# Microfinance in Nigeria and the prospects of introducing its Islamic version there in the light of selected Muslim countries' experience

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# MICROFINANCE IN NIGERIA AND THE PROSPECTS OF INTRODUCING ITS ISLAMIC VERSION THERE IN THE LIGHT OF SELECTED MUSLIM COUNTRIES'EXPERIENCE*

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***Abstract***

*Today widespread poverty is one of the major problems of mankind and its alleviation one of her major agendas. In recent years microfinance has emerged as an important instrument to relieve poverty in the developing countries. Today there are more than 7000 micro lending institutions providing loans to more than 25 million poor individuals across the world, their vast majority being the women. However these institutions face some serious challenges, especially in less developed countries where the proportion of people in poverty is high. The existing microfinance in Nigeria serves less than 1 million people out of 40 million being the potential number that need the service. Also, the aggregate micro credit facilities in Nigeria, account for about 0.2 percent of the GDP and is less than one percent of total credit in the economy. Addressing this situation inadequately would further accentuate the problem and slow down growth and development of the country. We find that the microfinance institutions charge interest rate as high as up to 100% for lending and pay as low as 5% on savings. This aggravates the existing inequalities in the distribution of wealth and income in Nigeria. Finally, Nigeria being a country with a Muslims majority, represents a potential for Islamic microfinance especially that most Muslims reject the conventional interest based micro financing, which is not tailored in line with their faith. This might cause failure of government project to combat poverty in the country through micro financing. Under the circumstance Islamic micro financing has potential to serve the country better. The paper has relied on the sources of Shari`ah law, secondary data from journals, periodicals, conference proceedings, text book , internet search and other sources of published data to support the argument.*

*Key words: Microfinance; Islam; Nigeria*

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# 1. INTRODUCTION

After 1970s the number of microfinance institutions around the world proliferated at a fast pace. In view of the dismal performance of the conventional finance sectors, policy makers, practitioners and international organizations advocated micro financing as the tool for poverty reduction. Today there are more than 7000 micro lending organizations providing loans to more than 25 million poor individuals across the world, the vast majority of who are women. The United Nations Capital Development Fund declared 2005 as the year of micro credit. The success of Grameen bank model in Bangladesh-which offered loans to poor people through group collateral-was emulated in many countries worldwide.

The Nigerian microfinance industry has come a long way; it boasts of all the four well-known models in the industry. A CBN study identified, as of 2001, 160 registered MFIs in Nigeria with aggregate savings worth N99.4 million and outstanding credit of N649.6 million, indicating huge business transactions in the sector (Anyanwu, 2004). Institutional structures for the provision of micro credit vary and may be any of the following: government or public sector-oriented, NGO supported, traditional or a mixture of two or more of these.[1]

With a population of about 150 million and GDP/capita of $641 (2006), two-thirds of Nigeria's people are poor. Nigeria has the third highest number of poor people in the world[2]. Most of these poor people are dependent on micro and small-scale farm and off-farm enterprises for their livelihood. As such, their entrepreneurial contributions are strategic to the Nigerian economic development and their growth has great potential to contribute to income generation and poverty alleviation.

One of the challenges microfinance currently faces in Nigeria is for the MFIs to reach a greater number of the poor. The CBN survey indicated that their client base was about 600,000 in 2001, and there were indications that they may not be above 1.5 million in 2003. The existing microfinance in Nigeria serves less than 1 million people out of 40 million potential people that need the service (CBN, 2005). Also, the aggregate micro credit facilities in Nigeria, account for about 0.2 percent of GDP and less than one percent of total credit to the economy. The effect of not appropriately addressing this situation would further accentuate poverty and slow down growth and development.

Another challenge is that most of micro finance funding goes to the commercial sector to the detriment of the more vital economic activities, especially agricultural and manufacturing which sectors provide the foundation for sustainable growth and development. Currently, only about 14.1 and 3.5 per cent of total MFI funding went to these sectors, respectively, while the bulk,

[1] A paper on Policy challenges for microfinance design and practice in Nigeria published by African institute for applied economics, accessed on 27/12/2007 at www.microfinancegateway.com

[2] A research conducted by UNDP in collaboration with Nigerian Government on :Development of a sustainable pro-poor financial sector Phase II MicroStart Nigeria

78.4 per cent, funded commerce.[3] Islamic microfinance has the potential of providing funds to the majority of poor Nigerians who mostly engage in agricultural and manufacturing activities through its various schemes.

However, recently efforts are being made in the field of MF with interest-free Islamic products being offered by the Islamic MF institutions (IMFIs) in Muslim countries even as their number or size is not large. They offer different product and serve as an alternative to the supposedly successful conventional model. Some Muslim countries have gone far in adopting such institutions while others are yet to start due to some constraints or unexplored potentials. Nigeria falls among the latter. There is consciousness and desire among the Muslims in Nigeria to have microfinance that is in compliance with Shariah. The social role of Islamic financial sector can be best exemplified by providing finance to the poor so as to increase their income and wealth[4]. Specialized poverty focused MFIs can provide much-needed finance to micro entrepreneurs resulting in the increase of their income levels and wealth.

The main objective of this study is to investigate the challenges facing micro financing in Nigeria and the prospects for Islamic micro financing providing an alternative to the conventional sources.. It will also attempt to demonstrate the need for Islamic microfinance as a viable institution for distributive equity in Nigeria.

The paper is divided into five sections. The next section focuses on the evolution and challenges of the microfinance in Nigeria. Section three surveys briefly the experience of Islamic microfinance in some Muslim countries including. Section 4 looks at the possibilities of introducing Islamic microfinance as an alternative to conventional microfinance. Yemen and Malaysia as a guide. It also provides evidences on the needs and potentials of micro financing in Nigeria. Finally section four contains some concluding remarks.

## 2. MICROFINANCE IN NIGERIA: EVOLUTION AND CHALLENGES

**Microfinance: concept and need**

"Micro financing" is the provision of financial services to poor and low income households without access to formal financial institutions. (Conroy, 2003) Microfinance is described also as "banking for the poor." Microfinance programmes provide loans, savings and other financial services to low-income and poor people for use in small businesses.

Originally based on traditional forms of community financing (a cross between finance and development assistance) microfinance is found all over the world in places such as Africa, Latin America and Asia. The microfinance movement began in earnest in the early 1980's in places

[3] Microfinance Institutions in Nigeria: Policy, Practice and Potentials by C. M. Anyanwu Deputy Director Central Bank of Nigeria, Paper Presented at the G24 Workshop on "Constraints to Growth in Sub Saharan Africa, "Pretoria, South Africa, November 29-30, 2004

[4] Khan (1997) suggests a variety of activities like *qard-hasan*, financing housing, meeting basic needs, and promoting and financing small entrepreneurs. All these aspects, however, can be covered in a comprehensive integrated program with focus on microfinancing.

like Bangladesh and Bolivia and has, over the last 20 years, captured the interest of multilateral donor agencies and private sector bankers. (Enugu Forum, 2006)

Microfinance institutions are essentially needed to serve the poor city dwellers overcrowding in slums or squatter settlements in appalling conditions. They lack access to basic services such as education for children and health care. Their survival tool kit lacks skills that are essential to enter the employment mainstream of the economy. Many of them are women, poorly trained and playing dual roles of provider and caregiver. These poor people are more exposed to the threats of contamination, bad sanitation, and disease than the rest of the population. (Otero, 1999)[5]

Hulme (2000) argues that MFIs are not a cure for poverty. However, MFIs could create and provide a broad range of micro financial services that would support poor people in their efforts to improve their own prospects and the prospects of their families.[6]He believes that effective microfinance makes these agencies designed to help the poor more likely to achieve the goals that poor people seek to achieve. (Hulme, 2000)

**Characteristics of Microfinance Institutions in Nigeria**

Before the emergence of formal microfinance institutions, informal microfinance activities flourished all over the country. Informal microfinance is provided by traditional groups that work together for the mutual benefits of their members. These groups provide savings and credit services to their members. The informal microfinance arrangements operate under different names: 'esusu' among the Yorubas of Western Nigeria, 'etoto' for the Igbos in the East and 'adashi' in the North for the Hausas (CBN, 2000). The key features of these informal schemes are savings and credit components, informality of operations and higher interest rates in relation to the formal banking sector. The informal associations that operate traditional microfinance in various forms are found in all the rural communities in Nigeria (Otu, et al, 2003). They also operate in the urban centres. However, the size of activities covered under the scheme has not been determined.

The non-traditional, formalized microfinance institutions (MFIs) are operating side by side with the informal services. The financial services provided by the MFIs in Nigeria include savings, credit and insurance facilities.

**Microfinance suppliers**

**(i) Commercial banks and Microfinance**

The response of the banking system in Nigeria is changing to pay attention to microfinance seekers. The Bankers' Committee has recently decided that 10 per cent of the funds accruing to the Small and Medium Industries Equity Investment (SMIEIS) should be channeled to micro enterprises through registered microfinance institutions. Under the SMIEIS arrangement, banks in Nigeria agreed to set aside 10 per cent of their pre-tax profit annually for equity investment in

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[5] An article titled Binging Back Development in Microfinance, Journal of Microfinance, Volume 1, number 1, 1999

[6] See Balancing Demand and Supply side of Microfinance, Journal of Microfinance,2003 ,Volume 5, number 2

small and medium industries. At the end of June 2004, over N24 billion had been set aside under the scheme, while less than N10 billion had been invested. Apart from providing a large volume of resources, the fund is fairly medium to long term in nature and this has the potential of positively changing the structure of the microfinance industry in Nigeria. (CBN, 2004)

**(ii). Development Finance Institutions**

Between 1964 and 1977, various development finance institutions (DFIs) were established at both at the national and state levels in the country. The national DFIs included the Nigerian Industrial Development Bank (NIDB), Nigerian Bank for Commerce and Industry (NBCI), Nigerian Agricultural and Cooperative Bank (NACB) and Federal Mortgage Bank of Nigeria (FMBN). Each institution was given the responsibility of promoting the development of a specific sector or sub-sector (CBN, 2000). The NIDB was established in 1964, from the restructuring of an existing Investment Corporation of Nigeria (ICON), and given the mandate of developing new industrial enterprises and expanding existing ones through the provision of medium and long term loans and equity participation. A decade later in 1973, the NBCI was established to provide funding to small and medium scale enterprises. Of more relevance to micro enterprises, the NACB was also established in 1973 to promote the development of the agricultural sector in which most of the operators are micro enterprises. Also the FMBN, which took over the assets and liabilities of the Nigerian Building Society (NBS), was established in 1977, with the mandate to provide funding for residential and other housing needs of individuals and corporate organizations. Two other DFIs, the Urban Development Bank and Education Bank, were established in 1992 and 1993, respectively, to cater for these two important sectors.These DFIs made varying contributions According to their sectors of responsibility. They funded various projects and enterprises, many of which are in operation today. However, with the drastic reduction in government subventions to them in the 1990s, their operations reduced drastically and by late 1990, they all ceased operating, as all of them depended mainly on government funding.

The poor performance of the DFIs notwithstanding, the need to channel financial resources to the productive sectors, have remained a major challenge to the government and the monetary authorities. Attempts have therefore been made to restructure the DFIs, give them commercial orientation and make sustainability the guiding principle. In December, 2007, the new government policy give licenses to 107 microfinance banks and converted 600 out of 761 community banks to microfinance banks which make the total number of microfinance banks 707 in the country. (Soludo, 2008)

## Micro financing: challenges

We have already referred in the introduction to some of the challenges micro financing faces in Nigeria. We elaborate them a little below.

**(a) Rates of interest**

According to Anyanwu (2004) the interest rates in the microfinance institutions are much higher than the prevailing rates in the banks. This ranges between 32-48%. During this period the banks are charging between 19.5% and 21.6 %.( Anyanwu 2004). Money lenders at informal sector charge interest rates of 100% or more.[7] Some of the clients when interviewed by MFI evaluators bitterly complained about the interest rates being too high.[8] Two reflections could be made. First, given the fact that people borrowing at this rate indicate that they are industrious and productive. It is only that they are not given access to financial institutions, because they do not have collateral to meet the requirements of formal financial institutions and then they remain poor and liabilities to the economy instead of being assets. Second, the objective of microfinance to combat poverty might be defeated since the clients have to repay back double of what they have received at all cost.

**(b) Inequitable in the Distribution of Wealth and Income**

The conventional Micro financing in Nigeria aggravates the inequitable distribution of income and wealth in Nigeria. This is due to the fact that while interest rate on borrowing from microfinance institutions ranges from 30% to 100%, interest rates on both voluntary and mandatory savings for the clients are between 4.5% and 6% per annum.[9]

Again, lending at this rate is taking the rewards of poor and redistributes it to the rich. The poor borrowers must pay the amount through group pressure even if it resort them to another borrowing or selling their properties.

Moreover, the current micro financing in Nigeria gives loan to commerce based activity to the detriment of agriculture based which is the source of income and sustenance for the majority of poor Nigerians. In a study conducted by CBN on the major ten MFIs in Nigeria it was found that the loan disbursement goes to the trade and commerce because of its fast yield and high return. The average loan on this sector was 78.4%. The corresponding figure on agriculture which most poor rely on for their lively hood was only 14.1%. It was only 3.5% on manufacturing and absolutely no funding is given towards housing and consumption. (Folake, 2005)

**(c) Outreaching the poor**

According Central Bank of Nigeria`s estimate the unreachable client of microfinance reaches 40 million.(CBN, 2004) Microfinance specific institutions in Nigeria have not been able to adequately address the gap in terms of credit, savings and other financial services required by the micro entrepreneurs. The existence of huge unserved market - over 80 million people (65% of Nigeria's active population).In 2005, the share of micro credit as a percentage of total credit was 0.9%, while it contributed a meager 0.2 percent of the GDP.(Bamisile, 2006)

The dominant microfinance institutions are concentrated in the south and eastern part of the country to the detriment of poor majority in the predominantly Muslim north. Out of the 36 states in Nigeria, 19 states are in the northern part and most of them apply Islamic Shari`ah

[7]See UNDP`s document on "Development of a sustainable pro-poor financial sector Phase II MicroStart Nigeria" www.uncdf.org. on 12/01/2008

[8] Ibid

[9] Ibid, the inequitable redistribution exists in the sense that the microfinance institutions represent the rich category of the people while the clients represent poor category and still the former charge the latter higher interest rate on loan as high as 100% in some cases and pays only 5% on savings made by the clients, an unfair justification for that matter.

principles since their first introduction in Zamfara state in 1999.[10]The incidence of poverty in the three Northern regions is high compared to the three southern regions. It was 71% in North West, 72% in North East and 67% in North Central. The corresponding figure in the South is 43% in South West, 23% in South East and 35% in South South. These numbers are what led Soludo to rightly conclude that "very high level of poverty is essentially a Northern Phenomenon". (Soludo, 2007)[11]

According to the CBN Governor after introducing new policy on microfinance he stated that "the new focus on small and medium-scale enterprises was borne out of the realization that the country could not go far in employment generation and poverty alleviation without these enterprises having their pride of place"(Soludo,2008)[12] He added that the microfinance policy, which evolved as a result of the perceived need for funding of businesses, which have no access to banks' funds, will benefit only 35 per cent of the nation's population, particularly micro and small scale entrepreneurs, due to uneven spread of the MFBs across the states.(Soludo,2008)

## 3. ISLAMIC MICROFINANCE: NATURE AND EXPERIENCE

### Islamic Micro financing: Nature

Even while the principles reflect a consensus, they do not imply or advocate a single and uniform approach to microfinance. As CGAP emphasizes, "diverse approaches are needed—a one-size fits-all solution will not work. Diverse channels are needed to get diverse financial services into the hands of a diverse range of people who are currently excluded. Making this vision a reality entails breaking down the walls—real and imaginary—that currently separate microfinance from the much broader world of financial systems."[13]

Theoretically, the main point of departure for Islamic microfinance from conventional credit/finance systems comes from the concept of joint liability. Conventional micro financing violates Islamic principles by charging interest rate. This is a matter of concern for Muslims due to the consequences of dealings with interest (riba). Islamic teaching does not allow a fixed return on capital, as charging and receiving interest (riba) is forbidden.

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[10] Shariah was strictly followed before colonialism of 19th century by majority of the northern part, after colonialism it was reduced to personal law only. With the coming of democratic government in 1999 the Governor of Zamfara states, then Alhaji Ahmad Sani Yarima established a committee to study the Nigeria`s constitution and look at the possibility of reintroducing the Islamic legal system(shariah) which will cover all aspects of Muslims life including businesses. The committee submitted their report which concluded that it is possible to apply shariah in any part of the country if the state so wishes.

11 Nigerian Economy: Can We Achieve The Vision 2020?By Prof. Chukwuma C. Soludo, Governor, Central Bank Of Nigeria 8th January, 2007

[12] http://allafrica.com/stories/accessed on 27/1/2008

[13]Brigit Helms, Access to All: Building Inclusive Financial Systems, Consultative Group to Assist the Poor, World Bank, 2006, P2

One of the primary and the most frequently articulated rationales by Muslim scholars is that charging interest is a form of social and economic exploitation, which violates the core Islamic teaching of social justice. Thus elimination of this is intended to promote economically just, socially fair, and ethically and morally correct economic behavior. (Iqbal and Mirakhor, 2007)

The logic as to why the Holy Qur`an has given such a severe verdict against interest is that Islam is against all exploitation and injustice; it standsis for economic system that aims to secure extensive socio-economic justice. Islam therefore condemns all form of exploitation particularly the injustice continued in the form of a lender being guaranteed a positive return without assuming a share of the risk with the borrower, whereas the borrower takes upon himself all sorts of risks in addition to putting in his skills and labor. By eliminating Riba, each party to the contract gets a fair and equitable reward, which ultimately leads to more equitable returns distribution and, therefore, to a more just economic system. (Hasan, 1986)

In a study conducted by Sadeq (2004) in Bangladesh on conventional MFIs and Islamic Micro finance he found that it was due to negative effects of social as well as economic nature of microfinance that attracted the critics to provide alternatives, which will be free from the negative effects. Some of them have come up with faith based micro financial services, and are categorized as Islamic Microfinance Institutions (IMFIs).[14] They and their services are different from their counterparts in number of ways.

First, the IMFIs provide micro financial products, which are free from interest. Their products are based on mark-up pricing, profit sharing and so on. Second, the IMFIs provide micro financial services to both men and women, without any differential treatment. In another study by Mannan (2007) [15]in Bangladesh he found that MFIs are based on the implicit assumptions of social class conflict, so they tend to empower women, whereas IMFIs intends to empower family by ensuring joint liability of husband and wife in case of lending to family or groups of families.

## Islamic Microfinance Experience

**Islamic Microfinance in Sudan:** Sudanese Islamic bank (SIB) established special micro-credit windows called “productive family branches” in the year 1992. These branches mostly adopted partnership financing, among other Islamic methods of finance. In the SIB experience the user of funds does not have to contribute in cash to the proposed investment, his share might be in kind (input), labor, or rent of machines or equipment (depreciation during musharakah period). In relatively profitable ventures the return on investment to the bank is much greater than in any

[14] See a paper titled Microfinance, Poverty Alleviation and Economic Development : Theory and Practice, presented at First International Conference on Inclusive Islamic Financial Sector Development, Brunei , 17-19 April, 2007

[15] In his paper “Alternative Micro-Credit Models in Bangladesh: a comparative Analysis Between Grameen bank and Social Investment bank LTD. Myths and Realites.”presented at first International Conference on Inclusive Islamic Finance, Brunei, 2007

other methods of finance. (Abdallah 1999)[16] The SIB however, did not pursue the experiment to the end due to the central bank regulations on one hand and the change in the management of the SIB on the other hand.

The experience of providing Islamic microfinance extended to other banks in Sudan, including Nile Bank, SSDB, ICDB, Agriculture Bank and Al-Baraka bank. *Murabah* was the dominant form used with few exceptions where benevolent loans were provided in addition to finance using the aforementioned formats.[17]

Sudan has faced many macroeconomic problems that have created a difficult business environment for small firms and micro enterprises. However in a study conducted by Ibrahim shows that these businesses have nevertheless played a major role in generating employment opportunities and increasing the family income of people of modest means. He evaluates the contribution of the informal sector, craft workshops and productive families, all of which have benefited from Islamic financing, especially since the 1990s. This has helped significantly with poverty alleviation, and there is much potential for this type of small and micro business support to be extended in the Sudan as well as elsewhere in Africa and the developing world more widely. Indeed, Ibrahim suggests that the profit and loss sharing techniques used for Islamic financing can be extended to interest-based banking.[18]

**Murabaha Model, Hodeimah Microfinance Program (Yemen)[19]:** Banking products have been available in Yemen for many years, however, many people, and the poor in specific, shied away from banking credit, mainly due to religious beliefs. In reaction to this, the Hodeibah Microfinance program (HMFP) was established in 1997, Hodeibah is a port city, characterized by having an active economy based on trading, fishing, food production, small industries handcraft and transportation. The program was the first of its kind in Yemen. By June 2000, it had 1770 active clients, 23% of whom are women, and US $ 350,000 in outstanding debts. The average disbursement size was US $ 240. The clients went through a cycle of disbursement levels and each level had a wide scope, based on group approach, where group members are not confined to the same disbursement amounts or same activities.

One of the main achievements of the program during its first phase was to develop a microfinance methodology closely tailored to local circumstances and based on Islamic banking principles.

16 In a paper " partnership (Musharakah): A new option for Financing small enterprises" published by Arab Quarterly Journal,p.259

17 Marbah, Zahira (2006), "Islamic Microfinance Institutions" Al-Azhar University Egypt, unpublished paper quoted by El-Karansahawy,2007,proceedings of the first International conference on Inclusive Islamic Finace, Brunei 2007,p14

18 Works on Islamic banking and Islamic finance,by Prof. Dr. Badr-El-Din A. Ibrahim.

19 www.uncdf.org, last accessed on 21-01-2008

However, the program uses murabaha as the tool which appears to be more expensive to the clients. There is limited application of Musharaka and Mudharaba in Yemen though it is preferred by the clients.[20]

**Malaysia`s Experience " AR-Rahnu"[21]:** The Malaysians developed a system known as "Ar-Rahnu" the system was simply based on the way widely accepted notion: "gold is women`s best friend." Malaysians made use of the simple facts all agree on, gold adorns a woman`s looks, it enhances status as it implies wealth, it is a saving mechanism as its price is stable and it normally appreciates, and it can serve as collateral whenever cash is needed. Micro financiers found out that Malaysians were reluctant to engage in banking activities that are un-Islamic. Therefore they devised a system whereby gold was used as collateral while the lender charges a fee for keeping the gold safe. Hence the system was based on the following principles of Islamic microfinance; it is interest free, transparent and customer friendly; it follows clear record keeping of all transaction, and secures safe keeping. "Ar-Rahnu" received wide acceptance in Malaysia by poor families and is considered a very useful tool in encouraging savings and investments.

It is based on benevolent loan (*Qardhul Hasan*) an agreement between a lender and a borrower whereby the lender is forbidden to ask for extra payment but the borrower is encouraged to give a token of appreciation.[22]

*Ar-Rahnu* is seen as an economic tool to improve the socio-economic development of the lower and middle income society, because of its flexibility and co-operative principles.[23]

## 4. ISLAMIC MICRO FINANCE FOR NIGERIA

One factor that might influence the need of Islamic microfinance in Nigeria is the size of Muslims population. Nigeria`s recent census shows that Muslims make up 55% of the country`s population.[24]Thus, the estimated number of Muslims stands at 77 million. This represents a potential market for financial service providers as these people are likely to engage in one economic activity or the other.

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20 See "Microfinance in the Arab world, shaping the industry`s future" by Aliriani head of SMED ,a paper presented at first annual conference of Sanabel, Microfinance of Arab Countries last accessed at www.microfinancegateway.com ,20/01/2008

21 Burhan Muhammed (2005) " Ar-Rahnu A New Microfinance Era in Malaysia" National Cooperative Organization of malaysia (ANKASA)

22 See A Paper Entitled *Ar-Rahnu* : A New Era In Microfinance In Malaysia By Dr Mohd Ali Baharum Deputy President National Co-Operative Organisation Of Malaysia (Angkasa) last accessed 2/01/2008

23 Ibid

24 See www.islamonline.net/english/news/2005 accessed on 29/01/2008. The 2006 census did not include questionnaire about religion as according to the officials it is politically sensitive. However the figure reveals that 53.4% of Nigeria`s population are from the north which is predominantly Muslim.(See African Economic outlook,2007)

Another factor that shows the demand of Islamic microfinance is the discountenance of some Muslims to conventional microfinance in Nigeria in protection of their faith. Poverty alleviation efforts cannot be effective nor have the desired impact unless all or at least a majority of the poor can be reached. Hence, the lack of understanding of these reasons especially religious may make the governmental and non-governmental organizations' efforts at combating poverty to flounder. (Abideen, 2006) This is similar with the finding of Gusau and Bawa (1993)[25] on the idea of establishing interest free banking system in Nigeria.[26] They found that the majority of the Muslims respondents said they will deposit in an Islamic bank if one is established purely for religious reasons; and they will abandon their present banks so as to rid themselves of interest. Based on these findings, the authors argued that interest free banking has good prospects in Nigeria.

Similarly in a research on small scale industries in one of the predominant Muslims states (Kano) in 1973 and 1980 indicate that there was still a great deal of resistance to interest on the part of Muslim small businessmen. Bank rates for loans ranged from 7.5% to 11.5% and the Kano State Small Scale Industry Credit Scheme offered loans at the subsidized rate of 3% per annum. When owner/managers were asked what a fair rate of interest was, 46.8% of the Muslims either answered none or that they were unfamiliar with interest or that taking loans with interest was not a possibility. Other questions dealing with interest reinforced the general conclusion that the Islamic prohibition against usury is still a strong force in Kano today. (Frishman, 1986)[27]
The influence of the Islamic prohibition against usury is quite strong and has influenced personal consumption and business economic activity in the city. Although adherence to this law is not absolute, it is clear that this aspect of Islam has been adopted by a majority of the Muslim population of the city.[28] For microfinance to be successful peoples` belief must be taken into consideration. This will be in form of providing various products that will suit the tenets of the Muslims in Nigeria.

Moreover, given the fact that the total number of Nigerians living below poverty line is 70%, despite the existence of different microfinance institutions, Islamic microfinance could be a complementary in serving these honorable Nigerians that are deprived access to financial services. Islam cares about others and wants ensure distributive justice and equity among people.[29] Allah says in the holy Qur`an

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[25] Quoted by Gusau A. 2004

[26] Same conclusion is reached by Obiyo and Chinyere (2007)

[27] In an article The impact of Islam on the urban structure and economy of Kano, Nigeria, published by The journal of Muslim minority affairs,1986

[28] Ibid

[29] See also Q 49:13, Q2:28,4: 10

*"There is therein (enough) provision for thee neither to go hungry nor to go naked". Nor to suffer from thirst, nor from the sun`s heat."* (20:118-119)

In another verse He says *"It is We Who have placed you with authority on earth, and provided you therein with means for the fulfillment of your life. Small are the thanks that ye give.* (7:10)
Furthermore another verse says

*"What Allah has bestowed on His Messenger (and taken away) from the people of the townships, - belongs to Allah, - to His Messenger and to kindred and orphans, the needy and the wayfarer; in order that it may not (merely) make a circuit between the wealthy among you. So take what the Messenger assigns to you, and deny yourselves that which he withholds from you. And fear Allah, for Allah is strict in Punishment.*(59:7)

Allah has provided sustenance for all living beings on the earth without making any discrimination between different creatures and their functions. (Hasanuzzaman, 1999)
According to a study conducted by Abubakar and Adam (2000) about living condition in Nigeria, they bring out facts and figures as to how the realities of the daily lives of the people (masses) actually make it difficult for them to carry out their religious obligations properly due to the levels of poverty , diseases, hunger and destitution to which they have been reduced to by the way the economy is organized and operated by the rich and the powerful, both Muslims and Christians, and by government policies formulated and implemented in the interest of these rich and powerful.[30]

According to Hasan (1988), the purpose of economic endeavor in organized community is to maximize overall social welfare. Its achievement requires, along with other things, an equitable distribution of the goods and services flowing from the productive process.[31]This calls for re-organization of the Nigerian economy in line with equitable distribution of wealth and income through policies that is more favorable to the poor majority. This will give room for Islamic micro finance institutions to penetrate and tackle poverty from grass root level, since Islam always preach for a more just social order and it considers wealth as initially common to all and should not remain concentrated in the hands of a few.(59:7)

The envisaged MFIs in Nigeria by the CBN lacks what Sulaiman, (2002) called Islamic characteristics. According to Khan (1997), while any MFI or lender for that matter can easily exhibit or provide the 'mechanics' of Islamic finance, they do so without consideration for the 'spirit' of it. He further stated that the spirit of it is based on the Islamic tenets of adl (social justice) and ihsan (benevolence).

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[30] A book written by Abubakar and Adam titled The living conditions of the "Talakawa"(Masses) and the Shariah in contemporary Nigeria, quoted by Umar Gama,in a bibliography on Shariah in the North of Nigeria.(1982-2004)

[31] See Hasan 1998 "Distributional Equity in Islam" in Distributive Justice and Nedd fulfillment in Islam, edited by Iqbal, Munawar

Nigerians, the rich and the poor, are enterprising and industrious. But the poor who account for over half of the population do not have access to formal banking services and they rely heavily on formal and informal micro finance institutions for credit. Nigeria's large population, over 140 million people, requires the production of goods and services on daily basis and funding is required for the production.

The microfinance market in Nigeria is very large. It is estimated that Nigeria has between 60 and 90 million micro entrepreneurs, making her the next biggest microfinance market after China and India. The total annual requirement of credit in Nigeria by the economically active poor and low income earners would be between US$6.0bn and US$9.0bn on the basis of US$100.00 per micro entrepreneur, while over 3 billion people require microcredit world wide. Nigeria`s large microfinance industry is a potential money spinner for prospective investors. (Soludo, 2008)[32] Hence, potential in Nigeria remains largely unexploited. (Radwan, 2008)[33]

There is therefore huge demand for financial services and the MFIs, thus given the challenges of conventional micro financing, Islamic micro financing have a prominent role to play. The future of the industry is therefore very bright in Nigeria.

## 5. CONCLUDING REMARKS

Microfinance (MF) is a powerful poverty alleviation tool. It implies provision of financial services to poor and low-income people whose economic standing excludes them from formal financial systems. Access to services such as, credit, venture capital, savings, insurance, remittance is provided on a micro-scale enabling participation of those with severely limited financial means. The provision of financial services to the poor helps to increase household income and economic security, build assets and reduce vulnerability; creates demand for other goods and services (especially nutrition, education, and health care); and stimulates local economies.

A large number of studies on poverty however, indicated that exclusion of the poor from the financial system is a major factor contributing to their inability to participate in the development process. In a typical developing economy the formal financial system serves no more than twenty to thirty percent of the population. The vast majority of those who are excluded are poor. With no access to financial services, these households find it extremely difficult to take advantage of economic opportunities, build assets, finance their children's education, and protect themselves against financial shocks. Financial exclusion, thus, binds them into a vicious circle of

[32] See "Framework For Public Private Partnership In Micro financing In Nigeria" Being A Keynote Address By The Governor Of The Central Bank Of Nigeria Professor Chukwuma C. Soludo, Cfr At The International Microfinance Conference And Annual Microfinance/Entrepreneurship Awards Held At The Sheraton Hotel And Towers, Abuja, Nigeria On January 17 -18, 2008

[33] Senior economist ,world bank in his paper "The Potentials of Public-Private Partnerships in Microfinance Delivery", at International Microfinance Conference Abuja , Nigeria on January 2008

poverty. Building inclusive financial systems therefore, is a central goal of policy makers and planners across the globe.

Nigeria is a country with Muslim majority and 70 percent of its population suffering from high poverty and a low growth syndrome. A number of governmental and non-governmental programs are put in place in the last three decades to eliminate poverty. Yet, there has been a very marginal gain in the poverty alleviation exercise.

The existing microfinance in Nigeria serves less than 1 million people out of 40 million potential people that need the service. Also, the aggregate micro credit facilities in Nigeria, account for about 0.2 percent of GDP and less than one percent of total credit to the economy. The effect of not appropriately addressing this situation would further accentuate poverty and slow down growth and development. The reasons for this can be attributed to the application of the micro financing in Nigeria. This research found that the microfinance institutions charge high interest rate in lending (as high as 100%) and pay low interest rate for saving (as low as 5%). This aggravates the existing inequitable distribution of wealth and income in Nigeria.

Again, with vast number of Muslims in the country whom reject the conventional micro financing since it does not tailor with their faith by dealing with interest rate, then, the outreach would be very low, leaving the poor in poverty. This might cause failure in government project to combat poverty in the country through micro financing. Thus, needless to say that Islamic micro financing will serve as the best alternative and represents its potentials in the country.

The importance of providing an alternative microfinance in Nigeria cannot be overemphasized. As CGAP emphasizes, "diverse approaches are needed—a one-size fits-all solution will not work. Diverse channels are needed to get diverse financial services into the hands of a diverse range of people who are currently excluded. Making this vision a reality entails breaking down the walls—real and imaginary—that currently separate microfinance from the much broader world of financial systems. In the context of Muslim societies, building inclusive (comprehensive) financial systems would most certainly require integration of microfinance with Islamic finance.

Islam has enjoined upon the state as well as community to share the responsibility of reducing poverty from society. The economic philosophy of Islam aims, at first, to reduce poverty by providing basic human needs, narrowing the gap between the rich and the poor, and developing the resources of the earth for the welfare of human beings for whom everything is in heaven and earth is made subservient.

Islamic microfinance Institutional framework allows the establishment of institutions catering to such diverse needs of the society. Socio-economic justice and equitable distribution of income are among the paramount goals of an Islamic economy, and these goals must be reflected in an Islamic financial system. There are various institutions and structures Islam has installed through which income and wealth can be redistributed to fulfil the basic needs for all in society. Among others, *zakah*, *awqaf* and *qard hassan* have played an important role in the past in increasing the welfare of society and mitigating poverty. These charitable acts have wide economic implications. The social objectives of the Islamic financial system can be fulfilled if these important traditional Islamic institutions are integrated into the contemporary financial sector. Although, in the conventional sense, such institutions are not a part of the financial sector, it cannot be ignored that they have a large potential for economic development, being part of the Islamic financial sector.

The recent conversion of about 600 community banks into microfinance banks by the Nigerian government is a step ahead in the right direction as the credit, which Yunus called the right of the poor, is now close to the poor Nigerians. However, this credit should be made interest free and a joint liability should be formed between the bank and the poor entrepreneur base on profit and loss sharing. This has important implications both at micro and macro levels. At micro level, it distributes income more fairly between the microfinance bank and the individual borrower. At macro level it avoids creating an indebted society which also has adverse effect on the economy.

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