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**Hire Purchase Under
Shirkah al-Milk
(HPSM) in Islamic
Banking and Finance**
A Shari'ah Analysis

**M. Kabir Hassan
Muhammad Mostofa Hossain
Aishath Muneeza**

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PREFACE I

In the rapidly evolving landscape of Islamic banking and finance, the concept of Hire Purchase under *Shirkah al-Milk* (HPSM) has emerged as a significant and promising mode of financing. This book delves deep into the historical development, Shari'ah permissibility, essential contracts, practical application, and Shari'ah issues related to the application of HPSM. It provides a comprehensive understanding of this dynamic and evolving field.

- Chapter 1 delves into the historical development of HPSM in the Islamic banking and finance industry. It explores the origins and evolution of this mode of financing, tracing its roots to the principles and teachings of Shari'ah. By understanding its historical context, readers will gain valuable insights into the evolution of HPSM and its relevance in the modern Islamic financial system.
- Chapter 2 focuses on *shirkah*, the first essential contract in HPSM. *Shirkah* is the cornerstone of HPSM, and this chapter unravels its principles, concepts, and legal implications. Readers will gain a profound understanding of the nature and significance of *shirkah* as a cooperative partnership and its role in facilitating HPSM transactions.
- Moving forward, Chapter 3 explores *ijarah*, the second essential contract in HPSM. *Ijarah*, or leasing, plays a crucial role in HPSM by enabling the transfer of the right to use an asset for a specified period. This chapter elucidates the fundamental principles of *ijarah*

and its application within the framework of HPSM, providing readers with a comprehensive understanding of this important contractual arrangement.

- Chapter 4 brings attention to the final essential contract in HPSM, which is sale. Sale is the culmination of the HPSM process, where the ownership of the asset is transferred from the bank to the customer. Through an in-depth analysis of the sale contract and its various forms, this chapter sheds light on the intricacies of this crucial transaction and its compliance with Shari’ah principles.
- Practical application of HPSM is focused in chapter 5. In this chapter, readers will explore the implementation and operational aspects of HPSM. The chapter discusses the practical considerations, challenges, and strategies involved in structuring and executing HPSM transactions, providing valuable insights for practitioners, researchers, and policymakers alike.
- In chapter 6, readers will find a comprehensive examination of how Islamic and conventional hire-purchase transactions are treated from accounting entries. This in-depth analysis equips readers with a hands-on understanding of both HPSM variants, and ultimately enriches the study’s overall value.
- Chapter 7 is dedicated to exploring the Shari’ah issues related to the application of HPSM. It addresses the various challenges, controversies, and arguments surrounding HPSM from a Shari’ah perspective. By delving into the intricate details and exploring multiple viewpoints, this chapter equips readers with a deeper understanding of the Shari’ah implications and considerations associated with HPSM.
- Chapter 8 showcases additional *ijarah* and *shirkah* contracts within the contemporary Islamic financial contexts. This chapter delves into the concepts of MMP (*Musharakah Mutanaqisa Partnership*), BBA (*Bay bi thaman Ajil*), and IMD (*Ijarah Mawsufah fi al-Dhimmah*). It also delves into the realms of *ijarah* and *musharakah sukuk*, contributing to a comprehensive exploration.
- Chapter 9 is included to provide an introduction to hybrid contracts. Within this chapter, the focus lies on elucidating the hybrid contract’s definition, its alignment with Shari’ah obligations, and concessions permitted by Shari’ah for hybrid contracts, as well as delving into other pertinent aspects to this unique contractual arrangement.

- Finally, Chapter 10 provides a comprehensive conclusion, summarising the key findings, insights, and implications discussed throughout the book. It serves as a valuable reflection on the knowledge gained and encourages further research and exploration in the field of HPSM.

This book is a testament to the growing importance and relevance of HPSM in the Islamic banking and finance industry. It serves as an indispensable resource for academics, researchers, students, practitioners, and anyone seeking a comprehensive understanding of the historical, conceptual, practical, and Shari'ah aspects of HPSM. The insightful analysis, practical insights, and nuanced discussions presented in this book make it an essential addition to the library of anyone interested in the dynamic world of Islamic finance.

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PREFACE II

Islamic finance has gained prominence since the 1970s, becoming a significant presence in the global financial landscape. Although its principles and philosophies are not new, as they were outlined in the Holy Qur'an and the Sunnah of the Prophet Muhammad (pbuh) over 1400 years ago. However, modern Islamic finance has garnered attention and recognition in recent years. This emergence is often associated with the revitalisation of Islam and the desire of Muslims to align all aspects of their lives with Islamic teachings. Today, Islamic finance has made significant strides and achieved remarkable milestones in the financial industry. It has expanded globally, transcending borders and attracting attention beyond Muslim-majority countries. Operating on ethical principles, Islamic finance has introduced responsible and transparent financial practices, fostering fairness and risk-sharing. The industry has showcased innovation by diversifying its product offerings to meet the evolving needs of customers. Furthermore, Islamic finance has played a crucial role in infrastructure development, promoted financial inclusion, and contributed to financial stability through its risk-sharing mechanisms. These achievements have elevated the recognition and acceptance of Islamic finance as an ethical and sustainable alternative in the global financial landscape.

Following its inception, Islamic Banking and Finance (IBF) has introduced various modes of financial contracts in the global financial landscape. These contracts are developed in accordance with Islamic Shari'ah principles to attract customers and compete with conventional

counterparts. In modern times, IBF has demonstrated innovation by creating multi-variant contracts that have been modified from their classical structures to meet the evolving needs of stakeholders. One such example is the Hire Purchase under *Shirkah al-Milk* (HPSM), also known as *al-ijarah muntahiyah bi al-tamlik*, which is implemented by several Islamic financial institutions worldwide, including Islami Bank Bangladesh Limited (IBBL). Hybrid contracts, like HPSM, are a combination of different contractual elements, making banking products more versatile and adaptable. In the case of HPSM, it is an advanced version of a traditional hire-purchase contract, comprising three contracts: *ijarah* (lease), *shirkah* (partnership), and sale. The *shirkah* contract in HPSM has a short-term duration. HPSM is a contemporary method of purchasing practised globally, offering deferred payment schemes or instalments as a hybrid banking product.

In HPSM, the ownership of the asset is jointly held by the bank and the client. The client makes regular instalment payments, while the remaining balance is treated as a mortgage owned by the bank. During this period, the client is authorised to possess and use the goods as long as they fulfil the specified conditions. Upon completion of all instalments, the asset becomes the sole property of the client. However, there are ongoing debates regarding the permissibility of HPSM. These disputes stem from various factors, including differences in determining the fundamental nature of the transaction (whether it is initially considered permissible or prohibited) and potential contradictions with hadiths that discourage certain types of combined contracts. Hadiths prohibit transactions involving the combination of sale and purchase contracts, and merging two contracts into one. These concerns raise questions about the positioning of HPSM products within contemporary Islamic financial institutions, emphasising the need for clarification and investigation.

Customers of a bank, especially when dealing with Islamic banking products, should have access to adequate knowledge and transparent information regarding the specifications, compliance with Shari'ah principles, and overall strategy of the products they engage with. However, there is a notable absence of a comprehensive book solely dedicated to HPSM from a Shari'ah perspective, with only limited scholarly articles available. This lack of comprehensive guidance on HPSM can lead to uncertainty and confusion among stakeholders regarding the product's compliance with Shari'ah principles, which poses a significant concern.

Therefore, there is a need to publish a comprehensive book that focuses on the theoretical and practical application of HPSM from a Shari'ah standpoint. This book aims to provide insights into the general concept of HPSM, including the policies, rules, and sub-contracts involved in its practical implementation by Islamic financial institutions. Additionally, it will comprehensively cover the documentation process and address the Shari'ah issues that may arise in the application of HPSM.

This book is expected to benefit students, policymakers, and practitioners by providing a comprehensive understanding of the application of HPSM in the Islamic finance industry. It aims to equip readers with the knowledge and insights necessary to address and overcome Shari'ah-related challenges associated with HPSM. By delving into the theoretical and practical aspects of HPSM, the book will enable readers to enhance their understanding of this Islamic banking product and explore ways to improve its implementation while ensuring compliance with Shari'ah principles.

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ABBREVIATIONS

AAOIFI	Accounting and Auditing Organization for Islamic Financial Institutions
A/C	Account
B/L	Bad/Loss
BBA	<i>Bay' bithaman 'ajil</i>
BDT	Bangladeshi Taka
BNM	Bank Negara Malaysia (Central Bank of Malaysia)
CIB	Credit Information Bureau
Cr	Credit
Dr	Debit
ERR	Expected Rate of Return
FTV	Finance to Value
HP	Hire Purchase
HPSM	Hire Purchase under <i>Shirkah al-Milk</i>
IBBL	Islami Bank Bangladesh Limited
IBF	Islamic Banking and Finance
IBFI	Islamic Banking and Financial Institutions
IFI	Islamic Financial Institution
IIFA	International Islamic Fiqh Academy
IIFA-OIC	International Islamic Fiqh Academy of Organisation of Islamic Cooperation
IMD	<i>Ijarah Mawsufah fi a- Dimmah</i>
IsDB	Islamic Development Bank
LC	Letter of Credit
MMP	<i>Musharakah Mutanaqisah</i> Partnership
MYR	Malaysian Ringgit

OIC	Organisation of Islamic Cooperation
PLS	Profit-Loss Sharing
RAA	Radia Allahu ‘Anha
SAW	Sallahu Alaihi wa Sallam
SPV	Special Purpose Vehicle
SWT	Subhanahu wa Ta’ala
USD	US Dollar

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Historical Development and Permissibility of HPSM

Abstract The Hire Purchase under *Shirkah al-Milk* (HPSM) in the Islamic banking and finance industry plays a significant role in facilitating financing arrangements. HPSM, which is widely practised by both conventional and Islamic banks, has found particular prominence in several jurisdictions. Despite some procedural and conditional variations, the overall practice of HPSM in both types of institutions demonstrates noteworthy similarities. This financing arrangement is structured as a combination of three distinct contracts: *shirkah*, *ijarah*, and sale. Under the HPSM framework, the bank finance or supplies the required types of equipment or goods on a rental basis. Crucially, the ownership of the leased property or equipment is jointly held by the bank and the client. The transfer of ownership takes place at the final stage of the contract, adhering to the customary practices aligned with Shari’ah principles. This chapter aims to delve into the historical evolution of HPSM, sheds light on its Shari’ah permissibility, and provides insights into the practical implementation of this financing arrangement in the IBF industry.

Keywords Hire purchase · *Shirkah al-Milk* · HPSM · *Musharakah* · *Ijarah* · Sale

Preview

Hire Purchase under *Shirkah al-Milk* (HPSM) plays a significant role within the Islamic banking and finance sector, facilitating essential financing arrangements. Both conventional and Islamic banks widely adopt HPSM, and its influence is particularly evident in multiple jurisdictions. Despite some procedural and conditional differences, the fundamental practice of HPSM exhibits largely similarities between these two types of institutions. This financing model encompasses a unique blend of three key contracts: *shirkah*, *ijarah*, and sale.

In the context of HPSM, financial assistance or essential equipment and goods are extended by the bank on a rental basis. An essential aspect of this arrangement is the shared ownership of the leased assets between the bank and the client. The conclusive transfer of ownership occurs at the contract's final stage, adhering meticulously to established Shari'ah principles and customary practices. The purpose of this chapter is to delve into the historical progression of HPSM, shed light on its adherence to Shari'ah principles, and provide comprehensive insights into the practical execution of this financing structure within the Islamic banking and finance industry.

1.1 DEVELOPMENT HISTORY OF THE HPSM CONTRACT

The term HPSM is also known as “leasing ending with ownership” or in Arabic called “*ijarah muntahiyah bi al-tamlik*”. The application of hire purchase was introduced in England in the nineteenth century, where it was commonly referred to as lease purchase (*al-bay' al-ijarah* or *al-ijar al-tamlikiyyah*) or lease ending with ownership (*ijarah muntahiyah bi al-tamlik*) (Al-Zuhayli, 2003). The origin of this contract dates back to a British musical instruments vendor who sought to facilitate the sale of his musical products to customers by introducing the hire-purchase agreement. Following the introduction of the hire-purchase concept, the demand for the contract has seemed to increase rapidly, and the same has been offered around the world by many companies to sell their various types of products. For instance, “SINGER”, one of the biggest home appliances and electronic products companies, started hire purchase-based sales to attract consumers to their several products (Dusuqi, 1994). Later on, in 1952, in the United States of America, this mode of transaction has widely been accepted with a new term, “leasing”, introduced by a company called “United States Leasing Corporation”. Numerous

companies have since adopted the hire-purchase model, leading to its widespread implementation across various regions in Europe; one of the leading companies among them is the “Mercantile Credit Company”. However, the first European leasing company was established in France in 1962 called “Locafance”. The hire-purchase concept then was quickly acknowledged and gained recognition thereafter and started getting applied in many other parts of the world (Al-Dusri, 2001).

Further, the hire-purchase mode of financing has become widely attractive among those customers who want to own a property but are incapable of paying the full cash price upfront. Abdullah (2005), hence, explains that by opting for a hire-purchase plan, individuals can acquire their desired property by making an initial payment and committing to regular payment or instalment terms over a mutually agreed-upon duration. Essentially, the consumer is given possession of the property in exchange for a promise to pay for it gradually over time. Throughout the payment tenure, the customer is entitled to full ownership and use of the property, devoid of assuming any ownership risks until all instalments are completed. As a result, this form of hire purchase has gained widespread recognition among customers seeking to obtain ownership of assets, especially consumer items.

In contrast, the theory of hire purchase being a combination of multiple contracts in separate sequences was considered uncommon among traditional Muslim scholars since no reliable sources indicated such a contract. Muslim jurists, instead, tended to address hire and purchase as separate concepts and discuss them under distinct titles such as “The Book of Sale” (*Kitab al-Buyu*) and “The Book of Letting” (*al-ijarah*). Notably, in various Islamic jurisprudence (*fiqh*) texts, these two headings were presented sequentially, despite being discussed separately. However, contracts such as hire and purchase are often considered essential in Islamic commercial activities, perhaps due to their close relationship with each other. When categorising different forms of contracts within Islamic financial realms, “the basic contract in many cases and situations are contracts of exchange and contract of the utilisation of usufruct. The former is a contract of sale or *bay*’, which implies the transfer of ownership of a property from one party to another, while the latter is a leasing contract (*ijarah*) which affects the transfer of usufruct of a property from one to another. Both contracts of sale and hire constitute the main commercial activities because all residual contracts are mostly dependent on these two contracts” (Abdullah, 2005).

Hire purchase was introduced by IFI in the 1980s. Currently, this is considered one of the most frequently applied contracts in the IBFIs domain. HP was known by different names around the world, such as, *al-ijarah al-muntahiyah bi al-tamlik*, *al-ijarah bi al-shart al-tamlik*, and *al-ijar al-muntaha bi al-tamlik* (Zakariyyah, 2004), *al-ijarah ma ‘a al-iqtina ‘* (Abu Ghuddah, 1998), *al-ijar alladhi yantahi bi al-tamlik* (Usmani, 1998), *al-ta’jir al-muntaha bi al-tamlik* (Abdullah, 1988), *al-ta’jir al-muntaha bi al-tamalluk*, *al-ta’jir ma ‘a al-mawa ‘idah bi al-tamalluk* (Kuwait Finance House, 2016), *al-ijar al-satir li al-bay’* and *al-ijar al-muqtaran bi al-wa ‘d* (Al-Sanhuri, n.d), hire purchase under *Shirkah al-meelk* (IBBL, 2022). HP has been a potential contract of Islamic banking and finance and has rapidly been recognised in its next decades of application. Abdullah (2005), therefore, brings works of literature where the comprehensive discussion of HP is exhibited; some of those works of literature, for example, are “Component of Islamic Banking by Sadeque in 1982”, “Money and Banking in Islam by Ziauddin Ahmed in 1983”, “Islamic Banking and Finance by Hassan in 1985”, “Leasing: An Islamic Financial Instrument by Alawi in 1986”, “The Experience of Islamic Banks in the Middle East by Al-Tatnimi in 1986”, “Principles of Islamic Banking, *Masraf Faysal Al-Islami*, Islamic Banking Contract by Shirazi in 1988”, and so forth. These writings played considerable roles in promoting the concept of HP in the financial spectrum, especially in the Islamic banking and finance industry, as it has been one of the best fits for the customer to avail their long expected asset, i.e. houses, personal vehicles, etc., based on the Shari’ah rulings. Along with the above works of literature, the HP has been promoted by well-established Islamic financial institutions during that time, including al-Barakah Investment and Development Company, Jedda, Faysal Islamic Bank of Bahrain, Bank Islam Malaysia Berhad, Dar al-Mal al Islami Trust, Geneva, Al Rajihi Banking and Investment Corporation, etc. (Lewis & Algaoud, 2001), and Islami Bank Bangladesh Ltd, Bangladesh.

Malaysia introduced a separate act on hire purchase to regulate the form and contents of hire purchase agreements, the rights and duties of parties to such agreements, and to make provisions for other matters connected therewith and incidental thereto whose number is [act no.24 of 1967] which further revised in 1978 (Act 212 w.e.f 15 November 1978) and amended by the Act A1384 which came into operation on 15 June 2011.