
MUDARABAH AS A MEANS OF FINANCING SMALL SCALE ENTERPRISES IN KANO STATE-NIGERIA

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ABSTRACT

One of the most fundamental aims of Islam is to realize greater justice in humanity. Nevertheless, this is not possible unless all human institutions, including the financial system, contribute positively towards achieving this objective. One of the needs for this, is to subject all aspects of human life, social, economic and international, to moral values. This will help toward maximization of wealth and want satisfaction as the highest measurement of human achievement. Although Islamic banking is for all, irrespective of religion, but the great expectation is for Muslim to distance themselves from interest/usury as it is forbidden and unacceptable. That is why Islam has its own economic system which is based on social justice and improved welfare of the whole humanity. The Nigeria financial system is a product of capitalist economy and therefore, the concept of interest-bearing instrument is relevant to the system. It is hard to imagine that there is an alternative to the interest-bearing financial system. Islamic banking is an alternative form of financial intermediation that is based on profit sharing; but with a moral dimension based on Islamic value system. It is not the only type of profit and loss sharing banking based on non-interest principles, but is the most developed form that has international acceptance and appeal. Although base on a religious law, it is nevertheless, not a religious product exclusively preserved for people of a particular religion. It is universally accessible to and enjoyed by people of diverse religious affiliation or ethical beliefs across the globe. A key element under the concept is that lending is not a business and linked to this, therefore is the no-interest rule. Thus, one cannot earn interest on a loan or require to pay interest on loans. Any pre-determine interest is prohibited.

Keywords: financial institutions, Islamic banking, Mudarabah agreement, small scale enterprise

INTRODUCTION

Mudarabah simply refers to Islamic partnership. It is defined as an agreement between two parties that engage in business where one avail the funds for the business while the other undertake the affairs of the business. In a Mudarabah agreement, the contract is between an investor (financier) and an entrepreneur or investment manager known as the Mudarib. Risk and reward are shared. In the case of a profit, both parties receive their agreed-upon share of the profit. In the case of a loss, the investor bears any loss of capital while the Mudarib losses time and effort (Makiyan, 2001).

The evolution of modern Islamic banking in Nigeria dates back to 1991 with the enactment of the Banks and Other Financial Institutions Decrees (BOFID). This Decree recognizes banks based on profit and loss sharing (section 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 (section 61). The designation of non-interest banks as specialized banks in 2010 was based on this provision (Dongarawa, 2011).

Between 1993 and 1995 investors started applying for banking license to operate Islamic banking and these initiatives did not materialize due to investors' non-compliance with CBN requirements. In 1996, Habib Bank opened a non-interest banking window offering a limited number of shari'ah-compliant products. However, since there was no framework for non-interest banking in the country, the attempt did

not register a significant success. In 2004, demand for the establishment of full-fledged non-interest banks continued from interested investors. An Approval-In-Principle (AIP) was granted to Ja'iz International Plc. to establish Ja'iz Bank upon meeting mandatory capital requirement (CBN, 2011).

In 2005, the Financial System Strategy (FSS) 2020 was launched. This blueprint aims to engineer Nigeria's evolution into Africa's major International Financial Centre (IFC) and enable Nigeria's transformation into one of the 20 largest economies in the world by 2020. Among its initiatives regarding the money market is to create institutions that attract huge un-banked informal sector, to create non-interest banking instruments to capture huge unbanked segments of the society. In 2008, the Islamic Finance Working Group was formed with support from Enhancing Financial Innovation and Access (EFIA), which brought together, the main stakeholders: NDIC, NAICOM, PENCOM, DMO, market operators interested in offering Islamic finance products and a representative of the Central Bank as an observer.

In August 2010, the CBN released the new banking model which designated non-interest banks among the specialized banks. The non-interest banks are to be categorized into two; namely; National non-interest bank, which shall have a capital base of N25 billion and will operate in every state of the Federation including the Federal Capital Territory (FCT). Regional non-interest bank, which shall have a capital base of N5 billion and operate in a minimum of six states and a maximum of 12 contiguous states of the Federation, lying within not more than two geo-political zones as well as the Federal Capital Territory (CBN, 2011).

On 11th November 2011, Ja'iz International plc received a license from CBN, to operate a regional bank and commenced business on January 2012, as Ja'iz Bank plc with offices and branches in Abuja, Kaduna and Kano. As of December 2012, the bank was a medium-sized but growing financial institution in Nigeria, at that time, the bank's total assets were valued at N14.1 billion (\$88.8 million) with shareholders' equity of about N10.1 billion (\$63.6 million). As at December 2013, Ja'iz bank maintains networked Head office with 10 branches nationwide.

LITERATURE REVIEW

Islamic banking in Nigeria has been so over flogged and Nigerians seem to be paying lip service to its practical implementation. A lot of theories have been postulated as to the challenges and prospects of Islamic Banking in Nigeria. There seems to be no practical approach to its implementation. According Gusau (2013), there is nothing new about the idea of Islamic banking. It has been in literature over 60 years and many volumes have been written in that respect. What is new perhaps, is applying the concept to a vast territory like Africa with its diverse ethnic groups, races, color and religion.

A few attempts made to initiate little practical operations have been settled by Nigerian government policies which are not favorable to the whims and caprices of Islamic Banking. For instance, Jaiz investment made a giant stride about fifteen years ago to make a bold move in this direction. Jaiz went as far as selling shares to Nigerians, individuals and corporate bodies to raised fund to meet the Central Bank of Nigeria condition which has been charged over times. Up till this moment, Jaiz is yet to commence operation because of the Nigerian environment which is believed not sustainable for Islamic banking. Some look at the introduction of Islamic banking in Nigeria as an attempt to Islamize Nigeria and Nigerians.

Meaning of Micro, Small, Medium and Large Scale Enterprises

Central Bank of Nigeria (CBN, 2003) defined Micro, Small, Medium, and Large Scale Enterprises respectively as follows; Micro/Cottage industry is an industry with a labor size of not more than 10 workers, or total cost of not more than 1.5 million, including working capital but excluding cost land. It

viewed Small Scale Industry as an industry with a labor size of 11-100 workers or a total cost of not more than 50 million, including working capital but excluding cost of land. Medium Scale industry was considered as an industry with a labor size of 101-300 workers or a total cost over 50 million but not more than 200 million, including working capital but excluding cost of land. And Large Scale Industry with a labor size of over 300 workers or a total of over 200 million, including working capital but excluding cost of land.

In country like India, Kenya and Uganda, number of employee is considered in defining SMEs, India considered 30-100 employees, Kenya 11-50 employees as small and medium enterprise (fatai, 2011; Ekpenyong & Nyong, 1992). In his definition of terms Anthony (2005), define a small enterprise as an enterprise whose total cost including working capital but excluding cost of land is between ten million naira and one hundred million naira; and a workforce between eleven and seventy full time staff.

As a developing economy, the CBN definition of SMEs in 2003 is the most encompassing. One may argue that if that is considered today uncountable number of businesses may qualify which may be difficult to cover. It is true but never forgets that these petty-petty businesses are the businesses that need real financial assistance which if provided will grow. Imagine an enterprise that worth 500million (half of a billion) but still participating as SMEs to share the meager financial assistance set aside for real SMEs. Now let consider the role of SMEs in an economy.

Role of the Small and Medium Scale Enterprises in an Economy

Despite the differences in the definition of SMEs, scholars unanimously agreed on the stimulating role it plays toward economic growth and development. According to Anthony (2005), the most important role of SMEs in developing countries is creating additional employments, which reduce poverty and enhance quality of lives. Apart from employment provision, Ekpenyong and Nyong (1992), and Kilby (1969), observed that SMEs provide inexpensive consumer goods with little or no import content which contribute to long-run industrial growth by moving out of SMEs to large scale industries.

Shokan (1997, as cited in Ayoze & Latinwo, 2010) considered employment provision, innovation, systematic development of rural areas reducing urban migration, development of the indigenous entrepreneurship, mobilization of domestic savings and utilization of local resources, production of raw materials in the form of semi processed goods for use by the bigger industries among others as the roles of SMEs in Nigerian economy. On his part, Fatai (2011), viewed the role of SMEs as economic and social. He sees addressing unemployment as economic whereas solving problems of hunger, poverty and increasing standard of living as social.

The foregoing show that SMEs play significant role in economic development. In Indonesia, Micro, Small and Medium Scale Enterprises contribute 56.53% to the GDP and absorbed 97.30% of the total work force in 2009 (Syauqi & Purnamasari, 2011). Whether SMEs are actually playing the expected roles in Nigeria is another issue. It depends on the prevailing environment within which they operate in the country. At this juncture, we consider the major problems facing SMEs in Nigeria.

Constraints of Small and Medium Scale Enterprises in Nigeria

SMEs in Nigeria face many problems, one of which is finance. Olusoji (1999) observed that SMEs could not secure finance due to lack of collateral to obtain loan from financial institutions. Finance is a functional area of business without which enterprises could not survive. All business operations would stand still in the face of inadequate finance. Inability of SMEs to prepare a convincing business plan, resisting interest based financing due to religious belief and high interest rate make it difficult for them to access fund (Ali, 2006). Sometimes government policies, liberalization and deregulation of interest rates,

frequent changes, and inconsistencies in government monetary policies do hinder SMEs (Ekpenyong & Nyong, 1992).

Syauqi and Purnamasari (2011) also align with the position that finance is one of the major problem bedeviling SMEs. Anthony (2005), ranked financing problem as number three (3) among the plethora of problems facing SMEs in Nigeria. On the other hand, Business Day (2004), viewed access to finance as number four (4) problem to SMEs after, power supply, government policies and infrastructure. As these scholars concurred there is no doubt that access to fund is a problem area for SMEs in Nigeria.

Principles of Islamic Finance

Shtayyeh and Piot (2008) viewed principles of Islamic finance as comprising prohibition of interest, prohibition of activities with excessive speculation (gambling, derivatives), prohibition to invest in certain sectors like; alcohol/drugs, pig related industry, interest related businesses, ammunition, pornography and prohibition on transaction that has to do with unseen. In addition, Iqbal (1997) mentioned risk sharing, money as potential capital, and sanctity of contract as part of the principles, and explained that suppliers of funds should be regarded as investors not creditors.

Money becomes capital only when it is combined with other resources in productive activity, and upholding contractual obligation as a sacred duty to minimize risk of asymmetric information and moral hazard. Sanusi (2011) noted that under Islamic finance principles, lending is not a business. Investments are to be only in morally and legally approved causes the same thing with the western concept of socially responsible or ethical investment.

In Islamic finance, interest is seen as oppression and exploitation of those who have not, by those who have. Gambling, unjust enrichment or unfair exploitation and game of chance (excessive speculation) discourage investment in a productive venture and encourage opportunism. Naturally, resources are limited compare to human needs it is irrational to use the meager resources in the production of harmful products like alcohol/drugs. Even though it may be economically profitable yet the principles of Islamic finance prohibits it. There are many Islamic financing modes, these include:

Murabahah (cost-plus sale contract): Murabahah transaction is a sale at a stated profit. In a Murabahah transaction, the bank purchases an asset from a third party and sell it to the client at a stated profit on a spot or deferred payment basis. In this way, the client can buy something without taking an interest-based loan (Khan et al., 2000).

Ijarah (lease): Ijarah is an Islamic lease. The bank purchases an asset and lease it to a client for a fixed monthly payments. An Ijarah may include an option for the lessee to buy the asset at the end of the lease, which is a way for Islamic banks to provide finance for ownership of goods and services (Khan et al., 2000).

Mudarabah (silent partnership): A mudarabah transaction is an investment partnership. In a mudarabah arrangement, the contract is between an investor (financier) and an entrepreneur or investment manager known as the Mudarib. Risk and rewards are shared. In case of a profit, both parties receive their agreed upon share of the profit. In the case of a loss, the investor bears any loss of capital while the Mudarib loses time and effort (Makiyan, 2001).

METHODOLOGY

The problem of the research study relates to how Mudarabah agreement help in financing small scale enterprises in Kano State. The research design adopted is the survey. Collected of data was through questionnaire. 45 copies of structured questionnaire were administered on staffs of Ja'iz Bank plc, Kano.

The population of the study is the entire staffs of Ja'iz Bank plc. However, the sampling technique adopted was the simple random sampling. In this regard, the 45 questionnaire were distributed to those staffs. The analysis is based on the 41 questionnaire received. Simple percentage was used as the data analysis tool.

RESULTS AND DISCUSSIONS

Table 1: Responses of the questions

Question	Agree	Disagree	Total
Do you think Mudarabah helps in promoting small scale enterprises in Kano?	35	6	41
Do we have enough qualified staffs to operate interest free Islamic banking?	32	9	41
Do you Mudarabah play vital role toward the economic development in Kano?	30	11	41
Does the regulations on profits or losses sharing encourage the partners in Mudarabah agreement?	29	12	41
Does the population of Muslims in Kano help in the smooth undertaking of Mudarabah contract?	26	15	41
Do you think Mudarabah agreement helps to reduce the level of unemployment in Kano?	27	14	41
Do you Mudarabah contract help to increase the performance of the company's profitability?	33	8	41
Does the Islamic banking system concerned with the viability of the project unlike the conventional banking system?	31	10	41
Do you think Mudarabah contract allow business owners to generate lawful funds in Kano?	36	5	41
Do you think Mudarabah is being benefited by even non-Muslims in Kano?	32	9	41

Source: Field survey (2023)

Table 2: Percentages of the Responses

Questions	Agree	Disagree	Total
Do you think Mudarabah helps in promoting small scale enterprises in Kano?	85%	15%	100%
Do we have enough qualified staffs to operate interest free Islamic banking?	78%	22%	100%
Do you think Mudarabah play vital role toward the economic development in Kano?	73%	27%	100%
Does the regulations on profits or losses sharing encourage the partners in Mudarabah agreement?	71%	29%	100%
Does the population of Muslims in Kano help in the smooth undertaking of Mudarabah contract?	63%	37%	100%
Do you think Mudarabah agreement helps in reducing the level of unemployment in Kano?	66%	34%	100%
Do you think Mudarabah contract help to increase the performance of the company's profitability?	80%	20%	100%
8. Does the Islamic banking system concerned with the viability of the project unlike the conventional banking system?	76%	24%	100%
9. Do you think Mudarabah contract allow business owners to generate lawful funds in Kano?	88%	12%	100%
10. Do you think Mudarabah is being benefited by even non-Muslims in Kano?	78%	22%	100%

Source: Field survey (2023)

In order to confirm whether Mudarabah helps to promote small scale enterprises in Kano, 85% of respondents agreed that Mudarabah helps to promote small scale enterprise, while 15% disagreed. On the item: Do we have enough qualified staffs to operate interest free Islamic banking, 78% of respondents agreed, while 22% disagree. On the item: Mudarabah play vital role toward the economic development in Kano, 73% of respondents agree while 27% disagreed. On the item: Regulations on profits or losses sharing encourage partners in Mudarabah agreement, 71% of respondents agreed while 29% disagreed.

On the item: The population of Muslims in Kano help in the smooth undertaking of Mudarabah contract, 63% of respondents agreed, while 37% of disagreed. On the item: Mudarabah agreement helps to reduce the level of unemployment in Kano, 66% of respondents agreed while 34% disagreed. On the item: Mudarabah contract help to increase the performance of the company's profitability, 80% of respondents agreed, while 20% disagreed. On the item: Islamic banking system concerned with the viability of the project unlike the conventional banking system, 76% of respondents agreed, while 24% disagreed. On the item: Mudarabah contract allow business owners to generate lawful funds in Kano, 88% of respondents agreed, while 12% disagreed. On the item: Do you think Mudarabah contract is being benefited by even non-Muslims in Kano, 78% of respondents agreed, while 22% disagreed.

The forgoing analyses and results show that Mudarabah contract really helps in promoting small scale enterprises, in such a way that, the businesses are making giant strides aimed at tapping vast capacities at the Islamic Development Bank (IDB) and other avenues for long term capital flow through sukuk market. It also indicates that Mudarabah contract play a vital role toward economic development of the country because government has determination to revamp Nigeria's ailing infrastructures and the massive investment in such critical sectors as power, roads, railways etc. as well as the emphasis on public and private partnership offers opportunities for Islamic banks to participate using shari'ah compliant financing modes especially sukuk.

Also, it is observed that Mudarabah contract also helps to reduce unemployment in Kano; and is increasing the performance of small scale businesses through on-going financial reform which have significantly stabilized and restored confidence in the Nigerian financial system. Islamic banks are expected to benefit from this renewed confidence and stable financial environment. Further, it was found that Mudarabah contract allows business owners to generate lawful funds in Kano by using interest free system in Islamic banking which offers a veritable incentive and attractive option for investors who are strangle by the high lending rates charged by interest based financial institutions.

CONCLUSION AND RECOMMENDATIONS

In view of the results of data analyses, the study concludes that Mudarabah is essential to growth of small scale businesses, and by extension, economic growth of Kano State. The study therefore recommends that:

- 1) Islamic economist and clerics need to come together and provide training to avail technical staffs that can handle and run the system more effectively and efficiently in Kano.
- 2) There should be a formation of professional association and appropriate standards that will aid the growth of Islamic financial institutions e.g AAOIFI.
- 3) Government should accelerate its bid to become the hub of Islamic finance of Africa and this can only be actualized when it sets enabling atmosphere for trading of Islamic capital market instruments e.g sukuk and other halal (permissible) investments.
- 4) It is very important to have a unified Shari'ah council whose decision will be binding on all practicing Islamic institutions. This will eliminate confusion and inconsistency, thus, promoting interaction with other conventional financial institutions.
- 5) The National assembly should promulgate exclusive laws that would address the peculiarities of Islamic banking.

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