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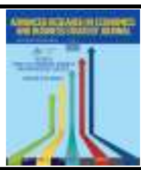

The adoption of Islamic Financing by Algerian Islamic Banks: A Case Study of AL-SALAM BANK ALGERIA

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ABSTRACT

In this paper, we aim to shed light on the reality of Islamic financing modes adopted by one of the existing Islamic banks in Algeria through the case of Al Salaam Bank Algeria. We find that Islamic banks in Algeria adopt various Islamic financing modes; some of them are directed towards the general public (individuals) in the form of consumption and real estate financing modes, while others are directed towards economic actors (enterprises) for financing investment projects and exploitation cycles.

Keywords: Islamic financing modes, Islamic banks, Algeria, Economic actors.

JEL Codes : G21; G23; G29.

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1. INTRODUCTION

Islamic finance has witnessed a wide development, especially in improving the quality of financial services provided and creating new financial products. It has become a better alternative to traditional financing, especially in Islamic countries, due to the failure of the latter to meet the financing needs of these economies as a result of the religious orientation of their populations and the weakness of other financing alternatives (the stock market) for the majority of these countries.

Algeria, like other Islamic countries, is striving to adopt this type of financing by striving to adopt it in its banks, attempting to develop its structures and products, and making it compatible with its economic environment. In this context and through our research, we aim to identify the various Islamic financing modes adopted by al-Salam Bank.

1.1 Problem statement

As mentioned earlier, the adoption of different Islamic financing modes in Algeria leads us to discuss the following problem statement

What are the Islamic financing structures adopted by Algerian Islamic banks?

1.2 Research questions:

- What are the different Islamic financing modes in Islamic economics?
- What kind of Islamic financing structures do the Islamic banks in Algeria offer?

1.3 research objectives:

- Present definitions of different Islamic financing modes.
- Present a set of different Islamic financing modes offered by al Salam Bank in Algeria.

2. THEORETICAL FRAMEWORK

2.1 The Long-term Financing Forms in Islamic Banks

2.1.1 Financing Forms with Mudharabah

The Concept of Mudharabah is defined as: "An agreement between two or more parties, one with his money (the money owner) and the other with his effort, expertise and skill (the partner), in which they share profits and losses together. The profits or earnings are divided between the two parties based on a mutually agreed ratio, but the partner only shares in the profits. In case of a loss, the money owner (the bank) bears the financial loss while the partner (the bank's client) bears the loss of his effort and work, provided he is not neglectful. If the opposite is established, he is obliged to compensate for the loss or pay it back (Sawan, M. H,2001).

Types of Mudharabah is divided into two types (Al-Malqi, A. A, 2000):

- **General Mudharabah**, or unrestricted, is the one in which there is no restriction in the agreement on the partner's authority to act, either in terms of the type, location, or persons with whom he is to transact. He has full freedom to act.
- Private Mudharabah or Restricted: It is the one in which the agreement includes conditions that restrict the partner's freedom to act, such as requiring the money owner

to invest in a certain commodity, sector, or location, or to only transact with a specific person, or other conditions.

2.1.2 Financing Forms Similar to Mudharabah Including cultivation, mugharasa and musakat:

Cultivation (muzara): It is an agricultural investment agreement in which the landowner provides the land and the bank provides the funds for cultivation. The profits are shared between them based on a mutually agreed-upon ratio.

Mugharasa: It is an investment agreement between the bank and the entrepreneur in which the bank provides the funds for a specific project and the entrepreneur manages it. The profits are shared between them based on a mutually agreed-upon ratio.

Musakat: "It is an agreement between the bank and the broker in which the bank provides the funds for a specific business or trade and the broker manages it. The profits are shared between them based on a mutually agreed-upon ratio. (Salahi, S,2010)

Financing through participation (Musharakah)

Concepts of Musharakah: participation of two or more parties to invest money or work together, agreeing on how to divide the profit, while losses are divided according to the participation ratio in the capital. Islamic banks typically invest money as a partner in financing projects, but with minimal involvement in management, leaving control and operation to the client (Nasser, S., 2005).

Types of Musharakah: There are diverse types of musharakah, but the most important and most commonly used in Islamic banks are:

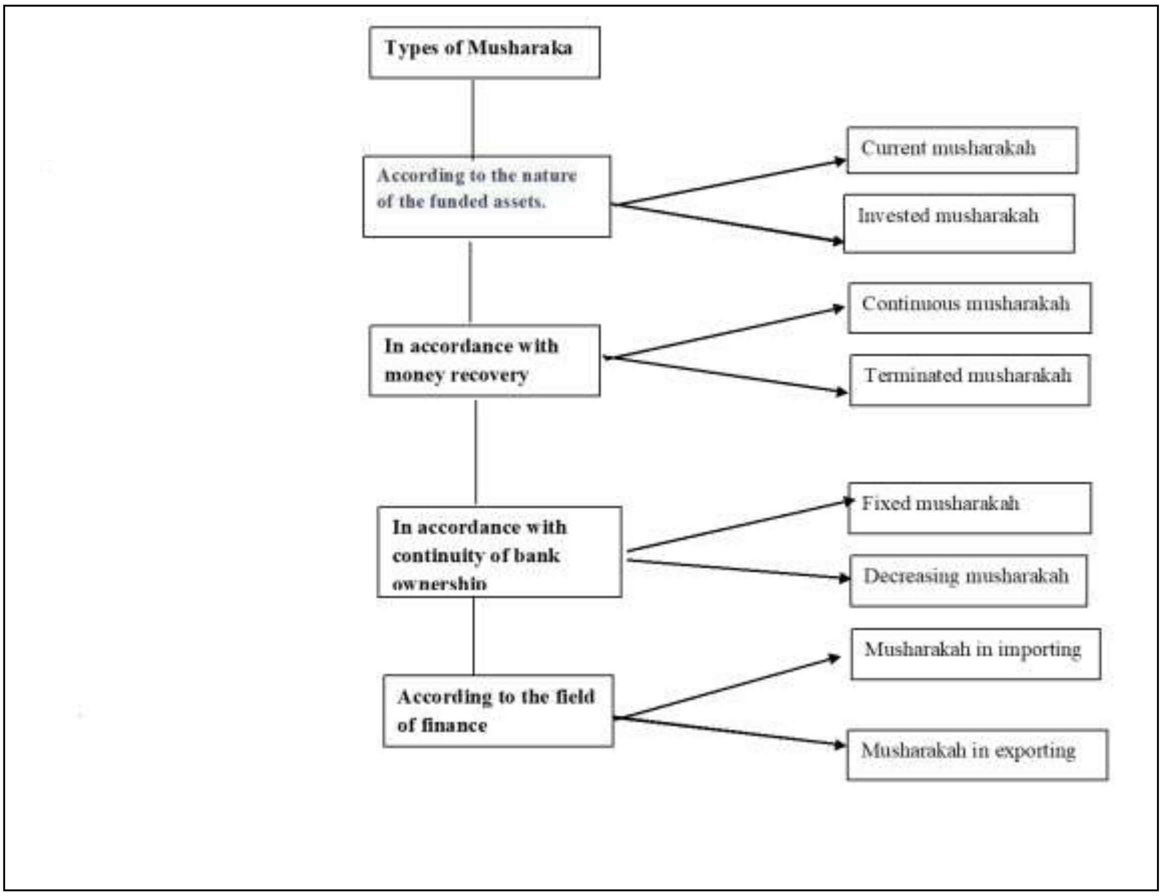
• Fixed or Continuous musharakah: "This means that the Islamic bank participates with one or more persons in a specific commercial project, such as a factory, building, or farm, by financing the shared project. The parties or sides become partners in ownership, management, and supervision of the project. Each partner is entitled to his share of profits from the project according to his share of capital and accounting for profits and losses is done at the end of each fiscal year (Al-Haythi, A. R. J,1998).

The idea behind it being fixed is the continuity of each partner's presence until the end of the project, meaning that each partner retains his share in the project's capital until it is completed and the company is dissolved **(**Al-Malqi, A. A, 2000)

• **Decreasing musharakah ending with ownership:** This is the contribution in which the Islamic bank participates in the capital of a company, factory, or any other commercial project with one or more partners in exchange for a share of the profits and with a promise to relinquish rights by selling its share to these partners, who are also obliged to purchase this share and to take over ownership, either gradually or once, as agreed upon in the conditions (Al-Haythi, A.

R. J,1998). It is also possible to give another classification of types of contributions in terms of their implications for the partners and the relationship between them as figure 1 present

Figure 1: Types of Musharaka (Salahi, S,2001).



2.2.The medium-term Financing Forms in Islamic Banks:

2.2.1 Leasing (Ijarah):

Is defined as a contract of permissible benefit for a specific period, of a known thing or that is described in detail, or of a known service in exchange for a specific consideration (Al-Shammari, S. R,2008).

Types of Ijarah: There are two types:

• **Leasing with ownership:** This is a "lease that ends with the tenant owning the leased asset in exchange for the tenant fulfilling their obligation to pay the rent, which in its essence represents the price of the benefit of the asset, with the remaining portion of the value of the asset, i.e., the original value at the end of the lease period - if there is one - being subject to a separate sale contract, taking various forms either through gift or through sale for a symbolic price(Shta, A. A. A,2003).

• **Operating Leasing:** This is a lease in which the tenant is granted the benefit of a specific asset for a specified period of time in exchange for specified payments, with the intention of the original asset being returned to the Islamic finance institution at the end of the lease period, allowing the institution to lease it again to another party or renew the contract with the same tenant if both parties so desire. This type of lease is characterized by the lessee bearing the capital expenditures for the asset, while the tenant bears the operating expenses (Al-Wadi, M. H., & Samhan, H. M,2008).

2.2.2 Deferred Sale

(Installment Sale) A deferred sale, in the terminology of Islamic jurisprudence, is "a sale in which payment of the price is deferred, i.e., payment of the price is added to a loan... and it is opposed to a cash sale or immediate sale (Abu Ghadah, A.-S., 2003). It is also known as a "deferred price sale or sale by installment. It is a credit sale, as the payment of the sale price is not immediate but instead due at a later date upon completion of the contract, as opposed to a regular sale. (Al-Malqi, A. A., 2000)

2.2.3 Manufacturing financing

Concept of Manufacturing is defined as follows:

• "It is a contract in which something is bought at present to be made by the seller with his own materials, with specific descriptions, and at a determined price (Al Zarga, M. A,1420 AH).

• "It is a contract of sale on credit, with the condition of work being done in a specific manner at a known price (Abdel-Salam, M. M. M. A,2009).

Types of Financing through Manufacturing: There are two types of manufacturing, which are (Belkhire, A,2008):

• Regular Manufacturing (Istisna)**:** This is the type of manufacturing that has been discussed by modern and classical Islamic jurisprudence books, where a contract is made between two parties, the manufacturer and the maker.

Parallel Manufacturing (Istisna Parallel): or Financing: This type of manufacturing was developed by Islamic banks, and it is composed of two separate contracts. The first contract is between the Islamic bank, considered a maker, and another party who needs a specific item. The price here can be deferred. The second contract is between the Islamic bank, considered a manufacturer, and the experts in the industry, who are to manufacture the required item according to the specifications agreed upon in the first contract. The price here can be deferred and is lower than the first price. If the bank receives the item and it becomes in its possession, it will deliver it to the person who requested it, and the bank will make a profit from the difference between the first and second prices, which is the price of the first and second contracts.

3. Short-term financing forms in Islamic banks

3.1. Murabaha financing

Definition of Murabaha: Some scholars define Murabaha as "selling with a marked-up price (Al-Kafrawi, A. M,1998). Others define it as "selling a commodity owned by the seller at the time of negotiation and contract at its historical cost (which includes the cost of acquisition and any other expenses related to the acquisition of the commodity) with the requirement of profit, whether a fixed amount or a percentage of the cost (Abu Mahaymid, M. O. M,2008).

Types of Murabaha in Islamic banks: There are two types of Murabaha in Islamic banks:

• **Simple Murabaha**: This is a contract that only involves a relationship between the bank and the customer, where the bank purchases the commodity for the purpose of trading, without knowing when it will sell it.

• **Compound Murabaha**: The customer, who wants to purchase, makes a request to the bank. The bank purchases the commodity with the description specified by the buyer, based on the promise from the buyer to actually purchase the Murabaha at the agreed-upon rate. The price is paid in installments based on the possibility (Al-Eyadi, A. S,2010).

The following table shows the differences between simple and compound Murabaha

Table 1. The Differences Between Simple and Compound Murabaha (Al-Ajlouni, M. M. ,2008).

Comparison element	**Simple Murabaha**	**Compound Murabaha**
Contract Time	known among early jurists (in fiqh)	emerged with the emergence of Islamic banks
Parties Involved	Two parties	Three parties
Presence of Commodity	Bank buys the commodity without knowing when it will be sold	Bank does not own the commodity, but purchases it based on the customer's request
Promise	Does not include a promise to purchase	Includes a promise to purchase as the bank buys it based on the customer's request
Objective	Trading	Financing
Money receives	Immediately or may be deferred	Deferred/Installments
Risk	Risk Arises from the risks of ownership	Risk Arises from the period the bank holds the commodity and the repayment period

3.2. Sale with Deferment (Salam)

3.2.1 Concept of Sale with Deferment Salam is defined as "the sale of a specified item with a deferred price in salam, where the price is paid immediately while the item is delivered at a later date. This requires that the item being sold be specified, known, and delivered as agreed in the contract (Hindi, M. I., 2000). It can also be defined as "a contract in which two exchangeable items are involved, one present and its value, and the other deferred and the item to be delivered (Ahmed, O. B., 1418 AH).

3.2.2. Types of Sale with Deferment: There are two types of Sale with Deferment in Islamic banks (Bourakeba, C,2011).:

• **Regular Salam:** In this type, the Islamic bank provides immediate financing and obtains the item at a later time.

• **Compensating Salam:** The bank purchases a future item and sells a similar item with the same maturity as the one purchased in the first contract. At maturity, the bank delivers the same item purchased in the first contract to the buyer if the obligations in both separate contracts are fulfilled. If the seller fails to deliver in the first contract, the seller should not fail to deliver in the second contract

3.3. **Interest-Free loan (qard al-hassan)**

3.1 The concept of an interest-Free loan: An interest-free loan is defined as a loan where the borrower returns the loan amount to the lender at the end of the agreed-upon term without paying any interest and without the lender having the right to share in the profits or losses of the trade in which the loan value was invested (Hindi, M. I., 2000). An interest-free loan is "when a lender gives a specific amount of money to a borrower to be returned without any increase, whether it is cash, in kind, or a benefit, and the only purpose of this act is to seek the pleasure of Allah (Qantaji, S. M., & Agha, I. M. O., 2009).

3.2 Interest-free loans in Islamic banks: Islamic banks have moved towards providing interest-free loans to their clients, where the bank offers a specific amount of money to its customers who face emergencies in their businesses so that they are not forced to resort to usury. The bank only requires repayment of the loan amount without charging the customer any fees or interest. Islamic banks also provide interest-free loans for social purposes such as marriage and education, with the aim of building cooperation and mutual assistance among members of the community.

4. CASE STUDY

- The financing and investment forms in Al-Salam Bank in Algeria:

4.1. Definition of Al-Salam Bank: Al-Salam Bank in Algeria is a multi-task and service bank that operates in compliance with Algerian laws and Islamic law in all its transactions. The bank was approved by the Algerian Bank in September 2008, and currently, the Al-Salam Bank in Algeria network consists of 23 branches located throughout the country (www.alsalamalgeria.com)

4.2. Islamic financing products in Al-Salam Bank:

Consumer financing for car and motorcycle purchases: This is a form of financing in which the bank sells cars and motorcycles that it owns and has collected through financing for the dealers. The bank offers dealers the opportunity to purchase available cars and motorcycles from its inventory, which it previously purchased and retained as collateral. This financing form is in the form of installment sales approved by the bank's Sharia Authority, with a repayment period ranging from 12 months to 60 months. This form benefits anyone with a stable and regular monthly income of more than 40,000 Algerian dinars, with a monthly installment that does not exceed 30% of the monthly income (www.alsalamalgeria.com).

Real estate financing for building or owning a home: This is a financing form that allows the acquisition of a new home from a real estate developer, with financing worth up to 20 million Algerian dinars for a repayment period ranging from 5 years to 25 years, through the form of rental (ijarah) financing with ownership. This financing form is based on the principle that the bank finances the construction of the house and the customer pays rental fees until the house is fully paid for and owned by the customer (www.alsalamalgeria.com).

Home renovation financing: A financing option that allows individuals to renovate their home with financing that can cover up to 100% of the cost of the work The maximum amount for this financing is 5 million Algerian dinars over a repayment period ranging from 2 years to 7 years, and this financing is done through the Istisna and Istisna parallel formulas for buildings (www.alsalamalgeria.com).

Professional equipment or transportation financing: This financing option enables the purchase of new professional equipment or transportation through either the Murabaha financing formula for the promising buyer or the lease-to-own formula (www.alsalamalgeria.com).

Engineering and civil works financing: This financing option is intended for those interested in carrying out expansion work, building a warehouse, preparing vacant spaces to add a new production line, or other similar projects. The amount of financing can reach up to 80% of the needs specified in the financing application, with a repayment period not exceeding 5 years. This financing is done through one of the following formulas: Murabaha for the promising buyer, Istisna and Istisna parallel, or the decreasing participation lease-to-own formula (www.alsalamalgeria.com)

Exploitation financing: This financing option is intended for several categories of economic operators, including industrial enterprise owners who need to purchase raw materials, people engaged in seasonal activities, and those interested in import or export operations. This financing is done through one of the following forms: short-term Murabaha, Salam, or participation (www.alsalamalgeria.com).

Real estate financing: This financing is intended for individuals who wish to expand their current activity and require a piece of land for industrial or commercial use or wish to build on that land. This financing is done through one of the following two Forms: the lease described in the debt or Istisna and Istisna Parallel (www.alsalamalgeria.com).

Lease (ijarah) financing Al Salam Ijarah is a form of leasing financing for professional equipment use, with a unilateral promise to sell at the end of the contract at a price agreed upon of 1 Algerian dinar on behalf of the tenant. The equipment and supplier can be freely chosen by the customer, and the financing period is from 3 to 5 years. This financing is carried out in one of the two approved formats by the bank's Shariah committee: a financial lease (Lease-to-Own) or an operational lease (www.alsalamalgeria.com).

CONCLUSION

In this research, we studied the most important financial products used by Islamic banks in general and Algerian Islamic banks in particular. Our study led to several conclusions, including:

- Islamic finance is currently a better alternative to conventional finance due to the variety of financial products and funding mechanisms that cater to the needs of individuals and organizations while respecting their religious principles.
- Islamic banks' financing products can be divided into three categories based on the duration of financing: long-term financing, which includes profit and loss sharing and partnership financing; medium-term financing, which includes rental (ijarah) financing, deferred sales financing and manufacturing financing; and short-term financing, which includes profit and loss financing and deferred payment financing.
- Algerian Islamic banks adopt several financing mechanisms that comply with Islamic law, including financing products for individuals in the form of consumer and real estate financing, as well as financing for economic players for investment projects and asset exploitation cycles.

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