NON INTEREST BASE BANKING
A CASE STUDY OF HABIB (NIGERIA) BANK LIMITED

BY

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DECLARATION

I hereby declare that this project, entitled Non Interest Base Banking, a case study of Habib (Nig.) Bank Ltd is a product of my research findings.

All relevant sources of information collected for the study are clearly acknowledged by means of references. This area of endeavour has not been previously presented in any form for a higher degree.



.....

JUMARE HAMISU ABUBAKAR

10th of June, 2001

DATE

CERTIFICATION

This project titled "NON INTEREST BASE BANKING, A CASE STUDY OF HABIB NIGERIA BANK LTD" by Jumare Hamisu Abubakar was produced under my supervision. I am satisfied that the document meets the requirements of the Department for the award of Master of Business Administration Degree of the Ahmdu Bello University, Zaria. Thus, is approved for its contribution to acknowledge and literary presentation.

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DEDICATION

This project is dedicated to the following:

My Mother:	Hafsat Abubakar Jumare
Wife:	Ramatu M. Dikko
Uncle:	Alh. Bashir Jumare
Brother:	Rabiu Abubakar Jumare

Who are sources of my inspiration in this direction and to Alh. Shafiu Idris Z/Aya (a friend) who showed financial concern all through the duration of the course.

SON & DAUGHTER: Al-Ameen and Fatimah, who although young has shown the importance of my absence during the course.

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First and for most thanks be to Allah (SWT) whose Peace, Mercy and Blessing be with his Prophet Muhammad (SAW).

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all members of our family, friends and well wishers like Abubakar Rufa'i, Mahmud Abubakar (Neighbour/Brother) and other well wishers who continuously pray for my success, I can not end up this acknowledgment without thanking my Mother and my late Father (RIP) who saw the completion of my first degree and is not alive to see the completion of this one "Allah Ya Jikanshi", Amin..

ABSTRACT

In consideration of various Religious views and different writers protracted arguments of the problems associated with the interest aspect and credit management under the conventional banking and the claims of the provisions an ultimate solution to the problems through the frame work of Non Interest Banking. The study is being undertaken with a view of seeing and analysing the Non Interest Banking NIB in form of "Case Study" with respect to "Habib Nigeria Bank Limited". It is Habib Bank experiment because it is the first bank to open Non interest window among the corventional commercial banks in Nigeria.

However, the concept of Non Interest Banking (islamic Banking) is relatively a new area in the field of Finance in Nigeria as such this study would reveal how the introduction of the Banking System with it principle of profit sharing can eliminate the present state of indebtedness, contribute greatly to knowledge and serve as basis for further research.

The study is divided into five chapters. Chapter one is the introduction, chapter two - Literature Review, Chapter Three - A non Interest Base Banking, Case Study with respect to Habib Nig. Bank Ltd, Chapter fours shows the presentation and analysis of Data where we found among other things that Non Interest Banking is very viable in Nigeria and people are interested in the concept as they are interest in having its knowledge and finally the chapter five summarises, concluded and gave Recommendation of the study.

Is also the belief of the researcher that a study of Non Interest Banking Case Study in respect to Habib Nig. Bank Ltd is of great relief in view of the severe crises both developed and developing countries as a result of high interest ate.

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CHAPTER ONE

1.0 INTRODUCTION

A bank is an organisation made up of integrated and inter department or set of system that enable it function toward a set objective.

A very important features of any system is that it has inputs and outputs, this could be compared to a human digestive system to example which receives inputs of food and by mechanical and chemical processes yields outputs of energy and enzymes and other materials vital for the nutrition of the body.

Western Banking originated or rather to say, the first banks were hardly more than agencies for concentrating and managing loans pf government, and as such had their origin in Italy as early as the twelveth century. The word "bank" originally signified a "pile" or mass of funds, like the Italian "month" and the French "mout" and was applied to mixing together of various government obligations, and their consolidation in sets of negotiable securities, which were issued, transferred and paid through "bankers" who sometimes collected the public revenue and made payments in connection with the handling of public debts. It was for such functions as those that the first banks were established at venice, Glorence and Genoa. But when a large and lucrative trade was

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developed by enterprising merchants of those cities that the Levant and the orient, and later by those of Antwerp and Amsterdam with distant parts of the world, and the result of the discoveries and adventures of the navigators of the fifteenth and sixteenth centuries, the necessary arose for some means of effecting commercial exchange on scale, even before known, at least not since the dim ages of Phoenician, Babylonian and Egyptian terrific.[18]

In the United State, in time of industrial and commercial activity, about ninety-five percent of all the exchange which take place in the interval between the production and consumption of the commodities by which men live are accomplished upon credit and mainly the agency of banks.

Before the Banking act 1979, status law had not been very helpful in defining a bank, several sets of parliament described bank merely as a company of body, corporate or partnership carrying on the business of Banking.[1]

A bank is made up of a system of credit services of loan, overdraft, discount services of credit lines, cheques clearing and non credit services of investment advises, trustee services credit information, and non interest banking services which known as Islamic banking.

Three characteristics were held to be usually found in a bankers business.

1. To accept money from and to collect cheques for customers and to place the cheques to the customers credit in a running account.

2. To honour cheque or orders drawn on the bankers by the customers when presented for payment, and to debit their customers in the running account according.
3. To keep customers running account in which credit and debits were entered.[1]

There is increasing disillusionment in the west with the capitalist system. Its tendency to make the richer and the poorer has always aroused resentment. Recently, so many religious men for example Birmin Bishop and others in December, 1984 asked whether it was ethnical to change interest on loan to developing countries. And also critism were labeled against goods which brings harm to people such as those concerned with tobacco, alcohol, gambling and pornography. All these business are forbidden by Islam[2].

These are so many reasons that gave rise to Non Interest banking among which the major is not all far from Religion. "It is not Islam only

that outlaws the institution of interest, because all religious that were before Islam condemned such oppressive and unhealthy transaction. Here I mean Judaism and Christianity. God has prohibited (it) Interest in the Toarah, but Jews made it permissible to a non - Jew. While it's forbidden in Christianity up to today. The statements is here in the Bible Luke chapter 6:34 - 35.[6]

Also the way and manner private individuals became hostages to the fluctuations of interest rates and how also small business have been bearing the burnt of harsh and callous treatment by their banks gave rise to the need of developing a system or an option, which is the non Interest Banking and Islamic Economic System. Even though the Marxist system of Economic management is a little different from capitalism it has not done much in solving the Economic problem of people.[2]

But the third Economic system which is the Islamic Economic System (Non Interest Banking System inclusive) has the profit sharing motive with a welfare ethic and in which the individual is obliged not only Strim for his own betterment but to contribute to the good of society as a whole.[3]

The system is based on an interest Free Profit and Loss Sharing System (PLS) whose risk is shared with it customers, a concept entirely alien to the conventional system.

Many people in the world have realised the viability of not Non Interest Banking (NIB) or rather called Islamic Banking. Several Banks have set up units operating on the principles followed by Islamic Banking. In Nigeria, Habib Nigeria Bank Limited is first to set up a Unit for Non Interest Banking (NIB).

1.2 STATEMENT OF PROBLEM

Due to the number of problems coursed by the Interest Based Conventional System and the critism labeled against same system. The Non Interest Banking (NIB) based on interest free system and profit sharing is hereby argued to hold an ultimate solution to the problems presented by the Conventional Banking System.

Some of the problems caused by conventional banks (ie. Interest Base banks) are as follows:

1. Both the two Nigeria major religion (Islam & Christianity) have prohibited transaction based on "Riba" usury i.e. Interest. "This is supported by verses from the Bible and Qur'an on the prohibition of Interest (Usury)".
   a. Bible - Ezekiel 18 verses 8, 9 and 13
      - Luke 6 verses 34 - 35
   b. Qur'an - Surah Albaqrah 2 verses 275 - 81

2. The most permicious problems by the Conventional Interest Base Banking is the creation of debt ridden economy, where the entire community, the Government and the society at large find themselves in debt which is unaccompanied with social economic political and psychological implication.

3. Repayment of public debt is no longer feasible by many developing countries because of the Interest element in the system.

4. The system of conventional banking base on interest system has been largely responsible for many evil in our Economy.[6] (This reason could be attributed to the eligious belief the people have on usury).

1.3 OBJECTIVE OF THE STUDY

The main objective of the study is to find out how Habib (Nig.) Bank Ltd operates its Non Interest Banking, its acceptance and relevant to the society it operates.

Other objectives include to acquire and examine all the response of individuals Banker on the Non Interest Banking product of the Bank vis - a - vis the benefit they drive from the new product.

Finally the project intends to analyse the response and the same recommendations.

1.4 SIGNIFICANCE OF THE STUDY

The researcher believes that the research is going to be significant to Nigerians in the following ways.

- It will enable us examine and find out how the Banking System base on Non Interest Element operates in Habib Nig. Bank.
- To see how the introduction of the Banking System with its principles of profit sharing can eliminate the present state of indebtedness.
- The study will be of great value to both state government, federal government, public as well as entrepreneurs, who either want or have applied to the government for licences to establish the Non Interest Unit in their Banks.
- The study is significant to those who accept the concept and those who think that the system is impossible to operate.

The study shall be limited to Habib Nig. Bank Ltd.

1.5 RESEARCH METHODOLOGY

In order to achieve the objective of this Research the researcher shall make use of both primary and secondary data for analysis.

PRIMARY DATA: This shall be through structured research questionnaire designed by the researcher whose the views of those in Habib Nig. Bank (Non Interest Banking Unit) only and some staff of few other Banks in Kaduna were sought. Personal interview with staff of the unit was also conducted because of researcher's accessibility to the staff of the unit.

SECONDARY DATA: This will be the Habib (Nig.) Ltd. Non Interest Banking Handbook, Bank Manual of Operation, Text Books, Newspapers and other Journals.

1.6 SCOPE AND LIMITATIONS

a. **SCOPE OF THE STUDY**: In conducting the research, it will not be possible to each or all banks in studying the concept of Non Interest Banking, this is because it is only Habib Nig. Bank that operate the product.

Therefore the researcher shall concentrate on Habib Nigeria Bank Limited, hence the study is limited to Habib Nig. Bank only.

b. **LIMITATION OF THE STUDY**:

The limitation of the studies are tied to its scope out of so many commercial banks, and other financial institute in Nigeria only

Habib Nig. Bank offers the product as at now therefore only Habib Nigeria Bank Limited is considered for analysis.

There are three major Limitations of the project research, they are as follows:

a. Time
b. Scanty Literature, and
c. Finance

As regards to (a) and (b) the researcher will confine himself to the literature available in Habib Nigeria Bank Limited.

1.7 DEFINITION OF CONCEPTUAL TERMS

1. BANK: A commercial institution with various financial activities, chiefly the handling of the money of its depositors.[12]

2. A CURRENT ACCOUNT: Is an active account on which cheques are drawn and into which credits are paid. Interest is not usually allowed on a credit balance but interest is charged if the account is overdrawn. Some banks make charge for the running of the account, although modern practice is for current accounts to bear no charge if they are kept in credit.[12]

3. A SAVINGS ACCOUNT: Is one into which small regular payments are made as a means of accumulating savings, Favourable of interest are usually offered in conventional banking system.[15]

4. A DEPOSIT ACCOUNT: is one in which money can be deposited to earn profit to share in profit. Withdrawal is subject to notice. So that the depositor cannot issue cheques on his account and normally withdrawals are by transfer to a current account.[4]

5. BANK BILL: A bill of exchange is an conditional written order to paid on demand e.g. Treasury Bills etc. It can be drawn or accepted by a commercial bank or an accepting house. It can be discounted at a preferential rate in conventional banking system.[1]

6. CONVENTIONAL BANKING: Is the traditional banking which is sanctioned usury and is based on interest system. The banking system encompasses the present day commercial banking, merchant and development banking system.[5]

7. NON INTEREST BASED BANKS: These are banks that are bases free system sometimes refer to as Islamic Banks, they are mostly governed by controls derived from Allah's (S.W.T.) course, while conventional banks are controlled only by hard competition

concerning goals and objective and while they constitute an integral part of the society. In harmony with its other constitutions, on the march towards achieving Allah's course, commercial banks are not related to their own society except through profit making.[10]

8. ISLAMIC ECONOMIC: Control and management of the money, goods and other resources of a community, society or household base on Islamic injunction and principles where interest element is absolute zero. The is same as Islamic Banking System.[10]

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CHAPTER TWO

LITERATURE REVIEW

2.0 BANKING IN DEVELOPED AND DEVELOPING ECONOMIES:

Banking either in developed or developing economy accept deposit and make loans and derive a profit from the difference in the interest rates paid and charged. And it depends entirely on public confidence in the system=s - soundness, since no bank could pay all its depositors should all of them simultaneously demand cash, as may happen in crisis. Commercial banks, in most of these countries prefer to make short-term loans. Since they involve less risk, although Japanese and West German banks provide long term financing.

They also have the power to create money through borrowing and lending. As in other businesses, operations must be based on capital, but banks employ comparatively little of their own capital in relation to total volume of their transactions. The purpose of capital and reserve accounts is primarily to provide an ultimate cover against losses or loans and investments. In Nigeria and the United States, capital accounts also have a legal significance, since the laws limits the proportion of its capital a bank lend to a single borrower.

In planned economies, banks do not create money however, but only facilitates transactions among individua s and state enterprises, regulate activity and accept deposits and payments such as taxes and fees. Modest interest rates are charged to consumers and firms to cover the expense of processing the transaction. The former Soviet system even though disintegrated is highly centra ized, held to the discipline of a central plan. Eastern European countries have experimented with semi-autonomous regional systems.[20]

The long term provision of industrial finance in Britain and the Commonwealth countries, for example, is usually handled by specialist institutions, with the commercial banks providing only part of a necessary capital. In Japan, the long-term financial needs of industry are met partly by special industrial banks (which also issue debentures as well as accepting deposits) and partly by the ordinary commercial banks.

Since the world war II the commercial banks in the US have developed the term loan however. The term loan is meant for financing industrial capital requirements. Most term loans have an effective maturity of little more than five years though some run for 10 years or more. They are usually arranged between the customer and a group of lending banks sometimes in co-operation with other institutions such as insurance companies and are normally subject to a formal term loan agreement.

Short term loans are the core of the banking business even in countries where commercial banks make long term loan to industry. Much short term lending consists in the provision of working capital, but the banks also provide temporary finance for fixed capital development aiding a customer until a long term finance can be found elsewhere.

Much of this short term lending is done by overdraft, particularly in the United Kingdom and a number of the Commonwealth countries, or by way of "Current account lending" in many Western European countries. The overdraft permits a depositor to overdraw an account up to an agreed limit. In theory, overdrafts are repayable on demand or after a reasonable notice has been given, but often they are allowed to run on indefinitely, subject to a periodic review. An advance is reduced or repaid whenever the account is credited with deposits and recreated when new cheques are drawn upon it, interest being paid only on the amount outstanding.

Again, in a number of countries including the United States, the United Kingdom, France, West Germany, and Japan short term finance is often made available on the basis of discountable paper - commercial bills or promissory notes. Some of these paper is usually re-discountable at the Central Bank, thus becoming virtually a liquid asset, unlike a bank advance or loan.[22]

2.1 TYPES OF BANK

Bank is an institution that deals in money, substitutes and provides other financial services. However, the essential quality of banking is the creation of money, either through credit, profit sharing venture or government action. Some institution often called banks as trust companies and home-loan banks, do not perform the functions of a bank. Their economic function is that of channelling savings from private individuals into the hands of those who will use them, in form of loans for building purposes or for the purchase of capital assets. These financial intermediaries cannot, however create money (i.e. credit) as the commercial banks do. Commercial banks, for example, are required to keep a portion of deposits as cash and near cash. (Near cash includes short-term, safe liquid instruments as treasury bills, commercial paper and deposits at the central or other commercial banks). They make loans generally by crediting borrowers with an addition to their chequeing accounts, which are effectively, approved overdraft. These cheques must be honoured by other banks even if the funds were created by the bank through the loan.

The principal types of banking in the modern industrial world are COMMERCIAL BANKING and CENTRAL BANKING. A commercial banker is a dealer in money and substitutes for moey, such as cheques or bills of exchange. The banker also provides a variety of financial

services. The basis of the banking business is borrowing from individuals, firms and occasionally governments - that is, receiving Adeposits" from them. With these resources and also with the bank's own capital, the banker makes loans or extends credit and also invest in securities. The banker makes profit by borrowing at one rate of interest and lending at a higher rate of interest and by charging commission for services rendered.[1]

ANOTHER TYPE OF BANKING is carried on by the CENTRAL BANKS, which are bankers to government and Alenders of last resort" to commercial banks and/other financial institutions. They are often responsible for formulating and implementing their country's monetary and credit policies, usually in co-operation with the government. In some cases, e.g. in Nigeria and the US the Central Bank of Nigeria and Federal Reserve System - have been established specifically to lead or regulate the banking system respectively; in other cases e.g. the Bank of England - have come to perform these functions through a process of evolution.

Broadly however, there are five types of banks in Nigeria:

1) the Central Bank of Nigeria which is the banker to all the banks.
2) Development banks of which are four namely:

a. Federal Mortgage Bank - to promote the development (financing) of housing.

b. Nigerian Agricultural and Co-operative Bank - for the development of agricultural industry.

c. Nigerian Industrial Development Bank - for the development of industries.

d. Nigerian Bank for Commerce and Industry B for the development of commerce and industries especially the small to medium scale ones.

3) Savings banks, of which there is only one i.e. the Federal Bank to encourage the saving habit especially among the low income earners both in urban and rural areas - (including the People's Bank).

4) Commercial banks - which operate in networks and retailers of financial services and products.

5) Merchant Banks - these are relatively young and are involved in wholesale or marketing of financial services and products. Now with new Regulation Merchant Bank can go on event retaind.

In banking, confidence and trust on the part of the depositors is the true basis of stability in both economies. Confidence/trust is achieved through the existence of a central bank, which acts as a "lender of last

resort". Another means of maintaining confidence employed in some countries is deposit insurance, which protects the small depositors against loss in the event of a bank failure.

Also, since the banker undertakes to provide depositors with cash on demand or upon prior notice, it is necessary to hold a cash reserve and to maintain a "safe" ratio of cash to deposits. The safe ratio is determined largely through experience. It may be established by convention (as it was for many years in England) or by statute (as it was for many years in England) or by same statute (as in the US and elsewhere). In credit management policies no banker can safely ignore the necessity of maintaining adequate reserve of liquids assets; as a result, some prefer to limit the sum of loans and investments to a certain percentage of deposits, not allowing the loan - deposit ratio to run for any length of time too high a level.

In long-term and medium-term lending, French Abanques d'affairs and the Western German commercial banks, have developed special means of reducing their degree of risk. Every investment is preceded by a thorough technical and financial investigation. The initial advance may be an interim credit, later converted intc marketable securities, and an issue of share to the public is arranged. One function of these banks is to nurse an investment - along until the venture is well established. Even

assuming its ultimate success, a bank may be obliged to hold such shares for long periods before being able to liquidate them. In addition, they often retain an interest in a firm as an ordinary investment as well as to ensure a degree of continuing control over it.[22]

2.2 THE FUNCTION OF BANKS

The commercial banks accept deposits, make loans and clear cheques, transfer bank deposits from one person or firm to another and provide a variety of services to their customers, including transaction of foreign exchange business, the purchase or also of stock exchange securities on their behalf, and acting as executors or trustees. They also provide loan facilities to their customers in the form of credit cards and overdraft. The credit card scheme is intended for the use of housewives and other shoppers and business. For large business customers, overdrafts facilities are very useful and usually re-negotiated at regular intervals. Under this arrangement, clients agree to a credit limit with the bank, and are able to draw cheques on their ordinary current accounts up to that limit. For all those services, the commercial banks charge interest or take commission in their credit management for their services rendered for the customers.[1] All procedure are followed in *Non Interest Banking*, with free from the Interest Element.

In short, the chief services are to receive, transfer and cash deposits and to make loans to its clients. It offers three principle types of banking account facilities, Current Account, Deposit Account or time Deposit Account, Savings Accounts, (on which it pays interest to its customers).[24]

In *Islamic banking system*, Non (*Interest Banking System* (NIB)) the *Shirakat* banks lend money to the industry and commerce on the basis of *Shirakat*, that is, they share the profits with the debtors rather than burden industry and commerce with a fixed rate of interest. The process of credit management is more involved in an Islamic system. For one thing, the banks would have to keep technical staff to examine each scheme of commerce and industry for which capital is sought. In otherwise, theme banks lend money only to those enterprises which are going to be productive. They cannot be indifferent as to whether their clients make any profit or not, as the conventional banks are. The result is that, under the technical vigilance of the banks, capital is directed to the most productive occupations and, therefore, the most conducive to national welfare.[25]

These banks also keep continuous contacts with their clients after they have approved their schemes and provided them capital. The banks find it beneficial to provide technical assistance and commercial guidance to their debtors. The need for constant vigilant over the actual working of

each debtors can be easily reduced to workable limits by making it a term of contract that they shall keep complete accounts just as the joint stock companies do. The banks consequently audit their accounts every six months to see the viability of the company.[26]

Again, like any other conventional bank, the Islamic bank accept deposits of all kinds from the public, who have according to Keynesia analysis different motives in depositing their savings. The chief motive of the main categories of depositors according to Keynesian approach is "Liquidity preference" and savings.[27]

1.3 CONCEPTUAL FRAMEWORK AND DEVELOPMENT OF NON INTEREST BANKING.

Non Interest Banking being a term refer to Islamic Banking is part of the broader concept of Islamic Economics as suggested by Islamic Schorlars. It is the introduction of values system and ethics religion (Islamic and Christianity inclusive) in the economic sphere.

Because of this ethical foundation, *Non Interest Banking* and finance for many Muslims is more than a system of mere commercial transaction. Following Islamic precepts in financial transaction are viewed by many as religious obligation.

The ability of an Institution to attract Investors successfully may depend not only on the profitability of their Institution, but also on the perception that the Institution faithfully observes Religions restriction.

Credit both in conventional based banking and in *Non Interest Banking* serves many purposes, it serves the lender, the borrower and the needs of the trade, in modern Industry sometimes Individuals need to defer using part of the income in order to accumulate for future uses.

It is very pertinent to mention here that due to the problems associated with the interest on loans and the religions belief individuals here against the interest, that when ever they hear a system is free from interest they preparably go for it, and are ready do forfeit all the gains their interest element brings.

A number of debates have been taking place since 1943 about the price rate of conventional bank, should the commercial Bank confine themselves to traditional role of short term lender or should they go in for medium term lending? Or should they take a stake in live purchase? Should the trustees saving bank introduce a cheque service for the customers. While credit and general banking management in conventional banks involve how interest rate could be managed. In *Non Interest Banking System* interest is totally prohibited and that every firm of interest is unlawful.

In Non Interest set up of Bank, some refers it as Islamic Banking System, although constrained by the role of Sharia, essentially perform the same function as those on conventional system, that is, they act as administrators of the Economy's payment system and as financial intermediaries (Stogler 1967).

As in the conventional system, the non interest depository financial intermediaries transfer the liability of business into a variety of obligation to suit the taste and circumstance of surplus units. Prohibition of interest in Non Interest Banks and the fact that banks have to rely primarily on profit sharing game to a major difference between the two system. (Conventional Banking and Non Interest Banking System). This is part of the credit management policies, Non Interest Banks have to offer their assets of primary securities in the firm of the risky ended. (Mutual fund) type packages for sale to investors and depositors, while Banks in a conventional system keep title to the asset portfolio they originate.

Almost all Islamic and Muslims Countries have practice *Non Interest Banking* management to various degrees, Interest free Banks have a lot being operating in several Muslims Countries. The authority of Islamic Representative of Iran for example these to convent their Banking System to an interest free Banks. In 1983 Pakistan on the other hand, choose to introduce an interest free system of management.

Quating one Prof. Sheikh Abdullahi of ABU Business School as saying AA lot of European Countries like UK and even United States of America USA have opened Non Interest Banks window in their computers due to the huge amount of deposit their loans from Arab combines whose sole belief is against the interest element of conventional banking.

Non Interest Banking has it's origin and development from the prohibition of interest "Riba" by the avoid leading Religious, Islam, Christianity and Judaism which emphatically forbidden interest. The subsequent topics of the chapter will back the relevant Religions Texts and how the procedure of *Non Interest Banking* is spelt out.

2.4 MECHANISM OF NON INTEREST BANKING.

The world's leading Religious of Islam, Christianity and Judaism have explicitly and emphatically forbidden interest. The Phraseology of verses in the Holy Quran and the Holy Bible leave no doubt in one's mind that the institution of interest is wholly repugnant to the spirit of those religions. The Biblical Quotation where interest is prohibited can be found in Deuteronomy 23:19-20, Leviticus 25: 35-37, Ezekiel 18:13, Jeremiah 15:10, Exodus 22:25, Luke 6:34 - 35, Nehemiah 5:11, Psalm 15:5.

The Qur'anic Quotations are in Surahs Al-run, verse 36; Al-NIsa, Verse 161; Al-Imran, Verse 130-3, Al-Baqarah, Verse 275-81.

The mechanism of Islamic Banking or Non Interest Banking which is base on the principal of partnership is free from interest. Therefore the question of paying interest to depositors in changing any interest from clients does not even arise.[28]

Greek Philosopher Aristotle described usurious profit as being alien to the legal trade.

The old testament (Exodus chapter 22) and (Deuteronomy chapter 23) prohibits usury of money victuals and anything that is lent. Shakespeare speaks of interest as a Abreed for barren metal."

Usury in Islam was the object of severe criticism. There are also Hadiths to this effect, up to the extent of equating the sin of usury to a man marrying his mother.

Islam permits trading and forbids interest. In short interest charged by the present conventional banks is usury, and any transaction having a hint of usury is not on any account legal in Islam.

In this regard therefore, the Islamic Banks being governed by the restrictions of the divine system (the Shari'ah) introduced some instruments, which have been set into practice a decade ago, gaining ground in Asia, Africa, Europe and the United States.[29]

Therefore, under the Islamic system of banking, there may be two types of depositors. The first type of depositors who can deposit their surplus funds, may be allowed to withdraw their funds any time without any notice. This type of deposit is for safe depositing only, not for investment in any productive activity where risk is involved. In this case of such deposits, the bank may recover Zakat and service charges from muslim and non-muslim depositors respectively. This taxation on idle funds is justified, because it checks the tendency to hoard cash in idle form and provides a stimulus for investing in productive activities.

The second type of depositors will not be in a position to withdraw their funds without notice. Their surplus funds may be invested in productive affairs on a short-term basis. The bank will not charge anything from these depositors; rather, they will be allowed to share the profit or loss of the bank proportionately at the end of the financial year. Even in Western countries some of the banks issue investment certificates or investment bonds on a fixed ratio of interest. But in an Islamic State, those investment certificate holders will be eligible to share the profits

of the bank proportionately in the form of dividends which may be worked out at the end of the financial year. Obviously, the Islamic bank cannot issue debentures for fund raising, (like in the conventional banks), as it involves paying of a fixed rate of interest.[30]

The following are the major instruments currently being used by the Islamic Banks or Non Interest Banks are: 475769

1. **Financing by Lending** - This implies all Loans with service charge (without interest) Qard Hassan (lending without return), i.e. loan on compassionate ground.[31]
2. **Modes of Financing** - Mudaraba Sales trade with mark-up (cost plus) trade with mark-down, trade with buy-back arrangement, Ijara (lease financing), hire purchase and development charge.[32]
3. **Investment type** - Musharaka (free partnership) equity participation, i.e. participation term certificate (PTC) decreasing partnership (Musharaka Mutanaqisa) Mudarabah (limited partnership) and investment or rent-sharing.[33]
4. **Zakat and Social Fund** - loans with service charges. In this case, banks provide finance and recover service charge in addition to the amount of finance provided. Service charge will be equal to the cost of operation, and will not include cost of deposits and provision for the bad debts.[34]

5. **Ijara (Lease financing)** - a lease is an arrangement by which a firm acquires the right to use an asset, without owning it for a certain period of time, by making a series of periodic cash payments to another firm which owns the assets. The owner firm is called "lessor" and the user firm is called "lessee". Periodic payment by lessee is the rental of the asset.[35]

6. **Hire-purchase** - is a technique of financing for vehicles, machinery and equipment for a medium and long term periods under joint ownership, subject to security and insurance cover. Payments are done installmentally. After payment of total purchases price and fulfilment of other agreed conditions of title of ownership passes on the "Hirer".[36]

7. **Development charge** - basically, financing for land development is done on the basis of development charge. Rate of development charge is normally determined by the Central Bank. Forestry, water resources (river basin) and roads can be financed on the basis of development charge.[37]

2.5 SOME QUOTATIONS FROM THE BIBLE, QURAN AND HADITH REGARDING INTEREST (USURY).

THE BIBLE

EZEKIEL 18:8, 9 & 13

18:8 *he that hath not given forth upon usury:*

Neither hath taken any increase, that hath withdraw his hand from iniquity; hath executed true judgement between man and man.

18:9 *hath walked in my statutes.*

And hath kept my judgements, to deal truly: he is just, he shall surely live, saith the Lord God.

18:13 *Hath give forth upon. And hath taken increase:*

Shall he then live ? He shall not live! He has done all these abominations; He shall surely die; his blood shall be upon him.

LUKE 6: 34 - 35

* *And if ye lend to them of whom ye hope to receive, what thank Have ye ? For sinner also lend to sinners, to receive as much again.*

* *But love ye your enemies, and do good and lend, hoping for nothing again, and your reward shall be great, and ye shall be the children of the Highest: for he is kind unto the unthankful and to the evil.*

2.6 THE QUR'AN

1. SURAH AL-BAGARAH, VERSES 275-81

Those who benefit from interest shall be raised like those who have been driven to madness by the touch of the Devil; this is because they say: "Trade is like interest" while God has permitted trade and forbidden interest. Hence those who have received the admonition from their Lord and desist may have what has already passed, their case being entrusted to God, but those who revert shall be the inhabitants of the fire and abide therein forever (275). God deprives interest of all blessing but blesses charity; he loves not ungrateful sinner (276).

Those who believe perform good deeds, established prayer and pay Zakkat, their reward is with their Lord; neither should they have any fear, nor shall they grieve (277).

O'believers, fear God, and give up the interest that remains outstanding if you are believers' (278). If you do not do so, then be sure of being at war with God and His messenger. But, if you repent, you can have your principal. Neither should you commit injustice nor should you be subjected to it (279).

If debtor is in difficulty, let him have respite until it is easier, but if you forego out of charity, it is better for you if you realize (280).

And fear the day when you shall be returned to the Lord and every soul shall be paid in full what it has earned and no one shall be wronged (281).

2.7 HADITH

From Abdullahi Ibn Hamzah: The Prophet, peace be on him said,

"A dirham of RIBA which a man receives knowingly is worse than commiting adultery thirty six times". Bayhaqi has also reported the above Hadith with the addition that "Hell befits him whose flesh has been nourished by the unlawful".

From Abu Hurayrah: The Prophet, peace be on him, said:

"RIBA has seventy segments, the least serious being equivalent to a man committing adultery with his own mother."

From Jabir: who reported that The Prophet, peace be upon him "Cursed the receiver of RIBA, the payer of RIBA, the one who records it and the two witnesses to the transaction and said: They are all alike (in guilt)".

2.8 THE NATURE OF INTEREST (RIBA)

The term Riba is used in shariah in two senses. The first is riba al-nasiah and the second is riba al-fadl. Riba al-nasi'ah refers to the interest on loans.

The prohibition of riba al-nasi'ah essentially implies that the fixing in advance of a positive return on a loan as reward for waiting is not permitted by Shariah.[38] The question is not whether the return is a fixed or a variable percent of the principal, or an absolute amount to be paid in advance or on maturity, but the **predetermined positiveness** of the return.

There is no room for arguing that riba refers to usury and not interest, because the prophet (SAW) prohibited the taking of even small gift, service or favour as a condition for the loan, in addition to the principal. However, if the return on principal can be either **positive** or **negative** depending on the final outcome of the business, which is not known in

advance, it is allowed provided that it is shared in accordance with the principles of justice laid down in Shari'ah.[39]

The Qur'an emphatically instructs muslims not to acquire each other's property wrongfully (2:88 and 4:29) see also 4:161 and 9:34). One of the important sources of unjustified earning is receiving any monetary advantage in a business transaction without giving a just counter-value. Riba represents, in the Islamic value system, a prominent source of unjustified advantage.[40]

The prohibition of riba appears in Quaran in four different revelation. First, 30:39, in Makkah, emphasized that while interest deprived wealth of God's blessing, charity raised it manifold. The second (4:161), in the early Medinah period, placed those who took riba in juxtaposition with those who wrongfully appropriated other people's property. The third (3:130-2), around the second or third year after hijirah, enjoined Muslims to keep away from riba if they desired their own welfare. The fourth, (2:275-81), near the completion of the prophet's (SAW) mission, severely censured those who take riba, established a clear distinction between trade and riba, and instructing them to take only the principal amount, and forego even this in case of the borrower's hardship.[41]

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The prophet peace be on him, also condemned, in the most unambiguous words not only those who take riba, but also those who give riba and those who record the transaction or act as witnesses to it (hadith A. 1 m. Ummer Chapra p 236). He even equated the taking of riba to committing adultery thirty-six times or being guilty of incest with one's own mother. The hadith is quoted thus:

> *"From Abu Hurayrah: The prophet, peace be on him, said: ARiba has seventy segment, the least serious being equivalent to a man committing adultery with his own mother.*[42]

The distinction between trade and interest as drawn in the Quaran thus, is very clear. While in trade an entrepreneur has the prospect of making a profit, he also faces the risk of incurring a loss. In contrast to this, interest is predetermined to be positive irrespective of the ultimate outcome of business, which may be positive of the ultimate outcome of business, which may be positive or negative, depending to a great extent on factors beyond the control of the entrepreneur.[43]

2.9.0 TYPES OF INVESTMENT AGREEMENT UNDER ISLAMIC BANKING

a. **Musharaka:** is an agreement between the bank and its client to participate in a business as temporary partners by providing agreed amount of funds for sharing profits, or losses during a specified period of time. The bank's liability

is restricted to the extent of funds deployed. Whereas the business is run by the client, the bank examines the feasibility and profit projection so as to monitor and supervise business transactions.

b. **Equity Participation and purchase of shares:** Investment on this basis means sharing risks and rewards of ownership. Under the scheme, the bank or financier purchase the shares of the company at market price or an agreed price. Profit will be shared in the form of interim or annual dividend, whereas loss will be borne in the form of reduction in the market price of the shares purchased.

Participation of Term Certificates (PTC): is an instrument of medium and long term financing which has been evolved to replace debenture financing. The instrument is transferrable. Profits are shared in agreed ratio while losses are shared in the radio or the investment of the Bank and the company. Only joint stock companies can raise funds by issuing PTCs.[44]

In Pakistan, for example, the National Investment Trust (NIT), Investment Corporation of Pakistan, and Bankers Equity Limited, issue participating term certificates (PTC). This is the most important financial instrument devised to meet the financial needs of industry on a long term basis.[45]

Banker's Equity has introduced several instruments of finance including mudarabah, participating term certificates (PTC), and Equipment leasing, etc. In fact it plays a role of intermediary financier. The loanable funds acquired B.E.are actually prov ded by the commercial banks of Pakistan and the State bank of Pakistan. Thus funds which are the disposal of B.E. have to be allocated primarily on the basis of economic feasibility of a particular project. As much, a careful examination of a project's feasibility is carried out before the financial assistance package is approved.[46]

While Decreasing Partnership (musharaka mutanagisa): is partnership whereby bank gives the partner the fright to supersede it in the ownership of enterprise in one or several stages according to the agreement concluded between them and to the type of the enterprise.

Mudarabah (limited Partnership): is a contract between two persons whereby one person puts in managerial efforts and/or skill to carry on a business; profit sharing to be agreec upon before hand. The capital owner is called "Rab-al-Mal" and the person who works or trades with the money is called "Mudareb". Profit is shared in agreed ratio either by half, third or any other way agreed upon. The bank may be a mudareb or Rab-al-mal. Mudarabah may be for "specific purpose". It may be perpetual or for a specific period. Mudarabah certificates are transferrable.

Investment on rent sharing: is generally applicable to financing for purchase or construction of houses. The bank and client contribute funds, as agreed, to purchase or construct the house. Rent of the building will be estimated - area wise and will be shared in the ratio of their investments or as agreed upon. Rent may be revised after every three years.[47]

2.9.1 THE PRINCIPLE OF MUDARABAH

The Islamic banking is based on the universally recognized principles of shirakah (partnership . That is the whole system of banking in which the shareholders the depositors, the investors and the borrowers participate on partnership basis. In mudarabah one party provides the necessary financial capital, and the other supplies the human capital needed for successful performance of the economic activity undertaken. This is not merely a partnership in the modern sense of the term however. It is something more than this, according to M.A. Manna because Islam has provided a code of economic ethics combining the material and spiritual values for the conduct of its economic system. Thus he argued that, the Islamic banking system can help establish certain institutions on the basis of mudarabah and thereby solve the age-old conflict between labor and capital.[31] Industrial, commercial and agricultural enterprises can be worked out on the principle of mudarabah combining the various units of production. The income resulting out of such enterprises can be shared proportionally among the various units of production after deducting all the legitimate expenses of the enterprises during the year.

However, Zubair Iqbal and Abbas Mirakhor argued that Mudarabah traditionally has been applied to commercial activities of short duration. According to them, Musharakah is more applicable to production or commercial activities of longer duration.

2.9.2 TIME OR FIXED DEPOSISTS (I.e. Mudarabah Deposit)

The main and primary motive of the depositors is "investment motive" or "finance (i.e. profit) motive". Their chief object is to earn some income on funds which they are not using. Those depositors earn interest on the deposits under the conventional system. But under Islamic banking system these deposit is called "mudarabah" or "investment" deposits and will constitute the main profit earning activity of the bank on the principle of profit sharing.

In short Mudarabah in Islamic banking is a contract in which one party the owner (Rabbul-mal) provides capital while the other party (Darib) brings labour and effort with the provision of profit sharing in some predetermined proportions.

(i) **Conditions of Mudarabah**: Sharing of profit/loss: there is no disagreement among Islamic Jurists on the condition governing the responsibilities of principal/agent in the case of profit sharing or loss. The entire loss has to be born by the principles whole the profit has to shared between them in some pre-specified proportions. This is so because in the case of loss agent has

suffered a loss of his effort and labour, so he cannot be asked any loss capital. Since the principal, on the other hand, provides capital his loss is the capital lose in the business.[50]

(ii) **Agent Responsibilities**: Unless specifically restricted from engaging in certain activities the agent is generally free to act "as he sees fit" for the pursuit. Hanafi law distinguishes writes udovitch two types of contract: a limited mandate and unlimited mandate commenda. A commenda with unlimited mandate is one which the investor authorized the agent to get completely at the letters discretion in all business matters. Such authorization is conveyed by investor's statement to the agent: "get with it (the investment) as you see fit". In this case the agent may;

1. Buy and sell all types of merchandise as he sees fit.
2. Buy and sell for cash and credit.
3. Give goods as Bid'ah leave them as a deposit or pledge.
4. Hire helpers as needed.
5. Travel with the capital.
6. Rent or buy animals and equipment.
7. Hingle it withy this own resources.
8. Give it as a commanda tc a third party.
9. Invest it with a third party.

In this case of limited mandate commenda, the activities of the agent restricted mainly relationship with the third party. In some

cases there were geographical restriction on the domain of the agent's operation.

iii. **Duration of Business**: There may or may not be a specified contractual period for the business, depending on the agreement between the principal and the agent. However, there is little disagreement among jurists regarding cancellation of mudarabah. The dominant Hanafi school allows the cancellation by any party during its currency, provided that the part is informed of the decision and it will not be harmful to the other party. It will be automatically cancelled in case of death, insanity or apostasy from Islam of wither party.[51]

Inspite of the above conditions, the bank is also empowered to prevent the entrepreneur or agent from taking such actions as may result in a loss due to failure to plan properly or other irregularities. Thus the bank is empowered to audit the accounts and acquire information regarding important decisions taken by the entrepreneur. It is however mandatory for the bank to keep essential secretes, as well for the entrepreneur, and to refrain from action detrimental to the interest of the enterprise.[53]

In mudarabah the entrepreneur are not allowed to acquire long-term loans for the simple reason that this pushes the financial liabilities of the partnership beyond limits of the jointly-covered capital. The entrepreneur is not authorize to increase the financial liabilities of the bank, and if the procure additional loan for investment is the business it is regarded as

his personal capital and he will be personally responsible for its repayment.[54]

However, in terms of profit sharing, the bank receives a fixed ratio of the profit earned from the capital provided to the entrepreneur, as mutual agreed between the two parties.[55] For example if the entrepreneur invests additional capital from another party on the basis of mudarabah, of say a sum of ₦100,000 has been acquired from another party (the investor) in addition to the ₦100,000 from the bank and a third sum of ₦100,000 invested by entrepreneur himself. Thus the business is run with a total of capital of ₦300,000. Supposing that in this deal with the investor, it has been decided that half of the profit earned from his investment will be paid to him and half to go to the entrepreneur, then from an overall profit of N30,000, N20,000 will go to the entrepreneur and N5,000 each to the bank and to the investor, that is,

	N 30,000 / N 300,000	01 (percent)
	(0.1 x N100,000)	N10,000
	N 10,000 / 2	N 5,000

But, if the business results in a loss amounting to N300,000, that loss will be divided equally (or proportionally, as the case may be), over all three capitals. The bank, the entrepreneur and investor will each suffer a loss of N10,000 and get back a sum of N90,000 only. No portion of the losses suffered by the bank and the investor will be borne by the

entrepreneur. However, the bank does not share in responsibility for the loan he obtained privately.

Also, when the entrepreneur invests his own capital in the business in addition to capital procured from the bank of say N100,000 in addition to the capital of N100,000 procured from the bank of the profit will first go on his additional investment. The remaining half will be further divided between him and the bank.

2.9.3. SHORT TERM AND LONG TERM FINANCING IN ISLAMIC BANKING (NON INTEREST BANKING).

The short-term financing of industry, trade and agriculture can be made by the Islamic bank on partnership basis. In this respect, the Islamic bank makes itself directly liable both to those who keep their funds with it and to those who borrow funds from it. Even a more important function of the Islamic commercial bank is that it can create credit. Islam has prohibited the charging of usury or interest. But allows financing of trade or industry on credit. Though there is a tendency of banks to expand credit beyond the limits of their reserves at times of prosperity and vice versa, yet business management contract allowed under Islamic code will be able to check the factors that shake economic stability and set successive economic crisis in motion.

Loans provided by ordinary deposit banks are often given on short-term basis not exceeding two years. Since most of their

borrowed funds are payable on demand or at short notice, they dare not lock them up in long term loans and investments. Therefore, it is recommended that specialized credit institutions like industrial or agricultural development banks and the like may be developed for long term financing of trade, industry or agriculture as the case may be, on partnership basis. The bank and the other party may work out the ratio of the profit and loss based on the amount of funds and on the length of period advanced in accordance with local practice and Islamic code.[56]

2.9.4. THE SYSTEM OF GUARANTEE

M.A. Maina in his book titled "Islamic theory and practice", felt that, Islamic bank can evolve the system of guarantee of loans for industries, working capital as well as for equipment. This guarantee may induce private capital formation, because the flow of private capital in Muslim countries has always been inadequate in relation to the trends towards external assistance. The bank"s guarantee he continued, may help the industrialists in the foreign exchange thus saved, however small in amount it may be, directed to other productive purposes. It is only in the development of small-scale industry that private initiative and enterprise find full scope of development and the economic base of democracy is strengthened, because it creates opportunities for employment for both unemployed and under-employed in an economy like Pakistan's.[57]

2.9.5 ISLAMIC BANK AND CONSUMPTION LOAN

The consumption loans are more or less unproductive in nature, though their influence on the productivity of the community has indirect bearing in so far as it stimulates production and supply. Moreover, the requirements of daily life are becoming more and complex. Therefore, its importance for genuine requirements of the individuals can hardly be over-estimated. But as they do not produce any direct income, it may not be possible for the Islamic bank to lend money for such loans on partnership basis. Therefore, the loans can only be made available either by people's co-operative societies or by some Government credit agency. The loans must, of course be granted if so be, against the deposit or fixed assets owned by the borrowers. The establishment charges of these banks will be borne by the state like the charges of hospital, orphanages, etc.

It is interesting to mention that a peculiar kind of loan existed B and it still does exist in all the muslim countriesBwhich was called Qard-i-Hassanah-a loan without interest. Because lending and borrowing had been mentioned in religious laws too, they were also governed thus. A debtor had to clear all his debts before his death, otherwise he would be a sinner. The lender, in some cases, not to subject his fellow men to his sin, would advance "Qard-i-Hassana" the repayment of which is not imperative.[58]

2.9.6. **PROFIT AND LOSS SHARING UNDER ISLAMIC BANKING**

Profit and loss sharing in trade, for example, is not the responsibility of the seller to share profit or losses of the buyer since risks and reward of ownership are passed on to the buyer as soon as the sale transaction is completed. The seller is concerned with the recovery of sale price. In "Trade Related modes of financing" the bank ultimately acts as "seller" and clients acts as "buyers." In "Trade Related mode of financing" the Bank recovers the sale price i.e. finance amount plus mark up.

While on the other hand, profit and loss sharing in investment, unlike trade; is shared where two or more persons make investment for carrying on a business, Bank shares in profits as well as in losses in "Investment type mode of financing", that, musharaka, mudarabah and equity participation, etc. Profit is shared in "Agreed Ratio" as "80 percent and 20 percent" or "60 percent and 40 percent", etc. Note however, distribution of profit on the basis of fixed ratio does not mean a "predetermined fixed rate of return." It is simply an agreement for the way profit will be shared, if it occurs. Loss must also be shard strictly in proportion to the respective capital distribution.[59]

Meanwhile, the difference between interest and mark up is, for example, if you lend N1,000 and recover N1,200 from the borrower, excess recovery of N200 is interest. Again if you lend 100 kgs of rice and recover 125 kgs of the same quality of rice

from the borrower, excess recovery of 25kgs of rice is interest. Interest is related to "lending-borrowing transaction". But if you purchase an article for N1,000 and sell it to your customer for N1,200, this excess of N200 is mark up (profit). Mark up is related to "trade" transaction.

Trade with mark up is a sale of goods at a price mutually agreed between the buyer and the seller. The sale price consists of cost of good plus margin of profit and the same is payable by the buyer on deferred payment basis either in lump sum or in instalments.

The bank, on the other hand, may in the event of early payment allow rebate in price and may recover amount which is less than the agreed sale price. It is also worthy to notice that the entire mark up is not the net profit of the bank, as certain expenses are to be met of it.

Finally, trade with mark down is purchase by the bank of trade bills/marketable securities belonging to a client at an agreed price which is lower than the face value (price).

The difference between the two represents the amount of profit. For example, the bank may purchase a trade bill for N2000 face value of which is N2100. In this case, N100 is the amount of profit (mark-down).

2.9.7 DEMAND OR CURRENT ACCOUNT DEPOSITS.

The primary purpose of those people who deposit their funds under this category is the "transaction motive" for keeping the extra liquidity readily available in a conventional form for spending and making payment to other people. The aim of these depositors is not to earn any income on their deposits but only to keep them safe and readily available for use. The banks do not pay any return or interest to the depositors, but instead charge them a nominal sum to cover expenses incurred in maintain their account. These depositors are issued with cheque books for their daily use to draw, transfer or make payment to other people from their funds whenever they wish without any limit.

In Islamic banking system, however, these deposits are not invested in making profit ventures but a reasonable sum is kept for making short - term interest - free loans (Qard - al - Hasna) to needy industrialist and agriculturalists, who may not otherwise qualify to receive a loan. According to Rahaman Afzular in "Banking and Insurance vol. 4" said;

> *It is quite appropriate for the bank to give interest free short term loans as well as overdraft facilities from this category of deposits for which it pays nothing to the depositors. However, a small portion of these deposits may be used for buying industrial shares which keep the funds in near liquidity form and, at the same time, will earn some profits.*[60]

2.9.8 **SAVINGS ACCOUNT DEPOSITS.**

On the other hand, the primary motive of the depositors in Saving Account is precautionary motive while their secondary motive may be investment motive. The depositors in this category unlike the first category are not businessmen, but usually belong to the Middle class who resort to saving chiefly because of "precautionary motive" unlike the Time Depositors. Under the conventional banking credit management, the banks invest these funds in short-term loans on interest to other people, or securities ion order to keep "ready money" available on demand. While under the *Islamic system the banks* may invest whole or part of these deposits on the basis of profit sharing (mudarabah) or buying the shares of some successful industrial or commercial firms in order to keep part of its fund in readily convertible cash form.

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2.9.9 **CONSUMER CREDIT (i.e. Personal Loans).**

Personal loans are given in conventional banking system for various purposes, but they carrying interest. The banks charge a very high rate of interest on these loans. These loans are usually repaid by the customers in small instalments. Who have established the credibility with it. The loans are given as charity loans (as Qard-al-Hasna) or free of interest for short period.

The loans are however, repaid in instalments. Although the Islamic banks does not charge any interest, it however, charges a small

fee for clerical and other expenses incurred by it. However, unlike the conventional banks the Islamic bank do not encourage the public (through advertisement to borrow personal loans for buying durable household, luxury articles, such as cars, television sets, etc.

The major source of industrial finance under the Islamic financial system is equity financing since it conforms to the Islamic principles of profit/loss sharing. Therefore under such a system the banks provide funds to industry by becoming a partner in the investment project or by buying shares of the company. In most cases the funds constitute redeemable capital of the firm.[61]

In the credit management policy however, it seems there will be no problem in the functioning of such a system as far as the long-term financing of industrial projects is concerned. But the real challenging problem arises when we look at the structure of short-term financing of industry under such a system. The demand for so called "working capital" is a sizeable proportion of total finance to industry and constitutes an important part of the present system (i.e. conventional banking system) provide such finance on the basis of a fixed interest rate, the problem is to see how an Islamic bank, where interest is prohibited, would handle this type of transaction.

Ahmed[62] and Simon[63], have suggested that these short term finances should be provided free of charge. However, Uzair maintains that such a proposal is not viable. He argues that any assistance from the bank requires insurance of certain costs for which it must be compensated. Since the party receiving this type of assistance would normally be getting some benefits, the bank should no go unrewarded.

2.10 CREDIT CONSIDERATION IN BUSINESS

Generally, Islamic principles of partnership and mudrrabah, it is, in the opinion of scholars, essential to convert the capital of the enterprise into cash for the sake of proper accounting and final division of profit or loss. This argument is aimed to avoid any possibility of fraud in the accounts, resulting in a misunderstanding or usurpation of the rights of any of the partners. Without doubt conversion of assets into capital would achieve that objective. But, while this is possible, in agriculture and commercial enterprises, to do so in modern industrial enterprises may entail many individual and social disadvantages. In our view if valuation of the assets of the enterprise is carried out in a way that both parties agree to, no serious problem need to arise, when profit or loss are worked out.[64]

2.11 GENERAL USE OF COLLATERAL IN CREDIT MANAGEMENT VIS-A-VIS NIB

An Islamic scheme does not have any collateral requirement. Thus an Islamic bank requires no collateral but shares ownership of the farm and its output until the loan is repaid. As such the introduction of Islamic

scheme would help to overcome the problem of small farmers who virtually have no access to the organized credit market, this consequently may lead to a lot of more investment activity in the economy.[65]

2.11 THE EFFECT OF RIBA (INTEREST0 ON THE WORLD ECONOMY

High interest rates have served as an important deterrent to investment in the capitalist system. For the period of 1970-78, interest payments represented one third of the return of capital before tax. This was three times the share of the 1960s and six times that of the 1950s. Since interest costs are at the expense of the profits, there has been an "erosion of corporate profitability" which according to the BIS Annual Report, is a key factor in the weakness of the overall volume of investment. Hence, the proportion of risk capital in total financing (equity + debt) has declined.[68]

Shareholders equity in the US non financial corporations constituted two thirds of total financing in 1950, but declined to nearly half of total financing in 1978. The main reason for the secular decline the growth of capital stock has not been the lack of aggregate demand but higher interest rates.[69]

Hilton Friedman posing the question of what accounts for this unprecedentedly erratic behavior of the U.S. economy?, responds by saying: "The answer that leaps to mind is the corresponding erratic behavior of interest rates."[71]

Mr. Iacocoa, L.A., chairman of the Chrysler Corporation observes that interest rates have been so volatile "that no one can plan for the future."[72]

Chief Olu Falae, former Minister of Finance, a former banker argued on how the Nigeria's debt picture more than doubled from a fairly manageable level of $11.39 billion in 1985 to $31.96 billion by December, 1989. He continues, that, despite the fact that $5.9 billion was disbursed in 1985 against a debt commitment of $21.2 billion, the nation's debt grew in bounds. According to him, the biggest problem is the capitalization of interest on loans, which he said were mostly accumulated during Shagari's administration.[73]

Borrowing nations have started finding that higher interest rates swallow up most of all of any new finance they are able to obtain. Pakistan for example paid an amount of $109 million to consortium by way of interest and amortization which constitute over one fourth of the disbursement from the consortium sources in 1967-68. The debt-servicing problem is thus a great concern for all developing countries such as Pakistan, which depend largely on a measure of international aid. Development loans without interest are likely to bring about a definite improvement on the existing pattern of world trade, and world production.[74]

In the 1980s some countries have experienced high real interest rates. Although most developing countries still place restrictions on interest rates, there has been a trend toward deregulation. Some countries with

unstable macro-economic conditions and distressed banks and borrowers have seen real interest rates on non preferential credit rise to high levels. Real rates have also been high in some economically stable countries that administered rates (for example, Korea and Thailand) because of a decline in inflation and strong loan demand. Although moderately positive real interest rates are desirable argued by some economists, extremely high real rates are not. They can cause distress among borrowers and swell fiscal deficits.[75]

In order to show examples of financial distress, we look at the following countries: Argentina, Bangladesh, Chile, Columbia, Costa Rica, Ghana, Guinea, Korea, Madagascar, Nepal and Norway:

Argentina - The failure of a large private bank sparked the 1980-82 banking crisis. By 1983, 71 out of 470 financial institutions had been liquidated. The restructuring process is not yet complete.

Bangladesh: Four banks that accounted for 70 per cent of total credit had an estimated 20 per cent of non performing assets in 1987. Loans to two-making public enterprises amounted to fourteen times the bank's total capital.

Chile: In 1981 the government liquidated eight involvement institutions that together held 35 per cent of total financial system assets. In 1983 another eight institutions (45 per cent of system assets) were taken over: three were liquidated, five restructured and recapitalize. In September

1988, Central Bank holdings of bad commercial bank loans amounted to nearly 19 percent of GNP.

Columbia: the 1985 losses of the banking system as a whole amounted to 140 percent of capital plus reserves. Between 1982 and 1987 the Central Bank intervened in six banks (24 per cent of system assets), five of which in 1985 alone had losses equal to 202 percent of their capital plus reserves.

Costa Rica: Public banks, which do 90 per cent of all lending, considered 32 percent of loans "uncollectible" in early 1987. This implied losses of at least twice capital plus reserves. Losses of private banks were estimated 21 percent of capital plus reserves.

Ghana:By mid-1988 the net worth of the banking system was negative, having been completely eroded by large foreign exchange losses and a high proportion of non-performing loans. The estimated cost of restructuring is $300 million or nearly 6 percent of GNP.

Guinea: The government that assumed power in 1984 inherited a virtually defunct banking system. 99 percent of loans proved irrecoverable. All six state-owned banks were liquidated, and three new commercial banks were established, each with foreign participation.

Korea: Seventy-eight insolvent firms, whose combined debts exceeded assets by $59 billion, were dissolved or merged during 1986 and 1987.

In addition, the Central Bank lowered interest rates on the re-discounts to commercial banks on loans to troubled industries.

Madagascar: In early 1988, 25 per cent of all loans were irrecoverable, and 21 per cent more were deemed difficult to collect. AGiven the low-level of reserves (less than 5 per cent of assets), the banking system as a whole was insolvent.

Nepal: In early 1988 the reported arrears of three banks (95 per cent of the financial system) averaged 29 percent of all assets.

Norway: Commercial and saving banks suffered heavy losses in 1987 and 1988 owing to the collapse of the price of oil and to imprudent lending.

United States: Between 1980 and 1988 - 1999 nearly 1,100 savings and loan associations (S $ LS) were closed or merged. In early 1989, more than 600 (one fifth of all (S & LS) were insolvent, and the cost of restructuring were estimated to roughly $80 billion in terms of present value. By 1989, 10 per cent of commercial banks were on the regulators' "watch list"[74]

UMOA countries (the Union Monetaire Quest Africane (UMOA) or West African Monetary Union, comprises Benin, Burkina Faso, Cote d'Ivoire, Mali, Niger, Senegal and Toto: More than 25 per cent of bank credits in the UMOA countries are non-performing. At least twenty primary banks

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are bankrupt: non-performing. At least twenty primary banks are bankrupt: non-performing credits are almost six times the sum of their capital, reserves and provisions.

Source: See Box 5:1 pp 71-72, WORLD DEVELO0PMENT REPORT 1989).[57] - 1996.

CHAPTER THREE

CASE STUDY

3.0 NON INTEREST BANKING - A CASE STUDY OF HABIB NIGERIA BANK LIMITED (HNBL).

3.1 HISTORICAL BACKGROUND OF THE BANK

Habib Nigeria Bank Limited was incorporated as a Private Limited Liability Company in November, 1982. It was granted with Bank license on 7th March, 1983 and commenced operational on 16th May of the same year.

3.1.1 OWNERSHIP

The shareholder ratio is 40% to Habib Bank Limited, Pakistan and 60% to Nigerians. In 1985 however, in compliance with the Nigerian Enterprises Promotion Act of 1977, the Nigeria. Partners of the ventures relinquished 10% of their shares to the Nigerian Employees for acquisition under the Staff Equity Participation Scheme.[76]

3.1.2 OBJECTIVES OF THE BANK

The Objective of the bank have been to:

* Introduce and maintain banking style with difference in Nigeria and develop a sgood bank with branch network in all the States of the Federation and Federal Capital Territory.
* The bank have over fifty (51) branches all over the country.

* Provide Financial and Technical assistance to the Public and private Sector Organisations within the framework of the Government of Nigerian's plans and policies.
* Mobile deposit by encouraging savings through introduction of efficient banking services and effective advertising programme.[76]

With these at the background, Habib Nigeria Bank Limited went into full range of retail Banking services tailored to the needs of all categories of customers, emphasizing services and professionalism with a difference.[76]

The main thrust of the bank's philosophy is the provision of quantity services with emphasis not only on the enhancement of social morals, but also on the need to be responsive to the requirements and aspirations of the communities in which it serve.

The Board is presently composed of six (6) Nigerian and four (4) Pakistanis, with Alhaji Musa Bello as Chairman while Mr. Akin Kekere-Ekun is the Managing Director and Chief Executive.[76]

3.1.3 SERVICES AND PRODUCTS OFFERED BY THE BANK

Since the period of Babangida's administration, licence were given to some Nigerians for interest free banks, but nothing has since then taken place, but Habib Nigeria Bank now has commenced the operations of Non Interest free Bank **(NIB)**, hence has increased it in of its products, ***well***, here are some of its products and services referred by the Bank apart of Non Interest Banking.[76]

1. TERM LOANS

To enable customers finance specific projects which usually require large capital outlay, the bank provides medium to long term financing for new projects and project expansion.

2. OVERDRAFT FACILITIES

The overdraft facilities are usually granted for a maximum period of year (which may be renewed annually) to enable our clients meet pressing cash calls or finance their working capital needs.

3. INLAND BILLS PURCHASE FACILITY (IBP)

This facility allows customers to obtain immediate payment on all their bills lodged with the bank by discounting same.

4. EQUIPMENT LEASING

For economy to achieve meaningful growth, it must generate sufficient savings for investment. Crucial to the issue of investment is the need for capital accumulation. Habib Nigeria Bank Limited in identifying with the need for capital accumulation, provide direct lease financing to allow customers the use of assets without bearing the capital outlay required.

The bank is also participating in Consortium Leasing deals along with other banks to enable its clients the use of assets that require huge capital investments.

5. PREFERENTIAL SECTOR FINANCING

In line with government efforts of encouraging small and medium scale enterprises, the bank pa ticipates actively in financing such enterprises through the National Economic Reconstruction Fund (NERFUND), and other Governmental bodies set up for that purpose.

6. WAREHOUSING LOAN

Customers also enjoy Warehousing or stock financing facility. Customers goods are pledgec as security and are then deposited in a warehousing in the name of the bank against which the customer is allowed credit accommodation.

7. EXPORT FINANCING

The bank has been in the fore front in providing short, medium and long term funds for export operation for its numerous customers. It is also a participation bank in the Nigeria Export Import (NEXIM) credit agency which was established by the government with a specific mandate to assist banks to provide pre- and post shipment finance in support of non - oil exports under the rediscounting and refinancing facility (RRF).

8. LOANS SYNDICATION

The bank, along with other banks is participating in quite a number of syndication. Syndication allows teaming customers raise large sum of money that would have been very difficult or impossible to get from other arrangements.

9. FOREIGN EXCHANGE DEALINGS

The bank's Central Foreign Exchange Department (CFX) guide customers in all foreign exchange transactions. Using reputable correspondent banks abroad, the Bank promptly open and confirm letter of credits for foreign exchange transactions as well as handle other legitimate remittances on behalf of its customers.

10. AGRICULTURAL AND RURAL DEVELOPMENT FINANCE

The bank is involved in a range of Agricultural Financing from production to marketing of commodities with full range of extension services tailored to the needs of all categories of farmers, with due emphasis on services and professionalism with a difference.

11. TREASURY OPERATIONS

The bank places funds with some selected banks and discount houses to maximize returns as well as diversity risks. The bank also issues and deals in money market instruments.

12. TERM AND SHORT NOTICE DEPOSITS

For customers that have surplus and idle funds, special deposit service are offered to them at an agreed interest rate and duration, this is in complete opposite to Non Interest Based Bank product of the bank.

13. GUARANTEES, BONDS AND INDEMNITIES

Part of the services being rendered to customers include issuance of Advance Payment Guarantees. Bank Guarantees, Bid Bond, Tender Bonds Custom Bonds and Indemnities to guarantee transaction entered into it clients and third parties. The third parties are therefore, assured of payments in respect of such transactions entered into by the banks customers.

3.2 TYPES OF FACILITIES OFFERED UNDER NON INTEREST BASED BANKING

There are 6 (six) major facilities offered by Habib Nig. Bank under Non Interest Banking in summary they are:

1. Non Interest Current Account.
2. Non Interest Savings Account.
3. General Purpose Investment Account (GPIA).
4. Specific Purpose Investment Account (SPIA).
5. Investment Financing, (this will have about 5 sub-units).
6. Benevolent loan (Discharge of Social Responsibility).[76]

Each facility will be discuss as follows:

1. NON INTEREST CURRENT ACCOUNT

   * To be operated as in the conventional banking system but without the interest element.
   * The Bank accepts deposits from its customers looking for safe custody of their funds and absolute convenience in their use.

* The Bank requests permission from such customers to make use of their funds so long as these funds remain with the Bank.
* The customers may withdraw a part or the whole of their balances at any time they so desire and the Bank guarantees the refund of such balances.
* The Bank provides its customers with cheques books and usual services connected with a Current Account.
* This account shall not be charged Commission on Turnover (COT).

2. NON INTEREST SAVINGS ACCOUNT

The account is similar to the existing Bank's savings account without the interest element. The following are its salient features:

* The Bank accepts deposits from its customers looking for the custody of their funds and a degree of convenience in their use in the form of savings accounts.
* The Bank requests permission from such customers to make use of their funds so long as these funds remain with the Bank.
* The customers may withdraw a part or the whole of their balances at any time they so desire and the Bank guarantees the refund of such balances.
* The Bank provides its customers with Savings Passbooks and other usual services connected with Savings Accounts.

3. GENERAL PURPOSE INVESTMENT ACCOUNT (GPIA).

* The Bank accepts deposits from its customers looking for investment opportunities for their funds in the form of a General Purpose Investment Account (G.P.I.A.).
* The account holder authorizes the Bank to invest the money in any of its projects.
* The deposits will have to be for a specified period.
* The Bank acts as "entrepreneur" and the customer as the "provider of capital". Both agree at the outset, among other things on how to distribute the profits, if any, generated by the Bank on the investment of the funds. The ratio of distribution of profits may be varied from time to time.
* The depositors do not participate in the management of the investment of the funds.
* This deposit is not legally repayable before its due date. Nevertheless, the Bank may repay it before maturity.

I. If investor agrees to forfeit profit and also undertakes to share loss if any, on the investment.

II. The Bank may also charge a penalty of 1% on the invested funds.

III. Alternatively the bank may advances some funds interest free to the investor pending the maturity of his investment in case of a dire emergency.

4. SPECIFIC PURPOSE INVESTMENT ACCOUNTS (SPIA).

* The Bank accepts deposits from its customers looking for investment opportunities for their funds in the form of Specific Purpose Investment Accounts.
* The Bank obtains the consent of the account holder after information through a written investment memorandum before money is put in a particular project. The Bank may invite depositors to subscribe to the financing of a particular project under the specific Purpose Investment accounts.
* Funds (deposits) shall be matched to specific investments projects.
* The deposit may be for a specified period.
* Once funds of an account are committee to a project, maturity of funds will be tied to the maturity of the project.
* Even though funds deposited in the Specific Purpose Investment Account may remain with the Bank for a fixed period and can be invested in profitable ventures, the Bank pays only the sum deposited if the money is not used in any transaction during the tenure of the deposit.
* Each of the investment accounts is treated as a separate contract even though the depositor may be the same.
* The Bank act as the "Agent", the Depositor as "Provided of Capital" and the utilizer of the funds as the "Entrepreneur". The Bank, the Depositor and the Entrepreneur will agree, among other things on how to distribute profit, if any, generated by the Entrepreneur on the investment of the funds.

* In the event of loss in the investment, the depositor bears all the loss.
* The depositors do not participate in the management of the investment of the funds.
* This deposit is not legally repayable before due date. Nevertheless, the Bank may repay it before maturity:

    a. If the amount is yet to be committed to any project;
    b. If the project the fund is committed to matures before the fund's maturity.

5. INVESTMENT FINANCING.

The Bank may participate or provide financing for its customers' projects or asset acquisition in various ways under the principles of profit and loss sharing and/or markup.

Below are some modes of financing/investment that Habib Nigeria Bank Limited provides to utilise the funds raised from its customers and/or sponsor shares.

1. **TRUSTEE PROJECT FINANCING.**

    a. The Bank may undertake to finance acceptable projects under the principle of Trustee Project Financing. In this instance the Bank is the "Provider of Capital" and will provide 100% financing for the relevant project.

b. The initiator of the project is the "entrepreneur" who will manage the project. The Bank cannot interface in the management of the project, but has the right to undertake the following and supervision tasks.

c. Both parties agree through negotiation on the ratio of distribution of the profit generated from the project, if any.

d. In the event of the project incurring a loss, the Bank bears the loss.

2. **JOINT VENTURE PROJECT FINANCING.**

a. The Bank may undertake to finance acceptable projects under the principle of joint ventures.

b. The Bank and the initiator or initiators of the relevant project will provide the financing for the project in agreed proportions

c. All parties including the Bank, have the right to participate in the management of the project, but any of the parties has the option to waive such a right.

d. All parties agree through negotiation on the ratio of distribution of the profits generated from the project if any. Such ratio need not (but any) coincide with the ratio of participation in the financing of the project.

e. In the event of a loss in the project, all parties bear the loss in proportion to their shares in financing.

3. **TRADE FINANCING.**

The Bank may provide specific facilities and/or financing mostly on short term basis for the purpose of facilitating trade or working capital for its customers. This facility/financing may be granted in connection with the purchase/import and sale/export of goods and machinery, and the acquisition and holding of stock and inventories spares and replacements, raw materials and semifinished goods.

The facilities/financing currently provided include:

a. Commodity Venture on the Basis of Markup.

One of the major objectives of this facility is to promote financial assistance to entrepreneurs who may need funds to purchase merchandise for trading. This facility operate on the basis of "markup" in which the Bank will purchase the requisite merchandise and resell to entrepreneurs at a marginal markup which will be the Bank's profit.

Payment may be on instalmental basis.

b. Letter of Credit

It is obvious that importers get involved generally in interest transaction from the time when L/C is negotiated, i.e. even before the cargo has been actually shipped.

To enable those who will not like to be involved in interest transaction. Habib Nigeria Bank offers the same facility under the following principles:

i. Letter of credit under the Principles of Agency: The customer deposits the full amount of the price of goods to be imported while the Bank establishes the letter of Credit and charges the customer fees and commissions.

ii. Letter of Credit under the Principles of Joint Venture: The customers informs the Bank of his Letter of Credit requirements and negotiates the terms of financing following the procedures as outlined in Joint Ventures Projects Financing.

iii. Letter of Credit Under the Principles of Trsutee Financing: The customer informs the Bank of his letter of credit requirements and negotiates the terms of financing following the procedures as outline in trustee Project Financing.

c. <u>Letter of Guarantee</u>

The Bank may offer Letter of Guarantee to companies or government departments on behalf of its clients and may charge a commission.

4. **RENTAL VENTURE.**

This is a contract for the use of rental assets or properties (tangible or intangible) for a specific period of time, at a fixed rent. Rental venture can be categorized into two:

a. Lease Purchase

A lessee under this contract may obtain finance from the Bank for the purchase of assets, which are depreciable in nature line vehicles, computers, machinery and equipment. When the full cost of the asset is recoverec by means of rent payable instalmentally, the Bank may offer the asset to the lessee at market value and if the lessee is not interested in purchasing the asset it may be sold in the open market. The amount this recovered will be profit for the Bank on the lease contract.

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b. Hire Purchase.

In this contract, the Bank will provide its prospective customer with a facility to purchase on an instalment basis, an asset of variable nature (whose market value keeps fluctuating), such as land, houses, shops, factories etc. The client will be able to take possession of the asset, on rent, as soon as the contract is signed.

The amount of rent and that of instalment to be paid by the client will be fixed by the Bank after evaluating the client's circumstances as well as market conditions.

The client will, however, be required to pay full value of the asset within a certain stipulated period, fixed by negotiations between the client and the Bank.

In order to maintain balance and equity between the Bank and the client, their share of rent will be assessed upon payment of each and every instalment, so much so that as the amount paid by the client increases, his share of rent goes on decreasing. In other words, the ownership of the asset will gradually shift from bank to the client as the rent is paid off.

Until the final payment however, the account will remain under the joint ownership of the Bank and the client.

Once the full values of the asset has been paid by the client, the Bank will assess the market value of the asset at that particular time, and the difference between this value and the original cost of asset

(which constitutes overall profit on total investment) will be divided between the Bank and the client in proportion to their investment.[76]

5. **L. P. O./TRADE FINANCIAL DEAL.**

The LPO/Trade Finance Deal is system of financing customers for trading in commercial transactions. It involves two contracts, viz:

a. The Purchase Commitment Contract (PCC), and
b. The Sale Commitment Contract (SCC).

The PCC is a promised or set of promises and implies that one party has agreed to purchase goods from a middleman at a specific price for a specific time o delivery. The SCC is also a promise or set of promises which implies that a merchant or owner of goods has agreed to sell the goods to a middleman at a specific price for a specific time of delivery.

Under this facility, a middleman can, at any time, seek finance from the Bank, to complete a business transaction described above. For this purpose, the middleman will have to obtain PCC and SCC forms filled in, and duly signed/stamped by the respective parties. On completion of the formalities described in the said form, the middleman and the Bank will

negotiate a percentage for distributing the profit in the ensuing deal.

6. **BENEVOLENT LOAN (DISCHARGE OF SOCIAL RESPONSIBILITIES.**

1. The Bank may use an appropriate proportion of the funds at its disposal for what may be considered as the discharged of social responsibilities through loans to deserving customers under the principles of benevolent loan.
2. These loans may be granted to truly deserving customers for personal or worthy economic projects with the underlying objective of support and assistance.
3. The borrower is obliged to repay only the principle amount of the loan according to its terms and conditions. The Bank cannot demand anything over and above the principle amount of the loan.

3.3 **ELIGIBILITY/CRITERIA FOR NON INTEREST ACCOUNT OPENING.**

All financing/investment proposals shall be appraised establish feasibility. Proposals must meet the following criteria;

- Reputation and integrity of the client.

Proof of positive demand situation either by firm commitment of a consumer or apparent supply gap position of the product.

Clear and unambiguous procurement process, quality and standard handling, storage and delivery plan.

Impeccable procurement source with cost implication and devoid of any encumbrances to acquisition disposability.

Evidence of capacity to meet financial obligation on the part of a client in the case of Joint Venture.

In the case of joint venture, the amount to be put in by a partner should be within the ceiling and floor of what the Bank may determine from time to time.

Projected cost and revenue should make a difference that justifies the proposed transaction; and

Adequate collateral and or guarantee to secure capital in the event of loss arising from negligence or willful act on the part of a client.

Business activities to qualify for patronage of the NIB System shall not bear any of the following characteristics:

* the alcoholic beverage trade
* related with interest as forbidden by Divine injunction
* involvement with gambling industry
* activities to do with pork meat or any other activities prohibited by Divine injunction.[76]

3.4 ACCOUNT OPENING PROCEDURE IN NON INTEREST BANKING.

All procedure and presolution that are observed in conventional Banking are equally observed in Non Interest Banking. Only that conditions are spelt out clearly as the case may be.

The main function which distinguishes the business of banking from other businesses is the acceptance of deposits from customers and honouring their drawings through cheques drawn against the deposits. The deposits are therefore the working capital or the stock in trade of a bank, without which it cannot function as a commercial or a business venture. The larger the deposit base of a bank, the greater will be its capacity to lend funds to its borrowing customers and as a result thereof earn higher profits. Thus utmost importance is to be given to securing deposits. This can be achieved through an effective marketing strategy and competitive and efficient service to the customers. For rendering efficient service to depositors, a well defined procedure and staff well conversant with it will be required.

The procedure for the accounting, operations and servicing of each of the above categories of deposits is laid down below for the guidance of Bank's staff.

1. OPENING OF CURRENT ACCOUNTS

   a. The only person in the Branch who may give final approval for the opening of an account will be the Manager. Under no circumstances will this authority be delegated.

b. The Manager will appoint an officer to be responsible for obtaining all documentation required for the opening of accounts as listed in subsequent paragraphs.

c. In opening accounts which establishes the Banker - Customer relationship, consideration should be given not only to the prospective profitability of the relationship but also to the character, moral and business reputation of the prospective customer and his/her connection and sphere of influence. For this purpose a potential customer will be interview by the Manager before opening his current account. The interview will cover the area of his general background, type of business/profession, capital and turnover, structure of the business for the recent years, his previous bankers/his banking habits/reasons for changing his banker etc. Once satisfied with the reliability of the potential customer the required Account Opening Form and Reference Forms will be given to him for completion of the account opening formalities as mentioned below.[76]

2. PRECAUTION TO BE TAKEN AT THE TIME OF COMPLETING ACCOUNT OPENING FORMS.

a. The Account Opening Form should be preferably filled in by the customer himself. This is necessary to avoid any complications which may arise because of difference in spelling of names or any other mistake which may seem unimportant but which may cause complications later. The

details on the account opening form are important because the banker/customer relationship is initially based on this Form.

b. In case of illiterate customers, the details can be filled by some person (preferably the Introducer) But it is necessary to clearly explain to him the rules and regulations and procedures of the bank regarding operations of such accounts. An illiterate Jurat stamp should be affixed on Account Opening Form and signed by the person who had filled the form and explained the contents of the form and bank's current/savings account to illiterate customers.

c. Due attention is to be given to the correctness of the address. Care should be taken to obtain complete addresses in addition to Post Box No. that the customer may have, as incomplete and vague address may cause problems in future.

d. Title of the account should be written in bold letters and the name should be complete and correct.

e. Special instructions regarding operation of the account should be understood and properly guided. In case of an odd instruction which may not be acceptable, the matter should be explained to the customer and clearcut instruction should be obtained.

3.5 IMPORTANCE OF INTRODUCTION

Opening of an account constitutes the establishment of relationship between the banker and the customer. The Relationship is that of a Debtor (Banker) and Creditor (Customer) when the customer maintains credit balance in his account. The relationship is reversed when the balance is in debit.

1. Establishment of a Contract

   The opening of an account involves the making of contract between the bank and the customer. By the establishment of the contract, both parties to the contract assume certain legally enforceable rights. In view of this, the bank, before opening an account, likes to have suitable introduction, a reference from some other respectable client. Who can introduce (in order of preference).

   a. The introducer should preferably be a client maintain account for at least 6 months with sufficient average balance and whose cheques are not frequently returned or stopped. For opening a current deposit account, only CD account holder can introducer.

      i. Manager or authorized officer of the concerned branch, if the prospective account holder is all known to them.

      ii. Manager of another branch of our bank. The letter of introduction should be obtained by the branch before opening the account.

iii. Accounts may also be opened with the help of references from other banks 9if it is the standard practice of the area of operation).

iv. In exceptional circumstances, introductions by such persons may also accepted who do not maintain accounts with us but who are otherwise well known to our bank and who are persons of sound means and excellent reputation.

b. Statutory Protection

Any carelessness on part of the banker at the time of opening an account in obtaining proper introduction or reference deprives him of statutory protection (Landbroke and Co. V Todd, 1914). The bank must make ordinary enquiries, which ordinary reasonable people should make in opening an account, ion order to avail itself of the statutory protection.

c. Inter-bank Courtesy.

Bankers usually exchange confidential reports about their customers. In the absence of a proper introduction the bank would be in a precarious position when providing any report on its customers.

d. Inadvertent Overdraft

The significance of introduction is highlighted especially when an overdraft is made inadvertently. The customer may not be traceable to the banker and in absence of introduction, it may be very difficult to locate him.

e. Wrongfull use of Cheque book

If a banker, without identifying the reliability of the new customer, issues him a cheques book, it is possible that he might draw bogus cheques in order to defraud the general public and as a result harm the image of the bank.

f. Customer Status.

It is possible that the new customer may be an undischarged bankrupt, the banker has no means, other than introduction to ascertain whether the amount deposited by him were acquired prior to or subsequent to adjudication of bankruptcy.

g. Checking the Source and genuineness

One of the primary requisites of opening a current account is proper and acceptable introduction. As a matter of course, the introducer accepts the fact of introducing the new account holder either by means of a letter or by signing on the Account Opening Form. Proper verification of the introducer's signature on account opening form is important. Sometimes it may also be necessary to check the operations in the introducer's account with a view to ascertaining his own status. In case an introducer's account does not disclose required information because of the account being recently opened or non-operative etc., then, it may be advisable to see his own introducers. The point is to check and be guided against possibility of a series of faulty introduction. In case the introducer is not an account

holder of the same branch, or where it might not be possible to obtain his signature because of his business, then the Manager may allow the account to be opened and amount deposited, but the cheques book is not to be issued unless introduction formalities have been completed.

3.6 ACCOUNT OPENING PROCEDURE

a. Opening an Account for an Individual

1. Have the customer complete the Current Account Opening Form for individual and firms as follows:

   i. **Account Number**: Select the next number from the "Account Opened and Closed Register".

   ii. **Title of Account**: Full name of the account holder to be written avoiding abbreviations.

   iii. **Special Instruction**: The name of the person who will operate the account to be written (self).

   iv. **Full name:** The forename will be printed first followed by surname.

   v. **Occupation or Nature of Business**: Details of occupation or business to be mentioned. The address should be mentioned in full instead of merely P. O. Box Number.

   vi. **Address**: The Address should be mentioned in full instead or merely P. O. Box Number. The P. O. Box Number if any should be noted in addition to complete

postal address of the customer. Telephone and Telex No. if available should also be noted on the form. In case of a salaried person, the name and address of his employer should also be recorded on the form.

vii. **Introduced by**: Signatures, names and addresses of two introducers of this account should be obtained along with their account numbers and the names of Branches where the accounts are maintained.

viii. **Signature of the official Opening the Account and Branch Manager**: The officer in charge of opening Current Accounts will sign in the space provided for it in the AOF and the Manager will after ticking the check list provided on the form sign the same in token of having authorised the opening of the account.

ix. **Cheque Book Issued**: The cheque serial numbers of the cheque book issued to the customer will be recorded by officer in Charge of opening Current Accounts.

x. **Initial Deposits**: The amount deposited by customer at the time of opening the account will be recorded.

ii. Ask customer to sign the form under 'Yours faithfully' using the signature that will be used in all further transactions with the Bank.

iii. Have two Specimen Signatures Cards completed and signed twice in the presence of the officer in Charge of opening Current Accounts and Signature to be

admitted by the officer in Charge in red ink over "Signature admitted" Stamp.

iv. Obtain 2 passport size photographs of the customer and affix them on the Specimen Signature Cards. The photographs are to be stamped and signed across by the officer opening the Account.

v. Have customer complete a cheques book request form (Form A) authorizing the bank to debit his account with the stamp duty and issue him a cheques book to operate the account opened by him.

vi. Complete the "Computer Record in-put data" form in duplication in respect of the new Current Account

vii. Hand over reference forms to the customer to be completed and signed by his referees and brought back to account is not in a position to produce two Current Account holders of the Branch to introduce his account).

viii When all the above documentation is complete, inform customer that he will be advised when all satisfactory referees have been received.

ix. Keep the Account Opening Form and other related documents obtained from the customer in a file marked "Accounts awaiting reference".

x. Upon receipt of reference from the customers referee:

    i. Examine the reference form to ensure that it is complete in every detail.

ii. If referee is customer of another Branch send reference letter under closed envelop to the Manager of the concerned Branch with a covering memo for verification of his signature under the bank rubber stamp.

iii. If referee is a customer of another bank send the reference form to the Manager of the Branch along with a covering letter to verify his customer's signature under one of the authorized signatories and return for necessary action.

iv. When all references are duly verified and authenticated give file to the Manager who will:

   a. Examine all the documentation to see that it is complete.

   b. Satisfy himself that the references are satisfactory.

   c. Date and sign the Account Opening Form authorizing the opening of the Account.

xi. Enter details into the Account Opened and Closed Register and allot the running number from the Register.

xii. Call the customer and request him to complete a paying - in - Slip and deposit cash without which no account should be opened. Enter the

amount and date of deposit on the Account Opening Form.

xiii A cheque book may then be issued to the customer after entering the cheque form numbers in the Cheque Book Issued Register.

xiv Record the cheque book number on the Account Opening Form under the initials of Officer in Charge of Account Opening.

xv. Give one of the Specimen signature Cards to the Officer in Charge Current Deposits and the second to the Manager to be placed in their respective Specimen Signature Card Boxes.

xvi Despatch letter of thanks to the Introducers of the Account and also be the account holders on the addresses given on the AOF.

xvii Ensure that the completed documents are securely filled in the customer's file.

xviii Place the customer's file in the Account Opening Form files cabinet in account number order.

3.7 OPERATION OF CURRENT ACCOUNTS

Payment of Cheques

As soon as a Current Account is opened and money deposited, debtor and creditor relationship is established between Banker and customer. The Customer can then exercise his right of withdrawing money from his

account by drawing cheques. The bank has the obligation to pay these cheques on demand provided they are drawn in the proper form, there is no legal bar to payment and the account has sufficient balance.[76]

3.8 CHANNELS OF PAYMENT

Payments of cheques drawn on accounts can be made through the following channels:-

a) Cash Payment

b) Clearing

c) Transfer

a) Cash Payment

Cash payment is made when an open cheque is presented at the counter, processed by the ledger keepers and authorized by Officer - in - Charge/Manager to effect payment after satisfying himself on the following points:-

a) Checking the date on the cheque to make sure it is post dated, stale or altered in any form. Any alteration should bear the signatures of the drawer.

b) Ascertaining whether the cheque is open or crossed: Crossed cheque cannot be paid in cash at the counter except to a bank.

c) Agreeing the amount in words with that in figures.

d) Making sure that the cheque has the right account number and signature thereon agrees with that on the Specimen Signature Card.

e) Checking whether the cheque is bearer or order. If order, the payee endorsement at the back of the cheque should be authenticated and the presenter should be identified by a good customer.

f) The cheque has been cancelled and passed as per authorized limits of the categories of staff in the Branch.

g) If the amount to be paid is substantial the person receiving the payment has been properly identified.

h) Checking the Current Account Ledger to make sure that the account on which the cheque is drawn has sufficient credit balance.

i) Agreeing the cheque number with the series on the Ledger against account and making sure there are not stop payment instruction for the cheque.

j) Making sure that the amount of the cheque is covered by the cleared balance on the account as no payment is allowed on the uncleared balance without the special approval of the Manager.

k) Checking whether there are any operational instruction which may stop honouring the cheque.

i) Checking posting in the Ledger to make sure it agrees with the amount on the cheque and posted to the proper account with the cheque bearing the "POSTED" stamp with initial of ledger keeper.

All the above points are to be checked with utmost caution to ensure that the procedures and legal requirements are fulfilled before making payment.

b) **Clearing**

Cheques may be presented for payment through the Clearing House, by other bankers on behalf of their customers, who are the payees or endorsees of these cheques. These are received through the Central Bank Clearing House via the Clearing Department of the branch handling the main clearing of our bank and regarded as cheques for Inward Clearing. It is pertinent to note here that cheques not returned as dishonored after prescribed clearing period are assumed cleared and the bank is legally bound to assume liability for them. Payment through this channel is apparently safer as the recipients are customers of other banks. Inward Clearing cheques received from Clearing Department should be treated for the purposes of payment in the same manner as stated in Section 6 (a) above; cheques to be returned should be handed over to the Clearing Department within prescribed time limit under their acknowledgment.

c) **Transfer**

This is the third channel and may take any of these two forms:-

i. When a customer of a branch deposit a cheque in his favor drawn by another customer of the same branch; the payment process involved is called internal transfer. The

cheque is paid in with proper documentation on the Pay-In-Slip for Current Account. Both the slip and cheque are stamped with "TRANSFER" stamp and passed to the Officer-in-Charge for proper scrutiny. When payment is authorized, postings are made to the ledger with proper documentation made in the Transfer Register. The cheque is normally treated as a debit voucher and the Pay - in - Slip as the credit voucher. The posted stamp has to be affixed here as well.

ii. **Transfer Delivery**

When instruments drawn on one branch are presented for payment by other local branches of the Bank the instruments or cheques are treated as Inter-Branch - Transfer Delivery. After proper scruitinization the accounts on which the cheques are drawn are debited while the presenting branches are credited through the main office account by responding the IBDAs received from them. The transaction is also documented in the Transfer Register.[76]

3.9 CANCELLATION OF CHEQUES

After proper scrutiny, posting and verification of signatures on the cheques, the officer-in-charge Current Accounts department will cancel them in red ink. The cancellation is to be done by signing the cheque from top left corner, stratching the signature to the right bottom corner of the cheque in such a way that it cancels the signature of the drawer

in the process. In case the amount of the cheque exceeds the passing powers of the officer-in-charge current accounts department a second cancellation will be done jointly by the Manager as per rules.

In computerized branches, the Posting Run is to be checked by an authorized officer every morning first thing before start of operations. Any discrepancies found in the checking should be brought to the notice of the Manager immediately and necessary correction entries passed with his permission.

3.10 STATEMENT OF ACCOUNTS

It is the duty of the Bank to furnish an account holder with a periodic Statement of his Account as agreed to at the time of opening his account. A statement of account is a record of debit and credit entries from the ledger folio of a customer's account. Unless otherwise required by the customer, the Bank issues statements of account to customers on monthly basis. In computerized branches instructions with regard to periodic issue of statement of accounts are to be fed in the Computer Programme in accordance with the wishes of the customers.

3.11 DORMANT ACCOUNTS

a) **Dormant Accounts defined**:

Current accounts not operated for six (6) months and over are to be treated as Dormant Accounts. The exercise of identifying dormant accounts is to be undertaken in June and December, each year by the Manager.

b) **Transfer to Dormant Accounts Ledger**

All accounts classified as dormant accounts should be closed and transferred to separate current account dormant ledger. Usual debit and credit transfer vouchers should be passed in transferring accounts from Operative Accounts Ledger to Dormant Accounts Ledger. After posting debit vouchers in the individuals accounts in the existing ledgers the relative accounts should be closed and ruled out with the remarks, "Accounts transferred to dormant current accounts ledger" under the full signature of the Manager. Each account is to be opened on a separate folio in the respective dormant accounts ledger with full particulars thereof under authentication of the Manager and Second Officer giving reference of the old ledger folio.

c) **Computerized Branches**

In the case of computerized branches, computer programme is to be suitably modified to observe the above.

3.12 STANDING INSTRUCTION PROCEDURE

a. **Definition of Standing Instructions**

A Standing Instruction is an instruction given by a customer to his or her Bankers to make regular, periodic payments of e.g. subscriptions, insurance premiums, rents etc from his or her account to the accounts of customers of the same bank or other banks.

b. **Death of Account Holder**

Notice or knowledge of the death of an account holder precludes the bank from paying further cheques on his account even though these be dated prior to his death. If the information is reliable the fact should be noted on the ledger with date and immediately be drawn below the last entry in the account by way of caution. All operation in the account should be stopped forthwith and following procedure with regard to different types of accounts is to be followed:-

c. **Change of Address**

The request for change of address should be obtained in writing. The signature on the letter should be verified before the instructions for change of address is accepted. If such a request is received by post extra care should be exercised in the verification of signature and in case any difference is noticed further correspondence be made with the customers and a copy of letter be sent to old address as a precautionary measure.

3.13 SAVINGS ACCOUNTS PROCEDURE

i) **Account Opening**

The Manager will appoint an Officer to be responsible for obtaining all documents required for the Opening of Savings Accounts as listed in the subsequent paragraphs. The Manager alone will authorize the opening of savings accounts after all the accounts opening formalities are completed.

i. At the time of opening of the account, every account holder is provided with a special Passport, containing rules and regulations governing the operations of the account.

ii. Under **no circumstances**, should operation in the account be allowed without production of the Passbook.

iii. Serial number of the Passbook issued is to be noted and authenticated, both on the Account Opening Form and the ledger in the cage provided for the serial number of the books.

i. All the entries in the Passbook are to be recorded in ink.

ii. Entries in the Passbook and the balance must be supervised by the Officer - in - Charge. The officer should also sign in full against the space and the column provided for the purpose n the Passbook.

iii. These Passbooks, being **security stationery** are serially numbered. For issue, Passbook Issued Register is to be maintained, with the following columns:

a. Date
b. Passbook Number
c. Name of Account holder
d. Previous Passbook Numbers
e. Account Number
f. Initials

3.14 COLLECTION OF CHEQUES THROUGH SAVINGS ACCOUNTS

Savings Accounts are primarily meant to be a facility to the public to effect savings out of their income and at the same time earn interest on their savings. Accordingly the operations in the Savings Account are generally restricted to cash deposit and cash withdrawals. However, local and out-station cheques in the names of the account holders themselves may be accepted for Savings Accounts.[76]

CHAPTER FOUR

ANALYSIS OF DATA

4.1 This study used the questionnaire method to collect primary data on the subject matter. A total of 55 questionnaires were distributed to eleven commercial Bank that were selected randomly. A total of 41 questionnaires were returned. This gives a 74% response which is deemed to be significant enought for analysis.

Below is a summary of the response to individual questions.

4.2 **Bank Response**.

The respondents were asked to indicate which of the Banks they work and their response are as follows:

Table 4.1 RETURNED QUESTIONNAIRES

Name of Bank	No.	%
Habib Nig. Bank Ltd.	9	21.9
Intercity Bank Plc	6	14.6
FSB	2	4.8
AIB	3	7.3
STB	3	7.3
First Bank of Nig. (FBN)	3	7.3
Union Bank of Nig.	3	7.3
U.B.A.	6	14.6
ECO Bank Plc	1	2.8
Societe General Bank	2	4.8
Zanith Bank Plc	3	7.3
Total	**41**	**100%**

Source: Returned Questionnaires

As revealed by table 4.1 above, 3 Banks, Habib Nig. Bank Ltd, Intercity Bank (Plc) and UBA had the highest response, they have 21.9%, 14.6% and 14.6% respectively, as for HNBL Bank it might be because the Bank is the first to start the Non Interest Banking.

4.3 NON INTEREST BANKING UNIT

One of the main distinguishing feature of Habib Nig. Bank with other Banks is the development of this product non interest Bank.

Table 4.2

Question	Banks	Response	No.	%
Do you have a non interest Banking unit.	HNBL Other Banks in the questionnaire	Yes No.	1 40	2.4 97.6
If you don't have, do you have the intention to establish the non interest of Banking unit.	All other Banks except HNBL	Yes	40	97.6

Source: Returned Questionnaires.

As revealed above the table 4.2 Habib Nig. Bank is the only Bank that has the product and other Bank are interested in introducing, the system in the future. This implies that the response are aware of the potentials of Non Interest Banking System.

Gender: Male/Female (Returned Questionnaires)

The respondent were asked to indicatre their Gender and the response is presented in Table 4.3. Their response are:

Table 4.3

Question	Response	No.	%
Indicate whether you are Male or Female	Male Female	374	82% 18%
Total		41	100%

Source: Returned Questionnaires.

As indicated in table 4.3, 82% of the respondent are Male Staff whiler the remaining 18% are Female Staffs. This is in line with the Staffing situation of the banking industry.

Religion

The respondent were asked to indicate their Religion and response is prevented in table 4.4. This is because are the staff are of different belief.

Table 4.4

Question	Response	No.	%
Indicate your Religion	Muslim Christian	338	80% 20%
Total		41	100%

Source: Returned Questionnaires.

As indicated in Table 4.4, 80% of the respondent are Muslims and 20% are Christians, after all in our last Chapter, we indicated several verses from both Holy Qur'an and Bible that forbids interest. The lopsided percentage in favour of Muslims is just really coincidental.

RELEVANCE OF NON INTEREST BANKING UNIT

The respondent where asked to indicated wheher it is relevant to the society or not. The responses is presented in Table 4.5.

Table 4.5

Question	Response	No.	%
Do you think it is relevant to the society.	Yes No	410	100% 0%
Total		41	100%

Source: Returned Questionnaires.

As reveal in Table 4.5 respondents are of the opinion that the Non Interest Banking Unit is indeed relevant to the Society.

SPECIFIC CONTROL MEASURES

As regards to the special control measures, this question was asked to know the specific control measures the managers consider in respect of loan disbursement i.e. the measure they consider before issue loan either with interest or without interest.

Their responses are as follows:

Table 4.6

	Trends	No	Total	%
a.	Market Trends	39	41	95%
b.	Customers Financed Position.	41	41	100%
c.	Conduct Account	40	41	97.6%

Source: Returned Questionnaires

Looking at Market trends with 95% managers ensures that they have personal knowledge of the trends in the Market. They also have discussions with other customers in the line of business as those useful information about the market situations, there by enabling the managers to take appropriate action to suit the situation, while customers financial position recorded 100% response it is usually obtained in addition through audited annual balance sheet and final accounts and comparison is made with previous years figure to see enatic the financial, position of the customers is improving or not loan accounts are scruitinized monthly, by inspectors to ensure that repayment are up to date.

Vouchers are examine at random by members of the management so as to indentify diversion of funds to purpose not approved by the Bank.

PAYMENT PROBLEM

The respondents were asked whether they have repayment problem. There response is presented as follows in Table 4.7

Table 4.7

Question	Response		No.	%
Do you have loan repayment Problem with your customers.	Non Interest Based Bank	Interest Based Bank		
	Yes	-	9	100%
	No	-		
	-	Yes	14	43.75%
	-	No	18	56.25%
Total			41	

Source: Returned Questionnaires

INTERPRETATION OF TABLE 4.7

With reference to Table 4.1 a total number of 41 questionnaires were returned indicating 74% responses, out of it 9 were from Habib Nig.

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Bank, the only Bank that has the Non Interest Banking Unit. Therefore as per Table 4.7 above 9 responses from Habib Bank shows that repayment problem is not so far being encountered in Non Interest Banking. 9 responses indicates 100% (Non problematic repayment case).

As regards to Interest Based Banks their have the 32 respondents shows that while 43.75% of the respondents in conventional Banks encountere repayment problem, 56.25% do not. Which shows that there is problem of loan repayment in the conventional Banks.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATION

The study is carried out to critically examined the non - interest banking and how it is applied in Habib (Nig.) Bank. It has been said that the most pernicious problem brought by the banking system based on the interest rate is the creation of a debt ridden economy wherein the entire busniness community, the government and the society at large find themselves in debt, which is not unacompanied with social, economic and political implication. It is largely because of this that an alternative banking system is strident.

5.1 SUMMARY

The study reviewed that genesis of Non Interest Banking worldwide and critically examined the Habib Nig. Bank experiment. It is an experiment because it is the first Non - Interest Banking window to be opened by a conventional bank in Nigeria. The response of customers and other members of staff in the industry were sought through, and questionnaires are duly analysed.

5.2 CONCLUSION.

The major findings of the study include the following:

a) Non Interest Based Banking System is viable in Nigeria.

b) A lot of Nigeria prefer Non Interest Bank to the Conventional Banking System because of its human approach to loans.

c) Even the bankers do not encounter problems in terms of loan repayment with regard to Non Interest Banking.

5.3 RECOMMENDATIONS:

- A number of sources supply credit information in addition to cost. A bank must consider the time it takes to investigate its customer particularly a credit applicant or somebody who has his LPO or job order to be financed.

- On the part of the Bank's personnel, training should be organized to more enlighten the staff on the concept of the Non-Interest Banking.

- On the part of the clients, enlightenment programme about the concept should once be organized in so many forms not only that Hannu da Yawa that took place t FRCN, Kaduna.

- The Bank should do everything possible to make its clients aware that they are not getting cheap fund by adopting the non-interest banking and they should be guaranteed that all terms of agreement reached either in the manual of procedure or verbal agreements reached are religiously followed.

- Clients should be told of their benefits by making investments in that system even though some people are against the interest for religious reasons.

- Safety of the customers loan would considered.

According to Bexley, it is obvious to both systems that credit facilities form the largest source of revenue. However, this does not imply that there is the need for management to look at every detail that goes into every loan. What is important is to exercise good control and judgement over the credit function. The following are some of the loan control elements for good management to utilize loan/credit quality, loan limits, loan performance and loan accruals (i.e. interest or profit).

Therefore all the credit officers should have credit limits that are commensurate with their experience and ability. This is particularly important in Islamic Banking system. Loans must be approved by a knowledgeable management group before they are advanced.

Since loans are the largest single source of income, the accrual of loan income requires management review from time to time. In conventional banking, over accrual of the interest income for a period of time in any amount requires a downward adjustment of income, which cannot only have an effect on the bank's tax position of earnings but also serve as a source of embarrassment.

As such, a constant review of balances risks and cost of funds must be carried out by conventional banking to ensure that loan pricing is fair to the customer and ensure a reasonable return to the bank.

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Meanwhile, in conventional banking, risk cannot usually be eliminated altogether, but the irreducible risk can be transferred to those more willing to bear it. Loan maturity, the choice of adjustable or fixed interest rates, equity and venture capital arrangements and collateral are all examples of different risk assignments. Thus, to cover risk, banks usually raise the interest rate they charge on loans. But this is not good enough and may be partially self-defeating, because the more credit-worthy borrowers may choose not to borrow. This may cripple investment and economic activity (AWorld Development Report 1989").

The risk of business can be more equitably distributed thereby improving the investment climate by elimination of interest and its replacement of profit-sharing according to fair ratio between the financier and entrepreneur. This removes one of the major sources of uncertainty and injustice, as M. Ummar Chapra quoted Dr. Anas Zarga that the abolition of interest and introduction of profit-sharing would not "change the level of uncertainty", it would however, redistribute the consequences of uncertainty he argues.

One good advantage of Non-Interest Banking over the conventional banking credit management policies is that the banking system takes an active part in the borrower's venture by using their technical know-how in exploring the best areas of investment and the most rationale to be followed. Thus, capital technical experience and human endeavor work together in co-operation to develop the economic life. The participation of the banks in the

borrowers ventures will provide the expertise guidance and minimize the risk of failure - a common hazard of building entrepreneur.

According to Wagar Mashood Kahan, Islamic scheme does not involve any collateral requirement. It is clear that requirement of a collateral in credit management restrictions the entry of potential investors in the credit market. This is especially true of the agricultural sector where small farmers have virtually no access to the organized credit market because they cannot bring the required collateral. ***As such the introduction of Non Interest Banking in the country would help to overcome this problem and consequently there may be a lot of investment activity in the economy viewing the fact that, about 89% of the Nigerian population are farmers.***

What is important to note however, whether in conventional banking or Islamic banking system is that a bank must be receptive to the needs of the community and profitability and set their credit policy accordingly. Thus, external factors, bank's condition, credit objectivity, personnel qualification (and Islamic injunctions in the case of Islamic banking) must be considered.

Bexley argues that some of the external factors that are critical to the credit function include the condition of the economy, customer mix, stability of the trade area, analysis of trade area, and growth elements

in the area. While these factors are beyond the banker's control, adjustment can be made to meet these external elements.

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APPENDIX I

QUESTIONNAIRE

1. Male/Female .....
2. Religion .....
3. Indicate the bank you work with.....
   .....

a. Habib Nig. Bank Ltd [ ]
b. UBA [ ]
c. First Bank FBN [ ]
d. FSB International Bank Plc [ ]
e. AIB Plc [ ]
f. Union Bank [ ]
g. Intercity Bank Plc [ ]
h. Zanith Bank Ltd [ ]
i. Societe General Bank Ltd [ ]
j. Eco Bank Plc [ ]

4. Is there a non interest banking unit in your Bank. Yes/No
5. If there is non, is there intention to established same unit in your Bank? Yes/No
6. Do you think it is relevant for the society ?
   If not why .....
   .....
   .....

7. What are specific control measures interms of:

a. Market trades.....

.....

b. Customers financial position .....

.....

c. Conduct of account you adopt.....

.....

8. Do you have problem of payment. Yes/No

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APPENDIX II

INTERVIEW GUIDE

1. What role does an Non Interest or Islamic Bank play ?.
2. What type of operations does the non interest or Islamic Bank perform (ie. In terms of both commercial and investment banking)?
3. What are the major achievements of Islamic banks so far?
4. What is the place of saving in the overall framework of Islamic banking?
5. What incentives and/or penalties are built-in or employed in an Islamic credit management to induce savers to employ their savings profitably and to overcome the liquidity preference of savers who do not wish to be active investors themselves?
6. Would the abolition of "Riba" (interest) introduce more or less efficiency in the allocation of resources and/or credit management policy ?.