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An Appraisal of Mudarabah System of Islamic Investment as a Panacea to Financial Exclusion in Nigeria

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Abstract
This paper analyses the expected role of mudarabah system of Islamic investment as a means of tackling the prolonged problem of financial exclusion in Nigeria. The study employs a desk research method to describe the level of financial exclusion in Nigeria and forecasts the future of it, most especially with the coming of Jaiz Bank as a full-fledged Islamic bank that uses mudarabah as one of its investment instruments. This paper concludes that Jaiz Bank and other conventional banks that offer Islamic window of banking operation should give more emphasis to Mudarabah system of investment as it offers the poor and disadvantaged members of the society with entrepreneual ability to come out from the poverty line and become fully included financially. These poor and disadvantaged people suffer more from the menace of financial exclusion.

Keywords: Financial Exclusion, *Mudarabah*, Jaiz Bank
JEL Classification: D92, G31, Z12

1. Introduction

The government of Nigeria and other developing countries has made financial inclusion a priority. Financial inclusion is the availability and equality of opportunities to access financial services. It includes the extent to which individuals and businesses gain access to appropriate, affordable and timely financial product and services. This is evidenced by initiating policy strategy on financial inclusion coupled with new funding vehicles. The government of Nigeria has set a target of reaching full inclusion by 2020. The strategy is considered relevant to achieving Central Bank of Nigeria's objective of maintaining external reserves and to safeguard the international value of Nigerian currency (Naira). This objective is believed to be achievable as financial inclusion increases access to finance for micro, small and medium scale enterprises, consequently leading to greater productivity, increases in non-oil exports among other advantages (CBN, 2013).

The financial inclusion in Nigeria cannot be underestimated. For instance, Nigeria contributes bulk to figures on figure on financial inclusion despite its position as economic giant of Africa with a population of over 190 million people. Statistically, it is clear that 73.2 million adults representing 41.6 percent of the adult population in Nigeria are financially excluded. Furthermore 38 percent of household report having a formal bank

account which includes both commercial banks (34% of household) and other financial institution such as microfinance, cooperative society and savings association thus, about 62% is accounted for.

In line with CBN financial inclusion strategy, a regional licence was granted to Jaiz Bank PLC in November, 2011 and the bank started operation in January, 2012 as the first and currently the only full-fledged non-interest Islamic bank in Nigeria. Other conventional banks like Stanbic IBTC and Sterling Bank obtained licence to operate only Islamic windows. One of the objectives of Jaiz bank is to be at every part of Nigeria so as to provide banking services to a large segment of the society that are unbanked. The bank undertakes to drive the retail banking to ensure that it provides financial inclusion to many people that are initially excluded. The Islamic bank products are expected to bring into the banking sector a large number of the population who previously stayed away from the organised conventional financial services, due to their aversion to interest based products (Umar, 2011). Interest free banking system serves as a means of achieving financial inclusion and attracting foreign investment especially from Middle East and Asian countries. It will also provide opportunity for manpower development, capacity building and healthy competition as well as fulfilling the demands and needs of not only the Muslim population but also the Non-Muslims (Dogarawa & Bello, 2014).

Issues on financial inclusion remained a global challenge with as much as 54.0 percent of adults financially excluded worldwide (World Bank, 2014). This situation is even more rampant in the developing economies where some countries have as much as 70 percent financial exclusion level. Consultative Group to Assist the Poor (CGAP, 2014) indicates that almost all economies in some Sub Saharan Africa were below the world financial inclusion average. This is as a result of the lowest share of banked households in the region. The global target has been to eliminate all hindrances and problems to financial inclusion ranging from lack of or low education, gender bias, age categorisation, to irregular income, stringent regulation and geographic locations of some citizenry that have contributed to the lack of access to financial services by billions of adults across the globe.

For example in Nigeria, Sanusi (2011) attributed the increase poverty level in the country of financial exclusion. He stressed that achieving optimum level of financial inclusion in Nigeria means empowering 70 percent of the population living below poverty level which will boost economic growth and development which could eventually reduce the level of poverty in the society.

In the year 2012, about 67.1 percent of the Nigerian population were reported to be living below poverty level, despite a continuous growth in the Gross Domestic Product (NBS, 2012). Economic analysts have described this kind of growth in GDP as exclusive since it has not translated into any real economic gain in terms of employment generation, poverty reduction and improvement in general standard of living of the citizenry. This uneven growth resulted in the exclusion of 57 percent of the country's adult population from formal financial services (Abiola, Folasade & Alexender, 2015). Today the non interest banking remains a key component of growth recording a huge performance. For instance, it recorded 5.5% in 2016, which doubles to 11% in 2017. Its gross earnings rose by 40 percent from 6.18 billion naira in 2016 to 10 billion naira in 2017. In a similar vein, Dabiri and Sanyaolu

(2018) wrote on appraisal of Jaiz bank on financial performance on non-interest banking. The study reports that bank current ratio in 2012 was 3.5% which fell to 2.6% in 2013, in 2014, it fell as low as1.5%, in 2015, and it increased to 1.8% and dropped to 1.5% in 2016. Bank quick ratio stood at 0.9% which rise to 1.7% IN 2013 and fell 0.6% in 2014, it further to 1.0% in 2015 and fell to 0.8% in 2016.

2. Literature

To understand the concept of financial exclusion, Sinclair (2001) viewed it from both narrow and broad senses. In narrow sense, financial exclusion entails exclusion from particular sources of credits and other financial services such as: insurance, bill payment services and having access to appropriate accounts. From the wider perspective, it refers to factors which have the effect of shutting out of the less privileged well off from mainstream money services. According to Howell (2005), financial exclusion is the process that prevents poor and disadvantaged social groups from gaining access to the financial system, this is however, considered as lack of access to a specific and particular products or services.

According McAteer (2008), financial exclusion of the poor is generally considered to mean a lack of access to banking services. It has been viewed as a result of closure of bank branches and building societies, offices and thus ignores the tendency of informal-sector lending offering a substitute for bank services in remote areas in United Kingdom. The concept is also viewed as the inability of some individuals (adult people) to access and use basic financial services. Such as: savings, loans, and remittances in a manner that is reasonably convenient, reliable and flexible in terms of access and design (Mor&Ananth, 2007).

In the argument of Obaidullah and Abdullatif (2007), exclusion of the poor from the financial system is a major factor contributing to their inability to participate in the development process. Building an inclusive financial system therefore, is a central goal of policy makers and planners across the globe. Financial exclusion can take different shapes and manifest in various forms by different groups (FSA report, 2000). In fact there is a general consensus among scholars on the issue of financial exclusion, virtually all agreed that it may either be a cause or a consequence of social exclusion or both (Howell, 2005). The concept has been the subject of increasing interest and debate this is because it is central to the broader issue of social deprivation (Warsame, 2009).

Causes of Financial Exclusion

Causes of financial exclusion are very complex and identifying one single factor that causes exclusion will be difficult or even impossible. For example according to Warsame (2009), low income causes further problems such as lack of savings which again causes a lack of funds or assets. In the same line, unemployment further begets low income which is one of the most frequently mentioned drivers of financial exclusion. Nevertheless, the major causes of financial inclusion include low income, unemployment, irregular/casual work, lack of financial education, poor financial habits and geographical distance (Howell, 2005).

Ironically, there is a report by Financial Service Authority FSA (2000) which argues that the problem of financial exclusion is a direct result of increased financial inclusion. This is because as financial inclusion increases in the society a small portion of individuals and households must be left behind. While kempson (2001) looks as the causes of financial

exclusion from competitiveness of financial services industry in which the low incomes people are considered unworthy of the financial product by the financial service providers. At the end, many individuals will not have their needs met by the competitive financial services market. Also ethics or religion is viewed as one of the causes of financial exclusion; relatively Muslims may be excluded than non-Muslims when they find it difficult to have a financial product in accordance to their beliefs.

Kempson (2006) identified some reasons why people are financially excluded. He analysed them in the following ways: Those that are unemployed may find it difficult to have a bank account, simply because banks need the proof of identity before they can offer some services. In the same line an identity is required due to the problems associated with money laundering. There are rules which prevent financial institution to relate with their clients without proper identification of whom those clients are. This identification is also required to avoid terrorist attacks. Some individuals are financially excluded due to lack of access to financial services in their areas, for example in most of the developing countries, rural areas are neglected which requires rural people to travel several kilometres before they can access financial products or services offered by banks. In Nigeria this is one of the most important barriers to financial inclusion.

Cultural and language barriers are some of the reasons minority community people face in accessing financial services. To Kempson (2006), countries with high level of financial exclusion, self-exclusion by individuals is more rampant with low income earners than the exclusion by banks through refusing to open an account. When a person is unemployed or has a low income, they may not likely to open an account with any formal financial institution; therefore they will not be financial included but rather be self-excluded. As such countries with high rate of unemployment and low levels of income tend to have higher levels of financial exclusion (Onaolapo&Odetayo, 2012). Lack of financial education of some customers about various financial products and services as well as the benefit attached to each product poses a serious challenge to financial inclusion system. Therefore, banks and other financial institutions need to educate their clients on different products available and especially when new product is introduced, so that individuals can take the full benefits of all products and services and get themselves included financially.

In Nigeria for example, the issue of hidden bank charges in the banking industry has been there for long. Some of these charges range from charges on e-banking, to mobile transactions. In such a case, customers are always complaining about unexplained deductions on text message alerts, which may sometimes be charged even twice for a single alert. These have contributed a lot to high level of financial exclusion from the formal financial institution in Nigeria. Globally, banks have different conditions with regard to opening an account with them; some banks demand high minimum cash balance for a potential customer to operate with them. In this situation those with low income will have themselves excluded because the terms and conditions can scare them away.

Most of developing countries have not taken the full advantage of mobile banking, which has been identified as a possible tool to provide basic financial services to millions of the unbanked people in both rural and urban communities. Mobile telephone allows expansion and access to financial services as well as reducing transaction cost, especially the cost of

running physical bank branches. The increased access to financial services for underserved individuals helps in narrowing the financial infrastructure gab, especially in developing economies like Nigeria, where time and distance in reaching physical bank branch cost high to the customers. Therefore ICT and mobile phones in particular play a significantly role in improving access to credit and deposit facilities, allow more efficient allocation of credit, facilitate financial transfer and boost financial inclusion which in turn will help to stimulate private investment and general economic growth (Onaolapo & Odetayo, 2012).

Consequent Effects of Financial Exclusion

The consequences of financial exclusion are many and can manifest in different forms or magnitude, ranging from financial implication to social implication. According to Warsame (2009), the consequences of not having a bank account could be really painful due to the inconveniences and extra cost associated with it. For example someone to receive a cheque from a third party in his name means paying extra money to get it cashed that is why, there are remitting agencies and cheque cashing enterprises in some countries who are the only option open to those who cannot access banking products and services. In the same line of analysis Streliz and Kober (2007) argue that those who are excluded financially pay more despite of being the poorest. For instance in most countries utility supplier charges more if the payment is not made through direct debit or electrically transferred, which means the poor will pay much as they are excluded from the highly banked and cashless economy. Looking at this argument it is very obvious that those excluded pay additional cost for the same services accessed by those that are financially included. In today's global financial advancement and development everybody needs to access financial services so as to avoid being exploited.

Another serious implication of being excluded financially arises when those excluded are in need of urgent finance or in total financial difficulties and cannot access it due to the fact that they are excluded from the mainstream financial system. The only alternative available is to raise the required finance from the sub-prime market and unlicensed lenders such as loan sharks whose charges are exorbitant. To Collard and Kempson (2005), the financial consequence of raising finance through these intermediaries is very alarming and far-reaching for the excluded people who are in most cases, the poorest and most vulnerable members of the society that cannot easily afford such extortionate charges.

Low income customers normally make use of loans from cash converters and credit retailers who buy and sell at high interest rates than average users. For example, it is normal for a poor person to get some goods most especially durable ones like a fridge, television set or even a radio set and end up paying double the amount originally borrowed. The interest charged was exorbitant due to his or her poor financial skills and the absence of alternative financial arrangement (Warsame**,** 2009).

From the social point of view, financial exclusion has many negative implications. For instance, one will feel discriminated or having low self-esteem living in a country where majority of the population is banked and he has no any bank account. In such a situation those that are excluded need to bring themselves down to ask for assistance whenever they have to receive or pay funds through a bank account. Warsame (2009) also argues that when faced with financial hardship, the excluded usually resort to unlicensed lenders like loan

sharks who apart from charging extortionate rates as interest also employ violence and intimidation tactics as a means of getting back their money in case the borrower defaults. This has a terrible negative psychological and social impact on the borrowers which can lead to serious health problems such as stress and depression. Further analysis indicates that financial exclusion reinforces social deprivation which is not limited to only one single individual but it affects the community as a whole. Under this situation a second class citizens can be created from those who are financially and socially excluded in the mainstream societal functions.

Financial exclusion can deny a segment of the society most especially poor and the disadvantaged individuals the opportunity to be active and productive members of the community and thus hinders them from fully integrating and contributing to the well-being of the nation in which they live. At the end of it, social ill will become more visible, such as lack of social cohesion which can lead to social disintegration. In terms of how people run their lives, financial exclusion can put them in a very difficult and critical situation, individuals will feel they have lost hope and total control of their lives. This position can cause anxiety and so many personal and community consequences.

3. The Advent and Concept of Islamic Banking and Finance

When people are asked what is Islamic banking and finance, for example, they will come up with different answers and understanding depending on their level of exposure about Islamic economics in general. To some, Islamic finance is just another religious doctrine to provide financing for mosques, charities or funding for Muslim entrepreneurs. Furthermore unconvinced secularist and other critical observers would argue that Islamic finance is a broader political agenda to transform the present state of the world or some aspect of it to be in according with the principles of Islam. However, it was discovered that Islamic banking and finance is much more than political or philanthropic endeavours. In fact since its first inception in the 50s and 60s it has witnessed the growing concern and interest among Muslims and non-Muslims alike such as academicians, bankers, fund managers, other professionals as well as the general public towards establishing a more viable, robust and competitive Islamic financial system that may serve as the best alternative to the conventional system of banking and finance operation (ISRA, 2012).

Islamic and conventional banks have similar purpose of channeling funds between the Surplus-Fund Units (SFU) and the Deficit- Fund Unit (DFU). However, Islamic banking and finance, is a system that complies with Islamic principles such as the prohibition of interest, excessive risk and speculation in its transaction (Idris & Lawal 2013). According to Abdelhamed (2005), as cited by Idris and Lawal (2013), the universally accepted definition states that an Islamic bank is a financial institution whose statutes, rules and procedures expressly state its commitment to the principles of Islamic Shari'ah (Jurisprudence) and forbids the receipt and payment of interest on any of its transaction. The Islamic Banking Act of Malaysia 1983 further defined Islamic banking as a company which carries on Islamic banking business, whose aims and operations do not involve any element which is not approved by the Shari'ah. Islamic banking was also defined by Abdel-Magid as a bank owned by its shareholders, established to conduct banking and investment activities in accordance with Islamic Shari'ah and its own articles of association (Kalaithasan& Mohammed, 2007).

It was observed by Chapra (2000) that every activity of rational human being has a purpose. It is this purpose that determines the difference and nature from other activities. According to him, the justification for Islamic banks would be there only if its operations are directed towards the realisation of a purpose that cannot be realized by the conventional banking system. The purpose that of Islamic banking is quite unique and, in a nutshell, Islamic banks are set up generally to comply with precepts of the Shari'ah (Abdullahi, 2013).

The guiding rules of Islamic financial system are derived from the Qur'an and Sunnah of the Prophet Muhammad (PBUH). The Shari'ah spells out the Qur'anic teaching in three dimensions namely: *Aqidah* (faith and belief), *Akhlak* (ethic and morality) and *Muamalat* (transactions). There are two types of guidelines one must observe in Islamic transaction. One is the legal guidelines, such as prohibition of taking or giving interest (*Riba*) in financial dealings as Qur'an says in chapter 2 verse 275 "Allah has allowed trading and for bidden (Usury) interest. To whosoever which the admonition has come from his load, then he desists from it". It also does not condone wealth creation by means of investment in unlawful transactions such as gambling. Allah (SWT) says, "They ask you about intoxicants and games of chance. Say: In both of them there is a great sin and means of profit for men, and their sin is greater than their profit" (Qur'an 2:219). The second aspect is the ethical guidelines; the Qur'an (2:282) enjoins trustworthiness (*Amanah*) and prohibits deceit and greed in profit taking. These commands and prohibitions by Almighty Allah are mean to foster harmony in economic transaction and activities so that justice can prevail and thus man is able to obtain peace of mind (Rosly, 2010).

4. Mudarabah and the Role it can Play in Tackling Financial Exclusion Problem

Literally, the word *mudarabah* is derived from the Arabic phrase "*al-darb fi al-ard*" which means to make a journey. This meaning is related to this type of partnership because normally it requires in the past to travel to do business. In the Qur'an, there is not any clear mention of the word *mudarabah* but some scholars use some verses to establish a legality of it, such as where Allah (SWT) says "…and others who travel in the land seeking of the bounty of Allah" (Qur'an, 73:20). Also he says "…. but when the prayer is ended, they disperse abroad in the land and seek Allah's grace'' (Qur'an, 62:10). In another verse Allah says "… there is no blame on you in seeking bounty from your lord…." (Qur'an, 2:198). From the above verses, one can see that they can be interpreted to include those who travel for the purpose of trading and seeking permissible income (ISRA, 2009). The history of *mudarbah* can be traced to the time of prophet Muhammad (PBUH) when he engaged himself in business trading goods owned by Khadija as a *Mudarib,* who he married later.

Technically, *mudarabah* is a partnership system of business where by one party (*rabbul mal*) provides capital and the other party (*mudarib*) provides business expertise and entrepreneurial skills. In other words, the investment capital comes from one partner the investor, while the labour and the management is the responsibility of the second partner the entrepreneur, and both parties enter into a contractual agreement of sharing the profit at a predetermined ratio. Incase of any loss, the provision of Islamic law stipulate that is to be born solely by the capital owner (*rabbul mal*), while the entrepreneur's (*mudarib*) labour and work will go in vain. Nevertheless if the loss occurs due to deliberate mismanagement or fraud by the entrepreneur, that should be his sole liability. Some classical scholars use *mudarabah* to mean *qirad* or *muqaradah*. Both terms are derived from the word *qaradah*

which means to cut off simply because the capital provider cuts off some of his money to be utilized by the entrepreneur in business activities (ISRA, 2012).

Mudarabah business transaction should be carried out under certain conditions, for example right from the period of the Prophet (PBUH) it was narrated that Al-Abbas bin Abdulmuttalib when giving capital through *mudarabah*, always advised the entrepreneur not to take the sea passage, not to descend valleys and not to buy any animal with a soft belly. If the entrepreneur does any one of these things then he is responsible. This issue was brought to Prophet (PBUH) and he agreed to it (AbdulRahman, 2014). The major conditions to be observed under *Mudarabah*are: conditions related to offer and acceptance (*Sighah*). Offer is done by uttering the terms of *Mudarabah* or any other terms to that effect, if the other party accepts the offer and takes the money, then *Mudarabah* contract is concluded. The second condition needs that both parties in the contract must be qualified persons under the law, which means that they must be of sound mind. Some other conditions are the determination of the value of the *Mudarabah* property in case it is in the form of other assets that are movable or immovable. This value must be determined and agreed upon on the day the contract is concluded. It is also a requirement that the mechanism for profit distribution to be clearly known to each party so as to eliminate any uncertainty and possibility of dispute. The distribution of the profit must be on the basis of an agreed percentage of the profit not on the basis of a lump sum or percentage of capital. This arrangement should be made initially while entering into the contract agreement.

Taqi (2009) described two main categories of Mudarabah in Islamic banking and finance. *Mudarabah Al Mutalaqah* (unrestricted *Mudarabah*): this is the kind of *Mudarabah* is the one that is left open for the entrepreneur to invest in any kind of business which is considered lawful from the Islamic point of view. The capital owner will allow the entrepreneur to administer a *Mudarabah* fund without restrictions on the type of work that is to be done, the location, the time, mode of payment, etc. Most of the Islamic banks around the world practice these principles. There is no restriction upon them from the depositors and investors to invest the money. The only condition is that the banks must ensure that the money is invested in lawful (*Halal*) business activity.

MudarabahAl-Muqayyadah (restricted *Mudarabah*): under a restricted *Mudarabah,* a capital provider restricts the entrepreneur that the investment should be limited to a particular location or to a particular type of business or contract. In this situation the entrepreneur is not authorised to invest the money in any business activity of his own choice but rather he should take permission from the capital owner. In this system the retail Islamic banks find it unattractive to accept the money under such a restriction, as it narrows down the channels and avenues of investing in reliable and more profitable activity and restrictions can increase the cost of running the specified projects (Iqbal & Murakhor, 2007).

In modern time Islamic banking, the *Mudarabah* principle is used as a mode of financing to invest the deposits of the customers in business ventures. The banks do this through the system of two-tier or second tier *Mudaraba*. Initially the capital owners or depositors give their money to the bank for investment, here the bank serves as entrepreneur while the depositors are the capital providers, then the bank will enter into a second agreement to give

money to the entrepreneur for investment where the bank now serves as the capital owner. According to Uzair (1955), this arrangement was designed in the early 50s.

The experience of Islamic banks with *Mudaraba* is few in number as the contract is prone to risk. The use of *Mudarabah* is mainly for short-term purposes in which the banks can reduce risk to a bearable low level and the return is virtually guaranteed. Due to this potentiality of risk, Islamic bank are not using *Mudarabah* financial technique to the fullest (Ahmed, 2009). Some of the ways banks adopt to minimise the level or extent of the risk involved in *Mudaraba* system are: the entrepreneur is required to submit the balance sheets, profit and loss accounts, progress reports and all the relative information to the Islamic bank. Also the representatives of the bank can check the accounts and do the stock taking at any time in the warehouse. In case of violation of the principle of the contract as well the breach of the trust, the bank can terminate the contact without giving any prior warning.

Mudarabah system of investment is regarded as very essential in tackling the problem of financial exclusion in Nigeria due to the consideration that the replacements of interest bearing financial products by profit and loss sharing modes of financing will inevitably promote small and medium entrepreneurship. Unlike conventional banks with their collateral-based lending and credit worthiness system that favour only established business and corporate clients. But Islamic banks with their emphasis on PLS instruments which are compatible with the needs of small entrepreneurs with viable projects ideas that are normally avoided by conventional banks due to insufficient collateral will now have a greater opportunity to be included financially. Therefore, *Mudarabah* arrangement will help in bringing poor and disadvantaged members of the society into the fold of financial inclusion.

5. Conclusion and Recommendation

Islamic banking system is based on profit and loss sharing scheme not based on interest or predetermined charges. The system ensures that more emphases are placed on reward for effort rather than on reward for merely owning capital. Islamic banking institutions had developed techniques that replace interest-based income with cash flows from the productive sources through partnership arrangement. It particularly attempts to find more socially acceptable and attainable substitute to interest bearing modes of finance, in its desire to provide justified distribution of wealth and income in the society. Because of its moral values and ethical standard, Islamic finance is gradually gaining universal acceptance and attracting funds from Muslims and Non-Muslims alike. Currently, Islamic banking is thriving and growing fast in many western nations who are aiming of becoming Islamic finance hubs.

The core values of Islam are built upon greater emphasis on social justice, inclusion and sharing of resources between the haves and have not. Islamic finance addresses the issue of financial inclusion from the two points of view either through promoting risk sharing contracts that provide an alternative to convention interest based products such as *Mudarabah* and *Musharakah* systems or through specific instruments of redistribution of wealth in the society, such as *Zakkah, Sadaqa, Waqf* and benevolence loan. Both modules complement one another in eradicating poverty as well as building a strong and healthy economy. Therefore, the paper recommends that the regulatory agencies and *Shariah*

Advisory Boards should make sure that the institutions providing *Shariah* compliant products and services give much emphasis to *Mudarabah* system of investments due to its ability to make the poor entrepreneurs to become economic active members of the society. Also Jaiz Bank and other banks that provide service in line with Islamic banking rules should intensify effort toward enhancing the social justice aspect of Islamic banking and finance.

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