each and every liability (including any third-party liability), losses, charges, claims, demands, actions, proceedings (whether civil or criminal), penalties, fines, damages, judgments, orders, sanctions, enforcement costs, fees, commissions, cost and expense or other outgoings of whatever nature including actual loss (together Losses) that may be suffered, incurred or paid by, or made or asserted against the Buyer or by any other person whether through contract, tort or otherwise due to:

(a) the Asset not being constructed in accordance with the Specifications.

The clause thus contains no indication that the buyer has the right to refuse to accept the asset, meaning that it can also be considered to be an omitted ruling. Although the classical jurists seem to be silent about this question when they discuss the contract of *istisnaa*, this issue is similar in principle to the presence of defects in an asset within an *ijarah* contract, which has been discussed in Ruling 5.1.5 of that contract.

Ruling 6.1 has also been omitted; it states that the manufacturer is discharged from liability if the subject matter is delivered to the ultimate purchaser, to a person

appointed by him, or if the ultimate purchaser is enabled to exercise full control over the subject matter.

Partial Contradiction

Ruling 6.7 (1) has correspondingly not been complied with; it states that if the manufacturer is late in delivering the subject matter, it is permissible for the ultimate purchaser to ask for compensation, given that the delay is not caused by intervening contingencies (AAOIFI, 2010). In Clause 8.1.1 of the contract under study, the ultimate purchaser is given two options in this event:

(a) immediately terminate this Agreement as described in Clause 9 (Termination by the Buyer); or

(b) require that the Seller shall pay liquidated damages to the Buyer for the default.

The first option complies with *Shariah* requirements and is therefore valid, yet the contradiction lies in the second option, which requires the seller to pay the liquidated damages unconditionally. Similarly, Clause 8.2.1 states that:

Notwithstanding the terms, conditions and provisions of this Agreement, if, for any reason, the Seller delays the Delivery of the Asset beyond the Additional Time, then the Seller undertakes to pay liquidated damages.

The contract therefore implicitly gives the ultimate purchaser the option to ask for compensation, *even* if this was caused due to intervening contingencies. Moreover, the contract gives greater protection and safeguards the right of the buyer in other clauses. For instance, Clause 10.1.1 states that:

The Seller may terminate the Agreement if the Seller does not receive from the Buyer an amount due within the time period mentioned in this

Agreement together with a grace period of [...] days unless such delay is due to circumstances beyond the control of the Buyer.

Thus, the seller has the right to terminate the agreement in circumstances that are beyond the control of the buyer, yet the reciprocal right is not given to the seller, meaning that the advantage lies with the buyer. In conclusion, it can be argued that Ruling 6.7 (1) has been diluted.

It is pertinent to indicate in this context that this penalty is unknown in this form within classical *fiqh* (Badran, 1968). Contemporary jurists who allow the penalty clause, whether in the case of *istisnaa* or other contracts, have, however, made it permissible on the condition that there are no intervening conditions on the party paying the penalty (see, for example, Bank Negara (2010), *Shariah Parameters on the Istisnaa Contract*). It can therefore be argued that diluting this ruling, as in the case of the contract being analysed, is not based on contemporary *fiqh*, and, as a result, it cannot be justified even within the wider Islamic law.

11.3.2.2 Identifying the overall *Shariah* compliance

The aim of this section is to explore under which *Shariah* compliance approach the contract in question can be classified. To achieve this, the framework devised in Chapter 6 has to be applied. The first question in addressing the *Shariah* compliance strategy is:

A: Is there any clause in the contract that violates ijmaa?

If yes, the contract is not valid in Shariah.

If no, go on to B.

As previously indicated, the jurists are not unanimous that *istisnaa* as a distinct contract is permitted in the first place. By extension, making a claim of consensus on

the particular *istisnaa* injunctions is also problematic in principle. The analysis, therefore, differs to those on previous contracts, which focused on the validation of the contracts in light of *ijmaa*, as no consensus on any particular ruling on *istisnaa* can be claimed. Hence, the first question is not applicable and so the following question applies:

B: Is there any ruling in the contract that is not acceptable according to the majority of scholars?

If yes, the contract is valid according to the liberal approach.

If no, go on to C.

Theoretically, the *istisnaa* contract is not permitted according to the majority of jurists, as was clarified in the previous section. The answer to this question is therefore positive and the contract is, therefore, valid according to the liberal approach.

11.4 MAQASID ANALYSIS

As with the previous case studies, the *maqasid* analysis involves two stages: identifying the *maqasid* underlying the rulings and examining the *istisnaa* case study.

11.4.1 Exploring The Underlying *Maqasid*: A Ratiocinative Approach

A theoretical analysis is conducted here in order to link each ruling with the *maqsid* or *maqasid* it fulfils. The ruling is stated and then the relevant *maqasid* are given with the justification. The following codes are used for the *maqasid*: A= circulation; B= preservation; C= persistence; D= justice; and E= transparency.

11.4.1.1 Analysis

Required rulings

- 1. Ruling 2.2.1 (1)** *It is a condition that the type, kind, quality and quantity of the subject-matter to be produced are specified.*

E: The type, kind, quality, and quantity of the subject matter have to be specified because otherwise there will be no knowledge of the subject matter (Kasani, 2000). Al Shirbini⁴⁹ (2009), in the book of *salam*, makes an analogy on sale when he states that the sale of an object which has been ascertained (*ayn*) is not permissible if it is unknown. Hence, it is an *a priori* argument to not allow the sale of a debt that is not known. Ibn Muflih (1997) also adds that if the subject matter is not specified, this may

⁴⁹ D: 1570 AD.

lead to disagreement and conflict. This ruling is therefore assigned the *maqsid* of transparency.

2. Ruling 2.2.1 (2) *It is a condition that the price of the subject matter is known.*

D and E: The price of the subject matter should be known as otherwise there will be a lack of knowledge and uncertainty in the contract (Al Zuhayli, 1984). In addition, Al Juwaini (2011), Ibn Muflih (1997), and Al Dusooki (1996) advance another justification for this ruling, asserting that there may be cases where the delivery of the subject matter is not possible, there has been delay, or the contract is revoked for some reason. In these cases, the seller will thus have to pay the buyer back the equivalent of the sum originally paid. If the price is not known at the outset of the contract, it would not be possible to return the exact amount, making it not equitable. Thus, the ruling is assigned the justice and transparency *maqasid*.

3. Ruling 2.2.1 (3) *A contract of istisnaa is binding on the contracting parties, provided that the aforementioned conditions are fulfilled.*

A and B: In his encyclopaedic treatise on *Hanafi* jurisprudence, *Al Muheet Al Burhani*, Al Bukhari⁵⁰ (2004) provides a clear justification for the ruling that the *istisnaa* contract is binding for both parties, arguing that for the seller (the *sanea*), the contract is binding as he has taken the liability and agreed to construct or manufacture the subject matter. For the buyer too (the *mustasnea*), it is also binding as otherwise this could harm the seller, who may be unable to find anyone to buy the subject matter and may thus incur a loss. In addition, Al Saloos (2003) and Al Zuhayli (1984) state that this ruling is consistent with the general concept of bindingness for contracts in Islamic commercial law. This ruling is therefore assigned both the *maqasid* of circulation and the *maqasid* of preservation because the notion of bindingness promotes the circulation of wealth and it prevents loss on the part of the seller.

⁵⁰ D. 1219 AD.

4. Ruling 2.2.1 (5) *The customer has the option to accept or to refuse the subject matter if the subject matter does not conform to the specification agreed upon.*

C: The customer has the option to accept or refuse the subject matter if it does not conform to the specifications agreed upon (Haider, 2003) as the contractual requirements have not been met, and the buyer has the right to accept or rescind. This notion follows from the concept of complying with the stipulations and conditions (Al Saloos, 2003) which, according to Ibn Ashur (2011), is an element of the *maqsid* of persistence.

5. Ruling 2.2.3 *It is not permitted for the manufacturer to stipulate in the contract of istisnaa that he is not liable for defects.*

B, D, and E: The manufacturer is not allowed to stipulate that he is not liable for defects in *istisnaa* as this is the default ruling in the case of ordinary sales (Ibn Qudama, 1999; Al Zuhayli, 1984). According to Ibn Rushd (2004), the rationale for this ruling is that it belongs to a category of *gharar*, which pertains to defects the seller is not aware of, and to the category of fraud in the case of defects that are known. Hence, this ruling is assigned the *maqasid* of preservation, justice, and transparency.

6. Ruling 2.2.4 *It is not permitted to conclude istisnaa contracts or processes of istisnaa in a manner that makes it a legal device for mere interest-based financing.*

A and D: *Istisnaa* should not be concluded in a manner that makes it a legal device for interest-based financing due to potential *riba*. Hence, the *maqasid* pertaining to the prohibition of *riba* apply here (see Chapter 8).

7. Ruling 3.1.1 *An istisnaa contract is permitted only for raw materials that can be transformed from their natural state by a manufacturing or construction process involving labour. Therefore, istisnaa is valid only in so far as the supplier has agreed to provide subject matter that is manufactured or constructed.*

E: The *istisnaa* contract is only valid for raw materials that can be transformed from their natural state by manufacturing or construction as, according to the AAOIFI (2010), items that are not the subject of transformation or manufacture do not fall under the definition of *istisnaa*, which etymologically and technically means the sale of objects that are created in such a specified manner. Al Zuhayli (1984) emphasises that where the subject matter is not subject to transformation then the contract is valid as *salam*, and not *istisnaa*, because consideration is given to the substance of the contract and not the title or wording. Hence, it can be understood from their arguments that the *maqsid* underlying this ruling is transparency. In essence, *Shariah*, in order to achieve transparency, recognises that the substance of the contract has to match its wording and title, thereby ensuring clarity, accountability, and transparency.

8. Ruling 3.1.3 (1) *It is not permissible that the subject matter of an istisnaa contract be an existing and identified capital asset.*

E: According to Ibn Rushd (2004), jurists did not disagree on the point that the subject matter of an *istisnaa* contract cannot be an existing specified capital asset—it has to be always taken as a liability or *dayn*. The same ruling applies to *salam* which the *istisnaa* contract is regarded as its subsidiary according to the majority of scholars (Al Saloos, 2003). Hence the rationale can be taken from the justifications given on the *salam* contract. In this regard, Al Shirbini (2009) asserts that the term *salam* implies a liability and thus a specific asset contradicts the concept of liability, *dayn*. Accordingly, Al Haitami (1996) states that this follows on from the maxim which states that the implications of the wording should be considered; namely, the term “*salam*” implies debtness and the subject matter should thus not be specified for it to comply with the debtness condition. This notion has been attested by Al Juwaini (2011). The same

arguments can be extended to *istisnaa*. Consequently, the *maqsid* that most ensembles this ruling is that of transparency.

9. Ruling 3.1.6 (1) *The manufacturer is under an obligation to produce the subject matter according to specification.*

C: The manufacturer has to produce the subject matter according to specification as obligations have to be respected. Thus, the *maqsid* allocated to this is persistence, which requires obligations to be honoured.

10. Ruling 3.1.6 (2) *The manufacturer is under an obligation to produce the subject matter within the period agreed upon or within such reasonable time as the nature of the work may permit, in accordance with accepted practice that is recognized by experts.*

C: The same justification used for ruling 3.1.6 (1) also applies here.

11. Ruling 3.2.5 *A contract of istisnaa cannot be drawn up on the basis of a murabahah date, for example, by determining the price of istisnaa on a cost-plus basis.*

E: The contract of *istisnaa* cannot be drawn up on the basis of a *murabahah* sale because the nature of *istisnaa* is different to the nature of *murabahah* and contradicts it in a number of ways. For example, the subject matter of *murabahah* should already exist, whereas the subject matter of *istisnaa* is an item to be manufactured. Therefore, this situation is akin to rulings 3.1.1 and 3.1.3 (1) in terms of considering the implication of the wording of the contract; hence, the *maqsid* of transparency is assigned to this ruling. This can be understood in the context of regulation and consistency between the form and substance of contracts.

12. Ruling 6.1 *The manufacturer is discharged from liability if the subject matter is delivered to either the ultimate purchaser or to a person appointed by him or if the ultimate purchaser is enabled to exercise full control over the subject matter.*

B and D: The manufacturer is discharged from liability if delivery takes place or the buyer is enabled full exercise of the subject matter as there is an agreement between jurists on this issue (Hamad, 1978). It can be inferred that the basis for this is that it is inequitable to hold the manufacturer liable after having delivered the object. In addition, the manufacturer may need to incur storage costs. Thus, this ruling is assigned two *maqasid*: justice and preservation.

13. Ruling 6.7 (2) *It is not permitted to stipulate a penalty clause against the ultimate purchaser for default on payment.*

A and D: The justification for Ruling 4.8 of the *murabahah* contract also applies here.

14. Ruling 6.8 *It is not permissible to sell the subject matter before taking either actual or constructive possession of it.*

C and E: It is not permissible to sell the subject matter before possessing it as this falls under selling what one does not own. Hence, the justification for Ruling 2.3.1 of the *murabahah* contract applies here.

Conditionally Required Rulings

15. Ruling 2.2.1 (4) *If there is a delivery date, then it must be stated.*

E: If there is a delivery date, it must be stated in order to ensure transparency and eliminate potential disputes.

16. Ruling 3.1.2 *It is permissible that the contract of istisnaa be concluded for the production of a subject matter having a unique description according to the requirement of the ultimate purchaser even if such a subject matter is subject to specification.*

E: The condition that the subject matter in this case has to have a unique description is to ensure transparency and eliminate any potential disputes. Hence, the *maqsid* of transparency is assigned to this ruling.

17. Ruling 3.2.2 *It is permissible to connect payment with the stage of completion of the work (such that a payment is made at the end of each stage), provided the stages of this type of work are subject to specification and their identification will not lead to dispute.*

E: The payment can be connected to the stage of completion if the stages are custom and subject to specification, as this, according to the AAOIFI (2010), will not lead to disputes. Hence, the *maqsid* of transparency is assigned here.

18. Ruling 4.1.1 (2) *It is permissible, after the conclusion of an istisnaa contract, for the manufacturer and the ultimate purchaser to agree on amending the manufacturing or construction specifications previously agreed upon or introducing additional specification requirements, on condition that the price is adjusted accordingly and a reasonable period for the execution of the new requirements is granted.*

B and D: The specifications of the contract can be amended if the price is adjusted accordingly and a reasonable time is granted for the execution of the new requirements as this serves two purposes. Initially, it serves the *maqsid* of justice as the price has to be adjusted accordingly to ensure the return is consistent with the work achieved. Further, the *maqsid* of preservation is reflected in this ruling as the money and the effort of both parties are preserved through the stipulation of price adjustment. The *maqsid* of justice and the *maqsid* of preservation are therefore assigned here.

On a similar note, the condition that reasonable time should be given for the new requirements can be understood in the context of Ibn Ashur's (2011) assertion that the worker should be provided with the means necessary to complete the work.

19. Ruling 4.2.4 (1) *In case the contractor is unable to continue to discharge his obligation, and if the failure to perform is due to the misconduct of the contractor, the ultimate purchaser is liable only for the value of the building structure and the builder is liable to compensate the ultimate purchaser for any actual damage or loss he suffered.*

B and D: If the contractor is unable to discharge his obligations due to misconduct on his part, the purchaser is only liable for what has been completed and the manufacturer has to compensate the buyer for any actual damage or loss; this ruling ensures that justice prevails and protects the money and rights of the contracting parties.

20. Ruling 6.3 (1) *It is permissible that the delivery of the subject matter takes place before the due date, on condition that the subject matter meets the specifications agreed upon, in which case the ultimate purchaser is obliged to accept the subject matter.*

B and D: The delivery can take place before the due date if the specifications have been met as the objectives of the contract have therefore also been met, and the manufacturer may incur losses if the purchaser does not accept. This scenario further entails an element of injustice, which indicates why both the *maqasid* of justice and the *maqasid* of preservation have been assigned to this ruling.

21. Ruling 6.7 (1) *It is permissible for the contract of istisnaa to include a fair penalty clause stipulating an agreed amount of money for compensating the ultimate purchaser adequately if the manufacturer is late in delivering the subject matter. Such compensation is permissible only if the delay is not caused by intervening contingencies (force majeure).*

B and D: The International Islamic *Fiqh* Academy (1992) has ruled out that the penalty clause is permissible if the delay is not caused by intervening contingencies. Al Saloos (2003) justifies this by saying that the *Shariah* rulings are based on ability, capacity, and the notion of the prevention of harm. Thus, it can be inferred that the basis for this ruling is eliminating harm, which entails the preservation of wealth as well as justice by not holding the seller liable for something out of their capacity.

22. Ruling 7.1 *[Parallel istisnaa] is permissible on condition that the delivery date stipulated in the parallel (sale) contract must not precede that stipulated in the original purchase contract, and, moreover, the two contracts should remain separate from each other.*

A and D: The two contracts should remain separate from each other as, according to the AAOIFI (2010: 196), this separation “has the effect of making the transaction a type of non-financing”. This ruling therefore aims at eliminating *riba*. Thereby the justification of Ruling 7.3 of the *mudarabah* contract applies here.

23. Ruling 7.3 *As a result of concluding an istisnaa contract in the capacity of a producer or supplier, the institution must assume liability for ownership risk and maintenance and insurance expenses prior to delivering the subject matter to the ultimate purchaser (the customer). Moreover, the institution is not permitted, in the parallel istisnaa contract concluded with the manufacturer, to transfer to the latter the risk arising from its obligations towards the customer.*

A and D: The imposition of the liability for the maintenance and insurance expenses on the ultimate purchaser can be considered as violating the maxim stating that the right to profit is associated with bearing risk, *al gurm bil gunm*. Hence, the justification for Ruling 2.5.2 of the *murabahah* contract applies here.

11.4.1.2 Standard results

This section quantifies the outcome of the previous theoretical analysis; the calculation method is explained in Chapter 8. Table 11.2 displays the ideal results, which are labelled as the ‘standard’ results, and Table 11.3 presents the weighted results.

Table 11.2: Matrix for The Standard *Istisnaa* Results

	<i>MAQASID</i>	CIRCULATION	PRESERVATION	PERSISTENCE	JUSTICE	TRANSPARENCY	TOTAL
	Ruling Reference	A	B	C	D	E	
Required Rulings							
1	2.2.1 (1)					1	1
2	2.2.1 (2)				1	1	2
3	2.2.1 (3)	1	1				2
4	2.2.1 (5)			1			1
5	2.2.3		1		1	1	3
6	2.2.4	1			1		2
7	3.1.1					1	1
8	3.1.3 (1)					1	1
9	3.1.6 (1)			1			1
10	3.1.6 (2)			1			1
11	3.2.5					1	1
12	6.1		1		1		2
13	6.7 (2)	1			1		2
14	6.8			1		1	2
Applicable Conditionally Required Rulings							
15	2.2.1 (4)					1	1
16	3.1.2					1	1
17	3.2.2					1	1
18	4.1.1 (2)		1		1		2
19	4.2.4 (1)		1		1		2
20	6.3 (1)		1		1		2
21	6.7 (1)		1		1		2
22	7.1	1			1		2
23	7.3	1			1		2
	Total	5	7	4	11	10	37

Table 11.3: Standard Weighted Results for *Istisnaa*

<i>Maqsid</i>	Circulation	Preservation	Persistence	Justice	Transparency	Total
Frequency	5	7	4	11	10	37
Weight	0.9740	0.2664	0.0456	0.5179	0.0765	1
Weighted Score	4.87	1.8648	0.1824	5.6969	0.765	13.3791

The ideal weighted results show that the *maqsid* of justice scored highest and is followed by the *maqsid* of circulation. The results also show a considerable difference between these two *maqsid* and the *maqsid* of persistence and transparency.

11.4.2 Examining The *Maqasidic* Achievement Of The *Istisnaa* Contract

The actual results for the *istisnaa* case study are presented in Table 11.4.

Table 11.4: Matrix For *Istisnaa* Case Study Results

	MAQASID	CIRCULATION	PRESERVATION	PERSISTENCE	JUSTICE	TRANSPARENCY	TOTAL
	Ruling Reference	A	B	C	D	E	
Required Rulings							
1	2.2.1 (1)					1	1
2	2.2.1 (2)				1	1	2
3	2.2.1 (3)	0	0				0
4	2.2.1 (5)			0			0
5	2.2.3		1		1	1	3
6	2.2.4	1			1		2
7	3.1.1					1	1
8	3.1.3 (1)					1	1
9	3.1.6 (1)			1			1
10	3.1.6 (2)			1			1
11	3.2.5					1	1
12	6.1		0		0		0
13	6.7 (2)	1			1		2
14	6.8			1		1	2
Applicable Conditionally Required Rulings							
15	2.2.1 (4)					1	1
16	3.1.2					1	1
17	3.2.2					1	1
18	4.1.1 (2)		1		1		2
19	4.2.4 (1)		1		1		2
20	6.3 (1)		1		1		2
21	6.7 (1)		-0.5		-0.5		-1
22	7.1	0.5			0.5		1
23	7.3	0.5			0.5		1
	Total	3	3.5	3	7.5	10	27

The next step is to divide the actual non-weighted scores with the standard non-weighted scores to obtain a non-weighted percentage compliance. Table 11.5 presents these results.

Table 11.5: *Istisnaa* Non-Weighted Percentage Compliance

<i>Maqsid</i>	Circulation	Preservation	Persistence	Justice	Transparency	
Actual	3	3.5	3	7.5	10	27
Standard	5	7	4	11	10	37
%	60%	50%	75%	68%	100%	73%

In addition, Table 11.6 presents the weighted *istisnaa* results.

Table 11.6: *Istisnaa* Weighted Results

<i>Maqsid</i>	Circulation	Preservation	Persistence	Justice	Transparency	Total
Frequency	3	3.5	3	7.5	10	27
Weight	0.9740	0.2664	0.0456	0.5179	0.0765	1
Weighted Score	2.922	0.9324	0.1368	3.88425	0.765	8.64045

Consequently, the actual weighted scores are divided by the ideal weighted scores to obtain the percentage compliance, as is shown in Table 11.7.

Table 11.7: *Istisnaa* Weighted Percentage Compliance

<i>Maqsid</i>	Circulation	Preservation	Persistence	Justice	Transparency	
Actual	2.922	0.932	0.137	3.884	0.765	8.640
Standard	4.870	1.865	0.182	5.697	0.765	13.379
%	60%	50%	75%	68%	100%	65%

The *istisnaa* transaction under investigation achieved an overall score of 65% in terms of its *maqsid* compliance. The *maqsid* of transparency has been considered the most in this transaction, attaining the full possible score, and it is followed by the *maqsid* of persistence with 75% compliance. The *maqsid* of preservation obtained the lowest score. The findings also show differences between the weighted and non-weighted scores.

11.5 CONCLUSION

The chapter conducted a comprehensive investigation of the *Shariah* compliance and the realisation of *maqasid* in the contract of *istisnaa*. The contract scored 76% in compliance with the AAOIFI *Shariah* standards. The rulings that were not complied with can, however, be justified by different views within classical Islamic law. The analysis has also shown that the contract is valid under the liberal approach of *Shariah* compliance. Regarding *maqasid al Shariah*, the *istisnaa* transaction scored 65% overall. The scores of the individual *maqasid* ranged from 50%, achieved by the *maqsid* of preservation, to 100%, achieved by the *maqsid* of transparency, which shows that the different *maqasid* are correspondingly realised differently in the contract.

CHAPTER 12

DISCUSSION, CONTEXTUALISATION, AND CONCLUSIONS

12.1 INTRODUCTION

Against the positive financial developments of IPF, it is important to examine the underpinning aspects of IPF from a legal and *maqasidic* perspective. Hence, this study aimed to explore the contracts used in IPF and examine their practice in Islamic financial institutions from two dimensions: the *Shariah* compliance and the adherence to *maqasid al Shariah*.

The first theme of the study was the *Shariah* compliance; it therefore began with a critical review of the main IPF contracts and their structures. The study then contributed to the development of a methodology for contract analysis. Its main contribution was the development of a framework for quantifying the compliance of contracts with the AAOIFI (2010) *Shariah* Standards. The study's second methodological contribution was the development of a framework for exploring the nature of *Shariah* compliance, termed the '*Shariah* Compliance Approach'. This has been borrowed from the literature on *Shariah* screening and applied to the context of contract analysis. Three *Shariah* approaches have been identified: the liberal approach, the majority approach, and the *ijmaa* approach. Four real cases of contracts—*mudarabah*, *murabahah*, *ijarah*, and *istisnaa*—were analysed using these two *Shariah* frameworks.

The second component of the study examined the classical and contemporary discourses on *maqasid al Shariah* and discussed the relationship between *maqasid* and Islamic commercial law. In addition, the study deconstructed the contracts of *mudarabah*, *murabahah*, *ijarah*, and *istisnaa* into their particular rulings, which were then linked to the appropriate *maqasid*. A framework was subsequently developed to

examine the contracts' compliance with the *maqasid*. In developing this framework it was pertinent to assign weights to the *maqasid*. Therefore, the study constructed an index, the *Maqasid al Shariah* Index (MSI), to measure the relative weights of *maqasid*. The index was then used to assign weights to the five *maqasid* of economic activity.

There were five research objectives associated with the present study:

Objective 1: To explore the nature and structure of project financing on a general level and that of IPF contracts more specifically. This has been dealt with in Chapter 2 and Chapter 3 through responses to the following research question: What types of contracts and structures are implemented in IPF?

Objective 2: To develop a framework for assessing and evaluating the *Shariah* compliance of real-life IPF contracts. This objective has been focused on in Chapter 6 as well as in the case studies in Chapters 8-11, which addressed the following research questions: To what extent are the IPF contracts compliant with *Shariah*? What types of violations of *Shariah* are observed in IPF contracts, if any? Can trends and generalisations be synthesised from the deconstruction and analysis of IPF contracts?

Objective 3: To identify the particular *maqasid* upon which the specific rulings and injunctions of IPF are based. In responding to this objective, Chapter 4 provided a survey on *maqasid al Shariah* and commercial transactions to answer the following research question: To what extent are *maqasid al Shariah* grounded in Islamic commercial law and finance? This objective has been further addressed in the case studies in Chapters 8-11, which answered the following research question: What are the *maqasid* underlying the rulings in IPF contracts?

Objective 4: To devise a methodology for quantifying the *maqasid* and measuring their realisation in real-life IPF contracts. Chapters 6 and 7 have concentrated on this objective methodologically and Chapters 8-11 empirically by responding to the following research questions: How do the distinct *maqasid* of economic activity rank in terms of importance? To what extent does the current practice of IPF contracts comply with *maqasid al Shariah*?

Objective 5: To investigate whether empirical analysis will be able to verify the prevailing philosophical methodology of Islamic financial contracts. This objective has been addressed in the empirical chapters—Chapters 8-11—that attempted to answer the following question: Can the empirical results verify the intentionalist methodology followed by the *Shariah* scholars in the design of Islamic financial contracts?

The remainder of the chapter is organised as follows: Section 12.2 contextualises, interprets, and discusses the findings; Section 12.3 discusses the research implications; Section 12.4 reports the research limitations and proposes avenues for future research; and Section 12.5 concludes with the epilogue.

12.2 CONTEXTUALISING THE FINDINGS: AN INTERPRETATIVE DISCUSSION

This section aims to provide an integrative analysis of the study by discussing the main results, findings, and implications throughout seven subsections. It is important to note that the discussion of the research findings follows the sequence of the research questions outlined in Chapter 1.

12.2.1 Contracts And Structures Implemented In IPF

Research Question 1 is as follows:

What types of contracts and structures are implemented in IPF?

The review of the prevailing structures of Islamic project financing has revealed that IPF, akin to other types of Islamic financing modes, deploys classical commercial contracts and adapts them to the specific needs of the projects being financed. There is no conceptual difference in terms of the nature of classical contracts used. The core difference is the way in which the contracts are adapted and modified. The main

contracts used in IPF are *mudarabah*, *musharakah*, *murabahah*, *ijarah*, *istisnaa*, investment *wakalah*, and *salam*.

The analysis has shown that although in some cases the contracts are used in IPF as stand-alone structures, they are combined together to form more complex financing structures. The *wakalah-ijarah* arrangement and the *istisnaa-ijarah* arrangement are two of the most prevalent structures of IPF, both in pure Islamic structures and Islamic multi-tranche financing where Islamic and conventional financing structures are combined.

In addition, *sukuk* are frequently used in IPF. These include asset-based *ijarah sukuk*, debt-based *istisnaa sukuk*, equity-based *musharakah sukuk*, and agency-based *wakalah sukuk*. The *ijarah sukuk* is the most dominant of these in the current practice and has a number of varieties (Al Amine, 2011; Dewar and Hussain, 2011).

The empirical examination of the contracts has also shown that the transactions are multifaceted and usually involve a variety of documents, yet the level of complexity differs from one contract to another. From the cases examined, the most complex transaction in terms of documents was the *ijarah*, while the *istisnaa* involved the least amount of documents. It can be concluded that although IPF is based mainly on the classical contracts, as is the case with most products in contemporary Islamic finance, the contracts of IPF add a further layer of complexity.

12.2.2 Adherence Of The Current Practice Of IPF To *Shariah*

Research Question 2 is as follows:

*To what extent are IPF the contracts compliant with *Shariah*?*

This question entails two main issues: whether the contracts are compliant with *Shariah* and, if so, what is the nature of the compliance? The analytical framework for this study developed two levels of analysis. The first analyses the contracts' compliance

with the AAOIFI (2010) *Shariah* Standards and the second identifies the nature of the *Shariah* compliance status.

Regarding the compliance with the AAOIFI Standards, Table 12.1 reports the results:

Table 12.1: Compliance of Contracts with The AAOIFI (2010) Standards

Contract	<i>Mudarabah</i>	<i>Murabahah</i>	<i>Ijarah</i>	<i>Istisnaa</i>
% Compliance	81.7%	68.4%	36.0%	76.0%

The results show that none of the contracts were found to comply with the AAOIFI standards completely. The degree of compliance ranges from 81.7% to a very low score of 36%. These results indicate the degree to which the IFIs adhere to the objectives they have set for themselves. The contracts studied explicitly state that they operate subject to the “Principles of *Shariah*”, which are defined in the contracts as “the principles of *Shariah* set out in the *Shariah* Standards published by AAOIFI and as interpreted and applied by the *Fatwa & Shariah* Supervision Board”. The results obtained do, however, show major deviations in terms of fulfilling the AAOIFI Standards, unless the *Fatwa & Shariah* Supervision Board has different interpretations of the AAOIFI Standards.

The scores obtained do not, however, necessarily denote the validity of a contract: they are merely a measurement of the degree of compliance with the AAOIFI Standards. This is because the violation of one specific ruling may make the contract invalid, despite having obtained a high compliancy score under the AAOIFI Standards. Therefore, it was important to subject the contracts to the second level of analysis, entitled ‘the *Shariah* Compliance Approach’. According to the framework on approaches to *Shariah* compliance—developed in Chapter 6—there are three *Shariah* compliance approaches: *ijmaa* approach, majority approach, and liberal approach. Under the *ijmaa* approach, the contract is considered as *Shariah*-compliant if, and only if, all of the *Shariah* scholars consider the contract to be compliant. In other words, there is *ijmaa* on the legitimacy of the contract. According to the majority

approach, a contract is seen as *Shariah*-compliant if, and only if, the contract is considered *Shariah*-compliant according to the majority of scholars. All of the particular rulings in the contract are considered compliant and are admissible according to the majority of scholars. For the liberal approach, a contract is deemed *Shariah*-compliant if at least one scholar or school of *fiqh* considers it so. If a contract is not compliant under any of these three approach, it is therefore not valid. Table 12.2 illustrates the comparative results of the contracts examined.

Table 12.2: Overall Compliance of Contracts

Contract	VALID			NOT VALID
	<i>Ijmaa</i>	Majority	Liberal	
<i>Mudarabah</i>				✓
<i>Murabahah</i>			✓	
<i>Ijarah</i>				✓
<i>Istisnaa</i>			✓	

The results obtained show that two out of the four contracts examined, the *mudarabah* and the *ijarah* are not compliant with *Shariah*, according to the methodology followed by this research. The other two contracts, the *murabahah* and the *istisnaa*, are valid according to the liberal strategy.

These results are not very encouraging with regard to the status of Islamic finance practice. They are indicative of the shortcomings of the current *Shariah* compliance status of IFIs. In addition, the results can be generalised since they are not merely single cases, but rather templates representing a large number of cases that are not only applied in one institution but are outsourced to various IFIs. Another point to consider is that the templates for the case studies are taken from a leading *Shariah* advisory firm. If this is the case with a leading IFI, which is well known for its quality and services in the Islamic financial sector, what would one expect from less experienced, lower-tier IFIs? The results indicate the need for improvement of the practice of IFIs in relation to *Shariah* compliance.

Moreover, these results highlight the following issue that was raised by Maurer (2010: 34): “ [do] the practitioners interpret and attempt to adhere to — or to diverge from — Islamic legal opinion when those opinions are seen to interfere negatively with “the market””? In other words, is ‘the market’ the immediate concern of the practitioners and scholars and, if so, has that concern led them to compromise *Shariah* rulings? The results seem to answer positively to both questions. In addition, the obtained scores support El Gamal’s (2006) *Shariah* arbitrage argument that jurists and scholars make rulings that favour their particular market requirements.

Another question that arises in this context is the one brought forward by Hassan and Lewis (2007: 152): “If Islamic banking merely modifies conventional financing in such a way as to satisfy the *Shariah* scholars, what is there that remains distinctive about the Islamic system?” The analysis has shown that for one of the cases, the *mudarabah*, the contract structure in some ways replicates a conventional loan transaction. Hence, the following question applies: what is there that remains distinctive about the *mudarabah* contract other than the form? The results show that IFIs are following the drift of financialisation, which verifies the assertion that there is a divergence between aspirations and realities in Islamic economics and finance (Asutay and Zaman, 2010).

12.2.3 Nature Of Violations Of *Shariah* Requirements In IPF Contracts

Research Question 2 is as follows:

What types of violations of Shariah are observed in IPF contracts, if any?

In Chapter 6, a typology for three types of non-compliance with AAOIFI *Shariah* standards was developed:

- i. **Omitted required rulings:** Required rulings that have not been stated in the contract.
- ii. **Direct Contradiction:** Clauses that directly contradict required rulings.

- iii. **Partial Contradiction:** Clauses that indirectly contradict or dilute required rulings.

Table 12.3 summarises the results for the types of non-compliance with AAOIFI standards across the four case studies:

Table 12.3: Non-Compliance Categories

Contract	Non-Compliance Category			Total
	Direct Contradiction	Partial Contradiction	Omission	
<i>Mudarabah</i>	1	1	1	3
<i>Murabahah</i>	1	0	4	5
<i>Ijarah</i>	7	1	0	8
<i>Istisnaa</i>	0	1	3	4
Total	9	3	8	20

The frequency results reveal that non-compliance is mainly due to direct contradiction. The omitted required rulings follow as the second most frequent source for non-compliance; the partially contradicted rulings occur the least. The three non-compliance categories should not be treated equally as they do not all possess the same importance and weight. Direct contradiction is the most serious non-compliance category, followed by partial contradiction and then omission. Omission can be caused by neglect and therefore it is the least serious. In addition, the IFI may argue that although the ruling has been omitted in the documentation of the contract, it has been taken into consideration in the contract’s real application.

There is another cause for the discrepancy in the contracts; it is not a violation but rather an ambiguity in the statement of a ruling. In other words, the ruling is stated in a less specific way—dilution. Across the four case studies, there were five instances of this type.

The main findings from this multiple-case study analysis are that all of the contracts exhibit a degree of non-compliance and that the main type of non-compliance is the

most significant: direct contradiction. This should set an alarm for the *Shariah* scholars and regulators.

Another important finding that emerges from the analysis is that the AAOIFI *Shariah* Standards (2010) may stipulate a ruling that has no strong evidence or rationale. Thus, it can be asserted that if the contract under investigation violates this ruling, it should not be considered a serious issue. The following example from the *ijarah* contract illustrates this:

The AAOIFI *Shariah* Standards Ruling 5.2.3 permits for floating rentals only after the first period, during which the rental is fixed. The origin of this ruling is a *fatwa* issued by Al Barakah's 11th forum (Abu Ghuddah, n.d.). However, neither the AAOIFI (2010) nor Al Barakah's resolutions (Abu Ghuddah, n.d.) justify why the first period has to be fixed. In addition, classical sources do not help to explain the ruling as this is a contemporary issue. Therefore, the question remains: why are subsequent periods permitted to be floating but the first period has to be fixed? What is the basis for this differentiation? Moreover, in the contract of *murabahah*, contemporary scholars permit a floating *murabahah* price from the first instalment. For instance, Al Shubayli (2005) and Meerah (2011) both maintain the permissibility of *murabahah* with a floating price but do not give any stipulations regarding the first instalment although it is widely acknowledged that the *murabahah* can be paid through instalments.

Even more explicitly, Meerah (2011) argues for the permissibility of *ijarah* with a floating rent and provides certain conditions for its validity. These include a clear understanding of the mechanism for ascertaining the rent and also the establishment of an upper and lower limit for any fluctuation so as to prevent major *gharar*. Meerah did not, however, provide any argument on fixing the first instalment. If a floating rental is permitted in principle, why is it not allowed for the first instalment? Therefore, the violation of Ruling 5.2.3 by the contract under investigation is not based on strong grounds. Thus, the violation is not a major issue and there are possibilities for validation.

The implication of this is that there is a need to review the AAOIFI *Shariah* Standards in light of the emerging issues and changing requirements of Islamic finance. The

findings of this study question the generally accepted view that these standards portray the 'best practice'. Therefore, the study recommends that the *Shariah* basis on which these standards are based should be revised. In addition, including *maqasid al Shariah* in these standards is an important step forward to insure moral articulation.

12.2.4 Trends And Consistencies In IPF Contracts

Research Question 4 is as follows:

Can trends and generalisations be synthesised from the deconstruction and analysis of IPF contracts?

One of the objectives of the study's deconstruction of the contracts was to discern trends and consistencies in the contracts. This is an important aspect of the analysis as it enables the study to infer generalisations regarding the contracts' design and *Shariah* compliance.

In terms of the design and *Shariah* engineering of the contracts—the combination of particular rulings to develop a product—the main issue to be discussed concerns the reference of the rulings: the schools of *fiqh* from which the rulings are taken.

The analysis has shown that no particular school of *fiqh* has been adopted in the design of the contracts. Rather, the rulings in each contract come from a variety of schools of *fiqh*. This is mainly because the contracts follow the AAOIFI Standards, which are compiled from different schools of *fiqh*. There are also instances where, as in the *ijarah* contract ruling 5.2.2, although the contracts followed the AAOIFI Standards, they violated the view of the majority of scholars. Hence, it can be inferred that the contracts do not follow any one school of *fiqh* and therefore no particular approach of *usul al fiqh* has been followed. There is no methodological coherence and thus, no methodology can be established. Moreover, the results have shown that none of the case studies are consistent with the AAOIFI Standards. As such, it can be argued that as the contracts do not follow a particular school of *fiqh* and do not even follow the AAOIFI rulings, which they claim to follow, then it is more of an eclectic,

patching approach (Saeed, 1997). This methodological inconsistency sheds light on the pragmatist approach of contemporary Islamic finance.

Another issue of importance to this discussion is the *Shariah* compliance. As has been discussed previously, all of the contracts scored differently in terms of compliance with the AAOIFI Standards. The *mudarabah* contract scored 81.7% while the *ijarah* contract scored 36%, although both originate from the same IFI. One possible explanation for this discrepancy may be that the *ijarah* package is significantly larger than the other packages analysed: it consists of seven documents and there is thus a higher probability that non-compliance will be found. This distinction does not, however, justify the very low score from a well-established financial institution. Furthermore, another reason may be that in the *ijarah* contract, an asset is being used by the lessee, which creates potential for damage. Thus, the banks opt to adopt a defensive position in order to protect themselves from being liable for any damages. Consequently, problems arise in the contract relating to issues of maintenance and defects in the asset being leased. In addition, while two of the case studies have been validated according to the Islamic commercial law, two were not validated. Although there may be reasons for these variations, this raises the issue of inconsistency in the product development of IFIs.

The empirical analysis of the contracts has also shown that there have been instances where a ruling is stated in the contract and simultaneously violated in a different clause or clauses. For example, in the *mudarabah* contract it is stated that the profit is distributed according to an agreed percentage. There are, however, other clauses in the contract that at least partially violate this ruling, indicating an inconsistency in the drafting of the contracts and the lack of *Shariah* overview and audit.

In conclusion, there is some sort of arbitrariness in the construction of the contracts and no particular methodology can be inferred. Moreover, each contract is, apparently, designed in isolation from the other and no particular thread can be identified across the cases studied. This is evident from the fact that each contract scores differently even though they originate from the same IFI. It can be said that this issue is a product of the lack of standardisation in *Shariah* market practice and legal documentation—an

issue which has long been debated in the Islamic financial field (Ali and Kamal, 2009; Atallah and Ghoul, 2011; Haron, 1998). In addition, the results support the view that *Shariah* plays a marginal advisory role in the current practice of Islamic finance (Khan, 2007) even though compliance with *Shariah* is a matter of identity for IFIs. When considering these observations within the wider context of Islamic finance and the Islamic moral economy, an issue arises concerning the unsystematic operations of Islamic finance. Moreover, the inconsistency in drafting the contracts and adopting a clear methodology can contribute to insecurity and distrust among Islamic investors and thereby hinder the development of the industry.

12.2.5 Grounding Of *Maqasid Al Shariah* In Islamic Commercial Law

Research Question 5 is as follows:

To what extent are maqasid al Shariah grounded in Islamic commercial law and finance?

The analysis of the classical discourse on Islamic commercial law largely proves that *maqasid al Shariah* are present and considered in Islamic commercial law. Several examples have been analysed, providing ample evidence that the *maqasid* have been considered by various scholars from different jurisprudential backgrounds. The analysis was not restricted to specific topics or particular contracts of Islamic commercial law; it extended to various issues from different topics in order to give a more holistic understanding through its results.

It is, however, important to make two remarks. Initially, finding examples of *maqasid*-based *ijtihad* is by no means a simple task. Although there exists a huge corpus of Islamic commercial law, the explicit reference to *maqasid* is not apparent in the majority of the topics of commercial law. Also, it can be claimed that the *maqasid* component is mostly present in the works of the jurists who combined between competency in Islamic law, *usul al fiqh* and *maqasid*. Both of these assertions can be supported by the most superficial survey of the works of scholars who attempted to

review the Islamic commercial law literature in light of *maqasid*, including the works of Ibn Ashur (2011), Hassan (2008), and Al Raysooni (2012).

These issues become more apparent within the ratiocinative *maqasid* analysis of the contracts conducted in Chapters 8-11. Although the study managed to link the rulings to the different *maqasid*, the exercise was challenging. The main issue was that the majority of the rationales given for the rulings in the classical sources were either texts from the Quran and *Sunnah* or *usuli*-based justifications, with very few references to *maqasid*. This was particularly observed in the major authoritative *fiqhi* references (Al Juwaini, 2011; Al Rafee, 1997; Al Ramli, 1993; Ibn Qudama, 1999). Hence, the researcher had to consult other works, which were not considered as the ‘most authoritative’ within the *fiqhi* school circles, in order to derive a *maqasid* justification for particular rulings. For example, reference was made occasionally to Ibn Taimiyah (2004) and Al Qarafee (1994) who, although they have written references in *fiqh*, are not considered the most authoritative within their respective schools of *fiqh*. Nevertheless, Ibn Ashur’s (2011) assertion that the leading *mujtahids* were aware of *maqasid* in their juristic reasoning is very important in this regard.

As for the contemporary discourse on Islamic commercial law, the study has found that the most novel contribution to *maqasid al Shariah* has been conducted by Ibn Ashur (2011) in his treatise *Maqasid al Shariah*. This is not to deny the other contributions that have enriched the discourse but only to say that his work had, evidently, the most impact on the contemporary *maqasid* discourse.

The study also analysed the institutional publications on Islamic finance. The survey has shown evidence of the presence, albeit superficially, of *maqasid*-based *ijtihad* in the issuance of *fatawas*, the development of new products, and the publication of standards. A coherent methodological application of *maqasid*, in most cases, has, however, not been formulated. The role of *maqasid* is marginal when compared to hundreds of conditions, standards, cautions, and prohibitions stated in the texts. The analysis has also demonstrated cases where *maqasid* have been overlooked and other cases where this divergence has been resolved. These cases envisage the learning curve for IFIs and the mounting awareness of *maqasid*.

To offer a conclusive response to this question, it can be argued that *maqasid al Shariah* are deeply grounded in Islamic commercial law and jurisprudential thought, but a very careful reading is required to derive instances of *maqasid*. Hence, many of the current perceptions on the mechanistic nature of *fiqh* can be challenged. Thus, this study contends that the problem is not with *fiqh*, which is dynamic, moral, and value laden, but with the prevailing practice that interprets *fiqh* as absolute and fails to appreciate the role of historical, social, and political contexts in shaping the discourse. Given that the classical *fiqh* was shaped by the context, the contemporary *fiqh should* also be based on the context; the key to this is through realising *maqasid al Shariah*. The *maqasid* are structural, constant, and fixed unlike *fiqh*, which is dynamic and dependent on context. In addition, there are further prospects for developing the discourse on *maqasid* just as Ibn Ashur (2011) created a breakthrough in the field.

12.2.6 Nature Of *Maqasid* Underlying Rulings And Injunctions

This section has two research questions:

Research Question 6 is as follows:

What are the maqasid underlying the rulings in IPF contracts?

A comprehensive survey and analysis of the rulings of four contracts has been carried out in this study. The analysis was committed to deriving the *maqasid* basis of each ruling by linking each one to its appropriate *maqasid/maqasid*. In total, and across the four case studies, ninety-seven rulings have been analysed in detail. The benchmark *maqasid* were the ones developed by Ibn Ashur (2011): circulation, preservation, persistence, justice, and transparency.

The research findings suggest that all of the rulings can be linked methodically to one or more of the *maqasid* of commercial transactions suggested by Ibn Ashur, which verifies and confirms his five-fold model. Based on this analysis, the *maqasid* of all the rulings of commercial transactions do not go beyond those formulated by Ibn Ashur.

Hence, according to the induction analysis undertaken in this study, these *maqasid* can form the basis for further research on the *maqasid* of commercial transactions.

The theoretical findings advance the argument that all injunctions are not ends but means to achieve certain *maqasid*, an argument advanced by Al Shatibi (2004). The injunctions are merely means to achieve higher goals. This finding implies that *Shariah* scholars in the Islamic financial field should pay more attention to the *maqasid* rather than concentrating on rulings and on fulfilling the legalistic aspect of contracts. Such an approach is severely limited because fulfilling the legalistic component of contracts is insufficient unless their goals and purposes are also achieved.

Furthermore, the results of the analysis have shown that each contract realises the various *maqasid* differently; each *maqasid* scores differently with each contract. For example, while the *maqasid* of preservation scores high with the *ijarah* and *mudarabah* contracts, it scores low with the *murabahah* contract. This may have a number of explanations, such as the nature of the contract. All contracts have different structures and diverse combinations of rulings; they are therefore expected to serve various *maqasid* differently. The nature of the contract has a direct impact on the nature of the *maqasid* it serves. The example of the *maqasid* of circulation illustrates this, scoring the highest at 55% with the *mudarabah* contract. This result can be attributed to the nature of the *mudarabah* contract, which is a profit-loss sharing contract, where there is a greater circulation of wealth occurring.

Another reason why the various contracts serve the *maqasid* differently may be due to the reference from which the rulings have been taken. As noted before, the AAOIFI *Shariah* Standards (2010) have been consulted as a reference point for the rulings. The compilation of the rulings for the different contracts is subject to the opinions of the authors, and given that the AAOIFI uses a diversified authoring panel, the AAOIFI does not follow one school of thought. Therefore, no clear patterns in terms of *maqasid* were observed. Each school of *fiqh* has its own distinct methodology in deriving rulings and, consequently, it would be expected to obtain a pattern regarding the different *maqasid* for the four contracts had a particular school of *fiqh* been

adopted. This matter can be related to wider issues regarding contemporary Islamic finance and whether the practice follows an informed methodology or is it an unsystematic approach as indicated earlier.

In addition, the analysis was adapted to real-life case studies, which may have affected the obtained results. In every contract there is a set of conditionally-required rulings and they vary depending on the contract. Each case study is unique in terms of the rulings it serves and consequently, the *maqasid* will vary from case to case, making it difficult to obtain a patterned set of results.

Another important issue that arises from the study is that the debate regarding *Shariah*-based and *Shariah*-compliant actions does not have a strong basis. The study has shown that all rulings in every contract adhere to certain *maqasid*, which are realised at the micro-level: the contractual level. This indirectly implies that *maqasid* have to be considered on the wider macro- level: the consequences. A transaction cannot therefore be considered as *Shariah*-compliant or *Shariah*-based if it has unethical consequences, even if the contracts are compliant with the *fiqh* requirements.

To be Islamic, the contract and all its implications and consequences have to be in accordance with both *Shariah* and *maqasid*. If so, it will be considered *Shariah*-compliant or *Shariah*-based. Compliance thus entails subscription to all aspects of *Shariah*. This concept has its roots in the Quran, in which one verse says that it is not acceptable to believe in parts of the religion and neglect other parts (The Quran, 2: 85). *Shariah* has to be taken as one whole; the reductionist approach is, thus, erroneous. It therefore may be better to classify products as Islamic or non-Islamic, instead of *Shariah*-based or *Shariah*-compliant.

This section now turns to Research Question 7, which is as follows:

How do the distinct maqasid of economic activity rank in terms of importance?

With the aim of identifying the relative weights and intrinsic values of the *maqasid* economic activity, Chapter 7 constructed an index, the *maqasid al Shariah* index (MSI), to measure the relative weights of *maqasid*. It then used the index to give weights to the five *maqasid* of economic activity.

The overall results for the *maqasid* ranking are presented in Table 12.4.

Table 12.4: Relative Weights of The *Maqasid* (MSI)

<i>MAQSID</i>	MSI
Circulation	0.9740
Justice	0.5179
Preservation	0.2664
Transparency	0.0765
Persistence	0.0456

A number of findings may be drawn from these results. At the widest level, the findings of this study confirm the widely held position that *maqasid* are not on an equal standing but rather differ in terms of their importance and weights (Ibn Ashur, 2011; Ibn Bayyah, 2010; Kamali, 2008b; Najjar, 2006). The results also report a significant variation between the *maqasid* in terms of their weights: the *maqsid* of circulation has a relative weight of 0.9740, followed by that of justice with 0.5179. Preservation appears later with a significant difference. At the lower ranks of the hierarchy are the *maqasid* of transparency and persistence, both with relatively close scores. The overall significant variation emphasises that *Shariah* commands are not on an equal level but are prioritised.

Moreover, the findings of the study challenge the dominant classical notion that perceives the *maqasid* relating to wealth as only preservation. The study presents solid evidence from the core sources (the Quran and *Sunnah*) in support of Ibn Ashur's (2011) argument that the *maqasid* of wealth are not limited to preservation but include circulation, justice, transparency, and persistence. This is also confirmed by the result that the *maqasid* of circulation and justice are more significant than the *maqsid* of preservation in terms of the weights.

A relatively interesting and unanticipated finding from this study is concerned with the importance and essentiality of the *maqasid*. The theoretical findings delineated in this study resonate with other literature on the importance of *maqasid* that classifies

maqasid al Shariah into *daruriyat*, *hajiyyat*, and *tahseeniyat*. The three *maqasid* that achieved the highest scores—circulation, justice, and preservation—have been considered by the classical and contemporary scholars as *daruriyat* (Al Ghazali, 1997; Al Juwaini, 1980; Al Razi, 1992; Al Shatibi, 2004; Ibn Taymiyah, 2004). In addition, the *maqasid* of transparency, which obtained a relatively very low weight of 0.0765 has been perceived to come from the *hajiyyat* category (Ibn Bayyah, 2010), albeit implicitly. Therefore, the results obtained from this investigation provide an induction-based rationale, supported by evidence, confirming the classical literature. This is a very significant finding as the literature validates the results and, according to Krippendorff (2004b), content analysis can be validated when the sources of analysed texts concur with the findings.

Another set of findings focus on the particular dimensions: the *Quran*, the *Sunnah*, and the *maslahah*. When comparing the results of the *Quran* and *Sunnah* dimensions, it was found that between the two most significant *maqasid*, circulation and justice, the latter occurs more frequently in the *Quran* than in the *Sunnah*. Conversely, the *maqasid* of circulation appears far more frequently in the *Sunnah* than in the *Quran*. The interpretation for this can be that the *Sunnah* is the explanation and operational tool of the *Quran*. Therefore, the *Quran* sets the general notions and guidelines whereas the *Sunnah* provides the operational tools for realising these higher notions; the *Quran* sets out the higher principles of morality, such as justice, while the *Sunnah* emphasises the means for realising the dogma, which in this case is circulation. This arrangement is based on the idea that circulation is a means for achieving social justice (Laldin and Furqani, 2013) as the concentration of wealth brings about numerous socio-economic problems (Kameel *et al.*, 2006).

12.2.7 Compliance Of Current Practice Of IPF Contracts With *Maqasid*

Research Question 8 is as follows:

To what extent does the current practice of IPF contracts comply with maqasid al Shariah?

In Chapters 8-11, the study conducted an examination of four genuine contracts taken from a leading IF institution. The contracts were assessed in terms of the *maqasid* compliancy. This methodology developed a new reading and interpretation of Islamic finance contracts based on *maqasid al Shariah*. Table 12.5 summarises the results obtained by each contract in terms of compliance with *maqasid*.

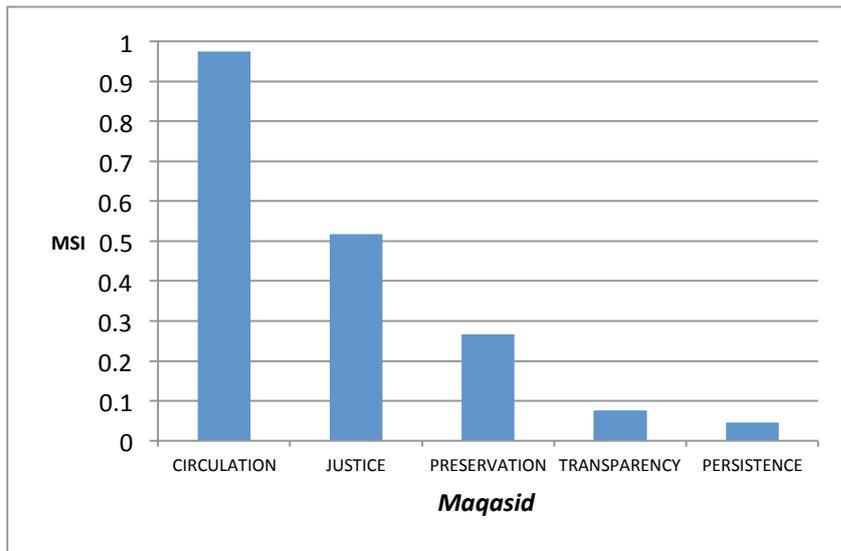
Table 12.5: *Maqasid* Compliance of Contracts

Contract	<i>Mudarabah</i>	<i>Murabahah</i>	<i>Ijarah</i>	<i>Istisnaa</i>
Score	82.3%	58%	10%	65%

Although they are taken from the same institution, which has been considered a pioneer in Islamic finance, the results show that compliances vary from 82.4% to 12%. This can be attributed to many reasons; one being that the nature of the contract and its complexity has a direct impact on the *maqasid* compliancy. For example, out of the four cases studied, the most complex transaction, which included the most documentation, was the *ijarah* contract and it achieved the lowest compliancy. In addition, the inherent risks in each contract may have forced the product designers to structure the contract in a certain way to mitigate the risks at the expense of complying with the *maqasid*.

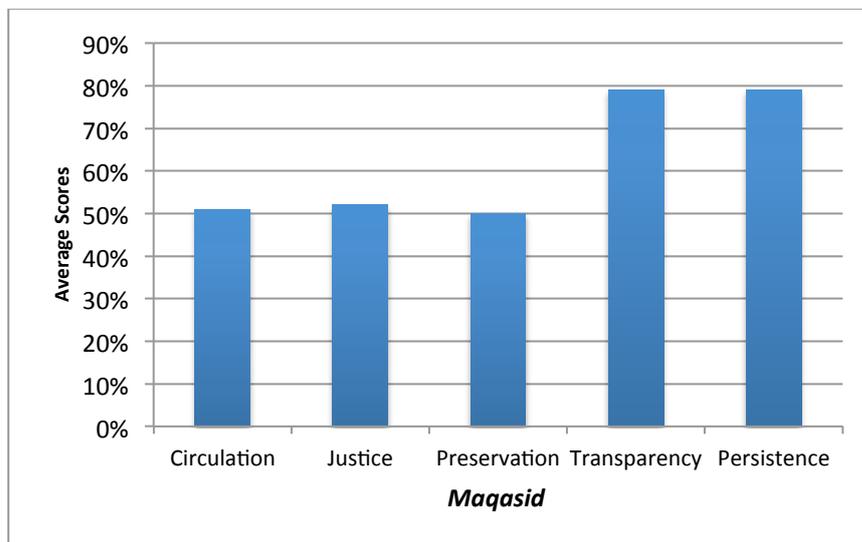
The most significant finding to emerge from this analysis is the comparison between the actual results and the weight of the *maqasid*. In Chapter 7, the five *maqasid* of economic activity were examined and their weights identified. Figure 12.1 compares the relative weights of the five *maqasid*:

Figure 12:1: Relative Weights of The Five *Maqasid*



However, the actual results of the four contracts do not concur with the ideal hierarchy and ranking of the *maqasid*. The *maqasid* of transparency and persistence, which are supposed to have less weight, scored—on average—higher than the more significant *maqasid*: circulation and justice. Figure 12.2 presents the aggregated scores for the five *maqasid* across the four case studies:

Figure 12:2: Average *Maqasid* Scores for the Case Studies



It can therefore be seen that a low *maqasid* compliance is achieved, but also that the *maqasid* that have less weight achieved higher scores in the cases studied than the *maqasid* that have more weight.

Measuring the *maqasid* compliance is very important as it can be the basis for validating or invalidating contracts. In this regard, Ibn Ashur (2011) asserts that valid contracts are those that meet the requirements of the *maqasid*.

Another set of findings from the analysis considers the relationship between *Shariah* compliance and *maqasid al Shariah*. Table 12.6 and Figure 12.3 compare the *Shariah* compliance scores and the *maqasid al Shariah* achievement of the cases studied.

Table 12.6: Comparison between *Shariah* Scores and *Maqasid* Scores

Contract	<i>Mudarabah</i>	<i>Istisnaa</i>	<i>Murabahah</i>	<i>Ijarah</i>
<i>Shariah</i> Score	81.7%	76.00%	68.40%	36.00%
<i>Maqasid</i> Score	82.3%	65%	58%	10%

Figure 12:3: Comparison Between *Shariah* Scores and *Maqasid* Scores



The results in Table 12.6 and Figure 12:3 depict that there is a linear relationship between the *Shariah* scores and the *maqasid* scores. The higher the *Shariah* scores, the higher the *maqasid* scores in general. Although these results provide empirical evidence to support the theoretical framework developed in Chapter 1 proposing that Islam reconciles both approaches; consequentialism and intentionalism, the weak

maqasid scores indicate bias towards ‘intentionalism’ as articulated by the prevailing *Shariah* position.

In addition, the results systematically show that the *maqasid* scores are lower than the *Shariah* scores, except for the *mudarabah* contract, in which case the *maqasid* score is higher than *Shariah* score. Thus, the complementarity methodology is achieved by *mudarabah* contract by producing (i) high *Shariah* and *maqasid* results compared to other contracts; and (ii) by producing *maqasid* scores higher than the *Shariah* scores. This justifies the theoretical expectations articulated by Islamic moral economy that *mudarabah* and *musharakah* are financially efficient and also produce a socially optimal outcome (although Choudhury (2001), critically questions the shortcomings of these two financing instruments in being socially optimal).

Moreover the difference between both sets of results can be explained as follows: different rulings have different inherent *maqasid*, and different *maqasid* have different weights. Hence, it is not surprising that the *Shariah* compliance is not necessarily equal to the *maqasid* compliance.

Based on this theorisation, it can be said that the reason why a contract may score a low *maqasid* achievement is because the *maqasid* that are not satisfied are the ones that hold greater weight. Therefore, the non-fulfilment of these *maqasid* has a considerable impact on the overall *maqasid* achievement.

12.2.8 The Prevailing Methodological Approach in Designing Islamic Financial Contracts: Reflections on the Theoretical Framework

The theoretical framework developed in Chapter 1 discussed two theories of normative ethics; namely intentionalism and consequentialism, and identified the Islamic stance to normative ethics, which is heavily consequentialist although it essentialises intentionality as the main motivator. Therefore, theoretically it is suggested in Chapter 1 that the complementarity methodology of Islam should also define the way Islamic finance and its operation should be constructed. This section hence provides a critical reflection on the established theoretical framework by utilising the findings developed in this study. In this context, Research Question 9 is as follows:

Can the empirical results verify the intentionalist methodology followed by the Shariah scholars in the design of Islamic financial contracts?

As the findings of this study suggest, the theoretical analysis of the *maqasidic* discourse has shown that *maqasid al Shariah* are endogenised in Islamic finance contracts. Therefore, based on grounded theory as a methodology, the study is able to uncover that consequentialism—which is an essential feature of *maqasid*—is a genuine recognised Islamic concept despite the fact that *Shariah* scholars do not consider it as part of the methodology of developing financial contracts. The implication of this is that consequences—in addition to considering them at the micro contractual level—should be appraised at the macro level to ensure a moral articulation of the proposed framework. That is to say that considering *maqasid* at the contractual level is not enough; the wider social implications are equally, if not more, important.

In addition, the evidence provided in Chapter 7 based on the analysis of *maqasid* from the Islamic core sources is also important in generating theory for this research. One of the main relevant findings of the analysis is that the *maqasid* of circulation and justice are the most regarded ones. This has the implication that these notions should be deeply embedded in the financial construction processes and therefore Islamic financial transactions should be fundamentally based on these *maqasid*. This reveals

the theoretical consequentialist underpinnings of the Islamic moral economy. In summarising the results of the grounded theory conducted by this study, it can be argued that the Islamic economic normative theory is a two-dimensional framework that reconciles between the philosophical tenets of intentionalism and consequentialism leading to complementarity. Consequently, the reductionist *fiqhi* approach in this sense of essentialising intentionalism but negating consequentialism does not fulfil the genuine *Shariah* requirements.

Turning to the applied part of the study, the empirical evidence is also relevant to the intentionalism-consequentialism debate. The results have shown that the contracts studied, in general, score higher in *Shariah* compliance than in *maqasid* compliance and in some cases—the *ijarah* for example—there is a considerable difference between both scores. Hence, the results verify that IFI's in the main adopt a deontological, intentionalist methodology, which is the position of *Shariah* scholars. The discourse analysis of the *fatawas* and resolutions also attests to this finding.

Furthermore, the empirical results regarding *maqasid* compliance show that the contracts give more consideration to the *maqasid* that have less importance. For example, the *maqasid* of justice—which is expected to score considerably higher, given its devised weight—scores low in comparison with the *maqasid* of persistence which, in theory, has a lower intrinsic value.

All in all, these results indicate the current state of the industry in light of the intentionalism and consequentialism theoretical framework. The higher *Shariah* scores show that the industry essentialises intentionalism.

In concluding, within the identified theoretical frame of 'complementarity methodology', it can be argued that Islamic finance contracts do not fulfil the *tawhidi* methodology in producing optimality between *Shariah* and *maqasid* positions; as the results are biased towards and provide evidence for the *Shariah* scholars' orientation of intentionalism merely.

12.3 RESEARCH IMPLICATIONS

This study was motivated by a belief that there is a gap in the literature on the intersection between IPF, *Shariah* compliance, and *maqasid al Shariah*. In responding to this potential gap, the study has conducted theoretical and empirical investigations. This section aims to examine and elucidate the implications of this study through various aspects.

Although the study is not the first on the general *Shariah* compliance and *maqasid al Shariah*, the findings contribute to the existing body of knowledge in various ways. The analytical framework for *Shariah* compliance in this study is appealing in that it provides a generic platform for examining, assessing, and evaluating the *Shariah* compliance of Islamic financial products. It can thus serve as a reference point for future *Shariah* scholars and Islamic finance researchers.

In addition, the comprehensive framework developed in this study for identifying and assessing *maqasid al Shariah* is an initial step in the direction of operationalising *maqasid al Shariah* and moving the discourse from theory to empirical reality. One implication for measuring the *maqasid* compliancy is that it shifts the focus from the traditional *fiqhi* compliancy to a new perspective, which is the achievement of the objectives of *Shariah*. Further, this new perspective allows *Shariah* scholars and product developers to design contracts in such a way that satisfies the *maqasid* rather than just focusing on the literal *fiqhi* rulings; priority should be given to *maqasid* when designing contracts. The *maqasid*-based approach may also allow *Shariah* scholars and product developers to be more selective in choosing the rulings they include or omit in a given contract based on the *maqasid* inherent in the rulings. This may prove useful, especially in the cases where *Shariah* scholars and product developers are in a situation that requires them to compromise some rulings for certain reasons such as regulatory restrictions. By looking at the contracts from a *maqasid* perspective, they may be able to compromise the rulings that include less *maqasid* or those that include less important *maqasid* for rulings with more significant *maqasid* based on the weights devised.

The *maqasid al Shariah* index (MSI) for weighing the *maqasid* is a very important methodological contribution and has various implications such as prioritising between the different *Shariah* rulings. For example, in the *murabahah* contract, there is a ruling stipulating that the base cost of the item has to be stated (AAOIFI, 2010). This ruling is based on the *maqasid* of transparency. Hence, this ruling can be overlooked in order to promote the *maqasid* of circulation, which has more weight and importance. This process is particularly important for *Shariah* standard-setting boards.

In addition, the empirical findings of the study have important implications for professional Islamic bankers and financiers. The findings in this study reveal a low level of *Shariah* compliance in general. Thus, Islamic banks are required to improve their standard of compliance with *Shariah*. This can be achieved by educating and informing the employees and particularly the product developers on the principles of Islamic finance. Moreover, the study's findings also provide implications for *Shariah* scholars regarding the importance of scrutinising and ascertaining the *Shariah* compliance of products before issuing *Shariah* approvals. Greater compliance with *Shariah*, combined with it being a matter of identity and a responsibility towards shareholders, will attract more potential investors for IFIs.

The study also provides evidence that illustrates the state of compliance with *maqasid al Shariah*. The results have shown that overall there is more emphasis on *Shariah* issues than on *maqasid*. This suggests that *Shariah* scholars and Islamic bankers should give more attention to the issue of *maqasid*. In addition, the study has revealed the important status of *maqasid* and its centrality to Islamic finance. The implication for IPF is that consideration should not only be given to *maqasid* on the legal level, but should also be extended to the social consequences of the projects and their impact on the wider community. A macro-understanding of *maqasid* is necessary—the role of *maqasid* in shaping products should be central, not peripheral.

On the policy and regulatory level, the results of the research provide evidence to support the on-going regulatory concern. The deconstruction of the contracts has revealed that there is no consistency in designing the contracts and no particular

methodology that can be inferred. Moreover, there were considerable variations in the *Shariah* compliance scores of the different contracts. Therefore, it is strongly recommended that policies be introduced to monitor the performance of IFIs to ensure that the objectives are being achieved. Regulatory initiatives should be put in place to ensure the enforcement of efficient practices. Standardising *Shariah* compliance policies is thus one of the recommendations of this study.

Although the findings here provide signposts that verify the social failure of Islamic banking, the study has provided useful lessons and information that can be used to evaluate the current practice of IFIs. This initial step is necessary in order to reshape the industry towards the realisation of the social and developmentalist aspect of Islamic banking.

12.4 RESEARCH CAVEATS, LIMITATIONS, AND FUTURE RESEARCH

The findings reported in this thesis should be accepted with a number of caveats and limitations regarding both components of the research: the *Shariah* compliance and the *maqasid al Shariah* compliance. This section outlines these limitations, proposes methods for addressing these limitations, and indicates potential avenues for future research.

In reviewing the literature on IPF, *Shariah* compliance, and *maqasid al Shariah*, there are limited resources and case studies that can be consulted. Generally, there is no clear methodology for contract deconstruction in the studies and literature on Islamic finance. In addition, there is a scarcity of sources that discuss the *maqasid* of the contracts. As a result, linking the rulings to the *maqasid* had to be, in some cases, based on the logical judgement of the researcher, adding a layer of subjectivity to the research. However, this can be understood as this research is emergent and contributes to the gap in the literature.

The major limitation of this research is that the empirical component has been based on case studies taken from one IFI in the United Arab Emirates. Although the choice of this institution is justified, as discussed in Chapter 5, further research is necessary to look at how contracts comply with *Shariah* and *maqasid al Shariah* in other countries and IFIs. A comparative analysis would enhance the findings, yet it is necessary to note that access to such documents is not usually facilitated by Islamic banks.

Furthermore, one of the challenges of the study was choosing the contracts to be examined. Given that this is a subject of enormous complexity and could not be studied comprehensively in all of its variations, detailed examination was restricted to four of the prevailing structures: *mudarabah*, *murabahah*, *ijarah*, and *istisnaa*. Future research could extend to other contracts such as investment *wakalah*.

Another limitation of the study is that all of the cases studied are mainly stand-alone structures: separate contracts that are not combined with other contracts. Hence, an important direction for future research is to analyse more complex financing structures such as the *wakalah-ijarah* arrangement and the *istisnaa-ijarah* arrangement. Moreover, multi-tranche financing, where Islamic project financings are combined with conventional contracts, is another area worthy of exploration.

Regarding the analytical model for examining *Shariah* compliance, one of the caveats of the analytical model is that it does not weigh the rulings. All of the rulings are assumed to have equal weighting.⁵¹ Although the study was successful in devising a model for weighing the *maqasid*, it was not successful in achieving this with regard to the rulings. This is problematic as the assumption that the rulings have equal weights is one that can be challenged: rulings differ in importance as is shown in the study. Hence, another study may be able to attach weights to the different rulings.

While the study has advanced the literature on the economic *maqasid* and made important theoretical contributions regarding gauging the respective weights of the *maqasid*, four cautionary notes should be considered. The first issue is the

⁵¹ Nonetheless, the classification of rulings into required and conditionally required, and the classification of *Shariah* approaches into *ijmaa*, majority, and liberal, places some qualitative weights in to the rulings.

interrelatedness among the five *maqasid*. The holistic nature of the *maqasid* phenomenon and the interrelatedness among the five *maqasid* mean that *maqasid* should not be treated as separate and isolated entities. This issue becomes more evident when devising the operational definitions for each *maqasid*. Further, the index construction technique is neither perfect nor entirely free from bias, which is observed within the case of the interpretation indicators, as the assignment of the numerical values to the different textual indications was, to a large extent, intuitive. Although the relative weightings were determined based on theoretical considerations, there is no scientific way in which, for example, the required indication can be said to be twice as strong as the divergent indication. Moreover, the choice of dimensions for capturing a social construct encompasses methodological problems. The question raised here is: “which and how many dimensions are relevant and should be considered or privileged?” (De Muro *et al.*, 2009: 4). This problem of which information should be excluded or included has also been raised by Sen (2001). Another technical problem involves the choice of indicators and whether or not they represent the dimensions adequately (De Muro *et al.*, 2009).

In addition, it should be noted that the *Sunnah* sample was limited to *Al Bhukhari* and *Muslim*, the most authoritative sources of *Sunnah*. Therefore, extending the sample to include other *Sunnah* treatises is another avenue for future research. Another important objective for future research is to conduct the inductive analysis of the Quran and *Sunnah* using electronic, data-mining techniques to supplement the manual approach. Future studies could also use and expand on this framework to investigate the weights of other *maqasid* rather than limiting the investigation to the five *maqasid* of economic activity. This can be particularly useful for exploring other aspects of the Islamic moral economy.

An additional area worthy of future research is the social impact of IPF. In other words, the consequences of projects in light of *maqasid al Shariah*, as this study has mainly examined the contracts and *maqasid al Shariah* from a legal perspective. This area may include the social and ethical issues that have to be considered in any Islamic project financing.

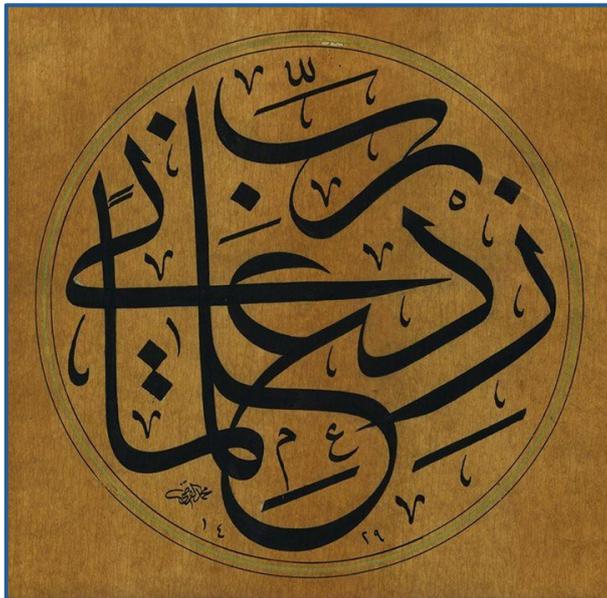
In this regard, the study proposes the development of *maqasid al Shariah*-based social impact assessment standards. These standards could be based on the World Bank International Finance Corporation (IFC) Performance Standards on Social and Environmental Sustainability (International Finance Corporation, 2012), which have become globally recognised as a benchmark for environmental and social risk project management. The eight performance standards on labour conditions, pollution prevention, and the protection of cultural heritage can be linked to *maqasid al Shariah*. This may provide the basis for an Islamic cost-benefit analysis theory and thus contribute, alongside this study, to the conceptualisation of *maqasid al Shariah* as the basis for realising the objectives of the Islamic moral economy.

Finally, a very important potential area for future research that emerged from the findings of this study, particularly the low *Shariah* compliance scores, is the consideration of classical Islamic commercial law and its capability of resolving the financial and economic problems of this era. In other words, is it appropriate to maintain the traditional approach to the study of Islamic commercial law when addressing contemporary Islamic finance? Or, should the premise be reconceptualised to account for the dynamic economic realities?

12.5 EPILOGUE

The primary contribution of the research is the extension of the theoretical and empirical literature on IPF, *Shariah* compliance, and *maqasid al Shariah*. A critical review of the main IPF contracts and their structures has been conducted. In addition, the study analysed the discourse on *maqasid al Shariah*. It examined the classical and contemporary discourse as well as the relationship between Islamic commercial law and *maqasid*. The study deconstructed the contracts of *mudarabah*, *murabahah*, *ijarah*, and *istisnaa* into their particular rulings, and it linked them to the appropriate *maqasid*. It also contributed to the development of a methodology for identifying *Shariah* compliance, as well as measuring the fulfilment of *maqasid al Shariah*.

Although the empirical results do not reflect a positive status quo of Islamic finance, it is hoped that this study will facilitate the development of Islamic economics by emphasising the importance of *maqasid* and the Islamic moral economy. The further implementation of *maqasid al Shariah* is the way to overcome the observed social failure in the industry and reconceptualise the role of Islamic finance in social welfare.



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APPENDIX A1

MUDARABAH CONTRACT REQUIRED RULINGS

No.	AAOIFI Ruling Reference	RULING
1	4.1	The contract formula must be stated. The <i>Mudarabah</i> contract may be concluded using terms such as <i>Mudarabah</i> , <i>Qirad</i> or <i>Mu'amala</i> .
2	4.2	Both parties should possess the legal capacity to appoint agents and accept agency.
3	4.3	The general principle is that a <i>Mudarabah</i> contract is not binding.
4	4.3 (a)	The <i>mudarabah</i> contract becomes binding when the <i>mudarib</i> has already commenced the business.
5	4.4	A <i>mudarabah</i> contract is one of the trust-based contracts. ⁵²
6	5	The type of <i>mudarabah</i> must be stated. ⁵³
7	7.1 (1)	The nature of the <i>mudarabah</i> capital has to be mentioned in the contract. ⁵⁴ In principle, the capital of <i>mudarabah</i> must be provided in the form of cash or tangible assets.
8	7.2	The capital of <i>mudarabah</i> should be clearly known to the contracting parties and defined in terms of quality and quantity in a manner that eliminates any possibility of uncertainty or ambiguity.
9	7.3	It is not permitted to use a debt owed by the <i>mudarib</i> or another party to the capital provider as capital in a <i>mudarabah</i> contract.
10	7.4	For a <i>mudarabah</i> contract to be valid and for the <i>mudarib</i> to be considered as having control over the capital, the capital must be, wholly or partially, put at the disposal of the <i>mudarib</i> , or the <i>mudarib</i> must have free access to the capital.
11	8.1 (1) ⁵⁵	It is a requirement that the mechanism for distributing profit must be clearly

⁵² Therefore, the *mudarib* is investing *mudarabah* capital on a trust basis in which case the *mudarib* is not liable for losses except in case of breach of the requirements of trust, such as misconduct in respect to the *mudarabah* fund, negligence and breach of the terms of *mudarabah* contract (AAOIFI, 2010).

⁵³ Note that this is not mentioned explicitly in ruling 5, but rather can be understood implicitly.

⁵⁴ Note that this is not mentioned explicitly in ruling 7.1, but rather implicitly.

⁵⁵ A bracket denotes that a single clause from the AAOIFI Standard has been split into two or more distinct rulings for the purpose of this analysis. This is because the same clause has more than one ruling.

		known in a manner that eliminates uncertainty and any possibility of dispute.
12	8.1 (2)	The distribution of profit must be on the basis of an agreed percentage of the profit and not on the basis of a lump sum or a percentage of the capital.
13	8.2 (1)	In principle, it is not permissible to earn a share of profit in addition to a fee in a <i>mudarabah</i> contract.
14	8.3	The parties should agree on the ratio of profit distribution when the contract is concluded.
15	8.6	It is not permissible for the capital provider to give the <i>mudarib</i> two amounts of capitals on condition that the profit earned on one of the two amounts would be taken by the <i>mudarib</i> while the capital provider would take the profit earned on the other amount. It is not also permissible for the capital provider to state that the profit of one financial period would be taken by the <i>mudarib</i> and the capital provider would take the profit of the following financial period. Similarly, it is not permissible to assign the profit from a particular transaction to the <i>mudarib</i> and the profit from another transaction to the capital provider.
16	8.7	No profit can be recognized or claimed unless the capital of the <i>mudarabah</i> is maintained intact. ⁵⁶
17	8.8	The <i>mudarib</i> is entitled to a share of profit as soon as it is clear that the operations of the <i>mudarabah</i> have led to the realization of a profit. However, this entitlement is not absolute, as it is subject to the retention of interim profits for the protection of the capital. It will be an absolute right only after distribution, i.e. when actual or constructive valuations take place.
18	9 (1)	The <i>mudarib</i> should employ his best to accomplish the objectives of the <i>mudarabah</i> contract. The <i>mudarib</i> should assure the capital provider that his money is in good hands.
19	9 (2)	The <i>mudarib</i> will act to find the best ways of investing in a permissible manner.
20	9.3 (1)	The capital provider is not permitted to stipulate that he has a right to work with the entrepreneur (<i>mudarib</i>) and to be involved in selling and buying activities, or supplying and ordering.
21	9.3 (2)	The capital provider is not entitled to lay down conditions that will restrict movements or actions of the <i>mudarib</i> .
22	9.5	The <i>mudarib</i> is not entitled to sell items for the <i>mudarabah</i> operation at less than the common or market price, or to buy items for the <i>mudarabah</i> operation at a price higher than common prices, unless if such action in either case is intended to achieve an objective that is obviously in the interest of the

⁵⁶ Whenever a *mudarabah* operation incurs losses, such losses stand to be compensated by the profits of future operations of the *mudarabah*. (AAOIFI, 2010).

		<i>mudarabah</i> .
23	9.6	It is not permissible for the <i>mudarib</i> to make a loan or a gift or a charitable donation out of the <i>mudarabah</i> funds. Likewise, the <i>mudarib</i> is not entitled to waive a right associated with the <i>mudarabah</i> operation unless the capital provider has consented to his doing so.
24	10.1	The (way/mode) for termination of the <i>mudarabah</i> must be mentioned in the contract. ⁵⁷
25	10.1 (d)	The contract terminates when funds of <i>mudarabah</i> contract have been exhausted completely. ⁵⁸
26	10.1 (e)	The contract terminates by death of the <i>mudarib</i> or the liquidation of the institution that acts as <i>mudarib</i> .
27	10.2	On the maturity of a <i>mudarabah</i> operation, the assets shall be subject to the liquidation process.

⁵⁷ Note that this ruling is not mentioned explicitly in clause 10.1, but rather implicitly.

⁵⁸ The original ruling has been amended and reformulated by adding the word 'completely'. This is because the contract does not terminate if the *mudarabah* funds suffer partial losses except if the losses occur before the initiation of the *mudarabah* (Al Buhooti, 1997).

APPENDIX A2

MUDARABAH CONTRACT APPLICABLE CONDITIONALLY REQUIRED RULINGS

No.	AAOIFI Ruling Reference	RULING
28	4.3 (b)	When the contracting parties agree to determine a duration for which the contract will remain in operation, the contract cannot be terminated prior to the end of the designated duration, except by mutual agreement.
29	8.9	If the <i>mudarib</i> has commingled his own funds with the <i>mudarabah</i> funds, the <i>mudarib</i> becomes a partner in respect of his funds and a <i>mudarib</i> in respect of the funds of the capital provider. The profit earned on the two commingled funds will be divided proportionately to the amounts of the two funds, in which case the <i>mudarib</i> takes the profit attributable to his own funds while the remaining profit is to be distributed between the <i>mudarib</i> and the capital provider according to the provisions of the <i>mudarabah</i> contract.
30	9.7	If there is no agreement on the right of the <i>mudarib</i> to receive living expenses from the <i>mudarabah</i> capital, then the <i>mudarib</i> should take living expenses in accordance with custom and reason. The <i>mudarib</i> is also entitled to traveling expenses in accordance with custom and reason.

APPENDIX B1

MURABAHAH CONTRACT REQUIRED RULINGS

No.	AAOIFI RULING REFERENCE	RULING
1	2.2.6 (1)	It is not permitted to carry out a <i>murabahah</i> on deferred payment terms where the asset involved is gold or silver or currencies.
2	2.3.1	It is not permissible that the document of promise to buy (signed by the customer) should include a bilateral promise which is binding on both parties (the institution and the customer).
3	2.4.1	It is not permissible for the institution to receive a commitment fee from the customer.
4	2.5.2	It is not permitted to impose on a customer who is the purchase orderer a guarantee regarding hazards that may affect the item such as damage and destruction during period of shipment or storage.
5	3.1.1	The institution is prohibited from selling any item in a <i>murabahah</i> transaction before having acquired ownership the item. Hence, it is not valid for the institution to conclude a <i>murabahah</i> sale with the customer before concluding the purchase, from the supplier of the item, of the subject matter of the <i>murabahah</i> , and before actual or constructive possession of the item as a result of the supplier giving control over the item or presenting documents that represent possession.
6	3.2.1	It is obligatory that the institution's actual or constructive possession of the item be ascertained before its sale to the customer on the basis of <i>murabahah</i> to the purchase order.
7	3.2.2	It is obligatory that the point when the institution passes on the risk of the item to the customer is clearly identified, with reference to the stages in which the item is transferred from one party to another.
8	4.1 (1)	It is not permitted for the institution to consider that the contract of <i>murabahah</i> to the purchase orderer is automatically concluded by its mere taking possession of the asset.

9	4.1 (2)	The institution may not force a customer who is the purchase orderer to take delivery of the asset and pay the <i>murabahah</i> selling price, if the customer refuses to conclude the <i>murabahah</i> transaction.
10	4.3 (1)	The institution has the obligation to disclose to the customer, when concluding the contract of sale, the details of any expenses that it would include in determining the selling price.
11	4.4	The institution is not entitled to include in the base cost of the item, for the purpose of calculating the <i>murabahah</i> price, any amounts other than the direct expenses that are paid to a third party. It is not permissible, for example, for the institution to add the cost of the item payments made to its own staff for their work, and the like. ⁵⁹
12	4.6 ⁶⁰	The base price of the item should be both fixed and known to both parties at the conclusion of the contract.
13	4.7	The institution's profit mark-up should be both fixed and known to both parties at the conclusion of the contract; the mere mention of the total selling price is not sufficient.
14	5.4 (1)	It is not permissible to stipulate that the ownership of the item will not be transferred to the customer until the full payment of the selling price

⁵⁹ Al Shubaily (2005) has stated that this ruling applies in the case where the seller does not disclose a detailed description of the expenses he is adding to the base amount. If, however, he discloses in detail, then Al Shubaily asserts that the jurists are unanimous that the seller is allowed to add any expenses even if they are not considered, by custom, direct expenses.

⁶⁰ The wording of 4.6 and 4.7 has been changed.

APPENDIX B2

MURABAHAH CONTRACT APPLICABLE CONDITIONALLY REQUIRED RULINGS

No.	AAOIFI Ruling Reference	Ruling
15	4.2	The institution is entitled to receive compensation for any actual damage it has incurred as a result of the customer's breach of a binding promise. The compensation consists of the customer reimbursing the institution for any loss due to a difference between the price received by the institution in selling the asset to a third party and the original cost price paid by the institution to the supplier.
16	4.3 (3)	If the institution failed to disclose any expenses, it is not entitled to include them unless they are customarily considered as normal expenses, such as transportation expenses, storage expenses, fees for letters of credit and insurance premiums.
17	4.8	It is not permitted to demand any extra payment either in consideration of extra time given for payment or for delay in payment that may be for a reason or no reason. In case of rescheduling, it is not permissible to extend the date of payment of the debt in exchange for an additional payment.
18	4.10	If the institution did not stipulate its exemption from pre-existing hidden defects whose effects appear after the conclusion of the contract, then it is responsible for pre-existing hidden defects excluding any new defects (recent defects).
19	5.6	It is permissible that the contract of <i>murabahah</i> consists of an undertaking from the customer to pay an amount of money or a percentage of the debt, to be donated to charitable causes in the event of a delay on his part in paying instalments on their due date.

APPENDIX C1

IJARAH CONTRACT REQUIRED RULINGS

No.	AAOIFI RULING REFERENCE	RULING
1	3.1	For the validity of an <i>ijarah</i> contract concerning a specified asset, the lease contract should be preceded by acquisition of either the asset to be leased or the usufruct of that asset.
2	4.1.1	The lease contract is a binding contract which neither party may terminate or alter without the other's consent except in case of force majeure. ⁶¹
3	4.1.2	The duration of an <i>ijarah</i> contract must be specified in the contract. The period of <i>ijarah</i> should commence on the date of execution of the contract, unless the two parties agree on a specified future commencement date, resulting in a future <i>ijarah</i> , that is, an <i>ijarah</i> contract to be executed at a future date.
4	5.1.1 (1)	The leased asset must be capable of being used while preserving the asset.
5	5.1.1 (2)	The benefit from an <i>ijarah</i> must be lawful in <i>Shariah</i> and the asset should be used lawfully.
6	5.1.4	The lessee must use the leased asset in a suitable manner or in conformity with common practice, and comply with conditions which are acceptable in <i>Shariah</i>
7	5.1.5	The lessor must accept responsibility for any defects of the leased asset which impair the intended use of the asset, and may not exclude his liability for any impairment that the leased asset may sustain, either by his own doing or as a result of events outside his control, which affect the benefits intended to be available under the <i>ijarah</i> contract.
8	5.1.7 (1)	The lessor may not stipulate that the lessee will undertake the major maintenance of the asset that is required to keep it in the condition necessary to provide the contractual benefits under the lease.
9	5.1.7 (2)	The lessee should carry out operating or periodical (ordinary) maintenance.
10	5.1.8 (1)	The leased asset is the responsibility of the lessor, including the insurance, throughout the duration of the <i>ijarah</i> , unless the lessee commits misconduct or negligence. Therefore, if the benefit from the leased asset is impaired wholly or partially as a result of the lessee's misconduct, while the property remains under lease, the lessee is obliged to restore or repair the usufruct, and rent for the time during

⁶¹ Note that ruling 4.1.1 has been merged with ruling 7.2.1.

		which the benefit is lost is not to be waived.
11	5.2.1	The rental must be specified, either as a lump sum covering the duration of the <i>ijarah</i> contract, or by installments for parts of the duration. It may also be for a fixed or variable amount, according to whatever designated method the two parties agree upon.
12	5.2.2	The rental is made obligatory by the contract and the lessor's entitlement to the rental runs from the time when the lessee starts to benefit from the asset or once the lessor makes the usufruct of the asset available to the lessee, and the entitlement to the rental does not necessarily commence on the date of signing the <i>ijarah</i> contract.
13	6.3	No increase in the rental due may be stipulated by the lessor in case of delay in payment by the lessee.

APPENDIX C2

IJARAH CONTRACT APPLICABLE CONDITIONALLY REQUIRED RULINGS

No.	AAOIFI Ruling Reference	Ruling
14	2.3	If the customer breaches his promise, in case a guarantee of the customer's commitment is taken, he is charged either the difference between the cost of the asset intended to be leased and the total lease rentals for the asset which is leased to a third party, or, if the asset is sold, the difference between its cost and the total selling price.
15	3.1 (b)	If the asset is to be acquired from the customer or from a third party, the <i>ijarah</i> contract shall not be executed unless and until the institution has acquired that asset.
16	3.3	A lessee of an asset may enter into a sub-lease contract with a party other than the owner for a rental that is either the same, lower or higher, payable either currently or on a deferred basis, unless the owner stipulates that the lessee should not assign or sublet the property to third parties, or should not do so without his approval.
17	5.1.8 (2)	If the lessor takes into account the insurance expenses implicitly when the lease rental is to be fixed, he may not, after the contract is signed, charge the lessee any cost in excess of the cost anticipated at the time of fixing the rent.
18	5.2.3	In case the rental is subject to changes (floating rental), it is necessary that the amount of the rental of the first period of the <i>ijarah</i> contract be specified. It is then permissible that the rentals for subsequent periods be determined according to a certain benchmark.
19	6.4	It may be provided in the contract of <i>ijarah</i> or <i>ijarah muntahia bittamleek</i> that a lessee who delays payment for no good reason undertakes to donate a certain amount or percentage of the rental due in case of late payment. Such donation should be paid to charitable causes under the co-ordination of the Institution's <i>Shariah</i> Supervisory Board.
20	6.5	In case of foreclosure of the security, the lessor may deduct from such amounts only what is due in respect of rental for previous periods.
21	7.1.3	In case of total destruction of the leased asset, the <i>ijarah</i> contract is terminated if it is concluded on an identified asset. In such a case, it

		may not be stipulated that the rest of the instalments should be paid.
22	8.1	In <i>ijarah muntahia bittamleek</i> , the method of transferring the title in the leased asset to the lessee must be evidenced in a document separate from the <i>ijarah</i> contract document and cannot be taken as an integral part of the contract of <i>ijarah</i> .
23	8.2	A promise to transfer the ownership by way of one of the specified methods is binding on one party only.
24	8.3	In all cases of transfer of ownership by way of gift or sale, it is necessary, when the promise is fulfilled, that a new contract be drawn up, since the ownership to the property is not automatically transferred by virtue of the original promise document that was drawn up earlier.
25	8.7	Transfer of the ownership in the leased property cannot be made by executing, along with the <i>ijarah</i> , a sale contract that will become effective on a future date in the case of <i>ijarah muntahia bittamleek</i> .

APPENDIX D1

ISTISNAA CONTRACT REQUIRED RULINGS

No.	AAOIFI Ruling Reference	RULING
1	2.2.1 (1)	It is a condition that the type, kind, quality and quantity of the subject-matter to be produced are specified.
2	2.2.1 (2)	It is a condition that the price of the subject-matter is known.
3	2.2.1 (3)	A contract of <i>istisnaa</i> is binding on the contracting parties provided that the aforementioned conditions are fulfilled.
4	2.2.1 (5)	The customer has the option to accept or to refuse the subject-matter if the subject-matter does not conform to the specification agreed upon.
5	2.2.3	It is not permitted for the manufacturer to stipulate in the contract of <i>istisnaa</i> that he is not liable for defects.
6	2.2.4	It is not permitted to conclude <i>istisnaa</i> contracts or processes of <i>istisnaa</i> in a manner that makes it a legal device for a mere interest-based financing.
7	3.1.1	An <i>istisnaa</i> contract is permitted only for raw materials that can be transformed from their natural state by a manufacturing or construction process involving labour. Therefore, <i>istisnaa</i> is valid only in so far as the supplier has agreed to provide a subject-matter that is manufactured or constructed.
8	3.1.3 (1)	It is not permissible that the subject-matter of an <i>istisnaa</i> contract be an existing and identified capital asset.
9	3.1.6 (1)	The manufacturer is under an obligation to produce the subject-matter according to specification
10	3.1.6 (2)	The manufacturer is under an obligation to produce the subject-matter within the period agreed upon or within such reasonable time as the nature of the work may permit, in accordance with accepted practice that is recognized by experts.
11	3.2.5	A contract of <i>istisnaa</i> cannot be drawn up on the basis of a <i>murabahah</i> date, for example, by determining the price of <i>istisnaa</i> on a cost-plus basis.
12	6.1	The manufacturer is discharged from liability if the subject-matter is delivered to either the ultimate purchaser or to a person appointed by him or if the ultimate purchaser is enabled to exercise full control over the subject-matter.
13	6.7 (2)	It is not permitted to stipulate a penalty clause against the ultimate purchaser for default on payment.
14	6.8	It is not permissible to sell the subject-matter before taking either actual or constructive possession of it.

APPENDIX D2

ISTISNAA CONTRACT APPLICABLE CONDITIONALLY REQUIRED RULINGS

No.	AAOIFI Ruling Reference	Ruling
15	2.2.1 (4)	If there is a delivery date, then it must be stated.
16	3.1.2	It is permissible that the contract of <i>istisnaa</i> be concluded for the production of a subject-matter having a unique description according to the requirement of the ultimate purchaser even if such a subject-matter is subject to specification.
17	3.2.2	It is permissible to connect payment with the stage of completion of the work, (such that a payment is made at the end of each stage), provided the stages of this type of work are custom subject to specification and their identification will not lead to dispute.
18	4.1.1 (2)	It is permissible, after the conclusion of an <i>istisnaa</i> contract, for the manufacturer and the ultimate purchaser to agree on amending the manufacturing or construction specifications previously agreed upon or introducing additional specification requirements on condition that the price is adjusted accordingly and a reasonable period for the execution of the new requirements is granted.
19	4.2.4 (1)	In case the contractor is unable to continue to discharge his obligation, and the failure to perform is due to the misconduct of the contractor, the ultimate purchaser is liable only for the value of the building structure and the builder is liable to compensate the ultimate purchaser for any actual damage or loss he suffered.
20	6.3 (1)	It is permissible that delivery of the subject-matter takes place before the due date, on condition that the subject-matter meets the specifications agreed upon, in which case the ultimate purchaser is obliged to accept the subject-matter.
21	6.7 (1)	It is permissible for the contract of <i>istisnaa</i> to include a fair penalty clause stipulating an agreed amount of money for compensating the ultimate purchaser adequately if the manufacturer is late in delivering the subject-matter. Such compensation is permissible only if the delay is not caused by intervening contingencies (<i>force majeure</i>).
22	7.1	It is permissible for the institution to buy items on the basis of a clear and unambiguous specification and to pay, with the aim of providing liquidity to the manufacturer, the price in cash when the

		contract is concluded. Subsequently, the institution may enter into a contract with another party in order to sell, in the capacity of manufacturer or supplier, items whose specification conforms to the wishes of that other party, on the basis of parallel <i>istisnaa</i> , and fulfil its contractual obligation accordingly. This is permissible on condition that the delivery date stipulated in the parallel (sale) contract must not precede that stipulated in the original purchase contract, and, moreover, the two contracts should remain separate from each other.
23	7.3	As a result of concluding an <i>istisnaa</i> contract in the capacity of a producer or supplier, the institution must assume liability for ownership risk and maintenance and insurance expenses prior to delivering the subject-matter to the ultimate purchaser (the customer). Moreover, the institution is not permitted, in the parallel <i>istisnaa</i> contract concluded with the manufacturer, to transfer to the latter the risk arising from its obligations towards the customer.