

# The role of moral transaction mode for sustainability of banking business

## A proposed conceptual model for Islamic microfinance banks in Nigeria

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### Abstract

**Purpose** – The purpose of this paper is to propose the use of Islamic moral transaction mode as a moderator in sustainable Islamic microfinance banks (IMFBs) business model.

**Design/methodology/approach** – The paper highlighted the major issues of microfinance banks in Nigeria and presented an integrated model that will suffice the long-term survival of the institution. Moreover, regression analysis is also employed to examine the impacts of financial outreach on the Nigerian economic growth.

**Findings** – The authors find that Islamic moral transaction mode will moderate the sustainable Islamic banking business which can influence the sustenance of IMFBs and the well-being of the society through financial outreach.

**Research limitations/implications** – The paper has empirically tested the impact of financial outreach on growth, and suggested future studies to investigate the existing relationships among the proposed model components. Therefore, further studies have the opportunity to develop measurements that will guide in testing the model, as well as strengthening its components.

**Practical implications** – Implementing this model will enhance the sustainability of IMFBs and socio-economic well-being of the society through financial outreach. Consequently, this study also suggests other policy measures that will improve the sustenance of IMFBs and the society as a whole.

**Originality/value** – The paper contributes to the existing literature of microfinance banks by linking the components of the sustainable business model to primary evidence of Sharia coupled with an in-depth link to generosity.

**Keywords** Nigeria, Sustainability, Islamic microfinance banks

**Paper type** Research paper

### 1. Introduction

Over the last five decades, Nigerian strategies and programs toward financing micro, small and medium enterprises have failed to hit the required targets in enhancing the socio-economic status of the poor despite the fact that 98 percent of the businesses in Nigeria are on a micro scale (Enhancing Financial Innovation and Access, 2012). Nonetheless, interest-based commercial banks are excluding them from financial outreach since 1992 (Luper, 2012; Terungwa, 2011). To this effect, the central bank in the country transformed the community banks to microfinance banks (MFBs) in 2005. MFBs were established in Nigeria with the aim to provide small loans and advances to poor through simple operations and without too much emphasis on asset-based collaterals (Central Bank of Nigeria, 2005; CBN, 2011a, b, c). In a nutshell, the focus of those banks is to reduce the menace of poverty and to improve well-being of the society. Similarly, Brundtland (1987) foresees sustainability as “uncompromising needs of present and future generations’ economic, social and environmental aspects of life.” As such, the Brundtland’s definition explicated the excessive need for sustaining people and their environment of which the poor is one of those segments of the society that requires immediate survival. Furthermore, Islamic banks are expected to sustain not only their operations but also the society and the environment through capital



allocation and financial decisions. This assertion can be easily viewed by Chapra model of Islamic banking (Dusuki, 2008a). However, banks cannot able to have positive influence on the societal well-being without having themselves been sustained. Therefore, institutional survival is a necessary condition before sustaining the society and environment particularly MFBs.

Nonetheless, in the case of Nigeria, 103 MFBS were closed due to poor risk management and failure in corporate governance among others (Central Bank of Nigeria, 2010a, b). Moreover, it has been noted that the failure of MFBS in providing socio-economic support to poor clients is related to the gap in institutional capacities and poor banking culture (Central Bank of Nigeria (CBN), 2011a, b, c). Interestingly, efforts have been made to reduce the level of financial exclusion through other non-traditional banking models. As a result, CBN framed new banking model that accommodated the non-interest financial institutions under specialized banks with an extension to full-fledged non-interest MFBS (CBN, 2011a, b, c). Islamic microfinance banks (IMFBs) are desirous to alleviate the hardship, and improve the socio-economic development of poor and micro entrepreneurs. In principles, IMFBs are expected to operate within the premise of Sharia guidelines of commercial transactions. Therefore, the need for sustainable business model to IMFBs is an uncompromising issue in order to sustain the socio-economic well-being of the society (Khaled, 2011).

Indeed, IMFBs are expected to fulfill the Sustainable Development Goals through equitable distribution of income and social justice (Dusuki, 2007). This present study adapts the previous components of Islamic banking sustainability and introduced the use of moderator from Islamic perspective. The proposed model is an integrated model derived from the previous conceptual study with some modifications (see Aliyu, 2014). Similarly, the study is designed to accommodate the regulatory and supervisory guidelines for MFBS coupled with the Sharia principles of Islamic moral transaction mode. Intuitively, Islamic finance has linkages with real economy through direct investment with sharing profit and loss provision. Also, It provides ethical standards by upholding moral values via prohibition of interest, speculations, uncertainty, gambling and promotes lawful acts. Therefore, it is expected that this model will help in guiding IMFBs to achieve the Sustainable Development Goals.

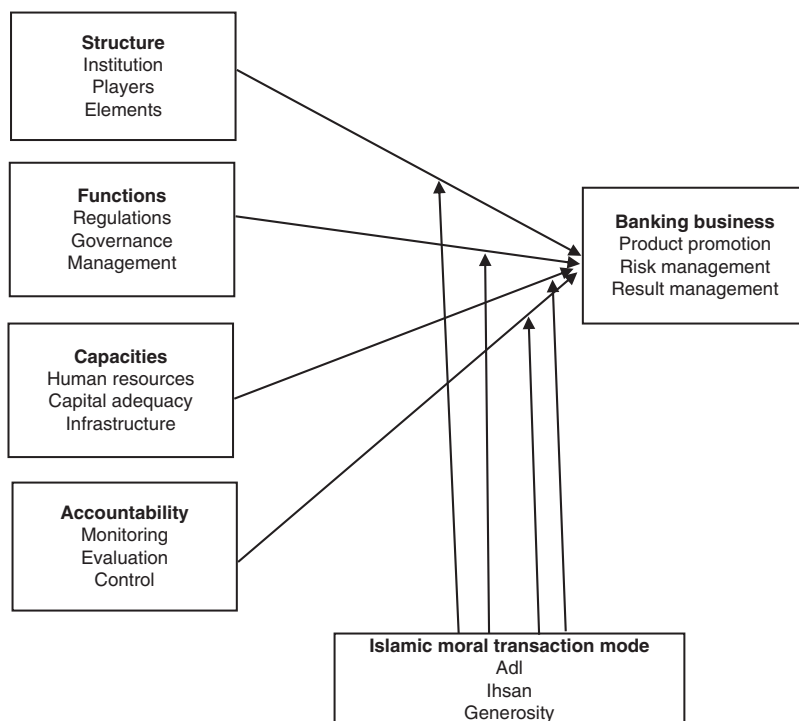
## 2. The model components

The model in Figure 1 shows the proposed schematic sustainable Islamic banking business model. The model has four major constructs in achieving sustainable Islamic banking business. Each construct of the model has three dimensions that constitute the conceptual components. In contrast to the conventional view, the moderating variable is deduced from the primary sources of Sharia. Therefore, Islamic banking business is proposed to be moderated with the functional influence of moral transactional mode. However, previous literature (Ahmed, 2007; Zaman and Asutay, 2009; Asutay, 2007) of Islamic finance had identified the need for integrating the concept of *Adl* and *Ihsan*, but, none of them used the concept as moderator to sustainable Islamic banking business with an in-depth link to generosity.

Therefore, this following section will review the related literature on each of the proposed construct in the model and relate it to the context of IMFBs. Consequently, deductions from the primary sources of sharia will stand as the major guide for the review.

### 2.1 Structure

Micro entrepreneurs in Nigeria are those who have total asset of less than five million naira (excluding land and buildings) and less than ten employees (Small and Medium Enterprises Development Agency of Nigeria, 2012). Therefore, borrowers of the ideal IMFBs in Nigeria are expected to be within the range of those prescribed amounts. The MFBS are established in Nigeria to focus on the clients who are within the range of "low-income earners, low income households, unbanked and underserved people (such as) vulnerable groups (including)



**Figure 1.**  
Proposed sustainable  
Islamic banking  
business model

Source: Adapted from Aliyu (2014)

women, physically challenged, youths, micro entrepreneurs (senior citizens), informal sectors operators, and subsistence farmers in urban and rural areas” (Central Bank of Nigeria (CBN), 2012a, b, p. 7). In the case of IMFBS, active poor or needy micro entrepreneurs should be the first priority for IMFBS (Ashraf and Hassan, 2013; Muhammad and Zakaullah, 2013). Thereafter, IMFBS can use Zakkah, Sadaqah and other channels such as *Qard Al-hasan* to help the dormant poor and needy (Ahmed, 2007). Therefore, the characteristic of customers in IMFBS are those with weaker financial position, improper business record, absence/insufficient collateral and those with unbanked status.

As argued by Aliyu (2014), the relationship with Islamic banks should go beyond the banker-customer (debtor-creditor) relationship as prevalent in the conventional banks. Rather, Islamic banks promote the relationship of partnership/investor-entrepreneur to achieve the objectives of Sharia and at the same time to gain the rewards from Allah. As a result, it requires justice, *Al-Ihsan*, fairness and brotherhood in all banking activities. It is forbidden in Islam to have business transactions such loan repayments and others that result in injustice and immoral behaviors between and among the contracting parties. Likewise, extension of loan repayment time could be granted to debtors who are in hardship (“has no money to pay-back” Q2: 280). This contradicts the conventional concept of debtor-creditor relationship that implies additional charges plus compounding interest rate in the case of debtor’s failure to make repayment within the feasible time limit. Regarding fairness and justice with customers even if they are illiterate, Allah drew our attention in debt transaction: “When you contract a debt for a fixed period, write it down. Let a scribe write it down in justice between you” (Q2: 282). The teachings of Islam abolished any hidden charges that could be accrued to the customers without his/her prior consent. On the other hand, “Let him (the debtor) who incurs the liability dictate and he must

fear Allah, his Lord, and diminish not anything of what he owes. But if the debtor is of poor understanding, or weak, or is unable himself to dictate, then let his guardian dictate in justice” (Q2: 282). Therefore, in this regard, the bank-customer relationship in Islam is more lenient and sympathetic to micro entrepreneurs compared to that of a conventional contract. Accordingly, it is also very important to adhere to the principle of partnership as highlighted above and at the same time to abide by other Sharia-permitted regulations which can be achieved through proper governance and management as discussed in the following section. Therefore, based on the structural relationship between the mode of transaction (partnership) and the adherence of regulation, the following proposition is formulated:

P1. IMFBS’ structural relationships will sustain the banking business.

## 2.2 Functions

The functions comprises of regulations, management and governance within the IMFBS to achieve the sustainable Islamic banking business. This newly proposed model of IMFBS activity is designed to achieve enterprises’ goals and objectives with the aid of commitments from the management through regulations and transparency in governance. The IMFBS are expected to serve the poor clients that are being excluded in the financial services in accordance to the Islamic principles of business transactions. Therefore, regulations that are designed to support good practices within the sectors must be abided with, so long as they are not contrary to the teachings of Islamic commercial jurisprudence. MFBS in Nigeria are bound to be regulated, and “[...], any contravention of this regulation constitute a ground for the revocation of the MFB’s license” (CBN, 2012a, b, p. 11). Therefore, IMFBS are subject to adopt mandated regulations in the country and at the same time being governed Islamic tenets. In addition, adopting other international guidance and regulations are seen as further supports toward achieving efficient operations of IMFBS. These include the standards developed by Accounting and Auditing Organization for Islamic Financial Institutions as well as Islamic Financial Service Board.

However, strict adherence to regulations did not preclude lenient and compassionate relationships among the working class of the IMFBS. In essence, the issue of class stratification has been clearly highlighted in the *Quran* in (Q43: 32) “[...], we raise some of them above others in ranks, so that some may employ others in their work [...].” Despite the fact that (Q49: 13) “[...], the most honourable of you with Allah is that (believer) who has *Taqwa* (i.e. he is one of the *Muttaqun* (the pious)).” Considering these verses and (Q3: 159), managements of IMFBS are expected to have compassionate living with their colleagues and to keep consulting them in making decisions. This would certainly ease the industrial dispute and improve commitment of the lower ranking personnel toward their services. In addition, managements are expected to protect the interests of the shareholders as well as the other stakeholders apart from the co-workers within the IMFBS. Furthermore, shareholders entrusted the management staff to oversee and manage their wealth, likewise the depositors. Therefore, compliance of prudential guidelines as being mandated for financial institutions is important in order to reduce financial indignities which may in turn affect the sustainability of Islamic banking business.

Moreover, the concept of Islamic corporate governance has surpassed the conventional ideas of Anglo-Saxon’s and that of the European model by incorporating the components of “Tawhid, Shura, and Shariah rules with Islamic morality and maintain the private goals without ignoring the duty of social welfare” (International Shariah Research Academy for Islamic Finance (ISRA), 2012, p. 690). The Islamic model of corporate governance centered on the epistemology of Tawhid ideology rather than those models on rationality which were derived from the selfishness of human logical thinking that can contradict the essence of human existence. The essence of our being on earth is to worship Allah (Q51: 56), and as our

Lord has created us with purpose (Q3: 191), that is to glorify Him solely in worship. Therefore, surrendering to the wills of Allah serves as the main guiding principle for all stakeholders. Meanwhile, stakeholders' rights and interests should also be channeled to achieve *maqasid al-Shariah* through an integrated concept of *shura* and vicegerency (Hasan, 2012). The highest supreme council under the Islamic corporate governance model shall be the Sharia board for regulating the activities of the IMFBS according to Islamic injunctions. It is intuitively known that Islamic financial system was built on investment contractual agreement based on profit and loss sharing. Thus, depositors or investment account holders have capital ownership of the business contrary to the conventional approach (ISRA, 2012). Similarly, active participations of the communal representation in governance framework will strengthen IMFBS' efforts to attain social, economic, environmental objectives of the banks sustenance:

P2. Participation of all stakeholders in the IMFBS' functional relationships will sustain the banking business.

Therefore, the success of this section can be attained with the aid of sufficient available resources (human, financial, technical and other infrastructures) which shall be elaborated in next sub-section.

### 2.3 Capacities

In achieving efficiency and sustainability of banking business, it is important for IMFBS to be selective in developing talents and human resources starting from the recruitment procedures. Recruitment and development (of human resources) is considered as a key for building effective management team (Pearce and Robinson, 2003). As identified in the work of Daft (2012), human resource management is broadly classified into managerial and operative functions. The former usually plans, direct, organize and set the organization under control while the latter is associated with the operative personnel. Therefore, qualifications and experience determine the placement category and apportioning of responsibilities to each staff. In addition, MFBS are proposed to recruit those with specialized experience and qualifications in handling small and micro entrepreneurs (Robinson, 2001). At the same time, IMFBS experts are required to have sound knowledge in *Fiqhul Mu'amalat*, *Usul al-Fiqh* and Islamic wealth management (Aliyu, 2014). Henceforth, considering the uniqueness and dynamism of Islamic finance in general, staff training and re-training on regular basis is of adequate importance (Sanusi, 2011; Dogarawa, 2013; Zouari and Nabi, 2013). On the other hand, IMFBS shall promote capacity building to their clients as part of social responsibilities and for their ease in loan recovery (i.e. in the area of loan usage, record keeping and management of small business). This will limit misuse of funds by the customers and promotes efficiency in utilization of funds. As such, Dusuki (2008b) extended the need for IMFBS' training to the clients for sustaining their businesses which in turn have direct impact on the banks' performance.

Capital adequacy is also considered as an important part of IMFBS' capacities to promote business sustainability apart from knowledge and expertise. The capital adequacy regulation is aimed to promote financial stability, reduce financial shocks, and the loss of depositors in case of insolvency of the bank (ISRA, 2012, p. 641). In the case of Nigerian MFBS, they are required to have the minimum of the paid capital[1]. And, MFBS basically sourced their capital through shareholders' fund, deposits from customers, debentures, grants/donations, fees and commission, loans from Islamic commercial banks (for IMFBS) and interest income (for interest-based MFBS). IMFBS can obtain funds from these sources except the ones that are interest-based and from non-halal transactions. In addition to these sources of capital, Sadaqat, Zakkah and Waqaf are other sources of funds that would be accessible to sustain IMFBS and their clients by extending these funds as Qard hasan (benevolent loan) (Khaled, 2011; Wilson, 2007; Ahmed, 2007; Hassan *et al.*, 2013;

Abdul Rahman *et al.*, 2013; Muhammad and Zakauallah, 2013; Ashraf and Hassan, 2013; Zouari and Nabi, 2013). Meanwhile, for the customers, IMFBS has a product which can attract investment account holders under the principle of *Mudarabah* (profit-sharing). Under profit-sharing mechanism, depositors and investment account holders are considered as part of the capital ownership structure apart from shareholders (ISRA, 2012). Therefore, additional measures have to be taken in safeguarding the capital structure of the IMFBS due to their exposures to several risks (see risk management below). At the same time, IMFBS need to achieve “customer-centric” objectives through providing infrastructural facilities for the convenience of clients in performing their banking transactions. For instance, the clients of IMFBS are micro entrepreneurs that need a mobile banking (e.g. via phone) to support their transaction without wasting time while promoting their products. At the same time, anti-fraud measures have to be set-up in order to hedge against fraudsters apart from loan tracking mechanism:

P3. Efficient and sufficient IMFBS’ capacities will sustain the banking business.

Despite adequate provisions of necessary capacities to IMFBS, accountability is another vital mechanism in sustaining the banking business, particularly on micro entrepreneurs. Micro entrepreneurs and banking staff required close monitoring and evaluation for transparency and efficiency.

#### 2.4 Accountability

Monitoring, evaluation and control are the integral components of the last sub-section of the independent constructs to sustainable banking business. Monitoring is regarded as functional activities through frequent checking, collecting and analyzing information for managerial decision making and to improve performance and results (Shorft, 2000). The information to be collected could be from present or past events. Therefore, it should be part of routine duties of the middle and top management cadre in IMFBS to be monitoring their clients through periodic follow-up visits. It is reported that many micro-borrowers access loans for “fulfilling (their) immediate consumption needs” instead of investing the amount into business while some are reported not even to have the required skills to operate the proposed business (Ashraf and Hassan, 2013, p. 231). Accordingly, the management needs to have close monitoring strategies within the IMFBS to assess, appraise and reviewing previous loans disbursements and evaluate the performance of clients’ repayment behavior. Consistent with these procedures, the staff performance can also be assessed toward achieving the goal of business sustainability. Thus, based on the above immense need of accountability to IMFBS, the following proposition is formulated:

P4. Proper accountability in the IMFBS will sustain the banking business.

The link between the four proposed independent constructs and the banking business in the model is been moderated through Islamic moral transaction mode. The Islamic moral of transaction is an extract from the six components of a verse (Q16: 90) which comprises *Adl*, *Ihsan*, generosity, *Al-Fahsah*, *Al-Munkar* and *Al-Baghy*. Although, this study focused on the first three commandments in the verse due to their unique features in guiding to righteousness.

#### 2.5 Islamic moral transaction mode

It is acknowledged that trust, equity, *Adl* and *Ihsan* are considered as necessary requirement for Islamic corporate managerial relations (Beekun and Badawi, 2005). The moderating construct in this model is a product of the six divine commandments of the *Quran* 16:90, whereas, the paper adopted the first three. In regards to the verse, Allah commands His servants to be “fair and moderate” and He encourages “kindness and good treatment” (Ibn Khathir, 2003, p. 2736). The words “fair and moderate” qualify the essence of using this

verse as a moderator for this model in the first place. The second reason is the uniqueness of its components as a whole. The verse is regarded as *Ajma'u Ayatan fil Qur'an* – the most comprehensive verse in the *Quran* as cited in the *Quranic* interpretation of Ibn Khathir “Ash-Sha’bi reported that Sha’tiyr bin Shaki said: I heard Ibn Mas’ud say: The most comprehensive *Ayah* in the Qur’an is in Surat *An-Nahl*” (Q16: 90). In the verse, all good virtues that will tranquillities our perfect living on earth and other factors that will distort peace and sustenance are there in. Allah orders us to enjoys *Al-Adl*, *Al-Ihsan* and to giving (help) to kith and kin and forbids us from *Al-Fahsha*, *Al-Munkar* and *Al-Baghy*.

*2.5.1 Al-Adl (justice).* *Al-Adl* (Justice) is placing things rightfully at their equal position. It is evidently clear in the law of equality in punishment (Q2: 178) “[...] free for the free, the slave for the slave, and the female for the female [...]” likewise in Q16: 126, Allah permits us only to do alike “And if you punish (your enemy, O you believers in the Oneness of Allah), then punish them with the like of that with which you were afflicted.” In Islam, “The recompense for an evil is an evil like thereof,” (Q42: 40), “And We ordained therein for them: Life for life, eye for eye, nose for nose, ear for ear, tooth for tooth, and wounds equal for equal” (Q5: 45). These citations explicate the act of equal placement without transgression of any rights.

The ideal and righteous placement for the children of Adam in the first place is to worship Allah (He Alone) (Q7: 29), He created us not but to worship Him Alone (Q51: 56). The second category relates to “*Alamin*” – all that exist (mankind, animals, plants and non-living things). Justice has to extend to all especially in establishing justice (Q4: 58; 4: 135). Similarly, justice and trust are magnificent of managers’ role in Islamic financial institutions. Therefore, extending justice to everyone in the society is of paramount importance and can be achieved through establishing trust among the players (Zaman, 2013). Without justice, asymmetry and closure of information will continue to impoverish the financial institutions. Specifically, IMFBs shall closely observe this even on their “poor” clients, staff, management, regulators and investors as prescribed in the above verse and (Q5: 8). Therefore, management in IMFBs is admonished to be just in their judgments, as said: “And if you judge, judge with justice between them. Verily, Allah loves those who act justly” (Q5: 42), likewise (Q7: 159-160 and Q7: 181) exemplified success in leadership is achieved through establishing justice and truthfulness. When leaders treat everyone and judge with justice, then, “they will not be wronged” (Q10: 47).

In financial transactions, Allah draws our attention to obtain justice in debt contract as to write it down and be just between parties. In the event where “the debtor is in a poor understanding, or weak or is unable to dictate for himself, then, let his guardian dictate in justice” (Q2, p. 282). The verse reveals the indispensable needs of justice in financial transactions even in the case of financial illiteracy of the customer. As been identified by Haqq (2011), IMFBs’ clients are mostly less educated, therefore the need for a fair and just contract between customer and bank is more pronounced in this case. At the same time, Islam does not allow usurping wealth unjustly except in the form of trade with mutual consent among parties: “And whoever commits that through aggression and injustice, We shall cast him into the Fire, and that is easy for Allah” (Q4: 29-30). Therefore, seeking bounty (trade, investment, merchandise and working for the sake of Allah is encouraged in Islam (Q62:10). Moreover, Prophet Shu’aib has extended such commandments to his people, as he said: “[...] O my people! Give full measure and weight in justice and reduce not the things that are due to the people, and do not commit mischief in the land, causing corruption” (Q11: 85). It is not only restricted to the measure and weight of grains alone, but punctuality to work in time, calculating dividend and assessment of values and measurements are all part of it. At this point it is clear that *Al-Adl* stands as a centripetal requirement in financial transactions, and the business transaction will not sustain alone without other attributes of *Ihsan*.

*2.5.2 Al-Ihsan (perfection).* The concept of *Al-Ihsan* (perfection) is the higher hierarchical stage ahead of *Al-Adl* position. One cannot attain the position of perfection in mannerism

without passing through: Islam, *Iman*, *Al-Adl* and then *Al-Ihsan*. The chain can be easily deduced from the hadith of Jibril of the 40 Annawawi collections (Badi, 2002) and (Q16: 90). The hierarchical chain of attaining *Ihsan* according to the above hadith would pass through Islam and *Iman*, while (Q16: 90) relates mentioned *Adl* before *Ihsan* which is the highest degree of perfection. Furthermore, the level of *Ihsan* according to the hadith; "It is that you should serve Allah as though you could see Him, for though you cannot see Him yet He sees you." The believers in this position have the highest degree of perfection in their deeds through righteousness. Those believers are cleansing themselves from their previous shortcoming with righteous deeds as contained in (Q5: 93). The verse expatriate that, doing righteous deeds in multiple of number through our daily affairs and fear of Allah will lead us to His love while performing it for His own sake and perfection. Afterward, this can be achieved only when one fulfilled the hieratical stage of *Al-Adl* as indicated severally in the *Quran*. For instance, the second part of (Q16: 129) after admonishing the believers for equal treatment: "And if you punish (your enemy, O you believers in the Oneness of Allah), then punish them with the like of that with which you were afflicted" then Allah extended to the level of perfection by saying: "But if you endure patiently, verily, it is better for *As-Sabirin* (the patient ones, etc.)." Likewise (Q42: 40), Allah said: "The recompense for an evil is an evil like thereof," and concludes with the position perfectionism as; "but whoever forgives and makes reconciliation, his reward is due from Allah." The next in the series of example is (Q5: 45) as it was mentioned: "And We ordained therein for them: Life for life, eye for eye, nose for nose, ear for ear, tooth for tooth, and wounds equal for equal" then the hierarchy of *Ihsan* here is; "But if anyone remits the retaliation by way of charity, it shall be for him an expiation," to mentioned few. Islam, *Iman* and *Adl* are attributes to *Ihsan*, increasing efforts in obligatory deeds toward fulfilling these attributes and extending them with Nawafil (voluntary or non-obligatory deeds) will leads one to the hierarchy of perfection (*Ihsan*). Indeed, the concept had centered on the principle of pleasing the creator in fulfilling the duties and responsibilities obligated upon everyone in life struggle. As it has been warned not to break oaths after confirmation (Q16: 91) and be sure in fulfilling obligations (Q5:1). The staff of IMFBS shall ensure full commitments to achieve their targeted results of this world and hereafter (Q28: 77). Therefore, succeeding good relationship in maintaining the worldly affairs had links us to generosity for all for the success (*Al-Falah*) of hereafter.

**2.5.3 Generosity.** The third dimension of the moderator and in the verse (Q16: 90) centered on the issue of kindness to kith and kin. It is also being part of *Ihsan* but it has been pronounced separately due to its importance in human relations and interactions. Generosity to kith and kin is an extension of kindness to close associate depending on the nature of relationship. Parents have special consideration (Q17: 24) since they had bestow you humility and mercy right from childhood stage. Therefore, parents and other close relatives are considered foremost in terms of blood relations while core staffs are also close to management when it comes to corporations. Therefore, operative staffs with management are under this category of relationship when it has built for the sake of Allah. Thus, close neighbors are considered intimate in residential arrangement compared to far distance neighbors. Similarly, Allah joined parents with kinsfolk, orphans, poor, neighbor, stranger and slave among those deserve generosity (Q4: 36).

The prophet warns the believers not to; "sever relations of kinship, don't bear enmity against one another, don't bear aversion against one another and don't feel envy against the other and live as fellow-brothers as Allah has commanded you" (Muslim: Book 32: Hadith 6217). The management staff of IMFBS should extend the rightful privileges of the co-workers regarding promotion, motivation, commendation and mutual relations without discrimination. Therefore, extending corporate social responsibilities from the within (IMFBS) would enhance success of the business and reduce staff frustration on the job. As prescribed in Bukhari



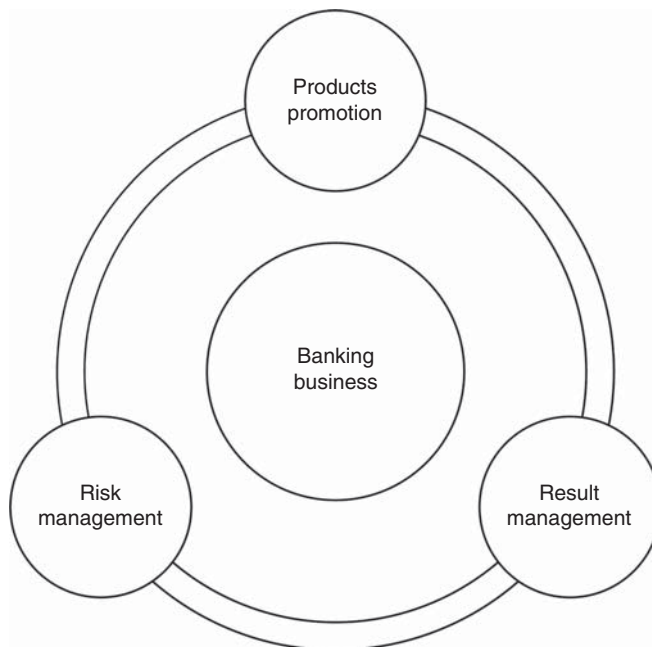
(Book 73, Hadith 49) “O Allah’s Apostle! I have two neighbours! To whom shall I send my gifts?” He said, “To the one whose gate is nearer to you.” In view of this, social responsibility has to begin with staffs first (i.e. the closed partner in terms of working relations) then others follow. Social responsibilities are well-known practice in Islam, in the sense that extending them to general public and sustaining environment including other non-human creatures (animal, plants and architectural creators) are part of good virtues of generosity. Islamic financial institutions are expected to incorporate Islamic social responsibilities to all aspect of their transactions. Therefore, bank-customer relations should be one with generosity in IMFBS since they are guests to the bank and the guests are treated with kindness in Islam (Bukhari: Book 8, Volume 73; Hadith 160). The Hadith links the components of Iman with generosity and kinship which are all part of *Ihsan*. As a result, the relational coexistence in Islamic financial transactions is sufficient through the commandment of *Adl*, *Ihsan* and generosity. Therefore, the following emerged based on the above discussions:

*P5.* The Islamic morality of transaction will influence the banking business to sustain.

It is imperatively clear that the banking business of IMFBS has the potential of becoming sustainable based on the fulfillment of the above conditions. Notwithstanding, promoting available products, risk and result management will also help in attaining a self-sufficiency level of the banking business.

### 2.6 Banking business

Figure 2 illustrated the diagrammatical components to the sustainable banking business for IMFBS. To attain the desired goal, this study also attached products promotion, result and risk management as the supporting drivers for achieving the sustainable business through the moderation of Islamic moral transaction mode. At the initial establishment of



**Figure 2.**  
Sustainable Islamic  
banking business

Source: Adapted from Aliyu (2014)

the business, IMFBS may start with products promotion followed by result and risk management. In Figure 2, the interrelation between the products promotion, result and risk management in the model have been linked.

**2.6.1 Product promotion.** IMFBS in Nigeria have to embark on intensive promotions on their products and provide possible options to counter response the failure of traditional banks toward enhancing societal well-being. Similarly, products promotion is one of the fundamental purposes of marketing while the distribution of goods, services and ideas succeeds when the former has sufficiently captured the mind of the targeted group. According to Hair *et al.* (2003), success of every business depends on the marketing strategy through knowledge of the market, employee empowerment and teamwork with effective training programs. These can be achieved when the previous model's components are sufficiently fulfilled. In view of the Nigerian case, for instance, majority of the populace are not aware with the range of products available in IMFBS. Therefore, it is necessary in this regard for IMFBS to "create massive awareness campaign" for attaining customer-centric objectives through the use of media (electronic and print), direct marketing campaign (Sanusi, 2011, p. 21) and appropriate products and service promotional strategies (Thambiah *et al.*, 2011). It is observed in the previous study that rural communities are not aware about the Islamic banking products compared with the urban settlers (Hakim *et al.*, 2011). Thus, products promotion strategies on a large scale will attract more customers to embrace Islamic banking products due to their profitability and religious inclinations (Bashir, 2013; Haron and Wan Azmi, 2005; Loo, 2010; Raza *et al.*, 2012; Abdullah *et al.*, 2012; Hakim *et al.*, 2011). The need for advertising banking products is indispensable for sustaining IMFBS' growth (Hakim *et al.*, 2011). Furthermore, IMFBS have prospect opportunities in Nigeria due to religious inclination of the citizens and financial institutions toward quest for Islamic banking regulatory framework (CBN, 2011a, b, c). Similarly, previous studies on product strategies supported that religious inclination influence people toward Islamic financial products (Bashir, 2013; Haron and Wan Azmi, 2005). In sum, promotions have tendencies of yielding higher results in Nigeria since general public are willing to patronize Islamic financial products. Direct promotions with Islamic ethical standards are consistent with the views of Hassan *et al.* (2008), these shall be based on: avoidance of false (Q2: 42; Q3: 71; Q9: 34; Q16: 62; Q16: 105; Q43: 19; Q74: 45) and misleading advertisement. In addition, it is consistent with the recommendations of previous studies (Akhter *et al.*, 2011; Bari and Abbas, 2011; Saeed *et al.*, 2001) on the needs for applying ethical standards to advertisement. Therefore, IMFBS' products and services in Nigeria are expected to be promoted within the permissible range of activities ascribed within the Sharia principles. Hussain *et al.* (2012) advocated that simple innovative promotions through direct campaign and quality in service delivery using modern technology would attract new customers. Thus, IMFBS can use the modern technology to grasp the market in Nigeria.

**2.6.2 Result management.** Result management is the second component of the sustainable banking business. Result is an assessed outcome of change whether positive, constant or negative due to action or event influence. Result management can be considered as strategies of achieving and maintaining planned objectives in an organization through direct or indirect influence of the players (management and operative staff, customers, investors, regulators and supervisors). Therefore, management of IMFBS can easily assess the results of investment activities through performance monitoring when all required input are efficiently employed. It is intuitively clear that pleasing Allah is enormous to the managerial targets of IMFBS apart from attainment of societal, economic and social benefits (Aliyu, 2014). Therefore, IMFBS are expected to exemplify the context of Q28: 77 in doing all good deeds to achieve the sets of results in this world and hereafter. For instance, if the main objective is to outreach customers; then IMFBS can begin with promoting products after

proper establishing the structural and functional relations with close compliance with Sharia principles. Thereafter, plan for target goal (outreaching customers) and pursuing it through promotion of goods and services is necessary for its operational sufficiency. Once the aim is defined and activities begin accordingly, monitoring task will continue to ensure that the target results are achieved. After that, evaluations of outcome are used to measure the results and communicate such results for making decisions. Similarly, follow-up and taking action on the lessons learned for the future events will help in sustaining the business to better positions. At this juncture, if the indicators meet the necessary required targets, it means there is no variation between planned and actual results. The second phase of the result management has to do with enjoying permissible activities and abstaining from evil and wrongful acts for the sake of Allah. At the same time, constant review on the result management will suffice IMFBS to be self-reliant through taking actions on the result outcomes and exploring other sources of business continuity.

*2.6.3 Risk management.* Risk management is another mechanism for internal control and the third component in sustainable banking business. Adopting enterprise risk management (ERM) will improve the business performance of IMFBS in Nigeria. The ERM components includes: "internal environment, objective settings, event identification, risk assessment, risk response, control activities, monitoring, information and communication" (Enterprise Risk Management – Integrated Framework, 2004, p. 2). However, CBN (2011a, b, c) advised that all Islamic financial institutions should sufficiently strategize in adopting appropriate policies, systems and procedures in identifying, measures (quantitative and/or qualitative), and to monitor and control their risk exposure. Furthermore, the effects of risk to IMFBS can be controlled through "managing, mitigating, transferring, reducing or avoiding the entire potential risk" (CBN, 2011a, b, c). Although, risk transfer is not in conformity with the Sharia principles as contained in Hadith 13 of the 40 Hadith Annawawi collections. "None of you (truly) believes until he wishes/loves for his brother what he wishes/loves for himself" (Badi, 2002). Therefore, transferring unwanted risk to others is violation of this "golden rule/ethic of reciprocity" of the mentioned Hadith. The IMFBS under this model is expected to reduce the menace of risk in the business through concrete observing the guiding principles in the previous level of structure, functions, capacities and accountability coupled with the influence of the moderator to banking business sustainability. The above assertion has strongly propositioned the following statement:

*P6.* Independent constructs coupled with moderation can sufficiently influence sustainable banking business of IMFBS.

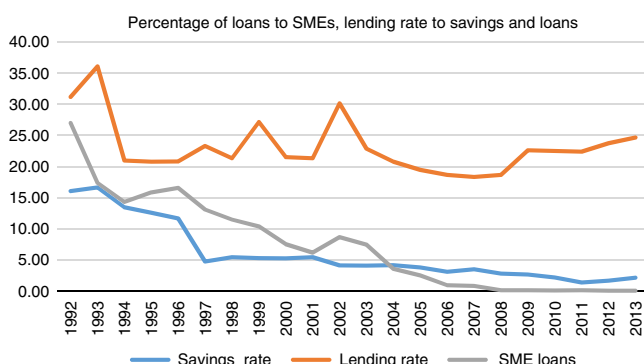
It is conceptually clear that IMFBS have the potential prospects in achieving Sustainable Development Goals, so long as the fundamental requirements in the model are fulfilled. It is intuitively clear that financial exclusion is the major identified gap that leads to the emergence of MFBS in Nigeria. The bank-entrepreneur relationship of Islamic banks will motive the IMFBS' clients to be productive and reduce the unbanked populace in the country. With this, IMFBS are expected to contribute immensely in financing micro, small and medium entrepreneurs which in turn have a multiplier effect on the economic growth of the country. In sum, this highlighted best practice to the IMFBS and their regulators in setting up tranquilized relationship with their clients on the financial outreach.

### 3. Data and methodology

Banks aims to intermedate among the economic agents and allocate resources for growth and development of an economy. Nonetheless, the scenario in Nigeria is quite alarming on the small and medium enterprises. Thus, the proportional percentage of SMEs financing to total loans and advance disbursed by the commercial between 1992 and 2013 is drastically declined, whereas

the lending rate is continuously increasing over the period. Figure 3 depicts the maximum lending rate at 1992 is 31.20 percent and rose to 36.09 percent in 1993, whereas the proportion of SME financing between the two periods reduced by 10 percent. The SMEs continue to face financial exclusion in the country which affects their level of contributions to the national growth and development. On the other hand, the single digit of the saving rate is discouraging people to save since 1997 which also have a causal effect on the investment promotion in the country. In 2004, the saving rate and percentage of SMEs financing intersected, and the financing continues to fall below the saving rate which recorded 0.1 percent in 2010.

Furthermore, the analysis is extended to explore the impact of SMEs financing of the commercial banks, loans and advance portfolios to micro, small and medium enterprises on the country's growth. As such, financial data are collected from Central Bank of Nigeria, macroeconomic variable generated from World Development Indicators and institutional quality index from international country risk guide database (see Table I). The analysis focused more on the traditional institutions since the data on Islamic financial institutions are insufficient to provide strong inference based on the time series estimation. The first commercial full-fledged Islamic bank (Jaiz) in Nigeria was established in 2012, and the available financial information is just for two years. Similarly, the comprehensive exposure draft for the IMFBS' guidelines and regulations was first released in the second quarter of 2016[2]. Therefore, financial data to the approved IMFBS are inadequate for thorough analysis. As a result, the study uses binary dummy variable of one to capture the establishment period of Islamic financial institutions in the country and otherwise zero.



**Figure 3.** Percentage of loans to SMEs, Lending rate to savings and loans

Variable	Source of data	Observations	Mean	SD	Min	Max
GDP	WDI	22	25.112	1.081	23.483	26.967
Loans and advance	CBN	22	8.836	1.831	4.911	11.452
Lending rate	CBN	22	23.175	4.409	18.360	36.090
Consumer price index	WDI	22	20.618	19.193	5.382	72.836
Corruption	ICRG	22	1.492	0.380	1.000	2.000
Manufacturing value added	WDI	22	4.743	1.898	2.410	9.031
Democratic transparency	ICRG	22	2.864	0.834	0.500	3.790
External conflict	ICRG	22	9.831	0.798	7.580	11.500
Ethnic tension	ICRG	22	2.386	0.867	1.000	4.000
Islamic bank year dummy	CBN	22	0.091	0.294	0.000	1.000
SME financing	CBN	22	7.505	7.518	0.100	27.000

**Note:** WDI, World Development Indicators; CBN, Central Bank of Nigeria; ICRG, International Country Risk Guide

**Table I.** Descriptive statistics

Table I depicts the descriptive analysis of the data. The sample has 22 observations which cover the available data period between 1992 and 2013 on SMEs financial outreach. The outcomes of the descriptive analysis reveal that the dispersion among the sample variables is between the range of zero and two except with consumer price index, SME financing, and lending rate. The variations of SME financing and lending rate are vividly glaring in Figure 3. As such, the fluctuation of the lending rate explains its volatile behavior, whereas the sharp decline of SMEs financing falls from 27 percent in 1992 to 0.10 in 2013 exhibit high rate of exclusion in the recent time.

Previous studies used institutional quality and found them relevant in predicting not only economic growth (Ehrlich and Lui, 1999), but also on financial outreach (Barry and Tacneng, 2014; Mertzanis, 2016) and poverty (Chong and Calderón, 2000; Perera and Lee, 2013) in various regions of the world.

### 3.1 Model specification

We extended previous study (Sultan and Masih, 2016) to investigate the effect of microfinance outreach on the Nigerian economic growth by adding institutional qualities (corruption, democracy transparency, external conflict and ethnic tension) and Islamic banks establishment time dummy. Similarly, apart from consumer price index (inflation proxy), this study also includes manufacturing value added as a part of macroeconomic variables since MFBS aims to support the real productive sector. The two models are specified as follows:

$$GDP_t = c + \sum_{f=1}^F \beta_{f1} X_t^{f1} + \delta_i X_t^i + \sum_{m=1}^M \beta_m X_t^m + \sum_{q=1}^q \beta_q X_t^q + \varepsilon_t, \quad (1)$$

$$GDP_t = c + \sum_{f=1}^F \beta_{f2} X_t^{f2} + \delta_i X_t^i + \sum_{m=1}^M \beta_m X_t^m + \sum_{q=1}^q \beta_q X_t^q + \varepsilon_t, \quad (2)$$

The difference between the two models is that the former include MFBS loans and advances while the latter use SME financing of the commercial banks. The model notations are describe as: where  $GDP_t$  is the growth of the gross domestic product at time  $t$ ,  $c$  is constant,  $\beta$  is the coefficient to the explanatory variable  $X_t^i$ 's, excluding that of dummy which appears as  $\delta$ . The loan and advances of the MFBS and the commercial banks to SMEs coupled with lending rate are represented as financing vector of  $X_t^{f1}$  &  $X_t^{f2}$ , for the two models, respectively. The variable  $X_t^i$  is the dummy variable of the Islamic financial institutions' establishment period in the country, while the macroeconomic vector is denoted as  $X_t^m$ , the group of institutional quality variables indicated as  $X_t^q$ , and disturbance  $\varepsilon_t$  which assume to fulfill  $\varepsilon_t \sim IID(0, \sigma_\varepsilon^2)$ .

## 4. Results and discussions

The outcomes of the two estimated models in Table II reveal clear practical and theoretical implications that are relevant to the socio-economic co-existence of the small-scale businesses which require the attention of policymakers. First of all, we find MFBS' outreach is positively increasing the GDP performance by 19 percent which is consistent with the earlier theoretical postulation of increasing economic growth (Sultan and Masih, 2016). On the other hand, SME financing by the commercial banks has a significant negative association with the GDP. It is, of course, clear in Figure 3 that, the SMEs financing falls drastically between 1992 and 2013 despite its immense importance. The outcome implies that commercial banks are allocating a higher proportion of their resources to other sectors than small-scale entrepreneurs despite the positive influence of the manufacturing value added to GDP. Manufacturing value added is found positively improving GDP at the 15 and

**Table II.**  
Microfinance and  
commercial banks  
financing to SMEs  
in Nigeria

GDP	Micro-finance		Commercial banks	
	OLS	OLS robust	OLS II	OLS robust II
Loans and advance	0.185** (0.064)	0.185*** (0.051)		
Lending rate	-0.031** (0.014)	-0.031** (0.014)	-0.034* (0.018)	-0.034 (0.020)
Consumer price index	0.003 (0.005)	0.003 (0.006)	0.003 (0.006)	0.003 (0.007)
Corruption	0.781*** (0.249)	0.781** (0.262)	0.865** (0.298)	0.865** (0.307)
Manufacturing value added	0.154*** (0.040)	0.154*** (0.031)	0.165*** (0.048)	0.165*** (0.036)
Democratic transparency	0.698*** (0.127)	0.698*** (0.118)	0.814*** (0.141)	0.814*** (0.120)
External conflict	-0.372*** (0.113)	-0.372** (0.134)	-0.462*** (0.125)	-0.462*** (0.127)
Ethnic tension	-0.552*** (0.132)	-0.552*** (0.154)	-0.581*** (0.155)	-0.581*** (0.178)
Islamic bank year dummy	0.046 (0.250)	0.046 (0.146)	0.151 (0.291)	0.151 (0.165)
SME financing			-0.030 (0.019)	-0.030* (0.016)
Constant	25.220*** (1.427)	25.220*** (1.603)	27.570*** (1.230)	27.570*** (1.332)
Mean VIF	4.20			4.17
Heteroskedasticity	22 [0.399]		22 [0.399]	
Skewness	13 [0.182]		8.4 [0.490]	
Kurtosis	0.2 [0.625]		0.6 [0.442]	
Serial correlation	0.2 [0.644]		2.3 [0.128]	
Functional form	3.9 [0.066]		3.3 [0.072]	
Observations	22	22	22	22
R <sup>2</sup>	0.978	0.978	0.969	0.969

**Notes:** Standard error are shown in parenthesis, square bracket contains *p*-value of each corresponding test. \*, \*\*, \*\*\*Significant at 10, 5, and 1 percent levels, respectively

17 percent for the MFBs and commercial banks, respectively. Therefore, enhancing financial support to the real productive sectors such as SMEs has the potential of increasing economic growth which has a direct effect on the societal standard of living. However, lending rate, external conflict, ethnic tension are all have an inverse relation to GDP. It is intuitively clear that high rate of interest excludes entrepreneurs to have access to finance and eventually reduce their productivity and increase chances for unemployment in the economy. Therefore, the need for complementary non-interest financial institutions is required to compete with the conventional peers in order to increase the financing outreach. At this juncture, Islamic financial institution is expected to accommodate the Islamic moral transaction mode in compliance with sharia principles. These include establishing justice, *Ihsan*, generosity coupled with other transactional prohibitions such as abolishing interest, gambling, and speculation among other (Aliyu, 2014). It is expected that absence of interest will increase the potential numbers of the unbanked populace to be banked, while justice and *Ihsan* will tranquilize mutual relations between the financier and the borrower. As detailed in Section 2.5, *Adl*, *Ihsan* and generosity attributes will moderate IMFBS' transactional relations to achieve sustainable banking business.

Moreover, external conflict of the neighborhood countries also has an inverse effect on the Nigerian GDP performance. The finding concurs with the real situation in the sense of the intra-trade between Nigeria and any country in conflict will reduce the income generation (derivable from the such country facing external conflict) which is expected to be part of the GDP components. Likewise, the similar explanation is inferred on the ethnic tension within the country since the flow of real productive activities will be affected. Therefore, Nigerian GDP performance is a control on the strength of the institution that transpires peace and tranquility living within and outside the country. However, we also find the positive influence of democratic transparency and corruption on GDP. Some previous literature argued that corruption increase growth positively especially in the developing economy (Leff, 1964). Consequently, the finding on democratic transparency is expected since individual freedom

and justice to everyone will enhance equal right. Nevertheless, the insignificant attribution to the Islamic banks year dummy is not surprising since the analysis account only for two observations (i.e. 2012 and 2013) after establishment. Therefore, our finding concurs with a previous study (Sultan and Masih, 2016) which suggest allowing IMFBS to use their various business strategies will enhance the societal well-being. This is possible with the support of strong institutional qualities. In sum, the findings of this study reveal that MFBs have the potential to enhance the Nigerian economic growth by financing SMEs better than the commercial banks. With this, IMFBS will complement the existing conventional microfinance banks in outreaching the entrepreneur through participatory financing.

## 5. Conclusion

The microfinance banks are established to provide financial access to micro, small and medium entrepreneurs. In line with financial inclusion objectives, Nigeria has redesigned the structure of the financial sector in which the apex bank introduced non-interest financial institutions. The modification of the banking model paves the way for IMFBS to be established in the country. As a result, developing the models that will guide the operations and sustenance of IMFBS are becoming necessary. Therefore, this study highlighted the interlinking relationship between the IMFBS and the concept of sustainability. Similarly, the paper introduced Islamic moral transaction mode as the moderator to the sustainable banking model which is expected to guide the IMFBS relationships with their players. Moreover, details on each construct have been provided with some evidence from the primary sources of Sharia. Specifically, the paper has significantly explained the necessary requirements that will suffice the sustenance of IMFBS in Nigeria. The role of the moderator in the model was conceptually identified and linked with the empirical analysis which is expected to influence the sustainable banking business.

The result of our analysis reveals that commercial banks are not outreaching SMEs as expected in Nigeria. Nonetheless, the finances access by the MFBs will not be enough to cater the needs of entrepreneurs in the country. Therefore, IMFBS has come at a right time, but regulators have to set policy measures that will enhance the banks' operations to improve societal well-being through result management. Consequently, assessing the socio-economic impact of the IMFBS will bridge the gap between the banks' practices and the theoretical aspiration. Moreover, regulators have to device means and persuade the banks to be using *zakat* and *waqf* funds for *Qard-hassan* (benevolent) financing to unskilled poor, and participatory financing on entrepreneurs. Thus, in this event, the Islamic moral transaction mode shall be put in place to moderate the relationship between the parties involved. Similarly, IMFBS shall accommodate group financing to reduce the monitoring and supervision cost on the entrepreneurs. This will ease the administrative cost that can be accrued on the borrowers. It is imperative that IMFBS have to balance between inclusiveness and their survival. Despite the great importance of financial outreach, the banks should not be reluctant on their institutional survival which can be achieved through the foundational constructs of the sustainable banking business model. The model can be applied to other microfinance banks that focus on the Sharia principles. Nonetheless, the paper has not empirically tested the existence of a relationship between the components of the model. Therefore, future studies have the opportunity to develop measurements that will guide in testing the model, as well as strengthening its components.

## Notes

1. Depending on MFBs coverage: 20 million naira (unit MFBs), state MFBs (100 million naira) and national MFBs two billion naira as minimum paid up capital.
2. The exposure draft of the guidelines on the regulation and supervision of non-interest (Islamic) microfinance banks in Nigeria was first released on the May 11, 2016. See: [www.cbn.gov.ng/Out/2016/FPRD/nimfb.pdf](http://www.cbn.gov.ng/Out/2016/FPRD/nimfb.pdf).

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