

**ASSESSMENT OF THE CHALLENGES OF ISLAMIC BANKING  
SYSTEM IN NIGERIA FROM 2010 – 2017**

*BY*

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**NOVEMBER, 2017**

## **DECLARATION**

I hereby declare that this thesis titled “Assessment of the Challenges of Islamic Banking in Nigeria from 2010 – 2017” has been written by me and that it is a record of my own research work. It has not been presented wholly or partially anywhere in any previous application for a higher degree. All quotations are indicated by quotation marks and sources of information are duly acknowledged by means of reference.

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## CERTIFICATION

This Dissertation titled “**Assessment of the Challenges of Islamic Banking System in Nigeria from 2010 – 2017**” A research carried out by Mohammed Sani Mahmud in the Department of Arts and Social Science Education, Ahmadu Bello University, Zaria, has been approved as partially meeting the requirement for the award of Masters Degree in Education (M.Ed. Islamic Studies).

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## **DEDICATION**

This research work is dedicated to my late parents, Malam Mahmud Idris and Malama Rabi'at Salihu.

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In the name of Allah, the Beneficent the Merciful. All praise is due to Allah who granted me the opportunity to conduct this research work from its commencement to completion successfully. May the peace and blessings of Allah be upon the noble Prophet Muhammad (SAW), his family, his Companions and all those who follow the righteous path up to the Day of Judgment, Amen.

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## **ABSTRACT**

In the name of Allah, the Most Beneficent, Most Merciful. The research explained the assessment and challenges of Islamic Banking operational nature from 2010 – 2017 and how the system could be established in Nigeria and the factors hindering its establishment in the country. The study highlighted some of the problems that hindered the establishment of Islamic Banking which include lack of adequate capital base etc. The main aims of this study is to highlight the importance of Islamic Banking in Nigeria and also to explain the problems attached to the operations of Islamic Banking in the country. The study also explains prospects of anticipated opportunities attached to Islamic Banking in the country in order to acquire relevant data. Primary and secondary DATA were obtained from necessary literature using historical, survey, and documentation methods, and using questionnaire and interviews as instruments. By the end of the research, the study tested the hypothesis “Islamic Banking in Nigeria was the solution to the socio-economic problems in the banking system” and found the result to be valid. Despite the problems and shortcomings outlined, there are potentials of its establishment in Nigeria. In order to achieve the objectives, some suggestive measures were recommended such as the need for Muslims to put total commitment to the cause and commit their resource and banking in order to prepare base for personnel, the use of media to propagate awareness of the concept of Islamic Banking etc. The research is expected to serve as an increase to existing literature where Islamic banking would be operational in Nigeria.



## TABLE OF TRANSLITERATION

Arabic Letter	Name	Transliteration
ا	alif	a
ب	Ba	b
ت	Ta	t
ث	Tha	th
ج	Jim	j
ح	Ha	kha
خ	Kha	kha
د	Dal	d
ذ	Dhal	dh
ر	Ra	r
ز	Zayn	z
س	Sin	S
ش	Shin	sh
ص	Sa	s
ض	Da	d
ط	Ta	t
ظ	Dha	dh
ع	Ayn	a
غ	Gha	gh
ف	Fa	f
ق	Qaf	q
ك	Kaf	k
ل	Lam	l
م	Min	m
ن	Nun	n

ھ	Ha	h
و	Wa	w
ی	Ya	y

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## **ABBREVIATION**

A.H	-	After Hijrah
C.E	-	Christian era
A.S	-	Alayhis-Salaam
R.A	-	Radhiya'llahu Anhu/Ankum/Anhum
S.A.W	-	Salla Allahu Alayhi Wasallam
A.M.L	-	Anti Money Laundering
C.F.T	-	Combating of the financing of terrorism
F.S.B	-	Federal Saving Bank
N.I.D.B		Nigerian Industrial Development Bank
N.A.C.B		Nigerian Agricultural and Cooperative Bank
N.B.C.I		Nigerian Bank of Commerce and Industry
O.I.S	-	Organization of Islamic Countries
G.I.A.	-	General Investment Account
R&DD-		Research and Development Department
F.D.I	-	Foreign Direct Investment

## OPERATIONAL DEFINITION OF TERMS

- **Adl:** - justice, impartiality, fairness, proper conduct acting in obedience to Allah.
- **Al-ihسان** - Performance of good deeds
- **Amanah:** - Trustworthiness, reliability, something deposited in trust
- **Bay mujallal:** - Sale against deferred payment
- **Din:** - A way of life
- **Falah:** - Well being, prosperity, salvation
- **Faqih:** - A Muslim jurist, lawyer. Plural (fuqaha)
- **Fiqh:** - Islamic law
- **Hadith:** - Saying, deeds or approval of the Prophet Muhammad (SAW)
- **Halal:** - Things permitted by shariah (see below)
- **Haram:** - Things prohibited by shariah (see below)
- **Hasanah:** - Good deed
- **Israf:** - Wastefulness, prodigality, extravagance
- **Kafir:** - An unbeliever in Islam, an ingrate.
- **Murabaha:** - Set profit sale
- **Mudaraba:** - Capital – Labour partnership.
- **Nisab:** - Minimum amount of property liable to payment of zakat
- **Qard-e-hasanah:** - A benevolent loan given on compassionate grounds without interest, repayable if and when the borrower is able to pay.

- **Riba:** - Increase or addition
- **Sadaqah:** - Alms
- **Shari'ah:** - Scheme of life envisaged by Islam
- **Sharikah:** - Partnership between two or more persons in business to make profit and share loss according to agreed ratio between them.
- **Sunnah:** - A path, way custom or manner of life of the prophet
- **Taqwa:** - Piety
- **Zakah:** - Purification or cleansing, obligatory alms



## CHAPTER ONE: INTRODUCTION

### 1.1 Background to the Study:

Banking is an important financial intermediary and vital institution in the economic structure of any country. The basic services a bank provides include checking accounts, which can be used like money to make payments and purchase goods and services; savings account and time deposits that can be used to save money for future use; loans that Consumers and businesses can use to purchase goods and services, and basic cash management services such as check cashing and foreign currency exchange. Therefore, bank is any financial institution that receives, collects, transfers, pays, exchanges, lends, invests, or safeguards money for its, customers. (Fuad, 1996)

However, an important question that agitates the minds of those who think that Islamic economic, whether proponents or critics, is the Feasibility of Islamic banking in Nigeria (which operates on interest free basis). Islamic Banking has the same purpose as conventional banking except that it operates in accordance with the rules of *shari'ah* known as *Fiqh al mu'amalat* (Islamic rules on transactions). According to Sadiya (1996), the basic principle of Islamic banking is the sharing of profit and loss and the prohibition of *Riba* (interest). Amongst the common Islamic concepts used in Islamic banking are profit sharing (Mudaraba). Safekeeping *Wadi'ah*, joint ventures *Musharakah*, cost plus *Murabahah* and leasing *Ijara'i*. Islamic banks lend their money to companies by issuing floating rate interest loans. The floating rate of interest is pegged to the company's individual's rate of return. Thus, the banks' profit on the loan is equal to a certain percentage of the Company's profits. Once the principal amount of the loan is repaid, the profit sharing arrangement is concluded. (Saleh, 1992). So (both profit and risk are shared. Such participatory arrangements between capital and labour reflect the

Islamic view that the borrower must not bear all the risk/cost of a failure, resulting in a balanced distribution of income and not allowing lender to monopolize the economy. Finally, Islamic banking is restricted to Islamic acceptable deals, which exclude those involving alcohol, pork, gambling, etc. Thus ethical investing is the only acceptable form of investment and moral purchasing is encouraged.

The banking system currently operating in Nigeria is the conventional banking system. Conventional banking system is interest based banking system. The whole credit system is built upon the institution of interest. Under the system, the borrower is obliged to pay a predetermined rate of interest on the amount borrowed even though he may have incurred losses. (Bello 2004). The relationship between the bank and its client is therefore, that of creditor and debtor, *iqtina* had led to so many economic and social evils among other things. The institution of interest puts a hock and brake on economic progress especially in underdeveloped economies. While businesses have collapsed, many potentials investors are scared or discouraged due to the predetermined interest rate charged by these banks.

From the foregoing, it is obvious that the detrimental effects of interest (applicable to conventional banking) are evident as interest was originally forbidden by all major religious of the world.

Similarly, the provision of interest can be regarded as exploitation. Islamic banking is a system that has its rules and regulations based on Islamic law and the only system that is performed entirely free of interest. (Karim and Ali, 1989). The establishment and application of Islamic banking particularly in Nigeria is the best way to curb these socio-economic maladies in the Nigerian system.

Jaiz International Bank is the only bank currently trying to establish an Islamic Bank in this Country; however, with the review of capital adequacy in Nigerian banks, the Islamic bank is delayed. Although the twenty five billion (N25b) capital base is one of the problems hindering its establishment, other problems such as lack of expertise, lack of awareness of its products, lack of research and development, etc contributed also. Other Conventional Banks such as Plateneus Habib Bank (PHB) had introduced interest free banking alongside conventional banking and some states in the Southern part of the country operate Islamic micro-finance banks.

This study is aimed at assessing the challenges on how Islamic Banking System can serve as a solution to the present Nigerian banking problems and also highlight the problems attached to *its* establishment and prospects of how to solve these problems in order *to* pave way for its operation in Nigeria.

## **1.2 Statement of the Problem**

Over a long period of time, Nigeria has been suffering from a number of economic ills, including poverty among large population, social and economic injustice, inflation, high rate of unemployment, gross inequalities in income and wealth distribution etc.

On the other hand, Islamic banking is a banking system based on profit and loss sharing ratio i.e. the outcome of investment determines the payment or return available to the parties to investment. (The main objectives of Islamic Banking System are removal of injustice, bringing in the optimal level of social welfare and ensuring justice in the lives of individuals and the society at large, through the concept of unity, brotherhood and social justice. Islam discourages and prohibits all forms of exploitation, extravagance, hoarding etc.

In spite of these advantages offered by Islamic banking, it is still not acceptable and spread in various parts of Nigeria. The possible problems that facilitate this research include:-

- i. Lack of adequate knowledge about Islamic Banking System: Many Nigerian especially the non Muslims are not properly mobilized and informed about the operation of Islamic Banks. Most of them think that the establishment of Islamic Bank means enforcing Islam on them (Saleh, 2003).
- ii. Lack of proper knowledge about the advantages of investing in Islamic Banks and the need for supporting its course. This is an indication that profit and loss sharing financial (PLS) grants to the financiers a rapid growth rate of return on their capitals when compared to the rate of interest finance. (Zubair, 1985:86).
- iii. Lack of awareness that Islamic Banks are operational in both Muslim on non-Muslim states.
- iv. Lack of awareness that even the non-Muslims borrow money from Islamic Bank.
- v. Lack of proper orientation that the highest shareholders in most of the Islamic Banks are non-Muslims

There are many other problems attached with the establishment and operations of Islamic banking in Nigeria shall be addressed accordingly.

### **1.3 Objectives of the Study**

The main objective of this study is to highlight the Assessment of the Challenges of Islamic Banking in Nigeria and also;

1. To examine the problems attached to the operation of Islamic banking in the Country.
2. To appraise the prospects of Islamic banking in Nigeria.
3. To create awareness about Islamic banking system to both Muslims and non-Muslims;

4. To encourage individuals who have good business proposals, but are off by high interest rate payable on loans in the conventional banking system, take advantage of the profit and loss sharing method of Islamic banking.
5. To motivate investors realize the potentialities of Islamic banking system and thereby willing to commit their resources to it.
6. To discuss the wisdom behind the prohibition of interest by Islam.

#### **1.4 Significance of the Study**

The researcher found it very useful to conduct this study, as it will make positive impact on individuals and the general public or institutions. The study will create awareness on the various opportunities offered by Islamic Banking System available to the Muslims and non-Muslims on different kind of investment available for various forms of investors. It will also be beneficial to them because it will encourage them to borrow from the bank and make payment of the debt easily without a single addition of interest.

The research work is expected to analyse how the problems that are affecting the establishment of Islamic banking in Nigeria could be alienated by highlighting the performance and achievement of Islamic banking system all over the world and thereby encouraging other banks to set and practice the banking system.

#### **I .5 Research Question**

1. What are the problems attached to the operation of Islamic banking in Nigeria?
2. What are the anticipated opportunities attached to Islamic banking in Nigeria?
3. Does Nigeria polity aware of Islamic banking system?
4. What are the advantages of the profit and loss sharing method of Islamic banking over the conventional banking system?

5. How can investors realize the potentialities of Islamic banking system and thereby willing to commit their resources to it?
6. What are the Islamic philosophies for prohibiting interest (Ribah)?

#### **1.6 Assumption of the Study**

The following are the assumption of this study:

1. At the end of the analysis of data, the researcher should know some significance way through which Islamic Banking strongly influenced the Nigerian perception.
2. Equally the recommendations by the study will provide an effective counter recourse for checkmating the hard work of the analysts against the unhealthy propaganda and negative brainwash of Nigerians on Islamic Banking System.

#### **1.7 Scope and Delimitation of the Study**

The scope of this study is solely based on the assessment of challenges of Islamic Banking System in Nigeria. The study could not cover other aspects of Islamic economy even though they both juxtapose one another. The work is delimited to Nigeria Banks operating an interest-free banking including any window open by any bank operating an interest-free system. Hence interest-free banking is the domain and main concern of the work.

## **CHAPTER TWO**

### **REVIEW OF RELATED LITERATURE**

#### **2.1 Introduction**

Bank is the central point of financial institutions. It is the place where all Finance activities take place. In Nigeria, the Banking sector is the mainstream of all socio-economic activities around the Country. It engulfs the oil sector, industries, conglomerates, agriculture, educational sector, etc because they all use the Bank as their financial resort. But the problems attached to the Banking system cause more harm than good because it is solely based on the concept of (*Ribah*) interest which causes economic breakdown to any society. In trying to solve these problems, Islam brought about Islamic Banking system which operates within the limits and principles of *Shari'ah* (Khan, 1983:96). The *Shari'ah* abhors interest and therefore uses different kinds of ways to usher Islamic economic procedures to the system. These kinds of concept such as '*Murabahah*', *Mudaraba*, '*Ijarah*', *Musharakah*' '*Bai-salami*'. '*Qard Hassan*' etc are devoid of interest (usury) and are the basis of Islamic Banking system. If properly implemented, the concepts will thoroughly cleanse the ills associated in the Banking sector and will solve the socio-economic problems attached to the system especially in a country like Nigeria.

#### **2.2 Banking History In Nigeria:**

According to Fermi in Basheer, (1984:61), the first Commercial Bank in Nigeria known as 'African Banking Corporation' opened its first branch in Lagos in 1892. It transferred its interest to Elder Dumpster and Co in 1893. This transfer later led to the establishment of a new Bank called: "The British Bank for West African" in the year 1893 and was registered in London in March 1894 (the same year it opened its first branch office at Lagos Nigeria).

Banking in any country are considered as the nerve of the nation's economy. They play an important role in the country's wealth. Banks are established to function as a financial intermediary between organizations, companies, government and individual, specifically for the purpose of transactions, transfer of funds and depositing money.

The Anglo African Bank was established in 1899 at old Calabar by the Royal Niger Company known as United African Company (U.A.C.) This Bank was established to compete with the British Bank for West Africa (B. B.W.A). Unfortunately it could not face the force competition and it was eventually sold out to British Bank for West Africa in 1912. Barclays Bank DCO (Dominion Colonial and Overseas) now known as Union Bank of Nigeria PLC established its first branch at Lagos in 1912. Another foreign Bank was the British and French Bank now known as United Bank for Africa (UBA) Plc which was established in 1949.

The above 3 foreign Banks dominated the Nigerian Banking scene and were principally concerned with international trade of expatriate: Banks were then in control of almost 90% of aggregate Bank deposits. Several attempts were made to break the monopoly and the opening and collapse of indigenous Banks were witnessed. The first indigenous Bank known as Industrial and Commercial Bank Ltd was founded in 1929 and it collapsed in the following year in 1930. Similarly the Nigerian Merchant Bank was closed down in 1936 after five years of rough operations. The first successful indigenous Bank, known as the National Bank was founded about the same time in 1933 (Sadiya, 1966).

The failure of these indigenous Banks was traced to mainly poor financial management, under capitalization and/or force competition from foreign Banks. According to Ajayi and Ojo (1981) by 1954, 21 out of the 25 indigenous Banks have collapsed. The failure led to loss of money by many small depositors as a result of which it became necessary for the Colonial Government to



enact laws for the reputation of Banks in Nigeria. Mr. G.D. Paton, an official of the Bank of England was appointed to investigate; this resulted in the passage of the first Banking legislations: Paton's recommendation eventually emerged as the Banking Ordinance of 1952. The Banking Ordinance could not effectively control the Banks and therefore it became necessary to establish a Central Bank to supervise and control the Banks. Thus, the Central Bank of Nigeria was established in 1958/1959 as the apex financial institution created to ensure effective and efficient payment of mechanism to promote monetary stability. From 1970 to date, we witnessed the control of 60% of the capital investment in Banking operations by Nigerians. With the oil boom and the indigenization Decree of 1972, majority of shares of the Banks operating in Nigeria came under the Nigerian citizens and the Federal Government. From the year 1986 the economy of Nigeria was deregulated and financial system was liberalized as a result of the introduction of the structural adjustment programme (SAP) (Usman, m2001).

As a result of this, many commercial Banks, Microfinance Banks and other monetary institutions emerged and there was large proliferation of Banks and most of them did not added value to their customers. Due to high rate of liquidity failure and lack of cooperate governance, many Banks collapsed, while others merged. By 2004, the Central Bank of Nigeria (CBN) issued a regulation that all commercial Banks must have a minimum capital base of N25bn. As a result, the Banking industry was scaled from 86 Banks to 25 Banks many Banks merged; others bought lesser ones while others collapsed.

### **2.3 Classification Of Banks:**

Banks can be classified into two categories viz, functional classification and structural classification Zaid (1993).

a) Functional Classification of Banks:

In this process, Banks are classified based on the functions they perform or execute. Under functional classification of Banks, we have Banks that include.

- i) Central Bank
- ii) Commercial Banks
- iii) International Banks
- iv) Development Banks/Specialized Banks
- v) Merchant Banks.
- i) Central Bank/Apex Bank:

The Central Bank is at the top most of the financial system. It acts on behalf of the government to regulate the activities of financial institutions. A major responsibility of Central Bank is the monetary policy it facilitates which is an important instrument of economic development as it is an integral part of economic policy of any economy. The Apex Bank in Nigeria is the Central Bank of Nigeria (CBN) which was established in 1958 and has 3 major Bank functions, namely by Ghannadian and Klein (1991:76).

1) Ensuring relative stability of economic prices.

2) Helping a rapid and sustainable rate of economic development.

3) Maintaining equilibrium in the Country's international payment position.

**(2) Merchant Banks:**

Diamond, (1984:2), a Merchant Bank is defined as a Bank which creates its operations on all or most of the following:

- i) Holding and dealing in quoted investments.

- ii) Medium term lending and the syndication of loans
- iii) Fund management for and on behalf of client.
- iv) Corporate financial advice on diverse matters such as new share and bond issues, capital reconstruction, merger and acquisition
- v) Accepts credit and all forms of export finance.

### **3) Commercial Bank:**

Fu 'ad (1996:62), Commercial Bank is most of the times referred to as the common people's Bank. They accept money from individuals and firms in various deposits and return the same amount on demand or at maturity. They also provide and give loans and overdrafts to their Customers provided the customers give either tangible/non tangible as collateral or security for them to secure the loan.

One of the significant importance of commercial Banking activity is the unique ability of the system to create money which makes it to be one of the most important determinants of aggregate money supply and consequently to a considerable extent, of the level of overall economic activity.

### **(4) Development Banks/Specialized Banks:**

These are Banks which were founded for a particular purpose. They are special financial institutions. Examples of specialized or development Banks are as follow:

- 1) Federal Saving Bank (FSB)
- 2) Nigerian Industrial Development Bank (NIDB)
- 3) Nigerian Agricultural and Cooperative Bank (NACB)
- 4) Mortgage Bank
- 5) Nigerian Bank for Commerce and Industry (NBCI)

### **5) International Banks:**

This refers to the specialized United Nations Agency established in 1944 otherwise known as World Bank. A related institution, the International Monetary Funds (IMF) was created at the same time (Steinherr, 1993).

The main objectives of the Bank as stated in the articles of agreement are;

1. To assist in reconstruction and development of territories of members by facilitating the investment.
2. To promote private foreign investment by means guarantees or participation in loans.
3. To supplement private investment by providing finance for productive purposes out of its own capital.

The Bank grants loans only to member Nations for the purpose of financing specific projects. Before a Nation can secure a loan, advisers and experts representing the Bank must determine that the prospective borrower CHT meet conditions stipulated by the Bank. Most of these conditions are designed to ensure that loans will be used productively and how it will be repaid. The Bank requires that the borrower be unable to secure a loan for the particular project from any other source on reasonable terms and that the prospective project should be technically feasible and economically sound. In ensure repayment, member government must guarantee loans made to private concerns within their territories. After the loan has been made; the Bank requires periodic reports from the borrower and from its own observers on the use of the loan and on the progress of the project (Presley, 1991:46).

### **b) Structural Classification of Banks:**

This is the classification of Banks based on their structures. Under structural classification there may be Banks such as:

- 1) Unit Banking
- 2) Branch Banking
- 3) Group/holding company banking
- 4) Chain Banking

**1) Unit Banking:**

This is characterized by a simple Banking company conducting operations at a restricted area and tends to be localized with each Bank maintaining a single office. It is a unique Banking structure which may have branches in exceptional cases but within a strictly limited area. This is also practiced here in Nigeria in the form of Community Banks and Peoples' Banks.

**2) Branch Banking:**

As the name indicates, branch Banking is a Banking that is characterized by a single Banking company conducting operations at two or more places. Usually the branches are controlled from a central point i.e. the main headquarters. In Nigeria, branch networking is fully practised; it is characterized by a few larger Banks with wide network of branches extending throughout the Country.

**3) Group Banking:**

In the group banking, a certain number of Banks combine together through the ownership of stock by holding companies. In this Banking system, a group of Banks is brought under one centralized management which exerts control over all the units. Although each Bank has got a separate entity itself, its affairs are controlled by a holding Bank.

#### **4) Chain Banking:**

In the chain banking system, chains of Banks are formed by the common stock ownership without any intervention by holding companies or by interlocking directorates. This type of banking system in the United States is also subjected to a number of government regulations ranging from statutory prohibitions to start certain type of holding companies to special investigation in control by the authority concerned. The chain Banking resembles the holding company because it involves stock ownership in a number of Banks by one or a number of individuals and interlocking directories. The main differences between the two lies in the fact that in the case of holding company Banking, the affairs of the group are controlled by a holding company whereas, in the case of chain Banking there is no such intervention from any control body or organization.

#### **2.4 Islamic Banking System:**

The mechanism of Islamic Banking which is based on the principle of partnership is interest free. This therefore eliminates the question of either paying or receiving interest to depositors and clients respectively. Khan (1987) said at the simplest level, Islamic Banking can be considered as equity-based rather than an interest—based Banking system. The depositor in essence purchases equity in the Bank and the Bank in return has an equity position in whatever activity the borrower uses the fund for.

In Islamic Banking framework, there may be two types of depositors. The first are those depositors that deposit their surplus funds and can withdraw their deposits without any notice. The object of deposit here is safekeeping and not for investment in any productive or profitable activity which involves risk. However, in the case of such deposits, the Bank may recover zakat and service charges from Muslims and non-Muslims respectively. This taxation as stated

by Mamman (2006) is justified as it checks the tendency to hoard cash in idle form and provides a stimulus for investing in productive activities.

Unlike the first type of depositors, the second type of depositors is not in a position to withdraw their funds without notice. Their surplus funds may be invested in productive activities on short term basis. However, the Bank does not charge anything from this class of depositors: rather they will be allowed to share the profit or loss arising from such investments of the Bank proportionately at the end of the financial year just like dividends, or something similar. However, the Islamic Bank can also raise funds if there is the need by inviting investments on a long term. But one thing definitely clear is that in Islamic Banking, debentures cannot be issued for Fund raising as it involves the payment of fixed rate of interest (Fuad, 1996).

At the same time however, it should be stressed that Islamic Banking goes further and requires that, loans and advances made by Banks also be based on equity participation and granted for ventures that are permissible.

According to Zaidi (1983) Islamic Banking system is based on the following fundamental principles:

- (1) It should help in advancing the socio-economic objectives of an Islamic society.
- (2) It should be conducted without transgressing any injunction of the *Shari'ah*

The starting point of an Islamic Banking, he also said, is abstinence from interest and it (Islamic Bank) derives its inspiration from the religious ethics of Islam and moulds its operation within the framework of the teachings of Islam. Fu'ad (1996) said:

*Islamic Banking is the Banking system that is conducted in consonance with the ethos and value system of Islam.*

Islamic Bank are multi-function Banks, offering all the Services rendered by commercial, investment and development Banks, but on an interest free basis. Even though the terms “Islamic Banking” and “Interest-free Banking” have been used inter-changeably, it has been stressed by several writers that the former is a more normative concept whereas the latter is the actual practice of Bank.

The Islamic Banking system, just like conventional Banks provides variety of services to its customers in various capacities and these include:

- a. Loan for agriculture
- b. Accepting deposits
- c. Investment
- d. Loans for trade and commerce
- e. Banking business
- f. Investment in other companies
- g. Financial assistance to industry

#### **2.4.1 Origin of Islamic Banking**

The first attempt to put Islamic Banking theory into practice probably took place in 1958 called National Institute of Islamic Banking and Insurance in London. Many centuries before, the economies of Muslim Countries were run on roughly Islamic economic principles. The First Islamic Bank probably had long existed in many Islamic Countries in the form of Qard-al-hasan funds. This is a pure loan transaction in which the client obtains cash from the Bank to be returned at a stipulated Future date free of interest (Fu’ad, 1996:24).



#### **2.4.2 Historical Development of Islamic Banking**

During the Islamic golden age, early forms of proto-capitalism and free markets were present in the Caliphate, where an early form of mercantilism were developed between the 12<sup>th</sup> – 18<sup>th</sup> Centuries, which some refer to as Islamic capitalism. A vigorous monetary economy was created on the basis of the expanding levels of circulation of a stable high-value currency (*dinar*) and the integration of monetary areas that were previously independent. A number of innovative concepts and techniques were introduced in early Islamic Banking including bills of exchange, the first forms of partnership such as limited partnerships and the earliest forms of capital accumulation, cheques, promissory notes, trusts, transactional accounts, loaning, ledgers and assignments. Organizational enterprises similar to corporation's independent from the state also existed in the medieval Islamic world, while the agency institution was also introduced during that time. Many of these early capitalists' concepts were adopted and further advanced in medieval Europe from the 1<sup>st</sup> Century onwards.

Bankers Journal Malaysia, (1993) states that the first Islamic Bank was established in the late 1950's in a rural area of Pakistan which charge no interest on its lending. The first modern experiment with full Islamic Banking was undertaking in Egypt under cover without projecting an Islamic image - for fear of being seen as a manifestation of Islamic fundamentalism that was anathema to the political regime. The pioneering effort led by Ahmad Elnaggar, took the form of a saving Bank based on profit sharing in the Egyptian town of Mit Ghamr in 1963. This experiment lasted until 1967 reviewed 1981 by which time there were nine of such Banks in the Country.

Fuad (1996:25) states that, in 1972, the Mit Ghamr saving project became part of. Nasr Social Bank which till date is still in business in Egypt. Islamic Banking movement owes its progress

both to the enterprise and efforts on the part of islamically motivated individuals and groups as well as to the initiative and encouragement of Governments of Muslim Countries. The late King Faisal Ibn AbdulAzeez of Saudi Arabia was the most notable in promoting the idea of setting up of an Islamic Development Bank to serve the Muslim *Ummah* Community. This is became a reality in 1975. It enjoyed the support of the entire member Countries of Organization of Islamic Conference (O.I.C). The first modern commercial Islamic Bank was Dubai Islamic Bank which opened its door in 1975. In the early years, the services offered were basically and strongly founded on conventional Banking services, but later the industry started to see strong development in new products and services. This was soon to be followed by the Faisal Islamic Bank of Egypt and Sudan in 1978. 1979 saw the commencement of business by the Jordan Islamic Bank. The Bahrain Islamic Bank started slightly later. Today there are over 300 Islamic financial Institutions spread over fifty (50) Countries, including the United States through companies such as the Michigan-based University Bank as well as an additional two hundred and fifty (250) mutual funds that comply with Islamic principles.

According to Bello (2004:36) Islamic Banking is one of the fastest growing sectors of the global financial service at a rate of 10 - 15% per year and with signs or consistent future growth. Islamic economic banking and finance are already part of the curricula at the post graduate level in many institutions all over the globe. The world Islamic Banking Conference held annually in Bahrain which started since 1994 is internationally recognized as the largest and most significant gathering of Islamic Banking and finance leaders in the world.

Now even the non-Muslim scholars, economist and bankers acknowledge that Islamic Banking has made a place for itself in the whole world of finance. The Vatican has put forward the idea

that the principles of Islamic finance may represent a possible cure for ailing markets (Fuad 1998).

### **2.4.3 Concepts And Principles of Islamic Banking**

Islamic Banking has the same purposes as Conventional Banking except that it operates in accordance with the rules of *Shari'ah*. Known as *fiqh-al-mu'amalat* (Islamic rules on transaction). The basic principles of Islamic Banking include profit sharing (*Mudaraba*), safekeeping (*wadi'ah*), joint venture (*Musharakah*) cost plus (*Murabahah*) and leasing (*Ijarah*). Islam has stipulated that economic activities can be pursued on items which do not harm the society or morality. According to Khan, (1986), the main goal of the Islamic banking system is social justice and equality. It tries to be fair for one and all and it helps in promoting individual enterprise and also controls the economic system in a fair and equal manner.

In the Islamic financial system, the financial institutions (Banks) become a partner in business. The utilization of the funds from the institution by a business house or an enterprise is on a profit and loss sharing basis. Gains from the business as well as losses earned due to the business are shared proportionately by the institutions and the enterprise. But this does not mean that the investments by financial institutions are speculative.

More so, before investing money, a thorough investigation is carried out on the risk factors associated with the business. Feasibility study of the project and necessary risk management principles are rightly undertaken to undermine the effect of loss. Investing in Islamic Banks may provide more profit and less risk because the financial institution has its own interest as it acts as a partner.

#### **2.4.3.1 Mudharaba**

This is a financing technique in which the owner of capital provides funds to the labour-partner for some business activities on the condition that profits generated will be shared between them according to agreed ratio.

This is a financing technique in which the owner of capital provides funds to the capital-user for some productive activity on the condition that profits generated will be shared between them. The loss if any, incurred in the normal process of the business and not due to neglect of misconduct on the part of the capital-user is borne by the capital-owner. The user does not invest anything in the business except his human capital and does not claim any wage for conducting the business.

The ration in which profits are distributed is fixed and predetermined, and known in advance to both parties. In the event of loss, the capital-provider loses his capital to the extent of the loss and the user of the finance loses his labour.

Iqbal and Mirakhor, (1987) are of the view that the finance user (client) guarantees to return funds only on two conditions; if he is neglect in the use of the funds or if he breaches the conditions of mudarabah.

#### **2.4.3.2 Set – Profit Sale**

This is a set-profit sale contract in which a client wishing to purchase equipment or goods requests the Islamic bank to purchase the items and sell them to him at cost plus a declared profit Ali, (1987:123).

It is one of the most popular modes used by Islamic Banks to promote interest free transactions. The ratio in which this instrument is being used varies from Bank to Bank. Typically *Murabaha* is only used in as financing, property, micro- finance as well as

import/export of commodities. Use of the instrument of *Murabaha* is however restricted only to those cases where *mudaraba* and *Musharaka* are not practicable. In reality there are risks associated with profit sharing and Banks may or cannot guarantee any income from these modes of financing (Hamoud, 1985:78). As a result, *Murabaha* with its fixed margin attached, offers lenders (i.e. the Banks) with a more predictable income stream. The purchase and selling price, other costs, and the profit margin must be clearly stated at the time of the sale agreement. The Bank is compensated for the time value of its money in the form of the profit margin. This is a fixed-income loan for the purchase of a real asset (such as real estate or a vehicle), with a fixed rate of profit determined by the profit margin. The Bank is not compensated for the time value of money outside of the contracted term (i.e. the Bank cannot charge additional profit on late payments); however, the asset remains as a mortgage with the Bank until the *Murabahah* is paid in full.

#### **2.4.3.3 Capital-labour Partnership (*Mudarabah*)**

Iqbal and Mirakhor, (1987:123) stated that *Mudaraba* is a special kind of partnership where one partner gives money to another for investing it in a commercial enterprise. The investment comes from the first partner who is called *rabbul mal*”, while the management and work is an exclusive responsibility of the other, who is called “*Mudarib*”. *Mudaraba* is an arrangement between the Bank and an entrepreneur, whereby the entrepreneur all mobilize the funds for the former for its business activities. The entrepreneur provides expertise, labour and management. Profits made are shared between the banks and the entrepreneur according to predetermined ratio. In case of loss, the Bank loses the capital, while the entrepreneur loses his provision of labour. It is this financial risk, according to *Shari'ah*, that justifies the Bank's claim to part of

the profit. The profit-sharing continues until the loan is repaid. The Bank is compensated for the time value of its money in the form of a floating rate that is pegged to the debtor's profits.

The *Mudaraba* is a contract, which one party providing 100 percent of 'the capital and the other party providing its specialist knowledge to invest (lie capital and manage the investment project. Profits generated are hired between the parties according to a pre—agreed ratio. Compared to *Musharakah*, in a *Mudaraba* only the capital partner (owner of the money) has to take the losses.

#### **2.4.3.4 Joint Venture (Musharakah)**

Khan, (1987:98) said that *Musharakah* is a relationship between two parties or more of whom contribute capital to a business and divide the net profit and loss pro rata. This is often used in investment projects, letter of credit, and the Purchase of real estate or property. In the case of real estate or property, the Bank assesses an impudent rent and will share it as agreed in advance. All providers of capital are entitled to participate in management, but not necessarily required to do so. The profit is distributed among the partners in a pre-agreed ratio, while the loss is borne by each partner strictly in proportion to respective capital contributions. This concept is distinct from fixed income in vesting (i.e. issuance of loans).

It is not allowed to fix a lump sum amount for any' of' the partners, or any rate of profit tied up with his capital. A management fee however, can be paid to the partner managing the *Musharakah* provided the agreement for the payment of such fee is independent of the *Musharakah* agreement. Loses are shared by all partners in proportion to their capital and all assets of *Musharakah* are jointly owned in proportion to the capital of each partner.

The rate of profit sharing should be determined. The share of each partner in the profit earned should be identified at the time of the contract. If however, the ratio is not determined

beforehand the contract becomes void. The proportion of profit to be distributed between the partners must be agreed upon at the time of affecting the contract.

The ratio of profit by each partner must be determined in proportion to the actual profit accrued to the business, and not in proportion to the capital investment. In the case of a loss, all the Muslim jurists are unanimous on the point that each partner shall suffer the loss exactly according to the ratio of investment. According to (Zaid, 1983:112):

Profit is based on the agreement of the parties but loss is always subject to the ratio of investment.

#### **2.4.3.5 Leasing (*Ijarah*)**

Leasing/*Ijarah* is, or can function as a financing technique. An individual short of funds may approach another with surplus to fund the purchase of an asset.

Naseef, (1988:40) described *Ijarah* as lease, rent or wage. Generally, *Ijarah* concept means selling benefit or use of service for a fixed price or wage. Under this concept, the Bank makes available to the customer the use of service of assets/equipments such as plant, office automation, motor vehicle for a fixed period and price.

Fu'ad, (1996:56) expanded that *al-Ijarah* contract is where the financier buys and leases equipment or other assets to the business owner for a fee or more often called rental income. The duration of the lease as well as the fee must be set in advance and mutually agreed. To be acceptable as an Islamic financial product, the leasing contract must meet the following conditions:

- i. The service that the asset is suppose to provide and for which it is being rented should be definitely and clearly known to both parties
- ii. The assets remains in the ownership of the leaser who is responsible for its maintenance so that it continues to give the service for which it was rented

- iii. The leasing contract is terminated as soon as the asset ceases to give the service for which it was rented.
- iv. If leased asset becomes damaged during the period of the contract, the contract will be invalid, and the price of an asset that may be sold to the lessee at the expiry of the contract cannot be pre-determined. It can be determined only at the time of the expiry of the contract.

#### **2.4.3.6 Hire Purchase (Al-Ijarah Wal-Iqtinah)**

This is a hire-purchase agreement between the bank and its clients. This contract is just the same as that of the *Ijarah* contract except that the business owner is committed to buying the equipment at the end of the leased period. Fees previously paid constitute part of the purchase price. This type of lease-to-purchase agreement is commonly used for home financing. It is a contract under which an Islamic Bank provides equipment, building or other assets to the client against an agreed rental together with a unilateral undertaking by the Bank or the client that at the end of the lease period, the ownership of the asset would be transferred to the lessee. The rentals as well as the purchase price are fixed in such manner that the Bank gets its principal sum along with profit over the period of lease (Siddiqui, 1986:173).

#### **2.4.3.7 Credit Sale (Bai Muajjal)**

This literally means sale on a deferred payment basis. This is a financial technique adopted by Islamic Banks that takes the form of *Murabaha Muajjal*. It is a contract in which the Bank earns a profit margin on the purchase price and allows the buyer to pay the price of the commodity at a future date in a lump sum or in installments. It has to expressly mention cost of the commodity and the margin of profit is mutually agreed. The price fixed for the commodity



in such a transaction can be the same as the spot price or higher or lower than the spot price (Zaidi, 1983:83).

#### 2.4.3.8 Advance Payment (Bai' Salam or Salaf)

This means a contract in which advance payment or forward buying is made for goods to be delivered later on. The seller undertakes to supply some specified goods to the buyer at a future date in exchange of an advance price fully paid at the time of contract. It is necessary that the quality of the commodity intended to be purchased is fully specified leaving no ambiguity leading to dispute. The objects of this sale are goods and cannot be gold, silver or currencies based on these metals. Barring this, Bai' Salam covers almost everything that is capable of being definitely described as to quantity, quality and labour. Hawari, (1984:37).

#### 2.4.3.9 Benevolent Loan (Qardul Hassan)

The concept of Qard al-hasan is to assist the poor or needy by offering a loan without any interest. The Quran states that such a loan is beautiful and admirable because the borrower of such a loan is God; not the person receiving the money. According to the verses of Quran, Allah (SWT) admires people who pay their wealth for servants of Allah by using this statement "loan to Allah", while this wealth is provided for people by Allah.

وَيٰٓاَيُّهَا الَّذِيْنَ اٰمَنُوْا قَرْضُوْا لِّلّٰهِ قَرْضًا حَسَنًا لَّعَلَّكُمْ تَكْفُرُوْنَ

A different and non-orthodox interpretation of the Quran's verses on *qard al-hasan* (by M.O Farooq) is that the context of the verses does not "seem to have anything to do with *qard* in general as business transactions in this world", but instead involves "the symbolic transaction between Allah and the believers". In these sorts of transactions believers can only give Allah loans, not gifts, because "Whatever we offer to Allah is ... treated as loan", since it is always

returned, "doubled or even more". In contradiction to orthodox religious legal teachings that the Qur'anic verses prohibit Muslims from charging interest on business loans, Farooq notes that the verses "specify no detail whatsoever in regard to conditions or limitations, including whether *qard* or *qard al-hasan* must be without excess. On the contrary, *qard al-hasan*, as a contract with God, consistently specifies an excess," (as the Quran talks of doubling the *qard hasan*).

Saleh, (2003:62) described it as a pure loan transaction in which the client obtains cash from the individuals or institution to be returned at a stipulated date free of interest. This is a loan extended on a goods will basis, and the debtor is only required to repay the amount borrowed. However the debtor may at his/her discretion, pay an extra amount beyond the principal amount of the loan (without promising it) as a token of appreciation to the creditor. In the case that the debtor does not pay an extra amount to the creditor, this transaction is a true interest-free loan. Some scholars or jurist consider this to be the only type of loan that does not violate the prohibition on *Riba* (interest), since it is the one type of loan that truly does not compensate the creditor for the time value of money Fuad, (1996:1).

Certain scholars allowed the lender to charge against costs incurred by him in making the loan available to the borrower. The service charges are not profit; they are actual costs in respect of such items as rental of premises, workers' wages, and stationary. Islamic law allows a lender to recover from the borrower the costs of operational and above the principal (IFFA, 1986), but an important condition attached to such charges, to prevent them becoming equivalent to interest is that the commission or charge cannot be made proportional to the amount or to the term of the loan (Ashker, 1987:67). This is used mainly by the Islamic Development Bank

(IBD) when it grants loans to government. Such service fees do not exceed 2.5 percent and have been within the range of 1-2 percent in recent years (Ahmad,1999:132).

#### **2.4.4 Islamic Injunction on Interest/Usury (*Riba*)**

##### **Classification of Riba (usury)**

Riba is broadly divided into two – Riba al Nasiah and Riba al-fadl – the former can be termed as loan interest. Literally it means ‘to postpone’, ‘defer’ or ‘wait’. Under Islamic Jurisprudence, it involves a contractual agreement by which a pre-condition increment in a loan or debit is agreed upon between the borrower and the lender. On the other hand, the later is a disparity in the exchange of commodities of the same genes.

The practice of riba al-Nasiah or loan interest was among the prevalent practices of the Arabs of Jahiliyyah period (the period the proceeded the advent of Islam).

According to Aliyu et al, (2013), they traced the following to be the commonest loan transactions involving riba at that time.

- (a) The Arabs of Jahiliyyah used to advance loan in the forms of dirham (silver coins) or dinar (gold coins) with an agreed increase on the amount of principal advance.
- (b) Arabs of Jahiliyyah advanced loans to be paid within the agreed period without interest initially if the borrower was able to pay back the loan within the specified agreed period. If however the borrower was unable to pay back the loan within the specified period, the creditor would give him more time against charging an added amount as a consideration for the postponment or deterrent f the payment of the loan.
- (c) The Arabs of Jahiliyyah used to advance loans based on the agreement that the debtor or borrower would pay a particular amount as interest monthly before the maturity date of the principal. On the maturity date, the debtor or borrower would then pay the

principal. If at the maturity date the debtor or borrower could not pay, then, the creditor or lender would extend the maturity date but with increase in the monthly payment of the addition.

When the religious of Islam came, it categorises the above practices on loan and debt agreements as riba or interest and therefore prohibits them. The Holy Qur'an and Hadith provide clear prohibitions of all such transactions and practices involving riba.

### **Prohibition of Riba in the Qur'an**

Riba was among the deeply rooted practices of the Arabs of Jahiliyyah period. The Holy Qur'an therefore addresses the prohibition of riba in a gradual manner. The Qur'an adopted evolutionary method to achieve a revolutionary result. In other words, the Holy Qur'an uses a gradual process of eradicating the deeply entrenched behaviour of charging interest on loans and debt of the Jahiliyyah period.

The first Qur'anic verse on riba in order of revelation does not contain a clear cut prohibition of riba but an indication that Allah the most High does not favour the practice involving interest. The verse further points out that it is not the charging of interest that will increase the people's wealth of a person in the sight of Allah but giving out charity. Allah says in suratu Rum verse 30:

لَئِنْ كُنْتُمْ تُحِبُّونَ الْوَدْعَةَ وَتُسْأَلُونَ عَنْهَا فَغَرُّوا بِهَا وَاتَّقُوا اللَّهَ ۚ إِنَّ اللَّهَ شَدِيدُ الْعِقَابِ

The next Qur'anic verse on riba does not also contain a clear prohibition on riba. It only lists out some of the evil practices of the Jews and for which they were reprimanded Riba is listed among such prohibited practices.

The verse serves as a kind of signal to the Muslims that since the practices of interest has been prohibited in the revealed book of the Jews, and Allah the Most High reproached them for their failure to desist from such practice. The same practice is also sinful for the Muslims. This is to

say that interest is prohibited for the Jews, it is a practice which the Muslims should avoid. The Qur'an on this issue reads: Q4:161

و و و و و ي ي ي ي ي د ن ا ئ ه ه ئ و

The first Qur'anic prohibition of riba comes in the following verse Q3:130-132

د ن ا ئ ه نه نو نوئو نو نو نو نو ئو ئي ئي ئپ ئي ئي ئ چ

The subsequent verses of the Qur'an on *riba* reiterate the prohibition of interest in the elaborate manner, emphasizing the prohibition and providing the punishment in this world and in the hereafter that would be meted on scholars who deal in interest.

The verses under reference are Q2:275 – 281

[illegible]

It is in the light of the above verses and statements of the prophet (P.B.U.H), many scholars opined that the warning against involvement in interest was so stringent that it cannot be equated with warning against other immoral acts such as fornication, adultery and consuming alcohol. Umar Chapra argues that while the Qur'an and Hadith prohibit interest in an unequivocal term, no distinction was made between interest and usury, and even a small gift is not allowed as a condition for a loan.

The interpretation of the prohibition of *riba* has in practice been subject to great controversy among contemporary scholars. Are fixed-interest loans preferable to those subject to interest-rate variations, so that the borrower knows at least the exact charges in advance and there is no

element of uncertainty? Under inflationary conditions, should interest rewards be allowed to compensate savers for the depreciation in the value of their savings? A prohibition of nominal interest to compensate inflation would penalize lenders and subsidize borrowers. It could be argued that the prohibition of *riba* applies to real interest, not to nominal interest as with inflation, a ban on latter may result in negative real interest (Fu'ad, 1996:132).

Islamic Banking originates from its abstinence from interest. The abstinence is based on the clear injunction in the Holy *Qur'an* and the *Ahadith* with regard to the prohibition of interest. The Arabic word for interest is "*Riba*", which encompasses interest in all its types and forms irrespective of whether the loans it relates to is for production and consumption purposes and whether the rate on interest is low or high.

### **Qur'anic Texts Regarding Interest Rate**

The prohibition of interest is enjoined by the Holy *Quran* in the strongest terms, and those who do not desist from this practice are declared of war from Allah and His Messenger. The *Qur'an* says:

أَمْ يَدْعُونَ مَعَ اللَّهِ إِلَهًا آخَرَ لَا إِلَهَ إِلَّا اللَّهُ سُبْحَانَ اللَّهِ عَمَّا يُشْرِكُونَ ۚ أَلَمْ يَكُنْ لَهُ الْخَلْقُ كُلُّهُ أَوَّلَ مَلَأَ ۚ سُبْحَانَ اللَّهِ عَمَّا يُشْرِكُونَ ۚ أَلَمْ يَكُنْ لَهُ الْخَلْقُ كُلُّهُ أَوَّلَ مَلَأَ ۚ سُبْحَانَ اللَّهِ عَمَّا يُشْرِكُونَ ۚ

Those who benefit from interest shall be raised like those who have been driven to madness by the touch of the devil, this is because they say trade is like interest while Allah has permitted trade and forbidden interest. Hence those who have received admonition from their lord and desist may have what has already passed. Their case being entrusted to Allah, but those who revert shall be the inhabitants of fire and abide there in forever. Al-Baqarah (2:275).

Allah also says:

ت ت ث ظ ژ ر ط ک ی د

Allah deprives interest of all blessings but blesses charity. He loves not ungrateful sinner al-Baqarah (2:276).

[illegible]

O believers fear Allah and give up interest that remains outstanding if you are believers....If you do not do so, then be sure of being at war with Allah and His Messenger. But if you repent you can have your principal; neither should you commit injustice nor should he subjected to it (Q2:278-279).

د نَا نَا هِئْ    هِئْ ئُو ئُو ئُو    ئُو ئُو ئُو    ئُو ئُو

If the debtor is in difficulty, let him have respite until it is easier but if you pay out of charity, it is better for you if you realize (Q2:280).

He also says.

ر ر نأ نه نو ئو ئو ئو ئو ئو

O believers! Devour not usury doubling its rate many times. I have fear for Allah and you shall prosper. Guard yourselves against the fireal-(Q3:130).

From the aforementioned quotations, we can see the stand of Islam as regards taking interest/usury. According to Ziaudeen (1983:92): the above mentioned warning of war from Allah and His Messenger clearly points that the institutions of interest is something which runs counter to the Islamic vision of a just and exploitation free economic and social order. He further explained that the rationale for prohibition of charging of interest on loans taken for consumption purposes is obvious. Such loans are usually taken by people of small means to meet urgent personal requirements as they have hardly any surplus of savings with which to meet such requirements.

The main rationale for prohibition of interest in the case of loans for production purposes stem from the concept of justice which is the cornerstone of the Islamic philosophy of social life.

Uncertainty is inherent in a business enterprise irrespective of the time and space dimensions. The operating results of the enterprise cannot be foreseen and the occurrence of profit or loss and their magnitude cannot be fully determined in advance. It is, therefore, a sheer injustice if the party providing more capital is guaranteed a fixed and predetermined return while the party providing enterprise is made to bear the uncertainty/risk all alone. On the other hand, a fixed interest rate can also be unjust to the lender of money in case the entrepreneur using this money earns a profit quite out the Proportion to what he pays by way of interest.

Therefore, the first step or principle of Islamic Banking is the abstinence from interest, because it creates Socio-economic injustice.

In Islam, therefore, the physical gift that are receives in reform because one has used one's intengibly good office, social standing, or personal reputation to render assistance to someone else is *riba*, and illegitimate. On the other hand, it encourages the saying of prayers and a word of thank you and appreciation to someone who has done us good.

### **Central Banks and Islamic Banks**

A central bank is an institution that manages a state's currency, money supply, and interest rates. Central banks also usually oversee the commercial banking system of their respective countries. In contrast to a commercial bank, a central bank possesses a monopoly on increasing the monetary base in the state, and usually also prints the national currency, which usually serves as the state's legal tender. Central banks also act as a "lender of last resort" to the banking sector during times of financial crisis

Islamic banking or Islamic finance or sharia-compliant finance is banking or financing activity that complies with sharia (Islamic law) and its practical application through the development of Islamic economics. Some of the modes of Islamic banking/finance include *Mudarabah* (Profit



and loss sharing), *Wadiah* (safekeeping), *Musharaka* (joint venture), *Murabahah* (cost plus), and *Ijar* (leasing).

Since Islamic banking in fact forms part of the banking system in the countries where they operate, they are naturally expected, like other banks to come under the control of central bank. Islamic banks differ from conventional banks as regards the nature of their relationship with their clients. In the case of Islamic banks, the relationship is one of direct trading or participation and not that of lender/borrower. Furthermore, Islamic banks do not trade in debts as do conventional banks. There is a consensus among Muslim economists that the central bank should supervise the Islamic commercial banks. This supervision should not be confined to a formal material appraisal of the quality of management decisions especially with respect to the more risky PLS Finance.

### **Current Accounts**

The current account consists of the balance of trade, net *primary income* or *factor income* (earnings on foreign investments minus payments made to foreign investors) and net cash transfers, that have taken place over a given period of time. The current account balance is one of two major measures of a country's foreign trade (the other being the net capital outflow). A current account surplus indicates that the value of a country's net foreign assets (i.e. assets less liabilities) grew over the period in question, and a current account deficit indicates that it shrank. Both government and private payments are included in the calculation. It is called the current account because goods and services are generally consumed in the current period.

Islamic banks accept into current accounts deposits from clients looking for safe custody of their funds, together with convenience and use thereof. On the principle of *al-wadiah* (trust) the

banks take permission for their clients to make use of their funds, while these funds remain with the banks.

### **Savings Accounts**

A savings account is a deposit account held at a retail bank that pays interest but cannot be used directly as money in the narrow sense of a medium of exchange (for example, by writing a cheque). These accounts let customers set aside a portion of their liquid assets while earning a monetary return.

A savings account is the most basic type of account at a bank or credit union, allowing you to deposit money, keeps the funds safe, and withdraws funds as needed. Savings accounts typically pay interest on your deposits, which helps you grow your money, but rates are relatively low on these low-risk accounts.

As you master your savings account, you'll use other accounts for specific financial needs (like a checking account for payments and purchases).

The other major types of deposit accounts are the transactional account (usually known as a "checking" (US) or "current" (UK) account), money market account, and time deposit.

Saving accounts are similar to current accounts except that the banks may, absolutely at their discretion, reward the clients from time to time by returning a portion of the profits generated from their funds.

### **General Investment Account**

A General Investment Account (GIA) is similar to a Stocks and Share in that it is a form of savings kept with a banking institution for a stated period, with the exception that it has no tax-free benefits. It is a vehicle for housing various investments and is a suitable 'feeder' account

to fund and simplifying contributions where the investment size exceeds the annual ISA allowance. Income tax is payable on income in addition you can use your annual capital gains tax allowance. This makes the GIA a tax efficient plan and the average rate of tax on gains is generally low.

General Investment Account (GIA) is based on the contract of Mudarabah (profit sharing) where the customer act as the provider of fund and the Bank acts as the entrepreneur. The Bank will invest the funds in carefully selected Shariah's high yielding, compliant investment avenues. The profit from the investment will be shared between the Bank and customers based on the pre-agreed profit sharing ratio.

Islamic banks accept into general investment accounts deposits from clients seeking investment opportunities for their funds on the principle of Mudaraba. The deposits are held for a specified period. In another word, Islamic banks serve as entrepreneur or borrower and the clients are the providers of capital or lenders.

### **Special Investment Accounts**

Special Investment Account is the short term investment account that tailored to offer you the maximum potential returns. Your funds will be efficiently managed accordance to Mudharabah principle for a specified period of time (tenure) with a pre-agreed profit sharing ratio.

In addition to the above Islamic banks may also accept deposits from its wealthy individual or corporate clients, in the firm of special investment accounts. These accounts are operated on the principle of Mudaraba, but the modes of investment of the funds and the distribution of profits may be negotiated individually.

#### **2.4.5 Prohibition of Interest by the Sunnah**

The prohibition of Riba (usury) was not only confined in the Holy Qur'an. The sunnah has also forbidden the following sale of barter transactions.

In addition to these Qur'anic verses, the Prophet (SAW) made a number of statements concerning interest. The following are some of the statement on interest recorded in different books of Hadith and Sunnah:

Narrated Abukrah (R.A): Allah's Apostle (SAW) said:

(عَنْ أَبِي سَعِيدٍ الْخُدْرِيِّ رَضِيَ اللَّهُ عَنْهُ، أَنَّ رَسُولَ اللَّهِ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ قَالَ: لَا تَبِيعُوا الذَّهَبَ بِالذَّهَبِ إِلَّا مِثْلًا بِمِثْلٍ وَلَا تُشِيقُوا بَعْضَهَا عَلَى بَعْضٍ وَلَا تَبِيعُوا الْوَرَقَ بِالْوَرَقِ إِلَّا مِثْلًا بِمِثْلٍ وَلَا تُشِيقُوا بَعْضَهَا عَلَى بَعْضٍ وَلَا تَبِيعُوا مِنْهَا غَائِبًا بِنَاجِزٍ)

Do not sell gold for gold unless equal in weight, nor silver for silver unless equal weight, but you could sell gold for silver or silver for gold as you like" (Al-Bukhari, P.23).

Interest has seventy-three manifestations; the least odious of these is equivalent to having sexual intercourse with one's mother. Behold; the most heinous increase is (the devaluing of) the honour of a Muslim. (Al-Hakim from Ibn Mas'ud and Abu Hibban from Abu Hurayrah in Bello P.25).

Al-Muwatta 3/335, Al-Bukhari 5/335

Whoever identifies with the cause of his brother and assists him to realise his needs and so the brother gives him a gift, which he accepts, has come to one big gate amongst the gates of riba. (Ahmad, ad Abu Dawud from Abu Umamah al-Bahili in Bello Pg. 26).

Umar (R.A) reported the Prophet (SAW) as saying:

The appearance of interest among a people is followed by the appearance of insanity among them: the appearance of adultery (and fornication) is followed by the appearance of death: and if they cheat in weights and measures, Allah denies the rain.

From Jabir who reported that the Prophet (SAW) said:

لعن رسول الله صَلَّى الله عَلَيْهِ وَسَلَّمَ أكل اربا موكله وكتبه وشاهيهء تال هم سرا

Allah cursed the receiver and prayer of interest (riba), the one who records it and the two witnesses to the transaction and said, "They are all alike." (Muslim, Tirmidhi and Ahmad).

وقال صَلَّى الله عَلَيْهِ وَسَلَّمَ ما ظهر في اربا ظهر غم الجنون ولا ظهر في قوم الزنا  
الا ظهر غم الموت و ما بخس قوم الكيل والوزن ال منهم الله القطر رواه مسام

In another report, the Prophet (SAW) said: "During my ascension, in the Seventh Heaven, I heard thunder and lightning over my head, and I saw people with their stomachs as large as houses between their hands; and inside their stomachs, snakes and scorpions were visible from the outside. I then asked, 'who are these, Gabriel?' and he replied, "The consumers of interest".

(Ahmad)

لما عرج بى سمعت في السماء السابعة فوق رأسي رعدا وصواعق ورايت رعيت  
رجال بطونهم بين ايديهم كالبيوت فيها حيات وعقارب ترا من ظاهر بطونهم, فقلت:  
وفي روايت قال: من هؤلاء يا جبريل؟ فقال: هؤلاء أكله الربا

The Prophet (SAW) also said:

وقال صَلَّى الله عَلَيْهِ وَسَلَّمَ "ما ظهر في قوم الربا إلا ظهر فيهم الجنون,  
ولا ظهر في قوم الزنا إلا ظهر فيهم الموت, وما بخس قوم الكيل والوزن  
إلا من منعهم الله القطر

"The appearance of interest among a people is followed by the appearance of insanity among them; the appearance of death; and if they cheat in weights and measures, Allah denies them rain"

Another reason for the prohibition may be a desire to monetise the economy and thus promote and develop it from an inefficient, primitive and develop it from an inefficient, primitive economy of trade by barter, to an economy in which all commercial transactions are bared and

expressed in the common, fair, efficient and practical denominator of money. Thus, Abu Said Al Khudri and Abu Hurairah narrated that: -

Allah's Apostle (SAW) appointed someone as governor of Khaybar, He brought to him an excellent kind of dates, Allah's Apostle (SAW) asked: Are all the dates of Khaybar like this? He replied; by Allah, no. O Allah's Apostle! We barter one measure of this (type of dates) for two measures (of other types of dates); and two measures (of this type of dates) for three measures (of other types of dates); Allah's Apostle (SAW) said: Do not do so (as that is a kind of usury) but sell the mixed dates (of inferior quality) for money and then buy superior dates with the money. (Al-Bukhari in Bello pg. 24).

#### **2.4.6 Biblical Injunctions On The Prohibition Of Interest/Usury:**

It is worth mentioning to state that Islam is not the only religion that prohibits the transaction of Ribah, Christianity and Judaism have also extended a stern warning on those who devour Ribah in their transactions.

Criticism of interest in Judaism is found in many biblical references (Deuteronomy 23: 19-20, Exodus, 22:25, Leviticus 25:37, Jeremiah 15:10, Ezekiel 18:13; Proverbs 28:8 Psalms 15:5 Nahemiah 5:7.

Christianity has also extended a stern warning on those who devour Ribah in their transactions.

The following are some of the Biblical Injunction on the prohibition of Interest/Usury:

##### **Prohibition of interest and other unlawful business in the Bible**

###### **(a) Exodus 22:25**

If you lend money to any of my people who are poor among you,  
you shall not be like a money lender to him, you shall not charge him  
interest

(b) Leviticus: 25: 35-37

If one of your brethren become poor, and falls into poverty among you, then you shall help him, like a stranger or a sojourner that he may live with you. Take no usury or interest from him; but fear your God, that, your brother may live with you. You shall not lend him your money for usury, nor lend him your food at an interest

Luke 6: 35 – 36

But love your enemies, do good and lend, hoping for nothing (interest) in return, and your reward will be great and you will be sons of the most high. For he is kind to the merciful (when you lend) just as your father also is merciful (to you)

**Ezekiel 18:13**

If he exacted usury or taken increase (interest) – shall he then live? He shall not live! If he has done any of these abominations, he shall be put to death. His blood shall be upon him.

**Luke:**

And he said to them. Collect no more than what is appointed for you and be content with your wages

**Psalms 15:5**

He who does not put out his money at usury (or interest), nor does he take a bribe against the innocent. He who does these things, shall never be moved (forward or prosper).

**Nehemiah 5: 10-12**

I also, with my brethren and my servants am lending them money and grain. Please, let us stop this usury (interest) restore now to them, even this day, their lands, their river yards, their olive groves, and their houses, also a hundredth of the money and the grain, the new wine, and oil, that you have charged them (on interest). So they

said “we will restore it, and will require nothing (of usury or interest) from them, we will also do as you say.

## **2.5 Islamic Banking In Nigeria**

Islamic finance generally is a mode of financing projects through Islamic legal means. It is brought out of the main Islamic Economics. Islam is a complete way of life, therefore there is no demarcation between social, political or economic life of a Muslim and every Muslim is expected to adhere to the tenets of Islam to guide his way of life (Chapra, 1993:63). The biggest and largest Country *in* Africa is Nigeria with a population of over One hundred and seventy (170) millions of which predominantly are Muslims, for this reason it is better for the Nigerian Society to evolve Islamic rules into the financial institutions in the Country. (Sadiya, 1996:86).

### **2.5.1 Paper Money versus Inflation Arguments**

One controversial argument used to justify bank interest to carry on its practice is that the money that the law prohibited is the charging of interest on gold and silver currency, namely gold and silver. The wisdom in this is clear because of their intrinsic value and because they are valuable minerals, which are sought on account of their utility even when they are not struck out as money.

Furthermore, it is argued that this paper money loses its value on account of fall in its purchasing interest received by a bank depositor from banks is no more than a compensation for loss in purchasing power suffered due to inflation where for example the interest rate may be 10% and inflation may be running at 15%. Indeed, in this case, a depositor has in effect actually suffered a loss of 5% in the value of his/her deposit.

In reality, part of this argument is fundamentally wrong, and part of it is a true statement intended to support falsehood. The errors in this argument are its restriction of ‘money’ and



‘value’ as defined by the jurists gold and silver alone and its rejection of the definition of money that people use in our modern age. This definition is that of paper money, which has become a measure of value, a means of exchange, and a store of value. There are the characteristics of ‘money’ or ‘value’ irrespective of the material used to make the money.

The logical consequence of this argument is the abolition of the obligatory zakat which is the third pillar of Islam; and the legitimization of the forbidden riba, which is one of the seven destructive sins, so long as the zakat does not become obligatory except on gold and silver and interest does not run except with regards to gold and silver as well!

It is unfortunate indeed that there are people who make this literalist and thoughtlessly imitative argument despite its obvious errors and danger. This (paper) money is what we use as consideration in trade and commerce, in the payment of salaries and wages, dowries, and blood money generally. Consequently all legal attributes of money are conferred non it.

Furthermore, one is regarded wealthy depending on how much of it one possesses, and stealing it is considered a punishable crime in all laws under the sun.

The part of this argument that is true but otherwise intended to support falsehood is that which relates to inflation and its effect on fall in value and in purchasing power of paper money. This is a reality over which there could be no dispute.

Contemporary scholars of Islamic jurisprudence have differed on the issue, the verdict of the shariah on it, and its effect on the repayment of monetary debts and other related issues that the loss in money remains and is accepted as legal tender.

Furthermore, why is it that this argument is raised only in respect of those who are owed by the bank (depositors and creditors) and it is never raised in respect of those who owed the banks – i.e. bank debtors?

Again, banks nonetheless do pay interest to their customers who transact with them in currencies whose values scarcely drop, such as the hard currencies, an example is bank customers who maintain foreign domiciliary accounts, denominated in US, dollars, with banks, the bank, pay them fixed interest charges, whether or not the values of these currencies fall or rise.

The issue is one of fundamentals, and the fundamental principle is conventional bank is interest, a stipulated interest money of any amount, in any currency under any condition, and of all circumstances.

### **2.5.2 Factors affecting the full Implementation of Islamic Banking in Nigeria**

There are several factors that inhibit the full implementation of Islamic Banking in Nigeria. The legal factor is there, the political factor, the social factors and even the economic Factor (Saleh, 2005). When we look at the legal factor we can see that the Banking decree in Nigeria does not allow the establishment of any Bank with a religious name but a compromise has been reached that you can open an interest free banking. There is some significant difference between Islamic Banking and an interest free Banking. An interest free banking is banking without interest but the mode of operation may not necessarily be Islamic. It may even have some Islamic window products. For example former Bank PHB, FIN Bank, and Stanbic IBTC and other Micro-Finance Bank such as Integrated Microfinance Bank, Kada Microfinance Bank etc have Islamic windows: you can transact interest free if you like but that does not mean the Bank will not transact with other non Islamic institutions like brewery and other prohibited transaction according to Islamic law. So a Bank can be an interest free but its instruments might not be Islamic. It does not deal directly with interest but the instruments on the people it gives loans may have some elements of un-Islamic practice (Sadiya, 1996:73). A

pure Islamic Banking is the one that does not deal with interest as well as its instruments, purely Islamic. They will not invest in gambling, brewery and any kind of trade that is un-Islamic.

Economic environment is seriously required for an Islamic Banking because you will need it especially for the development, of micro, small and medium enterprise. Even the conventional Banking is finding it very difficult to attract this group of beneficiaries because of the high rate of interest. Therefore, it is really very difficult for the economy to regain itself operating under this system (Dutsin-ma, 1999:73).

Socially, every Banking system whether secular or Islamic is based fundamentally on one aspect i.e. trust. Islamic Banking is primarily based on trust. To share profit and loss is extremely tied to trust. People must be trustworthy for them to actively participate in Islamic Banking. But unfortunately, given the circumstances in the Nigerian Economy, considering the social scenario, the level of distrust and dishonesty in the system may make it become difficult for an Islamic Banking to operate fully. For example there is a social account in the Islamic Banking where those people that are so weak, do not need any collateralization; they do not even need much agreement. The bank gives them money and when they trade and fail they do not pay anything back and if they succeed they repay the money they have collected. In the case of Nigeria this social account might be misused because nobody will be willing to bring back the money even if you did not succeed in the business (Garba, 1991:93).

When you look at the political situation, it is always hash and cry when you mention Islam; once you mention anything Islamic is like a repellent in Nigerian Economy. Even mentioning of OIC somebody will be saying Nigeria will be Islamized. Look at how the Arabic inscription on our currency was scaring some people. So the moment you say Islamic Banking, some

people will start saying the Muslims want to create their own financial system in the Country. So these are the inhibiting factors to the establishment of Islamic Banking (Ibrahim, 1991:89). Currently only *Ja'iz* Bank International Plc expects to be the financial institution that will operate wholly as Islamic Banking in Nigeria but based on some of the problems outlined earlier, it took a long time before it finally stand on its ground. It is the socio-political problems disappointment that Nigerian Muslims took a long time before they could raise twenty five billion Naira for the *Ja'iz* Bank. There are so many men in Nigeria who can single-handedly finance the establishment of *Ja'iz*. But the economic land scale is such that it makes them feel skeptical (Sadiya, 1996:82). This is due to the fact that social stigma or political relationship sometimes makes them to be feeling unsecured or invest and they are not even very sure whether this kind of banking system can be practicable. So the reality is that Muslims must be united to develop a financial system that will satisfy the yearnings and aspirations of the Muslims though some Muslims like Umar Mutallab, Rilwan Lukman, Aminu Dantata, Aliko Dangote, late Dr. Abdullateef Adegbite, Prof Adebisi and others are part of the shareholders/directors of *Ja'iz* Bank (Saleh, 2005:88).

Sequel to the above, *Ja'iz* Bank is now fully operational in Nigeria with branches in most of the states of the federation.

An Islamic bank is a financial and social institution whose objectives and operations as well as principles and practices must conform to the principles of shariah, and which must avoid the use of interest in any of its operations. It stands for an alternative financial systems based on Islamic ideals. It is not only a financier but also a partner in productive economic activity and development. The system essentially involves sharing of risk between the owners of capital and the entrepreneurs to share the results of collective effort.

Islamic banking, in fact has succeeded in establishing its credibility as evidenced by the successful operation of the Islamic Development Bank (IDB) since 1975.

### **2.5.3 Use OF Investment Funds**

Islamic Banks use their interestable funds in financing and participating in permissible economic activities, according to shariah approved modes on profit and income-sharing basis. In addition, they have provision for sadaqah (special assistance) and collection and payment of zakat to the needy and indigent in the society.

### **Some Problems Issues**

Despite the steady progress of Islamic banking system in the world and spectacular success of individual, Islamic banks and in terms of deposits mobilized and profit distribution, some countries undertaking total Islamization of banking system are facing initial problems in the following areas:

- Foreign capital/borrowing: Existing borrowing bearing interest and further borrowings.
- Domestic savings scheme (e.g.) interest-bearing, savings certificate/bonds of the government.
- Foreign currency deposits of non-residents.

The viability of Islamic banks based on shariah principles has been established and public enthusiasm for the new banks conforming to their faith and conviction has also been demonstrated by the working results of these banks. But total conversion of the entire system of banking and finance in most of the Muslim countries seems to be yet far off on account of several practical issues of national and international finance that need to be resolved. This requires not only deep knowledge of Islamic shariah and modern economics but also thorough research and analysis.

## 2.6 Prospects and Challenges under Islamic Banking

Although the entry of Islamic Banking into the field of finance has been well received, it has yet to cross many hurdles before it can claim to be an institution capable of handling the needs of financial market especially in Nigeria.

### 2.6.1 Prospects and Challenges under Islamic Banking

Most of the Islamic Banks operate on cost plus (*Bai-Murabahah*), *credit sales* (*Ba'i-Muajjal*), advance payment (*Ba'i-Salam*), supply (*istisna*), leasing (*Ijara*) modes of investment i.e. Islamic Banks always prefer to run on mark up guaranteed profit basis having *Shari'ah* coverage. For this reason some times the conventional economists and general people failed to understand the real difference between Islamic Banking and conventional Banking (Fuad, 1996:100-113).

Profit and loss sharing (*Mudaraba*), joint venture (*Musharakah*), etc modes of investment are ideal but Islamic Banks are not fully going into these modes, the reason for the above are as follows;

- (i) There is no systematic analysis and research. This is caused due to lack of committed entrepreneur, committed professionals. Shortage of skilled personnel, and lack of committed sponsors.
- (ii) The problems of forward contact/booking of foreign currency. As per- *Shari'ah*, currency transaction is to be made under certain terms and conditions laid down by it, such as spot possession of both the currencies by both parties which is not available in forward booking.
- (iii) Inland bill purchase/foreign bill purchase. This is another problem of Islamic Banking where the exporters immediately after export of the goods approach to

the Bank for funds before maturity of the bills to meet their daily needs. Here the Bank has to deploy billions each year but how and on what mode of investment?

- (iv) Unfamiliarity with the Islamic Banking System. The first problem is that despite the growth of Islamic Banks over the last thirty years. Many people in the Muslim and non-Muslim world do not understand what Islamic Banking actually is. There does not appear to be a single defamation of what is or what is not an Islamic Banking product and therefore difficult for regulators to clearly define Islamic Banking in relation to risk management. It is also an added burden on the Banks that have to educate customers in new markets. (Fuad, 1996:120)
- (v) Portfolio Management. The behaviour of economic agents in any Country is determined partly by past experience and constraints. The Islamic Banks are still growing in experience in many Countries but in different Countries do not freely choose arrangements which best suit their needs. As a result, their activities are not demand-oriented and do not react flexibly to structural shifts in the economic settings as well as to changes in preferences. Adequate financial mechanisms still has to be developed, without which finance intermediation, especially the risk and maturity transformation, is not performed properly. (Bello, 2004:65).
- (vi) The Regulatory Environment: The relationship between Islamic Banks and monetary authorities is a delicate one. The central Bank exercises authority over Islamic Banks under laws and regulations engineered to control and supervise both traditional Banks. Whatever the goals and functions are, Islamic Banks came into existence in an environment where the laws, institutions training and attitude are set to serve an economy based on the principles of interest. The operations of

Islamic Banks are on profit and loss basis (PLS) which actually do not come fully under the jurisdiction of the existing civil laws. IF there are disputes to be handled, civil courts are not sufficiently acquainted with the rationale of the operations of Islamic Banking.

- (vii) Use of Advance Technology and Media.\_Many Islamic Banks do not have the diversity of products essential to satisfy the growing needs of their clients. The importance of using proper advanced technology in upgrading the acceptability of a product and diversifying its application cannot be over emphasized (Musa, 2006:48).

Other problems such as need for professional bankers, blending of approach of Islamic scholars with the approach of the conventional bankers, absence of liquidity instruments; are all affiliated to Islamic Banking in the world.



## **CHAPTER THREE: RESEARCH METHODOLOGY**

### **3.1 Introduction**

Adherence to such a guide influences the researcher to clarify and follow the necessary procedure, whose failure to observe will adversely affect the objectivity of his research findings. For instance, Agbonifah and Yomere (1999) stressed that, supervisors are often interested in whether the methods of seeking answer to the research questions are acceptable if not the best in the circumstance. The supervisors will be concerned about the appropriateness of the prepared analytical technique.

Research may be basic or applied. Basic research deals with the relationship between two or more variables. The objective is to identify all relevant variables in a particular field and making generalization for proposition about their relationship. Applied research on the other hand tests the product of basic research findings. The objective is to test the theories, concepts and models derived from the research in real problem situation.

Therefore research methodology can be referred to the way by which a research is carried out in order to obtain information that will aid the researcher to achieve his/her objectives. Various

researchers, depending on the type of research objective, try to adopt different measures to carry out their research in order to give the accurate picture of the research topic.

### **3.2 Research Design**

According to Selltitz, et al, a research design is the arrangement of conditions for the collection and analysis of the research purpose with economy in procedure. The implication of this according to Abonifah and Yomere, is that the type of design that is applicable to a study depends on the purpose of the study. Thus, the research designs are classified into explanatory, descriptive, casual and correlational. It also been described as a plan or blue print that guides the researcher in the various stages of the research process. It refers to population being studied, the sample size, sampling method, source of data, measurement procedures and questionnaire design and sampling method sample six.

In content analysis usually, the documents to be examined will vary according to types, dates and sources of origin and other types of criteria. In content analysis, non probability sampling method is usually employed within the content, the following sampling methods are particularly appropriate:

- Stratified sampling
- Cluster sampling

In stratified sampling, the research population is organized into homogeneous sub-sets (strata) with heterogeneity between the sub-sets; the appropriate number is then selected from each sub-set (stratum). While cluster sampling involved vividly the region in which the study population is located into zones, (clusters), then we select zone at random and samples them at random. This technique is appropriate in a situation where the population is widely dispersed. However, when the documents are not readily available en-mass or they are acquired

apparently on opportunity basis, then the two mentioned techniques might not be applicable in a sort of these circumstances, opportunity can be accidental sampling is identified to be suitable alternative. Therefore the researcher has adopted opportunity accidental sampling as his sampling technique or method (Agbonifoh and Yomere 1999).

According to Olomolaye in Tukur (1999:72) “Opportunity sampling is a procedure in which you use only individual who happen to come to you or things which happen to be around you when you are carrying out your study” in that you take what you can find and your content with it”.

Furthermore, it is more economical and more convenient if the researcher was using large and scattered population where all study obtained excess data, it would be sized using stratified and or cluster sampling of data.

The design of this research is in the area of Islamic jurisprudence (fiqh) which helps in deducing laws from the source of *Shari'ah* on certain issues currently happening in the society. In the process to acquire relevant information/data, both primary and secondary data were used to draw logical conclusions. The primary data consists of personal interviews with stakeholders and the administering of questionnaires. The questionnaire is both structured and unstructured to enable the respondents give their personal opinion where necessary and also choose the appropriate responses from the alternatives provided. While the secondary data, which constitutes the bulk of the data was obtained from existing published materials such as text books, journals, magazines, and unpublished materials such as seminars, paper presentations and internet websites. The substantial amount of secondary data were used in chapter two (literature review) and are also going to be used in chapter four (Data presentation and analysis).

The necessary literature and information were easily obtained by using the survey method from the affirmative sources. The historical method was also used to highlight the past to gain a clear perspective of the future and the descriptive method was employed for the explanation of the basic principles of Islamic banking system to get the better understanding of the concept. Against this background, the methods were employed in this research with comparative analysis and to some extent in-depth approaches to accomplish the objective of the study, with the aim of depicting the present structure, nature and operational profile of Islamic banking system.

### **3.3 Research Population**

Agbonifah and Yomere (Ibid) defined the population of a study as that group about whom we want to be able to draw conclusions. That is the totality of the objects or elements being studied and to which the conclusions or generalization of our result will apply. He further said that in all cases of population your study must be clearly defined according to some relevant criteria so that we will be able to ascertain whether a given object, event, person or organization as the case may be is a member a net.

This in line with the above definition, the population of this research has been limited to speed dating officials. The rationale behind such choice of events and object as population is the study's determination to adopt content analysis as its operational technique and also due to its predication on historical and empirical background. Another rationale is its subscription to religious undertone as its leading attribute among others. However, the population of this research comprises among others, those elements that have bearing with culture and education.

In addition to the above accounts the banks offer the other services such as correspondent banking services, remittance and transfer, sale and purchase of foreign currency, sale of travelers cheques, trustee and nominee company services, and safe custody services.

For the purpose of this study, the population has been limited to speed dating officials such as; *Ja'iz* International Bank (10), former Bank PHB Staff (10 people), Stanbic IBTC Bank Staff (10), Unity Bank Plc (10), A.B.U Microfinance Bank, (10), Pension Officers (10), Academicians (10) and Self Employed People (10), irrespective of gender. age or religion. The sample size is Eighty (80) people. In other to make the study more representable, the following table illustrates the staff sampled for this study.

S/N	BANK	NUMBER OF STAFF
1.	Ja'iz	10
2.	Former Bank PHB	10
3.	Stanbic IBTC	10
4.	Unity Bank Plc	10
5.	ABU Microfinance	10
6.	Pension Officers	10
7.	Academicians	10
8.	Self employed people	10
Total	8	80

### 3.4 Research Techniques of Analysing Data

This explained the formal and techniques or procedures that were used in the analysis of the research. There are many tools and techniques that can be used in analyzing data collected but for the purpose of this study, tabular presentation and percentage techniques shall be used.

Tabular presentation: This is the tabulation of information obtained from data collection. Such tables contain summarized information and they provide a convenient means of compiling data in a form for easy relevance. Data are arranged according to their nature and purpose.

Percentage: This tool is commonly used to illustrate the proportion of the sample size that agrees or disagrees on a particular view. Data From questionnaire would be analysed using simple percentage of the population size and the response for or against the statement the sample majority determines the acceptance.

### **3.5 Research Instruments**

According to Abonifoh and Yomere (1999), content analysis refers to the examination of information contained in documents and other forms of storing data. He further stated that what are analyzed include:

- Books
- Newspaper publication, company newsletter or magazines
- Video (tape-recordings)
- Letters, memoranda, circulars etc.
- Minutes of meeting
- Personal diaries
- Reports
- Questionnaire

- Other media recording historical data

In the words of Ogunike, contents analysis implies “information gathered without the direct interventions of the researcher”. It de-emphasises the ability of the researcher to source for information using questionnaire/interview without prejudice interfacing with his finding. This is because, the researcher’s questions may directly or indirectly tele-guide the response of the respondents. Instead, the method insists that the rationality shall come from the affairs themselves. On the other hand, the researcher cannot actively explore or make meaning out of the information supplied by the respondents as the latter might obscure certain information (Ogunike 1989:12).

The use of instruments of data collection selected for this study are the questionnaire and oral interview and it was due to’ the researcher’s need to acquire comprehensive and relevant information about the topic being Studied. It is a clear fact that no method of data collection or research is full of proof or devoid of one or two short comings, nor is there any method which is not faced with certain constraints. For this reason, each method used in this study was chosen because of its strong points and its comparative advantage in certain aspects over other techniques.

The questionnaire was picked because of its ability to reach a wider audience and requires much less skill to administer. Furthermore, it places less pressure on the respondents for immediate responses and makes the respondents have greater confidence on their anonymity. Thus feel free to express their views.

### **3.6 Data Analysis**

It was indicated in the foregoing that the research has adopted content analysis in its instrumentation. It means it would invariably assure descriptive mode of analysing data. This

choice is more imperative as the research deals with quantitative data. In its attempt to provide awareness, the study may not approach the research questions in word-for-word basis. I would preparably address situation in content for content manner in line with the statement of problem of the study. This agrees with the sense that our data are content analyzed.

In the course of reviewing some literature, considerable data were collected, part of which could solve some aspects of the research's problem. Incidentally, the analysis entails the task of reframing such portions of the literature in an organized and articulate manner to make the message more glaring to the reader. In its conclusive part, the research would account precisely on the specific patterns of the study that deals with specific questions. It will also account on the justification of the result bored on the test of its hypothesis and or based on how it dealt with its assumption.

### **3.7 Summary**

In identifying its population, the research work chore documents and other information storage facilities. This is based on ots adoption of content analysis as its operational technique. Its predication on historical and contemporary background as well as its recipients outlook of its purpose, in its sampling method and sample size, the work has adopted opportunity sampling, whereas any excess data would cut to size using stratified and or cluster sampling data. Descriptive form of design was found fitting for this research, though it might borrow little from the course and effect relationships. Use of conventional instruments would always fail to produce objective finding, as respondent would observe information, the reason among others informed our choice of content/documentary analysis as the works research instrument. We would also examine the effects of the historical events on both the past and the present generation.



It was against this background that we exploited various mediums of sourcing data mainly from libraries, educational institutes, universities, organisations and internet. Following the produce of data analysis, the researcher has earlier informed that the research was built on religious background; therefore, scientific measurement would not serve as its main instruments. Thus it is most suitable with content analysis especially as it deals with qualitative data. While in the process of analysis it would address research questions in their context not in a series. Also our literature review contained data adequate to solve part of the research problems. Finally the research would mention where specific portion of the study deal with specific questions thereof. It would equally asses its result based on the test of its hypothesis. I would make recommendations on how to confront the adversaries of Islamic Banking now and in the future.

## **CHAPTER FOUR: PRESENTATION AND DATA ANALYSIS**

### **4.1 Presentation of Data**

This research work depended on the descriptive, historical and survey method in order to gain a clearer perspective of the part so as to be in good position to suggest ways towards having successful Islamic banking system in Nigeria. The tabular form helps in bringing out clear relationship that exists between variables in a systematic way that induces users to comprehend. Also the percentages measure the performance by showing the percentage change throughout the period under study.

The data presentation consists of respondents which was favourable as out of fifty (50) questionnaires administered, thirty six (36) were fully completed and returned. This was achieved because the questionnaires were submitted and collected personally.

### **4.2 Analysis of Data**

In the process of gathering data by the use of questionnaire for the project topic “Islamic banking in Nigeria; problems and prospects from 2010 – 2017”, the following information was realized:

**Table 1 – sex**

<b>Response</b>	<b>Respondent</b>	<b>Percentage (%)</b>
Male	29	80.6
Female	7	19.4
Total	36	100

The table above shows that the numbers of male respondents constitute 80.6% while those of women respondents constitute 19.4%. This shows lack of proper representation by the womenfolk in the economic sector in Nigeria.

**Table 2 – Age of Respondents**

<b>Response</b>	<b>Respondent</b>	<b>Percentage (%)</b>
18-27	5	13.9
28-37	19	52.8
38-47	5	13.9
48 & above	7	19.4
Total	36	100

This shows that the highest age bracket that responded is between 28-37 with 52.8%, while the age bracket of 18-27 and 38-47 are tied at 13.9 each and the age bracket of 48 and above constitute 19.4% of the total

**Table 3 - Religion**

<b>Response</b>	<b>Respondent</b>	<b>Percentage (%)</b>
Islamic	34	94.4
Christian	2	5.6
Traditional	0	0
Total	36	100

The table above shows that more Muslims responded to the questionnaires as 94.4% are Muslims while only 5.6% are Christians. This is as a result of the limitation and scope of the study to North Central region which is a predominantly Muslim Society. Also, some Christians that were administered the questionnaire promised to return it but couldn't do so despite pressurizing while others outrightly rejected it claiming Islamic banking concerns only Muslims and thus, does not affect them. There is no traditional believer because the region doesn't support that.

Table 4- Educational Level

<b>Response</b>	<b>Respondent</b>	<b>Percentage (%)</b>
Masters/PhD	11	30.5
Degree/HND	23	63.9
ND/NCE	0	0
Secondary	2	5.6
Total	36	100

The table shows that the number of respondents that have Masters/Postgraduate certificates constitute 30.5%, Degree/HND constitute 63.9%, ND/NCE certificate 0% and Secondary certificates 5.6%. It also shows that the respondents are literate.

Table 5 — Current Working Status

<b>Response</b>	<b>Respondent</b>	<b>Percentage (%)</b>
Bankers	14	38.9
Pension officers	4	11.1
Academicians	4	11.1
Self employed	9	25
Civil servant	5	13.9
Total	36	100

The table above shows that majority of respondents are Bankers which 38.9%, Pension Officers constitute 11.1% Academicians, 11.1%, Self Employed people constitute 25% and Civil Servants 13.9%.

Tables 6- which account do you operate?

<b>Response</b>	<b>Respondent</b>	<b>Percentage (%)</b>
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Savings	9	25
Current	22	61.1
Interest free only	2	5.6
Both interest free & conventional	3	8.3
Total	36	100

The table shows that there is a low patronage of the interest free accounts compare to those that operates both savings and current conventional accounts. This is as a result of lack of adequate knowledge about Islamic banking system.

**Table 7 – how you can rate the banking operational system in Nigeria?**

<b>Response</b>	<b>Respondent</b>	<b>Percentage (%)</b>
Poor	3	8.3
Fair	23	63.9
Good	10	27.8
Very Good	0	0
Total	36	100

This shows that majority of the respondents rate the banking averagely while few rate it below average and less than 30% are satisfied with its current operation. Despite the fact that few respondents patronize free interest account, they still believe it is better than the conventional system which had been operating for decades but yet at a lowly average rate. Therefore, if Islamic banking is fully implemented, they would cross-carpet to it.

**Table 8-How does the system relate to socio-economic problems in the Country?**

<b>Response</b>	<b>Respondent</b>	<b>Percentage (%)</b>
It contributes	21	58.3
It reduces	15	41.7
Total	36	100

Based on this table, there is a relatively close call between those that believe the conventional bank contributes to the problems in the socio-economic problems in the country or it reduces it. About 58% believe it contributes to the problems. This is as a result of high rate of interest and inflation in the system, lack of human face and other social stigma it creates. While the

remaining 42% that say it reduces the problems, after pressing, believe that we don't have a standard complimentary or substitute system (like Islamic system) that will constitute a threat and will offer better facilities: They also believe since the conventional banking sector is the only one that injects funds in the economic sector; it reduces the problems attached despite high inflation and interest rate.

**Table 9 - what do you know about interest banking?**

<b>Response</b>	<b>Respondent</b>	<b>Percentage (%)</b>
Nothing	1	2.8
Little	16	44.4
Much	14	38.0
Very much	5	38.9
Total	36	100

The table shows that majority of the respondents do not have adequate knowledge about Islamic banking. This fact is supported by majority of those being interviewed as most of them are only aware of it by name but do not know the full implication of the system and its advantages. With this respects, rigorous enlightenment is needed. While, others that have much knowledge about it are financially incapable of making any difference.

**Table 10 - Are you aware that some banks operate interest free banking?**

<b>Response</b>	<b>Respondent</b>	<b>Percentage (%)</b>
Yes	32	88.9
No	4	11.1
Total	36	100

The table above shows that majority of the respondents were aware that some banks operate window scheme of interest free banking. This also supplements the upper information which shows about 88.9.2% have idea on interest free banking.

**Table 11 – Do you patronize the interest free banking? (Briefly state reason)**

<b>Response</b>	<b>Respondent</b>	<b>Percentage (%)</b>
Yes	33	91.7
No	3	8.3

Total	36	100
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This shows that majority of the respondents will patronize the interest free (Islamic) banking. Most of those respondents explain that firstly it is a religions injunction to avoid interest in any form which must be followed. That also, they operate the conventional system only because of necessity as there is no substitute. Therefore there is a bright prospect for the Islamic banking system in Nigeria when fully implemented. Some also view it more far advantageous than the conventional system based on its products and services.

While those that say they will not patronize it, base their arguments on not knowing the full impacts of Islamic banking and afraid it will not survive the policies of Nigeria and are therefore skeptical in putting their money in the system.

**Table 12 – What is your view on Establishing an Islamic Bank in Nigeria?**

Response	Respondent	Percentage (%)
Necessary	20	55.5
Skeptical	14	38.9
Others	2	5.6
Total	36	100

This table shows that majority of the respondents view establishing Islamic bank in Nigeria as a necessity which is long overdue because of the teeming population of the Muslims in the country. Others express their eagerness for its establishment explaining the various prospects surrounding it and the numerous advantages it would bring to the economic sector especially in curbing the socio-economic problems in the sector. Some people express their skepticism towards its establishment claiming it couldn't survive the schisms and intrigues of the banking sector.

**Table 13 – *Ja'iz* bank is to establish Islamic Banking, what are the major issues challenging its establishment?**

<b>Response</b>	<b>Respondent</b>	<b>Percentage (%)</b>
Capital base	15	69.4
Trained personnel	2	5.6
Awareness	3	8.3
Others	6	16.7
Total	36	100

The table above shows that majority of the respondents believe adequate capital base is the main reason why *Ja'iz* bank is operational. They explained that when the bank opened public offer in 2002 in order to raise the then two billion Naira capital base, the offer was oversubscribed with about 120%. But with the capital raised on twenty five billion naira, the bank has to raise additional twenty three billion Naira which is still hindering its establishment. Other people gave other reasons such as lack of skilled personnel, lack of proper enlightenment and awareness, lack of committed wealthy individuals and sabotage effects, as reasons for its failure to be established. Therefore, it can be rightly said that despite the fact that there are other constraints hindering its establishment, the main constraints affecting it is lack of adequate capital base.

**Table 14 – Islamic Banking provides better facilities than conventional banking?**

<b>Response</b>	<b>Respondent</b>	<b>Percentage (%)</b>
Yes	32	88.8
No	2	5.6
May be	2	5.6
Other	36	100

Based on the above table, the majority of the respondents totally agree that Islamic banking will provide better facilities than conventional banking. They believe that the products being offered by Islamic banking are more customers-friendly than the conventional banking because the latter is just exploitation and destruction of economy based on the explanation provided in

chapter two. This proves that people believe Islamic banking will solve the socio-economic problems that the conventional banking contributes.

**Table 15 – What are the major products offered by Islamic Banking?**

Responses	Respondents	Percentage %
4 options	6	16.7
3 options	10	27.8
2 options	9	25
1 option	3	8.3
Total	36	100

Based on this table, it can be seen that there is an averagely low knowledge on the products of Islamic banking. Only 16.7% were able to answer the 4 options provided including officials of the banking sector. Therefore, if Islamic banking is to fully have impact on the Nigerian populace, there must be drastic far-reaching enlightenment.

**Table 16 – Do you think an Islamic bank will be sustained in Nigeria?**

Responses	Respondents	Percentage %
Yes	31	86.1
No	2	5.6
Neutral	3	8.3
Total	36	100

This table shows that Islamic banking has high potentials of survival because majority of the respondents explained that it will have huge market from both Muslims and non-Muslims alike and if proper mechanism is put in place, it will surely survive.

**Table 17 – Based on the nature of Nigerians, how can Islamic banks reclaim their money in case of defaulters (especially those using natural causes as reasons)?**

Responses	Respondents	Percentage %
Collateral	18	50%
Trust	12	33.3
Others	6	16.7
Total	36	100

Most respondents believe that the use of collateral will reduce defaulting while others explain that since Islamic banking is totally based on trust, it will serve as a risk averter because the



whole concept will be determined by the rate of trust. Few others believe in a country like Nigeria where there is average trust and the use of collateral will hinder small scale businessmen from acquiring loans, there should be other ways which the loans can be secured such as insurance payment, etc.

**Table 18 – How can Islamic bank prospers?**

<b>Responses</b>	<b>Respondents</b>	<b>Percentage %</b>
Proper mechanism	22	61.1
Large patronage	12	33.3
Others	2	5.6
Total	36	100

The table above shows that majority of the respondents believe if proper mechanisms are put in place and managed effectively, and then it will surely prosper beyond expectations just like it has been prospering in places around the world. Others feel if there is large patronage of customers, the bank will be afloat and will have abundant resources for survival. Whereas 5.6% of the respondents do not have awareness of how it will prosper.

**Table 19 – What are the expected potentials of Islamic banking that will enable investors commit their resources?**

<b>Responses</b>	<b>Respondents</b>	<b>Percentage %</b>
Products	20	55.6
Religious obligation	12	33.3
Others	4	11.1
Total	36	100

Majority of the respondents explained that Islamic products such as profit and loss sharing, cost plus, safekeeping; being offered by Islamic banking are the expected potentials that will make investors commit their resources based on their customer-friendly status and pure profitability. Other respondents believe that since it is a religious obligation to abhor interest in all ramifications, the injunctions would make investors avoid the interest banking and fully join the Islamic banking system as a religious requirement.

**Table 20 – Do you think Islamic banking can solve the socio-economic problems in the banking system?**

Responses	Respondents	Percentage %
Yes	30	83.3
No	6	16.7
T otal	36	100

**Field Survey: 2010**

This table portrays the hypothesis of the study in a strong mood because majority of the respondents believe the products offered by Islamic banking will definitely solve the problems attached to the socio-economy in the system. This statement was proved in chapter two where the topic was extensively discussed.

**4.3 Test of Hypothesis:**

The hypothesis of the study would be tested to confirm whether the statement is valid or not.

Thus;

$H_0$  = “Islamic banking in Nigeria is not the solution to the socio-economic Problems in the banking system”.

To test this hypothesis, reference is made to question No 20 in the questionnaire and table 20 in the data analysis where statistical values of Z score is computed and compared with the table value of Z as follows:

Variable	X	F	FX	X-X	(X-X) <sup>2</sup>	F(X-X) <sup>2</sup>	Decision
Yes	3	30	90	0.9	0.81	2.43	Rejects
No	2	6	12	-01	0.01	0.02	
	1	-	-	-	-	-	
<b>Total</b>		<b>36</b>	<b>102</b>			<b>2.45</b>	

$$\text{Mean} = x = \frac{\sum fx}{\sum f} = \frac{102}{36} \quad x = 2.83$$

$$= \text{Standard deviation (S.D)} = F \frac{(x-x)^2}{\sum f} = \frac{2.45}{36} = 0.07$$

$$\text{S.D} = \sqrt{0.07} = 0.2646$$

Having  $x = 2.83$ ,  $\text{S.D.} = 0.2646$  and  $n = 36$ ;

$$\text{Standard error (Sx)} = \frac{S.D}{\sqrt{n}} = \frac{0.2646}{\sqrt{36}} = \frac{0.2646}{\sqrt{6}}$$

$$Sx = 0.0441$$

$$\begin{aligned} \text{Population mean limit (u)} &= x + 1.96 (0.044) \\ &= 2.83 + 1.96 (0.0441) \end{aligned}$$

$$\text{Thus, } 2.83 + 96 (0.0441), \quad 2.83 - 1.96 (0.0441) \\ 2.744$$

Taking the upper limit range,

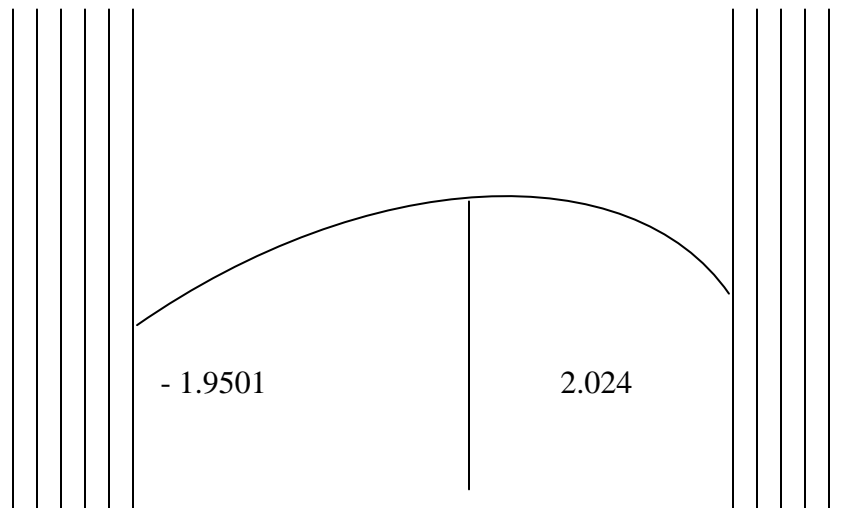
$$Z = \frac{x - v}{\frac{s}{\sqrt{n}}} = \frac{2.83 - 2.916}{0.0425} = -1.9501$$

Considering the lower

$$\frac{2.83 - 2.744}{0.0425} = 2.0224$$

From the above computations, it can be seen that the hypothesis tested valid since the statistical value of Z score lies between – 1.9501 and 2.024 which falls within areas termed as a rejected region on standard normal distribution curve.

This indicates that the null hypothesis is not to be accepted which the Islamic banking system in Nigeria is the solution to the socio-economic problem in the banking system.



**Decision rule:** We accept the hypothesis because it is within normal range.

## **CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATION**

### **5.1 Summary of the major findings**

This research work has revealed the theoretical, practical as well as the conceptual framework of Islamic banking system with reference to Nigerian environment. It has been observed that almost all heavenly religions have forbidden interest/usury, on the ground of which Islamic banks have been operating and even competing successfully with their conventional counterparts in the international scene.

The study explained the historical background of Islamic banking system and the operational nature of Islamic banks across the globe. Efforts were made to explain the concept of Islamic banking in Nigeria and the Factors affecting its establishment in the Country such as; inadequacy of capital base, lack of commitment by wealthy Muslims, lack of trained personnel and lack of awareness of the concept. The work indicated prosperous future for Islamic banking in Nigeria as they have been growing in market share, profitability and acceptability all over the world. This is however not without some degree of problems which when left unsolved will hinder the success of the system.

In line with conducting research of this nature, a literature survey was adopted where secondary data was reviewed. At the same time, data were also obtained from the primary sources where a number of people were interviewed and questionnaire was administered, the result of which is presented in chapter four of this work. And finally at the end of this chapter, the researcher will recommend some ways through which the identified problems would be addressed.

## **5.2 Conclusion**

The discussion in this work makes it clear that Islamic banking is not a negligible or temporary phenomenon. Islamic banking in the world is here to stay and there are signs that it will continue to grow and expand. Even if one does not subscribe to the religious injunctions against [lie institution of usury/interest, one may find in Islamic banking some potentials and innovative ideas, which could add variety to the existing financial network. One of the main selling points of Islamic banking is that, unlike conventional banking, it is concerned about the viability of the project and the profitability of the operation but not the size of the collateral. Good projects which might be turned down by conventional banks for lack of collateral would be financed by Islamic banks on a profit-sharing basis. Also the high interests charged by conventional banks bring about a lot of Socio economic hardships in the system. It is especially in this sense that Islamic banks can play a catalytic role in stimulating socio-economic development.

These being said, the benefit of Islamic banking in a growing economy like Nigeria cannot be over-emphasized. In line with the Federal Government's desire for a single digit interest rate to

spur socio-economic growth, nothing can be more apt than establishing a none-interest financial institution. Islamic banking will also contribute significantly to the overall development of the Country by developing micro credit schemes aimed at improving the overall communities, thereby drastically reducing unemployment rates. There are also ample opportunities to attract Foreign Direct Investments (FDI) into the Country.

Therefore it is our collective responsibility to make sure that Islamic banking is fully effective in Nigeria because every major religion abhors interest and as Muslims, we are obligated to ensure that an interest—free financial system is established within the *Ummah*; especially in a global environment that has become ever more demanding, a setting that is subject to the dominant forces of changes and that is *characterized* by unstable market conditions of intermediation.

### **5.3 Recommendations**

Despite various problems and shortcomings, the Islamic banking has the potentiality to operate in Nigeria and expand its activities to bring good to the Nation at large and the socio-economic sector in particular. Some suggestive measures are appended below:

1. Muslims need to put total commitment towards the cause of Islamic banking and commit their resources to make sure, at least for now, Jaiz International Bank is functional.
2. Educational institutions should introduce Islamic Finance and Banking as well as other related courses to supply need-based manpower by Islamic banks.
3. There should be the use of media in propagating the services and products being offered by Islamic banking system so that people would be aware of the concept.
4. Scope for training, motivation and programmes for Islamic bankers should be widened and strengthened.

5. Training-needs assessment should be made to cover three different forms of training aspects of an Islamic banker. These include:
- a. Ideological, which is related to *Quran* and the Sunnah.
  - b. Theoretical, which covers the technical aspects of banking in equipping an employee with knowledge about Islamic values and way of life.
  - c. Practical.
6. Group discussion, case—study on Islamic economics, banking and finance may be introduced by ministry of religious affairs, Islamic organizations: for bank officials at different levels of operations on regular basis.
7. A common web portal may be developed to facilitate clients in providing tips regarding Islamic banking, finance and economics. Social clubs can also be used such as twitters, face book etc.
8. Banks offering none—interest banking can develop unanimous *Shari'ah* Manual or guidelines for day-to-day consultation and clientele motivation.
9. Islamic Banking Diploma Course should be introduced for all Islamic bankers. And prospective clients should be equipped with the knowledge of Islamic banking through discussions, seminars, symposia etc.
10. There should be a research and development (R & D) department where new products will be determined in relations to the society and the needs and wants of the people in that environment.
11. Investment should be diversified and extended for long-term Financing under *Musharakah* and *Mudaraba*.
12. Cooperation among Islamic banks should be extended at international level where not only portfolios would be interrelated, but also where Financial and educational assistance would be rendered.

13. Uniform accounting system and standards already developed by the accounting and auditing organization for Islamic financial Institutions for providing consistency in accounting treatment of various operation and products of Islamic banks may be introduced by all concerned.

14. New and innovative products need to be designed for financing under profit and loss sharing basis. And Muslim Countries which have established Islamic banks should involve themselves with International trade on Islamic principles, which would contribute to grow international transactions under interest-free system. This will further help in developing an Islamic Common market.

#### **5.4 Limitation of the Study**

Various research works have different weaknesses peculiar to their background. This work has equally admitted to fall prey to some among others.

To start with, it is essential to note that a number of works on Islamic Banking including PhD dissertations have been conducted in Arabic language. It is therefore imperative for this work to serve its substantial data from those studies conducted in Arabic language. It is therefore imperative for this work to serve its substantial data from those studies conducted in Arabic language. Therefore, as experienced by every work of translation, this research would have to struggle with common problems of translation that is imprecision. This is because some words that exist in one language might not have a clear cut translation in the other.

This phenomenon induced many translators to adopt one popular technique that of free translation, these alternatives are seen as weakness to all works of translation this study inclusive. The aforementioned phenomenon created another off short; that is transliteration of some names of individual especially from Arabic to English language. This is yet another



factor of imprecision. However the work would use necessary, in addition to the transliterated one write the same name in Arabic language for the purpose of clarity.

Nevertheless, against the empirical culture the study being religious in nature, it is oriented towards belief in all the spiritual injunctions which it would collect in the process of its collection of data and information. Therefore the study had admitted its obvious inability to wholly apply empirical measurement in measuring information and data. The major limitation of my research is that of translation.

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## **APPENDIX**

### **REQUEST FOR COMPLETION OF QUESTIONNAIRE**

My name is Mohammed Sani Mahmud, a Master in Islamic Studies (B.Ed) student in the Islamic Studies Section, Department of Social Science Education, Faculty of Education, of Ahmad Bello University Zaria. I am currently conducting a research on the topic: **“ISLAMIC BANKING IN NIGERIA: PROBLEMS AND PROSPECTS”**; I therefore seek your kindness to help complete the questionnaire. All information collected will be highly confidential and strictly used for academic purpose only. Therefore, I need you to provide accurate answers.

Thank you.

#### **APPENDIX A: BIODATA**

1. Sex of the respondent:

(a) Male (b) Female

2. Age of the respondent:

(a) 18-27yrs (b) 28-37yrs (c) 38-47 yrs (d) 48 & above.

3. Religion:

(a) Islam (b) Christian (c) Traditional

4. Educational Level:

(a) Master/Postgraduate

(b) Degree/HND

(c) ND/NCE

(d) Secondary

5. Current working status (specify)

#### **APPENDIX B: OPERATIONAL NATURE OF BANKING IN NIGERIA**

6. Which account do you operate?

(a) *Savings* (b) Current (c) Interest free only

(d) Both interest free and conventional (e) none.

7. How can you rate the banking operational system in Nigeria?

(a) Poor

(h) Fair

(c) Good

(d) Very good

8. How will the system relate to socio-economic problems in the Country?

(a) It contribute to the problems

(b) It reduces the problems

9. What do you know about interest free banking?

(a) Nothing (b) Little (c) Much (d) Very much

10. Are you aware that some banks (like Bank PHB) operate interest free banking?

(a) Yes (b) No

11. Can you patronize the interest free banking'? (Briefly state reason)

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#### **APPENDIX C: PROBLEMS OF ISLAMIC BANKING IN NIGERIA.**

12. 'What is your view on establishing an Islamic bank in Nigeria?

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.....  
.....  
.....

13. *Ja'iz* bank has been successfully established, what are the major issues challenging **its** establishment?

(1)

(2)

(3)

(4)

14. 'Will Islamic banking provide better facilities than conventional banking?

(a) Yes (b) No

15. What are the major products offered by Islamic banking?

(a) .....

- (b) .....
- (c) .....
- (d) .....

16. Do you think an Islamic bank will be sustained in Nigeria? (State reason).

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 .....

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 .....

17. Base on The nature of Nigerians, how can Islamic Banks reclaim their money in case of defaulters? (Especially those using natural cause as reasons).

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 .....  
 .....  
 .....

#### **APPENDIX D: PROSPECTS OF ISLAMIC BANK IN NIGERIA**

18. How can Islamic bank prosper in Nigeria?

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 .....  
 .....  
 .....

19. What are the expected potentials of Islamic banking that will enable investors commit their resources?

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 .....  
 .....  
 .....

20. Do you think Islamic banking can solve the socio-economic problems n (lie banking system)? (State reason).



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Thank you for your time and your responses are highly appreciated.

## **APPENDIX II**

### **Requirements for Islamic Banking in Nigeria According to Central Bank of Nigeria**

Guidelines for the regulation and supervision of institutions offering non-interest financial services in Nigeria.

#### **Preamble**

The Central Bank of Nigeria (CBN) needs Banking Model Authorities the establishment of the following Banks and other Financial Institution ACT (BOFI) 1991 as amended:

- (i) Commercial Banks;
- (ii) Merchant Bank
- (iii) Specialised Banks;

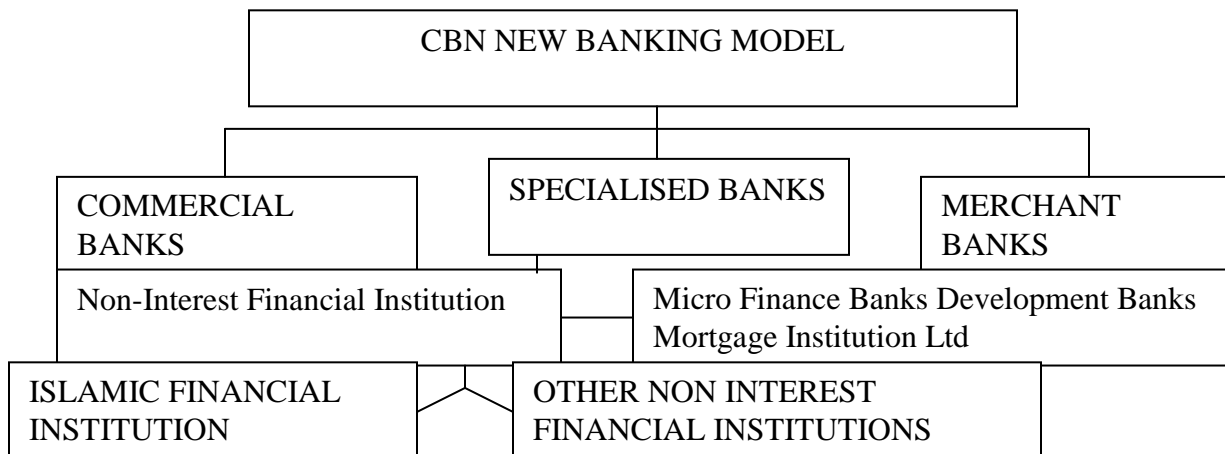
A specialised Banks include non-interest banks, Microfinance Banks, Development Banks; Mortgage Banks and such other banks as may be designated by the CBN from time to time.

Guidelines for other categories of non-interest banking will be issued upon request which shall be consistent with international best practice. The emphasis of their guidelines is on non-interest financial institutions operating under the principles of Islamic Commercial Jurisprudence, are of the categories of Non-Interest Financial Institution (NIFI). In addition, other guidelines in the conduct of banking under the principle of Islamic Commercial

Jurisprudence e.g. operational, corporate governance, product compliance, risk management and capital adequacy etc. will be issued in due course.

NIFI means a bank or other Financial Institution (OFI) under the purview of the Central Bank of Nigeria (CBN), which transacts banking business, engages in trading, investment and commercial activities as well as the provision of financial products and services in accordance with any established non-interest banking principles. Non-interest banking and finance models are broadly categorized into two:

1. Non-Interest Banking and finance based on Islamic Commercial Jurisprudence;
2. Non-Interest banking and finance based on any other established non-interest principle



Islamic banking as one of the models of non-interest banking, serves the same purpose of providing financial services as do conventional financial institutions save that it operates in accordance with principles and rules of Islamic commercial jurisprudence that generally recognizes profit and loss sharing and the prohibition of interest, as a model.

Other non-permissible transactions include those involving any of the following:

1. Uncertainty or ambiguity relating to the subject matter, terms or conditions.
2. Gambling;

3. Speculation;
4. Unjust enrichment;
5. Exploitation/unfair trade practices;
6. Dealings in pork, alcohol, arms and ammunition pornography and;
7. Other transactions, products, goods or services which are not compliance with the rules and principles of Islamic Commercial Jurisprudence.

Given the increasing number of requests from persons, banks and other financial institutions designing to offer non-interest banking products and services based on Islamic commercial jurisprudence in Nigeria, the CBN has developed their guidelines for the regulation and supervision of institution offering Islamic Financial Services (IFS) referred to in this guideline. All non-Interest Financial Institutions under this model are required to comply with these and any other guidelines that may be issued by the CBN from time to time.

The reference to IIFS for the purpose of their guidelines means:

- i. Full-Fledge Islamic bank or Full-fledge Islamic banking subsidiary of a conventional bank;
- ii. Full-fledge Islamic Subsidiary of Full-fledge Conventional Merchant bank;
- iii. Full-fledge Islamic Microfinance bank;
- iv. Islamic branch or window of a conventional bank;
- v. Islamic subsidiary, branch or window of a non-bank financial institution;
- vi. A development bank regulated by the CBN
- vii. A Primary Mortgage Institution licensed by the CBN to offer Islamic Financial services either full fledge or as a subsidiary; and
- viii. A finance company licensed by the CBN to provide financial services, either full-fledge or as a subsidiary.

## **Objective**

The objective of these guidelines is to provide minimum standards for the operation of IIFS in Nigeria. Accordingly, these guidelines are applicable to IIFS only and do not seek to regulate other non-interest financial institution which may be established from time to time.

## **Legal Framework**

### **Legal Basis**

There guidelines are issued pursuant to the non-interest banking regime under section 44 (1) (b) of the CBN Act 2007; sections 23 (1) 52; Financial Institutions Act (BOFI) 1991 (as amended) and section 4 (1)(c) of the Regulation on the provisions of other relevant sections of BOFIA 1991 (as amended), the CBN Act 2007, companies and Allied Matters Act (CAMA) 1990 (as amended) and circulars/guidelines issued by the CBN from time to time.

### **Corporate Power**

A non interest Financial Institution under this model shall ensure that its Memorandum and articles of Association (MEMART) state that its business operation will be concluded in accordance with the principles and practiced in accordance with the principles and practices of Islamic Commercial Jurisprudence.

### **Licensing Requirements**

A non Interest Financial Institution under this model shall be licensed in accordance with the requirements issued by the CBN from time to time.

Application for the grant of licenses shall be accompanied by evidence of a technical agreement executed by the promoters of the proposed institution with an established and reputable Islamic Bank or Financial Institution. The agreement shall explicitly specify the role

of the two parties and shall subsist for a period of not less than 3 years from the date of commencement of operations of the licensed IIFS.

A license to undertake Islamic banking business operations may be issued by the CBN upon such terms and conditions which authorize the operation of a non-Interest Financial Institution.

An IIFS with regional banking authorization shall be entitled to carry on banking business operations within a minimum of six (6) and maximum of twelve (12), lying within not more than two (2) geo-political zones as well as within the Federal Capital Territory (FCT).

The detailed licensing requirements can be obtained directly from the Financial Policy and Regulation Department (FPRD), Central Bank of Nigeria, Abuja or downloaded at [www.cbn.gov.ng](http://www.cbn.gov.ng)

#### **Financing modes and Instruments.**

IFS shall transact business using only financing modes or instruments that are compliant with the principles under this model and approved by the C.B.N.

#### **Commissions and Fees**

IFS may charge such commissions or fees as may be necessary in accordance with the principles under this model and divide to Bank charges. The Funds received as Commission and Fees shall constitute the bank's income and shall not be shared with depositors.

#### **Establishment and Operation of Islamic Subsidiary, Window or Branch of a Conventional Bank**

Conventional Banks and other Financial Institutions operating in Nigeria may offer or sell products and services in line with the principles under this model through subsidiary, window or branches.

#### **Corporate Governance**

All licensed IIFS shall be subject to: Guidelines on corporate governance for non interest Financial Institution issued by the CBN.

#### **CBN Advisory Council Experts**

There shall be an advisory body to be called CBN Advisory Council Experts to advise the CBN on matters relating to the effective regulation and supervision of IIFS in Nigeria. The qualifications, duties, responsibilities etc. of members of the council are contained in guidelines to be issued by the CBN.

#### **Profit Sharing Investments Accounts**

An IIFS shall ensure that relevant disclosures are made to Profit Sharing Investment Accounts (PSIA) holders in a timely and effective manner and also ensure the proper implementation of investment contract.

#### **Audit Accounting and Disclosure Requirements.**

All IIFS shall comply with relevant provisions of the circular issued by the CBN on disclosure requirement by financial institutions and other disclosure requirements contained in CAMA 1990 (amended) and BODIA 1981 (as amended). In addition, they shall comply with the relevant standards on disclosure issued by standards settings organization including the following:

1. Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI);
2. Islamic Financial services Boards (IFSB); and
3. Nigerian Accounting Standard Board (NASB).

#### **Minimum Capital Adequacy Ratio**

All IIFS shall maintain a Minimum Capital Adequacy Ratio (CAR) as may be prescribed by the CBN from time to time. The Minimum Capital Adequacy Ratio shall be consistent with the

prevailing CAR as may be prescribed for conventional banks and financial institutions by the CBN from time to time.

### **Risk Management**

All IIFS are required to put in place appropriate policies, systems and procedures to identify, measures, monitor and control their risk exposures. In addition, they are required to put in place a risk management system that recognizes the unique risk faced by IIFS such as displaced commercial, fiduciary, transparency, reputational, equity investment and rate of return risks. Further details and guidance are provided in documentations issued by the CBN and international standard setting organization including:

- i. CBN Prudential Guidelines:
- ii. Risk Management Guidelines Issued by the Based Committee on Banking Supervision, and
- iii. IFSB Guiding Principles of Risk Management for Institutions offering only Islamic Financial Services.

### **Anti-Money Laundering and Combating of the Financing of Terrorism (AL/CFT)**

AIV IIFS and their promoters are required to screen shareholders, customers are required to screen shareholders, customers, counterparties, transactions, products and activities against the proceeds of crime, corruption, terrorist financing and other illicit activism using legal and moral filters.

### **General**

Consistent with CBN objectives of promoting financial inclusion in Nigeria, no IIFS shall engage in act(s) or practice(s) that appear inimical to the achievement of these overall objectives as well as the integrity, credibility and long term interest and sustainability of the Islamic Financial Services sub-sector. (Wednesday, June, 22, 2011 Daily Trust page 6-8).

