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Digital Payment Transactions: Islamic Finance Perspective

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ABSTRACT

This paper provides an in-depth analysis of the implementation of Islamic finance contract (*akad*) in digital payment and Payment Technology (PayTech) transactions. With the rise of FinTech, digital payment has become a crucial component of the financial industry. However, implementing muamalat contracts in PayTech poses challenges related to unclear contracts, the relationship between parties, and security. The primary objective of this study is to identify the various types of online payment transactions and suggest alternative solutions to the Shariah issues that arise. To achieve this, the study adopts a qualitative methodology, which involves conducting library research and interviews with e-payment providers. The findings of the study shed light on several factors concerning Shariah issues and differences in the implementation of e-payment products and contracts. The paper aims to address the gap in previous literature by providing comprehensive insights into the implementation of Shariah-compliant PayTech transactions. The study recognizes the importance of refining the modus operandi of payment transactions when using new technology and ensuring compliance with Shariah principles in Islamic finance and banking. By doing so, the study contributes to the development of the Islamic finance industry, which is currently experiencing a surge in demand for Shariah-compliant financial products and services.

1. Introduction

The era of digitalization has changed the way businesses operate. Online business has become commonplace, and transactions also no longer rely solely on cash payments [1]. Cash based payments have now shifted to technology method payments. The evolution of wireless communication technology has provided a viable important concept for the next-generation

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wireless mechanism [2]. For that, the payment system adopted by a company or organization must function effectively and efficiently.

A well-functioning payment system is essential to the efficient operation [3] of the financial market as well as to support Malaysia's economic growth [4]. Therefore, a safe, secure, and efficient payment system must be created in line with the requirements set by authority body.

Electronic payment, also known as e-payment, refers to the exchange of funds through digital means such as credit cards, debit cards, and online banking systems. According to a study by the Reserve Bank of India, the growth of e-payment has been rapid in recent years due to the increasing use of mobile devices and the availability of internet services [5]. E-payment has become a popular alternative to traditional payment methods, as it offers convenience, speed, and security for consumers. According to a prior study, e-payment in Malaysia has seen significant growth in recent years. The authors highlight the increasing adoption of e-payment solutions by consumers and businesses, as well as the government's support for the development of a cashless society.

Islamic finance is a system of finance that is based on Islamic principles and values, such as mutual cooperation, risk sharing, and the prohibition of riba (interest) [6]. Islamic finance also emphasizes the importance of ethics and social responsibility in financial transactions [7]. Islamic finance transactions have gained significant attention in recent years. One of the key elements in Islamic finance is the use of Islamic finance contracts, also known as akad. The application of these contracts in payment technology (paytech) transactions has become an area of focus.

2. Problem Statement

E-payment and E-wallet using is a good move [8]. This paper questioning on how far e-wallet fulfil requirement of Islamic finance compliance. In a study entitled Consumer Acceptance of Electronic Payment Methods stated the findings of the study that the level of acceptance in e-payment is high [9]. Nevertheless, acceptance in replacing it as a virtual counter is at a minimum.

In addition, shariah principles such as sale and purchase, salam and khiyar (khiyar ayb) have been applied in the practice of e-Commerce that occurs today and it proves that the existence these principles in the books of classical fiqh by the scholars of the past are not merely theoretical but can be implemented in current business practice [10]. It also proves the flexibility of sharia in dealing with contemporary issues that arise due to the rapid pace of technology and changing times.

However, there are also comments on the concept of PayLater payment also known as istijrar found scholars disagree, if the price is not known by the buyer when buying/taking goods, and new buyers know the price after the amount at the end when you want to make a payment, then such buying and selling is prohibited [11]. This is the opinion of Jumhur ulama (almost all ulama consenses) from the four sects. However, according to one of the Shafi'i scholars, the sale and purchase is valid as long as it has a market price (*as-Si'rul Mitsl*) as is generally the case.

3. Literature Review

In a review of the literature, found that e-payment has the potential to increase financial inclusion, reduce transaction costs, and enhance financial stability [12]. Additionally, the study found that the implementation of e-payment systems has a positive impact on the economic growth of a country.

It is important to note that while e-payment offers numerous benefits, it also presents challenges such as security and privacy concerns, a lack of trust in the system, and the need for infrastructure development [5].

Payment technology is a process of utilizing the sophistication of technology for the purpose of any payment without the need to use paper money or cash. This technology only requires the user to have monetary value in any of the accounts that can be linked. Paytech refer to payment and technology, it includes everything ranging from the Internet of Things and cryptocurrencies or e money to your everyday contactless transactions and e-wallet transfers [13]. Paytech's are fintech companies that use technology to enable the electronic transfer of value, often focusing on making payments faster, secure, and can be done easily from anywhere [14]. PayTech refers to any payments that involve technology. This is a fast-growing sector of FinTech that focuses on transactions and payments rather than finance in general. In fact, PayTech companies make up 25% of FinTechs, valued at over $2.17 trillion [15]. While Bank Negara defines Payment system as any system or arrangement for the transfer, clearing or settlement of funds or securities in the Central Bank of Malaysia Act 2009 [16].

The global e-payment market has been growing rapidly in recent years, driven by technological advancements, and changing consumer preferences. According to a report by Grand View Research, the global e-payment market size was valued at USD 7,608.2 million in 2019 and is expected to grow at a compound annual growth rate (CAGR) of 14.8% from 2020 to 2027 [17].

In Malaysia, the e-payment industry has also experienced significant growth in recent years. According to the Central Bank of Malaysia (BNM), the value of e-payment transactions in the country increased from MYR 192.6 billion in 2015 to MYR 647.2 billion in 2019, representing a growth rate of 238.0% over the five-year period [18].

In summary, this writing is needed to bridge the gap between emerging digital payment technologies and Islamic finance principles. It addresses the practicality of applying Shariah principles to contemporary financial practices while also acknowledging areas of disagreement among scholars. It provides valuable insights for academics, practitioners, and policymakers in the field of Islamic finance and digital payments, ultimately contributing to a more informed and compliant financial ecosystem for Muslim consumers.

4. Research Methodology

The research methodology in this article is a qualitative approach which is used to explore and understand the non-numerical data and gain in-depth insights into the concept and experiences related to payment technology. This approach is useful in generating new ideas for research and gaining a comprehensive understanding of a problem [19].

The sources of research data for this article were gathered from both printed and online sources. The data was collected from various journals, libraries, and countries to ensure a comprehensive coverage of the topic. The research was conducted through document analysis, which involved analysing relevant materials and sources related to payment technology.

The document analysis was structured around three main aspects. Firstly, the research focused on understanding the concept of payment technology and the current developments in the field. Secondly, the research analysed the structure of payment and financial technology. Thirdly, the research explored the main issues and solutions in the field of payment technology.

5. Payment Technology Structure

According to Bank Negara Malaysia, payment technology is divided into two, namely payment through banking institutions and payment through service providers such as e-wallets [20].

The structure of PayTech shows that PayTech is divided into e-wallet and e-payment. E-wallet means an electronic wallet. It is a type of electronic card used for transactions made online via a computer or smartphone. The utility of an e-wallet is the same as a credit or debit card. E-wallets need to be linked to individual bank accounts to make payments. The concept of payment technology in Malaysia involves more than 40 private payment providers as well as financial institutions.

E-wallet is a prepaid account that allows you to make transactions, online and offline, through your computer or smartphone. It works as a fast mode electronic wallet that allows you to make transactions from the comfort of your home. It stores the details of all transactions on an online database. Various companies have their own digital wallets. Paytm, Mobikwik, Alipay, American Express, Apple pay, Microsoft Wallet, Samsung Pay, for example, are digital wallets. The largest companies that provide this service to consumers are Google, Amazon and Paypal. Advances in information and communication technology (ICT) have allowed humans to accomplish various tasks more effectively [21].

Electronic payment refers to a digital exchange of funds between parties using various payment methods. Some common types of e-payments include Automated Clearing House (ACH) transfers, wire transfers, bank transfers, credit/debit card payments, digital wallets, and mobile payments.

There are two primary modes of operation for e-payment accounts. One option is to deposit funds into an e-money account using a payment card. In this scenario, the balance in the account will be adjusted accordingly with each transaction made (e.g., money will be deducted when making a purchase online, and added when selling a product). Another option is to link an e-payment account to a payment card, where the funds in the e-payment account can be used directly for transactions. Islamic Finance compliant on PayTech transaction modus operandi:

5.1 Modus Operandi of E-Payment (Banking)

Final process is the Bank will make the transfer to the recipient.

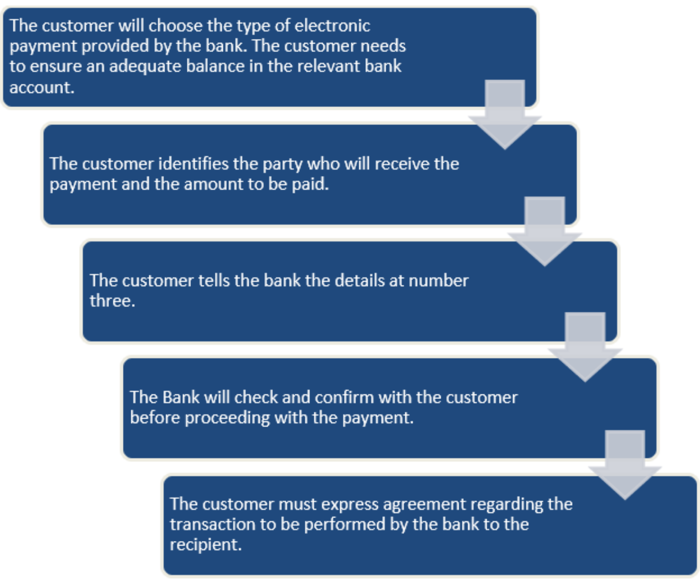

Fig. 1. Banking e-payment flow

5.2 Modus Operandi E-Wallet (Non-Bank Provider)

Next process is upon receipt of confirmation from the customer the e-wallet provider will proceed with the payment as requested by the customer.

Final process the merchant will receive payment from the customer through the e-wallet provider.

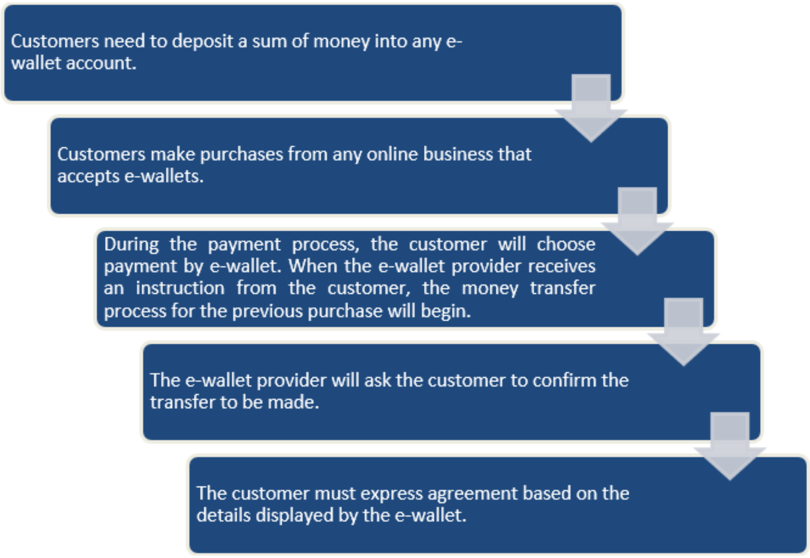

Fig. 2. Non Banking e-payment flow

6. Islamic Finance Proposed for E-Payment

Islamic Finance refers to a system of finance and banking that adheres to the principles and laws of Islam. This system allows for lawful and transparent transactions, such as buying and selling, hire purchase, and financing, while prohibiting interest (riba), gambling, and gharar (uncertainty) (Al-Quran 2:275) [22].

Wakalah is an appropriate concept to be applied in the relationship between customers and banks or private e-wallet providers. In this arrangement, the customer delegates the bank or e-wallet provider to make payments on their behalf. This creates a binding agreement between all parties according to Islamic contract law.

Wakalah is a form of agency, representation, or proxy, where one party delegates another to perform a task based on a mutually agreed contract. Banks, investment companies, and takaful companies often act as representatives for their customers to manage transactions.

In addition to wakalah, e-payment transactions must also comply with the principles of Islamic finance. Consumers are only permitted to use e-payment for acceptable and lawful transactions. Service providers must use Islamic banking institutions as intermediaries and all contracts must adhere to Islamic contract law.

It is important for customers to identify Islamic finance providers among banking institutions due to clear labels and statuses. This suggests that there is a level of transparency and regulatory oversight in the banking sector, which can reassure customers seeking Shariah-compliant services.

Challenges with Non-Banking E-Payment Providers guide us the need for caution when using non-banking e-payment providers. These entities may not have the same level of transparency or oversight, making it harder for customers to discern whether their services comply with Islamic finance principles. This issue is compounded by the increasing complexity of e-payment offerings, which may include investment and financial services.

Regulatory bodies are seen as crucial in ensuring that Muslim consumers are protected from non-Islamic finance solutions. Their role extends to enforcing standards, ensuring compliance, and providing guidance to both banking and non-banking e-payment providers.

It is importance of clear communication by e-payment providers regarding their Shariah-compliance status and the principles they follow. This transparency is key to building trust among Muslim customers and encouraging them to adopt e-payment services that align with their religious beliefs.

It is suggested that e-payment providers, both banking and non-banking, should seek guidance and regularly review their practices with recognized Shariah scholars and experts. This proactive approach ensures that their services remain compliant with Islamic finance principles and adapt to the evolving needs of the Muslim community.

In conclusion, the analysis underscores the importance of:

i. **Transparency:** Clear communication and labelling to help customers make informed choices.
ii. **Regulatory Oversight:** Active involvement of regulatory bodies to enforce compliance.
iii. **Continuous Improvement:** Regular consultations with Shariah scholars to stay aligned with evolving principles.

These elements collectively contribute to ensuring that e-payment transactions in Islamic finance are transparent, trustworthy, and consistent with Shariah principles, ultimately fostering the growth of Shariah-compliant financial services in the digital era.

7. Fundamentals of the Shari'ah of al-Wakalah

Wakalah is a commonly used contract in Islamic finance that refers to an agency agreement where one party (the principal) authorizes another party (the agent) to act on its behalf in a particular transaction. In the context of e-payment, wakalah can be used as a Shariah-compliant alternative to conventional payment methods.

Wakalah can be applied to e-payment transactions by incorporating the principles of wakalah into the contract between the e-payment service provider and the customer. The authors suggest that this would ensure compliance with Shariah principles and help address the challenges faced by online payment transactions, such as security and the relationship between parties [23].

The need to implement the concept of al-wakalah in helping the implementation of a task or a person's needs can be found through the evidence from the nas syara '. Allah Almighty says in Surah al-Isra 'which means: *"Indeed, you will have no power over my servants."80 And your Lord suffices for you as a guardian (as a Protector for them*)" (Al-Isra', 17:65).

Ibn Kathir describes the above verse about the greatness of the power of Allah SWT who can protect every human being who truly believes and is sincere to Him from falling into the valley of destruction and misleading [24]. Allah SWT is the representative for the preservation of the well - being of Muslims based on His Almighty nature from straying far based on the belief and adherence to the true teachings of Islam.

Pillars for wakalah:

i. representative
ii. representative receiver
iii. things represented (payment)
iv. offer and acceptance of the wakalah contract.

Shariah resolutions related to e-money parameters also support wakalah as one of the suitable contracts for online payment transactions. Therefore, a deep and technical understanding of wakalah contracts is important to ensure shariah-compliant modus operandi.

In Islamic finance, there are various types of contracts that can be used for digital payments, in addition to the Wakalah contract. These contracts are structured to ensure compliance with Shariah principles. Here are a few examples:

i. **Mudarabah Contract:** Mudarabah is a profit-sharing partnership where one party provides the capital (*Rabb-ul-Mal*) while the other provides labour and expertise (*Mudarib*). In the context of digital payments, this contract can be used when one party entrusts the other with their funds for investment or payment processing. The profits generated are shared according to a predetermined ratio, while losses are borne by the capital provider.
ii. **Musharakah Contract:** Musharakah is a partnership contract where both parties contribute capital and expertise to a joint venture. In digital payments, this contract can be employed when multiple parties come together to invest in and operate a payment platform or system. Profits and losses are shared based on the agreed-upon ratio.
iii. **Ijarah Contract:** Ijarah is like a leasing agreement. In the context of digital payments, it can be used when one party leases a payment processing system or software from another party for a specified period. The lessee pays rent (*ijarah*) for using the service, and ownership remains with the lessor.
iv. **Bai Salam Contract:** Bai Salam is a forward contract where the payment is made in advance for goods or services to be delivered in the future. In digital payments, this contract can be used when customers prepay for goods or services using digital payment methods, with delivery scheduled for a later date.
v. **Istisna'a Contract:** Istisna'a is a contract for the manufacture or construction of specific goods. In digital payments, it can be utilized for custom software development or the creation of specific digital products or services. Payments are made in instalments as the work progresses.
vi. **Wadi'ah Yad Dhamanah Contract:** This is a trust (safekeeping) contract where one-party deposits funds with another party for safekeeping. While not directly related to payment processing, it can be relevant to digital wallets and accounts used to store funds securely.

It's essential to note that the choice of contract depends on the specific nature of the digital payment transaction, the parties involved, and the desired outcome. Additionally, all these contracts must comply with Islamic finance principles, such as the prohibition of interest (riba) and uncertainty (gharar) and should be reviewed by Shariah scholars to ensure compliance.

8. Conclusion

In conclusion, the daily life of people nowadays is mostly dominated by mobile devices especially in carrying out business activities that involve any payment transaction [25]. Clear guidelines and communication are vital for ensuring the transparency and Shariah compliance of e-payment transactions in Islamic finance. While banking institutions offer a straightforward choice, caution is needed with non-banking providers. Regulatory bodies play a crucial role in safeguarding Muslim consumers. Non-banking providers must transparently communicate their Shariah compliance. Seeking guidance from recognized Shariah scholars is advisable for both types of providers to ensure ongoing compliance and meet evolving community needs. These measures are essential for fostering Islamic finance's growth and meeting the rising demand for Shariah-compliant digital financial services. It is important to have clear guidelines for e-payment transactions in Islamic finance. Both banking and non-banking institutions offer e-payment services, and it is straightforward for customers to identify Islamic finance providers among banking institutions based on their label and status. However, customers need to exercise greater caution when using non-banking e-payment providers to ensure that they are not participating in conventional finance systems. This is in line with the challenges of using Industrial Revolution 4.0 (IR 4.0) technology such as skills, attitudes, perceptions, knowledge, and legislation [26].

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