

## Islamic Working Capital Finance of Orio Pharma: Combination of *Ijārah* and *Mushārah*

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### Keywords

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*Mushārah*

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**Abstract.** This case is the overview of banking services of Al-Zamin Investment Bank to its client, Orio Pharma. It highlights the efficiency and effectiveness of bank in meeting the specific and unique requirements of its customers. The requirements of Orio Pharma included import of raw material from China and production of final goods. Al-Zamin bank offered them *Mushārah* and Leasing (*ijārah*) against mortgage of single security to meet these requirements. Along with Alzamin Investment Bank, the process involved Sustainable Development Authority (SDA), Soneri Bank, lawyer, Regional Coordinator, Regional In-Charge, supplier in China, and Shipment Company. This study discusses the different steps and role of participants in the process of fulfilling customer requirements.

**KAUJIE Classification:** K1, K13

**JEL Classification:** G23

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### INTRODUCTION

Working Capital Management (WCM) is a term that best describes actions or decisions undertaken by management that positively affect working capital of an organization (Kaur, 2010). WCM is an essential component because it positively affects organization's wealth in the form of profitability and liquidity (Naser, Nuseith, & Al Hadeya, 2013; Raheman & Nasr, 2007). There are three main strategies in managing working capital (Setiyaningsih, Rustiana, Jamilah, & Parewangi, 2014):

**Conservative Strategy:** This strategy showcases management's ability to fulfill working capital through long term sources of funds, instead of short term.

- **Moderate Strategy:** With this strategy, organization finances each asset in same time period along with its asset's turnover period.

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- **Aggressive Strategy:** It is a more secured strategy in which, among others, an organization settles for a bigger security margin; however, profitability level goes down.

WCM varies among manufacturing and banking sector, because banks provide services and not products. This case is about Orio Pharma (this is an alternative name due to copy rights) which is a pharmaceutical company in Pakistan. The contract commenced when Orio Pharma approached Alzamin Investment Bank for funds for the operation of Orio Pharma; the customer enquired if the bank had Islamic banking products. Alzamin bank provided them with *Mushārah* and *ijārah* against mortgage of their factory worth 30 million. Since commercial banks do not issue Letter of Credit (LC), therefore, Alzamin bank made arrangements with Soneri bank to meet the requirements of the customer.

This was a second type of *Mushārah* arrangement, in which the share of the bank was fixed whereas the rest of the profit was allocated to Orio Pharma. The bank believed that this was more of a *murābahah* than the *Mushārah* transaction, because in this case the process was such that the supplier made supplies and the bank made payment to the client. Since the bank had no *murābahah* model, *Mushārah* was adopted to fulfill the need of customer.

### Objectives of the Case Article

- Understanding of the type of services provided by Al Zamin Investment Bank
- It highlights the steps involved in the whole process
- Understanding customer's requirements of banking services by Al Zamin Bank
- It demonstrates the efficiency and effectiveness of Al Zamin bank in fulfilling customer requirements. As Al Zamin bank is a commercial bank which cannot provide customers with Letter of Credit (LC) so they involved Soneri bank in the process to meet customer objectives and expectations from the bank

### Documentation Involved

As the entire registered company was being mortgaged, so they were asked to submit the CNICs of directors, the articles and Memorandum of Association, the form 29 and form A, and NTN certificate. As the client was dealing in health sector, so they were also asked to provide certificate or NOC from Ministry of Health to further beef up their legal viability. Secondly, they were asked to provide approval for each product they intended to produce. Moreover, along with these documents they also provided a copy of the drawings and design of the firm, duly approved by the Ministry of Health. The map included information related to room size, ventilation and number of personnel involved in each segment. Their record showed that it was after thorough examination of the physical facilities and the generics of each product that the ministry finally got satisfied and issued license for operation. Along with list of products and all of its ingredients, the bank also obtained documents such as list of suppliers, bank statement, etc. to assess their financial worth. Moreover, as they agreed to mortgage the factory, the bank asked for evaluation of the factory and all other documents submitted to the bank, from an authorized evaluating authority.

The cheques were drawn when the customer submitted information of the material needed. The Bank did not pay advance cheques, rather sanctioned only a limited amount. The amount was not transferred till shipment documents, the Pro-forma invoices, and payment sheet from Soneri Bank (L/C opening bank) were received. These documents enabled the bank to assess what amount would be paid.

## ROLE OF PARTICIPANTS

### **Al Zamin Bank**

The concerned authority of Orio Pharma explained that they had two factories and desired to establish another one with Islamic mode of financing. The bank responded that a lease-back could be offered, which implies that the bank would purchase the machinery and would lease that on rent; so that the applicant would be left with sufficient finances for operation. Secondly, a limit through *Mushārah* was offered which could help clearing the Letter of Credits (LCs). Orio Pharma agreed to the terms of both instruments. The proprietary interest of the bank in the transaction was more similar to *mudārah*, accompanied by the rest of the process as *Mushārah*. In view of the agreed maximum value of the LCs to not exceed 50,000 rupees and the import bill not exceeding 5 million rupees, the bank decided a predetermined limit so that the inconvenience involved in assessment of each transaction separately is avoided. In return for the mortgage of the factory worth 30 million rupees, the bank provided an offer of 7 million rupees *ijārah* and 5 million rupees *Mushārah* which helped merge the two needs of the customer against the mortgage of a single security. In *Mushārah*, a limit of one year was offered. During this period, Orio Pharma had to clear the LC. Moreover, leasing facility was also provided.

### **Sustainable Development Authority (SDA)**

As the factory was located at the industrial estate where all the plots were on lease form SDA, therefore, the bank asked them to provide lease deed of the factory with the SDA along with sale deed clearly mentioning the authority of the factory owner to sell the factory for the leased period to another party. Other documents included allotment letter from SDA, NOC, and non-incumbent certificate issued by sub registrar of mortgages that showed the detail of mortgages of property. NOC is issued when the property is free from earlier mortgage, otherwise it is declined. Furthermore, bank asked them for NOC by SDA in case of *ijārah* and *Mushārah* with Al Zamin Investment Bank. As SDA issue only one NOC at a time, so they issued NOC in favor of bank. For other financiers, they would evaluate them under their conditions. If the client wants to mortgage the property with any other financier, then the owner must first cancel this mortgage on the letterhead subject to the approval of the Al Zamin bank to exclude it from other NOC by SDA. Orio Pharma submitted all these documents, which were reduced to a list and kept in record.

### **Regional Coordinator**

Office of the Regional Coordinator is responsible for verification and assessment of documents, in case the documents are complete. Moreover, there is no exhaustive list of

documents; in fact it varies from case to case. For example, the documentation formalities of one of the bank customer seeking *Mushārah* in licensed prey weapons were different from Orio Pharma. The office of the RC put the documents to detailed scrutiny and made sure that all the requisite documents have been provided.

### **In-charge in the Region**

It is worth mentioning that extreme care is exercised in collection and evaluation of documents submitted by the clients. In the first place, every department discusses the nature, scope and scale of operation of business and then list of documents is formed accordingly. The list and documents in the second stage are evaluated by Regional Coordinator. A cross check is also made with any acquaintance believed to be well versed with the subject. In the third stage, information is gathered to generally get an understanding about the industry in which the firm is located and so about the client, to weigh his professional worth. All these steps were carefully followed with regard to Orio Pharma. After incorporating the inputs of the Regional Office and fulfilling the above mentioned procedural formalities, the relevant section of the bank was satisfied to submit the case to the Regional Coordinator for onwards submission to the approval committee. After a thorough inspection of the documents, the approval committee was obliged to forward the case to the lawyer.

### **The Lawyer**

The lawyer is appointed by the bank, but the fee is paid by the customer. As per policy, the bank needed to hire the lawyer so that the lawyer independently arranges all the requirements. The lawyer produced a pre-mortgage opinion. Then the bank instructed him to prepare a registered mortgage deed for this case. This was a registered mortgage, so the lawyer created mortgage deed and Memorandum of Deposit of Title Deed (MOTD) in conformity to the State regulations, and agreement to create registered mortgage. Then the lawyer, the customer and representative of the bank went to the office of sub registrar to create mortgage. Accordingly, registration 1547 was made by sub registrar of companies (SECP requirement). All these documents were sent back to the lawyer for post-mortgage opinion and the bank started preparing two sets of legal documents i.e. for lease and the *Mushārah* separately. In the lease case, the bank applied the lease and sale back service structure for which two additional documents of sale agreements and sale invoices were drafted. Since the bank was a customer to purchase the machinery, Orio Pharma had to provide the sale invoices, Lease Agreement, the DP note, Letter of Continuity and Trust Receipt undertaking the guarantee. This was one set for the lease case. Other set of documents for the *Mushārah* included *Mushārah* agreement (partnership), letter of continuity, DP note, undertaking, etc. For *Mushārah*, the bank maintained two files, and the mortgage documents were sent to the regional coordinator for perusal and evaluation.

### **Audit Department**

The documents were then sent to the audit department for the detailed evaluation. They recorded their observations, and returned the file to coordinator.

### **Accounts Department**

The lease file was sent to the accounts department because the payment of the lease part of the case was due. In the case of *Mushārah* contract, the payment was made when the customer presented the LCs, postdated cheques and a cheque for the security deposits. The account department reduced the down payment by SD to economize on time, and a cheque for the remaining amount was sent in the name of the client. In the meanwhile, the customer received amount for day to day business and thus the lease service started.

### **Soneri Bank**

The bank could not open Letter of Credit (L/C) because it did not have banking license from SBP, rather working under the regulations of the SECP. The Islamic commercial bank, Soneri Bank was therefore approached to find a viable solution. In order to get the desired financial assistance from Soneri Bank, Al-zamin Bank furnished a letter of comfort to Soneri Bank to the effect:

- i- That the bearer ( Orio Pharma) was the client of Al-Zamin Bank
- ii- That the client be provided the desired financial assistance under the guarantee of Al-Zamin Bank
- iii- That one-time credit should not exceed 5 Million Rupees
- iv- That the letter of credit was valid for one year
- v- That in case of any default on the part of the client, Al-Zamin Bank would make bear the loss

This letter, being corporate guarantee, was accepted by the Soneri Commercial Bank as collateral. The client got the pro-forma invoice of the raw material intended to be imported from China. The purchasing officer of Orio pharma took these invoices to Soneri Bank for the LCs. The Soneri Bank opened LC as per the information in the invoices which the customer had sent to the supplier.

### **Supplier in China**

Supplier in China sent the documents to the respective bank in China, which communicated with Soneri Bank. Soneri Bank, in turn, guaranteed the payment upon the receipt of raw material. The China supplier sent the goods, handed over the shipment documents to its bank, which in turn sent them to the Soneri Bank for payment. The Soneri Bank made the payment, and then sent the payment sheet to Al-Zamin Bank and a copy of the L/C. On the other hand, the customer had brought the pro-forma invoice and a copy of the shipment documents, which he had received from the supplier (original comes to the bank). Al-Zamin Bank compared both, the customer's copy and bank's copy, and verified that there was no anomaly. The customer also compared bank copy with its own, and when Orio Pharma approved it, Al-Zamin Bank made payment to Soneri bank.

Soneri bank furnished a certificate to the effect that the documents were complete in all respects, that the goods correspond to specifications and that payment had been made to the counterpart in China. Al-Zamin Bank then made payment of 5 Million rupees to Soneri Bank which was the total value of the consignment. Soneri bank was also paid fee for its agency

service. Orio Pharma retained the original documents and received the goods from Shipment Company.

### The Shipment Company

Prior to the receipt of documents and goods, Al-Zamin Bank issued a letter in the name of one clearing agent recommended by the client. The agent cleared the goods from the shipment company and sent the consignment through a carriage company to the customer. This L/C was valid for 6 months and letter of comfort was for one year. Possible Assignments:

- Identify the need of the customer from Al Zamin Investment Bank
- Indicate the steps and documentations involved in the whole process
- Identify role of different participants in the fulfillment of customer objective
- Explain how different could be the case of Pharmaceutical company from other industries

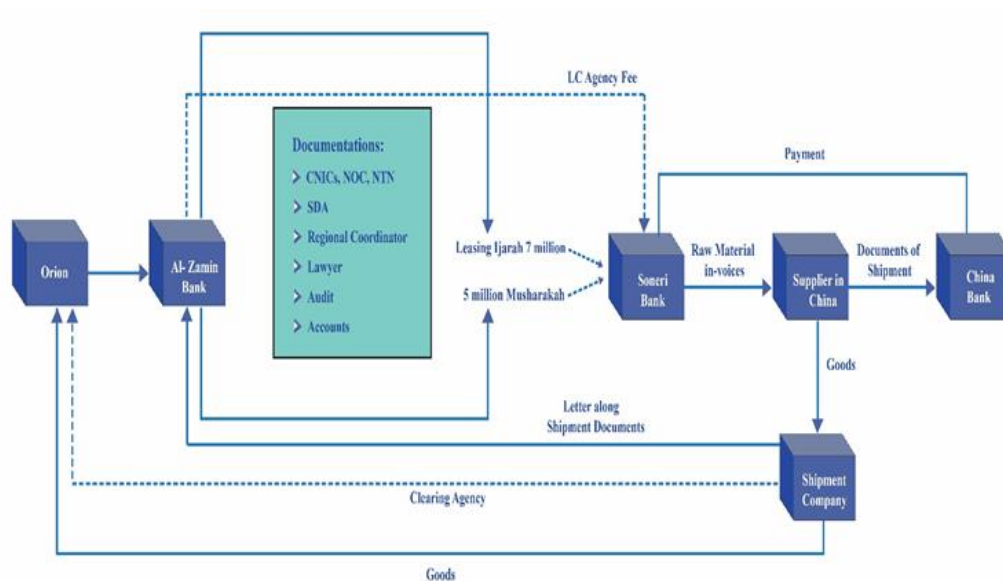


FIGURE 1. Visual representation of process involved in the case

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