

## Islamic Banking in Nigeria: Prospects and Challenges

Alexander Olawumi Dabor<sup>1</sup> & Meshack Aggreh<sup>2</sup>

<sup>1,2</sup>Department of Accounting, Veritas University, Abuja, Nigeria  
Correspondence: Alexander Olawumi Dabor(PhD), Veritas University, Abuja, Nigeria.  
Email:dabor.ola4real@yahoo.com

Received: July 20, 2017

Accepted: August 28, 2017

Online Published: September 1, 2017

doi: 10.23918/ijsses.v4i1p120

**Abstract:** Islamic banking is consistent with the principles of Sharia which prohibits acceptance of interest on loans. Islamic finance has increasingly become a significant source of finance in the Western world, especially in the United Kingdom, despite the regulatory hurdles presented before it non-Muslim financial environment. The Nigerian state has also joined the other nations to establish Islamic banking against all hurdles, misconstrued and initial misconception of what Islamic bank stand for. The objective of this study is to ascertain the benefits and challenges facing the growth of Islamic banking in the Nigeria. Nigeria is said not to the hub of Islamic banking and does not naturally have the inbuilt instruments needed for Islamic finance due to its multi-religious nature. This study employed primary data via administering of questionnaire. Two hundred copies of questionnaire were distributed to prospective customers of Islamic banking and non-customers of Islamic banking residing in four geo-political zones in Nigeria. Our data were analyzed by employing Z-test statistical technique and chi-square statistical technique. The result showed that lack of awareness and customers' preference for conventional banks and traditional money lenders are the major challenges facing the growth of Islamic banking in Nigeria. Our result further showed that poverty alleviation and job creation are the major benefits that will be derived from Islamic in Nigeria. Finally, the study reveals that there are greater opportunities for Nigeria the development and growth of Islamic financial system because most commercial bank customers are eager to switch from the convention banking (exhortative system) to take financial products that are interest free. The study recommended both Muslim and non- Muslim communities should be educated on the mission statement of Islamic bank and what they stand to gain from Islamic bank. The study also recommended that Islamic banking institutions in Nigeria should map out strategies that will enable them to compete favourably with conventional banks and the traditional money lenders

**Keywords:** Islamic Financing, Interest Rate and Principle of Sharia

### 1. Introduction

The of industrial revolution of 1890AD led to expansion of businesses as a result of increase in the volume of production hence there was need for industrialists to safeguard their funds. There was also need for appropriate funding of these industries in order to remain afloat. These two critical factors led the emergence of bank. Banks lend money to businesses to enable them to expand their market frontiers. However in the process of time banks were termed to be exploitive and were not in any way better than the crude money lenders despite the various statutory bodies put in place to monitor their activities. There was a need for a paradigm shift from the conventional banking system to a more equitable system.

One of such portable means that evolved to salvage this precarious situation is the interest-free financing. According to Azeez (2007) the main aim of the interest-free banking is to create an economic system that thrives on social justice and equitability. The author further documents that the interest-free banking system enhances individual enterprise and also controls the economic system in an impartial and equitable way. A typical example of a non-interest banking system is the Islamic banking system.

Islamic banking in modern times started in Egypt and Pakistan to replace the conventional banking which is presumed to be exploitive in nature. Bank Nasir Al-Ijtmahiy was established in Egypt in 1971 and was followed by the birth of Islamic Development Bank in 1974 in Saudi-Arabia. Dubai Islamic Bank in 1975, Faisal Islamic Bank, Sudan came to being in 1977. Baitul Tamuwily Kuwait in 1977, Faisal Islamic Bank, Egypt 1977, Jordanian Islamic Bank for Finance and Investment started operation in 1978. Islamic banking took the front burner on the international scene about two decades ago. Suffices to say that the principles of Islamic banking system however have been generally accepted in most nations of world for over a hundred years. Islamic financial system exists in Muslim community in diverse forms conferring to situation at hand. Ajani, Idowu and Olatubosun (2013) opine that Islamic banking originated from Islamic community and is meant to cater for Muslims but has spread into non-Muslims communities thereby extending its services to non-Muslim beneficiaries. In other words non-Muslim individuals and communities that pursue honest financial solutions can be attracted to Islamic banking. Kenny (2011) argues that Islamic banking is not only Islamic or specific banking which provides more ethical and moral concept of financial issues but it is also system that helps in creating a peaceful co-existence among diverse religions, enhances economic prosperity and built a health society. Interest is fully prohibited in Islamic law due to its adverse effects on individual and more severely its negative impact on overall society and the economy at large (Aghion & Murdoc, 2005). Usman (2011) reports that the main objectives of the Islamic banking system are eradication of inequality, delivery of optimal level of communal prosperity and ensuring fairness in the lives of persons and the society at large, through the ideology of unanimity, comradeship and community impartiality. It does not encourage any form of exploitation, wasteful spending and hoarding. Today Islamic banking has gained acceptance among non-Muslims because some major religions also forbid usury. For example Christianity and Judaism forbid usury. Some non-Muslim scholars, economists and bankers acknowledge the fact that Islamic banking has created a niche for itself in the world of finance (Usman, 2011).

Despite the controversies on what Islamic bank represents, it has gained acceptance in western countries like US, UK, and Denmark. In Nigeria, Islamic banking is facing a lot of impediments like legal factor, political factor, social factor and the economic factor. From the legal point of view it is clear that the Nigerian banking sector has no provision or guideline that permits the establishment of any bank with a religious coloration. Some non-Muslims argue that Islamic banking is funded by some religious fundamentalists with the aim of Islamizing Nigeria. Some schools of thought are also of the opinion that it should not be called interest-free bank rather than Islamic bank. On the contrary the initiators of Islamic banking explain that a bank can be interest-free, but its instruments for operation are non-Islamic. A pure Islamic banking system is not only concerned with interest but also the instruments used. For example Islamic banking system prohibits investment in gambling, sales of alcoholic drinks or any business activities that is un-Islamic.

Some non-Muslims agitated that setting up a Sharia Council by the Central Bank of Nigeria (CBN) to oversee Islamic bank operations insinuates that the government is trying to enforce Sharia. They also accused Mallam Sanusi (CBN governor) of being the brain behind the selling of Nigeria to Islam. Sanusi (2010) declares that Central Bank of Nigeria is not promoting or establishing Islamic bank. He explains that the CBN simply gave license of operation to an institution to perform Islamic banking activities in Nigeria and further explained that Sharia Council earlier constituted by CBN has been changed to Advisory Council to allay the intension in the air.

According Kenny (2011) some Nigerians both Muslims and non-Muslims alike are of opinion that the introduction Islamic banking is not timely considering the fact that the Nigerian state is bedeviled by the onslaught of insurgency. Anyansi (2011) further argues despite the good intentions of the initiators of Islamic bank, however they missed the timing. Against all hoards the first all Islamic bank - Jaiz bank was established to perform Islamic banking in Nigeria. From foregoing the objective of this study is to ascertain the prospects and challenges of Islamic banking in Nigeria

## **2. Literature Review**

### **2.1 Prospects of Islamic Banking**

Islamic banking has a lots of prospects notwithstanding the criticisms from various quarters. First, eradication of exploitation; Islamic banking uses the non-interest banking technique. Its intention is to relief customers from high interest charged by conventional banks. Anyansi (2011) reports that a lot of people do not see any reason for them to save their money with conventional banks because they believe that their money will left idle but with introduction of Islamic banking they are rest assured that their savings will be channeled into meaningful investment. It's mode of operation that gives investors more chances to gain access to direct financial opportunities. It will also provide better opportunities for businessmen. A lot of economic proposals to better the economy of Nigeria have been recommended by Islamic banking methods.

Aliyu (2010) documents that Islamic banking if fully implemented will create employment, owing to its mode of operation that create more channels for investors to get direct access to financial opportunities than conventional banks. The author further explains that the Islamic banking is driven by achievable targets unlike the unattainable targets set by most conventional banks which often than not make female bankers to indulge themselves in unscrupulous activities in the name of meeting the targets set for them by their employers. Tajudeen (2012) opines that Islamic banking adopts asset backed finance. This involves the transfer of assets which are not based on making money alone.

Aliyu (2010) is of the opinion that the introduction of Islamic banking will open door for new products like; Islamic Asset Management Companies, Takaful (Islamic insurance) companies and other viable products, thus deepening the financial market. In the long run, it will enable a large chunk of Nigerians to actively and effectively participate in economic development, owing to its nature and ability to offer an array of products and services that cater to the financing needs of the banking public.

Khan (1988) argues that interest-based economy has an in-built tendency towards inflation because the creation of money is not linked with productive investment but on contrary, Islamic banking reduces inflation to its lowest ebb by permitting money supply to be proportionate with economic activities. Islamic finance, though based on a religious law, is not just a religious activity whose adherents are only expected to people that engage in it. It is a business activity that is open to all segments of the society. Islamic bank provides opportunity for businessmen and investors by financing their projects through partnership; thus, contributes or generate employment opportunities.

Dogarawa (2009) reports that poverty is not only a function of availability of natural endowments, population size, economic and social policies, but also a function of the kinds of economic activities that are in operation. He further explained that conventional banking is synonymous with capitalism which creates climate for dog-eat-dog while Islamic Banking is based equitability with the hallmark of reducing or eliminating poverty from the society.

## **2.2 Challenges Facing Islamic Banking System**

The prospects of Islamic banking in Nigeria is beyond doubt not questionable. However there are many challenges limiting its growth. First, human resources poses a major challenge to growth of Islamic banking. Second, there are severe shortage of qualified Islamic bankers who understand both conventional banking and have adequate knowledge of Shariah finance. Most qualified bank staff prefer to be called bankers and very few will want to be recon with Islamic bank. Third; poor customer awareness strategy. Many persons both Muslims and non-Muslims do not understand what Islamic banking means and its mode of operations.

Furthermore, inadequate accessibility to short-term non-equity financial instruments such as sukuk and Shariah-compliant money market instruments equivalent to treasury bills pose a further challenge to growth of Islamic banking institutions thereby making management of their investment portfolio more challenging than conventional insurers that can simply invest in bonds and cash assets.

Finally Islamic finances do not make provision for developmental loans except provision for businesses. It does not have provision for those who wants to obtain education loan, loan to meet personal need like medical bills, burial, purchase of assets like, car and landed property. This is the major reason for high preference for conventional banking and traditional money lenders despite the high interest rate charged by these institutions. According to Amad and Khan (2011) customer will continue to patronize these institutions until a better alternative that will meet their financial needs emerges.

## **3. Methodology**

### **3.1 Sample Size and Sampling Technique**

The sample comprises two hundred prospective bank customers in Nigeria. These respondents were drawn from some selected prospective customers banks in four geo-political zones in Nigeria. Stratified random sampling technique was used to select the sample which is done to enhance randomization and

eschew biasness of sample. A questionnaire with open and close ended questions was used to extract needed information.

### 3.2 Method of Data Analysis

The data was analyzed using the chi-square technique and z-test. Z- test was used to determine whether two population means are different when the variances are known and sample is large. We also perform some pre-test like; descriptive statistic and question pretest to enable us to ascertain the validity and reliability of questionnaire.

### 3.3 Presentation and Data Analysis

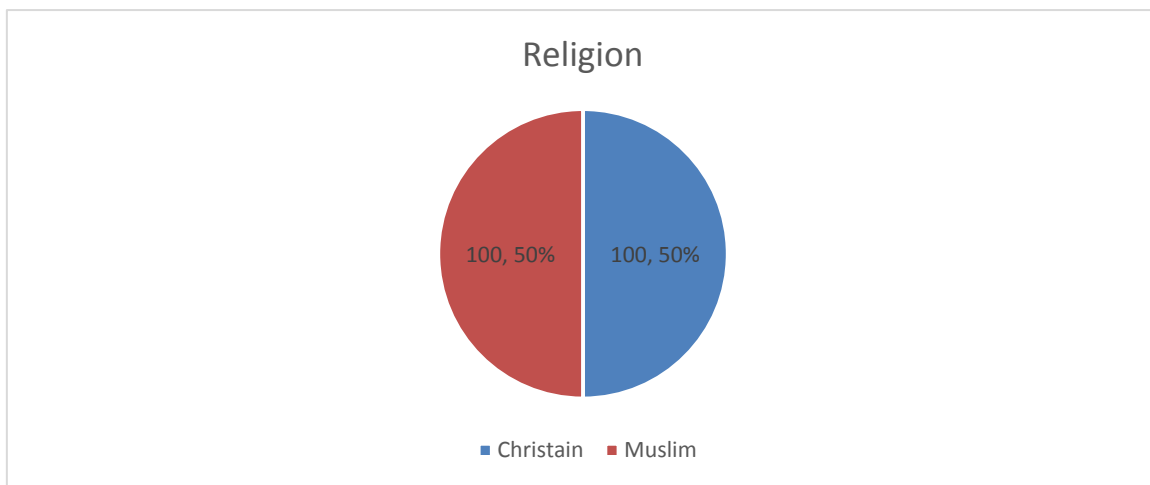
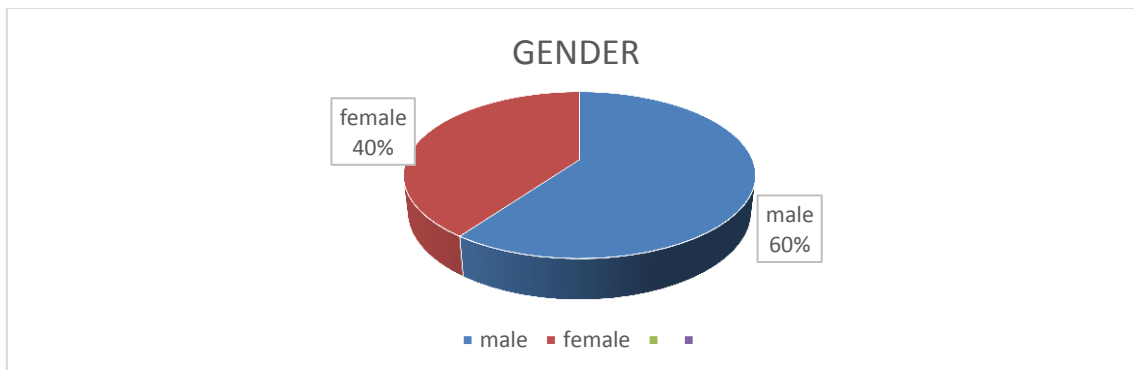


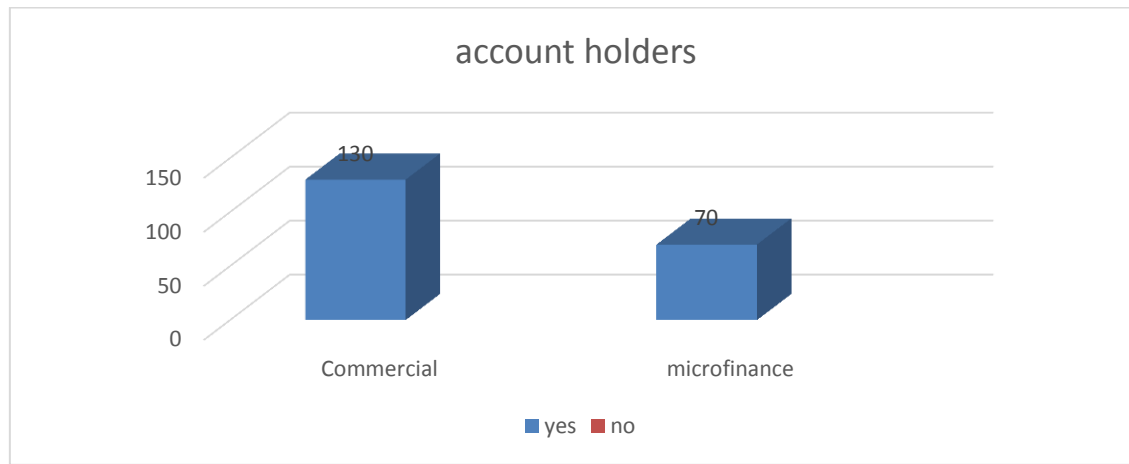
Figure 1: Professional accountants  
Source: Researcher's computation 2017

While 100(50%) of the respondents were Muslims, 100(50%) were Christians.



Source: Researcher's computation 2017

While 40% of the respondents were female, 60% of the respondents were male.



Source: Researcher’s computation 2017

While 130(65%) of the respondents were customers of commercial banks, 70(15% ) of them were customers of microfinance institutions

### 3.4 Interpretation of Z-test result

Table 1: Customers’ preference for conventional banks and traditional money lenders

	<i>CONBN</i>	<i>ISLBANK</i>
Mean	86.875	13.125
Known Variance	192	5852
Observations	8	8
Hypothesized Mean Difference	0	
Z	2.683149	
P(Z<=z) one-tail	0.003647	
z Critical one-tail	1.644854	
P(Z<=z) two-tail	0.007293	
z Critical two-tail	1.959964	

Source: Researcher’ computation 2017

The paired sample Z-test for one tail test shows a p-value of 0.0037 for one tail test, while p-value for two tail test stood at a value of 0.007. The critical for one tail and two tail test stood at 1.6 and 1.95 respectively. We therefore conclude that the null hypothesis could not be retained for both one and two tail test at 0.025 and 0.05 level of significant respectively in line with the thumb rule(0.003<0.025,0.007<0.05). This implies that bank customers have preference for conventional banking system.

Table 2: Inadequate trained personnel

	<i>CONB</i>	<i>ISLBNK</i>
Mean	69.66667	49.33333
Known Variance	4651	1333
Observations	6	6
Hypothesized Mean Difference	2.0	
Z	0.643856	
P(Z<=z) one-tail	0.025983	
z Critical one-tail	1.644854	
P(Z<=z) two-tail	0.001516	
z Critical two-tail	1.959964	

Source: Researcher's computation 2017

The paired sample Z-test for one tail test shows a p-value of 0.025 for one tail test, while p-value for two tail test stood at a value of 0.0016. The critical for one tail and two tail test stood at 1.6 and 1.95 respectively. We therefore conclude that the null hypothesis could not be retained for both one and two tail test at 0.025 and 0.05 level of significant respectively in line with the thumb rule(0.03< 0.025,0.01<0.05). This implies that Islamic banks have inadequately staffed compared to conventional banks.

### 3. Interpretation of Chi-Square Results

Table 3: Lack of awareness of Islamic bank represents

	Statement 1	Statement 3
Chi-Square	20.403 <sup>a</sup>	27.105 <sup>a</sup>
Df	4	4
Asymp. Sig.	.000	.000

a. 0 cells (0.0%) have expected frequencies less than 5. The minimum expected cell frequency is 28.6.

Source: Researcher's computation 2017

Table 3 presents the results for the chi-square test statistics. As observed, all the statements are all significant at 5% level as the asymptotic value of 0.00. Specifically, statement 1 has a chi-square and asymptotic value of 22.403 and .00 respectively. Statement 3 has a chi-square and asymptotic value of 21.105 and 0.00 respectively. All the asymptotic values are less than the alpha value of 0.05 at 5% significance level and the calculated chi-square also exceeds the theoretical value at 5%. In the light of the above we conclude that lack of awareness is a major facing Islamic banking in Nigeria.

Table 4: Poverty alleviation and job creation are major benefits

	Statement 11	Statement 14
Chi-Square	22.629 <sup>a</sup>	17.888 <sup>a</sup>
Df	4	4
Asymp. Sig.	.000	.000

a. 0 cells (0.0%) have expected frequencies less than 5. The minimum expected cell frequency is 28.6.

Source: Researcher computation (2017)

Table 4 presents the results for the chi-square test statistics. As observed, all the statements are all significant at 5% level as the asymptotic value of 0.00. Specifically, statement 11 has a chi-square and asymptotic value of 22.629 and .00 respectively. Statement 14 has a chi-square and asymptotic value of 17.888 and 0.00 respectively. All the asymptotic values are less than the alpha value of 0.05 at 5% significance level and the calculated chi-square also exceeds the theoretical value at 5%. This indicates that Islamic banking enhances job creation and alleviates poverty.

#### 4. Conclusion and Recommendation

Islamic banking system faced a lot of oppositions from both Muslim and non-Muslim alike. Some are highly of the opinion that the heterogeneity, pluralism and diversity of the Nigerian state do not permit the creation of a bank with religious coloration. Some accused the CBN former governor for using tax payer's money to establish a religious bank. However Mallam Sanusi responded that Islamic banking was initiated by his predecessor Professor Soludo and his Mr Lamu his deputy who happened to be a pastor. He further explains that CBN did not establish Islamic banking as speculated by some Nigerians but rather granted license of operation to some Islamic institutions to carryout Islamic banking. In order to reconcile the discrepancy between stakeholders' perspective and the institutional mandate of Islamic banking this study gathered data using survey research design. The result shows that the Nigerian banking customers have preference for conventional banking system despite the high interest rates it charges because it meets their personal needs such as purchase of assets, landed property, car, household equipment and other contingencies such as funeral ceremonies and payment of school fee for their wards. The result shows that lack of trained personnel poses a great challenge on the growth of Islamic banking in Nigeria. Furthermore, the study concludes that Islamic banking if properly implemented will lead to even distribution of resource and provides job opportunities for young Nigerians.

The study recommended that Nigerian Islamic banking Institutions should send their employees for comprehensive training that will equip them with knowledge in Islamic finance and its operations. It was also recommended that Islamic banks should organize customer awareness programs to enlighten customers on Islamic finance. Finally, the study recommended that Islamic banks should concentrate more on loan products that meet the personal need of the average Nigerian.



## References

- Aghion, B.A. & Murdoch, J. (2005). *The Economics and Microfinance*. Cambridge: MIT Press
- Ahmad, M.I., & Khan, M. (2011). Problems and prospects of Islamic Banking: A case Study of Takaful). MPRA Paper No. 22232.
- Ajani, S.A., Idowu, A.R., & Olatubosun, A.A. (2013) Prospects of Islamic Banking in Nigeria: An Overview of Islamic Financial Theories of Al-Hayat Relief Foundation to Grassroots Economic Development. *IOSR Journal of Humanities and Social Science*, 13(3), 39-47.
- Aliyu, U. (2010). Islamic Banking: The Hidden Treasures.” The Guardian 15<sup>th</sup> December.
- Al-Omar F. & Abdel-Haq M. (1996). *Islamic Banking. Theory, Practice and Challenges*. London: Zed Books Ltd. Dogarawa
- Anyansi, U. (2011) Islamic Banking Is About Equity II in Weekly Trust 2nd July.
- Azeez, A. (2007): Prospects of Islamic Banking System in Nigeria. *Journal of Arabic and Islamic Studies*. 2(2), 249-263.
- Dogarawa, A. B. (2009). Poverty Alleviation through Zakah and Waqf Institutions: A Case for the Muslim Ummah in Ghana. A paper presented at the First National Muslim Summit organized by Al-Furqan Foundation, Tamale. 3rd October.
- Kenny, J. (2011). Challenges and prospect of Islamic banking in Nigeris. Retrieved from [www.theguardiannewpapers.org.ng](http://www.theguardiannewpapers.org.ng).retrieved
- Khan, F. (1988). The Viability and Economics of Islamic Banking. Paper presented at the minar on Islamic Banking at Loughborough University, organized jointly by the Loughborough University Banking Centre, UK, the International Association for Islamic Economics and the Islamic Foundation, Leicester.
- Sanusi. (2010). Challenges facing the implementation of Islamic banking in Nigeria. Retrieved from [www.theguardiannewpapers.org.ng](http://www.theguardiannewpapers.org.ng).retrieved
- Tajudeen, S. (2012). Interest Free Banking: Investment and Profitability. Guest Lecture delivered at Al-Hayat National Annual General Meeting Held at Otunba Dipo Dina Stadium Ijebu-ode, June 17th.
- Usman, T. (2011). The adverse effects of interest on the society. Retrieved from [www.Islambanking.com](http://www.Islambanking.com)

## QUESTIONIARE

### Section A

**Instruction: Tick as Appropriate**

1. What group do you belong to? Christain [ ] ; Muslim [ ]
2. 3. Sex? Male [ ], Female [ ]
4. You are a customer of Microfinance bank [ ] commercial bank [ ] Others [ ]

### Section B

		SA	A	UD	D	SD
	<b>Lack of awareness</b>					
1.	Everybody has heard about Islamic	9	20	0	81	90
2	Lack of awareness of what Islamic banking represents is a major challenge against it acceptance	145	34	0	6	15
3.	Nigerians are not aware of the financial products of Islamic banking	118	30	2	29	21
	<b>Customer preference</b>					
4	Obtaining loan from Islamic banks takes longer time	102	50	0	8	40
5	Commercial banks have larger range of products	151	9	0	12	28
6	Microfinance banks have widely range loan amount to loanee	169	21	0	1	9
7	Nigerian customers prefer conventional or money lenders because absent of religion colorization	180	13	0	0	7
	<b>Lack of personnel</b>					
8	Islamic banking has more trained personnel than conventional banking	12	8	0	106	74
9	Most banker prefer to pick banking career with Islamic banker	143	17	0	25	15
10	Islamic bank have more qualified personnel	7	23	0	111	59
	<b>poverty alleviation and job creation</b>					
11	Islamic will help to evenly distribute resource	125	15	18	12	30

12	More projects will executed by Islamic system banking	113	17	10	13	47
13	Islamic banking will create more jobs opportunities	120	41	0	9	30
14	Acceptability of Islamic will help in creation of more wealth.	92	10	8	77	13

15. What are general comments on the benefits and challenges of Islamic banking.....

**Responses from respondents Table 1**

	SA	A	UD	D	SD	TOTAL
1.	9	20	0	81	90	200
2	145	34	0	6	15	200
3	118	30	2	29	21	200
4	102	50	0	8	40	200
5	151	9	0	12	28	200
6	169	21	0	1	9	200
7	180	13	0	0	7	200
8	12	8	0	106	74	200
9	143	17	0	25	15	200
10	7	23	0	111	59	200
11	125	15	18	12	30	200
12	113	17	10	13	47	200
13	120	41	0	9	30	200
14	92	10	8	77	13	200