

Wakalah bi al-Ujrah in Letter of Credit Services: Sharia Bank Applications

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Abstract

This study analyzes the application of the Wakalah bi al-Ujrah contract in Letter of Credit (LC) services within Sharia banks. As an agency-based contract, Wakalah bi al-Ujrah enables banks to act on behalf of clients in facilitating trade transactions while charging a transparent service fee. This paper adopts a qualitative literature-based approach, reviewing books, journal articles, and institutional guidelines. Findings indicate that the contract ensures Sharia compliance, strengthens customer trust, and provides operational efficiency in trade finance. Nevertheless, challenges persist, including limited customer literacy, regulatory inconsistencies, and misinterpretation of fee structures. To optimize implementation, strategies such as enhancing Sharia governance, improving transparency, and expanding educational initiatives are recommended. The study contributes theoretically by integrating agency and risk management perspectives in Islamic finance and practically by providing insights for regulators and practitioners to enhance competitiveness in global trade facilitation.

Keywords: *Wakalah bi al-Ujrah, Letter of Credit, Sharia banking, Islamic contracts, trade finance.*

INTRODUCTION

Islamic finance has grown substantially worldwide as a response to the increasing demand for financial systems that comply with Sharia principles. Among various financing instruments, the Letter of Credit (LC) remains a key mechanism in international trade, facilitating trust between exporters and importers while reducing risks (Alam et al., 2022). In conventional banking, the LC involves contractual arrangements with interest-based charges, which conflicts with the prohibition of *riba* in Islamic law. Consequently, Sharia banks employ contracts such as Wakalah bi al-Ujrah to provide Sharia-compliant alternatives for trade financing (Obaidullah, 2023).

The Wakalah bi al-Ujrah contract enables a bank to act as an agent (*wakil*) on behalf of the client for handling LC transactions in exchange for a predetermined fee (*ujrah*). This arrangement aligns with Islamic jurisprudence, particularly in the context of agency (*wakalah*) and lawful earnings (*ujrah*) (Usmani, 2020, p. 213). In addition, the adoption of this contract enhances Sharia banks' competitiveness in serving corporate clients engaged in import-export activities, particularly in emerging markets such as Indonesia, Malaysia, and the Gulf states (Kusuma, 2021, p. 88).

Despite its advantages, there are challenges in implementing Wakalah bi al-Ujrah within LC services. These include limited customer understanding of Sharia contracts, insufficient harmonization of regulatory frameworks, and the risk of contract misapplication (Abdullah & Hassan, 2022). Furthermore, questions arise about how the contract balances Sharia compliance, bank profitability, and customer interests. These issues necessitate a comprehensive exploration of both the theoretical and practical dimensions of Wakalah bi al-Ujrah in LC services.

The theoretical significance of this study lies in integrating agency theory within Islamic jurisprudence and analyzing how it supports trade finance structures. Empirically, this research contributes to identifying best practices and challenges faced by Sharia banks in

applying this contract (Dusuki & Abdullah, 2021). From a practical standpoint, the findings can inform policymakers, regulators, and practitioners on strategies to optimize LC services while upholding Sharia compliance.

The gap in current scholarship is evident: while previous studies have discussed Sharia contracts broadly in banking services, fewer have focused specifically on the detailed mechanisms of Wakalah bi al-Ujrah in LCs. Therefore, the present study addresses the following research questions: How is the Wakalah bi al-Ujrah contract structured in LC services? What benefits and challenges arise in its implementation? And how can Sharia banks optimize the use of this contract to enhance governance and competitiveness? These questions guide the subsequent sections of this article.

LITERATURE REVIEW

Studies on Islamic trade finance highlight the central role of Sharia contracts in structuring services that meet both commercial and religious requirements. Several researchers emphasize that wakalah serves as the foundational contract for agency-based transactions in Islamic finance, with ujrah representing the permissible remuneration (El-Gamal, 2021, p. 102). This contract framework has been widely applied in remittances, investment accounts, and trade financing instruments.

The literature also indicates that the LC, as a trade facilitation instrument, is one of the most important mechanisms for reducing transactional risks (Zainuddin, 2022). In conventional finance, it often involves interest-based structures, while Islamic banks reframe it through wakalah, murabahah, or mudarabah. A critical theme is the need for Sharia governance to ensure contract authenticity and prevent hilah (legal stratagems) that may compromise compliance (Chapra, 2020, p. 245).

Previous studies have also identified gaps in customer literacy regarding Sharia-based LC contracts (Rahman, 2022). This underlines the importance of transparent documentation, effective communication, and regulatory support. Overall, the literature positions Wakalah bi al-Ujrah as both an enabler of Sharia compliance and a competitive strategy for Islamic banks.

THEORETICAL FRAMEWORK

Agency theory provides the theoretical foundation for understanding Wakalah bi al-Ujrah. Within Islamic jurisprudence, wakalah denotes the appointment of an agent to act on behalf of the principal in a lawful matter (Kamali, 2020, p. 153). When applied in Sharia banking, this theory clarifies the fiduciary role of banks as agents and the rights of clients as principals. Unlike conventional agency arrangements that may involve interest or speculative risk, Islamic agency emphasizes accountability and ethical responsibility (Obaidullah, 2023).

The principle of ujrah (fee) further legitimizes the bank's remuneration. Islamic law recognizes the agent's right to receive compensation for services rendered, provided the fee is transparent and agreed upon by both parties (Usmani, 2020, p. 215). This ensures fairness and avoids exploitation.

Risk management theory also supports the analysis. LC transactions inherently involve risks such as payment default, currency fluctuations, and documentary discrepancies. By structuring the LC under Wakalah bi al-Ujrah, risk is distributed in a way that aligns with Islamic ethics while ensuring operational efficiency (Dusuki & Abdullah, 2021).

This theoretical framework thus combines agency theory, Sharia jurisprudence, and risk management principles to provide a foundation for analyzing the contract's application

PREVIOUS RESEARCH

Early research on Islamic trade finance primarily focused on general Sharia contracts. El-Gamal (2019) highlighted the flexibility of wakalah in structuring financial services. Later, Usmani (2020) elaborated on its jurisprudential foundations, noting its wide application in LC services.

Rahman (2021) conducted an empirical study in Malaysian Islamic banks, finding that Wakalah bi al-Ujrah was used in 70% of LC transactions, but customer understanding remained limited. Similarly, Abdullah & Hassan (2022) found that clients often confused wakalah with murabahah contracts, leading to misinterpretation of fee structures.

In the Indonesian context, Kusuma (2021) examined Sharia banks and found that regulatory inconsistencies hindered optimal implementation. More recently, Alam et al. (2022) studied Gulf Cooperation Council countries and emphasized the need for harmonized Sharia standards to strengthen international trade facilitation.

Collectively, these studies underscore the significance of Wakalah bi al-Ujrah in LC services while also revealing gaps in governance, literacy, and harmonization. The present study addresses these gaps by offering a comprehensive theoretical and practical analysis.

METHOD

The research adopts a qualitative, document-based approach. The type of data consists primarily of textual and secondary data, including books, journal articles, theses, and institutional publications (Creswell, 2021, p. 89).

Data sources include reputable international journals, Indonesian Sinta-indexed articles, authoritative books on Islamic jurisprudence, and official documents from institutions such as Bank Indonesia and the Islamic Financial Services Board (IFSB).

The data collection technique relies on systematic literature review and document analysis, guided by thematic categorization of sources (Bowen, 2020, p. 34).

The data analysis technique is thematic and interpretive, focusing on patterns, contradictions, and emerging themes in the literature regarding the application of Wakalah bi al-Ujrah.

Finally, conclusion drawing involves synthesizing the findings into a coherent framework that addresses the research questions and highlights both theoretical and practical implications (Miles & Huberman, 2020, p. 76).

RESULTS AND DISCUSSION

The application of Wakalah bi al-Ujrah in LC services demonstrates a convergence of Sharia principles and modern trade facilitation needs. Theoretical perspectives emphasize its legitimacy under Islamic jurisprudence, while empirical studies highlight its growing role in international trade transactions (Alam et al., 2022). This dual significance underscores the relevance of examining both conceptual and operational aspects.

1. Structure of Wakalah bi al-Ujrah in LC Services

The first research question concerns how Wakalah bi al-Ujah is structured in LC services. In practice, the bank acts as an agent for the client in opening the LC, verifying documents, and making payments on behalf of the client. The bank charges an agreed fee (ujrah), which is distinct from interest (Usmani, 2020, p. 217). This structure ensures Sharia compliance while maintaining operational efficiency.

2. Benefits and Challenges of Implementation

The second research question addresses the benefits and challenges. The benefits include Sharia compliance, risk reduction, and enhanced trust between clients and banks (Rahman, 2022). Challenges include limited customer awareness, potential misinterpretation of fees, and regulatory discrepancies between jurisdictions (Abdullah & Hassan, 2022).

3. Optimizing Governance and Competitiveness

The third research question concerns strategies for optimization. Sharia governance mechanisms, customer education, and harmonization of regulatory frameworks are key strategies. Enhanced transparency in fee structures and active involvement of Sharia supervisory boards further strengthen implementation (Dusuki & Abdullah, 2021).

The findings confirm that Wakalah bi al-Ujah provides a robust Sharia-compliant alternative for LC services. Each research question was addressed: the contract structure ensures compliance, the benefits outweigh the challenges, and optimization strategies can enhance governance and competitiveness.

Theoretically, the study contributes to refining the integration of agency theory and risk management in Islamic finance. Practically, it suggests that Sharia banks can strengthen trade facilitation roles through customer education, transparent fee systems, and robust governance mechanisms.

CONCLUSION

This article concludes that Wakalah bi al-Ujah is a viable contract for LC services in Sharia banks, balancing compliance, profitability, and risk management. The research affirms its theoretical legitimacy and practical relevance, while also recognizing challenges that require strategic interventions. Recommendations include improving Sharia governance, enhancing literacy programs for customers, and harmonizing regulations across jurisdictions. Future research may empirically examine customer perceptions, cross-country comparisons, and the impact of digital platforms on LC services in Islamic finance.

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