International Journal of Islamic Business & Management
Vol. 1, No. 1; 2017
Published by Centre for Research on Islamic Banking & Finance and Business

Challenges Faced in Full Establishment of Islamic Banking System in Nigeria

Zainab Idris[1]

[1]Department of Business Administration, Bauchi State University Gadau, Nigeria

Correspondence: Department of Business Administration, Bauchi State Universit, Gadau, Nigeria, E-mail: xee.idris@gmail.com

Received: September 23, 2017 Accepted: September 29, 2017 Online Published: October 4, 2017

Abstract

Islamic banking in Nigeria is still at its infant stage and surrounded by a lot of challenges and set bank. It is important to note that despite the huge number of Muslims population in the country, little progress has been made in ensuring its full take off and operationalization. The paper there examines the challenges Islamic banking is faced with in Nigeria. Through review of past studies, the paper the paper identify factors like; Problem of Competition with dominant conventional banks, Problem of Competition with dominant conventional banks, Double taxation and others as the major challenges of Islamic banking in Nigeria. However the paper, the paper recommends that Islamic banking and finance in Nigeria offers a huge investment opportunity for both domestic and foreign investors what is most needed to achieve this, is for all stakeholders to collaborate in a way that a structured, functional and sustainable Islamic banking model will be formulated and communicated widely so as to gain general acceptability. Furthermore, the paper will serve as a guide to investors by pointing the problems the Islamic banking sector is facing in Nigeria.

Keywords: Islamic banking, Islamic finance, Nigeria.

1. Introduction

The full take off and operationalization of Islamic banking and finance in Nigeria has been hindered by a lot of issues and challenges ranging from religious diversity of the country and inability of the stakeholders to collectively face the problems(Razimi, 2016). Even though to some extent the government is facilitating its full take off, most Nigerians lack the knowledge of Islamic banking and finance while other religions followers in the country completely oppose to the idea(Venardos, 2012).

However, the formation and implementation of Islamic Banking system and policy in Nigeria has created a lot of problems from some eminent Nigerians, demanding the Governor of Central Bank of Nigeria to justify the reasons while such policy should be applied in Nigeria where there are different religions(Orisankoko, 2012). The reason being that Nigeria is a multi-religious nation that is dominated by Muslims, Christians and religious activists. Despite the fact that the Holy Quran and Bible forbids interest or usury which is charged on borrowed fund (Abraham and Omahi, 2012).

Islamic banking is believed to be an alternative type of financial intermediation that is centred on the profit and loss sharing motive. It is seen as market focused based on a moral dimension which is in accordance to Islamic values, norms, principles and teachings (Abdul-Rahman Latif, Muda, & Abdullah 2014). It is not the only type of profit and loss sharing banking grounded on non-interest doctrines, but it is the most advanced form that has global acceptance and appeal (Sanusi 2011). Similarly, Garba (2012) asserted that Islamic banking has the same tenacity as the conventional banking except for that it operates in line with the doctrine of sharia's known as Fiqh al-muamalat (Islamic rules of transaction).

The rudimentary principle of Islamic banking is the distribution of profit and loss and the prohibition of riba (interest). Among the common Islamic concepts used in Islamic banking are profit sharing (mudarabah), safe keeping (waqf), joint venture (musharaka), cost plus (murabaha), and leasing (ijara). Conversely, Lawal (2012) opined that Islamic Banking is not identical with interest free banking. It functions on Islamic code of ethics which is founded on the Quran. Its entire finances are asset sponsored which makes its complete funds open for investment in the production of goods and services. Islamic banking rejects deal in all economic activities that has a social or moral issue to the society and it works on profit and loss sharing motive.

Also, there have been a series of campaign and castigations against establishment of Islamic banking that are planned and organized by non-Muslim authorities to blackmail the introduction and operations of the Islamic banking system in Nigeria. This overzealous move started since the first license to start non-interest banking was granted (Yunusa and Nordin 2015). Garba (2012) also argues that one of the major hullabaloo is apparently due to lack of understanding of the idea of Islamic banking and in what manner the system operates. The adversaries of the system largely hinged their opinions for opposing the system on what they termed as introduction of religion into banking and illegal marginalisation of non-Muslims from non-interest banking.

This needless opposition is ignited by the failure of the suitable authority in Nigeria to appropriately enlighten Nigerians particularly the non-Muslims on what Islamic banking is all about; who could be the customer of the bank and whether certain section of the society is excluded from its operations. Furthermore, Sanusi (2011) stated that deficiency of knowledge, expertise and technical aptitude to standardise, and administer Islamic banks as well as absence of Islamic cover (Takaful) to safeguard investments of Islamic banks against unexpected dangers and facilitate the growth of the industry respectively are some major factors affecting the growth of Islamic banking in Nigeria. Therefore, this study intends to identify the challenges and major setback that is hindering the performance and full establishment of Islamic Banking in Nigeria.

2. Brief History of Islamic Banking and Finance in Nigeria

The evolution of modern Islamic banking in Nigeria dates back to 1991 with the enactment of the Banks and Other Financial Institutions Decrees (Fada & Wabekwa, 2012). This Decree recognizes banks based on profit and loss sharing (sec 23 and 61). The Decree also recognizes 'specialized' banks and includes in the definition such other banks as may be designated from time to time (sec 61). The designation of non-interest banks as specialized banks in 2010 was based on this provision. Furthermore, Islamic banking system in several Muslim and non-Muslim countries with it absence in Nigeria fuel the desires and agitations for formation of Islamic banking. This eventually generated a lot of concerns for its non- existent in Nigeria despite its vast Muslim population (Daud, Yussof & Abideen 2011). This however made the federal government of Nigeria through the central bank of come up with a new policy guideline for the regulation of Islamic banking and finance in the country. However, in January 2009, the Central Bank of Nigeria became part of the Islamic Financial Services Board (IFSB) and became a full-council member and in March 2009, in which Central Bank issue the draft framework for the regulation and supervision of non-interest banks in Nigeria comments and suggestions by stakeholders (Sanusi

2011). The framework was later compiled and become into what is known as The Framework for the Regulation and Supervision of Institutions Offering Non-interest Financial Services in Nigeria.. An Approval-In-Principle (AIP) was granted to Ja'iz International Plc. to establish Ja'iz Bank upon meeting mandatory capital requirement.

2.1Challenges and Issues Facing Islamic Banking and Finance in Nigeria

The Islamic banking and finance system in Nigeria is been faced with a lot challenges. Some of this challenges include:Lack of knowledge of accounting and auditing standards pertinent to Islamic financial institutions,Inadequate Legal and Regulatory Environment, Problem of Competition with dominant conventional banks, double taxation, Lack of Sharia-compliant liquidity management instruments,Absence of Islamic insurance to protect Islamic banks, and Lack of public awareness on the importance of Islamic Banking and finance

2.1.1 Lack of Knowledge of Accounting and Auditing Standards Pertinent to Islamic Financial Institutions

One of the major issues facing Islamic finance and banking system in Nigeria is the challenge of have a well knowledgeable expertise to handle the system effectively most is especially with regard to the structure Islamic books of account (Venardos, 2012). The balance-sheet structure of Islamic banks is unique, and even though the work of the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) on accounting and auditing standards for Islamic banking products is available, there is the need to train conventional accountants and auditors in the application of the standards (Lewis, 2001).

2.1.2 Inadequate Legal and Regulatory Environment

Malami (2014) observed that the existing banking laws in many so called secular countries like Nigeria which are mainly applicable to the interest based conventional banks constitute the most serious challenge to the operation of interest free banking. He opined that Islamic banking operations in Nigeria will largely be inhibited by a number of banking laws and regulatory directives such as companies Act, Banking Act, and Central Bank ordinances. Similarly, Adebayo (2010) observed that the 2004 CBN bank consolidation policy which increased the capitalization of commercial banks from 2 billion to 25 billion constituted a potential bottleneck in the take-off of full- fledged interest free (Islamic) bank like JAIZ bank as well as the smooth running of Islamic windows in conventional banks. Therefore, (Adebayo, 2010) suggests that legal and regulatory bottlenecks have to be removed to avoid operational conflict by making necessary amendment to the Nigeria banking laws and regulations to accommodate the peculiarities of the IFB system. Alternatively, the IFB could be exempted from certain regulations associated with interest dealings.

2.1.3 Problem of Competition with Dominant Conventional Banks

In the face of increasing financial globalization, interest free banks are confronted with the challenges of stiff competition with the present conventional interest based banks, who are well established. Interest free banks as new entrance may found it different to compete favourably with the existing big and strong banks in the short run. Mirakhor (2007) observes that perhaps the most challenging issue facing the implementation of an Islamic financial system is the development of risk bearing instruments that can provide the investor with sufficient degree of liquidity, security and profitability to encourage their holdings. The proposed Islamic non-interest banking will definitely encounter the challenge strict competition and comparison with the existing conventional banks in the country (Okeke & Ojukwo , 2012).

Islamic banks therefore, face the challenge of developing innovative services and products for mobilizing deposits and utilizing them effectively for financing under profit and loss sharing system. Islamic banks like all other banks under the interest based system have to remain competitive and tailor their services and products according to the needs and requirements of their clients simultaneous to ensure that the product designed by them remain within the framework of Sharia.

2.1.4 Double Taxation

Double taxation that would be levied on Islamic banks as a result of stamp duties and capital gains tax that are subtracted upon asset transfer. Islamic banks face a tremendous challenge in this respect because their financial intermediation is asset- based(Vasigh, Fleming & Humphreys, 2014). 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. Other jurisdictions, including the UK and Luxembourg have modified their tax laws to exempt Islamic banks from double taxation on assets they acquire for financing purposes.

Another challenge in the area of taxation is that profits generated from the financial instruments offered by Islamic banks are not given the tax relief enjoyed by debt instruments in conventional finance. Debt instruments issued in Nigeria are currently exempted from taxes including income tax and VAT. Similarly interest payments on loans advanced are given the same relief. The same status should be granted to receivables in a Murabahah or Ijarah-based financing.

2.1.5 Lack of Sharia-Compliant Liquidity Management Instruments

Islamic banks cannot invest their excess liquidity in interest-based instruments, which are the liquidity management instruments in the market, which 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 for monetary policy operations are all interest-based with no equivalent government securities or other money market instruments that are Sharia-compliant, all of which are essential to avoid a liquidity bottleneck for Islamic banks when they come into operation.

2.1.6 Inadequate Public Awareness on the Importance of Islamic Banking and Finance

There is apparently low awareness of the Islamic banking concept in Nigeria. Hence, for interest free banking system to work efficiently in Nigeria, there is a great need for sensitization of all the stake holders (government/public, government and individuals) by Islamic professional scholars and Muslim economists. This is borne out of the fact thatNigeria is a secular state.Hence, government should not be seen as trying to Islamize the country's financial/banking system. This means that the tendency of the non-Muslims to misconstrue the ideology because of its religious colouration calls for nation-wide awareness. According to (Okeke & Ojukwo , 2012), In the Nigerian situation, the problem of policy making and implementation have often been lack of proper communication to the people by the government of the benefits they stand to get from a policy and the methods by which a particular policy is to be implemented. The proposed Islamic (non-interest) banking system may not see the light of the day if not properly communicated to the people before its full implementation.

2.1.7 Absence of Islamic Insurance to Protect Islamic Banks

The absence of Islamic insurance (Takaful) to protect investments of Islamic banks against unforeseen hazards and facilitate the growth of the industry respectively also serve as a contributing factor to the development of Islamic banking and finance in Nigeria. Though the Nigerian insurance deposit corporation (NDIC) serves as an insurance for other conventional banks in the country, it may not meet the Islamic standard to cover other Islamic banks. Therefore it may result to a mix up which can temper with the principles of sharia.

3. Conclusion

Islamic banking and finance in Nigeria like in most countries around the globe is evolving, although with different degrees of successes. A number of countries in Asia and the Middle and East have passed the advocacy stage and are deeply engaged in research and innovations. In Europe and the United States governments and global financial institutions are not only adopting and promoting its application but even developing indices for assessing and tracking the performance of the industry (Abdul-Rahman Latif, Muda, & Abdullah 2014). The issues, challenges and opportunities surrounding its evolution in Nigeria are, however, unique. This study concludes that Islamic banking and finance in Nigeria offers a huge investment opportunity for both domestic and foreign investors what is most needed to achieve this, is for all stakeholders to collaborate in a way that a structured, functional and sustainable Islamic banking model will be formulated and communicated widely so as to gain general acceptability (Vasigh, Fleming & Humphreys, 2014). The study further concludes that effective and harmonious relationship and understanding between different religious sects in the country will also go a long way in enhancing the growth and development of Islamic banking and finance in Nigeria.

The study recommends that both government and promoters of Islamic banking should add more effort through effective collaboration that will bring about a more detailed guideline for full operationalization of Islamic banking and finance in Nigeria. The guidelines should not ambiguous and it should state clearly the rules and policies for conduct of the business in Line with Sharia principles. There is also need for the government to collaborate more with other stakeholders as it regards to awareness creation and education of the general public about the benefits of Islamic banking and it openness to everybody irrespective of religion.

References

Abdul-Rahman, A., Latif, R. A., Muda, R., & Abdullah, M. A. (2014). Failure and potential of profit-loss sharing contracts: A perspective of New Institutional, Economic (NIE)

Theory. Pacific-Basin Finance Journal, 28, 136-151.

Adebayo, A. (2010), "The Propagation of Non-Interest Banking in Nigeria: An Appraisal of the Ideological Risk", http://lawlib.wlu.edu/lexopus/works/850-1.pdf

Okeke, V., & Ojukwu, U. G. (2012, March). The political economy of the proosed Islamic banking and finance in Nigeria: Prospects and challenges. Kuwait Chapter of Arabian Journal of Business and Management Review, 1(7), 203-206.

Prof, .. C. (2009). Banking in Nigeria at a Time of Global Financial Crisis. Lagos : Central bank of Nigeria.

Mirakhor, A., and Zaidi, I. (2007), "Profit-and-loss sharing contracts in Islamic finance" in Hassan, M. K. and Lenwis, M. K. (eds.), Handbook of Islamic Banking. Massachusetts: Edward Elgar Publishing, Inc.

Fada, K. A., & Wabekwa, B. (2012). People's perception towards Islamic banking: a field work study in Gombe Local Government Area, Nigeria'. International Journal of Business, Humanities and Technology, 2(7), 121-131.

Lewis, M. K. (2001, June). Islam and accounting. In Accounting Forum (Vol. 25, No. 2, pp. 103-127). Blackwell Publishers Ltd.

Malami, S., Dabiri, M., and Kareem, O. (2011): "Islamic-Banking Prospects and Challenges of Islamic Banking in Nigeria". Being a Paper presentation at a One-day colloquium of the Nigerian Institute of Advanced Legal Studies on theme Islamic Banking: Prospects and Challenges. University of Lagos, Akoka, Lagos, Nigeria.

Orisankoko, A. S. (2012). Socio-Economic and Legal Challenges of Shari'ah Compliant Banking Operation, its Developmental Impacts and the Struggles of the Believers: Epistemological Lessons from Nigeria. Journal of Islamic Economics, Banking and Finance, 8(2), 45-66.

Razimi, M. S. A. (2016). The Prospect and Challenges of Islamic Banking and Finance in Nigeria: A Conceptual Approach. Research Journal of Applied Sciences, 11(11), 1362-1371.

Sanusi, L. (2011): “Guidelines for the Regulation and Supervision of Institutions Offering Islamic Financial Services (IIFS) in Nigeria”, in Leadership Newspaper, Wednesday June, 22. Pp.1-5.

Vasigh, B., Fleming, K., & Humphreys, B. (2014). Foundations of airline finance: Methodology and practice. Routledge.

Venardos, A. M. (2012). Islamic banking & finance in South-East Asia: Its development & future (Vol. 6). World Scientific.

Copyrights

Copyright for this article is retained by the author(s), with first publication rights granted to the journal.