

## **Sukuk and Nation Building: A Theoretical Analysis of Sukuk Financing in Nigeria**

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### **ABSTRACT**

The emergence of *Sukuk* as an instrument of Islamic finance is a significant development that provides alternative means of funding for corporate entities, governments and financial institutions. Despite the tremendous expansion of Sukuk finance globally, the phenomenon is to some extent new in Nigeria, though the regulator, (SEC) has released regulations for *Sukuk* operation in the country, apart from Osun State Government that has listed its *Sukuk* and the recent FGN *Sukuk* issuance, evidence shows that, none within the corporate and financial bodies had listed any *Sukuk* in Nigeria. It is against this backdrop that this paper aims at assessing the role of Sukuk financing in nation building with special reference to the recent Sukuk issuance by the Government of the Federation for the rehabilitation of Federal roads across the the Country. The researchers adopted analytical and descriptive approaches in this study. The main findings of the paper have shown that despite the novelty of Sukuk finance to Nigerian context, it has incalculable impact on nation building. It also revealed that *Ṣukūk* have countless economic potentialities to Nigerian economy in terms of economic development, financial inclusion, economic diversification, Liquidity Control and infrastructure financing, among others.

***Keywords:* Sukuk, Nigeria, Shari'a and Nation Building.**

## A. INTRODUCTION

Achieving human capital development in any given society relies upon buoyant infrastructure development, since the growth of any country's economy solely depends on the status of its infrastructure. Thus, the economic impact of infrastructure development of any nation building cannot be over-emphasized. The dearth of needed infrastructure in a country like Nigeria places serious restriction on human capital development. It is, perhaps, in view of its crucial role to achieving rapid economic growth that advanced nations of the world commit huge investment to infrastructural development.

Subhani, (2010) observed that consciousness of the ethical flaws of the conventional financial system has increased as a result of the global financial crisis of 2007. This, in essence makes the appeal for Islamic finance beyond the Muslim World; since many countries have realized the necessity of exploring a financial system that can hold out the unfolding circumstances. Consequently, the viability of the Islamic financial system has not only grown but has rapidly expanded. In Nigeria, the demand for more infrastructures in all sectors has been increasing speedily with the high rise in the country's population. Funding has been the key constraint to address this infrastructural challenge. Indeed, the government resources can hardly meet the increasing demand. Therefore, government has been outsourcing external liquidities in form foreign loans to set off budgetary deficits in order to address infrastructural challenges (Olaseni M.Alade, 2012).

The issuance of guidelines for the operations of *Sukuk* in the country by the relevant regulatory body (SEC) creates economic value within a *Shari'ah* compliant structure that has been successfully practiced in some jurisdictions, particularly, Asian countries and Middle-east in financing project and infrastructure development. Though the emergence of Sukuk to Nigerian Capital Market is a new development, but it provides alternative funding avenue for both State and Federal Governments to finance projects and infrastructure development for nation building.

This paper explores the role of Sukuk financing in nation building. It will be presented in five major sections starting with the conceptual overview of Sukuk financing. This will be followed by relative analysis between Conventional Bonds and Sukuk (Islamic Bonds) in the second part as well as origin and history of Sukuk issuance around the world in the third part. A historical overview of the

development of Sukuk in Nigeria will be presented in the fourth part. The fifth part is a presentation on the role of Sukuk financing in nation building within Nigerian context. Finally the paper concludes with some recommendations.

## B. TEORITICAL

### Conceptual Overview on Sukuk

Etymologically, the term Sukuk originated from the Arabic root of '*Sakk*' which connotes monetary tool or cheque, it is reported that the modern cheque originated from this Arabic term. In contemporary financial terms, Sukuk is referred to an Islamic alternative to conventional bond or a sharia-compliant financial instrument that represents proportionate beneficial possession in the specific tangible asset(s) of particular projects or business venture (IIBI, 2019).

The Sharia standard no.17(2) of AAOIFI defined the term Sukuk as “a certificates of equal value representing undivided shares in ownership of tangible assets, usufruct and services or in ownership of the asset of particular project or special investment activity. Similarly, The Islamic Financial Service Board(IFSB) in its Capital Adequacy Standard(IFSB 2) defined *Sukuk* as “certificate that represents the holders proportionate ownership in an undivided part of underlying asset where the holder assumes all right and obligations to such asset”.

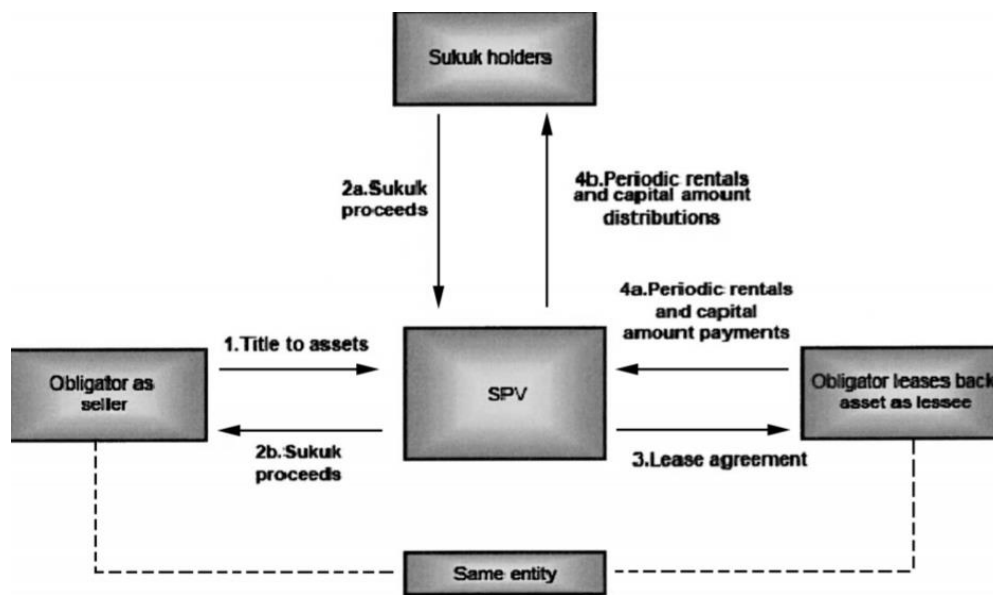
In Nigerian context, the Securities and Exchange Commission of Nigeria (2013), defined *Sukuk* as: “Investment certificates or notes of equal value which evidences undivided interest/ownership of tangible assets, usufructs and services or investment in the assets of particular projects or special investment activity using Sharia principles and concepts as approved by the SEC”.

According to (Ayub M, 2007), there are three (3) major parties concerned in any *sukuk* structure, namely: originator, investors and issuer. The originator is the government in case of sovereign Sukuk or corporate entity in case of cooperate sukuk that is set to gain from the issuance of *sukuk*, while the investors are certificate holders, the issuer (SPV) is an independent legal entity that administers the pool of assets related to the sukuk and acts as an intermediary between originator and investors.

However, there are 14 different modes of *Sukuk* that did not contradict Shariah rules as recognized by AAOIFI. This include; *Salam Sukuk* (a kind of

forward contract on sale of a particular commodity), *Ijara Sukuk* (a lease contract), *Istisna'a Sukuk* (use for project finance and in manufacturing), Hybrid *Sukuk* (comprising *Istisna'a*, *Murabaha*, and *Ijarah* pooled together), as well as *Mudarabah* (a profit sharing contract between parties to a transaction) and *Musharakah Sukuk* (a partnership not much different from *Musharakah*). It noteworthy that despite the variety of *Sukuk* models, the most commonly issued model around the world is *Ijara Sukuk* model for both governments and corporate entities, due to its straightforwardness and support of Sharia scholars, in addition to its resemblance with lease financing in conventional economic system (Afshar, 2013).

Figure I: *Ijara Sukuk* Structure



Sources: Adopted from Afshar, (2013).

### Conventional Bonds and Sukuk

According to (Afshar, 2013), bonds are long-term debt mechanisms that are issued by corporate entities and/or governments, which generate face value and coupon (interest) for investors until maturity of the bond. This interest-bearing debt

instrument is impermissible in Islam as it involves trading in debt that is characterized with the major elements of prohibition in Islamic financial principles, such as *Riba* and *Gharar* (Salisu, 2015).

Conversely, *Sukuk* are considered as alternative to conventional bonds, but the two instruments are significantly different from one another. Thus, the term ‘Islamic bond’ is used as a synonymously with *Sukuk* due to some similarities in payments, nevertheless, the most distinctive feature of *sukuk* is their compliance with Sharia and being asset-based (Shafiu, 2014). Moreover, returns to investors under *sukuk* represent entitlement of investment turnover from a trade transaction or possession of an identified asset or venture, but in case of bonds, the returns are typically fixed interest rate (Oladele, 2014).

According to (Wilson, 2004) all *Sukuk* structures have common features which include: clarity of rights and obligations; utilizations of funds judiciously for what it was meant for and backing securities by real underlying assets, rather than security paper. However, the backed asset for any *Sukuk* structure must itself be in conformity with Islamic ethical consideration. For instance, a building structure is not eligible as a backing asset for issuance of any type of *Sukuk* if the major occupant is a commercial sex worker (Oladele, 2014).

### **Origin and History of Sukuk Issuance around the World**

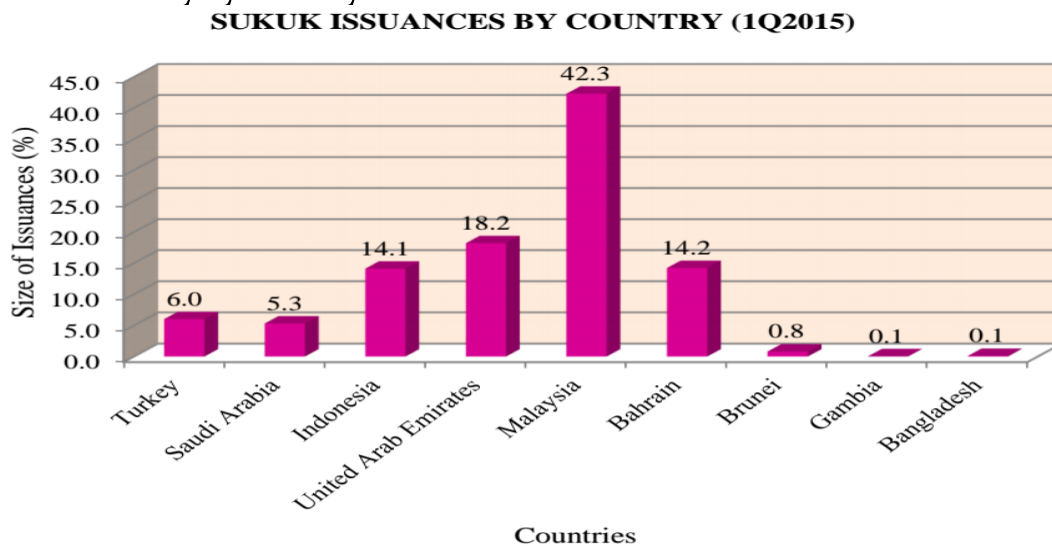
The beginning of *Sukuk* dated back to the early history of Islam when papers were issued to represent financial liabilities of trade and other commercial activities (ISRA, 2014) It was reported that during the Umayyad Caliphate, precisely under Caliphateship of *Marwan bn al-Hakam*, commodity coupons known as *sukuk al-badai* were issued to soldiers who then sold these *sukuk* before its maturity to obtain cash. Zayd bin Thabit and one of the Companions of Prophet (SAW) went to Marwan and said, “Marwan! Do you make usury *halal*(permissible)?” He said: “I seek refuge with Allah! What is that?” He said, “These receipts (*Sukuk*) which people buy and sell before they take delivery of the goods.” Marwan therefore sent a guard to follow them and to take them from people’s hand and return to their owners.”(Al-Muwatta).

The *OIC Fiqh* Academy legitimized the concept of *Sukuk* in February, 1988. Consequently, a non-Islamic company, Shell MDS issued the maiden *Sukuk* in

Malaysia in 1990, with a modest size of RM 125 million (about US\$30 million) in accordance with the structure of *Bai' BithamanAjil* (deferred payment sale). But since then there was no issuance by other market players or countries until when the sukuk market took international dimension in September 2001 the first international sovereign Sukuk of a US\$ 100 million were issued by the Government of Bahrain. It was also the first *Ijarah sovereign Sukuk* with a 5 year maturity period and fixed rental rate of 5.25%.

The global *Sukuk* market witnesses concrete growth, the annual *Sukuk* issuance almost increased from total global *Sukuk* issuance of just over US\$ 1 billion towards the end of 2001 to US\$ 118.8 billion in 2014. The flag bearers of the market were the United Arab Emirates, Malaysia and Saudi Arabian, as well as emerging front line such as Turkey, and Indonesia. In recent times, many non-Muslim Majority countries joined the *Sukuk* market. Therefore, the market recorded tremendous growth in the UK, Senegal, Hong Kong, South Africa, Luxembourg states, hence, the *Sukuk* market remains a feasible as well as competitive source of liquidity around the world (MWIFM, 2015).(Bank Negara Malaysia, 2015)

**Figure 2: Country by Country Sukuk Issuances Size**



**Sources:** 2015 IQ, Global Sukuk Report

## C. METHODOLOGY

### The Sukuk Market in Nigeria

The introduction of Islamic capital market has been a relatively recent development in Nigeria in comparison with the more established conventional products. The legal backing for the issuance of *Sukuk* in Nigeria was firstly enshrined in the Investments and Securities Act, 2007. Subsequently in February, 2013, SEC introduced new rules for the regulation of Sukuk issuance in the country. This development paved way for the first *Sukuk* in Nigeria in October, 2013, which was initiated by the Osun State Government to fund the educational infrastructure in the State. It was issued with the value worth N11.4 billion naira (approximately US\$73 million), at a rate of 14.75% per annum at N 1,000 per unit and matures on 8th of October, 2020 (Oladele, 2014). This millstone achievement is regarded as a turning point in the history of *Sukuk* issuance in Nigeria, as such; Osun State Government is seen as trailblazer in this regard (Lotus Capital, 2014).

However, at Federal Government level, the first Sukuk bond issuance was the Federal Government of Nigeria (FGN) N100.0 Billion *Ijarah Sukuk*, which was issued in 2017 with a tenor of seven (7) years and a Rental Income rate of 16.47% per annum, which will be paid every six months. The proceeds were used to construct and rehabilitate major economic roads in the country, selected by Ministry of Power, Works and Housing; with the aim of promoting financial inclusion and deepening the investor base for FGN securities (Debt Management Office [DMO], 2017)

According to the CBN Half Year Activity Report, 2019: “The total FGN Sukuk Bonds outstanding at end-June 2019 stood at ₦200.00 billion, the two issues of the 7-year Sukuk of ₦100.00 billion each attracted rental rates of 16.47 and 15.74 per cent, respectively, payable semi-annually. The proceeds were specifically aimed at the rehabilitation of major economic roads across the country (*CBN Half Year Activity Report*, 2019).

Table I: FGN First and Second Sukuk Issuances

TABLE 5.13							
FGN Green Bond Profile as at June 30, 2019							
Auction ID	Bond Tranche	New Nomenclature	Rental Rate	Issue Date	Issue Amount (₦)	Redemption Date	Coupon Payment Dates
NGGB0005Y00001	1ST FGN GREEN BOND 2022 SERIES 1	13.4800% FGN GREEN BOND DEC 2022	13.4800%	22/12/2017	10,690,000,000.00	22/12/2022	22 JUNE & 22 DEC
NGGB0007Y00008	2ND FGN GREEN BOND 2026 SERIES 1	14.5000% FGN GREEN BOND JUNE 2026	14.50%	13/06/2019	15,000,000,000.00	6/13/2026	13 DEC & 13 JUNE
	TOTAL				25,690,000,000.00		

Sources: CBN Half Year Activity Report, 2019

### Sukuk Financing and Nation Building in Nigerian Context

According to (Gambari I. A, 2007), nation-building is about building a common sense of purpose, a sense of shared destiny, a collective imagination of belonging. Thus, nation-building is all about building the tangible and intangible threads that hold a political entity together and gives it a sense of purpose.

From the forgoing, nation building is more than the development of behaviors, values, and lingua franca. It also extends to building the physical structures by exemplary people, sustained by governmental and non-governmental institutions that advocate for socio-economic development and good governance in the country.

On the other hand, the introduction of *Sukuk* financing into Nigerian capital market has definitely brought about a reliable and cheaper alternative source of fund that will accelerate economic growth and nation building via the following channels:

## D. RESULT AND DISCUSSION

### Avenue for Infrastructural Development

Infrastructure development has been identified as one of the great economic benefits of *ṣukūk* in the issuing countries. In Muslim-majority countries such as United Arab Emirates, Malaysia and Qatar, *Sukuk* instruments were used for mega-projects such as construction of airports in Bahrain & Malaysia; and the construction of Hamad Medical Centre (HMC) in Qatar among others (Hasan, Kayed & Oseni,



2014).

In Nigeria, besides the Osun state *ṣukūk* that has remained a reference point of *ṣukūk* issuance in the country, the first and second FGN *Sukuk* that were meant to cover financing deficit of infrastructural development and embark on constructing and rehabilitating 25 major economic roads across the country have impacted enormously in filling the infrastructure deficit gap for nation building in the country. This is no doubt a clear testimony for the potentials of using *sukuk* as a tool for capital rising and infrastructural development for nation building in Nigeria. Therefore, the adoption of *ṣukūk* by the Nigerian government has created a great opportunity in covering infrastructural deficit in the country.

### **Development of Real Sector of the Economy**

The role of Islamic Finance in promoting real economic activities would not be over emphasized; since it has in-built principles that support financial stability, inclusiveness and economic development. According to (Bank Negara Malaysia, 2015), there are several key principles of Islamic finance which help to promote real economic development. These include among others the deploying of finance in service of the real economy, greater emphasis on profit and loss sharing, facilitate redistribution of wealth and opportunity and utilize risk-sharing modes of financing. Thus, even during the global financial crisis and its aftermath, Islamic financial institutions were less affected, protected by their fundamental operating principles of risk sharing and the avoidance of leverage and speculative financial products.

In Nigeria, considering the huge success recorded in the Osun state *ṣukūk* as well as the first and second FGN *Sukuk*, particularly the construction and rehabilitation of 25 federal roads across the six geo-political zones, it enormous that the *sukuk* issuance has a great impact on the real economy of Nigeria. This in essence, has transformed the Nigerian economy into a more diversified and private sector driven economy by creating a platform for the global financial capital market in supporting initiatives by Nigerian Government in its bid for nation building and sustainable development (FMW, 2018).

### **Financial Inclusion and Economic Diversification**

The issuance of *ṣukūk* in any given economy opens a wide door for economic diversification and many other opportunities for the real sector's development such as agriculture, mining, industries among others. This will no doubt help in diversifying the revenue base of the federal government from ethical sources which will further accelerate development of the country. Therefore, this development shall yield at numerous benefits for the economy, such as infrastructural development, job creation and poverty alleviation among others.

On the other hand, *Sukuk* issuance in Nigeria has alleviated the age-long financial exclusion as a result of religious justifications particularly among Nigerian Muslims rich men that cannot invest in interest based financial instruments. Meanwhile, with the beginning of the *Sukuk* financing, the federal and state governments will be able to access such ethically based funds and use them to fill infrastructural deficit.

Consequently, the invention of new products into the financial system will motivate diversification and provide investors with alternative investment options particularly ethical investors within and outside the country. According to (Chaudhry, 1999), Islam considers interest as the most exploitive institution for humanity and has abolished its roots in its every form and manifestation. Thus, many investors who were not participating in equities and other securities as a result of Sharia non-compliance found *Sukuk* market as a fertile ground for investment; by so doing they improve real economy and strengthen financial inclusion for nation building and sustainable development in the country.

### **Mechanism for Reduction of Overreliance on Foreign Debts**

Foreign debt is that portion of a country's debt that is acquired from foreign sources such as foreign corporations, government or financial institutions. It is that part of the total debt of a country that is owed to creditors outside the country. According to Edo, (2002) Nigeria is a highly indebted country; these debts majorly foreign has severe and adverse effects on investment and the economy at large. He also observed that fiscal expenditure, balance of payments and global interest rate are the crucial factors in explaining the accumulation of external debt in the country. The situation stimulated economic crisis in the country.

The issuance of the first and second FGN *Sukuk* for the construction and rehabilitation of 25 federal roads across the six geo-political zones has created alternative avenues for financing government projects without resorting to foreign debts, which enormously has great negative impact on the real economy of Nigeria. According to (Olaseni M.Alade, 2012), *Sukuk* plays an important role in financing the economy accounting for more than half of the country's total debt, both in terms of balance outstanding and issuance.

### **Mechanism for Liquidity Control**

(Gambari I. A, 2007) opined that *Sukuk* are liquidity management apparatus for Islamic financial institution. The Government or financial institutions can buy *Sukuk* if they want to reduce the excess liquidity at their disposal and they can also sell *Sukuk* in the secondary market if they want to have or increase their liquidity base. In other words, *Sukuk* increases the liquidity of the originator and provides an avenue for investors who wish to diversify their investment portfolios seeking exposure in a different asset class, to achieve portfolio diversification. Similarly, (Ogunbado, 2019) observed that another benefit of *sukuk* is the possibility of turning assets into securities, thus helping to the development of capital market.

In Nigeria, since the introduction of Islamic banking, the major challenge of the industry in the words of (Olayemi, 2015) was lack of a viable Shari'a compliant instrument for liquidity management, but with the issuance of the Osun state *şukūk* as well as the first and second FGN *Sukuk* this challenge was relatively addressed. Since then, the Nigerian *Sukuk* market has been providing the Nigerian Non interest financial institutions with the needed liquidity structure that will serve as a channel through which non-interest financial institutions can invest their money with the aim of generating positive returns that are Shariah-compliant for both short and longer terms. This development has positively transformed the real sector of the Nigerian economy (Tariq, 2004).

### **E. CONCLUSION**

No doubt, among the Islamic Financial Instruments (IFIs), *şukūk* has remained the highest instrument of funds mobilization for investment and real sector

development. Apart from funding infrastructure, sukuk market provides the much needed instruments for liquidity management for the financial institutions. The institutions can buy sukuk if they want to dispose excess liquidity and sell sukuk if they are in need of cash.

In Nigeria, considering the huge success recorded in the Osun state *ṣukūk* as well as the first and second FGN *Sukuk*, particularly the construction and rehabilitation of 25 federal roads across the six geo-political zones, it enormous that the *sukuk* issuance has a great impact on infrastructure development in the country. Many projects that are affected with Sukuk financing were ongoing projects, some lasted for more than a decade, but with the recent development in Sukuk financing the roads are close to completion. It is interesting to note that many local beneficiaries of *Sukuk* financed projects don't have awareness on Sukuk as an alternative mode of project financing; rather it is mostly misunderstood as a construction company that is committed to complete abandoned projects.

Hence, Nigeria will continue to reap from the benefits of Sukuk issuance taking into cognizance its potentialities in terms of economic diversification, financial inclusion and infrastructural development among others as well a large Muslim population who would like to invest their money in an interest free sharia compliant product.

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