VOL. 11 NO. 7,
FEBRUARY, 2026
E-ISSN 3026-9679
P-ISSN 3026-9423

African Scholar Publications & Research International
www.africanscholarpub.com

Journal of Business Dev. and Management Res. (JBDMR)

Capital Adequacy and Profit-Sharing Behaviour in Nigerian Islamic Banks: Evidence from Jaiz Bank and TAJ Bank (2023–2025)

***Olawole, Babawale Y.; & **Akinbode, Feyisayo A. (PhD)**

*Department of Banking and finance, Olabisi Onabanjo University, Ago Iwoye.
**Department of Accouting, Olabisi Onabanjo University, Ago Iwoye
Corresponding Author: olawoleboy@gmail.com
DOI: https://doi.org/10.70382/ajbdmr.v11i7.058

Abstract

This study investigates the relationship between capital adequacy and profit-sharing procedures in Nigerian Islamic banks, with a particular focus on Jaiz Bank Plc and TAJ Bank Limited for the years 2023–2025. Profit-and-loss sharing (PLS) is the foundation of Islamic banking; however, Basel III-aligned regulatory capital requirements may have an impact on payout stability, profitability, and incentives for taking on risk. The study examines the relationship between Capital Adequacy Ratio (CAR) and Profit Sharing Ratio (PSR), Return on Assets (ROA), and Non-Performing Financing (NPF) using quarterly panel data, fixed effects regression, and dynamic Generalised Method of Moments (GMM) estimation. The results show that while lowering financing risk, increased capital adequacy greatly improves profit-sharing stability and profitability. In contrast to the capital trade-off idea, higher capital buffers support operational resilience and depositor confidence rather than displacing distributable earnings. The findings are consistent with buffer capital theory and show that regulatory capital has a disciplinary effect on Islamic banking practices in emerging markets. The study has policy implications for regulators, Islamic bank management, and stakeholders in the financial industry, and it adds to the scant empirical literature on non-interest banking in Nigeria.

Keywords: Capital adequacy, Islamic banking, profit-sharing, financial stability, risk management

Introduction

Over the past ten years, Nigerian Islamic banking has grown significantly, offering Shariah-compliant financial intermediation based on asset-backed financing and risk-sharing. The official institutionalisation of non-interest banking in Nigeria began with the founding of Jaiz Bank and continued with the arrival of TAJ Bank. These organisations function under a dual banking framework that supports both conventional and Islamic financial systems, and are governed by the Central Bank of Nigeria (CBN). Nigeria experienced macroeconomic instability between 2023 and 2025, which was marked by monetary tightness, exchange rate liberalisation, and high inflation. Bank capital sufficiency becomes crucial to financial stability during these times. Because profit-sharing schemes directly link depositor returns to bank performance, the issue is more complex for Islamic banks. Therefore, depositor confidence, risk appetite, and profit distribution strategies may all be impacted by regulatory capital requirements. Although the relationship between capital sufficiency and profitability is well documented in conventional banking literature (Ozili, 2022; IMF, 2024), there is still little empirical data on how capital buffers impact profit-sharing practices in Islamic banks, especially in Nigeria. In order to fill this vacuum, this study looks at Islamic banks in Nigeria during a time of recent macroeconomic turbulence and regulatory reform.

The study addresses three research questions:

1. Does capital adequacy influence profit-sharing behaviour in Nigerian Islamic banks?
2. How does capital adequacy affect profitability?
3. Does stronger capital reduce financing risk?

Conceptual Review

Over the past ten years, Nigerian Islamic banking has grown steadily, providing Shariah-compliant financial intermediation based on asset-backed financing and risk-sharing. Non-interest banking in the nation was formally institutionalised in 2012 with the founding of Jaiz Bank, and then TAJ Bank entered the market. The Central Bank of Nigeria (CBN), which oversees both conventional and Islamic financial institutions, is in charge of these banks' operations within a dual banking system (Ahmed & Khan, 2021; IFSB, 2023). In contrast to traditional fixed-income deposit arrangements, the Nigerian Islamic banking model places a strong focus on profit-and-loss sharing (PLS) contracts, such as mudarabah and musharakah, where depositor returns are directly correlated with bank performance.

Nigeria's macroeconomic instability between 2023 and 2025 was marked by monetary tightening, exchange rate liberalisation, and high inflation. Because it increases resilience to shocks and maintains depositor confidence, capital adequacy becomes essential for banking stability in such circumstances (Ozili,

2022; IMF, 2024). The function of capital is particularly complex for Islamic banks since it has a direct impact on risk appetite, profit-sharing practices, and the ability to make dividends smoothly without endangering solvency (Ahmed & Khan, 2021). This work fills a crucial research vacuum caused by the paucity of empirical data from Nigeria, especially with regard to the impact of capital buffers on PLS results.

Empirical Review

Empirical research emphasises how capital adequacy stabilises banking systems. Higher capital buffers improve profitability and lower systemic risk in emerging markets, according to Ozili (2022). Capital resilience is emphasised by the International Monetary Fund (2024) as a crucial factor in maintaining financial stability in the face of macroeconomic crisis.

Olawole et al. (2026) investigated how Islamic money may help Nigeria combat climate change and advance environmental sustainability. Their analysis concluded that robust governance, regulatory reforms, and strategic incentives to encourage innovation and draw in sustainable investment are necessary to fully realise the promise of Islamic financing for climate action in Nigeria.

Profit smoothing strategies for shifted commercial risk in Islamic banking scenarios are described by Ahmed and Khan (2021). The Islamic Financial Services Board states that Islamic banks generally have larger capital holdings than their conventional counterparts (2023). Nonetheless, empirical studies with an African focus are still scarce. This research makes a contribution by supplying empirical data from Nigeria after 2023, directly connecting CAR to profit-sharing practice and utilising dynamic panel methods.

Theoretical Framework

The study is grounded in three complementary theoretical perspectives.

Buffer Capital Theory

According to buffer capital theory, banks keep capital over the regulatory minimum requirements in order to withstand unforeseen shocks and prevent supervisory involvement. It implies that banks can stabilise distributions and absorb unforeseen losses by keeping capital above regulatory minimums (IFSB, 2023). Institutional stability and depositor confidence are improved by larger capital buffers (IFSB, 2023). Capital buffers may stabilise payment behaviour in Islamic banking, because depositor rewards are contingent on achieved profits.

Risk-Sharing Theory

Principles of profit-and-loss sharing, such as mudarabah and musharakah, are the foundation of Islamic finance. The statement emphasises that Shariah-compliant contracts put depositors at risk for performance; hence, capital adequacy may mitigate profit-smoothing and replace commercial risk. Depositors are subject to performance risk in Islamic investment accounts,

in contrast to traditional deposit contracts. Thus, capital adequacy may affect displaced commercial risk and profit smoothing behaviour (Ahmed & Khan, 2021).

Agency Theory

According to agency theory, managers may smooth payouts in order to preserve their reputation and prevent depositor withdrawal. By lessening the pressure for opportunistic distribution strategies, strong capital sufficiency may discipline such behaviour. Additionally, it emphasises the managerial motivations to preserve depositor confidence and preserve reputation, suggesting that higher capital positions may restrain opportunistic profit distribution behaviour (Ahmed & Khan, 2021). Using robust dynamic panel methodologies, this study adds empirical evidence from Nigerian Islamic banks after 2023 by relating capital sufficiency to financing risk and profit-sharing behaviour.

METHODOLOGY

The released financial accounts of Jaiz Bank and TAJ Bank provided the quarterly financial statistics (2023Q1–2025Q4). Official CBN statistical releases were the source information regarding macroeconomic indicators.

Dependent Variables

- Profit Sharing Ratio (PSR)
- Return on Assets (ROA)
- Non-Performing Financing Ratio (NPF)

Independent Variable

- Capital Adequacy Ratio (CAR)

Control Variables

- Bank Size (log total assets)
- Liquidity Ratio
- Inflation Rate
- GDP Growth

Model Specification

Model 1: Profit-Sharing Behaviour

$$PSR_it = \alpha + \beta 1CAR_it + \beta 2SIZE_it + \beta 3LIQ_it + \beta 4INF_t + \varepsilon_it$$

Model 2: Profitability Model

$$ROA_it = \alpha + \beta 1CAR_it + \beta 2SIZE_it + \beta 3LIQ_it + \beta 4GDP_t + \varepsilon_it$$

Model 3: Risk Model

$$NPF_it = \alpha + \beta 1CAR_it + \beta 2SIZE_it + \beta 3LIQ_it + \beta 4INF_t + \varepsilon_it$$

Fixed effects and dynamic GMM estimations were applied. Diagnostic tests confirmed absence of multicollinearity and serial correlation.

RESULTS

Descriptive Statistics

Table 1: Descriptive Statistics (2023Q1–2025Q4)

Variable	Mean	Std. Dev.	Min	Max
CAR (%)	19.42	3.81	14.20	25.63
PSR (%)	8.24	1.38	5.91	10.41
ROA (%)	2.73	0.92	1.18	4.12
NPF (%)	4.81	1.29	2.87	7.23
SIZE (log assets)	12.86	0.54	11.92	13.71
LIQ (%)	31.45	4.73	23.18	39.27

Note. CAR = Capital Adequacy Ratio; PSR = Profit Sharing Ratio; ROA = Return on Assets; NPF = Non-Performing Financing.

The capital adequacy levels of both banks were significantly higher than the Central Bank of Nigeria's regulation requirement. A conservative capital stance during the recapitalisation reform era is suggested by the mean CAR of 19.42%. The comparatively steady PSR (mean = 8.24%) suggests that, in spite of macroeconomic fluctuations, payment consistency is moderate. The NPF mean of 4.81% indicates good risk management because it stays within prudential bounds.

Significantly, the CAR standard deviation (3.81) is smaller than the PSR standard deviation, suggesting that capital buffers were more stable than changes in the profit distribution. The idea that adequate money serves as a stabilising anchor is supported by this.

Correlation Analysis

Table 2: Correlation Matrix

Variable	CAR	PSR	ROA	NPF	SIZE	LIQ
CAR	1.000					
PSR	0.421***	1.000				
ROA	0.368***	0.512***	1.000			
NPF	-0.437***	-0.298**	-0.469***	1.000		
SIZE	0.295**	0.276**	0.333**	-0.261**	1.000	
LIQ	0.318**	0.241*	0.214*	-0.284**	0.402***	1.000

Note. *p < .10, **p < .05, ***p < .01.*

According to the correlation matrix, there is a significant positive correlation between CAR and PSR ($r = 0.421$, $p < .01$). A substantial negative correlation ($r = -0.437$, $p < .01$) was seen between CAR and NPF. Multicollinearity is not evident (all correlations < 0.70).

The preliminary evidence that capital buffers lower financing risk exposure is provided by the negative CAR–NPF connection.

Fixed Effects Regression: Profit-Sharing Model

Table 3: Fixed Effects Regression — Dependent Variable: PSR

Predictor	Coefficient	Std. Error	t	P
Constant	2.117	0.842	2.51	.018
CAR	0.084***	0.023	3.72	.001
SIZE	0.021**	0.010	2.01	.049
LIQ	0.016*	0.008	1.89	.061
INF	-0.009	0.006	-1.42	.164
Adjusted R^2	0.48	F = 9.31		.000

Source: Author's Computation (2026)

The impact of capital adequacy on profit-sharing behaviour is favourable and statistically significant ($\beta = 0.084$, $p < .01$). This suggests that PSR rises by about 0.084 percentage points for every 1% increase in CAR.

This result validates the Buffer Capital Theory and shows that increased capital enhances rather than limits payment sustainability. Instead of using withholding measures, capital buffers seem to be used as stability tools by Islamic banks. Additionally, bank size has a positive impact on PSR, indicating that scale efficiency increases the ability to distribute earnings.

Profitability Model

Table 4: Fixed Effects Regression — Dependent Variable: ROA

Predictor	Coefficient	Std. Error	t	p
Constant	0.913	0.412	2.22	.032
CAR	0.112***	0.029	3.86	.000
SIZE	0.037**	0.015	2.47	.019
LIQ	0.011	0.009	1.22	.228
GDP Growth	0.018*	0.010	1.83	.072
Adjusted R^2	0.52	F = 10.47		.000

Source: Author's Computation (2026)

Profitability is considerably increased by CAR ($\beta = 0.112$, $p < .01$). According to this, capital strength enhances operational resilience and earnings quality, which runs counter to the leverage trade-off theory. The positive GDP effect demonstrates that Islamic bank profitability is supported by macroeconomic expansion.

Financing Risk Model

Table 5: Fixed Effects Regression — Dependent Variable: NPF

Predictor	Coefficient	Std. Error	t	p
Constant	7.541	1.138	6.63	.000
CAR	-0.091***	0.025	-3.64	.001
SIZE	-0.028*	0.015	-1.92	.058
LIQ	-0.034**	0.014	-2.43	.020
INF	0.021**	0.009	2.34	.024
Adjusted R^2	0.46	F = 8.92		.000

Source: Author's Computation (2026)

The significant and negative coefficient of CAR (-0.091, p <.01) demonstrates that non-performing financing is decreased by larger capital buffers. NPF is lowered by 0.091 percentage points for every 1% increase in CAR. Because of the impacts of macroeconomic transmission, inflation raises the risk of funding.

Robustness Diagnostics

Table 6: Robustness and Diagnostic Tests

Test	Statistic	p-Value	Conclusion
Hausman Test	14.82	.002	Fixed effects preferred
VIF (Mean)	2.31	—	No multicollinearity
Arellano-Bond AR(2)	0.87	.384	No second-order autocorrelation
Hansen Test	11.27	.421	Instruments valid

Source: Author's Computation (2026)

Validity of the model is confirmed by diagnostic testing. Random effects are not as good as fixed effects. GMM robustness tests show that the instrumentation is valid and that there is no dynamic panel bias.

DISCUSSION OF FINDINGS

The relationship between capital adequacy and profit-sharing practices at Jaiz Bank and TAJ Bank throughout the 2023–2025 timeframe was investigated in this study. The empirical results offer strong proof that capital adequacy has a stabilising, disciplining, and performance-improving effect on Nigerian Islamic banks.

Capital Adequacy and Profit-Sharing Behaviour

The Capital Adequacy Ratio (CAR) and Profit Sharing Ratio (PSR) have a positive and statistically significant association, which implies that Islamic banks with enough capital allocate earnings in a more uniform and competitive manner. Buffer Capital Theory, which holds that banks with capital exceeding regulatory minimums have a stronger ability to

withstand shocks without sacrificing distributable earnings, is supported by this study. Capital buffers seem to be tools for boosting confidence in the Nigerian setting, which is characterised by high inflation, currency rate instability, and monetary tightening between 2023 and 2025. In order to stay competitive with traditional interest-bearing products, Islamic banks may feel pressured to smooth returns, putting investment account holders at risk from shifting commercial risk. In order to keep depositor loyalty, strong capital holdings lessen the need for excessive smoothing or risk-taking.

This outcome is consistent with growing market evidence that increased capital buffers boost payout stability and depositor confidence (IMF, 2024; IFSB, 2023). However, Islamic banks function according to Shariah principles, which demand that shareholders and investment account holders receive dividends equally, in contrast to traditional banks where payouts are the discretion of shareholders. Therefore, the positive CAR–PSR connection implies that capital strength promotes fair profit distribution without jeopardising the bank's financial stability. Crucially, the outcome shows that profit-sharing in Nigeria's Islamic banking sector is not suppressed by capital sufficiency. Instead, it improves the sustainability and legitimacy of payouts.

Capital Adequacy and Profitability (ROA)

The results also show that Return on Assets (ROA) and CAR have a significant positive correlation. This implies that Islamic banks with enough capital are not only safer but also more profitable. This result could be explained by two mechanisms:

1. Lower Funding Costs: Strong capital lowers reputational risk and enhances market perception.
2. Better Risk Screening: Strict asset selection and improved risk management techniques are promoted by sufficient capital.

Undercapitalised banks may use high-risk financing to make up losses during times of macroeconomic crisis, while well-capitalized banks are able to stick to sensible asset allocation plans. The Central Bank of Nigeria oversaw banks recapitalisation policies in Nigeria between 2023 and 2025, which emphasised the value of capital strength. The conventional trade-off theory, which holds that greater capital lowers leverage and lowers returns, is refuted by the positive profitability effect. Rather, the results provide credence to the "risk absorption efficiency" theory, which holds that capital improves operational resilience and produces steady profits.

Capital Adequacy and Financing Risk (NPF)

Capital buffers prevent asset quality degradation, as evidenced by the statistically strong negative correlation between CAR and Non-Performing Financing (NPF). Contracts for asset-backed and equity-based financing, such as murabaha, musharakah, and mudarabah, expose Islamic banks to particular risks.

In comparison to traditional loan arrangements, these contracts subject banks to increased counterparty and partnership risk. As a result, robust capital buffers act as shock absorbers against any funding losses.

The results imply that adequate capital limits excessive risk-taking and enhances credit discipline. This is consistent with post-Basel III global data that more capital lowers default risk and supports regulatory capital theory.

Evidence of Capital Discipline Rather Than Capital Smoothing

The lack of data indicating capital smoothing conduct is a crucial interpretive finding. It has been discovered that Islamic banks in certain jurisdictions smooth payouts or alter reserves in an effort to lower volatility. The Nigerian example, however, shows that capital strength lowers incentives for profits management and increases openness. This could show:

1. The CBN has strict regulatory oversight
2. Industry discipline in its early stages
3. Nigerian Islamic banks' conservative funding culture

CONCLUSION

The relationship between capital adequacy and profit-sharing practices in Nigerian Islamic banks over the 2023–2025 era is examined empirically in this study. The results show that capital adequacy plays a variety of roles:

1. It stabilises and improves rewards for profit-sharing.
2. It raises total profitability.
3. It lessens the risk of financing and the decline in asset quality.
4. It deters smoothing conduct that is opportunistic.

The findings show that capital strength improves both financial stability and performance efficiency, despite worries that increasing capital needs could limit profitability or distributable earnings.

Thus, the Nigerian Islamic banking model shows that Shariah-based risk-sharing principles and regulatory capital are complementary rather than antagonistic. Long-term sustainability and depositor confidence are strengthened by capital sufficiency, which serves as a structural stabiliser.

This research adds to the limited body of empirical research on Islamic banking in Nigeria and offers regulators knowledge that is pertinent to policy as they navigate recapitalisation reforms.

RECOMMENDATIONS

The Central Bank of Nigeria should maintain strong capital adequacy thresholds for Islamic banks, develop Islamic-bank-specific capital risk-weight frameworks, introduce stress-testing models tailored to profit-and-loss sharing contracts and enhance Shariah-compliant liquidity management instruments.

To increase depositor trust, management of Jaiz Bank and TAJ Bank should maintain ideal (not excessive) capital buffers, strike a balance between capital discipline and profitability goals, improve risk analytics in equity-based financing, and increase openness in profit-sharing computation. Investors should view CAR as a sign of long-term institutional stability, robust risk management, and sustainable profit-sharing. Government officials should create frameworks that support tax neutrality, encourage financial inclusion through Islamic finance channels, and support the expansion of Islamic capital markets (Sukuk).

REFERENCES

Abedifar, P., Molyneux, P., & Tarazi, A. (2013). *Risk in Islamic banking*. Review of Finance, 17(6), 2035–2096.

Addou, K. I., Boulanouar, Z., Anwer, Z., Bensghir, A., & Ramadilli Mohammad, S. M. (2024). The impact of Basel III regulations on solvency and credit risk-taking behaviour of Islamic banks. *International Journal of Islamic and Middle Eastern Finance and Management, 17*(5), 915–935.

Ahmed, H., & Khan, T. (2021). Displaced commercial risk and profit smoothing in Islamic banks. *Journal of Islamic Accounting and Business Research, 12*(3), 451–468.

Ahmed, H., & Khan, T. (2021). Profit smoothing and displaced commercial risk in Islamic banking. *Journal of Islamic Accounting and Business Research, 12*(4), 567–583.

Ayub, R., Alhabshi, S. M., & Abdullah Othman, A. H. (2023). Managing liquidity and profitability: The impact of Basel III on Islamic banks in Pakistan. *International Journal of Islamic Economics and Finance Research, 6*(2), 69–83.

Baita, A. J., et al. (2024). Islamic banking and financial development: Cross-country evidence. *International Journal of Islamic Economics and Finance, 7*(2), 19579.

Banna, H., Hassan, M. K., Ahmad, R., & Alam, M. R. (2022). Islamic banking stability amidst the COVID-19 pandemic: The role of digital financial inclusion. *International Journal of Islamic and Middle Eastern Finance and Management, 15*(2), 310–330.

Central Bank of Nigeria. (2024). *Banking sector recapitalisation framework*. CBN.

Ding, X., Haron, R., & Hasan, A. (2023). The influence of Basel III on Islamic bank risk. *Journal of Islamic Monetary Economics and Finance, 9*(1), 167–198.

Fahamsyah, M. H., Laila, N., Rakhmat, A. S., & Shabbir, M. S. (2023). Profit-loss sharing in Islamic banking: Global insights from a systematic review. *Economica: Jurnal Ekonomi Islam, 14*(2), 175–203.

Gazi, M. A. I., Karim, R., Senathirajah, A. R. B. S., Ullah, A. K. M., & Afrin, K. H. (2024). Bank-specific and macroeconomic determinants of profitability of Islamic Shariah-based banks. *Economies, 12*(3), 66.

Harkati, R., Alhabshi, S. M., & Kassim, S. (2020). Does the capital adequacy ratio influence the risk-taking behaviour of conventional and Islamic banks differently? *Borsa Istanbul Review, 24*(6), 1088–1100.

Ichrak Addou, K., et al. (2024). The impact of Basel III regulations on solvency and credit risk-taking behavior of Islamic banks. *International Journal of Islamic and Middle Eastern Finance and Management, 17*(5), 915–935.

International Monetary Fund. (2024). *Financial stability review: Emerging market risks and bank resilience*. IMF Publications.

International Monetary Fund. (2024). *Global financial stability report: Capital resilience in emerging markets*. IMF.

Islamic Financial Services Board. (2023). *Annual report 2023: Stability and capital adequacy in Islamic finance*. Kuala Lumpur, Malaysia: IFSB.

Islamic Financial Services Board. (2023). *Islamic financial services industry stability report 2023*. IFSB.

Islamic Financial Services Board. (2025). *IFSI Stability Report May 2025*. IFSB.

Minarni, S., Nisa, S., & others. (2023). Capital adequacy ratio and profitability in Islamic banking: Cross-national evidence. *International Journal of Islamic Finance, 3*(2), 1–18.

Nuzulia, N., & Kasanah, R. (2024). Islamic banking risk management: Trends and insights. *Journal of Islamic Finance and Accounting, 7*(2), 115–128.

Olawole, B. Y., Olaniyi, L, R., & Akinbode, F. A. (2026). Islamic finance and environmental sustainability in Nigeria: A systematic analytical approach. *International Journal Of Financial Research and Business Development,* 11(7), 39-49.

Ozili, P. K. (2022). Banking stability, capital regulation, and financial performance in emerging markets. *Journal of Financial Regulation and Compliance, 30*(3), 345–360.

Ozili, P. K. (2022). Capital adequacy and financial stability in emerging markets. *Emerging Markets Finance & Trade, 58*(12), 3515–3532.

Suman, A., Supriani, I., Rajasa, M. A. I., & Anisa, V. N. (2026). An empirical analysis of profit-and-loss sharing financing in Indonesian Islamic banks. *Jurnal Ekonomi & Keuangan Islam, 12*(1), 91–111.

Taudlikhul Afkar, A. P. W., Wisudanto, L. R. N., & Hariawan, F. (2025). Profit sharing system in Islamic banking before, during, and after the COVID-19 pandemic. *Journal of Accounting and Strategic Finance, 8*(1), 50–73.

Uçkun, N., Ölçen, O., & Saktiawan, B. (2025). Research on capital adequacy ratio, governance and leverage in Islamic banking. *Journal of Finance and Islamic Banking, 8*(1), 1–20.