



Profit vs Interest

Islamic banking's pricing termed 'profit' is derived from a permissible (halal) transaction

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THE COMMON expression we often hear about Islamic and conventional banking is that both are the same. Why? The most straightforward answer could be the rate pricing is similar. The only difference is that one is Islamic, and the other is conventional.

Such an assumption is utterly inaccurate as two similar things are not necessarily the same. As the saying goes, "similar yet different". Let us take the example of chicken curry from halal and non-halal restaurants.

When comparing the outcome, both chicken curries are the same. However, the process is different as the halal restaurant must slaughter the chicken, whereas the



non-halal restaurant does not have to meet such requirements.

The same goes for Islamic and conventional banking. They are two different entities but have similar outcomes. Even though the rate pricing appears to be the same, it is factually distinguishable.

Islamic banking's pricing termed "profit" is derived from a permissible (halal) transaction such as a sale and purchase contract. In contrast, conventional banking's pricing termed as "interest" is obtained from a direct loan contract. Thus, it is impermissible because it amounts to usury (riba).

Permissible Sale and Forbidden Riba

In the Qur'an (2:275), Allah SWT has recorded a 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? Not! Allah SWT has firmly and clearly explained the prohibition: "Allah has permitted the sale and forbidden riba."

Interest refers to an excess amount derived from a lending/borrowing transaction. To understand what is "interest" and "profit" respectively, let us take two situations.

For the first situation, Mr A applies for a facility from a conventional bank to help him purchase 10 tonnes of papers. The traditional bank will lend him RM100,000 for that purchase. In return, Mr A will pay back RM100,000 plus three per cent interest in six months. The total amount is RM103,000, and the RM3,000 is the interest.

Meanwhile, in the second situation, Mr A seeks financing from an Islamic bank to help him purchase 10 tonnes of paper. First, the Islamic bank will buy the papers from Company X at RM100,000 and then sell the papers to Mr A at an agreed price comprising RM100,000 plus three per cent profit, payable in six months. The total amount is RM103,000. Gain refers to the RM3,000 derived from a sale-based transaction.

You may be wondering the situations are similar but why a sale is allowed, but riba is prohibited when in both, a three per cent rate will result in Mr A paying a total of RM103,000. Nonetheless, the first situation is impermissible, while the second one is permissible.

The primary contract between Mr A and the conventional bank is called a loan (known as qard), and Shariah prohibits any additional charge during the repayment.

Islam prohibits any additional charge in a loan repayment because it is considered riba, as mentioned by the Prophet, SAW hadith: "Every loan that draws benefit is riba". The statement of the hadith includes such an additional charge in the lending contract.

In the Islamic banking system, every product offered has an 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 sale and purchase contract known as bay' murabahah (cost plus profit). The profit from the second situation is derived from a sale and purchase contract, where the Islamic bank needs to buy the merchandise first, which is the 10 tonnes of paper. Then, the bank will sell to Mr A at a markup price.

Although Mr A needs to pay Islamic bank by instalment, the underlying contract is a sale and purchase. The profit gained from that valid sale contract is allowed and permissible, as mentioned by Allah SWT in the Qur'an.

Conclusion

In a nutshell, Islamic banking provides an alternative option for those who want to be free from riba transactions. Even though we may see similar outcomes between Islamic and conventional banking in terms of profit and interest rate superficially, 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. ¹

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