

THE CONTRACT OF BAY' AL-SALAM AND ISTISNA' IN ISLAMIC COMMERCIAL LAW: A COMPARATIVE ANALYSIS

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ABSTRACT

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This paper aims at exploring the comparison between *bay' al-salam* and *istisna'* from the perspective of their similarities and differences. For this purpose, the nature and conditions of *bay' al-salam* and *istisna'* contracts will be first discussed. Next, the paper will focus on the comparison between *bay' al-salam* and *istisna'*. The paper is based on secondary data which is to compare *bay' al-salam* and *istisna'*. This study found there were obvious differences and similarities between *bay' al-salam* and *istisna'*. For instance, *bay' al-salam* whereby people pay first and goods will be delivered later. In contrast, *istisna'* sale is based on specification whereby price and goods are delivered later. This paper indeed gives an overview of these products.

Keywords: *Bay' al-salam, istisna', similarities, differences*

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1. Introduction

A sale (*bay'*) is an exchange of one item for another or the exchange of an owned commodity for another in a beneficial and special manner (Ramadan, 1987). Sales are permitted, with supporting evidence from the *Quran*, the *Hadith* and *Ijma'* (Laldin, 2006). Sale may be partitioned into eight (8) categories with respect to the two compensations and price:

- i. *Firstly*, general sale (*bay' al-mutlaq*), which is the exchange of a non-fungible for a fungible. This includes the common example of selling goods in exchange for general prices (Udovitch, 1967);
- ii. *Secondly*, exchange sale (*bay' al-muqayadah*), which is the exchange of one specific non-fungible for another such as the exchange of a dress for an animal;
- iii. *Thirdly*, currency exchange (*al-sarf*), which is an exchange of one non-fungible for another, i.e. a general "price" for another;
- iv. *Fourthly*, bargaining or negotiation sale (*bay' al-musawamah*), where the object of sale is exchange for a price that is agreed upon by the buyer and seller;
- v. *Fifthly*, forward sale (*bay' al-salam*), that is the exchange of a liability as the object of sale for a non-fungible as the price;
- vi. *Sixthly*, sale at a loss or below-cost sale (*bay' al-wadiyah*), that is the exchange of an object of sale at a price below the price for which the seller bought it;
- vii. *Seventhly*, at-cost sale (*bay' al-tawliyah*), which is the exchange of an object of sale at the same price originally paid for it by the seller; and
- viii. *Eighthly*, cost-plus sale (*bay' al-murabahah*), that is the exchange of an object of sale for a price equal to the original price plus a determined profit.

Furthermore, there are other types of historically known sales such as commission to manufacture (*istisna'*) and the sale of fruits on the trees (*bay' al-daman*). For the purpose of this paper, only two (2) types of sale will be discuss, namely *bay' al-salam* and *istisna'*.

It is one of the basic conditions for the validity of a sale in *Shari'ah* that the object must be in the physical or constructive possession of the seller (Weeramantry, 2001). This condition has three ingredients; firstly, the object must be exist, secondly, the seller should have acquired the ownership of the object and thirdly, mere ownership is not enough, meaning that it should have come in to the possession of the seller, either physically or constructively. If the seller owns an object, but he has not taken its delivery himself or through an agent, he cannot sell it (Petersen and Rajan, 1997).

However, there are only two (2) exceptions to this general principle in Islamic Jurisprudence. The first exception is *bay' al-salam* and the other exception is *istisna'*. Both are sales of a special nature and in this paper the concept of these two kinds of sale and the extent to which they can be similar or difference will be expounded.

2. Definition of *bay' al-salam* and *istisna'*

2.1. Definition of *bay' al-salam* contract

Bay' al-salam is a sale of an object, which is not available at the time of the conclusion of the sale, but will be delivered in the future on a fixed future date. The price is, however,

to be paid immediately during the session of the contract. In other words, the transaction is called *bay' al-salam*, when it is a sale for an agreed price with immediate payment for a determinate thing, to be delivered in the future on a fixed date (Nawawi, 1999).

In other words, *salam* or *salaf* is the sale of a deferred item in exchange for an immediate (forward) price. It is the sale of a liability whose characteristics are described in exchange for a price or capital-sum paid in advance. The Maliki school defined *bay' al-salam* as a sale in which the capital-sum (price) is paid in advance and the object of sale is deferred to a specified term. Whereas, the Shafi'i and Hanbali school defined the forward contract as a contract over described merchandise sold as a deferred liability on one party, in exchange for a price that is received during the contract session.

Bay' al-salam was allowed by the Holy Prophet Muhammad s.a.w. subject to certain conditions. The basic purpose of this sale was to meet the needs of small farmers who needed money to grow their crops and to feed their families up to the time of harvest. After the prohibition of *riba*, they could not take usurious loans. Therefore, it was allowed for them to sell the agricultural products in advance (Usmani, n.d.).

2.2. Definition of *istisna'* contract

Literally the word *istisna'* is a derivative from the root word *sana'* or to manufacture or to construct something. *Istisna'* is an order or request to manufacture something, whereby the requestor invited, induced or caused another to make or manufacture some goods for him. Technically, it is a contract to purchase for a definite price something that may be manufactured later on according to agreed specifications between the parties. In other words, it is a contract of sale of specified items to be manufactured or constructed with an obligation on the part of the manufacturer or contractor to deliver them to the customer upon completion (Akhtarzaite, 2006).

In other words, *istisna'*, like the *bay' al-salam* contract, is a contract whereby the sale of future goods is allowed on a certain condition or conditions. The *istisna'* contract allow an order to be placed with a manufacturer to make a certain product, answering a definite description at an agreed price to be paid either in advance or on completion. In *istisna'*, the subject matter is non-existent goods at the time of the conclusion of the contract but it is treated as valid the principle of equity (*istihsan*) and on the basis of customary practice (*'urf*) (Nawawi, 1999).

The contract of *Istisna'* creates a moral obligation on the manufacturer to manufacture the goods, but before he starts the work, any one of the parties may cancel the contract after giving a notice to the other. However, after the manufacturer has started the work, the contract cannot be cancelled unilaterally (Usmani, n.d.).

3. Conditions of *bay' al-salam* and *istisna'*

Bay' al-salam and *istisna'* have been allowed by the based on the *Hadith* of the Prophet which allowed the sale of future goods. All the Muslim jurists allowed such condition because it was customarily practiced in the business sector and responded to the public needs. It was, therefore, an exception to the general rule of the existence of the subject matter of sale. However, *bay' al-salam* and *istisna'* are bound by special rules and conditions.

3.1. Conditions of *bay' al-salam*

- i. *Bay' al-salam* cannot be affected on a particular commodity or on a product of a particular field or farm. For instance, if the seller undertakes to supply the barley of a particular field, or the fruit of a particular tree, the *bay' al-salam* will not be valid. This is because there is a possibility that the crop of that particular field or the fruit of that tree is destroyed before delivery, and given such possibility, the delivery remains uncertain. The same rule is applicable to every commodity the supply of which is not certain (Usmani, n.d.);
- ii. It is necessary that the quality of the object of sale is fully specified leaving no ambiguity which may lead to a dispute. All the possible details in this respect must be expressly mentioned. Also, the exact date and place of delivery must be specified in the contract (Nawawi, 1999);
- iii. *Bay' al-salam* can be affected in those commodities only the quality and quantity of which can be specified exactly. The things whose quality or quantity is not determined by specification cannot be sold through the contract of *bay' al-salam*. For example, precious stones cannot be sold on the basis of *bay' al-salam*. This is because every piece of precious stones is normally different from the other either in its quality or in its size or weight and their exact specifications is not generally possible;
- iv. It is necessary for the validity of *bay' al-salam* that the buyer pays the price in full to the seller at the time of affecting the sale. It is necessary because in the absence of full payment by the buyer, it will be tantamount to sale of a debt against a debt, which is expressly prohibited by the Holy Prophet s.a.w;
- v. *Bay' al-salam* cannot be affected in respect of things, which must be delivered at spot. For instance, if wheat is purchased in exchange of barley, it is necessary that the delivery of both be simultaneous (according to *Shari'ah*) (Usmani, n.d.); and
- vi. It is necessary that the quantity of the object of sale is agreed upon in unequivocal terms. If the object of sale is quantified in weights according to the usage of its traders, its weight must be determined and if it is quantified through measures, its exact measure should be known. What is normally weighted cannot be quantified in measures and vice versa.

3.2. Conditions of *istisna'*

- i. The subject matter should be well defined without ambiguity with respect to quality, quantity and other relevant characteristics. This follows since the object to be manufactured is an object of sale, which must be known by specifying those aspects. Therefore, if any of those aspects of the object of the contract is not specified, the contract would be rendered defective due to ignorance that may lead to legal dispute (Sudin & Shanmugam, 2001);
- ii. The subject matter should normally be used by the people (e.g. jewelry, shoes, pots, means of transportation, etc.). The *istisna'* is not proper if the subject matter is rarely used by the people;
- iii. There is no specific term of deferment is specified. Hanafi school ruled that if the parties to the contract specify a term of deferment, the *istisna'* becomes defective and the contract is converted to a *bay' al-salam* that must satisfy all the other conditions of the latter contract;

- iv. The price of the subject matter of *istisna'* is known at the time of the conclusion of the contract. The price could not be increased or decreased on account of the normal increase or decrease in commodity prices or the cost of labor. This is to avoid *gharar* (uncertainty) in the price of the subject matter. The price or consideration for the manufactured good to be determined could be in cash or tangible goods or the usufruct of an asset for a particular duration. As a matter of fact, the utilization of the usufruct of the manufactured item itself (the subject matter of *istisna'* upon completion) could also be the price of the contract; and
- v. The manufacturer must undertake to construct the goods with his own material. If the buyer supplies the raw material to be manufactured it is considered then as *Ijarah*, instead of *istisna'*. It is not permitted for the manufacturer to stipulate in the contract of *istisna'* that he will not be liable for defects in the subject matter. The reason for this prohibition is that *istisna'* is a sale of specified goods to be delivered in future, while the exclusion of liability as to defects is valid only in the sale of particular identified goods (Muhammad Al-Amine, 2001).

4. The similarities of *bay' al-salam* and *istisna'*

Bay' al-salam is the exchange of an immediate price for a deferred object of sale, where the object of sale or the commodity is established by description as a liability on the forward seller and *istisna'*, on the other hand, is a contract between the buyer and the worker, where the worker provides the raw material. However, there are a number of similarities for both contracts:

- i. Both contracts may not include direct *riba*, for instance through the unity of genus for the price and object of sale (e.g. wheat for wheat) with an increase in one of the two (2) compensations (*riba al-fadl*) or with deferment and increase (*riba al-nasiah*). According to the *Hadith*, the commodity for which such trading is forbidden are the six, namely gold, silver, wheat, barley, dates and salt and ones that can be inferred to carry the same legal restriction;
- ii. Both contracts involve sales of non-existing items, permitted to meet economic needs and based on common practice (Rosly, 2005);
- iii. Both contracts require full knowledge of the price in terms of genus, type, amount and characteristics, otherwise the contract would be considered defective due to ignorance. In terms of the price payment, Imam Malik allowed a deferment of the price payment for up to three (3) days, ruling that a payment within three days is legally equivalent to an immediate payment, since anything approximately equivalent to another inherits its legal status;
- iv. The object of sale in both contracts (to be delivered or manufactured, respectively) must be well known to the buyer and seller in terms of its genus, type, amount and characteristics. Therefore, in both contracts, the object to be delivered is considered an object of sale which must be fully known to the contracting parties;
- v. In terms of financing potential, this means the extent to which a given contract can be regarded as a suitable means of financing. *Bay' al-salam* and *istisna'* can be regarded as a suitable means of financing. Both of the contracts have greater financing potential;

- vi. According to Abu Hanifa, both contracts require a clarification of the location of delivery of the object of sale if transportation of the object is costly. On the other hand, Abu Yusuf and Muhammad ruled that the location of the contract session is the default delivery location; and
- vii. The Hanafis have agreed that the inspection option is not established for both contracts. This is due to prevent the object from returning as a liability on the seller.

5. The differences of *bay' al-salam* and *istisna'*

Keeping in view these natures of *bay' al-salam* and *istisna'*, there are several points of difference between these two (2) contracts which are summarized below:

- i. *Bay' al-salam* contract is binding on both parties and may only be voided by mutual agreement. On the contrary, *istisna'* is not binding and may be voided by either party. If the manufacturer delivers the manufactured object to the commissioner to manufacture, he loses his option but the buyer retains his (Nawawi, 1999);
- ii. The term of deferment is a condition in *bay' al-salam*, since it is not permitted for the majority of jurists except Shafi'i for a term of deferment less than one month. In contrast, Abu Hanifa has ruled that the specification of a term of deferment in *istisna'* converts it into a *bay' al-salam*. Abu Hanifa also highlighted the ruling that there is no conditional option in *bay' al-salam*. Conversely, Abu Yusuf and Muhammad ruled that *istisna'* is valid whether or not a term of deferment is specified since such specification is customary. Whereas, the Shafi'i have permitted immediate *bay' al-salam*, in disagreement with the other schools of jurisprudence (Akhtarzait, 2006);
- iii. The subject of *istisna'* is always a thing which needs manufacturing, while *bay' al-salam* can be affected on any thing, no matter whether it needs manufacturing or not (Usmani, n.d.);
- iv. The contract of *bay' al-salam*, once affected, cannot be cancelled unilaterally, while the contract of *istisna'* can be cancelled before the manufacturer starts the work (Kamali, 1991);
- v. The commodity of *bay' al-salam* is a liability on the seller and thus must be a fungible measured by volume, weight, length or number of approximately homogenous items. On the contrary, the subject matter in *istisna'* contract is non-fungible as opposed to a fungible liability;
- vi. The time of delivery is an essential part of the sale in *bay' al-salam* contract while it is not necessary in *istisna'* contract that the time of delivery is fixed (Usmani, n.d.);
- vii. It is necessary that the delivery of the price in *bay' al-salam* is in full during the contract session. In other words, *bay' al-salam* requires full payment and receipt of the price during the contract session, prior to the physical parting of the buyer and seller. But, this is not the condition in *istisna'* where people usually pay a down payment equal to half or one-third of the price, following the Hanbali school's ruling. The common practice of *istisna'* is a partial advance payment during or shortly after the contract session, with full payment only at the time of delivery;
- viii. In terms of scope, this refers to activities and commodities to which each of these contracts is more relevant. *Bay' al-salam* is relevant to any property that can permissibly be sold and precisely described. It does not include

- commodities that cannot be precisely described. Whereas, *istisna'* is a confined to the industrial sector especially goods produced on prior order;
- ix. In terms of guarantees, which means the extent to which each of the two (2) parties who practice a given contract can have a guarantee for his rights and how he could appropriately deal with the risk involve thereof. *Bay' al-salam* involves higher degree of risk for the financier compared to the *istisna'* because of the latter as an independent contract since principal (price) can permissibly be delayed. As for *bay' al-salam*, some external arrangements like mortgage and collateral have been enacted for the contract in order to minimize the risk element it involve; and
 - x. The motivation for *bay' al-salam* is the seller's need for immediate funds to spend for his family sustenance as well as to help him with his production. On the other hand, *istisna'* is a commercial contract that results in profits for the manufacturer, while meeting the needs of the commissioner to manufacture. Hence, the motivating need for this contract is the need of the buyer rather than the seller.

6. Conclusion

This study has discussed the *bay' al-salam* and *istisna'* contracts in terms of its similarities and differences. We have seen that *istisna'* contract is a contract between the buyer and the worker, where the latter provides the raw materials. The condition of this contract is the specification of the object to be manufactured with sufficient accuracy to remove ignorance. Whereas, the *bay' al-salam* contract is exchange of an immediate price for a deferred object of sale, where the latter is established by description as a liability on the *bay' al-salam* seller. The object of the *bay' al-salam* does not exist at the contract session and its delivery is deferred to a definite future time period. In a nutshell, this study has given an overview about the resemblance and disparity between *bay' al-salam* and *istisna'*. Although it does not reflect the broad-spectrum of the concepts, but at least it contributes something important by adding more literature regarding these two types of sale.

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