



Islamic financing/banking in the Nigerian economy

Is it workable? A review of related issues and prospects

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Abstract

Purpose – The purpose of this paper is to examine the concept of Islamic banking in Nigeria, against the backdrop of the country's peculiar socio-cultural background and economy.

Design/methodology/approach – The paper reviews related issues and prospects in the context of Islamic banking in the Nigerian economy.

Findings – Implementation and success of Islamic banking in Nigeria would require: re-shaping the society, restructuring of the economic system and re-framing of the laws according to the dictates of Islam. This will not be easy in Nigeria, given her multi-religious nature. The most difficult and important task, however, is the reformation of society, which has to be undertaken as an on-going process. The paper recommends a dual banking system, where the conventional system will run side by side with the Islamic banking system.

Originality/value – The paper offers some useful suggestions that may lead to effective interest-free banking operations in Nigeria.

Keywords Banking, Islam, Interest, Nigeria

Paper type Research paper

Introduction

The interest-free banking system is one which operates according to the tenets/teachings of the Islamic faith. The most important feature of this banking system is that it is interest-free. Apart from this feature, the interest-free banking system has other objectives – amongst which are the equitable distribution of income and wealth and increased equity participation in the economy. Interest has no place in the Islamic order. The injunctions regarding the prohibition of “Riba” (as interest is referred to) are contained in the Holy *Qu'ran*, the basic source of Islamic ideology. It must be mentioned at this point that other religious faiths are also equivocal in condemning interest in modern business/commerce.

Islam prohibits Muslims from taking or giving interest (riba) regardless of the purpose for which such loans are made and regardless of the rates at which interest is charged. Some attempts have been made to distinguish between usury and interest and between loans for consumption and for production.

It has also been argued by some scholars that riba refers to usury practiced by petty money lenders and not to interest charged by modern banks and that no riba is involved when interest is imposed on productive loans but these arguments have no general acceptance. Apart from a few dissenting opinions, the general consensus among Muslim scholars clearly is that there is no difference between riba and interest.



Review of related literature

Prohibition of interest

Virtually all the major religions the world over are against interest on any form of loan. As far as Islam is concerned, the prohibition of interest is absolute and total. The universal condemnation of interest is immediately apparent, even with a cursory glance at most religious literature. The Holy *Qu'ran*, in verse 278 of surah Al-Baqarah, states:

“O ye who believe! Fear Allah and give up what remains of your demand of *riba*, if ye are indeed believers” and vs 2: 279 says. “If you do it not, take notice of war from Allah and His Messenger but if ye turn back, ye shall have your capital sums. Deal not unjustly and you shall not be dealt with unjustly.”

It therefore follows that interest is prohibited as it leads to injustices (*Zulm*) and Islam is against all forms of injustice and exploitations. It pleads an economic system which aims at securing, extensive socio-economic justice.

“Usury,” a term used in the Holy Bible (King James Version), to mean interest is also forbidden by God as can be found in Deut. 23 verse 19 – “Thou shalt not lend upon usury to thy brother; usury of money, usury of victuals, usury of anything that is lent upon usury.” Among the revealed religions, Judaism, prior to Islam had also prohibited interest. The old Testament reads:

[...] if ye lend money to any of my people with you who is poor, you shall not be to him as a creditor; neither shall you require interest from him.

Hence, if it is on the basis of religion alone, interest – free banking could very well thrive in Nigeria but there are other factors at play.

Alternative form of financing

The Islamic ban on interest does not mean that capital in an Islamic system is costless. Islam recognizes capital as a factor of production but it does not allow the factor to make a prior or predetermined claim on the productive surplus in the form of interest. This obviously poses the question as to what will then replace the interest rate mechanism in an Islamic framework. There have been suggestions that profit-sharing can be a viable alternative (Kahf, 1982a, b). It is believed that the financing on the profit and loss sharing system of Islamic banking in a conducive environment would not only ensure a healthier financing portfolio and of course, higher rates of return to depositors but would also lead to optimum allocation of resources for over all economic growth and welfare of the society individually and collectively.

According to Parsa (n.d.), some alternative Islamic contracts are as follows.

Musharakat. This is very much like a “joint Venture” agreement which stipulates the conditions of a partnership. An Islamic bank enters into an agreement with a potential industry or commercial client in which they both put up some “Equity or Venture capital” for an investment project(s) and they both share, according to some mutual agreement, the profits and losses.

Mudarabah. This is a profit sharing agreement, much like a silent partnership. The Islamic bank under this contract would provide capital to a client such as an industrialist who needs to finance a factory in return for which the industrialist agrees to pay the bank (or the financial institution) a certain percentage of the factory’s net profits every year.

Murabahah. Under this agreement, an Islamic bank finances goods that a trader or an individual wants, through purchases in the bank's name, and then resells them to the individual at an agreed markup which can be used for trade financing.

Mozaraah. This is an agreement for joint cultivation and/or nurturing. Under this agreement, a landowner provides a piece of land to a farmer and the farmer provides the work to cultivate the land and they share the product of the farm according to a mutually agreed upon formula.

Ijarah. This is a rental or lease agreement through which the services of an individual or legal entity or organization is rented out or leased against a mutually-agreed upon fee, rent, leasing fee. It can eventually lead to the ownership of buildings or the rental equipment by the user of the funds (*Mostaa-jir*).

Mossaghaat. Under this agreement, the owner of a garden enters into a contract with someone else to nature, cultivate, and take care of his garden as a gardener or caretaker raising fruit trees and continuing to work in the garden as a caretaker of the trees to the point of preparing the trees for the next crop.

Interest free banking in Nigeria: the journey so far

Nigeria is the most populous black nation in the world with a population of about 150 million. It is made up of 250 languages and 36 states. Nigeria is made up of people with not only diversified cultural background but also diversified religious backgrounds. However, the two predominant forms of religion found in this country are Islam and Christianity.

The history of Islamic banking in Nigeria is recent and dates back to the mid-1990s. The pioneers of this non-interest bank financing are Habib Nigeria bank and Ahmed Zakari Company. Habib Nigeria Bank limited pioneered Islamic Banking in Nigeria. The idea was conceived in 1995 and approved by The Central Banking of Nigeria on the March of 4th 1998. In August 2001, Habib Nigeria Bank, now known as Bank PHB (Platinum Habib Bank Plc) introduced a new product tagged "Non interest banking". Under the scheme, the banks lending portfolio was tailored towards lending to entrepreneurs who are profit-oriented and profit-motivated rather than interest-oriented as is the practice in credit banking.

Bank PHB has been able to achieve the integration of Islamic banking principles into the structure of the conventional banking system with its interest free financial products designed in such a way that Muslims can operate bank accounts and still stay true to the Islamic faith.

The products' Bank PHB are offering under the Islamic banking scheme are:

- *Hajj* investment, which is a special savings account that enables Muslims to save gradually and with ease for the annual *Hajj* pilgrimage.
- Deposit accounts.
- Current accounts.

Holders of current accounts are insulated from loss in the event of bank business failure while holders of other accounts are entitled to different degrees of profit sharing (Onwuamaeze, 2007).

According to reports made by The Institute of Islamic Banking and Insurance (2000), Habib Nigeria Bank announced a growth in profit from N548.62 million in 1998 to N879.84 million in 1999 representing a 60.38 percent increase.

Other performance indices such as gross earnings and total assets also increased significantly from N1.95 to N3.07 billion and N10.654 to N15.79s billion between 1998 and 1999, respectively.

Jaiz Bank International Plc. (JBI) was confirmed in 2006 as Nigeria's first fully-fledged Islamic bank. (Middle East Banker March, Mohammed, 2006).

Jaiz Bank International products include:

- *Jaiz current account.* This is similar to a current account in conventional banking but a marked difference is that no interest is paid to depositors. It is essentially safe keeping (*AI-Wadiah*) arrangement between the depositor and the bank, which allows depositors to withdraw their funds at any time.
- *Jaiz savings deposit accounts.* This includes Jaiz regular savings account (under *AI-Wadiah*), Jaiz *Haji* savings account and Jaiz savings account (under *Mudarabah*).
- *Jaiz investment accounts.* This is similar to fixed term accounts. The bank offers two types of investment accounts, namely the joint investment account and the specified account.
- *Joint investment account.* This involves the entering into a *mudarabah* contract by the depositors with the bank, whereby depositors are jointly considered as *Mudarib* (lender). The depositors will authorize the bank to select suitable investment and project profits are shared according to agreed profit-sharing ratios between the bank and the investing depositors. Losses are also borne by the investing depositors and the bank in proportion to their contribution.
- *Specified investment accounts.* Under this type of account, the bank receives monies from depositors who wish to appoint the bank as an agent for investing their deposits in specific projects or in specific manner on the basis that the bank will receive a part of the net profits realized, but will not be liable for any loss which is not attributable to any violation or fault by the bank.

Other products offered by the JBI covers micro-credit finance, cost-plus financing (*Murabaha*), leasing (*Ijarah*), trust financing agreements (*Mudarabah*), equity participation (*Musharaka*) and *Istisnaa* (a contract for the acquisition of manufactured good specification, or order, where the prices are gradually paid in accordance with the progress of the job).

Operating Islamic banking system in Nigeria

Market potentials

The market potential for Islamic banking in Nigeria is very high. Muslims constitute a very high percentage of the over 130 million Nigerians. Right now, there have been calls by Islamic leaders in this country for the establishment of an Islamic banking system to operate side by side with the conventional banks. In the word of Atuche, the Managing Director of Bank PHB:

[...] interest free products are part of the bank's innovative drive to make banking service available to a significant segment of Nigeria's population who were excluded because of their religious belief (Onwuamaeze, 2007).

Speaking on the emergence of Islamic banking, the Sultan of Sokoto and the President, Nigeria Supreme Council of Islamic affairs, commended Bank PHB for its foresight in

initiating Islamic banking products and called on Nigerians to embrace it. He described the advent of Islamic banking as a fitting response to the yearning of Muslims faithful for banking products that would enable them to stay true to their faith while carrying out financial transactions (Onwuamaeze, 2007).

Issues and challenges

For Islamic banking to achieve the desired effects in Nigeria, a number of challenges as well as problems have to be addressed and overcome.

A few of such issues, challenges and problems shall be discussed below.

Enactment of the enabling laws. As at the time of this writing, the enabling laws for the full operation of Islamic banking are yet to be passed in Nigeria. The successful operation of interest free banking can mostly be ensured only in an economic environment where interest is highly prohibited such that any transaction based upon interest is not only frowned at; but also declared a punishable offence. Back here in Nigeria, this law cannot strictly enforced, hence the possibility that some capitalists would jeopardize the larger interest of the people for their private benefit will exist.

Accounts and transparency. When a business is financed under the profit-loss-sharing scheme, it is necessary that the actual profit/loss be made known.

Though no satisfactory methods have yet been devised, the first requirement must be the existence of the necessary records.

On the borrower's side, there may be two difficulties:

- (1) Many small businessmen do not keep any accounts, let alone proper accounts.
- (2) Larger businesses do not like disclosing their real account to anybody. There is this fear that if they disclose their accounts to the bank, that tax authorities will become wise to the extent of their business and profits.

Transparency and its benefits depend critically on the availability of a number of related services and tools, ranging from reliable information software to high-quality auditors and recruiting agencies to credit bureaus that capture clients' credit histories.

Unfortunately these services are scarcely available to financial institutions in this part of the world.

Education and retraining of staff. The bank staff will have to acquire many new skills and learn new procedures to operate the Islamic banking system. This will obviously be a time consuming process which would be aggravated by two other factors which are:

- (1) the great number of persons to be re-trained; and
- (2) the additional staff that need to be recruited and trained to carry out the increased work.

The question of morality. The value system is such that if it is not re-directed is capable of making a caricature of this noble intention. What am I saying? Islamic banking, like conventional banking, can run conveniently in Nigeria and produce excellent and desired results; but our value system has to be renewed. Right now, a lot of emphasis is placed on materialism which in the first place is against the teachings of the Islamic faith.

In a society where the moral standards of citizens is low and in which the tendency to sacrifice public goods for personal benefits is too strong and common, it would require more legal sanctions to be able to run a successful interest-free banking system.

Prospects of Islamic banking system in Nigeria

Mopping up of excess liquidity

Mopping up excess liquidity in the Nigerian economy appears to be the first major prospect of the perceived Islamic banking system in this country. It is on record that liquidity management is of great concern to the Central Bank of Nigeria. Part of the reasons why the Apex Bank finds it difficult to direct the growth/development of the economy is because there is excess liquidity outside the banking system. In the northern part of Nigeria; the banking system is not highly patronized because of interest which is an integral part of the conventional banking system. The truth is that our current banking system contravenes the belief of most people, Muslims and Christians alike. The result is excess liquidity (owing to low patronage of the banks) outside the banking system, hence the problem of liquidity control and management. With Islamic banking in Nigeria a greater number of these monies outside the banking system will be channeled back to the system and as such control will be more effective.

Problem of collateral security. In practice many debt schemes especially in the agricultural sector require collateral. The requirement of collateral by small and medium scale farmers in Nigeria is the greatest problem faced by them; since this is the greatest challenges they face in their bid to raise funds. In the time past, the Federal Government of Nigeria had taken some positive steps to address this issue, which until now is still lingering. In the acquisition of a bank loan, most of these peasant farmers do not have such collaterals that the banks require and so are not able to get such loans to finance their businesses. On the other hand, the Islamic banking system does not require any collateral, and as such the introduction of an Islamic scheme would help to overcome this problem which would lead to a lot more investment activity in the economy. The importance of these small businesses in the growth of any economy cannot be overemphasized. The generations of employment, the discouragement of rural to urban drift, etc. are some of their importance; hence any banking system that would remove the collateral bottleneck would be a welcomed development.

Recommendations/conclusions

It is important to appreciate that implementation and success of Islamic banking in Nigeria would require: re-shaping the society, restructuring of the economic system and re-framing of the laws according to the dictates of Islam. This will not be easy in Nigeria, given her multi-religious nature. The most difficult and important task, however, is the reformation of society, which has to be undertaken as an on-going process.

We therefore, need to change our priorities and emphasis should be laid on improving the ethics, honesty and values of the society. This will then create a more conducive environment for a much more financing under profit- and loss-sharing system of Islamic banking. Another challenging issue facing the implementation of an Islamic financial system is the development of risk-bearing instruments that can provide the investors with a sufficient degree of liquidity, security and profitability. The Islamic banks would also have to face the challenges of developing innovative services and products for utilizing these funds effectively and efficiently for financing under the profit- and loss-sharing system. The Islamic banks, while having an objective of earning profit, should identify with *Shariah* as regards objectives, principles, and operations.

The sponsors or directors of these Islamic banks should be individuals who could be Christians or Muslims but who believe in interest-free banking. They should be men and women of high integrity and reputation with an enviable track record in banking. These persons would take up these challenging assignments for reasons other than profit motives.

Finally, it is obvious that it would be almost impossible to operate a successful Islamic banking system in Nigeria. This does not erode the numerous benefits that would result from a successful Islamic banking system. We therefore recommend a dual banking system, where the conventional system will run side by side with the Islamic banking system.

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