PROMOTING FINANCIAL INCLUSION THROUGH THE INTENTION TO ADOPT ISLAMIC MICROFINANCE IN NIGERIA: A STUDY OF SELECTED STATES

BY

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A thesis submitted in fulfilment of the requirement for the degree of Doctor of Islamic Banking and Finance

The International Institute for Islamic Banking and Finance
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JAN 2021

ABSTRACT

Financial inclusion, which includes the availability, accessibility and usage of formal financial services, has in recent years, been one of the major subjects attracting attention from governments and other development agencies. This is due to its role in the reduction of extreme poverty, increasing shared prosperity and supporting inclusive and sustainable development. This study, therefore, examined the determinants of intention to adopt Islamic microfinance (IMF) among prospective customers in Nigeria, in order to promote access to formal financial services. The quantitative study employed the proportionate stratified random sampling technique to collect data from 450 respondents, using close-ended questionnaires. The data was analyzed using Analysis of Moment Structures-Structural Equation Modeling (AMOS-SEM). The decomposed theory of planned behavior (DTPB) was used as the underlying theory to test 13 hypotheses. Results showed the intention towards the adoption of Islamic microfinance is high in Nigeria. Similarly, nine of the 13 hypotheses were supported, out of which attitude, subjective norm and perceived behavioral control were found to have positive and significant influence on the behavioral intention to adopt Islamic microfinance. The results also showed that religiosity moderates the relationship between subjective norms and behavioral intention. Overall, 69.2% of the hypotheses in the study were supported. Consequently, the study recommends the need for stakeholders in the Nigerian financial system to embark on enlightenment campaigns that will improve the public attitude on the role of Islamic microfinance banks in the promotion of financial inclusion and poverty reduction. There is also the need for government to ensure the provision of basic infrastructure to ensure easy access to financial institutions and services for prospective users. Finally, Islamic microfinance banks Islamic microfinance banks should improve their marketing operations highlighting the benefits to be derived from adopting their products and services. Overall, the findings of the study have provided additional insights to the growing literature of Islamic finance in Nigeria. For the government and policy makers, it will assist in shaping Islamic microfinance policy direction. The study also revealed the role of referents, especially among highly religious people, in influencing the behavioral intention to adopt Islamic microfinance.

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خلاصة البحث

ان الشمول المالية ، الذي يشمل توافر الخدمات المالية الرسمية وإمكانية الوصول إليها واستخدامها في السنوات الأخيرة، أحد الموضوعات الرئيسية التي جذبت انتباه الحكومات ووكالات التنمية الأخرى. ويرجع ذلك إلى دورها في الحد من الفقر المدقع ،زيادة الرخاء المشترك ودعم التنمية الشاملة والمستدامة. ولذلك، درست هذه الدراسة محددات النية في اعتماد التمويل الصغير الإسلامي بين العملاء المحتملين في نيجيريا، من أجل تعزيز الحصول على الخدمات المالية الرسمية. واستخدمت الدراسة الكمية تقنية أخذ العينات العشوائية الطبقية المتناسبة لجمع البيانات من 450 مجيبا، باستخدام استبيانات قريبة. تم تحليل البيانات باستخدام تحليل نمذجة المعادلات الهيكلية لهياكل اللحظة (AMOS-SEM). تم استخدام النظرية المتحللة للسلوك المخطط (DTPB) كنظرية أساسية لاختبار 13 فرضية. وأظهرت النتائج أن النية تتجه نحو اعتماد التمويل الصغير الإسلامي مرتفعة في نيجيريا. وبالمثل، تم دعم تسع من الفرضيات ال 13، التي تبين أن الموقف والقاعدة الذاتية والسيطرة السلوكية المتصورة لها تأثير إيجابي وكبير على النية السلوكية لاعتماد التمويل الأصغر الإسلامي. كما أظهرت النتائج أن التدين يخفف من العلاقة بين المعايير الذاتية والنية السلوكية. وبشكل عام، تم دعم 69.2٪ من الفرضيات في الدراسة. وبناء على ذلك، توصي الدراسة بضرورة أن يشرع أصحاب المصلحة في النظام المالي النيجيري في حملات تنوير من شأنها تحسين موقف الجمهور من دور المصارف الإسلامية للتمويل الصغير في تعزيز الشمول المالي والحد من الفقر. وهناك أيضا حاجة إلى أن تكفل الحكومة توفير الهياكل الأساسية لضمان سهولة وصول المستخدمين المحتملين إلى المؤسسات والخدمات المالية. وأخيرا، ينبغي على بنوك التمويل الأصغر الإسلامية أن تحسن عملياتها التسويقية مع تسليط الضوء على الفوائد التي يمكن جنيها من تبني منتجاتها وخدماتها. وبشكل عام، قدمت نتائج الدراسة رؤى إضافية للأدب المتنامي للتمويل الإسلامي في نيجيريا. وبالنسبة للحكومة وصانعي السياسات، سيساعد في تشكيل توجه سياسة التمويل الأصغر الإسلامي. كما كشفت الدراسة عن دور المراجع، خاصة بين المتدينين للغاية، في التأثير على النية السلوكية لاعتماد التمويل الأصغر الإسلامي.

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APPROVAL PAGE

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DECLARATION

I hereby declare that this dissertation is the result of my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

Abdurrahman Abdullahi

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ACKNOWLEDGEMENTS

In the Name of Allah, The Most Gracious, The Most Merciful.

All praises are due to Allah (SWT) in whose favors and mercies I am able to complete this colossal but interesting PhD journey. May the peace and blessings of Allah (SWT) be upon His beloved servant and messenger, Muhammad (PBUH), his household, companions and those that follow them in righteousness until the day of resurrections.

The completion of this challenging but fascinating journey will not be complete without the help, guidance and assistance of so many people. I would like to start by expressing my heartfelt gratitude and appreciation to my esteemed supervisors, Asst. Prof. Dr. Anwar Hasan Abdullah Othman and Prof. Dr. Salina Hj. Kassim for their guidance, and excellent supervision throughout this interesting journey. With their support and guidance, I have been able to contribute to the body of knowledge through published works in journals and conference proceedings during this expedition. May Allah (SWT) reward them abundantly.

Furthermore, I wish to express my deep appreciation to the panel of my proposal defense for their comments, suggestions and constructive criticism. These are Assoc. Prof. Dr. Syed Musa Jaafar Alhabshi and Asst. Prof. Dr. Syed Marwan Mujahid. I also feel honored and deeply indebted to the PhD Coordinators at the IIiUM, Asst. Prof. Dr. Nur Farhah Binti Mahdi and Asst. Prof. Dr. Hebeebullah Zakariyya, for their kind assistance, tremendous support and well wishes. I wish them Allah’s guidance in their future endeavors. I would also like to thank Sister NurFadilah Binti Fauzi of the Post-Graduate Unit, IIiBF for her immense assistance during my PhD studies.

I would also like to express my sincere thanks and appreciation to my classmates and friends Ya’u Isah and Sulaiman Sani who contributed immensely to my success in this awesome journey. Same goes to my friend Sani Tazara for making our stay in Malaysia exciting. Others that contributed to the success of this journey include Dr. Nuruddeen Zauro, Dr. Idris Ahmed, and Dr. Abdullahi Hassan Goron Dutse, among others. I thank them all.

I cannot conclude this write-up without acknowledging my late parents Alhaji Malam Abdullahi and Hajiya Binta Abdullahi for their love, prayers and training that guides me to the path of knowledge. May Allah (SWT) grant them Jannatul Firdaus. Similarly, I would like to acknowledge the love, patience, support and encouragement of my family, especially my lovely wife Hadiza, and my children, Aisha, Muhammad, Abdullah and Aliyu. I pray for Allah (SWT)’s continuous support, blessings, mercies, guidance and protection to this family.

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INTRODUCTION

1.1 BACKGROUND OF THE STUDY

Financial inclusion has in recent years, been one of the major subjects attracting attention from governments and other development agencies. It is defined it as the proportion of individuals and firms that use financial services (World Bank, 2014). It involves the availability, accessibility and usage of financial services, which include operating an account for savings, having access to credit, owning an insurance policy, or a mortgage facility, amongst others. Sarma (2008, p. 3) defined it “as a process that ensures the ease of access, availability and usage of the formal financial system for all members of an economy”, while the World Bank (2008) sees it as the absence of barriers in the use of financial services.

Others such as Beck & Demirgüç-Kunt (2008, p. 238) defined financial inclusion as “the extent to which households and firms can access and use formal financial institutions”. Cámara & Tuesta (2014, p. 6) defined financial inclusion as a financial system “that maximizes usage and access, while minimizing involuntary financial exclusion ... and that the degree of financial inclusion is determined by three dimensions: usage, barriers and access”. Another definition by Naceur, Barajas, & Massara (2015) is the share of the population who use financial services, while the Central Bank of Nigeria (2018) considers access to a broad range of financial services at affordable cost to suit the need of all users, as the achievement of financial inclusion.

For this thesis, the author adopts the combined definitions of Central Bank of Nigeria (2018) and Cámara & Tuesta (2014) to describe financial inclusion. Accordingly, this study defines financial inclusion as the provision of a broad range of financial products and services that suit all users at an affordable price, as well as the removal of barriers to promote access to, and usage of these products and services by the adult population.

An inclusive financial system helps in “reducing extreme poverty, boosting shared prosperity and supporting inclusive and sustainable development” (World Bank, 2014, p. 1). It also supports effective allocation of resources, enhances the efficiency and well-being of the people by promoting saving practices, and limits the growth of informal sources of credit that are usually exploitative (Sarma, 2008). The main concern of financial inclusion, therefore, is to provide access to an array of financial services - credit, savings, insurance and money transfers – through a variety of financial institutions that will allow that poor and low-income improve their living conditions and escape poverty (Duvendack & Mader, 2019).

The absence of financial inclusion (otherwise known as financial exclusion) is “a lack of access to financial services by individuals or communities due to their geographic location, economic situation or any other ‘anomalous’ social conditions which prevent people from fully participating in the economic and social structures of mainstream communities” (Sain, Rahman, & Khanam, 2013, p. 268). Beck & Demirgüç-Kunt (2008) and Mohieldin, Iqbal, Rostom, & Fu (2012) considers the causes of financial exclusion to be either involuntary or voluntary. Involuntarily exclusion arises due to limitations on the part of the users such as low income or high risk. It could also arise due to discrimination from financial institutions against the users of financial services based on their social, religious or ethnic background. Voluntary exclusion, on the other hand, involves individuals and firms that do not require these services or those that exclude themselves because of religious or cultural reasons.

The distinction between voluntary and involuntary financial exclusion is of high importance to policymakers, in the sense that involuntary exclusion indicates the presence of obstacles to financial inclusion, which can be addressed by formulating and implementing the right policies. To eliminate poverty and income inequality, it is recognized the world over those policies should be designed and implemented in order to bring those excluded into the formal financial system. Where present, financial exclusion promotes income inequality, social instability and negatively impacts on efforts to promote social development (Wang & Guan, 2017).

Consequently, policy makers and regulators, as well as international bodies in charged with enhancing economic growth and tackling extreme poverty have prioritized financial inclusion as the way forward. This was illustrated by the declaration of the year 2005, as the international year of microcredit, which is the easiest and most potent way of providing financial services to the poor. Furthermore, in 2009, the United Nations Development Program (UNDP) initiated a project aimed at boosting financial inclusion among the poor by developing appropriate financial products and services to cater for their needs. This may not be unconnected to the realization that financial inclusion is beyond micro-credit, but also include other financial products and services such as savings, insurance and financial transfers. In 2010, the G-20 endorsed the Financial Inclusion Action Plan as a mechanism to foster financial inclusion through the Global Partnership for Financial Inclusion (GPFI). This strategy was reviewed in 2014 to include new actions and criteria for measuring their performance (Wang & Guan, 2017).

One important channel through which governments promote access to financial services among the poor and underprivileged is microfinance. This refers to the advancement of small loans, provision of micro-savings and micro-insurance products, as well as remittance services. Microfinance has an advantage over commercial banks in the provision of financial access to the poor because of their ability to operate in rural settings. They also circumvent the problem of information asymmetry through group lending, and ensure repayment of loans through peer pressure from other borrowers.

Another tool of promoting financial inclusion is the Islamic microfinance. Defined as the provision of non-interest financial products and services to the low-income, Islamic microfinance operates based on Islamic jurisprudence which prohibits dealing in interest, the avoidance of gharar (ambiguity), participating in risk-sharing activities, and ensuring the welfare of all members of the society (Nabi, Islam, Bakar, & Nabi, 2017). It uses partnership, trade and lease-based financing structures that ends in changing ownership of physical assets (Rhule, 2016). It is, therefore, the Sharia-compliant way of providing financing to those that could not access conventional products and services that will support them start up a new business, or maintain their existing business (Hassan, 2015a).

Islamic microfinance combines the advantages of conventional microfinance in reaching the poor and underprivileged, and that of Islamic finance which potentially combines Islamic social finance, known for caring for the poor, and that of microfinance, which provides financial access to the marginalized segments of the society (Hersi, 2018). According to Nabi et al. (2017), Islamic microfinance is an effective tool in promoting financial inclusion and poverty alleviation. The authors defined it as a form of alternative financing model to the poor, especially those that exclude themselves from the conventional financial system because it is interest-based. It utilizes both charity and profit based models.

Over the years, significant progress has been recorded globally in providing access to financial services among adults. For instance, in 2018, Demirgüç-Kunt, Klapper, Singer, & AnsarHess (2018) analyzed data from 148 countries to explore the savings and credit behaviours of the financially active population, as well as how they transfer and receive funds or manage financial risks. The analysis showed that over the period of five years (2012 – 2017), the number of adults owning a bank account with formal financial institutions had increased to 69 per cent from 51 per cent, with five hundred and fifteen (515) million adults owning an account with a financial institution or a mobile money provider during the period. This increase in the number of account holders was recorded owing to deliberate policies at national and international levels, by governments, central banks, financial institutions and international development institutions, aimed at increasing financial inclusion among the poor (Cámara & Tuesta, 2014).

However, wide variations in the use of formal financial services across regions, income groups and individual characteristics, still remain. For instance, in 2012, 89 per cent of adults in high-income countries reported owning an account, as compared to only 41 per cent owning one in developing countries. In 2017, this disparity remained, with 94 per cent of adults in high-income countries owing an account, compared with 64 per cent in developing countries. Within the developing economies too, variations exist. In 2012, 46 per cent of men own an account, while only 37 per cent among women do. In 2017, this trend continued with 72 per cent of men owning an account compared to 65 per cent among women. In addition, among the estimated 1.7 billion adults that remained unbanked, majority of them live in developing countries, with around half residing in just seven countries – Bangladesh, China, India, Indonesia, Mexico, Nigeria and Pakistan (Demirgüç-Kunt et al., 2018).

In Nigeria, the first National Financial Inclusion Strategy (NFIS) was developed by the Federal Government in 2012. This is due to the need to boost access to credit (through the promotion of savings and investment) and bring more adults into the formal financial system. Targets were set around the strategy to enhance financial inclusion by improving access to financial services, encouraging usage, as well as the provision of affordable and appropriate products to all segments of the society. Others objectives include increasing financial literacy, consumer protection and focus on gender issues (Central Bank of Nigeria, 2012).

In addition, non-interest (Islamic) banking was introduced in 2010, and the first full-fledged Islamic bank started operations in 2012. The objective was to broaden financial inclusion by providing alternative financial products and services into the banking industry. Specifically, it was aimed at addressing the financial needs of the Muslims, as well as other individuals that require alternative / ethical forms of financing. This is due to the believe that some Muslims voluntarily exclude themselves from accessing conventional financial products and services because they are interest-based (Kama & Adigun, 2013).

Prior to that, in 2005, the Regulatory and Supervisory Framework for Microfinance was issued by the CBN. The Framework is to “enhance the provision of diversified microfinance services on a long-term, sustainable basis for the poor and low-income groups” (Central Bank of Nigeria, 2005). In 2017, the CBN issued the Guidelines on the Regulation and Supervision of Non-interest (Islamic) Microfinance Banks (NIMFBs) in Nigeria, to ensure fairness between conventional and NIMFBs. It is expected to accelerate financial inclusion by targeting the poor and low-income that were yet to be integrated into the formal financial system through the conventional commercial banks or MFBs (Central Bank of Nigeria, 2017). All these were expected to increase the level of financial inclusion in the country, especially in areas that are highly excluded, such as the northern part of the country that is predominantly Muslim.

The combination of these, and other policies and programs had helped in enhancing financial inclusion in Nigeria. Between 2010 and 2018, the percentage of adults using formal financial services grew from 36.3% to 48.7%. The percentage of adults using formal savings and fund transfer products also improved within the period. Nevertheless, challenges still remain in the provision credit facilities, pension and insurance. Other challenges include the regional imbalance in the provision and usage of formal financial services in the country. To address these challenges, the CBN and other stakeholders had intensified efforts to expand access to formal financial services through increased financial literacy, promoting a conducive environment for the expansion of digital financial channels, provision of stable regulatory and supervisory environment, and continued engagement and collaboration among all the stakeholders in the financial space.

1.2 STATEMENT OF THE PROBLEM

The main objective of financial inclusion is to provide access to an array of financial services - credit, savings, insurance, pension and money transfers. This is done through a variety of financial institutions including commercial, merchant, microfinance banks, as well as other financial institutions that provide alternative forms of financial products and services, including non-interest (Islamic) banks and microfinance banks. Due to this realization, the CBN has developed a number of policies and programs to enhance financial inclusion in Nigeria. These include the adoption of the National Financial Inclusion Strategy, the introduction of non-interest (Islamic) banking, the review of the policies and guidelines on the operations of microfinance banks, and the introduction of Islamic microfinance banks.

Consequently, a moderate level of success was recorded in increasing the level of financial inclusion across the country. The level of financial inclusion, measured by the number of adults using formal financial services in Nigeria, grew from 36.3 per cent in 2010 to 48.7 per cent in 2018. Around 14.5% were served informally, while 36.8% remained completely excluded from having access to financial services (Central Bank of Nigeria, 2018, 2019b). In terms of channels of access to financial services, the percentage adult population with payment and savings products rose from 22.0% and 24.0% in 2010 to 36.2% and 32.6% in 2018, respectively. However, these fall far below the set targets of 63.2% and 52.5%, respectively, for payments and savings products in the NFIS.

Despite the moderate success achieved, problems still remain. The level of access to, and use of formal financial services in Nigeria is considerably low, compared with the targets set in the NFIS document or its peers in Africa. The percentage of adults with credit, insurance and pension products in the country stood at 5.5%, 2.0%, and 8.5%, respectively. This gives an increase of 3.5, 1.0 and 3.5 percentage points, respectively, between 2010 and 2018. The numbers are also well below the 2020 targets of 40% each for credit, insurance and pension products. In terms of the number of microfinance bank branches per 100,000 adults, the number declined from 2.9 in 2010 to 0.9 in 2018, and is also below the 2020 target of 4.7 branches / 100,000 adults (Central Bank of Nigeria, 2019b). All these in the face of increasing adult population that require formal financial services. Also, among some of its peers in Africa, Nigeria lags behind. For instance, the level of exclusion was 7 per cent in South Africa (in 2018), 17 per cent in Kenya (in 2016), 22 per cent in Uganda (in 2017), and 22 per cent in Namibia (in 2017), compared with about 36% total exclusion rate in Nigeria. Demirgüç-Kunt et al. (2018) reported that about half of those lacking access to formal finance (using account ownership as proxy) in developing countries reside in seven countries, among which is Nigeria, where four per cent of those financially excluded globally reside.

Another challenge is the regional disparity in the level of financial inclusion in Nigeria. Northern Nigeria, which is predominantly Muslim, is behind its southern counterpart in the accessing and usage of formal financial services. In the south-east, south-south and south-west, more than half of their adult population (59.0, 55.0 and 78.0 percent, respectively) were accessing formal financial services by end-2016. In the north-west, north-east and north-central, however, only 24.0, 25.0 and 48.0 percent, respectively, were accessing formal financial services in 2016. Furthermore, only 33 per cent of adults in north-east and north-west (combined) are financially included (Central Bank of Nigeria, 2019b). Thus, while 36% of Nigerian adults are excluded from accessing formal services, 55% and 62% are excluded in the north-east and north-west, respectively. This is far above the national average.

This study therefore thus focused on the two most excluded regions (Northwest and Northeast) by selecting Kano and Katsina States (North West) and Bauchi (North East). There are seven states in the Northwest, with Kano and Kano being the most financially excluded in the region (75.2%) and Katsina the third most financially excluded (64.0%) in the Region. Bauchi state, on the other hand, has the second highest level of financial exclusion in Northeast (at 60.8%). At the national level, Kano, Katsina and Bauchi ranked second, fourth and fifth, respectively (EFInA, 2018). As a result, the CBN regarded the north-east and north-west geo-political zones among the five most financially excluded groups during the review of the implementation of the National Financial Inclusion Strategy (Central Bank of Nigeria, 2018).