

# Introducing Salam as an alternative financing tool for paddy field cultivation in Sri Lanka (special reference to Eastern province)

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**Abstract:** Islamic banking is one of the fastest growing industries all over the world. In Sri Lanka even it is a non-Muslim country it has achieved a significant growth within the short period of time. As an alternative to Interest based financial institution, Islamic financial institutions also offer their customer varies financial products according to modern financial needs. However, there are certain classical Islamic financial products less usage like '*Salam*' even though it's an original financing mode. This paper attempts to propose potential application of '*Salam*' in Islamic Financial Institutions in Sri Lanka.

**Keywords:** Islamic financial institutions, Salam, agricultural finance, paddy field.

## Introduction

Interest is strictly prohibited in Islam. Banks and financial institutions are the major centers promote interest based transactions. Nowadays, the entire commercial transaction of the world depends on banks and financial institutions, therefore the involvement of Muslims the well-known business community; into those banking transaction is unavoidable. As a result of this, Islamic banking system has come to practice eliminating the prohibited elements of normal banking system by the effort of the Islamic scholars. Islam not only prohibits interest but also it has given lots of many other modes to do finance and encourage to do research according to the guidelines of Sharia to find out the solutions for new problems of human life.

Thus, Mudharaba, Musharaka, Murabha, Ijara, *Salam*, Istisna are the mainly used products all over the world in the Islamic Banking industry. Each and every products mentioned above are governed by different rules of sharia and have certain characteristics, therefore; Islamic financial institutions use those products according to needs of the customers. So, Islamic financial institutions all over the world including Muslim and non-Muslim countries practice those modes of finance to offer their customers variety of financial products.

## Research Problem

As an alternative to conventional financial institutions Islamic financial institutions also have to offer financial services satisfying the customers' financial expectations according to modern financial needs. Thus Islamic finance has been developed another area of study as financial engineering to find out new products. As a result, Islamic finance has successfully started almost all the banking, insurance products as well as capital market operations.

Sri Lankan Islamic financial institutions are offering Islamic financial services successfully, even though none of the institution still not started to offer financial services using *Salam* which is one of the original financing products while it is in use in foreign Islamic financial Institutions like Malaysia, Singapore, and Indonesia. Therefore this research aim to propose slam based financial transaction to Sri Lankan Islamic financial industry as good profit making product and good capital providing product for needy customers.

## Objective

The objectives this paper is to look at the possibility to offer *Salam* based financing targeting paddy field farmers of Eastern province. And also this paper aims to examine the reasons of less usage of *Salam* in Sri Lankan Islamic financial Industry with some solutions which can be used to overcome those reasons.

## Research Methodology

This study also employs qualitative method by analyzing data collected through in depth interviews with several people in Islamic banking industry and the people in agricultural sectors, site - visit to the agriculture business and field research as well as library research to find out the current process of agricultural finance and to the marketing system of their crops the researcher has interviewed the farmers and the rice mill owners. To identify the reasons behind un-implementation of *Salam*, the researcher has interviewed the Islamic bankers. To know the products offered by the Islamic financial institutions in Sri Lanka the researcher has read the annual reports of the companies and the country report like KPMG.

This study will be useful for the people who need finance in advance in sharia compliant manner as well as to the industry to make opportunity to provide different types of products and to get good profit. This type of research should be conducted to increase understanding on Islamic finance as well as specific issues which may frequently or occasionally occur in organization context. Moreover, it examines problems faced by the Islamic financial institutions that tried to introduce *Salam*-based financing in its operations and accordingly proposes some alternative solutions for the problems which identified by this study.

## Brief Evolution on Islamic banking in Sri Lanka:

In Sri Lanka, the history of Islamic banking starts with the establishment of Amana Investment Ltd in 1997. With amendment took place in 2005 in Sri Lankan Banking Act No.30 of 1988, Islamic Banking has been included to their lists of permissible businesses under schedule II and IV. Hence both Licensed Commercial Banks (LCB) and Licensed Specialized Banks (LSB) are permitted to offer Islamic Banking products.

## Market players:

There are only one fully fledged Islamic Bank (Amana bank) in the country, four Islamic windows of conventional banks regulated by Central Bank of Sri Lanka (CBSL), four Islamic windows of finance and leasing companies, institution which are incorporated by parliament Acts, number of Islamic financial institutions registered under the company act provide advisory services and capital market operations and only one Takaful company.<sup>1</sup>

Islamic banking in Sri Lanka has been able to stir interest in all communal groups of the country. The current non-Muslim consumer market in Sri Lanka constitutes more than 20% of the total Islamic banking market share. The value of the Sri Lankan financial sector was estimated at about USD 1.2 billion. In 2011 as declared by Faizal Salieh Managing Director of Amana Bank to KPMG country report. Another significant achievement is that Amana bank the only one fully fledged Islamic bank in Sri Lanka has declared the profit in 2012, 140 million LKR.<sup>2</sup>

## Product profile

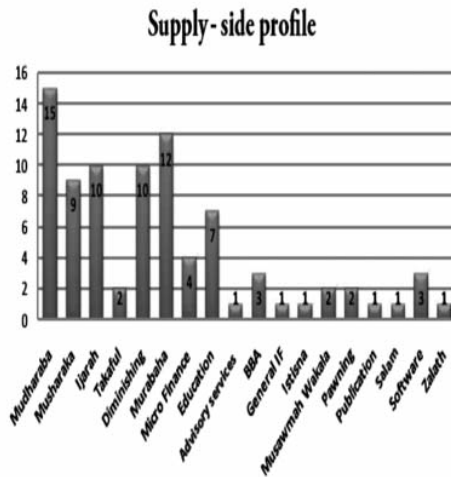
According to the KPMG country report on product profile, the most popular product in terms of market prevalence is Mudharaba followed by Murabaha, Diminishing Murabaha and Ijarah. Despite the size of the market, there are seven education service providers and three Islamic finance software

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<sup>1</sup> Source: <http://azharseylan.wordpress.com>

<sup>2</sup> Source: <http://www.kpmg.com>

developers. Whilst the banking and financial sector products dominate, it is worth noting the presence of considerable diversity in the range of services available with Consultancy / Advisory services also having a ten player presence in the market. However the application of *Salam* is very low level comparing to the other financial product like Mudaraba and Murabaha.



The previous report shows that, the practice of *Salam* is 1 percent in 2011, but in 2012 according to the interview it is zero.<sup>3</sup>

## Literature Review

*Salam* is an ancient form of forward contract wherein the price was paid in advance at the time of making the contract for prescribed goods to be delivered later.

<sup>4</sup>Under *Salam* contract, the price is paid in advance at the commencement date of the contract for prescribed goods to be delivered later. In this way *Salam* is an exceptional contract of sale, because of the future delivery of subject matter of sale as explained by Taqi Usmani “It is one of the basic conditions for the

validity of a sale in Shari’ah that the commodity (intended to be sold) must be in the physical or constructive possession of the seller. This condition has three ingredients: Firstly, the commodity must be existing; therefore, a commodity which does not exist at the time of sale cannot be sold. Secondly, the seller should have acquired the ownership of that commodity. Therefore, if the commodity is existing, but the seller does not own it, he cannot sell it to anybody. Thirdly, mere ownership is not enough. It should have come in to the possession of the seller, either physically or constructively. If the seller owns a commodity, but he has not taken its delivery himself or through an agent, he cannot sell it. There are only two exceptions to this general principle in Shari’ah. One is *Salam* and the other is *istisna*”<sup>5</sup>.

*Salam* have been used interchangeably with *salaf* in the hadith of Prophet Muhammad p.b.u.h.to describe the contract for future delivery of specified goods with up-front payment of the price. The parties stipulate a certain time for supply of goods of specified quantity and quality.

The concept of *Salam* has been described mostly in every Islamic classical fiqh literature as well as modern researches clearly because the *Salam* is the contract directly declared in hadith of the Prophet (p.b.u.h) narrated by Bukhari and Muslim: “Whosoever make buying and selling by way of *salaf* (*Salam*), he should do the buying and selling with a clear dose and scales up to the time limit”. Therefore, the permissibility of *Salam* is unquestioned. The Hanafis, Hanbalis, Shafi’is and Malikis agree that the *Salam* is permissible although each of the jurisdictions has their own definitions, rules and requirements regarding the *Salam* contract.

However contemporary scholars like Sabiq (2006), Ayub (2007) and Usmani consider some important similar things about *Salam*:

<sup>3</sup> Source: <http://www.kpmg.com>

<sup>4</sup> Ayub, 2007

<sup>5</sup> Usmani 98

The sale is legally approved transaction in Islam, not only approved it has been encouraged in Quran and Sunnah. *Salam* as a kind of sale it is also has got the consent of Sharia. According to Ibn Abbas, the Qur'an verse 2:282 also refers to *Salam*. He says that according to analogy if postponement of payment is allowed then postponement of the delivery can also be allowed. It is clearly described in Fiqhu al sunna for Seyyed Sabiq.

Another hadith reported by Imam Bukhari and Imam Muslim described about how *Salam* should be practiced. The hadith mentioned that upon migration from Makkah, Prophet Muhammad p.b.u.h. came to Madinah, where the people used to pay in advance the price of fruit (or dates) to be delivered within one, two and three years. However, such sale was carried out without specifying the quality, measure or weight of the commodity or the time of delivery. The holy Prophet commanded: "Whoever pays money in advance (for fruit) (to be delivered later) should pay it for a known quality, specified measure and weight (of dates or fruit) of course along with the price and time of delivery".<sup>6</sup>

### Security in *Salam*:

It is permissible to ask for security or a pledge in a *Salam* transaction as proved from the Sunnah of Prophet Muhammad p.b.u.h. Imam Bukhari has captioned two chapters "Kafeel fis *Salam*" and "Al-Rihn fis *Salam*" and reported that the holy Prophet borrowing grain from a Jew against the pledge of an iron breastplate. The seller can be required to furnish any security, personal surety or a pledge. In contemporary world, the bank, in the event of the seller's default, has the right to sell out the pledge and purchase the stipulated goods from the market in collaboration with the customer or take away his advance payment out of the sale proceeds and return the balance to the owner. If the bank gets its money back, it cannot be more than the price paid in advance, as the advance price is like a debt outstanding on the

seller. Purchase of the stipulated commodity by the bank from the sale proceeds of the pledge should not result in any exploitation of the customer.<sup>7</sup>

Literature review shows that the agricultural productivity and efficiency heavily depends upon availability of credit to farmers on proper time. Farmers go towards private money lenders and brokers who charge higher interest rates as well as tie the farmers to sell their crops at rates lower than the market rates as a result of less or no access to formal credit. At the same time, financial institutions must take necessary precautionary measures to minimize the chances of adverse situations including delayed payments and willful defaults. Last but not least, reduced costs and increased production can also be achieved by improving infrastructure in rural areas and easy access of farmers to modern technology.

### Conceptual framework on *Salam*

In Bai-*Salam* contract, in exchange of full advance payment of commodity, the delivery occurs at some future date, delivery is hence said to be deferred. (Usmani, T 1998) suggests that the basic purpose of this sale contract is to meet the needs of the farmers who need money to grow their crops and to fuse for general consumption up till harvest time. The contract is beneficial for both parties as the farmer receives the money in advance at the time of need, while the buyer normally pays the price at bit lower rates and also finds an opportunity of business and possible future profits. Bank can demand a guarantee in different forms like mortgage, hypothecation or personal guarantee to reduce lending risk.

Another possible of modern structure is that, in *Salam*, both seller and buyer can enter into a parallel contract. In contemporary condition, bank as seller can sell goods on parallel *Salam* on similar conditions and specifications as it previously purchased on the first *Salam*, without making one contract dependent on the

<sup>6</sup> AAOIFI, 2004-5a, p. 171. ...

<sup>7</sup> AAOIFI, 2004-5a, Standard on Salam, clause 3/3, p. 165

other. Meanwhile, the date of goods delivery may be set the same between the two *Salam* contracts.

In parallel contract of *Salam* the bank enters two different contracts. The first contract between the farmers and the bank where the bank is the buyer and the second contract is between the third party and bank where is the bank is the seller. Thus, after purchasing a commodity by way of *Salam*, the financial institutions may sell it through a parallel contract of *Salam* for the same date of delivery. The period of *Salam* in the second (parallel) transaction will be shorter and the price may be a little higher than the price of the first transaction. The difference between the two prices shall be the profit earned by the institution. There are two specific conditions for parallel *Salam* along with the conditions of normal *Salam*. 1. Each one of two contracts must be independent of the other. (No any condition depending on the rights and obligation of the other)

The purchaser in parallel *Salam* should be a third party only. (The seller in the first contract cannot be made purchaser in the parallel contract of *Salam*, because it will be a buy-back contract, which is not permissible in Shari'ah.)

This contract can become an important alternate mode of agriculture financing especially in the Muslim countries where the farmers sometimes stay away from the financial institutions due to the element of interest and inappropriate disbarment and repayment schedules of the loans and the cash flow needs of different crops. In its soul, the contract of Bai-*Salam* is a trading contract rather than a loan.

It extra has advantages in agricultural-financing when compared with other modes of Islamic financings such as Profit and Loss Sharing (PLS) and Bai Muajjal (sale on deferred payments). PLS requires heavy work to determine the appropriate and adequate profit and loss sharing ration. On the other hand Bai Muajjal is converse to Bai-*Salam*. In this contract,

available commodities are purchased at time of agreement but payments are to be made at some future dates to the sellers but Bai-*Salam* provides cash to the farmers when it is required (at the time of sowing fertilizing or just before harvesting). The contract is in line with the standards of modern banking. Banks deal in money rather than commodities is the only limitation in this case. To solve this problem, bank can enter into two separate but parallel contracts, one with the seller and second with the buyer of the commodity. Bank can act as an intermediary between the two parties, but important, rather necessary is that these contracts with both parties must be independent of each other.

## Discussion and Findings

Agriculture credit has proved to have a large impact on the rural economy. Credit fulfills capital requirements of farmers to make new investments in crops or technology. Due to rapid mechanization, use of modern seeds and pesticides and application of fertilizers are some of the important factors that have raised the need of credit for farmers. Agriculture sector contributes nearly percent of the total GDP in Sri Lanka. Agricultural sector should be very potential to significantly reduce unemployment level.

There are 66008 hectare of irrigated paddy land and 11314 rain fed paddy land harvesting paddy fields only in Ampara district<sup>8</sup> as like there many hectares of paddy land in other districts of eastern province. So, *Salam* as an original agricultural product it can be easily practice in eastern regional branches of Islamic banking industry. There are almost every popular financials institution in this region which offer Islamic financial products like Amana bank, LOLC Al Falah, Slamath, As Safa, BOC An Noor, MCB, HNB, Commercial Bank. Another possible factor is the most of the people in this region are Muslims, thus, it is another advantage for the industry to promote *Salam* based finance as described earlier in literature.

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<sup>8</sup> source: Ampara DS Office Report (2010)

Currently there are several practices are in practice in the paddy land sector to get finance for their crops as well as for marketing their harvest. Farmers who have no enough capital to grow their crops they normally take interest based loan from banks, or they take some advance money from rice mill owners who purchase their harvest finally. The first case is obviously wrong as it involved interest. The second type is also the type of loan which probably effect the farmers that they can't sell their crops to another purchaser other than rice mill owner who gave them advance, this is because the farmers lose their marketing power.

To sell the crops the farmers have two options the one is they can sell it to rice mill owners at market price on negotiable basis. Another option is that they can sell to government representatives. Normally the government pays more price than private rice mill owners. But unfortunately they purchase up to their credits limit only or up to the limited space of their warehouse. In case, the government purchaser stop purchasing the crops the farmers have to sell their crops whatever the price the rice mill owner demand because they have to repay the loan which they got from the bank.

IFI can introduce *Salam* as an suitable financing product to solve this problem of farmers as well as to earn reasonable profit for the institution. As the condition of *Salam* the byer (IFI) has to pay the price in full advance for the farmers who need fund to grow their crops and to feed their family. If this proposed product was practiced the farmers cannot go for interest based loans or advance money with rice mill owners in which they lose their bargaining power. In the other side, this is one of the huge service to the society to eradicate them self from the interest.

For applying this practice, the IFI can have the following arrangements:

1. The IFI can establish a subsidiary especially for *Salam* based finance for agricultural sector, with expert in the field of IBF as well as in agricultural sector.

The subsidiary is fully responsible for marketing the crops.

2. Otherwise the big miller/ rice mill owner can act as a middle man who has insightful knowledge about the local area by appointing an agent to recommend the farmers and the marketing crops. According to his recommendation the IFI can provide funds for the farmers on *Salam* basis.

The subsidiary or with the help of agent the institution can enter into parallel contract of *Salam* with farmers and the rice mill owners or government purchaser.

Here the IFI can purchase through *Salam* the huge amount of paddy that cannot be purchased by the millers individually.

According to the interview, there are mainly two reasons behind less usage of *Salam* among the IFI in Sri Lanka. The first one is it cannot be allowed by the CBSL (Central Bank of Sri Lanka) separately. The second one is that *Salam* is a risky mode, because the crops can be destroyed due unexpected events like natural disaster.<sup>9</sup>

The first factor is easily answerable because, CBSL no need to allow the *Salam* separately, because CBSL already allowed to do sale transection as it is allowed to Murabaha sale. Thus, *Salam* also another kind of sale it can be used under the same act of CBSL.

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<sup>9</sup> Ismail deen Marikar chairman, ADL Capital

The second factor also can be answered in the following ways.

Islamic finance never encourage earn profit without bearing any risks. Thus, to earn good profit it wants to be getting ready to face all challenges.

However, comparing other modes which are in practice in IFI, the *Salam* is the original financial product, therefor the IFI should take interest to make the *Salam* as one of its product.

And also, the *Salam* based transections are normally in practice in other countries like Malaysia, Singapore, Pakistan, etc. we can take their operation as an example for our country.

Otherwise IFI want to insist the Takaful company to introduce crop Takaful, especially for *Salam* based transections

## Conclusion

The paper tries to introduce the *Salam* as an important instrument for paddy field cultivations. *Salam* is a trade-based instrument, and against advance full payment, thus, the farmers as well as the institution can get good profits on it. Exploring the agriculture related problems and hurdles faced by farmers can help in proper application of this instrument. The above discussion shows that farmers hardly afford to purchase the inputs on cash. Even it's tough enough for them to meet personal consumption expenses from farm income. Thus banks should take care before proceeding *Salam* instrument to reduce risks large-scale willful defaults. Lastly, two innovative models are proposed in this paper for the feasible application of *Salam*. Banks can offer this instrument either with the help of middlemen who have insightful knowledge about the local area or they can take up the process as a new subsidiary. The ultimate objective of the proposed models is to develop such a system that can result in a win-win situation for both banks and farmers.

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# “பாரம்பரிய முஸ்லிம் மருத்துவர்களின் மருத்துவ முறைகள்” (கெகிராவைப் பிரதேசத்தை மையப்படுத்திய ஆய்வு)

(1) இஸ்லாமிய கற்கைகள் அறபுமொழிபீடம் தென்கிழக்குப்பல்கழைக்கழகம்  
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**ஆய்வுச் சுருக்கம் (Abstract):** இஸ்லாம் மருத்துவத்துறைக்கு தூண்டுதலும் முக்கியத்துவமும் அளித்துள்ளது. இதனால் இத்துறையில் முஸ்லிம்கள் ஈடுபாடு காட்டினர். அந்தவகையில் மருத்துவத்துறைக்கு அவர்கள் ஆற்றிய பங்களிப்பானது மருத்துவக் கலை வரலாற்றில் ஓர் அத்தியாயமாகக் கொள்ளப்படுகின்றது. நீண்டகால வரலாற்றுடன் தொடர்புபட்ட கெகிராவைப் பிரதேச முஸ்லிம்களின் வைத்திய முறைகள் இன்றுவரை அவர்களால் நடைமுறைப்படுத்தப்பட்டு வருகின்றமை, அவ்வைத்திய முறைகள் அவர்களுக்கு மத்தியில் இன்றும் செல்வாக்குப் பெற்றிருப்பதனை எடுத்துக்காட்டுகின்றது. இருந்த போதும் அண்மைக்காலமாக பாரம்பரிய வைத்திய முறைகளில் சில முஸ்லிம்களால் கைவிடப்பட்டுள்ளதோடு அவற்றின் தேவைகளும், பயன்பாடுகளும் இப்பிரதேசத்தில் அருகிவருகின்றன. இதனால் கெகிராவைப் பிரதேச பாரம்பரிய முஸ்லிம் மருத்துவர்களையும் அவர்களின் வைத்திய முறைகளையும் இனங்காணுதல், இப்பிரதேசத்தில் இவ்வைத்திய முறைகள் அருகிவருகின்றமைக்கான காரணங்களையும் கண்டறிதல், இவ்வைத்திய முறையை தொடர்ந்தும் இப்பிரதேசத்தில் பேணுவதற்கான ஆலோசனைகளை வழங்கி எதிர்காலத்தில் இத்துறையில் முஸ்லிம்களை ஈடுபாடு கொள்ளச் செய்தல் போன்ற நோக்கங்களை அடிப்படையாகக் கொண்டு இவ்வாய்வு மேற்கொள்ளப்பட்டுள்ளது. இவ்வாய்வுவிற்காக முதலாம் இரண்டாம் நிலை தரவுகள் பயன்படுத்தப்பட்டுள்ளன.

**கலைச்சொற்கள்:** பாரம்பரிய மருத்துவம், கெகிராவை, பாரம்பரிய மருத்துவர்கள்.

## அறிமுகம் (Introduction)

கெகிராவைப் பிரதேசமானது வடமத்திய மாகாணத்தில் அநுராதபுர மாவட்டத்தில் அமைந்துள்ளது. மூவின மக்களும் கலந்து வாழும் இப்பிரதேசத்தில் உள்ள சுமார் 143 கிராமங்களில் 19 கிராமங்களில் முஸ்லிம்கள் வாழ்கின்றனர். நீண்டகால வரலாற்றுப் பாரம்பரியத்தைக் கொண்ட இப்பிரதேச முஸ்லிம் மக்கள் மத்தியில் யூனானி மருத்துவ முறைகளோடு ஆன்மீகம் சார்ந்த சில மருத்துவ முறைகளும் நடைமுறையில் இருந்து வந்துள்ளன. கண்டி மன்னர்களின் காலத்தில் முஸ்லிம்கள் அவர்களின் அரசசபை வைத்தியர்களாக கடமையாற்றியுள்ளனர். இந்த கருத்தினை அநுராதபுர மாவட்டத்துடன் தொடர்புபடுத்திப் பார்க்கும் போது கண்டி இராட்சியத்தைப் போன்றே மன்னர்களின் வரலாற்றுடன் தொடர்புபட்ட ஒரு நகரமாக இது விளங்குகின்றது. “அநுராதபுரத்தை ஆட்சி செய்த மன்னர்களின் காலப்பகுதியில் மருந்து வகைகள் அரேபியாவில் இருந்து இறக்குமதி செய்யப்பட்டுள்ளதனை மிகிந்தலையில் அமைந்திருக்கும் புராதன மருத்துவ நிலையத்தின் இடிபாடுகளில் கண்டெடுக்கப்பட்ட “ஸாஸானிய” இஸ்லாமிய மட்பாண்டங்கள் உறுதி செய்கின்றது. இவை கி.பி 7ம் நூற்றாண்டுக்கும் 9ம் நூற்றாண்டுக்கும் இடைப்பட்ட காலப்பிரிவைச் சார்ந்ததெனவும், பொருட்களை சேமித்து வைப்பதற்காக பயன்படுத்தப்படும் இந்த மட்பாண்டங்களில் அரேபியா பாரசீக வளைகுடா போன்ற பகுதிகளில் இருந்து யூனானி மருந்துவகைகள் இறக்குமதி செய்யப்பட்டிருக்கலாம். எனவும் கூறப்படுகிறது.” (இஸ்லாமிய சிந்தனை:2007)