

***Istiṣnā'* in Islamic Banking: Concept and Application**

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Abstrak

Istiṣnā' ialah akad tempahan sesuatu aset secara pertukangan yang dimulakan dengan tempahan atau pesanan dibuat oleh pembeli dan yang menerima tempahan ialah penjual atau penerima tempahan untuk membuat sesuatu barang yang dikehendakinya supaya disiapkan dalam masa tertentu dengan harga dan bayaran yang ditetapkan. Penulisan ini menjelaskan konsep *istiṣnā'* dan peranannya sebagai salah satu instrumen penting dalam pembiayaan di institusi-institusi perbankan dan kewangan Islam yang menggantikan bunga dalam sistem perbankan dan kewangan konvensional.

Introduction

This paper will analytically explain the theory of the contract of *istiṣnā'* and its practical application in Islamic banking and financial institutions operations. The topics to be discussed, among others, are the concept and definition of *istiṣnā'*, differences between *salam* sale and *istiṣnā'*, legitimacy of *istiṣnā'*, the binding effect of *istiṣnā'* contract, conditions for the legality of *istiṣnā'*, liquidated damages and penalties in *istiṣnā'*, termination of the contract of *istiṣnā'*, the modes of application of *istiṣnā'* in modern banking and financial institutions' transactions.

***Istiṣnā'* and its Concept and Definition**

The word *istiṣnā'* is derived from the word *ṣana'a* which literally means "making, manufacturing or constructing something." According to Ibn Manzūr, *istiṣnā'* occurs when someone invited, induced or caused another to make the thing.¹ Al-Fayruzabadī says that *istiṣnā'* occurs when someone asked for something to be made for him.² The word *istiṣnā'* has also been used in the al-Qur'ān and al-Ḥadīth. For example, Allah SWT says, "The work of Allah who perfected all things."³ In the Ḥadīth, it is reported that the prophet Muḥammad SAW had ordered someone to make a ring. He ordered that it should be made for him.

Legally, al-Kāsānī, a Ḥanafī jurist defines *istiṣnā'* as "when one orders a craftsman to prepare a piece of furniture for a determined price, to be delivered later or one may engaged a cobbler to make a pair of shoes for a fixed price," or "a contract on a commodity on liability with the provision of work" or "to order a manufacturer to produce a specific commodity in a specific way".⁴ Al-Samarqandī, also defines it as a contract with a manufacturer to make something.⁵ The *Majallah al-Aḥkām al-'Adliyyah* defines *istiṣnā'* as "to make a contract with a skilled person to make something." The person who makes it is called *sani'* and the thing made *maṣnū'*, and the person who causes it to be made *muṣṭāni'*.⁶ Muṣṭāfa Aḥmad al-Zarqā' defines *istiṣnā'* as a contract of selling a manufacturable thing with an undertaking by the seller to present it manufactured from his own material with specified descriptions and at a determined price.⁷ From the above discussions, it could be said that *istiṣnā'* is the giving of an order to a labourer or artisan to make a definite article with agreement to pay a definite price for that article when made.⁸ Or in other word it is a contract ('*aqd*') made with a manufacturer pursuant to which the manufacturer agrees to produce a specific thing for a purchaser on certain agreed-upon specifications at a determined price and for a fixed date of delivery. This undertaking of production includes any process of manufacturing, construction, assembling or packaging.

Differences Between *Salam* Sale and *Istiṣnā'*⁹

Salam sale (*bay' al-salam*), also known as *bay' al-salaf'* or *bay' al-mafalis* is a sale in which advance payment is made to the seller for deferred supply of goods. The future date must be set at the time of the contract.¹⁰ Despite the fact that *istiṣnā'* and *salam* have some points of similarities such as the non-existence of the subject-matter (*ma'qūd 'alayh*) or the future delivery, there are some points of differences as follows:

1. The subject-matter in the contract of *istiṣnā'* is always something that

needs manufacturing. Therefore, it cannot be used for agricultural products, while *salam* is possible in anything whose descriptive conditions can be fulfilled. Yet, the scope of this point of difference between *salam* and *istiṣnā'* might become much wider, nowadays, in favour of *istiṣnā'* than it was before due to the explosive industrialization and manufacturing. Yet this is another form of the flexibility of *Shari'ah*, which is suitable to the changes of time and places. Therefore, there is no ground for the reservation raised by some scholars¹¹ as to what contract financing the manufacture of fungible (generic) good would be? Is it *istiṣnā'* or *salam*? Yet, as it is mentioned above, any transaction that involves manufacture can be concluded according to *istiṣnā'* contract.

2. It is necessary in *salam* contract that the price is paid in advance at the time of making the contract, while in *istiṣnā'* it can be prompt, deferred or paid in installments.¹²
3. The classical jurists have also cited among the differences that the contract of *salam* is binding while the contract of *istiṣnā'* is not. However, this question will be discussed later in line with the modern approach that the contract of *istiṣnā'* is binding from the beginning.

Legitimacy of *Istiṣnā'*

Majority of the Muslim jurists maintain that the legality of *istiṣnā'* transaction is on the *salam* sale and on the ground of custom (*'urf*) which has prevailed from the time of the Prophet SAW. According to Ḥanafī jurists *istiṣnā'* is legalized by *istiḥsān* in the sense that in *istiṣnā'*, the subject-matter of the contract is a thing which is not in existence at the time of conclusion of a contract. In this regard, al-Kāsānī says, "Concerning the legality of *istiṣnā'*, in principles it would not be allowed on the basis of analogy (*qiyās*) because it is a sale of what we do not have nor on the basis of *salam* and the Prophet had prohibited the sale of what we do not have and it is allowed on the basis of *istiḥsān* because people are unanimous about its need. They have used it through the ages and the Prophet has said, "My Community shall never agree on an error"¹³ and "What is good for Muslims is good in the sight of Allah."¹⁴

On the other hand, Ṣiddīq al-Darīr opines that *istiṣnā'* is based on *qiyās* and not against it as it is claimed by the Ḥanafīs. He argues in this regard that *istiḥsān* is an obvious contract where the subject-matter does not exist and it is declared to be illegal according to the majority of fuqaha' because it is against *qiyās* and it is allowed under the basis of *istiḥsān* by the Ḥanafīs due to the need of the people for such a contract. But he believes that even though the subject-matter in this contract

does not exist, its availability is certain, and there is no risk (*gharar*) especially in the opinion that *istiṣnā'* is a binding contract. Then it is a legal contract, and any contract free from excessive risk (*gharar*) is a contract in accordance with *qiyās*.¹⁵

The Binding Effect of *Istiṣnā'*¹⁶

The Ḥanafī jurists generally divide the binding effect of this kind of contract into three stages. Their views are mainly based on their position about the legal basis of this contract. According to them, since it is in principle against *qiyās*, and only allowed under *istiḥṣān* due to the people's needs, therefore, the question of its obligation must remain under the general principle, in line with *qiyās*.

At the first stage, where the work of manufacturing has not yet started, the Ḥanafī jurists are unanimous that the contract is not binding (*'aqd ghayr lāzim*) upon either of the parties and the manufacturer may refrain from making the commodity. On the other hand, both contracting parties have the right of revocation. In this case, al-Kāsānī says, "There is no dispute that *istiṣnā'* is not binding contract unless the work starts, and anyone of the contracting parties has an option to revoke it because in principle it should not be allowed, therefore, its obligation should remain in line with the general principle."¹⁷

At the second stage, the manufacturer may finish making the needed goods, but the purchaser has not seen the manufactured object yet. The manufacturer still has the right even to sell the commodity to a third party. Al-Kāsānī argues that the fulfillment of the obligation here is not restricted only to a specified thing but it is something in the *dhimmah* (responsibility) which can be fulfilled by any similar commodity.

The third stage is when the required goods have been manufactured and presented to the purchaser. In this case, Muslim jurists have different opinions whether the purchaser has the right to reject the commodity or not. Al-Imām Abū Ḥanīfah is of the opinion that the purchaser can exercise his option of inspection (*khiyār al-ru'yah*) after seeing the goods, because *istiṣnā'* is a sale and if somebody purchases a thing which he has not seen, he has the option to cancel the sale after seeing it. The same principle is also applicable to *istiṣnā'*. However, Abū Yūsuf, a disciple of Abū Ḥanīfah, opines that if the commodity was in conformity to the inspections agreed upon between the parties at the time of the contract, the purchaser is bound to accept the goods and he cannot exercise the option of inspection (*khiyār al-ru'yah*).¹⁸

However, it is reported in *al-Muḥīṭ al-Burhāni* that Abū Yūsuf went back on his opinion and considered the contract of *istiṣnā'* as binding from the first stage

whereby no one has the right to revoke the contract on reason, otherwise, the manufacturer will be harmed and it is possible that he will not find anyone who will buy the goods from him in time or he may not get a similar price as agreed upon with the first purchaser. Moreover, the manufacturer has undertaken to do the job, then he should be obliged to complete it.¹⁹

Finally, influenced by Abū Yūsuf's new opinion and the change of circumstances in the new and modern transactions, *Majallah al-Aḥkām al-'Adliyyah* considers the contract of *istiṣnā'* as binding from the beginning. "After *istiṣnā'* is concluded by an agreement, the parties cannot go back on the bargain. But if the thing does not agree with the description, the person who gives the order has an option".²⁰ It is clear from the above mentioned article of *Majallah* that the contract is binding from the beginning unless the recommended goods do not fulfil the prescriptions in the contract.

In addition, the opinion of contemporary Muslim jurists and economists are in line with the *Majallah* provision. Furthermore, the practice of the Islamic banks and financial institutions are also based on this opinion. Also Prof. Dr. Wahbah al-Zuhayli says in the connection, "If we have to evaluate the opinion endorsed by the *Majallah*, we can deduce that it is correct and sound opinion to prevent dispute and misunderstanding between the parties involved in the contract as well as being in line with the *Shari'ah* principle that all contracts are generally binding, particularly in modern circumstances where contracts are concluded for the manufacturing of important and expensive things like ships, aircraft and so on. Therefore, it is inconceivable that the contract of *istiṣnā'* will not be binding."²¹

Conditions for the Legality of *Istiṣnā'*

These conditions are divided into general conditions and specific conditions. In the case of general conditions, the *istiṣnā'* sale must fulfil the requirement of a valid contract as discussed by the jurists, i.e. the capacity of the contracting parties, offer and acceptance, and the subject-matter should be a valuable thing. In addition to these general conditions, there are some specific conditions for the contract of *istiṣnā'* to be legal, as follows:

1. The object must be precisely determined both in its essence and quality. In other words, it is a condition in *istiṣnā'* contract to state in the clear type, quality, quantity and all the specifications required because it is a condition that the sold commodity must be known by the parties involved to avoid ignorance which may lead to dispute later on.²²
2. The recommended manufactured goods should be things that people customarily deal with in the field of manufacture. Otherwise, the contract of

istiṣnā' will be invalid. In this regard, Ibn 'Ābidīn, a Ḥanafī Jurist, is of the opinion that it is not permissible to practise *istiṣnā'* in what is not familiar among people under this contract such as the manufacture of cloth.²³ However, the example of cloth manufacture prohibited by the early Ḥanafīs was undoubtedly different from the modern practice, as nowadays it has become very familiar.²⁴ Perhaps what was said by the earlier jurist was just an example on reason the types of manufacture differ from age to age and for this reason the *Majallah al-Aḥkām al-'Adliyyah* cites new permissible things stating that: "or if there is a bargain with a ship-carpenter to make a ship or boat and its length, breadth, quality and things required are explained, the *istiṣnā'* becomes a complete contract".²⁵

3. It is a condition that the time of delivery is specified whether it is short or long so as to avoid ignorance, which might lead to conflict between the two parties. Nevertheless, this is not the position in Abū Ḥanīfah's view where he says that the time of delivery must not be stipulated in the contract of *istiṣnā'*, otherwise the contract will be a contract of *salam* rather than *istiṣnā'*.²⁶ However, the two disciples of Abū Ḥanīfah, namely, Abū Yūsuf and al-Shaybānī hold that it is not a condition to stipulate a time of delivery. If the time of delivery stipulated, the contract would still be a contract of *istiṣnā'* and would not be transformed to a contract of *salam*. They argue that this is customarily practiced and people normally stipulate a time of delivery in the contract of *istiṣnā'*. As *istiṣnā'* itself is allowed, because of the need and practice of the people, the stipulation of time for delivery would be part of the practice and it would not transformed *istiṣnā'* into a *salam* contract.²⁷ It is worth to mention here that the opinion of Abū Yūsuf and Muḥammad b. al-Ḥasan al-Shaybānī is preferable to the view of Abū Ḥanīfah and in line with the practice of the modern transaction which makes the stipulation of a time of delivery a necessary requirement. Moreover, in our time, the era of heavy industry and technology, when the manufacturing of some commodities may take years to complete, it is reasonable and rational to make the stipulation of delivery compulsory for the stability of transactions.
4. The materials should be supplied by makers, if they are supplied by the buyer, the contract is regarded as *al-Ijārah* and not *istiṣnā'*.
5. It is a condition that the place of delivery is stated if the commodity needs loading or transportation expenses.

Liquidated Damages and Penalties in *Istiṣnā'*

Al-Majma' al-Fiqh al-Islāmī in its resolution No. 66/3/7, 1992 concerning the con-

tract of *istiṣnā'* adopted that it is lawful that a contract of *istisna'* includes a clause about liquidated damages and penalties.²⁸ By liquidated damages and penalties it is meant a prior agreement between the parties to a contract about what amount shall be payable in the event of one party failing to complete or delaying his contractual obligation.

The basic source of legality of this concept lies in what is reported by al-Bukhārī, narrated by Ibn Sīrīn that “a man said to a hirer of animals prepare your traveling animals and if I do not go with you on such and such day. I shall pay you a hundred *dirhams*, but he did not go on that day. Shurayḥ said, “If anyone imposes a condition on himself of his own free will without being under duress, he has to abide by it”. There are also another Ḥadīth which is narrated by Ayyūb from Ibn Sīrīn that, “A man sold food, and the buyer told the seller that if he did not come to him on Wednesday, then his deal would be cancelled, and he did not turn up on that day”. Shurayḥ said to the buyer, “You have broken your promise” and gave the verdict against him.” Shurayḥ in both cases had given the verdict against the person who makes the condition against himself without duress.²⁹

Another Ḥadīth of the Prophet SAW, “Muslims are bound by their stipulations”. It is evident that the clause of liquidated damages is in the interest of the contract and it is acatalyst and an inducement for its fulfillment. Even though this topic did not receive ample attention from the classical fiqh literatures, but during the later part of Ottoman Empire the topic has been revived. The Islamic State became very large, foreign trade have developed with Europe, the method of internal commerce have expanded and the scope of *istiṣnā'* widened especially through the recommendation of manufactured commodities from foreign industries. In this connection, people need for such conditions to secure their economic interest.³⁰

Termination of the *Istiṣnā'* Contract³¹

As one of the nominated contracts in Islamic Commercial Law, *istiṣnā'* is terminated by the normal ways of termination of contracts, namely when manufacturer makes the commodity and presents it to the purchaser and receives the payment. Furthermore, the jurists are of the opinion that the contract of *istiṣnā'* can be terminated by the death of one of the contracting parties. This rule is based on the analogy of *istiṣnā'* to *Ijārah* in the Ḥanafī School due to the similarity between *ijārah* and *istiṣnā'*.³² However, due to the extensive application of the contract of *istiṣnā'* nowadays' transactions, the manufacturer is not a single person. It is rather a large corporation. Therefore, it is not applicable the contract will be ended by the death of one or two persons because this one or the other has signed the contract on behalf of the corporation. Thus, it must be differentiated between a contract of *istiṣnā'*

between individuals and one which involves corporations and companies. In the former case, it will be terminated by the death of one of the contracting parties, but in the second case, it will continue as long as the corporation or company is in existence and will not be affected by the death of its members.

Modes of Application of *Istiṣnā'*

The Islamic Bank can use *istiṣnā'* as a buyer by contracting with industrial and manufacturing institutions, or with any artisan to manufacture or construct for it some commodities with specific description. Then it can sell them after receipt, for cash, installed or deferred payment through *murābahah* or *bay' bi-thaman Ajil*. Thus the Islamic Bank will be involved in direct investment. However, this method is subject to the extent of the position of the Islamic Bank where in practice some Islamic Banks are not allowed to be involved directly in commerce.

It is also permissible for the Islamic Bank to enter *istiṣnā'* contract in the capacity of seller to those who demand the purchase of a particular commodity. Then it will draw a parallel *istiṣnā'* contract in the capacity of a buyer with another party to make or manufacture the commodity agreed upon in the first contract. This method is most suitable to the practice of Islamic Banks nowadays.

The Practical Steps of the *Istiṣnā'* Sale and The Parallel *Istiṣnā'*³³

1. *Istiṣnā'* Sale Contract.

- a) The buyer expresses his desire to buy a commodity and forwards the *istiṣnā'* request to the bank with a specific price. The modes of payment whether cash or deferred shall be subject to agreement. The bank usually calculates what it will actually pay in the parallel *istiṣnā'* contract plus the profit it deems reasonable.
- b) The bank puts itself under obligation to manufacture the commodity and to deliver it in a specific period subject to agreement. The bank takes into consideration that the due date is the same as of the due date its receipt of the commodity in the parallel contract.

2. The Parallel *Istiṣnā'* Contract

- a) The bank expresses its desire to order the manufactured commodity, which it has undertaken to manufacture in the first contract (with the same specifications as in the first contract). It agrees with the manufacturer on the price and the date of delivery.
- b) The seller puts himself under obligation to manufacture the specific com-

modity and to its delivery on the due date agreed upon in the contract.

Delivery and Receipt of the Commodity

- a) The seller delivers the manufactured commodity to the bank directly or to any party in place decided by the bank in the contract.
- b) The bank delivers the manufactured commodity directly by itself to the purchaser or authorizes any party to deliver the commodity to the purchaser. The buyer has the right to make sure that the commodity satisfies the specifications he has mentioned in the contract. Each party is only responsible to the party it contracted with.

The deal in the parallel *istiṣnā'* involves three parties, firstly, the customer (the buyer); secondly, the Islamic bank (the seller), and finally, the original manufacturer. Furthermore, sometimes, especially, in building construction, it may involve four parties; the customer, the Islamic bank (contractor), the sub-contractor and a consultant or an expert to supervise the execution of the construction contract.

Conclusion

The above discussion can be safely concluded that *istiṣnā'* contract in Islamic Commercial Laws is one of the important methods of investment in Islamic banking and can play an important role in economic development. It encourages the demand for manufacturing goods, financing economic activities, contributing to the stabilization of prices of manufactured goods, promoting industrial and technological advancement and making use of the available possibilities of the economy.

End Notes

1. Ibn Manzūr, *Lisān al-'Arab*, Beirut: Dār al-Ṣadīr, 1955, Vol. 8, pp. 208 -212.
2. Al-Fayruzabādī, Majd al-Dīn Muḥammad b. Ya'qūb, *al-Qāmūs al-Muḥīt*, Beirut: Muassasah al-Risālah, 1983, p. 54. See also E. W. Lane, *Arabic-English Lexicon*, Lahore, 1982, Vol. 4, p. 1733.
3. Surah al-Naml (27): 88.
4. Al-Kāsānī, 'Alā' al-Dīn Abū Bakr b. Mas'ūd (d. 587/1191), *Kitāb Badā'i' al-Ṣanā'i' fī Tartīb al-Sharā'i'*, 1984, Cairo, Vol. 6, p. 2677.
5. 'Alā' al-Dīn al-Samarqandī, *Tuḥfah al-Fuqahā'*, 1983, Damascus, Vol. 2, p. 538.
6. *Majallah al-Aḥkām al-'Adliyyah*, Artikel 124.
7. *'Aqd al-Istiṣnā' wa Madā Ahammiyyatihā fī al-Istithmārat al-Islāmiyyah al-Mu'āṣirah*, Jeddah: Islamic Development Bank, 1995, p. 21.

8. See Ibn 'Ābidīn, Muḥammad Amin b. 'Umar 9d. 1306/1888), *Hāshiyat Radd al-Mukhtār 'alā Durr al-Mukhtār*, Pakistan: Maktabah Majīdiyyah, Rashidiyyah, 1399, Vol. 4, p. 236.
9. Muḥammad al-Bashīr Muḥammad al-Amīne, *Istiṣnā' (Manufacturing Contract) In Islamic Banking and Finance: Law and Practice*, Kuala Lumpur, 2001, pp. 6-10.
10. Wabbah al-Zuhaylī, *al-Fiqh al-Islāmī wa Adillatuh*, Damascus, 1989, Vol. 4, pp. 598-599.
11. See Frank E. Vogel and Samuel I. Hayes, *Islamic Law and Finance, Religion, Risk and Return*, The Hague: Kluwer International, 1998, pp. 147-148.
12. See, for example, Wabbah al-Zuhaylī, *op.cit.*, Vol. 4, pp. 634-635.
13. Ibn Mājah, *Sunan Ibn Mājah*, 'Kitāb al-Fitan', Ḥadīth no. 3950.
14. This is not a genuine Ḥadīth. It is just the saying of Ibn Mas'ūd, reported by Aḥmad, al-Bazzār and al-Ṭabarī. See Aḥmad Shākīr's comment on *Musnad al-Imām Aḥmad*, Vol. 5, p. 211, Ḥadīth No. 3600.
15. Al-Darīr, Ṣiddīq Muḥammad al-Amīn, *al-Gharar wa Atharuh fī al-'Uqūd*, Jeddah, 1991, p. 457.
16. Muḥammad al-Bashīr Muḥammad al-Amīne, *op.cit.*, pp. 30 – 34.
17. Al-Kāsānī, *op.cit.*, Vol. 5, p. 2680.
18. Ibn al-Humām, Kamāl al-Dīn Muḥammad b. 'Abd al-Wāhid al-Siwāsī (d. 861/1457), *Sharḥ Faḥ al-Qadīr*, Pakistan, 1985, Vol. 8, p. 116; See also al-Kāsānī, *op.cit.*, Vol. 6, p. 2680.
19. Quoted by Muḥammad al-Bashīr, *op.cit.*, pp. 32-33.
20. *Majallah al-Aḥkām al-'Adliyyah*, Art. 392.
21. Al-Zuhaylī, *op.cit.*, Vol. 4, p. 634.
22. Al-Kāsānī, *op.cit.*, Vol. 6, p. 2677; Muḥammad al-Bashīr, *op.cit.*, pp. 48-49.
23. Ibn 'Ābidīn, *op.cit.*, Vol. 5, p. 223; See also Ibn al-Humām, *op.cit.*, Vol. 5, p. 355.
24. Kāsīb 'Abd al-Karīm al-Badrān, *'Aqd al-Istiṣnā': Dirāsah Muqāranah*, Iskandariyah: Dār al-Da'wah, 1980, p. 166.
25. *Majallah al-Aḥkām al-'Adliyyah*, Art. 388.
26. Al-Kāsānī, *op.cit.*, Vol. 6, p. 2678.
27. Ibn 'Ābidīn, *op.cit.*, Vol. 4, p. 213.
28. Quoted by Muḥammad al-Bashīr, *op.cit.*, pp. 54-55.
29. Al-Bukhārī, *Ṣaḥīḥ al-Bukhārī*, "Book of Conditions", Vol. 5, p. 354.
30. Al-Zarqā', *Al-Madkhal al-Fiqhī al-'Ām*, Damascus: Dār al-Fikr, 1968, Vol. 3, p. 386.
31. Muḥammad al-Bashīr, *op.cit.*, pp. 80-82.
32. Al-Kāsānī, *op.cit.*, Vol. 6, p. 2672; Ibn al-Humām, *op.cit.*, Vol. 5, p. 354.
33. Muḥammad al-Bashīr, *op.cit.*, pp. 89-94.