

## **AN INTRODUCTION TO THE ISLAMIC PERSPECTIVES OF CONDUCTING BUSINESS**

Ahmad H. Juma'h  
Professor  
Metropolitan Campus  
Inter American University of Puerto Rico  
San Juan, Puerto Rico

Raed N. Abu-Mounes  
Islamic Banking, Foundation of Jurisprudence.  
Assistant Professor  
Department of Islamic Jurisprudence and its Foundation.  
Faculty of Shari'a, University of Jordan  
Amman-Jordan

### **Abstract**

This article is an introduction to the Islamic perspectives with respect to conducting business activities without engaging in the utilization of the interest rate (Ribba) mechanism. Several examples of allowed mechanisms in Islam are presented (such as partnership, leasing and investment funds). The benefits to the society should be seen as a priority and the individual benefit should not contradict the society's benefit. Ethics and moral orientations in Islam are more important than creation of laws.

### **Introduction**

Solutions to economic problems can turn complicated. It seems that economists claim that they conduct scientific research to solve economic and finance dilemmas. We can observe more complicated concepts, mechanisms and instruments with respect to economic issues without solving the main economic dilemmas, in particular wealth distribution.

Psychology, sociology, sexology, and economics try to study humans' behaviors through observations and experiments. Human beings cannot be considered only as physical bodies and biological systems. People behaviors are influenced by many variables. Humans are intellectual beings whose nature demands the satisfactions of their reasons. Humans are moral and spiritual beings and they are part of the vast and immense system of the universe. Islamic believes

concentrate on preparing and teaching individuals to serve the society. Investors, merchants and traders act on behalf of the society and at the same time satisfy their own objectives.

The Islamic believes with respect to conducting business have similarities and differences with capitalist and socialist economic systems. This article compares and discusses the actual finance activities with respect to Islamic laws and the issues related to the economic problem dealing with financing business activities; followed by examples of partnership, limited partnership, leasing, and exceptions such as advance payment for manufacturing, and advance payment to purchase a product. We end the article with a conclusion.

### **The Economic Problem and Islamic Perspectives**

Many authors argue that there is no such thing called Islamic economic or finance. The confusion may rise because the Islamic guidelines are not separable from the main objectives of Islam. Therefore, we cannot separate the rules and guidelines related to economic activities from the Islamic forms of life and Islamic believes.

Before studying any economic problem, the most important question in Islam is considered, why human beings exist and what are their responsibilities and duties in this universe? Life is short and not comparable with the hereafter. People should act in a good manner to gain the hereafter. This implies that investors should consider the benefit of the society in achieving their own benefit. Therefore, we cannot separate economic activities from the Islamic ethics of conducting business.

In explaining the relationship between the existing business activities and how to conduct business without involving agreements with interest rate, we have to consider the main sources of Islamic regulations that are the specifications and guidelines indicated in the Holy Koran by Prophet Mohammed and the explanations agreed by the majority of Islamic scholars. This is because the Islamic economic rules are part of the form of life as a holistic system.

Distribution of wealth is one of the most important issues in studying human beings and society. Accepting the human needs in particular and accepting the needs of ownership of some properties by individuals are important issues in Islamic teachings. Some human behavior contributes to the economic problems, among them selfishness, immoral habits, and support from discriminating biased and corruptive political systems. The individual conducts that exceed the limits of moderations are not accepted in Islam because they are considered against the society's benefit.

Accumulating wealth without helping other members of the society who are deprived from basic needs is one example of unfair distribution of wealth. In consequence starvation, diseases, and needy people would not participate in the development of other human beings. This unfair distribution of wealth will adversely affect the whole process of human progress and in the long run it will also affect wealthy people because they are part of the whole system. The basic human needs should be guaranteed before guaranteed the individual's rights such as property ownership. Property ownership is allowed, but with some limitations to assure social justice.

More wealthy people are continually shifting the necessity to another form of necessities. They are continually maximizing their utilities. This is considered as wasting the human capital. For example, one rich family consists of three members, living in a palace full with pleasures. These unneeded pleasures in our minds may convert in a necessity for them. When this family contributes nothing to needy people, wasting human capital is assumed therefore, affecting the structure of the society. It is assumed that the richer class is becoming smaller in number in comparison with the poor class. It is argued that less than 1% of the world populations own more than 99% of the global wealth.

In the international market and similar to individual's conducts, every country tries to produce more quantities at the minimum cost of production. Countries try to monopolize the sources of productions that include technology. This also makes the gap between rich countries and poor countries huge.

How can we solve the individual's dilemmas of reaching the basic needs of living for all the member of society? According to the communist solution, the production should be taken out of the hands of individuals and transferred to the community which is responsible for the distribution of wealth.

According to the Islamic economic perspective, the natural laws inherent to human nature should not be altered. The introduction of some external laws such as common laws or regulations should not be considered sufficient. The moral reformations and attitudes among human beings are more important than external regulations. Generating works and encouraging people to work and not to rely on helps and grants from others are very important to solve human's needs.

The applications of external laws should not be allowed except in situation where they are inevitable to apply. The natural principles on economic perspectives of life should be

conserved, not through laws and regulations but through moral instructions. Individuals should be free and retain the right of ownership and can accumulate wealth by means of their earnings. However, monopoly and exploitation of others should be prohibited.

Disparity exists between humans because their abilities are different. In principle, all things, issues, or works are permitted in Islamic laws except if there is a clear indication that they are unlawful. For example, bribery, stealing, gambling, speculations, business based on fraud, and monopoly of the means of production (by one or a group) are unlawful. The main reason of prohibition of an issue is the bad effect to society and the individual as well.

The accepted spending in Islam are those related to living in a decent way. Also, encourage people to spend in social activities that include helping needy people. Rich people should spend some of their surplus in social welfare. It is unlawful to lend the accumulated surplus (savings) based on interest rate whether it is for commercial purposes or personal purposes. People can invest the surplus in trade, industry, manufacturing or providing capital to others and participate in profit and losses of the business established. This facilitates the circulation of money and therefore, contributes to fair distribution of wealth.

Assume a person wants to keep some money, then the external law (regular charity or “Zakat” in Arabic) is applied and he (she) should pay 2.5% of the accumulated money over one year. Zakat is part of a reform society that makes moral pressures (education) on human behavior. It assumes that not all persons have similar conducts. Some people have the tendencies towards accumulating wealth by investing their surplus. For these individuals, Islam has placed some legal limitations that include prohibition of interests acquired by lending money to others. Islam does not recommend accumulation of money in the hands of a few persons, and facilitates the circulation of money, so the needs of others can be satisfied.

In the early era of Islam, Bit El Mal (the house of money) was the Islamic institution responsible for collecting “Zakat” and distributing it among needy people. Nowadays this institution practically does not exist in what’s called Islamic countries. Many civic institutions realize similar works to help needy people and to generate works.

### **Conducting Business Activities with Respective to Islamic Laws**

The relationship between Islamic Laws and communist, socialist and capitalist activities depend on the type of the activities and whether these activities include some type of prohibitions in Islam. For example, prohibiting individual from property rights is unacceptable in

Islamic laws. Some types of business conducts in capitalism are common in Islamic activities. These activities include: joint partnership and limited partners. However, Islamic laws differ with respect to bonds and preferred shares, because of the privilege given to the bonds and preferred shares that contain fixed interest rate.

### **Sharing concept and debt bearing interest**

Some people may think that Islamic laws are against the principles of capitalism. This is not true because in Islam the origin of things, activities, and practices is not prohibition. The central issue that differentiates between Islamic laws and capital practices is the interest rate. In the Holy Koran, interest is prohibited. Interest (“Ribba” in Arabic) is the increase in the original value of a thing.

For example, a Computer cost \$1,000 now is sold with annual interest rate of 12% will cost \$1,120 (assuming simple interest rate) at the year end. Off course any default will increase the computer’s value. Assume the same computer is sold for \$1,120 and the value will paid at the end of the year, this is not considered “Ribba” in Islam.

Both amounts are equals, but in Islamic perspective the treatment is not the same because the deal with interest does not fix the amount to be received and could vary after the year. However, in the second situation, the amount is fixed and should not pay more if the market situation is changed. All engagements that contain interests are prohibited. Islam considers interest as a mean of bad business conduct and influence the fair distribution of wealth.

Islam offers a partnership (in Arabic Musharakah) as a mean to conduct business, where all the partners share profits or losses of the business. In the capitalist economics, many authors consider long term debt as more preferable than equity. In Islam loans without interests are permitted, but partnership is preferable for investors and all parties share profits and risks.

In Islam social benefit is more important than individual benefit. Through interest, the capital is concentrated among a few investors and limits the circulation of money between individuals. Contracts based on interest rates makes one party with little risk and other party with greater risk. This is against the fair distribution of wealth. Through partnership, both parties share profit earned by the partnership as accorded. Through the concept of sharing or partnership, a wide range of business can be conducted without violating the Islamic principles and believes. According to interest based business, the following table shows how many years a specific amount of money, given a fixed interest rate compounded monthly, will become double.

Interest rate compounded monthly	10%	15%	20%	25%
Time/year to double the principal	6.96	4.65	3.49	2.8

### **Money and Commodities**

In the non-Islamic banking systems money and commodity are traded equally in many transactions. In other words, one dollar can be sold for two or more dollars on the spot or on credit. In the Islamic laws “Shari‘ah”, money and commodity have different objectives and characteristics so they are treated in different ways. Money has no intrinsic utility. It is only an instrument of exchange. The commodities have intrinsic utility and can be utilized directly to fulfill human needs. Islamic scholars have stated that if a society does not differentiate between money and products then unfair distribution of wealth will occur.

### **Partnership**

Partnership means "Shirkah" in Arabic, and it is referred to companies that are divided into:

- Joint ownership of a particular property where two or more people share specific amount of money in acquiring, for example, a property or business.
- Joint commercial or contractual partnership. This type include:
  - Sharing a business by the investment of some capital by all partners.
  - Sharing a service business by investing talents or time and without investing capital. The earned income is distributed among partners based on agreed terms.
  - Sharing a business without investing capital or work occurs where partners purchase commodities on a deferred price and sell them at spot. The earned income is distributed among partners based on agreed terms.

According to Islamic scholars, “Musharakah” is used to refer to the capital invested by partners to form a joint venture or partnership. The main items of such valid contract include: a) that each part should be capable of entering into a contract, b) the contract must take place with free consent from each part, c) without any duress, d) fraud or e) misrepresentation.

The contract should indicate the proportion of profit to be distributed between the partners. The Islamic Law considers the contract invalid if it contains no indication of the profit distribution. This means that the contract should contain clear language with respect to profit distribution. Each partner should receive a percentage of the actual profit accrued to the business, and not a percentage of the capital invested by such partner. It is not permitted to assign a fixed

amount profit to any partner solely based on his initial investment. This assures that the risk is assumed by all partners.

In “Musharakah”, all partners have the right to participate in the management decisions or work. However, the partners may agree that only selected partners should assume the management for a specific amount of money. Other partners who are not participating or working in the partnership are entitled to the profit, only to the extent of their investment. The ratio of profit allocated to them should not exceed the ratio of their investment. However, if all the partners work for the partnership, each one is treated as an agent of the partnership.

### **Limited partnership**

Another way to conduct business is by means of a special partnership which includes limited partners “Mudarabah in Arabic”. The partners who offer money and do not participate in the business are called limited partner. In this situation management and work is a responsibility of the other partner or general partner. The difference between general partner and limited partner is based on the investment, the right to manage the business, profit sharing and liability responsibility. The investment in “Musharakah” comes from all the partners, but the investment in “Mudarabah” comes from some partner (similar to limited liability partner).

In “Musharakah”, all the partners can participate in the management of the business and can work for it, but in “Mudarabah”, management is the only the responsibility of the general partner. The liability of the partners in “Musharakah” is unlimited and the liabilities should be divided equally among all the partners based on their investment ratio. However, in the case of “Mudarabah”, the liability of investors is limited to their investment.

Another form of “Musharakah” is “Diminishing Musharakah” where an investor and a client participate either in the joint ownership of a property or equipment or business. The share of the investor is divided by units to enable the client to purchase these units in a timely manner until all the units are purchased by the clients and become the owner of the business.

“Murabahah” refers to a particular kind of sale where the seller discloses the actual cost incurred in acquiring the goods, and the total sale is the original cost plus the agreed profit that could be a lump sum or a percentage of original cost. The payment in “Murabahah” could be at spot or on future date based on the agreement of the participants.

### **Bonds, Preferred Shares, and Common Shares**

From the previous discussion, Islamic Laws are against bonds and preferred shares. This is because both bonds and preferred shares are treated with privilege since bonds holders and preferred shares holders receive defined or fixed percentages based in the principal not in sharing company profits.

In current finance, bonds and preferred shares are equity or equity equivalent. In Islamic Laws, common shares are allowed since all common shares holders receive dividends based on company profit and the shares owned by each shareholder. Common shares holders assume risks equally and this is a special form of partnership allowed by Islamic Laws.

### **Sale on credit**

Sale is the exchange of a product by another product (or money) with mutual consent. The goods sold must exist, owned and in the physical or constructive possession of the seller. However, the promise to sell something which is not yet owned or possessed creates only a moral obligation and in some cases may create a liability, and it can be enforceable by the Islamic Laws.

Features of sales in Islamic Laws indicates that a) a sale must be instant and absolute, b) the goods must have a value, known and identified to the buyer, c) the product delivery and terms of sale must be certain and should not depend on any contingency and, d) the product price is fixed.

A sale with deferred payment or payments and with specified dates of deferred payment are allowed in Islamic Laws. This is called a “Bai‘ Mu’ajjal” and is similar to sales on credit, but without involving interests in the sale contract.

### **Lease, payment in advance, and investment funds**

Hiring employees and leasing a property is called “Ijarah in Arabic”. “Ijarah” is used for two concepts, a) first to contract a person as an employee to conduct certain tasks or services for a fixed salary, b) to lease or rent an asset or a property. “Ijarah” is used in Islamic perspective as a form of investment and as a mode of financing.

“Salam” is a sale when the buyer pays in advance the full amount in cash of a specific good that will be received in the future. This exemption, for example, is used to satisfy farmers who need money in advance to produce the product, helping farmers to avoid taking usurious loans.



Advance payment for production “Istisna in Arabic” is entering into a contract to purchase a product before it comes into existence. The price should be fixed with the consent of the manufacturer and buyers, including product specifications are fully specified in the agreement.

The Islamic Investment Fund is used to enable investors to share an investment to earn profits. The participants or subscribers of the fund receive a certificate that enables them to receive profits based on their investments. The dividends should be based on the actual profit and not on a fixed percentage based on the face value of the investment.

### **Conclusions**

As we can see Islamic Laws with respect to business activities states that economic activities associated with interest rate are not allowed. Since, interests do not allow fair distribution of wealth between investors, and therefore it is against the benefit of the society. Also, interests reduce the velocity of money circulation and treat money as a product.

Islam has few prohibitions on how to conduct business; however the main issue is the prohibition of money interest. In spite of, several actual business activities are allowed in Islam, but without interest rate. These include a) partnership either general or limited, b) leasing, c) contracting for product manufacturing and services and, d) investment funds.

Further translation from Arabic to other languages is needed to present more advance concepts of Islamic views on how to replace business activities associated with interests to other forms of business without involving interests.

The Islamic banks have motivated many Muslims to conduct business without engaging in interest rate. However, many studies are needed to describe actual activities of Islamic banks and how people perceive these activities.

### **References**

Samy Hasssan Ahmad Hamud, (1982), **Developing Banking Activities in Accordance with Islamic Sharia**, 2<sup>nd</sup> edition, Dar el Fikr, Amman Jordan.

Uof Mahmoud Al-Kufrawy, (1988), **Money and Banking in the Islamic System**, Dar el Jammah Masriyah, Egypt.

Rafique Younes El Massry, (2005), **The Principle of Islamic Economy**, Dar el Kalam, Syria.

Mohammad El Gazali, (2005), **Islam and the Economic Situations**, Dar el Kalam, Syria.

Ahmad Salem Abdallah Mulhes, (1989), **Baia' Murabaha and its Applications in Islamic Banking**, Al resallah Al hadita, Jordan

Mohammad Muslehuddin, (2000), **Banking and Islamic Law**, Islamic Book Services, India.

Najatullah Siddiqui, (1971, reprint 1997), **Banking without interest**, Markazi Maktaba Islami, Delhi, India

S. Abul A'La Maududi, (1999), **Economic System of Islam**, 4<sup>th</sup> edition, Islamic Publications (PVT) Limited, Lahore, Pakistan

Kharib Mohammad Said Ahmad, (1981), **Islamic Economy: A study in Social Science**, Dar el Marifa, Egypt

#### **CITATION FROM THE HOLY KORAN: TRANSLATION OF THE MEANINGS**

Surah 2: Baqarah 275-280

“Those who ear Riba (usury) will not stand (on the day of resurrection) except like a person beaten by Satan leading him to insanity. This is because they say “trading is like Riba”, where Allah has permitted trade and forbidden Riba. So whosoever receive admonition from his Lord and stop eating Riba shall not be punished for the past; his case is for Allah (to judge); but however returns (to Riba), such are the dwellers of the fire-they will abide therein (2:275). Allah will destroy Riba and will give increase Sadaqat (deeds of charity, alms, etc.) and Allah likes not the disbelievers, sinners (2:276). Truly those who believe, and do deeds of righteousness, and offer prayers perfectly, and give Zakat (regular or established charity), they will have their reward with their Lord. On them shall be no fear, nor shall they grieve (2:277). O you who believe! Be afraid of Allah and give up what remains (due to you) from Riba if you are (really) believers! (2:278). And if you do not do it, then take a notice of war from Allah and His Messenger, but if you repent, you shall have your capital sums. Deal not unjustly, and you shall not be dealt with unjustly (2:279). And if the debtor is in a hard time, then grant him time till it is easy for him to repay, but if you remit it by way of charity, this is better for you if you did but know (2:280).”

Surah 3: Al-Imran 130

“O you who believe! Eat not Riba doubled and multiplied, but fear Allah that you may be successful (3:130).”

Surah 4: An-Nisa' 159-161

“And there is none of the people of the Scripture, but must believe in him, before his death. And on the Day of Resurrection he will be a witness against them (159). For the wrong-doing of the Jews, We made unlawful to them certain good food which was lawful to them, and for their hindering many of Allah's way (160); And their taking of Riba, though they were forbidden from taking it and their devouring of men's substance wrongly. And We have prepared for the disbelievers among them a painful torment (4:161)”

Surah 30: RUM 39

“And that which you give lay out in order that it may increase, has no increase with Allah, but that which you give in Zakat seeking Allah’s Countenance then those, they shall have manifold increase (30:39).”