



WOLKITE UNIVERSITY
SCHOOL OF GRADUATE STUDIES
DEPARTMENT OF ECONOMICS

DETERMINANTS OF INTEREST FREE BANKING SERVICE
THE CASE OF COMMERCIAL BANK OF ETHIOPIA,
HOSSANA DISTRICT, ETHIOPIA

BY:
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WOLKITE, ETHIOPIA



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HOSSANA DISTRICT, ETHIOPIA**

**A Thesis Submitted to the Department of Economics, College of Business and
Economics, Wolkite University for a Partial Fulfillments of the Requirements
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DECLARATION

ALEBACHEW GETNET, author of this thesis titled “Determinants of Interest Free Banking Service: In Case of Commercial Bank of Ethiopia Hossana District” do hereby declare that, apart from the references of other people’s work, which has been duly acknowledged, the research work presented in this thesis was done entirely by me at the Department of Economics, Wolkite University, Ethiopia, 2022, I do further declare that, this work has neither been presented in for any degree at this University or elsewhere.

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ABBREVIATIONS AND ACRONYMS

CBE	Commercial Bank of Ethiopia
CSA	Central Statistics Agency
DBE	Development Bank of Ethiopia
ET	Ethiopia
ETB	Ethiopian Birr
GOV	Government
IFB	Interest Free Banking
IFBW	Interest Free Banking Window
IFI	Islamic Financial Institutions
IS	ISLAMIC BANKING
MIS	Management Information System
NBE	National Bank of Ethiopia
PLS	Profit and Loss Sharing
SDD	Special Demand Deposit
UFA	Universal Financial Access

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ABSTRACT

This study examines determinants of Interest free banking services in Ethiopia with particular reference to the commercial bank of Ethiopia. The study has employed and the cross sectional data. The study has used primary data which are quantitative and qualitative in nature and have been collected through structured and semi structured questionnaire and interview. A total of 399 sample respondents were taken through multistage sampling. The data was analyzed using descriptive statistics of mean, frequency and percentage using STATA version 13 software. From the study result, training in this study Disagree (33%), neutral (18.63%) and agree (49 %). Almost half of the respondents were agreeing on having training. Training has positive and statistically significant impact on interest free banking. Giving different trainings sharia rule, financial flow, financial transaction and skills are very important. The customers were not aware about the Interest Free Banking services and products, but 82.5 % of the respondents say there is lack of advertising by media or banking sectors. In this study male customers have higher probability to participate IFB than females. From the view of customers in the service of CBE there is little satisfaction. The customers do not get the service on time and wanted amount of cash money. The bank management and staffs should give different services, implant different technology and time saver mechanism

Key word, *Interest Free Banking, Probit analysis, Hosana District*

CHAPTER ONE

INTRODUCTION

1.1. Background of the Study

The interest-free banking system is one which operates according to the tenets/teachings of the Islamic faith. The most important feature of this banking system is that it is interest-free. Apart from this feature, the interest-free banking system has other objectives – amongst which are the equitable distribution of income and wealth and increased equity participation in the economy (Clifford, 2008). It also prohibited investing in businesses that provide goods or services considered contrary to its principles, *Haraam*, such as businesses that sell alcohol or pork, or businesses that produce media such as gossip columns or pornography, which are contrary to Islamic values (Mohammed 2012).

Interest free banking is inseparable of Islamic economics which aimed at realization of a greater justice in human endeavor, which is achievable only with participation of all human institution inclusive of financial system (Adeniran, 2013). On the principle that prohibits interest and other unethical and non shariah compliant activities, Islamic banking set to achieve this gigantic objective. In addition, it strive on increasing all Halal aspect of business through provision of products and services base on shariah principle with implementation of legitimate profit and loss sharing, paying Zakah, prohibition of interest, monopoly and other forms of unethical trade and transaction such as dealing with pork, alcohol and gambling (Sanusi, 2012).

According to some, this growth owes to some unique features inherent in Islamic financial products. Adel (2010) explained the economic merits of Islamic banking by pointing out that credit expansion through Islamic banking is linked to the growth of the real economy by allowing credit primarily for the purchase of real goods and services. It also requires the creditor to bear the risk of default by prohibiting the sale of debt, thereby ensuring that he evaluates the risk more carefully.

The emergence of Interest free financial system has created a new dimension to the current economic models and financial developments. Hence, use of such innovations is highly appreciated even if its implementations depends on the customers intentions. Therefore, this study is concerned with examining the willingness of the Ethiopian customers to use interest free

banking and the factors that may influence their decision; because, customers are the ultimate users of the products to be adopted. The results showed that perceived relative advantage, perceived compatibility, customers' level of awareness and subjective norm have a significant positive impact on the attitude towards interest free banking in commercial bank of Ethiopia (Debebe Alemu 2015).

The role and functions of Islamic banking within the banking system in a modern economy are very important, and in fact, it is at the heart of every robust economy. For the fast four decade, Islamic banking sector has grown in a large scale with a double digit annual growth rate and recently by almost 20 %. The institution has witnessed an unprecedented expansion and its effect was observable within the Muslims countries and has extended to all nooks and crannies of the globe (Rustam, et al.,2011).

Conventional banks have begun to accept IFB deposits from consumers who are interested in the service as a result of this directive. NBE issued a new proclamation in May 2019 with directive No: SBB/72/2019, allowing the establishment of full-fledged IFB in Ethiopia, after 7 years of exclusive IFB window service in Ethiopia, which is mostly associated with a cost-plus markup financing facility. Following this, the NBE granted the ZamZam Bank and Hijra Bank a business license to begin full-fledged IFB services, which still have space for improvement. Although the approval of a full-fledged IFB in Ethiopia is a significant opportunity for IFB business expansion, challenges such as a lack of a conducive legal framework, a shortage of skilled professionals, hostile attitude towards Islamic banks, and a lack of leadership engagement may still have an impact on IFB performance in Ethiopia (Hailu & Bushra, 2020)

According to IMF (2015) Islamic banks were indeed successful in the provision of innovative products and services to their customers irrespective of their faith. For its noticeable achievements, Islamic banking has become attractive so, that many countries are yearning and or struggling to have it in operation like the case of Ethiopian from sub-Saharan Africa that have just embraced and started enjoying the system. Interest free banking has grown rapidly over the past decade, and its banking segment has become systemically important in a dozen countries in a wide range of regions..Islamic finance is projected to continue to expand in response to economic growth in countries with large and relatively unbanked Muslim populations. It is also fueled by the large

savings accumulated by many oil-exporting countries that are seeking to invest in Shari'ahcompliant financial products.

Nonetheless, Islamic finance faces a number of challenges. For example, despite the efforts of Islamic finance standard setters, in many countries the industry is governed by a regulatory and supervisory framework developed for conventional finance. Therefore, it does not fully take account of the special nature of Islamic finance (Al-Maraj, 2014).

The growing reach of Islamic finance promises a number of possible benefits. For example, it is often argued that Islamic finance is inherently less prone to crisis because its risk-sharing feature reduces leverage and encourages better risk management on the part of both financial institutions and their customers. It is also argued that Islamic finance is more stable than conventional finance, because: (i) Islamic finance involves prohibitions against speculation; (ii) financing is asset-based and thus fully collateralized; and (iii) it is founded on strong ethical precepts. Moreover, Islamic financial institutions (IFIs) are considered to be a good platform for increasing access to financial inclusion, including access to finance for SMEs, thereby supporting growth and economic development (IMF, 2015).

The industry is still largely a nascent one, lacking economies of scale, and operating in an environment where legal and tax rules, financial infrastructure, and access to financial safety nets and central bank liquidity are either absent or, if available, do not appropriately take into account the special characteristics of Islamic finance Askari et al.,(2010). National Bank of Ethiopia (NBE) has authorized banks to undertake IFB business in year 2011 following this authorization banks have started IFB services in year 2013.

According to Sefiani (2014), for the sizable Muslim population in Ethiopia, there is a need for adequate banking services to serve this segment of the population. Currently, 18 private and government owned banks are operating in Ethiopia more than seven banks have adopted the IFB system. These include Commercial bank of Ethiopia (CBE), Nib international bank S.C, Oromiya international bank S.C, United bank S.C and Wegagen bank S.C. They are the first banks to have startedInterest free banking service as per the requirements.

“Interest free banking” refers to a system of banking or financial activity that is compliant with Shariah principles and guided by Islamic economics which prohibits the collection and or payment of interest as well as engaging in activities forbidden by Shariah. In fact, Interest free banking provides profit-sharing investment accounts to the depositors. These depositors are not assumed to share the profits/losses of the bank but neither fall in to the category of the capital of the bank nor can be regarded as liabilities of the bank, in the accounting sense (Elgar, 2009).

One of the services offered by Ethiopian banks includes profits/losses sharing banking service. This service needs careful screening because of the danger of adverse selection, and careful monitoring as this may lead to the problem of asymmetric information and moral hazard. One factor contributing to adverse selection is that in a mixed financial system with both Interest free and conventional banks, entrepreneurs may not like the idea of profit sharing if they have rosy expectations of the success of their ventures whereas they may prefer profit-sharing finance from Interest free banks if they are less sure of a positive outcome. This might burden Islamic banks with a disproportional share of bad debts (Khan, 2010).

1.2. Statement of the Problem

According to IMF (2015) interest free banking has the potential to contribute in at least three dimensions. First, it promises to foster greater financial inclusion, especially of large underserved Muslim populations. Second, its emphasis on asset-backed financing and risk sharing feature implies that it could provide support for small and medium sized enterprises (SME), as well as investment in public infrastructure. Finally, its risk-sharing features and prohibition of speculation suggest that Islamic finance may, in principle, pose less systemic risk than conventional finance. However, for this potential to be realized, and to allow this industry to develop in a safe and sound manner, a number of challenges need to be addressed.

The Central Statistics Agency (CSA, 2007) of Ethiopia reported that the Muslim population consist nearly twenty one million of the total population of the country which is nearly 34% of the total population, but until 2011 there was no specific service for Muslims who wanted to perform their business according to their faith. These factors have consequently in habited a good number of potential customers from doing business with the banks available in the country because those people considered the services offered by the banks as against their religious faith.

Numerous researches on the prospects, challenges, operational and risk aspects of Interest free banking in developed and emerging market countries are available. However, due to its novelty to Ethiopia the concept is not yet well researched and the literature is still few. Among these studies Mohammed (2012) has studied the Prospects, Opportunities and Challenges of Islamic Banking in Ethiopia“ in his work discuss the potential challenges as: lack of awareness, regulatory, supervisory and institutional challenges, lack of support, gap in research and development in Islamic studies, lack of qualified human resource as well as wrongful association with specific religion and the global terrorism but this study was conducted before the practical introduction of the IFB in Ethiopia . Therefore, it was not based on actual observation of facts.

Akmel (2015) study is about “determinants of Islamic banking for resource mobilization in Ethiopian commercial banks. “The study focuses determinants of IFB only on resource mobilization other determinants are not well addressed. On the other hand a research by Debebe (2015) who studied the factors affecting customers’ use of IFB in Ethiopia and found out that 100% of IFB account holders were all Muslims. Evidently, the failure of banks to meritoriously serve the Ethiopian Muslim population hinders the development of the Muslim inhabited areas in particular and the economy of the nation as a whole. This study is about impact assessment on the attitude towards IFB usage which does not address the current problem at hand. And also Teferi’s (2015), study is about “Contribution of IFB to economic development and its prospect in Ethiopia.”The contribution of the study includes assessing the Muslim population in to the banking (financial system) to the economic development and GDP growth.

This study has a gap of taking the realities of other countries and in Kerima Ali Mohammed’s (2016) study which is about “Challenges on Interest Free Banking Services” the study discuss the challenge faced by service providers and users of IFB products and scope of service provided by Ethiopian banking through IFB including whether there is unmet demand of users, awareness of customers and capacity of bank.¹This, study, therefore, will be attempts to fill the above research gap by investigating the determinants of interest free banking service in the country.

Therefore, as the idea of interest free banking is still new for the economy, new for the society, and new even for business practitioners it is necessary look at the opinions regarding services and

¹The study doesn’t address the Determinants and Current Performance of interest free banking as a new business strategy in Ethiopia.

products offered under Interest free banking by Ethiopian commercial banks and their regularity with the original Interest free banking law. It is equally important to ascertain the determinants surrounding the Service of IFB so as to formulate alternative solutions for its effectiveness. This study analyzes the above mentioned points by considering the case of commercial banks of Ethiopia operating in Hossana District, which is one of the first bank to start interest free banking service in Ethiopia and who starts working as a division level.

1.3. Research questions

Based on the above statement of the problem the researcher has been developed the following basic research question.

1. What is the current status of Interest free banking service in commercial bank of Ethiopia?
2. What are the determinants of interest free banking service in commercial bank of Ethiopia?

1.4. Objective of the Study

1.4.1. General Objective

The general objective of this study is to investigate the determinants of interest free banking Services in case of Commercial Banks of Ethiopia operating in Hosana District.

1.4.2. Specific objectives

This study attempt to achieve the following specific objectives

1. To assess the current status of Interest free banking services in commercial banks of Ethiopia
2. To investigate the determinates of Interest free banking Service in Commercial Banks of Ethiopia

1.5. Significance of the study

This study was tackled the challenges and opportunities of IFB system for investments from the service providers point of views. Hence the present the study will fill that gap by giving firsthand information on such as an important topic. It is expected to contribute both theoretically and practically. Theoretically, the findings of this study will be contributes by filling an important gap to serve as a reference material to the existing body of the literature and initiate other interested researchers. Moreover, the result of the stud contribute by providing case specific evidences on the probable situation faced by Commercial Banks of Ethiopia that are offering interest free banking services.

In addition, since IFB is in its infant stage in Ethiopia, the research results was a valuable reference for the financial students who wish to understand and undertake similar study on factors influencing adoption of the IFB.

This study is expected to provide a basis for extension of knowledge on the factors which influence's the adoption of Interest free banking product on their use in various private and government bank organizations in Hossana district. The study was also improves customers awareness, attitudes and their perception towards of new technology by clarifying how this new technology is employed and diffused.

1.6. Scope and limitation of the Study

The research was geographically delimited to be conducted in Hossana district in selected CBE branch. In order to conduct the study in depth in the given time and resources available, this study was focused only on purposively selected sample respondents who are working in the Commercial Bank of Ethiopia. The first and main reason why this bank was chosen is that, they are the leader to start the IFB delivering service in Ethiopia. The data was collected from employees, managers, supervisors of the banks from their selected branches based on high number of IFB users and deposit mobilization.

The limitation interms of coverage and method. With regard to coverage, it was limited to evaluate Ethiopian economy, the period covers was only one year of data. The time and financial constraints were that affect the research work. The research was under some constraint

in trying to investigate this study among them to related literature found in the library are not in Ethiopian context that has using as a secondary source, lack of finance and there was no sufficient internet service for further information.

1.7. Organization of the Paper

This study organized into five chapters. The first discussed about introductory part, the second chapter presents a review of literatures. The third chapter deals about study area, methodology and data used followed by Chapter four, results and discussion. Finally, chapter five presents the summary, conclusions and recommendation of the study.

CHAPTER TWO

REVIEW OF RELATED LITERATURE

2.1. Theoretical Literature Review

2.1.1. Concepts and definition of Interest free Banking

Many scholars give various meanings to this term Interest free banking. It refers to a system of banking or banking activity that is consistent with the principles of the Shari'ah (Islamic rulings) and its practical application through the development of Interest free banking economics. The principles which emphasize moral and ethical values in all dealings have wide universal appeal. Shari'ah prohibits the payment or acceptance of interest charges for the lending and accepting of money, as well as carrying out trade and other activities that provide goods or services considered contrary to its principles.

While these principles were used as the basis for a flourishing economy in earlier times, it is only in the late 20th century that a number of Interest free banking was formed to provide an alternative basis to Muslims although Interest free banking is not restricted to Muslims. In Islamic finance, the term “loan” refers only to a benevolent loan (*qard al hasan*), a form of financial assistance to the needy to be repaid free of charge. Other instruments of Islamic finance are not referred to as “loans” but rather as financing modes falling under one of the three categories: Profit-and-loss sharing (PLS), non-PLS contracts, and fee-based products (Hussain et al., 2015).

According to Yahiya Abdul-Rahman, (2010), Interest free banking defined as conventional banking minus the word interest with a new contract that does not include the word interest and that is structured in a convoluted version of buy/sell, in which the seller changes ownership to the bank and then the bank sells it to the eventual buyer. Many participants in Interest free banking business thought with good intentions that these guidelines made the contract Interest free.

Interest free banking according to Sandrararajan, (2011) consists of mobilizing funds through noninterest bearing deposits and through investment deposits based on “profit-sharing and lossbearing” contracts and channeling these funds to finance permissible (under the Shari'ah law) investments activities, using various forms of Interest free finance contracts. Interest free banking as described according to Yahiya Abdul-Rahman, (2010) as a system of banking that mobilizes

saving on the basis of profit and loss sharing that is considered to be fairer and more conducive to measurement and development. Owing to the growing demand by the Muslim population in Western countries and also to the increasing interest of Islamic investors to diversify geographically their portfolios, conventional banks are increasingly becoming interested in entering the market of interest free financial products (HassenandLewis, 2007)

Financial institutions in general and banks in particular are exposed to a variety of risks, whereby the extent of these risks depends on the portfolio characteristics of individual banks (IMF, 2001). The variety of risks to which banks are exposed justifies looking at aspects of bank operations that can be categorized under the camel framework⁴. Recent studies have attempted to deepen our understanding of the financial soundness indicators that are more relevant for the analysis of financial stability. The recent studies have focused on the contemporaneous indicators of financial health.

2.1.2. Interest (Riba)

Interest is the component in the banking concept. According to Mohammed et al., (2010) interest is one of the most effective factors for deciding to deposit in banking system. Herald and Heiko, (2009) also mentioned interest as one of the determining factor for commercial bank deposit and it is important element of Interest free economic society. All covers the meaning to load additional money on funds lent to borrower. In addition to this Iqbal and Mirkahor, (2011) interest simply refers to the “premium” that must be paid by the borrower to the lender along with the principal amount as a condition for the loan or for an extension in the duration of loan. Interest is a contractual instrument by which the lender collects a predetermined interest added to the principal amount it has lent out. The principal amount can be money, gold, silver, or tangibles including wheat, barley, etc. (Qasaymeh, 2011)

2.1.3. Prohibition of interest

Prohibition of interest is any unjustifiable increase of capital, whether in loans or sales, it is the central tenet of the system. More precisely, any positive, fixed, predetermined rate tied to the maturity and the amount of principal that is, guaranteed regardless of the performance of the investment is considered interest and is prohibited (Iqbal and Mirkahor, 2011).

2.1.4. Development of Interest Free Banking

Despite Interest free banking or Islamic banking is a recent phenomenon, the basic practices and principles of Islamic finance date back to the early part of the seventh century (Warde 2013). Its roots belong to the early days of Islam and it was available in all financial matters of state solved through Islamic financial law. Islamic financial system is gradually improved and nowadays it is recommended and exercised by many Muslim countries as well some non-Muslim countries. Modern Islamic finance emerged in the mid-1970s with the founding large Islamic banks such as Dubai, Malaysia, Bahrain and Kuala Lumpur. The development initially occurred through marketing of a steadily expanding supply of Sharia compliant financial instruments. The growth of geographical reach and the emergence of new financial centers for Islamic banking in broad range of retail products and services have largely contributed to make Islamic banking as competitive as the conventional banking method.

According to Al-Jarhi and Iqbal (2001), the practice of Islamic banking, at present, takes one of the following forms: (I) Islamic banks operating within a financial system where all banks are Islamized; (II) Islamic banks operating alongside other conventional banks and (III) Shariah-complaint branches, windows and funds established by some conventional banks. Rising awareness and demand for Islamic products, Along with supportive government policies and growing sophistication of financial Institutions, have together raised the rate of growth (Masood, 2014).

In 2008, the Ethiopian Banking Business Proclamation (592/2008) was amended to include a provision for IFB. Three years later, the NBE issued a directive that authorizes the business of IFB (SSB/51/2011). The NBE directive that allowed banks to offer interest-free banking services alongside their conventional operations came into play in October 2011, but IFB in Ethiopia only started in September 2013, when Oromia International Bank (OIB) launched the service. A month later, Commercial Bank of Ethiopia (CBE) joined the market at the end of October, 2013 followed by United Bank which began providing the service on May 1, 2014 (Joseph, 2013, Mikias 2014). Two years later, Abay Bank has again joined as of December 2015; Cooperative Bank of Oromia as of March 2015, Wegagen and Dashen banks has also joined the industry in second half of 2016.

In accordance BSD No SBB/51/2011, the NBE authorizes the business of IFB under the umbrella of the Conventional banking with limited scope: “Interest-free banking business’ refers to banking business in which mobilizing or advancing funds is undertaken in a manner consistent with Islamic finance principles and mode of operation that avoids receiving or paying interest;” and “interest-free banking window” refers to a unit within a conventional bank exclusively offering interest-free banking services.

2.1.4.1. Interest free banking models

2.1.4.2. Interest free window service

According to Juan Sole, (2007) an interest free banking window is simply a window with a conventional bank via which customer can conduct business utilizing only sharia compatible instruments. Sanusi (2011) defines interest free banking window as a business model in which conventional banks offer interest free banking products and services from their existing branch network. In short, interest free banking window refers to a situation whereby a conventional banking system provides some of the interest free banking products or services. In other words, it can be seen as a banking system that meets up only the profit, loss, and risk sharing principle of interest free banking for some of its products(Audu and Mikailu, 2014).

2.1.4.3Subsidiary/branch Interest free banking service

The commercial banking unit, which offers shari’ah compliant products and services only in the specific branch. It is a semi-independent office of a bank engaging in banking activities such as accepting deposits or making loans at facilities away from a bank's home office. This branch banking established when the main bank feels there is a potential of concentrated customers are found in the area want to serve these customers.

2.1.4.4. Full-fledged Interest free banking service

Once a conventional bank has operated an Interest free window for some time and has gathered a sizeable customer base for its Interest free banking service activities, it may decide to establish an Interest free subsidiary, or even fully convert into a full-fledged Interest free bank. By following either of these two routes, the bank may benefit from economies of scope and concentration of knowledge and expertise. The bank will be able to offer a wider range of Shariah-compliant

banking products than through the Islamic window alone. For example, it may be better equipped to fully engage in Islamic investment banking activities, such as underwriting sukuk (bond) issuances or managing Shariah-compliant investment and hedge funds, or to manage its own treasury and money market operations (Sole, 2007).

2.1.4.5. Sources of Funds for Interest free banks

Interest free banking institutions utilize various mechanisms for mobilizing funds from the general public, depending on the institution's organization, geographic location, market strategy, capital resources and charter. Interest free banks are deposit-taking institutions but do not pay interest on deposits. Their sources of funds classified as either include shareholder investments, savings accounts, current accounts, and investment accounts. The source of funds in Interest free banks can be used for borrowing by corporate investors to fund specific project. (Delwin A. Roy 1991)

2.1.4.6. Shareholder Funds

An Interest free bank may raise an initial equity funds by following the principles of musharaka (equity participation) under this principle, the capital owners enter in to a partnership with the bank by contributing equity in return for a share of banks profit or loss on the basis of predetermined ratio (Bala et.al 2009).

2.1.4.7. Wadiah saving accounts

Interest free banks offer saving account with an aim of drawing in and persuading depositors to enjoy this safe keeping facility. Bank customers normally choose saving accounts because of fulfilling precautionary motives. Interest free banks practice the principle of wadia in operating customer saving account. The bank may request permission to use customer funds deposited in these accounts as long as these funds remain within the banks discretion. The bank does not share with the customer profit earned from the use of customer funds deposited in these accounts funds but does guarantee the customer deposits. The bank however reward customer with gift as a token of its appreciation for being allowed to use the funds (Haron& Wan-Azmi, 2008).

The situation is very different in the Interest free banks. Here too the depositor's first aim is to keep his savings in safe custody. Interest free banks divide the conventional savings account into

two categories. Savings account and investment account. The investment accounts operate fully under the PLS scheme capital is not guaranteed, neither is there any pre-fixed return. Under the savings account the nominal value of the deposit is guaranteed, but they receive no further guaranteed returns. Banks may consider funds under the savings accounts too as part of their resources and use it to create assets (Abdul-Gafoor, 1995:14).

This is theory in practice; however, the banks prefer, encourage and emphasize the investment accounts. This is because since their assets operate under the PLS scheme they might incur losses on these assets which losses they cannot pass onto the savings accounts depositors on account of the capital guarantee on these accounts. In the process the first aim of the depositor is pushed aside and the basic rule of commercial banking capital guarantee is broken (AbdulGafoor, 1995).

2.1.4.8. Current Accounts

The current account is a deposit account that can be used for business or personal purpose and like a saving account. Account holders are not guaranteed and return for keeping their funds with the bank, but they may be rewarded a gift. The primary distinction between current account and saving account is that the minimum balance limits and withdrawals are more flexible for current accounts (Bala et.al (2009: 25).

In addition to this according to Haron& Wan-Azmi, (2008) current accounts also known as checking accounts, meaning cheque is used to make several types of payments. Current accounts are demand deposit accounts kept with the bank on custodial arrangements and are repayable in full on demand. Current accounts are based on the principle of wadia (trust or safe keeping) or amanah (trust), creating an agency contract for the purpose of protecting and safekeeping the depositor's assets (Iqbal and Mirkahor, 2011).

2.1.4.9. Investment account deposits

According to Tabir, (2007) Investment deposits represent the case when owners of the fund seek a return on their funds and are willing to spare these funds for an agreed period. These accounts also operate on the principle of mudarabah, but the modes of investment of the funds and distribution of the profits are customized to suit the needs of the clients. In general, these accounts are linked to special investment opportunities identified by the bank. These opportunities have a

specific size and maturity and result from the bank's participation in a pool of investment, private equity, joint venture or a fund. Investment deposits can have various deposit arrangement options:

A. Investment deposit under Mudarabah Option

A mudarabah transaction requires that the contract be explicit on the following matters: goal or purpose of the mudarabah, its tenure, role function of the concerned parties, profit-sharing ratio, principle for sharing losses, the extent to which indebtedness can be created in the name of the mudarabah and the principle for final settlement. There can be more than one line of mudarabah deposits in order to address diverse goals and concerns of the depositors. Each such line of deposits can be for a distinct purpose, and has separate starting and maturity dates. (Sayeed, 2007)

B. Investment deposit under Musharakah deposit option

Investment accounts operate on the principles of (profit sharing). With this option the banks accepting deposits from investors for either a fixed or unlimited period of time. The accounts are also known as profit and loss sharing accounts. Musharakah option can be construed as sharing in both capital and effort (Bala et.al, 2009).

C. Investment deposit under Ijara Option

According to this option, ownership of funds always remains with the depositors, and is at no stage shared with the banks (as opposed to the case of mudarabah or musharakah) or transferred to them (as in the case of a loan). The banks come in the picture as manager of depositors to administer the funds. Under these circumstances, owner of the funds and, hence, all profits belong to the depositors. The banks would be entitled to a fee.

2.1.5. Uses of financial resources in Interest free Banking

Financial intermediation is the major function of modern banking system. Financial intermediation means taking funds from people who have more than they need at this juncture in time and providing those funds to persons who need them for their economic transactions and activities. (Hassen and Lewis, 2007)

According to Yahiya Abdurahman, (2010) Interest free banking pays close attention as to whom and what to finance. Interest free banks (IFB) do not finance for example alcohol and gambling related businesses, such as liquor stores or gambling casinos. It also does not finance

environmentally irresponsible companies and businesses that are not fair to their employees. IFB does not finance speculative activities that are focused on making money out of money, based on speculations in the different financial, commodities, and real estate markets. It is community banking at heart. It believes in community development. It considers its role to be a qualified professional entity that is sound, safe, responsible, and trustworthy to attract the deposits and savings of the community (Abdulrahman, 2010).

Offer a broad spectrum of financial structures ranging from simple sharia compliant retail products such as saving and current accounts to leasing trust finances and large scale infrastructure financing. (Bala et. al, 2009)

2.1.5.1. Murabah Financing

Murabah financing is a popular method used by interest free banks to meet short term trade financing needs for its customers. It is often referred to as cost Plus-financing or mark up financing. In this type of financing the bank agrees to fund the purchase of specific asset or goods from a supplier at the request of customers upon acquiring the asset, the bank sells it to the customer at the predetermined mark up. Murabah financing is the back bone of contemporary interest free banking (Bala et.al, (2009: 30). An advantage of murabah is that an interest free bank is usually rigorous financially than its customers, so it can obtain discounts on purchases for its clients. When goods are purchased for several clients at one time, the discount may be larger, this controls costs for clients and contributes to the overall success of murabah (Roy, 1991).

2.1.5.2. Musharakah Financing

Musharakah is a type of partnership financing in which one of the partners is an interest free bank. Profits and losses are shared on predetermined formula. Profit sharing need not be based on the proportion of the shares owned, but liability of loss is limited to the contributions of the shareholders. In other words, investors cannot be liable for more than the amount of capital they invest in the partnership. (Shanmugan and Gupta, 2007) Musharakah is an Arabic word which means sharing, and relates to the sharing of profits or losses resulting from joint ventures or partnerships. In the business environment musharakah is a partnership contract based upon equity participation, by which partners provide capital under joint venture. The sharing of profits and losses resulting from such partnerships is pre-determined and partners may co-manage the

enterprise. The bank may act as a passive partner while the customer manages the venture (South Africa art; 281:35)

2.1.5.3. Mudarabah Financing

It is a commercial activity in which an Islamic bank entrusts funds to an entrepreneur. Which is also known as trust financing? The arrangement enables the entrepreneur to carry out business projects. Profits are distributed between the bank and entrepreneur on predetermined ratio. All losses are born by the supplier of the fund (bank) as long as there has been negligence on the part of the entrepreneur Bala et.al (2009).

2.1.5.4 Ijarah

Ijara means to give something on a lent. Under the ijara arrangement the bank purchases a tangible asset based on the clients' specification and leases it to the client. The bank gives the right to use the asset to lessee as well as physical position of the asset. In return the lessee makes rental payments based on the agreed schedule. Up on the expiration of the lease the lessee returns the asset to the bank (lessor). Ijara is typically used for high cost assets with long life span (Bala et.al (2009).

According to Delwin A. Roy, (1991) Ijara is a source of short or medium-term finance that is used by businesses in fields such as construction, for the financing of heavy machinery or other equipment. The bank purchases goods such as construction equipment and then leases them to the client on a specified sum, fixed-period basis. Monthly payments by the client are fixed at rates which cover all or most of the original purchase price of the item over the period of the contract. A contract can incorporate both Murabaha and Ijara if the eventual sale to the client is agreed upon at the time the original contract is made.

2.15.5. Bai' bithman Ajil (BBA)

Bala et.al (2009: 28) defines bai' bithmanajil is the sale of goods by the bank to a customer on a deferred payment basis over a specified period at a price that included a markup or profit margin agreed to by both parties. Bai' bitmanajil plan is commonly used for financing the purchase of real property, vehicle or consumer goods.

2.15.6. Al-Ijarathumna al bai (AITAB)

Financing on this modality essentially an ijara (leasing) contract combined with bai-purchase contract. Under the first contract, the purchaser (customer) leases the goods from the owner (the Bank) at an agreed rental price for specified period. Upon expiration of the leasing, the purchaser

enters into a second contract to purchase the goods from the owner at an agreed price (Bala et al (2009: 34).

2.1.5.7. Istisna and Tawaruk

In istisna financing, a commodity is purchased or sold before it comes in to existence, which is an exception to the sharia principle requiring that an underlying asset be present in order for a financial transaction

In this structure the bank directly or indirectly buys an asset and immediately sells it to a customer on a differed payment basis. The customer then sales the same asset to a third party for immediate delivery of and payment (Bala et al (2009).

2.1.5.8. Bai Salam

Financing is a forward financing transaction frequently used in the agriculture industry. In this structure, the bank purchases specified asset in advance of a predetermined delivery date. Typically the bank receives a discount for the advance payment plus a profit margin (Bala et al (2009).

2.1.5.9. Qard Hassen

This refers a gratuitous, or charitable, contract in which the borrower is required to repay only the amount borrowed with no profit (mark up) to the lender. It is a form of benevolent financing extended on a good will basis. Quad hassen literally mean good loan (Bala et al (2009).

2.1.6. Principles of interest free Banking Service

The main principles of Islamic banks activities comprise of prohibition of interest (riba) in all forms of transaction undertaking business and trade activities, based on, fair and legitimate profit (Mirakhor, 2000). Moreover operations of Islamic banking primarily are based on a profit and loss sharing (PLS) principle. An Islamic bank does not charge interest but rather participates in the yield resulting from the use of funds. The depositors also share in the profits of the bank according to a predetermined ratio. There is, thus a partnership between the Islamic bank and its depositors, on one side, and between the bank and its investment clients, on the other side, hereby acting as a manager of depositors' resources in productive uses, that is an interest free/ Islamic bank in relation to its clients plays the role of partner, investor and trader. The complexity of Islamic banking comes from the variety (and nomenclature) of the instruments employed, and in understanding the underpinnings of Islamic law (Kettell, 2011).

Islamic banking is a unique type of banking system that devoid all forms of transactions that are prohibited in Islam. So for any bank to be classified as Islamic bank, the following basic principles

must be adopted for its operations (Samad, 2004; Bello & Abubakar, 2014). Predetermined loan repayments as interest (riba) is prohibited, Speculative behaviour is prohibited, only Shariah-approved contracts are acceptable, profit and loss sharing is at the heart of the Islamic system, contracts are sacred, the implementation of Zakat the compulsory Islamic tax and transparency in all transactions. These basic principles are then applied to the various specific transactions of, for example pledge, deposit, and guarantee, agency, assignment, land tenancy, waqf foundations (religious or charitable bodies) and partnerships. Interest free banking is a narrow concept denoting a number of banking instruments or operations, which avoid interest.

According to Bala et.al, (2009) interest free finance is based on the themes of community banking, ethical banking, and socially responsible investing. Its goal is to be an ethical, indigenous, and equitable mode of finance. The six key principles that govern interest free are as follows.

A. Freedom from interest or segregation of funds

The Quran, the Muslim holy book, expressly forbids Interest, which includes any payment of interest (not only excessive interest) on monetary loans. A loan with a fixed return to the lender regardless of the outcome of the borrower's course of action is viewed as unfair. Interest is also believed to be exploitative and unproductive because it is considered to represent sure gain to the lender without any possibility of loss as well as a reward in return for no work. These factors are believed to lead, in turn, to inflation and unemployment and to stifle the social and infrastructural development of a nation. (Bala et.al, (2009)

B. Risk-and-Return Sharing

The profit and loss sharing is related to the principle that profits are distributed according to contractually agreed shares but liability to losses should be proportionate to the capital contribution (Monzerkahn and Khan, (1992). Risk sharing principle applied because interest is prohibited, pure debt security is eliminated from the system and therefore suppliers of funds become investors, rather than creditors. The provider of financial capital and the entrepreneur share business risks in return for shares of the profits and losses (Iqbal & Mirkahor, 2011).

An interest free banking service provider shares in the profit and loss of each borrower's business transaction. In turn, the bank divides its share of profits and losses with its general and special investors who have deposited funds in the bank. (Bala et.al, 2009) Shari'a prohibits Muslims from earning income by charging interest but permits income generation through the sharing of risks and rewards between the parties to a transaction. This profit-sharing mechanism is believed to

encourage people to become partners and work together rather than to enter into a creditor–debtor relationship. Partnership promotes mutual responsibility for the outcome of the financed project, which is believed to increase the likelihood of success of the venture. A tangential aim of the partnership approach is that such increases in successful projects also provide stimulus to the economy. (Bala et.al, (2009)

C. Shari’a-Approved Activities

Interest free banking service providers may engage in or finance only activities that do not violate the rules of Shari’a. To ensure that all products and services offered are Shari’a compliant, each interest free banking service has an independent Shari’a supervisory board.

D. Sanctity of Contract

Yahiya Abdul-Rahman, (2010) explains that Interest free banking service providers cannot finance alcohol-related businesses, gaming, gambling, polluting businesses, or other unethical activities. They finance businesses in a fair and just way and serve all customers of all background.

E. Prohibition of speculative behavior

An interest free financial system discourages hoarding and prohibits transactions featuring extreme uncertainty, gambling, and risk. (Iqbal and Mirkahor, 2011) interest free views contractual obligations and the related full disclosure of information as a sacred duty. Full disclosure is intended to reduce financial speculation (gharar), which is strictly prohibited by Islam, by providing as much information as possible for investors to make accurate assessments about the risks and rewards of an investment. The conditions that are necessary for a contract to be valid include a competent understanding of the underlying asset(s) and the profit-sharing ratio, as well as the presence of a willing buyer and seller. Contracts must also not offend Islamic religious and moral principles; if they do, they are considered as illegal and unenforceable. Bala et.al, (2009).

F. Segregation of Funds

An important principle behind interest free finance is the desire to maintain the moral purity of all transactions. The funds intended for Shariah-compatible investments should therefore not be mixed with those of non-Islamic investments. This requirement is not based on the assumption that the activities of non-Muslims are intrinsically impure. The rationale behind this principle is rather one of prudence, in the sense of taking all the necessary precautions to ensure that interest free funds do not become mixed with other funds that may be involved with Riba, Gharar, or haram activities.

Therefore, in order to ensure compliance with Islamic principles, conventional banks wishing to offer IB products must guarantee and publicize that the funds devoted to conventional activities will not be mixed with those destined for Islamic activities. In operational terms, this requires that banks establish different capital funds, accounts, and reporting systems for each type of activity. In this sense then, when a conventional bank opens an Islamic window, to a large degree, it is in fact establishing a separate entity from the rest of the bank (Sole, 2007).

2.1.7. Opportunities to interest free banking

Interest free banking operation now exists in about 100 countries worldwide and is said to be growing at 10-15% a year. In Africa, with a well over 40% of the population constituting Muslim society, the interest free banking business has spread out quiet quickly as the target community eagerly awaited its introduction into the markets (NIB, 2015).

The current trend seems to be toward separation between interest free and conventional banks. Some countries have opted for a clear separation between these banks, while others have allowed conventional banks to set up Islamic windows, opening the way for some of the largest multinational banks to participate. Even large conventional banks in United States and Europe have opened Islamic financing windows (IMF, 2005).

According to Nuri Hussein, the acting director of the OIB, interest free banking department the newly-introduced Islamic banking is booming in Christian-majority Ethiopia. OIB managed to mobilize 300 million Birr within two months, have more than 4,000 customers, who have deposited in the Islamic banking program and Customers are now depositing on average 2-2.5 million Birr on daily basis (DireTube.com).

2.1.8. Determinant factors of Interest free banking

In interest free banking system there is a serious shortage of scholars and qualified managers. Unfortunately the managers are not well trained in the use of interest free financial practices. Interest free banking in western countries especially in UK is facing the problem of legal system because Interest free banking not yet proper regulated due to this there is possibility to create tension between Interest free banking and regulators. It is fact that interest free banking is not well regulated at the moment because they have not a strong branch network. Islamic bank of Britain has only eight branches around the UK.

In conventional system, long-term finance is provided through long-term bonds and equities. Apart from the general public, the most important source of these long-term investments is investment banks, mutual funds, insurance companies and pension funds. Islamic banks do not deal with interest bearing bonds. Therefore, their need for equity markets is much higher. On the top of it, the most of the products in Islamic banks are based on goods and commodities while prices and currency rates go up and down frequently, creating a big risk for them being traders in reality especially in the case of Salam and Istisna'a. To hedge the risk, they are in need of derivative products and consequently of Future Exchanges (Abdul Jabbar, 2001).

As to Ephrem Mekuria, communications manager of CBE & Taye Dibekulu, president of UB, He explained to Addis fortune Magazine, that the customers are increasing in number; however lack of awareness from potential customers and the absence of a highly qualified workforce in the area are the major challenge in interest free banking. Also according to Andualem Hailu, planning and research manager at Awash International Bank, there are some contentious issues, like double-taxation and calculations of taxes on the investments and the bank which needs to be clear in the process (Addis Fortune.net 2014).

2.1.8.1. Advertising and Awareness of the service of IFB

According to Oxford Dictionary; “Awareness is concern about and well-informed interest in a particular situation or development”. In this study we examine the awareness/knowledge regarding Product and services, awareness in term of advertisement and awareness about financial teaching of Islam. Previous studies provide evidences about the impact of awareness regarding products and services. Rammal and Zurbruegg (2007) discovered that people were interested in IB products however unawareness to these products was the biggest hurdle in Australian market. The customer’s awareness level towards IB products is better in some of the common products such as current accounts, time deposit account. But most of the customers are unaware of the specific Islamic financial products such as Murabaha, Ijara Khattak and Rehman (2010).

2.1.8.2. Religious factors in IFB Service

Kirkpatrick (2005) expressed religion as psychological connection, dominant emotional relationship to things. Religion is a cause, principle, or a system of beliefs, service held to with

ardor and faith. Islamic bank has a spirit and philosophy of Islam, regarding interest-free transactions and risk sharing. Metawa and Almosawi (1998) found the religion as the main factor affect customer perception in the selection of Islamic banking system and not the yield on their investment. In addition he found religiosity is ranked highest factor affecting selection criteria followed by profitability. In UK, the volume of deposits of Muslims in Islamic financial institutions in primarily influenced by religious reasons, Omer (1992).

The same finding is supported by Othmen and Owen (2001); Walkhid and Afrita (2007); Haron et al (1994), where religion is major influential factor of IB adoption. Conversely, a Jordan based study found that religion did not play significant role to adopt an Islamic bank, but profit driven criteria was an important factor to choose a bank (Erol, C. and El.B. Radi, 1989). Regarding the Islamic banking selection criteria most of the customers have adopted Islamic banking due to the religious reasons, but there are some other factors that motivate the customers for the adoption of the Islamic banking system such as, bank efficiency in the transaction, their confidentiality to its customers, its working hours etc. (Khattak and Rehman., 2010). Studies by Hegazy (1995) on Egypt, Naser et al., (1999) on Jordan, Kareem and Afiff (2006) and Rohmah (2006) on Indonesia and Dusuki and Abdullah (2007) on Malaysia are agree with the findings that religiosity is not the main reason for people to support Islamic Banks.

2.1.8.3. Accessibility of IFB services in all branches

Accessibility is one of the important variables in determining the adoption criteria of Islamic Banks. It refers to geographically extended number of branches that a particular organization has in order to provide access to its customers. Haron et al, 1994 found convenience as a major factor influencing selection criteria of IFB, he conceptualize convenience as wide branch network, location being near home or work, convenient working hour of ATM, and bank location. Small network of branches is one of the factors that have significant effect on low growth of Islamic banking, so Islamic Banks should try to reach more people by opening more branches and it will certainly increase public confidence on them. Adnan, (2011).

2.1.8.4. Shortage of Sharia'a experts and human capital resources

The sustainability of Islamic banking depends adequately on qualified human personnel, training, and above all research on Islamic finance. This is due to the increasing challenges that continuously rock the banking industry especially with the advent of technology. However, the personnel and managers of Interest free banks are recruits from conventional banks who are not really conversant with Interest free banking operations. Thus, there is low understanding of moral and religious implications of their investments with the business ventures. Furthermore, very few training centers on Islamic finance exist in the Country and no refresher courses for professionals to improve their skills.

The implementation of financial products and adaptability to technology is low and above all, the necessary expertise and institutional capacity for Research and Development (R & D) that is not only necessary for the realization of their full potential, but also for its very survival in this age of fierce competition, sophisticated markets and an informed public is absent. There is still an acute shortage of skilled human resources in Islamic banks and inadequate training is given to staff on how to incorporate fundamental Sharia'a- compliant Islamic banking principles. Most importantly, there is an evident scarcity of competent Sharia'a experts in the Islamic banking industry, with a small group of experts serving on several Sharia'a boards of Islamic banks worldwide.

On the other hand, *Sharia'a* scholars at small Islamic banks have little insight into the complexities of present-day financial markets. Nevertheless, Islamic banks are urged to build up a strong base of research & training to develop a corps of Sharia'a experts with high moral and professional integrity. They should also establish a central Sharia'a board and an external audit committee to provide a truly independent scrutiny of their adherence to Sharia'a principles (Manar Mahmood Al-Gazzar, 2014).

2.2. Empirical Literature

Abdulmajid et.al (2015) wrote about the efficiency in interest free banking and conventional banking an international comparison investigates the efficiency of interest free banks and conventional banks using an output distance approach. They obtained measures of efficiency after allowing the environmental influences such as country microeconomic conditions accessibility of

banking services and the bank type. The parameter estimates highlighted that interest free banking appears to be associated with higher input usage.

Furthermore, by allowing for bank size and international differences in the underlying inefficiency distributions, it demonstrated statically significant differences in inefficiency related to these factors even after controlling for specific environmental characteristics and interest free banking. Due to this interest free banks are found to have high returns to scale than conventional banks. While this suggests that interest free banks may benefit from increased scale, they emphasize and the results suggest that identifying and overcoming the factors that cause interest free banks to have relatively low potential output for a given input usage levels will be the key challenges for Islamic banking in the coming decades (Abdulmajid et.al,2015).

Abate (2016) assessed the Ethiopian interest-free banking regulation in light of global Islamic finance standards and concluded that using as a legal framework the existing single and sketchy proclamation No. SBB/ 51/2011 to govern interest-free banking service will be a challenge. He recommended NBE to develop a comprehensive directive for a smooth application of interest-free banking system. Sefiani (2014) states that the absence of a suitable legal framework, the lack of skilled Islamic banking experts and inadequate awareness about Islamic finance products are the challenges of Interest-free banking practice in Ethiopia. Sefiani recommended the NBE to revise the proclamation No. SBB/ 51/2011 in order to resolve legal problems affecting the interest-free banks.

Ismaeil (2015) showed the recent development of insolvency of many conventional banks made by the Central Banks to initiate the acquisition of some banks while others were ordered to merge. This was a strong signal to seek for alternative banking system. However, the advocacy for the Islamic banking system as alternative to conventional banking system has been received with mixed feelings. He also posited that awareness, manpower, legal framework, societal belief, cash requirements were some of the challenges while economic growth, attraction of investors, and fostering of egalitarian society are the likely prospects for the establishment of the interest free banking. He concluded that interest free banking system hold a potential to transform all sectors of the economy with eradication of poverty, equitable distribution of income and employment opportunities in the country through effective mobilization and allocation of capital.

Ahmed (2019) investigated Ethiopian interest-free banking proclamation after the enactment of Directive No. SBB/72/2019. According to Ahmed (2019), there is no difference between the proclamation No. SBB/ 51/2011 and Directive No. SBB/72/2019. Moreover, the legal framework of Ethiopia is not appropriate for launching full-fledged interest-free banking. Accordingly, there is a need for a conducive legal framework to practice full-fledged interest-free banking in Ethiopia.

Rodney Wilson, (2010) indicated that interest free banking finance has become increasingly significant in financial centers in the West, notably London, despite the regulatory hurdles presented by operating in a non-Muslim financial environment. At the same time interest free financing methods are viewed as a challenge and opportunity by Western bankers, many of whom have sought to get involved in this growing industry. In client driven societies there is willingness by those in financial services to listen and learn from the experiences of interest free banks, which in the longer run may bring a major breakthrough for interest free banking at the retail level in the West.

In Ethiopia, IFB is a recent phenomenon. As a result, there is little empirical literature on the area. The studies conducted so far include the following: Among these studies Mohammed in 2012 has studied the Prospects, Opportunities and Challenges of Islamic Banking in Ethiopia“ in his work discuss the potential challenges as: lack of awareness, regulatory, supervisory and institutional challenges, lack of support, gap in research and development in Islamic studies, lack of qualified human resource as well as wrongful association with specific religion and the global terrorism but This study was conducted before the practical introduction of the IFB in Ethiopia.

Therefore, it was not based on actual observation of facts. And also Akmel Hailu’s (2015) study is about “challenges and prospects of Islamic banking for resource mobilization in Ethiopian commercial banks. “The study focuses on challenges and opportunities of IFB only on resource mobilization other challenges and opportunities are not well addressed. On the other hand a research by Debebe Alemu (2015) who studied the factors affecting customers’ use of IFB in Ethiopia and found out that 100% of IFB account holders were all Muslims. Evidently, the failure of banks to meritoriously serve the Ethiopian Muslim population hinders the development of the Muslim inhabited areas in particular and the economy of the nation as a whole. This study is about

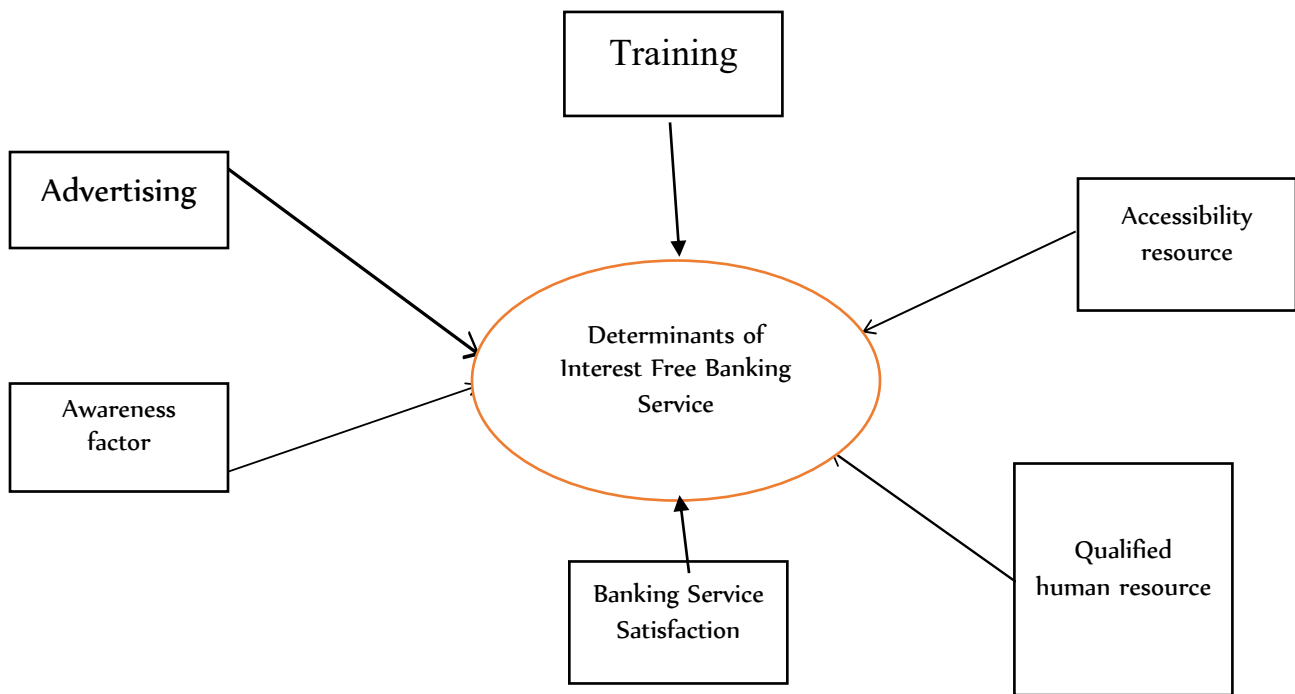
impact assessment on the attitude towards IFB usage which does not address the current problem at hand. And also Teferi's (2015), study is about "Contribution of IFB to economic development and its prospect in Ethiopia".

This study has a gap of taking the realities of other countries and in Kerima Ali Mohammed's (2016) study which is about "Challenges on Interest Free Banking Services" The study discuss the challenge faced by service providers and users of IFB products and scope of service provided by Ethiopian banking through IFB including whether there is unmet demand of users, awareness of customers and capacity of bank .the study doesn't addressed the opportunities of interest free banking as a new business strategy in Ethiopia. This, study, therefore, attempts to fill the above research gap by investigating the challenge and opportunity of interest free banking from the service provider's view.

2.3. Conceptual Frame work

The researcher derive conceptual framework from the concept interest free banking service and their determinants. They expected from previous studies are advertising, awareness, Religious, Accessibility and Qualified human resource. As a result conceptual framework is developed using the above parameters. Based on the overall review of related literatures, the following conceptual model study is developed. The model shows the correlation between variables (independent) that was affect by interest free banking performance (dependent) variable.

Figure 2.1 conceptual framework



Source: Own development, 2022

CHAPTER THREE

RESEARCH METHODOLOGY

3.1. Description of the Organization

The District that was in Hosaena is a town in southern Ethiopia, and the administrative center of the Hadiya Zone. Located in the Southern Nations, Nationalities, and People's Region, Hosaena has a latitude and longitude of 7°33'N 37°51'E with an elevation of 2177 meters above sea level. The result of the study indicated that Islamic finance in Ethiopia is representing by three financial institutions such as Islamic banks, Islamic Insurance and Islamic microfinance. From the users of almost 50% of them were found in Gurage zone.

The history of commercial bank of Ethiopia (CBE) dates back to the establishment of the state bank of Ethiopia in 1942. CBE was legally established as a share company in 1963. It has 780 branches stretched across the country as of January 6/2014. The banks plays a catalytic role in the economic progress development of the country currently the bank has more than 7 million account holders and combines a wide capital base with more than 18,000 talented and committed employees. In general customers could now enjoy speedy processing of account, easy access of fund and improved services from any branch of bank. CBE extends the following credit facilities to its esteemed customs.

Overdraft is a form of credit facility by which customers are allowed to draw cash beyond the deposits of their current accounts for the day to day operational needs of business. Merchandise loan facility is a short term credit facility extended to customers against merchandise or its documentary evidence. Like Railway Receipts, Warehouse Receipts, Airway Bills. Merchandise loan facility is extended to customers for a maximum period of one year and its maximum advance rate is 80% of the amount of the merchandise. Pre-shipment Export Credit facility is a short term loan extended to customers engaged in export business for purchase of raw material, processing, warehousing, packing, transporting the finished goods to shipment.

Revolving export credit facility is an advance extended to exporters upon presentation of acceptable export documents except bill of loading. It is to solve working capital problems of exporters with continuous export transaction emanating from money tied up in goods in transit of

shipment. Agricultural input loan is a short term loan granted to customers for the purchase of fertilizers, improved seeds and agro-chemicals. Agricultural investment loan is a short to long term loan granted to customers engaged in commercial farms or agro-processing industries for working capital as well as purchase of agro-processing machineries or equipment for plant, crop and animal production in small medium or large scale farming.

Although, CBE entertain Coffee farming Term Loan Financing and Micro -Finance Institution's Loan (official web site of CBE). Commercial bank of Ethiopia gives the following credit facilities to its esteemed customers, overdraft, merchandise loan facilities, per-shipment export credit facilities, special truck loan financing, medium and long term loan agriculture investment and micro finance institutions loan (CBE annual report 2011/12)

Currently Commercial Bank of Ethiopia has 34,879 permanent employees. CBE operates a network of 1,666 branches and 1,501 ATMs across Ethiopia in 2020. Among those branches, this study was conducted at the Hossana district around wolkite. This study was involved CBE that involved in provision of services related with IFB system.

The financial services by this banks will be almost the same and range from: 1)Wadiah amanah (saving with guarantee) 2) Amanah (qard) current account, 3) Mudharabah (profit sharing saving account), 4) Mudharabah (profit sharing fixed time deposit account). Trade partnership financing include: 1) Murabh, 2) salam, 3) Istisana, and 4)Ijara

3.2 Research Design

The study is based on cross-sectional research design. Accordingly, the study used both quantitative and qualitative research strategies. The quantitative method was used to analyze data that were collected from structured household surveys. The qualitative research also used to analyze the data that was collected by unstructured interviews with key informants: banking experts.

The researcher testsquestionnaires for consistency, clarity and duplication/ homoscedastic. Appropriate training, including field practice, was necessarily develop the enumerators' skill, regarding the objectives of the study and the content of the questionnaire, on approach the respondents and conducting the interview. The design appropriately shows the determinants of

interest free banking practice: in case of Commercial bank of Ethiopia Hossana district, the probit was designed.

3.3. Data Sources and Collection Methods

This paper was used both primary and secondary source of data. Multi-stage random sampling method was employed and the structured household survey questionnaire were used to collect primary data on the identification of the demographic, socioeconomic and factors that determining Interest Free Banking Practice: In Case of Commercial Bank of Ethiopia Hossana District. Respondents are randomly selected from a representative random sample of users of the Hosana district. In addition, unstructured interviews were conducted from the key informants at sub-district levels. Furthermore, secondary sources such as documents, journal articles and related materials were used to back up the findings from primary sources.

3.3.1 Population

A population can be defined as all people or items (unit of analysis) with the characteristics that one wishes to study (Kothari, 2004). CBE has totally 30 districts in Ethiopia based on location. The district was found in Hossana city. Branches that are located in Hossana city surrounded zones. To make the research manageable, Hosana District commercial bank branches are considered for this research. The total population for this study was 42,307 customers.

3.3.2 Sampling Techniques

Multi-stage random sampling methods was used to obtain the necessary information from formal informants. The first stage of the section is the study area (Hossana district) that selected by purposively; as a result, the customer's selected from this district. necessarily the customers are both interest free banking users and not users. The reason why the researcher select these branches is because of easily access data for this study.

The second stage, is branch selection, six branches are randomly selected from the total of 64 branches from Hossana district. The customer's drawn from the selected branches by using random sampling techniques to avoid sample selection bias. In the determination of sample size the three criteria are very important to gather the required data from sample respondents. These included the level of accuracy, the level of confidence or risk and the degree of variability in the attributes being

measured that enable the researchers to determine appropriate sample size (Miauou&Michener, 1976).

3.3.3 Sample Size Determination

The following formulas by (Kothari, 2004) would be used to determine sample

size:

$$n = \frac{z^2 \times p \times q \times N}{e^2(N-1) + z^2 \times p \times q} \dots \dots \dots 1$$

$$n = \frac{(1.96)^2 \times 0.5 \times 0.5 \times 42,307}{(0.05)^2(42,306) + 1.96^2 \times 0.5 \times 0.5} = 399$$

$$ni = Wh * n$$

Where: n= the desired Sample Size

Z = standard normal deviation (1.96 as per table of area under normal curve for the given confidence level of 95%), e = margin of error for this study 5% was taken (0.07), the general accepted margin of error for representative sample is 10% or less.

N= total number of respondents in study areas of Hosana (42,307), which was taken from Commercial Bank of Ethiopia (CBE). p = sample proportion, success for each household to be included in the sample proportion (p= 0.5) and q = 1- p, q=0.5, failure for each household to be including in the sample. The six branches and sample from each branch were selected from the district for the study.

3.1.2 Definitions of the variables

The variables that this study uses are described as the following:

The dependent variable for the econometric model of this study is the usage of interest free banking service, the variable is binary, the study was used the probit regression model to identify the factors that determine of interest free banking practice: the case of commercial bank of Ethiopia. In this situation the dependent variable is a binary one justifies the use of probit model. The dependent variable assumes the two values: 1 if the customers are users of interest free banking and 0 otherwise.

Interest free banking (IFB): The involvement of institutions, governments, and various conferences and studies on Islamic banking (Conference of the Finance Ministers of the Islamic Countries held in Karachi in 1970, the Egyptian study in 1972, The First International Conference on Islamic Economics in Mecca in 1976, and the International Economic Conference in London in 1977) were instrumental in applying the application of theory to practice for the first interest-free banks

Awareness factor: Awareness of the Islamic banking products and services refers to the understanding and acknowledgement of the existing tradable items, the content of products/services as well as the functions. The knowledge of these are acquired by having in touch with the products and services directly or hearing from other sources on it. Beside the growing development of Islamic banking in all over the world particularly in Bahrain, the awareness employees who work at those banks are not rigorously evaluated and assessed. Ramdhony (2013)

Qualified Human: Excellent leadership, communication and interpersonal skills. An excellent understanding of employee and labour law. The ability to work within a stated business plan, develop staff and work according to the needs of a business

Advertising is always present, though people may not be aware of it. In today's world, advertising uses every possible media to get its message through. It does this via television, print (newspapers, magazines, journals etc), radio, press, internet, direct selling, hoardings, mailers, contests, sponsorships, posters, clothes, events, colours, sounds, visuals and even people (endorsements).

Accessibility resource: It is safe to say no one would choose to give up his or her privacy and independence in getting service. However, this is a reality for some of your customers. You have the ability to give your customers independence and gain respect as a socially responsible company.

Religious factors: Thus, Islamic Banking are facing strong regulatory challenge in the cross border activities including financial engineering, some sorts of Shariah issues, lack of proper institutional framework, lack of appropriate legal framework, lack of equity institutions, for maintaining proper accounting standards.

Banking Service: The Islamic bank is to promote trade activities as an active interaction with Surplus Units and Deficit Units of the economy. The other function of Islamic bank is the provision of agency services and other market compatible products to facilitate its customers.

Table 3.1 Definition of variables and expected signs

No	Variable	Definition of Variable	Expected Sign
1	IFB users	CBE Customers were use or not use IFB service	+V or -V
2	IFB	Mobilizing or advancing of funds in a manner consistent with Islamic Finance principle (Shari'ah) and that avoids receiving interest	+ V/ -V
3	Awareness factor	Consumer awareness have been tested as one of the key variable and positively influence customers attitude in numerous studies specifically in the area of on-line banking, internet-banking and self- services technology adoption (Khedmatgozar et al., 2012).	+ V
4	Qualified human	Good leadership, communication, understanding of labour law and the ability to work within a stated business plan.	+ V
5	Advertising	The company briefs the agency on the brand, its imagery, the ideals and values behind it, the target segments and so on. The agencies convert the ideas and concepts to create the visuals, text, layouts and themes to communicate with the user	+V
6	Accessibility Resource	Staff training is the key to ensuring good customer service, Policy, Guide line, Customer Service & Teller Counters, Communication, Forms and Documents, Accessible Bank Statements; Social, Responsibility and Deliver Dignity	+V
7	Religious factors	challenge in financial engineering, some sorts of Shariah issues and lack of proper institutional framework.	-V
8	Banking Service	good service for customer and Staff, easy and understandable Guide line, and using recent technology make the IFB preferable.	+V

3.4. Model Specification

3.4.1. Theoretical model

Islamic economics refers to the knowledge of economics or economic activities and processes in terms of Islamic principles and teachings. Islam has a set of special moral norms and values about individual and social economic behavior. Therefore, it has its own economic system, which is based on its philosophical views and is compatible with the Islamic organization of other aspects of human behavior: social and political systems. Is a term used to refer to Islamic commercial jurisprudence and an ideology of economics based on the teachings of Islam that is mostly similar to the labour theory of value, which is "labour-based exchange and exchange-based labour".

When speaking in terms of a labor theory of value, "value", without any qualifying adjective should theoretically refer to the amount of labor necessary to produce a marketable commodity, including the labor necessary to develop any real capital used in the production. Both David Ricardo and Karl Marx tried to quantify and embody all labor components in order to develop a theory of the real price, or natural price of a commodity. The labor theory of value as presented by Adam Smith did not require the quantification of past labor, nor did it deal with the labor needed to create the tools (capital) that might be used in producing a commodity. Smith's theory of value was very similar to the later utility theories in that Smith proclaimed that a commodity was worth whatever labor it would command in others (value in trade) or whatever labor it would "save" the self (value in use), or both. However, this "value" is subject to supply and demand at a particular time:

3.4.2 Methods of Data Analysis

Descriptive and econometric method was used to analyze the primary data, after that the enumerator collects from interest free bank users structured questionnaire. Descriptive Statistics are used to describe the basic features of the gathered data. Descriptive methods such as measure of averages, percentages, using graphically displays and tabular description which summarize the data. The method is used the statistical tools and economic theories in combination to estimate the economic variables and to forecast the intended variables.

The assumptions of OLS such as Multicollinearity/ Correlation, Heteroskedasticity and normality tests was conducted for the variables that were include in the study to check adequacy of the model.

The Statistical test mainly used to analyze the determinants of interest free banking in the commercial bank of Ethiopia. The probit regression model was employed to analyses what are the determinants that affect IFB users or not. STATA, Eviews and SPSS software packages were used.

3.4.3 Empirical Model

The logit and probit models are the most frequently used models when the dependent variable is dichotomous (Gujarati, 2004; Verbeek, 2004; Green, 2003; Woodridge, 2002). The probit and logit models are quite similar, so they usually generated predicted probabilities that are almost identical. Econometric models such as the Logit model which is corresponding to a logistic distribution function and probit model that corresponds to normal distribution are commonly used for qualitative responses like “yes” or “no” a qualitative binary variable.

Logit and probit model can be used interchangeably and the two models give nearly similar results. The study applies probit regression model to identify the determinant variables and their marginal effect on customer’s usage for the two sets of IFB users and not users. For this study one dependent variable is used. In the first stage, a probit is estimated on the decision to collect with data from both users and nonusers.

The study was used the probit regression model to determine the interest free banking service. The fact that the dependent variable is a dichotomous one justifies the use of probit model. Accordingly, the dependent variable assumes only two values: 1 if the IFB users and 0 otherwise.

$$\text{Determinants of Interest Free Banking Service} = \alpha_1 + \beta_i \sum^{n_1} x_i + \varepsilon \dots \dots \dots (1)$$

Where Y_i is a vector of binary variables, such that $Y_i = 1$ if the i th respondent partspante in interest free banking and 0 otherwise. x_i is a vector of explanatory

$$y_i = \begin{cases} 1, & \text{probability to use IFB } (p_i) \\ 0, & \text{other wise } (1 - p_i) \end{cases}$$

Consequently, if N observations are available, then the likelihood function is

$$L_i = \prod^{N_i} p_i^{y_i} (1 - p_i)^{1-y_i} \dots \dots \dots (2)$$

The logit or probit model arises when P_i is specified to be given by the logistic or normal cumulative distribution function evaluated at $X_i'\beta$. Let $F(X_i'\beta)$ denote cumulative distribution functions.

Since the purpose of the study is to investigate the determinants of interest free banking Service in case of Commercial Banks of Ethiopia operating in Hossana district. The researcher was used probit regression models.

Where;

Interest free banking service=f (IFB components)

AGE= Age of Respondents

Gender= gender of respondents

EDUC= Educational Level

IFB = Interest Free Banking

ADF= Advertising Factors

RF= Religious Factors

ACF= Accessibility Factors

BSS= Banking Service Satisfaction

HRF= Human Resource Factors

3.5. Ethical Considerations

In the first place, the department was approved the thesis proposal. In addition, the researcher followed logical procedures in every stage of data collection processes. Accordingly, the respondents were introduced about the purpose of the study then inform consent from the respondents and responsible officials of the Hosana district office. Therefore, on the basis of these ethical principles, efforts were made and confidentiality would be assure and kept throughout the process of this research work.

3.6. Diagnostic test

Multicollinearity problem arises when at least one of the independent variables is a linear combination of the others. To solve this problem, check the variance inflation factor (VIF) technique was employed for identifying whether the problems of multicollinearity among explanatory variables exist or not (Gujarati, 2006). If VIF value is greater than 10, it is used as a signal for strong multicollinearity among the explanatory variables.

$$VIF = \frac{1}{1 - R_i^2} \quad (3)$$

Where, R_i^2 is the square of multiple correlation coefficients that results when one explanatory variable (X_i) is regressed against all other explanatory variables. Heteroscedastic is the test for disturbance term normally distributed or not. Robust the result is the solution. Also normality test checked by using Shapiro swilk test ($W > 0.05$) the sample is normally distributed.

CHAPTER FOUR

RESULTS AND DISCUSSION

4.1. Descriptive Results

4.1.1. Socio-economic and Demographic characteristics of respondents

The section emphasizes that socio-economic and demographic structure of the respondents and presents the results of data that were gathered from primary sources through questionnaire and interview. From the table 4.1 the collected data has been analyzed and interpreted accordingly. As per the sampling design 131 IFB users and 268 not users the questionnaires were distributed to CBE customers. From the total distributed questionnaires which distribute to CBE customers, IFB users and not users were fully collected.

Table 4.1: Questionnaire Response Rate

Sample	Distributed		
	Number		percent
Customer IFB no users	male	120	30
	female	120	30
	total	240	60
Customer IFB users	male	100	25
	female	59	15
	total	159	40
Total		399	100%

Source: Own Computation from responded questionnaire, 2022

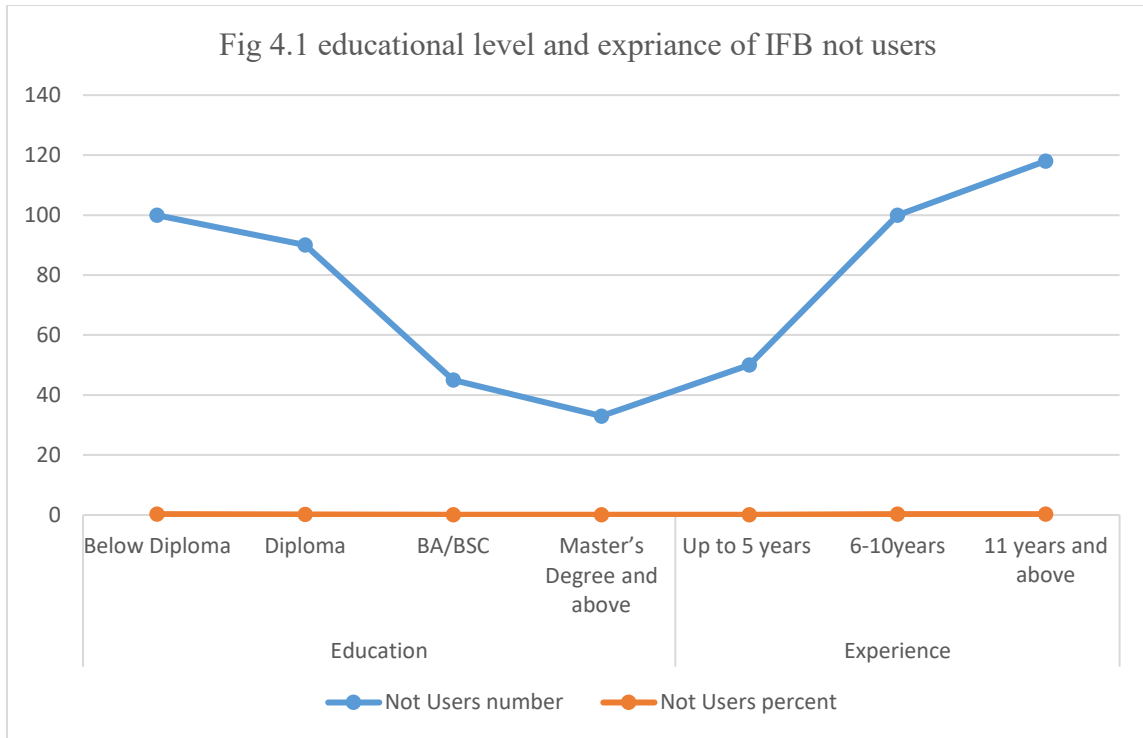
Table 4.2: The demographic Characteristics of Respondents

Service	Not Users			Users		
		number	percent		number	percent
Education	Below Diploma	100	25%	Below Diploma	86	21.5%
	Diploma	90	22.5%	Diploma	23	5.76%
	BA/BSC	45	11.3%	BA/BSC	15	3.76%
	Master's Degree and above	33	8.3%	Master's Degree and above	7	1.75%
Experience	Up to 5 years	50	12.5%	Up to 5 years	50	12.5%
	6-10years	100	25%	6-10years	50	12.5%
	11 years and above	118	29.57%	11 years and above	31	7.77%
Exposure to IFB	Up to 2	-	-	Up to 2	50	12.5%
	2-4 years	-	-	2-4 years	60	15%
	4-above years	-	-	4-above years	21	5.2%

Source: Own Computation from customers of CBE, 2022

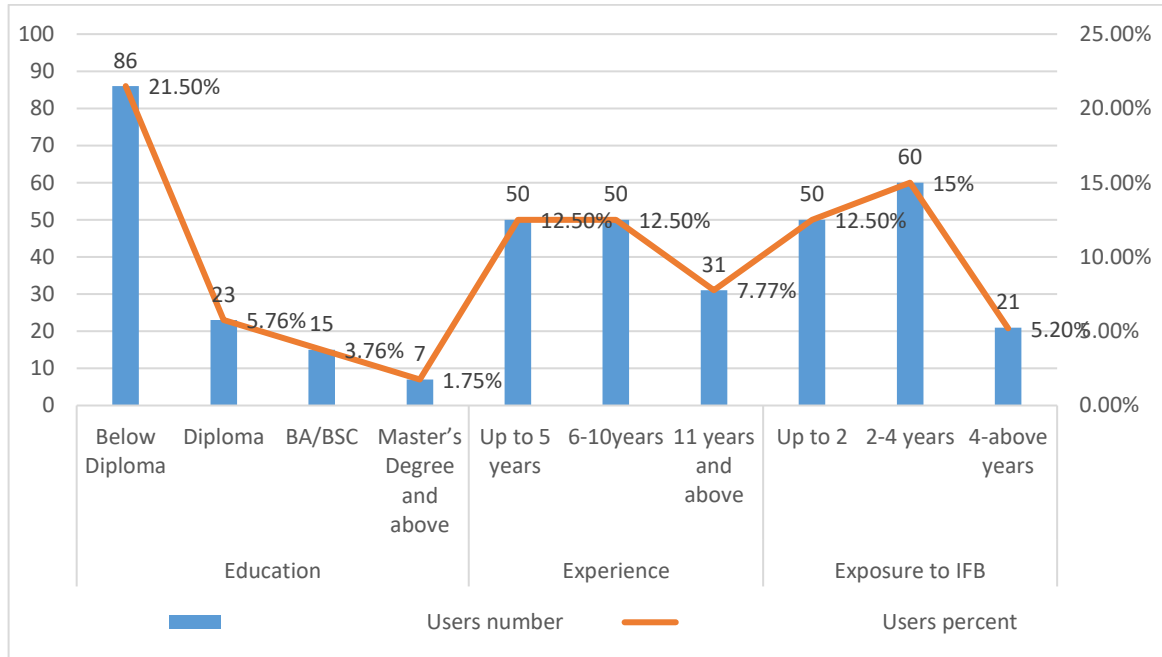
The above table 4.2 results categorizes the customer level of education, number of year used in CBE and exposure to IFB service. From those IFB users are half of the not users. Total numbers of IFB service users are 131. Their educational level 86 or 21.5% Below Diploma, 23 or 5.7% were Diploma, 15 or 3.7% were Degree and 7 or 1.75 % were MSc and above. The years that the respondents served in CBE was 50 respondents or 12.5% served up to 5 years, 50 customers served 6-10 year and 31 customers were served 11 years and above. 50 or 12.5% of the customers were exposed to IFB service up to 2 years, 60 or 15% of respondents were exposed to 2-4 years and 21 or 5.2% were 4 and above years.

From the result those IFB not users total number was 268. Their educational level 100 or 25% Below Diploma, 90 or 22.5% were Diploma, 45 or 11.3% were Degree and 33 or 8.3 % were MSC and above. The years that the respondents served in CBE was 50 respondents or 12.5% served up to 5 years, 100 customers served 6-10 year and 118 or 29.57% customers were served 11 years and above.



Source: Survey result (2022)

Fig 4.2 the educational, experience and exposure of IFB users



Source: Survey result (2022)

From the above figure 4.1 discussed IFB not users educational level and years of using CBE and figure 4.2 also emphasis IFB user’s educational level, experience and exposure to use IFB service.

Table 4.3: Descriptive Statistics of continuous Variables.

Variables	Obs	Mean	Std. Dev.	Min	Max
Age of respondents	399	46.89589	16.71316	18	90

Source: STATA version 13 using Own survey 2022

The above table 4.3 discuss that, the respondents average age is 46.9 from the youngest age of 18 (the productive) and the oldest age 90 years old. From the current many developing countries scenario most of the population number was young age. This is true for Ethiopia also. In many studies clarified that from Ethiopian population more than 70% was young age. This study also 350 or 87.7% of population were between working age (18 to 65) years.

Table 4.4: Descriptive Statistics of Categorical Variables.

Categorical Variables	Description	Freq.	Percent	Cum.
Training	Strongly Disagree	75	20.55	20.55
	Disagree	44	12.05	32.60
	Neutral	68	18.63	51.23
	Agree	134	36.71	87.95
	Strongly agree	78	19.54	100.00
	Sex of respondents	Male	220	55.14
Female		179	44.86	100
Customer have lack of Awareness	Disagree	38	9.5	9.5
	Neutral	107	26.8	36.3
	Agree	190	47.6	83.9
	Strngly Agree	64	16.1	100.00
Advertising factor or media	Disagree	8	2	2
	Neutral	62	15.5	17.5
	Agree	187	46.87	64.4

	Strongly agree	142	35.6	100.00
Religious factor	Strongly Disagree	2	0.55	0.55
	Disagree	13	3.56	4.11
	Neutral	57	15.62	19.73
	Agree	170	46.58	66.30
	Strongly agree	123	33.70	100.00
Accessibility factor	Strongly Disagree	91	24.93	24.93
	Disagree	61	16.71	41.64
	Neutral	44	12.05	53.70
	Agree	119	32.60	86.30
	Strongly agree	50	13.70	100.00
Banking Service of Satisfaction	Strongly Disagree	69	17	17
	Disagree	77	19.3	36.3
	Neutral	60	15	51.5
	Agree	107	26.8	78.3
	Strongly agree	86	21.7	100.00

Source: STATA version 13 using Own survey 2022

Banking system is one of the most important economic sectors and strongest financial intermediaries in the economies that plays a key role in economic development in societies through receiving the deposits of depositors and instead pay loans and facilities to applicants and give interest (Iravani et al, 2012).

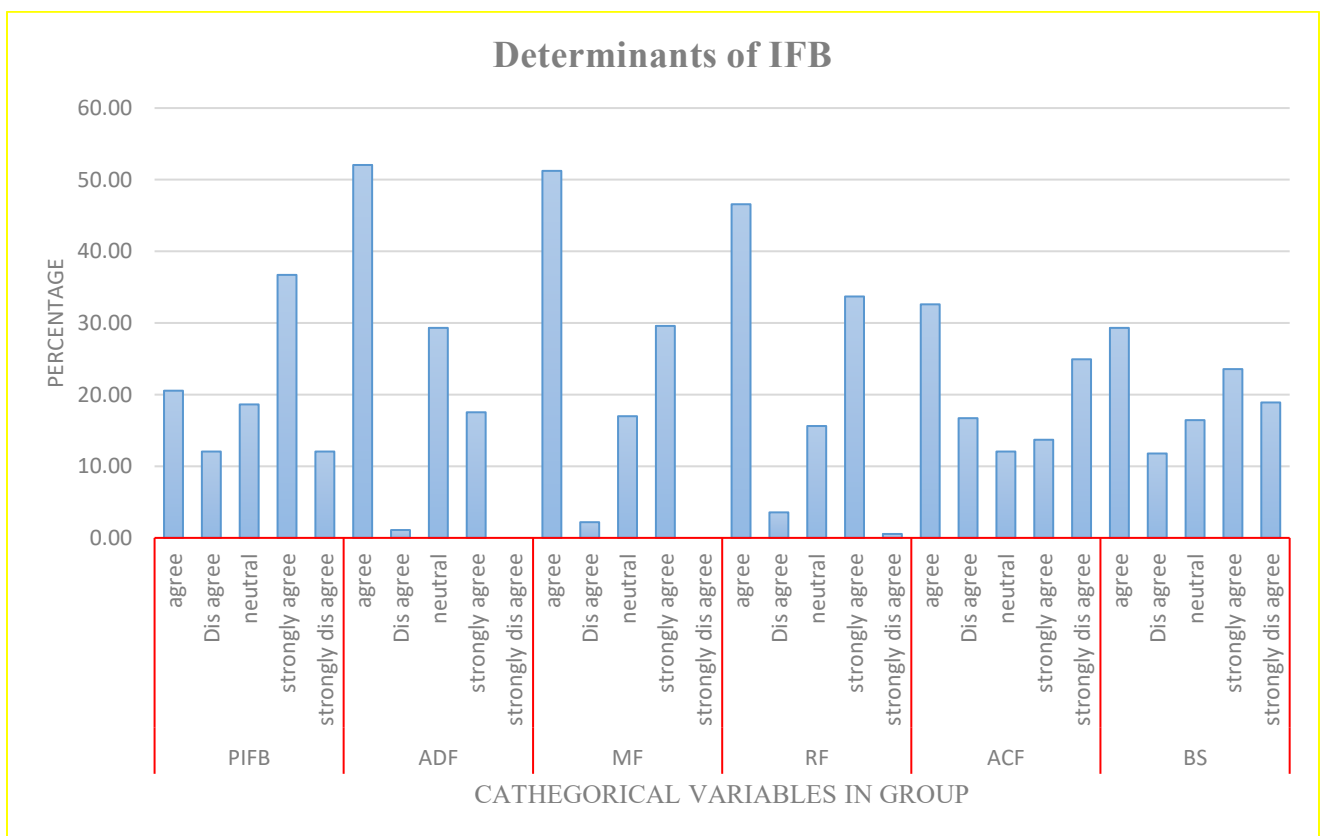
Interest free banking is inseparable of Islamic economics which aimed at realization of a greater justice in human endeavor, which is achievable only with participation of all human institution inclusive of financial system (Adeniran, 2013).

The having training in studies area Strongly Disagree (20.55%), Disagree (12.05%), neutral (18.63%), agree (36.71%) and stronglyagree (19.54%). The sex of respondent's male (220) and females (179).Most of the Customers have lack of Awareness in the districtstrongly Disagree (0%), Disagree (1.10%), neutral (29.32%), agree (52.05%) and strongly agree (17.53%).

To spread the awareness of Islamic financial industries to Ethiopia; There is lack Public Median this district strongly Disagree (0%), Disagree (2%), neutral (15.5%), agree (46.87%) and strongly agree (35.6%) almost 80 % of respondents are agree and strongly agree this is may be governmental or public media and religious issue are independent to each other.non-Muslims cannot use the product of IFB Strongly Disagree (0.55%), Disagree (3.56%), neutral (15.62%), agree (46.58%) and strongly agree (33.70%). From the table most of the respondents confirm statement.

Lack of IFB access in all branches of CBE in Hossana district were Strongly Disagree(24.93%), Disagree (16.71%), neutral (12.05%), agree (32.60%) and strongly agree (13.70%). On Interest Free Banking Services customers and staff satisfaction were presented as Strongly Disagree (17%), Disagree (19.3%), neutral (15%), agree (26.8%) and strongly agree (21.7%).

Fig 4.3. Categorical Variables that Determin Islamic Banking



Source: Own computation 2022

From the above diagram result show that 20% of them are agree and 37% of the respondents were believed or strongly agree there is training practice on IFB system, but 12.5% disagree and

12% of respondents were strongly disagree, that means there is training on the organization.19% of respondents were neutral.

From the respondents 52% and 17.5% of the Customer have an awareness about the major types of interest free banking services and products but, 29% of the respondents were neutral and only 2% of them have no an awareness. This shows that most of the customers have knowledge about interest free banking. There is lack Public Media to spread the awareness of Islamic financial industries to Ethiopia 81% of the respondents were agree and strongly agree the statement.

From the respondents 80% of them believe non-Muslims cannot use the product of IFB and 4% does not agree on the statement and 15% were neutral. The IFB an accessnot have in all branches of CBE,46% of respondents were agree and strongly agree, but 42% were not agree and rest of 12% were neutral.

Having a satisfaction on the IFB service 48.5% of respondents were agree and strongly agree, but 36.3% of the customers and staffs were does not satisfied and the rest 15% of respondents are neutral.

4.2. Probit regression

Table 4.5 Probit regression analysis

```

Probit regression                               Number of obs   =       399
                                                Wald chi2(8)    =       61.23
                                                Prob > chi2     =       0.0000
Log pseudolikelihood = -217.30709             Pseudo R2      =       0.1396
  
```

IFBS	Robust		z	P> z	[95% Conf. Interval]	
	Coef.	Std. Err.				
Gender	-.2663755	.1510153	-1.76	0.078	-.5623601	.029609
ADF	-.241981	.1170587	-2.07	0.039	-.4714117	-.0125502
RF	.1623518	.0996657	1.63	0.103	-.0329893	.357693
HR	.0596103	.0850133	0.70	0.483	-.1070127	.2262333
BS	-.228841	.0625079	-3.66	0.000	-.3513543	-.1063278
age2	-.0295769	.0600623	-0.49	0.622	-.1472969	.0881431
PIFBTR	.5149273	.0714033	7.21	0.000	.3749795	.6548751
Educ_01	-.0148076	.0693629	-0.21	0.831	-.1507563	.1211411
_cons	-.8642692	.6538652	-1.32	0.186	-2.145821	.417283

Source: STATA version 13 using Own survey 2022

From the above table 4.5, eight total explanatory variables are included in the model, four of them are significant impact on dependent variables. The determinants of interest free banking Service: affect either positively or negatively were; the respondents having training for IFB is positively affect the interest free banking but the other variables has a negative impact.

4.3. Probit Estimation Result

Maximum likelihood estimates of the probit model and the Marginal effects of the variables

Table 4.6 Probit Model result and marginal effect

Marginal effect

. mfx

Marginal effects after probit

Y= Pr (IFBS) (predict)

= .3023386

Variable	Robust Coef.	Std. Err.	z	P>z
Gender	-.2663755	.1510153	-1.76	0.078*
ADF	-.241981	.1170587	-2.07	0.039**
BSS	-.228841	.0625079	-3.66	0.000***
PIFB-TR	.5149273	.0714033	7.21	0.000***
_cons	-.8642692	.6538652	-1.32	0.186

Source: STATA version 13 using Own survey 2022

Where ***, ** and * significance level at 1%, 5% and 10% Wald chi2 (8) = 61.23

The table 4.6: result shows the marginal effect of the probit regression model probability that the customers of IFB users. The LR chi square which measures the overall significance of the model, i.e., with the null hypothesis that all coefficients are zero is rejected this showing that at least one of the coefficients is different from zero. From econometric variables likelihood of the customers uses IFB are given the statistically significant variables. Therefore, those four statistically significant explanatory variables are: gender of customers, advertising factor, banking service and IFB training.

The Gender of household head is important and statistically significant variable (at 10%) level of significance. The female respondents are lower participation in IFBS. This leads the interest free banking service to downward and negative direction. This may happen most of the time females have many tasks in their home and society specially in developing countries saving habit is less and most of females are using cultural way of saving rather than using bank service.

This study in line with the previous studies Gebru et al., 2014. It is highly probable it did improve families' access to better housing and generated a huger rural saving in form of cash. Diversion of

income to none basic goods does not seem to be serious problem. However, it may have negative effect on gender empowerment of rural women.

The customers having training and sharia rule was very important variable for the customers those to participate in interest free banking. The increment of Training improves every aspect of socio economic, cultural and religious aspects. The customers having training was positive and statistically significant (at 5%) level of significance, then it increases respondents participation to upward and the farmer's economic situation changes from subsistence living standard to commercialize. The having different training that improves the skill of saving, gain good knowledge about the religion, improves better skill about bank service and so on.

This study is in lined with Abraham Redi (2017). In his study training has positive and significant impact on IFB workers. Further analysis using multiple regressions indicated that the determinant factors are having significant relationship ($p < .05$) and explained 55 percent variation in the product knowledge of IFB workers. It is found that underlying Sharia' principles and training are having a significant positive impact on employees' product knowledge. However, underlying Arabic Terminology is not significant to the model. The result explained that the increase of a unit in underlying Sharia' principles will affect the increase of 0.350 unit of product knowledge; while the other variables are held constant. Similarly, 0.253 unit of product knowledge is expected to increase if a unit of training increase.

Customer have lack of Awareness (ADF) is important and essential variable that helps the respondents that use the interest free banking service. The respondents loss an awareness or lack of awareness increases the interest free banking service leads to decrease. This in line with (Yewubdar Getachew, 2018) Availability of less number of customers is one of the obstacles and limits the bank to be the existed one. As the respondent of the officials show that some banks may not deliver the service even for one customer with in the whole day because of unavailability of customer.²

²The response of the bank officials, customers did not have trust if the product is delivered by non-Muslim staff and customer also believed that the service which it is delivered by the bank based Shariah compliant IFB product and services. As the response of bank officials, customers believed that there is mixing of IFB and conventional banking transaction and the bank is not even committed to give truly IFB services this has eroded the customers' trust.

In Banking Service the customer's satisfaction (BS) is a negative and significant impact on IFBS at 1% level of significance. If satisfaction the customers have decreases on the service of CBE interest free banking service then IFBS would leads to downward. Customers satisfaction was power full variable in banking industry, so many banks tries to satisfy their customer through serving additional time, holydays and so on. But CBE customers so many time rise aggrieved in the service. Some customers said they have no get the comfort in CBE service. Peters (1999) and et al., Schneider (1985) argue that higher customer services without managing quality, it is impossible to give value added services. The organization can deliver satisfactory services to customers when their respective with basic resources including logistics, equipment, administrative and management support. Zeithaml (2000) argues that service quality is an important aspect and therefore, banks must accredit their customer's perception and then meet the customer needs by providing desired services. Further supports this by arguing that ³

The explanatory variables age, human resource, religious factor and education have not significant impact on interest free banking service in the study area. The increment of uneducated customers make IFB service to negative. The age of household on average is 46, which implies more participants are higher age customers but the contribution of productive age group is less in this study area. The education and human resource is not yet this much important. The Pseudo R2 results 14% show that variation in the dependent variable, which implies that percentage of the variation to determinants of IFB is explained by the variables included in the model. The 30.23% of dependent variable predicted by independent variables, then the model is good for prediction. The model overall significance and fitness can be checked with the chi2 test; thus, Prob > chi2 = 0.0000 indicates that the explanatory variables predict the dependent variable. (See appendix)

³“Satisfied employees make for satisfied customers (and a satisfied customer can, in turn, reinforce employees' sense of satisfaction in their jobs).”Zeithaml (2000).

4.4. Diagnostic Tests

4.4.1. Diagnostic test for Probit Regression Model Analysis

The most common issues when working with cross-sectional data are multicollinearity and heteroscedasticity. Multicollinearity is where two or more independent variables are correlated with each other. The existence of multicollinearity might cause the estimated regression coefficients have the wrong sign. The correlation analysis result shows that the numbers are less than 0.5206 this indicates there is no multi collinearity or serial correlation among the variables.

Heteroscedasticity is where the variance of the error term is not constant. Heteroscedasticity is a situation where the disturbance terms, do not have constant variance. Since the presence of heteroscedasticity would result in inconsistent estimators, the model was then estimated with STATA version 13 software and used robust standard error to eliminate heteroscedasticity problem.

Probit model for interest free banking, goodness-of-fit test. The **Hosmer–Lemeshow** test is a statistical test for goodness of fit for Probit regression model. It is used frequently in risk prediction models. The test assesses whether or not the observed event rates match expected in the model. This statistical test is widely used in the probit/logit model statistical/econometric model that, in its basic form of the binary dependent variable. This goodness-of-fit test compares the observed proportions to the test proportions to see if the differences are statistically significant or not. The p-value is less than the significance level (0.05) then the model is not a good fit. Then we conclude that the customers interest free banking participation effect is not significant, and then the econometric model is well fit. (See appendix 2.3)

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1. Summary

The variable that determines interest free banking, Customers were IFB users or not, Advertising factors, religious factors, Human resource factors, Gender, Age of customers, education, Practice or training of Islamic banking and bank service. From these variables half of them were statistically significantly influence IFB. Gender, Lack of awareness ADF and bank service (BS) have a negative impact but the only having training were positive impact.

5.2. Conclusion

Now a day the bank sectors are the most financial center for flow of money. This sector has two major wings that are Interest free banking (Islamic banking) and non interest free Banking system. This sector is most important economic sectors and strongest financial intermediaries in the economies that play a key role in economic development in societies. From the study result, training in this study Dis agree (33%), neutral (18.63%) and agree (49%). Almost half of the respondents were agreeing on having training. Training has positive and statistically significant impact on interest free banking. Giving different trainings sharia rule, financial flow, financial transaction and skills are very important.

The of the customers were not aware about the IFB services and products, but 82.5 % % of the respondents say there is lack advertising by media or banking sectors. This is may be affected by independency of governmental or public media and religion and almost all non-Muslims cannot use the product of IFB and 17.5 respondents does not conform there is lack of advertisement IFB. Lack of advertising IFB has negative and highly significant 5% level of significant. From this result customers have relatively little knowledge stated that the operation of Islamic banks is similar with conventional bank only the name changed. if some one deposit money, you will get profit sharing as an interest for a conventional bank. With little knowledge, because lack of advertising the intention to use Islamic banking products.

Gender has one of the necessary variable that determine the interest free banking. From Hosana District CBE collected sample data IFB not users are 240 from those half of them are females. IFB

users are 159 from this number only 59 are female customers. In this study male customers have higher probability to participate IFB than females. UFA (2020) report shows that the neighboring country Kenya 82 % adult have an account and Rwanda 50%, although 62% of Ethiopians reported 26% saved formally at financial institutions, while 38% saved with a person outside of family or In most developing world sub-Saharan African countries like Ethiopia females does not participate in banking industry rather than they can hold in their home and use cultural financial mechanism specially ekub, edir and so on. This makes gender has negative and 10 % significant impact on interest free banking.

The satisfaction of customers on the service of CBE is very important and statistically significant variable on interest free banking. From the view of customers in the service of CBE there is little satisfaction. The customers do not get the service on time and sometime customers does not get wanted amount of cash money. This make customer's satisfaction down ward and some customers decided to shift private banks.

In Banking Service the customer's satisfaction (BS) is a negative and significant impact on on IFB. If the service is good the satisfaction of customers is high. In this study area the service less than the standard.

The correlation coefficient show that independent variables were positively and negatively related with dependent variable (Interest freebanking) within the range of -0.0869 to 0.5206 so, this shows that there is no serial correlation between variables.

According to the respondents even though interest free banking system important for customers of the bank, there is lack of suitable banking policies and comprehensive legal framework, lack of advertising and awareness, religious believers and lack qualified human resource in Islamic banking, lack of trust by the customer, unavailability of IFB products in all branches are some major obstacles that to deliver and utilize the service.

This study examines the determinants of IFB in commercial bank of Ethiopia Hossana District. It gives hindsight for the staff and management of Commercial bank of Ethiopian towards Interest free banking factors. The contribution of this study is vital as it has identified the major determinants for the development of IFB system and Service for customers to deliver and utilize IFB products.

5.3. Recommendation

- The government should prepare different training in practice of Interest Free Banking system for employees as well as for customers that helps to know the principle and services of IFB.
- The female's participation in IFB is very less in study area, but the involvement of females is necessary for economic growth in the country. So, the household head as well as the responsible bodies should improve such kind of problem through sharing or minimizing tasks of their home and the giving beneficiary information about saving in banking and using interest free banking.
- Advertising and awareness creation, in bank should has to build the trust and confidence of its customer by being transparent/disclose all its products, transaction and its IFB business activity to the public and confirm they are in line with Sharia.
- Training has positive and statistically significant impact on interest free banking. So banks should giving different trainings on sharia rule, financial flow, financial transaction and skills are very important to scale up our economic performance.
- The bank management and staffs should give different services, implant different technology and time saver mechanism
- Banks should give priority to customer's satisfaction. The satisfaction of customers on the service of CBE is very low on interest free banking. In service attract to be customer and live in the bank for long periods.

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Appendix 1
Questioners

WULKITE UNIVERSITY

MASTERS OF ECONOMICS

QUESTIONNAIRE TO BE FILLED BY EMPLOYEES AND CUSTOMERS

Researcher: Alebachew Getinet

Contact Address: +251-921574179

Research topic: “The Determinants of Interest Free Banking Practice In Case Of CBE (Hosana District)”

Dear respondents: I would like to express my earnest appreciation for your generous time, honest and prompt responses.

Objective: This questionnaire is designed to collect data about the Determinants of Interest Free Banking Practice In Case Of CBE (Hosana District). The information that offered with questionnaire was used as a primary data in this study. This study conducting as a partial fulfillment of the requirements for the degree of Masters of economics at Wulkite University. Therefore; this research is to be evaluated in terms of its contribution to our understanding of Determinants of Interest Free Banking Practice In Case Of CBE (Hosana District) and its contribution to improve the area.

I need your help and would appreciate your golden time to complete the attached questionnaire on Interest Free Banking Practice. Results will be used to help and expand our knowledge and understanding of any major shift in Interest Free Banking Practice.

All answers will be kept strictly confidential and only aggregate results will be reported.

Thank you in advance for your cooperation.

General Instructions

- There is no need of writing your name.
- In all cases where answer options are available please tick (✓) mark on the space provided or circle it on the five point scale accordingly.

PART –I Background information of the respondent(for all respondents)Please put a tick (✓) mark where you think is appropriate in the box provided.

1	General information/item	Option/dimension	Put(✓)
1.1	Gender	Male (1)	
		Female (2)	
1.2	Age	
1.3	Educational Level	Below diploma	
		Diploma	
		First degree	
		Masters and above	

Part IIPlease, indicate your opinion by marking the appropriate box on the two point and fill the correct value in the blank space

	Are you User of interest free banking	Yes	no
I	What is the your income that is saved in IFB of CBE	..	
N			

Part IIIPlease, indicate your opinion by marking the appropriate box on the five point scale where: 1=Strongly Disagree 2= Disagree 3=Neutral4=Agree 5=Strongly Agree

2	Practice of Interest Free Banking Services	1		3	4	5
2.1	There is training in practice of IFB system					
2.2	The current status in the development of interest free banking in Commercial bank of Ethiopia is high					

2. 3	There is suitable banking policies for Islamic banking					
2. 4	IFB system is highly practiced to enhance the growth of Ethiopian economy.					
2. 5	There is legal framework and directives to implement IFB system in Commercial bank of Ethiopia					
3	Advertising Factors	1	2	3	4	5
3.1	Customer have no anawareness about the major types of interest free banking services					
3.2	There is lack Public educations and Media to spread the awareness of Islamic financial industries to Ethiopia.					
3.3	Customers knows the Interest free banking products that currently provided by the bank					
3.4	I know that all interest free banking products and services are free of interest					
3.5	I have enough information about the benefit of interest free banking products and services					
3.6	The media give me a good feeling about using IFB					
4	Religious factors	1	2	3	4	5
4.1	People believe non-Muslims cannot use the product of IFB					
4.2	Only Muslim Community has awareness about IFB system					
4.3	Interest free Banking products and services suite my religious belief					

4.4	I Prefer Interest free banking products and services because they are Shariah-compliant					
4.5	I believe IFB services is based on the Islamic financial principle					
5	Accessibility Factors	1	2	3	4	5
5.1	There is lack of IFB access in all branches of CBE					
5.2	There is no wide electronic communication system in banks					
5.3	ATM card, Mobile banking banking (electronic services) is available for IFB					
5.4	There is lack of full-fledged services are provided in all branches					
5.5	There is internet banking service for IFB in all branches					

6	Human Resource Factors	1	2	3	4	5
6.1	In CBE how many percent of qualified human resource in Islamic banking to ensure that Islamic banking Services					
6.2	There is human capital gap and academic institutions for IBF system					
6.3	There is less individual commitment level in IFB system					
6.4	Lack of long term human resource strategy for IFB system					

6.5	Employee turnover determines the practices of IFB system					
7	Interest Free Banking Service					
7.1	Are you satisfied on the service of IFB					
7.2	Have you got fast service					
7.3	Have you use the technology					

Part III: Background Information for Respondents; Dear respondents, please label a characteristic that correspond to your background data by using “√” mark.

8. Year of Experience in CBE:

Up to 5 years 6-10 years 11 years and above

8.1 Exposure to Interest-free banking:

Up to 2 2-4 year 4-above year

Appendix 2.2 Marginal effect

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. mfx
Marginal effects after probit
Y= Pr(IFBS) (predict)
= .3023386
```

variable	dy/dx	dy/dx Std. Err.	z	P>z	[95% C.I.]	X
Gender	-.0929414	.05274	-1.76	0.078	-.196305 .010422	1.38095
ADF	-.0844298	.04083	-2.07	0.039	-.164455 -.004405	3.85965
RF	.0566464	.03472	1.63	0.103	-.0114 .124693	4.11278
HR	.0207987	.02968	0.70	0.483	-.037371 .078969	3.98496
BS	-.0798452	.02123	-3.76	0.000	-.121446 -.038244	3.33835
age2	-.0103197	.02098	-0.49	0.623	-.05144 .0308	6.74511
PIFBTR	.1796639	.02369	7.58	0.000	.133232 .226095	3.36842
Educ_01	-.0051666	.0242	-0.21	0.831	-.052607 .042274	1.88471

Appendix 2.3 Hosmer-Lemeshow goodness of fit of the model

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. estat gof
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Probit model for IFBS, goodness-of-fit test

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number of observations = 399
number of covariate patterns = 388
Pearson chi2(379) = 408.63
Prob > chi2 = 0.1415
```