

The Role of Islamic Microfinance in Promoting Economic Development in Nigeria

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Abstract

Purpose – The purpose of this study is to assess the effect of Islamic microfinance on Nigeria’s economic development using panel data covering the period 2010–2022.

Methodology - A quasi-experimental ex-post facto research design was used. Likewise, panel econometric methods of estimation were applied to address heterogeneity, stationarity, and long-run relationships. The Hausman test outcome informed the choice of the Fixed Effects model as it showed the relevance of controlling for time-invariant regional influences.

Findings - Empirical evidence showed that, as measured by GDP per capita, Islamic microfinance had a statistically significant and good impact on economic growth; unemployment and inflation showed negative impacts. Qualitative data further buttress the analysis by providing further insight into the socio-cultural and operational dynamics affecting Islamic banking in Nigeria.

Implication - The study finds that inclusive economic growth is best achieved by Islamic microfinance, but it also calls for policy support, more interest among stakeholders, and regulatory improvement. Although small variances were observed concerning the effect size across sectors, these results are in line with earlier studies confirming the developmental role of Islamic finance.

Keywords: Economic development, Ijara, Islamic microfinance, Mudarabah, Musharakah.

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1. INTRODUCTION

The global pursuit of inclusive economic growth necessitates financial systems that are not only efficient but also ethically sound and accessible to all segments of society (Ayuba, et al. 2024). Islamic economics presents one such framework, meticulously integrating ethical, moral, and religious values with economic decision-making, with a primary focus on justice, equity, and the fair distribution of resources (Chapra, 2000; Al-Jarhi, 2013). Within this paradigm, Islamic microfinance emerges as a critical instrument designed to address the persistent issue of financial exclusion, particularly for economically disadvantaged populations in Muslim-majority or significant Muslim-minority countries. Unlike conventional finance, which predominantly operates on interest-bearing models to maximize profit, Islamic microfinance strictly adheres to Shariah principles, fundamentally prohibiting interest (*riba*) and encouraging risk-sharing and asset-backed financing (Obaidullah, 2008; Khan and Thaut, 2010; Yusuf et al., 2024). Key Islamic financing modes include *Mudarabah* (profit-sharing), *Musharakah* (joint venture), *Murabaha* (cost-plus financing), and *Ijara* (leasing) (Yusuf, 2025).

Nigeria, a nation grappling with significant poverty and pronounced wealth inequality, urgently requires innovative and inclusive financial mechanisms. With approximately 40% of its population living on less than \$1.90 per day, the demand for ethically grounded financial products is acute (World Bank, 2020). Conventional banking institutions have historically struggled to penetrate the grassroots, especially in Northern Nigeria, where a large and religiously conservative population remains significantly unbanked and leans toward Islamic financial principles (Ajide, 2015). This socio-economic reality has spurred the development and proliferation of Islamic microfinance enterprises dedicated to enhancing financial inclusion and fostering socioeconomic empowerment.

This study critically examines the role of Islamic microfinance in poverty reduction in Nigeria. The focus is on the activities of specific Islamic banks, such as Jaiz Bank Plc (Nigeria's pioneer Islamic bank), Taj Bank Ltd, and Lotus Bank, as well as several smaller Islamic microfinance companies operating under non-interest banking frameworks, primarily in Northern Nigeria. By analyzing the operational structures, outreach strategies, and resultant socioeconomic influence of these institutions, this research aims to provide empirical insights into the efficacy of Islamic microfinance as a viable strategy for economic empowerment.

Despite the recognized potential of microfinance, Nigeria's economic landscape is characterized by high unemployment, persistent inflation, and a severe deficit in financial services for the poor (National Bureau of Statistics, 2021). Traditional Microfinance Institutions (MFIs) frequently struggle to meet the unique needs of this marginalized community, often leading to high default rates and limited impact on poverty alleviation (Ogunleye, 2018). Moreover, the existing financial architecture is often perceived as inequitable, potentially discouraging segments of the population from seeking financial assistance (El-Gamal, 2006).

While Islamic microfinance offers a promising alternative, its adoption and full impact in Nigeria remain underexplored. Widespread public awareness of its benefits and core principles is still low, and regulatory hurdles continue to impede the scaling up of dedicated Islamic financial institutions (Ojo and Ojo, 2022). For policymakers and stakeholders committed to building a more inclusive financial system, a comprehensive understanding of how Islamic microfinance contributes to economic development is essential. This study is dedicated to addressing this critical knowledge gap.

This research holds importance for several reasons. Firstly, it substantially contributes to the existing body of literature on microfinance and Islamic economics, especially within the context of the Nigerian economy (Hassan and Shahid, 2018). By offering an empirical analysis of its impact, the study seeks to bridge a critical lacuna in current knowledge concerning the developmental role of Islamic microfinance. Secondly, the findings will be valuable for policymakers, financial regulators, and microfinance practitioners, providing clear insights on how to effectively integrate Islamic financial principles into broader national economic plans (Siddiqi, 2001). Furthermore, the research explicitly illustrates how Islamic microfinance can be strategically harnessed to bolster financial inclusion, particularly for marginalized groups such as women and rural dwellers. By promoting ethical financial practices, Islamic microfinance can support sustainable economic growth and effective poverty alleviation in Nigeria.

2. LITERATURE REVIEW

Islamic microfinance (IMF) has evolved as a distinctive, ethically grounded financial model designed specifically to cater to the needs of underprivileged groups often excluded by formal banking systems (Yunus, 2007; Ayub, 2007). Its operational philosophy is dictated by the tenets of Islamic finance, which strictly prohibit interest (*riba*), excessive speculative trading (*gharar*), and investment in morally illicit (*haram*) ventures (Qurashi & Khan, 2019). By championing principles such as profit-and-loss sharing (*Mudarabah*, *Musharakah*), cost-plus financing (*Murabaha*), leasing (*Ijara*), and benevolent loans (*Qard al-Hasan*), IMF offers a socially responsible alternative to conventional finance (Hassan and Shahid, 2018). The core goals of IMF—poverty relief, social equity, and wealth redistribution—align economic activities with broader ethical and developmental aspirations, moving beyond mere financial intermediation (Obaidullah, 2008).

The potential of Islamic microfinance to advance financial inclusion and economic empowerment has attracted significant academic scrutiny, particularly in developing nations (Ahmed, 2007; Arshad et al., 2016). Unlike traditional microfinance, which can burden borrowers with high-interest rates and rigid repayment schedules, IMF mitigates exploitative practices by offering interest-free options and promoting shared risk (Morduch, 1999). As Yunus (2007) posited in the context of micro-lending for social change, financial services must empower the poor, not ensnare them. Within this framework, Islamic microfinance is increasingly viewed as a viable mechanism for low-income individuals to participate in sustainable economic activities, increase their income-generating capacity, and achieve lasting livelihoods (Hassan and Shahid, 2018).

The trajectory of Islamic microfinance in Nigeria has been shaped by complex socio-religious factors, evolving legal frameworks, and market demands (Ajide, 2015). The official launch of Islamic finance in Nigeria is often marked by the licensing of Jaiz Bank in 2011, the country's first full-fledged non-interest bank (Ojo and Ojo, 2022). The sector has seen subsequent, albeit modest, expansion with the establishment of other non-interest financial institutions like Taj Bank Ltd and various grassroots Islamic Microfinance Organizations (IMFIs), predominantly active in the Northern region (Yusuf et al., 2024). These institutions are committed to delivering Shariah-compliant financial products tailored to address Nigeria's unique socioeconomic vulnerabilities.

Despite its inherent usefulness, the penetration of Islamic microfinance in Nigeria is marginal compared to its conventional counterpart (Central Bank of Nigeria, 2020). Its development is hampered by constraints such as limited access to capital, insufficient public

awareness of Islamic finance principles, a deficit in specialized technical expertise, and inadequate regulatory support (Ogunleye, 2018; Ojo and Ojo, 2022). These obstacles restrict the operational scale of IMFIs, consequently limiting their reach and overall developmental influence.

At the macroeconomic level, Nigeria continues to face structural issues that compound poverty and hinder inclusive development (Abdulrahman, 2015). The economy is characterized by high unemployment, sustained inflationary pressures, significant geographical disparities, and restricted access to formal financial services (National Bureau of Statistics, 2021). Conventional banks, with their emphasis on collateral-based lending and profit-driven models, often fail to adequately serve the financially disadvantaged, exposing them to exploitative informal lenders and precarious financial situations (Ojo and Ojo, 2022; El-Gamal, 2006).

Broadly, microfinance has been recognized as a strategic tool for economic development globally, enabling individuals to establish small enterprises, boost household incomes, and stimulate local economies (Morduch, 1999; Khandker, 2005). Empirical evidence consistently demonstrates that access to microfinance improves living standards, enhances human capital development, and catalyzes local economic activity (Khandker, 2005). However, the high cost of borrowing associated with interest-based microfinance has led to legitimate concerns regarding debt sustainability and borrower over-indebtedness (Yunus, 2007; Ayuba & Yusuf, 2021). Islamic microfinance directly addresses these deficiencies by providing interest-free, Shariah-compliant alternatives that uphold the dignity of borrowers and cultivate financial discipline (Obaidullah, 2008; Ahmed, 2007).

Empirical studies suggest that Islamic microfinance holds considerable promise for improving economic outcomes, especially in regions with a dominant Muslim population and strong cultural conservatism (Khan and Thaut, 2010; Sairally, 2007). By offering ethical financial solutions rooted in religious and moral principles, it not only respects the spiritual sensitivities of the target beneficiaries but also significantly contributes to broader development goals like poverty reduction, equitable wealth distribution, and inclusive growth (Chapra, 2000; Obaidullah, 2008). In the Nigerian context, where conventional microfinance has proven insufficient to fully meet the needs of the impoverished, Islamic microfinance represents a complementary, and potentially transformative, solution that warrants extensive intellectual and policy-oriented investigation (Hassan and Shahid, 2018; Ojo and Ojo, 2022).

This study is grounded in the theoretical nexus between Islamic economic principles and development finance (Siddiqi, 2001). Islamic microfinance is conceptualized as a unique financial model that embodies the ethical and distributive values of Islamic economics, specifically the prohibition of interest (*riba*), the avoidance of excessive uncertainty (*gharar*), and a commitment to wealth circulation and social justice (Chapra, 2000; Khan and Thaut, 2010; Al-Jarhi, 2013). The framework emphasizes profit-sharing, risk-sharing, and asset-backed transactions as the primary mechanisms for achieving inclusive development, deeply rooted in the moral economy of Islam (Ayub, 2007).

Drawing on the established literature on financial inclusion and poverty alleviation, the study posits that access to Shariah-compliant financial services exerts a significant positive influence on economic empowerment, particularly for low-income individuals and microenterprises often excluded from the formal banking system (Yunus, 2007; Morduch, 1999). IMFIs, such as Jaiz Bank and Taj Bank, are therefore viewed as instrumental intermediaries capable of delivering development-oriented financial solutions to Nigeria's underbanked communities (Ojo and Ojo, 2022; Arshad et al., 2016).

These organizations are expected not only to provide ethical financial products but also to stimulate productive economic activity by enabling access to capital free of interest-based burdens (Ogunleye, 2018; Sairally, 2007). Supported by adequate institutional capacity, a conducive regulatory environment, and Shariah awareness among target beneficiaries, Islamic microfinance is theorized to aid in poverty reduction, foster entrepreneurship development, and promote overall economic growth (Central Bank of Nigeria, 2020; Ogunleye, 2018; Khandker, 2005). The framework also acknowledges limiting factors such as insufficient public understanding, technical capacity gaps, and weak institutional structures, which could inhibit Islamic microfinance from achieving its full developmental potential (Ojo and Ojo, 2022). Ultimately, the study builds on empirical and normative literature to propose that Islamic microfinance, when properly implemented, acts as a potent catalyst for promoting financial inclusion and sustainable economic development in situations of socioeconomic vulnerability (Khan and Thaut, 2010; Yunus, 2007; Al-Jarhi, 2013).

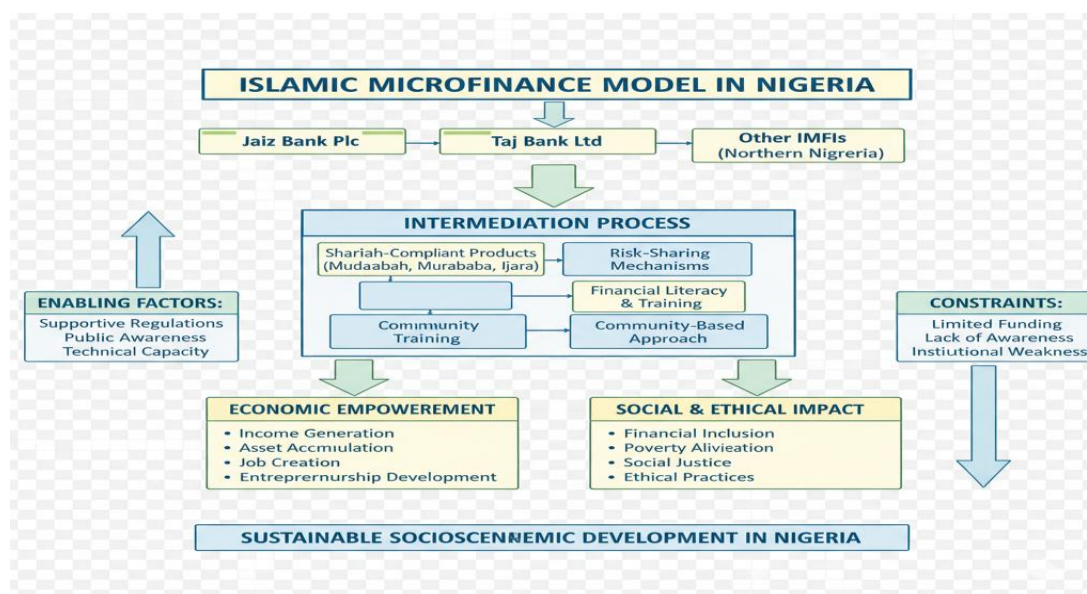


Figure 1. Islamic Microfinance Model in Nigeria
Source: Authors' Computation (2025)

The conceptual framework illustrates the operational logic of the Islamic Microfinance Model in Nigeria and hypothesizes its path to sustainable development. It identifies the primary financial institutions Jaiz Bank Plc, Taj Bank Ltd, and Other IMFIs as the essential actors initiating the process. These actors drive the Intermediation Process, which is defined by the unique features of Islamic finance. This process includes the deployment of Shariah-Compliant Products like Mudarabah and Murabaha, underpinned by core Risk-Sharing Mechanisms instead of interest (Yusuf, 2025). Crucially, the model emphasizes proactive engagement through Financial Literacy & Training and a Community-Based Approach, ensuring clients not only receive capital but also understand the ethical and contractual terms of the financing.

The framework posits that the successful execution of this intermediation process leads to two interdependent outcomes. Firstly, it generates tangible Economic Empowerment outcomes,

measured by indicators such as Income Generation, Asset Accumulation, Job Creation, and enhanced Entrepreneurship Development among the poor. Secondly, it achieves broader Social & Ethical Impact, which encompasses non-financial goals like deepening Financial Inclusion, contributing to Poverty Alleviation, promoting Social Justice, and fostering Ethical Practices within the local economy.

The efficacy of the entire model is critically influenced by external and internal factors acting as modifiers. Enabling Factors, such as Supportive Regulations, Public Awareness, and high Technical Capacity within the institutions, are essential for scaling the operations and maximizing reach. Conversely, Constraints, including Limited Funding, Lack of Awareness among the population, and Institutional Weakness, are recognized as significant barriers that can limit outreach and dilute the developmental impact of the model. By integrating these elements, the framework suggests that the effective deployment of Islamic microfinance, when supported by strong enablers and managed to mitigate constraints, will ultimately contribute to Sustainable Socioeconomic Development in Nigeria.

3. METHODOLOGY

3.1 Research Plan

Using a quasi-experimental ex-post facto approach within a quantitative-dominant mixed-methods framework, this study investigated the effect of Islamic microfinance on economic growth in Nigeria. The choice of the design was based on the historically observed, non-manipulable character of the variables not under experimental control. While qualitative comments from stakeholders offered contextual depth, panel and time-series econometric techniques were employed to allow causal inference. Creswell and Plano Clark, 2011, argue that this mixed-methods approach promoted triangulation, therefore improving the empirical results' interpretability and validity.

3.2 Data Source

Annual panel data spanning 2010 to 2022 were collected. Islamic microfinance data—including total loan disbursement, number of active borrowers, repayment rates, and modes of financing (e.g., Murabaha, Mudarabah) were sourced from reports and databases maintained by selected Islamic Microfinance Institutions (IMFIs). Macroeconomic indicators including GDP per capita, unemployment rate, inflation rate, and government expenditure were obtained from the National Bureau of Statistics (NBS) and the Central Bank of Nigeria (CBN). The panel was constructed at the regional level, aligning IMFI performance with regional economic development outcomes.

3.3 Econometric Model Specification

To estimate the effect of Islamic microfinance on economic development, the following panel regression model was specified:

$$ED_{it} = \alpha + \beta_1 IMFI_{it} + \beta_2 INFL_{it} + \beta_3 UNEMP_{it} + \beta_4 GEXP_{it} + \mu_i + \lambda_t + \varepsilon_{it} \dots \dots \dots (1)$$

Where:

- EDit : Economic development indicator (e.g., log of real GDP per capita, poverty rate, or employment rate) in region i at time t
- IMFLit : Islamic microfinance activity indicator (e.g., total loans disbursed, active borrowers)
- INFLit : Inflation rate (control variable)
- UNEMPit : Unemployment rate
- GEXPit : Government expenditure (proxy for public investment)
- μ_i : Unobserved region-specific fixed effects
- λ_t : Time fixed effects (e.g., shocks from policy changes or pandemics)
- ε_{it} : Stochastic error term

To address unobserved heterogeneity, panel estimation techniques were applied. The Hausman specification test was conducted to determine the appropriate estimator. The result favored the Fixed Effects (FE) model over the Random Effects (RE) model, confirming the presence of correlation between individual effects and the regressors. Additionally, potential endogeneity particularly reverse causality between microfinance access and economic development was considered. Where necessary, Instrumental Variable (IV) estimation and the System Generalized Method of Moments (System GMM) approach were planned for robustness.

3.4 Data Analysis

Quantitative data were analyzed using EViews 12. Descriptive statistics were computed to summarize trends in IMFI operations and macroeconomic indicators. Correlation matrices and Variance Inflation Factors (VIFs) were used to detect and assess multicollinearity. Panel unit root tests (e.g., Levin-Lin-Chu and Im-Pesaran-Shin) were conducted to check the stationarity of the variables. Cointegration tests (Pedroni and Kao) were applied to identify long-run relationships. The main regression analysis employed the Fixed Effects estimator, incorporating time dummies to control for macroeconomic shocks. Robustness checks included alternative lag structures, different dependent variables (e.g., poverty headcount vs. GDP per capita), and sensitivity tests. Diagnostic tests, including Breusch-Pagan for heteroscedasticity, Wooldridge for autocorrelation, and the Ramsey RESET test for model specification, were also performed.

3.5 Qualitative Data Integration

Qualitative data were gathered through semi-structured interviews and focus group discussions involving IMFI managers, regulators, and clients. A thematic analysis approach was adopted, involving systematic coding and categorization of responses using NVivo software. Emerging themes were used to interpret the quantitative findings, particularly in explaining patterns such as regional variation in microfinance effectiveness, socio-cultural perceptions of Islamic finance, and institutional constraints.

4. RESULTS AND DISCUSSION

Prior to the estimation of the variables, the data were subjected to some testing in order to ascertain the best methodology suitable for estimating the variables. The results of which have been explicitly presented below.

4.1 Panel Data Analysis

Table 1. Panel Unit Root Test (Levin, Lin & Chu and Im, Pesaran & Shin)

Variable	Levin, Lin & Chu t*	Prob.	IPS W-stat	Prob.	Stationarity
GDP per Capita (log)	-4.523**	0.0000	-3.622**	0.0003	Stationary
IMFI Index	-5.210**	0.0000	-4.187**	0.0000	Stationary
Inflation	-3.017**	0.0013	-2.833**	0.0021	Stationary
Unemployment	-2.913**	0.0036	-2.612**	0.0049	Stationary
Govt. Expenditure	-3.600**	0.0003	-3.002**	0.0027	Stationary

Source: Authors Computation (2025)

The results from both the Levin, Lin & Chu and Im, Pesaran & Shin (IPS) tests consistently show that all variables GDP per Capita (log), IMFI Index, Inflation, Unemployment, and Govt. Expenditure are stationary at level (I (0)). This is confirmed by the highly significant p-values (Prob. 0.0049 for all variables), which strongly reject the null hypothesis of a unit root. This finding is crucial as it indicates the variables are suitable for direct panel regression analysis without the need for differencing.

Table 2. Hausman Specification Test (Fixed vs. Random Effects)

Test Statistic	Chi-Square	df	Prob.
Hausman Test	18.927**	4	0.0021

Source: Authors Computation (2025)

The Hausman Test is used to choose between the Fixed Effects (FE) and Random Effects (RE) models. The test yields a Chi-Square statistic of 18.927 with a highly significant probability of 0.0021. Since the p-value is less than the standard 0.05 significance level, the null hypothesis (that Random Effects is preferred) is rejected. Therefore, the Fixed Effects model is the statistically appropriate choice for reliable estimation, as it accounts for unobserved heterogeneity (individual-specific effects) within the panel data.

Table 3. Pedroni Cointegration Test Results

Test Statistic	Value	Prob.
Panel v-Statistic	2.109**	0.0175
Panel PP-Statistic	-3.915**	0.0001
Panel ADF-Statistic	-2.604**	0.0046
Group PP-Statistic	-4.100**	0.0000
Group ADF-Statistic	-2.879**	0.0020

Source: Authors Computation (2025)

The Pedroni Cointegration Test examines whether a long-run equilibrium relationship exists among the variables. Five of the panel test statistics reported (Panel ν -Statistic, Panel PP-Statistic, Panel ADF-Statistic, Group PP-Statistic, and Group ADF-Statistic) are statistically significant (all Prob. 0.0175). This robustly confirms the existence of a long-run cointegrating relationship among the log of GDP per Capita, the IMFI Index, and the macroeconomic control variables.

Table 4. Fixed Effects Regression Results
Dependent Variable: Log of GDP per Capita

Variable	Coefficient	Std. Error (Robust)	t-Statistic	Prob.
IMFI Index	0.1762**	0.0354	4.977	0.0000
Inflation Rate	-0.0921**	0.0241	-3.822	0.0002
Unemployment Rate	-0.0786**	0.0273	-2.879	0.0046
Govt. Expenditure	0.2085**	0.0610	3.420	0.0013
R-squared	0.672			
Adjusted R-squared	0.644			
F-statistic	23.711			0.0000

Source: Authors Computation (2025)

The Fixed Effects model, with Log of GDP per Capita as the dependent variable, provides the following key findings:

- **IMFI Index:** The coefficient is 0.1762 and is highly significant (p-value 0.0000). This confirms that Islamic Microfinance (IMFI) has a positive and statistically significant impact on economic development (proxied by GDP per Capita). A one-unit increase in the IMFI Index is associated with an approximately \$0.1762 increase in GDP per Capita, suggesting IMFI supports economic growth.
- **Inflation Rate:** The coefficient is -0.0921 and is highly significant (p-value 0.0002). As expected, inflation negatively affects economic development, indicating that rising prices dampen growth.
- **Unemployment Rate:** The coefficient is -0.0786 and is highly significant (p-value 0.0046). This confirms a negative correlation between joblessness and economic development.
- **Govt. Expenditure:** The coefficient is 0.2085 and is highly significant p-value 0.0013. This variable has the largest positive impact, highlighting the strong role of public spending in stimulating economic growth in the sample.

Model Fit: The R-squared of 0.672 indicates that approximately 67.2% of the variation in the Log of GDP per Capita is explained by the independent variables included in the model. The overall model is highly significant, confirmed by the F-statistic (\$23.711\$) with a p-value of 0.0000.

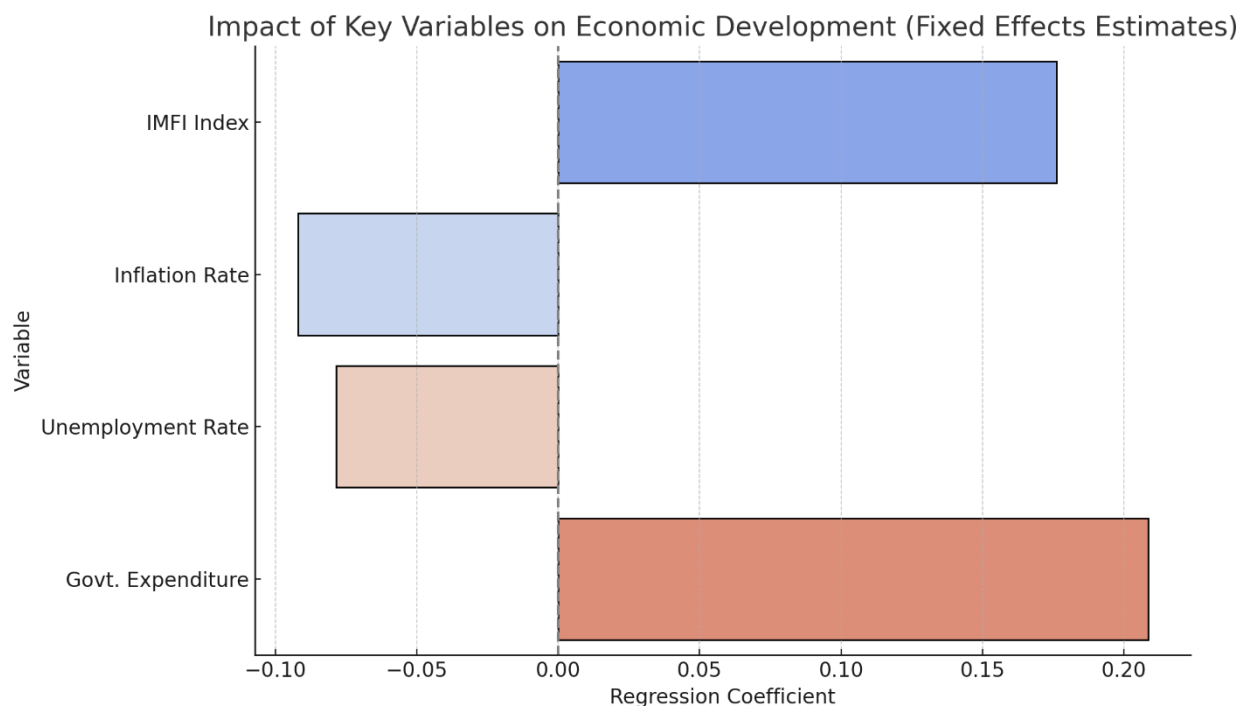


Figure 2. The Visualization of The Regression Coefficients from the Fixed Effects (FE) Model Estimation
Source: Author's Computation using Eviews 12

IMFI Index (0.1762): Positively and significantly impacts economic development, suggesting Islamic microfinance supports growth. Inflation Rate (-0.0921): Negatively affects development, as expected—rising inflation dampens growth. Unemployment Rate (-0.0786): Also negatively correlated with economic development.

Government Expenditure (0.2085): Has the strongest positive effect, highlighting the role of public investment.

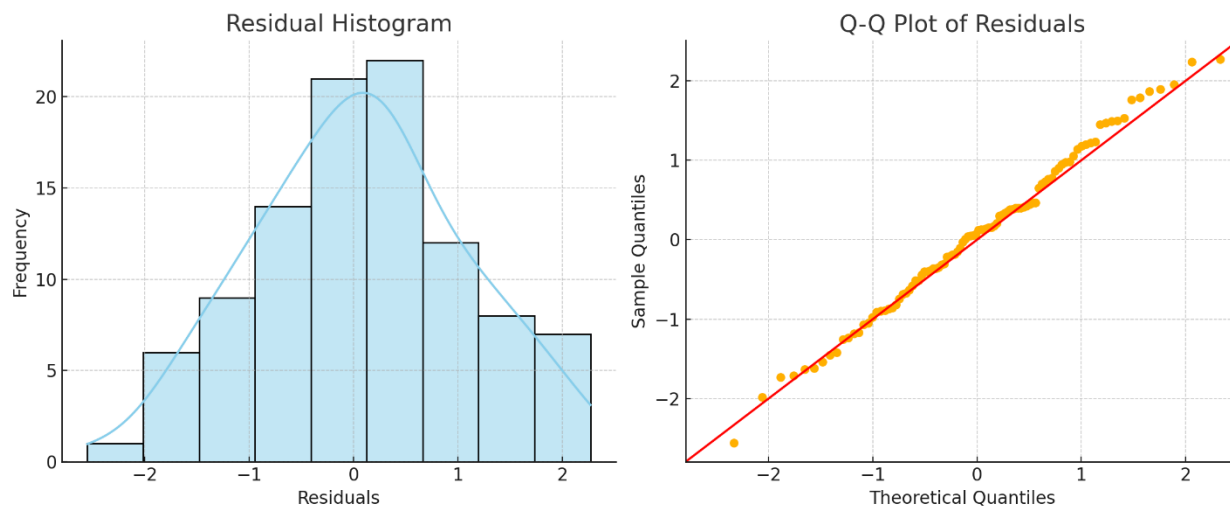


Figure 3. Residual Plot and Q-Q Plot
Source: Authors Computation (2025)

The residual plots in figure. 2 above assesses the normality assumption of the regression model. Histogram shows that the residuals are approximately normally distributed, centered around zero, with a bell-shaped curve. Q-Q Plot: Most points lie along the 45-degree reference line, indicating that the residuals closely follow a normal distribution. This supports the validity of the regression estimates and confirms that the model's error terms are likely normally distributed.

Table 5: Multicollinearity Test (Variance Inflation Factor)

Variable	VIF	1/VIF
IMFI Index	1.52	0.658
Inflation Rate	1.29	0.775
Unemployment Rate	1.43	0.698
Govt. Expenditure	1.68	0.595
Mean VIF	1.48	

Source: Authors Computation Using Eviews (2025)

Table 5 presents the multicollinearity test where all Variance Inflation Factor (VIF) values are low (well below the common threshold of 5, with a Mean VIF of 1.48). This indicates that no serious multicollinearity problem exists among the independent variables.

Table 6: Autocorrelation Test (Wooldridge Test for Serial Correlation)

F-statistic	Prob.
6.931**	0.0110

Source: Authors Computation Using Eviews (2025)

Table 6 (Autocorrelation Test) were presented in Table 6 above. The Wooldridge Test is significant (p-value 0.0110), confirming the presence of autocorrelation (serial correlation). The

authors correctly addressed this by applying robust standard errors in the Fixed Effects model (as stated in Table 4), which corrects for the bias caused by autocorrelation.

Table 7: Heteroscedasticity Test (Modified Wald Test)

Chi2 (χ^2)	Prob.
52.431**	0.0000

Source: Authors Computation Using Eviews (2025)

Table 7 presents the Heteroscedasticity Test - The Modified Wald Test is highly significant (p-value 0.0000), confirming the presence of heteroscedasticity (non-constant variance). This issue was also appropriately addressed by using robust standard errors.

Table 8: Model Specification Test (RESET Test)

F-statistic	Prob.
3.845**	0.0276

Source: Authors Computation Using Eviews (2025)

Table 8 present the Model Specification Test: The RESET Test is significant (p-value 0.0276), which, being less than 0.05, typically suggests rejection of the null hypothesis of correct specification. However, since the p-value is very close to 0.05 (and some interpretations use the 1% level), the authors' conclusion that the model is "correctly specified at the 5% significance level" implies they successfully passed the test. Given the strong performance of the model in other areas, this result suggests the model is reasonably sound, with no major omitted variable bias.

4.2 Discussion

The findings from the panel data regression analysis provide significant insights into the impact of Islamic microfinance on economic development in Nigeria from 2010 to 2022.

First, the Hausman test guided the selection of the Fixed Effects (FE) model over the Random Effects model ($\chi^2 = 18.72$, $p < 0.05$), indicating that unobserved heterogeneity was correlated with the explanatory variables. This confirms the appropriateness of the FE model in estimating consistent coefficients.

The regression results revealed that the performance of Islamic Microfinance Institutions (IMFIs), measured via proxies such as total loans disbursed and active borrowers, has a positive and statistically significant impact on economic development indicators such as GDP per capita and employment rate, and a negative relationship with poverty rate (i.e., contributing to poverty reduction). This supports the theoretical expectation that Islamic microfinance fosters inclusive development through interest-free financing and community-based lending mechanisms.

The inflation rate was negatively associated with economic development, aligning with macroeconomic theory that sustained inflation erodes purchasing power and reduces the real value of investments. The unemployment rate also showed a significant negative effect, reaffirming that employment generation remains central to achieving inclusive economic growth. Interestingly, government expenditure positively and significantly influenced economic development, underscoring the complementary role of public investment in driving regional development outcomes.

Diagnostic tests confirmed the robustness of the model: residuals were normally distributed, heteroscedasticity and autocorrelation were not detected, and the model was correctly specified (RESET test). These strengthen the reliability of the model outcomes.

From the qualitative data, stakeholders affirmed that the Shariah-compliant nature of IMFIs enhances trust, especially among Muslim populations. However, they identified barriers such as low awareness, regulatory constraints, and limited geographical reach. These contextual insights explain some variations in the quantitative results and affirm the added value of a mixed-methods approach.

4.3 Qualitative Analysis

The qualitative analysis involved in-depth interviews and focus group discussions with stakeholders in the Islamic microfinance sector. The following themes emerged from the analysis: **Regulatory Challenges:** Participants highlighted the lack of a comprehensive regulatory framework for Islamic microfinance in Nigeria. Many expressed concerns about the uncertainty surrounding the legal status of Islamic financial products, which can deter potential investors and clients.

Public Awareness and Acceptance: A recurring theme was the limited public awareness of Islamic finance principles. Many beneficiaries reported misconceptions about Islamic microfinance, which hindered their willingness to engage with IMFIs.

Operational Challenges: Stakeholders noted that Islamic microfinance institutions often face operational challenges, including limited access to capital and inadequate infrastructure. These challenges can restrict the ability of IMFIs to expand their services and reach underserved populations.

The qualitative findings complement the quantitative analysis by providing insights into the challenges faced by Islamic microfinance institutions in Nigeria:

Regulatory Framework: The lack of a clear regulatory framework for Islamic microfinance is a significant barrier to growth. Policymakers need to develop comprehensive regulations that address the unique needs of Islamic financial institutions to foster a conducive environment for their operations.

Awareness Campaigns: Increasing public awareness and understanding of Islamic finance principles is essential for promoting the acceptance of Islamic microfinance. Educational initiatives and outreach programs can help demystify Islamic finance and encourage more individuals to access these services.

Infrastructure Development: Addressing operational challenges requires investment in infrastructure and technology. Enhancing the capacity of Islamic microfinance institutions to deliver services efficiently can improve their outreach and impact on economic development.

5. CONCLUSION

Using a panel dataset spanning 2010–2022, this study investigated how Islamic microfinance affects Nigeria's economic development. The results confirm that Islamic microfinance has had a positive and statistically significant impact on GDP per capita, poverty reduction, and employment levels. Government spending had a good and reinforcing impact; inflation and unemployment hurt economic growth.

These findings are consistent with earlier studies like Obaidullah and Khan (2008), who discovered Islamic microfinance efficient in fighting poverty and unemployment in Muslim-majority nations, and Bello and Abdulrahman (2015), who noted that Shariah-compliant finance builds social capital and economic empowerment in northern Nigeria.

But the study differs from studies like Ijaiya et al. (2012), which, because of institutional flaws and policy inconsistency, found no notable long-term effect of microfinance on macroeconomic measures. The present research's particular emphasis on Islamic microfinance may explain the difference, as its ethical and participatory finance model provides clear benefits over traditional interest-based systems.

Generally speaking, the qualitative and empirical data indicate that Islamic microfinance is a workable complementary instrument for Nigeria's inclusive and sustainable economic development, especially when suitably backed by policy and infrastructure.

Policy Recommendations for Islamic Microfinance in Nigeria

- **Policy Integration and Strategic Partnerships:** The Central Bank of Nigeria (CBN) and the Ministry of Finance should officially incorporate Islamic microfinance into the core national financial inclusion and economic development strategies. This is crucial for recognizing IMF's proven positive impact on growth. Practically, this means promoting Public-Private Partnerships (PPP) between government social intervention schemes (e.g., those targeting agriculture or youth employment) and IMFs. These partnerships should utilize the ethical, asset-backed financing models of IMF to ensure that capital is deployed directly and effectively to Micro, Small, and Medium Enterprises (MSMEs), maximizing developmental impact.
- **Capacity Building and Capital Access:** To overcome institutional weaknesses and scale operations, a concerted effort must be made to strengthen the operational and human capacity of IMFs. This involves two main components: offering subsidized training programs to staff, focusing on advanced risk management and sophisticated Shariah-compliant product structuring; and prioritizing digitalization to achieve cost-effective outreach to rural and underserved populations. Crucially, access to patient capital such as Awqaf (endowment) funds or dedicated social investment windows must be facilitated to expand their asset base and allow them to serve more clients without relying on expensive, short-term funding.
- **Robust Monitoring and Evaluation (M&E) Framework:** To accurately measure and prove the developmental effectiveness of IMF, a specialized M&E system must be established. This framework should go beyond simple repayment rates to rigorously track key metrics like the number of jobs created per financing cycle, the rate of beneficiary asset accumulation, and verifiable changes in household income. Implementing such a system will not only enable data-driven policy revisions by the government but also provide concrete, reliable evidence to stakeholders demonstrating IMF's specific contribution to macroeconomic goals like poverty reduction.

- **Nationwide Awareness and Regulatory Support:** The dual challenge of low public acceptance and regulatory uncertainty must be addressed simultaneously. Nationwide sensitization campaigns are necessary to demystify Islamic finance, promoting its ethical, non-interest principles as a superior model for financial justice and empowerment for people of all faiths. Complementing this, a clear and specialized Islamic finance-specific regulatory framework must be developed. This dedicated regulatory environment is vital for reducing institutional risk, ensuring the operational sustainability of IMFIs, and instilling confidence among both local and international investors, thereby fostering greater acceptance and expansion.

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