

# Islamic Banking and Finance Review



## An Alternative Islamic Mode of Finance for SMEs: A Case for Bai Salam

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### Research Paper Information:

#### *To cite this article*



Ishtiaq, S. M., Nihal, H. M. S., & Mukhtar, M. M. (2015). An alternative Islamic mode of finance for SMEs: A case for Bai Salam. *Islamic Banking and Finance Review*, 2(1), 17-27.  
[Crossref](#)

#### *Access this article online*



[Article](#)



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<https://doi.org/10.32350/ibfr.2015.02.02>

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Volume 2 1436-H/ 2015  
ISSN (E): 2413-2977  
ISSN (P): 2221-5239

Journal

<https://doi.org/10.32350/ibfr>

Issue

<https://doi.org/10.32350/ibfr.2015.02>



This is an Open Access Journal

**Published By**  
Institute of Islamic Banking  
University of Management and  
Technology (UMT)



<https://iib.umt.edu.pk/ibfr/home.aspx>



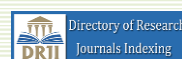
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**An Alternative Islamic Mode of Finance for SMEs:  
A Case for *Bai Salam***

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**Abstract**

Financing and procurement play a vital role for the success of small and medium enterprises (SMEs), but, *riba* and *gharar*, commonly used in conventional transactions, are the barriers for the Muslims to get benefit of this deal. *Riba* is pre-determined excess return to the extended loan while *Gharr* is a kind of uncertainty that may lead to dispute. *Gharar* includes selling of commodity which does not exist or which is not owned and possessed by a seller. *Bai Salam* is the best alternate Sharia compliant solution to *riba* and *gharar* based transaction. *Bai Salam* which is generally used in agricultural products can also be employed on non-agriculture objects. It can also be executed by way of parallel *Salam*. This paper aims to discuss *Bai Salam* and its implications on SMEs in the context of 2011 Punjab Assembly Bill.

**Keywords:** *Bai Salam*, *Parallel Salam*, Economy, Business, Small and Medium Enterprises



Ishtiaq, Sheikh. Muhammad., Nihal, Hafiz Muhammad. Sarfaraz., & Mukhtar, Muhammad Mubashir. (2015). An Alternative Islamic Mode of Finance for SMEs: A Case for *Bai Salam*. *Islamic Banking and Finance Review*, 2(1), 17-27. ISSN 2221-5239. © 2015



## 1. Introduction

Small and Medium Enterprises (SMEs) are a backbone for economy, as they provides the opportunity of trade and finance to limited scale companies. In Pakistan, during the fiscal year 2012, the growth rate of SMEs had been increased by 7.5 percent (Afraz et al., 2014). This remarkable growth conceives the need of financing methodology that is equitable in every context, transforming the benefits to the stakeholders. Among the biggest challenges being faced by the Muslims is the challenge of overcoming the illusion of *riba*, the strictly prohibited deal in Islam (Al Quran 2: 278 – 279).

Islam provides its own set of financing and lending mechanisms. A genuine application of Islamic regulations would relieve the greater part of humanity from the debt and insecurity that the interest based paradigm has inflicted upon us (Diwany, 2010). The modes which Islam provides ranges from *Musharaka*, *Modaraba*, *Salam*, *Istisna*, *Qard*, *Murabaha*, *Musawamah* and others which are combination and permutation of the aforesaid.

## 2. Bai 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” (Usmani, 1998). In a nutshell, *salam* is a 100% advance payment with the future specified date of the good to be delivered. Definitions of *bai salam* in view of different shariah jurisprudents compiled by *Lakhnawi & Lakhnawi* (2010) in *Umdatul Riaya Fi Sharhi Sharil Wiqaya* are;

- According to Sahib ul Bahar and Sahib ul Multaqa: A sale contract in which the payment is on spot and the delivery is deferred.
- According to Burjundi: A sale contract in which sale executed in order to transfer the ownership of the commodity to the purchaser in future whereas the payment is made on spot to the seller.
- According to Allama Aine: A sale contract in which the seller possess the right of receiving payment on spot and the buyer receives the good after sometime.
- According to Allama Shami who quotes from Qouhestani: A kind of sale and purchase contract in which one thing is on spot (payment) and the second thing is deferred (delivery of goods).

The concept of *Bai salam* is also stated in the Holy Quran (Lakhnavi & Lakhnavi, 2010):

هو مشروع بالكتاب: وهو آية المدينة، روى الحاكم في ((المستدرک)) (2: 314) في تفسير سورة البقرة، عن ابن عباس قال: أشهد أنّ سَلَفَ المضمون إلى أجلٍ مسمّى قد أحله الله في الكتابِ وأذن فيه، قال الله تعالى: {يَا أَيُّهَا الَّذِينَ ءَامَنُوا إِذَا تَدَايَيْتُمْ بِدَيْنٍ إِلَى أَجَلٍ مُّسَمًّى فَاكْتُبُوهُ...} الآية [البقرة: 282]، وقال: حديثٌ صحيحٌ على شرطِ الشيخين، ولم يخرّجاه. كذا في ((نصب الراية)) (4: 44)

“O you who believe, when you transact a debt payable at a specified time, put it in writing, and let a scribe write it between you with fairness...” (Surah Al Baqarah: 282). Ibn Abbas says “I take oath that the above verses were revealed in the context of *salaf* (i.e., *bai salam*).”

Before the prohibition of *riba* in Islam, farmers used to take *riba* based loans for their need. The Holy Prophet ﷺ provided alternate solution to the *riba* based transaction by way of *Bai Salam*. Ibne Abbas expounds:

(فما روى ابن عباس) أن رسول الله (ص) قدم المدينة، وهم يسلفون في الثمار السنة والسنتين والثلاث، فقال: "من أسلف في شئ فليسلف في كيل معلوم، ووزن معلوم إلى أجل معلوم."

“Whoever wishes to enter into a *salam* contract, he must affect the *salam* according to the specified weight and the specified delivery date.” (Narrated by Ibne Abbas in Sahih Al Bukhari; Book of Salam, Bab: A *Salam* contract on a specified weight), 2240, 2241, pp.174.

*Bai Salam* was allowed to make easiness in the economic sphere mixed with flexibility in financing requirements. Also, the “Arabs depended on seasonal trade and agriculture for their livelihood, the practice of *salam* sale with forward delivery must have been common in their life. Al Bukhari reports from Al Bara’ Bin ‘Azib:

“(When) the Prophet ﷺ came (to Al Madinah) we used to do *salam* sale against forward cash payment until the season. (Al Bukhari, V 4, p.269)” (Kahf & Khan, 1992). Abdullah bin

Shaddad and Abu Burda sent me to ‘Abdullah bin Abi Aufa and told me to ask ‘Abdullah whether the people in the life-time of the Prophet used to pay in advance for wheat (to be delivered later). Abdullah replied, “We used to pay in advance to the peasants of *Sham* (Syria) for wheat, barley and olive oil of a known specified measure to be delivered in a specified period.” I asked (him), “Was the price paid (in advance) to those who had the things to be delivered later?” Abdullah bin Aufa replied, “We did not use to ask them about that.” Then they sent me to ‘Abdur Rahman bin Abza and I asked him (the same). He replied, “The companions of the Prophet used to practice *salam* in the life-time of the Prophet; and we did not use to ask them whether they had standing crops or not.” (Sahih Bukhari 1: 2154).

Apparently on face value *Bai Salam* seems as a void contract, because basic sale and purchase requirements are neglected in it. Such as, existence of subject matter, possession and ownership of the buyer over the commodity. But when compared in the light of Shairah, “there are still other needs for financing especially those emerging out of unforeseen circumstances. In this regard Muslim writer’s usually quoting two famous sayings of the Prophet صلى الله عليه وسلم promising an ample reward for benevolent loans. Commenting on these sayings, Ibn Qudamah argues that the purpose of lending is to relieve and assist a person who is under pressure and is facing adversity (Al Mughni, V. 4: 353). In fact as the text of the Hadith shows, the Prophet صلى الله عليه وسلم himself indicates that a loan seeker would only ask for a loan as a result of necessity and financial despair. It should be noted that needs which require borrowing may pertain to either consumption or production. Hence *Bai Salam* was looked upon as a means of providing financial facilities to producers” (Kahf & Khan, 1992). Ijma (consensus of Shairah jurists) is also held on *Bai Salam* (Lakhnavi & Lakhnavi, 2010):

وبالإجماع: لأنهم أجمعوا على جوازه لحاجة الناس إليه، والقياس يأباه؛ لأنَّ المسلم فيه يبيغ وهو معدوم، ولما كان يبيغ موجود غير مملوك، أو مملوك غير مقدور التسليم ليس بصحيح، فبيغ المعدوم أولى، لكنَّا تركناه لوجود النصوص الصريحة على جواز ما نحن فيه من الكتاب والسنة.



“Due to the non existence of the subject matter and not in the ownership of the purchaser one can consider this transaction to be void but all jurists consider *Bai Salam* permissible due to necessity of the people. Also the Quran and Sunnah consider it permissible.”

According to the Muslim jurists who are in the favored of Bai Salam argued that there are certain strict conditions which are necessary to be satisfied otherwise the agreement of *salam* contract would be void (Usmani, 1998; Mansoori, 2008).

- 1- The basic idea for *salam* is that seller must be able to get 100% payment in advance from the buyer; at the time of sale agreement with no barter between the commodities like wheat and cotton etc
- 2- The good in the contract must not be having shortage and be available in the market from the contract to the date of delivery. *Bai Salam* agreements cannot be applicable for the particular goods whose supply is limited
- 3- There would be no ambiguous measurement of the commodity. The measurement of the commodities must be in the standard and usual measure in the market
- 4- The exact delivery date and place must be defined in the contract and they must be delivered physically
- 5- *Salam* contract is applicable only on those goods in which there is no ambiguity in the quality of the good because ambiguity in quality and specification may lead to dispute.
- 6- *Salam* should be held bilaterally
- 7- Until the time commodity is handed over to the buyer, the commodity will remain at the risk of seller

Parallel *salam* is also acceptable in Shariah with two conditions:

- 1- It is only allowed with third party
- 2- The two *salam* contracts neither dependent to one another nor contingent upon any other situation

The flexibility is not extended in the context of penalty, according to AAOIFI Shariah Standard number 10, “It is not permitted to stipulate a penalty clause in respect of delay in the delivery...” of the subject matter (*al-Muslam fih*).



There are three substitutes for failing in fulfilling the contract, either the buyer waits for the delivery or terminate the contract by recovering the paid capital or take other kind of delivery which does not exceed the amount of the contract and neither the price of that commodity is more than the market price (AAOIFI, 2006). Another word of caution is that *Bai Salam* cannot be executed in those commodities that may fall in *riba-ul-hadith* (i.e., in which the delivery must be on the spot basis like sale of gold with gold or gold with silver and vice versa etc.)

### 3. Scope of *Salam* in Small and Medium Enterprises (SMEs)

In Pakistan, the SMEs are comparatively larger in number than large scale industries and are responsible for having competition in majority of the economic sectors. In Pakistan, the SMEs comprise almost 90% out of all enterprises because it employs around 80% of the non-agricultural labor force while its part in the annual GDP of the country is 40%. The SMEs normally face the shortages of finances and other factors of production like marketing, training of the human resource and financial development.

Small and Medium Enterprises Development Authority (SMEDA) is given obligatory services to facilitate and help small and medium businesses in Pakistan. It provides financial, marketing, technical services and supervision to the SMEs. A cluster of different SMEs are made by SMEDA in order to enhance the efficiency by undertaking cluster development programs, such as:

- 1- Textile (ginning technology up-gradation and development of handloom clusters)
- 2- Horticulture, fruits and vegetables (export processing zone, fruit processing facility and co-ordination with EPB)
- 3- Fisheries (establishment of shrimp farms and fish processing facilities)
- 4- Gems (glass work, ceramics, sanitary ware, pottery and bangles)
- 5- Agriculture (support services for agricultural credit and trade promotion)

In the earlier era of Islam, *Bai Salam* was introduced for small farmers to grow crops to feed their family members till their production process to be completed and other necessities to be fulfilled. But with the advancing times it started to be used to expand the businesses, to accomplish the liquidity needs



and to achieve the working capital for the international trade (exports and imports) etc. This nature of transaction is constructive and beneficial for both parties which are engaged in contracts. The seller receives the prices of their products in advance for those products that have not been produced on one side while the buyers are the beneficiaries in the form of having comparatively lower prices normally for the products produce through *salam* than the prevailing market prices.

*Bai Salam* can be used as an alternative financing mode in the current times also. Currently, in formal sector *Bai Salam* is used by Islamic Banks, which have advanced PKR 2.7 billion under this mode of financing, (SBP, 2010). Informal arrangements can also be made by SMEs with their raw material providers. Hypothetical case is being diagrammed which highlights the flow of the contracts (see Figure 1).

### **Simple *Bai Salam* Case**

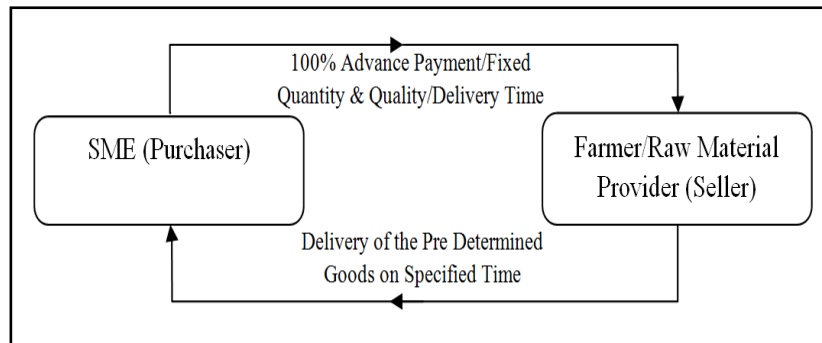
In simple *Bai Salam* case, the SMEs pays the price of commodity in advance which it intends to purchase from the farmer or raw material provider, the seller. 100 percent advance payment of the fixed quantity and pre-determined quality must be delivered in the specified time. The needs of both the parties are fulfilled in this specific mode of Islamic financing, such that no one can be harmed with this agreement.

### **Parallel *Bai-Salam* Case**

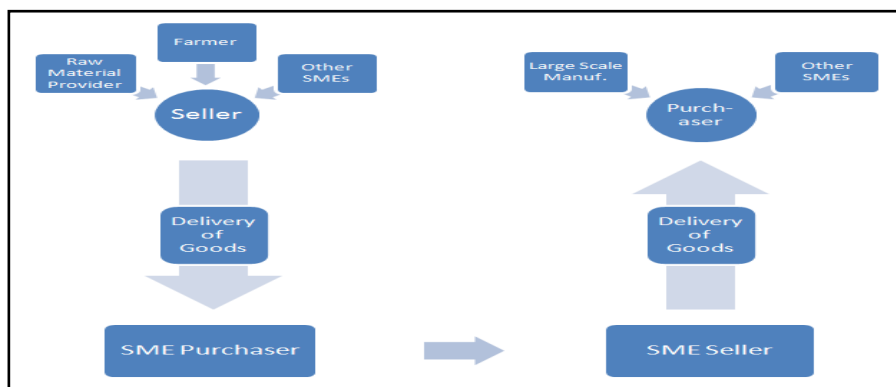
The Parallel *Bai Salam* (see Figure 2) case is showing the agreement of the same SME as purchaser and as a seller simultaneously, with the first seller and with the other buyer respectively. The two agreements of the same SME are not contingent to the buyer and seller directly. The first seller may be the raw material provider, farmer or other SME; these goods are purchased by the SME. The same SME will be treated as the seller for the other agreement with the purchaser who may be the large scale manufacturer or other SMEs. In this way the seller receives the money which he requires for running his business and the purchaser benefits by getting a reasonable price. *Bai Salam* helps the SMEs plan pricing, budgeting, target market and future business prospects.



**Figure 01: Bai Salam Mode of Financing**



**Figure 02: Parallel Bai Salam Financing Case**

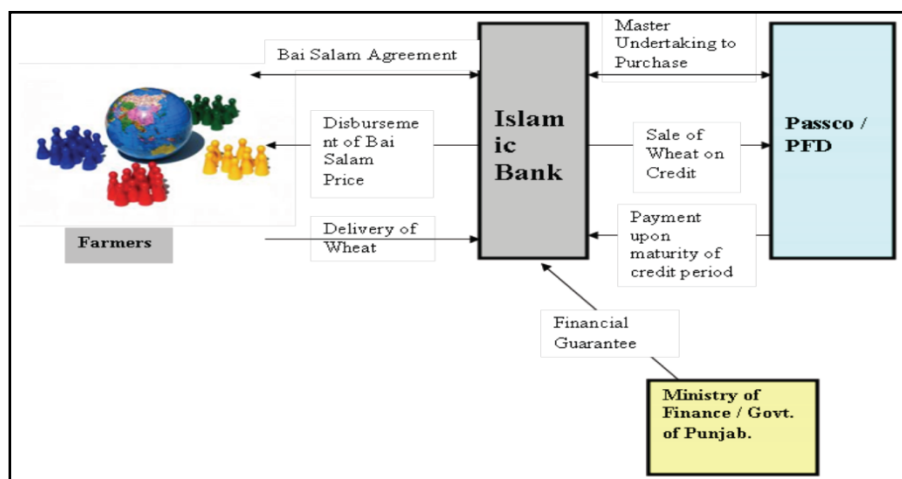


#### 4. Summary of *Bai Salam* Bill of Government of Punjab

Punjab Assembly passed a *Bai Salam* bill which officially announced the removal of *riba* from the agricultural sector of Punjab. The credit flowing from the financial institutions to the agriculture sector comprised of only 6 percent, whereas the middle man (Aarthi) is the main source of providing financing to the farmer; 95 percent. The bill “favors the small farmers and can be effective in systemic eradication of Aarthi culture, introduce corporate farming, curb hoarding and inflation and change price mechanism.” The bill intends towards a co-operative farming mechanism in which clusters of four small farmers, each having a land holding of twelve acres or less can group together and enter a *bai salam* contract (Shahid, 2011). This co-operation will help the farmers in growing major cash crops and will place them in better position to compete with larger land holding agriculturist. The government of Punjab and Islamic Financial Institutions can jointly help in this project as providing better technological equipments like solar powered tube wells,

tractors and sprinkles etc. All these technologies can be given on the basis of Ijarah to the whole cluster. As the money input channels through the financial institutions or government or private sector, it will tend to increase the quality of the product, increase in research and increase in yield of the crop. By the intervention of the government through *bai salam*, the hoarding problem can be overcome and by the removal of *riba* the problem of inflation can be controlled, as it will be a sharing basis contract. The bill deems the government to fix a percentage of financing amount on Islamic Banks which will flow towards the farmers, through which the farmers will purchase the inputs. The Figure 3 depicts the methodology proposed in the bill.

**Figure 03: Methodology of Punjab Assembly Bill on *Bai Salam***



## 5. Conclusion

This paper discusses *Bai Salam* and its implementation on the SMEs in context of the government of Punjab Bill of *Bai Salam*. The mechanism of *Bai Salam* is self evident in advocating the equitable and justified approach of Islam in context to the moral and social order of a society. The SMEs sector with its consistent high growth rate can benefit from *Bai Salam*, such that the seller can get advance payment for his goods which would benefit him in his business and the buyer benefits from early price setting plus the known quality and quantity of the good, which would help him in planning for his future steps in business. The Punjab government role in promoting *Bai Salam* in agriculture sector is very encouraging, as they can easily launch and run the whole system, reaping benefits for the stakeholders on the whole.



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## Appendix

### Definitions of *Bai Salam* by Lakhnavi & Lakhnavi (2010)

وعرّفوه بعبارات:

منها: أخذٌ عاجلٌ بأجل، وهذا فاسد؛ لأنّ السلعة إذا بيعت بثمنٍ مؤجلٍ يوجد هذا المعنى، وليس بسلم، ولو قيل: بيعٌ أجلٌ بعاجل، لكان أصوب، وقال في ((البحر)) (6: 168): الظاهر أنّ قولهم: أخذٌ عاجلٌ بأجل، تحريفٌ من النّسخ الجهلة، فاستمرّ النقل على هذا التحريف. انتهى. [قلت: هذه العبارة فيها تبديل مخلّ، فإن عبارة ((البحر)) (6: 168) هي: والظاهر أنّ قولهم أخذٌ عاجلٌ بأجل من باب القلب، والأصل أخذٌ أجلٌ بعاجل وهو أولى مما في ((البنية)) من أنّ قولهم أخذٌ عاجلٌ بأجل تحريفٌ من النّسخ الجاهل فاستمرّ النقل على هذا التحريف]

ومنها: هو بيعٌ أجلٌ بعاجلٍ، ذكره في (الملتقى ص 120) ومنها: بيعٌ الشيء على وجهٍ يوجبُ الملكَ للبائع في الثمنِ عاجلاً، وللمشتري في الثمنِ أجلاً، سمّي به؛ لما فيه من وجوبِ تقدّمِ الثمن، ذكره البرجنديّ.

ومنها: هو عقدٌ يثبتُ الملكَ في الثمنِ عاجلاً، وفي الثمنِ أجلاً، ذكره العلامة العينيّ [في ((الرمز)) (2: 50)]

ومنها: شراءٌ أجلٌ بعاجلٍ؛ لأنّ السلم اسمٌ من الإسلام. ذكره العلامة الشاميّ [في ((رد المحتار)) (4: 203)] نقلاً عن الفهستنائيّ [في ((جامع الرموز)) (2: 39)].

وركنه: الإيجابُ والقبول، بأن يقول المشتري: أسلمتُ اليك عشرة دراهمٍ في كُرّ حنطة، وأسلفت، فيقول البائع: قبلت، وينعقد بلفظِ البيع في الأصحّ، وهو روايةُ الحسن - رضي الله عنه - عن أبي حنيفة - رضي الله عنه -، وصورته: أن يقول: اشتريتُ أو بعثتُ منك كُرّ بُرّ صفتهُ كذا، بكذا إلى كذا، على أن توقّيه في مكان، وقال زفر - رضي الله عنه - وعيسى بن أبان - رضي الله عنه -: لا يصحّ، وهو وجهٌ في مذهبِ الشافعيّ؛ لأنّ السلمَ عقدٌ ثبتَ على خلافِ القياس بلفظِ خاصّ، فلا يعدلُ عنه. ولنا: أنّ كلاً من البيع والسلم تملك مالٌ بمال، فيكونُ البيعُ اسمٌ جنسيه فيصابُ به كما يصابُ باسمه. كذا في (كمال الدراية ق 420)

### Cornerstone's of *Bai Salam*

- 1- Offer and acceptance by the parties.
- 2- Fixation of price
- 3- Time of delivery
- 4- Place of delivery
- 5- Quality and quantity of the commodity

