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INTRODUCTION OF ISLAMIC BANKING IN NIGERIA: A CRITIQUE

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Abstract

This study is a critique of the emergence of Islamic Banking in Nigeria as response to the increasing number of cultural minorities and differences in the nation vis-a-vis the principles and rules of Islamic commercial jurisprudence. While adopting review analysis as the method of the study, the paper argues that the introduction of Islamic banking in Nigeria will relatively exacerbate the lingering problem of banking and economic instability of the country as against the proponent appeal that Islamic banking as a zero-interest bank when commenced operation in Nigeria will play a catalytic role in stimulating economic development of the country. The study, therefore, concludes that Nigerian banking business environment is not conducive for banking system that is based on 'mudaraba' and 'musharaka' mode of finance. Among other suggestions, the paper recommends that medium and long-term financing be developed in financing Islamic banking. The implication of this recommendation is that it will help the bank in corporate finance and equity participation.

Keywords: Islamic banking, finance, economy.

Introduction

In recent time, the introduction of Islamic Banking in Nigeria has continued to gain momentum. Islamisation of banking products and services has become a growing concept, arising from the relentless agitation of Muslims to drive a banking model that will conform to Islamic jurisprudence and faith (Iman). Islamic banking is in consonance with the ethos and value system of Islam. A system of banking activities that is consistent with Islamic law (Shariah) and principles guided by Islamic economic theories (Bashir, 2000). Suffice it to say that Islamic banking is an interest free banking that is expected to not only avoid interest-based transactions prohibited in the Islamic Shariah but also to avoid unethical practices and possibly participate actively in achieving the goals and objectives of Islamic faithful (Nesib, 2008). Importantly, an observer in the trends of Nigerian system will agree that it has been characterised with incessant banking reforms and development. Most of these reforms no doubt go with the initiating regimes. Although, this incessant banking reforms have been questioned and criticised in the academic circle, yet the Central Bank of Nigeria (CBN) under the leadership of Sanusi Lamido Sanusi, initiates a new phase of banking reforms targeted not only on the introduction of Islamic banking in Nigeria but also to hasten the progress of that arm of banking. Specifically, he maintains:

> This policy (policy of Islamic banking) has been on for about threes years and has been approved in principle for some time. I can recall that Jaiz International Bank PLC has been given approval in principle to operate fully as an Islamic Bank. All that CBN is waiting for them to do is to mobilise their capital base of ₦25 billion, required for operations in the Nigerian banking system (Sanusi, 2010).

The above assertion confirms that the current reform programms have introduced Islamic Bank in Nigeria. Further still, in March 2009, the CBN released a framework for non-interest banking in Nigeria promising collaboration with regulatory authorities to ensure a successful implementation. Against this backdrop, this stud,y therefore, criticizes and interrogates the emergence of Islamic banking in Nigeria.

The study is also motivated to contribute to Islamic banking knowledge and literature in Nigeria financial system. However, the rest of the paper is arranged as follows:

Historical Development of Islamic Banking

The evolution of Islamic banking is indeed historic. Like every other history, Islamic banking originated from Islamic countries of the world where Islamic economy is predominant. While the conventional banking business originated from the Babylonian City of Mesopotamia (now modern Iraq) in about 500 years ago, Islamic banking traced its origin from Mit Ghamr, a small town in Egypt in about 1963 (Ready, 1918). The first experiment which marked the historical take-off of Islamic banking was undertaken by Egyptian, under cover, in avoidance of projecting an Islamic image for fear of being seen as a manifestation of Islamic fundamentalism which was anathema to the political regime. This first attempt or experiment was pragmatically led by Ahmad El Najjar. The first Islamic banking started in the form of savings bank based on profit sharing (mudarabah). The exercise continued until 1967, when the number of such savings bank rose to nine (9) banks in Egypt. According to records, these banks engaged directly in instrument trade and industry, partnership business and the likes. They shared profit with their depositor in the bank. The first Islamic bank in Egypt historically functioned as savings investment institution and less of commercial banks. Although before this period, Muslim faithfuls in Egypt and other Muslim countries of the world were confined with the involvement of conventional banking business and transaction activities such as current account, money transfer, borrowing from banks and depositing (saving) with them, but this was extremely difficult for them because it was at variance with their Iman (faith). This attracted the attentions and concern of Muslim scholars who felt there was great need to maintain Muslim principles in the financial transactions and banking business (Abdul, 2007).

Subsequently, in 1974, the Organisation of Islamic Countries (OIC) established Islamic Development Bank (IDB). IDB was primarily an inter-governmental bank aimed at providing funds for development project to member countries, free-based financial services and profit-sharing financial assistance to member countries. It also operated free interest and explicitly based on shariah principles (Man, 1988).

In 1970, prior to dimensional changes in political economy and Islamic economy of Muslim countries, there was no longer panic in establishing Islamic financial institutions under hid and cover. As a matter of fact, a plethora of Islamic banking came into existence both in letter and in spirit; for instance, in 1975, the Dubai Islamic Bank was established; in 1977, the Faisal Islamic Bank of Sudan was established; in 1977, the Faisal Islamic Bank of Egypt was established; in 1979, the Bahrain Islamic Bank was founded, among others; all in the North America and some part of East. Also, in the Asia-pacific region, the Philippine Amanah Bank (PAB) was established in 1973, by the Presidential Decree basically as specialised banking institution. According to Mastura (1988), PAB was established as a respond by the Philippines government to the Muslim rebellion in south, designed to serve the special banking needs of the of the Muslim communities. Meanwhile, PAB has eight branches located in the major cities of the southern provinces, in addition to the head office located at Zamboanga city in Mindanao. Though Philippine Amanah Bank operated two windows - interest based operations and Islamic mode of financing; it is indeed fascinating to state that PAB has been converted into full-fledged Islamic bank presently.

Further, Malaysian Islamic bank was established in 1983. The Bank started as Muslim Pilgrims Savings Corporation set up in 1963 to help Muslim preparing for the Hajj or pilgrimage to Mecca and Medina to save some money. However, in 1969, it was recorded that the Muslim Pilgrims Savings Corporation was changed to Pilgrims Management and Fund Board popular known as Tabung Haji. In spite of the change in name, Tabung Haji retained its cardinal function as a financial company. The good track records of the Tabung Hajj in the areas of financial service delivery to the benefiting Muslim communities no doubt provided the impetus and the legal framework for successful establishment of Bank Islamic Malaysia Bechad (BIMB). BIMB was the first ever recorded full fledged Islamic bank in Malaysia, though the mother Tabung Haji provided 12.5 percent of its initial capital of M$80 million then. This bank has grown in size to the extent of being the biggest issuer of Sukuk - Islamic bonds world over (Man, 1988; Nasib, 2008).

India, the western world and a Muslim minority country is not left out in the development of Islamic banking and financial institutions. She witnessed a proliferation of interest-free savings and loan societies in seventies. The Islamic banking system now called Islamic Finance House was established in Luxembourg in 1978. There is also an Islamic Bank International of Denmark in Copenhagen and that of the Islamic Investment Company in Melbourne, Australia, all in Muslim minority countries (Ariff, 1988). In nutshells, the development of Islamic banking has been very encompassing such that presently, Islamic and non-Muslim countries of the world, namely: Bahamas, Algeria, Abania, Bahrian, Bangladesh, Bruneil, Dubai, Djubuti, Egypt, Iran, Iraq, Paskistan, Guinea, Malaysia, Mauritania, Morocco, Niger, North Cyprus, Oman, Tobago, Palestine, Qatar, Senegal, Saudi Arabia, Sri Lanka, Sudan, Trinidad, Tuinisia, Turkey UAE, Abu Dhabi, Sharia, Yemen, among others, operate Islamic banking (Nasib, 2008).

Principles of Islamic Banking

In the theory of Islamic economy *cum* Islamic banking, several principles form the basic ideology and philosophy of Islamic bank. In this study, an attempt is made to discuss the first two of the principles, which are prominent, upon which other ones are anchored.

- *Prohibition of Riba (Interest)*

Riba, in Islamic economic literature, means interest. Riba is highly prohibited in a true Muslim folk. The dangers associated with the violation of Riba cannot be over emphasised. It has seventy segments, the least serious being equivalent to a man committing adultery with his own mother, a tradition of prophet Muhammad narrated by Aba Huraiah (Haron and Shanmugan, 1997). The prohibition of Riba is clearly mentioned in four different revelations in the Qur'an; Surah al-Rum, Chapter 30, verse 39; Surah al-Nisa Chapter 39. verse 161; Surah al-Baquara, Chapter 2 verses 275 281. Ariff, (1988) maintains that "the first revelation emphasis that interest deprives wealth of blessings from God. The second revelation condemns it, placing interest in Juxtaposition with wrongful apparition of property belonging to others. The third revelation enjoins Muslims to stay clear of interest for the sake of their own welfare. The fourth revelation established a clear distinction between interest and trade, urging Muslim to take only the principal sum and to forgo even the sum if the borrower is unable to repay". According to the same Qur'an, it is stated that "those who disregard the prohibition interest are at war with God and His prophet, and prophet even condemned not only those who take interest but also those who give interest and those who record or witness the transaction. It is upon this Riba prohibition that lies the economic philosophy of Islamic banking. Therefore Muslims advocate absolute free interest banking and services.

- *Profit and Loss Sharing (Mudaraba)*

Another basic principle of Islamic banking is profit and loss sharing (PLS). This hinges on the fact that profit making is prohibited in Islamic Banking. Profit, in other words, is lawful. Meanwhile, profit and loss sharing (i.e., Mudaraba and Mudarib) has been explained in two ways; Al-arabi (1966) as cited by Aburime & Alo (2009), advanced the idea of a two tier muduaraba which could enable the bank to mobilize savings on a mudaraba basis and allocate the funds so mobilised on mudaraba basis as well. This means that under the principle of PLS (Mudaraba), Islamic bank would act as an entrepreneur borrower (Mudarib) in as far as the depositors were concerned; while the borrowers would act as mudaraba in so far as the bank was concerned.

Simply put, apart from prohibition of profit, the principle of PLS vis-a-vis Islamic banking mandates banks to share their profit with both depositors and investors because the depositors are also seen as owners of the capital used in making the profits. The depositors are also made to share in the risks of the bank (i.e. Loss).

However, the PLS principle of Islamic banking has varing sharing ratios and mode of payment possibly from bank to bank, place to place and time to time depending on supply and demand conditions. For instance, in Malaysia, profits are declared on nthly basis, in Egypt it is on quarterly basis, Bangladesh and Pakistan are on half-yearly while in Sudan it is declared annually.

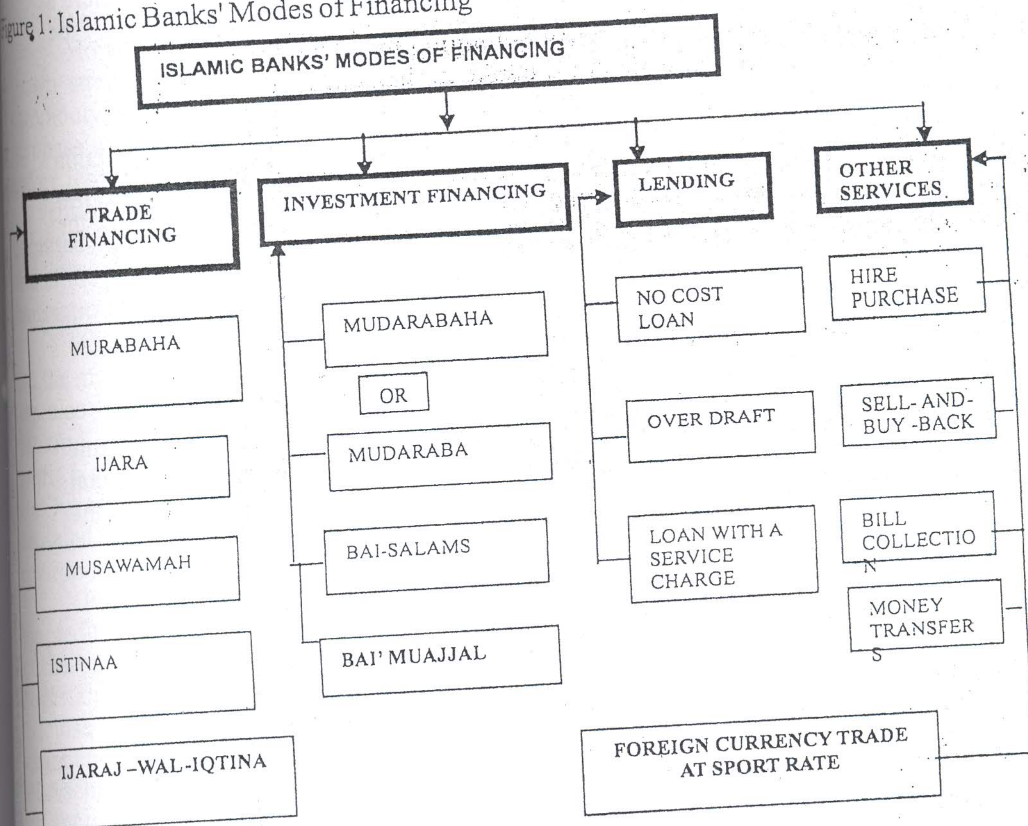
Other principles of Islamic banking

Other principles of Islamic banking are Justice, equity, solidarity, forbidden objectives and creatures. No gain of profit without effort or liability, acquisition of property rights and duality of risk (Schaik, 2001).

amic Banks' Modes of Banking and Financing

In practical terms, drawing closely from Islamic countries and Islamic economic literature, Islamic bank uses different model or methods of financing and acquisition of assets. Some of their modes of financing that requires mentioning are summarised in the diagram below:

Figure 1: Islamic Banks' Modes of Financing



Source: Authors

The diagram shows the various categories of Islamic banks' mode of banking services and finances namely, trade financing, investment financing, lending and other banking and finance services. Some of them can be described as:

Murabaha

This can also be called mark up financing. Literally, murabaha means a sale on mutually agreed profit. It is an Islamic banking transaction and method of trade finance where the seller discloses his cost and profit. This is done by a client requesting a bank to buy certain goods for him and the bank does that for a definite profit over the cost (Gafoor, 2007).

Ijarah

Ijarah simply means leasing method of Islamic banking and finance.

Bai muajjal

Literally, it means credit sale. It is an Islamic banks mode of financing where a bank earns profit margin on purchase price and allows the buyer to pay the price of the commodity in lump sum either by later date or by installment.

Musawamah

This is trade finance technique where the two parities involved in the transaction are expected to maintain price secrecy. Seller or buyer is not expected to reveal the price. Musawamah is used where the seller is not in a position to ascertain precisely costs of the commodities that he is offering to sell (El Ashker, 1987).

Istinaa

Istnnaa literally means prepayment.

Ijarah-wal-Iqtina

This simply means hire purchase-financing. A contract under which an Islamic bank provides equipment, building or other assets to the client against an agreed rental price with the undertaking by the bank that at the end of lease period, the ownership in the asset would be transferred to the leasee (Ray, 1996).

Bai Salam.

Simply put, Bai Salam means an advance payment.

Mudarabah or mudaraba

This means trust financing.

Musharaka

This is joint venture financing just as ordinary joint ventures with independent entity.

No-Cost Loan

In the operations of Islamic banks, they set aside some part of the funds that is used to granting of no-cost loan to the needy persons. Examples of such needy persons are subsistent farmers, small entrepreneurs, craft man and some needy customers with pathetic issues.

Sell-and-buy-bank

It is an Islamic mode of financing where a client sell his/her goods to the bank on agreed price payable now with the understanding that he/she will buy same goods back after some time on agreed price higher than what he/she is being given now. However, other mode of Islamic banks financing are self explanatory as can be seen in Fig. 1 above.

Criticism of Islamic Banking in Nigeria

From the review of the principles of Islamic banking *cum* its modes of banking and financing above, Mudaraba and Musharaka constitute, in practice, the twin pillars of Islamic banks financing.

However, Islamic banks including, the Nigeria Jaiz International Bank have shown strong preference for the other modes of financing that are less risky. This commonly accepted mode is mark-up. In murabaha transaction, the bank finances the purchase of a good or asset by buying it on behalf of its client and adding a mark-up before reselling it to the client on a costplus basis. Is this mark up not interest charge by conventional bank which Islamic bank forbid? We are saying that this is an interest admitted through the back door or could be likened to rejection of an offer with right hand and at the same time collecting it with left hand. Therefore, what makes the Mudaraba transaction Islamically legitimate?

Again, an excessive profit is prohibited according to Islamic jurisprudence (Figh) but the most popular Islamic transaction is majority profit oriented. Of course, this profit can also be as exploitative as interest. This is sacrosanct to the institution of Islamic banking, since such profits are replacement of pre-determined interest by uncertain profit. Naqvl(1981) supported this argument as he contends that Mudaraba is not based in the Qu'ran or the Hadith, but was a custom of the pre-Islamic Arabs. Thus, this crude and outdated Arabic custom may not work very well in the modern Nigerian business environment.

Further, the main sources of income to the Islamic banks have been predicted on the profit which will be done on PLS bases. It is in this profit and loss sharing that the bulk of the banks problems lie. In the first place, when it comes to business matter, most Nigerian insincerity and dishonesty manifest, hence they may found it very difficult to disclose their account and profit in order to borrow from Islamic banks. This will be disincentive to would-be-borrowers in the first place. Secondly, financing business under PLS scheme presupposes that the actual profit/loss of the business be well calculated, but no such satisfactory methods has been devised in Nigeria vis-à-vis Islamic banking practice and even where it is available it is prone to abuse. Thirdly, most of the small and medium-term business in Nigeria do not keep records not to talk of proper systematic accounts, even where it is maintained in the large business scale, they may not like to disclose their real account and profit. The effort and expenses involved on the side of the bank to checking the accounts of numerous small and large business defiantly may be exorbitant and will cut into their own much valued profit. So, both sides (borrowers and banks) would prefer avoiding the PLS mode of financing.

The survival of Islamic banking in Nigeria is very doubtful. Psychologically, most of the proponents of Islamic banking in Nigeria tend to behave as if they have a captive market in the Muslim masses that will religiously come to them. In other words, they appear rather complacent, forgetting that Nigeria is not absolutely a Muslim country. Aburime & Alo (2009) argue that there are many Muslims who find it more convenient to deal with conventional banks and are unbiased about shifting their deposit to Islamic bank. In other words, there are lots of entrepreneurs who would prefer fixed interest financing cost to sharing profit with Islamic banks. These classes of entrepreneurs if they have a choice will happily borrow fund from conventional banks instead of going into Mudaraba and Musharaka kind of transactions.

Islamic Banks financing style is dominantly short-term as analysed above. Islamic Banks are skeptical on participating in long-term financing. Meanwhile, analysing from the term structure of 20 Islamic banks in 1988, Gafoor (2007) reported that less than 10 per cent of Islamic banks' total asset go into medium and long term investment while 60% goes into short term investment. The implication is that Islamic bank cannot play active role in the field of corporate financing on participation bases. Other reasons are: first, long-term low- yield projects tie up capital for very long periods and so, risks are high. Another reason is that, the longer the maturity of the project, the longer it takes to realise the returns, thus Islamic bank cannot pay a return to their depositor as quickly as the conventional banks. Thirdly, participating in enterprises on the PLS basis is complex and time, consuming and, therefore, all procedures and negotiations require expertise and experience. In Nigeria, we do not have such expertise and experienced Islamic financiers. Even where it is available, it is not sufficient. Further still, analyst argues thus:

> There is no commonly accepted criterion for project evaluation based on PLS partnership. Each single case has to be treated separately with utmost care, assessed and negotiated on its merits, bring about analytical ambiguities, drags and cumbersomeness (Aburime and Alo, 2009).

Islamic banking or zero-interest banking may not fare very well in Nigeria under the current arrangement of interest-free banking. It will operate successfully only in a country where interest is legally prohibited and any transaction based upon interest is declared a punishable offence. After all, experiences have shown that Islamic banking thrives in environment characterised by a reluctant to hand over funds to banks, and of course, Nigeria business environment is not like that. This is because there is lack of developed Islamic financial products institution and market.

The way to make it really happen, in our opinion at least, is for the large Islamic investment houses right now in the private sector or the quasi private sector to launch products.

We believe that there is no shortage of potentially fertile investments and would advise Islamic firms to look at sustainable investments along key "themes". There are some themes in the world which are fairly obvious and one of them is the growth in the world's population. All people need to eat, all people need to drink, all people particularly as they get richer need electricity and they need power, among others. There is a strong Islamic tradition of husbanding resources which, over a year or two, may go up and down, but over a three to ten-year horizon represent a key opportunity. Investments in such sectors that would devote a lot of time to agriculture, to water, and to renewable energy would augur well with the ethics of Islamic finance.

A number of areas, we believe, are ripe for such Islamic investment not least the Hajj, one of the five pillars of Islam which calls for Muslims to travel to the holy city of Mecca. Governments of populous Muslim countries such as Malaysia and Indonesia already administer sizeable Hajj funds which seek to provide for pilgrims to make the journey to Saudi a\Arabia and protect them from unscrupulous tour operators.

The ministries of Hajj could be enormously influential in setting up Hajj asset management units so that is one area which is so Islamic but also matches what asset management can do. Other areas with potential include products to provide for the dowry payment made in many Muslim countries on the occasion of marriage, and also funds to administer the payment of Zakat - the annual donation of a certain proportion of a Muslim's wealth to charity. All of these are great building blocks for a strong industry, and they could be done quite easily at broader level.

For such a vision to take root, the time is fast approaching for Islamic institutions to take the plunge.

Islamic banks products in Nigeria are dearth. In the past, for instance, Nigerian conventional banks have attempted to serve the Nigeria Muslim with unique Muslim customer designed products and services but their effort ended in futility because most of them were strictly warned to separate any thing about Islamic banking separately from their normal conventional banks (i.e., running Islamic products as a separate banks). This made many banks to withdraw from such arrangement except Bank PHB who operates skeletal Islamic banking services in Nigeria.

The Network of Islamic banks are still underdeveloped and small, globally. There is no developed Islamic money and capital market. All these are childhood diseases of Islamic banks and it can kill it in Nigerian just as the death of Kuwait Islamic Finance house and Islamic Bank International of Denmark.

Conclusion

Conclusively, this paper has been able to draw attention on the historical development of Islamic banking, the theory of Islamic banking, the methods/modes of Islamic banking and financing among others.

Specifically, the study criticizes, in its entirety, the introduction of Islamic banks in Nigeria banking system. The incessant spate of banking reforms in Nigeria have made the Nigerian banking system unstable when compared to what obtains in other African countries and worldover. The problems associated with financing style of Islamic banking are complex vis-à-vis Nigeria that is still in a circular status. The Islamisation development and securitisation of money and capital market will only alleviate the problems of Islamic banking but will not solve it as against the general appeal that Islamic bank when commence operation in Nigeria will play a catalytic role in stimulating economic development of this country. We believe that great deal of work should be done by Muslim and Islamic economist in the area of Islamic banking vis-a-vis Nigerian Banking sector and economy so that the dream of Islamic Banking in Nigeria will be a dream come true possibly in the near future and not now.

Whether you are investing Islamically or by any other value or criteria, you have still got to aim to maximise your returns, but in a sustainable way. Some Islamic investment houses were guilty of losing themselves in a maze of transactions where they bought real estate projects on their own books before selling them at a premium to a sister company and then passing them on to end-investors. Sharing the risk is one of the differentiating parts of Islamic investment. There are opportunities for new relationships between conventional and Islamic institutions if the later would address the lack of standardisation within Islamic finance itself which would hamper Islamic institutions in their efforts to achieve the scale of their more-established conventional peers.

The biggest challenge is a lack of consistency in the application of Sharia rules. The fact is that there are so many schools of thought, or schools of jurisprudence, and they seem to be spending an awful lot of time emphasising the differences and attacking each other, rather than identifying common ground.

It is very difficult to see Islamic asset management being a large revenue driver for traditional asset managers whilst the market is so fragmented with the arguments within the Islamic world. If you had to have a separate *fatwa* for each and every single investment or for each and every single client because the different scholars disagree with each other then you are not going to create scale and it is scale that drives asset management, that actually drives profitability.

The way to make it really happen, in our opinion, at least, is for the large Islamic investment houses right now in the private sector or the quasi-private sector to launch products.

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