Government Regulation as A Selective Moderator of Islamic Banking Adoption in Nigeria: Evidence from A Consumer-Level PLS-SEM Model

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***Abstract*—This paper investigates whether government regulation changes the strength of relationships between consumer-level determinants and Islamic banking adoption in Nigeria. The study addresses a gap in Nigerian research, where regulation has often been considered from legal, institutional or macroeconomic perspectives rather than as a contextual factor in consumer adoption.**

Data were obtained through a quantitative cross-sectional survey of customers of Jaiz Bank Plc, TAJ Bank Limited and Lotus Bank Limited. From 598 distributed questionnaires, 383 valid responses were analysed using Partial Least Squares Structural Equation Modelling (PLS-SEM).

Government regulation had no significant direct effect on Islamic banking adoption ($\beta = 0.070$, $p = 0.148$), but it significantly moderated three relationships. It strengthened the relationship between consumer innovativeness and adoption ($\beta = 0.119$, $p = 0.005$), strengthened the relationship between perceived risk and adoption ($\beta = 0.262$, $p = 0.019$), and weakened the positive relationship between service quality and adoption ($\beta = -0.296$, $p < 0.001$).

The interactions involving customer awareness ($\beta = -0.044$, $p = 0.197$), perceived benefit ($\beta = -0.095$, $p = 0.171$), perceived trust ($\beta = -0.012$, $p = 0.439$) and Shariah compliance ($\beta = 0.008$, $p = 0.464$) were not significant.

The model explained 56.9% of the variance in adoption and had $Q^2 = 0.284$. The findings position regulation as a selective contextual condition rather than a universal direct determinant, with implications for regulatory clarity, consumer protection, responsible innovation, risk communication and service delivery.

***Index Terms*—Government regulation; moderation; Islamic banking adoption; consumer innovativeness; perceived risk; service quality; institutional theory; Nigeria; PLS-SEM**

I. INTRODUCTION

Islamic banking in Nigeria operates within a formal regulatory environment that combines prudential banking requirements with the governance expectations associated with non-interest finance and Shariah-compliant operations. Regulation can strengthen financial stability, consumer protection, transparency and institutional legitimacy, but compliance requirements can also increase costs and constrain operational flexibility. The central question is therefore not simply whether regulation affects adoption, but whether the regulatory environment changes how consumers' perceptions and characteristics translate into adoption.

The dissertation identifies a specific literature gap. Existing Nigerian work has considered regulation mainly through legal, policy, institutional or macroeconomic perspectives, while consumer adoption studies have generally concentrated on determinants such as awareness, trust, service quality, relative advantage, risk and innovation. The present research integrates these perspectives by treating Government Regulation as a moderator of seven consumer-level relationships: Customer Awareness, Service Quality, Shariah Compliance, Perceived Trust, Perceived Benefit, Perceived Risk and Consumer Innovativeness.

This paper therefore focuses on the institutional contingency embedded in the dissertation's full model. Its contribution is to show that a variable can be statistically unimportant as a direct predictor while still materially changing other relationships. This distinction is particularly important for financial regulation because rules may operate by shaping the

environment in which consumers interpret risk, innovation and service performance rather than by directly persuading them to adopt a bank.

II. LITERATURE REVIEW AND HYPOTHESES

2.1 Government regulation and Islamic banking

Government Regulation is conceptualised as the extent to which government policies, regulatory frameworks, supervision and guidelines influence the operation and adoption of Islamic banking services. In Nigeria, the regulatory environment includes licensing, prudential requirements, capital adequacy, liquidity management, disclosure, corporate governance, consumer protection and Shariah governance. The dissertation notes that regulatory reforms are intended to strengthen resilience and public confidence while potentially increasing compliance demands.

2.2 Institutional Theory

Institutional Theory provides the strongest theoretical basis for Government Regulation in the dissertation. The theory emphasises the influence of rules, norms, beliefs and institutional expectations. Its regulatory pillar concerns formal rules, monitoring and enforcement; its normative pillar is relevant to expectations of appropriate and Shariah-compliant conduct; and its cultural-cognitive pillar relates to shared understandings through which consumers interpret Islamic banking.

Regulation may therefore strengthen legitimacy and reduce uncertainty without becoming a simple direct predictor of adoption.

2.3 Regulation and consumer innovativeness

Consumer innovativeness represents willingness to experiment with relatively unfamiliar banking products, services and technologies. Diffusion of Innovations Theory suggests that consumers differ in their readiness to accept innovations. However, financial innovation involves money, institutional credibility and longer-term consequences.

A credible regulatory environment can reduce uncertainty and give innovative consumers greater confidence to consider new Islamic banking alternatives. The dissertation therefore hypothesises that Government Regulation positively moderates the relationship between Consumer Innovativeness and adoption.

H1: Government Regulation significantly moderates the relationship between Consumer Innovativeness and Islamic Banking Adoption.

2.4 Regulation and perceived risk

Perceived Risk Theory emphasises uncertainty and anticipated negative consequences. Consumers may seek information, rely on trusted institutions or consider regulatory safeguards when evaluating financial services. Regulation can establish consumer-protection mechanisms, prudential safeguards and oversight that alter the way customers interpret financial and performance risks. The dissertation consequently proposes a moderating relationship between regulation and perceived risk.

H2: Government Regulation significantly moderates the relationship between Perceived Risk and Islamic Banking Adoption.

2.5 Regulation and service quality

Service quality is the strongest direct determinant in the dissertation. However, service delivery takes place within an institutional environment. Regulation may improve minimum standards and consumer protection, but it can also increase compliance requirements and reduce operational flexibility. The dissertation's model therefore tests whether Government Regulation changes the strength of the service quality–adoption relationship without assuming the direction of the interaction.

H3: Government Regulation significantly moderates the relationship between Service Quality and Islamic Banking Adoption.

2.6 Other moderation relationships

The full dissertation also tests whether Government Regulation moderates the relationships between Customer Awareness, Perceived Benefit, Perceived Trust and Shariah Compliance and adoption. These relationships are important because regulation may shape information credibility, product value perceptions, institutional trust and confidence in Shariah governance.

The remaining hypotheses are therefore stated in null-form consistent with the dissertation: no significant moderating effect is expected for each of these four relationships.

III. METHODOLOGY

The study used a quantitative cross-sectional survey. The population comprised customers of Jaiz Bank Plc, TAJ Bank Limited and Lotus Bank Limited, with the dissertation reporting approximately 1.96 million customers across the three banks. Six hundred and ninety? No: the study distributed 598 questionnaires, of which 383 were returned and retained, producing a 64% response rate. The questionnaire measured Government Regulation with seven items and the seven consumer determinants and adoption with the item counts reported in the dissertation.

PLS-SEM was employed because the model includes multiple latent constructs and interaction terms. The measurement model was evaluated using item loadings, internal consistency, convergent validity and discriminant validity. The structural model was evaluated through path coefficients, bootstrapped t-statistics and p-values, R^2, f^2 and Q^2. A p-value ≤ 0.05 was treated as statistically significant. The Fornell-Larcker assessment supported discriminant validity, although Customer Awareness and Service Quality showed a relatively high correlation (0.854), which remains an interpretive limitation.

IV. RESULTS

4.1 Direct regulatory effect

Path	β	t	p	Interpretation
Government Regulation → Adoption	0.07	1.048	0.148	Not significant
Consumer Innovativeness → Adoption	-0.021	0.339	0.367	Not significant
Customer Awareness → Adoption	-0.153	2.559	0.005	Significant negative
Perceived Benefit → Adoption	0.449	4.011	<0.001	Significant positive
Perceived Risk → Adoption	0.09	0.776	0.219	Not significant
Perceived Trust → Adoption	-0.127	1.643	0.05	Borderline negative
Service Quality → Adoption	0.538	8.164	<0.001	Significant positive
Shariah Compliance → Adoption	-0.035	0.421	0.337	Not significant

Government Regulation did not significantly predict adoption directly (β = 0.070, p = 0.148). This is a central finding because it distinguishes the direct effect of regulation from its interaction effects. Service Quality and Perceived Benefit remained the strongest positive direct determinants, while Customer Awareness was negative and Perceived Trust was borderline negative.

4.2 Moderating effects

Interaction	β	t	p	Decision
Customer Awareness × Regulation → Adoption	-0.044	0.854	0.197	Not significant
Consumer Innovativeness × Regulation → Adoption	0.119	2.57	0.005	Significant positive
Perceived Benefit × Regulation → Adoption	-0.095	0.951	0.171	Not significant
Perceived Risk × Regulation → Adoption	0.262	2.091	0.019	Significant positive
Perceived Trust × Regulation → Adoption	-0.012	0.153	0.439	Not significant
Shariah Compliance × Regulation → Adoption	0.008	0.089	0.464	Not significant
Service Quality × Regulation → Adoption	-0.296	4.954	<0.001	Significant negative

The results demonstrate a selective moderation pattern. Regulation significantly strengthened the relationship between Consumer Innovativeness and adoption (β = 0.119, p = 0.005). It also strengthened the relationship between Perceived Risk and adoption (β = 0.262, p = 0.019). In contrast, regulation significantly weakened the positive relationship

between Service Quality and adoption ($\beta = -0.296$, $p < 0.001$). The four remaining interaction terms were not statistically significant.

4.3 Model explanatory and predictive capacity

The complete structural model explained 56.9% of the variance in Islamic Banking Adoption, with adjusted $R^2 = 0.560$. The 0.009 difference between R^2 and adjusted R^2 indicates relatively stable explanatory power after adjustment. Service Quality had the largest f^2 (0.117), followed by Perceived Benefit (0.041); the remaining direct predictors had very small or negligible individual effect sizes. Predictive relevance was $Q^2 = 0.284$.

V. DISCUSSION

The absence of a direct regulatory effect, combined with significant interaction effects, indicates that Government Regulation functions more as a contextual condition than as an independent consumer-level motive. Consumers may not adopt Islamic banking simply because they perceive regulation to be strong. Instead, regulation can influence whether particular consumer characteristics or perceptions become consequential in the adoption process. This interpretation is consistent with Institutional Theory, which focuses on how formal rules shape the environment in which actors operate.

The positive interaction between Consumer Innovativeness and Government Regulation suggests that regulation can make innovation more actionable. Innovative consumers may be willing to experiment with new financial alternatives, but financial innovation carries uncertainty. Clear licensing, supervision, consumer protection and predictable rules can increase the credibility of new offerings and help innovative consumers translate openness into adoption. The result therefore supports the dissertation's recommendation that regulators support responsible financial innovation.

The positive interaction between Perceived Risk and Government Regulation is theoretically interesting because the direct perceived-risk effect was not significant. This suggests that risk perceptions become more consequential under the regulatory environment rather than acting independently. The interaction should not be interpreted as evidence that regulation simply removes risk. Instead, regulation may make consumers more attentive to risk-related information, safeguards and institutional arrangements, thereby changing how perceived risk relates to adoption.

The negative interaction between Service Quality and Government Regulation is the strongest moderation effect. Service quality remains strongly positive as a direct determinant, but higher perceived regulation weakens that positive relationship. One interpretation, consistent with the dissertation, is that service quality does not operate in isolation: stronger regulatory requirements may alter operational flexibility, service processes or customer expectations. Alternatively, where regulatory safeguards become salient, customers may place relatively greater weight on institutional assurance and less incremental weight on service quality. The cross-sectional design means these interpretations should be treated as explanations to be tested rather than established causal mechanisms.

The non-significant moderation of Customer Awareness, Perceived Benefit, Perceived Trust and Shariah Compliance indicates that regulation does not universally condition every consumer determinant. Awareness and benefit may operate primarily through customers' own evaluations of information and value; trust may depend more on direct institutional experience; and Shariah compliance may be treated as an inherent characteristic of Islamic banking rather than a regulatory-dependent adoption cue. The selective pattern strengthens the case for treating regulation as a contextual variable rather than assuming a universal interaction effect.

VI. IMPLICATIONS

For regulators, the evidence supports clear, consistent and predictable guidelines, stronger consumer protection, transparent communication and institutional oversight. Regulation should facilitate responsible financial innovation rather than merely impose compliance obligations. For Islamic banks, the results suggest that service quality improvements should be accompanied by regulatory awareness, transparent risk communication and customer education. Banks should explain how risks are managed and how regulatory safeguards protect customers while continuing to improve physical and digital service channels.

Theoretically, the paper extends a consumer adoption framework by demonstrating that institutional

variables may have little direct explanatory power while still materially conditioning selected relationships. The finding supports an extended theoretical perspective combining TPB with Diffusion of Innovations, Perceived Risk Theory and Institutional Theory. Empirically, the study contributes Nigerian evidence on regulatory moderation at the consumer level, an area identified as underdeveloped in the dissertation's literature review.

VII. CONCLUSION, LIMITATIONS AND FUTURE RESEARCH

Government Regulation is not a universal direct determinant of Islamic banking adoption in Nigeria. Its importance lies in its selective ability to change how consumer innovativeness, perceived risk and service quality relate to adoption. The model explains 56.9% of adoption variance, but 43.1% remains outside the model. The results therefore support a conditional rather than purely direct understanding of regulatory influence.

The study is limited by its cross-sectional design, self-reported measures and sample scope. The dissertation also reports an internal inconsistency in Chapter Five, where 215 valid responses are mentioned, while the abstract, response-rate table and Chapter Four report 383 valid responses and the statistical results are based on 383. This article uses 383 because that figure is consistently reflected in the response-rate and empirical results sections. Future research should replicate the model longitudinally, use larger samples, compare regions and demographic groups, and test alternative moderators and mediators that may explain the remaining variance.

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DATA-SOURCE AND PUBLICATION DISCLOSURE.

This manuscript is a journal-formatted derivative of the author's PhD dissertation, "Effect of Government Regulation on the Financing Determinants of Islamic Banking Adoption in Nigeria," Baze University, July 2026. The companion manuscript separates the regulatory-moderation analysis from the direct-determinants analysis. Any journal submission should transparently disclose the common underlying dissertation dataset and comply with the target journal's policies on prior dissemination, thesis-derived manuscripts and publication ethics.