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ISLAMIC FINANCE, AN ALTERNATIVE STRATEGY TO PROJECT FINANCE AND INFRASTRUCTURE DEVELOPMENT: OPTION FOR NIGERIA

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ABSTRACT
Islamic finance is based on principles of Shariah or "Islamic law". The major principles of shariah are ban on interest, a ban on contractual uncertainty, adherence to profit/ risk sharing, promotion of ethnical investments that enhances society, and asset backing. The international market for Islamic finance is growing at the rate of 10-12% annually and through international and regulatory bodies, there has been effort to standardize regulations in Islamic finance across different countries and institutions. Nigeria with a growing population of over 140 million require huge funding to provide critical infrastructure to cater for its teeming population which is not forth coming from the conventional financial institutions. The finding shows that, due to the recent global financial crisis, conventional financial institutions were reluctant to provide funding for infrastructural development to both developed and developing economies. Alternatively, Nigeria can utilize cheap funding option through Islamic financing instruments as Sukuk (Islamic bond) and Mushakarah (Partnership/Joint venture), a non- interest instrument which can provide much needed finance for the development of critical infrastructure as well as collaborating with Islamic development bank to access free donation and non- interest loan for investment in infrastructure which is critical in achieving the target of the millennium development goals. Based on the findings, the following recommendations were made; that the central bank of Nigeria should establish the National Shariah advisory council which would be responsible for guiding Islamic financial institutions in Nigeria, as they emerge, to ensure that their activities fully comply with Shariah principles; and also conventional financial institutions willing to continue rendering Islamic products and service to customers in Nigeria would also be advised by the council on ways to ensure that the product and services they specifically design for their customers are Shariah compliant.

INTRODUCTION
Islamic finance is a based on Shariah an Arabic term that is often refers to as "Islamic Law". Shariah Principles provide guidelines for all aspect of Muslim life, including religion, politics, economics, banking, business and law (Silva, 2006).Islamic finance has the same purpose as conventional finance except that it operates in accordance with the rules of Shariah. The Shariah accepts the need for financial intermediation but prohibit riba (usury) which is universally interpreted as charging or earning interest on business transaction or guaranteed return of capital. As an alternative to interest, Shariah principle consider profit/loss sharing and make-up plus cost pricing to be appropriate base for business transaction between the supplier of capital and the entrepreneur. The Quran states that "*trading is permitted and usury is forbidden*" (Quran 2:275.6) (Igbal and Mirakhor, 2007). Silva (2006) stated that the

major principles of Shariah that are applicable to Islamic finance that differ from conventional finance are:

a. Ban on Interest (Riba): In conventional forms of finance, a distinction is made between acceptable interest and usurious interest (i.e excessive rates of interest). In contrast, under Islamic law, any level of interest is considered.
b. Ban on Uncertainty: - Uncertainty in contractual terms and conditions is not allowed, unless all of the terms and conditions of the risk are clearly understood by all parties to a financial transaction.
c. Risk- sharing and profit- sharing: In the opinion of Andreas (2007) parties involved in a financial transaction must share both the associated risks and profits. Earnings of profits or returns from assets are permitted so long as the business risks are shared by the lender and borrower.
d. Ethical Investments that enhance society: Andreas (2007) stated that there are certain investments in industries that are prohibited by the Quran, such as alcohol, pornography, gambling and pork based products are prohibited.
e. Asset- backing: The National Bureau of Asian research (2008) stated that Shariah required each financial transaction must be tied to a 'tangible, identifiable underlying assets'. Under Shariah, money is not considered as asset class because it is tangible and thus, may not earn a return.

The existence of Islamic finance has been an old practice, but its transformation into global financial industry is traced back to early 1960's. It originated from the Persian Gulf, at the same time, expanded globally to south East Asia, Europe, North America and Africa. Islamic finance is growing at a rate of 10-15% per annum and with signs of consistent future growth and have more than 300 institutions spread over 51 countries, plus an additional 300 mutual funds that comply with the Islamic investment principles. Experts estimated that the total size of assets held internationally under Islamic finance, generally ranging from $800billion to $1 trillion (Qakley, Bond, O' murchu & Jones, 2008). However, due to the global financial crisis, banks globally have frightened access to financing restraining funding of infrastructure developments and consequently slowing down economic growth and development. In Nigeria, one of the option available to the country to explore is the Islamic finance, through financing instruments such as Sukuk, non- interest bank can provide cheaper funding option as well as much needed finance for the development of critical infrastructure within the country.In Nigeria, the regulatory authority recently released a draft frame- work for the regulation and supervision of non-interest banks otherwise known as Shariah banking. The regulatory authority set up an advisory committee on non- interest banking within the central bank to be called the central Bank Shariah Council (CSC), which will be outsourced. The council shall advice the central bank on Islamic laws and principles for the purpose of regulating non- interest banking business. According to the CBN guidelines in line with the provisions of section 39(1) of banks and other financial institutions Act BOFIA 1991 (as amended) have mandated all banks offering non- interest banking products and services to have a Shariah compliance review mechanism and a Shariah Advisory Committee (SAC) as part of their governance structure and shall not include the words "Islamic" as part of their registered or licensed name (Simon, 2009). These guidelines open a new window of opportunity by introducing all aspects of Islamic finance to Nigeria's finance landscape with notable entrant as Jaiz international Bank Plc as the first wholly Islamic bank.

CONCEPTUAL ISSUES:

Islamic Finance Key Products

In theory the Islamic financial system is based on contracts, of which there is three types namely: - intermediation, transactional contracts and asset based transactions.

i. **INTERMEDIATION CONTRACTS**

a. Mudarabah (Profit /Loss sharing): is an arrangement or agreement between the bank, or a capital provider, and an entrepreneur, whereby the entrepreneur can mobilize the funds of the bank for its business activity. The entrepreneur provides expertise, labour and management. Profits made are shared between the bank and entrepreneur according to predetermined ratio. In case of loss, the bank losses the capital invested, while the entrepreneur loses his provision of labour. It is this financial risk, according to the Shariah, that justifies the banks claim to part of the profit. The profit- sharing continues until the loan is repaid. The bank is compensation for the time value of its money in the form of a floating rate that is pegged to the debtor's profits. (Nomani, Farhad; Rahnema, Ali, 1994) The drawbacks are problems associated with monitoring and control, especially when the lending is to small businesses. Double book keeping for tax evasion occur, making it difficult for the bank to discover the actual profit made.

b. Kifala (benevolent loan): This is the situation when the debtor assumes full liability for debt pledging to repay it to the creditor without interest. A third party acts as guarantor and repays the debt should the debtor, for whatever reason, be unable to pay the debt.

c. Wadiah (safe keeping): A Bank is deemed as a keeper and trustee of funds. A person deposit funds in the bank and the bank guarantees refunds of the entire amount of the deposit, or any part of the outstanding amount, when the depositor demands it. Though depositors share no profit, the bank can invest the funds. Often prizes are offered to attract to customers. The depositor, at the banks discretion may be rewarded with gift as a form of appreciation for the use of funds by the bank or depositors may approach the bank for short- term free loans but the bank can levy a charge to cover administration costs.

d. Hibah (Gift): This is a token given voluntarily by a debtor to a creditor in return for a loan. Hibah usually arises in practice when Islamic banks voluntarily pay their customers gift on saving account balances, representing a portion of the profit made by using those savings account balances in other activities.It is important to note that while it appears similar to interest, and may, in effect have the same outcome, Hibah is a voluntary payment made (or not made) at the banks discretion and cannot be guaranteed. However, the opportunity of receiving high Hibah will draw in customer's saving, providing the bank with capital necessary to create its profits. If the venture is profitable then some of this profit may be gifted to its customers as Hibah.

e. Qard Hassan (Interest free loan): This is the situation where by a lender provides a loan to a needy borrower at no charge, repayable when the borrower is able. The lender can impose a service charge to cover the cost of administering the loan, but it cannot be linked to the size or length of the loan. The loan is repaid when the borrower is able to do so. This is a loan extended on a goodwill basis, and the debtor is only required to repay the amount borrowed. However, the debtor may, at his or her discretion, pay an extra amount beyond the principal amount of the loan (without promising it) as a token of appreciation to the creditor.

f. Juala (Custodian): This refers to a service charge paid by one party for specific service such as fund management or acting as a trustee.

g. Wakalah (Power of Attorney): This occurs when a person appoints a representative to undertake transactions on his/ her behalf:

II. TRANSACTIONAL CONTRACTS

i. Musharakah (Partnership/Joint venture): This is an equity agreement between the bank and one or more partners to share the risks of an investment project within an agreed period of time. In the case of an industrial concern, both parties contribute to the capital of the operation (taken to mean capital) assets, technical and managerial expertise and working capital etc). The returns / losses are determined by the percentage contribution each party for profit sharing and each case is death with on its own merits. In the case of real estate or property, the bank asses an imputed rent and will share it as agreed in advance (Nomani, Rahnema & Ali 1994). All providers of capital are entitled to participate in management, but not necessary required to do so.

iii. Asset Backed Transaction

i. Murabaha (cost- plus/ Mark –up): This concept refers to the sale of goods at a price, which includes a profit margin agreed to by both parties. The purchase and selling price, other costs and the profit margin must be clearly stated at the time of the sale agreement. The bank is compensated for the time value of its money in the form of profit margin. This is a fixed- income loan for the purchase of a real asset (such as real estate or a vehicle), with a fixed rate of profit determined by the profit margin. The bank is not compensated for the time value of money outside of the contracted term (i.e the bank cannot charge additional profit on late payments); however, the asset remain as a mortgage with the bank until the Murabaha is paid in full.

ii Musawamah: is the negotiation of a selling price between two parties without reference by the seller to either cost, or asking price. While the seller may or may not have full knowledge of the cost of the item being negotiated, they are under obligation to reveal these costs as part of the negotiation process. This difference in obligation by the seller is the key distinction between Murabaha and Musawamah with all other rules as described in Murabaha remaining the same. Musawamah is the most common type of trading negotiation seen in Islamic commerce.

iii. Bai- salam (Advance payment): means contracts in which advance payment is made for good to be delivered later on. The seller undertakes to supply some specific goods to the buyer at a future date in exchange of an advance price fully paid at the time of contract. It is necessary that the quality of the commodity intended to be purchased is fully specified leaving no ambiguity leading to dispute. The objectives of this sale are goods and cannot be gold, silver or currencies based on these metals. Barring this, Bai- Salam covers almost everything that is capable of being definitely described as to quantity, quality and workmanship.

iv. Bai- muajjai (Credit sale): Literally bai muajjal means a credit sale. Technically, it is a financing technique adopted by Islamic banks that takes the form of murabaha muajjal. It is a contract in which the bank earns a profit margin on the purchase price and allows the buyer to pay the price of the commodity at a future date in a lump sun or in installments. It has to expressly mention cost of the commodity and the margin of profit is mutually agreed. The price fixed for the commodity is such a transaction can be the same as the spot price or higher or lower than the spot price.

v. Bai' bithaman ajil (Deferred payment sale): This concept refers to the sale of goods on a deferred payment basis at a price, which includes a profit margin agreed to by both parties. This is similar to murabaha, except that the debtor makes only a single installment on the maturity date of the loan. By the application of a discount rate an Islamic bank can collect the market rate of interest.

vi. Bai'al- inah (Sale and buy- back agreement): The financier sells an asset to the customer on a deferred- payment basic, and then the asset is immediately repurchased by the financier for cash at a discount. The buying back agreement allows the bank to assume ownership over the asset in order to protect against default without explicitly charging interest in the event of late payments or insolvency. Some scholars believe that this is not compliant with Shariah principles.

vii. Ijarah (Lease): Means lease, rent or wage. Generally Ijarah concept means selling benefit or use or service for a fixed price or wage. Under this concept, the Bank makes available to the customer the use of service of assets/ equipments such as plant, office automation, motor vehicle for a fixed period and price. Ijarah gives the lessee the right to access the equipment on payment of the first installment. This is important as it is the access and use (and not ownership) of equipment that generates income. Ijarah arrangement aid corporate planning and budgeting by allowing the negotiation of flexible terms.

Viii. Ijarah thumma al- bai (hire purchase): Parties enter into contracts that come into effect serially, to form a complete lease/buy back transaction. The first contract is an Ijarah that outlines the terms for leasing or renting over a fixed period, and the second contract is a Bai that triggers a sale or purchase once the term of the Ijarah is complete. For example, in a car financing facility, a customer enters into the first contract and leases the car from the owner (bank) at an agreed amount over a specific period. When the lease period expires, the second contract comes into effect, which enables the customer to purchase the car at an agreed price.
The bank generates a profit by determining in advance the cost of the item, its residual value at the end of the term and the time value or profit margin for the money being invested in purchasing the product to be leased for the intended term. The combining of these three (3) figures become the basis for the contract between the bank and the client for the initial lease contract.

xi. Ijarah- Wal- Iqtina: A contract under which an Islamic bank provides building or other assets to the client against an agreed rental together with a unilateral undertaking by the bank or the client that at the end of the lease period, the ownership of the asset would be transferred to the leasee. The undertaking or the promise does not become an integral part of the leasee contract to make it conditional. The rentals as well as the purchase price are fixed in such manner that the bank gets back its principal sum along with profit over the period of lease.

x. Istinah: Is defined as a contract for the acquisition of manufactured goods, by specification or order, where the price is paid gradually in accordance with the progress of the Job. This technique can be used for real estate development, where builders are paid at different stages of the building process. This form of financing can also be also utilized for the expansion of production facilities.

xi. Sukuk (Islamic Bonds): Is the Arabic name for a financial certificate but can be seen as an Islamic equivalent of bond. However, fixed-income, interest- bearing bonds are not permissible in Islam. Hence, sukuk are securities that comply with the Islamic law (Shariah) and its investment principles, which prohibit the charging or paying of interest. Financial assets that comply with the Islamic law can be classified in accordance with their tradability and non- tradability in the secondary markets.

xii. Takaful (mutual insurances): Is an alternative form of cover that a Muslim can avail himself against the risk of loss due to misfortunes. Takaful is based on the idea that what is uncertain with respect to an individual may cease to be uncertain with respect to very large number of similar individuals. Insurance by combining the risks of many people enables each individual to enjoy the advantages provided by the law of the large numbers. Takaful is based on collective protection. Members paying into the scheme are its owners, and benefit from the fund should the event they insured against occur.

ALTERNATIVE FINANCING OPTIONS FROM ISLAMIC FINANCIAL MARKET

Islamic finance has a distinctly different form than conventional finance- non interest, no fixed returns, sharing of risk, prohibition of certain types of investment, and obligation to contribute to the poor, among others. It is a growing field, but practices still vary and are unsettled, affected by differing interpretations of Islamic financial law. In many ways, it increasingly emulates the results of financing with conventional instruments, but sometimes with difficultly or inefficiency. While there are cases of blurring with conventional instruments, it remains largely separate from conventional finance. Aziz (2007) opined that Islamic finance will be critical to the future development of infrastructure in Asia and other developing countries like Nigeria. She lamented that the global sukuk market is estimated to be US$18billion and these funds could be utilized to increase liquidity is the Islamic world. The Islamic bond market has typically been 10 to 20 basis points lower than mainstream bonds, but more multilateral agencies are issuing sukuks to finance development projects and government agencies and the corporate sector have considered doing the same.

Considering Nigeria's past experience with conventional financial institutions like IMF, World Bank and the resultant effect of the evil of interest which manifested in the country's external debt. A breakdown shows that in 1985 the country's debt was $5billion. Over the years, $16 billion was paid and the country still owed $28 billion. This meant that $ 29bilion was interest rate calculated over $5 billion debt. This shows the extent to which interest rate may prove unprofitable to a debtor both at the short and the long run. However, Nigeria with population of over 140 million were over 60% are rated to be living below the poverty line and require huge infrastructures to cater for the growing population (Weller, 1999). Adeola (2008) opined that Nigeria can borrow a leaf from gulf countries especially United Arab Emirate (Dubai) and utilize Islamic finance options which offers cheap funding to government by offering for subscription to the Islamic bonds market (Sukuk) to build massive infrastructure as well as exploiting alternative option of equity participation such as Musharakah (partnership/ joint venture) which are based on principles of sharing of the profit and risk of investment projects.

Thus, through financing instruments such as Sukuk, non interest bank can provide much needed finance for the developments of critical infrastructure, thus supporting the developmental agenda of government as well as the cornerstone in achieving the target of the millennium development goals. Islamic bond and equity participation instruments are naturally suited for project finance and their potential should be explored through consultations early in the project development process so that the financing plan can be tailored to the specific requirements of Islamic finance. Another alternative option to project finance and infrastructure development is working in collaboration with the Islamic development bank (IDB) which channels donations or non- interest loan for investment in infrastructure among other things.

In the past few years, the IDB has begun issuing sukuk bonds in International capital markets, which opens the potential for future issuing of bonds focused on infrastructure development. However, one major issue facing the prospect of utilizing Islamic finance for infrastructure investment is the shortfall of basic banking and instruments for Islamic populations in Nigeria. The lack of basic banking facilities imposes major hardships on this population segment, which is denied the means to save and transact. Development of Islamic instruments to serve basic individual and community financial needs and effectively delivering them to the target population would have two important impacts. First, it would contribute to poverty alleviation for a very large population and second, it would mobilize the savings of a very large population in ways that might help support infrastructure development. By talking action on increasing access to basic Islamic financial services, over time a few pools of Islamic investment funds could be developed. Secondly, another constraint for using Islamic bonds to support infrastructure finding are also limited due to difficulties in constructing long- term instruments that are not specifically tied to sharing of income or loss on specific projects, which is not in the nature of many types of infrastructure projects, and because of lack standardization of instruments because of unharmonized shariah (Islamic law) interpretations, which acts to segment the market and prevent development of market signals that can be direct the flow of funding into high priority infrastructure projects. The Islamic financial services boards "ten year framework and strategies" states that harmonization of shariah interpretations effective legal interaction with conventional finance will play an important role in fostering greater growth of the industry. (ISDB/IFSB, 2005)

CONCLUSION

Perhaps, the recent global financial crisis and economic slowdown have not affected only the developing economies but the developed economies as well. These recession results in significant decline in export, total savings as well as government tax and revenue as a result, infrastructure faces stiffer competition from other competing needs.

However, due to the global financial crisis, banks have tightened access to financing limiting funding options. And because economy is critical to achieving a sustainable economic growth and development, Islamic finance is another alternative financial model that is attracting serious attention all over the world now. This is because there is a need to promote an alternative to conventional finance whose interest based factor has promoted capitalism rather than alleviate poverty.

Adeola (2008) opined that Islamic finance was crucial to the alleviation of poverty; it would ensure equity formation through mobilization of idle resources to more dynamic recipients and consequently build a virile economy and a long lasting and stable democracy in the country. Adeola (2008) lamented the consequences of Islamic finance for an emerging economy such as Nigerian include; a more equitable allocation of risk in the finance system, rate of interest is replace by the rate of profit on equity and profit sharing, by mark- ups on credit purchase finance and by rental rates on leasing finance, a curb on excessive credit creation and curtailment of speculative tradition due to the disapproval of margin trading and derivatives; the minimization of bankruptcies as banks, savers and investors jointly absorb losses, because of profit sharing system essentially spreads the net positive or negative outcomes of the business between money capital and human capital. Furthermore, Islamic finance portends for better integration of the real and financial sectors of the economy, banks and savers investors and fund owners are all strongly tied together leading to an economic system with a high degree of integrity that can withstand shocks; better business ethics, banks only entertaining economically viable financing requests; transparent transacting with clients, depositors as well as fund seekers due to compliance with the avoidance of uncertainty resulting in clear contracts for every transaction; greater economic stability.

However, the major weakness of Islamic finance stem from the fact that there is lack of uniformity in the religious principles applied in Islamic countries. In the absence of a universally accepted central religious authority, Islamic banks have formed their own religious boards for guidance. Islamic banks have consulted their respective religious boards, or shariah advisors to seek approval for each new instrument. Analysts are optimistic that the introduction of non- interest finance would have a significant impact on the Nigerian financial sector and the economy as a whole. Also the introduction of non- interest finance will herald the entry of new market and institutional players such as the Islamic money market, Islamic asset management companies, Islamic insurance companies etc, thus deepening the financial market. Similarly they expressed concerned that if proper regulatory frame work is lay down for operational parameters of Islamic finance, the sector stand a good chance of attracting prospective investors because the Nigerian population is estimated at 140 million the country stood at the threshold of becoming a hub for Islamic financial services on the continent and beyond.

RECOMMENDATIONS

Based on the aboved discussion of this paper, the following recommendations are being drawn;

1. That the central bank of Nigeria should establish the National shariah Advisory council which would be responsible for guiding Islamic financial institutions in Nigeria as they emerge, to ensure that their activities fully comply with shariah principles; and also conventional financial institutions willing to continue rendering Islamic products and services to customers in Nigeria would also be advised by the council on ways to ensure that the products and services they specifically design for their customers are shariah compliant.
2. The Nigerian legal system need to be reformed and strengthened in order to provide mechanism for resolving dispute that will arise as a result of enforcement of contracts between parties especially the Nigerian constitution coming from the background of a secular state.

3. Similarly the evolution of Islamic finance in the Nigerian financial landscape poses a serious challenge in the area of manpower requirement. This is because virtually all the staff lacks basic knowledge and experience in Islamic finance, therefore the current crop of bank staffs need to undergo training in order to acquire many new skills and learn new procedures necessary to effectively conduct Islamic finance. Even if a bank is not a wholly Islamic financial institution, its management staff will still have to be familiar with Islamic financial techniques to effectively operate alongside Islamic financial institution in the industry.
4. Islamic financial service board (IFSB) should adopt international shariah compliant financial regulation standard that will serve as a guide to investors considering Islamic finance as well as harmonizing the different interpretations of Islamic financial law.
5. As a matter of policy in strengthened the non- interest financial institutions, the Nigerian Deposit Insurance Corporation should extend its coverage to these non-interest financial institution to insure all depositors against risk when it is eventually introduced.
6. Nigeria government should subscribe to the membership of Islamic development bank (IDB) to serve as a cornerstone in accessing free donation and the non- interest loan offered by IDB to member countries for investment in infrastructure development

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