

## Islamic Banking in Nigeria: Issues and Justification

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### Abstract

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Islamic banking is a system of banking that is consistent with the principles of Islamic law tailored and protected by Islamic economics. The aim of introducing the system in Nigeria was to accelerate economic development in the country through risk sharing and prohibition of interest on loans. Different opinion in Nigeria saw Islamic banking as a way of Islamizing the country, though the system has received commendations as regards to nonpayment of interest. The paper provides a general over view of Islamic banking, rationale for the establishment, problems and justification of Islamic banking in Nigeria. The study therefore employed a descriptive survey design to investigate the need and reason for Islamic banking system in Nigeria. Questionnaires were administered to 60 entrepreneurs and 40 bank staff within Imo State in Nigeria. The findings show that interest free banking affect the entrepreneurs, micro, small and medium enterprise, unemployment level and the real sector of Nigerian economy positively. It is therefore recommended that banks in Nigeria should adopt Islamic banking system since it will lead to economic development in the country.

**Keywords:** *Islamic Banking, Risk sharing, Interest free banking, Economic development*

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## **Background to the Study**

The structure of the financial system in Nigeria took a great shift with the introduction of Islamic banking under the governorship of Mallam Lamidon Sanusi in June 2011. The policy was targeted at growing the banks and positioning them and inducing improvement in their operational efficiency.

This system of banking is based on Islamic law which is centered on the prohibition of interest and despising of uncertainty, which is capable of improving the real sector operation of the economy through the entrepreneurs thereby stimulating real growth to the economy. According to Shehu (2012) "the Islamic system of banking and finance is coveted for its prohibition of interest, despising uncertainty and denouncing speculation. With emphasis *on* resources mobilization for active partnership with entrepreneurs and real sector operators in the economy, the Islamic system proved to be capable of stimulating real growth -non inflationary growth, by way of forging mutual cooperation in risk taking and profit and loss sharing".

In Nigeria, the introduction of Islamic banking (non interest banking) did not receive absolute acceptance by the citizens because most people perceived that it is a plan to Islamize the country and promotion of the northern agenda. Though there are others who believed that it will avail them the opportunity to carry out their businesses activities without having serious bottleneck experienced in the conventional banks. In the wake of the recent recession in Nigeria, it has really exposed the deficiencies of the conventional banking system due to problems created by interest rate behaviors, hence the need to encourage Islamic banking as an alternative for economic recovering. This will pave way for entrepreneurs, small scale business, men and women to get an interest free loan, which would help to accelerate growth and enhance stability.

Based on the above background, this paper seeks to assess the general overview of Islamic banking, theory and practice of Islamic banking, rationale for the establishment of Islamic banking, problems and justification of the system in Nigeria.

## **Literature Review**

### **Conceptual Framework of Islamic Banking in Nigeria**

The major problems experienced by entrepreneurs in Nigeria are lack of and limited access to funds especially the initial running capital. The conventional banks have made it difficult for businesses to thrive well because of high interest charges and collateral which do not encourage micro and medium business enterprise, the idea of Islamic banking in Nigeria context centers on non interest banking.

Non interest banking is referred to as a system of banking where by the banker lends money to a customer to finance a transaction or a project without charging interest for such a loan but sharing profit or loss accruing from the use of such loan to the customer (Okeke and Ojukwu 2012). It is a system of banking that is consistent, with the principles of the Islamic law based on the principle that deals with universal appeal and lay emphasis on moral and ethical value in all dealing of human transactions.

Islamic banking is a deposit-taking banking institution whose scope of activities includes all banking activities excluding borrowing and lending on the basis of non interest. It is generally seen as a conventional banking minus the word 'interest' with a new contract that does not include the word "interest" and that is structured in a convoluted buy/sell, in which the seller changes ownership to the bank or finance company and then the bank sells it to the eventual buyer (Abdul-Rahman, 2010). The institution can offer various profit sharing related products whereby depositors share in the risk of the bank lending. Depositors earn a return and borrower repay loans based on the profit generated from the projects on which the loan is lent. It is an arrangement where a bank and a borrower establish a joint commercial enterprise and all contribute capital as well as labour partner in agreed proportions while the loss will have to be shared in strict proportion of capital contribution.

### **Theory and Principles of Islamic Banking**

Islamic banking is based on the principles of Islamic law and guided by Islamic economies built on the theory of profit and loss sharing and prohibition of interest (using) i.e. interest free financial structure. Based on the principle, there is no justifiable reason why a person should enjoy an increase in wealth from the use of his money by another, unless he is prepared to expose his wealth to the risk of loss also. As long as the owner of the money is willing to become a shareholder in the enterprise and expose his money to the risk of loss, he is entitled to receive a just proportion of the profit and a share based on the prevailing interest rate. Islamic banks lend money to companies by issuing floating rate loans. The floating rate of interest is pegged to the company's individual rate of return. Thus the bank profit on the loan is equal to a certain percentage of the company's profit. Once the principle amount of the loan is repaid, the profit sharing arrangement is concluded. This practice is called Musharaka. So the venture funding (Mudarabe) of an entrepreneur provides labour while financing is provided by the bank so both profit and risk are shared. Such participatory arrangements between capital and labour reflect the Islamic view that the borrower must not bear all the risk/cost of a failure resulting in a balanced distribution of income and not allowing the lender to monopolise the economy. According to Okeke and Ojukwu (2012), there are strict rules applying to finance under Islamic law:

- 1 Riba (interest) is prohibited in all transactions.
- 2 Business and investment are undertaken on the basis of halal (legal, permitted) activities.
- 3 Maysir (Gambling) is prohibited and transaction should be free from gharar (speculation or unreasonable uncertainty)
- 4 Zakat (almsgiving) is to be paid by the bank to benefit society
- 5 All activities should be in line with Islamic principles.

Furthermore, Abdul-Rahman (2010) explained that: any predetermined payment over and above the actual amount of principal is prohibited i.e. lender should not charge any interest or additional amount over the money lent. The lender must share in the profit losses arising out of the enterprise for which the money was lent. Islamic finance is based

on the belief that the provider of capital and the user of capital should equally share the risk of business venture whether they are industries, firms, companies etc.

### **Rationale for Islamic Banking in Nigeria**

Different reasons have been adduced in favour of the abolition of interest charges of Islamic banking services. Some of the reasons are:

**Unearned Income: According to Siyanbola (2013),** Interest is fixed. When interest is charge, the lender knows his return (Unearned income) he is sure of it, he is not working for it but profit is the result of initiative, enterprise and efficiency. It is the result of the definite value-creation process.

**Exploitation of the Needy:** Usury (interest) is the rankest, most extortionate, most merciless which eats the marrow out of the bones of them cultivates and condemned home to life of penury and slavery (Jain 1929).

**Non Interest Payment and Profit Sharing:** Islamic banking operates in accordance with principles and rules of Islamic commercial jurisprudence that generally recognizes profit and loss sharing and the prohibition of interest as a model. Instead of charging interest on financing given out, Islamic banks give financing based on joint venture and will share any profit and loss with the borrower (Okeke and Ojukwu, 2012).

**Preference for Viability and Profitability:** Islamic banking is concerned with the viability and profitability of the business not the interest and size of the collateral. Their relationship with customers is based on equity partnership instead of debt based and creditor-investor.

**Mechanism of Inequitable re distribution of wealth:** Interest act as a mechanism by which the rich get richer and the poorer get poorer. The Islamic finance abhors interest on the bases that it contradicts the principle of distributive equity.

**Agent of economic Instability:** Siyaribol (2013) state that interest is an endemic factor in the instability on interest based economy. And that the greatest problem in the capitalist economy is that of the crises and interest plays a peculiar part in bringing about the crises. He further state that even Keynes, the campaigner for interest based monetary policy admits the fact that rate of interest is not self-adjusting at the level best suited to the social advantage but constantly tends to rise too high. He maintains that interest may infact cause inflation.

### **Issues on Islamic Banking in Nigeria**

The idea of establishing Islamic banking in Nigeria was anchored on the development and growth of the economy through interest free loan, soundness, public trust and confidence in the system. The major issues of concern centers on the following view point.

The issues on the knowledge of people over the practice and operation of Islamic banking. Before the introduction of Islamic banking in Nigeria, the central bank of Nigeria did not take time to educate and enlighten stakeholders, Muslims and Christians alike and other members of the public on how Islamic banking originated from and is based on Islamic jurisprudence and economic principles, its operation is not discriminatory to non-Muslims but is open to every member of the society including Muslims, Christians and other non-Muslims.

Again, religion wise, the system encounters criticism anchored on the Islamization of the country. According to Shehu (2012), the fear that the country has been expressed in many quarters with various degree of threats and intimidations. The religionists were of the view that the CBN is attempting to Islamize the industry and expose non-Muslim into some form of financial exclusion. Another issue centers on the deposit and investment operation. Since all financial institutions are based on the principles of taking and offering of interest, the position of Islamic banks on the issue of interest is very clear as enunciated in the Quranic and prophetic traditions. Only monies and investment that are Halal or shariah complaint are considered. The system does not accept deposit from casinos, alcoholic industries, proceeds from prostitution, sale of wine etc. under this conditions it will be difficult to engage in interbank transactions with other conventional banks.

Furthermore, shortage of expert in Islamic banking becomes an issue. According to Eze and Chiejina (2011), shortage of experts in Islamic banking, uncertainty in accounting principles involving revenue realization, disclosures of accounting information, valuation, revenue and expense matching to Islamic bank poses challenges to the system. Khan and Bhatti (2008) opine that the result of Islamic banking schemes may not be adequately defined, particularly profit and loss shares attributed to depositors.

Also the central bank of Nigeria did not take time to educate and enlighten the stakeholders, Muslim and Christians and the public on how Islamic banking works and make them understand that even Islamic banking originated from and is based on Islamic jurisminatory to non-Muslims but is open to everybody in the country.

According to Shehu (2012), the issue of product standardization is a challenge facing not only Nigerian Islamic finance institutions, but the entire Islamic banking and finance industry globally. He further states that a number of Islamic banking products are conceived and packaged differently, and while some are available in some countries/regions. Others are not approved of by the Shariah experts across the globe. To develop a uniform standards on how Islamic banking should work have not yielded any good fruit.

### **Method of the Study**

For the purpose of this paper, the study utilized secondary data for literature review and thereafter, primary data was also collected through questionnaire survey among worker of some banks and entrepreneurs in Owerri. The researcher engages the use of random

sampling techniques and 100 questionnaires was distributed, 80 of the completed questionnaire was returned and analyzed. The returned questionnaire was designed as strongly agree (SA), Agree (A), strongly disagree (SD), and Disagree (D).

## Data Analysis

**Table 1:** Questions and responses

	SA	A	D	SD	MEAN	
There is need for Islamic Banking in Nigeria	32	32	16	0	3.2	ACCEPTED
The modus operandi of Islamic Banking is known to you	64	16	0	0	3.8	ACCEPTED
Most enterprises have not benefited from Islamic Banking	0	6	8	66	1.3	REJECTED
Islamic banking will help the Nigerian economy to grow	48	21	1	0	3.2	ACCEPTED
Islamic banking will helped to reduce unemployment and improve the real sector positively	32	32	12	4	3.2	ACCEPTED
Allocation of financial resources on the basis of profit and loss sharing gives maximum weight to the profitability of the investment	32	32	16	0	3.2	ACCEPTED
Interest free banking will bring about increase in production activities	60	20	0	0	3.7	ACCEPTED
Non interest banking has significant impact on real sector of Nigeria	46	34	9	0	3.6	ACCEPTED
Interest free banking is a veritable tool that can protect Nigeria from economic meltdown and debt burden	28	26	16	10	2.9	ACCEPTED
Free interest banking will contribute to industrial and economic growth of Nigeria	32	32	16	0	3.2	ACCEPTED
Islamic banking is concerned with the viability of the project and profitability of the operation not the size of the collateral	32	30	0	16	3.0	ACCEPTED
Islamic banking expended efficient and effective allocation of investible funds in Nigeria	30	50	0	0	3.4	ACCEPTED

**Source:** Computation from field work survey, 2018.

## Discussion

The table above shows the mean response of the question distribution to the respondents in some of the banks as it concerns Islamic banking practices in Nigeria. The above table

revealed that: there is need for Islamic banking in Nigeria and the system will help to reduce unemployment, improve real sector and economic growth as well. The table also reveals that interest free banking help to increase production activities, contribute to industrial and economic growth, and efficient and effective allocation of investible funds in Nigeria and that in turn gives maximum weight to the profitability of the investments.

### **Conclusion and Recommendations**

From the study, It is crystal clear that the Nigeria economy is deteriorating and entrepreneurs and enterprises are constantly going down. The interest free banking has now become a potent tool that can protect these enterprise and entire Nigeria from the economic meltdown and debt burden there are into. The issue of acceptability as a result of religious criticism and lack of expertise and knowledge of the practice should be addressed. Based on the analyses, the system should be embraced since it will help to reduce unemployment, increase production, improve investment and economic growth as well.

The study therefore recommends that:

1. Conventional banks should key into the system because of the benefits accruing to both banks and the public.
2. The CBN should strive to perfect the frame work for the regulation of Islamic banking in Nigeria.
3. Manpower development needs to be taken serious in the banking system. This is to ensure that the staff receives relevant training in other to facilitate rapid growth in the economy.

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