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ISLAMIC BANKING IN NIGERIA: A CRITICAL APPRAISAL OF ITS EFFECT ON THE NIGERIAN ECONOMY

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Abstract

Islamic banking came as a result of Islamic belief which prevents dealing in interests. It is carried out on a sharing of profit and loss basis. Islamic banking operates on two principles called Mudarabah and Musharak. Many Muslims do not put their money in the bank thereby encouraging idle cash. Several literature's were reviewed to assess different authors view on Islamic banking impact in a country's banking sector. Questionnaires were conducted to ascertain public opinions on the Islamic banking concepts and its desirability in the Nigerian banking sector as well as necessary inference were drawn from such a survey accordingly. The paper recommends adequate supervision and normal prudential guidelines to streamline its operation. The paper concludes that Islamic financing as a part of a financial sector development strategy should be encouraged by regulations and supervision authorities, that accommodate its forms while ensuring that their unfamiliarity is not exploited to defraud clients.

Key words: Islamic, Usury, Shariah

INTRODUCTION

Modern banking system was introduced into the Muslim countries at a time when they were politically and economically at a low ebb, in the late 19th country. The main banks in the home countries of the imperial powers established local branches in the capitals of the subject countries and they catered mainly for the import and export requirements of the foreign business. The banks were generally confined to the capital cities and the local population remained largely introduced by the banking system. Borrowing from the banks and depositing their savings with the bank were strictly avoided in order to keep away from dealing in interest which is prohibited by Islamic religion.

According to the Institute of Islamic Banking and Insurance (1990), "Islamic Banking refers to a system of banking or banking activity that is consistent with the principles of the Shariah (Islamic rulings) and its practical application through the development of Islamic economies". Nigeria's quest for a virile banking reform had led to the adoption of several strategies that would truly give the nation's economy an edge towards growing sustainability. No doubt, the bail out of "'failed banks" and the acquisition of assets from bad banks' did save the economy and Nigeria to a large extent from such kind of economic blows suffered in the Scandinavian banking crises. It is true that the CBN had emphasized on its readiness to establish or give licence to banks wishing to operate interest free banking system which is popularly known by many as Islamic banking because is in tandem with Islamic jurisdictions and beliefs that prevent dealings in interest (Riba or usury) it is also true that the Bank has the jurisdictions, as provided in its Act to allow such financial or banking practice, but what should not be true is the believe that the CBN's policy was meant to enforce Islam or Shariah on Nigerians. For the avoidance of doubts, as it were with conventional commercial banks, interest-free banking system has its inherent pros and cons which affect the Muslim and non – Muslims alike. A first glance of how interest free banking system operates could set a pace of reasonable understanding to its fault. The bank has both Muslims and non-Muslim customers. Its lending principle is based on the belief that providers of capital and the users of capital should equally share the risk of business ventures. Translated into banking, the depositor, the bank and the brrower should all share the risks and the rewards of financing business ventures. Interestingly, the flexible nature of Islamic finance provides enormous opportunities. It has positive and far – reaching implications for the Nigerian economy. The interest – free banking principle in Islam allows only one kind of loan and that is guard-el (literally good loan) whereby the lender (the bank) also shares in the profits or losses arising out of the enterprise which the money was lent. Islam encourages the economy of wealth redistribution; customers are encouraged to invest their money and to become partners in order to share profits and risks in the business. This is unlike the interest – based commercial banking system, where all the pressure is on the borrower. He must pay back his loan, with the agreed interest, regardless of the success or failure of his venture. Ahmad et al (2007) defined an Islamic Bank as "a financial institution whose status, rules and procedures expressly state its commitment to the principle of Islamic Shariah and to the banning of the receipt and payment of interest on any of its operations. Thomas (1995) is of the view that *Riba, Gharar* and *Maysir* manifested in the conventional system can wreak havoc in an economy as advanced as USA, as depicted by the massive failures of US savings and loans institutions of the 1980s. Islamic Banking aims to promote economic growth through risk-sharing instruments whose payoffs fluctuate with economic output and do not structurally impair the economy in the manner that excessive fixed-interest debt does in a poor economic environment such as a recession (Asquith et al., 1994; Andrade and Kaplan, 1998). The present day multi – rich Nigerians can hoard money, thereby limiting or eliminating the purchasing power of money. This practice have negatively marred the efforts at keeping inflation at bay, as this idle money are not utilized in economic activities that could improve the country’s Gross Domestic Product (GDP) over time. Under the Islamic Banking system, human intitiative and risk involved in a productive venture are more important than the money used to finance it. The true nature of wealth in Islam requires social preferences and market exchange mechanisms that are ethicized by human consciousness. Islam gives precise moral injunctions as to what are, and are not acceptable kinds of wealth. While Islam employs various practices that do not involve charging or paying interest, the Islamic financial system promotes the concept of participation in a transaction backed by real aspects, utilizing the funds at risk on a profit and loss sharing basis which is important for the Nigerian economy. Such participatory modes used by Islamic banks are known as Musharakah and Mudarabah. This by no means implies that investments with financial institutions are necessarily superlative. This can be excluded by carefree investment policy, diversification of risk are prudent management by Islamic financial institutions. The concept of profit – and – loss sharing in an enterprise, as a basis for financial transactions is a progressive one as it distinguishes good performance from the bad and the mediocre. These concepts therefore encourage better resource allocation and management. Finally, Islamic finance is not a product to be offered to a niche market, it is a system. Therefore, it is fair to promote the system as did by United Kingdom government. Nigerian could buy from the West, especially with the united States strategy in understanding the system and how US Deputy secretary of the Treasury Robert M. Wimmitt showed the world that U.S. was interested in learning more about Islamic finance through holding on “Islamic finance 101 course in Washington to educate government officials on its nitty-gritty. Whatever the system that the CBN (Apex Bank) deems fit to aid in strengthening the banking industry, it is left for the customers and Nigerians to decide on which financial product to explore. As it stands today with many conventional banks increasing minimum cash balance in savings (deposit) accounts to ₦25,000.00 and thereabout. Islamic banking could be a succour towards sustaining competition in Banking performs for a surviving economy which average citizens earns far less than 18,000.00 per month. The goods the saver wants will cost more in the future, so he is justified in charging a rent for the use of his loan. Keynes (1936), argued that money is the most liquid of assets, that is to say it is the asset most readily exchangeable for other forms of assets and that interest is the price paid for loss of liquidity. The theory that interest protects savings from inflation neither explains why the rate of interest is, nevertheless, always above the rate of inflation, nor does it question the proposition that inflation is the cause of interest. Nor do these theories answer the question as to why interest should be the market regulator; the supply and demand for money. Why should interest be paid for one’s postponement of enjoyment of present goods, or paid for abstain from diminishing one’s present capital, which would otherwise be diminished by the ranges of time and consumption? Asked by advocates of Islamic (non – interest) banking. Another Islamic principle is that there should be no reward without risk bearing. This principle is applicable to both labour and capital. As no payment is allowed to labour unless it is applied to risk, so no reward for capital should be allowed unless it is exposed to business risks. Consider two persons, one of whom has capital but no special skills in business while the other has managerial skills but possesses no capital. They can co-operate in either of two ways.

1. **Debt – financing** (the western loan system): The businessman borrows capital from the capital owner and invests it in his trade. The capital owner is to get back his principal an additional amount on the basis of a fixed rate, called the interest rate, as his compensation for parting with liquidity for a fixed period. This payment is due irrespective of whether the businessman has made a profit using the borrowed money. In the event of a loss, the borrower has to repay the principal amount of the loan, as well as the accounted interest from his own resources, while the capital – owner loses nothing. Islamic views this as an unjust transaction.
2. **Mudarabah** (the Islamic way, or pls). The two persons co-operate with each other on the basis of partnership, where the capital – owner provides the capital and the other party puts his management skills into the business. The capital – owner is not involved in the actual day – to – day running of the business, but is free to stipulate certain conditions that he may deem necessary to ensure the best use of his funds. After the expired period, which may be the termination of the contract or such time that returns are obtained from the business, the capital owner gets back his principal amount together with a pre-agreed share of the profit. The ration in which the capital – owner and the manager of the enterprise is determined and mutualy agreed at the time of entering the contract, before carrying out the project. In the event of loss, the capital owner bears all the loss and the principal is reduced by the amount of the loss. It is the risk of loss that entitles the capital – owner to share in the profit. The manager bears no financial loss, because he has cost time and his work has been wasted. This is in essence, the principle of Mudarabah.

Islamic banking has a unique dispensation on the theme of wealth, its ownership, distribution, and social relationship. Although the system encouraged customer to purchase, it also prohibits or discourage investment in practices and products that are considered forbidden. The Apex bank can make policies for the financial system and operators, as much as it is provided by enabling laws.

Interest – free banking is a product of CBN, to take effect if the listed legal provisions and other careful indices are put in place to meet the economic objective for which it is meant for. All that is needed is a careful and extensive capacity building in collaboration among various stakeholders to develop cognate expertise in non – interest banking, development of a regulatory and supervisory framework for the effective operation of non – interest banking in Nigeria. As it stands, interest – free banking system and Islamic banking system refers to the same policy as they operates in line with the provisions and jurisdictions of the Islamic Shariah system; nevertheless, it does not connotes a means of enthroning Islam over the sovereignty of Nigeria but a mere banking policy aimed at salvaging the country's financial system as seen practiced in the United Kingdom, America and parts of Europe.

1.0 THEORETICAL BACKGROUND

Islamic banking refers to a system of banking or banking activity that is consistent with the principles of the Shariah (Islamic rulings) and its practical application through the development of Islamic economics. The principles which emphasize moral and ethical values in all dealings have wide universal appeal. Shariah prohibits the payment or acceptance of interest charges (riba) for the leading and accepting of money, as well as carrying out trade and other activities that provide goods and services considered contrary to its principles while these principle were used as the basis for a flourishing economy in earlier times, it is only in the late 20th century that a member of Islamic banks were formed to provide an alternative basis to Muslims although, Islamic banking is not restricted to Muslims. Islamic banking has the same purpsoe as conventional banking except that it operates in accordance with the rules of Shariah, known as fight al-Muamalat (Islamic rules on transactions). Many of these principle upon which Islamic banking is based are commonly accepted all over the world, for centuries rather than decades. These principles are not new but arguably, their original state has been altered over the centuries. A popular belief persists that Islamic banking is simply an interest – free financial structure. But in fact, Islamic economics is a complete system of social and economic justice. It deals with property rights, the incentive system, the allocation of resources, economic freedom and decision–making and the paper role of government. Western bankers' loan said that savings are investments would soon dry up if interest were not paid. But this is due to identifying "rate of interest" and 'rate of return" as posited by the Islam world. To them "God has permitted trade, but forbidden riba (interest)". Therefore it is only the fixed, or predetermined, return on savings or transactions that is forbidden, not an uncertain rate of return, such as the making of profit. Modern economists have developed many arguments to justify interest. One argument is that interest is the reward for saving a compensation that the creditor pays the debtor for the latter's temporary loss of the use of capital.

3.0 ISSUES AND RELEVANCE OF ISLAMIC BANKING

The desire of enlightened Muslims to seek the moral equivalent of modern capitalism goes back to Egypt in the early 1960s. The processing effort in Egypt took the form of a savings bank based on profit–sharing in the form of Mit Ghaya. The Islamic Development Bank (IDB) was established in 1975 by the Organization of Islamic Conference (OIC), but it was primarily an intergovernmental body aimed at providing funds for development projects in member countries. Islamic banks came into existence in Saudi Arabia and the United Arab Emirates. Since then, Islamic financial institutions have emerged in large number of Muslim countries including Kuwait, Bahrain, Qatar, Turkey, Pakistan, Indonesia and a belt of other IDB member countries.These institutions have taken the form of commercial banks, investment banks, financial companies etc.

MARKETING SIZING

Islamic banking today is an industry that is still evolving. The industry manages approximately $180 billion dollars today, growing at approximately 15% per annum. The growth of Islamic banking is a result of economic growth in Islamic world fuelled primarily by oil wealth. This growth created a growth middle–wealth segment and hence made banking a necessary service to larger segment of the population rather than a service for the few, as had to be the case some 10 to 15 years earlier.

THE MARKETS AND THE PLAYERS

More than $^{2}/3^{rd}$ of Islamic finance business is currently originated in the Middle East. The GCC countries, with the exception of Oman are all major markets of Islamic finance. Bahrain is regarded as the hub for Islamic finance. Non–GCC markets for Islamic finance include Egypt, Malaysia, Turkey, Indonesia and Pakistan. Malaysia operates a dual banking system promoted by the government. It allows conventional financial institutions, investment banks, commercial banks, and finance companies to launch separate Islamic banking divisions. Bank Negara

Malaysia (the Central Bank) has its own Shariah Advisor Board which sets the rules for the entire Islamic banking sector, ensuring uniformity in products and services.

THE PRODUCTS AND STRUCTURES

Islamic banks around the world have devised many financial products based on the risk–sharing, profit–sharing principles of Islamic banking. Banking activities requires a number of financial instruments that have been developed to satisfy the Islamic doctrine and provide acceptable financial returns for investment. Broadly speaking, the areas in which Islamic banks are most active are in trade and commodity finance, property and leasing. Almost every Islamic bank has committee of religious advisers whose opinion is sought on the acceptability of new instruments and services and who have to provide a religious opinion of bank's activities for year–end accounts.

COMMUNITY BANKING

Muslims in Britain and throughout the world aspire to carry out their financial matters in accordance with the principles of Islamic law. Muslims are forbidden from obtaining the various conventional banking and insurance products and services in the forms currently offered due to their incompatibility with the principle of Islamic law. It is estimated by various surveys that over 2 million Muslims are permanently residing in the UK. The community is predominantly composed of people from Indian sub continent who have settled in Britain during the 1950s. Beside that, there are also Muslims of middle Eastern and North African Origins. Beside the market represented by Muslims living in Britain, there is potential overseas investor to be introduced by HSBC.

ISLAMIC BANKING IN NON – MUSLIM COUNTRIES

The modern commercial banking system in nearly all countries of the world is mainly evolved from and modeled on the practices in Europe, especially that in the United Kingdom. The philosophical roots of this system resolved around the basic principles of capital certainty for depositors and certainty as to the rate of return on deposits. In order to enforce these principle for the sake of the depositors and to ensure the smooth functioning of the Banking System Central Banks have been vested with powers of supervision and control – all banks which wish to operate in non–Muslim countries have some difficulties in complying with these rules.

CERTAINTY OF CAPITAL AND RETURN

While the conventional banks guarantee the capital and rate of return. The Islamic banking system, working on the principle of profit and loss sharing, cannot, by definition, guarantee any fixed rate of return on deposits. Many Islamic banks do not guarantee the capital either, because if there is a loss it has to be deducted from the capital. Thus, the basic difference lies in the very roots of the two systems.

RIBA (USURY OR INTEREST)

Ebrahim (1999, 2000) based on Ibn Qayyim (n.d), classifies two forms of Riba (also, Chapra-1986, Rahman-1969, Saeed-1995): Riba-al-fadl implies any form of unfair trade, market manipulation or engaging a market participant to trade under duress, and Riba-al-nasi'ah implies risk-free debt contracts, in fact, any risk-free return from an investment vehicle or strategy.

4.0 DATA PRESENTATION AND ANALYSIS

Structured questionnaires were administered to 120 respondents and 105 were returned. This number represents 88% of the total number administered.

Table 1: Level of Understanding of Islamic Banking

Responses	**Number**	**Percentage**
No knowledge at all	0	0%
Peripheral knowledge	58	55%
In-depth knowledge	35	33%
Advanced knowledge	12	12%
Total	**105**	**100%**

Source: Survey report 2013

The result show that 55% of the sampled banking population have peripheral knowledge of Islamic Banking, 33% of the sampled opinions have indepth knowledge while only 12% have advanced knowledge. The result shows that this area of knowledge in Banking is still growing and is not wholly understood by the banking public and consumers of Banking products.

Table 2: Level of impact or success of Islamic Banking in Nigeria

Responses	**Number**	**Percentage**
80% and above – Excellent	12	12%
60% - 79% - Very Good	36	34%
40% - 59% - Fair	48	46%
Below 40% - Poor	9	9%
Total	**105**	**100%**

Source: Survey report 2013

The Result shows that over 55% (representing fair and poor category) believe that the level of success of Islamic Banking is low. Hence, there is great work to be done (in terms of awareness) on the banking public to enhance its level of success.

Table 3: Islamic Banking or non-interest Banking has negative consequences in the Nigerian Banking Industry

Responses	**Number**	**Percentage %**
Strongly Agree	12	11
Agree	36	33
Neutral	45	43
Disagree	12	13
Total	**105**	**100%**

Source: Survey report 2013

The Responses shows that over 44% of the sampled population believe that Islamic banking has negative consequence on the banking economy in Nigeria. However, while 13% disagree, 43%

are quite indifferent or neutral about this. This suggests that the outcome of Islamic banking may turn out to be negative if the scope and framework is not properly defined.

Table 4: Charging interest for monies lent out by financial institutions is wrong and against Godly morals.

Responses	Number	Percentage %
Strongly Agree	0	0%
Agree	0	0%
Neutral	12	12%
Disagree	93	89%
Total	**105**	**100%**

Source: Survey report 2013

The survey Result shows that 89% of the sampled population disagree that charging interest for monies lent out by financial institutions is wrong. This result suggests that it will be pretty difficult for non-interest banking to survive on the Nigeria Banking industry moreso, with a greater part of the population being Christians.

Table 5: Can Islamic Banking survive along with the conventional banks in terms of profitability and shareholders' wealth?

Responses	Number	Percentage %
yes	0	0%
No	93	89%
Neutral	12	11%
Total	**105**	**100%**

Source: Survey report 2013

The above responses shows that 89% of the sampled populations do not agree that the Islamic Banking will survive along with the conventional banks in terms of profitably and shareholders' wealth maximization. This result indicates that the average capitalist investor in the Nigerian Banking industry will not be willing to invest or support the growth of an Islamic Bank since he will only be interested on maximizing its wealth. This will also help to delimit the growth and development of Islamic Banking in Nigeria.

Summary of findings from the above Survey

From the findings, the following can be adduced about the impact of Islamic Banking on the Nigerian Banking industry.

- It is still at its elemental stage and requires further awareness.
- The environment is not yet ripe to support this kind of banking system.
- Majority of the Nigerian population that are Christians may not be willing to support the introduction and growth of Islamic banks.
- This kind of Bank (Islamic Bank) may not survive on a capitalist business environment like Nigeria.
- The supply of business knowledge required for such a system of banking to thrive is not yet in place.

5.0 RECOMMENDATIONS

Islamic finance, as part of a financial sector development strategy,ought to be encouraged, mainstreamed, and adjusted to. An IMF study on the matter concludes that Islamic finance should be encouraged by regulation and supervision that accommodate its forms while ensuring that their unfamiliarity is not exploited to defraud clients. Normal prudential and supervision norms should be adequate. The IMF study does, however, suggest that higher capital adequacy ratios and more detailed disclosure requirements may be appropriate. Also, there should be a modified “CAMEL” (capital adequacy, asset quality, management, earnings and liquidity) system of banking supervision for Islamic banking special risks are the generally uncollateralized nature of Islamic banking and greater risks in the profit–sharing forms of lending. To the extent that Islamic banking is collateralized or does not engage in profit–sharing forms, the issues are less serious.

CONCLUSION

People have needs– food, cloths, houses, machinery, services; the list is endless. Entrepreneurs perceive these needs and develop ways and means of catering for them. They advertise their products and services, people expectations are raised and people become customers of the entrepreneur. If the customers’ needs are fulfilled according to their expectations they continue to patronize the entrepreneur and his enterprise flourishes. Otherwise his enterprise fails and people take to other entrepreneurs. Banks too are enterprises, they cater for people’s needs connected with money safe–keeping, acquiring capital, transferring fund etc. The Fact that they existed for centuries and continue to exist and prosper is proof that their methods are good and they fulfill the customers’ need and expectations. Conventional commercial banking system as it operates today is accepted in all countries. The regulation is on account of the fact that the banking operations involve dealing in interest which is prohibited in Islam. Conventional banks have ignored this concern on the part of their Muslim clientele. Muslims patronized the conventional banks out of necessity and, when another entrepreneur the Islamic banker offered to address their concern, many Muslims turned to him. The question is; has the new entrepreneur successfully meet their concerns, needs and expectations? Broadly speaking, banks have three types of different customers; depositors borrowers and seekers of bank’s other services such as money transfer since services do not generally involved dealing in interest, Muslims have no problem transacting such business with conventional banks; neither do Islamic banks experience any problems in providing these services. Islamic banking is a very young concept, yet it has already been implemented as the only system in some Muslim countries as mentioned earlier. There are Islamic banks in many Muslim countries as well. Despite the successful acceptance, there are problems. These problems are mainly in the area of financing. With only minor changes in their practices, Islamic banks can get rid of all their cumbersome and sometimes doubtful forms of financing and offer a clean and efficient interest free banking. All the necessary ingredients are already there. The modified system will make use of only two forms of financing – loans with a service charge and Mudaraba participatory financing both of which are fully accepted by all Muslim writers on the subject. Such system will offer an effective banking system where Islamic banking seems a powerful alternative to conventional banking where both co-exist. Additionally, such a system can offer responsible financing to socially and economically relevant development projects. This is an additional service Islamic banks offer over and above the traditional services provided by conventional commercial banks. Many of its instruments are the same as those used by other financial institutions like leasing, advance purchase, etc the difference lies in the first instance in the social improvement for sharing responsibility, risk, and poverty. Consequently fixed interest transactions in which risk is assigned entirely to the borrower are avoided more important for participants, Islamic finance represents part of a divinely sanctioned economic gestalt into which they fit. Thus Islamic finance render financial services to and otherwise underserved group including small, rural and agricultural producers; Furthermore a social thrust to assist smaller producers and consumers and is often given in the context of a movement to assist them, but it requires some adjustment, mostly formal, of techniques and regulation to take account of Islamic values.

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