



**AN EMPIRICAL STUDY ON THE VIABILITY OF
ISLAMIC BANKING SYSTEM IN NIGERIA: A
CASE STUDY OF LAGOS STATE**

BY

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ABSTRACT

The Nigerian Banking and Other Financial Institutions Decree (BOFID No.25) of 1991 has been amended to permit banking transactions based on Profit and Loss Sharing (PLS) arrangement, but yet there is no single Islamic Bank in Nigeria. All efforts by both the regulators and the bankers to establish Islamic Banking system in Nigeria have become unrealizable because of certain unclear factors. This study was conducted to critically analyze the viability of Islamic banking system in Nigeria taking Lagos State as a case study. In making the study, dimensions of viability that includes Market, Economic, Financial, Business, Political and Social viability and their components such as interest, desire, awareness, attitude, perception, preferences, acceptance, business, social and political inclinations were investigated using three sets of questionnaires that were directed to five groups of respondents namely, potential individual customers, business entities, government agencies, professionals in the banking sector and regulators of the Nigerian banking industry. The data gathered for this research were sufficient and adequate for the analyses conducted. Using descriptive statistics, parametric and other non-parametric statistical techniques, it was found that religious sentiments, wrong perceptions and poor public awareness were the key factors that hindered the establishment of Islamic Banking. Other factors such as acceptance to participate, interest to bank, competence and attitude of the regulators and services providers, and economic instability also affect the overall viability of Islamic Banking system. This study gives some implications for some issues like taxation, regulatory framework and the two approaches in establishing Islamic Banking systems; i.e. full pledge and window schemes to be adopted in Nigeria.

خلاصة البحث

قد وافقت المصرفية النيجيرية والمؤسسات المالية الأخرى بمرسومها رقم 25 الصادرة في العام 1991 على ممارسة المعاملات المصرفية على أساس تقاسم الأرباح والخسائر، ومع ذلك فإن تأسيس نظام المصرفية الإسلامية لما لم يتحقق بعد. وبالرغم من كل الجهود من قبل المنظمين والمصرفيين لتأسيس النظام المصرفي الإسلامي في نيجيريا لم يتحقق بسبب عوامل معينة. وقد أجريت هذه الدراسة لتحليل قابلية النظام المصرفي الإسلامي في نيجيريا، لاغوس نموذجاً. ولأجل البحث عن العوامل التي تؤثر على إمكانية نجاح الأسواق وقابليتها الاقتصادية والمالية والتجارية والسياسة والحياة الاجتماعية بما فيها العناية والرغبة والوعي والموقف والإدراك والخيار والقبول ونوع العمل والميول الاجتماعية والسياسية، فقد استخدمت الدراسة ثلاثة استبيانات موجهة إلى خمسة مجموعات من المشاركين تشمل أفراد الزبائن المحتملين، والكيانات التجارية، والوكالات الحكومية، والمهنيين في المؤسسات المصرفية، والمنظمين في الصناعة المصرفية النيجيرية. وكانت معلومات الدراسة كافية ودقيقة لإبراز الطريقة المثلى الملائمة لتأسيس نظام المصرفية الإسلامية. وباستخدام المنهج الوصفي بالإضافة إلى أساليب إحصائية غير بارامترية أخرى تبين الدراسة أن المشاعر الدينية والتصورات الخاطئة والتوعية العامة الضعيفة هي العوامل الرئيسية التي تعوق تأسيس البنوك الإسلامية. والعوامل الأخرى مثل عزوف المشاركين وعدم رغبتهم في البنوك وموقف المنظمين ومقدمي الخدمات وكفاءاتهم، وعدم الاستقرار الاقتصادي وغيرها أيضاً تؤثر على إمكانية تطبيق نظام المصرفية الإسلامية في نيجيريا. وتقدم هذه الدراسة آثاراً على القضايا الضريبية والإطار التنظيمي وطريقي تأسيس نظام المصرفية الإسلامية: أي تأسيس نظام المصرفية الإسلامية الكاملة والنظام المصغر (أي ممارسة المصرفية الإسلامية جزئياً).

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DECLARATION

I hereby declare that this thesis 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.

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.....

Date

This thesis is dedicated to my children; Ahmad, Muhammad, Abdul-Hakeem, Safiya and to those that Allah (S.W.T) in his infinite mercy may give me later, so that it will serve as an inspiration and a legacy for them to copy in the future.

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LIST OF ABBREVIATIONS

AAOIFI	Accounting and Auditing Organisation for Islamic Financial Institutions
ABC	African Banking Corporation
AU	African Union
BBWA	Bank for British West Africa
BNM	Bank Negara Malaysia
BOFID	Banks and Other Financial Institutions Decree
CBN	Central Bank of Nigeria
CIA	Central Intelligent Agency
CITA	Companies Income Tax Act
ECOWAS	Economic Community of West African States
EFCC	Economic and Financial Crime Commission
FA	Factor Analysis
FBN	First Bank of Nigeria
FBIR	Federal Board of Inland Revenue
FIRS	Federal Inland Revenue Services
GDP	Gross Domestic Product
GOVT	Government
HNB	Habib Nigeria Bank
IAS	International Accounting Standards
IDB	Islamic Development Bank
IFC	International Finance Corporation

IFIs	Islamic Financial Institutions
IFSB	Islamic Financial Services Board
JNI	Jama'atul Nasrul Islam
KYC	Know Your Customer
LCC	Lagos City Council
MOF	Ministry of Finance
NDIC	Nigerian Deposit Insurance Corporation
NDLEA	Nigerian Drugs Laws Enforcement Agency
NPC	National Population Commission
OIC	Organization of the Islamic Conference
OPEC	Organization of the Petroleum Exploration Countries
PANAS	Positive and Negative Affect Scale
PCA	Principal Component Analysis
PDP	Peoples Democratic Party
PLC	Public Listed Company
SAP	Structural Adjustment Program
SAS	Statement of Accounting Standards
SEC	Securities and Exchange Commission
SRR	Statutory Reserve Requirement
UK	United Kingdom
UN	United Nation
US	United States
VAT	Value Added Tax
WHT	Withholding Tax

LIST OF SYMBOLS

b	Billion
k	Thousands
m	Million
\$	US Dollar
N/ N	Naira (Nigerian currency)
%	Percentage
&	And
i.e.	That is

DEFINITIONS OF TERMS

- i. ***Shari'ah***- Islamic laws, which govern the personal and public life of a Muslims and their communities.
- ii. ***Halal*** – means lawful and permissible things according to Shari'ah. It refers to all the transactions and actions sanctioned by the Islamic law.
- iii. ***Musharakah*** - A type of partnership between two or more parties that combined either their capital or labour or creditworthiness together, and agreed to share the profits, enjoying similar rights and liabilities arising from that partnership at an agreed sharing ratio. But this definition does not cover both types of Shirkah as it covers only Shirkah in its commercial usage and tends to forget another type of Shirkah, i.e. shirk at al-mulk (partnership in ownership).
- iv. ***Mudabarah*** – A type of partnership where one party supplies the capital and the other the labour. The person who owns the capital is called “*rabbul mal*” (the owner of the capital) and the person who performs the works is called the *mudarib* (workman).
- v. ***Murabaha*** – means a contract for purchase and resale that allows the customer to make purchases without having to take out a loan and pay interest. The Islamic bank purchases the goods for the customer and re-sells them to him on a deferred basis adding an agreed profit margin. The customer then pays the sale price for the goods over installments, effectively obtaining credit without paying interest.
- vi. ***Ijarah*** – Is a form of leasing .It involves a contract where the bank buys and then leases an item to a customer for a specified rental over a period. The

duration of the lease as well as the basis for rental are set and agreed in advance.

- vii. ***Ijarah Wa – Iqtina (hire purchase)***: - It is the agreement between the bank and its clients.
- viii. ***Qard*** – It is a loan, free of profit .In essence, it means that the customer ‘s current account is a loan to the bank , which is used by the bank for investment and other purposes .And it has to be paid back to the customer, in full, on demand.
- ix. ***Qard- al-hasana*** – This is an interest free loan .It means lending to a needy person gratuitously without expecting any return, except the exact amount lent. Since Qard al-hasana has no return to the lender, the Shari’ah provided for the security for the loan.
- x. ***Bai Salam*** – This is a type of sale in Islamic banking in which the price of an item is paid at a time of contract but the object of sale becomes due as debt in kind.
- xi. ***Bai Mu’ajjal*** – This is a type of sale in Islamic banking in which the object of sale is delivered at the contract time but the price becomes due as debt. It refers to such sale in which delivery is spot while payment is deferred but cost is not known.
- xii. ***Istisna’a*** – This is a type of sale in Islamic banking in which the price of an item is paid at the time of contract and the object of sale is manufactured.
- xiii. ***Takaful*** - Islamic insurance provided under the principle of mutual support and help among participants
- xiv. ***Tabarru’*** - A gift or sadaqah

- xv. **Gharar** - Deception involving the deliberate creation of, or exploitation of, or uncertainty in the contract of business
- xvi. **Maqasid Shari'ah** – Essence or Objectives of Shari'ah
- xvii. **Maysir** – Gambling and betting
- xviii. **Riba** - An addition or excess in the principal of a loan or exchange of ribawi items.
- xix. **Wakalah** - Agency
- xx. **Ujrah** : means commission or token
- xxi. **Bai Musawamah**: It refers to normal sale in which cost price is not known.
- xxii. **Bai Muqayada**: It refers to barter sale excluding currency sale.
- xxiii. **Bai Surf**: It refers to the sale of gold, silver and currency.
- xxiv. **Bai Muajjal**: It refers to such sale in which payment is delivery is spot while payment is deferred but cost is not known.

CHAPTER 1

INTRODUCTION

1.0 INTRODUCTION

Islam has enunciated a number of moral, social, economic and institutional reforms to help in realizing its goal of shaping the entire life style of mankind, including their general welfare and socio-economic justice, all of these reforms were built into the economic system of Islam as its integral part. The prohibition of *Riba* (interest) is one of these reforms. After colonization, Muslim dominated countries were therefore faced with challenges of how to design and run an economic and financial system that is accordance with Islamic ideology, eliminate *Riba* and help realize the socio-economic goals of *Shari'ah*. In an effort to achieve these goals, Islamic Banks, Islamic Capital Markets and Takaful companies were therefore initiated and set up as an alternative to the conventional (interest based) ones. Muslims depositors and investors with strong believe and understanding of the incongruent nature of *Riba* in Islam got the opportunity of depositing and investing their surplus funds in Islamic banks or *Shari'ah* compliant investment.

While there is no prohibition on the accumulation of wealth in Islam, it was commanded and considered sinful to do so at the expense of the poor as wealth is considered as trust and a test to the mankind from Allah (S.W.T). Failure to use it wisely, especially to reduce the hardship of the poor is detrimental to the person that holds that wealth. Islamic Financial Institutions therefore, are institutions involved in the mobilization of savings/funds, the struggle against hiding and channeling of these

savings/funds towards investment to serve the Muslim *Ummah* and the society in a way compatible with the principles of the *Shari'ah*.

The history of modern banking functions among Muslims started since the time of the Abbasid caliph Al-Muqtadir (295-320 AH or 908-933 AC) in which Muslims had their own markets and fulfilled most of the banking needs of commerce, industry and agriculture within the constraints of the then prevailing technological environment. The extensive mobilization of savings and their accessibility to businessmen provided a great boost to the growth of output and trade from Morocco and Spain in the west, to India and China in the East, Central Asia in the North and Africa in the South (Chapra, 1985).

Today, there are so many Islamic banks and other Islamic financial institutions all over the world. Although, the Islamic banking is still in its infancy stage compared to the conventional banking, there had been rapid development of the Islamic banks as well as the proliferation of Islamic financial institutions in over 50 countries. These institutions are managing funds of over 1.6 trillion US dollars and have an annual growth rate of about 15-16%. Due to this impact, which the Islamic banking is making in the global financial system, there is growing interest by the conventional banks to participate in the Islamic financial system globally. This impact is felt not only in countries with predominant Muslim population but also in Europe, Australia and America. Both Muslims and non-Muslims patronize these Islamic banking products because, perhaps, people had recognized the fairness and benefits of the system.

This growing interest in Islamic banking is reflected in recent mergers between Islamic banks and conventional banks. In the year 2000, for instance, there was a merger between Badar Islamic Bank and Forte Bank in Russia; Citibank opened Islamic bank in Bahrain as a wholly owned subsidiary. Moreover, many conventional