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A Comparative Analysis of Riba Prohibition in Murabahah and Mudharabah Contracts: The Case of Malaysian Islamic Banks

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ABSTRACT

Islamic finance is based upon the principle of prohibition of riba, which requires that a financial transaction must be based on real economic activity, risk sharing and ethical concerns instead of the fixed guaranteed returns. Despite this principle, the Islamic banking operations especially in Malaysia use the debt based contracts like Mudharabah continues to be heavily relied on and thus creating an apprehension that substantive fulfilment of the riba prohibition has been fulfilled. This paper discusses how riba is avoided in operating the Murabahah and Mudharabah contracts under the Malaysian Islamic banking system through evaluating the economic substance, risksharing, and suitability with the purpose of Shariah (Maqasid al-Shariah). As a qualitative and descriptive study design, the research is grounded on a review of the classic Islamic jurisprudence, the current academic literature and regulations provided by Bank Negara Malaysia as well as the Shariah Advisory Council. The results show that, despite the fact that both agreements are formally deemed to be Shariah-compliant, there are some considerable discrepancies in the applicability of both. The use of Murabahah is much more popular because it is easy to administer, predict income, and it requires less operational risk. Mudharabah, in contrast, is more consistent with the objective of justice and equity and is more typically in line with the Shariah goals of justice, equity and ethical financing, but is limited by information asymmetry, monitoring costs and governance issues. The paper finds that adherence to the form of contract is not adequate to fulfill the aim of the riba ban, hence the importance of putting more emphasis on the substance of risk sharing and economic involvement to enhance the ethical basis of the Islamic banking in Malaysia.

Keywords: Islamic banking, Riba, Murabahah, Mudharabah, Maqasid al-Shariah, Malaysia

INTRODUCTION

Prohibition of *riba* (usury) is one of the principles of Islamic finance. This ban is grounded on the Quranic injunctions and jurisprudential decisions that do not guarantee returns on lent funds *(Dheere, 2025)*. As a result of this, the Islamic financial institutions structure their contracts to avoid the use of interest based structures, but rather use asset based sales and profit sharing schemes to accommodate the ethical goals of the Shariah law.

An example of a highly developed structure of Islamic banking in Malaysia, which is the integration of regulatory oversight by the Bank Negara Malaysia and Shariah oversight by its Shariah Advisory Council (SAC). All these mechanisms make sure that the financial contracts are Shariah compliant *(Bank Negara Malaysia, 2010)*. Among other technical standards, its Shariah Standard on Mudharabah provides the operational specifications to ensure that the institutions could realize these principles *(Bank Negara Malaysia, 2012)*. However, recent research marks longstanding challenges in faithfully adhering to contracts by implementing such a contract in a way that reflects the strict prohibition of riba without recreating the effects of customary financing.

Murabahah and Mudarabah are the two most common financing systems in the Islamic banking. Murabahah is a cost-plus sales agreement where the financier buys a given asset and resells it to a client at an agreed premium thereby converting the transaction to a sale instead of a loan. Empirical studies in the recent times have however shown that the fixed markup mechanism which is inherent in Murabahah can be titled towards imitating interest-based outcomes except where the transfer of asset and accompanying risk are substantially performed *(Nurbaidah, Hidayah, & Muhajirin, 2025; Djumadi, Arzal Syah, Hamida, Mujahidin, & Kamiruddin, 2025)*. Mudarabah on the other hand, involves a partnership where the investor and business person equally divide profits in predetermined ratios and deal with losses according to Shariah determinations. This arrangement makes actual risk sharing instead of insured profits *(Bank Negara Malaysia, 2012).*

Empirical and qualitative discussions indicate that, compared to Mudarabah contracts, Murabahah contracts are usually easier to administer and carry lower risk of operations due to confrontation of the issue of moral hazard and asymmetry of information. However, Mudarabah is closer to the Shariah ethos of risk sharing *(Alam, A., Sukmana, R., Fianto, B. A., & Izzuddin, A., 2022)*. The resultant comparative analysis of operational avoidance of riba of the contracts of Murabahah and Mudarabah contracts provides important insights about which structure expresses the ethos of avoiding riba more efficiently and the same structure meets the ethical requirements of the Islamic financing.

Problem Statement

Although the Islamic law categorically prohibits riba, the Islamic banking still uses a debt-based contract, specifically Murabahah, which is the most prevalent in the portfolios of the Malaysian Islamic banks because of its predictability of income, reduce risk, and efficiency in its operations *(Hassan et al., 2019)*. Despite the fact that Murabahah is considered Shariah compliant, its economic features, including fixed profit rates, and minimal risk sharing, have made it questionable as to whether it substantially complies with the riba prohibition *(El Gamal, 2016*).

Researchers argue that Murabahah is often a manifestation of hiyyal al-Shariah legal maneuvers that are not necessarily normative of its moral ambitions (maqasid al-Shariah) *(Kamla & Haque, 2019)*. Practically , it can be similar to the traditional interest-based lending thus questioning the imperative of justice and fairness underpinning Islamic finance.

Mudharabah, by contrast, is based on the profit and loss sharing, does not allow guaranteed returns, and encourages vegetable risk sharing, thus being closer to the Shariah principles *(AAOIFI, 2021)*. However, its implementation is still limited by some alternative considerations like information asymmetry, monitoring expenses, and regulatory barriers *(Bank Negara Malaysia, 2023).*

Our study will analyze the practicality of Murabahah and Mudharabah and the contractual framework that better supports the prohibition of riba. The research will provide initial

information on how Islamic banks can balance and Shariah goals and lead to a more ethical and sustainable financial industry.

Research Questions

1. How is the ban on riba in Murabahah and Mudharabah contracts applied in Malaysian Islamic bank?
2. What are the major distinctions between Murabahah and Mudharabah in the avoidance of riba?
3. Which contract would mirror the ethical and Shariah goals of riba prohibition?

Research Objectives

1. To examine Murabahah and Mudhrabah contracts in terms of riba prohibition in the Malaysian Islamic

Bank.

2. To contrast the distinction between Murabahah and Mudharabah in avoiding riba.
3. To establish which contract has more Shariah objectives such as fairness, risk sharing, and ethical finance between murabahah and mudharabah.

LITERATURE REVIEW

This section will be discussing the prohibition of riba' in Islamic finance and will be examining how the Islamic financing contracts, particularly Murabahah dan Mudharabah contract, is positioned as a mechanism in order to avoid a riba. This section also will focus on scholarly perspectives rather than personal evaluation.

Concept of Riba

Classical Scholar's View on Riba

Prohibition of riba is a central concept in the study of Islamic commercial jurisprudence. Riba is prohibited as stated in Quran, in the Surah al-Baqarah (2:275-279) which clearly distinguishes between lawful trade (buying and selling) and unlawful riba. Scholars of classical Islamic law have interpreted these passages as a clear prohibition that unjustified excess in financial transactions, especially those that result from the deferment of loans and unequal exchange, is forbidden (*El-Gamal, 2006*).

In traditional fiqh texts, riba is categorized into two types which are riba al-nasi'ah and riba al-fadl. Riba al-nasi'ah is identified as a type of increase that arises from the deferment of debt in a loan bargain, meanwhile riba al-fadl is a function of disparity in the exchange of similar goods. All for schools of Sunni jurisprudence which are Imam Malik, Imam Hanafi, Imam Hanbali and Imam Syafie are agree that riba is forbidden is Islam since it is deficient in justice in economic dealings (*Hassan, Lewis, & Latiff, 2013*).

Classical scholars also go on to argue that riba fosters exploitation and creates imbalances in socioeconomic levels. Consequently, Islamic commercial law support differents form of contracting include partnership funding and transactions connected to actual business and risk-sharing (*Visser, 201*9)

Contemporary Understanding of Riba in Interest-Based Finance

Modern scholars of Islamic jurisprudence tend to expand the traditional prohibition of riba into contemporary interest-based financing arrangements. A majority of scholars view conventional banking interest as a form of riba al-nasi'ah because of its predetermined and risk-free nature, independently of the performance of economic activity associated with such financing arrangement (*Kahf, 2006)*.

In the case of Malaysia, this principle is further reinforced by the relevant government and Shariah authorities. The Shariah Advisory Council of Bank Negara Malaysia held that interest-based transactions are riba and are therefore prohibited (*Islamic Development Bank, 2018*). Meaning that, financial institutions that offer services under shariah law are compelled to offer these facilities on the basis of shariah-compliant transactions that include consideration of ethical and risk-sharing elements.

Murabahah and Riba Avoidance

Supportive Scholarly Views on Murabahah

Murabahah is a cost plus sales agreement whereby the seller reveals the cost incurred to buy the property and marks up the agreed profit on it. Contemporary academics overwhelmingly accept murabahah as an acceptable Shariah-compliant method of financing provided it meets all the requirements, which include the legitimate ownership of the property by the seller and the risk of property ownership as well as the cost and profit disclosure (*Hassan et al,. 2013*).

Murabahah is exempted from the prohibition of riba because the profit is made as a result of a sale transaction and there is no loan agreement, according to murabahah proponents. The fact that there is a principle of purchase and the process of ownership transfer makes murabahah different from the riba related concept of lending, which involves the exchange of money for money with a surplus, as identified by Visser in 2019. In Malaysia, murabahah and the different forms of murabahah are often employed in the operational mechanism of the Islamic banks.

Academics also emphasize that murabahah allows financing to be connected with actual transactions in the economy, which satisfies one of the primary objectives of Islamic finance. Its popularity allows the islamic bank to efficiently handle its liquid and credit risks while staying within the confines of being compliant with the tenets of Shariah rules (*Ghozali, 2018*).

Critical Scholarly Approaches to Murabahah

Even though it has been widely accepted and used as a financing technique under Shariah law, there has been criticism leveled at murabahah. These criticisms suggest that it has the primary potential of falling into line and representing an economic reality not different from other types of financing. Other authors express their concerns about the substance over form problem regarding the murabahah transaction, its compliance with the purpose of Shariah (maqasid al-shariah), specifically the principles of justice and risk-sharing (*Djafri, 2018*). There are concerns as well in the context of Malaysia on the over-cominance of the murabahah product of financial services.

Mudharabah and Riba Avoidance

Mudharabah Based on Profit and Loss Sharing Model

Mudharabah refers to partnership where one partner, known as rabb al-mal, contributes funds and another partner known as mudharib**,** administers the business. Sharing of profit is done according to a ratio and the losses (if any) would be borne by the rabb al-mal, provided there is no negligence on the part of mudharib (*Hassan et al., 2013*).

In this regard, mudharabah is perceived as an Islamic financing mechanism that is more compliant than riba as it involves sharing risks. The contribution of business risks to the gains is underlined by Kayed (2012) Kah and Mohowed (2016). In Islamic finance, there is an expectation to bear business risks for the purpose of profit.

From this point, it could be said that murabahah does not involve riba since there are sound grounds for the profit that the bank earns, which could be attributed to its involvement in the actual business through risk, asset-liability, and actual business risk. Another point that has been raised concerning the role and application of Murabahah has to do with its service to the general public, which could be referred to as maslahah. This has specially emerged to fulfill and cater to the requirements in Malaysia and Indonesia, which are dominated by Murabahah.

Alignment with Shariah Objectives (Maqasid Al Shariah)

Some scholars contend that mudharabah is in close alignment with the Shariah goals, especially with regard to justice in wealth distribution and economic production. Through encouraging entrepreneurship and basing profits or losses on actual business performance, mudharabah represents a valid means in relation to sustainable economic development and societal welfare (*Al Amine, 2016*).

Mudharabah under the Malaysian Islamic banking system, has been identified as one of the Shariah-preferred contracts in principle. But still, its usage in financing, in spite of being encouraged through regulations, has yet to gain widespread acceptance, especially when compared with debt contracts, even for the purposes of sharing risk and returns on investment.

Practical Challenges Highlighted in the Literature

Even though it has theoretical advantages, the literature also illustrates the practical problems in conducting mudharabah financing in the real sector. Such problems are associated with the risks of the business, information asymmetry, moral hazard problems and the problems of auditing the operations of the business. Based on these limitations, the Islamic banks regard mudharabah as less favorable due to the uncertain profit and increased cost of the process (*Yustiardhi et al., 2020).*

Studies conducted among Southeast Asian nations have also shown empirical evidence that the practice of mudharabah is more pertinent to deposit-taking than financing. Malaysia stated that the lack of transparency, restrictions in the management of risks, as well as the absence of oversight, are the factors that have hampered the practice of mudharabah financing *(Basyarudin, Hakim and Mukhlas, 2025*).

METHODOLOGY OF THE RESEARCH

This study uses qualitative and descriptive research methods through a literature review approach. In this study, it aims to examine the concept of riba and analyze how Islamic financing contracts, particularly in Murabahah and Mudharabah, are seen as a mechanism to avoid riba based on the views of classical and contemporary scholars as well as academic studies.

The academic literature, reports and journal articles that published within the last ten years are used for the literature review to ensure that the findings are current and relevant. Moreover, all these sources are obtained primarily from Google Scholar and regulatory publications by Bank Negara Malaysia and decisions from the Shariah Advisory Council were also being used. The selection of literature review is based on these following criteria, which are published within the last ten years, related to riba, murabahah and mudharabah and Islamic financing contracts and included scholarly opinions and academic analysis. The selected literature is then analysed thematically to identify the key scholarly perspectives on the role of these contracts in avoiding a riba.

FINDINGS & DISCUSSION

This paper affirms that both the Murabahah and Mudharabah remain Shariah-compliant in both legal and official regulatory authorities and that of the Bank Negara Malaysia (BNM) and the Shariah Advisory Council (SAC). Yet, according to recent sources, the two contracts differ significantly on operational avoidance of riba that is examined through economical substance, risk distribution, and adherence to Maqasid al-Shariah (the objectives of Shariah).

Practically, the riba avoidance in Murabahah is highly based on contractual provision. Murabahah is put under sale contract under predetermined cost with a predetermined profit margin which will be disclosed and this makes it acceptable under formal Shariah protocols as understood in the Malaysian Islamic financial standards. However, its substantive implementation has been criticised by scholars, who have also pointed out that banks tend to represent real risk through a rapid transfer of ownership and at pre-negotiated margins which are functionally equivalent to traditional interest bearing loans *(Nurbaidah, Hidayah, & Muhajirin, 2025)*. This reflects apprehensions in more general academic literature on Islamic finance that Murabahah lays plans on legal artifice as opposed to economic fact, which may compromise some of the fundamental Shariah aims of fairness and equitable wealth distribution (Maqasid) *(Nurbaidah et'al., 2025; Syah, Mokal, and Rifas, 2024)*. This practice brings about the question of whether Murabahah entirely actualises the prohibition of riba in spirit even though it appears to be in form.

In comparison, Mudharabah incorporates risk-sharing and the profit-loss sharing throughout the frame. Recent reviews reveal that Mudharabah involves investors (Shahibul maal) and businesspeople (Mudharib) to risk and profit in fixed proportions according to agreed rates doing away with any assured profit on capital that occurs without actual economic activity. The latter is entirely valid to the principle of the Islamic law according to which only the risk and effort give a reason to gain, which is why this structure makes it more in line with the spirit of

Riba prohibition and on the principle of the Maqasid al-Shariah like equity and distributive justice *(Khayat, Wargo, and Niskaromah, 2025)*. In practice Mudharabah have been adopted by few banking portfolios, however, empirical evidence indicates that these issues are operational: information asymmetry and increased cost of monitoring *(Khayat et al., 2025; Safitri, Wahyudi, and Hanifah, 2024)*.

The recent literature has also highlighted that the nature of Murabahah ruling in financing of the Islamic banks in the world today might be prejudging the intent behind the ethical objectives of Islamic finance. Despite being considered non-regulatory, the widespread practice of Murabahah indicates the presence of a legal and moral compliance-noncompliance gap between the law and implementation of Maqasid, which is why implementing product design reform enhancing the relevance to justice and social well-being is recommended *(Nurbaidah et al., 2025)*. Back to the literature on Mudharabah, it emphasizes the fact that institutional and operational barriers are the primary limitation regardless of normative superiority and not any prohibition of the doctrines.

Comprehensively, the comparative analysis indicates that regulatory adherence to Shariah contracts is not enough to ensure that the Islamic financial products are not failing to attain the Maqasid al-Shariah. The understanding that the key in enhancing such a system to be adopted by the board of trustees is risk sharing and substantial economic participation and not formal compliance may assist regulators and institutions to correct deficiencies in governance frameworks ensuring that Islamic finance attains its legal and ethical goals.

Contribution of Study to Islamic Finance Literature and Malaysian Practice

Taking these findings into consideration, the current paper contributes to the existing academic body of knowledge on Islamic finance in several ways. First and foremost, it contributes to the theoretical knowledge by establishing the distinction between form and substance avoidance of riba and, therefore, proves that adherence to the Shariah should be measured not only according to the contractual legality but also on the economic ground. This comparative framing goes beyond what is available in the literature which assists in either justifying the permissibility of Murabahah or advocating the ambitions of Mudharabah alone.

Secondly, the investigation adds contextual value in that its analysis is placed within the Malaysian Shariah system of governance and the standards of bank Negara Malaysia (BNM) and the decisions made by the Shariah Advisory Committee (SAC) are applied to the prohibition of riba. Thus, it sheds light on a regulative-ethical dilemma, according to which regulatory compliance might be attained without necessarily adhering to the Maqasid al-Shariah, which is a viewpoint that has been relatively underrepresented in the literature on the topic of Malaysian Islamic finance.

Thirdly, the results also present practical implications to regulators and Islamic financial institutions by showing that the prevalence of Murabahah is more influenced by prudential and operational factors than opting to be more congruent to Shariah goals. This fact highlights the need to have governance changes and incentive schemes that facilitate an increased take-up of truly risk-sharing agreements.

CONCLUSION

The current research findings support the view that, although both Murabahah and Mudharabah are acknowledged as Shariah compliant contracts in the condition of the regulatory framework of the Bank Negara Malaysia and in the decisions that are made by the Shariah Advisory Council, the degree to which each of the contracts translates the ban on riba is vastly different. Murabah also avoids riba in its sale transactions that are legally contracted and on an assets basis making it compliant with prudential and regulatory requirements. However, its reliance upon fixed profit margins and limited risk sharing mechanisms often produces economic results that are similar to traditional interest based financing. On the contrary, Mudharabah is more substantive in its prohibition against riba since it does not allow guaranteed returns and requires actual income sharing, and reflects better the principles of the Maqasid al-Shariah and, particularly, justice and equity in the use of money.

The study argues based on the normative perspective that majority of Murabahah in Malaysia is based on practical and risk-management factors as opposed to increased Shariah compliance. Despite the fact that Murabahah is ultimately necessary in ensuring financial sustainability and cost-effectiveness in operations, overdependence on debt-based contracts will reduce Islamic finance to a mere form-related substitute and undermine its value-based nature. In a way, Mudharabah, despite its difficulties in operation, better mirrors the ethical basis of Islamic finance through its convergence of returns with actual economic operation and common risk. Therefore, the only way to focus on substantial prohibition of riba is to go beyond legal adherence and focus on the substantive and moral purposes.

The scope of the study is limited by the qualitative and literature-based approach used and the fact that it was conducted on two Islamic financing contracts only in the Malaysian regulatory environment. The empirical evidence collected on Islamic financial institutions, regulators, and Shariah committees should be incorporated in future studies to determine how the Islamic ban on riba is being applied. In addition, further research would be possible to explore governance, regulatory incentives, and risk-mitigation instruments that may contribute to the increased feasibility of profit-and-loss sharing contracts. Such studies would improve the morality and sustainability of Islamic finance beyond the official compliance with Shariah.

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