



**THE CHALLENGES AND PROSPECTS OF INTEREST FREE BANKING;
BY TAKING EVIDENCE FROM BANKING INDUSTRY IN ETHIOPIA
(COMMERCIAL BANK OF ETHIOPIA AND OROMIA
INTERNATIONAL BANK AS A COMPARATIVE STUDY)**

MA Thesis

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WOLKITE UNIVERSITY, WOLKITE, ETHIOPIA

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BANKING; BY TAKING EVIDENCE FROM BANKING INDUSTRY IN ETHIOPIA
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AS A COMPARATIVE STUDY)**

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DECLARATION

I, the undersigned, declare that this study entitled: The challenges and prospects of interest free banking; by taking evidence from banking industry in Ethiopia (commercial bank of Ethiopia and Oromia international bank as a comparative study)is my original work and has not been presented for a degree in any other university and that all sources of materials used for the study have been duly acknowledged.

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School of graduate studies Wolkite University advisors' approval sheet (submission sheet-1) this is to certify that the thesis entitled "Analyzing the challenges and the prospects of IFB banking taking evidencing from banking industry in Ethiopia commercial bank of Ethiopia & oromia international bank) as comparative study" submitted in partial fulfillment of the a requirement for the degree of master's with specialization in MBA, the graduate program of the department/school of management, and has been carried out by ArarsaDababeyi ID.NO **GSE\022\10**, under our supervision. Therefore we recommend that the student has fulfilled the requirements and hence hereby can submit the thesis to the department.

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This is to certify that ArarsaDabaBeyi has done a study on the topic “The challenges and prospects of interest free banking; by taking evidence from banking industry in Ethiopia (commercial bank of Ethiopia and Oromia international bank as a comparative study)”. This study is of his original work and all the sources of materials used for the research paper had been duly acknowledged approved by the Board of Examiners.

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ABBREVIATIONS AND ACRONYMS

AAOIFI Accounting and Auditing Organization for Islamic Financial Institution

CBE Commercial bank of Ethiopia

GDP Growth Domestic Product

IFSB International Financial Service Board

IFSB Islamic Financial Service Boar

IDB Islamic Development Bank

NBE National Bank of Ethiopia

OIB Oromia International Bank

UAE United Arab Emirate

AwBA wash Bank

UB United Bank

WB Wagagan Bank

NB Nib Bank

CBO Cooperative Bank of Oromia

AbBAbay Bank

AB Abissinia Bank

DB Dashen Bank

ATM Automatic Teller Machine

ICT Information Communication Technology

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ABSTRACT

The main objective of this study was to analyze the challenges and prospects of Interest Free banking; by taking evidence from banking industry in Ethiopia (Commercial bank of Ethiopia and Oromia international Bank as a comparative study). The study was employed descriptive research method. The study was used both primary and secondary data which was collected through structured and semi structured questionnaire and interview. A total of 75 sample respondents were taken through judgment sampling. Of the total sample interest free banking staffs of the CBE & OIB constitutes 40 and 35 respectively. This study was used Judgment (Purposive or deliberate) sampling methods. The banks were also selected on the basis of Purposive or deliberate) sampling. The data was analyzed by descriptive statistics of mean, frequency and percentage by using SPSS version 20, software. The main findings of the present study reveals about the situation regarding IFB services; the main challenges faced by surveyed banks in implementing IFB system included lack of awareness by potential customers about IFB services, institutional challenges including taxation, desire for special regulations and lack of specialized human resource. In addition, the difficulty in segregation of funds for effective implementation of IFB was another problem expressed by respondents. The challenges are higher in commercial bank of Ethiopia when compared to Oromia international bank, while the demand of IFB are properly addressed in Oromia international bank when it is compared to commercial bank of Ethiopia.

Key Words: Challenges and prospects, Interest free Banking, CBE, OIB & Bank

CHAPTER ONE

1.1 BACKGROUND OF THE STUDY

One of the most emerging trends in the global economies is the idea of Interest free banking and Finance (Ahmad, 2000), that emerged in the global landscape as an alternative banking system which is in line with values and ethos of Islam, and governed by the principles of Sharia Law that requires not charge interest and avoid any unethical practices in achieving its goals and objectives (Gait and Worthington, 2008).

This form of interest-free banking has developed over a long period of time in Egypt in 1963 with the introduction of new products in the industry. According to Fakhurul-Ahsan (2014) and Usman (2003), 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 healthy economy. Hence, Islamic banking is growing at an average rate of 15 percent a year in size and number, which makes it the fastest-growing sector in the financial markets of the contemporary world (Saidi, 2007; Chong & Liu, 2008).

While, the global Islamic banking and finance industry assets worth at over USD 1.3 trillion in 2012 and expected to reach USD 2 trillion in next three to five years, there are concerns that development of Islamic banking remains somewhat limited and that the industry may be suffering from a lack of innovation and lack of initiatives in convincing customers that they are really offering Sharia compliant Service and not dressing up conventional banking practices (Karbhari et. al., 2004). The current status of Islamic finance in Sub Saharan Africa is remain small, although it has potential given the region's demographic structure and potential for financial deepening (IMF, 2012).

Despite the growth of Islamic banking worldwide, as the others African countries Ethiopian banking industry was continued to conduct most of their banking transactions using traditional banking system because of lack of supportive regulatory and policy regimes that facilitate the establishment of Islamic financial institutions is the most important worth of mentioning.

Since, Muslims believe that banking with the conventional banks is against their religious faith; large numbers of potential Muslim customers are not banking with the existing conventional banks available in the country (Mohamed Olad, 2012).

To satisfy the community that have problem with the current banking system and to provide alternative banking system the National Bank of Ethiopia (NBE) will have expected to approve a directive that paves the way for the establishment of the Islamic bank in Ethiopia(Mohammed, A.U, 2013).

A circulated draft form of the NBE's directive has allowed Ethiopian nationals to establish a bank exclusively engaged in interest free banking however, that hope was short living one as the finally issued draft does not allow the establishment of full-fledged Islamic financial institution(Debebe,2015).However, the directive has only opened the door for existing commercial banks to create an interest-free banking window alongside of their operations. This Come in to force in October 2011, but interest-free banking in Ethiopia started only in September 2013, when the Oromia International Bank S.C launched the service. The Commercial Bank of Ethiopia joined the market at the end of October, followed by United bank S.C, which began providing the service on May 1, 2014(Debebe, 2015).

Islamic banking and finance witnessed a rapid expansion over the last few decades and it is still currently expanding (El-Hawari et.al 2004). Due to higher demand, research should be conducted to analyze the challenges and prospects of Interest free (Islamic) banking services. The challenges that are affecting the banks to deliver interest-free banking have been at the forefront of several research works in the developed and some developing world. There is very much limited published works that investigate the challenges and prospects of interest-free banking services in the context of developing countries like Ethiopia.

To date there have been very few such studies, a significant exception to this is the study conducted by Shaik Abdul Majeeb , (2014) that studied the Role and Progress of Islamic Banking in India, Ethiopia and Rest of the World and the Potentiality of Islamic banking in Ethiopia.

In Ethiopia, understanding the challenges and prospects of interest-free banking is more important, mainly because interest-free banks have to compete with the long-established conventional banks in a dual-banking system.

The survey research on challenges to use interest-free banking services is timely and very important Ali Mohammed (2016).

Major countries like Britain and the US has set up Islamic banking subsidiaries that are successful. Some of the champions of the Islamic way want to see business expand beyond the

natural market of Muslim countries. They believe that now, more than ever, there is a market for non Muslims who share in the values espoused in Islamic economics Debebe (2015).

However, Ethiopian Muslims are not part of this huge potential growth of that is occurring all corners of the world due to many factors in which lack of supportive regulatory and policy regimes that facilitate the establishment of Islamic financial institutions is the most important worth of mentioning. Kerima Ali (2016).

Since Ethiopian Muslims are not part of this huge potential growth, the researcher motivated to conduct the study on this title.

1.2. STATEMENT OF THE PROBLEM

Ethiopia has large Muslim population whose contribution to the national economy is also huge. This section of the society has been disadvantaged to modern finance, not by design, but due to their faith and the secular nature of the financial industry. They have strong fears against conventional banks whose functions are based on interest, thus this community need banking system that best suits their need and at the same time in line with their religion (Kerima Ali Mohammed, 2016).

At International level there are several empirical studies on Islamic banking and finance. The studies were investigated the challenges faced by the Islamic banks. Few of these studies are given below.

According to the study of Aris et.al (2013), in Malaysia Islamic banks serves Wadiah Amana, Quard Hassan, Mudarabah, Musharakah, Murabaha, Ijara, Istisna, BaiInah, BaiBithamanAjl. On the other hand, research work conducted by Olaoye et.al (2013) revealed that products availed by interest free banks in Thailand and Bangladesh includes: Mudarabah, Musharakah, diminishing partnership, Murabahah, Ijarah, Al- Istisna, IstisnaTamwili, Salam, Current account, saving account and investment account.

The research work which was conducted to assess the interest free banking so far has been conducted by different researchers, in different contexts.

According to the findings of Iqbal, Ahmed & Khan (1998), Jabr (2003), Karbhari, Naser & Shahin (2004), Sahle et al (2005), Ibrahim (2012), Kinyanjui (2013) and Bello &Abubakar (2014), interest free banking faces challenges in its implementation and operation.

These studies have revealed that though there are some challenges common to many countries, there are also challenges which are unique to each country due to social, cultural, economical, technological, and political, religion and other factors. However, the common findings of all the above are: inadequate legal and poor supervisory framework, inadequate manpower with the requisite knowledge, shortage of experts in Islamic banking, lack of awareness and high competition from the conventional banks.

In Ethiopia, however, few studies were conducted on the attributes of IFB. Among these studies Mohammed in 2012 has studied the Prospects, Opportunities and Challenges of Islamic Banking in Ethiopia and his work has identified the potential challenges as: lack of awareness, regulatory and supervisory challenges, institutional challenges, lack of support and link institutions, 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. This study was undertaken before the practical introduction of the IFB in the country.

Therefore, it was not based on actual observation of facts on the ground. On the other hand Teferi's (2015) study is about Contribution of IFB to economic development and its prospect in Ethiopia. The study has assessed the contribution of including the Muslim population in to the banking (financial system) to the economic development and GDP growth.

Since the above mentioned studies lacks empirically to analyze the challenges & prospects of Interest Free Banking services in Ethiopia, this study therefore attempts to fill the research gap which means why Ethiopian Muslims are not part of this huge potential growth by assessing the challenges & prospects of Interest Free Banking by the taking an evidence of Commercial Bank of Ethiopia & Oromia International Bank. The rationale behind for selecting both banks are based for the experience they had on the Interest Free Banking.

1.3. RESEARCH QUESTIONS

Based on the above problem statement, the study tried to answer the following questions

1. Why the bank limited its IFB Services to only Window service?
2. What is the extent capacity level of the bank to provide IFB Services?
3. What do you think the fate of IFBS to expand in Ethiopian Banking system?
4. What is the Demand level of the Bank to deliver the IFB services to the customers?

1.4. OBJECTIVES OF THE STUDY

1.4.1. GENERAL OBJECTIVE OF THE STUDY

The general objective of the study was to analyze the challenges and prospects of Interest Free banking; by taking evidence from banking industry in Ethiopia (Commercial bank of Ethiopia and Oromia international Bank as a comparative study).

1.14.2. SPECIFIC OBJECTIVE OF THE STUDY

The specific objectives of the study were:

1. To identify the reasons that made the banks to limit their IFB Services to what they are providing now.
2. To assess the capacity level of the Banks to provide IFB Services.
3. To assess prospects of IFBS in Ethiopian Banking system.
4. To assess the Demand level of the Bank to provide the IFB services.

1.5. SIGNIFICANCE OF THE STUDY

The findings of the study will be useful in many ways for Commercial Banks of Ethiopia and Financial Institutions. The results of the study will help dissatisfied Muslim community in general and the business community in particular.

It will also benefit those concerned policy makers to formulate necessary and solution-oriented policies that will in fact have a benefit to all citizens.

This study will help in making decisions with regard to fast tracking policy dimensions that will not help only solving the problem but also the effective operation as well as supervision of Islamic financial services institutions.

In addition, this study will try to give an investment tip to both current as well as potential investors to target this untapped market which will help in improving the economy, living standard of citizens as well as competition and efficiency. The other important benefit that the findings of this study will have is its contribution to knowledge building and academic research by helping other researchers to undertake a further detail investigation on the subject and providing relevant empirical evidences. And the contribution of this study to the existing body of

knowledge by increasing the terms of IFB and how the IFB banking system benefit both parties by sharing loss and profit.

1.6. SCOPE OF THE STUDY

This study conducted on the challenges and prospect of IFB in banking industry in Ethiopia context. Moreover, the study area is limited to the head offices of CBE & OIB. Further, the study included only staffs of interest free banking business.

1.7. LIMITATIONS OF THE STUDY

The finding of the study will provide invaluable insights in to challenges and prospect of interest free baking system in Ethiopia. But the study area is limited to CBE and OIB which are located Addis Ababa city. Moreover, as it is descriptive study which does not show the case and effect of the variables nor is it necessarily replicable by others.

1.8. ORGANIZATION OF THE PAPER

This paper was organized into five chapters, the first chapter was dealt with the introduction of the study that is, background, statement of the problem, research questions and objective, significance, limitation and scope of the of the study. The second chapter was presented the theoretical and empirical literatures about Interest free/Islamic Banking. The third chapter was presented about the methodology of the research that is the research design, sampling technique, method of data collection, data collection instruments, method of data analysis and so on.

The fourth chapter of the paper was presented the findings as well as the primary and secondary data analysis. Finally the fifth chapter was dealt with the conclusion and recommendations of the study.

1.9. OPERATIONAL DEFINITION

Islamic banking: is banking which provides banking services based on Islamic law (Sharia).

Interest free banking window: a business model in which conventional banks offer Islamic banking products and services from their existing network

Halal: Sharia compliant

Unrestricted Investment Deposits (Unrestricted Mudaraba): is an earning deposit which mobilized with the knowledge that bank acts as the Mudarib (manager) and invests the fund without restriction and intervention of the capital provider in any Sharia compliant manner.

Restricted Investment Deposit (Restricted Mudaraba): is an earning deposit which is mobilized with the knowledge that bank acts as the Mudaraba (manager) and invests the fund in restricted investment based on active intervention of the capital provider complemented with professional advice from the bank side.

Wadiah (Safekeeping) Deposit: is a peculiar non-earning type of IFB deposit that operates under the contract of Wadiah Yad Dhamanah (guaranteed custody).

Demand Deposit (Amana Current Accounts): are non-earning deposits that operate based on the principle of al-Wadiah, whereby the depositors are guaranteed repayment or withdrawal of their funds on demand.

Mudarabah (Silent Partnership): is a financial transaction in which there are two partners in the contract. The Islamic bank will act as the capital Provider (Rabb-ul-Maal).

In this type of financial contract, profits are shared between Islamic bank and the entrepreneur (client) based on predetermined ratio.

Murabahah (Cost-Plus Sale Contract): is a sale contract between Islamic bank and its client at a fixed profit called mark-up.

Ijara (Lease): is a contract whereby an Islamic bank purchases an asset and leases it out to its client on the agreement that the client will be paying a fixed amount at regular interval usually monthly for a specified period of time to the Islamic bank.

Musharakah (Equity Partnership): is a contract in which two or more persons contribute capital for the establishment of a particular business venture. Islamic bank will act as a partner in this case in order to contribute in the capital formation as well as in sharing profits and loss.

Salam (Forward Trade Contract): is a sale contract whereby Islamic bank agrees to supply some specific commodities to the buyer (its client) at a future date that is specified in exchange of an advanced full spot payment to the bank.

Istisna (contract of manufacture): It is a contract in which a party orders another manufacture and provide a commodity, the description of which, delivery date, price and payment date are all set in the contract. It is used by Islamic banks, and consists of two separate Istisna contract.

Sharia: is the religious law of Islam

CHAPTER TWO

LITERATURE REVIEW

INTRODUCTION

This chapter presents an assessment of literature review on what has been covered by other researchers. The review aims to capture their views on the subject matter being discussed and is aligned to the theme and objectives of the study. The areas covered under both the theoretical and empirical aspects of the study. This chapter has the following sub-divisions: - theoretical review, empirical review and conclusion & knowledge gap.

2.1. CONCEPTS AND DEFINITIONS

Interest free (Islamic) finance is defined as a financial service or product that is consistent or principally implemented to fulfill with the principles of Islamic law (Gait and Worthington, 2008). An Interest free (Islamic) bank is a financial and social institution whose objectives and operations as well as principles and practices must obey the rules to the principles of Islamic Shari 'a (Hassan and Ahmed, 2002). Interest free (Islamic) banking provides services to its customers free of interest, as the giving and taking of interest is prohibited in all transactions rather it provides awards or returns on the basis of Interest free (Islamic) banking performance through profit-and-loss sharing (PLS) (Lewis and Algaoud, 2001 and Ahmed, 2008).

The definition given by Moin (2008) depicts Islamic banking as the system of banking consistent with principles of Islamic law (Sharia) and guided by Islamic economics. According to Kettell (2011), Islamic banks provide commercial services that comply with the religious injunctions of Islam. They provide services to their customers free from interest (the Arabic term for which is riba). The giving and taking of interest is prohibited in all transactions under the Islamic financial principles. Sharia prohibits the practice of giving or accepting additional money for money that is borrowed.

Bello & Abubakar (2014) define Islamic banking as banking system that operates strictly on the basis of Sharia.

Thus, based on the definition given by the above authors, Islamic banking is banking operations based on Sharia which prohibits the giving and taking of interest in all transaction.

2.1.1 CONCEPT OF IFB

According to the study made by Ibrahim (2012), the concept of Islamic Banking and Interest Free Banking is synonymously used in Islamic. According to Economics literature it is an alternative banking framework to the interest-based conventional banking practice. However, there is a difference between an interest-free bank and an Islamic bank but they are sometimes used interchangeably. Islamic banking not only avoids interest in its entire effect but also it avoids all other Islamic prohibited activities. Interest-free banking system on the other hand, does not engage in interest but there is no reason to suppose that all its other activities will be done strictly according to Islamic law “Sharia”.

2.1.2. PRINCIPLES OF IFB

The 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, Mohammed (2013). Islamic banking is a unique type of banking system that avoids all forms of transactions that are prohibited in Islam.

2.1.3. THE IFB MODELS – THE WINDOW

Vis-À-Vis the others Interest-Free Banking is implemented in various countries using different structures and approaches. The three major models are Full-fledged, Subsidiary and Window models. In some countries, such as Sudan, Iran, and some Gulf countries, a Full-Fledged Bank is more promoted and dominates the market.

This type of bank is a Sharia Compliant Bank that operates based on an independent management system, specifically raised capital, specially designed products and uses different risk management, accounting, and auditing procedures.

This bank is more dominant in Muslim majority countries since it is relatively strict in following the Sharia principles ((Global Islamic Finance Report, 2014).

The second IFB model is the Subsidiary Model. A Subsidiary Model is defined as a division or unit under the conventional parent bank to offer Islamic banking products. This is different from the window system by its segregated capital and management team.

However, in the end, the owner bank is a conventional one which also offers interest-bearing products. This is introduced into the system of various well-known international banks too. Even though it is not differently treated from the window system in many countries, the subsidiary model is not similar in its means of raising funds. The third type of Interest-Free Banking is the Window Model. In this model, the conventional banks are allowed to have an especially operating division or unit to provide a 'Sharia-Compliant' Banking product.

An IFB window can be defined as a department or a division, unit or even a separate finance company set up by a conventional financial institution that offers Sharia-Compliant products and services to customers who prefer Sharia compliant services over conventional ones (Global Islamic Finance Report, 2014). Solé (2007) defined an IFB window as a ,window within a conventional bank via which customers can conduct business utilizing only Sharia-Compatible instruments." Similarly, Investopedia differentiates windows from the full-fledged banks by describing the window as a conventional bank providing financial services based on Islamic law principles. The windows are not independent entities that can operate differently from conventional services. In many non-Muslim majorities of nations, such as the United Kingdom, the Subsidiary and Window models are more practiced than the Full-fledged Interest-Free Banks. In some countries, a mixed of these models is allowed to operate in parallel. In Ethiopia, however, the Window Model is so far the only model practiced since 2013.

The Commercial Bank of Ethiopia, the public one, and other private banks have established special divisions that offer Sharia-Compliant banking and financing products. Currently, there are some initiatives to start subsidiary and full-fledged operations.

2.1.4. THE INCEPTION AND EXPANSION OF IFB WINDOW

Services in Ethiopia Since the inception of the Interest-Free Banking services as a window in 2013 by Oromia International Bank, the sector has swiftly grown in the last 6 years. In 2013, the biggest commercial bank, the Commercial Bank of Ethiopia, followed and immediately started to attract many customers.

In the next year, United Bank followed the footsteps of the first two banks. In 2015, another three banks, namely the Cooperative Bank of Oromia, Wegagen Bank and Nib Bank had joined the market (Abdulkadir Wahabaman, 2019).

In 2016, 2017 and 2018, Abay Bank, Abyssinia Bank, and Dashen Bank respectively have introduced the interest-free window services. Currently, a total of 10 banks have window-based IFB services in Ethiopia.

Table 1. Historical development of interest-free window banking in Ethiopia

S. N	Name of Bank	Year establishment	Number of Branches	IFB starting year	Capital in Billion ETB
1	Oromia International Bank(OIB)	2008	260	2013	1.9
2	Commercial Bank of Ethiopia(CBE)	1963	1340	2013	40
3	United Bank(ub)	1998	233	2014	2.6
4	Wagagan Bank(WB)	1997	292	2015	3.2
5	Nib Bank(NB)	1999	228	2015	3
6	Cooperative Bank of Oroia(CBO)	2004	332	2015	1.9
7	Abay Bank(AbB)	2010	162	2016	1.5
8	Awash Abank(AwB)	1995	382	2016	4.2
9	Abissinia Bank(AB)	1996	284	2017	3.3
10	Dashen Bank(DB)	1995	281	2018	3.7

Source: Compiled from the Websites of Each Bank

Oromia International Bank is the pioneer of the Interest-Free Banking services' window in Ethiopia. Still, it is one of the leading banks in providing the services. It has deposit, financing, bank guarantee services, and other service categories.

In the deposit category, the bank offers Wadiah Saving, Amanah Current, Labbiak Wadiah (for Hajj and Umrah pilgrimage), Unrestricted Mudaraba Investment Deposit and Diaspora Wadiah

Saving. Under the financing services, it provides Murabaha Services and Interest-Free Export Financing Facility AbdulkadirWahabaman(2019).

The Murabaha Financing, in return, has Local Murabaha, Import Murabaha, Merchandise Murabaha categories.

Besides, the bank Guarantee services include Performance Guarantee, Bid Bond Guarantee and Foreign Employment Guarantee Facilities. Oromia International Bank also provides other services such as Import-Export Services, Local Remittance Services, Foreign Remittance Services, and Advisory Services on IFB businesses.

Commercial Bank of Ethiopia has three major categories of IFB services; Mudaraba (Savings Account), Wadiah (Savings Account) and Qard (Current Account). Under the Mudaraba Account, the customer deposits and the bank use it in Sharia-Compliant activities. If it generates any profit, they share it according to the pre-agreed ratio and the performance of the bank. The minimum default profit ratio is 67% to the customer and the rest to the bank. If it generates a loss, the customer and the bank share in proportion to their contribution to any investment they made. In this service, the customer is allowed to withdraw his/her money at any time on demand. The Commercial Bank of Ethiopia also has the Wadiah category of services.

This service is allowed to work with a bankbook, ATM cards, and electronic payment services. This is a system under which the bank accepts the deposit of customers to allow them to withdraw any time without restriction when they need it. However, by informing the depositors the bank has the right to utilize the funds in Sharia-Compliant businesses. This account type also has various classes to address different segments of the community like the Mudaraba one. In its third category, the Commercial Bank of Ethiopia also provides Qard (Current Account) services. Under this service, the customers deposit their money in the form of a loan to the bank with an agreement to take it any time they demand. However, officially the bank states its rights to use these funds for any permissible businesses.

The other bank with an Interest-Free Banking services window is the United Bank. It offers services in four categories.

The first one is the deposit or Wadiah product that includes current Al Wadiah, Saving Al Wadiah, and Mudaraba deposit accounts.

In the second category, the primary mode financing or investment type, the Mudaraba and Musharakah services are offered. In the third category, called as a secondary mode, financing for direct credit, Murabaha, Istinah, Kafalah, Selam, and Ijarah are included. Finally, the secondary mode financing in the international banking operations category has Wakalah and Kafalah elements.

Nib International Bank has Wadiah Saving, Musharakah, Mudaraba, Selam, Istinah, Ijarah and Qerd services. On the other hand, Wegagen Bank offers limited Interest-Free Banking services. It has the WadiahAmanah or safekeeping deposit services. Under this contract, the bank provides only safekeeping services for the funds of its customers. The customers have the right to instruct the bank to manage the money in Sharia-Compliant activities. However, the bank must pay the principal to the customer at any time requested.

Besides, the WadiahAmanah, Wegagen Bank also offers a slightly different service of QardAmanah or simply Interest-Free Current Account.

Likewise, the Oromia Cooperative Bank offers three major types of Interest-Free Banking Services through its windows. It has a Mudaraba Investment Service in which a Profit-Loss Sharing Ratio is agreed between the bank and the customer. Secondly, the bank also offers Musharakah Investment under which the bank and the client joint own a property, equipment or a commercial enterprise. In this contract, the profit, if any, is shared based on the pre-agreed ratio while losses are shared in proportion to their financial contribution to the investment.

Moreover, the bank has a Diminishing Musharakah service. This service allows the bank and the customer to buy or own tangible property, and the customer is expected to pay periodic installments to fully own the property.

Abay Bank is one of the banks with the Interest-Free Banking Services (IFBS) window in Ethiopia. It offers various services to government institutions, civil-society organizations, and individuals. These services are assessed to be free from usury/interest, alcohol, pork, gambling, casino, pornography, dead meat, and dead animal trading-related businesses or investment. The bank has Interest-Free Banking services under three categories.

The first one is the interest-free deposit account services category which includes Wadiah Current Account, Wadiah Saving Account, Mudarabah Term Deposit/ Investment Account (Unrestricted), and Mudarabah Saving Account. The second category is the Interest-Free Financing services that include Murabaha, Salam, Istisna, Mudarabah, Musharakah, Ijarah, and Free Cost Loans/Qard Al - Hasan. In the last category, Letter of Guarantee Facility/Kafala, Hawala, and Foreign Exchange Service are provided.

Awash Bank is one of the biggest private banks in the country. It is also a well expanded private bank in Ethiopia with its presence in far and wide. The Interest-Free Banking window services provided by Awash Bank are two types. The first one is the Fund Mobilization Scheme which includes Wadiah Saving Accounts, Labbaik-Wadiah Savings (For Hadji&Umrah), Wadiah Educational Saving for students, Wadiah Current Account (Amanah) and the Unrestricted Mudaraba Investment Account.

The Mudaraba Investment Account requires at least 1 million ETB initial deposits and an agreement on the profit-sharing rate between the bank and the customer. Fund mobilization or financing and loan scheme are the second one. Under this category, there is a Murabaha financing scheme or simply the cost-plus mark-up schemes, Ijarah financing, IFB trade services such as Murabaha, Musharakah, and Wakalah, Interest-Free Export Financing Scheme or Qard, IFB loan from charity accounts for the neediest persons, Kafalah (IFB bank guarantees) and Hawallah. Abyssinia Bank and Dashen Bank are relatively the newcomer banks to the market of Interest-Free Banking window services.

Consequently, they have limited products and services. Most of their services are at the infant and promotional stage. On the other side, currently, some banks are under the progression of varying the model of delivering the services.

2.1.5. THE PERFORMANCE OF THE IFB WINDOW IN ETHIOPIAN BANKS

Oromia International Bank is the leading bank in Ethiopia in bringing in an Interest-Free Banking Services Window. As a result, it is a little more experienced than the others. It has recorded remarkable progress in terms of customer size, the amount of deposits and investment funding. In the last couple of years, the bank has expanded its Interest-Free Window Banking Services to more than 242 branches throughout Ethiopia to address more customers. Besides,

continuous training has been conducted to produce qualified human resources in the sector. Consequently, beyond its expansion, it has also increased the interest-free products in its service lines.

Moreover, the number of customers in the Interest-Free Banking Services Window has significantly increased year by year. The total number of customers in the IFB section was 167,451. It reached 248,614 in 2018 by recording a 48.5% within a year.

Until June 2018, the IFB window deposits reached 3 billion ETB which is equivalent to 107 million dollars. This figure is 48% bigger than a similar figure in the previous year.

The IFB deposit covers 15% of the whole deposit portfolio. When we see the types of the IFB services, Wadiah deposit covers around 70% of the overall IFB window services followed by Amana deposits.

TABLE 2. INTEREST-FREE DEPOSIT PRODUCTS OF OIB

IFB deposit type	Amount in million ET		Growth in %	Share in %	
	2016/17	2017/18		2016/17	2017/18
Wadiah Deposit	1358	2102	54.8	66.9	69.8
Amanah Deposits	644	911	41.4	31.7	30.2
Mudaraba Deposit	28	0	-99.1	1.4	0
Total	2030	3013	48.4	100	100

Source: OIB Annual Report, 2018.

Oromia International Bank has also been doing great in its Interest-Free Banking Financing Services. In 2018, the total fund available for financing various economic activities in the market reached 1.59 billion ETB which is equivalent to 57 million dollars.

This also shows that the amount increased by 50% from the previous year – 2017. The total interest-free financing covered 13.6% of the total corporate finance. However, it showed a significant change from 12.8% in 2017 to 13.6% in 2018 YewubdarGetachew (2018).

In addition to the progress in Interest-Free Deposits and Financing, the bank has also recorded a 34.3% growth in its IFB foreign currency generation.

It has generated a total of 48.41 million dollars in 2018. This number was around 36 million dollars in 2017. Similarly, the interest-free foreign currency covered 15.4% of the total foreign-currency accumulation of the bank in the same year. Considering the deposits, financing and foreign-currency formation in its Interest-Free Banking Window, Oromia International Bank has generated a total income of 223 million ETB in 2018. This number has a remarkable increase from the previous year of 157 million ETB. Within a year, the income increased by about 42%. This income covers 9% of the total income of the bank including the conventional stream.

Murabaha Financing is the leading product in generating income to the bank. It covered above 61% followed by fee and commission income with 37.7%.

In 2018, the total expense of the Interest-Free Banking Services Window reached 28 million ETB which is 21% higher than similar expenses in 2017.

Personnel and other operating expenses constituted 53.5%, loan impairment charge covers 33% and impairment losses on other assets cover 12.9%. This is indicated in the table below (Oromia International Bank, (2019). 2018 Annual Report).

2.1.6 ISLAMIC AND CONVENTIONAL BANKING

The main difference between Islamic and conventional banks is the use of money. In conventional banks, money is used as a commodity that is bought and sold through the interest's usage (Pasha 2014).

Table 2.1 the major difference between Islamic and Conventional banking

Conventional banking system	Islamic banking system
Charge interest on loans.	Do not charge interest. Riba (interest) is an unjust return, interest or usury. The term applies to any financial gain by the lender as a condition of a loan and in a commodity trade. It also applies to any disparity in quantity or time of delivery; as such transactions are illegal under Islamic law (Martins, 1997; Chong & Liu, 2008). Zero-return loans. Prohibits the charging or receiving of interest. A unique feature of Islamic banking is its profit-and-loss sharing paradigm, which is based mainly on the mudarabah (profit-sharing) and Musyaraka (joint venture) concepts of Islamic contracting (Chong & Liu, 2008)
Principal stakeholders are Shareholders.	The principal stakeholder is God. The aim is to serve God, while the stakeholders are the clients and the general public. Clients are partners and the decisions are in the interest of society.
Support arms industries and industries that pollute the environment and exploit children	Shariah law places restrictions on business activities. The law further prohibits trading in alcohol, tobacco, products that contain pork, defense and weapon production and certain entertainment activities like gambling and pornography (Chong & Liu, 2008)
Gives loans to whoever has a guarantor or collateral.	Gives loans to those who need loans. Do not need collateral to get a loan.
Decisions are made in the interest of shareholders	Islamic principles advocate for an economic system in which all forms of exploitation are eliminated. The other principle is Mudaraba (trust Financing), a profit-sharing agreement between two parties in which one Provides the finance and the other provides entrepreneurial and management skills.

<p>Designed for those who have money and who do not care what it is used for. Consumers have no opportunity to choose where money is invested. Provides no information about what it does with depositors' money.</p>	<p>Islamic banks have an interest in how the money borrowed is used. The Islamic banks have a stake in the financial activities so that money is not used for economic activities that are injurious to society. Those who lend to the Islamic banks expect the banks not to invest their money in business activities that are not Shariah-compliant. Islamic banks invest only in business activities that are Shariah-compliant</p>
<p>Its investment rewards companies even if they act irresponsibly.</p>	<p>Islamic banks share profits and losses. Murabaha (cost-plus financing) is a contract sale between the bank and its client for the sale of goods at a price that includes a profit margin for both parties.</p>
<p>Designed for those who have money and who do not care what it is used for. Consumers have no opportunity to choose where money is invested. Provides no information about what it does with depositors' money.</p>	<p>Islamic banks have an interest in how the money borrowed is used. The Islamic banks have a stake in the financial activities so that money is not used for economic activities that are injurious to society. Those who lend to the Islamic banks expect the banks not to invest their money in business activities that are not Shariah-compliant. Islamic banks invest only in business activities that are Shariah-compliant. Its.</p>
<p>Its investment rewards companies even if they act irresponsibly.</p>	<p>Islamic banks share profits and losses. Murabaha (cost-plus financing) is a contract sale between the bank and its client for the sale of goods at a price that includes a profit margin for both parties.</p>
<p>Seeks to satisfy demand.</p>	<p>Seeks to satisfy need.</p>

2.2. EVOLUTION OF MODERN INTEREST-FREE BANKING

Islamic banking has a recent origin as compared to its conventional counterparts. Although scholars have discussed and analyzed issues with regards to a system of banking that is interest free based much earlier, much exclusive attention to the subject matter is a 20th century phenomenon (Bala, 2004).

As Bala (2004) the history of interest free banking could be divided into two parts. First, when it still remained an ideal; second when it became a reality by private initiative in some countries and.

2.3. INTEREST FREE BANKING AS AN IDEA

Bala (2004) indicated as the earliest reference to the reorganization of banking on the basis of profit sharing was written by Anwar Qureshi (1946), NaiemSiddiq(1948) and Mohamed Ahmed (1952). They have all recognized the need of commercial banks that use profit and loss sharing mechanism and have proposed a banking system based on concept of Mudarabah (profit and loss sharing). In 1960th interest free banking attracted more attention because of emergency of young Muslim economists. The first idea emerged in that of Mohammed vizier (1955). Another set of idea emerged in the late sixties and early seventieth, Abdullahal-araby (1967), Nejatullahsiddigi (1961, 1969), Al Najjar (1971), Baqiral-sadr(1961,1974) were the main contributors.

2.4. INTERNATIONAL INSTITUTION OF ISLAMIC FINANCE

The industry has set up institutions to guide operations around the world, although it has been difficult to ensure standardization of Islamic products across different countries. According to Sefiani (2014), there are two internationally renowned institutions.

These institutions have been widely used as standard setting bodies and benchmarks for Islamic and IFB products- Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI) and International Financial Services Board (IFSB). The detail is shown as follows.

2.5. ACCOUNTING AND AUDITING ORGANIZATION FOR ISLAMIC FINANCIAL INSTITUTION (AAOIFI)

AAOIFI was established in Bahrain in 1991 with the objective of issuing international standards for the Islamic finance industry on accounting, auditing, and corporate governance. AAOIF protocols can be used as a support to issue standards for IFB. AAOIFI has 88 standards including 48 Sharia standards, 26 Accounting standards, 5 Auditing standards, 7 Governance standards and 2 Ethics standards. AAOIFI has over 200 members in more than 40 countries.

Members include regulatory and supervisory authorities, multilateral agencies, private sector entities, professional firms and industry associations.

AAOIFI standards have introduced greater harmonization among Islamic finance actors across the world. The advantage of rolling out AAOIFI-compliant products is that they are in line with internationally recognized standards.

The products launched have been approved, tested and accepted by the Muslim community. Several central banks and monetary agencies from secular-based countries have heavily relied on AAOIFI standards to develop their IFB industry (Sefiani, 2014).

2.5.1. INTERNATIONAL FINANCIAL SERVICES BOARD (IFSB)

The other institution is IFSB that is based in Malaysia, which was launched in 2002 and serves as an international standard setting body that provides prudential standards and guidelines for regulatory and supervisory agencies to ensure soundness and stability of the Islamic Financial industry including: retail banking, capital markets and Takaful (Islamic insurance).

The IFSB has 13 standards, 5 guide notes, 1 technical note. IFSB standards are fully compatible with AAOIFI standards and allow for further enhancing the standardization of the product offering. IFSB is the sole international regulatory body offering prudential standards for the Islamic banking industry (Sefiani, 2014).

2.6. TYPES OF ISLAMIC BANKING

According to Al-Jarhi and Iqbal (2001), the practice of Islamic banking, at present, takes one of the following forms:

- ✓ Islamic banks operating within a financial system where all banks are Islamized
- ✓ Islamic banks operating alongside other conventional banks and
- ✓ Sharia- complaint branches, windows and funds established by some conventional banks.

2.7 AN OVERVIEW OF INTEREST FREE/ISLAMIC BANKING INDUSTRY

Muslim scholars have developed a radically different model of banking which does not make use of interest. The earliest experiments in Islamic banking took place in most cases on individual initiative with governments playing a more or less passive role. In 1963, Islamic banking came into existence on an experiment basis on a small scale in a small town of Egypt. The success of this experiment opened the doors for a separate and distinct market for Islamic banking and finance. As a result, in 1970s Islamic banking came into existence at a moderate scale and a number of full-fledge Islamic banks was introduced in Arab and Asian countries where most of these Islamic banks were in Islamic countries (Ziauddin 1994). Having started on a small scale, Islamic banks and non-banking financial institutions are now in operation even on more intensive scale (Moin 2008).

The mile stone, in growth and popularity of Islamic Financial Institutions (IFIs), was the Conference of Foreign Ministers of Muslim countries (1973), where decision of establishment of Islamic Development Bank (IDB) was taken place. It has aimed to promote Islamic Banking with the objective of providing development funds for Infrastructure development projects in developing or less developed countries. Then the first commercial bank was established in United Arab Emirates (UAE) in 1974 on private initiative, followed by Islamic Development Bank (IDB) establishment as an international financial institution in 1975 held in Jeddah, Saudi Arabia (Pasha 2014). By the mid-1980s, Interest free banking, based on Islamic principles became an established part of mainstream banking in the Middle East and South Asia. They continued to sprout across South and East Asia in addition to Turkey and the Arab countries.

Now the practice of Islamic banking is not limited to Arab and Muslim countries but has spread "from East to West", all the way from Indonesia and Malaysia towards countries where Muslims are minorities, such as UK, Luxemburg, Denmark, Australia, India and the Americas. Not only that many conventional banks including some major multinational western banks have also started using Islamic banking techniques (Iqbal&Molyneux, 2005). According to Standards and Poor's rating services (2014), the assets held by Islamic financial institutions worldwide is estimated to be \$ 1.8 trillion and likely to sustain double digit growth over the coming few years to reach about \$ 3 trillion. The sound economic resilience of the industry's twin engines- Malaysia and the Gulf cooperation council (GCC: comprising Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and UAE) will help the industry sustain strong growth rate.

Despite the economic and financial downturns that have engulfed many international economic and financial centers, Islamic financing still exhibits a two-digit growth over the past few years. The industry is operating across 75 jurisdictions with 600 institutions. As a result of this growth and spread, Islamic finance is no longer limited to its traditional Muslim and Arab markets; rather, it has spread, in various degrees, all over the globe (Belouafi&Chachi 2014).

2.8 ISLAMIC BANKING DEPOSIT PRODUCTS

According to Kettell (2011), in the mobilization of funds, Islamic banks depend on four main sources that include shareholders' funds, current accounts, investment accounts and savings accounts. The bank and the investment deposit holders share the realized profit in accordance with the ratio agreed upon between the parties at the time of contracting.

The deposit in the current account is treated as if they are loans from the clients to the bank and therefore, bear no yield to the account holders. However, being loans to the bank, their principal is guaranteed by the bank. According to Ziauddin (1994), Hassen& Lewis (2007) and Kettll (2011) the source of deposit mobilization of IFB products are shown as follows.

2.8.1 UNRESTRICTED INVESTMENT DEPOSITS (UNRESTRICTED MUDARABA)

According to Moin, M (2008), the type of deposit is an earning deposit which is mobilized with the knowledge that bank acts as the Mudarabah (manager) and invests the fund without restriction and intervention of the capital provider in any Sharia compliant manner. The profit on the investment will be shared as per agreement and loss will be shared by the depositor (capital provider). The bank has discretion to participate in the investment. The bank can pool the money for its daily IFB business activities.

2.8.1.2 RESTRICTED INVESTMENT DEPOSIT (RESTRICTED MUDARABA)

Such type of IFB deposit is an earning deposit which is mobilized with the knowledge that bank acts as the Mudarabah (manager) and invests the fund in restricted investment based on active intervention of the capital provider complemented with professional advice from the bank side. The profit on the investment will be shared as per agreement and loss will be shared by the depositor (capital provider) Moin, M (2008).

2.8.1.3. WADIAH (SAFEKEEPING) DEPOSIT

It is a peculiar non-earning type of IFB deposit that operates under the contract of WadiahYadDhamanah (guaranteed custody). The bank accepts deposits from its customers looking for safe custody and convenience and requests permission to make use of the customer funds for investment purposes promoting transparency.

The customers may withdraw their balances at any time. Profit generated from the use of the customers' funds belongs to the bank. However, the bank may at its absolute discretion reward the customers by declaring profits to them. Under the contract of Wadiah, the custodian i.e. the Bank is not allowed to mention or to promise any reward on the deposit received. The owner/depositors too cannot demand any rewards or return from their Bank on their savings Al-Sultan, W (1999).

2.8.1.4 DEMAND DEPOSIT (AMANA CURRENT ACCOUNTS)

Amana Current accounts are non-earning deposits that operate based on the principle of alwadiah, whereby the depositors are guaranteed repayment or withdrawal of their funds on demand.

At the same time, the depositor does not receive return for depositing funds in a current account, because the guaranteed funds will not be used for profit and loss ventures Kettell, B (2011).

2.9 ISLAMIC BANKING FINANCING PRODUCTS

As a general rule, Islamic finance involves the carrying out of investment and /or the purchase of goods, services and assets. Islamic banks provide financing using two basic methods. The first depends on profit and loss sharing and the second involves the sale of goods and services on credit and leads to the indebtedness of the party purchasing those goods and services (AlJarhi and Iqbal 2001). Financial instruments based on Islamic principles have been developed to facilitate everyday banking activities by providing halal (Sharia-compliant) methods of lending or borrowing money and still offering some acceptable returns for investors. Theoretically, there are several IFB financing products but practically, banks do not provide all of the IFB products (Abdullahal-araby (1967).

2.9.1. MUDARABA (SILENT PARTNERSHIP)

A Mudarabah contract is a financial transaction in which there are two partners in the contract. One of the partners will provide the needed capital (Rabb-ul-Maal) and the other partner will go into the business as entrepreneur (Mudarib). That is, the Islamic bank will act as the capital Provider (Rabb-ul-Maal). In this type of financial contract, profits are shared between Islamic bank and the entrepreneur (client) based on predetermined ratio.

However, in the event of loss the Islamic bank (or depositors) bears the loss while the entrepreneur loses his or her effort provided. It was not as a result of his or her negligence, Bello A&Abubakar M (2014).

2.9.1.2. MURABAHA (COST-PLUS SALES CONTRACT)

This type of contract is mostly used in the procurement of equipment. It is a sales contract between Islamic bank and its client at a fixed profit called mark-up.

In this contract, the client will provide all the specifications of the commodity and the Islamic bank will take the risk of purchasing it for the client at a cost plus mark-up which the client can either pay in installment or sum at a spot or at a stated period Aris, N et al (2013).

2.9.1.3 IJARA (LEASE)

Ijara is synonymous to leasing contract in conventional banking. It is a contract whereby an Islamic bank purchases an asset and leases it out to its client on the agreement that the client will be paying a fixed amount at regular interval usually monthly for a specified period of time to the Islamic bank. It may also include the option of the client purchasing the asset at the end of the contract from the bank Kinyanjui, S (2013).

2.9.1.4 MUSHARAKAH (EQUITY PARTNERSHIP)

Musharakah is a contract in which two or more persons contribute capital for the establishment of a particular business venture in such a way that each partner has right to either involve in the administration of the business or not.

However, partners may decide to be active or sleeping partner at their own will. In this kind of transaction in Islamic banking, profits are shared based on agreed ratio which need not be equal to their individual capital contribution, but loss is shared strictly based on individual capital contribution. So, Islamic bank will act as a partner in this case in order to contribute to the capital formation as well as in sharing profits and loss Kettell, B (2011).

2.9.1.5 SALAM (FORWARD TRADE CONTRACT)

This is a sale contract whereby Islamic bank agrees to supply some specific commodities to the buyer (its client) at a future date that is specified in exchange of an advanced full spot payment to the bank. That is, the client pays the full amount and delivery of the commodity to the client is done in specific future date by the Islamic bank Moin, M (2008).

2.9.1.6. ISTISNA (CONTRACT OF MANUFACTURE)

It is a contract in which a party orders another to manufacture and provide a commodity, the description of which, delivery date, price and payment date are all set in the contract. It is used by Islamic banks, and consists of two separate Istisna contract Sefiani, Z (2014).

2.10. EMPIRICAL LITERATURE REVIEW-ETHIOPIAN CONTEXT

To date there have been very few studies conducted regarding the Interest free banking in Ethiopia. Among few Mohamed, (2012) who studied Islamic banking prospect, opportunities and challenges in Ethiopia and concluded as even if there is more than 30 million Ethiopian Muslims everywhere want Islamic Banking and offers huge opportunities to exploit that Islamic banking face the challenge of lack of awareness and understanding ,legal, supervisory, regulatory and/or institutional challenge , negative attitude of people towards Islamic banking (wrong association with religion), lack of trained human resource, capital resource constraints and lack of suitable banking policies. Shaik Abdul Majeed, (2014) that studied the Role and Progress of Islamic Banking in India, Ethiopia and Rest of the World and the studies result Ethiopia of economic development, largest population and well growing condition of financial markets and infrastructure areas. After that the National Bank of Ethiopia (NBE) directive allowed banks to provide interest-free banking service using a separate window along with their other banking services to serve the public and Oromia International Bank, a private financial institution, becomes the first to implement interest-free banking [Islamic banking] in Ethiopia and serving more than 4000 customer base and daily deposits are around two to two and half million birr per day on an average (Debebe, A. (2015). S. Sankaramuthukumar&A.Devamohan, (2008), which studied the Potentiality of Islamic banking in Ethiopia and the result from the study revealed as the Ethiopian Muslims are vibrant and they establish their identity in bad feeling of that fact Ethiopia is a Christian dominated country.

Ethiopian Christians have no way affected or influenced the Ethiopian Muslims. Of course, this is good from society's point of view, since both the communities (Christians and Muslims) live in peace and harmony. This indicates the potentiality for the establishment of an Islamic bank for Ethiopian Muslims.

2.11. PROSPECTS FOR ISLAMIC BANKING IN ETHIOPIA

The prospect of Islamic Banking looks very bright. Ethiopian Muslims everywhere want Islamic Banking. In addition, Ethiopia having more than 30 million Muslims offers huge opportunities to exploit. The size of the market will be very large as majority of Ethiopian Muslims, in the name of religious faith, are looking for interest free financial services (Debebe, A. (2015).

It is pertinent to mention here that Islamic banking is not meant for Muslims only but non-Muslims may also avail the benefit of it. And it is feasible to have a parallel banking system: one based on Sharia along with a conventional one. Islamic banking is an effective mechanism to overcome the liquidity and inflation problems while allowing general growth. For real general growth, which requires increase in income and employment should be ensured for all segments of the society Mohammed, M (2012). If Islamic banking is introduced, the inadequate labor capital ratio, for informal sector workers and farmers associated with agriculture and manufacturing industries could be resolved through equity finance, which might be a revolution in our agriculture and unorganized sector. With improved labor capital ratio, our vulnerable workers associated with agriculture and unorganized sector might be able to compete effectively with the formal sector workers. Thus Islamic Banking may financially empower majority of Ethiopian workers and farmers Ahmad, K. (2000). Islamic banking may bring our political leaders to substitute grants and subsidies with equity finance which helps achieve self-reliability that never comes through grant and subsidies schemes, through specialized financial institutions Teferi, M (2015). Moreover, with introduction of Islamic banking, Ethiopian government will certainly gain diplomatic advantages to make financial dealings with Muslim dominated nations especially to attract trillion dollars of equity finance from the gulf countries. Finally, Islamic banking should not be regarded as religion based banking business, but could be profitably used to resolve issues pertaining to economy Teferi, M (2015).

2.12. CHALLENGES FACING ISLAMIC BANKING SERVICES

2.12.1 LACK OF AWARENESS AND UNDERSTANDING

Despite the growth of Islamic banking over the last 30 years, one of the main challenges facing Islamic banking is the poor understanding about its operations in the Muslim and non-Muslim world Njamike, K. (2010).

2.12.2 LACK OF SUPPORTIVE INSTITUTIONAL AND MARKET LINKS

Islamic banking is at an early stage of learning and experience, lacking the flexibility to choose arrangements which best suits their need in reacting to structural shifts in the economic setting as well as changes in consumer preferences.

For example, Islamic banks, without having an interest-free money and capital market, will not have adequate instruments to meet the pre-condition for liquidity management and effective maturity transformation.

So, adequate financial mechanism still has to be developed, without which financial intermediation, especially the risk and maturity transformation, will not be performed properly Pasha, A (2014). Moreover, however well integrated it may be, any system cannot thrive exclusively on its built-in elements. It has to depend on a number of link institutions and Islamic banking is not an exception to this rule. They also need research and training forums in order to promote entrepreneurship amongst their clients. Such support services properly oriented towards Islamic banking are yet to be developed in many countries Sekaren, U (2003).

2.12.3 THE REGULATORY CHALLENGES

The relationship between Islamic banks and monetary authorities is a delicate one. Whatever the goals and functions are, Islamic banks came into existence in an environment where the laws, institutions training and attitude are set to serve an economy based on the principles of interest. For example, the operations of Islamic banks are on a profit and loss share basis (PLS), which actually does not come fully under the jurisdiction of the existing civil laws Agbolade, O. K. (2011). In non-Muslim counties (i.e. countries with less than 50% Muslim population), central banks are very stringent in granting licenses for Islamic banks to operate. Islamic banks must also meet the additional requirements of other government and non-government authorities Kettell, B (2011)

CHAPTER THREE

RESEARCH METHODOLOGY

INTRODUCTION

This chapter provides the reader an overview of the methodological considerations and assumptions underlying the research process. It describes the methods and procedures that the researcher used in order to achieve the research objectives. The chapter covers the research approach used in the study, research design, target population, sample size, source of data and data collection and finally how the data was analyzed.

3.1. RESEARCH DESIGN

The researcher tries to analyze the challenges and prospects of IFB in Ethiopian Banking system by taking CBE & OIB as comparative study. To conduct this study and to realize the objectives of the study, mixed research approach is used. Mixed methods research is an approach to inquiry that combines or associate both qualitative and quantitative forms. It involves philosophical assumptions, the use of quantitative and qualitative approaches and mixing of both approaches in a study.

3.1.3. TARGET POPULATION AND SAMPLING TECHNIQUES

As the general, the study population included all the commercial banks which are registered by National bank of Ethiopia during the field study period. For the purpose of this study, the commercial banks were depended on the basis of those that adopted interest free banking services. However, specifically Oromia international bank and Commercial Bank of Ethiopia are selected from the population. Hence, the study population was targeted specifically employees of both head offices of CBE and Oromia International Bank S.C who work at IFB related. These banks were selected on a purposive basis.

The major reason for selecting Commercial Bank of Ethiopia (CBE) was that it is the largest government and the second bank by launching the IFB Services in the country.

The major reason for selecting Oromia International Bank S.C is that, it is the first private bank which launched IFB Services in the Ethiopian banking system (<http://www.combanketh.com>) &<https://orointbank.net> and CBE is the strongest commercial bank in Ethiopia.

So, by considering their experience, inclusiveness from both private and government, and capacity of the banks this study selected both banks to assess the challenges and prospects of interest free banking in Ethiopia. Thus, the target population of the study was 75 workers from the two commercial banks. The following table shows the detail information related to target population of the study.

Table 3.1: Population size of each bank

Name of Banks	Total Number of IFB workers
CBE	40
OIB	35
Total	75

Source: From department of IFB of both Banks as of September, 2019 OIB and December, 2019 of CBE

In line with the target population of the study, this study was used purposive sampling techniques for employees to reach at the specific respondents. The researcher used purposive sampling techniques to since it is suitable to identify IFB workers from conventional banking. The banks were also selected on a purposive base because it is suitable to select the banks which are experienced in IFB banking system.

3.1.4. METHOD OF DATA COLLECTION

This study was used both primary & secondary sources to obtain data. From the primary sources data was collected through questionnaire and interview. In addition, data was also gathered from the banks' report. The researcher was collected the primary data through administering questionnaire and interview. The questionnaire was involved both structured and unstructured questionnaires. The questionnaires were self developed which the researcher believes they will answer the research questions.

Questionnaire was prepared in English language. The questionnaires have two parts: close and open ended. The close ended part of the questionnaire was using Likert scale. This scale includes items that are simply-worded statements to which respondents can indicate their extent of agreement or disagreement on a five scale ranging from strongly agree to strongly disagree.

Accordingly, Linkert scale method which indicate the respondents level of agreement or disagreements for the statement with a five point scale ranging from strongly agree to strongly disagree response- Strongly agree, agree, Neutral, disagree, strongly disagree respectively.

The open ended questions of the questionnaires were allowed respondents to give their opinion without any restriction.

The other instrument that was used to collected primary data was interview. The researcher was conducted interview through a face to face contact with the respective bank staffs to obtain data. The secondary data was collected by extracting relevant and supportive data from the banks' report.

3.1.5. DATA ANALYSIS TECHNIQUE

The researcher was performed primary data such as interview & questionnaires and secondary data analysis from responses which was collected on the research questionnaires. These data was analyzed using statistical tools through descriptive statistics/analysis and was present using tables that show the frequencies, percentages, standard deviation and mean values which facilitate the analysis and to make it easily understandable for readers. To assist the analysis of data, Statistical Package for Social Science- SPSS 20 version software was employed. Finally, the primary and secondary data was summarized and present to provide information for the research questions that was raised and also to triangulate some of the response that was obtained through close ended questions.

3.1.6. RELIABILITY ANALYSIS

Reliability is the degree to which the measure of a construct is consistent or dependable. It implies consistency but not accuracy (Bhattacharjee, 2012). The most popular test of internal consistency is the Cronbach's alpha.

The higher the coefficients, the better the measuring instrument (Sekaren, 2003). According to Hair, et al., (2006), if α is greater than 0.7, it means that it has high reliability.

Table 3.3: Reliability Statistics Challenges

Cronbach's Alpha	Cronbach's alpha	N of Items
Demand for IFB products	0.735	6
Capacity of the bank to delivery IFB products	0.794	4
Challenges of the bank to delivery IFB product	0.754	5
Prospects of the IFB products in industry	0.791	4

Source: SPSS output

For internal consistency test, Cronbach's alpha model of testing have been employed and the result obtained showed Cronbach's alpha coefficient above 0.7 which indicates it is highly reliable.

CHAPTER FOUR

DATA ANALYSIS AND PRESENTATION

INTRODUCTION

This chapter presents the results and analysis of data that were gathered from primary and secondary sources through questionnaire and interview. The collected data have been analyzed, and interpreted accordingly. In this study 40 and 35 questionnaires were distributed to IFB employees of the CBE & OIB respectively. And the entire questionnaires distributed to employees have been collected, however, out of questionnaires distributed to bank's IFB workers 64 (85.3%) have been collected and the rest of respondents (14.7%) did not return.

4.1 DEMOGRAPHIC CHARACTERISTICS OF THE RESPONDENTS

In order to achieve the objective of the study; the researcher was used purposive sampling techniques in order to generalize the total population of the study; the data collected through a questionnaire distributed to respondents was analyzed and discussed. The researcher has distributed 75 questionnaires to respondents; which includes four types of questionnaires, the first questionnaire was distributed to analyze the capacity of the banks in providing interest free banking, the second question was organized to identify challenges of interest free banking, the third questionnaires' was to know prospects of interest free banking, and finally, the last question was to identify the demands of interest free banking. So, the overall returned questionnaire was 64 questionnaires (85.3%) and the rest of respondents (14.7%) did not return.

In the following section, the respondent's personal information is presented. It covers gender, age, job and experience in the bank they are serving. So, the data collected with regard to challenges and prospects of interest free banking will be analyzed hereunder through frequency distribution and descriptive statements.

Table 4.1 Characteristics of Sample Staffs

DEMOGRAPHIC CHARACTERISTICS OF THE RESPONDENTS				
Gender	Respondents from OIB		Respondents from CBE	
	Frequency	Percent	Frequency	Percent
Female	19	59.4	20	62.5
Male	13	40.6	12	37.5
Total	32	100.0	32	100.0
Age				
20-25	9	28.1	1	3.1
26-30	11	34.4	13	40.6
31-35	6	18.8	11	34.4
above 36	6	18.8	7	21.9
Total	32	100.0	32	100.0
Educational level				
First Degree	27	84.4	28	87.5
Masters & Above	5	15.6	4	12.5
Total	32	100.0	32	100.0
Position				
Bank trainee	13	40.6	7	21.9
Customer Service Officer	14	43.8	21	65.6
Customer Service Manager	4	12.5	3	9.4
Branch Manager	1	3.1	1	3.1
Total	32	100.0	32	100.0
Experience				
up to 2 years	4	12.5	3	9.4
3-6	9	28.1	7	21.9
7-10	8	25.0	11	34.4
above 10 years	11	34.4	11	34.4
Total	32	100.0	32	100.0

Source: researcher own computation, 2020

The result of above table illustrates the respondent's gender those participated in this study from both Oromia international bank and commercial bank of Ethiopia. As it can be observed in the above table; the respondents participated in this study from Oromia international bank are 19 (59.4%) of female and 13 (40.6%) of male respondents. On the other hand, from commercial bank of Ethiopia; 20(62.5%) of female respondents and 12(37.5%) of male respondents are participated.

From the above table, the researcher concludes that both banks are dominated by female staffs and the numbers of female and male staffs in the banks are close to one another. The conclusion drawn is based only on the respondents participated in the particular study.

In addition, it is clear from the above table that majority of the workers in interest free banking and staffs of Oromia international bank are between the age of 26-30 years, which is confirmed by the respondents response rate of (34.4%, N32) followed by the age bracket of 20-25 (28.1%, N 32).

On the other hand, a majority of respondents from commercial bank of Ethiopia those participated in this study are between an age bracket of 26-30 years, and this can be evidenced from the respondents response rate as 13 (40.6%, N 32) of respondents agreed. The second largest of the respondents from CBE are between the age brackets of 31-35 (34.4%).

The result of data collected implies that, majority of the interest free banking employees and staffs of both banks are dominated by young's level age bracket. But staffs of Oromia international bank are more in youngest age bracket than commercial bank of Ethiopia, and this can benefit the bank to deliver a good interest free banking service since the staffs are energetic and young.

Educational level of respondent is another factor that was investigated in the course of this study. The results showed that the majority of the employees are a holder of BA degree in both Oromia international bank and commercial bank of Ethiopia bank with a responding rate of 84.4% and 87.5% (N=64) respectively. On the other hand 15.6% and 12.5% of respondents had a master degree and above from both banks. This reveals that the people who were assigned to fill the questionnaires of this study had a great knowledge about their profession and therefore could contribute by providing insights necessary for this study. The respondents were expected to be people with knowledge about IFB system.

Regarding the positions of respondents in the Banks, it was found out that the majority were Customers service officers who were the main respondents for this study from both Oromia international bank and commercial bank of Ethiopia with 43.8% and 65.6% (N=32), bank trainee also participated at 40.6 % and 21.9 % of respondents, and CSM and Branch managers are held 12.5% and 9.4 %, and 3.1% and 3.1% respectively.

The result of the data collected implies that; on the grand basis the respondents participated in this study are customer service and above when it is compared to bank trainee. So, since they are related bank's activities, especially interest free banking, the information collected from the respondents seems appropriate to analyze the data.

From this table 4.1, it is possible to conclude the job experience of the respondents. It was shown that the highest percentage of the respondents (34.4%) from Oromia international bank for those experience which have greater than 10 years bracket and the second larger respondents 28.1% were those have experience of (3-6) years bracket, 25% were in (7-10) years bracket, and the remaining are in the bracket of up to 2 years' experience.

On the other hand, the majority of respondents from commercial bank of Ethiopia have an experience of greater than 7 years but less than 10 years. The data collected implies that the experience bracket of 7-10 years and above 10 years scores the same result of (34.4%, N 32) respectively. The second largest year bracket was found between 3-6 years (21.9%) and the remaining are in the bracket of up to 2 years. From this, it is possible to understand that; respondents participated in this study from commercial bank of Ethiopia are found more experienced than respondents from Oromia international bank. Hence, having high experience results in adopting changing environment and improves the service quality

4.2 DESCRIPTIVE STATICS

Table 4.2: Summary of Descriptive statistics

Based on data collected from Oromia International Bank					
	N	Min.	Max.	Mean	Std. Deviation
Capacity of the bank to delivery IFB products	32	2.00	3.00	2.5625	.50402
Prospects of the IFB products	32	1.00	2.00	1.9062	.29614
Demand of the IFB products	32	1.00	4.00	2.5313	.76134
Challenges of the bank to delivery IFB product	32	1.00	4.00	2.1875	.89578
Valid N (listwise)	32				
Based on data collected from Commercial bank of Ethiopia					
Capacity of the bank to delivery IFB products	32	1.00	3.00	2.3750	.55358
Prospects of the IFB products	32	1.00	3.00	2.2813	.52267
Demand of the IFB products	32	3.00	4.00	3.2500	.43994
Challenges of the bank to delivery IFB product	32	1.00	3.00	1.8750	.55358
Valid N (listwise)	32				

Source: SPSS output, 2020

As it can be observed from the above table 4.6, result of descriptive analysis, this study is conducted to identify challenges and prospects of interest free banking service in commercial banks (particularly by taking a comparative study on commercial bank of Ethiopia and Oromia international bank).

In doing so, the study considered to identify the issues from different perspectives like identification of IFB demands, challenges of IFB, and prospects of IFB and capacity of banks in providing this service. Hereunder the mean, minimum, maximum and standard deviation of each variable is going to be discussed. Hence, the discussion is based on comparative analysis.

The mean distribution of capacity of banks with regard to providing interest free banking is 2.5625 and 2.3750 respectively and standard deviation of 0.50402 and 0.55358 respectively (based on the data collected from Oromia international bank and commercial of Ethiopia). The standard deviation value implies that how much each question is deviated from its means values to measure the non-similarity of respondent's response rate. With this regard the data collected from commercial bank of Ethiopia found highest score in standard deviation.

From the data collected it is possible to understand that the mean value of capacity of commercial bank of Ethiopia is lower than the mean value of capacity of Oromia international bank. The implication is that; the capacity of the bank (CBE) in proving of interest free banking is found to be greater than the capacity of Oromia international bank. The conclusion given is by taking into account the nature of scaling the questions (Likert scale). The more the result approaches to one or two the more the respondent's agreement with statement and the more the result deviated from one or two the more the respondent's disagreement with the statement.

Finally, the minimum and maximum score of the variable capacity found as 2 (agree) and 3 (neutral) from Oromia international bank and 1 (strongly agree) and 3 (neutral) from commercial bank of Ethiopia.

The mean distribution of the prospects of interest free banking has two values based on the data collected from two banks. The data collected from Oromia international bank shows that; a prospect of IFB has mean value of 1.9062 and standard deviation of 0.29614. Whereas, the data collected from commercial bank of Ethiopia shows that; the mean value of prospects of interest free banking has a value of 2.2813 and standard deviation of 0.52267.

The minimum and maximum of the prospects value has 1 which represents (strongly agree) from both banks and maximum of 2 and 3 (agreed and neutral).

The standard deviation of the study shows that each observation is deviated from its mean value by the coefficient stated on each variable. And, it shows the non-similarity of respondent's responses rate.

The result of data collected implies prospects of interest free banking scores the highest result under commercial bank of Ethiopia. The implication is that; the prospects of interest free banking are less expected from commercial bank of Ethiopia when it is compared to Oromia international bank. The conclusion given is by taking into account the nature of scaling the questions (Likert scale). The more the result approaches to one or two the more the respondent's agreement with statement and the more the result deviated from one or two the more the respondent's disagreement with the statement.

The mean value of variable demands of IFB is 2.5313 and 3.2500 respectively with standard deviation of 0.76134 and 0.43994 respectively.

The minimum and maximum score of 1 (strongly agree) and maximum of 4 (disagree) from Oromia international bank. And 3 (neutral) and 4 (disagree) from commercial bank of Ethiopia.

The standard deviation of the variable is an indication of how much value each observation is deviated from its mean value.

Based on the finding of the study, the demand of interest free banking services in Oromia international bank is higher than the demand of interest free service in commercial bank of Ethiopia. The last variable is challenges of IFB implementation; the mean value of this variable is 2.1875 (Oromia international bank) and 1.8750 (commercial bank of Ethiopia). And, standard deviation of 0.89578 (Oromia international bank), and 0.55358 (commercial bank of Ethiopia) with the maximum and minimum value of the observation is 3 and 4 (neutral, and disagree) respectively and minimum of 1 (strongly agree) from both respondents.

The result of data collected implies challenges of interest free banking scores the lowest result under commercial bank of Ethiopia. The implication is that; the challenges of interest free banking found greater from commercial bank of Ethiopia when it is compared to Oromia international bank. The conclusion given is by taking into account the nature of scaling the questions (Likert scale). The more the result approaches to one or two the more the respondent's agreement with statement and the more the result deviated from one or two the more the respondent's disagreement with the statement.

4.2. Discussion of Respondents response rate with regard to Challenges, Prospects, Capacity, and Demands of IFB.

Table 4.3 Staffs Response about Challenges

Challenges items	Strongly agree		Agree		Neutral		Disagree		Strongly disagree	
	CB E	OIB	CBE	OIB	CBE	OIB	CB E	OIB	CB E	OIB
Tax system is the problem of IFB in Ethiopian Banking	29%	21%	68.8%	48%	9.4%	15%	0%	0%	0%	0%
Regulation of NBE not allow full fledges of IFB banking system	20%	24%	70%	63%	2%	10%	1%	7%	0%	%
nature of IFB	12%	33%	46%	59%	21%	0%	14	0%	7%	8%
Lack of specialized human resource is affected the growth of IFB Banking	37%	32%	52%	61%	6%	7%	5%	0%	0%	0%
Lack of awareness about IFB Banking system is high by customers side	17%	24%	68%	36%	11%	33%	4%	0%	0%	7%

Source: researcher own computation, 2020

The data collected with regards to challenges of the IFB shows that 97.8% of respondents were agreed or strongly agreed on the problem of tax system statement as the main challenges for delivering of interest free banking services from CBE. On the other a large number of respondents were agreed or strongly agreed on the statement of tax system used is a proxy to challenges of interest free banking and this can be evidenced since most of OIB respondents (68%) witnessed the issue.

Besides, 90% of respondents from Commercial Bank of Ethiopia are disagreed or strongly agreed with the statements that Regulation of NBE not allow full fledges of IFB banking system is a challenges of interest free banking services. And also 87% Oromia International Bank agreed or strongly agreed the Regulation of NBE not allow full fledges of IFB banking system

In addition The above table show that, based on the sample staff response about Lack of specialized human resource is affected the growth of IFB Bankingservices, 89% of respondents of CBE & 93% of the Oromia International Bank have agreed (strongly agree and agree) respectively that there is the problem of specialized human resource that affect the growth of IFB Banking.

From the data collected the researcher has concluded that challenges of interest free banking service is witnessed as the main factor that influence both banks. However, commercial bank of Ethiopia has faced a high challenge when it is compared to Oromia international bank, and this can be evidenced from the respondents' response rate.

Table 4.4 Staffs Response about Prospects of IFB

Prospects Items	Strongly agree		Agree		Neutral		Disagree		Strongly disagree	
	CBE	OIB	CBE	OIB	CBE	OIB	CB E	OIB	CB E	OIB
IFB services will promote the habit of saving of the people.	3.1%	9.4%	65.6%	90.6%	31.3%	0%	0%	0%	0%	0%
IFB services will increase investment.	11.8%	31%	73%	57%	6%	12%	9.2%	0%	0%	0%
IFB services will compete with conventional.	6%	13%	11%	27%	63%	57%	20%	3%	0%	0%
IFB services will reduce the loss of financial concerning with paying interest rate.	26%	18%	48%	65%	17%	12.5%	9%	4.5%	0%	0%

Source: researcher own computation, 2020

The questions involved for identification of future prospects of interest free banking are to know if IFB services will promote the habit of saving of the people, If IFB services will increase investment, if IFB services will compete with conventional, and if IFB services will reduce the loss of financial concerning with paying interest rate.

The above table shows that the respondents from both Banks agreed or strongly agreed, (68.70 & 100% that implementation of interest free banking service will promote the habit of saving of the people.

Moreover, 40.2% of CBE & 88% of OIB respondents agreed or strongly agreed that IFB services will increase investment in Ethiopian Banking system. But 63% of Commercial Bank of Ethiopia and 57% Oromia International Bank being neutral on the IFB services to compete with conventional as witnessed with response rate.

On the other hand, the respondents from commercial bank of Ethiopia has also agreed and strongly agreed with the statements (74%) and those of the Oromia International Bank agreed & strongly agreed (83%) with the statement that the IFB services will reduce the loss of financial concerning with paying interest rate. While 17% of CBE and 12.5% of OIB being neutral respectively, but small percent 9% of CBE & 4.5% of OIB respondents disagree with the statement.

From the result of data collected, the researcher has concluded that prospects of interest free banking found to be higher in Oromia international bank when it is compared to commercial bank of Ethiopia.

Table 4.5 Staffs Response about Capacity of IFB

Capacity Items	Strongly agree		Agree		Neutral		Disagree		Strongly disagree	
	CBE	OIB	CBE	OIB	CBE	OIB	CBE	OIB	CBE	OIB
The bank has knowledgeable manpower to provide interest free Service.	26%	14%	56.3%	45.8%	11.6%	23.2%	6.1%	17%	0%	0%
The bank has the necessary IT infrastructure to process & delivery the services of interest free banking	40.7%	24%	46%	47.9%	6%	17%	7.3%	11.1%	0%	0%
The bank has the skill to develop interest free banking Service that suites the current and future	15.5%	23.8%	69.4%	52.6%	8.1%	23.6%	7%	0%	0%	0%

Ethiopian market										
The bank provides interest free banking Service at convenient branches and adequate windows with the customer expectation	43%	37%	48%	41.8%	3.6%	12%	5.4%	9.2%	0%	0%

Source: researcher own computation, 2020

The questions which are represented to explain the capacity of the banks are; if the bank has knowledgeable manpower to provide interest free Service; if the bank has the necessary IT infrastructure to process & delivery the services of interest free banking; if the bank has the skill to develop interest free banking Service that suites the current and future Ethiopian market; if the bank provides interest free banking Service at convenient branches and adequate windows with the customer expectation are were used to identify the capacity of the banks with regard to interest free banking system.

The result of primary data reveals that; only 59.8% of respondents are agreed or strongly agreed on the skill of the bank to develop interest free banking Service that suites the current and future Ethiopian market from Oromia international bank and the remaining respondents (23.2%) and (17%) responded as silence (neutral) and disagreement on this statement respectively.

On the other, a large number of respondents were agreed or strongly agreed on the capacity of the bank in providing interest free bank service from commercial bank of Ethiopia(59.4%), and this can be evidenced from the respondent’s response rate as of respondents responded.

Besides, 86.7% of respondents from commercial bank of Ethiopia has agreed and strongly agreed on the bank has the necessary IT infrastructure to process & delivery the services of interest free banking statements while that of the OIB agreed and strongly agreed,(71.9%).

But 6% and 7.3% of Commercial Bank of Ethiopia are responded as neutral and disagreement with the statement respectively. And also 17% and 11.1% of the OIB respondents are responded as neutral and disagreement with the statement respectively. And also with the question which say does the bank has the skill to develop interest free banking Service that suites the current and future Ethiopian marketthe respondents of CBE agreed or strongly agreed (84.9%),on the statement while 8.1% & 7% responded as neutral and disagree with the statement.

For Oromia International Bank 76.4% of respondents agreed or strongly agreed with the statement, while the rest 23.6% responded as neutral with the bank skill to develop interest free banking Service that suites the current and future Ethiopian market.

From this someone can understand that; in the current situation with regard to interest free banking service the capacity of commercial bank of Ethiopia found significant when compared to Oromia international bank. This may because of related sufficient number of windows provided for IFB and other related issues.

Table 4.6 Staffs Response about Demand Items of IFB

Demand Items	Strongly agree		Agree		Neutral		Disagree		Strongly disagree	
	CBE	OIB	CBE	OIB	CBE	OIB	CBE	OIB	CBE	OIB
There is no demand for interest free banking Service other than the currently availed one.	0%	0%	0%	0%	16%	0%	54%	71%	30%	29%
The bank is providing frequently Mudarabah financing Service.	3%	47%	58%	21%	0%	32%	0%	23%	4%	0%
The bank is providing Musharakah financing Service	41%	48%	37%	51%	14%	1%	8%	0%	0%	0%
The bank is providing Istisna financing Service.	17%	18%	13%	65%	67%	%	3%	12%	0%	5%
The bank is providing Ijara financing Service	11%	32.7 %	13%	55.2%	73.9%	%	2.1%	12.1 %	%	%
The bank is providing Selam Financing Service.	22%	17%	47%	35%	18%	48%	7%	%	6%	%

Source: researcher own computation, 2020

The Demands of IFB are measured by a proxy number of questions like; if there is no demand for interest free banking Service other than the currently availed one; if the bank is providing frequently Mudarabah financing Service; if the bank is providing Musharakah financing Service; if the bank is providing Istisna financing Service; if the bank is providing Ijara financing Service; if the bank is providing Selam Financing Service; if the bank is providing Murabaha Financing Service; and if the bank is providing kardi financing.

The result of the data collected with this variable reveals that 54% & 30% of respondents of Commercial Bank of Ethiopia were disagreed and strongly disagree respectively when those of Oromia International Bank replied as disagree (71%) and strongly disagree (29%) on the

statement which say There is no demand for interest free banking Service other than the currently availed one.

This implies that there is more demand in both banks on interest free banking services but it is high in Oromia international bank when compared with CBE respondents response.

On the Musharakah financing Service, the respondents of OIB agree and strongly agree 21% and 47% respectively while CBE agree 3% & 58% respectively with the statement which say 'The bank is providing frequently Mudarabah financing Service.'. This implies that there is more demand on Mudarabah financing Service in CBE than in Oromia international bank.

On the Musharakah financing Service the both banks' respondents' response almost similar on the statement that the bank is providing Musharakah financing Service with 38% & 41% agree and strongly agree by CBE respectively while 51% & 48% agree and strongly agree by OIB respectively. On providing Istisna financing Service, 65% of Oromia International Bank agrees while 67% of CBE respondents were unable to decide the issue of the variable.

On the other hand the respondents of CBE bank has kept silent to react on the Ijara financing Service, (73.9%) neutral, while Oromia International Bank respondents agree 55.2% with the statement.

From the data collected and taking in to the consideration of respondent's response the researcher has concluded that the statements which are provided to identify the demand of IFB are properly addressed in Oromia international bank when it is compared to commercial bank of Ethiopia.

This implies that there is more demand on interest free banking services in Oromia international bank. So, simply one can understand that there is no more demand by customers to use interest free banking service.

Generally, the findings of this study are supported by those of previous researches conducted regarding the interest free banking in Ethiopia.

Those studies include Mohamed (2012) Shaik(2014) Sankaramuthukumar&Devamohan (2008), and Debebe (2015) which showed that the Islamic banking, had a huge untapped opportunities in Ethiopia to serve more than 30 million Ethiopian Muslims but still needed to address challenges related with lack of awareness and understanding, legal, supervisory, regulatory and/or

institutional challenge, and negative attitude of people towards Islamic banking (wrong association with religion), lack of trained human resource, capital resource constraints and lack of suitable banking policies.

4.3 RESULT OF INTERVIEW DISCUSSION

In line with questionnaire distributed the researcher has prepared some interview questions and an open ended questionnaire to investigate the challenges and prospects of interest free banking. The following section of the study reveals the result of an open ended questions and interview discussions. To know the challenges of IFB open ended question which says; what do you think the challenges that the bank has faced to deliver Interest free Services was asked and the result of the respondents highlighted the issue of Government financial police not allow full-fledged of IFB service on the country, Lack of research & development, and IFB Principles were listed as a challenges of IFB.

The second question was prepared to know the reason(s) for the bank to limit its interest free banking products to the existing one only; and the majority of the respondents are agreed on that NBE allowed only window service, IFB Principles and IFB is taken as supporter of existing conventional banking system and gives less credence to Islamic customers.

The third question was prepared to know the opinion & comment regarding the challenges on the delivery of interest free banking and the respondents replied the issue as Government regulation problem, IFB principles problem, Nature of IFB problem, sharia requirements and financial police of the country are main challenges.

To deeply know the challenges and prospects of interest free banking the interview was conducted with some personnel's of the bank.

The first question was to identify the types of interest free banking services currently provided by the banks was asked. And the result of majority respondents highlights that the bank is currently providing Mudaraba (Savings Account), Wadiah (Savings Account) and Qard (Current Account), Mudaraba Time Deposit Account).

The issue of identifying the factors which made the bank to limit its service to current type Services only was replied as Regulatory changes, desire for special regulation, and IFB Principles.

With regard to the challenges the bank faces to deliver interest free banking service; the issue of Lack of awareness & understanding, Regulatory changes, Inadequate Marketing promotion, Double taxation, Window Model, Absence of equity market, Lack of Sharia advisor, Lack of trust with in the bank, and Lack of suitable banking policies was clearly highlighted.

With regard to the issue of competent employee, IT & the necessary infrastructure to provide IFB services, the respondents have replied that the banks had good IT structure, Necessary infrastructure and competent employee.

Finally, the issue of providing products that meets the demand and expectation of customers was asked by the researcher and the answer of the respondents reveals that; there are many types of products that are not availed to customers, customers demand products that facilitate investment, share profit & loss among agreed parties, facilitate LC, Sophisticate import & export activities and Avoids gambling and uncertainty.

CHAPTER FIVE

CONCLUSIONS AND RECOMMENDATION

INTRODUCTION

The previous chapter presented the results and discussion of the findings obtained from primary data sources. The purpose of this chapter is to present conclusions and recommendations of the study. Accordingly, the chapter is organized in two parts, the first part presents the conclusions of the study and the second part presents the recommendations that provided based on the findings of the study.

5.1. CONCLUSION

The objective of this study was to analyze the challenges and prospects of Interest Free banking; by taking evidence from banking industry in Ethiopia (Commercial bank of Ethiopia and Oromia international Bank as a comparative study). To achieve the objective of the study, the study adopted descriptive research design and mixed research approach. Furthermore, purposive sampling techniques were used to select a number of sampled banks from the total population of the banking industry.

More specifically, primary and secondary data was used to analyze the challenges and prospects of interest free banking; the primary data was collected through questionnaire and interview, the questionnaire was prepared in two different formats. The first format contains closed ended questions and the second format contains open ended questions. In order to achieve the objective of the study 75 questionnaires was distributed to respondents and 64 of them were returned the questionnaire and the remaining 11 was unreturned.

The main findings of the present study reveals about the situation regarding IFB services; the main challenges faced by surveyed banks in implementing IFB system included lack of awareness by potential customers about IFB services, institutional challenges including taxation, desire for special regulations and lack of specialized human resource. In addition, the difficulty in segregation of funds for effective implementation of IFB was another problem expressed by respondents. The challenges are higher in commercial bank of Ethiopia when compared to Oromia international bank.

On the other side, IFB in Ethiopia was believed to still have a huge unused opportunity to be exploited by other financial services providers which would use customer satisfaction as a role in offering IFB services. The potential prospect that IFB service brings are; promote the habit of saving of the people, increase investment, and reduce the loss of financial concerning with paying interest rate. Other potential prospect mentioned included global trends, economic growth in Ethiopia and within Muslim communities.

The prospects of interest free banking are more witnessed by Oromia international bank compared to commercial bank of Ethiopia.

The finding of the study reveals that on the general basis; Ethiopian banking industry has a capacity to provide interest free bank service. Particularly, commercial bank of Ethiopia has more capacity to provide interest free banking services compared as to Oromia international bank.

Besides, with regard to demand of interest free banking services, the finding of the study reveals that on the general basis interest free banking service is not as expected when it is compared to the number of Muslims peoples in the country. But, on the particular basis the respondents from Oromia international bank witnessed that there is more demand of interest free banking service when compare to commercial bank of Ethiopia.

Finally, the researcher has concluded that; the prospects of interest free banking for both commercial bank of Ethiopia and Oromia international bank is found more significant than its challenges in Addis Ababa in particular and in Ethiopia in general. However, there are a number of challenges that both banks need to be worked on first for effective implementation of IFB in commercial banks of Ethiopia.

5.2. RECOMMENDATIONS

With respect to the findings of the study the following recommendations are forwarded: the recommendations are given in two stages.

Generally,

The National Bank of Ethiopia shall give attention to the IFB system and facilitate regulations that allow effective implementation of IFB system in Ethiopia.

The federal revenue authority shall check the issues related with taxation of IFB system.

Recruitment of more Muslims in banks who would be watching over the IFB system shall be considered as it may ensure the conformity of the services and the Sharia law.

Research focusing on studying the challenges faced by banks in implementing IFB is desirable as it may provide more details on the subject area.

The difficulty in segregation of funds shall be looked into to facilitate for effective implementation of IFB different vaults.

PARTICULARLY

Commercial bank of Ethiopia shall provide necessary training, and experience share for manpower specialized on matters of IFB services.

Commercial bank of Ethiopia shall believe in prospects of providing interest free banking and take necessary action with regard to interest free banking.

Commercial bank of Ethiopia shall consider the demands of interest free banking and different awareness shall provide by the bank to Muslim society.

Oromia international bank shall improve the bank in providing interest free banking services

5.3. FURTHER RESEARCH AREA.

This study was conduct on the challenges and prospects of interest free banking evidence from Ethiopian banking commercial bank of Ethiopia and Oromia international bank as a comparative study. However the sample size used in this study is only commercial bank of Ethiopia and Oromia international Bank. Hence, the researcher suggests other researcher to conduct the study on the same title by increasing a number of observations (bank to be included in the sample).

On the other hand, another researcher can conduct a study to examine how IFB users are satisfied with the service quality provided by those banks

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Annex

WOLKITE UNIVERSITY

COLLAGE OF BUSSINESS AND ECONOMICS

DEPARTMENT OF MANAGEMENT

MASTERS OF BUSINESS ADMINISTRATION (MBA)

INTRODUCTORY STATEMENT

This questionnaire is designed with the objective of collecting information to analyze the challenges and prospects of Interest Free banking; by taking evidence from banking industry in Ethiopia (Commercial bank of Ethiopia and Oromia international Bank as a comparative study). for the partial fulfillment of the Master of Science Degree in Business Administration (MBA) in the Department of Management under the College of Business and Economics, Wolkite University.

General Directions:

- ✓ You are kindly requested to give genuine responses.
- ✓ You don't need to write your identification (Name).
- ✓ Feel free to respond.
- ✓ Encircle the corresponding number of your choices from the given alternatives.
- ✓ The study is completely academic and all responses are confidential.
- ✓ Tick mark „✓“ on your agreement.

Thank you in advance for your cooperation

SECTION I: DEMOGRAPHIC CHARACTERISTICS OF RESPONDENT

1. Age of the respondents' -25 years old -30 years old 31-35 years old
 Above 36 Years old
2. Sex: Male Female
3. Marital Status: Single Married Divorced Widowed
4. Current Job Position in the bank: Bank trainee Customer Service Officer
Customer Service Manager Branch Manager

5. Banking Experience in number of years: Up to 2 years 3-6 years

7-10 years above 10 years

6. Educational level of the respondent

Diploma holder First degree above first degree holder

SECTION II: CAPACITY, DEMAND AND PROSPECTS OF IFB

This section is divided in to three sections; in each section there are statements which address issue about the banks' capacity to deliver interest free Service, level of demand the Bank has to provide interest free banking & prospects of IFB. Therefore, please read each of the statements in each section and rate your level of agreement or disagreement with each statement by using a tick mark „√“ on one of the five alternatives.

1. BANK'S CAPACITY TO PROVIDE INTEREST FREE SERVICES.

Items	Strongly agree	Agree	Neutral	Disagree	Strongly disagree
1 The bank has knowledgeable manpower to provide interest free Service.					
2 The bank has the necessary IT infrastructure to process & delivery the services of interest free banking					
3 The bank has the skill to develop interest free banking Service that suites the current and future Ethiopian market					
4 The bank provides interest free banking Service at convenient branches and adequate windows with the customer expectation					

PROSPECTS OF IFB

S.N	Items	Strongly agree	agree	Neutral	Disagree	Strongly disagree
1	IFB services will promote the habit of saving of the people.					
2	IFB services will increase investment.					
3	IFB services will compete with conventional.					
4	IFB services will reduce the loss of financial concerning with paying interest rate.					

LEVEL OF DEMAND FOR INTEREST FREE BANKING

Items	Strongly agree	agree	Neutral	Disagree	Strongly disagree
1	There is no demand for interest free banking Service other than the currently availed one.				
2	The bank is providing interest free banking Service that customer really need.				
3	The bank is providing frequently Mudarabah financing Service.				
4	The bank is providing Musharakah financing Service				
5	The bank is providing Istisna financing Service.				

6	The bank is providing Ijara financing Service					
7	The bank is providing Selam Financing Service.					

CHALLENGES OF IFB

S.N	Items	Strongly agree	agree	Neutral	Disagree	Strongly disagree
1	Tax system is the problem of IFB in Ethiopian Banking system.					
2	Regulation of NBE not allow full fledges of IFB banking system					
3	nature of IFB					
4	Lack of specialized human resource is affected the growth of IFB Banking					
5	Lack of awareness about IFB Banking system is high by customers side					

INTERVIEW QUESTIONS FOR BANK EMPLOYEES

1. What types of interest free banking service does the bank currently made available to its customers?
2. What are the factors which made the bank to limit its service to current type Services only?
3. What challenges is the bank face to deliver interest free banking service?
4. Do you think the bank has the competent employee, IT & the necessary infrastructure to provide IFB services?
5. Do you think the bank is providing products that meet the demand and expectation of customers?