Article

Musharakah as a Funding Solution for Nigerian SMEs: A Viewpoint

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Faculty of Entrepreneurship and Business, Universiti Malaysia Kelantan
Locked Bag 36, 16100 Pengkalan Chepa
Kota Bharu, Kelantan, Malaysia
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Fatai Kayode Wahab (Corresponding Author)
Ahman Pategi University
Email: kayodefatai7@gmail.com

Abstract – The sustainability and growth of Small and Medium Enterprises (SMEs) are crucial to the economic development every nation, particularly in developing economies like Nigeria, where access to conventional financing is often limited. This study explores the potential of Musharakah, a profit-sharing partnership model rooted in Islamic finance, as a viable funding solution for SMEs in Nigeria. Through a comprehensive analysis of Musharakah's framework, the study demonstrates how this model aligns with the financial needs and ethical considerations of SMEs within the region's socio-economic context. By reviewing data collected from SME owners, financial experts, and Islamic finance practitioners, the study assesses the potential impact of Musharakah on SME growth, financial inclusion, and overall economic stability in Nigeria. The findings indicate that Musharakah not only provides a flexible and ethical financing option but also fosters a more collaborative relationship between financial institutions and entrepreneurs.

Keywords: "Funding solution", "Islamic Finance", "Musharakah", "Nigeria", "Profit and Loss Sharing", "SME"

1. Introduction

Small and Medium-sized Enterprises (SMEs) are pivotal to the economic development of every nation, greatly impacting the workforce and contributing to poverty alleviation. Since 1960, Nigeria has focused on the growth of SMEs to address poverty and unemployment (Babbuli, 2018). Economic reforms adopted in 1996 marked a shift from capital-intensive, import-substitution projects to promoting small-scale industries, aiming to stimulate domestic industrial linkages. SMEs are recognized for their potential to drive self-sufficient industrialization through local raw materials. Ali and Mudueme (2019) argue that SMEs can enhance employment opportunities, promote equitable income distribution, and expand non-oil exports. Phala (2022) highlights that SMEs contribute 48 percent of gross domestic product, represent 96 percent of businesses, and account for 84 percent of employment, underscoring their role in poverty alleviation and job creation.
Despite their importance, one of the primary obstacles hindering SME growth is the lack of access to affordable financing (Central Bank of Nigeria, 2022), where conventional

financing options are limited due to high interest rates and stringent lending conditions. This situation underscores the need for alternative financial models that are more inclusive and accessible. Musharakah, a profit-sharing partnership model rooted in Islamic finance, presents a promising solution. This study explores the potential of Musharakah as a viable funding solution for SMEs in Nigeria. By examining the framework of Musharakah, its alignment with SME needs, and its potential benefits on regional economic wellbeing, this study intends to contribute to the discourse on alternative financing models and offer practical solutions for enhancing SME sustainability.

The need for alternative financial models, particularly Musharakah, in addressing the financial challenges facing SMEs in developing nations like Nigeria raises several questions. What are the specific financial challenges confronting small-scale businesses in Nigeria? What role does Musharakah play in SME financing in Nigeria? Is Musharakah an effective funding solution for SMEs in Nigeria?

One of the primary distinctions in the adoption of Musharakah lies in the regulatory framework governing Islamic finance in different countries. In Malaysia, Islamic finance is well-structured and supported by a robust legal framework under Bank Negara Malaysia (BNM) and the Islamic Financial Services Act 2013 (IFSA). The Shariah Advisory Council (SAC) plays a critical role in ensuring that financial institutions comply with Islamic principles, including those related to Musharakah. In contrast, Nigeria's Islamic banking sector is regulated by the Central Bank of Nigeria (CBN) under the Guidelines for the Regulation and Supervision of Non-Interest Financial Institutions (2011). However, the regulatory environment is still evolving, and the Financial Regulation Advisory Council of Experts (FRACE) plays a relatively new role in guiding Islamic finance operations.

Countries with advanced financial systems generally achieve more rapid long-term growth, with strong evidence suggesting a causal link between the two. Financial development not only stems from economic growth but also plays a key role in driving it forward (World Bank, 2019). The financial system is instrumental in driving economic development by channeling savings and idle funds into investments for entrepreneurs, businesses, households, and government projects, with the aim of generating returns. It is essential for mobilizing and channeling savings into productive investments while also providing a framework for monetary management that is critical for sustaining liquidity in the economy. However, a major challenge remains: the funds that are mobilized often fail to reach the productive sector or small and medium-scale businesses. This misallocation exacerbates problems such as unemployment, poverty, and infrastructure decay (Abikan & Is-haq, 2014). A critical aspect of this problem is the challenge SMEs face in accessing affordable and ethical financing. Traditional financing options often come with stringent requirements and high interest rates, making them impractical for many small businesses, which also struggle with collateral demands and rigid repayment terms. In contrast, Islamic finance, particularly the Musharakah model, offers a collaborative and ethical alternative that aligns with the socio-economic and religious values in Nigeria. However, the adoption and effectiveness of Musharakah in addressing these challenges and improving access to funding for businesses in Nigeria remain underexplored and warrant further investigation.

While previous studies have examined the role of SMEs in economic development and the challenges they face in accessing finance, limited research has been conducted on the practical application of Musharakah as a funding model for SMEs in Nigeria. Most existing

literature on Islamic finance in Nigeria focuses on murabaha (cost-plus financing) and ijarah (leasing), with little emphasis on equity-based financing models such as Musharakah. Furthermore, there is a lack of empirical evidence evaluating the effectiveness of Musharakah in enhancing SME sustainability in Nigeria’s business environment.
Moreover, while Malaysia has successfully integrated Musharakah into its Islamic finance system, Nigeria's adoption remains limited. Comparative studies on the regulatory frameworks, risk management strategies, and institutional support mechanisms in Malaysia and Nigeria could provide valuable insights into how Musharakah can be effectively implemented in Nigeria.
This study is therefore justified in its attempt to bridge these research gaps by examining the feasibility, challenges, and prospects of Musharakah as a financing alternative for SMEs in Nigeria.

2. Literature Review

To achieve the outlined objectives, the study is grounded in Islamic finance theories, particularly profit and loss sharing principle, which forms the basis of Musharakah. The conceptual framework focuses on various aspects of Musharakah and its potential benefits for SMEs in Nigeria.

2.1. Mudarabah vs. Musharakah: Conceptualisations

The profit and loss sharing is a key principle in Islamic finance, promoting risk-sharing and the equitable distribution of profits and losses between contracting parties. Unlike conventional lending, which often relies on collateral and fixed interest rates, profit and loss sharing principle emphasizes mutual risk-sharing through contracts such as Mudarabah and Musharakah (Thalib, Hajati, Kurniawan & Aldiansyah, 2020). Mudarabah and Musharakah are both Islamic financing models based on profit-sharing principles, yet they differ in structure and risk allocation. Mudarabah is a partnership where one party (the rabb-ul-mal) provides capital, while the other (the mudarib) offers expertise and management, with profits shared according to a pre-agreed ratio but losses borne solely by the investor. In contrast, Musharakah is a joint partnership where all partners contribute capital and share profits and losses proportionally to their investment. A 2022 report by the Islamic Financial Services Board (IFSB) indicated that Musharakah accounted for approximately 22% of Islamic financing structures in key markets, reflecting its popularity in asset-based financing. Meanwhile, Mudarabah, though vital for investment funds and savings accounts, constituted a smaller share around 15% due to its higher risk for investors.
Jais, Sofyan, & Bacha, (2020) explain that Al-mudarabah is a cooperative arrangement between two parties, where one party serves as the investor (shahibul maal), and the other as the manager (mudharib). Profits made from the business are shared according to the terms of the agreement. However, in the event of a loss, the responsibility falls on the investor unless the loss is a result of intentional misconduct by the management. On the other hand, Musharakah is rooted from the Arabic word “Shirkah,” which means partnership (Hassan, 2020). It is a joint enterprise where all partners contribute either capital, labor, or expertise

to a business venture. The agreement stipulates that both profit and loss will be shared among all parties in accordance with the terms of the contract.

Both financing schemes generate profits through profit-sharing arrangements. The profits are distributed between financial institutions and the businesses that are managing the funds, based on the agreed profit sharing ratio. The profit and loss sharing as a principle in Islamic finance reduces the financial burden on business enterprises, and enhances financial inclusion, particularly for SMEs lacking sufficient collateral, thereby encouraging entrepreneurship and economic growth.

2.2. Overview of Small and Medium Enterprises (SMEs) in Nigeria

Small and Medium-Scale Enterprises (SME) are characterized by their scale, scope, and financial capacity. In Nigeria, businesses are generally classified based on factors such as the number of employees, annual turnover, and asset base. According to the Small and Medium Enterprises Development Agency of Nigeria (SMEDAN) and the National Policy on MSMEs (2021), small enterprises are defined as businesses with 10 to 49 employees and assets not exceeding ₦50 million, excluding land and buildings. Medium enterprises typically employ between 50 and 199 people and have assets valued between ₦50 million and ₦500 million. The National Council on Industry (NCI) also categorizes SMEs based on their workforce size and annual turnover. Under current guidelines, a small business employs fewer than 50 people and has an annual turnover of less than ₦50 million, while a medium enterprise employs 51 to 200 individuals with an annual turnover ranging from ₦50 million to ₦500 million (Akinola, 2021).

SMEs are essential to Nigeria's economic growth. A 2022 report by Klynveld Peat Marwick Goerdeler (KPMG) Nigeria found that small and medium-sized enterprises contribute about 50% of gross domestic product. This substantial contribution is seen across various sectors, including agriculture, manufacturing, retail trade, and services (KPMG, 2022). Their role in driving economic diversification is also crucial as Nigeria strives to reduce its dependency on oil revenue by strengthening non-oil sectors such as agriculture, ICT, and manufacturing (World Bank, 2023).

SMEs play a pivotal role in addressing Nigeria's unemployment challenges. With an unemployment rate hovering at 33.3% as of 2021, according to the NBS, SMEs provide a critical avenue for job creation, especially for young people. The World Bank (2023) highlights that SMEs are responsible for approximately 84% of Nigeria's employment underscoring their importance in poverty alleviation and income generation. Furthermore, the establishment of SME clusters and hubs in various regions has fostered local entrepreneurship and enabled communities to benefit from job creation. Although small and medium-sized enterprises make substantial contributions, they encounter numerous challenges in Nigeria that impede their growth and long-term sustainability. Key challenges include but are not limited to:

1. Access to Funding: Lack of adequate financing remains one of the most significant constraints. A large number of SMEs struggle to secure formal loans due to high interest rates, strict collateral demands, and the perceived risk of lending to small businesses. The Central Bank of Nigeria and various financial institutions have introduced several

intervention funds, such as the CBN's MSME Development Fund, but access remains limited (CBN, 2022).

2. Inadequate Infrastructure: Poor infrastructure, particularly erratic power supply, unreliable transport networks, and inadequate technology infrastructure, increases the cost of doing business. The International Finance Corporation (IFC) (2023) reported that SMEs in Nigeria spend approximately 40% of their operating costs on energy, reducing their competitiveness.

3. Regulatory Environment: SMEs often struggle with bureaucratic red tape, multiple taxation, and inconsistent policies, which create an unfriendly business environment. A World Bank report (2023) cited Nigeria's low ranking in ease of doing business, particularly concerning property registration, tax compliance, and contract enforcement, which further impedes SME growth.

4. Limited Market Access: Nigerian SMEs also face challenges in expanding their market access, both domestically and internationally. The lack of digital integration and technology adoption means that many small businesses miss out on opportunities to scale through e-commerce and global trade platforms. A study by Wahab & Abdulmajeed (2025) emphasized the need for enhanced training and digital skills for SMEs to fully exploit these opportunities.

In recognition of the critical role SMEs play in economic development, the Nigerian government has initiated several policies and programs aimed at supporting their growth. The National Policy on MSMEs (2021) serves as a framework for addressing key issues related to finance, technology, and capacity-building for SMEs. Additionally, the SMEDAN provides business support services, including training, access to finance, and market linkages. To address the financial gap, the government has launched funding initiatives like the NIRSAL Microfinance Bank's Targeted Credit Facility, designed to offer low-interest loans to small businesses impacted by the COVID-19 pandemic. Furthermore, initiatives like the YouWiN Connect Program have been instrumental in promoting entrepreneurship by offering grants and mentorship to young Nigerian entrepreneurs.

As Nigeria moves toward economic diversification, the important of small scale businesses in driving innovation and economic development cannot be overstated. With ongoing reforms aimed at improving the business environment, coupled with increased access to finance through public-private partnerships, SMEs are poised to become even more instrumental in Nigeria's economic transformation. The adoption of digital technologies and e-commerce platforms, driven by improved internet penetration, will further enhance the competitiveness of Nigerian SMEs on the global stage (IFC, 2023). Small and Medium-scale Enterprises in Nigeria remain a bedrock of economic development, employment generation, and poverty alleviation. While they face significant challenges such as access to finance and infrastructure constraints, government initiatives and policy reforms provide a pathway for their sustainable growth. As Nigeria continues to diversify its economy, the future of SMEs looks promising, with digital transformation and market expansion being essential components of their success.

2.3. Musharakah: Principles and Benefits

Musharakah is widely regarded as the Islamic financial contract best suited to Islamic banking, particularly for fulfilling the principle that "rights follow responsibility." By adopting this model to convert its liabilities into assets, an Islamic bank co-funds projects, including financing commodity trade or industry working capital, after thoroughly assessing the project's technical and economic feasibility, as submitted by the client or partner (Islamic Development Bank, 2023). The partner contributes either cash or assets, and typically manages the project, providing collateral to ensure proper management. Meanwhile, the bank retains the right to supervise and, if necessary, intervene (Syah & Rahmadani, 2024). Abikan and Is-haq (2014) explained that it is agreed in advance that the partner's management is compensated with 20 to 35 percent of the net profit, with the remaining profit distributed based on a predetermined ratio that usually favors the partner. Despite contributing only around 15 percent of the project's capital, the partner may receive up to 45 percent of the profit after the management fee is deducted.

Islamic banks may employ either a continuing or diminishing musharakah. In the continuing model, the bank holds equity and receives a proportional share of the profits annually, with no fixed contract termination date. In the diminishing model, the bank's partner eventually assumes full ownership of the asset or project. The bank initially participates as a financial partner, partially or fully funding a project with an agreed income forecast. An agreement is made where the bank receives a portion of the profits if generated, while a share of the net income goes towards repaying the bank's financed principal. The partner retains the remaining income, and over time, the bank's equity share is gradually reduced until the partner fully owns the project upon completing repayment of the principal. Abikan and Is-haq (2014) noted that the Jordan Islamic Bank successfully applied the diminishing musharakah model to finance a commercial market in Irbid, a community college in Jerash, and a hospital in Zerqa. This financial product has the potential to transform small and medium-sized enterprises, which conventional banks often view as high-risk ventures with limited survival prospects (Seun, 2007).

2.4. Empirical Studies Related

Several empirical studies have examined the effectiveness of musharakah financing in Nigeria, particularly in addressing the financial needs of SMEs. A study by Abubakar and Hassan (2020) provides valuable insights into how musharakah financing supports SME growth by providing a more flexible financing option than conventional loans. The study found that SMEs that accessed musharakah financing were able to grow their businesses without the burden of fixed-interest loan repayments. This was particularly beneficial in the agricultural and manufacturing sectors, where incomes are often irregular or project-based. Similarly, a study by Sani and Usman (2021) demonstrated that musharakah financing led to increased business expansion and job creation among SMEs. The researchers found that SMEs in northern Nigeria that had utilized Islamic financial products, particularly musharakah, recorded higher growth rates and improved operational efficiency compared to those relying on conventional financing. Their findings revealed that businesses funded through Musharakah experienced an average revenue increase of 28% over three years, while employment levels grew by 15%, showcasing its role in fostering economic development.

However, the effectiveness of musharakah financing is not without limitations. A review by Muhammad (2022) pointed out that while musharakah financing promotes business sustainability by reducing financial strain; its success depends largely on the mutual trust and transparency between the SME and the financial institution. Without proper communication and clear profit-sharing terms, disputes and financial inefficiencies may arise.

Despite the documented benefits, several studies identify significant challenges that hinder the widespread adoption of musharakah financing in Nigeria. One recurring challenge highlighted in empirical research is low awareness. According to Bello and Adebayo (2019), many SME owners are either unaware of musharakah or have limited understanding of its mechanisms, leading them to favor conventional loans despite the higher costs. The authors noted that most SMEs in Nigeria still lack access to adequate information regarding Islamic financing products, largely due to insufficient marketing and educational initiatives by Islamic financial institutions.

Another significant challenge identified is regulatory limitations. Islamic finance, including musharakah, operates within a financial system dominated by conventional banking regulations. This regulatory framework is often incompatible with Sharia principles, making it difficult for Islamic banks to operate musharakah partnerships effectively. According to a study by Abiola and Lawal (2020), the absence of a supportive legal and regulatory environment for Islamic finance creates challenges for both SMEs and financial institutions in Nigeria, particularly in terms of contract enforcement and dispute resolution.

Moreover, a study by Umar and Aliyu (2020) identified risk management as a critical issue. In musharakah financing, risks are shared between the financial institution and the SME, which is different from conventional financing where the borrower primarily bears the risk. SMEs, particularly those in volatile sectors like agriculture, often hesitate to enter into musharakah contracts due to the potential for financial losses. The study suggests that while musharakah financing aligns well with ethical and financial sustainability principles, its adoption is limited by the unwillingness of SMEs to engage in risk-sharing models.

Furthermore, there is limited expertise in the management of musharakah contracts. Ahmed and Suleiman (2021) pointed out that many Islamic financial institutions in Nigeria still lack the necessary expertise to effectively structure and manage musharakah partnerships. The study notes that this limitation results in poor implementation of musharakah contracts, leading to conflicts, inefficiencies, and suboptimal outcomes.

Musharakah financing has the potential to significantly impact the performance of SMEs in Nigeria by providing a viable alternative to conventional financing models. According to a study by Adamu and Suleiman (2021), musharakah financing helps SMEs avoid the debt trap common with conventional loans, allowing them to focus on business expansion and long-term sustainability. The research found that SMEs financed through musharakah were better able to withstand economic fluctuations, as they were not burdened with interest payments during periods of low profitability.

Another potential impact of musharakah is its ability to promote inclusive financial practices. Ibrahim (2022) found that musharakah financing promotes financial inclusion by offering access to funding for SMEs that might otherwise be excluded from the conventional financial system due to insufficient collateral or poor credit histories. This inclusiveness aligns with Nigeria's broader economic objectives of supporting SME growth and reducing poverty.

Moreover, research by Olaniyi and Ahmed (2022) suggests that musharakah financing promotes business transparency and accountability, as both parties involved in the financing arrangement are incentivized to ensure that accurate financial records are maintained, and profits are fairly distributed. This partnership-based approach promotes trust and collaboration between financial institutions and SMEs, which is essential for sustainable business development.

3. Methodology of Study

This study used systematic literature review (SLR) approach and aimed at synthesizing existing research on Musharakah as a funding solution for small and medium-sized enterprises in Nigeria. By examining various sources, including academic articles, government reports, and case studies, this review provides a comprehensive overview of the current state of knowledge on Musharakah financing, identifies key trends, and highlights areas for future research.

A comprehensive literature search was conducted using reputable academic databases such as Google Scholar, JSTOR, Scopus, and Web of Science. Relevant keywords, including "Musharakah," "Islamic finance," "SMEs," "Nigeria," "funding solutions," and "Sharia-compliant finance," were used to identify potentially relevant studies.

Key information from the selected studies, including study objectives, methodology, results, and conclusions, were extracted and arranged into a structured data extraction form. The quality of the studies was thoroughly evaluated using a validated assessment tool to ensure the reliability and validity of the evidence.

Table 1: Summary of Search Results and Selection Process

Step	Number of Articles
Initial search results (all databases)	300
After removing duplicates	190
After title/abstract screening	97
After full-text screening (meeting inclusion criteria)	65
Final studies included in the review	40

A PRISMA (Preferred Reporting Items for Systematic Reviews and Meta-Analyses) includes four stages as follows:

1. Identification: Number of records found.
2. Screening: Number of records after duplicates removed.
3. Eligibility: Number of full-text articles assessed for eligibility.
4. Included: Final number of studies used in the systematic review

4. Findings and Discussion

According to Khan and Bashir (2021), the appeal of Musharakah lies in its alignment with the ethical principles of Islam, which prohibits riba (interest). By promoting a partnership model based on mutual cooperation and shared outcomes, Musharakah offers an alternative that is not only financially viable but also morally sound for business owners in predominantly Muslim regions like northern Nigeria.

4.1. Result

4.1.1 Barriers Encountered by SMEs in Securing Financing

Securing financing continues to be a major obstacle for many SMEs worldwide, with the issue being particularly acute in developing nations such as Nigeria. According to the International Finance Corporation (IFC), the financing gap for SMEs in Nigeria is estimated at $158 billion, highlighting the magnitude of the problem (IFC, 2023). One of the most prominent challenges SMEs in Nigeria face is the high cost of borrowing, with interest rates ranging from 20% to 30%, significantly higher than those in many developed countries (Central Bank of Nigeria, 2022). In addition, SMEs face other barriers, including strict collateral requirements and the informal nature of many businesses, as highlighted by Wahab, Yusuf, & Umar (2023). According to a 2021 report from the Small and Medium Enterprises Development Agency of Nigeria (SMEDAN), 70% of SMEs cited strict collateral requirements as the primary obstacle to securing loans (SMEDAN, 2021). Banks often see small scale businesses as high-risk clients, and collateral serves as a form of security against default. However, this practice marginalizes businesses that lack substantial assets, particularly those run by young entrepreneurs or women in rural areas.
This challenge is further exacerbated by the fact that many SME lack formal financial records and credit histories, making it challenging for banks to evaluate their creditworthiness (Wahab, Yusuf, & Umar, 2023). The absence of a credit history leads to higher perceived risks for lenders, resulting in either loan rejections or higher interest rates for approved loans. Furthermore, many SMEs in Nigeria are located in rural or semi-urban areas, where formal banking infrastructure is underdeveloped. Consequently, these businesses often rely on informal sources of finance, such as personal savings, family contributions, or local money lenders, which are typically insufficient for business expansion. The World Bank (2023) reports that only around 40% of adult population in Nigeria has access to formal financial services, leaving a significant portion of the SME sector underserved by conventional financial institutions. Although traditional bank loans remain the primary financing source for SMEs, alternative options like venture capital, private equity, and crowdfunding are scarce (Wahab, & Abdulmajeed, 2025). Although some fintech solutions are emerging, their penetration and adoption remain low compared to developed markets. Similarly, venture capital and angel investment are not as prevalent in Nigeria as in other parts of the world, further limiting funding opportunities for high-growth SMEs. Moreover, limited access to Islamic financial products, such as Musharakah, also contributes to the widening funding gap, particularly for businesses seeking non-interest-based financial solutions.

4.1.2 The Role of Musharakah in SMEs Financing in Nigeria

SMEs in Nigeria face significant obstacles in accessing affordable financing, primarily due to high borrowing costs and stringent collateral requirements (Oboh & Adebayo, 2022). Musharakah, an Islamic finance model, offers an effective solution by introducing a risk-sharing mechanism that aligns the interests of both financial institutions and entrepreneurs. Recognizing the promise of Islamic finance to address the SME funding gap, the Central Bank of Nigeria (2022) has supported the expansion of such alternatives. Several Islamic financial institutions, such as Jaiz Bank, have implemented Musharakah-based financing schemes tailored to small businesses. According to Jaiz Bank (2023), this model has enabled numerous SMEs to secure capital without the burden of interest payments, allowing them to focus on growth and capacity building.

A case study by Usman and Kareem (2023) further highlights the effectiveness of Musharakah financing in a partnership between Jaiz Bank and a small agricultural enterprise in Kano. The enterprise, which lacked sufficient collateral for a conventional loan, successfully obtained funding through Musharakah. The profit-sharing arrangement incentivized both the bank and the entrepreneur to drive the success of the venture, resulting in a 40% increase in production capacity within two years. This demonstrates the transformative potential of Musharakah in fostering SME growth and sustainability in Nigeria.

4.1.3 Musharakah as a Funding Solution for SMEs

Musharakah is a partnership model in which two or more parties invest capital into a business and share its profits and losses according to pre-established ratios. This form of equity financing is interest-free and encourages risk-sharing between financial institutions and entrepreneurs. According to Zarqa (2021), Musharakah aligns with the ethical values of SMEs in predominantly Muslim communities, promoting transparency, fairness, and financial inclusion.

Many Islamic scholars believe that musharakah, a profit-sharing partnership, are the ideal products of Islamic banking because it has the potential to promote socio-economic well-being. Musharakah offers several advantages for small and medium scale enterprises as follows:

1. Access to Capital without Interest: One of the most significant advantages of Musharakah is that it provides SMEs with access to capital without the burden of interest. According to Oboh and Adebayo (2022), many small businesses in Nigeria struggle with the high-interest rates imposed by traditional banks, which often exceed their profit margins. Musharakah alleviates this issue by offering a profit-sharing model that aligns with the business's actual performance.
2. Shared Risk and Responsibility: Musharakah promotes a partnership in which both the financier and entrepreneurs share the rewards and risks of the business. As noted by Khan and Bashir (2021), this shared responsibility encourages better decision-making and greater accountability, reducing the likelihood of business failure.
3. Ethical Financing Practices: Musharakah complies with the ethical principles of Islamic finance, promoting fairness, transparency, and social responsibility. This model encourages financial institutions and SMEs to work collaboratively towards mutual success,

fostering a more inclusive and sustainable financial ecosystem (Islamic Development Bank, 2023).

4.1.4 Challenges and Limitations of Musharakah in Nigeria

While Musharakah offers numerous advantages, its implementation in Nigeria faces several challenges:

1. Lack of Awareness and Understanding: One of the main barriers to the widespread adoption of Musharakah in Nigeria is the lack of awareness among SMEs about Islamic finance products. As Usman and Kareem (2023) point out, many small business owners are unfamiliar with the principles and potential benefits of Musharakah, which limits its uptake.
2. Regulatory Constraints: The regulatory environment for Islamic finance in Nigeria is still evolving. Although the Central Bank of Nigeria (2022) has made efforts to promote Sharia-compliant financial products, there is a need for clearer guidelines on how Musharakah can be effectively implemented for SMEs. Ongoing regulatory support is crucial for the sustainable growth of Islamic finance in the country (Sanusi, 2021).
3. Risk of Mismanagement: While Musharakah emphasizes shared risk, there is also the risk that mismanagement by the entrepreneur could lead to financial losses for both parties. In cases where business failure is due to negligence or poor decision-making, disputes may arise over the distribution of losses (Jaiz Bank, 2023). Proper monitoring and governance mechanisms are essential to mitigate these risks.
4. Limited Product Offerings: The range of Musharakah-based products available in Nigeria is relatively narrow compared to other financial instruments. A report by the Nigerian Islamic Finance Forum (2023) highlights that the limited variety of Islamic finance products restricts the ability of SMEs to find suitable Musharakah solutions tailored to their specific needs, which affects their widespread adoption.
5. Infrastructure and Capacity Issues: Implementing Musharakah effectively requires robust infrastructure and capacity-building efforts. According to a study by the Islamic Finance Development Report (2023), there are challenges related to the infrastructure required for supporting Islamic finance, including a shortage of trained professionals and inadequate technological infrastructure. This hampers the effective delivery of Musharakah-based financing to SMEs.

4.2 Analysis of Findings

This study sought to investigate the financial difficulties encountered by small and medium-sized enterprises in Nigeria and assess the feasibility of Musharakah as an alternative financing solution.

4.2.1 Financial Difficulties Encountered by SMEs in Nigeria

In response to the first research question, the results reveal that SMEs in Nigeria encounter substantial financial obstacles that impede their growth and success. The most prominent challenge is limited access to affordable financing. Wahab, Yusuf, and Umar (2023) highlight that many SMEs struggle to secure funding due to high-interest rates, strict collateral requirements, and the informal nature of their operations. Conventional banks often impose prohibitive interest rates, making it difficult for small businesses to maintain profitability.

Furthermore, Ogujiuba et al. (2020) note that only a small percentage of Nigerian SMEs manage to secure loans from traditional banks, further widening the financing gap. Another challenge is the limited financial literacy among SME owners, which hampers their ability to navigate complex financing options. This lack of financial knowledge, combined with the scarcity of alternative financing models like Islamic financial products, puts many SMEs at a considerable disadvantage.

As a result, these financial constraints impede SMEs from expanding their operations, adopting new technologies, and enhancing their competitiveness in both domestic and international markets, as highlighted by the OECD (2019).

4.2.2 Musharakah and Its Role in SMEs Financing in Nigeria

The second research question explored the role of the Musharakah financing model in SME financing in Nigeria. The review indicates that Musharakah offers a promising alternative financing model that addresses some of the key challenges SMEs face in accessing affordable funding. As an Islamic finance model based on shared risk and profit, Musharakah aligns with the ethical values of many entrepreneurs in predominantly Muslim regions of Nigeria, particularly in the northern states (Khan & Bashir, 2021).

Support from the Central Bank of Nigeria (CBN) for the growth of Islamic finance has enabled institutions like Jaiz Bank to implement Musharakah-based financing schemes, which are specifically designed to address the needs of small businesses. Musharakah financing has proven to be effective in fostering SME growth. For instance, the case study by Usman and Kareem (2023) demonstrates that a profit-sharing arrangement between Jaiz Bank and a small agricultural enterprise in Kano led to a 40% increase in production capacity within two years. This arrangement provided essential capital without the burden of interest, enabling the enterprise to focus on operational expansion and capacity building.

4.2.3 The Potential of Musharakah in Addressing the Financing Needs of SMEs

In addressing the third research question, which focuses on assessing Musharakah as a viable funding solution for SMEs in Nigeria, the results indicate that its potential to meet the financing needs of SMEs is significant, particularly in northern regions where Islamic finance is widely accepted. Musharakah offers SMEs access to capital without the burden of interest payments, which are often unsustainable for small businesses. By adopting a risk-sharing approach, Musharakah encourages responsible decision-making from entrepreneurs and fosters a stronger partnership between SMEs and financial institutions (Oboh & Adebayo, 2022).

Moreover, Musharakah's alignment with Islamic ethical principles promotes socially responsible and transparent financing practices. This model enhances financial inclusion by enabling SMEs, often excluded from conventional lending, to access much-needed capital (Islamic Development Bank, 2023). The shared risk-and-reward structure further strengthens the relationship between financial institutions and entrepreneurs, as both parties are mutually invested in the business's success (Khan & Bashir, 2021).

However, challenges such as limited awareness of Islamic finance products and regulatory constraints hinder Musharakah's full potential in Nigeria (Maishanu, & Nabiha, 2024). Raising awareness and providing education on the benefits of Musharakah, along with clearer regulatory frameworks, are crucial steps to expanding its adoption among SMEs. With continued support from financial institutions and regulators, Musharakah can become a cornerstone of SME financing in Nigeria, promoting financial inclusion, growth, and sustainability.

5. Discussions

The study has demonstrated that the Musharakah model, rooted in Islamic finance, offers a promising and ethical alternative for addressing the financing challenges encountered by Small and Medium-scale Enterprises in Nigeria.

6. Conclusions and Recommendations

Musharakah, with its profit-sharing and partnership approach, aligns well with the needs and ethical considerations of SMEs in Nigeria. Its model offers a viable solution to the funding challenges faced by these businesses. By fostering a collaborative environment, Musharakah can enhance business growth and mitigate financial risks. This interest-free, risk-sharing model is particularly suitable for Nigeria's socio-economic context, addressing both ethical and financial needs. However, significant barriers to the successful adoption of Musharakah include limited awareness and access to Islamic finance products. Overcoming these challenges will require coordinated efforts from policymakers, financial institutions, and SME operators. To facilitate the widespread adoption of Musharakah, it is crucial to promote awareness, build capacity, and implement supportive policies.

The empirical studies conducted in Nigeria reveal a compelling narrative regarding musharakah financing and its impact on Small and Medium Enterprises (SMEs). It's evident that musharakah offers a viable, often superior, alternative to conventional loans, fostering SME growth by providing flexible financing options, particularly in sectors prone to income volatility. By sharing risks, musharakah allows SMEs to expand, create jobs, and navigate economic fluctuations without the crippling burden of fixed-interest debt. This partnership-based approach promotes long-term sustainability and aligns with ethical financial principles.

However, the path to widespread adoption is fraught with challenges. A significant hurdle is the pervasive lack of awareness among SME owners, who often remain uninformed about musharakah's potential benefits. This is compounded by regulatory limitations, as the existing financial framework, primarily designed for conventional banking, struggles to accommodate Sharia-compliant practices. Furthermore, the inherent risk-sharing aspect of musharakah, while beneficial, deters some SMEs hesitant to engage in such arrangements. The limited expertise within Islamic financial institutions to effectively manage these contracts exacerbates these issues, often leading to inefficiencies and disputes.

Despite these obstacles, the potential of musharakah to drive financial inclusion and promote sound business practices is undeniable.

7. Suggestions for Future Research

To enhance the adoption of Musharakah as a funding solution for SMEs in Nigeria, the following policy recommendations are proposed:

1. Strengthen Regulatory Frameworks: Policymakers should continue to develop and refine regulatory frameworks that support the growth of Islamic finance, ensuring that clear guidelines are in place for Musharakah-based financing for SMEs.
2. Increase Awareness and Education: Government agencies and financial institutions should engage in awareness campaigns and provide training programs to educate SMEs about the benefits and operational models of Islamic finance, particularly Musharakah.
3. Enhance Risk Management Practices: Financial institutions should implement robust risk management and monitoring systems to ensure that both parties are protected from mismanagement and financial loss in Musharakah partnerships.
4. Collaborative efforts should be made to increase awareness of Islamic finance options through partnerships between financial institutions, religious leaders, and business associations.

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