

Concept of ijarah and its advantages



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Ijarah means lease, rent or wage. Generally, Ijarah concept means selling benefit or use or service for a fixed price or wage. Under this concept, the Bank makes available to the customer the use of service of assets / equipments such as plant, office automation, motor vehicle for a fixed period and price. Advantages Of Ijarah The following are the advantages of Ijarah to lessee: 1)Ijarah conserves capital as it may provide 100% financing. 2)Ijarah enables the Lessee to have the use of the equipment on payment of the first rental.

This is important since it is the use (and not ownership)of the equipment that generates income. 3)Ijarah arrangements are flexible because the terms and rental provision may be tailored to suit the needs of the Lessee. Therefore, it aids corporate planning and budgeting. 4)Ijarah is not borrowing and is therefore not required to be disclosed as a liability in the Balance Sheet of the Lessee. Being an “ off balance sheet” financing, it is not included in the computation of gearing ratios imposed by bankers.

The borrowing capacity of the Lessee is therefore not impaired when leasing is resorted to as a mean of financing. 5)All payments of rentals are treated as payment of operating expenses and are therefore, fully tax-deductible. Leasing therefore offers tax-advantages to profit making concerns. 6)There are many types of equipment, which becomes obsolete before the end of its actual economic life. This is particularly true in hightechnologyequipment like computers.

Thus the risk is passed onto the Lessor who will undoubtedly charge a premium into the lease rate to compensate for the risk. A Lessee may be willing to pay the said premium as an insurance against obsolescence. 7)If

the equipment used is for a relatively short period of time, it may be more profitable to lease than to buy. 8) If the equipment is used for a short duration and the equipment has a very poor second hand value (resale value), leasing would be the best method for acquisition