

17. SALAM

Glossary

Rabb-us-salam:	Buyer
Muslam ilaih :	Seller
Ra's-ul-maal :	Cash price
Muslam fih :	Purchased commodity

This mode of financing can be used by modern banks and financial institutions especially to finance the agricultural sector. In a Salam, the seller undertakes to supply specific goods to the buyer at a future date in exchange of an advanced price fully paid at spot. The price is in cash but the supply of purchased goods is deferred.

Purpose:

- To meet the needs of small farmers who need money to grow their crops and to feed their families up to the time of harvest. When Allah declared Riba haram, the farmers could not take usurious loans, therefore the Prophet (Allah bless him and give him peace) allowed them to sell their agricultural products in advance.
- To meet the need of traders for import and export business. Under Salam, it is allowed for them to sell the goods in advance so that after receiving their cash price, they can easily undertake the aforesaid business. Salam is beneficial to the seller because he receives the price in advance and it is beneficial to the buyer also because normally the price in a Salam is lower than the price in spot sales.

The permissibility of a Salam is an exception to the general rule that prohibits forward sales and therefore it is subject to strict conditions, which are as follows:

Conditions of Salam

1. It is necessary for the validity of a Salam that the buyer pay the price in full to the seller at the time of effecting the sale. In the absence of a full payment, it will be tantamount to sale of debt against debt, which is expressly prohibited by the Prophet (Allah bless him and give him peace). Moreover the basic wisdom for allowing a Salam is to fulfill the seller's instant need. If it is not paid in full, the basic purpose is not achieved.
2. Only those goods can be sold through a Salam contract in which the quantity and quality can be exactly specified. For example, precious stones cannot be sold on the basis of a Salam because stones differ in quality, size, weight and their exact specification is not possible.

3. Salam cannot be effected for a particular commodity or for a product of a particular field or farm (e.g. supply of wheat of a particular field or the fruit of a particular tree) since there is a possibility that the crop is destroyed before delivery and given such possibility, the delivery remains uncertain.
4. All details in respect to the quality of goods sold must be expressly specified leaving no ambiguity, which may lead to a dispute.
5. It is necessary that the quantity of the commodity is agreed upon in absolute terms. It should be measured or weighed in its usual measure only, meaning what is normally weighed cannot be quantified and vice versa.
6. The exact date and place of delivery must be specified in the contract.
7. Salam cannot be effected for things that must be delivered at spot.
8. The commodity of a Salam contract should remain in the market right from the day of contract up to the date of delivery or at least on the date of delivery.
9. The time of delivery should be at least fifteen days or a month apart from the date of agreement. The Salam price is generally lower than the price of a spot sale. The period should be long enough to effect prices. The Hanafi school does not specify any minimum period for the validity of Salam. It is alright to have an earlier date of delivery if the seller consents to it.
10. Since price of a Salam is generally lower than the price of a spot sale; the difference in the two prices may be a valid profit for the bank.
11. A security in the form of a guarantee, mortgage or hypothecation may be required for a Salam in order to ensure that the seller delivers.
12. The seller at the time of delivery delivers commodities and not money to the buyer who would have to establish a special cell for dealing in commodities.

Benefits

There are two ways of benefiting from the contract of Salam:

1. After purchasing a commodity by way of a Salam, the financial institution can sell it through a parallel contract of Salam for the same date of delivery. The period of Salam in the second parallel contract is shorter and the price is higher than the first contract. The difference between the two prices is the profit earned by the institution. The shorter the period of a Salam, the higher the price and the greater the profit. In this way institutions can manage their short term financing portfolios.
2. The institution can obtain a promise to purchase from a third party. This promise should be unilateral from the expected buyer. The buyer does not have to pay the price in advance. When

the institution receives the commodity, it can sell it at a pre-determined price to a third party according to the terms of the promise.

Parallel Salam

1. In an arrangement of parallel Salam there must be two different and independent contracts; one where the bank is a buyer and the other in which it is a seller. The two contracts cannot be tied up and performance of one should not be contingent on the other. For example, if A has purchased from B 1000 bags of wheat by way of a Salam to be delivered on 31st of December, A can contract a parallel Salam with C to deliver him 1000 bags of wheat on 31st of December. However, while contracting parallel Salam with C, the delivery of wheat to C cannot be conditioned with taking delivery from B. Therefore, even if B does not deliver wheat on 31st of December, A is duty bound to deliver 1000 bags of wheat to C. He can seek whatever recourse he has against B, but he cannot rid himself from his liability to deliver wheat to C. Similarly, if B has delivered defective goods, which do not conform to the agreed specifications, A is still obligated to deliver the goods to C according to the specifications agreed with him.
2. A Salam arrangement cannot be used as a buy back facility where the seller in the first contract is also the purchaser in the second. Even if the purchaser in the second contract is a separate legal entity, but owned by the seller in the first contract; it would not be a valid parallel Salam agreement. For example, A has purchased 1000 bags of wheat by way of Salam from B - a joint stock company. B has a subsidiary C, which is a separate legal entity but is fully owned by B. A cannot contract the parallel Salam with C. However, if C is not wholly owned by B, A can contract a parallel Salam with it, even if some shareholders are common between B and C.