

PRACTICAL APPLICATION OF CURRENCY SALAM TRANSACTION IN ISLAMIC BANKING- A CASE STUDY OF PAKISTAN

Syed Muhammad Hassan Bukhari*

Dr. Muhammad Junaid Sharif*

Islamic banking with the passage of time is acquiring impetus. Many local and international banks have started to open separate Islamic banking branches and windows to cater the needs of customers who are interested in shari'ah approved products. Islamic banking system is facing a good competition from developed conventional banking system in products and services. With the passage to time the awareness of Islamic banking and its products is improving substantially. The purpose of the study is to understand the practical procedure of currency salam transaction in Islamic banks. Methodology of this paper is quantitative research. For this 60 questionnaires were distributed among bankers dealing in currency exchange transactions in Islamic Banks, out of which 52 respondents were received and used. The content and descriptive analysis techniques were employed to analyze the data. The SPSS software is used to analyse the data collected by questionnaire. The study supports the literature and according to data almost 71% respondents of Islamic banks believe that *salam* transaction is practically implemented in selected Islamic banks.

Key words: Currency, *Bai*, *Salam*, Contract, *Sarf*

Introduction

Eradication of *riba*, *gharar* and *qimar* is the first challenge for the establishment of Islamic financial markets. Although Islamic banking has lucratively provided the Islamic models for banking and insurance but research proved that currency markets still needs to be addressed.¹

One of the important task of Islamic banking is to ensure that every transaction between fund provider and user is according to Quranic spirit of Justice and mutual-aid . Islamic banking is considerably an evolving system as compared to any other banking system. Muslims have desire to have such a financial system where the money of savers goes into the hands of investors in such ways which are permitted by the *Shariah*. Islamic scholars and bankers put their efforts to provide such instruments which are not only according to *shariah* but also able to pay them *halal* returns. These scholars are now very successful in their true efforts but still the concepts of Islamic banking and finance are in development stages. Islamic banking and financial institutions have expanded to the global market as the western countries are eager to experiment with Islamic financial techniques.

* Lecturer, Virtual University of Pakistan, Lahore..

* Associate Professor, Govt. Islamia College Civil Lines, Lahore.

To design the various parameters and new products to capture market is a biggest challenge for scholars and practical bankers of Islamic banking.²

According to Gupta demand for financial instruments has been increased rapidly. Individuals and organizations are dealing in financial assets such as foreign currencies, bonds, shares and loans.³ The prices of these financial assets fluctuate due to market conditions and these fluctuations put dealers on great risk.⁴ To address these types of risks new financial instruments have been introduced in financial markets called financial derivatives. Significance of financial derivatives as tools of risk management are considered less importance as compared to future and option contracts in minimizing risk.⁵ With the use of future and option contracts country party risk is handled up to non-existence.⁶ Derivatives are considered very effective for production planning in agriculture for high volume of trade. With the use of future contracts price could be received in advance and goods delivered on agreed date.⁷ Farmers and millers have a great risk of adverse movements in prices with change in market forces. The only remedy for buyer is to buy the goods in advance at the desired price and keep it in for future time to use it. In this case, the buyer has to incur storage cost and or transportation use to make it available at future date, in the same way the seller can also retain it for buyer for future date for which he adds it in price.⁸ Currency *salam* can also be used as future contract to facilitate the Islamic product market.

Currency *salam* is a new product derived from the mechanism of *salam* transaction not only to address the future market need but also to address risk faced by Islamic financial instruments in financial markets. In this transaction, currency of one country is fully paid in advance to the seller and seller provides the currency of other country on agreed future date to buyer.

Salam

“Salam is a sale whereby the seller undertakes to supply some specific goods to the buyer at a future date in exchange of an advanced price fully paid at spot”⁹

Islamic legitimacy is derived from the following Quranic verse:

Those who eat riba will not stand (on the Day of Resurrection) except like the standing of a person struck by Satan leading him to insanity. That is because they say: “Trading is only like riba,” whereas God has permitted trading and forbidden riba. (Qur’an, 2:275)

According to Ibn Abbas the above mentioned Quranic Verse (2:282) was revealed to address *salam* in particular, for in permitting lending, it also permits *salam* transaction.

Another hadith explained by Ibn Abbas “When God’s messenger came to Madina, the people were paying one or two years in advance for fruits, so he said: “ Those who pay in advance anything must do for a specified weight and for definite period.¹⁰

METHODOLOGY

The research strategy is quantitative and data collected to fulfill the objectives of this research study. In order to address the practical procedure of the product in Islamic banks primary data was collected by survey method by introducing questionnaire. Research design of this study is based on the objectives provided for the research. The research being conducted is the mixed research and is the exploratory study as very few work has been done so preliminary work needs to be done to comprehend the nature of problem. Study setting for this research is Non-contrived, Field study (Minimal interference of the researcher). Unit of analysis is Individual (Books, *Shariah* advisor, Islamic bankers and books) and the Time horizon is Cross sectional. The target population of the study were bankers and *shariah* advisors of two selected Islamic Banks of Lahore which are offering currency *salam* product to their customers.

The data was collected from approximately 50 *shariah* advisors, Islamic bankers. Judgmental and snow ball sampling techniques were used for sampling the population. The Population is of 20 banks out of which only 3 banks offering this product, so the target population is of 3 bank’s *shariah* advisors and Islamic bankers which are almost 100. Sample size is taken of 60% of target population.

The data that was collected for this research was of both primary sources. The Survey design was used for primary data collection in which questionnaire was distributed among the *shariah* advisors of three selected Islamic Banks of Lahore. According to Saunders, survey is the standard strategy for primary data collection for business research as it intends to collect a significant amount of data from a large sample in cheapest way.¹¹

The instrument used for data collection is questionnaire. The questionnaire is based on Dichotomous Scale and guided to investigate the currency *salam* product with respect to implementation of practical procedure in Islamic Banks. The instrument used was self-created by pilot testing. In data analysis process the data cleaned by eliminating

unresponsive questions and coding applied. The data analyzed by using SPSS software and different descriptive analysis statistical techniques. From data analysis further recommendations for currency *salam* product and future prospects for research will be derived.

“Construct validity does not concern the simple, factual question of whether a test measures an attribute. Instead it is about the complex question of whether test score interpretations are consistent with a nomological network involving theoretical and observational terms.”¹² To address the validity of instrument used for data collection factor analysis is used. The results are showing communalities extraction that question 2 & 4 and question 3 & 5 are showing same themes respectively.

Table is showing the results.

Communalities

	Initial	Extraction
Is currency salam transaction practically implemented as per shariah standards?	1.000	.557
Currency rate used by your bank is the rate derived by the Government for currency salam transaction.	1.000	.948
Which date currency rate is being used by your bank?	1.000	.540
If Government rate is not used then which kind of rate is being used by your bank?	1.000	.942

Extraction Method: Principal Component Analysis.

It is very important to consider the reliability of the instrument used for gathering data. The cronbach alpha is used to measure the reliability of the instrument. The 88.5% result shows the significance of questions.

Case Processing Summary

		N	%
Cases	Valid	46	88.5
	Excluded	6	11.5
	Total	52	100.0

a. List wise deletion based on all variables in the procedure.

Item Statistics

	Mean	Std. Deviation	N
Is currency salam transaction practically implemented as per shariah standards?	1.30	.465	46
Currency rate used by your bank is the rate derived by the Government for currency salam transaction.	1.39	.493	46

Which date currency rate is being used by your bank?	1.20	.401	46
If Government rate is not used then which kind of rate is being used by your bank?	2.28	.911	46

RESULTS AND DISCUSSIONS

In line with the objective, the exploratory study was undertaken to get the data by using self-administered questionnaire. The questionnaire was prepared by using dichotomous scale and distributed among those bankers who deals in currency *salam* transactions of two Islamic banks in the city of Lahore. It was assumed that the respondents would be competent enough to read and understand English, so they could select answers in the questionnaire. For the analysis of data initial analysis techniques were applied by using SPSS 17. The questionnaire is designed to understand that how currency *salam* transaction is practically implemented in Islamic banks.

The questionnaire contains two main sections. The first one is designed to collect information about the demographic variables of the respondents. The second part is about such constructs which differentiate the practices of both banks to do currency *salam* transaction. The questionnaire was designed in such a way to avoid biasness.

The target sample size in this study is 60 respondents which is sufficient as only these banks are offering currency *salam* products in Pakistan. Out of these questionnaires, 52 were returned and usable. The usable response rate was 86% which is acceptable as per previous studies.¹³

The results depicts that out of these 52 respondents, almost 94% of the respondents are male, while 6 % of them are female. Furthermore, the age grouping indicates that 67 per cent are between 20 to 30 years old and 33 per cent are between 31 and 40 years old.

With regards to the educational level, 79 per cent are holding a Masters, and 21 per cent are holding an MPhil degree. For the experience status, around 25 per cent of the respondents have less than 2 years of experience, 36 per cent have experience between 2 to 3 years and 39 per cent have experience between 5 to 10 years.

Education

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Mphil	11	21.2	21.2	21.2

Master	41	78.8	78.8	100.0
Total	52	100.0	100.0	

Experience in years

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Less than 2	13	25.0	25.0	25.0
	2-5	19	36.5	36.5	61.5
	5-10	20	38.5	38.5	100.0
	Total	52	100.0	100.0	

Age in years

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Up to 30	35	67.3	67.3	67.3
	31-40	17	32.7	32.7	100.0
	Total	52	100.0	100.0	

Permissibility of currency salam transaction:

The first question asked by the respondents was is currency salam transaction allowed according to shariah in Table 1. The results clarify that all respondent found this transaction permissible as 100 percent result figured out.

Table 1**Is currency salam transaction allowed according to shariah?**

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Allowed	52	100.0	100.0	100.0

Practical implementation as per Shariah

On the second question which was asked by the respondents that is currency *salam* transaction practically implemented as per *shariah* 71% respondents agreed that it is as per *shariah*.and almost 29 per cent respondents response was in disagreement. From the result it could be derived that training of bankers required extency training to understand the practical procedure as per *shariah*.

Table 2**Is currency salam transaction practically implemented as per shariah standards?**

		Frequency	Percent	Valid Percent	Cumulative Percent
--	--	-----------	---------	---------------	--------------------

Valid	Yes	37	71.2	71.2	71.2
	No	15	28.8	28.8	100.0
	Total	52	100.0	100.0	

Currency rate applied for transaction

Table 3 shows that 81 per cent of respondents agreed that the rate which is used for the currency salam transaction is date of delivery.

Table 3

Which date currency rate is being used by your bank?

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Date of Transaction	42	80.8	80.8	80.8
	Date of Delivery	10	19.2	19.2	100.0
	Total	52	100.0	100.0	

Rate used for transaction is of Government rate

The results of Table 4 shows that 61% of respondents do agree that currency rate used for the currency salam transaction is the rate which provided by Government.

Table 4

Currency rate used by your bank is the rate derived by the Government for currency salam transaction.

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Yes	32	61.5	61.5	61.5
	No	20	38.5	38.5	100.0
	Total	52	100.0	100.0	

Rate used other than government rate

Table 5 shows that for currency salam transaction internal driven rate of bank is used.

Table 5

If Government rate is not used then which kind of rate is being used by your bank?

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Internal Driven	16	30.8	30.8	30.8
	Mutual Agreed	5	9.6	9.6	40.4
	Not Applicable	31	59.6	59.6	100.0

If Government rate is not used then which kind of rate is being used by your bank?

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Internal Driven	16	30.8	30.8	30.8
Mutual Agreed	5	9.6	9.6	40.4
Not Applicable	31	59.6	59.6	100.0
Total	52	100.0	100.0	

Conclusion and recommendations

The practical implementation of currency *salam* transactions in Islamic banks is explored. The questionnaire properly address the main ingredients and analyse the practical procedure and implementation of currency *salam* transaction in Islamic banks.

After the above thorough discussion and research results shows that 100% respondents agree that *salam* transaction is allowed in Islam and 71% are agreed that it is practically implemented in their bank as per *shariah* guidelines.

This is pioneer study conducted in Lahore regarding the *salam* transaction in currencies. Although it is a pioneer study but it has some limitations. Firstly the questionnaire is used as a data collection tool so it is expected that biasness factor may affect the research and make it less generalized. Secondly that data is collected from the three Islamic banks of Lahore only. The reason is this only these three banks are offering currency *salam* product in Pakistan. That's why it was very difficult to increase the number of respondents to make the study more intensive.

The findings have sound implications for the body of knowledge, the practitioners, stakeholders and specially to policy makers of *shariah* boards who can analyze that is the practical procedure of currency *salam* transaction is as per *shariah* rules. The results enrich the literature to practically understand the procedures and practical hurdles found to comply with *shariah* jurisdiction.

Hence, the future studies are recommended firstly to take *shariah* scholars point of view on the procedure of currency *salam* transaction provided by the bankers, secondly it should be extended to other banks of different countries as well. For instance, there are efforts that have been done by other banks to initialize currency *salam*

transactions in their banks as it is good product to capture the entire currency market.

REFERENCE & NOTES

- ¹ Obaidullah, Mohammed. "Financial Contracting in Currency Markets: An Islamic Evaluation...," *International Journal of Islamic Financial Services* 3, no. 3 (2001).
- ² Iqbal, Munawar, Auşāf Aḥmad, and Tariqullah Khan. *Challenges Facing Islamic Banking*. Islamic Development Bank, Islamic Research and Training Institute, 1998.
- ³ Gupta, SL. *Financial Derivatives: Theory, Concepts and Problems*. PHI Learning Pvt. Ltd., 2005.
- ⁴ Kevin, S. *Security Analysis and Portfolio Management*. PHI Learning Pvt. Ltd., 2008.
- ⁵ Al-Amine, Muhammad al-Bashir. "Commodity Derivatives: An Islamic Analysis." New York: Palgrave Macmillan, 2005.
- ⁶ Gurusamy, Dr S. "Financial Services and Markets." (2004).
- ⁷ Kamali, Mohammad Hashim. "Islamic Commercial Law: An Analysis of Futures." *American Journal of Islamic Social Sciences* 13, no. 2 (1996): 197-224.
- ⁸ Ehsan, Muhammad. "Islamic Perspective on Financial Derivatives: Demand for Instruments of Risk Management in Various Businesses of Pakistan." Durham University, 2012.
- ⁹ Usmani, Justice Taqi. *An Introduction to Islamic Finance*. Karachi: Idara Isha'at e Diniyat, 1998.
- ¹⁰ Al Zaabi, Obaid Sai. "Salam Contract in Islamic Law: A Survey." (2011).
- ¹¹ Saunders, Chad, and Mike Chiasson. "Using Knowledge Management Systems to Structure Knowledgeable Practices." Paper presented at the System Sciences, 2009. HICSS'09. 42nd Hawaii International Conference on, 2009.
- ¹² Cronbach, Lee Joseph. "Construct Validity in Psychological Tests, Psychological Bulletin." In, no. 52 (1955): 281-302.
- ¹³ Metawa, Saad A, and Mohammed Almosawi. "Banking Behavior of Islamic Bank Customers: Perspectives and Implications." *International Journal of Bank Marketing* 16, no. 7 (1998): 299-313.