IMPACT OF ISLAMIC FINANCIAL SYSTEM ON ECONOMIC GROWTH: A STUDY OF JAIZ BANK PLC., ILORIN METROPOLIS

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ABSTRACT

Globally, Islamic finance is set to be one of the fastest-growing sectors. Islamic financial system prohibits interest payments and establishes equity and profit sharing for operational structure activities. As a result, this study sought to examine the impact of the Islamic finance system on economic growth in Jaiz Bank Plc, Ilorin Metropolis. Specifically, it will examine (i) the extent to which philosophies of the Islamic financial system affect economic growth and (ii) determine the extent to which Islamic financial intermediaries affect economic expansion. A cross-sectional survey was adopted using simple random sampling techniques. Data were obtained using a questionnaire distributed to 232 staff from a total population of 1,234. Hypotheses drawn are tested using regression analysis. The findings show a significant and positive impact of philosophies of the Islamic financial system on economic growth (R2 = 0.393, p-value < 0.05) and Islamic financial intermediaries on economic expansion (R^2 = 0.595, p-value < 0.05). The study concludes that a structural Islamic financial system positively and significantly impacts economic growth. The study recommends that managers endeavour to implement the philosophies of the Islamic financial system as it promotes the circulation of funds, which assists in the economy's growth.

Keywords: *Islamic Financial System, Intermediaries, Instruments, Economic growth, Economic expansion.*

Introduction

Economic growth is important for a country to grow since a developed nation's population would enjoy greater living standards. A nation must conduct more production and investment activities to boost economic growth to achieve economic development (Haniffa, & Hudaib, 2019). The Islamic banking system is centred on Islamic ontological and epistemological concepts and on ideas of social virtue, good governance, environmental protection, and moral conduct on the part of both individuals and organizations. The Shariah principles, also known as Maqasid al-Shariah, are the guidelines that govern Islamic banking and finance. According to Saeed et al. (2020), the foundation of these regulations is the prohibition of interest and other forbidden aspects, as well as the profit and loss sharing that distinguishes Islamic banking from conventional banking (AlMannai, & Ahmed, 2019). As a result, this study seeks to examine the impact of the Islamic financial system on economic growth. A study of Jaiz Bank Plc.

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Statement of the Problem

The position of the financial system in Nigeria has been worrisome, inhibiting the prosperity of financial activities and economic growth. Individuals struggle to attain a sustainable life, and businesses are drastically downsizing to survive. Businesses that cannot carry out transactions have been forced to close, and people illegally sell new currency notes at higher rates. This has practically crippled many small businesses as shop owners now spend more time at banks than in their business premises (Asadu, 2023). Every business can suddenly fall due to a lack of adequate cash flow, which in turn happens due to poor cash flow management. The cash shortages have made life even more difficult in Nigeria, where 63% of the population is poor, 33% is unemployed, and as of 2021, only 45% of adults had a bank account (World Bank, 2023).

Bank distress is a result of unethical behaviour, and it appears that the penalties for these unprofessional actions are insignificant. Hence, this study seeks to fill the gap by researching the Impact of the Islamic Financial system on economic growth: a study of Jaiz Bank Plc., Ilorin Metropolis.

Research Objectives

The main objective of this study is to examine the impact of the Islamic financial system on economic growth in Jaiz Bank Plc. Nigeria. Specifically, the study seeks to:

i. examine the extent to which philosophies of the Islamic financial system affect economic growth.
ii. determine the extent to which Islamic financial intermediaries affect the economic expansion.

Research Hypotheses

With the aforementioned, the research hypotheses were formulated:

$H0_1$: Philosophies of Islamic financial system has no significant effects on the economic growth.

$H0_2$: Islamic financial intermediaries have no significant effects on the economic expansion.

Literature Review

Concept of Islamic Financial System

An Islamic financial system relies on the transfer of funds from the surplus spending unit to the deficit spending unit (Haniffa & Hudaib, 2019). This process is governed by a set of Divine laws and ordinances that are embodied in the Qur'an and Sunnah, such as avoiding interest , uncertainties, gambling, illegal dealings, and unethical transactions (Rashid, Hassan & Shah, 2020).

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Philosophies of the Islamic financial system

The cornerstone of the Islamic financial system is the sharing of risk, ownership and control of tangible assets, participation in trade, leasing, and building contracts with the aid of various Islamic financing methods. As a result, asset management is a focus of Islamic banks' efforts to generate income (Iqbal & Mirakhor, 2007).

1. **Prohibition of Interest (Riba):**

   Riba is providing or receiving money/capital at a fixed percentage of interest. There is no place for interest to be used in the Islamic financial system due to its strict prohibition in Islamic law.

2. **Customers:**

   The Islamic financial system is not merely restricted to the Muslim world but has got popularity in some non-Muslim countries. Before the financial crises of 2008, Islamic finance was popular in most of the Muslim world but after the crises, the world recognizes Islamic banks, which represents itself as a reliable alternative to the traditional financial system.

3. **Poverty Alleviation:**

   The Islamic financial system has the future to address the challenges facing society to alleviate the utmost poverty and enhance common prosperity through access to finance, establish a financial sector and stability. The concept of Islamic microfinance has been developed to help the poor as an alternative remedy to alleviate global poverty.

4. **Halal Businesses Activities:**

The parties concerned will not be engaged in businesses that are prohibited by Shariah. Like smuggling, wine business, pork breeding, gambling, night clubs, tobacco, pornography, casino games.

5. **Speculation/Gambling (Maisir):**

   Gambling is an acquisition of getting money/wealth by chance 23. The practice of speculation and gambling are strictly prohibited as there are no real assets exist and ownership of asset depends on the occurrence of an uncertain happening in the future which makes the contract null and void as per Islamic law.

2. **Uncertainty (Gharar):**

   The Islamic financial system helps to reduce uncertainty due to linkage with the real economy. In Islam speculation is prohibited as it comprises high uncertainty and is a form of gambling where minority investor gets what the majority lose.

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3. **Risk Sharing:**

   The profit or loss from the economic activities in the future will be shared by the supplier and user of resources at the agreed ratio but the total amount will not be fixed. It depends on the agreement of the parties concerned that how much percentage or ratio they will get in future profit.

Islamic Financial Instruments

IFIs and markets offer different instruments to satisfy providers and users of funds in a variety of ways: sales, trade financing and investment (Naz & Gulzar, 2022). The types of financial instruments offered depend on the nature of contracts dealing with commercial and business transactions based on Islamic principles. Iqbal and Mirakhor (2007) classify such contracts into four categories: transactional, financing, intermediation and social welfare.

Economic Growth

The most effective means of eradicating poverty and raising standards of living in emerging nations is economic growth. Growth may create beneficial cycles of wealth and opportunity.. Combining policies that encourage growth with those that enable the poor to fully engage in the possibilities created and so contribute to that growth is a dilemma for policymakers (Acemoglu, 2009).

Economic Expansion

Real GDP expands when it moves from a low point to a high point over the course of two or more quarters. When the economy is stimulated, there is an increase in employment, which is followed by a rise in consumer confidence and discretionary expenditure (Sabiu & Abduh, 2020). The economy may experience expansion due to both internal and external causes, including fiscal and monetary policies, interest rates, credit availability, weather conditions, technological advancements, and other influences on producer incentives (CFI, 2023).

Theoretical Review

The Theory on Financial Intermediation

The work of Gurley and Shaw (1960) served as the foundation for the theory on financial intermediation, which was developed beginning in the 1960s of the twentieth century. The informational asymmetry theory and the agency theory are the foundations of the financial intermediation theory. The circumstances that lead depositors to withdraw their funds prior to the due date are given particular consideration in the interaction between the bank and depositors (creditors).

Neoclassical Growth

Robert Solow and Trevor Swan first introduced the neoclassical growth theory in 1956. Neoclassical growth theory is an economic theory that outlines how a steady economic growth rate results from a combination of

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three driving forces labor, capital, and technology. The theory states that short-term equilibrium results from varying amounts of labor and capital in the production function. The theory also argues that technological change has a major influence on an economy, and economic growth cannot continue without technological advances. Neoclassical growth theory outlines the three factors necessary for a growing economy. The economic growth that a country enjoys and the equilibrium of the economy is determined using the neoclassical growth theory. From the above theories, this study is pinned to the neo-classical theory which explain the broad effect of capital, labour and technology in the economic growth. It realizes how much inflow and outflow of capital would influence the sustainability and growth of an economy. It emphasizes on combination of capital and labor of an economy to determines its output. Finally, technology is thought to augment labor productivity and increase the output capabilities of labor.

Empirical Review

Ledhem & Mekidiche (2020) investigated on economic growth and financial performance of Islamic banks: a CAMELS approach. Exploding the link between the financial performance of Islamic finance and economic growth in all of Malaysia, Indonesia, Brunei, Turkey and Saudi Arabia within the endogenous growth model framework. The study applied dynamic panel system GMM to estimate the impact of the financial performance of Islamic finance on economic growth using quarterly data. The sample contained all Islamic banks working in the five countries. The findings demonstrated that the only significant factor of the financial performance of Islamic finance, which affects the endogenous economic growth, is profitability through return on equity (ROE).

Naz and Gulzar (2022) examined Islamic Banking Sector Development and Economic Growth: Empirical Evidence from Malaysia. examines the linear association between Malaysian Islamic banking sector and short- and long-run economic growth for the quarterly period of 2007Q1 – 2019Q4 by employing the Pesaran et al. (2001) Autoregressive Distributed Lag (ARDL) technique of integration. The findings show that the link between Islamic bank deposits and economic growth is positively insignificant in the short run. Meanwhile, in the long run, the findings suggest that Islamic bank deposits affect growth in a positively significant way, confirming the supply-leading hypothesis.

Sabiu and Abduh (2020) examined on Islamic financial development and economic growth in Nigeria: A bounds testing approach. Using a bounds testing approach to the cointegration and error correction method developed within the autoregressive distributed lag (ARDL) framework, this paper analyses the short- and long-run dynamic relationships between Islamic financial development and economic growth in Nigeria. Quarterly

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time-series data (2012:1 to 2019:3) are employed for the variables. The findings indicate a significant short- and long-run relationship between Islamic financial development and economic growth.

Methodology

The study examined the impact of Islamic financial system on economic growth; a study of Jaiz bank plc. The study adopted a cross-sectional survey research design. A structured questionnaire was designed to obtain the necessary data for the study. A reliability test of 73.2 was derived using Cronbach's Alpha coefficient, which was above the threshold of 0.70, as stated by Nunnally (1978). Meanwhile, simple random sampling was used to select the number of senior staff members. 150 questionnaires were distributed to 150 respondents from the total population of 150 staff in Jaiz Plc, Ilorin metropolis. Due to the population's size, the population's total number was considered the sample size. Meanwhile, 142 were filled and returned out of 150 questionnaires distributed to the respondents, corresponding to an 80% response rate. The stated hypotheses were tested using multiple regression analysis using SPSS software.

Data analysis and Presentation

Test of Hypotheses

$H0_1$: Philosophies of Islamic financial system has no significant effects on the economic growth.

Table 1: **Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.596[a]	.355	.314	.171

a. Predictors: (constant), Prohibition of Interest (Riba), Risk Sharing, Uncertainty (Gharar), Halal Businesses Activities

Source: SPSS output 2023.

Table 1 shows the model summary of the impact of the Islamic financial system's philosophies on economic growth. The correlation coefficient is 0.596, and the R-square is 0.355. This explains that the Islamic financial system's philosophies are highly positively related to economic growth. As a result, the variables explained about 35.5% of the variation in economic growth, while the remaining 64.5% was explained by other factors not included in the model.

Table 2: **coefficients** [a]

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	3.532	.210		4.338	.001
	Prohibition of Interest (Riba)	.601	.039	.420	5.312	.000
	Risk Sharing	.723	.031	.582	3.058	.001
	Uncertainty (Gharar)	.610	.076	.525	8.201	.001
	Halal Businesses Activities	.544	.018	.319	.8120	.000

a. Dependent Variable: economic growth

Source: SPSS output 2023

As shown in table 2, the regression coefficient table where prohibition of interest (riba), risk sharing, uncertainty (gharar) and halal business activities were statistically significant to economic growth with probability value less than 0.05 ($p > 0.05$). As a result, it is said that philosophies of Islamic financial system have significant impact on economic growth. This is in line with the findings of Yazdan1 and Sadr (2012) stating that there appear to be a bi-directional relationship between Islamic financial system and economic growth.

$H0_2$: Islamic financial instruments has no significant effects on the economic expansion.

Table 3: **Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.711[a]	.505	.656	.428

a. Predictors: (constant), cost plus sale (murabahah), leasing (ijarah), deferred delivery sale (salam), charitable loan (qard hassan).

Source: SPSS output 2023

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As shown in table 3, the model summary of the impact of Islamic financial instruments on economic expansion. The table presents the correlation coefficient to be 0.711 and R-square to be 0.505. This explains that Islamic financial instruments are highly positive related to economic expansion. As a result, the variables explained for about 50.5% of the variation in economic expansion while the remaining 49.5% was explained by other factors not included in the model.

Table 4: coefficients [a]

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	2.121	.612		4.951	.002
	cost plus sale (murabahah)	.530	.023	.928	3.184	.001
	leasing (ijarah)	.763	.048	.237	4.488	.001
	deferred delivery sale (salam)	.461	.438	.349	4.575	.001
	charitable loan (qard hassan)	-.321	.213	-.308		.330

a. Dependent Variable: economic expansion

Source: SPSS output 2023

As shown in table 4, the regression coefficient table where cost plus sale (murabahah), leasing (ijarah) and deferred delivery sale (salam) were statistically significant to economic expansion with probability value less than 0.05 ($p < 0.05$). However, charitable loan (qad hassan) was statistically insignificant to economic expansion with probability value greater than 0.05 ($p > 0.05$). As a result, it is said that Islamic financial instruments have significant impact of economic expansion. This is contrast with the findings of Jobarteh and Ergec (2017) stating that it shows unidirectional short and long run causality from Islamic finance development.

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Discussion of Findings

This study examined the impact of Islamic Financial system (philosophies and intermediaries) on economic growth in Jaiz Bank, Ilorin metropolis. The findings from the result of objective one shows revealed that the relationship between the philosophies of Islamic financial system and economic growth were highly significant. This implies that the philosophies of Islamic financial system has a high and positive significant on the economic growth. This outcome is in tandem with the findings of Naz and Gulzar (2022) and Ledhem and Mekidiche (2020). The result of objective two observed that there exists a negative relationship between charitable loan (qard hassan) as a mediating variable for Islamic financial instruments and economic expansion with a p value of .330 > .005. this implies that the Islamic financial system has a weak approach towards charitable loan (qard hassan). This is in contrast with the findings of Jobarteh and Ergec (2017), Sabiu and Abduh (2020), Rabaa and Younes (2016) and Lawal and Imam (2016).

Conclusion

Based on the aforementioned findings, adopting the Islamic financial system for stable economic growth is important. The Islamic financial system's impact is set to be positive in assisting the economy in actualising good sustainability and stability. With these findings, the Islamic financial system positively and significantly impacts economic growth.

Recommendations

Based on the conclusion drawn, the following recommendations were made:

i. It is well known that the Islamic financial system was established to ease the affairs of individuals and organisations. Managers should endeavour to implement the philosophies of the Islamic financial system, as it promotes the circulation of funds, which assists in the growth of the economy.

ii. Since an average individual can satisfy their wants without exploitation or risk burden, Islamic financial intermediaries should be embraced because they serve as a panacea to the poverty level among citizens and strengthen the economy's expansion.

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