

## AN ASSESSMENT OF PATRONAGE OF ISLAMIC BANKING PRODUCTS AMONG SMEs IN SOUTH WEST, NIGERIA

**Babawale Y. OLAWOLE**

Olubisi Onabanjo University, Ago Iwoye, Ogun State, Nigeria

[olawoleboy@gmail.com](mailto:olawoleboy@gmail.com)

### **Abstract**

*The viability and profitability of Islamic banks depend on how well their products are being patronized. This study assesses the level of patronage of Islamic banking products by SMEs in Southwest Nigeria. Primary data were collected through the administration of one hundred and fifty (150) questionnaires to various SMEs across Southwest Nigeria. Descriptive analysis was used to analyze the collected data. The study found that there is significantly low patronage of Islamic banking products among SMEs in Southwest Nigeria, as only about 21% of respondents have a thorough awareness of Islamic banking products. Factors discovered to have hindered the patronage of Islamic banking products are low awareness of the existence of Islamic banking products, wrong perception of SMEs about Islamic banking products and proximity of Islamic banks to SMEs. Others are: unwillingness of SMEs to share profit and lack of proper understanding of the operations of Islamic banking products.*

**Keywords:** Islamic banking products, SMEs, Patronage, Awareness.

## 1. INTRODUCTION

It was anticipated that a sizable number of productive Nigerians in the southwest region would have access to funds at a reasonable rate of interest and that the level of poverty would have decreased with the introduction of the banking system to Nigeria in 1883 Augustine & Agbo (2020). Nonetheless, the World Poverty Clock (2023) estimates that 71 million Nigerians are living in extreme poverty, while data from the National Bureau of Statistics shows that 133 million individuals are classified as multidimensionally poor. According to Businesslist.com, Nigerian banks charge an average interest rate of roughly 25 percent on their loans. Due to the high interest rates and their inability to offer collateral, many people were unable to obtain funding from banks (Lusadi, 2005). This is a testimony that the existence and operations of high interest rates and has not been able to provide funds to business as it was envisaged. On January 13, 2011, Islamic banking was introduced to Nigeria, providing an additional means of affordable financing for the impoverished. This is because, as standards, Islamic banking considers the viability of feasibility studies rather than interest rates and the potential lender's ability to repay. In an Islamic financial system, the impoverished do not need to provide collateral to access funds. The idea of Islamic banking has been more and more popular over the past few decades; credit should be given to the significant opportunities it presents, including the ability to attract and grow foreign investment and diversify the investor base (Ahmad, 2009, Totaro, 2009). This is demonstrated by the remarkably high compound annual growth rate that the Islamic banking sector experienced between 2006 and 2009, the years of the global financial crisis (Wilson, 2010).

However, as good as the Islamic banking services are in relation to the “haves” and “have-nots”, the Islamic banks can only survive and serve their purposes if they are patronized by people. The viability and profitability of Islamic banks depend on the number of customers they can attract. Conventional deposit banks have long imposed stringent collateral security requirements and high interest rates on its customers, making it difficult for them to borrow money. (Marimuthu 2015). It is anticipated that the weaknesses of conventional banking that have been discovered will help Islamic banking attract clients; however, it was discovered that SMEs have little interest and knowledge of Islamic banking and its offerings, which has made Islamic banking unpopular (Kareem 2017, Omoruyi and Eseoghene 2022). In light of the above assertion, this study assessed the patronage of Islamic banking products by SMEs in Southwest Nigeria. The objective of this study is to assess the patronage of Islamic banking products

among Small and Medium Scale Enterprises in Southwest Nigeria and to determine the factors that affect the patronage of Islamic banking products in Southwest Nigeria.

## 2. LITERATURE REVIEW

The Islamic financial system is a system rooted in the principles of Shariah or Islamic law. It provides a range of services, products, and instruments that strictly adhere to these Divine Laws; Marimuthu (2010). According to Olawole (2019), Shari'ah (Islamic law) is the fulcrum of Islamic finance. Islamic banking is a different type of profit-driven financial intermediation. In other words, Islamic banking maintains a strong moral component rooted in the Islamic value system while operating in accordance with market pressures. Central to the teaching of the Shariah regarding all commercial and financial transactions is prohibition against *maysir* (gambling), prohibition against the sale or purchase of unlawful goods and services, prohibition of *gharar* (speculation) and the prohibition of *riba* (interest),

*Riba*, often known as interest or usury, is defined variously and in different ways by different academics. While some academics understand it to imply the same thing as others, others attempt - without much success - to distinguish it from interest paid in the traditional banking system. *Riba* literally translates to "increase" or "excess" over the loan principal (Abraham, 2008). He went on to say that since usury is intrinsically wrong and has been forbidden in the Qur'an, the term "riba" refers to it. However, *Riba* was split into two by Islamic law: *Riba al-Nasihah* and *Riba al-Fadl*. The kind of *Riba* that is associated with quality in the direct exchange of goods is known as *Riba al-Fadl*. It refers to receiving a higher-grade commodity in return for a lower quality one. Sales transactions are referred to in the *Riba al-Fadl* concept. However, *Riba al-Nasihah* shows an increase in the loan or debt payable's principal. In a similar vein, *Riba al-Nasihah* deals with loan money for any length of time with the understanding that the borrower will repay the lender for the entire amount borrowed plus an additional payment at the conclusion of the first agreed-upon period. Regardless of whether the deal is profitable or not, the lender receives this additional sum in exchange for giving the borrower a longer period of time to repay. In contemporary banking transactions, interest fall under *Riba al-Nasihah*. Under the current banking system, the excessive and delayed exchange of money for money is referred to as *Riba*, and regardless of the term, it is forbidden in Islam. More specifically, the term "*riba*" refers to any positive, fixed, predetermined rate that is related to the principal amount and the maturity; in other words, it is a guaranteed rate regardless of the investment's performance. In summary, *Riba* denotes an augmentation or a surplus of a loan's principle.

Nonetheless, regardless of the reason for the loan or the interest amount, Muslims are not allowed to accept or provide interest (*Riba*) under Islam. The holy Qur'an has several revelations that address the *Riba*, or prohibition of interest. The first revelation (Quran, Al-Baqarah, Chapter 2, Verse 276) highlights that interest (*Riba*) robs riches of God's gifts. The second revelation forbids interest (*Riba*) and contrasts it with the unlawful taking of another person's property (Quran, An-Nisa, Chapter 4, Verse 161). For their own well-being, Muslims are advised by the third revelation (Quran, Ali-Imran, Chapter 3, Verse 130) to abstain from interest (*Riba*). Lastly, the fourth revelation (Quran, Al-Baqarah, Chapter 2, Verse 275) makes a clear distinction between interest and commerce, advising Muslims to accept only the principal amount and to give ample time for borrower to pay, advising that it is however a good deed to let go if the borrower lacks the capacity to pay back loan. Moreover, according to the Quran, people who disobey the prohibition of interest, are directly opposed to God and His Prophet. Furthermore, according to the Prophet, there is an equal duty for those who provide interest, document, or witness such transactions as for those who engage in taking interest (*Riba*). Consequently, Islamic banks that operate on an interest-free basis link themselves with Islam's ban on interest (*Riba*), a standard that is not met by conventional banking systems (Ahmed 2009).

#### *Features of Islamic Bank*

Islamic banking is a unique kind of banking that refrains from doing business in ways that are against Islamic law. Prohibition of interest (*Riba*), prohibition of speculating (*Gharar*), profit, loss, and risk sharing, Shari'ah-approved activities, social justice, mandatory zakat payment, and supervision by Shari'ah advisors are some of the fundamental principles that must be followed for a bank to be recognised as an Islamic bank (Sanusi 2011; Abraham 2012).

#### *Islamic Banking Products/Services*

Islamic finance uses asset-backed financing as a substitute for interest-based lending. Several financial tools are used in this kind of funding. One of these is the *Qard Hasan loan*, an Islamic bank's charitable loan offered to worthy clients in an effort to reduce poverty. Islamic banks reduce poverty by providing charitable loans to worthy customers. The beneficiary is solely required by *Shari'ah* to reimburse the Islamic bank for the initial sum. Although the client may choose to pay more as a thank you, this desire should not be revealed to the bank at the

beginning of the transaction. Additionally, no additional amount or set or predetermined rate should be mentioned when the loan is being disbursed.

Mudarabah (Silent Partnership) is another Islamic banking product. It is a contract that incorporates a financial arrangement with two partners: one assumes the role of the entrepreneur (*Mudarib*), while the other provides the required capital (*Rabb-ul-Maal*). The Islamic bank (*Rabb-ul-Maal*) acts as the capital supplier in this arrangement. Profits are split according to a predefined ratio between the Islamic bank and the client/entrepreneur under this financial arrangement. Nonetheless, in the event of a loss, the entrepreneur bears the loss of effort, unless it stems from their incompetence, then the Islamic bank (or its depositors) covers the loss. In the Islamic banking system, there are two parts to the *mudarabah* contract. The first component concerns the agreement that the Islamic bank has with its depositors, while the second one deals with the agreement that the Islamic bank has with the entrepreneur.

*Murabahah* (Cost-Plus Sale Contract) is another Islamic banking product, which is a contract that is predominantly employed for the acquisition of equipment. It operates as a sale contract between the Islamic bank and its client at a set profit rate known as a mark-up. Under this agreement, the client furnishes all the specifications of the commodity, and the Islamic bank assumes the risk of procuring it for the client at a cost plus the agreed mark-up. The client has the flexibility to make payments in installments, as a lump sum immediately, or at a predetermined interval. Another Islamic banking product is *Ijarah* (Lease), whose operation is similar to the conventional banking contract for leasing. It is a contract in which an Islamic bank buys an asset and leases it to a customer, with the understanding that the customer will pay the Islamic bank a specific sum on a regular basis, usually once a month, for the agreed-upon duration of time. It might also involve the client's choice to buy the asset from the bank at the conclusion of the contract. A contract in which two or more people contribute cash for the development of a specific business endeavour with the understanding that each partner has the option to get involved in the business's administration or not is known as a *Musharaka* (Equity Partnership), another Islamic banking product. On the other hand, couples are free to choose whether to be active or passive partners. Profits in this type of Islamic banking transaction are distributed according to a predetermined ratio, which need not match each party's individual capital contribution or loss distribution, however, is rigidly determined by each party's individual capital contribution. In order to share in the profits and losses as well as to contribute to capital building, the Islamic bank will therefore take on the role of partner in this instance.

*Patronage of Islamic Banking*

Augustine & Agbo (2020) used discriminant analysis to examine the differences between the respondents' demographic variables and perceptions of male and female with regard to the general perception and awareness of Islamic banking. The survey was conducted among both Muslims and non-Muslims to learn about awareness levels, patronage, motivation, and perception towards Islamic banking in Nigeria. The results showed that Islamic banking is not well-known among the respondents. Nonetheless, the study's findings indicate that attitudes on the adoption of Islamic banking are generally positive. Omoruyi and Eseoghene (2022) investigated whether factors like return rate, Islamic teaching, bank reputation, and service quality explain why clients choose to do business with Nigeria's Islamic bank, Jaiz Bank. In order to accomplish this, a survey research design was chosen, and the study's population was made up of all of the Jaiz Bank branch's clients in Herwa Gana Ward, the Gombe Local Government Area's Commercial Area. The study's focus was on an adequate sample of sixty respondents. Convenient sampling was used to select the respondents. Of the 60 surveys that were distributed, 52 were found to be legitimate. Simple percentages, descriptive statistics, regression, and correlation were used to analyse the data. It was found that the rate of return, Islamic principles, and bank reputation have a major impact on clients' attitudes towards Islamic banking in Nigeria.

Aldeen et al. (2019) looked at customers' awareness levels of Islamic banking in an effort to better understand how they perceived Islamic banking compared to traditional banks. In Damascus City, the qualitative method was applied through semi-structured interviews using the phenomenological approach. The primary conclusions of this study was that consumers were not aware of how Islamic banks operate. According to this survey, it is strongly advised to launch an educational advertising effort to increase Syrians' understanding of Islamic banking. In Aceh, Indonesia, Abd. Majid & Zulhanizar (2016) conducted an empirical investigation on the relevant variables that both customers and non-customers consider important when choosing an Islamic bank. Using the convenience sampling technique, a sample of 300 Bank Aceh Syariah clients and non-clients was chosen. The study, which employed the logistic regression technique, found that the characteristics of the banks, their trustworthiness and services, adherence to Shari'ah, and tangible items all had an impact on the consumers' choice of banks. The characteristics of the banks and their adherence to Shari'ah were found to be the most important considerations for both customers and non-customers

when choosing an Islamic bank in Aceh, Indonesia. Zeyad and Norailis (2013) made an effort to identify the variables influencing client loyalty in Islamic banking. Two complete Islamic banks in Malaysia conducted a poll of their customers in order to gather data for the study. To conduct the study, a sample of 250 respondents was chosen. Utilising Principle Component Analysis (PCA), the impact of the variables on client loyalty was calculated. According to descriptive statistics, respondents generally exhibited a high degree of loyalty.

### **3. METHODOLOGY**

Survey Research Design was adopted for this study which involves the collection of primary data sourced from questionnaires. This is because of its (Descriptive Survey Research Design) suitability for this type of research work that requires questioning and interviewing respondents Falza (2022). The research work used both questionnaire and interview as research tools. The population of this study includes all small and medium-sized businesses (SMEs) in South West Nigeria; however a sample of 150 SMEs from the six states in Southwest Nigeria were investigated for this study. According to The National Survey of Micro Small and Medium Enterprises (MSME) (2017), there are 23,289 SMEs in the south western states of Nigeria; distributed as follows: Ekiti 928, Lagos 8,395, Ogun 2,465, Ondo 2,363, Osun 3,007 and Oyo 6,131. It is on this basis that the sample were selected as Ekiti 6, Lagos 54, Ogun 16, Ondo 19, Osun 19 and Oyo 40.

Data collected from the administration of questionnaire was used in order to examine the level of patronage of Islamic banking products among small and medium-scale enterprises in Southwest of Nigeria. The questionnaire was structured into two (2) sections. Section A focused on the demographic distributions of the respondents while Section B focused on the assessment of patronage of Islamic banking products among SMEs in Southwest Nigeria. The method of data analysis that the study adopted was descriptive analysis using simple percentages to analyze data.

### **4. RESULTS**

The study found that there is significantly low awareness of Islamic banking products among SMEs in Southwest Nigeria, as only about 21% of respondents have a thorough awareness of Islamic banking products; This finding corroborates the study of Kareem (2017) who found out that there is low patronage of Islamic banking products.

Factors discovered to have hindered the awareness and patronage of Islamic banking products are low awareness of the existence of Islamic banking products, wrong perception SMEs have about Islamic banking products; and proximity of Islamic banks to SMEs. Others are unwillingness of SMEs to share profit and lack of proper understanding of the operations of Islamic banking products. This is in contrast with the submission of Omoruyi & Eseoghene (2022) who found out that Lack of financial knowledge according to the study is associated with risky, borrowing and paying behaviors in Islamic banking and their products; however, Zeyad et al (2013) stated in their study that financial literacy influences a certain behavior that an individual does. People differ in their degree of financial literacy, and these variations in literacy will show up in the various behaviours that they exhibit. According to Faisal (2022), working women in developing nations' saving and investing behaviours are influenced by their level of financial literacy. The knowledge, competence, awareness, behaviour, and attitude needed to make wise financial decisions and ultimately achieve personal financial welfare is referred to as financial literacy.

This study also revealed that different factors account for the low patronage of Islamic banking products in Southwest of Nigeria. The factors are non-accessibility of Islamic banks to SMEs, Proximity/location of Islamic banks to SMEs and wrong assumption that Islamic banks belongs to Muslims alone. In conclusion, this research highlights the need for increased awareness and education about Islamic banking products specifically tailored to SMEs in Southwest Nigeria. By addressing these factors, Islamic banking can become a more attractive and accessible option for this important sector of the economy.

## 5. CONCLUSION

The viability and profitability of Islamic banks depend on the number of customers they can attract. The study concludes that Islamic banking products, despite their attractiveness and feasibility enjoy low patronage. The study concluded that religion is a major factor that contributes to the low patronage. This is so because it was found that the general perception of operators of Small and Medium Scale Enterprises is that Islamic banking products are designed to lure customers to become Muslims and are also an attempt to Islamize the country. This has prevented most of the customers who are in need of credit from patronizing Islamic banks

The study concludes that the low proximity of Islamic banks to Small and Medium Scale Enterprises is also one of the reasons that account for the low patronage of Islamic banking

products. Other factors are low awareness of Islamic banking products and the wrong perception of operators of Small and Medium Scale Enterprises that Islamic banking products do not suit the needs of their business.

Based on the conclusion of the study, the researcher recommends as follows:

- i. The financial system should be tagged “**non-interest banking**” rather than “**Islamic banking**” to make the bank appeal to non-Muslims.
- ii. There should be a proper public enlightenment program on the essence and operation of Islamic banks to allay the fear that it is meant to Islamize the country.
- iii. There should be an increase in the number of branches of Islamic banks in Southwest of Nigeria, so that Small and Medium Scale Enterprise will have easy access to their products.

**References**

- Abd. Majid M. S., and Zulhanizar S. (2016). The patronage behaviour of Islamic bank's customers. *Journal of Islamic Economics, Volume 8 (2)*.
- Abraham, A. A. (2008). Challenges and solutions to Islamic banking system in a pluralistic–secular country like Nigeria. *Mediterranean Journal of Social Sciences*. 5(6).
- Ahmed, M. (2009). Islamic banking. *Asian-Pacific Economic Literature*, 2(2), 46-62.
- Augustine O. & Agbo P. O. (2020). Patronage behaviour of Nigerians towards Islamic banking: a discriminant analysis approach, SSAAR (JMSE). *Journal of Management Science and Entrepreneurship*.
- Bohn, B. (1981). Theory of interest. *Asian Economic and Financial Review* 2(1), 88-99.
- Chermi, H. and Y. Jerbi (2015). Sukuk as an attractive alternative of funding and investment in Tunisia. *Journal of Emerging Economies and Islamic Research*, 3(1). www.jeeir.com
- Faisal Ahmad (2022). Advancement of Islamic banking and finance in the socio-economic context of Bangladesh based on IBBL. *International Journal of Islamic Banking and Finance Research Vol 10 No 1 (2022)*:
- Falza K (2022). The impact of Islamic financing on the operations of SMES in Oman. *International Journal of Islamic Banking and Finance Research*, Vol 9 No 1 (2022):
- Kareem, O.B. (2017). Operation of Islamic banking. *The Economist Newspaper Limited*. Sept 13, 2014. Retrieved 15 September.
- Lusadi, B.F. (2005). Strategic directions for developing an Islamic banking system, *The Pakistan Development Review* 44: 4 Part II (Winter 2005), 1003–1020.
- Marimuthu, D. (2010). Efficiency of Islamic banking in Malaysia: A stochastic frontier approach. *Journal of Economic Cooperation* 27, 37-70. 17
- Mohamad, S., Salah, M., Mokhtar, Y., and Alwi, S.F.S. (2015). Enhancing cross border connectivity: venturing into Islamic finance as a new source of infrastructure financing. *Journal of Emerging Economies and Islamic Research*, 3(3).
- Olawole B. Y. (2019). Assessment of patronage of Islamic banking products in Ogun state, dissertation submitted to Olabisi Onabanjo university, Ago Iwoye.
- Omoruyi A. and Eseoghene J. I. (2022). Patronage factors and the behavior of customers towards Islamic banking in Nigeria. *Airlangga International Journal of Islamic Economics and Finance Vol. 5 No. 01, January-June 2022*
- Sahil Buhari, Collection of sayings and actions of prophet Muhammad
- Sahil Muslim, Collection of sayings and actions of prophet Muhammad

Sanusi, L.S. (2012). Banking reform and its impact on the Nigerian economy; being a lecture delivered at the University of Warwick's economic summit, UK 17<sup>th</sup> February, 2012. [Governor, Central Bank of Nigeria]

The Holy Bible

The Holy Quran

Totaro, L. (2009). Vatican says Islamic finance may help western banks in crisis. *BloombergL.P.*:<http://www.bloomberg.com/apps/news?pid=20601092&sid=aOsOLE8uiNOg&refer=Italy>.

Wilson, R. (2009), Why Islamic banking is successful? Islamic Banks Are Unscathed Despite of Financial Crisis.

Zamir, B and Abbas, F. (2007). Islamic finance: big interest, no interest. *The Economist Newspaper Limited*. Sept 13, 2014. Retrieved 15 September.

Zeyad M. EM. Kishada and Norailis Ab. Wahab (2013). Factors Affecting Customer Loyalty in Islamic Banking: Evidence from Malaysian Banks. *International Journal of Business and Social Science Vol. 4 No. 7; July 2013*

APPENDIX

**RESEARCH QUESTION:** Level of awareness of Islamic banking products in South West Nigeria

**Table 1 Demographic Characteristics of Respondents**

CHARACTERISTICS		NUMBER	PERCENTAGE
SEX	MALE	64	43%
	FEMALE	86	57%
AGE	20-29	15	10%
	30-39	45	30%
	40-49	71	47%
	50 AND ABOVE	19	13%
QUALIFICATION	OND/NCE	72	48%
	HND/BSC	48	32%
	MBA/MSC	10	7%
	OTHERS	20	13%
RELIGION	ISLAM	61	41%
	CHRISTIAN	85	57%
	TRADITIONAL	4	2%

Source: Researcher’s Field Survey, 2023

**Table 2: Are you aware of the existence of Islamic banking in South West Nigeria?**

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid No Awareness	92	61.3	61.3	61.3
Little Awareness	24	17.0	16.0	77.3
Fairly Awareness	18	11.0	12.0	89.3
High Awareness	16	10.7	10.7	100.0
Total	150	100.0	100.0	

Source: Researcher’s Field Survey, 2023

**Table 3: Factors hindering awareness and patronage of Islamic banking products**

1	Low awareness of the existence of Islamic banking products,	50
2	Wrong perception SMEs have about Islamic banking products	42
3	Proximity of Islamic banks to SMEs.	35
4	Unwillingness of SMEs to share profit	16
5	Lack of proper understanding of the operations of Islamic banking products.	7

Source: Researcher’s Field Survey, 2023 (transcript of interview held with respondents)

**Table 4: Existence of Islamic banking in South West Nigeria**

	Frequency	Percent	Valid Percent	Cumulative Percent
--	-----------	---------	---------------	--------------------

Valid	No Awareness	92	61.3	61.3	61.3
	Little Awareness	24	17.0	16.0	77.3
	Fairly Awareness	18	11.0	12.0	89.3
	High Awareness	16	10.7	10.7	100.0
	Total	150	100.0	100.0	

Source: Researcher’ Field Survey, 2023

**Table 5: Awareness of Islamic Banking Products**

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid No Awareness	92	61.3	61.3	61.3
Little Awareness	26	17.3	17.3	78.7
Fairly Awareness	16	10.7	10.7	89.3
High Awareness	16	10.7	10.7	100.0
Total	150	100.0	100.0	

Source: Researcher’ Field Survey, 2023

**Table 6: Level of awareness of how Islamic banks operate**

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid No Awareness	92	61.3	61.3	61.3
Little Awareness	26	17.3	17.3	78.7
Fairly Awareness	16	10.7	10.7	89.3
High Awareness	16	10.7	10.7	100.0
Total	150	100.0	100.0	

Source: Researcher’ Field Survey, 2023

**Table 7: Aware of Islamic banks interest free loan**

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid No Awareness	92	61.3	61.3	61.3
Little Awareness	24	16.0	16.0	77.3
Fairly Awareness	6	4.0	4.0	81.3
High Awareness	28	18.7	18.7	100.0
Total	150	100.0	100.0	

Source: Researcher’ Field Survey, 2023

**Table 8: Awareness of profit-sharing scheme of Islamic banks**

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid No Awareness	92	61.3	61.3	61.3
Little Awareness	28	18.7	18.7	80.0
Fairly Awareness	11	7.3	7.3	87.3
High Awareness	19	12.7	12.7	100.0
Total	150	100.0	100.0	

Source: Researcher’ Field Survey, 2023

**Table 9: Awareness of location of Islamic banks**

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid No Awareness	112	74.7	74.7	74.7
Little Awareness	18	12.0	12.0	86.7
Fairly Awareness	11	7.3	7.3	94.0
High Awareness	9	6.0	6.0	100.0
Total	150	100.0	100.0	

Source: Researcher’ Field Survey, 2023