

## **Comparative Study between Murabaha and Conventional Loan and Finance Practices in Sri Lanka (Special Reference to Products and Services)**

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### **ABSTRACT**

Banks play a vital role in every aspects of economy that provide financial solutions to empower the business life of individual and the community. The survival and success of banks depend on their appropriate products and services. Consequently, conventional and Islamic banks offer variety of loans products which seem similar in the outlook but should have dissimilarity in the contract. Therefore, this study aims to make a comparative analysis of Murabaha based loan offered by the Islamic banks over conventional loan. And Islamic bank was compare with conventional banks instead of being used for Islamic banking products and services. The researchers have applied the qualitative research method. And the data was collected for this study was from both primary and secondary sources. Primary data were collected through direct interview and discussion while Secondary data were gathered from journal articles, other research papers, books, annual reports of banks, and official websites if IFIs. Researchers chose Amana Bank, LOLC AL- Falah which are considered as Islamic Bank and Islamic window and Peoples Bank, Hatton National Bank which are conventional banks in Akkaraipattu branch, are used as random sample of this study. According to this study, the findings identified that, Islamic bank products and services are conceptually different from conventional sector though the outlook of the products are similar in the practice. As a result of that issues, this study clearly mentioned that, because, both banks use different contracts for their loan facilities.

**Key words:** partnership business, Islamic Banking, Conventional loan, Personal short term loan, IFIs

### **INTRODUCTION**

Islamic financial system is based upon a commerce law known as fiqh al-mu'amalat. This law considers issues of social justice, equity, and fairness in all business transactions, and promotes the entrepreneurship, protects the property rights and emphasizes the transparency of contractual obligations according to divine law of Allah and his last messenger Muhammad (PBUH). It is based on Shari'ah approved products which do not involve Riba (interest/usury), Gharar (uncertainty), maisir (gambling), and non-halal (prohibited) activities. Although Islam has allowed the profits, but the pre-determined fix amount of returns is not allowed. Risk of loss and variability of profits must be faced to get the return.

Islamic banking is different from the conventional banking as it is interest free. Islamic banking operates under different principles and they have different risk profiles. The Islamic banks have regulations of two types, first is the government and the central bank that govern the conventional banks as well and the other is the Shari'ah Supervisory Board that approves the products of the Islamic banks and keep them over the implementation of the rules defined by the board. The central bank defines some rules which are specific to the Islamic banks. For

example: minimum capital requirements are higher to establish an Islamic bank than the conventional banks. Islamic banks have to pay more taxes and registration costs because it is asset-based banking and the bank has to own the goods it further sells which eventually are paid by the client, but it increases the cost.

## **METHODOLOGY**

This study is a field based research to design to comparison between Murabaha over conventional loan. As an exploratory study, the researchers have applied the qualitative research method. The data collected for this study are both primary and secondary sources. Primary data were collected through direct interview and discussion. Secondary data were gathered from journal articles, other research papers, books, annual reports of banks, and official websites of IFIs.

‘Amana Bank’ and ‘LOLC AL-Falah’ are as mentioned Islamic Bank and Islamic window and ‘Peoples Bank’, ‘Hatton National Bank’ which are conventional banks were selected as sample for this study to represent IFIs in both private and government sectors.

## **RESEARCH OBJECTIVE**

This paper aims to compare short term personal loan between conventional banks and Islamic Financial Institution in Sri Lanka.

## **RESEARCH QUESTIONS**

Based on the above objective the following research question is developed: How Murabaha (cost plus profit) differ from short term personal loan between conventional and Islamic banks?

## **RESEARCH PROBLEM**

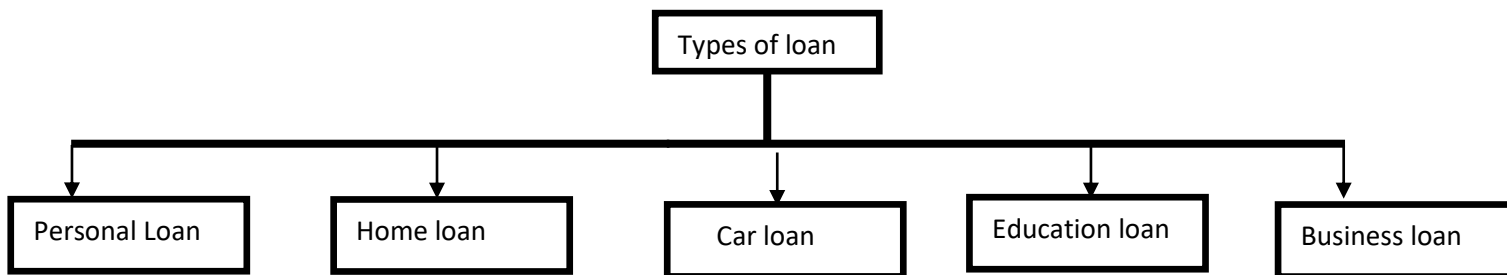
Islam as way of life has given clear guidance in every aspects of life. There are some different contracts followed by conventional and Islamic banking system. Especially in housing loan, short term personal loan are provided by the conventional and Islamic sector. In Murabaha (cost plus profit) it can defines as selling good on the markup (profit) or cost-plus price while charging interest on the loan as practice of conventional bank. According to the common view of both systems practiced in conventional and Islamic will be appeared as same result. As profit of partnership business in Islamic banks and charging interest on loan in conventional both are considered as same. This is issue has been taken as a research problem for this study.

## **LITERATURE REVIEW**

### **What is loan?**

The loan is a type of debt. Like all debt instruments, a loan entails the redistribution of financial assets over time, between the lender and the borrower. In a loan the borrower initially receives an amount of money called the principal amount. The amount of money is paid back in regular installments or partial repayment on an annual basis each instalment being of the same amount. (Aaron Hill, 2018)

There are some kinds of loan offered by the financial institutions. According to (Renita Philip, 2017) list out that.



1. **Personal loan:**-This loan can be availed to meet the expenses related to marriage, travel, honeymoon, holiday, and medical expenditure or for any other personal use. It is also available to pensioners, defense pensioner. As the name suggests, loans received as personal could be utilized by the recipient for any requirement. For example – marriage, home improvement, travel or any miscellaneous expenses. The interest rate is highest for this category of loan.
2. **Home loan:** - It is usually taken for a very long duration. It is a life time dream of every individual to have his/her own house. It is a primary human need next in importance only to food and cloth. However, is a major expenditure and cannot be funded out of a family’s normal monthly income or saving. A home loan is based on mortgage and is like any other loan which is offered to a borrower against a security.
3. **Car loan:** - For those individuals who prefer to travel more conservatively or to get to their destination faster with newer models coming out each year the options available to the customers are both attractive as well as convenient. All resident salaried people, professionals, and self- employed businessmen and framers can apply for this loan.
4. **Education loan:** - Education is the most important investment one can make in life. Higher studies and specialization in certain fields call for additional financial support from time to time. Just like personal loans, the rate of interest is really high for this category.
5. **Business loan:** - Again, the interest rate is really high for this category mostly because of the risk involved. Business loan facility enables individuals, proprietorship such as partnership firms and co-operative societies to avail of working capital or undertake development of shops or by way of loan / overdraft. The loan is provided

against the security of tangible collateral securities in the form of mortgage land and building.  
(Retina Philip, 2017)

### **Short term Personal loan**

Personal loan can be taken for any personal requirement ranging from marriage to holidaying or maybe to buy a lifestyle product or medical emergencies. Normally personal loan will be very helpful to the end users for their personal use and now they can easily get loan from bankers and private finance based on their eligibility like salary and business income. (Mr. Kamlesh Indoram, 2017)

This loan can be availed to meet the expenses related to marriages, travel, honeymoon, holiday, and medical expenditure or for any other personal loans received as personal could be utilized by the recipient for any requirement. For example marriage, home improvement, travel or any miscellaneous expenses. Personal loans are the fastest growing products of unsecured credit facilities in spite of high interest rate. Personal loans are the easy option of people for financial requirements as they do not attract encumbrances and with a little practical formality to obtain them. (Krishnaven, 2018)

Nowadays the banking sector offers different types of house loan those first one, secured personal loans Secured loan is granted to individuals, provided that they deposit some form of security, such as titles, log books or share certificates. Unsecured personal loans. Second one unsecured loan on the other hand is a loan that is issued and supported only by the borrower's credit worthiness rather than a type of collateral. (Florence, (2018).

### **Importance of personal loan**

Nowadays personal loans are plays Important role in our society. Because, it helped to fulfill the personal needs. Thus it is very important to every needed persons. The repayment of personal loan it has short period of time. Since most personal loans are small amount. The customer can choose a fixed repayment period according to the customer requirement. At the same time Personal loans are personal the best part about personal loan is that u cannot provide the proof to the bank about what the customer really want to do with the money. The loan amount can be use current needs of customer there is no restriction on how the borrowed amount is finally used – the borrower has full freedom to use the money for any purpose they want.

Furthermore Personal loans are particularly appropriate for education, as in the case of student loans, to acquire new skills and for life-long learning, improving job qualifications. They can be used to improve mobility and working conditions, such as loans for work-life balance, including childcare. It has Lack of collateral. A personal loan is an 'unsecured loan', meaning you are not required to provide any security to the lender in the form of cash, shares or any other assets. This might make it more attractive to some customers who may not be able to raise the cash required as collateral.

Therefore it was improving human capital and contributing to better job opportunities, personal loans lead to increased competitiveness and productivity. By encouraging the social

integration of marginalized and disadvantaged individuals and by improving life for individuals, personal loans can help reduce public expenditure for social services.

### **Murabaha**

Murabaha is a term of Islamic Fiqh and it refers to a particular kind of sale. If a seller agrees with his purchaser to provide him a specific commodity on a certain profit added to his cost, it is called a murabaha transaction. The basic ingredient of murabaha is that the seller discloses the actual cost he has incurred in acquiring the commodity, and then adds some profit thereon. This profit may be in lump sum or may be based on a percentage. The payment in the case of murabahah may be at spot, and may be on a subsequent date agreed upon by the parties. .(Taqi Usman, 2006)

### **ANALYSIS**

Based on the objective in our research to explain different between the short term personal loan in Islamic financial Institution as well as conventional Banks. Islamic financial institution's personal loan ( Murabaha) totally different from conventional personal loan such, contract at the same time in features. The following will explain that statement.

### **Comparative study of features of murabaha and short term personal loan**

*Table: 01*

<b>Features</b>	<b>Murabaha (short term personal loan )</b>	<b>Conventional short term personal loan</b>
<b>Types of contract</b>	Sale contract	Loan contract
<b>Subject matter</b>	Subject matter should be a commodity/asset	Subject matter mostly would be money
<b>Operations</b>	Operational mechanisms shall be in line with the Shari'ah rules	Operational mechanisms shall be in line with the national loan regulations and law

<b>Repayment</b>	It is specific schedule and most often deferred either lump sum or instalment	It is specific schedule if interest is fixed and schedule will be uncharged the over the period
<b>Profit loss sharing</b>	The purchaser becomes the owner of the commodity, and at the same time becomes liable for its full price (cost plus profit)	The lender does not own the assets acquired with the loan amount advanced, whilst the borrower becomes liable for the amount of loan in addition to interest (repayment plus interest)
<b>Early payment</b>	Early payment cannot be mandatory. The bank will provide the some discount voluntarily	Early payment discount is built in and early payment also leads to less interest expense
<b>In case of default</b>	The bank can be sue the client and demand payment	The bank can be sue and demand payment as well as the additional charge
<b>Extension of repayment</b>	The bank extends the repayment date but no additional penalty can be charged	Repayment date extension the interest will be increase.

(According to the interview)

According to the *table:01* it is shown that short term personal loan comparison between the conventional and Islamic bank. Based on the above table of figure in short term personal loan that has more different in their features. Those are completely differ from conventional bank such as Type of contract, subject matter, operation, profit loss sharing and extension of repayment.

According to Islamic Banking system short term personal loan contract is a cost plus sale. Customer request to bank acquire and sell an assets to it and Bank will purchase and resell it to customer. Both parties know original cost and markup costs (cost plus profit) either against immediate payment or on a deferred payment basis. The client asked for a loan and bank lends the agree amount of money. Charging the fixed interest rate for amount. Therefore interest is the major different between them. Furthermore in murabaha contract the subject matter should be in the assets or commodity but in conventional short term personal loan subject matter is the money. In Islamic point of view money is not an assets or commodity it is the medium of exchange but conventional banks they used as a subject matter.

Operations mechanism of short term personal loan in IFIs they shall be following the under line with the Shari'ah rules but conventional banks they shall be following the under line with the national loan regulations and laws. All activities of the IFIs must to be in the shari'ah rules because its provide the guide lines of which products are offering by IFIs to their customer. But as far as conventional banks are not concerned about the shari'ah rules because it only specify for the IFIs .they only follow the national loan regulation and law .

Furthermore as profit loss IFIs has fixed margin since the cost plus the markup is decided at onset of the contract and both parties are known about the price. rather conventional banks it shall be usually variable margin since most of the interest rate is variable whereby the customers are unknown about the how much interest they want to pay in future to the bank . Here the uncertainty is comes into the contract therefore IFIs disclose the cost and cost plus.

At the same time in the case of default both banks are charge as same for the late payment. But the purpose will be different one from another. In conventional they charge the late payment for the purpose of profit earning the way of collecting the interest from the their customer but in IFI they used only for the charitable purpose and they cannot consume anything from it they not used as earning profit Because of Islam prohibited interest in all transaction and contract .

According to above analyzing Islamic point of view for short term personal loan differ from conventional view because, the Islam prohibited the riba therefore, the IFIs also prohibited the riba in all contracts whereby murabaha contract also freeform interest. But conventional banks they always include the riba in all contract .this is the major different between both. Feather more, the short term personal loan in conventional banks they offer under the central bank of Sri lank rules and regulation. But IFIs worked out under the Sariah supervision board (SSB) as well as central bank of Sri lank rules and regulation. Both banks offer the same product but their way of short term personal loan is differs one from another. The customer's choose the schemes which they fell are good and better for them.

## CONCLUSION

The study carried out under the topic of comparative study of short term personal loan between conventional bank and Islamic bank. Researchers taken Amana Bank, LOLC AL-

Falah which are the Islamic Bank and Islamic window and Peoples Bank, Hatton National Bank which are conventional banks were selected as the sample of this study. It's clearly mentioned that there are some different between inside of their agreement and features while using short term personal loan between conventional and Islamic bank contractual agreement. The purpose of this study the researcher find that what are the different in the short term personal loan between conventional and Islamic Banks .Therefore researchers find out some major different and also some similarities. According to Islamic view, short term personal loan differ from conventional view because, the Islam prohibited the Riba therefore, the IFIs also prohibited the riba in all contracts whereby Murabaha contract also freeform interest. But conventional banks they always include the Riba in all contract .this is the major different between both. For purpose of this study clarify and identify the different between the Murabaha and conventional Loan. The researchers were point out some practicable recommendations for the Islamic banking.

## RECOMMENDATION

- Islamic Bank and window should use easy and simple procedures for sanctioning of short term personal loans for the customers.
- The loan passing procedures should be quicker by the Islamic Banks and window as like as conventional Banks.
- Many attractive advertisements should be provided to the customers for awareness about personal short term loan schemes of both banks
- Many attractive advertisements should be provided to the customers for awareness and clearly identify the different between Islamic and conventional personal short term loan schemes

Through that recommendation the researcher hope that, it will be able to clarify and identify the different between the Murabaha and conventional loan.

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