

clear intention of abidance of the rules set out by Shariah.

Given these circumstances, one should remain careful regarding the matter of identification of the right Islamic financial institution. In this respect, I have observed that a few businessmen have obtained finance on Islamic modes even from conventional banks or Islamic banks (with bad reputation). In such case, the only thing that needs to be ensured by the person obtaining the finance is that all the contracts and documents are made according to Shariah and these are actually complied with, in substance and in form.

Conventional financial institutions

Even in certain circumstances, various conventional financial institutions also offer certain Shariah compliant financial services. These services may be offered in two different forms. The first one is through Islamic banking windows being operated in form of Islamic banking subsidiaries and stand-alone Islamic banking branches of these commercial banks, in which case these may be considered equivalent to an Islamic financial institution as their operations are licensed by the State Bank as Islamic bank and are subject to supervision of their respective Shariah Advisors, as well as, the State Bank.

In the second form, a number of conventional financial institutions, which include commercial banks, investment finance companies and investment banks, leasing companies and insurance companies also invest in certain Shariah compliant avenues and provide certain other financial services that are not repugnant to the injunctions of Islamic Shariah.

The commercial banks that offer Islamic financial services under their normal windows include certain banks that are subsidiaries and branches of various multinational Islamic financial institutions and generally operate under the Islamic modes of financing but are licensed under the conventional banking system and as a consequence, have certain doubtful operations being a part of such banking system.

To be continue.....

قرب ہے بالانہ پستی رفتن است قرب حق از جس پستی رفتن است

Another issue that has earlier been discussed a bit, is the matter of documentation of financial arrangements, dealings and agreements. We have learnt that it is the basic guidance from the holy Qur'an that any dealing, except hand by hand transfer, should be documented and witnessed. It has been particularly observed that amongst family members and friends such documentation is avoided being considered to be just a formality. Practical experiences have suggested that in absence of written agreements and documentation, whenever some complexities and disputes arise, the relationships and partnerships are spoiled whereas the businesses get collapsed.

General public

Obtaining finances from general public has now become easy and practicable, as well as, more economical and easy to deal. Generally the modes of obtaining finances from general public are issue of public securities including shares, units of equity and certificates or units of redeemable capital besides certificates of investment through a Modaraba, and securitization through use of a special purpose vehicle (SPV). The most common form amongst these is the issue of equity shares.

This issue is of particular significance that, in Pakistan, it is not legally possible to invite public deposits or any other form of public investment except for through the listed securities, for which the issuing enterprise has to follow the relevant laws, listing regulations and the code of corporate governance.

Islamic financial institutions

Islamic financial institutions are now dealing a massive portfolio of financial assets and investments of around US\$ 300 billion throughout the world and these are now actually enjoying a sizable presence. Although a number of Islamic financial institutions are being run on purely commercial terms, and there are certain indications that they do not ensure to fulfill the Shariah compliance requirements "in substance" and instead their overall emphasis is on documentation, which is sometimes completed simultaneously. However still there are a number of institutions that are being run by faithful Muslims with a

قرب کے لئے اور پرمیانیچے جانا نہیں ہے، اللہ کا قرب وجود کی قید سے چھوٹنا ہے۔

daily product balance of the contribution of the bank, as well as, the customer in the respective pool. Nonetheless, this option is not very easy to use and requires complex computations, as well as, mandates a timely and accurate financial reporting system of the customer. Moreover, this also requires honesty and fairness in the financial reporting by the customer. In view of these difficulties, this model is rarely used by the Islamic financial institutions as an alternate to running finance and short-term loans and accordingly, most of short-term financing is made by them on the basis of Murabaha.

Sources of interest-free financing

Following are the general sources available for obtaining interest-free financing:

- * Family and friends;
- * General public; and
- * Islamic financial institutions.

Family and friends

The first source that is generally available for interest-free financing is the family and friends. In this respect the Muslims are encouraged to provide Qard-e-Hasana to their relatives, friends and even to general public if they have enough resources available. Particularly, in a Hadith, it is made obligatory to lend Qard-e-Hasana with regard to a person in need asking loan on such basis, for the one who has sufficient funds available with him. This is the reason that resulted in development of a school of thought which is against the Modaraba, Muzara'a and Ijara or any other lending of assets or money with return thereon irrespective of the mode of return, on the principle of mutual cooperation.

In this respect, the majority of the jurists is of the view that it is always preferred to lend money and assets on the basis of mutual cooperation. Nevertheless, there is no bar on lending the moneys and assets on any of the allowable principles particularly including, but not restricted to, Modaraba, Musharaka and Ijara.

Other options of redeemable capital include Musharaka TFCs, Participation Term Certificates (PTCs) and Musharaka Certificates. Details regarding these options have already been discussed in previous chapters.

Short-Term Financing

Conversion of short-term financing on Islamic principles has proved to be the most crucial and complex for the purpose of conversion of businesses on Islamic principles. It is because, generally the options of short-term finances and overdrafts (running finances) are very easy and practicable in the conventional banking, whereas in case of Islamic banking, although a number of alternates have been developed, these are not considered to be an easy alternate to the conventional options.

Conventionally, the matter of running finances is dealt with by determining a credit limit and an interest rate. Once these are mutually agreed, the bank provides on open opportunity to the customer for operating such an account just similar to a current account and the financial charges are calculated on the basis of daily product balances. Similarly, once the customer determines that his working capital needs are somehow fixed to a minimum limit, he has an easy option available to interchange these running finances with short-term loans and bridge finances with comparatively lower rates of interest.

In contrast thereto, in Islamic modes of financing, the alternates available for the purpose are not easy to operate. Generally the first and the foremost used option in this respect is considered to be the Murabaha. However, the term for Murabaha is always fixed and accordingly it is not a real alternate to the running finances. Similarly, its rate once fixed, cannot be changed and accordingly, it is not comparable with the benefits of the running finance from business perspective.

The only option which is available for running finances is Musharaka based on daily product balance. In this model, the bank and the customer become partner in the business pool of the customer and profit thereon is distributed on the basis of computation of the

whatever name called) may carry any weightage in the profits of the Company (but not exceeding the weightage of their capital to the total capital) and would be sharing loss in the proportion of the respective capital. These may and may not be listed. Their sharing in business may be restricted to a special project or may comprise of the whole business. In case of a limited project, it would be permissible to give them preference over the normal shareholders, which would ideally not be possible in case of partnership in the whole enterprise.

We feel that the issuance of this sort of shares would be in the benefit of the owners, as they might not want anybody to interfere in the business matters. This will obviously also be in the benefit of the investors who want to invest in Shariah compliant modes only. More importantly, these will not be repayable like any form of redeemable capital or financing from banks and other financial institutions. Similarly, these may be transferable to any other person like ordinary shares and may be traded in the capital market or even used in the money market for security based instruments.

Long-Term Financing

The options for long-term financing are generally available in most of the forms of Islamic financial instruments. Such arrangements may be obtained by any business from the Islamic financial institutions, as well as, the general public under any of the approved modes of Islamic finance. For ease of reference, we may divide these in two basic types i.e. redeemable capital and long-term financing. The difference between these two basic modes is that in the first one i.e. the redeemable capital, security instruments are issued which are easily tradable and even sometimes these are listed on stock exchanges. Whereas, the long-term financing are based on contracts and are generally not transferable.

The most common mode currently used for redeemable capital is issuance of Term Finance Certificates (TFCs). However, as discussed earlier, mostly the TFCs issued in the country are not on a Shariah Compliant basis.

These were allowed in the original Companies Act of 1913 (the inheritance of English rule on British India) whereas the same were not allowed in the Companies Ordinance, 1984 (enacted under General Zia ul Haq's regime). Only a few companies who had originally issued them prior to 1984 used to have preference shares in circulation. Since last few years, these are once again allowed to be issued (probably an evidence of American rule instead of the British one) and a few companies have just commenced to issue them.

The Shariah conclusion regarding preference shares under all the common models is divided. A few scholars render these to be to be Haram beyond any doubt because these carry interest, with a condition that in case of loss such interest will not be paid or the principal might also get lost. Others are of the view that since these profits (irrespective of being fixed or cumulative) are paid out of profits only, hence, these are permissible though not preferable. Another matter that this second group ignores is the matter of preference, i.e. in case of losses and liquidation of a company, they get preference over the normal shareholders, which is against Shariah principles i.e. losses have to be borne by the partners in proportion to their capital investment. Another principle which is ignored is regarding the profit sharing ratios, which according to most of the jurists, can not be higher than the capital investment ratio of the dormant partners. Needless to mention, that the preference shareholder, by all means, are dormant shareholders while common shareholders are working partner through their agent.

In view of the above discussion, it may be concluded that preference shares may be declared Halal or Haram, not by name but by a careful analysis of the legal structure and the rules governing these shares.

Modaraba Preference Shares – A proposed Model

Still there is some food for thought for the corporate law experts that they may devise a model of preference shares based on Modaraba concept. These may also be termed as Permanent Modaraba Shares. In such a proposed model, the preference shares (by

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Equity Financing on Modaraba Basis

The second option for equity financing is the Modaraba basis. Modaraba is actually a dormant partnership so in case of a partnership or entrepreneurship, it is a very effective tool. However, it is the agreement that counts because a number of matters are supposed to be based on the Modaraba contract. Such contract should, however, be in compliance with the Do's and Don'ts for Modaraba.

The companies may currently obtain Modaraba financing from banks and other financial institutions, as well as, from individuals through issuance of redeemable capital or under various forms of long-term Modaraba financing contracts. This is the direct method of obtaining Modaraba financing for companies, which has one very important factor i.e. these all finances are repayable, or in other words, all such Modarabas are for limited term.

As far as the permanent Modaraba financing for companies is concerned, currently it is a bit typical or rather complexly engineered. This mode is provided under the Modaraba Companies and Modarabas laws. Under this mode the company has to register itself as a Modaraba management company or has to form a subsidiary or associated company for the purpose. If it does not want to get into such hassle, then it has to contact an existing Modaraba management company which should ideally be managed by a financial institution.

Such Modaraba company will then form a Modaraba, which will provide finance to the first company under any approved mode of Islamic finance.

Permissibility of Preference Shares

Preference shares are issued by companies under various schemes. The most common structure of their issue is that these carry a fixed dividend which is subject to profits of the company and is accumulated for the periods during which an enterprise suffers losses and the accumulated sum becomes payable whenever the company gets in profits again. Generally they do not have any right to participate in the business affairs of the Company.

business. From Shariah perspective, the equity financing may be based on only one principle i.e. the profit and loss sharing. Profit and loss sharing basis have two styles i.e. with active participation and without participation.

Equity Financing on Musharaka Basis

Profit and loss sharing with active participation or right of participation in business is, as discussed earlier generally called Shirkah or Musharaka. Partnership and common shares of companies are different forms of Musharaka that can generally be used for equity financing. Nevertheless, in any form of Musharaka, all the partners have the right to interfere into the business activities and particularly the decision making either directly or through their agents (managers and directors). Accordingly, it is never advised by the experts of strategic financial management to acquire most of the capital through this system i.e. through common shares or partnership capital.

Partnership capital may be obtained from friends, relatives and peer businessmen. Similar are the sources for subscription of common share capital for limited liability companies. However, for major companies, these shares are listed and are further subscribed to the general public, as well as, the financial institutions.

Obtaining capital on either of these bases has two major setbacks. The first one, as discussed earlier is the fact that, in such a case all the partners and subscribers have the right to interfere in the business affairs and decisions, either directly or through agents (directors). This situation may eventually cause difficulties in running the business and even might result in hostile takeovers. To avoid this risk, in the partnership deed and articles and memorandum of association, different rights may be assigned to different types of capital in order to avoid these issues to the maximum extent possible.

The second issue in this form of equity financing, from financial management perspective, is the fact that anything paid in "servicing" of such equity is not tax deductible for the business and eventually the cost of capital turns out to be on the higher side. These rights etc. should, nevertheless, be in compliance with the Shariah requirements.

even to pay more than the cash cost. Even then, if you can manage to arrange it, you might not only save some bucks at the end, but might also get rid of interest-bearing borrowings.

Another important tool relating to creditors management is the use of Istijrar arrangement or cyclical Murabaha arrangement. In such a case, you may arrange that all the supplies that you want to purchase are first purchased by an Islamic financial institution and then sold to you on a Murabaha basis at a price including mark-up against the extended credit terms. This way you may easily get rid of interest-bearing working capital loans and running finances.

Needless to mention, it is strictly prohibited in Shariah to contradict a contract you have earlier made. You may recall that according to a Hadith, not fulfilling the commitments is an indication of Hypocrisy or Nifaq (نفاق). This means that if you have committed to make a payment within thirty days, then not only "ethically", but literally "religiously", you are required to fulfill your commitment. Nevertheless, this is observed to be a general practice in the business world that the customers try to avoid payment day by day through false commitments and statements, as well as, by threatening against loss of future business.

This overall approach is against the basic injunctions of Shariah and should be avoided and all the payments to the suppliers and contractors should be paid immediately when due. In any case, an additional payment against late payment is not allowed in Shariah. Even if it is included just as a penalty, preferably a self-imposed penalty, to discourage late payments, the same should be paid in charity by the person who receives it.

A similar issue relates to the delays in payments to the employees. From Shariah perspective, it is a must to pay the dues of an employee, either on contract or on permanent basis, immediately when these become due as per the terms of contract and any delay therein is unlawful and against the very basic injunctions of Shariah.

Equity Financing

Logically the equity financing is the first issue in establishing a

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this is the most beneficial method for enterprises involved in manufacturing of machinery units, vehicles, and major projects.

Any of the suitable methods may ensure that the enterprise does not pile more than required level of inventories and eventually results in savings in holding costs including physical storage and borrowing costs.

The best practice that can be applied for ensuring adequate working capital arrangement is to enter into suitable credit terms agreements with the suppliers or to fix Murabaha arrangements for terms equivalent to the normal inventory days-in-hand period. This will ensure maximum utilization of the enterprises resources. Anyway, in case of stocks, generally the Murabaha is the best available form. As an alternate, options like Salam, Istisna or Istijrar may also be used depending on the nature of business, as well as, the nature of material to be procured.

Creditors Management

Managing creditors is the third important aspect of working capital management. As a thumb rule, as long as you can stretch the repayment time, it is better for the business because you are saving your cost of capital. It may be evidenced that a few companies that are working at a minimum capital and even without borrowings of a single penny. They are just doing their business against suppliers' credit of six month, irrespective of as to whether the suppliers have included the premium for this credit period in the product price. In presence of such credit, generally, they don't need any borrowings or even to invest their own capital in order to meet the day to day business needs.

However, this was just an example and not a practical situation for most of the companies, particularly those in manufacturing business. From Shariah perspective, the basic idea that can be derived in this manner is that if you need financing for working capital, first try to negotiate with your suppliers. It is quiet possible that you might need to sacrifice the prompt payment and cash discounts and rebates that they were previously offering to you, or

- ★ **Material Resource Planning (MRP) Approach** – Under this approach, an enterprise plans for its material use for a future period, generally on an annual basis and accordingly, all procurements are made in a planned manner. Various factors of cost saving are considered in this approach. Nevertheless, this approach generally requires good computer software at the back end, in order to ensure that the maximum benefits are reaped out of this approach. This is the best approach for trading enterprises who use their sales forecast as the prime basis for this approach;
- ★ **Manufacturing Resource Planning (MRP II) Approach** – MRP II, is an advanced version of MRP which is suitable for manufacturing industry and similarly also requires some good computer software. This approach is a bit complex because it commences from the sales forecast and after taking into account the proposed stock levels, production details and estimated sales, it manages the procurement plan. For this purpose, it requires a good budgetary control in the enterprise, which is a by-product of this sort of system. MRP II is now the most commonly used stock managing approach for the manufacturing concerns;
- ★ **Just In Time (JIT) Approach** – In this approach, which is basically developed by Japanese manufactures, the overall objective is to ensure a zero inventory. The motto of this approach is to “procure when you need”. In this approach, the procurement plan is strictly in accordance with the manufacturing plan and eventually with the sales forecast or the sales orders. This is the most advanced approach for managing inventories, nevertheless, it can not function properly in most of the environments, particularly those of countries like Pakistan where the procurement lead times are really significant (particularly keeping in view the import process) and even then the deliveries are not guaranteed. Anyway,

Needless to mention, the engineering for securitization transactions is a bit complex and involves legal and financial issues and accordingly, it is always advisable to obtain adequate advices and opinions from legal, corporate and financial consultants.

Inventory Management – Stock Level Control

Second key element of working capital management is the management of inventory, predominantly the stock levels. Particularly, in a manufacturing industry, it has more significance because in such an industry, a number of stock items are not in a saleable condition, including raw and packing materials and work-in-process. Consequently, the stock holding costs including the physical costs, as well as, the borrowing costs or the cost of capital is more significant in a manufacturing business.

Generally the stock level controls have been developed by various experts in different ways that are suitable for most of the businesses. Following is a brief of the general techniques used by various industries for management of stock levels:

- ★ **Minimum Stocks Approach** – Under this approach the enterprise plans to ensure that all the stocks and inventories are procured in a minimum quantity. This approach is generally not feasible for large businesses and businesses where the lead time for procurement is on the higher side. This is considered to be the most suitable method for retail businesses;
- ★ **Economic Order Quantity Approach** – Under this approach, an enterprise plans for the minimum stock levels, maximum stock levels, and economic order quantity, for each inventory item, based on a formula depending on various factors including the holding costs, order costs and lead time. This approach is considered to be the best on a long-term basis for medium sized enterprises. Particularly, this approach do not mandate a comprehensive use of computer software and may easily be applied manually;

equity of such SPV is contributed by a consortium of financial institutions or even may be subscribed by the general public.

Sale of current receivable is allowable in Islam in only one condition, i.e. the sale proceeds are equal to the amount of receivables without any discount or markup. However, in a Shariah compliant securitization model, an SPV may be hired as a worker in the *Juala* contract and the securitization may be performed under the mode of a *Juala* contract, with a simultaneous interest-free loan contract, as discussed above.

Securitization of Future Receivables

Securitization is more often used for sale of future receivables of service providers. However, under Shariah principles, sale of future receivables is not allowable at all, because a receivable that do not exist as of the given date can not be transferred even at an equal amount. Yet, there are alternate options for sale of future receivables in form of sale of capacity, space, scope and functions. As an example, if a telephone service provider is willing to sell its future receivables amounting to Rs. 100 million to an SPV, such service provider may identify a telephone exchange or a region whose total revenue for a given period of time is equivalent to Rs. 100 million and then agree to sell such capacity to the SPV for a discounted amount, say Rs. 90 million. It would, however, entail the risk of profit or loss which is the essence of a Shariah compliant product.

Accordingly, during the given period, all the revenues earned by such exchange or regions shall be assumed to be earned by such SPV and any gain or loss thereon i.e. any excess or shortfall against the amount of Rs. 90 million shall be the profit or loss of the SPV. While finalizing the transaction the financial managers may include the risk premium in the amount of sales. Similarly, an airline may go for selling a particular route or a given number of seats of an aircraft. Accordingly, for all sort of service providers, securitization of future receivable or rather future services is a practicable option for raising funds for their needs.

The work is completed by the bank or by the worker and an agreed fee or reward is paid to him by bank, whereas the bank collects his reward from the customer with whom an initial Juala contract had been entered

In a Juala transaction, the indication of the task, duly involving some effort, and the reward is necessary. Similarly, the reward should be known valuable and a permissible consideration and it may or may not be portion of the realized result. As an example, the bank may agree that if it recovers full amount then it will be entitled for 3 percent of amount received and if it recovers 80 percent amount, then it will be entitled for 2 percent of the amount recovered, and so on.

In Juala, there is a possibility that the reward may be paid in advance in full or in part before completion of work, however in such case the worker shall not be absolutely entitled for reward until the required result would be realized and therefore, such payment shall be refunded by him if he cannot fulfill the requirement. There are certain further Shariah requirements that need to be complied at the time of entering into a Juala contract.

This model generally works with a simultaneous interest-free loan contract through which the bank pays the amount of need to the customer at the inception of the transaction and instead of receivables being sold to the bank; these are just held as security against such loan. On the other hand, the bank earns the reward on the Juala contract against recovery from debtors. Like any other complex Islamic financial product, it is necessary that the agreement for these transactions should not be linked to each other. Unfortunately, the Islamic financial institutions have not yet commenced offering this product in Pakistan.

Securitization of Receivables

In the organized service sectors, another practice is used which is nowadays becoming more common in Pakistan. Under this practice, the organization sells its current or future receivables or both to a financial intermediary or a special purpose vehicle (SPV) and obtains cash there against at the very inception of the transaction. The

transferred against an equal amount irrespective of the time of payment by the bank to the customer in accordance with the Shariah principles of Hawala (حوالہ). In Hawala, the bank has recourse available to the customer in case the eventual debtors do not make the payment. In view of the same, the banks are allowed to obtain securities from the customers to make good their loss on account of default.

Jurists have allowed the banks to charge service charges on these transactions only to the extent of actual or reasonably estimated expenses incurred by them on account of documentation, administration and recovery. Such service charges do not include any risk premium or notional cost of capital or opportunity cost and accordingly these are generally very nominal. You might note that this situation is against the interest of the bank and consequently, most of the Islamic banks do not enter into these transaction.

Juala

The second option that may be used as an alternate to bills discounting is called Juala (جعلہ). Juala is a contract in which one party undertakes to give a specific reward to anyone who may be able to realize a specific or uncertain required result. Juala is an exception to the general business contracts whereby uncertainty is not allowed whereas Juala is not affected by uncertainty with regard to the subject-matter of the contract, i.e. the work to be done. In a Juala contract it is sufficient to determine the required outcome of the transaction.

In a normal Juala based bills discounting transaction, the customer negotiates the bank for performance of an uncertain work i.e. recovery of its bills receivable or general debtors, in a specified time for an agreed reward. The bank agrees to perform work after conducting a cost versus benefit analysis and a Juala contract is entered into between bank and customer. Then the bank decides either to perform the work by itself or to find a worker who has expertise to perform such an uncertain work on its behalf and a parallel Juala contract or a work contract (based on fixed fee or service charges) is made with him.

The most practicable model that may be used by the Islamic financial institutions in bills discounting is a complex transactions and even then, it does not fetch any material return. Under this option, the bank may provide an interest-free loan to the customer in foreign currency, equivalent to the amount of foreign currency bill receivable after a given period. Such loan amount may be paid to the customer after converting the same in the local currency at the rate prevailing at the date of transaction. The bank simultaneously enters in a promise-to-sell the foreign currency in the forward currency market at a rate which is generally higher than the spot rate prevailing on that date. The difference between these two rates is the profit earned by the bank on such transaction. When the export proceeds are received the bank may receive the same directly and adjust against the loan to the customer, and then sell these at the pre-agreed promise-to-sell rate. As an alternate, the bank may go for a risk and reward situation if it is expected that the foreign currency rates are expected to rise in future and in such case no promise-to-sell may be entered into and instead such currency may be sold in the open market once the export proceeds are realized.

It is also pertinent to note that certain Islamic financial institutions are using the option of Salam of currency in a similar form of transaction, which is not permissible in view of the most of the jurists whereas, only a few jurists in the sub-continent have allowed this on the premise that the paper currency is considered to be Thaman Istilahi and not the Thaman Haqiqi.

Second option in this respect which is rarely used by the Islamic financial institutions is to transfer such debt at an equal amount and obtain nominal service charges, which are fairly equivalent to the actual amount of expenses incurred or estimated to be incurred on such transaction.

General Bills Discounting

Two options are generally available in Islamic finance against bills discounting. In the first option, the amount of debt needs to be transferred to the financial institution in exactly equal amount. It means that a debt of Rs. 100 receivable after 1 month should be

Another area, whereby bills discounting or factoring option is needed, is the area of retail or wholesale sales where the amounts are stuck with the customers due to the nature of the industry. Generally the wholesalers and retailers have a practice of not making the payments unless they have made full sales of the goods or even unless they get the new consignment. Even worse, a number of these guys do not even bother to pay the money as they have a practice of financing all their needs on the money of the suppliers, or in other words they have a practice of maintaining "sufficient" credit from their suppliers.

Similarly, in certain receivables from the government departments and autonomous bodies there is a practice of delayed payments, due to the prevailing culture in the country. Such a practice, by any means, is not in compliance with the Shariah requirements.

In this respect, generally the option of commissions and discounts are used and instead of banks and financial institutions, individuals and service organizations are hired to perform such services. Particularly, in case of the culture prevailing in Pakistan it is least potential for banks and financial institutions to indulge in such "dirty" sort of business.

From Shariah perspective, the matter of discounting of bills, as prevailing in the conventional financial markets is not permissible at all, being a kind of Riba. However, there are certain options available as an alternate of the conventional bills discounting and factoring products. In the ensuing paragraphs we shall discuss these options for various kinds of bills receivable.

Export Bills Discounting

Export bills discounting is widely being used in Pakistan by most of the exporters. Generally, the exporters have a practice of depending on two forms of financing. The first one is the export refinance, whereas the second is discounting of export bills receivable. Particularly, in case of textile and garment exporters, these two types of financing are considered sufficient and these fulfill their most of the financing needs.

the seller may later give any prompt payment discounts and rebates at his own will without any mutual contract.

An alternate to the same is allowed in form of Ba'y Istijrar. In this option, a seller and the customer agree that they will buy and sell goods in routine according to some pre-agreed benchmark. As an example they can agree for the market rate or a price with 10 percent discount on the market rate. This option is allowed by most of the jurists subject to the condition that there remains no ambiguity or Gharar in the transaction. In the given example, if they have agreed at a price equivalent to the prevailing market rate and the credit period as one month from the date of taking delivery, such rate should be clearly known and identifiable. Any negotiation after the sale is not allowed in Shariah because it becomes a negotiation on a debt and not on the price. However, as discussed above, discounts may be allowed at this stage at the absolute discretion of the seller and these shall not become a practice.

Bills Discounting or Factoring

In debtors' management, bills discounting is an area of prime significance in the conventional financial management. The basic concept behind this theory is the fact that if the amounts are stuck in debtors for long periods and the enterprise's own rate of return on capital is higher than the rate of interest prevailing in the market, it is beneficial for the business to get these bills discounted through banks or other financial institutions, in order to ensure availability of required liquidity.

Similarly, with the companies having adverse financial ratios, it is sometimes difficult to obtain further financing and the only option they have available for obtaining financing without further disturbing their financial ratios is to get the bills receivable discounted or sold.

Generally, bills discounting is more important in case of export sales whereby sales are made against Usance L/Cs and the amounts are expected to be realized at a fixed time in future. During the time of blockage of funds, the enterprise might be in need of money and such need is fulfilled through discounting of bills.

delayed debtors' collection period is an indication of a possible failure of a business. In this respect, the first and the foremost issue is prompt debtors' recovery through an effective sales coordination and follow-up.

We know that once the sales price is determined it cannot be changed i.e. no interest or additional charges may be levied if a debtor delays (even intentionally) a payment. Nevertheless, most of the jurists have ruled that in case of Islamic financial institutions, in order to avoid intentional defaults, a self-imposed penalty may be stipulated in the respective terms of sale, but the same should be paid in charity. However, discount or rebate may be given at the sole discretion of the seller.

In order to manage your working capital in an effective manner, you may arrange Murabaha, Salam or Istisna arrangements with Islamic financial institutions, who will first buy your products on cash payment and then sell these to your customer on extended credit terms. However, for these financial products, it would be necessary for all the concerned parties to ensure that the relevant Shariah requirements are fulfilled. In case of Istisna and Salam you may also obtain advance from the bank which will provide you further flexibility in your working capital management, particularly in Salam whereby the whole sum is required to be paid at spot, at the time of entering into the contract.

It is also pertinent to discuss a common issue in our traditional markets. Generally, while making purchases on credit basis, particularly in retail and wholesale markets, the description of goods is mentioned but the rates are not finalized and these are finalized at the time of settlement. Generally, this is because of the seller's intention to get the benefit of day by day increasing rates of commodities or to ensure that lesser discount is offered if the actual payment is made within a few days. In this respect it should be clear that once the title and possession of goods is transferred, the sales transaction stands consummated and accordingly, from Shariah perspective, it is pertinent to finalize the rates at this very moment which shall never be changed, failing which will make this transaction unlawful or even Haram. However, as discussed earlier, most of the jurists allow that

respectable scholars in order to ensure their desirability and permissibility for Muslim world. This aspect, sadly, still appears to be unaddressed.

Working Capital Management

Working capital management is generally a tough task for a businessman. In working capital management, the prime objective is to maintain liquidity of a business by ensuring the most effective and efficient utilization of resources, financing facilities and funds available, as well as, stretching to the maximum extent possible, the liabilities to the maximum credit period available.

Working capital management is performed in various areas with different techniques and approaches. The most significant areas in this respect are the main areas of a business cycle i.e. Customers (debtors), Suppliers (creditors) and the inventories and production cycle. Generally, the short-term financing facilities are also considered

to be a part of working capital cycle and their effective management is also considered significant in this area.

Effective and efficient working capital management emerges as more important, if the business is being run under the principles defined by the Holy Quran and Sunnah. In the ensuing pages, a few basic facets of working capital management under Islamic principles have been discussed. Anyway, since, the utilization of financing facilities is primarily dependant on the effectiveness of other aspects of working capital management; the same need not be discussed in detail.

Debtors' Management

Debtors' management, which generally denotes the management of receivables from trade debtors, is a key element for effective working capital management. We all know that a delayed payment by a debtor would result in an opportunity loss. This opportunity loss is not allowed to be recovered from the customer because it will tantamount to Riba, but the same may be avoided to the maximum extent possible for improved business performance. A

profits only) according to the prevailing market rates e.g. deciding that the profit over and above a fixed benchmark will be divided in a proportion different to the normal profit sharing ratio.

Similarly, the financial management decisions to be made by the management of an enterprise may be made using the time value of money concept, using it as a performance barometer or pricing tool.

Managing Finances – Why and How?

Management of finances is a key to success of a business. Although marketing, quality of products, and innovation are generally considered to be the keys to success of business by various schools of thought, nevertheless, it can easily be observed that the number of businesses that have been failed due to inadequate financial management is the highest as compared to the above factors. Particularly, there are instances whereby certain mammoth business empires failed even if all the three factors other than the financial management were considered to be adequate. As a most recent example you can consider the American energy giant Enron, which was one of the America's 10 largest companies and for consecutive many years was awarded as the America's most innovative company. The failure of Enron was an evidence of poor financial management coupled with a fraudulent misreporting of financial statements, which when identified, compelled Enron to declare itself to be bankrupt and eventually resulted in a fall of that empire.

Accordingly, it may be concluded that the marketing, innovation and the product quality, all are dependent on adequate financial management for the success of a business, failing which results in an anticipated disaster unless and until the other factors are super normal. On the contrary, it has been observed that adequate financial management coupled with just below average marketing, minimal innovation and average product quality, resulted in success of various businesses.

Before going into details of the topic, at the outset, it needs to be clarified that the present financial management theories have been imported directly from the West and these need to be studied by our

Haram. If just a pricing model or just the similarity of a cash-flow model makes the transaction Haram, what you will say regarding a conventional loan offered at a price much higher or much lower than the market prevailing rates for which the pricing model and the cash-flow model are not similar to those generally applied in the industry. Does anybody think that such dissimilarity will make it Halal? Accordingly, from Shariah principles it is rightly concluded that it is the substance of a transaction what makes it Halal or Haram and not a pricing model used to price the transaction or the cash-flow model used for the payments and repayments in monetary terms.

Here it would be worthwhile to have a look on another example for better understanding of the pricing issue. Suppose you enter into a supermarket in UK and see that the pork, the beef and the Halal beef are all being sold for GBP 2 per kg. Do you think that this similarity of price or the fact that these products are being sold under the same roof renders the Halal beef as Haram? If not, then we should better understand the principle that it is the substance and form of the transaction that makes it Halal or Haram and not its pricing, rate or the cash-flow model or the institution that offers such transaction.

Similarly, even as an entrepreneur or as an individual willing to obtain loans under Islamic modes, you have full right to compare the pricing mechanism and the cash-flow models being proposed by the respective financial institutions in order to ensure as to whether these are at competitive rates or not.

Due to the same reason, most of the Shariah boards have allowed the respective Islamic financial institutions to engineer their products even on the basis of floating rates etc. which may even be subject to the interest rates benchmarks issued by the central banks or the rates prevailing in the international market e.g. LIBOR or KIBOR. It should be kept in mind that floating rates options are available in leased based products only whereas in case of Murabaha and other trade-based modes, each transaction may be subject to these benchmarks prevailing as of the date of such transaction, nevertheless, once the transaction is consummated, and the payable amount cannot be changed. In certain profit and loss sharing based transactions, the Shariah scholars have also allowed to set benchmarks (for sharing of

Time Value of Money as a Performance Measurement Tool

As discussed earlier, the time value of money concept is also used as a performance measurement tool or as a tool for pricing of financial instruments and transactions. This is the concept where it is just applied theoretically in order to work out the real gains and losses of a project, investment or loan.

Most of the Shariah jurists have allowed the Islamic financial institutions to market their products on the pricing models very much similar to those used by the conventional banks. For example, an Ijara Muntahia Bittamleek transaction introduced by an Islamic financial institution might be very similar to a finance lease transaction offered by a conventional leasing company, except for a difference of Takaful / insurance cost which in Islamic mode is to be borne by the lessee and accordingly, the same is built-in the rentals. Similarly, in a housing finance based on diminishing Musharaka model, the overall cash-flow model will be quite similar to that of a housing finance scheme of a conventional bank (except where in certain Islamic models, the house is revalued on suitable intervals).

The basic reason behind this similarity is to ensure three objectives. The first one, which is more important one, is to provide an "even playing ground" to the Islamic financial institutions in order to ensure their survival in the overall banking system. The second one,

that even by Islamic financial institutions, it has to be ensured that their shareholders and depositors get some return and preferably a return equivalent to those of conventional banks. And the third reason is to avoid arbitrage amongst Islamic and conventional financial systems which may be exploited by a few big-guns to get the benefit of the pricing difference between the two parallel financial systems. For such reason, time value of money concept is used for performance measurement and pricing of financial products.

The objective of this discussion was just to emphasize that merely an amortization schedule similar to the one offered by a conventional bank, is not a basis for declaring a Halal product to be

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is permissible to charge for the benefits obtained from use of or availability of assets and goods. And this idea is the basis for the concept of time value of assets or goods. Any rent, Ijarā or Kiraya are permissible from Shariah perspective beyond any doubt. Only the Kiraya for land and houses is questioned by a very negligible number of jurists, based on certain Ahadith, although those allowing these also have sought guidance from other Ahadith. On the other hand, getting benefit of goods by purchasing them on a higher price with deferred payment, or purchase at a lower price on the basis of delivery at a future days are all allowable situations from Shariah perspective.

Now we should compare a Murabaha transaction carried out as an Islamic financial instrument, with an interest-based transaction. Besides many other conditions and rulings that distinguish a Murabaha from a financing transaction, the basic difference between the two is that in case of interest, the accretion is against availability of a specific sum of money during the tenure of loan. On the contrary, in Murabaha, the mark-up is against the availability of asset at an earlier date so that the person purchasing the asset becomes able to get the benefit of such asset.

Similarly, although an Ijara Muntahia Bittamleek is quite similar to a loan repayable in installments or a conventional finance lease, but the additional amount which is being paid is against the benefit or usufruct of the asset, whereas many other Shariah conditions make it different from the conventional installment loan or a finance lease.

Being prudent one should always try to avoid anything suspicious or for which he might has doubts in mind. Nevertheless, nobody has the right to proclaim something "Not-Haram" as "Haram". The objective of this debate is not to prove that Murabaha and Ijara Muntahia Bittamleek are perfectly Shariah compliant transactions. We know that because of being of a fixed-return basis and to some extent being resembling to Riba these should be avoided to the maximum extent possible and the profit and loss sharing modes should be used to the maximum extent possible, but this would be Taqwa, not Fatwa, because most of the Shariah scholars have consensus on permissibility of these instruments, subject to strict adherence to the rules applicable thereto.

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agreed time or after indefinite time shall not be considered equal to a notionally equal sum of cash or cash equivalent already in hand.

Accordingly, all the theories of financial management circle around the concept of time value of money and all the computations, comparisons and analyses of financial transactions and series of financial transactions are performed using the same barometer.

When we try to understand its background, we come across the fact that the time value of money concept is purely based on the concept that every sum of money in hand may be invested and acquire some "fixed risk-free return" thereon and all the economic factors support this presumption in a capitalist society, although sometimes the theoretical and actual rate of return are quite different. In other words, this whole theory is based on the interest, as it always anticipates accretion in cash and decrease in the value of receivables based on the interest or discounting factors.

Since the very basic foundations of this concept are based on interest, therefore we cannot accept it as the prime concept of an Islamic financial management system. More importantly, a general misunderstanding observed amongst a number of "conscious" Muslims is that they feel that every form of return on investments based on time value of money resembles to interest and should be considered Haram. This is the reason that a number of people feel that Murabaha and Ijara along with many other forms of Islamic finance should be considered Haram because these ensure a fixed return based on the "time value of money" concept as similar to the identical financial products in vogue in the secular economic system.

At this stage, it would be pertinent to discuss the system of "time value of assets" which is the alternate to this concept in an Islamic financial system.

Time Value of Assets

We all know that any form of interest including accretion or discounting of receivables based on the time factor, is not Halal from the Shariah perspective. Nevertheless, we should also appreciate that it

INTEREST-FREE FINANCIAL MANAGEMENT

Omar Mustafa Ansari

Most of the basic concepts of financial management in a purely secular business move around the concept of time value of money. In the Islamic Shariah the concept of time value of money is denied at all. However, the utility of money is not denied and it has been advised to spend and invest money in all lawful means according to the injunctions of Shariah. At the outset we should first discuss the concept of time value of money and its impacts on society.

Time Value of Money

The fundamental concept of conventional financial management is the time value of money. According to this concept, capital or money is considered to be a prime factor of production along with the labour, entrepreneurship and land. In this concept, it is assumed that every factor of production has its worth and time value i.e. in order to acquire any of these factors for some time you need some consideration to be paid in some manner, whatsoever, generally in form of money. Being more practical, two most important factors that are worked out are the entrepreneurship and money, as the practical examples suggest that when these two factors are combined, other factors may be easily borrowed or purchased, as desired.

In this concept, the results of every financial transaction are calculated in form of time value of money. You can term this concept as a barometer for computation the results of a financial transaction or a series of financial transactions. As a base of this concept, it is assumed that money in hand has more value than any amount receivable because the former one may be invested and might get return during the time, accordingly, any amount receivable after some