

CHALLENGES AND PROSPECTS ON INTEREST FREE BANKING
SERVICES WITH PARTICULAR REFERENCE TO AWASH BANK SOUTH
DISTRICT.

BY

DANIL GOSSAYE ANDETA

A THESIS SUBMITTED TO THE DEPARTMENT OF MANAGEMENT, COLLEGE OF BUSINESS
AND ECONOMICS, SCHOOL OF GRADUATE STUDIES WOLKITE UNIVERSITY IN PARTIALS
FULFILLMENT OF THE REQUIREMENTS FOR THE DEGREE OF MASTER OF BUSINESS
ADMINISTRATION.

JUNE, 2018

WOLKITE, ETHIOPIA.



CHALLENGES AND PROSPECTS ON INTEREST FREE BANKING SERVICES
WITH PARTICULAR REFERENCE TO AWASH BANK SOUTH DISTRICT.

BY

DANIL GOSSAYE ANDETA

ADVISOR- DR. SHIMELS

CO ADVISOR – FUAD HUSSEN

A THESIS SUBMITTED TO THE DEPARTMENT OF MANAGEMENT, COLLEGE OF
BUSINESS AND ECONOMICS, SCHOOL OF GRADUATE STUDIES WOLKITE
UNIVERSITY IN PARTIALS FULFILLMENT OF THE REQUIREMENTS FOR THE
DEGREE OF MASTER OF BUSINESS ADMINISTRATION.

JUNE, 2018

WOLKITE, ETHIOPIA.

Declaration

DANIL GOSSAYE ANDETA, declare that this thesis entitled: “challenges and prospects on interest free banking services with particular reference to Awash bank south district.

” is outcome of my own effort and study and that all sources of materials used for the study have been duly acknowledged.

To the best of my knowledge, this study has not been submitted for any degree in this University or any other University. It is offered for the partial fulfillment of the degree of Masters of Business Administration.

By: DANIL GOSSAYE ANDETA

Signature -----

Date -----

ADVISORS' APPROVAL SHEET
SCHOOL OF GRADUATE STUDIES
Wolkite UNIVERSITY
ADVISORS' APPROVAL SHEET
(Submission Sheet-1)

This is to certify that the thesis entitled “-----
-----” submitted in partial fulfillment of the requirements for the degree of **Master's** with specialization in -----, the Graduate Program of the **Department/School of**, and has been carried out by----- Id. No, -----under my/our supervision. To the best of my knowledge, is an original work and not submitted earlier for any degree either at this University or any other University.

Therefore I/we recommend that the student has fulfilled the requirements and hence here by can submit the thesis to the department.

----- Name of major advisor	----- Signature	----- Date
--------------------------------	--------------------	---------------

----- Name of co-advisor	----- Signature	----- Date
-----------------------------	--------------------	---------------

SCHOOL OF GRADUATE STUDIES
Wolkite UNIVERSITY
EXAMINERS' APPROVAL
SHEET

We, the undersigned, members of the Board of Examiners of the final open defense by have read and evaluated his/her thesis entitled “-----”, and examined the candidate. This is,

Therefore, to certify that the thesis has been accepted in partial fulfillment of the requirements for the degree-----.

Name of the Chairperson

Name of Major Advisor

Name of Internal Examiner

Name of External examiner

SGS Approval

Final approval and acceptance of the thesis is contingent upon the submission of the final copy of the thesis to the School of Graduate Studies (SGS) through the Department/School Graduate Committee (DGC/SGC) of the candidate's department.

Stamp of SGS Date: -----

ACKNOWLEDGMENTS

Praise Allah, the almighty for successful completion of my research. I am particularly profoundly grateful to my advisor Tiruneh Legesse, Asst. Professor, for his useful and constructive comments, without which this work would have not been completed successfully.

I am greatly indebted for his constant encouragement, devotion, tolerance, and overall professional assistances. This study was also made possible by the assistance obtained from the respondents who have demonstrated their willingness to complete the questionnaires, interviews and provide me with the required information valuable for the completion of the study.

Contents

Declaration.....	1
ACKNOWLEDGMENTS	4
List of table	Error! Bookmark not defined.
List of figures.....	Error! Bookmark not defined.
ACRONYMS	10
<i>Abstract</i>	12
CHAPTER ONE	13
1. INTRODUCTION	13
1.1. Back ground of the study	13
1.2. Statement of the problem.....	15
1.3. Objectives of the study.....	18
1.3.1. General objective	18
1.3.2. Specific objectives	18
1.3. RESEARCH QUESTIONS	18
1.5. SIGNIFICANCE OF THE STUDY.....	18
1.6. DELIMITATION/SCOPE OF THE STUDY	19
1.7. LIMITATION OF THE STUDY	19
1.9. ORGANIZATION OF THE STUDY	19
CHAPTER TWO	20
2. REVIEW OF RELATED LITERATURES	20
2.1. Theoretical Review	20
2.1.1. Concepts and definition of Islamic Banking.....	20
2.1.1. Interest (Riba)	21
2.1.2. Prohibition of interest.....	21
2.1.3. Islamic banking Service Models	22
2.1.4. Islamic banking window service.....	22
2.1.4.1. Subsidiary/branch Islamic banking service.....	22
2.1.4.2. Full-fledged Islamic banking service	22

2.1.5.Sources of Funds for Islamic banks	22
2.1.5.2.Shareholder Funds.....	23
2.1.5.2.Wadiah Saving accounts	23
2.1.5.3.Current accounts	24
2.1.5.4.Investment account deposits	24
2.1.5.5.Investment deposits can have various deposit arrangement options.....	24
(a).Investment deposit under Mudarabah Option.....	24
(b).Investment deposit under Musharakah deposit option	25
(c).Investment deposit under Ijara Option	25
2.1.6.Uses of Financial resources in Islamic Banking	25
2.1.6.1.Murabah Financing	25
2.1.6.2.Musharakah Financing.....	26
2.1.6.3.Mudarabah Financing	26
2.1.6.4.Ijarah	26
2.1.6.5.Bai`bithmanAjil (BBA).....	27
2.1.6.6.Al-Ijarathumna al bai (AITAB)	27
2.1.6.7.Istisna	27
2.1.6.8.Tawaruk	27
2.1.6.9.Bai Salam	27
2.1.6.9.QardHassen	27
2.2.Empirical Evidence.....	28
2.2.1.Empirical Literature Review-Ethiopian Context	30
2.3.1.Principles of Islamic Banking Service	33
The five key principles that govern Islamic banking are as follows.....	33
2.3.1.1.Freedom from interest.....	33
2.3.1.2.Risk-and-Return Sharing.....	33
2.3.1.3.Shari`a-Approved Activities	34
2.3.1.4. Sanctity of Contract	34
2.3.1.5.Prohibition of speculative behavior	34
2.3.1.6.Segregation of Funds	34
2.3.2.Functional roles Islamic banks play.....	35
2.3.3.Efficient Capital Mobilization	35
2.3.5.Pooling of Resources and Diversification of Ownership	35

2.3.6.Efficient Contracting.....	35
2.3.7.Transparency and Price Discovery.....	36
2.3.8.Better Governance and Control.....	36
2.3.9.Operational Efficiency	36
CHAPTER THREE	37
3.1. RESEARCH DESIGN AND APPROACH	37
3.1. Design of the study	37
3.2. Data sources	37
3.3. Instruments of Data Collection	37
3.4 .population of the study.....	37
3.4 Sample Size and Sampling Techniques	38
Table 1.1Depending on organizational structure south district branches selected is as follows.....	38
Table: 1.2. Selected bank.....	39
Data Analysis	39
CHAPTER FOUR.....	40
DATA PRESENTATION, INTERPRETATION AND ANALYSIS	40
4.1 respondents background.....	40
Figure 4.2Age	Error! Bookmark not defined.
4.3 Education	42
Figure 4.3 Education.....	Error! Bookmark not defined.
4.4.Reliogion.....	42
Figure 4.4 Religion	Error! Bookmark not defined.
4.5 Bank experience.....	42
Figures 4.5 banking experience.	Error! Bookmark not defined.
4.2 ANALYSIS AND PRESENTATION	43
4.5. EMPLOYEE AWARENESS LEVEL FOR INTEREST FREE BANKING PRODUCTS.....	43
Table.4.3 Employees' awareness about the level of IFB products.....	43
4.6. RELIGIOUS AND CULTURAL DIFFERENCE IN ETHIOPIA.....	45
Table 4.4. Religious and cultural difference in Awash Bank s.c	45
Table 4 .3.Expected operational challenges of IFB services in Awash Bank s.c	47
Table 4.6.Islamic Banking Service and their future plan.....	49
4.8 Application of Inferential Statistics	51
4.3.1 Correlation among Variables	51

4.3.2 Regression Analysis of Variables	52
Table 4.17: Regression Analysis of Coefficients.....	53
CHAPTER FIVE	56
SUMMERY OF FINDINGS, CONCLUTION AND RECOMMENDATION	56
5.1. SUMMERY OF FINDINGS.....	56
5.2. CONCLUTION	58
5.3. RECOMMENDATIONS.....	59
References.....	60
Appendix 2.....	62
A: APPENDEX.....	63
WOLKIT UNIVERSITY.....	63
Appendix B	65

LIST OF TABLE

Table 1.1 Depending on organizational structure south district branches selected is as follows.....	38
---	----

Table 1.1 Depending on organizational structure south district branches selected is as follows.....	38
Table.1.3 Employees' awareness about the level of IFB products.....	43
TABLE1.4.. RELIGIOUS AND CULTURAL DIFFERENCE IN ETHIOPIA	45
Table 1 .5.Expected operational challenges of IFB services in Awash Bank s.c	47
Table 1.6.Islamic Banking Service and their future plan.....	49
Table 4.17: Regression Analysis of Coefficients.....	53

LIST OF FIGURE

Figure 4.1sex.....	Error! Bookmark not defined.
--------------------	------------------------------

FIGURE4.2education.....
.....47

Figure4.3Age.....**E**
rror! Bookmark not defined.

Figure 4.3
Education.....
.....47

Figure4.4.Religion.....
..... 42

Figure 4.4
Religion.....
..... **Error! Bookmark not defined.**

ACRONYMS

NBE – NATIONAL BANK OF ETHIOPIA

CBE – COMMERCIAL BANK OF ETHIOPIA

UB – UNITED BANK

OIB- OROMIA INTERNATIONAL BANK

IS – ISLAMIC BANKING IBS- ISLAMIC BANKING SERVICE

IFB – INTEREST FREE BANKING

IFI-ISLAMIC FINANCIAL INSTITUTION

R&D – RESEARCH AND DEVELOPMENT

BBA- BAI BITHMAN AJIL

Abstract

The recent development of starting Islamic banking service in one window in connection with conventional banking service made to examine the challenges and prospects of Islamic banking service for resource mobilization in Awash banks. The study was conducted based on data collected from staffs of through questionnaires. To achieve the objectives of the study respondents were drawn from south district. Data was collected through questionnaire by using stratified sampling from a sample of 230 and 223 were properly filled and returned. Besides, Semi-structured interview were used to guide for the qualitative data collection tools. The data collected from the questionnaire were analyzed using SPSS version 20 statistical tools such as percentages and mean followed by interpretation. The study focuses that awareness, culture and religion influencer, legal framework, societal belief, resource requirements as some of the challenges while economic growth, attraction of investors, and fostering investment are the likely prospects of the banks. The study concludes that Islamic banking service would bring additional capacity in the economy in connection with additional resource for banks, investment opportunity, reaching unbanked customers and employment opportunities in the country through effective mobilization and allocation of capital. Based on the above conclusions it is recommended that banks need to create awareness for public acceptance and training of staffs, employ good marketing techniques, governing body need to establish clear set of legal framework, and compliance with sharia issues should be adhered.

Key words: *Islamic Banking, Islamic banking window service, deposit items in Islamic banking, financing modalities of Islamic banking*

CHAPTER ONE

1. INTRODUCTION

1.1. Back ground of the study

The conventional banking system excludes the Muslim society, not by design, but due to its principle of using interest while playing its financial intermediary role and its involvement in business that the religion does not allow to be engaged in. This significant portion of the world population remained unbanked for centuries. Thus, this has created strong reservations against conventional banking system from the Muslims side and they demanded banking system that does not contradict with their religion. Hence, Interest free/Islamic banking (IFB) is being introduced on this ground. According to Metwally (1984 as cited in Al-sultan, 1999) in Muslim society banking activity is acceptable but what is not acceptable is the usage of interest for financial intermediation and the involvement of business activity that contradict the Islamic law. Thus, Interest free/ Islamic banks were established to conform to Islamic law- Shariah and meet the banking needs of this society. It is emerging industry not only in Muslim countries but also in non-Muslim countries. Nowadays, many countries are experiencing “Dual banking” system where interest-free banks operate along with conventional banks. Ethiopia having a significant Muslim population provides a huge potential for Islamic/interest free banking though interest free banking is meant for all those who would like to use the banking service apart from religious restriction. The study made by Mohammed (2012), has found out that there is need for Islamic banking products and services in Ethiopia. The significant Muslim population – according to the 2007 national census, the Muslim population comprises 33.9% of the total population (www.csa.gov.et accessed on 12/02/2016) - in Ethiopia, offers the opportunity for substantial customers that would patronize Islamic banking products.

National Bank of Ethiopia (NBE) has authorized banks to undertake IFB business in year 2011; following this authorization banks have started IFB services in year 2013. According to Sefiani (2014), for the sizable Muslim population in Ethiopia, there is a need for adequate banking services to serve this segment of the population. Banks reach to their customers through providing products and services that meet the need and wants of these customers.

According to Aris et al (2013), the increasing trends of Islamic Finance, Islamic Financial institutions (IFIs) around the world are encouraged to develop and innovate new products in order to meet the ever-changing demand from its customers and potential customers. In order to satisfy the banking need of this

population, banks shall provide adequate IFB services, create conducive environment and encourage the use of these services accordingly.

Islamic banking, on the one side, is being spread all over the world and regarded as a fastest

Growing market, on the other side; it is not free from issues, problems, and challenges. The

Islamic banking faces serious problems to practice Islamic laws, proper interbank money

Market is not available and poor regulatory framework for interest free banking (Irfan, Majeed

&Zaman 2014).

Recently Islamic banking services come into existence in Ethiopia to play an important intermediary role in attracting savings, especially from customers, and channel the collected fund into productive investments. The banking service mainly focuses on financing primarily based on profit-and-loss sharing, trading, leasing. Both mobilization and investment of funds should be conducted in accordance with the principles of Islamic Shari'a" (www.albarakah.com, 2014).In Islamic banking service. unlike conventional banking service, they are not allowed to charge interest by lending money to their customers, because, under Islamic commercial law, making money from money is strictly prohibited (Chintaman, 2014 p. 5).In contrast to this the conventional banking business charges an interest from the loans made to customers and pay interest to the deposits made by customers".

In order to attract and retain the specific needs of the Islamic banking service of the market some commercial banks start the Islamic banking service in one segregate window with the conventional banking service as per the requirement of the NBE directive. There are more than 18 private and government owned banks operate in the country. Among these Commercial bank of Ethiopia, United bank S.C and Oromia international bank S.C. start Islamic banking service as per the requirement. (www.nbe.gov.et).

When we saw their services according to the percepts of Islamic finance resource allocated for this service found from interest free activity. This implies that not only their lending but also their funding should make use of halal (interest free) financial instruments. Therefore to start the business the fund allocated for the service should be found from interest free activity. Islamic banks will be offering profit-sharing investment accounts to the depositors. These depositors are not assumed to share the profits/losses of the bank but neither fall into the category of the capital of the bank nor can be regarded as liabilities of the bank, in the accounting sense of the term (Elgar, 2009).

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

In implementing this banking business the bank should also to note how the customer should be served and who answers client questions. Everyone who works inside an Islamic bank should understand Islamic finance principles. The bank training of the staffs is not only about religious concepts, the product knowledge that leads the staffs to understand how Islamic banking is different from conventional banking.

Thus, the aim of this study is to empirically identify challenges on IFB services with particular reference to awash bank.

1.2. Statement of the problem

As already mentioned under the background section, Ethiopia has large Muslim population whose contribution to the national economy is also enormous. 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 reservations 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.

According to Teferi (2015), introduction of IFB does not only create inclusive financial system for the Muslim population but also has a potential to influence and enhance the economic Development of the country through resource mobilization and employment creation by Encouraging people to use the banking system.

Although the international experience of interest free banks and even the theoretical literature shows the existence of several types of IFB products, the information obtained through interview and observation from two Commercial bank of Ethiopia shows that it has availed

some of IFB products and the availed products are not also being utilized as expected.

At International level there are several empirical studies on Islamic banking and finance. The studies investigated several aspects of the Islamic banking service from the type of services (scope of service) to challenges faced by the Islamic banks. Empirical study in Ethiopian context related to the scope of service and challenges on IFB services. This, study, therefore, attempts to fill this research gap by investigating the challenge faced by service providers and users of IFB products and scope of service provided by Ethiopian banking through IFBW including whether there is unmet demand of users, awareness of customers and capacity of bank as these have been identified in the literature as Awash Bank South District is taken as a case study.

According to the study of Aris et al (2013), in Malaysia Islamic banks serve Wadiah Amana,

Quard Hassan, Mudarabah, Musharakah, Murabaha, Ijara, Istisna, BaiInah, BaiBithamanAjil.

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, a lease ending in the purchase of the leased asset,

Al- Istisna, IstisnaTamwili, Salam, Current account, saving account and investment account.

On the other hand the research work which was conducted to assess the challenges of 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, 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. Debebe (2015) has conducted a study on „Factors Affecting Customers to Use Interest Free Banking in Ethiopia“. The study is centered on „customers“ intention and willingness to use interest free banking“. The result showed that perceived relative advantage, perceived compatibility, customers“ level of awareness and subjective norm have a significant positive impact on the attitude towards Interest free banking in awash bank. This study is about impact assessment on the attitude towards IFB usage which does not address the current problem at hand.

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.

Thus, none of the above studies have addressed the reasons for why the bank has availed some of IFB products to the market. Except in the international studies which took realities of other countries, to the best of the researcher“s knowledge, there is paucity of empirical study in Ethiopian context related to the scope of service and challenges on IFB services. This, study, therefore, attempts to fill this research gap by investigating the challenge faced by service

providers and users of IFB products and scope of service provided by Ethiopian banking through IFBW including whether there is unmet demand of users, awareness of customers and capacity of bank as these have been identified in the literature as challenges, and awash bank is taken as a case study.

1.3. Objectives of the study

1.3.1. General objective

The general objective of the study is to empirically identify the challenges and prospects on Interest free banking services with particular reference to Awash Bank South District.

1.3.2. Specific objectives

This study specifically strives to achieve the following special objectives:

The specific objectives of the study are:

- 1) To assess religious and cultural difference in awash bank that influence IFB products and services.
- 2) To assess the operational challenges of IFB in Awash Banking Industry.
- 3) To investigate overall awareness of employees towards IFB products and services.

1.3. RESEARCH QUESTIONS

This study is designed to address the following basic research questions:

- 1) What are the major challenges that face Interest Free Banking Operation in Awash Banking industry and the problems encountered in practicing IFB?
- 2) How banks do fit their conventional banking system in line with Islamic/interest free Banking.

1.5. SIGNIFICANCE OF THE STUDY

The significance of this study occurs in two ways. Firstly this study identifies operational challenges and prospects of Interest Free Banking. Secondly, the findings of this study add to the wealth of knowledge in other Interest free banking studies. It will also be helpful for individuals who want to conduct further studies in related topics and other organizations that face similar problems. Inevitably, this study contribute to the growing body of research on antecedents to operational challenges of IFB by examining over all challenges of towards IFB products and services to provide factor that influence the performance of IFB products and services the study become necessary. It is believed that this study add value to the literatures because the study become reference for the future research.

1.6. DELIMITATION/SCOPE OF THE STUDY

The main focus of this study is to identify the operational challenges and prospects of interest free banking in awash banks of South district that is highly engage delivering IFB Services. Furthermore, while conceptually challenges can be broadly categorized as operational and institutional, this study only focuses on the operational challenges that are hampering the implementations of IFB in the study cases.

1.7. LIMITATION OF THE STUDY

Some constraints such hinder the need to include a large sample size that can nearly represent the total population of the study. In order to get a clear picture of the issue involving larger number of respondents in the different organizations is required. But due to time constraint and lack of access to sufficient research fund hindered to include more cases. The shortage of up-to-date reference materials and research works that are relevant to the topic, specifically relevant to the Ethiopian context.

1.9. ORGANIZATION OF THE STUDY

This paper is organized into five chapters. Chapter one comprises the introduction parts of the paper, which includes background of the study, statement of the problem, research question, objective of the study, significance of results, delimitation/scope of the study, limitation of the study, operational definitions of key terms and organization of the study. Chapter two presents literatures that can help to frame the study. It included theoretical framework and country specific studies. Chapter three discusses the methodology adopted by the study that is important to address the objectives of the study. It discusses the research design and approach, study population and sample size, sampling technique, data source and collection method, data validity and reliability, method of data analysis and ethical consideration. Chapter four incorporates the data analysis and discussion part. Finally, chapter five presents the summary, conclusion and recommendation part of the thesis.

CHAPTER TWO

2. REVIEW OF RELATED LITERATURES

This part of the study attempts to present a brief theoretical framework, views of different scholars which are one way or the other pertinent to the study as well as ends with presentation of the knowledge gap in Ethiopia banking industry and conceptual framework are presented in this section.

2.1. Theoretical Review

2.1.1. Concepts and definition of Islamic Banking

Many scholars²² gives various meaning to this term Islamic banking. It refers to a system of banking or banking activity that is consistent with the principles of the Shari'ah (Islamic rulings) and its practical application through the development of Islamic economics. The principles which emphasize moral and ethical values in all dealings have wide universal appeal. Shari'ah prohibits the payment or acceptance of interest charges for the lending and accepting of money, as well as carrying out trade and other activities that provide goods or services considered contrary to its principles. While these principles were used as the basis for a flourishing economy in earlier times, it is only in the late 20th century that a number of Islamic banks were formed to provide an alternative basis to Muslims although Islamic banking is not restricted to Muslims. (www.islamic-banking.com).

²³ and that is structured in a convoluted version of buy/sell, in which the seller changes ownership to the bank and then the bank sells it to the eventual buyer. Many participants in „Islamic“ banking business thought, with good intentions, that these guidelines made the contract Islamic.

Islamic banking according to Sandrararajan, (2011) consists of mobilizing funds through noninterest bearing deposits and through investment deposits based on “profit-sharing and loss-bearing” contracts and channeling these funds to finance permissible (under the Shari’ah law) investments activities, using various forms of Islamic finance contracts.

Islamic banking as described according to Yahiya Abdul-Rahman, (2010) it is a brand of banking that is socially responsible and is community-based in both spirit and intent. This brand of banking is the

manifestation of Judeo-Christian-Islamic values. In addition to this Islamic banking does not discriminate, because discrimination in service and financing and in dealing with others is a major sin in all Abraham faiths.

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

2.1.1. Interest (Riba)

Interest is the component in the banking concept. According to Mohammed and Mahdi, (2010) interest is one of the most effective factors for deciding to deposit in banking system. Herald and Heiko, (2009) also mentioned interest as one of the determining factor for commercial bank deposit and it is important element of Islamic economic society. All covers the meaning to load additional money on funds lent to borrower. As such it is fundamental to understand the Islamic economics to have fair idea about Islamic banking.

Kahn, (1986) also defines an interest-based, or traditional, banking system is symmetrical, with interest being paid and charged for the use of funds. In addition to this Iqbal and Mirkahor, (2011) interest simply refers to the “premium” that must be paid by the borrower to the lender along with the principal amount as a condition for the loan or for an extension in the duration of loan.

Interest is a contractual instrument by which the lender collects a predetermined interest added to the principal amount it has lent out. The principal amount can be money, gold, silver, or fungibles including wheat, barley, dates, etc (Qasaymeh, 2011).

2.1.2. Prohibition of interest

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

Prohibition of interest is not exclusive to Muslims. The origin of norms in Christianity prohibits interest. It is said in the Bible 'Thou shalt not lend upon usury to thy brother, usury of money, usury of victuals, usury Of anything that is lent upon usury' (The Holy Bible (King James Version) Old Testament, Deuteronomy 23: 19 183)

2.1.3. Islamic banking Service Models

2.1.4. Islamic banking window service

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

2.1.4.1. Subsidiary/branch Islamic banking service

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

2.1.4.2. Full-fledged Islamic banking service

Once a conventional bank has operated an Islamic window for some time and has gathered a sizeable customer base for its Islamic banking service activities, it may decide to establish an Islamic subsidiary, or even fully convert into a full-fledged Islamic bank. By following either of these two routes, the bank may benefit from economies of scope and concentration of knowledge and expertise. The bank will be able to offer a wider range of Shariah-compliant banking products than through the Islamic window alone. For example, it may be better equipped to fully engage in Islamic investment banking activities, such as underwriting sukuk (bond) issuances or managing Shariah-compliant investment and hedge funds, or to manage its own treasury and money market operations. (Sole, 2007).

2.1.5. Sources of Funds for Islamic banks

The institution of Islamic banking forms a cornerstone required to create an Islamic financial environment. Islamic banking plays a vital role in the economic development of Islamic societies by facilitating the mobilization and allocation of dormant savings, which used to be intentionally kept out of interest-based financial channels. Islamic banking institutions utilize various mechanisms for mobilizing funds from the general public, depending on the institution's organization, geographic location, market strategy, capital resources and charter. (Delwin A. Roy, 1991:438).

Islamic banks are deposit-taking institutions but do not pay interest on deposits. Their sources of funds classified as either include shareholder investments, savings accounts, current accounts, and investment accounts. The source of funds in Islamic bank can be used for borrowing by corporate investors to fund specific project. (Bala et.al (2009: 24).

2.1.5.2.Shareholder Funds

An Islamic bank may raise an initial equity funds by following the principles of musharaka (equity participation) under this principle, the capital owners enter in to a partnership with the bank by contributing equity in return for a share of banks profit or loss on the basis of predetermined ratio. (Bala et.al (2009: 23).

2.1.5.2.Wadiah Saving accounts

Islamic banks offer saving account with an aim of drawing in and persuading depositors to enjoy this safe keeping facility. Bank customers normally choose saving accounts because of fulfilling precautionary motives (Haron& Wan-Azmi, 2008).

Islamic banks practice the principle of wadia in operating customer saving account.

The bank may request permission to use customer funds deposited in these accounts as long as these funds remain within the banks discretion. The bank does not share with the customer profit earned from the use of customer funds deposited in these accounts funds but does guarantee the customer deposits. The bank however reward customer with gift as a token of its appreciation for being allowed to use the funds. (Bala et. al (2009: 25).

The situation is very different in the Islamic banks. Here too the depositor's first aim is to keep his savings in safe custody. Islamic bankers divide the conventional savings account into two categories. Savings account and investment account. The investment accounts operate fully under the PLS scheme -- capital is not guaranteed, neither is there any pre-fixed return. Under the savings account the nominal value of the deposit is guaranteed, but they receive no further guaranteed returns. Banks may consider funds under the savings accounts too as part of their resources and use it to create assets (Abdul-Gafoor, 1995:14).

This is theory. In practice, however, the banks prefer, encourage and emphasize the investment accounts. This is because since their assets operate under the PLS scheme they might incur losses on these assets which losses they cannot pass onto the savings accounts depositors on account of the capital guarantee on these accounts. In the process the first aim of the depositor is pushed aside and the basic rule of commercial banking --capital guarantee-- is broken (Abdul-Gafoor, 1995:14).

It is suggested that all Islamic banks guarantee the capital under their savings accounts. This will satisfy the primary need and expectation of an important section of the depositors and, in Muslim countries

where both Islamic and conventional banks co-exist, will induce more depositors to bank with the Islamic banks. At the same time, it will remove the major objection to establishing Islamic banks in non-Muslim countries. Siddiqi, (1980:219.).

2.1.5.3. Current accounts

The current account is a deposit account that can be used for business or personal purpose and like a saving account. Account holders are not guaranteed and return for keeping their funds with the bank, but they may be rewarded a gift. The primary distinction between current account and saving account is that the minimum balance limits and withdrawals are more flexible for current accounts. Bala et.al, (2009: 25) In addition to this according to Haron& Wan-Azmi, (2008) current accounts also known as checking accounts, meaning cheque is used to make several type of payments.

Current accounts are demand deposit accounts kept with the bank on custodial arrangements and are repayable in full on demand. Current accounts are based on the principle of wadia (trust or safe keeping) or amanah (trust), creating an agency contract for the purpose of protecting and safekeeping the depositor's assets. (Iqbal and Mirkahor, 2011:154).

2.1.5.4. Investment account deposits

According to Tabir, (2007:81) Investment deposits represent the case when owners of the fund seek a return on their funds and are willing to spare these funds for an agreed period. These accounts also operate on the principle of mudarabah, but the modes of investment of the funds and distribution of the profits are customized to suit the needs of the clients. In general, these accounts are linked to special investment opportunities identified by the bank. These opportunities have a specific size and maturity and result from the bank's participation in a pool of investment, private equity, joint venture or a fund. (Iqbal and Mirkahor, 2011:154).

2.1.5.5. Investment deposits can have various deposit arrangement options

(a). Investment deposit under Mudarabah Option.

A mudarabah transaction requires that the contract be explicit on the following matters: goal or purpose of the mudarabah, its tenure, role function of the concerned parties, profit-sharing ratio, principle for sharing losses, the extent to which indebtedness can be created in the name of the mudarabah and the principle for final settlement There can be more than one line of mu darabah deposits in order to address diverse goals and concerns of the depositors. Each such line of deposits can be for a distinct purpose, and has separate starting and maturity dates. (Sayeed, 2007:87).

(b).Investment deposit under Musharakah deposit option

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

(c).Investment deposit under Ijara Option

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

2.1.6.Uses of Financial resources in Islamic Banking

Financial intermediation is the major function of modern banking system. Financial intermediation means taking funds from people who have more than they need at this juncture in time and providing those funds to persons who need them for their economic transactions and activities. (Hassen and Lewis, 2007:279).

According to Yahiya Abdurahman, (2010) Islamic banking pays close attention as to whom and what to finance. Islamic banks (IFB) do not, for example, finance alcohol- and gambling-related businesses, such as liquor stores or gambling casinos. It also does not finance environmentally irresponsible companies and businesses that are not fair to their employees.

IFB banking does not finance speculative activities that are focused on making money out of money, based on speculations in the different financial, commodities, and real estate markets. It is community banking at heart. It believes in community development. It considers its role to be a qualified professional entity that is sound, safe, responsible, and trustworthy to attract the deposits and savings of the community. (Abdulrahman, 2010:198) .

Islamic banks offer a broad spectrum of financial structures ranging from simple sharia compliant retail products such as saving and current accounts to leasing trust finances and large scale infrastructure financing. (Balaet. Al, (2009: 26).

2.1.6.1.Murabah Financing

Murabah financing is a popular method used by Islamic banks to meet short term trade financing needs for its customers. It is often referred to us “cost Plus-financing “or mark up financing. In this type of financing the bank agrees to fund the purchase of specific asset or goods from a supplier at the request of customers up on acquiring the asset, the bank sells it to the customer at the predetermined mark up. Murabah financing is the back bone of contemporary Islamic banking. Bala et.al, (2009: 30).

An advantage of murabaha is that an Islamic bank is usually sounder financially than its customers, so it can obtain discounts on purchases for its clients. If goods were purchased for several clients at one time, the discount may be even larger, which controls costs for clients and contributes to the overall success of murabaha. (Roy, 1991:434).

2.1.6.2. Musharakah Financing

Musharakah is a type of partnership financing in which one of the partners is an Islamic bank. Profits and losses are shared on predetermined formula. Profit sharing need not be based on the proportion of the shares owned, but liability of loss is limited to the contributions of the shareholders. In other words, investors cannot be liable for more than the amount of capital they invest in the partnership. (Shanmugan and Gupta, 2007).

Musharakah is an Arabic word which means sharing, and relates to the sharing of profits or losses resulting from joint ventures or partnerships. In the business environment musharakah is a partnership contract based upon equity participation, by which partners provide capital under joint venture. The sharing of profits and losses resulting from such partnerships is pre-determined and partners may co-manage the enterprise. The bank may act as a passive partner while the customer manages the venture (South Africa art; 281:35).

2.1.6.3. Mudarabah Financing

in which an Islamic bank entrusts funds to an entrepreneur. Which is also known as trust financing? The arrangement enables the entrepreneur to carry out business projects. Profits are distributed between the bank and entrepreneur on predetermined ratio. All losses are born by the supplier of the fund (bank) as long as there has been negligence on the part of the entrepreneur. (Bala et.al (2009: 34).

2.1.6.4. Ijarah

Ijara means to give something on a lent. Under the ijara arrangement the bank purchases a tangible asset based on the clients' specification and leases it to the client. The bank gives the right to use the asset to lessee as well as physical position of the asset. In return the lessee makes rental payments based on the agreed schedule. Up on the expiration of the lease the lessee returns the asset to the bank (lessor). Ijara is typically used for high cost assets with long life span. (Bala et.al (2009: 32).

According to Delwin A. Roy, (1991:434) Ijara is a source of short- or medium-term finance that is used by businesses in fields such as construction, for the financing of heavy machinery or other equipment. The bank purchases goods such as construction equipment and then leases them to the client on a specified sum, fixed-period basis. Monthly payments by the client are fixed at rates which cover all or

most of the original purchase price of the item over the period of the contract. A contract can incorporate both murabaha and ijara if the eventual sale to the client is agreed upon at the time the original contract is made.

2.1.6.5. Bai' bithman Ajil (BBA)

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

2.1.6.6. Al-Ijarathumna al bai (AITAB)

Financing on this modality essentially an ijara (leasing) contract combined with bai-purchase contract. Under the first contract, the purchaser (customer) leases the goods from the owner (the Bank) at an agreed rental price for specified period. Upon expiration of the leasing, the purchaser enters into a second contract to purchase the goods from the owner at an agreed price. (Bala et al (2009: 34).

2.1.6.7. Istisna

In istisna financing, a commodity is purchased or sold before it comes in to existence, which is an exception to the sharia principle requiring that an underlying asset be present in order for a financial transaction to be taken (Bala et al (2009: 34).

2.1.6.8. Tawaruk

In this structure the bank directly or indirectly buys an asset and immediately sells it to a customer on a differed payment basis. The customer then sales the same asset to a third party for immediate delivery of and payment. (Bala et al (2009: 34).

2.1.6.9. Bai Salam

Financing is a forward financing transaction frequently used in the agriculture industry. In this structure, the bank purchases specified asset in advance of a predetermined delivery date. Typically the bank receives a discount for the advance payment plus a profit margin. (Bala et al (2009: 34).

2.1.6.9. Qard Hassen

This refers a gratuitous, or charitable, contract in which the borrower is required to repay only the amount borrowed with no profit (mark up) to the lender. It is a form of benevolent financing extended on a good will basis. Quad hassen literally mean good loan. (Bala et al (2009: 34).

2.2. Empirical Evidence

At international experience, many studies on challenges of Interest free/Islamic banking have been conducted. These studies have shown that Islamic banking in Muslim or non-Muslim countries have faced a number of challenges, (Iqbal, Ahmed & Khan 1998, Bello & Abubakar 2014, Njamike 2010, Ibrahim 2012, Kinyanjui 2013, Jabr 2003, Saleh and Zeitun (2005) & Karbhari, Naser & Shahin, 2004). Thus, Ethiopia is not an exception.

However, to the best knowledge of the researcher, there is paucity of research work on the topic under study in Ethiopian context and the researcher believed this will make the study to contribute knowledge and fill the gap in the area.

According to studies conducted on challenges of IFB at international level, the identified challenges in the researchers' respective countries differ due to the difference in each country's social, economical, cultural, religious, political, and technological and other factors though there are some common challenges to these countries. Thus, the researcher has reviewed some of the studies and has presented as follows.

Iqbal, Ahmed & Khan (1998) has divided the challenges of Islamic banking as institutional and operational challenges. The institutional challenges are poor institutional framework, inadequate legal framework and supervisory policies, poor supervisory framework, disparity in accounting standards, lack of equity institutions, absent of organized secondary financial market, and lack of short term market placement of funds. While the operational challenges are improper financial engineering, lack of teaching, training, research and development in this institution, lack of profit sharing finance, inability to adequately mobilize deposits, competition, and finally globalization.

The study made by Bello & Abubakar (2014) revealed that challenges of interest free banking in Nigeria are: inappropriate institutional framework, inadequate legal framework, lack of equity institutions, poor supervisory framework, disparity in accounting standard, lack of secondary financial markets, lack of short-term financial instruments and institutions religious and cultural differences, lack of innovations in financial products, lack of profit sharing finance, Shariah related issues, inadequate manpower with the requisite knowledge, lack of awareness and competition.

According to Njamike (2010) the major problems and challenges in introducing Islamic banking in Zimbabwe are political intervention in the selection of borrowers, financial instability, inability of the government to restore law and order in the country, resistance from the banking community, inadequate infrastructure for information dissemination, inconsistency in policy making and implementation of the fiscal and monetary authorities, Central bank control and supervision of Islamic banking with unqualified persons in Islamic finance, absence of Islamic interbank, misperception, current political and economic situation, and default culture.

The research made by Ibrahim (2012) showed that legal frame work, manpower, competition, financial literacy, religion and moral hazard constitute significant constraints on the operation of the interest-free window. and to overcome these challenges and improve the performance of the interest free banking system his work has recommended for vigorous public enlightenment (sensitization) program on interest-free banking, intensive manpower training and development, promotional efforts, introduction of innovative services and products, progressive monitoring and supervision of business partners/ clients, cooperation with other interest free institutions and relevant stakeholders, expansion of the scope of the operational guidelines of non-interest banking by the Central Bank of Nigeria and active government participation in Interest-Free Banking at all levels.

Kinyanjui (2013) argue that lack of legal support, lack of standard financial contracts and products, nature of Islamic banking, lack of proper mechanism of transparency and disclosure to the public, shortage of experts in Islamic banking, absence of accounting (and auditing) standards pertinent to Islamic banks, and potential conflicts with central banks are the challenges of interest free banking in Kenya.

Study conducted by Jabr (2003) in the Palestinian territories concludes that challenges of Islamic banks are: lack of adequate banking law for Islamic banking; existence of unproductive money; lack of awareness; lack of operational difference between Islamic and conventional banks; Islamic banking lacks the ability to channel deposits into long-term investment; lack of experience in Islamic Shariah; excessive short-term financial instrument; inability to make use of Mudaraba and Musharaka financial institutions; inferior technical resources and technology; Islamic banks are compel to recruit staff trained in traditional banking; inability to differentiate ownership from management; and lack of financial innovations.

Saleh and Zeitun (2005) find that lack of public awareness and acceptance, lack of research and development institutions, inadequate manpower, and high competition from conventional banks offering Islamic windows are the major challenges of Islamic banking in Lebanon.

The study conducted in the United Kingdom regarding problems, challenges and opportunities of Islamic banking has identified the main problem as lack of expert staff and competition from the conventional banks. It has been concluded that the e-banking can play pivotal role for the success of Islamic banking. There is also a need to recruit professional individuals who have the knowhow about the Islamic banking (Karbhari, Naser&Shahin, 2004).

The research works reviewed so far were conducted in different country which is based on the respective countries reality. However, the empirical findings of all of these researchers agree on one thing, that 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. Thus, the researcher is motivated to identify challenges to deliver and use of IFB product in the Ethiopian context.

2.2.1. Empirical Literature Review-Ethiopian Context

In Ethiopia, IFB is a recent phenomenon. As a result, there is little empirical literature on the area. The studies conducted so far include the following: Mohammed (2012) has conducted research on „Islamic Banking: Prospects, Opportunities and Challenges in Ethiopia“, research work conducted by Teferi (2015) was on „contribution of IFB to economic development and its prospect in Ethiopia“; on the other hand, study conducted by Debebe (2015) is on „Factors Affecting Customers to Use Interest Free Banking in Ethiopia“. Accordingly, their findings in brief and the gap thereto is presented as follows.

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 and the respondents do not have real life experience on interest free banking products delivery and use.

Debebe (2015), has conducted a study on „Factors Affecting Customers to Use Interest Free Banking in Ethiopia“. His study has centered on „customers“ intention and willingness to use interest free banking“. The results showed that perceived relative advantage, perceived compatibility, customers“ level of awareness and subjective norm have a significant positive impact on the attitude towards interest free banking in commercial bank of Ethiopia. This study is about impact assessment on the attitude towards IFB usage which does not address the current problem at hand.

On the other hand Teferi“s (2015) study is about „Contribution of IFB to economic development and its prospect in Ethiopia“. He assessed the contribution in including the Muslim population in the banking (financial system) to the economic development and GDP growth. Except research conducted by Mohammed, the other studies are not related to the current study.

Therefore, except in the international studies which took realities of other countries, to the best knowledge of the researcher, there is paucity of empirical study in Ethiopian context related to the scope of service and challenges of providing and using IFB products. This study, therefore, attempts to fill this research gap by investigating the challenge faced by both service providers and users of IFB products and scope of service provided by Ethiopian banking through IFBW including whether there is unmet demand of users, awareness of customers and capacity of bank as these have been identified in the literature as major challenges, and commercial bank of Ethiopia is taken as a case study.

IFB industry is highly nascent in comparison to the conventional banking industry. It is striving to develop its own institutional, operational, and regulatory infrastructures in order to grow and prosper (Khan &Bhatti 2008).

Abdulmajidet. al (2010) writes about the efficiency in Islamic banking and conventional: banking an international comparison investigates the efficiency of Islamic and conventional banks using an output distance approach . They obtain measures of efficiency after allowing the environmental influences such as country microeconomic conditions accessibility of banking services and the bank type. The parameter estimates highlight that Islamic banks appear to be associated with higher input usage. Furthermore by allowing for bank size and international differences in the underlying inefficiency distributions, it demonstrate statically significant differences in inefficiency related to these factors even after controlling for specific environmental characteristics and Islamic banking. Due to this Islamic banks are found to have high returns to scale than conventional banks. While this suggests that Islamic banks may benefit from increased scale, they emphasis and the results suggest that identifying and overcoming the factors that cause Islamic banks to have relatively low potential output for a given input usage levels will be the key challenges for Islamic banking in the coming decades.

Ismaeil, et al. (2010) writes the recent development of insolvency of many conventional banks made the Central Banks to initiate the acquisition of some banks while others were ordered to merge. This was a strong signal to seek for alternative banking system. However, the advocacy for the Islamic banking system as alternative to conventional banking system has been received with mixed feelings.

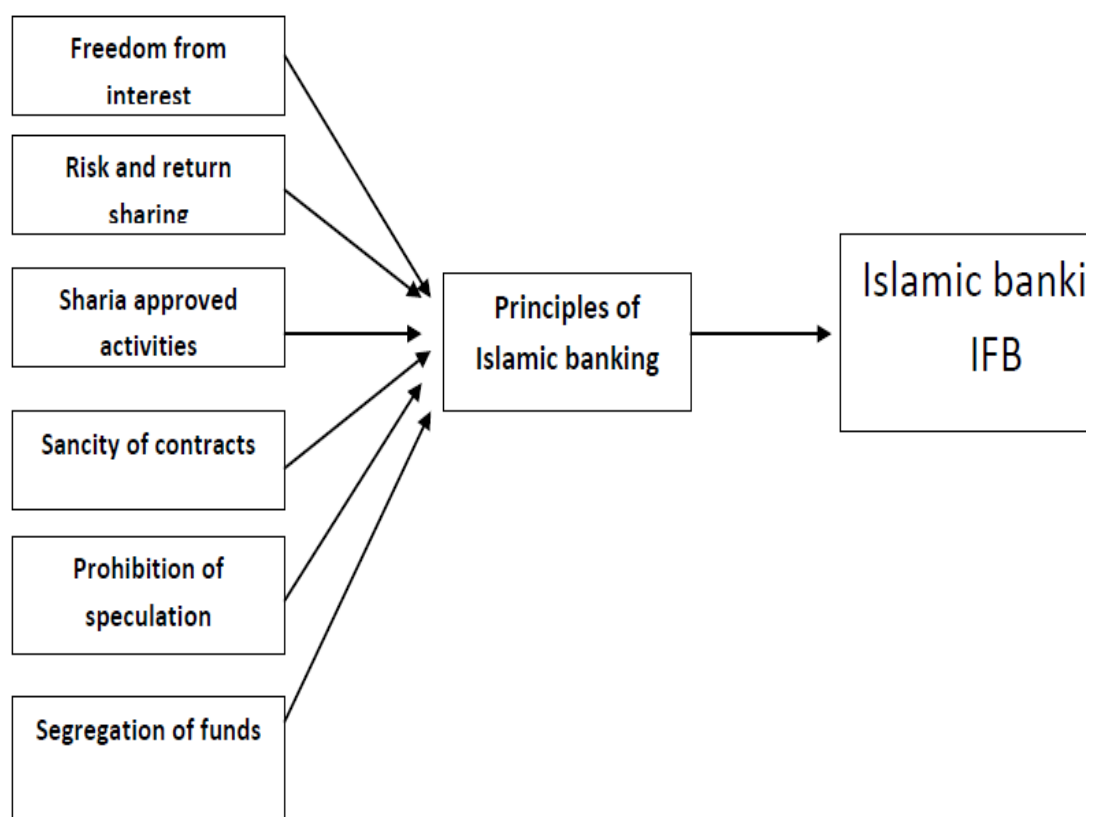
Islamic financial system in perspective, operations of Islamic financial system as well as the challenges and prospects for the country's economy. It posits that awareness, manpower, legal framework, societal belief, cash requirements as some of the challenges while economic growth, attraction of investors, and fostering of egalitarian society are the likely prospects for the establishment of the Islamic banking. It concludes that Islamic banking system will bring transformation to all sectors of the economy vis-a viz eradication of poverty, equitable distribution of income and employment opportunities in the country through effective mobilization and allocation of capital.

Roddney Wilson, (2000) writes that Islamic finance has become increasingly significant in financial centers in the West, notably London, despite the regulatory hurdles presented by operating in a non Muslim financial environment. The growth of Islamic finance partly reflects demand from Muslim resident and non-resident clients for Islamic deposit facilities and fund management services which involve shari'ah compliance. At the same time Islamic financing methods are viewed as a challenge and opportunity by Western bankers, many of whom have sought to get involved in this growing industry. In client driven societies there is willingness by those in financial services to listen and learn from the experiences of Islamic banks, which in the longer run may bring a major breakthrough for Islamic banking at the retail level in the West.

Hanudin Amin, (2013) in his article of some view points of Islamic banking retail deposit products in Malaysia writes that our illuminations are centered on the current accounts, saving accounts and

investment accounts. A brief note on negotiable Islamic certificate of deposits (NICD) is also provided. These deposit products are examined in terms of their definitions, features and calculations. On the same note, some discrepancies between deposit facilities offered by Islamic and conventional banks are exposed. The purpose of such exposition is to provide novice readers a basic but profound explanation concerning the difference between the two categories of deposit facilities.

2.3. Conceptual framework



Source, own survey ,2019

2.3.1.Principles of Islamic Banking Service

According to Bala et.al, (2009) Islamic finance is based on the themes of community banking, ethical banking, and socially responsible investing. Its goal is to be an ethical, indigenous, and equitable mode of finance.

The five key principles that govern Islamic banking are as follows

2.3.1.1.Freedom from interest

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

2.3.1.2.Risk-and-Return Sharing

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

An Islamic banking service provider shares in the profit and loss of each borrower's business transaction. In turn, the bank divides its share of profits and losses with its general and special investors who have deposited funds in the bank. (Bala et.al, 2009).

Shari'a prohibits Muslims from earning income by charging interest but permits income generation through the sharing of risks and rewards between the parties to a transaction. This profit- sharing mechanism is believed to encourage people to become partners and work together rather than to enter into a creditor-debtor relationship. Partnership promotes mutual responsibility for the outcome of the financed project, which is believed to increase the likelihood of success of the venture. A tangential aim of the partnership approach is that such increases in successful projects also provide stimulus to the economy. (Bala et.al, (2009).

2.3.1.3. Shari'a-Approved Activities

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

2.3.1.4. Sanctity of Contract

Yahiya Abdul-Rahman, (2010:200) explains that Interest free banking service providers cannot finance alcohol-related businesses, gaming, gambling, polluting businesses, or other unethical activities. They finance businesses in a fair and just way and serve all customers of all backgrounds. They scrutinize the businesses they finance to ensure that the business owners treat their employees fairly and without discrimination.

2.3.1.5. Prohibition of speculative behavior

Islamic financial system discourages hoarding and prohibits transactions featuring extreme uncertainty, gambling, and risk. (Iqbal and Mirkahor, 2011:10) Islam views contractual obligations and the related full disclosure of information as a sacred duty. Full disclosure is intended to reduce financial speculation (gharar), which is strictly prohibited by Islam, by providing as much information as possible for investors to make accurate assessments about the risks and rewards of an investment. The conditions that are necessary for a contract to be valid include a competent understanding of the underlying asset(s) and the profit-sharing ratio, as well as the presence of a willing buyer and seller. Contracts must also not offend Islamic religious and moral principles; if they do, they will be deemed illegal and unenforceable (Bala et.al, (2009: 7-8).

2.3.1.6. Segregation of Funds

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

Therefore, in order to ensure compliance with Islamic principles, conventional banks wishing to offer IB products must guarantee and publicize that the funds devoted to conventional activities will not be mixed with those destined for Islamic activities. In operational terms, this requires that banks establish different capital funds, accounts, and reporting systems for each type of activity. In this sense then, when a

conventional bank opens an Islamic window, to a large degree, it is in fact establishing a separate entity from the rest of the bank. (Sole, 2007: 5).

2.3.2. Functional roles Islamic banks play

Financial institutions, Islamic or otherwise, play indispensable roles in financial systems. The first role is providing support for various financial markets. For instance, exchanges of various types are institutions that facilitate the functioning of markets, by setting rules of trading and providing clearinghouse and margin logistical support. (Iqbal and Mirkahor, 2011).

2.3.3. Efficient Capital Mobilization

The ultimate function of a financial system is to perform efficient resource allocation through capital mobilization between savers and users of capital. This function is performed efficiently when the economic agents have access to capital through a liquid market for varying maturity structures; that is, from the very short to the very long term needs. Access to capital has to be easy, transparent, and cost effective, with minimal transaction costs and free of information asymmetries. (Iqbal and Mirkahor, 2011).

2.3.4. Efficient Risk Allocation

Under uncertainty and volatile market conditions, the function of risk sharing, risk transfer, and risk pooling becomes critical in a financial system. In the absence of such functionality, the financial system will discourage projects that attract high risk but also high value-added to the economy. The “insurance” function is vital for any financial system and the availability of efficient risk sharing facilities promotes diversification and allocation efficiencies. (Iqbal and Mirkahor, 2011).

2.3.5. Pooling of Resources and Diversification of Ownership

A financial system provides a mechanism for the pooling of funds to undertake large-scale indivisible investments that may be beyond the scope of The Islamic Financial System any one individual. They also allow individual households to participate in investments that require large lump sums by pooling their funds and then subdividing shares in the investment. The pooling of funds allows for a redistribution of risk as well as the separation of ownership and management. (Iqbal and Mirkahor, 2011).

2.3.6. Efficient Contracting

A financial system should promote financial contracting that minimizes incentive and agency problems arising from modern contractual arrangements among owners, managers, regulators, and other stakeholders. Both financial institutions and financial markets have distinct incentive problems arising from the conflicting interests of investors, managers, owners, and regulators. A financial system should

therefore encourage financial contracting which minimizes distortion and enhances allocation efficiency. (Iqbal and Mirkahor, 2011).

2.3.7. Transparency and Price Discovery

A financial system should promote the efficient processing of information such that all available information pertaining to the value of an asset is available at the lowest cost and is reflected in the value or price of the asset. This price-discovery function leads capital being allocated to the most productive use in the most efficient manner. (Iqbal and Mirkahor, 2011).

2.3.8. Better Governance and Control

Advances in modern finance have highlighted the importance of good governance, especially with respect to financial institutions and markets. A financial system should facilitate transparent governance and promote discipline in management through external pressures or threats, such as takeovers, so that any misallocation and misappropriation is minimized. (Iqbal and Mirkahor, 2011).

2.3.9. Operational Efficiency

A financial system should provide for the smooth operation of financial intermediaries and financial markets by minimizing any operational risk due to failures in processes, settlement, clearing, and electronic communication. The smooth and transparent execution of financial transactions develops reputation and “trust” among economic players and therefore is beneficial

CHAPTER THREE

3.1. RESEARCH DESIGN AND APPROACH

A research design is the conceptual framework within which a research was conducted. To achieve the above mentioned research objectives, descriptive research design was adopted. In addition, the study adopted a quantitative research approach in addressing the research objectives of the study.

3.1. Design of the study

This chapter presents the underlying principles of research methodology and design. The purpose is to choose the appropriate research method for the study. Keeping the purpose of this study, the researcher has adopted both quantitative and qualitative approach. Conducting mixed methods research involves collecting, analyzing, and interpreting quantitative and qualitative data in a single study or in a series of studies that investigate the same underlying phenomenon (Onwuegbuzie & Leech as cited in Debebe, 2015). The study employed descriptive research based on survey and the data are of cross sectional type to construct an empirical finding on the challenges to deliver and use interest free banking products in Ethiopia with particular reference to Awash bank.

3.2. Data sources

In this study, both primary and secondary sources were used to gather information about the challenges and prospects on Interest free banking service Awash bank to south district.

3.3. Instruments of Data Collection

There are two kinds of data sources, primary and secondary sources. This study would be used both Sources to obtain data. From the primary sources data were collected through Questionnaire and interview. In addition, data would extract from the bank's report.

Questionnaires have the advantage of obtaining data more efficiently in terms of researcher time, energy and cost and it is one of the most appropriate data collection instruments for survey research. Moreover, questionnaire, as a data collection instrument facilitates easier coding and analysis of the collected data. The researcher would be collected primary data through administering questionnaire and interview. The questionnaire would be involve both structured and unstructured questions to collect data from IFB customer and staff.

3.4 .population of the study

According to data from, there are 9 districts and over 402 branches. Therefore, the target population of this study would be the employees of awash bank south District clerical staffs in selected branch. Among of 9(nine) districts the researcher would be select awash bank south districts due to it's largest number of branch distribution in a given districts.

The target population 490. Among them the sample was 223.

3.4 Sample Size and Sampling Techniques

The Researcher was used stratified sampling technic. Clerical staff of the awash bank selected branches under south district is subjects for the study and there are 42(forty two) branches distributed in outline branches in these particular given districts. The researcher would be propose to select south district due to it's largest number of branch distribution among of the given district and the nearness of the district to the researchers living and working area. Based on the number of customers they serve and amount of transaction they handle, the branches in Awash bank s.c are classified in. The research participants or the population of the study would be limit to clerical employees of the awash bank s.c south district, therefore all selected branches in south district would be selected for the survey by considering the researcher distributing the questionnaire. Accordingly, Hossana, Alaba-Kulito, Werabe, and Areka branches are selected purposively, representing grade 1, 2, 3, and 4 respectively. The study is targeted only at clerical employees of the bank so that they are able to fill questionnaire and understand items in the questionnaire. The existing data indicates that the number of clerical employees under the district as of December 2018 has reached 490. An appropriate sample size for this number of population (i.e. 490 individuals) is 223.

In calculating the sample size the researcher would be used by Slovin's formula (Slovin, 2006). It is calculated as follows

$$n = \frac{N}{1 + N(e)^2}$$

$$\frac{490}{1 + 490(0.05)^2} = 223$$

Where n: is the sample size (223)

N: is the population size (490)

e: is error term (0.05)

Using this formula, considering 5 percent margin of error, 90 percent level of precision and a proportion of 90 percent for the maximum possible degree of variability the sample size taken from the population is 223 respondents.

Table 1.1 Depending on organizational structure south district branches selected is as follows

No	Branch's	Grade	Areas
1	Hossana	1	Outline branch
2	Alaba-Kulito	2	Outline branch
3	Werabe	3	Outline branch
4	Areka	4	Outline branch

Hence, depending on the organizational structure and branch distribution, the combination of stratified and purposive sampling technique would be used in the study. Stratified sampling technique would be used to categories branches of the bank by their grade as grade 1, grade 2, grade 3, and grade 4. Purposive sampling method would be helping the researcher to select the branches which would be suitable for collecting the required data.

Table: 1.2. Selected bank

S	The selected bank	Total number of employee..	Sample size
1	Hossana	N1=160	$n1 = 223x \frac{55}{460} = 27$
2	Alaba-kuilto	N2=160	$n2 = 223x \frac{55}{460} = 27$
3	Warabe	N3=100	$n3 = 223x \frac{60}{460} = 29$
4	Arka	N4=100	$n4 = 223x \frac{53}{460} = 26$

Proportions of N1....Nk and n1.....nk will be taken as $n1 = 210x \frac{N1}{N}$

3.1.2 Methodology of data analysis

The collected data would be rearrange and summarize based on the respondent's feedback. The data would be analyze by using descriptive statistics and presented using tables and percentage.

Data Analysis

Different statistical techniques would be employed on the basis of the nature of the data collected. Consequently, the data collected from the respondents would be analyzed quantitatively and qualitatively.

The study would address to empirically identify the challenges and prospects on Interest free banking services with particular reference to Awash Bank South District

CHAPTER FOUR

DATA PRESENTATION, INTERPRETATION AND ANALYSIS

This chapter deals with the data presentation, interpretation and analysis of the study. It has two parts. The first is background of the respondents; and the second part deals with major components on challenges and prospects of Islamic banking (interest free banking) in awash bank s.c south district.

The implementation of the service of interest free banking service in the country encountered challenges and has future growth prospect, which can be observed in terms of the perspectives of the participants..

To achieve the main objectives of the research a total of 230 questionnaires were prepared and distributed to Employees, supervisors, and managers of banks. Out of these questionnaires, 223 of them were collected with a response rate of 85%. However, only 223 responses were valid with complete answers. Therefore, only 223 questionnaires were used for further analysis.

4.1 respondents background

Description of the characteristics of the sample target population gives some basic information about the sample and their composition. The demographic characteristics include: Gender, Work experience, level of education, and occupation. This aspect of the analysis deals with the personal data of respondents. The table below shows the details of background information of the respondents.

Table 4:1 Respondents background

Variables	VARIABLE CATAGORIES	Frequency	Percent
Gender	Male	162	71.4
	Female	61	26.9
Age	18-25	89	39.2
	26-35	56	24.7
	36-45	10	4.4
	Above 45	68	30
Educational level	Diploma	37	16.3
	Degree	160	70.5
	Master degree	26	11.5
Religion	Muslim	82	36.1
	Non-Muslim	141	62.1
Bank experience	1-4	138	60.8
	5-10	62	27.3
	11-15	23	10.1

4.1 Gender

Among the total respondents i.e. 162, (71.4%) of them were male and the remaining 61 (26.7%) were female. This shows that the number of female staff is less by more than half from the number of male staff which means there is gender imbalance in the organizations.

4.2 Age

Regarding the age group of the respondents, the larger portion of the respondents that is 56 (24.7%) falls within the age group of 26 to 35. Age group from 18 to 25, 36 to 45 and above 45 hold 89 (39.2%), 10 (4.4) and 68 (30%) number of respondents respectively. From this we can say that banks in our study are filled with more younger, energetic and productive manpower that can be able to transform the mission and vision of the organization into reality.

4.3 Education

Concerning educational status of the respondents, staffs who are degree graduates have the largest portion which is around 160 (70.5%), among the total respondents, 26(11.5%) of them have master's degrees. From the above table we can see that less number from the selected respondents have diploma. The fact that almost all of the respondents being educated in different levels it is believed that they can easily understand the questionnaire as desired by the researcher.

4.4. Religion

Concerning religion status of the respondents the large number of respondents that is 141 (62.10%) were non-Muslim religion, among the total respondents 82 (36.1) Muslim. These shows that the number of Muslim staff is less by more than half from the number of non-Muslim staff which means there is religion imbalance in the organizations.

4.5 Bank experience

Based on the data collected through questionnaire, the large portion of respondents 138(60.8%) fall within the range of 1 to 4 years of service, the second highest percent 62 (27.3%) of the respondents have between 5 to 10 years of experience, the rest 23 (10.1%) of respondents have

11 to 15 years. It is the researcher believe that these combination of the respondents were good enough in finding the accurate information because the majority of respondents have one to four years of experience.

In general the above table which is characteristics of the respondents shows that the study is represented by those who are qualified in understanding the questionnaire as well as the subject matter, most of them are at their younger age and acquired experience which helps them to respond their true feeling without fear of losing their job and those who have an experience of more than four years in banks, again which helps them to understand the practice of IFB which were implemented in various banks . As a result it is the researcher belief that the study is well represented by the respondents which helps to get the opinion of all which assures the accurate data have been secured from the respondents of the sample size.

4.2 ANALYSIS AND PRESENTATION

This section deals with the analysis and interpretation of data that obtained from the response collected through the distributed questionnaire. It also presents the data obtained via interview with the management position staff and secondary data also analyzed.

Note: SD=strongly disagree, D=disagree, N=neutral, A=agree, SA=strongly agree

4.5. EMPLOYEE AWARENESS LEVEL FOR INTEREST FREE BANKING PRODUCTS

Respondents were asked to answer certain items that would scale their assessment regarding employee awareness level for interest free banking products. The following tables show the results for respondents' frequency score and their understanding about the scales of employee awareness level for IFB products. The result is showed on tables as below.

Table.4.3 Employees' awareness about the level of IFB products

Item	Response	fre	perce	Mean	St.dv
I am aware of thetypes and features of IFB products	SD	43	18.9	3.0673	1.38848
	D	42	18.5		
	N	31	13.7		
	A	71	31.3		
	SA	36	15.9		
I know the difference between IFB products and the conventional banking products	SD	30	13.2	3.3991	1.331
	D	29	12.8		
	N	37	16.3		
	A	76	33.5		
	SA	51	22.5		
I know well the IFB products that are currently provided by the bank	SD	28	12.3	3.30	1.209
	D	28	12.3		
	N	43	18.9		
	A	97	42.7		
	SA	27	11.9		
I know that IFB products are offered to Muslims and Non-Muslims	SD	51	22.5	2.98	1.30
	D	25	11		
	N	37	16.3		
	A	96	42.3		
	SA	14	6.3		

Source: Own Survey (2019)

The result shows that, 107 (47.2%) of responded positively agree that with aware of the type and features of interest free banking products whereas 85 (37.4%) % of responded negatively disagree that aware of the type and features of interest free banking products while 31 (13.7%) of the respondents are neutral. According to above findings we can say that most of the respondents did agree with aware of the type and features of interest free banking products.

Another important item in the Employee awareness level for interest free banking products scale was whether respondent's think that there is difference between interest free banking products and the conventional banking products? The result for this question is presented as follows. As the data in Table (4.1) shows, the number of respondents that believe there is difference between interest free banking products and the conventional banking products', 127 (56%) of responded positively agree that there was difference between interest free banking products and the conventional banking products high when compared to other respondent categories. In addition, 59(26%) of the responded negatively disagree that with there was difference between interest free banking products and the conventional banking products, while 37 (16.3%) of the respondents neither agree nor disagree with the statement of there is difference between interest free banking products and the conventional banking products'. So, we can say that from this observation that significant number of respondents 127 (56%), think that knows difference between interest free banking products and the conventional banking products.

The number of respondents shows, the issue of IFB products currently provided by bank is one of the components in Employee awareness level for IFB products, the scale address whether respondents believe that there is well known the interest free banking products that are currently provided by bank ? The result for this question is presented as follows that majority of the respondents 124(54.6%) of positively agree that with the statement of there was well known the interest free banking products that are currently provided by bank, whereas 56(24.6%) of responded negatively with the statement of there is well known the interest free banking products that are currently provided by bank. And 43(18.9%) are indifferent. majority of the respondents believe that there is well known the interest free banking products that are currently provided by bank. This result provides us to observe that there is well known the interest free banking products that are currently provided by bank.

The issue of Employee awareness level for IFB products scale was whether respondent's think well known that interest free banking products are offered to Muslim and Non-Muslim? The result for this question is presented as follows.

The result shows that majority of the respondents 110(48%) of responded positively agree that with the statement of there is well known that interest free banking products are offered to Muslim and Non-Muslim, whereas 51(22.5%) of responded negatively disagree that with the statement of there is well known that interest free banking products are offered to Muslim and Non-Muslim. And 37(16.3%) are neither agree nor disagree. significant number of respondents 110 (48%), think that well known that interest free banking products are offered to Muslim and Non-Muslim..

4.6. RELIGIOUS AND CULTURAL DIFFERENCE IN ETHIOPIA

Respondents were asked to answer certain items that will scale their assessment regarding religious and cultural difference. The following tables show the results for respondents’ frequency score and their understanding about the scales of religious and cultural difference in Ethiopia. The result is showed on tables as below.

Table 4.4. Religious and cultural difference in Awash Bank s.c

Item	Res	Freq	Percent	Mean	St.dev
Our (Ethiopian) diversity in culture makes difficult to introduce FB services	SD	48	21.1	2.7354	1.475
	D	78	34.4		
	N	25	11		
	A	36	15.9		
	SA	36	15.9		
Our (Ethiopian) diversity in religion makes difficult to	SD	31	13.7	2.7309	1.320
	D	64	28.2		

introduce IFB services	N	38	16.7		
	SA	45	19.8		
Currently targeted customers for IFB services are only Muslims	SD	33	14.5	2.7040	1.392
	D	64	28.2		
	N	39	17.2		
	A	44	19.4		
	SA	43	18.9		
The service that is given by the bank is through Muslim religion follower staffs	SD	47	20.7	3.0404	1.363
	N	30	13.2		
The customer are happy while served by Muslims staffs than other religion followers	A	35	15.4		
	SA	35	15.4		
	SD	30	13.2	3.0000	1.362
	D	29	12.8		
	N	30	13.2		
	A	98	43.2		
	SA	36	15.9		
The customer believes the bank uses their money for Shariah prohibited activities	SD	36	15.9	2.7085	1.375
	N	22	12.9		
		12	5.3		
	A	81	35.7		
	SA	78	34.4		

Source: Own Survey (2019).

The result shows, 126(55%) of responded negatively disagree that with our (Ethiopians) diversity in culture makes difficult to introduce IFB services whereas 72 (31.8%) % of responded positively agree that there is our (Ethiopians) diversity in culture makes difficult to introduce IFB services while 25 (11%) of the respondents are neutral. According to above findings we can say that most of the respondents did disagree with our (Ethiopians) diversity in culture makes difficult to introduce IFB services.

The result in Table (4.2.) shows, the number of respondents that believe there is our (Ethiopians) diversity in religion makes difficult to introduce IFB services', 95(41.9%) of responded negatively disagree that, there was our (Ethiopians) diversity in religion makes difficult to introduce IFB services low when compared to other respondent categories. In addition, 95 (41.9%) of responded negatively positively agree that with there was our (Ethiopians) diversity in religion makes difficult to introduce IFB services, while 38 (16.7%) of the respondents neither agree nor disagree with the statement of there is our (Ethiopians) diversity in religion makes difficult to introduce IFB services'. Significant number of respondents 95 (39.6%), think that disagree with our (Ethiopians) diversity in religion makes difficult to introduce IFB services.

The issue of Targeted customers for IFB service are only Muslims is one of the components in Religion and cultural difference in Ethiopia, the scale address whether respondents _believe that currently target customers for IFB service are only Muslims? The result for this question is presented as follows.

The above table shows that majority of the respondents 97(42.6%) of responded positively agree that with the statement of currently target customers for IFB service are only Muslims, whereas 87(38.3%) of responded negatively disagree that with the statement. And 39(17.2%) are indifferent. majority of the respondents believe that currently target customers for IFB service are only Muslims. This result provides us to observe and infer that currently target customers for IFB service are only Muslims.

Another important item in the Religious and cultural difference in Ethiopia scale was whether respondents _think that the service that is given by bank is through Muslim religion follower staffs? The result for this question is presented as follows. The result shows that the respondents 123(54.2%) of responded negatively disagree that with the statement of there was the service that is given by bank is through Muslim religion follower staffs, whereas 65(30.8%) of responded positively agree with the statement. And 30(13.2%) are neither agree nor disagree.

The number of respondents shows, the number of respondents that believe the customer are happy while served by Muslim staffs than other religion followers, 134 (59.1%) of responded positively agree that customer were happy while served by Muslim staffs than other religion followers high when compared to other respondent categories. In addition, 59(26%) of the responded negatively with the customers were happy while served by Muslim staffs than other religion followers, while 30 (13.2%) of the respondents neither agree nor disagree with the statement of the customer are happy while served by Muslim staffs than other religion followers‘.

The result shows that majority of the respondents 159(70.1) of responded positively agree that with the statement of there was the customer believes the bank uses their money for sharia prohibited activities, whereas 52(26.9%) of responded negatively with the statement. And 12(5.3%) are neither agree nor disagree.

Table 4 .3.Expected operational challenges of IFB services in Awash Bank s.c

Item	Response	frequency	percent	Mean	Stad.dev
There is inadequate legal and regulatory environment	SD	23	10.1	3.6682	1.42917
	D	23	10.1		
	N	31	13.7		
	A	91	40.1		
	SA	55	24.2		
There is a problem of	SD	41	18.ˆ	3.5919	1.25178
	D	36	ˆ5.9		

religious misconception on IFB service	N	20	8.8		
	A	75	33		
	SA	51	22.5		
There is a problem of human resource in IFB	SD	52	22.9	3.2646	1.444476
	D	37	16.3		
	N	45	19.8		
	A	54	23.8		
	SA	35	15.4		
Banks provide conventional banking services on IFB	SD	50	22	2.9238	1.40415
	D	36	15.9		
	N	40	17.6		
	A	68	30		
	S	29	12.8		
Customers believe banks will use IFB related services for conventional banking service	SD	35	15.4	2.9552	1.37473
	D	23	10.1		
	N	22	9.7		
	A	95	41.9		
	S	48	21.1		
There is a problem of providing dedicated windows for IFB service	SD	36	15.9	3.4395	1.35389
	D	16	7		
	N	12	5.3		
	A	81	35.7		
	SA	78	34.4		

Source: Own Survey (2019)

The result presented on table (4.3.) shows that 146(64.3%) of responded positively agree that with the inadequacy of legal and regulatory environment for interest free banking in awash bank as operational challenge whereas 46(20.2%) % of the respondents have believe that there is inadequate legal and regulatory environment for Interest free banking while 31 (13.7%) of the respondents are neutral. According to above findings most of the respondents did agree with inadequate Legal and regulatory Environment for Interest free banking as operational challenges of IFB service in Ethiopia.

Another important item was whether or not respondents think that there is problem of religious misconception on IFB service. About 131(55.8%) of responded positively there was a problem of religious misconception on IFB service. On the other hand, 77(23.9%) of the respondents disagreed that

religious misconception on IFB service is not a challenge and 20(8.8%) of the respondents was indifferent. The result shows that employees responded the religion difference in awash bank makes difficult to introduce interest free banking services due to currently the target customers for interest free banking service are only Muslims.

The above table shows that majority of the respondents 90(40.8%) of responded positively agree that with the statement of there was a problem of Human resource in IFB service, whereas 89(39.2%) of responded negatively with the statement. And 19.8(40%) are indifferent. majority of the respondents believe that there is a problem of Human Resource in IFB service. The result show that train and hire skilled human resource is a key to overcome this problem.

Another important item in the Expected operational challenges of IFB services in awash bank scale was whether respondent's _think that banks provide conventional banking services on IFB windows? The result for this question is presented as follows. The results further shows that majority of the respondents 97(52.8%) of responded positively agree that with the statement of there was banks provide conventional banking services on IFB windows, whereas 86(37.9%) of responded negatively with the statement. And 40(17.6%) are neither agree nor disagree.

143(63%) of responded positively agree that customers believe banks use IFB related services for conventional banking service as a challenge high when compared to other respondent categories. In addition, only 58(25.5%) of the responded negatively disagree that with customers believe banks use IFB related services for conventional banking service as challenges, while 22 (9.7%) of the respondents neither agree nor disagree with the statement of customers believe banks use IFB related services for conventional banking service'. Majority of the respondents thought that customers believe banks use IFB related services for conventional banking service.

The majority of the respondents 159(70.1%) of responded positively agreed that with the statement that there was a problem of providing dedicated window for IFB service, whereas 52(22.9%) of responded negatively with the statement. And 12(5.3%) are neither agree nor disagree.

Table 4.6. Islamic Banking Service and their future plan

Item	Res	frequ	percent	Mean	Stad.dev
If the existing banks offer certain Islamic banking products, the access to	SD	30	13.2	3.66	1.429
	D	30	13.2		
	N	24	10.6		
	A	89	39.2		

Islamic banking will improve the tendency for business expansion	SA				
Banks have any short term/medium term plan to engage in IFB activities and take advantage of the untapped potential growth and opportunity that Islamic banking provide	SD	19	8.4	3.44	1.33
	D	18	7.9		
	N	26	11.5		
	A	23	12.5		
People would use investment loan service due to its attractiveness and ease of access	SA	71	31.3		
	A	28	12.3	3.78	1.28
	D	27	11.9		
	N	37	16.3		
	A	87	38.3		
	SA	44	19.4		

Source: Own Survey (2019)

According to the respondent reply for the question 1 raised indicates as per the above table 4.4 that about 139(61.2) of responded positively agree that access to IFB would be improve the tendency of business expansion and investment activity. 24(10.6%) has neutral idea on the issue. On the other hand 60(26.4) of responded negatively disagree on this respect.

Table 4.4 item no 2 indicates about banks short/medium term plan effects on their business toward getting potential growth and market opportunity. The data reveals 160(70.7) of responded positively agree that with this respect. 26(11.5%) has neutral idea on the issue. 37(16.3) of responded negatively on this respects.

. Respondent on this issue replied as per the above table 4.4 item no 3 indicates that 131(57.7) of responded positively on this respect. 37(57.7%) has neutral idea on the issue. On the other hand 55(24.2) of responded negatively on this respect

Table.4.7. Summary of Descriptive Statistics of Variables

Quantitative Variables	Nature of Variable	Mean	Satd.dev
Awaness	In Dependent variable	18.2197	4.02147
Culture influence	Independent variable	18.4843	3.92709
Challenge and prospect	Independent variable	19.8430	4.05564
Interest free banking	Dependent variable	10.6413	2.99947

Source: own survey, 2019

4.8 Application of Inferential Statistics

In this section, the results of inferential statistics are presented. For the purpose of assessing the objectives of the study, Pearson’s Product Moment Correlation Coefficient and regression analyses were in use. Using these statistical techniques, conclusions are drawn with regard to the sample and decisions are made with respect to the research hypothesis in the next chapter while here the processed data result was presented and discussed.

4.3.1 Correlation among Variables

Brooks (2008), Correlation between two variables measures the degree of linear association between them. To find the association of the independent variables with the dependent, correlation coefficient was used. Values of the correlation coefficient are always ranged between ± 1 . A correlation coefficient of $+ 1$ indicates that a perfect positive association between the two variables; while a correlation coefficient of $- 1$ indicates that a perfect negative association between the two variables. A correlation coefficient of zero on the other hand, indicates that there is no linear relationship between the two variables. The table 8 below indicates the correlation coefficients for the relationship between interest free banking and its independent variables has linear and strong correlations.

Pearson correlation coefficient(r) is used to test if a linear relationship exists between two variables. The correlation coefficient is a statistical measure association between two numerical variables (Zikmund, 2003). It is the most widely used for summarizing the degree of relationship and direction between two variables. The correlation coefficient is a standardized measure of an observed effect, it is a commonly used measure of the size of an effect and that values of $\pm .1$ represent a small effect, $\pm .3$ is a medium effect and $\pm .5$ is a large effect (Brooks 2008). coefficient as observed in the correlation table 8. Therefore, the other effect factors require further findings.

Correlations

		Awaness rising	Culture influence	challenges	Interest free bank
Ldifb	Pearson Correlation	1	.423**	.622**	.828**
	Sig. (2-tailed)		.000	.000	.000
	N	223	223	223	223
Crdifb	Pearson Correlation	.423**	1	-.058	.401**
	Sig. (2-tailed)	.000		.391	.000

	N	223	223	223	223
hrmifb	Pearson Correlation	.622**	-.058	1	.505**
	Sig. (2-tailed)	.000	.391		.000
	N	223	223	223	223
Ifbak	Pearson Correlation	.828**	.401**	.505**	1
	Sig. (2-tailed)	.000	.000	.000	
	N	223	223	223	223

** . Correlation is significant at the 0.01 level (2-tailed).

4.3.2 Regression Analysis of Variables

Multiple regression analysis is used to show the degree to which the independent variable explains the variance in the dependent variable, it also indicated that the respective contribution of each of these independent variable and helps to determine whether the results are statistically significant or not. The correlation result only shows the relationship between the variables, but it does not show the exact percentage changes of the dependent and independent variables and the strength and degree of the relationship between variables (Kothari, 2004). Therefore, significance of the hypotheses were tested using multiple regression analysis, and the exact percentage changes of the dependent and independent variables and the strength and degree of the relationship between variables, so that the tables below present the results to the regression analysis.

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.830 ^a	.689	.685	1.68392

a. Predictors: (Constant), hrmifb, crdifb, ldifb

R represents the value of the multiple correlation coefficients between the predictors and the outcomes (field, 2005). Here R has a value 0.830; this value represents high correlation between the independent variables awaness rising, culture influence and challenge.

The value of R² is 0.689 which tells that these three variables of interest free banking can account for 68.9 % of the variation in the overall effectiveness of the interest free banking in awash bank south distrect.

Table 4.17: Regression Analysis of Coefficients

Coefficients^a

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	1.322	.811		1.630	.105
1 ldifb	.586	.044	.786	13.229	.000
1 crdifb	.053	.036	.069	1.488	.138
1 hrmifb	.015	.040	.021	.384	.701

a. Dependent Variable: IFB

Predict the outcome then this saving culture should be different from 0 (and big relative to its standard error).

As indicated in the table .4.16, t-statistics can be derived that to test whether a interest free banking value is significantly different from 0. The t-tests measures whether the predictor is making a significant contribution to the model or not. Therefore, if the t-test associated with a interest free banking value is significant (if predictor's sig value is < .05) then the predictor is making a significant contribution to the model.

Diagnostic tests

Multicollinarty

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	1.322	.811		1.630	.105		
	awareness	.586	.044	.786	13.229	.000	.402	2.486
	Culture influence	.053	.036	.069	1.488	.138	.653	1.530
	Challenge	.015	.040	.021	.384	.701	.488	2.048

a. Dependent Variable: interest free banking

1. Since correlation coefficient is less than 0.8 or 80% there is no multicollinarty problem.

Since viral inflation factor (vif) is than less 10 or 1/vif less than 1 there is no multicollinarty problem.

The β - values tells that to what degree of extent each predictor affects the outcome if the effects of all other predictors are held constant. It means when employees awareness increases by one unit, interest free banking increases by .586 units keeping all other variables held constant.. When culture influence

increases by one unit, interest free banking increase by 0.053 units keeping all other variables held constant. When oppuruinty increases by one unit, interest free banking increase .015.

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATION

This chapter focuses on the summary of the major findings of the research, and provides conclusion, limitation and recommendations.

5.1. SUMMARY OF FINDINGS

The main objective of this study was empirically identify the challenges and prospects on Interest free banking services with particular reference to Awash Bank South District by having the following basic questions and objective to be addressed.

- 1) What are the major challenges and prospective that face Interest Free Banking Operation in awash Banking industry and the problems encountered in practicing IFB?
- 2) How banks do fit their conventional banking system in line with Islamic/Interest free Banking and the objective to be addressed assess religious and cultural difference in Ethiopia that influence IFB products and services, to assess the operational challenges of IFB in awash Banking Industry and to investigate overall awareness of employees towards IFB products and services.

In order to address the above basic questions and objective, descriptive survey research design was employed which comprises quantitative methods of data gathering. Data was gathered through questionnaire that was made to triangulate and increase the validity of the data obtained. To collect representative data, 230 questionnaire copies were distributed by using non probabilistic expert sampling technique. Out of which, 223 of the questionnaires were collected.

The data collected from target respondents through questionnaire was compiled and summarized by using SPSS statistical package for social science software version 21. The variables were analyzed by using frequency counts and percentages. Finally, information obtained through open ended questionnaire, were mathematically analyzed and interpreted.

According to the data analysis presented in previous chapter, there were positive and negative findings concerning the implementation of the interest free banking challenges and prospects by awash banks highly engaged on banks process interest free banking services.

On the other hand the adverse findings obtained from respondents that need the attention of banks are discussed as follows.

- 1) Employees responded that bank doesn't give training to various topics related to interest free banking on a regular basis due to shortage of up-to-date reference materials, specifically relevant to the context.

2) Employees responded the training that is given by the bank is not good enough to make aware of interest free banking products and services due to shortage of up-to-date reference materials, specifically relevant to the context.

3) Employees responded the religion difference in Ethiopia makes difficult to introduce interest free banking services due to currently the target customers for interest free banking service are only Muslims.

4) The customers are happy while served by Muslim staffs than other religion followers. This implies religion difference matters.

. During the study some positive findings are obtained.

1) Most of the employees of the awash banks filled with educated employees more than 84 % of them degree holder and above degree this indicate the banks have productive employees.

2) More than 93% of employees of awash banks understand the challenges of IFB and the strategy of the bank is positive for the organization.

3) Most of the respondents have clear understanding the type and feature of IFB, difference between IFB products and conventional banking products, IFB products that meets the current demand of its customer and understand the banks capacity to provide IFB products.

4) Most of the employees of the awash banks filled with diversity in terms of profession, skill, Gender, and experience and also filled with young employees.

5) Most of respondents of awash banks filled inadequate legal and regulatory environment IFB, problem of religious misconception on IFB and problem of human resource were major operational challenges of IFB.

6) Most of the respondents filled employee awareness level and the bank capacity to provide IFB services was the banks fit conventional banking in line with interest free banking services.

7) Most of respondents of awashbanks filled banks provide conventional banking services on IFB window, banks use IFB related services for conventional banking service and problem of dedicated windows for IFB service were a problem of practicing IFB.

5.2. CONCLUSION

The results and healthy growth of the interest free banking industry compared to the conventional banking industry during recent time are clear evidence that the principles and rules representing the foundation of Interest free banks are solid and valid. Ultimately, it has resulted in the Interest free banking system is a fairly new player in the awash financial industry, and thus, is faced with many problems and challenges of interest free banking.

The study was conducted to empirically identify the challenges and prospects on Interest free banking services with particular reference to Awash Bank South District.

Interest free banking is mostly large amounts that should be given great concern by the bank in relation to the country's growth and transformation plan. However, interest free banking was different challenges that can be seen from employees and the banks angles.

Based on the findings of this study to conclude that the major challenges of interest free banking services in awash bank were inadequate legal and regulatory environment IFB, problem of religious misconception on IFB and problem of human resource on IFB services shows that lack of 61 support from the shariah advisory to IFB process of the bank was the greatest challenge that is affecting the smooth running of IFB financing in awash banks.

Another findings of this study to conclude that banks fit conventional banking in line with IFB services were the speed and degree of success with which interest free banking was emerge in conventional systems whether the customers and employee are well informed about the opportunity and risks at hand implies the employee awareness level in all aspects to process and deliver IFB products and services that meets the current demand that are provided by the bank and training to employees on various issues related to IFB products/services

In addition to this the banks provide conventional banking services on IFB window, banks use IFB related services for conventional banking service and problem of dedicated windows for IFB service were a problem of practicing IFB services.

An efficient rating system as described in the literature is the one that highlights a positive correlation between challenges of interest free banking and the problem in counter with practicing IFB services. Accordingly, Interest free banking is different from conventional banking, so there are lots of chances of improving the Interest free banking network and there were more chances to grow.

Finally, the growth increase the banking sectors have to faces some challenges and these must be overcome. Interest free banking is playing vital role in the growth of economy with special reference to corporate social responsibility.

5.3. RECOMMENDATIONS

In considering the major findings of the study and the conclusions drawn, some efforts were made to forward possible recommendations for the attainment of a better result out of the operational challenges and prospects of IFB in awash banking industry for the better achievement of the objectives.

1) It is important to ensure uniformity and harmonization of shariah standards and practices across the board. There, is a need to have one shariah board to support the system. This will also help in enhancing the credibility and confidence in the interest free banking system.

2) To continuously develop upon the Islamic legal infrastructure and framework to cater for the ever developing needs and requirements of interest free finance and to face the challenges of today's and the future's modern world. It is also important to ensure harmony with conventional legal framework. From a human resource perspective, an extreme focus, attention, and generous investment should be given and allocated to develop and train a new generation of experts in interest free banking regulations and laws.

3) The bank should have given training to various topics related to interest free banking on a regular basis to maximize the skill and knowledge of employees.

4) There should be intensive manpower training and development in the area of Interest-Free Banking through the establishment of research centers and capacity building workshops to develop cognate experience.

5) In order to minimize the religion difference in Ethiopia makes difficult to introduce interest free banking services due to currently the target customers for interest free banking service are both Muslims and non-Muslims.

6) Finally, Enhancing and enforcing the standards for effective corporate governance to protect and safeguard customers, as well as for effective market discipline and transparency, to provide timely and reliable information to The enforcement of these standards will help in enhancing industry credibility and will create confidence among all stakeholders.

In general, it is advisable for awash banks to sustain all its current strengths, and improve its limitations mentioned above to challenge future uncertainties for the proper implementation of IFB and the success of employees and the bank overall/IFB/?

Reference

- ., A, Z. (1994). Islamic Research and Training. *islamic banking satat of the art Jeddah* , p (13).
- Al-Jarhi,M& Iqbal M (2001). (2001). Islamic banking answer to some frequently asked questions",Islamic development bank:. *Islamic Resarch Traing institutes* , Occasion paper No 4 .
- Aris, N et al. (2013). Islamic banking products: Regulations, Issues and challenges. *The Journal of Aplied business Research* ., Vol.29,NO .4.
- BelloA & Abubaker M. (2014). Challenges and Solutions to Islamic Banking System in a a Pluralistic– Secular Country like Nigeria", . *Mediterranean Journal of socail sciences MCSEER Pubilshing.*, Rome -italy Vol ,5N06 .
- Carvallho,J,Bello A Application of (BelloA & Abubaker M. (1984,2014). mathematical sampling techniques. *Records management quarterly*, 1863.
- Hossan ,M & Lewis,M (2007) . (2007). *Handbook of Islamic banking*. UK: Edward Elgar pubilsging Ltd.
- Irfan,Majed,Zaman,K. (2014). The performance & efficiency of Islamic Banking in. *Economa sreia mangement*, VOL.17.
- Jabr H ,An-najah(Irfan,Majed,Zaman,K,. (2003). Islamic Banking in Palestine Challenges and Prospects". *university j,Res*, (A,sc).
- Mahamed, M. (2012). Islamic banking: Prospects, opportunities and challenges in Ethiopia",. *Depratment of accounting and Finance* .
- Teferi, M. (2005). Contribution of IFB to economic development and its prospect in Ethiopia",. *The development of islamic banking in Lebanon*, NO(2).
- ., A, Z. (1994). Islamic Research and Training. *islamic banking satat of the art Jeddah* , p (13).

- Al-Jarhi, M & Iqbal M (2001). (2001). Islamic banking answer to some frequently asked questions", Islamic development bank: *Islamic Research Training institutes*, Occasion paper No 4.
- Aris, N et al. (2013). Islamic banking products: Regulations, Issues and challenges. *The Journal of Applied business Research*, Vol.29, NO .4.
- Bello A & Abubaker M. (2014). Challenges and Solutions to Islamic Banking System in a Pluralistic–Secular Country like Nigeria", *Mediterranean Journal of social sciences MCSEER Publishing*, Rome -Italy Vol ,5N06 .
- Carvallho, J, Bello A Application of (Bello A & Abubaker M. (1984, 2014). mathematical sampling techniques. *Records management quarterly*, 1863.
- Hossan, M & Lewis, M (2007) . (2007). *Handbook of Islamic banking*. UK: Edward Elgar publishing Ltd.
- Irfan, Majed, Zaman, K. (2014). The performance & efficiency of Islamic Banking in. *Economia sreira mangement*, VOL.17.
- Jabr H , An-najah (Irfan, Majed, Zaman, K., (2003). Islamic Banking in Palestine Challenges and Prospects". *university j, Res*, (A, sc).
- Mahamed, M. (2012). Islamic banking: Prospects, opportunities and challenges in Ethiopia", *Depratment of accounting and Finance* .
- Teferi, M. (2005). Contribution of IFB to economic development and its prospect in Ethiopia", *The development of islamic banking in Lebanon*, NO(2).

Appendix 2

Diagnostic tests

Multicollinarty

Coefficients^a

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
	B	Std. Error	Beta			Tolerance	VIF
1 (Constant)	1.322	.811		1.630	.105		
Ldifb	.586	.044	.786	13.229	.000	.402	2.486
Crdifb	.053	.036	.069	1.488	.138	.653	1.530
Hrmifb	.015	.040	.021	.384	.701	.488	2.048

a. Dependent Variable: interest free banking

- Since correlation coefficient is less than 0.8 or 80% there is no multicollinarty problem.

Since viral inflation factor (vif) is than less 10 or 1/vif less than 1 there is no multicollinarty problem.

The β - values tells that to what degree of extent each predictor affects the outcome if the effects of all other predictors are held constant. It means when employees awareness increases by one unit, interest free banking increases by .586 units keeping all other variables held constant.. When culture influence increases by one unit, interest free banking increase by 0.053 units keeping all other variables held constant. When oppuruinty increases by one unit, interest free banking increase .015.

WOLKIT UNIVERSITY

COLLEGE OF BUSINESS AND ECONOMICS

DEWPARTMENT OF MANAGEMENT

Dear Respondents,

This questionnaire is designed to collect data's on the topic challenges and prospects of interest free banking service: case of awash bank south district 'The purpose of the study is for the partial fulfillment of the requirement for MBA program. For the successful accomplishment of the study, the response of employees of the bank will have pivotal role by being used as valuable input for the study. I assure you that the information to be shared by you will be used only for academic purpose and kept confidential. So, you are kindly requested to genuinely fill the questionnaire.

Thank you in advance for your cooperation!

Part one: Background Information

Dear respondents, please label a characteristic that correspondent to your background data by using tick —√—mark.

1.1 **Gender:** 1= Male 2 male

1.2 **Age:** 1=18-25 2=26-35 3=36-45 4=Above 45

1.3 **Educational qualification:** 1= Diploma 2= B C3=Master De

1.4 **Religion:** 1=Muslim 2=Non-Muslim

1.5 **Banking experience in number of years:** 1= 1-4 2= 5-10 3= 4=
Above 15

1.6 **Your current position in the bank:**

1= Director 2= Manager 3= Professional

Part Two: Five-point Likert scale questionnaires

1. Strongly Disagree; 2. Disagree; 3. Neutral; 4. Agree; 5. Strongly Agree

1. Level of Demand for interest free banking products

		SD	D	N	A	SA
1	I am aware of the types and features of interest free banking products.					
2	I know the difference between interest free banking products and the conventional banking products.					
3	I know well the Interest free banking products that are currently provided by the bank.					
4	I Know that Interest free banking products are offered to Muslims and non-Muslim.					

2. Religious and cultural difference in Ethiopia.

Items		SD	D	N	A	SA
1	Our (Ethiopians) diversity in culture makes difficult to introduce IFB services.					
2	Our (Ethiopians) diversity in religion makes difficult to introduce IFB services.					
3	Currently targeted customers for IFB service are only Muslims.					
4	The service that is given by the bank is through Muslim religion follower staff's.					
5	The customer are happy while served by Muslim staffs than other religion followers					
6	The customer believes the bank uses their money for sharia prohibited activities.					

3. Expected operational challenges of IFB services in Ethiopia.

Items

SD D N A SA

- 1 There is inadequate legal & regulatory environment for Interest Free Banking.
- 2 There is a problem of religious misconception on Interest Free Banking service.
- 3 There is a problem of human resource in Interest Free Banking service.
- 4 Banks provide conventional banking services on IFB windows.
- 5 Customers believe banks will use IFB related services for conventional banking service.
- 6 There is a problem of providing dedicated windows for IFB service.

Appendix B

WOLKITE UNIVERSITY
COLLEGE OF BUSINESS AND ECONOMICS
DEPARTMENT OF MANAGEMENT

Interview questions

The following are question prepared and communicated with some selected staffs of the banks

1. Do you think that there is adequately prepared and trained staff for Islamic banking /interest free banking / service?
2. What training and/or support would help to make the service easier?
3. What are the major problems that you encounter as a department while rendering IFB?
4. What are the major complaints from customers on the service you provide?

5. Do you have reached a satisfying number of clients through the provision of Islamic banking /IFB/?