

ISSN 115 - 960X



Ilorin Journal of Business and Social Sciences

Volume 19, No 1

October, 2017

*Published by the Faculty of Social Sciences,
University of Ilorin, P.M.B. 1515, Ilorin, Nigeria*

Contents

	Pages
Catalyzing Women's Participation in Post-insurgency Peace Process in North-east Nigeria: The Import of Domesticating Resolution 1325 Gbemisola Animasawun	1-17
The Nexus Between Agricultural Capital Expenditure and Economic Growth in Nigeria. Oyerinola, David Sunday Abayomi, Muftau Adesina Alabi, Salihu Otubu	18-29
The Imperatives of Comparative Public Administration and New Public Management in a Changing Global Environment Adewale K. Kupoluyi Taiye A. Awotunde Abdulrahman Abubakar	30-47
Legislative Turnover and Lawmaking Effectiveness in Kogi State House of Assembly, 1999-2015 Asimiyu Olalekan MURANA Abdulrauf AMBALI Adebola Rafiu BAKARE	48-66
Impact of Human Capital Development on Economic Growth in Nigeria (1980-2012) Oyerinola, David Sunday Abayomi, Muftau Adesina Alabi, Salihu Otubu	67-78
Power Relations between State and Local Governments as Predictor for Poor Healthcare Delivery System in Kwara State ABDULLAHI, Alabi ISIAQ, Atanda Abdulwaheed ABDULQADRI, Toyin Nafiu	79-96
Weather Induced Flood and Food Security in Ifelodun Local Government Area, Osun State, Nigeria Adeleke, E. A Tilakasiri, S. L. Lateef, T. B.	97-112
The Prospects and Challenges of Operating an Islamic Banking System in Nigeria: A Case Study of Jaiz Bank Plc Alabi, Moshood Kolawole	113-131

THE PROSPECTS AND CHALLENGES OF OPERATING AN ISLAMIC BANKING SYSTEM IN NIGERIA: A CASE STUDY OF JAIZ BANK PLC

Alabi, Moshood Kolawole
Department of Economics,
University of Ilorin.
Alabi.mk@unilorin.edu.ng

Abstract

This paper examines the prospects and challenges of operating an Islamic (Non-Interest) Banking System in Nigeria with an in depth focus on Jaiz Bank Plc, the first and only Islamic bank in Nigeria. A look at the performance of Islamic banks across the globe revealed that it has the potential of guaranteeing financial inclusion for more Nigerians, providing alternative financial products and services which are ethical, ensuring stability in the Financial Sector and attracting huge Foreign Direct Investments. Indeed, the Jaiz Bank experience has been able to achieve that. Even though Jaiz bank and indeed other Islamic banks are going to be faced with stiff competition and several challenges like dearth of manpower, inadequate Shari'ah-compliant liquidity management instruments and a lack of knowledge of Islamic Finance, Accounting and Auditing standards, these challenges are however surmountable. The CBN and Islamic bank promoters must embark upon massive public awareness encourage Human Capital Development in Islamic finance and chart ways of fully integrating and accommodating the Islamic banks and their products into the Nigerian financial market.

Keywords: Islamic Bank, Non-interest Financial Institutions, Return on Assets, Sukuk,

Introduction

Islamic banking refers to a system of banking or banking activity that is consistent with Islamic law (Shariah) principles and guided by Islamic economics. It is an interest-free form of banking which transacts banking business, engages in trading, investment and commercial activities, as well as providing financial products and services in accordance with the principles and rules of Islamic jurisprudence (Akinyemi, 2011).

Islamic banking is an area that has mushroomed to become an increasingly substantial segment within the global financial market. It has been recognised as a viable and competitive form of financial intermediation not only in Muslim countries but also outside the Muslim world and offering a wide range of financial products and services. The industry that started on a modest scale since its inception in the mid-1970s has shown a rapid expansion and evolution over the past five decades. It is in fact one of the fastest

growing industries, having posted double-digit annual growth rates for almost 30 years (Iqbal and Molyneux, 2005). Indeed, the industry is witnessing tremendous growth both in terms of assets and geographical spread. Today, more than 300 Islamic finance institutions, with assets worth \$2.293 trillion as at the end of December 2016 (Global Islamic Finance Report, GIFR, 2017), are spread across 50 economies around the world in both Muslim and non-Muslim countries.

The Islamic banking sector, which is the dominant component of the Islamic finance industry, has grown dramatically since the first known experiment started in the Egyptian village of Mit Ghamr in 1963. It boasts of assets worth \$1.5 trillion (Islamic Financial Services Board Report IFSB, 2016). Other sectors of the Islamic finance industry like the Global Sukuk outstanding stood at \$290.6 billion, Islamic funds' assets at \$71.3 billion and The Takaful sector at \$23.2 billion (IFSB, 2016). It is offered in major financial centres including UK, Luxembourg, Singapore, Hong Kong, Malaysia, UAE, Bahrain, South Africa, and it has become a part of the services of major western financial institutions such as HSBC, Deutsche Bank, Citigroup, and Standard Chartered. Its asset portfolios are tracked by major index providers such as Dow Jones Islamic (as early as 1999), NASDAQ, MSCI Emerging Market Islamic and FTSE.

The history of Islamic banking, otherwise known as interest-free banking, in Nigeria can be traced back to 1990 when former Habib Nigeria Bank Limited (now KeystoneBank) applied and got approval to open an Islamic banking window. The Bank however commenced this service in 1999. In 2004, Jaiz International Bank Plc applied for a full-fledged Islamic banking license and was granted approval in principle, AIP, to that effect. However, it could not meet up with the new capital requirement of N25 billion; hence it was unable to commence operation then. Other banks like Stanbic IBTC Plc, the former Intercontinental Bank (now Access bank), UBA and Standard Chartered were also given approval to open Islamic banking windows (Umar, 2011; Usman, 2003). In April, 2010, the first full-fledged Islamic Microfinance bank, Al-Barakah Microfinance commenced operations in Lagos (Mohammed, 2010). Finally, on the 6th of January, 2012, history was made as Jaiz Bank Plc, the first full-fledged Islamic Commercial Bank in Nigeria, commenced operation from three branches in Abuja, Kaduna and Kano.

Some researchers have argued that Islamic financial institutions are a viable alternative to promote economic growth and are better-suited to absorb macro-financial shocks because of structural advantages over the conventional banking model (Dridi and Hasan, 2010; Ebrahim and Safadi, 1995; Khan, 1986; and Mills and Presley, 1999). Wilson (1990) remarked that it was the success of Islamic banking that compelled many commercial banks to provide Islamic banking products to their clients.

On the other hand, El-Gamal (2005) and others have concluded that Islamic finance

simply seeks to replicate the functions of conventional financial instruments and is primarily a form of rent-seeking legal arbitrage. Meanwhile, Beng and Ming (2006), revealed that Islamic banking, as it is practiced today in Malaysia, is not very different from conventional banking, and the alleged benefits of Islamic banking exist in theory only.

In June, 2011, the Central Bank of Nigeria (CBN) rolled out its Non-Interest Banking Guidelines alongside the fact that it had licensed JAIZ Bank to operate Islamic banking. However, this announcement was met with mixed reactions. While a few supported the introduction, majority kicked against it. Little thought was given by the different parties over the basic idea behind the Islamic (non-interest) system of banking and the gains the country could derive from it (Okeke and Ojukwu, 2012).

It is against this backdrop that this paper seeks to explain what Islamic banking stands for as well as the benefits which Nigeria stands to derive from its practice. Specifically, this study sets out to provide answers to the following research questions: (a). What are the Salient features and products of an Islamic Banking System? (b). What are the Benefits and Challenges to be faced in operating this system in Nigeria? The objectives of the study are to: (a). highlight the Basic Principles, Products and Services of Islamic Banks (b). examine the Benefits and Challenges of practicing Islamic Banking in Nigeria with emphasis on the performance of Jaiz Bank Plc. (2012-2017)

Conceptual Framework

Meaning of Interest: Interest which is also known as 'Riba' or 'Usury' refers to the premium that must be paid by the borrower to the lender along with the principal amount as a condition for the loan or for an extension in its maturity (Abdullah, 2010). According to Keynes' Liquidity Preference theory of Interest, he defined the rate of interest as the reward for not hoarding but the reward for parting with liquidity for the specified period and that this rate is determined by the demand for and supply of money (Jhingan, 2002). Meanwhile the Loanable funds theory views it as the price which equates the supply of credit to the demand for it and it is determined by the demand and supply of loanable funds (Jhingan, 2002). Austrian-born Economist, Bohm-Bawerk built upon the Time Preference theory of Interest. He tried to explain interest from the concept of technical superiority of the present over the future as well as the time value of money. He said because an average person prefers the present to the future, if he is required to forgo his present comfort or use of his funds then he is entitled to have some remuneration known as interest. In this case, time is treated as a type of commodity which has a price (Saad, 2003).

Basis for Charging Interest: Interest rate has been used over the centuries and is still being used as an important monetary policy instrument by national governments or Central Banks. It is used in controlling the amount of money in circulation. The key role of

interest as argued by proponents of conventional banking is that it encourages efficient and effective allocation of funds through increased savings and borrowing amongst the people. It is said to be the reward for money kept or lent to someone for whatever purpose; either consumption or production.

A Critique of Interest Rates

The interest-based system was generally assumed to be superior to the interest-free system on the criterion of efficiency. It was, however, considered to be inferior on the criterion of equity or socio-economic justice (Stiglitz, 2003). The persistent instability and crises to which the international financial system has become exposed over the last few decades and the problems it has created have, however, raised doubts about its superiority on the efficiency criterion. There is not a single geographical area or major country which has been spared the effect of these crises. Hence there is an uneasy feeling that "something is wrong with the global financial system" (Chapra, 2009).

The bursting of the Housing bubble and the high default rate in the sub-prime mortgage lending which led to the 2007 financial crisis has had two main effects in the United States. Firstly, the banks have become less willing to lend money, driving up the price of borrowing. The value of bonds issued worldwide against mortgages, for example, crashed from \$1.9 billion to \$500m in the year 2008. Secondly, some financial institutions have been devastated - most importantly the private finance initiative (PFI) industry (Cecchetti, 2008a). The third world has also not been spared. Many economists and commentators have highlighted the causes of credit crisis due to lack of proper regulation, legislation and transparency (Cecchetti, 2008b; Adrian and Shin, 2008; Goodhart, 2008). Furthermore, the credit crunch has also brought to the fore, the fragility of capitalism and the free-market economy. Islamic economists (Siddiqui, 2009; Chapra, 2009) continually refer to the global economic crisis as a fall out of charging interest rates (Riba) right from the time of the Great depression to the crisis in the western countries. Unemployment, Inflation, Huge budgetary imbalances, excessive monetary expansion, large balance of payments deficits, Poverty amidst plenty, insufficient foreign aid, inadequate international cooperation and increasing inequality can all be related to the flaws in the theory of interest (Chapra, 2000).

It is these weaknesses of the interest-based financial system which creates a strong rationale for the introduction of a new architecture for the international financial system- Islamic banking and Finance. Islamic banking tries to remove interest and introduce in its place the principle of risk-reward sharing. Core principles of an Islamic Financial system are justice, equity and welfare. Islamic economics seeks to establish a broad-based economic well-being with a high rate of employment and economic growth and at the same time providing socio-economic justice and equitable distribution of income and wealth (Chapra, 2000). Islamic finance has the potential for further contributions in at

least three dimensions. First, it promises to foster greater financial inclusion, especially of large underserved Muslim populations. Second, its emphasis on asset-backed financing and risk-sharing feature means that it could provide support for small and medium-sized enterprises (SME); as well as investment in public infrastructure. Finally, its risk-sharing features and prohibition of speculation suggest that Islamic finance may, in principle, pose less systemic risk than conventional finance (Kammer, A. et al., 2015).

Empirical Evidence

A number of empirical studies have revealed the profitability of Islamic banking business in different countries. The performance of Islamic banks has been judged by using different key ratios like profitability ratios, liquidity ratios, risk and solvency ratios (Sarker, 1999; Samad and Kabir, 1999). For example, Iqbal (2001) made trend analysis to depict the overall performance of the Islamic banks as compared to the conventional banks. According to him, Islamic banks in general are fairly stable, profitable and well capitalised. Their profitability ratios compare favourably with international standards in banking.

According to the Islamic Finance Services Industry Stability report (2016), an assessment of the Islamic banking industry performance was carried out for the period 2008–2014 while making use of a sample of 59 Islamic banks in 11 major Islamic banking markets. The total assets of these sample banks amounted to \$672.2 billion which represents 71.6% of the total Islamic banking assets. The banks remained well capitalised above the regulatory minimum requirements. The average total capital was 16.40%. The average return on assets (ROA) and return on equity (ROE) was 0.95% and 8.96% for 2014 respectively as against the 0.89% and 8.89% respectively for 2013. These banks fared much better than a sample of 32 global banks whose ROE fell from 7.2% in 2010 to 5.8% in 2014 (IFSB, 2016).

Hassan and Dridi (2010) examined the performance of Islamic banks and conventional banks during the recent global crisis by looking at the impact of the crisis on profitability, credit and asset growth, and external ratings in a group of countries where the two types of banks have significant market share. Their analysis suggested that Islamic Banks were affected differently unlike the Conventional Banks. Factors related to Islamic Banks' business model helped limit the adverse impact on profitability in 2008. Their credit and asset growth performed better, thus contributing to financial and economic stability than those of Conventional Banks in 2008–2009. External rating agencies' re-assessment of Islamic Banks' risk was generally more favourable. In their own studies, Imam and Kpodar (2015) established a positive link between Islamic banking and its impact on financial inclusion and economic development.

Samad and Kabir (1999) evaluated the performance of Islamic banks in Malaysia in terms

of its profitability, liquidity, risk and solvency. Financial ratios were applied to measure these performances. A comparison between the Islamic banks and eight other conventional banks was also made. The study revealed that Islamic banks made significant progress on return on assets and return on equity during 1984–1997. The comparison of Islamic banks and the group of eight conventional banks revealed that there was no difference in economic participation between them. Sarker (1999) used "Banking Efficiency Model" to judge the performance of Islamic banking in Bangladesh. He concluded that Islamic banks could operate with certain level of efficiency even within the presence of conventional banking.

Alam (2000) undertook a case study to examine the contribution of Islamic Bank of Bangladesh Limited (IBBL) towards small and rural sector. The study revealed that IBBL succeeded in attracting both deposits and investment positions since it started its activities. By far the most impressive argument in favour of Islamic finance has been that it integrates the financial sector with the real sector. The debt-propelled conventional system fails to do so. In the Islamic financial system there is an existing or potential real asset corresponding to every financial asset. Not so in the conventional system in which financial assets based on or derived from other debt-based financial assets go on multiplying, making the system more vulnerable to speculation, leading to instability. Instability originating in the financial sector spreads to the real sector affecting balance of payments, employment, production and living standards. Another great argument in favour of Islamic finance is its possible contribution to stability (Siddiqi, 1983). It was shown that a financial system based on profit sharing will be more stable than one dominated by debts. This was an addition to the earlier argument in favour of an interest-free system based on profit-sharing that focused on justice and fairness, one that had more resonance in a world experiencing great instability (Abdul Gafar, 2011).

The Basic Principles and Products of an Islamic Banking System

- i. **Prohibition of Interest:** The most essential feature of Islamic banking is that it is interest-free. Islamic banks neither charge nor pay interest. Islam prohibits Muslims from taking or giving interest (i.e. *riba* or *usury*) regardless of the purpose for which such loans are made and regardless of the rates at which interest is charged. The prohibition of *riba* is mentioned in four different revelations in the Qur'an, viz: Surah al-Rum Chapter 30, verse 39; Surah al-Nisa Chapter 4, verse 161; Surah al-Imran Chapter 3, verses 130–132; and Surah al-Baqarah Chapter 2, verses 275–281. Interest is equally prohibited in the Holy Bible: Exodus 22: 25–27 and Leviticus 25: 35–38.
- ii. **Profit and Loss Sharing:** A basic principle of Islamic banking is the *Mudarabah* also known as Profit and Loss sharing Agreement. Profit is lawful in Islam. The Islamic bank's primary objective is to earn profit. Economic Agents involved in any financial transaction must share from the associated profit and loss of the transaction entered into.

Equally, the profit and loss sharing ratio should be spelt out at the onset.

iii. **Ban on Uncertainty:** Uncertainty in terms and conditions of all transactions is prohibited and should not be allowed. All the terms and conditions of the associated profit and loss should not only be clearly spelt out at the take-off of the business but be thoroughly understood by all parties to the financial transaction

iv. **Prohibition of Unethical Investments:** Islamic Banks are prohibited from financing or investing in industries that are into the production of alcoholic drinks, gambling, pornography, haram products etc. This is because such activities are totally against the teachings of the Holy books and they fall short of the acceptable moral standard. Besides, these activities result in increased social vices in the society as against the engagement of resources in productive ventures.

v. **Asset-backed financial Transactions:** Investment activities of Islamic banks have been favourably skewed towards the real sectors of the various economies in which they operate. Their investment activities usually border on equity financing, trade financing and real estate investments. These transactions are always tied to tangible and identifiable assets. A legitimate mode of real sector financing recognized in Islam is one based on equity participation known as Musharakah in which the partners in a joint venture use their capital jointly to generate a surplus. Profits or losses will be shared between the partners according to some agreed formula depending on the equity ratio. Participatory financing is a unique feature of Islamic banking, and can offer responsible financing to socially and economically relevant development projects.

vi. **Low Consumer Lending:** Since Islamic banks do not charge interest rates, consumer loans are therefore unattractive because there is no profit to be derived in the form of interests on the loans. Hence, Islamic banks deliberately avoid consumer lending. However, while recognizing the need for such interest-free /benevolent loans known as qard hasan, especially for meeting basic needs, Islamic banks do set aside a small portion of bank loanable funds for such consumer loans.

Products and Services Offered by Islamic Banks

Like conventional banks, Islamic banks act as financial intermediaries by attracting funds from surplus lenders such as individuals and institutions and then channel them to firms which need to finance their productive activities. However, the difference between the conventional and Islamic banks lies in how these intermediary roles are performed. Below are the various products and services offered by Islamic banks:

Islamic Banks' Modes of Financing

Islamic banks adopt several modes of acquiring assets or financing projects. In the main,

they can all be broadly categorized into three: investment financing, trade financing and lending.

A. Investment Financing

i. **Musharakah (Joint Venture):** Musharakah is also known as Equity Participation or Partnership Finance. With Musharakah, two or more parties come together to provide finance for a given project. The partners work out and agree on modes of profit and loss sharing. However, losses are shared exactly in proportion to the capital controlled by each party. In the management of a project, all parties may participate while in some cases, some may forego their right for others.

ii. **Mudarabah (Profit-Sharing Agreement):** In a mudarabah arrangement, the contract is between A rabb-ul-mal (i.e. a Bank or financier) and A Mudarib (i.e. an Entrepreneur) whereby the bank provides the entire capital needed to finance a project, and the Entrepreneur customer provides the expertise, management and labour. Risk and rewards are shared. In the case of a profit, both parties receive their pre-agreed upon share of the profit. In the case of a loss, the rabb-ul-mal (Bank) bears the loss of capital while the Mudarib (Entrepreneur) loses his time and effort and goes unrewarded. Most theoretical models of Islamic banking are based on the mudarabah (profit-sharing) and/or musharakah (joint venture) concepts of Profit and Loss Sharing (Dar and Presley, 2000).

B. Trade Financing

i. **Murabahah (Mark-up Sale Contract):** This has been found to be the most popular technique of financing among Islamic banks. It is a mark-up or cost-plus based financing. In this method of financing, a client contracts a bank to finance the purchase of a certain commodity on his behalf and then resell it to him (the client) at a predetermined price that includes the original cost plus a negotiated profit margin. The client pays the price either lump sum or in instalments, at an agreed later basis.

ii. **Ijarah (Leasing):** Under this scheme, the bank purchases a real asset and leases it to a client for fixed monthly payments. As in conventional banking system, the period of lease may be determined by mutual agreement.

iii. **Salam (Forward Trade Contract):** It is a sale where the seller (Customer) undertakes to supply some specific goods to the buyer (Bank) at a future date that is agreed upon in exchange for an advanced price fully paid at spot. This mode of financing is widely used to finance the agricultural sector.

iv. **Istisna (Partnership in Manufacturing):** It means to order a manufacturer to manufacture a specific commodity for the purchaser at a fixed price which is agreed upon with the consent of both parties and that necessary specification of the commodity (intended to be manufactured) is fully settled between them. Istisna is widely used in the housing finance sector.

C. Lending Qard-e-Hasan (Interest-Free Loans):- The bank sets aside a part of its funds to grant interest-free loans to needy persons such as small farmers, entrepreneurs, producers, etc. and to needy students and consumers.

The Jaiz Bank Experience: Brief Background

Jaiz Bank Plc, Nigeria's first full-fledged Non-interest bank, is a national bank and a quoted public company owned by over 26,000 shareholders spread over the six geopolitical zones of Nigeria. The Banks balance sheet has grown from ₦12 billion naira in 2012 when it commenced operation to about ₦82 billion as at 2017. The banks customer base has risen to over 230,000 cutting across all strata of the society. Product offerings have also grown including savings account, current account, home and household finance, auto finance, lease finance and working capital finance. It had just 3 branches at inception but now it boasts of 30 branches spread across the country.

Assessing Jaiz Bank's Performance

Jaiz Bank has been in existence for 7 years. This study takes a look at the bank's performance over the last 6 years using the financial ratio analysis. There are two profitability ratios that are frequently used to measure a bank's overall performance and they are the Return on Assets ratio (ROA) and the Return on Equity ratio (ROE). Al-Tamimi (2006), Heffernan and Fu (2010) and Alper and Anbar (2011) made use of these same ratios in their studies. This study makes use of both ratios as indicators of the banks overall performance. The ROA is measured by dividing the bank's net profit after tax by its total assets. It represents the bank's ability to achieve returns on its operation by using its sources of fund. The ROE is measured by dividing the bank's net profit after tax by its total equity. It represents how much profit is generated from using shareholder funds.

Table 1: ROA and the ROE and other vital financial ratios of Jaiz bank

Financial Ratios	2012	2013	2014	2015	2016	2017
Return on Assets (ROA)	-0.052	-0.022	0.016	0.017	0.004	0.009
Return on Equity (ROE)	-0.072	-0.068	0.062	0.08	0.021	0.05
Liquidity	4.117	2.173	1.173	1.296	0.941	1.154
Leverage	0.228	0.289	0.372	0.342	0.4	0.435
Capitalisation	0.716	0.323	0.253	0.217	0.218	0.188
Operational Efficiency	9.106	2.524	0.956	0.82	0.93	0.838
Staff Expenses	0.46	0.382	0.483	0.47	0.426	0.426
Asset Utilisation	0.009	0.027	0.065	0.084	0.073	0.058

Source: Authors calculation from the Annual Reports and Accounts of Jaiz Bank Plc., 2012 – 2017

Looking at the table above, we observe that in the first two years of the banks operation, they recorded loss. This is evidenced by the negative values obtained for the Return on Assets (ROA) and the Return on Equity (ROE). The bank broke even in 2014 as the ROA was 1.6% that year and it increased to 1.7% in 2015. However, it came down in 2016 to 0.4% and in 2017, it rose to 0.9%. Judging the banks performance while making use of the ROE also shows that the bank, after recording loss in 2012 and 2013, made ROE of 6.2% in 2014. It increased to 8% in 2015 but came down to 2.1% in 2016. In 2017, the ROE stood at 5%.

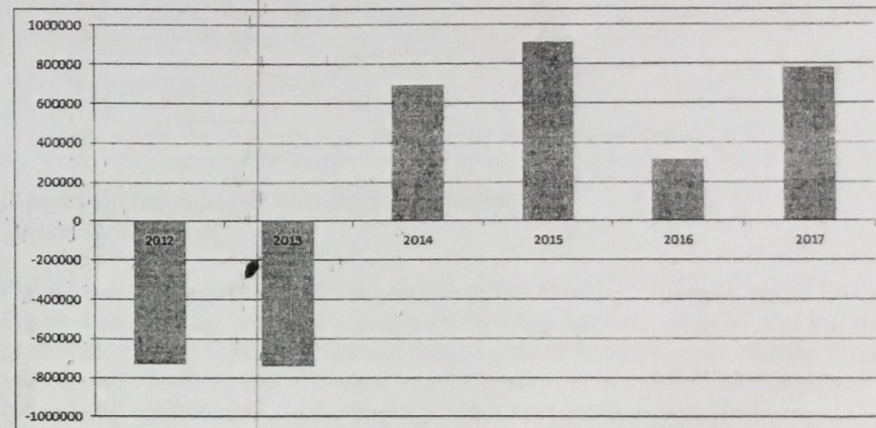


Figure 1: Net Profit After Tax N'000

Source: Authors extraction from various Annual reports and Accounts of Jaiz Bank Plc.

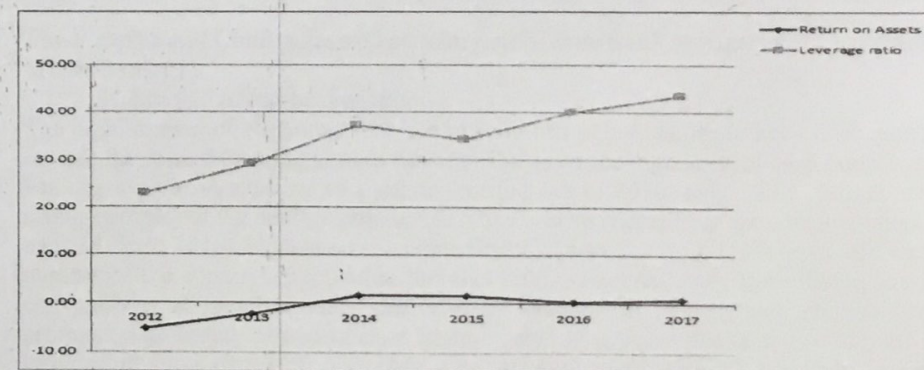


Figure 2: Relationship between ROA and Leverage

Source: Authors design

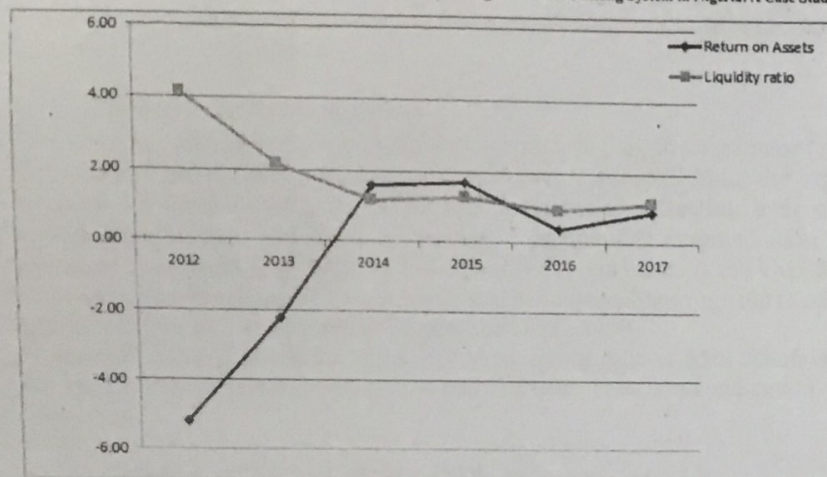


Figure 3: Relationship between ROA and Liquidity
Source: Authors design

Figures 2 and 3 show the relationship between Jaiz Banks ROA, leverage and liquidity. Figure 2 shows that there is a positive relationship between leverage and the Banks performance while figure 3 shows that there is a negative relationship between liquidity and the banks performance.

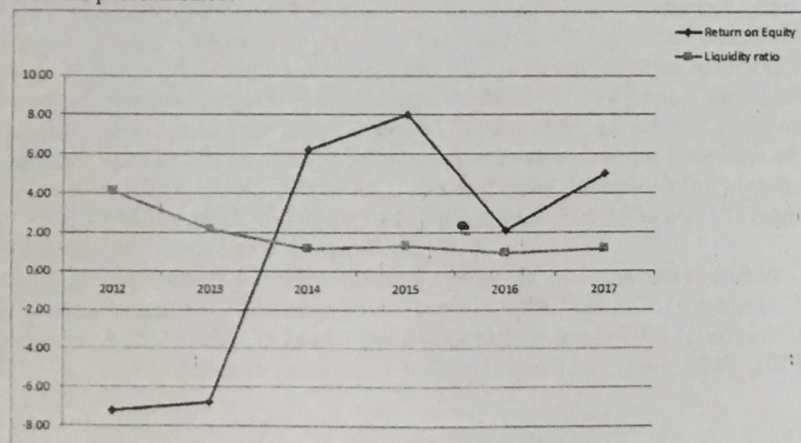


Figure 4: Relationship between ROE and Liquidity ratio
Source: Authors design

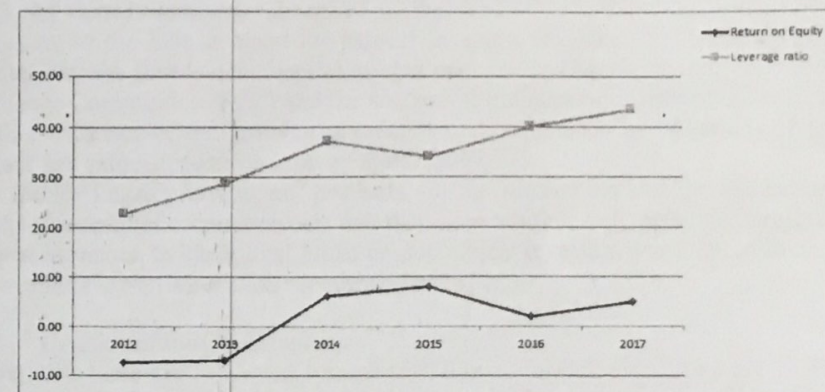


Figure 5: Relationship between ROE and leverage
Source: Authors design

Figures 4 and 5 show the relationship between Jaiz Banks ROE, liquidity and leverage. Figure 4 shows that there is a negative relationship between liquidity and the Banks performance while figure 5 shows that there is a positive relationship between leverage and the banks performance. The negative relationship between ROA, ROE and Liquidity is an indication that when excess liquidity is not invested it reduces the banks ability to generate more profit. The positive relationship between ROA, ROE and Leverage is a clear indication of the banks ability to utilize shareholders' money and turn it around to make profit.

The Benefits and Challenges of Operating an Islamic Bank in Nigeria: A Case Study of Jaiz Bank Plc.

i. It attracts the Non-banking Public

The high number of Nigerians who out of religious belief choose to keep their money outside the formal banking system has contributed to the high level of cash outside the banking system. According to a survey carried out in 2016, only 38.3% (about 36.9 million people) of the adult population in Nigeria have access to or use a deposit money bank (EFInA, 2016). Non-interest Islamic financial services would help bring in a large number of the country's population that had hitherto steered away from the organised conventional financial services due to their aversion to interest and interest-based products. The beauty of non-interest Islamic banking is that it does not discriminate in terms of religious affiliation, patronage, employment and ownership. It is simply a means of guaranteeing financial inclusion for more Nigerians.

Jaiz Bank started in 2012 with a customer deposit of ₦3.2 billion but by the end of 2017, the customer deposit had grown to ₦56.5 billion representing a growth of about 1618%.

The bank also boasts of having over 230,000 loyal customers spread across the length and breadth of Nigeria. (Jaiz Bank, 2017)

ii. Stability in the financial Sector

An interesting fall-out of the global financial crisis is the growing interest and demand for Islamic financial products and services across the world. Amid the crisis, Islamic financial institutions have displayed strong resilience reflecting their conservative approach to business and focus on the basics of financial intermediation. One of the Financial Soundness and Stability Indicators (FSIs) of banks is the Capital Adequacy Ratio. A system based on profit-sharing would be more stable compared to one based on a guaranteed interest rate on capital (Hassan and Dridi, 2010).

At the end of 2017, Jaiz Bank had a capital adequacy ratio of 33% which is three times above the 10% minimum regulatory requirement. This is an indication of financial soundness.

iii. Development of the Real Sector of the economy

According to Iqbal (2007), the essential characteristic of Islamic modes of financing is their direct and inseparable link to the real economy or physical transactions. The government's determination to revamp Nigeria's ailing infrastructure and the massive investment in such critical sectors as Power, Roads, Railways, etc as well as the emphasis on Public Private Partnership (PPP) offers opportunities for Islamic banks to participate using various Shariah-compliant financing modes especially the Sukuk (an Islamic investment certificate that shares some of the characteristics of conventional bonds). There would be enhanced investment in the critical sectors of the economy through the issuance of Sukuk. Currently in Nigeria, the Federal Government issued the debut sovereign sukuk of N100 billion in September 2017 with the intention of channelling the fund realised into road projects. According to the Minister of Finance, the sukuk which has a tenor of 7 years was oversubscribed to the tune of N105.87 billion (Debt Management Office, 2017). The global sukuk issuance reached a new high of \$290.6 billion in 2016 (IFSB, 2016). Malaysia is the dominant country in the global market, accounting for 46.4% while Indonesia and Saudi Arabia had 9.9% and 9% respectively (World Bank and Islamic Development Bank, 2016).

Jaiz Bank has consistently provided financial support to grow the real economy. In 2012, it provided finance of N1.2 billion, in 2013 it was N10.2 billion, in 2014 it was N21 billion, in 2015 it was N25.3 billion, in 2016 it was N35.3 billion and in 2017 it provided the sum of N35.6 billion as finance to develop the real economy. (Jaiz Bank, 2012, 2013, 2014, 2015, 2016, 2017)

iv. High Demand for Ethical Investments:-

There is a growing preference for ethical investments, products and services by discerning Muslims and None Muslims alike. During Jaiz Banks Initial Public Offer in

2003, its shares were oversubscribed to the tune of 115.98% (Jaiz Bank, 2012), a testimony to the high demand for Ethical Investments. Also, the licensing of Lotus Capital Plc, the first Islamic capital market operator in Nigeria, by the Securities and Exchange Commission (SEC) and the successful Initial Public Offer of the company is another evidence of the growing popularity and acceptance by Nigerians of Islamic finance as a value proposition (Lotus Capital, 2017).

Jaiz Bank's flagship investment products are the Musharaka and the Mudaraba. The Banks statement of account reveals that they have continuously generated profit for her Ethical investors. In 2012, total profit paid to ethical investors was N39.2million and it grew rapidly to N919.2 million as at the end of 2017.

v. Creation of Job Opportunities:-

In the UK, there are 5 Islamic commercial Banks, in Indonesia there are 13 Islamic commercial banks while in Malaysia, there are 16 Islamic commercial Banks (Bank Indonesia, 2016; Bank Negara Malaysia, 2016). These Banks have succeeded in creating jobs for several people; like in Indonesia, over 51,000 people have been employed and this does not include those working in Islamic windows of conventional banks (Bank Indonesia, 2016). Establishing Islamic banks in Nigeria will definitely follow suit. At present, Jaiz Bank already has 30 branches and has employed 593 workers (Jaiz Bank, 2017).

The Challenges facing Jaiz Bank Plc

i. Lack of Shariah-compliant Liquidity Management Instruments

Islamic banks cannot invest their excess liquidity in interest based instruments, which are the liquidity management instruments available in the market, and this places them at a competitive disadvantage with respect to their conventional counterparts. Also the current interbank market and the instruments used by the Central Bank of Nigeria for monetary policy operations are all interest based with no equivalent government securities or other money market instruments that are Shariah compliant, all of which are essential to avoid a liquidity bottleneck for Islamic banks when they come into operation. It is difficult for Islamic banks to manage liquidity risk with Islamic products where interest-free capital markets do not exist.

This is a major challenge to Jaiz Bank as they have to keep looking for ways to manage their liquidity. It is only when excess liquidity is invested that it can generate returns.

ii. Widespread ignorance about the true meaning of Islamic Banking

There is a lot of misperception about Islamic banking in Nigeria, and with the ethno religious diversity of Nigeria, it makes it imperative to create mass awareness and acceptance. Misinterpretation of the concept might jeopardise its success. According to Brown, Hassan and Skully (2007), many people do not understand Islamic banking; this includes both Muslims and non-Muslims. The fact that shari'a (Islamic jurisprudence) boards, which oversee the transactions in relation to the Qur'an, are often at the individual

bank level, can lead to many interpretations of what is and what is not a suitable 'Islamic transaction'.

Jaiz Bank, has a customer base that cuts across all strata of the society irrespective of religion, tribe, gender or status. However, more can still be done as we have a huge number of potential customers who think Jaiz Bank is for Muslims only.

iii. Dearth of Manpower and knowledge of Islamic Accounting and Auditing standards

The lack of Shariah scholars knowledgeable in conventional economics, law, accounting, banking and finance, places severe constraints on the regulatory Shariah compliance mechanism of Islamic banks. Eze and Chiejina (2011) identified this challenge to include lack of suitable trained staff that are able to perform adequate credit analysis on projects as well as suitable managers. There is the need to train conventional accountants and auditors in the application of accounting standards for Islamic Financial Institutions. These include accounting principles involving revenue realization, disclosures of accounting information, accounting bases, valuation, revenue and expense matching to Islamic banks and profit and loss shares attributable to depositors (Khan and Bhatti, 2008).

Jaiz Bank still lacks the much needed manpower that is highly skilled in the knowledge and practise of Islamic banking.

iv. Double Taxation

Double taxation refers to the tax that would be levied on Islamic banks as a result of stamp duties and capital gains tax that are deductible upon asset transfer. Islamic banks face a tremendous challenge in this respect because their financial intermediation is asset based. In home financing for example, the Islamic banks take possession of the asset either through sale or construction contract, and they pay stamp duty for that. When they resell the asset to a customer through a mark-up sale or a lease ending with ownership contract, another stamp duty is charged for the asset transfer. In countries like the UK and Luxembourg, they have modified their tax laws to exempt Islamic banks from double taxation on assets they acquire for financing purposes (Hassan and Lewis, 2007). Jaiz Bank continues to face this challenge of double taxation and this takes away part of their profit.

The Way Forward and Caution

Given all the challenges mentioned above, it should be stated that these challenges are however surmountable considering the relative importance of this sector to the economy. The Central Bank of Nigeria and the Promoters of Islamic Banking must take the following steps:

- 1) Embark on massive public awareness amongst all the key stakeholders.
- 2) Encourage the development of adequate Human Capital in the field of Islamic Finance.

3) Lay emphasis on good Corporate Governance which would ensure transparency and accountability.

4) The CBN alongside other financial regulators and operators must chart ways of fully integrating and accommodating the Islamic banks and their products in the Nigerian Financial Market.

5) Islamic banks, just like conventional banks, are vulnerable to fraud hence the need for these banks to take adequate steps to prevent fraud from happening. In granting loans, clients could be asked to group themselves first into cooperatives or associations as this would reduce the risk of default.

Conclusion

From the preceding discussion, it is clear that the opportunities abound for the growth and development of Islamic banking in Nigeria as can be seen from the Jaiz Bank Plc. experience. Indeed, it is no longer a negligible or merely a temporary phenomenon. It is here to stay and there are signs that it will continue to grow. Islamic banking may not be the total solution to Nigeria's ailing financial sector. However, it has the potential of attracting funds and investment into the sector with the resultant effect of ensuring financial stability. Operating a dual banking system, Islamic and conventional, just as it is being practised in Malaysia, would open up the economy and eventually lead to economic growth and development. At this point one can conclude that if more Islamic Banks are allowed to operate as alternative financial intermediaries in Nigeria, while making provision for a comprehensive regulatory framework, adequate Islamic Finance Experts and massive public awareness, they will certainly replicate the various achievements recorded worldwide.

References

- Abdul Gafar, I. (2011). *The Theory of Islamic Banking: Look Back to Original Idea*. Journal of Islamic Economics, Banking and Finance, 7(10).
- Abdullah, I. (2010). *Islamic Banking in Nigeria: Issues and Prospects*. Central Bank of Nigeria, Bullion, 34(2) April-June
- Adrian, T. and Shin, H. S. (2008). "Liquidity, Monetary Policy, and Financial Cycles." Federal Reserve Bank of New York, Current Issues in Economics and Finance, January/February 2008
- Akinyemi, B. (2011). *The Survival of Islamic Banking Vis-À-Vis Non-Interest Banking in Nigeria: An Overview*. Arabian Journal of Business And Management Review, 1(4); November.
- Alam, M. N. (2000). *Islamic Banking in Bangladesh: A Case Study of IBBL*. International Journal of Islamic Services, 1(4).
- Al-Arabi, M.A. (1966) *Contemporary Banking Transactions and Islam's Views Thereon*. Islamic Review, May, pp. 10-16.

- Alper, D. and Anbar, A. (2011), 'Bank Specific and Macroeconomic Determinants of Commercial Bank Profitability, Empirical Evidence from Turkey'. *Business and Economics Research Journal*, 2(2), 139-152.
- Al-Tamimi, H. A. (2006). The Determinants of the UAE Commercial Banks' Performance: A Comparison of the National and Foreign Banks. *Journal of Transnational Management*, (4): 35-47.
- Bank Indonesia (2016), Annual Report, 2016
- Bank Negara Malaysia (2016), Annual Report, 2016
- Brown, K., Hassan, M. K. and Skully, M. (2007), Operational Efficiency and Performance of Islamic Banks. In Hassan, M. K. and Lewis, M. K. (eds.), *Handbook of Islamic Banking*. Massachusetts: Edward Elgar Publishing, Inc.
- Cecchetti, G. (2008a) Sub-prime Series: Part 4: Does Well-Designed Monetary Policy Encourage Risk- Taking? In Andrew Felton and Carmen Reinhart, (eds.), *The First Global Financial Crisis of the 21st Century* ;www.voxeu.org/index.php?q=node/758.
- Cecchetti, G. (2008b). Federal Reserve Policy Responses to the Crisis of 2007: A Summary. In Andrew Felton and Carmen Reinhart, eds., *The First Global Financial Crisis of the 21st Century*, 2008c; www.voxeu.org/index.php?q=node/1048.
- Central Bank of Nigeria (2011), 'The Framework for the Regulation and Supervision of Institutions Offering Noninterest Financial Services in Nigeria'
- Central Bank of Nigeria (2016), Annual Report 2016
- Chapra, M. (2000). Why has Islam Prohibited Interest? Rationale behind the Prohibition of Interest in Islam. *Review of Islamic Economics*, 9: 5-50.
- Chapra, M. (2009), "Global Islamic Financial Crisis, Can Islamic Finance Help?" *New Horizon*, January-March, 2009, Issue No.170, <http://www.newhorizonislamicbanking.comcom/index.cfm>
- Choong, Beng Soon, and Ming-Hua Liu, (2006) "Islamic Banking: Interest-Free or Interest-Based?" Available at SSRN: <http://ssrn.com/abstract=868567>
- Dar, H.A. & Presley, J.R. (2000). Lack of profit-loss sharing in Islamic banking: Management and control imbalances. *International Journal of Islamic Financial Services* 2(2).
- Debt Management Office DMO (2017), www.dmo.gov.ng
- Ebrahim, M., and A. Safadi, (1995). Behavioral Norms in the Islamic Doctrine of Economics: A Comment. *Journal of Economic Behavior of Organization*, pp. 151157.
- El-Gamal, M. (2005), Mutuality as an Antidote to Rent-Seeking Sharia-Arbitrage in Islamic Finance, <http://www.ruf.rice.edu/elgamal/>.
- Enhancing Financial Innovation and Access (EFInA) (2016), Access to Financial Services in Nigeria 2016 survey, www.efina.org.ng
- Ernst & Young (2011), The World Islamic Banking Competitiveness Report 2012
- Eze, I. and Chiejina, A. (2011), Furore over Islamic banking in Nigeria. *BusinessDay*, Monday, 18 July. <http://www.businessdayonline.com/NG/index.php/analysis/features/24733-furore-overislamic-banking-in-nigeria?format=pdf>
- Global Islamic Finance Report (2017), Leadership in Islamic Banking and Finance, GIFR, 2017
- Goodhart, A. (2008), The Background to the 2007 Financial Crisis. *International Economics and Economic Policy*, 4(4): 331-46.
- Hassan, K. & Lewis, K. (2007). *Handbook of Islamic Banking*. Massachusetts: Edward Elgar Publishing, Inc.
- Hassan, M & J. Dridi (2010). The Effects of the Global Crisis on Islamic and Conventional Banks: A Comparative Study. IMF working paper September 2010 WP/10/201
- Heffernan, S. A. and Fu, X. (2010). The Determinants of Bank Performance in China. *Applied Financial Economics*, 20: 15851600.
- Imam, P. & K. Kpodar (2015), "Is Islamic Banking Good for Growth?" Working Paper WP/15/81, International Monetary Fund, Washington, DC
- Islamic Financial Services Board IFSB (2016). *Islamic Financial Services Industry Stability Report 2016*. Kuala Lumpur: Islamic Financial Services Board.
- Iqbal, M. (2001), Islamic and Conventional Banking in the Nineties: A Comparative Study. *Islamic Economic Studies*, 8(2): 127.
- Iqbal, M. (2007). International Islamic Financial Institutions. In Hassan, M. K. and Lewis, M. K. (eds.), *Handbook of Islamic Banking*. Massachusetts: Edward Elgar Publishing, Inc.
- Iqbal, M. and Molyneux, P. (2005), *Thirty Years of Islamic Banking: History, Performance and Prospects*. Palgrave Macmillan, New York.
- Jaiz Bank Plc. (2012), www.jaizbank.com
- Jaiz Bank Plc. (2012), Annual Report and Accounts, 2012
- Jaiz Bank Plc. (2013), Annual Report and Accounts, 2013
- Jaiz Bank Plc. (2014), Annual Report and Accounts, 2014
- Jaiz Bank Plc. (2015), Annual Report and Accounts, 2015
- Jaiz Bank Plc. (2016), Annual Report and Accounts, 2016
- Jaiz Bank Plc. (2017), Annual Report and Accounts, 2017
- Jhingan, M. (2002). *Macroeconomic Theory*. Vrinda Publications Ltd
- Kammer, A. et al. (2015). *Islamic Finance: Opportunities, Challenges and Policy Options*. IMF Staff Discussion Notes No. 15/5. (Washington, D.C.).
- Khan, M (1986), Islamic interest-free banking: A theoretical analysis. *International Monetary Fund Staff Paper*, 33 (10), 1-27.
- Khan, M. M. and Bhatti, M. I. (2008), *Developments in Islamic Banking: The Case of Pakistan*. New York: Palgrave Macmillan.
- Lotus Capital Halal investments (2017) retrieved from www.lotuscapitallimited.com

- Mills, P., and Presley, J. (1999). *Islamic Finance: Theory and Practice*. London, United Kingdom: Macmillan.
- Mohammed, S. (2010). *Islamic Microfinance Bank Launched*, a report in the Daily Trust Newspaper, 15th April.
- Okeke V.O. & Ojukwu U. G. (2012). The Political Economy of the Proposed Islamic Banking and Finance in Nigeria: Prospects and Challenges, Kuwait Chapter of Arabian Journal of Business and Management Review, 1(7)
- Saad, A. (2003). *Islamic Banking: Theory and Practice*. Ahnour International
- Samad, A. & H. Kabir (1999). The Performance of Malaysian Islamic Banking During 1984-1997: An Exploratory Study. *International Journal of Islamic Financial Services*, 1(3).
- Sanusi, L. S. (2011). *Islamic finance in Nigeria: Issues and Challenges*. Being a Lecture delivered at Markfield Institute of Higher Education (MIHE), Leicester, UK.
- Sarker, A. (1999). *Islamic Banking in Bangladesh: Performance, Problem and Prospects*. *International Journal of Islamic Financial Services*, 1(3)
- Siddiqi, M. N. (1983). *Issues in Islamic Banking*, Leicester: The Islamic Foundation.
- Siddiqi, M.N. (2009). Current Financial Crisis and Islamic Economics. *Radiance Views Weekly*, X L V I (3 8) . 2 0 0 9 - 0 1 - 0 4
<http://www.radianceweekly.com/137/3039/GLOBALMELTDOWN->
 Downloaded on January 5, 2009
- Stiglitz, J. (Spring 2003). *Dealing with Debt: How to Reform the Global Financial System*. *Harvard International Review*, Spring: 54-59.
- Umar, B. A. (2011). *Islamic Finance in Nigeria: Issues and challenges*. New Nigeria (January).
- Usman, S. (2003). The Legal and Regulatory Issues of Islamic Banking in Nigeria. In: Sulaiman, S. and Galadanci, B. (eds.), *Islamic Banking: General Framework and Case Studies*. Kano: International Institute of Islamic Thought (IIIT).
- Usmani, M. T. (1998). *Introduction to Islamic Finance*. Karachi: Idaratul Ma'arif.
- Wilson, Rodney (ed.) (1990). *Islamic Financial Markets in the Global Economy*. Edinburgh: Edinburgh University Press.
- World Bank and Islamic Development Bank Group (2016). *Global Report on Islamic Finance: Islamic Finance: A Catalyst for Shared Prosperity*. Washington, DC: World Bank. doi:10.1596/978-1-4648-0926-2. License: Creative Commons Attribution CC BY 3.0