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Islamic Banking and the Sustainability of Micro Enterprises in Nigeria

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Abstract

The Central Bank of Nigeria (CBN) recently released guidelines/framework for the operation of Islamic banking in Nigeria and Jaiz bank has consequently been granted approval in principle to operate under the guidelines. Based on the tenet of Islam on which the Islamic banking will be predominantly run, it is likely that the Micro Enterprises sector which has remained somewhat a 'financial orphan' in the Nigerian financial system will heave a sigh of relief. Thus, this paper explored the question of whether the positive virtues of Islamic banking paradigm can sustain Micro Enterprises in Nigeria, using the perception of major stakeholders who can affect or will be affected by the introduction of Islamic banking practice. The results showed that the Islamic banking will positively affect the fortunes of small scale enterprises in Nigeria, provided the ethical bases on which the tenets of Islam is based are vigorously adhered to. The education, sensitization, and communication to stakeholders of issues associated with Islamic banking should commence in earnest. A rigorous capacity building program should be embarked upon by all regulatory bodies, firms and training institutions in order to provide the needed manpower for effective and ethical implementation.

Keywords: Islamic banking, Micro enterprises, Stakeholders, Ethics, perception.

1. Introduction

The approval in principle which the Central Bank of Nigeria (CBN) has granted Jaiz Bank and the release of the guidelines/framework for Islamic banking are generating intense controversy within the Nigerian financial sector. This is a welcome development and an indication that Islamic banking will soon effectively take its root in the Nigerian financial system. Based on the tenet of Islam on which the Islamic banking will be predominantly run, it is not unlikely that the Micro Enterprises sector which has remained somewhat a 'financial orphan' in the Nigerian financial system will heave a sigh of relief.

The Micro Enterprises (hereinafter, MEs) are crucial to the development of any nation as they serve as the bedrock or engine that drive economic development. Apart from generating employment especially for the poor, MEs play very significant roles as conduit of economic growth and development. For instance, MEs are relatively less capital-intensive and therefore ideal as a channel for industrial development for capital deficient economies, flexible and react quickly to changes, easy adaptation to local market and local sources of raw materials among others.

In-spite of the numerous advantages which the MEs have to offer, the banking sector in Nigeria is lukewarm in meeting the credit requirements/needs of MEs. This scenario, according to Sanusi (2005), is because "project proposals are poorly prepared, inadequate financial documentation and collateral are provided, as well as the inability of the promoters of MEs projects to raise equity contribution." He further averred that conventional banks regard the MEs as high risk ventures due to absence of succession plan in the event of the death of the proprietor.

The consequence of the above situation is that working capital has remained a great challenge to the MEs. And so, the proprietors of MEs are restricted to funds from family members and friends and therefore unable to grow and respond to challenges in a timely fashion as they arise. Besides the inability to raise funds from the banks, MEs, by their structure are also not able to access funds from the capital market. Although the MEs are not able to raise funds form the banks and the capital markets, the locus of blame should not be placed at the door steps of the these institutions alone. The reasons being that some operators who had some access to loanable funds deliberately divert such funds to sources other than the projects for which they were obtained. Also, they have aversion to disclosure and ownership dilution, among others (Sanusi, 2005).

So, there have been some credibility problems which the conventional banks have had to deal with in connection with resources extended to MEs operators. These ills are part of the issues which the Islamic banking paradigm has the potential to address, given that there exist the appropriate infrastructures and institutions.

The objectives of this article are therefore to address, from the perspective of stakeholders, the general benefits of Islamic banking in Nigeria and the extent to which the positive virtues of the Islamic banking paradigm will sustain MEs in Nigeria, in the light of recent economic realties and the poor ethical environment in which business is conducted in the country. To address these issues section 2 of this article examines literature on the virtues and tenets of Islamic banking in the context of Nigerian environment. Section 3 explains the research methods used in this study and Section 4 reports the results of the study, while section 5 is conclusions and recommendations.

2. Review of Related Literature

There is a role which small and micro enterprises can play and actually do play as an engine of industrial growth and development of any country. These roles can neither be too strongly or too often emphasized. In the poorest economies, for instance, Masakure, Cranfied and Henson (2005), observe that "MSEs and microenterprises in particular, are a major source of employment and income, especially for the poorest members of the society." Therefore, Masakure et al (2005) further noted that there is a great deal of interest in the performance of firms in the microenterprise sector and its scope to generate employment, both through new business start-ups and the expansion of existing businesses. Thus, any nation that neglects the small/micro enterprise sector will always have unemployment problem, together with its attendant vices and remain a dependent economy (Fasoranti, Akinrinola and Ajibefun, 2006).

The official definition and conceptualization of microenterprises is often tied along with small enterprises. However, Mensah, Tribe and Wess (2007), in the context of Ghana, see microenterprises as "business activities employing not more than four persons." In the context of Nigeria, Small and Medium Enterprises (SMEs) are conceptually divided into Medium Scale Enterprises (MSE), Small Scale Enterprises (SSE) and Micro Enterprises (ME). According to Babajide, (2011), micro enterprises are those enterprises employing less than ten persons and have assets of the value of five million Naira or less, excluding land and buildings.

One of the major challenges of the micro enterprises is finance. Due to their size and nature, they find it difficult to raise funds from the big banks. They should be entitled to micro finance to enable them contribute to the growth of the economy. Microfinance is an amazingly simple approach that has been proved to empower very poor people around the world to pull them out of poverty. Yusus (2006) describes microfinance as a financial system that relies on the traditional skills and entrepreneurial instincts of the active people. He further observed that microfinance through which microcredit can be extended to customers is based on the premise that the poor have skills which remain unutilized or underutilized and which the established banks do not take advantage of.

According to Gert van Maanen (2004), microfinance is "banking the unbankable, bringing credit, savings and other essential financial services within the reach of millions of people who are too poor to be served by regular banks, due to lack of sufficient collateral." The summary of the preceding discussion is that, notwithstanding the relevance of small scale enterprises towards the growth and development of the industrial sector, they still face a number of problems that limit their growth and development, especially finance.

The situation persists even though a number of measures had been taken previously to address the problem. For instance, the Federal government, according to Oye (2006) has taken the following initiatives towards solving the problem of the small scale enterprise sector:

(i) Setting up and funding industrial areas and estates (to reduce overhead cost)

(ii) Providing local finance through its agencies- including the Central Bank of Nigeria

(iii) Facilitating and guaranteeing external finance through the World Bank

(iv) Facilitating the establishment of the National Directorate of Employment

(v) Family support programme and

(vi) The bankers' committee initiative in collaborating with CBN on establishment of investment scheme for small and medium scale enterprises. Under this scheme, banks are expected to set aside ten (10%) of their profit before tax for equity investments in small and medium scale industries.

The ratio of loans to small scale enterprises to commercial banks total credit just before and after the consolidation exercise shows that the small enterprise sector is not in the scheme of things of the commercial banks even though they have the obligation to assist the sector and consequently the economy. The details in the Table 1 below attest to this assertion.

TABLE 1 RATIO OF LOANS TO SMALL SCALE ENTERPRISES(SCE) TO COMMERCIAL BANKS' TOTAL CREDIT (2000-2006)

Year	Loans to SCE (N'm)	Bank Total Credit (N'm)	Loans to SCE as % of Total Credit
2000	44,542.3	508,302.2	8.7
2001	52,428.4	796,164.8	6-6
2002	82,368.4	954,628.8	8.6
2003	90,176.5	1,210.033.1	7.5
2004	54,981.2	1,519,242.7	3.6
2005	50,672.6	1,899,346.4	2.7
2006	21,201.7	2,385,638.3	0.9

Source: CBN Statistical Bulletin, Vol. 17. 2006

Though the various programmes were set up with the best of intension, there is nothing visible to be shown as any success recorded under the various schemes. Before the consolidation exercise, loans to SCE was rising but started to fall after the exercise such that by 2006, loans to SCE as a percentage of total loans was just 0.9. This is un-expected having regard to the fact that the banks had more money in their coffers after the consolidation exercise.

Whatever the situation, the introduction of Islamic banking has seemingly come to bridge the gap and bring in the poor who lack collateral to ordinarily access credit in conventional banks. This is because Islamic banking is part of the drive of Nigeria to propel its economy by promoting financial inclusion by introducing alternative products without undermining any group or interest in the country. No doubt, financial inclusion is a major challenge, as almost 50 percent of adult Nigerians do not have access to capital; and this was keeping these groups of individuals out of banking practices.

A basic principle of Islamic banking is justice. This is an essential requirement for all kinds of Islamic financing. In contrast with conventional banking, Decker (2011), observed that Islamic banking looks "into moral and ethical values in its banking operations and also they are restricted from financing alcoholic beverages, tobacco or morally questionable activities." Based on the foregoing, Islamic banking can do well if the operators will really follow what its tenets are and will greatly bring about a dramatic change in the banking sector in Nigeria

3. Research Methods

This is a descriptive study in which questionnaire was used to collect data in order to determine the perception of major stakeholders on the introduction of Islamic banking and the sustainability of micro enterprises in Nigeria. The major stakeholders include bank customers, managers and employees of banks, micro finance operators and others who have operational interest in banking activities. The choice of the stakeholders is consistent with the description of Freeman (1984) who defined stakeholders as "any group or individual who can affect or is affected by the achievement of the firm's objectives." The survey was conducted in the seven local government areas of Edo North, in Edo State. The seven local government areas concerned were considered suitable for the study because they are comparatively populated by both Moslems and Christians.

A structured questionnaire which required the respondents to answer on a five-point Likert scale anchored by (5) indicating very strong and (1) very weak was administered to respondents. On this scale, a score of 5 or 4 indicates that the item is perceived to be essential while a score of 3 or 2 indicates that the item is perceived to be fairly important, but not essential, while a score of 1 indicates that the item could be disregarded for being unimportant. Before the final version of the questionnaire was sent out, it was pilot tested to determine the appropriateness and relevance of the questions in the instrument. To obtain a score for these questions, the mean score was calculated. A total number of 1475 questionnaires were distributed to the respondents, out of which 1361 were returned and 1310 were found usable. The questionnaire was self-administered by hand to the respondents. Respondents were randomly selected from among identified stakeholders. The number of questionnaires distributed; the number of usable and the overall response rate.

Table 2 PROFILE OF QUESTIONNAIRE DISTRIBUTED

Stakeholder Group	**No of Questionnaire Distributed**	**Usable Returned**	**Response Rate (%)**
Customers	456	405	88.9
Micro Enterprises Operators	169	138	81.65
Bank Employees	182	143	78.57
Bank Branch Managers	36	31	86.11
Local Communities	348	326	93.68
Accounting/Banking Academics	63	57	90.47
Other	221	210	95.02
Total	**1475**	**1310**	88.9

Field survey, (2011)

The table above indicates that the overall response rate is 88.9 %. The response rate is considered large enough for the purpose of drawing inferences (Stevens 2002). The basic statistics on gender, religion, age, marital status, stakeholder group and educational level of the respondents are presented in Table 3. The age distribution is well mixed. However, majority of the respondents are within the group of 31-40 years. This could suggest that the future of Islamic banking in Nigeria is bright. The results reported in Table 3 also indicate that the majority of respondents are well educated. Besides, the respondents are well distributed between Moslems and Christians.

Table 3: DISTRIBUTION OF RESPONDENTS

		Frequency	Percent (%)	Customers	Managers	Employees	Operators of MEs	Others
Gender	Male	917	70	451	43	128	208	87
	Female	393	30	237	5	64	59	28
Religion	Islam	642	49	385	20	87	103	47
	Christianity	624	47.63	280	28	105	151	60
	Others	44	3.37	23	-	-	13	8
Age	Below 20	67	5.11	51	-	-	-	16
	20 -30	357	27.25	237	7	50	39	24
	31 -40	503	41.45	262	13	68	121	39
	41-50	241	18.40	98	19	45	59	20
	Above 50	142	7.79	40	9	29	48	16
M/ Status	Single	420	32.06	246	3	84	29	58
	Married	811	61.91	392	43	102	229	45
	Others	79	6.03	50	2	6	9	12
Education	Primary/Sec	393	30.0	236	-	58	61	38
	OND/NCE	371	28.3	172	-	46	104	49
	HND/BSc	367	28.0	200	22	52	83	10
	Professional	70	5.40	41	5	7	10	7
	Postgraduate	83	6.3	23	21	29	8	2
	Others	26	2.0	17	-	-		9

Field survey, (2011)

These information shown in the above table reflects the fact that the respondents are mature, educated and experienced enough to understand the import of the introduction of

Islamic banking activities into the Nigerian banking environment and hence qualified to participate in the survey.

4. Survey Results

Table 4 below shows the result of the evaluation of the perceived benefits that various stakeholders would derive from the introduction of the Islamic banking paradigm in Nigeria.

Table 3 GENERAL BENEFITS OF ADOPTING ISLAMIC BANKING IN NIGERIA

		Mean Score for Stakeholders				
		CUST	MGR	EMP	ME/ OP	OTHS
1	Self rule enforcement by banks	3.76	3.21	3.80	3.65	3.05
2	More realistic planning experiences	3.69	4.56	3.60	4.55	3.50
3	Better access to capital	3.20	3.58	3.58	3.86	4.56
4	Reduced cost of capital	3.47	3.50	3.86	4.59	3.66
5	Better understanding of risk and return	3.87	4.32	3.76	3.50	4.35
6	Enhanced competitiveness	3.10	4.38	2.68	4.10	3.59
7	Improved regulatory oversight and enforcement	4.35	3.34	4.45	3.67	3.34
8	Better information for market participants	2.86	3.53	2.56	3.43	4.00
9	Sound system of corporate governance	3.15	4.36	3.45	3.58	4.34
10	Better risk management	2.40	3.69	3.26	3.80	3.58
11	Ethical environment	4.05	4.08	4.66	4.56	4.00
12	A higher standard of financial disclosure	4.32	3.45	4.50	4.78	3.84

Field survey, (2011)

Stakeholders- CUST = Customers; MGR= Managers; EMP = Employee; ME/OP =Micro Enterprises operators and OTHS= Others.

The results shown in Table 4 indicate that there is no consensus among the stakeholders on any of the potential benefits of the introduction of Islamic banking in

Nigeria. While the customers believe Islamic banking will provide better regulatory oversight, it is the belief of the managers that the introduction will lead to better and more realistic planning. Similarly, employees and micro finance operators believe that the introduction will result in higher standard of financial disclosure while other stakeholders rate better cost of capital as the main point in the introduction. Better information for market participant was rated lowest by both the managers and employees. On the overall, the stakeholders believe that a number of benefits will be derivable from the introduction of Islamic banking in Nigeria.

Table 5 below shows the mean scores of the virtues of Islamic banking introduction in Nigeria by the various stakeholders.

Table 5 VIRTUES OF ISLAMIC BANKING AND SUSTENANCE OF MICRO ENTERPRISES S IN NIGERIA

S/ N	Islamic Banking Virtues	Mean Score Stakeholders				
		CUST	MGR	EMP	ME/ OP	OTHS
1	Prohibition of interest	3.59	3.10	3.60	2.05	3.40
2	Absence of collateral security for loan	3.62	3.58	2.24	3.40	3.85
3	Profit sharing scheme	3.39	3.46	2.35	3.56	4.45
4	Risk sharing	3.39	3.26	3.40	3.30	4.20
5	Easy access to investible funds	2.87	2.68	2.50	3.50	4.55
6	Better corporate governance	3.70	3.50	3.60	3.60	4.70
7	Promotion of partnership	3.00	3.41	2.50	3.00	3.46
8	Preservation of property rights	3.05	3.35	2.60	3.45	3.50
9	Transparency in contractual obligations	3.46	2.65	2.45	3.65	2.80
10	Absence of speculative behaviour	3.50	3.52	3.50	4.34	3.56
11	Better and more effective regulatory control	2.90	2.64	2.55	3.89	3.78
12	Better Board oversight	3.56	3.23	3.41	4.20	2.38

Field Survey, (2011)

Table 5 identifies the virtues which are the hallmarks of Islamic banking worldwide. The customers do not believe strongly that better access and more regulatory control will be effective. Managers do not believe also that access to investible funds, transparency in contractual obligations and effective regulatory control will represent strong virtues of Islamic banking in Nigeria. Overall, risk sharing, better corporate governance, absence of speculative behaviour and board oversight will represent the high point of the virtues of Islamic banking in Nigeria. The virtues as identified in the Table 5 above represent the major challenges of conventional bank. Thus, if the operators of Islamic banks are able to confine themselves within the framework of these virtues, the Islamic banking concept will contribute significantly to the banking environment in Nigeria.

Table 6 below shows the evaluation of the virtues inherent in Islamic banking from the perspective of the Muslims and Non-Muslims,

Table 6 VIRTUES OF ISLAMIC BANKING AND SUSTENANCE OF MICRO ENTERPRISES IN NIGERIA- MUSLIMS VS NON-MUSLIMS

S/N	Islamic Banking Virtues	Mean Scores of Stakeholders	
		Muslims	Non-Muslims
1	Prohibition of interest	3.59	3.40
2	Absence of collateral security for loan	3.85	3.62
3	Profit sharing scheme	4.45	3.39
4	Risk sharing	4.20	3.39
5	Easy access to investible funds	4.55	3.37
6	Better corporate governance	4.70	3.70
7	Promotion of partnership	3.46	3.55
8	Preservation of property rights	3.05	3.50
9	Transparency in contractual obligations	2.80	3.46
10	Absence of speculative behaviour	3.56	3.50
11	Better and more effective regulatory control	3.78	3.21
12	Better Board oversight	4.55	4.56

Field survey, (2011)

In Table 6 above, the virtues of Islamic banking were evaluated on the basis of the perception of Muslims and Non-Muslims. Both Muslims and Non-Muslims are positive that the virtues as identified if well applied, will result in positive outcome for the overall benefit of the economy. This represents a good standing and support of the new banking concept.

The perceptions of stakeholders on twelve virtues of Islamic banking in the context of Nigeria were examined in Table 7, using factor analysis to determine which of these virtues is the strongest and see if they could be identified in similar groups.

Table 7 ROTATED COMPONENT MATRIX ON VIRTUES OF ISLAMIC BANKING

Factor				
Variable	1 Islamic Business Ethics	2 Accountability	3 Entrepreneurship	Communality of each variable
X_1	0.725			0.635
X_2	0.715		0.454	0.644
X_3	0.685		0.421	0.578
X_4	0.647			0.560
X_6		0.785		0.650
X_9		0.730		0.638
X_{12}		0.655		0.572
X_{11}		0.645		0.530
X_8		0.634		0.524
X_7			0.741	0.640
X_5	0.485		0.725	0.620
X_{10}			0.671	0.542
Eigen value	3.292	2.348	1.765	
% of Variance	26.685	17.464	12.458	
Cumulative %	26.685	44.149	56.607	

Extraction Method: Principal Component Analysis. Rotation Method: Varimax with Kaiser Normalization.

[a] Rotation converged in 7 iterations.

The results in Table 7 reveal the presence of three factors with all 12 virtues exhibiting large factor loadings (above 0.3 significant levels). The eigenvalues for the three factors are above 1 (3.292, 2.348 and 1.765 respectively). These three factors explain a total of 56.607 % of the variance. Specifically, Factor 1 has four significant loadings while both Factor 2 and 3 have five and three respectively. The three factors under which the virtues are classified are business ethics, accountability and entrepreneurship. These are virtues that are hardly present in conventional banking sector but which form the hallmark and basis for Islamic banking. It is hoped that these virtues will be adhered to as much as possible to make the Islamic banking paradigm a success for small scale and other enterprises in Nigeria.

In testing whether factor analysis was appropriate in identifying the virtues, KMO and Bartlett's Test of Sphericity were conducted. The KMO test revealed a value of 0.862 while the Bartlett's Test of Sphericity also reached statistical significance (0.000). Based on these favourable results, factor analysis was conducted using principal component analysis (PCA) and varimax rotation with Kaiser Normalisation.

FIG 1 KEY TO VARIABLES

VARIABLES	
X_1	Prohibition of interest
X_2	Absence of collateral security for loan
X_3	Profit sharing scheme
X_4	Risk sharing
X_5	Easy access to investible funds
X_6	Better corporate governance
X_7	Promotion of partnership
X_8	Preservation of property rights
X_9	Transparency in contractual obligations
X_{10}	Absence of speculative behavior
X_{11}	Better and more effective regulatory control
X_{12}	Better Board oversight

5. Conclusion and Recommendation

This study has provided evidence of the potential benefits of the introduction of Islamic banking in the Nigerian banking environment. The results show that the introduction of Islamic banking in Nigeria will lead to a number of important benefits to small scale enterprises which will set the tone for the industrial growth and development of Nigeria. The benefits will be largely driven by a number of potential virtues which can be conveniently subsumed under business ethics, accountability and entrepreneurship. The benefits and potential success factors notwithstanding, there are a number of challenges to be faced in the process of adoption Islamic banking. These among others include the unenviable ethical environment in which business is conducted in Nigeria and the ability to remove any religious colouration from the operations so that non-Muslims will not feel *disfranchised* from participating in the scheme.

Against the backdrop of the objectives of this paper, the following recommendations are hereby suggested: The education, sensitization, and communication to stakeholders of issues associated with Islamic banking should commence in earnest. A rigorous capacity building program should be embarked upon by all regulatory bodies, firms and training institutions in order to provide the needed manpower for effective and ethical implementation.

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