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ISLAMIC BANKING: PROFIT VS INTEREST

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The common expression we often heard about Islamic and conventional banking is that both are just the same. Why? The simplest answer could be the rate pricing is similar; the only difference is that, one is Islamic, and the other is conventional. Such assumption is utterly inaccurate as two similar things are not necessarily same; as the saying goes, “similar yet different”. Let us take the example of chicken curry from halal and non-halal restaurants respectively. When comparing the outcome, both chicken curries are the same, however, the process is different as the halal restaurant is required to slaughter the chicken whereas the non-halal chicken does not have such requirements from the very start. The same goes to Islamic and conventional banking. They are two different entities despite having similar outcome. Even though, the rate pricing appears to be the same, it is factually distinguishable. Islamic banking’s pricing termed as “profit” is derived from a permissible (halal) transaction such as a sale and purchase contract, whereas conventional banking’s pricing termed as “interest” is obtained from a direct loan contract; thus, it is impermissible because it amounts to usury (riba).

In the Qur’an (2:275), Allah SWT has recorded similar expression by the people of ignorance on the prohibition of riba: “Those who consume riba will not stand (on the Day of Resurrection) except like the standing of a person beaten by Shaytan leading him to insanity. That is because they say: sale is only like Riba”. Are sales and riba the same? Absolutely not! Allah SWT has firmly and clearly explained the prohibition: “Allah has permitted sale and forbidden riba.”



Interest refers to an excess amount derived from a lending-borrowing transaction. To get more understanding on what is “interest” and “profit” respectively, let us take two situations. For the first situation, Mr. A applies a facility from a conventional bank to help him purchase 10 tonnes of papers. The conventional bank will lend him RM100,000 for that purchase; and in return Mr. A will pay back RM100,000 plus 3% interest in 6 months’ time. Total amount is RM103,000, and the RM 3,000 is the interest.

Meanwhile, In second situation, Mr. A seeks a financing from an Islamic bank to help him for that purchase of 10 tonnes of paper. First, the Islamic bank will purchase the papers from Company X at RM100,000 and then sell the papers to Mr. A at an agreed price that comprises of RM100,000 plus 3% profit of which can be paid in 6 months’ time. Total amount is

RM103,000. Profit refers to the RM 3,000 which derived from a sale-based transaction.

You may be wondering why sale is allowed, but riba is prohibited given that in both situations, Mr. A owes from bank? Both situations depict similarities in term of rate pricing and outcome whereby 3% of rate will resulted in Mr A paying a total of RM103,000. Nonetheless, the first situation is impermissible, while the second one is permissible.

In Shariah, when the primary contract between Mr. A and the conventional bank is a loan (known as qard) as in the first situation, any additional charge during the repayment is prohibited. Islam prohibits any additional charge in a loan repayment because it is considered as riba as mentioned in the Prophet SAW hadith: “Every loan that draws benefit is riba”. The statement of the hadith includes such additional charge in the lending contract.

In the Islamic banking system, every product offered have underlying Islamic contract. One of the contracts that is being used extensively is a sale and purchase contract. The second situation illustrated above is a form of sale and purchase contract known as bay' murabahah (cost plus profit). The profit from the second situation derived from a sale and purchase contract, where the Islamic bank need to buy the merchandise first which is the 10 tonnes of paper, then the Bank will sell to Mr. A on a markup price. Although Mr. A need to pay to Islamic bank by instalment, but the underlying contract is a sale and purchase, and not a direct lending. The profit gained from that valid sale contract is allowed and permissible, as mentioned by Allah SWT in the Qur'an.

In a nutshell, Islamic banking provides an alternative option for those who want to be free from riba transaction. Even though superficially we may see similar outcomes between Islamic and conventional banking in term of profit and interest rate, the actuality is that both differ in the substance and the underlying contracts. Profit is permissible and blessed, whereas interest is prohibited; this is where the main difference between the two lies.