



# The Application of *Ar-raham*-based Microcredit facility as an Alternative Instrument for poverty alleviation in Nigeria

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## Abstract

One of the major challenges facing developing nations like Nigeria is the continuous increase in the level of poverty, which widens the gap between the rich and the poor amidst increasing population and economic growth. In Nigeria, there are scores of microfinance outlets but their operational products are yet to stem the tides of people falling into the poverty bracket. UNICEF reported that about 70.8% of Nigerians live on less than a dollar per day amidst the country's growing GDP. This rise in the level of poverty culminating from the uneven distribution of the national wealth continue to exacerbate economic instability and social insecurity in Nigeria. Government and other relevant bodies have continued to explore different kinds of solutions to minimize the multifarious challenges posed by the exponential rise in income disparity that has eating deep into the fabrics of the national economy. The micro financing structure has been proven to be helpful to stimulate greater financial inclusion of the low-income groups especially in developing economies. Focal among the many factors responsible for this challenge is the issue of interest charged by the banks to small and medium enterprises despite the rising rate of inflation. Meanwhile, the issue of transacting in *riba* is prohibited in Islam and some other religions because of its oppressive nature. This paper therefore proposes *Ar-Rahn* based credit facility aimed at ensuring that the unemployed, the poor and low income earners have access to non-interest based micro financing in Nigeria to aid their financial inclusion and achieve the broader objectives of microfinancing in Nigeria.

*Keywords:* ar-rahm, pawn-broking, *riba*, poverty, micro-credit, Nigeria.

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## 1. Introduction

The Nigerian economy is said to be the largest in Africa with the population of over 170million people, vast land mass, multiple natural resources deposit and the highest oil producing nation in Africa. Recent reports have shown that Nigeria is now considered as the second largest economy to South Africa in Africa despite the economic recession that continue to increase the level of unemployment and poverty (Aderinokun, 2016). Microfinance banks began operation in Nigeria in the 1970s and up till today, over 900 companies have been licensed by the Central Bank of Nigeria (CBN) to offer micro-credit facilities in order to increase access to financing to Small and Medium Enterprises (SMEs). Yet many Nigerians remain un-bankable, poor and unemployed. Ikechukwu (2012) noted that the economy is getting bigger as the population is increasing but the poverty line is getting wider bringing more hardship to the increasing population.

The economic and financial challenges make many people to rely on government unavailable loans and microfinance scheme toward fulfilling personal goals. Many African countries including Nigeria keep solace in the SMEs which made amongst others, pawn-broking outlets mushroom in different nooks and crannies of the society. Notable among the earliest pawn broking outlets include the *Susus* of Ghana, *Esusu* and *Ajo* in Nigeria and have extended up until now where public and private institutions, as well as religious bodies have adapted the practices to the modern cooperative societies (Tony, 2014). Conventional banks and many financial houses were also given licenses by the respective arm of the government with sufficient legal and financial backings to enhance their operations in the areas of

advancing micro-credit support to the low-income segment of the society (CBN Microfinance guideline, 2006). The law allows them to give out loans to individuals or group and take tangible assets as collateral, in case of default or bankruptcy. The aspect of collateral is similar to an Islamic financial contract known as Ar-Rahn, which is the basis for this research paper.

*Ar-Rahn* as an Islamic financial contract is used as security for loan acquired until the debt is settled, (Fairouz 2012). In the Islamic law, it is defined as “possessions offered as security for a debt so that the debt will be taken from it in case the debtor defaults to pay back the due money” (Javed and Shariq, 2004). Meera (2013) described Ar- Rahn as Islamic mode of pawn-broking where a non-financial asset, usually gold, is placed as collateral for loan undertaking without bearing interest. It is a permissible contract in *Shari’ah* and Islamic jurists’ have justified the authenticity of pawn transaction based on the Sunnah of Prophet Muhammad (PBUH); where when he passed away, his shield was found with a Jewish man in Medina as collateral. The purpose of the mortgage (pledge) is to sell the collateral at maturity after insolvency is established, and so as to fulfill the right of every party as due.

One of the features of Ar-rahn contract is that all items permissible as sales are also permissible as mortgage pledge item. This will serve to reduce risk, and enhance tradability or liquidity such that the lender can recoup his claims from the item in case of solvency or inability to repay the debt, (AAIOFI No. 39 standard, 2014). Unlike *Ar-rahn*-based system, (Azila, 2011) explained that the pawn broking is a conventional system whereby a property is kept as a pledge or security for loan or money borrowed. Meera (2013) further explained that the experience with conventional pawn broking is such that interest is charged on the loan amount, whereas the collateral is used to settle any unpaid balances should default occur. Pawn is usually used as pledge of goods or deposit of personal property in exchange for loan or money borrowed. The lender usually declares all pledged items as collateral security for the loan given to customers to mitigate risk in the event of default. The pledge can be sold in replacement of the loan and whatever remains shall be returned to the owner. Azila (2011) noted that this is one of the reasons why the pawn operators ensure the pledged item is usually more valuable if not equal to the amount borrowed. Given the two-tiered benefits of serving as risk mitigating instruments for the lenders and savings for future use to borrowers, this study proposes the use of Ar-Rahn as a means of stimulating micro-credit facilities in Nigeria.

## 2. Literature Review

In 2005, the Federal Government of Nigeria formulated microfinance policy guidelines for licensing microfinance bank operations. The growth and efficiency of these banks have been forestalled by many factors such as; intermittent and sometimes inconsistent government policy for the operation and implementation of microcredit facilities, insufficient human capital, inadequate infrastructures, socio-cultural misconceptions and religious belief (Joseph and Eseoghene, 2010) Corruption and fraud practices among regulators and operators are other factors mitigating the effectiveness of the microfinance in Nigeria (CBN, 2005; Adewale, 2014). Hence, there is an urgent need for all stakeholders such as regulators, promoters, practitioners and researchers to find sustainable solutions to these challenges (Ikechukwu 2012). A related field of study shows that one of the reasons why microfinance as an institution is not efficient in alleviating poverty is because majority of the products focus on extending credit facilities to the beneficiaries rather than promoting entrepreneurial activities and small scale financing (Agba et al. 2014). The purpose of microcredit facility is to make financing and loan available to peasant farmers and small business enterprises by boosting rural financial market. (Khadija et al. 2013) This will eventually reduce rural-urban drift and alleviate poverty in the country.

Equally the role of the Government is essential in providing appropriate policy that will attract the public and donors’ confidence (Alani and Sani, 2014). In Malaysia, Mohd Nor et. al. (2012) mentioned that one of the national initiative programs of Dr. Mahathir’s government was the decision to create an economy and society that is based on trustworthiness, efficiency, effectiveness, just and disciplined nationals. In doing so, structural economic programs of institutions were targeted among others for sustainability development. Ar-Rahn-based instrument was one the many programs introduced with the basic intent of alleviating poverty and sustaining the institutions. The author also noted that one of the factors that assisted the growth of rahn-based instrument in Malaysia is the problem faced by the customers of the conventional pawn shops in losing their property. Rahn was seen as a better alternative in protecting their

pledge item from being auctioned unlawfully especially in the event of default. Meera (2013) explained that in 1992, Malaysia launched the first Ar-Rahn operations by Mu'assasah Gadaian Islam Terengganu and Kedai al-Rahn. Within 1992 and 1993, the Government through Bank Rakyat has introduced rahn-based instruments to several states in Malaysia particularly the Muslims dominated areas such as Terengganu, Kelantan, Kedah, Penang, Johor, Negara Sembilan and the federal capital territory, Kuala Lumpur.

According to Hisham et al. (2013), the cheapest way to obtain financing is the Ar-Rahn-based instrument because it is free of interest rate. It is one of the means of providing educational needs and small scale capital for businesses and financing for entrepreneurs. The author opined that Ar-rahn-based instruments will help to alleviate poverty, improve family economic capabilities, and maintain evenly distribution of funds in the nation. The practice of Ar-rahn business in Malaysia has shown its resilience and as well as its acceptability from the people as it has reliably kept the pledged item as compared to the conventional where borrowers usually lose their pledged properties (Joseph and Eseoghene 2010). That notwithstanding, Hisham et al. (2013), cautioned that the government, operators, and researchers need to improve more on the policy framework to enhance the operational procedures of Ar-Rahn based instruments products and service delivery. This is needed to ensure the Ar-Rahn-based instruments maintain its relevance in the society and its customers keep increasing. Hisham et al. (2013), advised that Ar-Rahn operators should also design products that serve the needs of other income classes of the society because people perceive Ar-Rahn-based instrument as a financial product for only the poor and as such mitigates the growth of the product.

The recommendation by Hisham et al (2013) is in congruence Hamid et. al. (2015), who stated that one of the intents of Malaysia Government for introducing Ar-Rahn-based instrument is to create a transparent alternative that satisfy the Shariah requirements in order to attract willing customers who may not have access to the conventional pawn shops and microfinance houses because of the interest rate and collateral challenges. The Government also views this as avenues toward contributing to the development of the Malaysian economy through the Islamic financial products that will attract new investors and subsequently improve the economy. One of the findings of their study revealed that one of the factors that influence the choice of customers toward Ar-Rahn-based products among most Malaysians is the basic intent of adhering to the Shari'ah compliant product as patronizing Ar-Rahn is seen as a religious obligation. Selamah and Abdul Ghafar (2015) provided empirical analysis on Ar-Rahn operations in Malaysia using the Data Envelopment Analysis (DEA). They gathered that apart from Bank Rakyat, majority of the other operators are resilient but require more capital in order to improve the financing scheme.

In the case of Nigeria, general economic activities are officially controlled by three different institutions; the Federal Ministry of Finance with the main function of managing and controlling government income and expenditure, the Central Bank of Nigeria; maintains the country's reserves, provides monetary advice and acts as lender of last resort and the Nigeria Stock Exchange through the Security Commission manages and controls the capital market of the economy. However, the challenge of economic instability which has led to unavailability of short term loans to the middle and lower class of the country made them result into informal institutions in settling their financial obligation such as "Esusu Societies", "Ajo Societies", and other daily contributions and cooperative societies (Ikechukwu 2012). In 2007, the CBN introduced a new framework whereby the community banks can transform into microfinance banks, thus increasing the loan scheme from 5 million naira to 20 million naira. Ikechukwu (2012) noted that the purpose for such initiative was to ensure financial inclusion of low income group in the society and ease financial access to small and medium scale enterprises. However, the objective for the establishment of these microfinance banks and licensing of several pawn shops were being defeated because of the interest rate which stifled the survival of the start-ups (Adewale, Mustafa, and AbdulKadir, 2015). In the northern parts specifically and some adherents of the Islamic faith in the southern parts of Nigeria considered the presence of interest as unlawful under Islamic law and thus refrain from it (Adewale, Ataul Huq, and Meera, 2014). These challenges have reduced the level of success recorded in the implementation of the micro-credit scheme launched by the government (Ikechukwu, 2012). It is therefore, yet to be seen how Islamic finance alternative financing platforms and products like *Ar-Rahn* can be optimized towards enhancing financial inclusion in Nigeria especially among the Muslim poor.

The rest of the paper is arranged as follows: 1. the reasons why conventional microfinance and pawn shops have not recorded expected success in Nigeria and, 2. the possibility of introducing a practical

alternatives; using the islamic *Rahn*-based financial facilities, 3. the meaning of Ar-Rahn, its juristic authenticity, practical success and modus operandi in some Muslim countries like Malaysia, 4. reasons why the *Rahn*-based financial alternatives will work in Nigeria, 5.the role of the government via Central Bank of Nigeria in formulating necessary guidelines for microfinance banks and pawn shops in implementing *Rahn*-based facilities. The final section covers the conclusions and recommendations on the application of *Rahn*-based financial facilities as an alternative towards poverty alleviation.

### 3. Research Methodology

This section explains the instruments and approach used to gather resources for the purpose of exploring the necessity of Ar-Rahn based financial instruments as a means of alleviating poverty in Nigeria. The study explored the federal laws of Nigeria as an embodiment of laws that guides the activities of the entity called Nigeria including that which relate to the financial subsection of the economy. The primary source of data in Islamic law was explored in order to determine the evidence and legal intent of promulgating the *Rahn*-based micro credit facility in alleviating poverty. The positions of the four prominent schools of thought in Islamic jurisprudence were examined and the laid down requirements and procedures expected in practicing the *Rahn*-based microcredit instrument evaluated. Review of extant literature, newspapers cuttings, Nigeria financial acts and central bank acts were sources explored for the secondary data. The review focuses on the extent and nature of the current conventional operations of microfinance services and the relevance of Ar-Rahn as an alternative business model to alleviate poverty.

#### 3.1 Rahn-based Financial Instrument as a Practical alternative to the conventional financial facilities toward poverty alleviation

The literary meaning of *Rahn* according to the renowned Arabic dictionary (Lisanu-l-Arab, 1411) is: “*whatever that is kept with another person in replacement of what was taken from him*”. This means that whatever that is kept as trust or collateral with another person could be referred to as *rahn*. Collateral means what is withheld or held back in constancy and always with the lender until loan is repaid (Ibn Manzūr, 1400). Technically, it means a legal act that requires financial debt documentation between the mortgagor (borrower) and mortgagee (lender) whereby the collateral is held with the mortgagor in exchange of loan or asset borrowed until the obligation is fulfilled (Surilawana, 2014).

#### 3.2 Authenticity of Rahn in Islamic law

The term *Rahn* is mentioned in the Quran as a base for its usage thus:

*“And those who believe and whose families follow them in Faith, - to them shall We join their families: Nor shall We deprive them (of the fruit) of aught of their works: (Yet) is each individual in pledge for his deeds”* (at-Tur: 21).

*“If you are on a journey and cannot find a scribe, a pledge with possession (may serve the purpose) And if one of you deposits a thing on trust with another, Let the trustee (Faithfully) discharge His trust and let him fear his Lord. Conceal not evidence; for whoever conceals it, His heart is tainted with sin. And Allah Knoweth all that ye do”* (Al-Baqarah: 283).

This verse of the Quran according to the Ibn Katheer who explains that it is permissible for anyone on journey to borrow money and give pledge item as collateral if there is no scribe or witness between the two party. That the word *farihānun* meaning (then pledge) is a conditional statement in Arabic which indicate that the Ar-Rahn contact is not binding unless the pledge is held as collateral either by the lender or an appointed third party. (Ibn Katheer, 1999).

In the hadith reported by Aisha; may Allah be please with her “That the Prophet (Pbuh) bought food from the Jews and mortgaged his Armor with him” (Ibn Hajar, 1372). Reported by Ibn Abass as saying, “The prophet (Pbuh) died and his shield was found mortgaged with a Jew (Ibn Hajar Al Asqalāni, (1372-1449). This evidence from the tradition of the prophet (pbuh) indicates that it is permissible in Islamic law to operate a mortgage transaction or contract with a non-muslim such as Jews and even Christians. The collateral is the underlying asset or property withheld in exchange of the loan. It is an important factor in

the contract between mortgagee and mortgagor because it acts as a disincentive to default whereby the asset could be auctioned for sale in the case of default and lender is only entitled to the exact amount of money borrowed, the remaining is returned to the owner unlike in conventional collateral where the asset is fixed (Khan & Nasir, 2004 and Ibn Qudāmah, 1997).

Abu Hurairah, a companion of the Prophet (pbuh) reported him to have said: “A ride (as collateral) with its expenses whoever takes the benefit of the collateral shall be liable for its expenses” (Sahihu Imam Bukhari 810). This tradition of the prophet (Pbuh) emphasized the permissibility of receiving collateral by the lender until the debt is settled with the condition that he is liable to safe keeping of the pledged item, and is required to seek the pledged item owner’s permission before any form of usage or deriving utility whereby lender will bear all expenses arising from the usage of the pledge item such as repair, damage or wear and tear. This has formed a fundamental base in Islamic law for operating pawn contract whereby the pawn operator (mortgagor) can give short term loan to the mortgagee (borrower) who gives in return a pledged item as agreed upon by the mortgagor. (Ibn Rajab al hambali, 795).

### 3.3 The Intent of Shari’ah on the legitimacy of rahn-based micro credit facility

The intent of Shari’ah on man is to protect their affairs in the five basic components, the protection of religion, the protection of life, protection of senses, protection of personality and protection of wealth. Hence, these protections could occur in any of the hierarchical Shariah critical points such as *Adaruriyyāh* (the basic necessity), *Al-hājjiyyāh* (basic needs) and *Atahsinīyāh* (embellishment). The intent of Shariah law could either protect man in any of these hierarchies, part of them or all of them. For example, giving access to loan for an urgent medical attention could be referred to *Adaruriyyāh* (basic necessity). The discharge of such obligation could be classified as protection of life and religion especially if the person involved is a scholar or an important personality for the promotion of religious knowledge and awareness. However, Islamic worldview about poverty alleviation is not only on material wealth but also on the spiritual fronts, whereby the subject is able to identify himself as a vicegerent of Allah on earth by utilizing the resources needed to serve His cause (Riwajanti 2013).

The intent of the Shari’ah for legalizing the transaction of *Rahn*-based Islamic pawn alternative is to create easy access to fund for the needy and the poor as a form of socio-economic protection. However, the mortgagee (lender) who held the pledged property is allowed to dispose it once the mortgagor (borrower) is declared by Islamic law as insolvent. The mortgagor is permitted to take out only the equivalent amount of the money or material borrowed while the remaining is returned to the mortgagee (pledge owner). This is another form of protection and socio-economic security. Through this means, there is re-distribution of wealth among the people of that particular society. The intent of Shariah as stated in Islamic law is meant to maintain even protection between the mortgagor (borrower) and the mortgagee (lender). This will alleviate poverty; reduce crime and hatred among people by promoting harmony, security and peaceful coexistence among the people of a society (Ibn Ashur 2006 and Dusuki 2007).

### 3.4 Legal Provisions for Rahn-based contract According to the AAOIFI Shariah standards.

- a. The Shariah provision states that; it is not permissible for a party to the contract of *Rahn*-based facility (either as mortgagor or mortgagee) to cancel the contract without the prior permission or acceptance from another, because it is a mutual agreement.
- b. The Shariah provision states that; it is not permissible for a party to the contract of *Rahn*-based facility (either as mortgagor or mortgagee) to cancel the contract without the prior permission or acceptance from another, because it is a mutual agreement.
- c. The provision also states that the immediate and simultaneous exchange of loan with collateral must be noted in the contract.
- d. The provision permits the appointment of a third-party agent to collect or take possession of the pledge collateral. Either of the party to the contract has mutual right towards transfer of the pledge. The third party could equally be appointed as an arbitrator in case of default to declare the borrower insolvent and take appropriate action on the pledged property.
- e. The death of either party does not affect the contract per say, rather the hirer of either party will automatically be responsible.

- f. The pledge owner has the right to request for his collateral if the lender misplaced, damaged or misused the pledged property.
- g. The provision permits that; the mortgagee (lender) has the right to take possession of the pledge property until the debt is settled and has no right to continuously hold it once the debt is fulfilled.

### 3.5 The Shariah legal provisions on the pledge collateral (*Al marhūn*)

- a. The provision states that; the pledge property must be cash-based item, known, identifiable and is subject to submission from the mortgagee.
- b. The provision states that; *Rahn*-pledge could either be an item, debt certificates, securities (shares and bond) and all agricultural produce that can be sold and repurchased with another item.
- c. The provision also states that; it is permissible for the mortgagor to pledge an item or property belonging to many people but with condition of seeking other members' owners' permission before it can be accepted as pledge.
- d. The provision regards pledge property as a trust kept in the custody of the mortgagee (lender), hence, if the property gets damaged or loss as a result of natural occurrence, the mortgagee will not be liable but mortgagee will be responsible if there are evidences indicating he is responsible for the damage or loss.
- e. The borrower is obliged to sign by attesting to the ownership of the pledged property, if the pledge is later found to belong to another owner either as stolen property or otherwise indicate the mortgagor as not the actual owner of the property, such contract is declared null and void.
- f. The provision permits the mortgagor (borrower) to borrow or rent any property, items from third party with the intention of using it as pledged or collateral in getting a *Rahn*-based credit facility from the mortgagee (lender).
- g. The provision states that; any growth appreciation in value of the pledge property of item is taken as part of the real asset; and shall be for the mortgagor (owner of pledge item).
- h. The provision permits the mortgagor (borrower) the ability to benefit from the pledge item but with the permission of the mortgagee (lender) while the mortgagee cannot benefit from the pledge item even with permission except with a mutual compensation in return.
- i. The provision states that the mortgagor (borrower) is responsible to bear all expenses arising from the management and safe keeping of the pledge item.

### 3.6 Shariah Legal provision on the *Rahn*-based credit facility (*Al marhun bihi*)

- a. The legal provision states that; the credit facility (loan) in form of cash or material need must be legitimate debt. That is such debt must be free from interest and usury.
- b. The provision also stated that; it is not permissible to use *Rahn*-based financial tools in the trust fund or trust transactions such as agency transaction (*Wakālah*), deposit transaction (*Wadī'ah*) active partnership transaction (*Mushārah*), partnership contract (*Mudārah*), or deposit made for rental (*Wadī'ah li-ijārah*), but if it is meant to deposit as guarantee for any loss or damage made to rented items, then such is permissible.

### 3.7 Shariah legal provision on the use of current account and insurance policy document as pledge:

- a. The provision specified that in the case of current account and insurance policy documents, such must be transferred into investment deposit account in order to be used as pledged item and the mortgagor has the right to any accrued profit from the capital pledge while the financial institution has the right to the profit accrued from invested transactions made with capital pledged.

- b. The Microfinance company is allowed to accept debt owed to the customer by a third party as a pledge item provided there are sufficient documents to support the debt owed
- c. The provision also stated that an insurance policy on any of the pledged item must be borne by the borrower and in the occurrence of damage or loss, the compensation shall be to the account of the borrower (mortgagor).

### 3.8. Shari'ah provision on Zakat (due charity) on the pledge items and properties

- a. The mortgagor (borrower) is responsible for paying *zakat* (due charity) on the property pledge or any financial growth or appreciation accruing to the items, hence, the mortgagor (borrower) is permitted by law to postpone the payment of (zakat) due charity on the item until the pledged collateral is recovered, thereby calculating the previous years in pro-rata (arrears).
- b. The provision also states that *zakat* (due charity) is subject to all current account, insurance policy, trust funds account, investment account, *Nisāb* shares, bonds and sukūk, salam, and Istinai contract, that is; *Zakat* (due charity) is obligatory on all pledged items in *Rahn*-based facility provided the item has attained the minimum worth (*nisāb*) of *zakat*.

### 3.9 Shari'ah provision on the permissibility of financial security documents (Shares, Islamic bonds)

- a. The Shariah provision states that the financial capital instruments such as shares and Islamic bonds are permissible items to be used as pledged collaterals in *Rahn*-based credit facility. The Shares must be from company that are not transacting in any of the non- Shariah compliant products such as; alcohol, gambling, pork, usury-based financial institutions and other forbidden transactions under the Shariah law. Preferred stocks and bonds are categorically referred by majority of Shariah jurist as non-Shari'ah compliant products and are not permissible to trade in them; hence they are not allowed as pledged items (AAOIFI Shariah standard 2015).

## 4. Practical Success of Pawn contract in some Muslim countries

In recent times, there have been rising concerns from policy makers in some Muslim countries toward the application of Islamic financial facilities in alleviating poverty. This is one of the objectives of Shariah in Islamic economy and finance (Ibn Ashur 2006 and Dusuki 2007). Hence, micro-financial facilities have been introduced by different banks in some Muslim countries such as commercial banks, mortgage bank and microfinance banks. In Malaysia for example, there are microcredit facilities that were structured by the Islamic pawnbrokers and other financial institutions in order to satisfy the demand of the customers. These facilities include various instruments such as *Wadī'ah wa damānah* (Protected savings that is kept by the customer with the bank or pawn shop) *ujrah* (fee charged by the pawn shop on every item pledged as collateral for certain period of time), *qard* (loan that the customer received from the pawn shop in exchange for the pledged for certain period of time) *Rahn* (collateral that is withheld by the pawn shop until the loan is settled). Dusuki (2007) noted that development of these facilities has led to the acceptance from members of the public and have thus increased access to micro-credit facilities to low income group in the society.

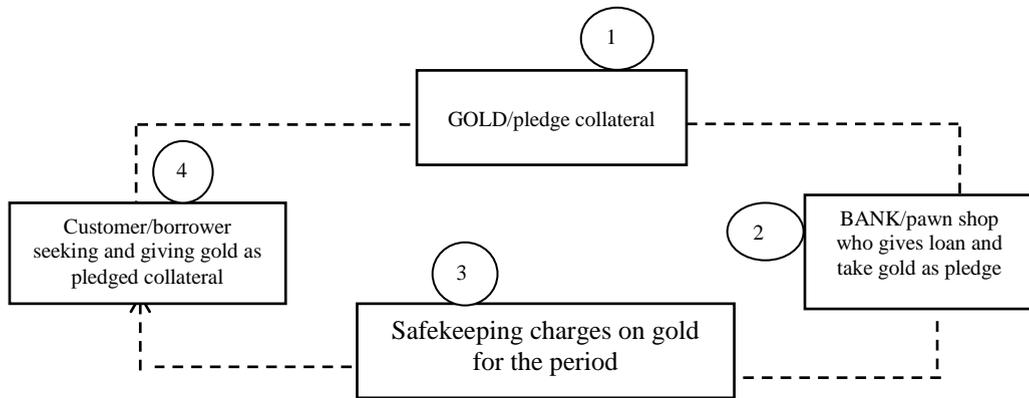
### 4.1 The Procedure and flow of contractual activities between the bank and the customers as thus:

- (1) Gold has been accepted to be the basic and original means of exchange because its value is stable over time. The customer is hereby expected to deposit his gold with the bank under the principle of *Wadī'ah wa damānah* (saving plus protection services) to pay in return to the bank; *ujrah* (fee charged by the pawn shop on every item pledged as collateral for certain period of time).

- (2) The bank is expected to provide protection for the deposited gold in return for the *ujrah* charged for an agreed period of time in the contract.
- (3) The Customer can now use the contracted deposit made with gold as collateral with the bank to acquire microcredit facility.
- (4) The bank will grant loan and other microcredit facility to the customer based on the worth of the deposited gold.

**4.2 Procedure in *Rahn*-based microcredit contract:**

First contract:



Second Contract:

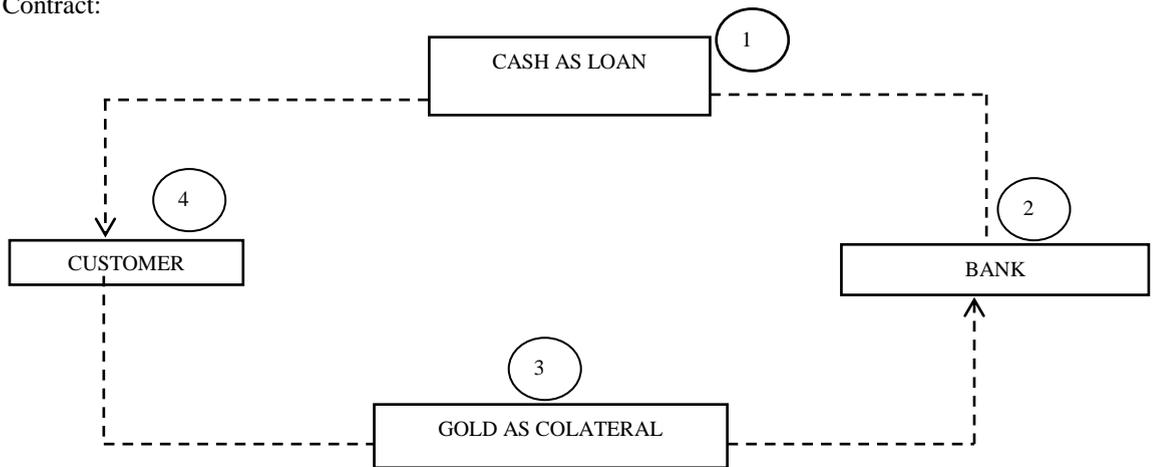


Figure 1: [13] culled from (Fairooz et. al. 2012)

#### 4.3 Advantages of rahn-based microcredit as against conventional pawn shops in Nigeria

In the 1990s, pawn shops operators in Malaysian were mainly Chinese. They usually give credit facilities plus interest, where many of the borrowers were likely going to be more indebted with the increasing rate of usury imposed on the loan. Additionally, the collaterals are usually disposed upon maturity and no return will accrue to the borrower even if the collateral is more than the loan acquired. Presently, the emergence of rahn-based micro finance institutions offer microcredit facilities based on the principles of rahn have gained much recognition in Malaysia, because the services provided have created an alternative to the low-income earners and the poor people (Surilawana et al. 2014). Some of the benefits are discussed below.

Firstly, the security and protection of both party is guaranteed. The bank as the lending party already has the gold withheld as collateral to protect it from any loss that might arise from default repayment or bankruptcy of the borrower. Under Islamic law, the bank has the right to auction the pledge (gold) at the situation of bankruptcy and deduct the equivalent amount owned but the balance must be returned to the borrower. Secondly, the contract is attractive and profitable to the pawn shop. Many investors now identify it as lucrative and lawful business. The bank is allowed to charge certain percentage of the deposited material as safe keeping charges which vary according to the operating bank between the ranges of 3.25% and 5% of the pledged material per year. This service charge is expected to be permissible under Islamic law for the (pawnshop) lender. The pawn shop operators are responsible for safekeeping of the pledged item, and they are allowed to make use of the pledge item and be responsible for it expenses, loss or damage.

This is an easy and fast way of providing fund for the needy and the lower income earners within the society in order to be able to settle their immediate financial challenges. The common conventional method of collateral has a lot of cumbersome paper works which usually discourage the lower income earners whose demand for loan is usually immediate and urgent. The process of paper work will definitely make it uncomfortable to potential loan seekers to apply for one. Moreover, the *Rahn*-based microcredit facility contract usually ensures safekeeping of the pledge material such that the borrower can easily get back their property. In the conventional pawn shop, customers seldomly get back their pledge and this gives rise to a lot of challenges since the borrower is initially in financial distress, such may add to his problem (Fairooz et. al. 2012).

## **5 Reasons why the *Rahn*-based financial alternatives will work in Nigeria economy**

### **5.1 The level of poverty and unemployment in Nigeria**

According to Kazi and Leonard (2012), the World Bank record has shown the increasing rate of unemployment and poverty in the world, and African in particular where almost all its nations are least developed (Kathleen et al. 2016). However, Nigeria with the largest population and economy in African still has most of her citizens living below international poverty level set by World Bank of \$1 per day. According to the survey conducted by (Kazi & Leonard 2012 and Aslam & Aliyu 2014), over 24% of the Nigerian people are unemployed and 65% of them are youth. Alani and Sani (2014) reported that over 46% of adults in Nigeria are un-bankable and they represent one-third of the total population. Low socio-economic status has been the major catalyst for the high increase in the poverty, crime and civil unrest in many parts of Nigeria. However, many researchers and policy makers have argued that microcredit activity is one of the major means of alleviating poverty in Nigeria. The poor are usually struggling for the basic needs of life: food, clothing and shelter. The micro financial institutions are usually meant to cater for these strata of the society (Okozie et al. 2013). Kasali et al. (2015) report shows that micro credit facilities have tremendous impact in alleviating poverty in the south-western Nigeria Looking at the geo-political zones in Nigeria, the south west part of the nation comprises Christians, Muslims unlike in the northern part of the nation where majority are Muslims. The religious belief on the legality of transacting in interest would have made it difficult for some people in participating in the conventional microcredit schemes as it is usury based. The population is increasing and poverty level is becoming wider; hence, there is a greater need to structure facilities that will ease the financial burden of teeming low income segment of the population.

### **5.2 The Role of the Government in application of *Rahn*- based microcredit in Nigeria**

The Central bank of Nigeria annual report shows that the CBN was established in 1958 by the Federal Act of Nigeria with the basic objectives of issuing legal tender currency, maintaining stability in the economy, acting as bankers to the other banks and maintaining the foreign reserves, (CBN annual report, 2012). All these functions entail continuous research and policy formulation by the apex bank which is subject to the executive approval. The CBN annual report of 2012 shows that over 200 billion naira was budgeted for small and medium credit guarantee through the Commercial Agriculture Credit scheme (CACS). The fund is expected to be managed by the commercial banks and micro-financial institutions attached to the commercial banks that are duly registered with the government. This is one of the implementation methods adopted by the apex bank toward maintaining stability in the economy. The Micro, Small and Medium Enterprises Development Funds (MSMEDF) were also used in launching over 200 billion soft loans to crystalize the women entrepreneur's projects across the country (CBN, 2012 and 2013). In the same vein, in year 2000, Dr. Joseph Sanusi launched the government support for sustainable micro-credit schemes with the intent of alleviating poverty among the unemployed, the poor and low income earners (Daily trust, Abuja 2002)

However, considering that the intent of the regulatory body is to meet the demand of the low-income group of the society, (Kahn & Shariq 2004) argued that the objective may be defeated because these categories of people are usually the unemployed or low income earners who could not meet up with the criteria and conditions of applying for loans as set up in conventional financial banks. Finally, the challenge with most of the initiatives aimed at alleviating is the inclusion or the usury and interest rate elements in the schemes. This has led to the default of many participants and exclusion of others who sees it as being unlawful.

### 5.3 Learning from Malaysia rahn-based credit mechanism

In an effort to enhance and legalize the operation of Rahn-based micro credit facilities in Malaysia, the Bank Negara (Central Bank) issued Shari'ah framework (Rahn-Shariah Requirements and Optional Practices, Exposure Draft, 2015), as a policy for the operationalization of the facilities by the financial institutions. The willing conventional banks can use rahn-based instrument as a short-term loan facility and following the Shari'ah guidelines as stipulated by the Bank Negara Malaysia. The framework comprises of the policies, and mandatory regulatory requirements of *Rahn* operation, the Shariah compliance of *Rahn*; such as its legal provision, and related legal instruments. The second part entails the Shariah requirements for Rahn and its optional practices such as the contracting parties, the instruments, and terminologies. This legal instruments and policy documents have been the major catalyst in the operation of Ar-Rahn based credit facility in Malaysia. Thereby the financial houses are guided on the mode of operation that must be compliant with the Shariah rulings as given in the framework. (Exposure draft 2015 and Zaihan & Norsita 2015). However, there is a recent submission by a researcher that the Federal Government of Nigeria through the CBN needs to formulate suitable policy around the application and implementations of the microcredit facilities for the poor. He pointed out certain challenges confronting the growth of microfinance banks in Nigeria, among which are the available loans are not accessible to the poor, (Ikechukwu 2012).

According to a recent research conducted by Ikechukwu (2012) on the impact of religious belief on Nigerian socio-economic activities, the result shows that; the religious belief is a factor in the Nigeria socio-economic activities. Muslims believe the microfinance banks are operating in interest (*riba*) and such is forbidden in their religious doctrines. Hence, the northern part of Nigeria, which has 75% of her population being poor and unemployed has 20% microfinance banks located in the region. Whereas, the southern part with 25% of her population being poor is saturated with 80% of microfinance banks and pawn shops, (Ikechukwu 2012). This lopsidedness in location of the microfinance banks has led to the closure of many microfinance banks. Subsequently many banks and shops folded up and their licenses were seized by the government. This informs the position of many researchers that the government needs to responds positively to its policy on microfinance facilities by considering possible micro credit facilities alternative that can fulfill the belief and aspiration of the poor and unemployed population of the country. Example of good application of rahn-based microcredit facility is what was done in Malaysia to alleviating poverty and bridge the gap between the rich and poor. The introduction *rahn*-based helps to meet up with aspiration of the poor whose religious belief may not permit to deal in products offered by the conventional microfinance banks particularly because of the interest rate imposed on loan and related risk from collateral pledge (Dziauddin et al. 2013).

However, Jaiz Bank as the only full-fledged Islamic bank in Nigeria continue to provide financing services to its customers such as import finance and other corporate Shari'ah compliant financing services to their customers with flexible collaterals. At present, the idea of Ar-Rahn-based micro credit is not available whereby the poor and the lower income earners could have access to short-term and quick loan in meeting up their immediate needs.

## 6. Findings

Some of the findings of the study includes the followings:

- a. There were geographical imbalances in the location of microfinance banks in the country. This is evident where there are a lot of microcredit operators and pawn shops located at the cities and few were located at the rural areas as indicated in previous field studies, (Ikechukwu 2012).
- b. There are no indications that any of the licensed fully fledged Islamic bank, Islamic windows or even the pawn shops operate the Rahn-based micro credit facility.
- c. There are no legal provisions from the government concerning the operation of the *Rahn*-based micro credit facilities.

- d. There is one-third population of the un-bankable adults that the market of *Rahn*-based credit facilities can still explore, but these customers are either not participating in banking activities as a result of inadequate information or certain religious belief surrounding the imposition of interest and usury on loan.
- e. The CBN, the *Islamic* banks and other Islamic financial institutions are yet to collaborate in exploring and promoting the operations and investment in pawn business for the purpose of alleviating poverty.
- f. The CBN therefore, through the banks should embark on awareness campaign programs on the possible alternative of using *Rahn*-based microfinance facilities.
- g. The Federal Government legislature should formulate laws that will enhance the formulation of regulation for the operation of *Rahn*-based microfinance tools.
- h. The Government should increase its financial support for the willing banks toward introducing *Rahn*-based credit facilities

## 7. Conclusions and Recommendations

The study found that the operation and existence of conventional micro finance banks and pawn shops are widely known across Nigeria particularly among the educated and the rich. The purpose for which they are established is yet to be fulfilled as the poverty rate is increasing yearly despite different schemes and trust fund provided by the government through the Central Bank and other financial regulatory authorities. Efforts should be made by the government in considering the reasons why many un-bankable poor Nigerians are not benefiting from the billions votes of the budget meant for poverty alleviation project and programs. Hence, the Federal Government should as a matter of urgency propose bill through the CBN to the legislatures to enact new laws enhancing the permissibility of *Rahn*-based micro credit facilities. Though, Kazi and Leonard (2012), Tony (2014), Kasali et. al (2015) and Aliu (2016) have all attested that microfinance banks have played a significant role in alleviating poverty in Nigeria. At the same time, they were quick to recognized that there are still more than two-third employable adults of the population uncatered for, which are actually in need of the micro credit facility. The introduction of *Rahn*-based micro credit facilities would serve to reduce some of these challenges.

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