

Proposed the pricing model as an alternative Islamic benchmark

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Abstract

Purpose – The purpose of this paper is to find applicable Islamic pricing benchmarks (IPBs) instead of the market interest rates which are currently used in Islamic finance as benchmark.

Design/methodology/approach – The suggested model (Islamic pricing benchmark model (IPBM)) obviously reveals the feasibility and practical effectiveness of a substitute to London Interbank Offered Rate (LIBOR) and as an evaluator tool to suggested investment projects. The model is a suggested mechanism which could be used as an alternative choice to the conventional borrowing based on the forbidden *Riba* or on interest. The suggested IPBM depends on estimating the rate of return for any project on consideration of the cash flows in future which is expected to be relative to the invested capital.

Findings – The IPBM approach might be applied to financial tools, where the fund owner bears the loss since it is not because of negligence. An instrument to help identify the investment for target rates of return (as an alternative choice to LIBOR) to identify a breakeven point based on expected cash flows for the project to be financed instead of based on seeking the indicators of interest or *Riba* (as LIBOR). This feature of the IPBM model as an Islamic benchmark renders it as a *Shariah* pricing mechanism for the Islamic financial products.

Practical implications – The IPBM could be used as a financial instrument to assist in identifying the investment for the target return rates to determine a breakeven point based on expected cash flows for the project to be funded instead of being based on seeking the interest indicators or *Riba* (as LIBOR). This feature as an Islamic benchmark is considered as a *Shariah* pricing mechanism for the Islamic financial products. In particular, the proposed model incorporates the *Shariah* parameters. In that, it is hoped that the Islamic financial instruments will be more comprehensive in their *Shariah* compliance and thereby may bring more credibility to the Islamic financial system in general.

Originality/value – This paper highlights several important issues related to the IPBMs in Islamic financial institutions which are not widely discussed among researchers. This study contributes to finding an alternative IPB for the Islamic financial products which is currently using the conventional interest rate (LIBOR) as its benchmark. The current study provides empirical evidence for the possibility of relying on the IPBM as an Islamic benchmark to price Islamic financial transactions.

Keywords LIBOR, *Shariah*, Islamic benchmark, Pricing models

Paper type Research paper

1. Introduction

In the last two decades, Islamic finance and banking has rapidly established itself in the global market as an alternative method of investment (Ahmed *et al.*, 2018; Norma *et al.*, 2010; Al-Omar and Iqbal, 1999). The present pace of growth shows a very promising future for Islamic banking and finance, and has been offered by its proponents as the solution for the current financial crisis in the global economy (Ahmed *et al.*, 2013; Beck *et al.*, 2013; Hasan and Dridi, 2010). However, Islamic banking and finance has been using conventional finance benchmarks, such as BLR, Kuala Lumpur Interbank Offered Rate (KLIBOR), COFI, London Interbank Offered Rate (LIBOR), etc., to determine its own cost of funds (COFs), and

