Acceptance of Interest-Free Banking among Small and Medium Enterprises: A Structural Equation Model

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ABSTRACT

Interest-free banking in Nigeria is evolving, which is supposed to be solid and ready to compete with conventional commercial banks that have dominated the market for more than a century. SMEs had difficulty in getting the funding they required to grow. The study examines the determinants of SMEs' acceptance of interest-free banking in Nigeria. The study used purposive sampling and adapted a questionnaire to collect data from a sample of 323 SMEs registered with the Small and Medium Enterprise Development Agency of Nigeria (SMEDAN). A structural equation modelling via analysis of moment structures (SEM-AMOS) was used for data analysis and hypotheses testing. The study found a significant positive relationship between SME owners' religion, financing opportunities and acceptance of interest-free banking. The study also finds a positive but insignificant effect of a service cost on the acceptance of interest-free banking. Knowing the drivers of SMEs' acceptance of interest-free banking could guide banks' marketing strategies to compete with other types of banks in the industry. The study recommends that interest-free banks ensure the provision of products and services that comply with the religion of their existing and potential customers.

Keywords: Financing opportunities, interest-free banking, religion, service cost

1.0   INTRODUCTION

Small and medium enterprises (SMEs) are essential to all global economies. They support the overall economic operations of a country, earn income, and create millions of employment opportunities. However, the small business sector faces significant risks (Salleh et al., 2021), including the risk of not having sufficient capital to expand and survive, the risk of having their products, ideas or services copied by more giant, more established corporations, and the risk of lagging in technological advancement. Small businesses fall behind as they need more capital and technology to advance their businesses. It is anticipated that the inclusion of Islamic financial institutions will benefit the real economy, including the financing of SMEs. Islamic financial institutions operate their investing and financing operations following universal principles. They operate under the ethical, participatory, risk-sharing, equitable, and property rights principles that are universally accepted (Ali et al., 2020).

In the financial life of a business, banking is crucial. Banks play a crucial role in pushing funds from surplus to the areas of need in every economy (Bernard Azolibe, 2022). Banks do not produce wealth; however, they play a vital role in creating, transferring, and distributing wealth. Interest-free banking is a new system that has a significant role in the

growth of a country. Interest-free banks provides alternative banking services without charging interest. Interest-free banking is a model that allows SMEs to enjoy banking services at a substantially low cost by eliminating fees associated with traditional banking. Customers' involvement in interest-free banking reflects the institution's guiding principles, which include rejecting all types of interest and using profit-and-loss sharing. Consequently, interest-free banking has the potential to strengthen SMEs' financial situation and give them the tools they need to grow.

One of the industries with the fastest growth rates is interest banking, which can compete with traditional banking. It is among the most significant players in the modern service sector, particularly in Nigeria. In many nations, institutions that provide Islamic financial services make up a sizeable and expanding portion of the financial sector. The number and breadth of Islamic financial institutions have increased since the advent of Islamic banking roughly three decades ago, from one institution operating in one country in 1975 to over 300 institutions operating in more than 75 countries now (Čihák & Hesse, 2010). Because Shariah finance is a hybrid of Islamic economics and current financial concepts, its products can be sold to both Muslims and non-Muslims, small and large corporations. The most significant aspect of interest-free banking is risk-sharing among investors, banks, and borrowers. This technique of risk sharing is utilised to address the difficulties of interest and risk in the functioning structure of interest-free banking.

This study selects Jaiz bank plc as a focal point, being the only full-fledged interest-free bank in the country. The selection follows the Central Bank of Nigeria's (CBN) announcement in 2011 that it had granted Jaiz Bank PLC a licence to operate as a fully-fledged interest-free bank. This announcement sparked a contentious discussion on the viability and acceptability of the system, as many Nigerians cannot distinguish religion from politics or economics. As an emerging industry, the interest-free banks in Nigeria have to compete with the already established conventional banks. Despite the fear of acceptance among stakeholders, the growth of the new banking system over time has demonstrated otherwise. For instance, due to greater confidence, Jaiz bank's total customer deposits climbed by 25%, from N68 billion in 2017 to N85 billion in 2018. Income after taxes increased by 55%, from N537 million in 2017 to N834 million in 2018. In 2018, the bank's balance sheet increased by 25% to N109 billion, from 12 billion in 2012 to N300 billion in 2021 (Jaiz-Bank, 2022). This development prompted the study to uncover the determining factors that informed the decision of many Nigerian SMEs to bank with Jaiz.

2.0   LITERATURE REVIEW

In the literature, factors influencing bank selection criteria have been examined from theoretical and practical angles. Customers' bank preferences or selection factors significantly influence traditional and interest-free banking providers. Studies have identified several factors involving the choice and acceptance of interest-free banking. Hassan et al. (2018) examined how Bangladeshi clients felt about local Islamic banks. The study looked at six critical factors: corporate effectiveness, adherence to Islamic law, convenience, core banking, confidence, and cost-benefit. The study found that, in addition to religion, factors such as depositors' goal to maximise return, financial transaction system, consistency in service with uniformity, and increased cost-benefit implications were essential to clients selecting their intended services. The findings correspond to the study by Subramaniam et al. (2019) that, in addition to knowledge, subjective norms, attitudes, and religious values also influence the intention to use Islamic banking in New Zealand. Holding to this view, Alshannag et al. (2020) stated that interest-free banking offers relative advantages in terms of religion, economy, and ethics; it is assumed that when the possibility of intention rises, more consumers will embrace interest-free banking products.

Interest-free banks in many nations have created several alternative financing products and programmes to promote SMEs

within the framework of the fundamental Shariah principles (Ahmad & Chowdury, 2020). Religions are groups of beliefs visible in how followers interact with the outside world and live their daily lives (El-Massah, 2020). According to Ali et al., (2020), the religious beliefs of managers and owners of SMEs also hurt their willingness to engage in conventional financial services and problems associated with the policy, institutions, and the workplace (Hafiz et al., 2021). As a result, many SMEs turn to interest-free banks as a substitute for traditional banking providers (Ali et al., 2020).

Generally, SMEs depend on banks because they give them financing opportunities they need to expand (Eniola & Entebang, 2015). Bank financing opportunities imply the bank's capacity to supply capital for investments and other commercial ventures to customers (Awan & Bukhari, 2011). When these services are readily available, especially at a lower cost, customers may naturally hurry to the bank. Because of poor capacity, and lack of required collateral, conventional banks are reluctant to offer such opportunities to SMEs (Bekele & Worku, 2008). Furthermore, banks may be hesitant to lend to SMEs due to the perceived risks involved in lending. Banks must have a thorough understanding of the variables influencing SME performance in order to evaluate the risks related to lending to SMEs (Salleh et al., 2020). Interest-free banks, however, can offer these services at affordable prices and without charging any interest. Additionally, interest-free banks can advise and direct SMEs on how to expand their businesses. Therefore, it is crucial to ensure that SMEs have access to funding to support and encourage economic growth.

A critical concern for small firms is the cost of banks' services to SMEs. Banks have a history of charging small businesses exorbitant service fees, which can be a significant entrance hurdle for these businesses. While banks are significant institutions offering society essential services (Rabiu et al., 2019), they could also overcharge. The SMEs that depend on banks for financing may suffer as a result. Banks can force small firms out of business by charging prices too high for them

to afford. Banks charge interest on loans to make money, which can be costly for small businesses. In order to boost the likelihood that SMEs will borrow money, banks might also give them favourable loan conditions (Al Balushi et al., 2019). Instead of charging interest, interest-free banks can provide goods such as raw materials at lower prices to SMEs to boost their activities (Fasih, 2012).

2.1   Theory

The study used Rational Choice Theory (RCT) to understand how SME owners made their selection decision between conventional and interest-free banks. The rational choice theory, often known as choice or rational action theory, is a theory that directs how the social and economic behaviour of an individual is understood and modelled. The central claim of the rational choice theory is that collective social behaviour reflects the sum of individual decisions. Each person independently makes decisions based on personal preferences and the limitations (or choice set) he or she faces (Fumagalli, 2021). Tehulu and Wondmagegn (2014) assert that the theory provides insightful knowledge about some customers' decision-making processes. At the SME level, the theory opined that entrepreneurs choose the actions (or outcomes) they prefer most. In the case where actions (or outcomes) can be evaluated in terms of costs and benefits, a rational firm chooses the action (or outcome) that provides the maximum net benefit (i.e., the maximum benefit minus cost) (Friedman, 1996).

The theory is pertinent to this study as it offered guidance on SMEs' selection when choosing a good or service based on their anticipated advantages, given their preferences. Most SMEs prioritised their faith and culture, particularly those in the research area. As such, their patronage of a bank may depend on so many factors, including religion (Mansori, 2012), financing opportunities (Eniola & Entebang, 2015) and service cost (Song et al., 2018). When relating the theory to SMEs' prices and demand for goods or services, it is essential to note that it assumes that people act rationally. Irrationality may still be

problematic when it comes to the actions of specific people, but it does not affect the overall behaviour of markets and may therefore be disregarded (Nasidi et al., 2021).

Interest-free banks operate offer different packages that gives their customers cost-based advantages. The Central Bank of Nigeria (CBN) provided a basis for the application of charges to all financial institutions operating in Nigeria. The circular allows for negotiation on charges of some of the products offered by these banks (CBN, 2020). The document gave an edge to interest-free banks to take advantage of charging lesser fees then their conventional banks counterparts. For example, Qard-e-Hasan, a loan offered to customers which is returned at an agreed period without interest, return or share in the profit and loss or any strict repayment schedule. Although the bank may claim service charges to cover the cost of providing such loans, the charges are independent of the total sum lent (Al-Sultan, 1999).

Thus, the study hypothesised the following;

H_1: Religion significantly affects SMEs' acceptance of interest-free banking in Nigeria

H_2: Financing opportunities significantly affect SMEs' acceptance of interest-free banking in Nigeria

H_3: Service cost significantly affects SMEs' acceptance of interest-free banking in Nigeria

2.2 Research Framework

Researchers have looked into the customer acceptance criterion for interest-free banking using a variety of methodologies and approaches. These researchers have taken into account convenience, service quality, religion, affordable services, bank reputation and image, quick banking, the effect of family and friends, service delivery, and staff friendliness (Marimuthu et al., 2010; Loo, 2010; Asif & Anjun, 2012; Egboro, 2013; Kaya, 2014; Eze & Nwankwo, 2014). Other studies examined social and technological aspects, speed and service quality, bank reputation and image, convenience, marketing considerations, and financial factors (Tehulu & Wondmagegn, 2014). The present study proposed religion, financing opportunities and service cost as predictors.
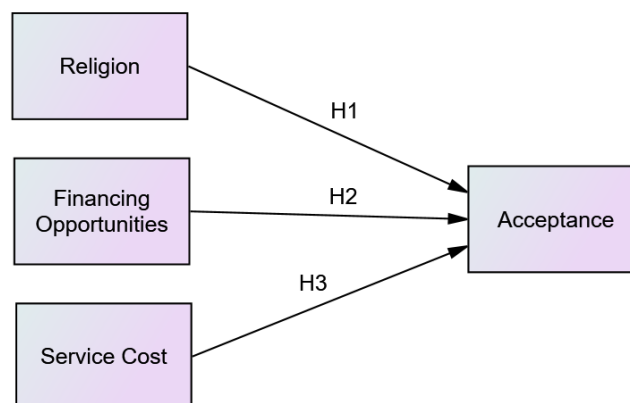

FIGURE 1
Research Framework

3.0   METHODOLOGY

The study is quantitative and uses cross-sectional data collected from all registered SMEs in Nigeria. Purposive sampling was used to collect data from the respondents. Simple random sampling was adopted to collect data from 323 SMEs registered with Small and Medium Enterprise Development of Nigeria (SMEDAN). Nevertheless, in keeping with Dewaele (2018), the sample was increased by 10% to reduce the sampling error and any

errors made when gathering and inputting data. The study further grouped the population according to six homogenous sectors of SMEs' operation; education, manufacturing, wholesale/retail, accommodation and food services, human health and social work, and others. Finally, purposive sampling was used to get to the respondents in the study area for collecting data. Covariance-based structural equation modelling (CB-SEM) was used for the analysis and hypothesis test.

3.1 Instrument

A structured questionnaire with a five-point Likert scale, ranging from 1 for strongly disagree to 5 for strongly agree, was employed to gather data. There are two sections to the questionnaire. Three independent variables (religion, financing opportunities and service cost) were used, while acceptance was the dependent variable. Seven items were adapted from Khan et al. (2007) and Mokhlis (2009) to measure religion. The study further adapted six questionnaire items from Chung et al. (2013) to measure financing opportunities, while eight items from Amin et al. (2011) and Chigamba and Fatoki (2011) were adapted to measure service cost. Finally, the study adapted seven items from Khan et al. (2007) and Salehi and Rajabi (2015) to measure SMEs' acceptance of interest-free banking in the study area.

3.2 Demographic Characteristics

Table 1 presents the summary of the demographic attributes of the research respondents. From the table, 245 (75.9%) of the respondents are male, and 78 (24.1%) are female, implying that men are more involved in SME business than their female counterparts. The table indicates that 54 (16.7%) are below the age of 25, compared to those between 26 years and above 269 (83.3%). The study further analysed the education level of SME owners. About 6 (1.9%) attended school outside the modern school system, and 49 (15.2) acquired tertiary education, with the majority of 151 (46.7%) and 117 (36.2%) attending primary or secondary school. Furthermore, the study examined how long SMEs existed in their respective businesses. The result of the analysis revealed that only 40 (12.4%) existed for more than ten years; 44 (13.6%) existed for more than six years; 151 (46.7%) existed for 3-5 years, while 88 (27.2%) existed between 1 to 2 years. The distribution of SMEs based on the area of operations; education represents 83 (25.7%); manufacturing accounted for 127 (39.3%), accommodation and food services included 27 (8.4%); wholesale and retail represented 31 (9.6%); human health and social work has 31 (9.6%); while 24 (7.4%) accounted for other business types not included in the current study.

TABLE I
Demographic Characteristics of Respondents

Variable	Category	Frequency	Percent
Gender	Male	245	75.9
	Female	78	24.1
	Total	**323**	**100.00**
Age	18 - 25	54	16.7
	26 - 35	90	27.9
	36 - 45	87	26.9
	46 - Above	92	28.5
	Total	**323**	**100.0**
Education Level	Primary	151	46.7
	Secondary	117	36.2
	Tertiary	49	15.2
	Others	6	1.9
	Total	**323**	**100.0**

Years of Existence	0 - 2	88	27.2
	3 - 5	151	46.7
	6 - 10	44	13.6
	10 - Above	40	12.4
	Total	**323**	**100.0**
Nature of Business	Education	83	25.7
	Manufacturing	127	39.3
	Accommodation and food services	27	8.4
	Wholesale and retail	31	9.6
	Human health and social work	31	9.6
	Others	24	7.4
	Total	**323**	**100.0**

3.3 Data Analysis Techniques and Tools

In the current study, three constructs have been used as the exogenous variables; religion, financing opportunities and service cost, while acceptance of interest-free banking was used as the endogenous variable. To evaluate the relationship between the variables using measurement and a structural model, structural equation modelling (SEM) is used. SEM is a well-known method for determining variable coefficients' direct and indirect effects and measuring the causal relationship between endogenous and exogenous variables (Garba, 2022). Traditional statistical approaches to data analysis specify default models, assume measurement occurs without error, and are somewhat inflexible. However, structural equation modelling requires the specification of a model based on theory and research. SEM is a multivariate technique that incorporates measured variables and latent constructs and explicitly specifies measurement error (Suhr, 2006).

4.0 RESULTS AND DISCUSSIONS

Structural equation modelling (SEM) is a comprehensive statistical approach to testing hypotheses about relations among observed and latent variables (Hoyle, 1995). It concurrently analyses the relationship between observable and latent variables and the association between the latent variables, making SEM a popular second-generation technique for analysing the relationships between numerous variables. In SEM, the measurement model describes the variables, but the structural model describes how the variables are associated. Cronbach's alpha (α), Average variance extracted (AVE), and composite reliability (CR) were used to establish the validity and reliability of the research instrument (Awang, 2015). In order to display the factor loading and assess the convergent validity, factor analysis was conducted. A path diagram was used to illustrate the significance and direction of the interaction between the constructs. The data were analysed using AMOS version 26 and SPSS version 26.

4.1 The Measurement Model

As recommended, the measurement model of the latent construct for their dimensionality, validity, and reliability shall be carried out before examining the structural model. In order to illustrate the links of the observed indicators to the latent constructs, a confirmatory factor analysis (CFA) was carried out because it should be assessed before looking at the measurement and structural model. Using Cronbach's alpha, the study evaluates the reliability of the research instrument. An instrument's reliability is its capacity to deliver the same output over time consistently (Garba et al., 2022; Haktanir et al., 2022; Nasidi et al., 2022). In line with the literature, the model's fitness indexes for pooled CFA must be met (Bentler, 1990). The RMSEA value should be ≤ 0.08, while the GFI, CFI and TLI values should be ≥ 0.90. Relative/Normed Chi-Square values must be approximately ≤ 5.0 (Bentler, 1990; Browne et al., 1993; Marsh & Hau, 1996). The fitness

indexes for the CFA model satisfies the minimum threshold (RMSEA; 0.066 < 0.085, CFI; 0.941 < 0.9, TLI; 0.928 < 0.9, IFI; 0.941 < 0.9, GFI; 0.908 < 0.9 and ChiSq/df = 2.391 < 5).

TABLE II
Psychometric Properties of the Constructs

Constructs	Items	Factor Loadings
Religion (CR = 0.849, AVE = 0.531, α = 0.715)	R1	.625
	R2	.812
	R3	.744
	R5	.678
	R6	.769
Financing Opportunities (CR = 0.872, AVE = 0.581, α = 0.886)	FO1	.892
	FO2	.844
	FO3	.701
	FO4	.703
	FO5	.641
Service Cost (CR = 0.833, AVE = 0.635, α = 0.807)	SC1	.924
	SC2	.870
	SC4	.543
Acceptance (CR = 0.808, AVE = 0.514, α = 0.772)	ACC2	.677
	ACC3	.715
	ACC4	.703
	ACC5	.769

Table 2 presents the psychometric properties of the constructs, including Cronbach's alpha, AVE and CR. According to Kline (2005)and Fornell & Larcker (1981), the value of AVE should be at least 0.50. The minimum value of CR should be 0.70 (Awang et al., 2015; Hair et al., 2019). The result of CR ranges from 0.808 to 0.872, above the lower limit. Cronbach's alpha of all the constructs ranges from 0.772 and above, indicating good internal consistency of the items (George & Mallery, 2010).

The study further assessed the normality of the data before proceeding to the structural model. The Maximum Likelihood Estimator (MLE) in structural equation modelling is robust to kurtosis violations of multivariate normality in a large sample size with a kurtosis Critical Region less than 7.0 (Hair et al., 2010). The data is regarded as normal if the skewness and kurtosis are between -2 and +2 and -7 and +7. All items had skewness values between -1.377 and .977 and kurtosis values between -.539and 2.197, according to the instrument's normality test results. Since the skewness values are within the range of absolute values of 1.5, the assumption of normalcy for the field data is satisfied (Tabachnick & Fidell, 2013).

4.2 The Structural Model

The path coefficient is calculated using the maximum likelihood method in the structural model. A path diagram shows the relationship between the constructions and their direction. The model's goodness of fit (P-Value = 0.000, RMSEA = 0.066, CFI = 0.941, TLI = 0.928, IFI = 0.941, GFI = 0.908, Chisq/df = 2.391) indicates that the model is acceptable, and the probability level (0.00) shows that the data's departure from the model is significant at 5%, reflecting that the model is acceptable. The fitness indexes indicated that the model met the minimum threshold and that the model was fit (Bentler, 1990; Browne et al., 1993; Marsh & Hau, 1996). The result of the study found squared multiple correlations (R^2) of 0.52 (52%), indicating a strong correlation between exogenous and indigenous variables. The explanatory variables accounted for a 52% variation in SMEs' acceptance of interest-free banking in Nigeria.
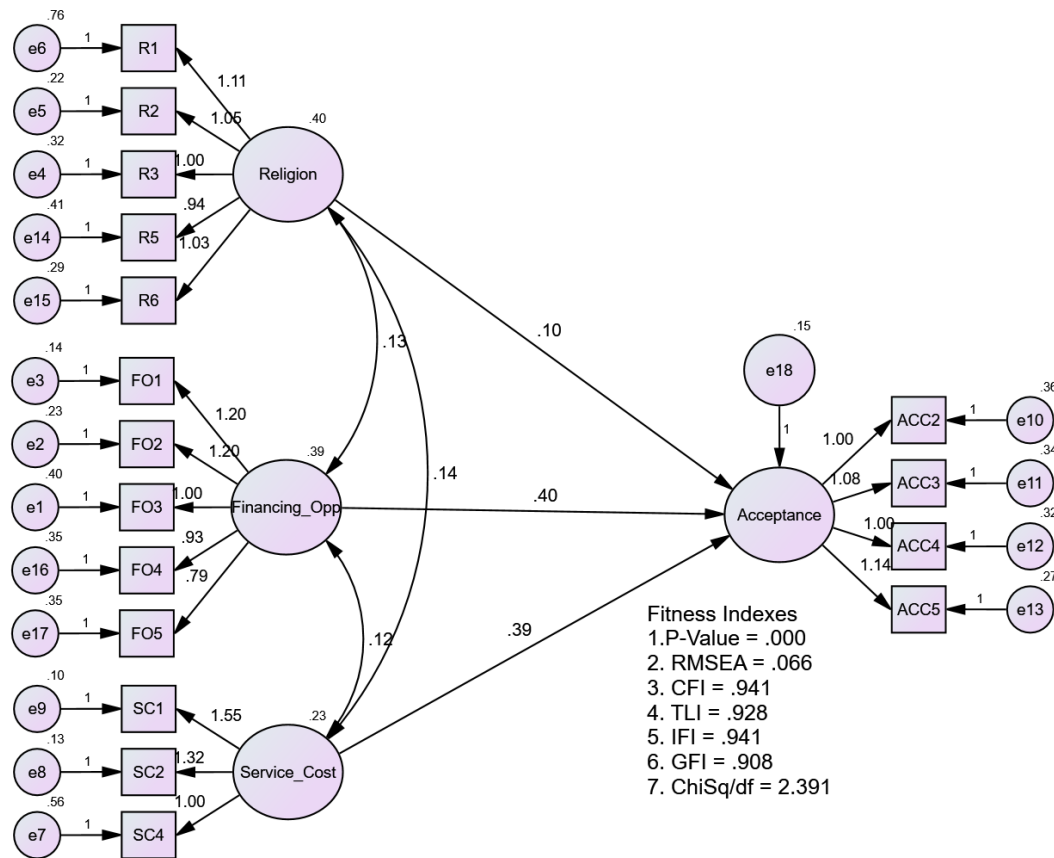
FIGURE 2
Unstandardised Path Coefficients

Table 3 summarises the findings, while Figure 2 shows the unstandardised estimates of the direct effects of exogenous and endogenous variables through observable and latent variables. All the path coefficients are statistically significant except for religion and acceptance of interest-free banking. The path coefficient between religion and acceptance is 0. 10, which denotes a weak positive relationship between the two constructs. The P-value of religion and acceptance, as presented in Table 3, shows that the relationship is insignificant, and the first hypothesis is not supported. The relationship between financing opportunities and acceptance was positive and significant (β= 0.397, t= 6.518) at 1%. Thus, the hypothesis is supported. Finally, the result reveals a positive and significant relationship between service cost and acceptance (β= 0.390, t= 4.670) at 1%. Thus, the hypothesis is supported.

TABLE III
Regression Weights

Hypotheses			Estimate	SE.	CR.	P	Remark
Religion	--->	Acceptance	.098	.055	1.790	.073	Insig.
Financing Opportunities	--->	Acceptance	.397	.061	6.518	***	Sig.
Service Cost	--->	Acceptance	.390	.084	4.670	***	Sig.

*Note: *p<0.05, **p<0.01, ***p<0.001*

5.0   DISCUSSIONS

The present study investigates the impact of religion, financing opportunities and service costs on the acceptance of interest-free banking among SMEs in Nigeria. The hypothesised relationships of the constructs were tested using SEM-AMOS, and the results demonstrate that financing opportunities and service costs have significant positive impacts on the acceptance of interest-free banking among SMEs. According to the study, religion has a positive but insignificant effect on SMEs' acceptance of interest-free banking in Nigeria. Contrary to the study findings, Hamid and Othman (2009) proclaim that Muslim consumers select Islamic financial products/services solely for belief-related reasons. However, this view contradicts the popular opinion as Muslims and non-Muslims choose interest-free banks and investments for profitability, resilience, risk-sharing and ethical reasons (Abou-El-Sood & El-Ansary, 2017; ElMassah & Abou-El-Sood, 2021).

There are a vast number of financing opportunities available to small business owners, but not all of them are created equal. Among the most appealing are interest-free banks, which can provide a much-needed boost to businesses struggling to get off the ground. The study also found that financing opportunities positively affect SMEs' acceptance of interest-free banking. Although there are divergent views, especially among scholars of the Islamic faith, that some of these financing packages offered by interest-free banks have some element of usury. Ali et al. (2020) posit that most SMEs avoid interest-based conventional financing opportunities due to spiritual beliefs. However, before taking advantage of these financing opportunities, it is crucial to understand how they work and the potential drawbacks.

Finally, the result of the study revealed a significant positive impact of service cost on the acceptance of interest-free banks by SMEs. Commercial institutions typically offer banking services in conventional, interest-free, or other formats to make a profit. However, the cost of the services provided by interest-free banks can vary depending on the country and the specific bank. There may be a small service fee in some cases, while there may be no fee in others. According to Kotler and Armstrong (2012), customer value is the customer's comparison between all the benefits and costs incurred to accept an offer. Amin et al. (2011) posit that if the prices of Islamic products are higher than or equal to that of conventional banks, it will be difficult for intended users of such products to use them or adopt them unless other reasons are doing so, such as social influence.

6.0   CONCLUSION

This research work was carried out to examine the factors determining the acceptance of Interest-free banking among SMEs in Nigeria. Religion was an insignificant predictor. The study found that financing opportunities and service costs influence SMEs' acceptance. Price in traditional demand theory is a significant determinant of demand and supply. Customers patronise a good or service at cheaper than at higher rates. The research shows that cost-efficient services offered by interest-free banks are critical to their acceptance decision. Customers generally preferred spending less to more and at the same time maintaining the same or even maximising level of satisfaction.

6.1   Implications

The study provides enhanced empirical literature for researchers and students of learning in Islamic finance, consumer behaviour and marketing strategies of banks. The study further contributed to the general body of knowledge by integrating and modifying the determinants of customers' acceptance of interest-free banking into a model and subjecting it to rigorous tests of reliability and validity, making it a helpful tool for prediction interpretation. The study will guide the bank managers' decisions and enable them to frame their marketing strategies toward providing products/services that match the expectations of their customers.

6.2 Future Research

The research focusses on SMEs registered with the small and medium enterprise development agency of Nigeria, and this gives limited scope generalisation ability of the findings. Further studies should incorporate micro, small and medium enterprises in Nigeria.

7.0 ACKNOWLEDGEMENT

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