



An Assessment of Islamic Banking in Nigeria: Financial Needs, Challenges, and Growth Opportunities

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Abstract

This study assesses the current state of Islamic banking in Nigeria, focusing on its financial needs, the challenges it faces, and the opportunities for growth within the Nigeria financial structure. Despite the growing interest in Islamic finance globally, Nigeria's Islamic banking sector remains underdeveloped in comparison to other regions. The research explores the historical context, regulatory framework, and the role of Islamic banking in the Nigerian financial landscape. It identifies key challenges such as limited awareness, inadequate infrastructure, regulatory complexities, and a lack of Shari'ah-compliant financial products tailored to local needs. The study also highlights the financial requirements of the Islamic financial products, including capital infusion, technological advancements, and financial literacy. Furthermore, it outlines the prospects for growth, emphasizing the potential for Islamic banking to address the financial inclusion gap, stimulate economic development, and offer alternative financing solutions to sectors like agriculture, SMEs, and infrastructure. Recommendations are made to foster a more inclusive and sustainable Islamic banking environment in Nigeria, focusing on policy reforms, public awareness, and strategic partnerships.

Keywords: *Islamic Banking, Challenges, Growth, Opportunities, Nigeria, Shari'ah-Compliant Finance. Introduction.*

Introduction

Islamic banking, grounded in the principles of *Shari'ah*, has emerged as an alternative financial system that prioritizes ethical practices, profit-sharing, and the prohibition of interest (*riba*). Over the past few decades, the global Islamic banking industry has experienced remarkable growth, driven by a rising demand for *Shari'ah*-compliant financial services. In Nigeria, with its significant Muslim population and diverse financial needs, Islamic banking holds immense potential to contribute to the economic landscape while addressing the unique preferences of its adherents.

The introduction of Islamic banking in Nigeria represents a strategic effort to broaden financial inclusion and meet the needs of individuals and businesses seeking ethical and interest-free financial solutions. Establishing institutions like Jaiz Bank and other non-interest financial operators has laid the foundation for this system. However, the development of Islamic banking in Nigeria has not been without challenges. Regulatory hurdles, limited public awareness, and competition with conventional banks have significantly hindered its growth.

Despite these challenges, the Islamic banking sector in Nigeria continues to present numerous expansion opportunities. With a growing Muslim population, increasing interest in ethical finance, and potential integration with digital banking technologies, Islamic banking is well-positioned to address Nigeria's financial needs. This paper, therefore, seeks to assess the current state of Islamic banking in Nigeria, exploring its economic impact, identifying the challenges it faces, and highlighting the opportunities for growth and development.

Concept and Principles of Islamic Banking

Islamic banking operates on the principles of *Shari'ah*, which governs all aspects of Muslim life, including financial transactions. Unlike conventional banking, Islamic banking prohibits interest (*riba*) and speculative activities (*gharar*)

while promoting profit-sharing, ethical investments, and risk-sharing mechanisms. These principles ensure that financial activities align with ethical and moral standards, fostering fairness and justice in economic transactions.¹ The core concepts of Islamic banking revolve on issues that included; firstly, prohibition of interest (*riba*). This means that Islamic banking strictly forbids the charging or paying of interest on loans or deposits. Instead, financial institutions earn profits through equity participation, where they share in the risks and rewards of investments. Secondly, profit and loss sharing (PLS), Islamic banks employ profit-sharing arrangements, such as *Mudarabah* (partnership financing) and *Musharakah* (joint venture), where returns are based on the performance of the underlying business or investment. Thirdly, Islamic banking involves Asset-Backed Financing, which requires all financial transactions to be backed by tangible assets or services, ensuring that investments contribute to real economic activities through *Ijarah* (leasing) and *Murabahah* (cost-plus financing) among others. Fourthly, Islamic banking should avoid contracts with excessive uncertainty or speculation (*gharar*). Transactions must be transparent, and all terms must be clearly defined to prevent exploitation. Fifthly, Islamic banks are obligated to invest in socially responsible and *halal* (permissible) ventures, avoiding industries such as alcohol, gambling, and pork production.²

These principles not only differentiate Islamic banking from its conventional counterpart but also make it an attractive option for individuals and businesses seeking ethical and interest-free financial solutions. By adhering to these concepts, Islamic banking fosters economic stability, equitable wealth distribution, and financial inclusion, making it a vital component of Nigeria's financial growth.

Islamic Banking and the Financial Needs of Nigerians

Nigeria, as one of Africa's largest economies, faces diverse financial needs among its population. These needs range from basic access to banking services to more sophisticated financial products that can cater for businesses and individuals' needs. A significant portion of the Nigerian population remains unbanked or under banked, primarily due to religious beliefs, lack of trust in conventional banking, and limited access to financial institutions in rural areas. Thus, Islamic banking offers a viable solution to address these challenges. This is in the way, Islamic banking, with its emphasis on ethical practices and interest-free financing, appeals to individuals who are reluctant to engage with conventional banks due to religious or cultural reasons. By providing *Shari'ah*-compliant financial services, Islamic banks can bridge the gap and promote financial inclusion.³

Similarly, Small and Medium Enterprises (SMEs) are the backbone of Nigeria's economy, yet many struggle to secure funding from conventional banks due to high-interest rates and stringent loan requirements. Islamic banking offers profit-sharing arrangements, such as *Mudarabah* and *Musharakah*, which provide SMEs with affordable financing options while sharing the risks and rewards of their ventures. Moreover, the demand for affordable housing and improved infrastructure in Nigeria remains a greater challenge to many Nigerians. Islamic banks can offer asset-backed financing instruments, such as *Ijarah* and *Istisna*, to facilitate housing projects and infrastructure development. These solutions provide ethical and interest-free alternatives for individuals and businesses seeking long-term investments.⁴

Furthermore, with increasing awareness of ethical and sustainable finance, many Nigerians are seeking financial products that align with their values. Islamic banking promotes investments in socially responsible projects, avoiding industries that are harmful or exploitative. This aligns with the growing demand for ethical financial solutions. Still, the bank can play a significant role in empowering women and youth by providing financial products and services through promoting entrepreneurship and offering microfinance assistance. Hence, the banks can help these groups overcome financial barriers and contribute to economic growth. This in the long run will not only address the financial needs of Nigerians, but also improve the financial viability of the banks.⁵

The Growth and Challenges of Islamic Banking in Nigeria

The growth of Islamic banking in Nigeria has been steady, reflecting a rising demand for *Shari'ah*-compliant financial services. This growth is attributed to increasing awareness among the population, regulatory support, and the establishment of non-interest financial institutions. However, there are challenges affecting the Islamic banking system

¹ M. Ayub, *Understanding Islamic Finance*, Wiley & Sons, Singapore, 2007, p. 17.

² Z. Iqbal and A. Mirakhor, *An Introduction to Islamic Finance: Theory and Practice*, Wiley & Sons, Singapore, 2011, p. 58.

³ R. Abdu, "The Role of Islamic Banking in Enhancing Financial Inclusion in Nigeria", A Paper presented at the International Conference on Islamic Economics and Finance, Abuja, Nigeria, 2019, p. 9.

⁴ PricewaterhouseCoopers (PwC), "The Future of Banking in Nigeria: Navigating Growth Opportunities in Islamic Finance", np, 2021, p. 123.

⁵ I. O. Yusuf, "Overcoming Regulatory Challenges in Islamic Finance: A Case Study of Nigeria", Proceedings of the Islamic Finance Summit, Lagos, Nigeria, 2022, p. 43.

that inhibits its efforts to achieve its full potentials and again autonomy. Chiefly among is public awareness among the majority Nigerians of the principles and benefits of Islamic banking. This lack of understanding limits the bank's ability to attract a broader customer across all the regions of the country. Similarly, legal constraints have been a bane that hinders the development of innovative Islamic banking system and its products.⁶

Moreover, shortage of trained personnel with expertise in Islamic finance poses a significant challenge. This limits the capacity of the institution to design and deliver efficient *Shari'ah*-compliant products. More so, Islamic banks face stiff competition from well-established conventional banks, which often have larger capital bases and wider networks. In addition to this, inadequate infrastructure, particularly in rural areas, hampers the expansion of Islamic banking services in Nigeria.⁷

It should be noted that, despite these challenges, the growth potential of Islamic banking in Nigeria remains significant. However, if these challenges can be overcome, Islamic banking system can contribute more effectively to Nigeria's economic growth and financial inclusion.

Opportunities for the Growth of Islamic Banking in Nigeria

Islamic banking in Nigeria presents a range of opportunities for growth and development, fueled by both internal and external factors. These opportunities, if strategically executed, can drive the expansion of Islamic banking system and its contribution to the Nigerian economy. Firstly, people living in rural areas without access to any financial institution present opportunity for Islamic banking. By offering ethical and interest-free financial products, Islamic banks can attract individuals and businesses that have traditionally avoided conventional banking due to religious or cultural reasons. Expanding outreach through mobile banking and agent networks can further enhance accessibility. Secondly, with Nigeria's large and growing Muslim population, the demand for *Shari'ah*-compliant financial services is expected to rise. Islamic banks can give emphasis in areas with large Muslim population and develop financial products to meet the specific needs of this demographic, including personal financing, savings accounts, and investment options.⁸

Thirdly, Nigerian government and regulatory bodies, such as the Central Bank of Nigeria, have shown increasing support for Islamic banking. Policies and incentives that encourage non-interest banking can foster an enabling environment for growth.⁹ Additionally, partnerships with international Islamic finance organizations can provide technical expertise and funding. Fourthly, Nigeria's infrastructural deficit and housing challenges create opportunities for Islamic banking to play a critical role in financing developmental projects. Using instruments such as *Sukuk* (Islamic bonds) and *Istisna* (construction financing) to harness its growth and enhance financial support of the individual Nigerians. Thus, Islamic banks can support large-scale infrastructure projects while adhering to *Shari'ah* principles.¹⁰

Conclusion

The paper reveals that there is a growing and significant potential for this financial model to address the diverse financial needs of individuals, businesses, and the broader economy. As a system that operates in compliance with *Shari'ah* principles, Islamic banking provides a viable alternative to conventional banking, particularly for those seeking interest-free financing and ethical investment opportunities. Despite its potential, Islamic banking in Nigeria faces several challenges that hinder its full development. These include limited public awareness and understanding of Islamic finance principles, regulatory and operational constraints, and insufficient product diversity. Additionally, the lack of trained professionals in Islamic finance and limited collaboration with global Islamic finance networks further restricts growth.

Nevertheless, the opportunities for Islamic banking in Nigeria remain immense. With a large Muslim population, a rising demand for ethical and inclusive financial services and growing global recognition of Islamic finance, Nigeria is well-positioned to become a leader in the sector within Sub-Saharan Africa. Moreover, the introduction of innovative products, digital transformation, and strategic partnerships with conventional financial institutions can accelerate the sector's growth and inclusivity. To fully realize its potential, stakeholders must focus on key areas such as public education on Islamic banking, strengthening regulatory frameworks, capacity building, and promoting financial literacy.

⁶ A. J. Sule, and R. A., Shittu, "Adoption of Islamic Banking in Nigeria: Challenges and Opportunities", in: *Journal of Islamic Finance*, 4(2), p. 57.

⁷ A. Bello, "Islamic Banking in Nigeria: Issues and Prospects", in: *International Journal of Islamic Finance and Economics*, 6(1), 2014, pp. 23–34.

⁸ A. R. Usman, and A. Tahir, "Promoting Financial Inclusion through Islamic Banking: Evidence from Nigeria", in: *African Journal of Finance*, volume 10, No. 4, 2018, p. 56.

⁹ Sule, and Shittu, "Adoption of Islamic Banking in Nigeria: Challenges and Opportunities...", p. 58.

¹⁰ A. U. F., Ahmad, and M. K. Hassan, "Regulation and Performance of Islamic Banking in Bangladesh", in: *Thunderbird International Business Review*, 49(2), 2007, P. 272.

Additionally, fostering collaborations between local Islamic banks and international Islamic finance institutions can create a more robust financial ecosystem. While challenges persist, the prospects for Islamic banking in Nigeria are promising. By addressing these challenges and leveraging growth opportunities, Islamic banking can play a transformative role in promoting financial inclusion, economic development, and ethical investment in Nigeria's financial sector.

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