Islamic Peer-to-peer (P2P) Financing as an alternate Model of MSME financing in Nigeria

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Abstract. In emerging economies, including Nigeria, the Nano, Micro, Medium & Small enterprises ("NMSME") sector are essential actors for socio-economic development. In recent times, the increasing convergence of technology and financial services (FinTech) has transformed financial service delivery and engendered cheap, sustainable and innovative alternative mechanisms of funding for NNMSMEs, prime among of which is the Peer-to-peer (P2P) financing. This study examines the plausibility of Islamic P2P Financing model as a viable option for NMSME funding in Nigeria. The study will utilize both primary and secondary data sourced from official publications, surveys, articles, interviews, working papers, websites, e-books, and online resources to drive its goals. The study finds out that evolution of digital economy, vibrant and demand driven NMSME ecosystem, the growth of Islamic finance industry, and importantly, an evolving regulatory regime, among others, are factors that are driving Islamic P2P Financing model in Nigeria. The study recommends that for Islamic P2P financing to be effectively leveraged to fund the NNMSMEs in Nigeria, the numerous stakeholders must synergize to utilize the opportunities presented by the model. It further recommends the requisite policy advocacy and development of Shari'ah compliance framework by the regulators and appropriate authorities towards assuring investors and practitioners of the integrity of the model.

Keywords: Islamic Peer-to-Peer (P2P) financing, Fintech, Nano Micro Small and Medium Enterprises (NMSME) funding, Nigeria

1 Introduction

The recent technological advancement enables individuals to interact without physical presence, it may thus be said that financial technology (also known as FinTech) is one of the consequences of such development. FinTech provides a platform for the seamless operationalization of a peer-to-peer (P2P) Financing. A definition of FinTech was offered by Chuen, D. L. K., & Teo, (2015) to be the revolution in the medium of providing financial products and services, through the mobile phones, portable devices and the internet, to meet emerging consumer expectations. Irano, (2016) attempted to refine the definition of FinTech. He thus described it as the alliance between technology sectors and financial services in such a way that is focused providing financial products and services for start-ups, Nano, micro, small and medium-sized enterprises (NMSMEs). These products and services were hitherto traditionally provided by conventional financial service industry.

In the global south, large number of NMSMEs have had to employ the aid of financing platforms to garner funds to start and nurture their businesses. These platforms are reputed for providing swift and seamless access to financing compared to the traditional conventional financing option. In these climes, there are a number of Islamic financing platforms that had effectively assisted enterprises seeking to fund their businesses. In recent times however, this fund raising modality had been extended to some societies in the global north; a case in point is the establishment of 'Qardus' in the United Kingdom. It is worth noting that the United Kingdom experience occurred about 5 years sequel to the launch of Asia's first Islamic P2P financing platform for NMSMEs; Kapital Boost (CIBAFI, 2020). Ethiscrowd is another Islamic P2P financing platform that enabled Indonesian families to own reasonably priced homes. In 2016, an Islamic Fintech Alliance was formed by eight Islamic crowdfunding platforms. These platforms are; Ethiscrowd, Funding lab, Kapital Boost, Easi up, Blossom Finance, Launchgood, Skola fund and Narwi. The key objective of the alliance was to promote Islamic fintech standards, enhance trust, and broaden its social impact and access by securing support from different stakeholders, including the regulators (Ashfaq & Zada, 2021). This support from the numerous stakeholders became more important in the post COVID era, which had left businesses negatively impacted in developing climes such as Nigeria, India, Indonesia, Malaysia, among others (Remmiya Rajan & Dinesh, 2023). The ability of businesses to cope with the headwinds from incidences depends on the capacity of the entrepreneur, aside the support and aid from authorities to assist them sustain their businesses (Dhanalakshmi & Jwalapuram, 2023)

The Nano, Micro, Medium & Small enterprises ("NMSME") in Nigeria create the most jobs, which makes it an active supportive sector for the promoting the generation of wealth and entrepreneurial innovation (Soreh, 2017). According to the SMEDAN/NBS, (2021), NMSMEs account for majority of new jobs created in Nigeria which is reckoned to be about 58 million jobs. The report noted that the drive for increased entrepreneurship activities by Nigerian youths was aided by factors such as high level of unemployment, increase in demand for locally made products spurred by the recent economic recession, and the sustained drive by the federal government of Nigeria to diversify the country's heavy reliance on oil export as the mainstay of the economy. The SMEDAN classified the enterprises based on their assets and employee strength as follows:

Table 1: Re-hatched SMEDAN/NBS 2021 report classification of NMSMEs in Nigeria

S/N	Classification	Asset	Workforce
1.	Nano/Homestead Enterprises	Less than 3 million	1-2 persons
2.	Micro Enterprise	3<25 Million	3-9 persons
3.	Small Enterprises	25< 100 Million	10-49 persons
4.	Medium Enterprise	100 Million	50-199 persons

Although, proponents of Islamic crowdfunding had documented several value propositions of Islamic P2P financing in financing projects and NMSMEs in developing country, but till date, there has not been much attention on the efficacy of Islamic financing in addressing NMSMEs funding issues in Nigeria. Dai & others, (2020) has highlighted the benefits of Islamic P2P financing avenues and financial technology (fintech) platforms in ameliorating the financing gap in the NMSME subsector of the economy. These benefits may be relevant for addressing NMSME funding issue in Nigeria. Nigeria has a demography that tilts to the young. That is, more than half of its population below 45 years old, and this demography makes a low-cost NMSME financing an economic imperative (Reed & Mberu, 2014).

This study is divided into four sections. The first section introduces the discussion on P2P financing in Nigeria. The second section of the paper aggregates and analysis the literature on the subject. The third section discusses the finding of the study, while the fourth and final section concludes the study and proffer recommendations.

2. Literature Review

FinTech provide a veritable fundraising platform for innovative business ideas of the nano, micro, small and medium-scale enterprises (NMSMEs) through leveraging the internet space, where funds can be raised from a crowd of investors. P2P financing, aided by the platforms within the internet space is a novel financing option for start-ups and innovation driven enterprises (IDEs). The reward and returns for these ventures are usually negotiated and agreed upon (Md Husin & Haron, 2020). P2P financing platforms enable fund seekers to appeal for funds directly from would-be investors virtually. They secure the required funds in a cheap way, devoid of formalities and costs associated with processing similar requests from the conventional financial institutions and finance houses (Gerber et al., 2012).

Nguyen et al., (2020) outlined about six business models of FinTech which include peer-to-peer (P2P) lending, wealth management, insurance services, payment online system, crowdfunding, and capital market. According to Langley, (2016) P2P funding is subset of crowdfunding initiative, which is a digital economy model through which funds are provided by large numbers of individuals (*the crowd*). These funds are thereafter aggregated and disbursed via online medium to a range of applicants, entrepreneurs, small and medium institutions. B. K. Adhikary et al., (2013) had categorized crowdfunding into two distinct classes; financial return-based crowdfunding and community-based. The later consist of donation-based and reward-based crowdfunding, while the former consist of peer-to-peer (P2P) lending crowdfunding, equity-based crowdfunding, and royalty-based crowdfunding. On the other hand, (Azganin et al., 2021) outlined six form of crowdfunding, as articulated by (European Commission, 2015) to include; Donation-based or charity crowdfunding, Reward-based crowdfunding, Peer to Peer (P2P) financing, Profit/revenue sharing, Debt-securities crowdfunding, and Hybrid model crowdfunding. It has been posited that the P2P crowdfunding models focuses on lending and borrowing, and the equity-based crowdfunding model focuses on investment. It is further observed that these two models attract adequate regulation by the authorities, as against the reward-based and donation-based crowdfunding models which focuses on charity causes and relief services, that have remain unregulated even in the UK and US (Zhao et al., 2019).

Kazaure et al., (2021) has identified several financing models that were introduced in Nigeria to enhance the development of the NMSME sub sector without reducing the extensive finance gap in the sector; this include low interest finance (debt) model like the Central Bank of Nigeria N220Billion MSME development fund, matching fund model (equity/debt) like the Bank of Industry cottage industry matching and the Central Bank of Nigeria Small and Medium Enterprises Equity Investment Scheme (SMEEIS). All these has contributed little towards improving the finance gap because of high administrative/ transaction costs of lending or investing small amount, insufficient assets and low capitalization and information asymmetry (K. Ogujiuba et al., 2013; K. K. Ogujiuba et al., 2004).

Augustine, (2019) states that the challenges NMSMEs face in funding start-up businesses provides basis for a viable alternative to the conventional arrangement, which is seen in the P2P financing option. Brown et al., (2016) surmised that aside raising capital, other merits of P2P financing and crowdfunding include authentication of business idea and products. It also creates a sales conduit for the financed products to stakeholders and backers. When contrasted with the traditional conventional source of finance, P2P financing processes are seamless and are equally less shackled with regulations and bottlenecks constituted by legislations (E. Gerber & Hui, 2013)

Md Husin & Haron, (2020) opined that as NMSMEs constantly face lack of effective access to financing which stunts their business growth and limit their potentials to upscale their capacities. It is believed that the emerging crowdfunding model may help resolve this challenge while at the same time enhance NMSMEs' financial sustainability. Nordin et al., (2017) argued that the alternative means of enabling the NMSMEs achieving the fruition of their creative ideas is by tapping into the P2P financing option. A UNDP, 2019 report also indicated that P2P financing and crowdfunding platforms positively impacts the growth and development of NMSMEs, it highlighted that 70 per cent of borrowers have observed a substantial increase in their turnover, while 63 per cent have recognized a substantial benefit (UNDP, 2019). More so, Huang et al., (2018) stated that crowdfunding platforms can play a key role in funding NMSMEs. Further, Hendratmi et al., (2020) study depicts how Islamic P2P financing supports the development of Start-ups in Indonesia, while Mustafida et al., (2021) observed that the conventional financial institutions are unable to provide the requisite financial support to enable small businesses achieve their dreams due to their heavily regulated and inflexible processes. Moreover, the Islamic financing models by nature are inherently structured to support the nurturing and development of innovative start up enterprises better than the facility that may be provided by the conventional financial institutions.

3. Discussions and Findings

3.1. Potential of Islamic P2P Financing in Nigeria.

Islamic P2P financing had recorded successes around the globe, especially in countries like Malaysia, Indonesia, United Kingdom, the Kingdom of Saudi Arabia and United Arab Emirate (Azganin et al., 2021). Some of these jurisdictions share similar features with Nigeria, that portends the great potentials for the success of Islamic financing in Nigeria. Some of these potentials include:

3.1.1. Development of Nigerian Islamic finance industry.

The development of the Islamic Finance ecosystem in Nigeria started with the licensing of the first non-interest bank window in 1992. The licensing did not come as a surprise due to the consistent yearnings and aspirations of the Nigerian Muslims who make over 55% of the country's population (Lawal, 1995). Since then, there have been rapid progress in the Islamic banking sub-sector. This has given birth to three fully fledged non-interest (Islamic) banks, two non interest windows of conventional banks and three fully fledged non-interest (Islamic) microfinance banks (CBN, 2020). These sporadic progress led to complementary growth in the other sub-sectors of Islamic finance in Nigeria. These include but not limited to the National Pension Commissions' (PenCom) regulation on Investment of Pension Fund Assets in sukuk; Non-Interest Deposit Insurance Scheme (NIDIS) developed by the Nigeria Deposit Insurance Corporation (NDIC) (Hamisu, 2018); National Insurance Commissions' (NAICOM) guidelines for takaful operators and had thus far licensed four full-fledged Takaful operators (National Insurance Commission, 2020); the Securities and Exchange Commissions' (SEC) Non-Interest Capital Market Master Shari'ah-compliant Mutual Fund, NSE Shari'ah-compliant equities Index, rules and guidelines on Sukuk issuance, amendment of Nigeria Exchange Group (NGX) rules to accommodate the listing of sukuk in the NGX (Securities and Exchange Commission, 2013), successful issuance of several sovereign and corporate Sukuks (Debt Management Office, 2018). This interplay by various players in the Islamic finance eco system in Nigeria has brought to lime light the viability of Islamic finance offerings in Nigeria. The speed at which the Islamic finance industry is growing in Nigeria is unprecedented. This outlook on the level of awareness and progress made so far provides a veritable foundation for the springing Islamic P2P platforms.

3.1.2. Nigeria Digital Economy

The onset of globalization and internet of things have brought about the increasing interplay between technology and finance, hence growing popularity of FinTech (Md Husin & Haron, 2020) In 2021 Nigeria had 104.4 million internet users, which increased by 19 million (+22%) between 2020 and 2021 (DataReportal, 2022). Internet penetration stood at 50.0% in January 2021. In the current period, there were almost 187.9 million mobile internet users as at January 2021 and mobile phone internet usage is mostly popular. Nigeria was reported to top the list of African countries based on the volume of mobile device usage (Umeh, 2022). Nigeria has also in recent time has been promoting digital economy and putting in place required infrastructure and policy for same (National Policy on 5G for Nigeria's Digital Economy, 2021). This includes the recent licensing of generation 5 (5G) telecommunication services (Hassan-Wuyo, 2022). These developments have given impetus to the widespread adoption of financial technology (FinTech). FinTech apparently is the bedrock for P2P Financing. The financial regulators reckon with this reality and acted in this light. The CBN licensed FinTech firms to operate in the financial sector (Aroh, 2021), while the SEC issued guidelines on the operations of crowdfunding, crypto-currencies and other FinTech instruments (Rules on Crowdfunding, 2021). These developments naturally set the stage for the emergence of Islamic peer-to-peer (P2P) financing in furtherance of the country's digital economy aspirations.

3.1.3. Vibrant MSME Ecosystem

Nano, Micro, Small and Medium Enterprises (NMSMEs) have been a source of employment and livelihood to people across the globe, and have consistently attracted the interest of researchers, overtime due to the importance of the sector in providing jobs, developing entrepreneurships while mopping up unemployment occasioned by shrinking government involvement in businesses (Choudhury & Goswami, 2019). Nigeria is not an exception where the sector has consistently provided employment to over 90% of Nigerian workforce. To give the MSME sector the desired attention required, the Federal Government of Nigeria created the Small and Medium Scale Enterprises Development Agency of Nigeria (SMEDAN) in 2003 to encourage citizens in creating small businesses, and to facilitate the promotion and development of enterprises. The number of NMSMEs in Nigeria as at 2021 stood at 41,543,028. (SMEDAN/NBS, 2021). Nigeria has a huge MSME sector with huge potentials that is yet to be realized and developed, majorly due to challenges associated with access to finance (SMEDAN/NBS, 2021). These NMSMEs are concentrated mostly in the cities of Lagos and Kano, among other cities like Port Harcourt, Aba and Ibadan, etc (SMEDAN/NBS, 2021). In Nigeria, because of the vibrant nature of the MSME ecosystem, even before the advent of crowdfunding rules, crowdfunding activities started brewing in different cities to bridge the financing gap of NMSMEs. It became more pronounced in the commercial center of the country Lagos between 2016-2020 (Aderemi & Muhammad Shahrul Ifwat Ishak., 2020). The eco-system witnessed the evolution of various investment based crowdfunding platforms like Thrive Agric, reQuid, Agropartnerships and Farmcrowdy that give the best return on investment at the time, ranging from 15%, 20% and up to 50% (Tan & Reddy, 2020). These entities operated several business models of mostly sponsoring real farmers and supporting them with extension farming services to support high yield production, but reQuid went far and beyond by aggregating other platforms like Farmsponsor and allow investors to trade (buy and sell) units in farms operated by partner platforms (Ajifowoke, 2022). Nigeria has a huge and vibrant MSME sector with huge potentials that is yet to be realized and developed, majorly due to challenges associated with access to finance outside of the conventional sources, which seem to be beyond the reach of the NMSMEs.

3.1.4. Demand Driven population

The demand drive for an Islamic P2P financing in Nigeria stems from three key elements; huge youth population, urban domiciliation of most NMSMEs and the Muslim majority factors. Nigeria is one of the fastest growing countries in the world with a population growth of about 2.64% of the total world population according to National Population Commission as at 2022 (National Population Commission, 2022).

Considering the religion factor, Islam is widely practiced in the North and the South west, while traditional religions and Christianity in the remaining southern regions. By the 2019 NBS report, the northern part of Nigeria has the most population, and by implication, the most affected by the lack of financial access and unemployment (National Bureau of Statistics, 2020). Researches have shown that the compatriots of the southwest and northern regions[1] of the country are known to be of Muslim majority (O. A. Lawal, 1995) and had consistently demonstrated willingness to adopt Islamic financial services in their daily commercial endeavours (Ringim, 2014). Although Lagos of the south-western states, had maintained some sort of neutrality due to its cosmopolitan nature[2] (Garba, 2020). Notwithstanding, in recent times, the quest for Islamic financial services in Lagos is getting more prominent (Adunola, 2022).

According to Simon Kemp, (2021) 52.3% of the population in Nigeria lives in urban centres while 47.7% lives in rural areas. Nigeria has a demography that tilts to the young. That is, more than half of its population below 45 years old, and this demography makes a low-cost MSME financing an economic imperative (Reed & Mberu, 2014).In 2021 Nigeria had 104.4 million internet users and the number of internet users in Nigeria increased by 19 million (+22%) between 2020 and 2021 (DataReportal, 2022). Internet penetration stood at 50.0% in January 2021. In the current period, there were almost 187.9 million mobile internet users as at January 2021 and mobile phone internet usage is mostly popular. Nigeria tops the list African countries in terms of the volume of mobile devise usage (Umeh, 2022). The

[1] That is, Northwest, Northeast and North central.

[2] The case of Muslim Bank West Africa Limited of 1957 testifies to the fact that the south westerners yearn for a commercial way of life that aligns with their faith. However, the political and administrative class in the south west is predominantly Christian. They thus often undermine the popular demand.

accumulation of these factors set the stage for the appropriate stakeholders to consider Islamic P2P financing as a veritable alternative to the conventional options.

3.1.5. Legal Framework for Crowdfunding

In Nigeria, the greatest change in crowdfunding industry that brings out its potentials to the fore is the development of crowdfunding Rules and Regulations by the Security and Exchange Commission (SEC) on 21st January, 2021 after an exposure draft that was released in May 2020. SEC is empowered by Investment and Securities Act ("ISA") 2007 to regulate on securities in Nigeria by developing rules and regulations that will guide and protect investors in the capital market. (Rules on Crowdfunding, 2021).

Before the coming into force of the rule SEC had to suspended all crowdfunding activities because of operating against the Companies and Allied Matters Act (CAMA) 1990 and Investment and Securities Act 2007 which did not allow private companies to raise money from the public. Other crowdfunding platforms that operate are mostly donation, charity and reward based but not for investment. This include NaijaFund, which link subscribers with friends family to raise donation funds for a commission ; Fund An Enterprise fundraising activities in the form of endowments to support NMSMEs; Indiegogo operates on a reward grounded scheme, whereby the investors or the clients willing to donate, give money and receive a gift rather than investment; Kickstarter help creative artist like musicians, writers, artists, and designers to raise funds online (Ajifowoke, 2022). Even though SEC has set of new rules regulate the industry from fraudsters and scammers, but this set of rules doesn't cover the operations of charity or donation based platforms. The only platforms that are regulated by SEC are those that raise money from the public for investment purpose

The SEC on 21 January 2021 issued a new rule to regulate the activities of crowdfunding, this is to curtail the activities of private companies that engage in crowdfunding without approval from the commission. The key provisions of the SEC Rules 2021 cover subjects such as Eligibility, exemptions, key participants, due diligence, data protection and privacy, operation of trust account, among others (Rules on Crowdfunding, 2021).

The SEC has issued capital market operating licences to, and have provided necessary regulatory support to entities which have been known to provide Islamic asset management services. These entities include; Lotus Capital, Marble Capital, Buraq Capital, One17 Capital and TrustBanc Arthur which are specifically known to be Islamic finance capital market players, other conventional capital market players still operate one or more Islamic capital market or asset management products[3]. These conventional entities include FBN Quest, Stanbic Asset Management, Apel Capital,

[3] This information was extracted from a Technical Committee member of Non-Interest Financial Association of Nigeria (NIFIAN), a recently formed umbrella body for Islamic Financial Institutions in Nigeria.

United Capital, Chapel Hill & Denham, Capital Trust Asset Management, Norrenberger, Cardinalstone Asset Management, among others[4]. It may thus be safe to say that the SEC guidelines on crowdfunding and the ready market players apparently provide required groundwork for a robust Islamic P2P financing.

4.0 Conclusion and Recommendations

FinTech has proven to be a game changer in modern financial intermediation. This is true for NMSMEs in particular, who are faced with hurdles in assessing funding from the conventional financial institutions for their business expansion. Just as this is the case around the globe, it is the same in Nigeria. Added to this is the recent consciousness about, and interest in Islamic financial offerings by individuals and businesses in Nigeria, a country of over 200 million populations with about 55% Muslim compatriots. Incidentally, the cluster of NMSMEs is thicker in the north and south western regions of the country, which regions account for the Muslim majority population. Aside these, other factors that engender potentials for Islamic P2P financing in Nigeria include internet penetration, tech savvy youth population within the urban areas, competitive returns on investment, and an evolving robust regulatory framework from a supportive regulator.

Flowing from the study, it is thus recommended that the private sector players, the MSME associations, business development service providers and Fintech experts should leverage on the recognized opportunities to cooperate on exploring the Islamic P2P financing to bridging the financing needs for NMSMEs. The policy makers are urged to facilitate policy advocacy that will see adequate awareness about the potentials of Islamic P2P financing being created. On the regulatory side, the Shari'ah compliance framework that will drive the sustenance and integrity of the endeavor needs to be evolved.

This paper is limited to focusing on the Islamic P2P financing as an alternative funding means for NMSMEs within the Nigerian environment, which is essentially regulated by the Securities and Exchange Commission (SEC) of Nigeria. Other related avenues that can be explored by future studies include the possibilities of Islamic P2P financing in the larger sub-Saharan Africa and other Muslim majority societies around the globe.

4 Ibid.

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