Islamic Banking in Nigeria: Principles, Problems and Prospects

INTRODUCTION

Muslim nations are bedeviled by a dilemma as a result of predominance of interest-based transactions in their societies. The reason for such kind of dilemma is because Islam is unequivocally against interest (riba) which is the bed-rock of the conventional banking system. Almost all Biblical religions condemned interest and foremost thinkers for example Aristotle echoed this condemnation by considering money as unproductive and barren. The condemnation of interest could be seen in Christianity because in Luke, 6:35 the Christ was reported saying: “Lend freely hoping nothing thereby”. But unfortunately, the church later altered its doctrine on interest and legalized it. What resulted into this was the divorce of religion from mundane affairs which was welcomed by Christian societies.

Colonialism aided the infiltration and permeation of interest-based transactions in Muslim nations through weakening of Islamic values and promotion of western influence (Ahmad, 1994). Being that banks are very crucial in economic growth for the services they provide such as financial mediation between savers and investors, credit creation and encouragement of capital accumulation, many Muslims patronize conventional banks in the absence of alternative (Ahmad, 1984 and 1994). This situation started to change with the recent Islamic resurgence and process of Islamization of Muslim economies because Muslims started to struggle for the establishment of Islamic banks in their nations (e.g. Pakistan, Iran, Sudan, etc). Therefore, Muslim scholars devoted time to peruse the works of renowned jurists and scholars on Islamic banking with a view to designing workable models for implementation. Their contributions started to appear in the late forties and early mid fifties of the century although the sixties and seventies witnessed more detailed and refined contributions (Ahmad, 1994).

The pioneering experiment of Islamic banking was conducted in Mit – Ghamr in Egypt from 1963 to 1967 and remarkable success was recorded though later the bank was abandoned for political reasons (Ahmad, 1987). The year 1971 heralded the establishment of the first Islamic bank i.e. Nasser Social Bank in Cairo which started operations in 1972. Many Islamic financial institutions subsequently emerged in both Muslim and non-Muslim nations (e.g. Australia, Denmark, India, Uganda, Philippines, South Africa, U.K., U.S.A., Luxembourg, etc.). There are many Islamic financing institutions operating in different parts of the world and expansion is going on in their numbers and sizes.

This paper therefore intends to discuss on Islamic banking in Nigeria starting from the conceptual definition of terms before dwelling on principles, problems and prospects. The discussion is as follows:

CONCEPTUAL DEFINITION OF TERMS

Interest-free /Islamic banking

The concepts of Islamic banking and Interest-free banking though used interchangeably by some people are distinct. Interest-free banking merely connotes conduct of banking without interest butt does not necessarily mean Islamic. Absence of interest is a necessary condition for Islamic banking but the sufficient condition is that such kind of banking must be based within the matrix of Shari’ah (Ahmad, 1987). Therefore, to qualify as Islamic banks, the interest-free operations of banks have to be imbued with the real spirit of Islam so that they bring revolutionary changes in the society in line with the ethos of the value system of Islam.
Principles of Islamic Banking

The principles of Islamic banking are based on the tenets of the Shari'ah based-on bans and commandments (Iqbal, 1997). They are the prohibition of Riba, Halal/Haram Code, Gharar/Maisir, and Shari'ah Board. They are explained below:

Prohibition of Interest

The prohibition of interest can be viewed from both the perspective of the Glorious Qur'an and Ahadith of the Noble Prophet (SAW):

Some of the verses of the Quran which forbid interest are:

Those who eat Ribâ will not stand (on the Day of Resurrection) except like the standing of a person beaten by Shaitân (Satan) leading him to insanity. That is because they say: “Trading is only like Ribâ,” whereas Allâh has permitted trading and forbidden Ribâ. So, whosoever receives an admonition from his Lord and stops eating Ribâ, shall not be punished for the past; his case is for Allâh (to judge); but whoever returns (to Ribâ), such are the dwellers of the Fire – they will abide therein forever. Allâh will destroy Ribâ and will give increase for Sadaqât (deeds of charity, alms). And Allâh likes not the disbelievers, sinners.
Baqara, 2:275-276

O you who believe! Eat not Ribâ doubled and multiplied, but fear Allâh that you may be successful. Ali Imran, 3:130

As for Ahadith, some of them that forbid interest include:

Jabir (RA) reported that the Messenger of Allah cursed the devourer of usury, its payer, its scribe, and its two witnesses. And he said that they are equal (in sin). (Muslim transmitted it) (Al-Sunan al-Kubraa)

Abu Saeed al-Khudri (RA) reported that the Messenger of Allah (SAW) said: Gold for gold, Silver for silver, wheat for wheat, barley for barley, date for date, salt for salt and like for like in hand to hand (transaction). Whoso gives more or takes more, then the taker and the giver are equal in taking interest therein.
(Al-Bani M. N.)

Looking at the above evidences, it can be presumed that the philosophical foundation of Islamic banking is deduced from careful perusal of what Allah mentioned in Baqara, 2:275 that “He has forbidden usury and permitted trade”.

The rationale for prohibiting interest and permitting trade is not farfetched since profit arising from trade are concomitant of value creating activities comprising initiatives, enterprises and efficiency unlike interest which as perceived by Ahmad (1985) is a contractual obligation on the part of the borrower to pay a fixed and pre-determined amount over the capital borrowed along with the obligation to pay the capital in full after the stipulated time. It can be discerned therefore, that, interest is paid irrespective of whether the borrowed sum is for consumption or investment, profit is realized or loss is incurred. Other verses also came with prohibition of interest so as to consolidate the philosophical foundation of Islamic financial system just as what Allah said in Ali Imran, 3:130 cited above. The verse clearly indicates prohibition of interest especially the practice of unsympathetic compounding of interest over the principal as a result of inability to pay at stipulated time. In addition to prohibiting usury and permitting trade, Allah (S.W.T.) likened those who take interest to those touched by devil (Baqara, 2: 275). He further explained that interest is deprived of all blessing unlike charity (sadaqa) which is blessed (Baqara, 2: 276). Another serious warning on interest is where Allah the Almighty gave notice of war (against those who practice riba) from Him and His Messenger (Baqara, 2: 278-279).

Therefore, from both the Glorious Qur’an and Ahadith of the Prophet (SAW) Riba has been condemned. Furthermore, during the time of the Prophet (SAW), Riba was not only charged on money loans but was also charged on exchange of commodities in barter transactions just as indicated in the above-mentioned Ahadith. So, the Prophet (SAW) prohibited Riba in both the forms. Some modern economists have tried to distinguish bank interest from Riba and have held that bank interest is not prohibited. But majority of the Muslim scholars are unanimous in holding that Riba in every form is prohibited including bank interest.

In spite of all the condemnations of riba by the texts of the Qur’an and Hadith, a general consensus emerged among Islamic scholars on prohibition of riba but ironically, controversies emerged concerning its
meaning and interpretation (Irfanul Huq, 1981, Aliero, 1995). Thus, few voices argue that *riba* is different from modern bank interest buttressing their points that *riba* refers to compound interest which is mostly on productive loans, etc. (Aliero, 1995).

Although these divergent views are worth noting, however, the consensus is that all types of interests, be they simple or compound, arising in production or consumption, claimed by an individual or institution, is prohibited in Islam (Habibur Rahman, 1982). To say it in another way, “*riba* means any addition however slight over and above the principal sum lent and thus include usury.

**The Concept of Halal and Haram**

Islam has introduced concept of *Halal* (lawful) and *Haram* (unlawful) in its economic system. This concept reigns supreme in the realm of production as well as consumption. Certain means of earning livelihood and wealth have been declared unlawful such as interest, bribery, gambling and games of chance, speculation, short weighing and short measuring, business malpractices, etc. Unlawful means of earning are strictly forbidden and a follower of Islam is permitted to earn through lawful and fair means. Similarly, in the field of consumption certain items of food are unlawful such as dead animals, blood, swine flesh and animals slaughtered in the name other than that of Allah.

Hence Islamic banks are not allowed to finance contracts or items forbidden in Islam, such as the ones mentioned above, etc. Furthermore, as the fulfilment of material needs assures a religious freedom for Muslims, Islamic banks are encouraged to give priority to the production of essential goods that satisfy the needs of the majority of the Muslim community. As a guide, participation in the production and marketing of luxury activities is considered as unacceptable from religious viewpoint when Muslim societies suffer from lack of essential goods and services such as food, clothing, shelter, health and education, etc.

Some of the relevant verses of the Quran and Ahadith of the Prophet (SAW) that highlight on the concept of *halal* and *haram* include the following:

**Verses of the Quran:**

*O mankind! Eat of that which is lawful and good on the earth, and follow not the footsteps of Shaitân (Satan). Verily, he is to you an open enemy.*

Baqarah, 2:168

*O you who believe (in the Oneness of Allâh – Islâmic Monotheism)! Eat of the lawful things that We have provided you with, and be grateful to Allâh, if it is indeed, He Whom you worship, He has forbidden you only the Maitah (dead animals), and blood, and the flesh of swine, and that which is slaughtered as a sacrifice for others than Allâh (or has been slaughtered for idols, on which Allâh's Name has not been mentioned while slaughtering). But if one is forced by necessity without willful disobedience nor transgressing due limits, then there is no sin on him. Truly, Allâh is oft-Forgiving, Most Merciful.*

Baqarah, 2:172-173

*And eat up not one another's property unjustly (in any illegal way, e.g. stealing, robbing, deceiving), nor give bribery to the rulers (judges before presenting your cases) that you may knowingly eat up a part of the property of others sinfully.*

Baqarah, 2:188

**Ahadith of the Prophet (SAW):**

*Abu Hurairah (RA) reported that the Messenger of Allah (SAW) said: Verily Allah is pure. He does not accept but what is pure .... Then he mentioned about a man disheveled in hair and laden with dust, making his journey long and extending his hands towards heaven: O Lord! O Lord! while his food was unlawful, his drink unlawful, his dress unlawful and he was nourished with unlawful things. How can he be responded for that?* (Muslim Transmitted it) (Al-Adhkar al-Nawawiyyah).

Abu Masud Al-A’ansari reported that the Messenger of Allah (SAW) cursed the bribe taker and the bribe giver. (Transmitted by Bukhari and Muslim) (Al-Imam Bi’Ahadith al-Ahkam)

*Abdallah-bin-Amr (RA) reported that the Messenger of Allah (SAW) cursed the bribe taker and the bribe giver.* (Transmitted by Al-Tirmidhi) (Al-Bani M. N.)

**Shari’ah Board**

In order to ensure that the practices and activities of Islamic banks do not contradict the Islamic ethics, Islamic banks are expected to establish a Religious Supervisory Board. This board consists of Muslim jurists, who act as independent Shari’ah auditors and advisers to the banks, and are involved in vetting all new contracts, auditing existing contracts, and approving new product developments. Also, the Shari’ah Board oversees the collection and distribution of zakat. This additional layer of governance is quite different from that of a conventional bank (Algaoud and Lewis, 1999).

**Modes of Financing in Islamic Banking:**

The sources of funds available for Islamic banks as contained in the earlier Islamic banking models are Bank share capital, Mudaraba deposits and demand deposits, (Ahmad, 1994). These funds mobilized by bank can be used in a variety of ways known as modes of financing. Islamic modes of finance are categorized into two namely modes based on PLS principles and modes not based on PLS. The modes based on PLS are usually considered as core modes of financing such as Mudaraba, Musharakah or Sharikah whereas the trade
financing modes refer to Bai’ Mu`ajjal, Bai’ Salam, Ijara and Ijara wa Iqtina`. Murabahah and Ju’alah. The underline principles of modes of financing are universal having been drawn from Islam which is also universal. If there are any slight difference in their application it is as a result of custom (urf) of the people in each location which is acceptable in Islamic jurisprudence provided they don’t clash with the Shari’ah. Below are some popular Islamic modes of finance being adopted worldwide by Islamic banks and financial institutions:

**Mudarabah**: This is a mode of finance where one party provides capital and the other party goes into the business by providing entrepreneurship. If any profit is realized it is distributed in accordance with mutually agreed ratio just as was mentioned earlier. On the other hand, if a loss is realized it is solely borne by the provider of capital unless otherwise caused by negligence and violation of the contract. Mudarabah could be of two categories first-tier and second-tier. First-tier Mudarabah is between the bank and the depositor and thus profit is shared according to predetermined ratio and loss is borne by the depositors. Second-tier Mudarabah is between the bank and the entrepreneur where profits are also shared according to mutually agreed ratio while losses are borne by the financiers. Mudarabah is very crucial in poverty alleviation because it enables people with business skills who have no money to obtain finance and thus secures job for them as a means of earning livelihood.

**Musharaka**: Musharaka is another mode of finance which is a partnership between two or more people each of them making contribution to the capital. All the parties have right in the management of the capital. If any profit is realized it is distributed according to mutually agreed ratio which needs not be same as capital proportion (Ahmad, 1987), but loss is shared according to the capital contribution. Under this mode of financing, bank and other partners who can be depositors can provide finance to entrepreneurs who together with the financiers can manage the business and profits are shared according to agreed ratio and losses borne by financiers according to proportion of capital contribution.

**Purchase of Share and Investment Certificates**: Banks can purchase shares and investment certificates of companies and other business entities (private/public) on the basis of profit and loss arrangement. The bank can use its share capital and the money deposited by its clients to buy these shares and whatever profit or losses accrue for these shares affect the bank and clients accordingly depending on whether such profits and losses arrangements entail mudarabah or musharakah.

**Murabahah** (mark up): This is a mode of finance whereby a client requires the bank to buy an asset or a commodity and sell it to him at an agreed mark up price which is paid within an agreed time period either installmentally or in lump sum. The customer provides the specification of the equipment and the bank shoulders the risk of procuring it. As opined by Ahmad (1987: 20) “Most of Islamic banks use the technique of murabahah to purchase raw materials, goods, machinery and equipment at cost and sell to the client on a “cost plus negotiated profit margin”. On the other hand, Chapra (1983) opines that Murabahah is perfectly legitimate, Siddiqi (1983) disapproves and considers it just like lending on fixed rate of interest.

**Bai Mu`ajjal**: In this type of contract the bank permits the customer to pay the price of the commodity at deferred period either in lump sum or installment basis. The price fixed for the commodity can be same as spot price, higher or lower than it. This contract was approved by the council of Islamic Ideology Pakistan in 1993. But some Muslim economists are against this contract. For instance, Siddiqi (1983) saw it as having semblance with interest and preferred that it should be removed from the list of permissible modes altogether. Ahmad (1994) viewed that it is allowed since Shari’ah experts saw no objection to banks engaging in it.

**Bai Salam**: This is a contract where a customer pays for some goods he desires to purchase in advance and the goods are delivered to him at a specified future date. This mode of finance is considered permissible because of the element of risk therein.

**Ijara**: This is a leasing arrangement where Islamic banks allow their customers to use their properties such as houses, machineries for a specified period of time in order to earn a fixed claim termed as rent. In this kind of contract, the terms of lease are decided based on mutual consent between lessor and lessee. Although nobody raised strong doubt pertaining to permissibility of Ijara in Islam it could be exploitative if very high rentals are charged, therefore its operation has to be checked and closely watched.

**Ijara wa Iqtina** (hire purchase): This is a contract whereby an Islamic bank finances some houses, equipments, machineries, etc. for the customers based on mutually agreed rental together with a commitment from the customer to make a separate additional deposit in an account which will ultimately transfer ownership of such goods to the customers. This kind of contract will help minimize the sufferings of the poor especially those who can’t for instance build their own houses or buy certain equipments they require in their jobs. They can now make use of these goods and gradually possess them with ease through hire purchase.

**Qard hasana**: This refers to the loans which Islamic banks advance to their customers without interest or service charges and the principal is paid at customers
convenience. The basis of this type of loan can be found in the Qur’an:

Who is he that will lend to Allāh a goodly loan so that He may multiply it to him many times? And it is Allāh that decreases or increases (your provisions), and to Him you shall return.” (Baqarqah, 2: 245).

Also, the Qur’an says:

... “and lend to Allāh a goodly loan. And whatever good you send before you for yourselves (i.e. Nawâfil – non-obligatory acts of worship: prayers, charity, fasting, Hajj and ‘Umrah), you will certainly find it with Allāh, better and greater in reward.” (73: 20).

As suggested by Ahmad (1987), Islamic banks should take care to see that qard hasan or benevolent loans are granted to those needy section of the society who are in need of support and help so as to be economically invigorated. This is likely to alleviate poverty and check poverty-induced corruption/crimes such as bribery, theft, prostitution, etc.

Problems of Islamic Banking

There are many problems that are likely to confront Islamic banking especially when they are established in secular environments. These problems have been repeatedly discussed by several scholars. For example, Siddiqi (1983), Ahmad (1994), Gusau (1986), Aliyu (1988) etc. some of these problems are presented as follows: -

Problem of Conventional Banking Laws: As far as existing banking laws are concerned, they do not favour Islamic banks which are interest-free and operate under profit and loss sharing. In some countries central banks require commercial banks to keep certain proportions of their deposits with them; where these proportions are high such as 25 %, ability of Islamic banks to expand will be thwarted. Similarly, in some countries central banks prohibit commercial banks from engaging in trade – related activities which is a big hindrance on Islamic banks. To solve these problems, Islamic banks need to be exempted from these laws. It is gratifying to note that the CBN has for long designed legal framework for Islamic banking which got inputs and blessing from various stakeholders. This paved way for smooth takeoff of Jaiz bank.

Problem of Inter-bank Relationship: At the beginning, when they are newly established, Islamic banks may not be widespread to transact with one another as a result of which they have to deal with conventional banks which are based on interest. This problem can only be solved if more banks are established so that they can deal with one another or otherwise the business conducted between Islamic banks and conventional banks should be operated along profit and loss agreement.

Problem of Excess Liquidity: With establishment of Islamic banks people will rush to deposit their money with them and this will likely bring the problem of excess liquidity since the deposits are in the form of cash and liquid assets and the banks may lack investment avenues and long term investment opportunities to clear the excess.

Oppositions from Christians and other non-Muslims: Challenges are definitely expected from non-Muslims who may consider Islamic banking as a process of Islamizing the nation. The vehement oppositions of non-Muslims to the implementation of Shari’ah in Zamfara State is a testimony that they will frown at Islamic banking. But this should not prevent Muslims from struggling to introduce Islamic banking because non-Muslims are not compelled to deal with them unless if they wish to do so. And just as it is evidently clear that the constitution does not deny Shari’ah there is no way it will deny Islamic banking.

Problem of Fraudulent practices from Clients:

This is an issue which involves immorality such as for example concealment of truth in declaration of the quantum of profit by clients. Some clients may also approach Islamic banks for qard hasan loan with the aim of defaulting. These problems can be reduced by moral training and effective management auditing. Also, sincerity should be counted as a basis for judging one’s likelihood of getting loan or entering partnership with Islamic banks.

Prospect of Islamic Banking in Nigeria

Several efforts heralded the emergence of interest free windows provided by conventional banks in the country such as Habib Bank, Stanbic IBTC, Guarantee Trust Bank etc and ultimately the emergence of Jaiz Bank in Nigeria. After the International Islamic Economic Conference held in Usmanu Danfodiyo University Sokoto in 1985, the programme of Islamization of knowledge emerged and several courses related to Islamic banking were introduced into the syllabi of some Departments. Similarly, the first International Conference on Islamic Banking was sponsored by Islamic Education Trust (IET) in Nigeria held at Minna, Niger State. Seminars, workshops, dissertations, theses, projects and publications started to appear from various institutions pertaining to Islamic banking which inspired awareness on the need to have an alternative to conventional banking system ( Bello and Dikko 2004). The yearnings for Islamic Banking were fuelled by the prospects for the same as evidenced by the Muslim population in the nation and the non-exclusion of Non-Muslims from business provided, they agree on the principles of the Shari’ah.

There are many business men and business women among the Muslims and non-Muslims in almost all the parts of the country that will be potential customers of the Islamic banks. Similarly, the customs of the various
potential customers of the Islamic bank are in line with critical areas the Islamic Bank can finance through its modes of finances. Most of the potential customers are craftsmen such as farmers, traders, artisans etc. Various studies conducted by scholars such as Gusau (1986), Gusau and Bawa (1993), Aliyu, (1988) revealed that there are lots of prospects for Islamic banking in the country. These studies revealed that people oppose interest-based banking due to interest rate charged; injustices attached to it like inflation, etc. Similarly, the studies indicated that people needed Islamic banks for their fairness, convenience, etc.

Given the prospects for the Islamic banking, two groups eventually emerged with the same goal of having an Islamic Bank in the Country namely Halal Group and Jaiz group. Eventually the two groups merged and pursued the project of getting the bank licensed. The merger of two groups namely Halal Bank properties and Jaiz Bank with similar motive gave birth to Jaiz International Plc. In April 2003, Jaiz International Plc. commenced business on Friday 6th, January 2012 as regional non-interest financial service provider licensed by CBN. This is the giant stride in Islamic finance recorded in the country. Efforts are still being put to secure a license from the CBN for the conduct of national banking throughout the country.

So far Jaiz is the only full-fledged non-interest Bank in the nation that gives Muslims morale booster in providing a menu of Shariah compliant modern banking services. Initially, Jaiz started operation in three locations namely Abuja, Kano and Kaduna but it is gratifying to note that at the moment its operations expanded to fourteen locations such as Gombe, Maiduguri, Katsina, Gusau, Sokoto (commissioned on 7th April, 2014). One good thing is that Jaiz does business with both Muslims and Non-Muslims provided Shari‘ah led down principles are adhered to without any discrimination. According to Mutallab (2014) Jaiz has grown its investments from N1.9 bn to N9.4bn which is more than 380%. Similarly, the customer deposits also grew from N3.2bn to N18.6bn which is more than 460%. As for the profitability the total earnings of the bank grew by more than 750% by the end of last year. The bank also collaborates with established Islamic banks across the globe such as IDB as well as other regulatory agencies such as AAOIFI.

CONCLUSION

So far in this paper, we have traced the history of the emergence of Islamic Banking and distinguished between Interest free and Islamic Banking. The paper also discussed the principles, problems and prospects of Islamic Banking in Nigeria. Unlike conventional banking, Islamic Banking functions and operates within the matrix of the shari‘ah. It is recommendable that since a legal framework is provided by CBN and Jaiz Plc had already swung into action, other players should come forth to open many Islamic Banks even if the adjective “Islamic” is not employed provided the operations of the banks are in conformity with Shari‘ah. Those operating interest free windows can also expand to full-fledged Islamic Banks. It is our contention that Islamic Banks can actively participate in achieving socio-economic objectives of poverty alleviation, equitable distribution of income, employment opportunities, economic stability, etc. It is also possible that poverty-induced crimes will reduce with development of Islamic Banking in Nigeria. Therefore, Governments, NGOs, and private individuals should strive hard to support Islamic Banking in Nigeria so that it can unleash its potential benefits to the citizens.

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