OPPORTUNITIES AND CHALLENGES OF INTEREST FREE BANKING (IN CASE OF COMMERCIAL BANK OF ETHIOPIA)

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Abstract

This study examines challenges and opportunity of Interest free banking services in Ethiopia with particular reference to the commercial bank of Ethiopia. The study has employed descriptive research based on survey and the data are of cross sectional type. The study has used both primary and secondary data which are quantitative and qualitative in nature and have been collected through structured and semi structured questionnaire and interview. A total of 200 sample respondents were taken through multistage sampling. Of the total sample interest free banking customers and staffs of the bank constitutes 170 and 30 respectively. The data was analyzed using descriptive statistics of mean, frequency and percentage using SPSS version 20software. Based on the analysis of the obtained data, this research has found out the opportunities of IFB are the existence of Potential customer and the diplomatic advantages. The challenges were 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.Accordingly, the following recommendations were forwarded by the researcher based on the results of the findings in conjunction with literature review reflections: aggressive promotion and marketing campaign about IFB products, provide sustainable and continuous training to build the capacity of the manpower, the bank shall increase accessibility of its products within branches.

ACRONYMS

CBE	**COMMERCIAL BANK OF ETHIOPIA**
NBE	**NATIONAL BANK OF ETHIOPIA**
IFB	**INTEREST FREE BANKING**
IMF	**INTERNATIONAL MONITORY FUND**
IFI	**INTERNATIONAL FINANCIAL INSTITUTION**
PLS	**PROFIT AND LOSS SHARING**
ECX	**ETHIOPIAN COMMODITY EXCHANGE**
SPSS	**STATISTICAL PACKAGE FOR SOCIAL SCIENCE**

CHAPTER- ONE

INTRODUCTION

1.1. Background of the Study

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

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, Majored&Zeeman 2014).

To satisfy the demand of Ethiopian Muslim customers, National Bank of Ethiopia (NBE) in 2008 amended Ethiopian Banking Business Proclamation (592/2008) to include provision of IFB and it pave the way for the establishment of Islamic banking in Ethiopia. However, the declaration was amended by another declaration (SSB/51/2011) which prohibited the establishment of full-fledged Islamic financial institution but give the right to open the door for existing commercial banks to create an interest-free banking wing. As (Senate,2015) explanation Zeeman bank which was expected to join the banking industry as a full-fledged interest free banking, was unable to start operation as the supervisory directive requires that interest-free banking be given a long side conventional banking service. IMF (2015) Islamic finance is projected to continue to expand in response to economic growth in countries with large and relatively unbanked Muslim populations. It is also fueled by the large savings accumulated by many oil-exporting countries that are seeking to invest in Sharia's-compliant financial products.

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

Nonetheless, Islamic finance faces a number of challenges. For example, despite the efforts of Islamic finance standard setters, in many countries the industry is governed by a regulatory and supervisory framework developed for conventional finance. Therefore, it does not fully take account of the special nature of Islamic finance (Al-Maraj, 2014). The industry is still largely a nascent one, lacking economies of scale, and operating in an environment where legal and tax rules, financial infrastructure, and access to financial safety nets and central bank liquidity are either absent or, if available, do not appropriately take into account the special characteristics of Islamic finance (Askari etal 2010; Ernst and Young, 2014; IFSB, Is DB, and IRTI, 2010).

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

One of the services offered by Ethiopian banks includes profits losses sharing banking service. This service needs careful screening because of the danger of adverse selection, and careful monitoring as this may lead to the problem of asymmetric information and moral hazard. One factor contributing to adverse selection is that in a mixed financial system with both Interest free and conventional banks, entrepreneurs may not like the idea of profit sharing if they have rosy

expectations of the success of their ventures whereas they may prefer profit-sharing finance from Interest free banks if they are less sure of a positive outcome. This might burden Islamic banks with a disproportional share of bad debts (Khan, 2010). The purpose of this study would be assess the challenges that Banks face in implementing interest free banking service and identify the opportunity of interest free banking in the case of CBE.

1.2 Statement of the problem

Just 40 years since its contemporary inception, Islamic banking is now a worldwide phenomenon, with Islamic banks in over 60 countries across the Globe (Akhtar 2007). The development of the Islamic banking industry is moving at a fast pace, and almost every country now has some form of Islamic financing (Ahmad, 2015: 12-25). According to a report by The Economist Intelligence Unit (2015), population growth, increased consumer spending power, and the dominant place of Islam in Africa's demographic makeup, mean that 'Islamic economy' is playing an important role in the economic trajectory of the continent. Africa's challenges, notably infrastructure financing and the need for wider access to financial services, also provide an opportunity for the Islamic finance industry to grow (Iqbal et al., 1998).

Numerous studies have been conducted worldwide in the Islamic banking sector and many studies existed in opportunities and challenges of IFB. From the few studies, Iqbal et al. (1998) show that the challenges hindering Islamic banking are institutional as well as operational challenges in Pakistan, Iran and Sudan. The institutional challenges were 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.

Saleh et al. (2005) show the Lebanese experience with Islamic banking since the foundation of the first Islamic bank. They 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.

In Ethiopia few studies were conducted on the attributes of IFB. Among these studies Mohammed (2012) studied opportunities and challenges of Islamic Banking in Ethiopia and showed the potential challenges to be 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 wrong association with specific religion and the global terrorism.

According to the study by Kerima (2016), challenges on interest free banking services in Commercial Bank of Ethiopia, utilization of the existing IFB products have been challenged by lack of awareness of customer, inadequate marketing and promotion, double taxation, nature of IFB products, non-provision of IFB products/services in all branches, the IFB being delivered in a window model and lack of trust and confidence.

Based on the 2017 annual report review and assessment of numerous researches and literatures done on the area of Interest free banking in Ethiopia, specifically in the case of Commercial Bank of Ethiopia, I have come across that there is no contemporary finding that depicts the existence of potential demand and the challenges that hinders the smooth running of IFB in the competitive banking industry in Ethiopia. By taking the above points in consideration, my research is intended to bridge the gap by analyzing the opportunities and challenges of interest free banking in Ethiopia, the case of Commercial Banks of Ethiopia.

1.3 Objectives of the study

1.3.1 General objectives

"The General objective of the study is" to assess opportunities and challenges of interest free banking in the case of Commercial Banks of Ethiopia.

1.3.2 Specific objectives

This study specifically strives to achieve the following specific objectives:

1. To examine the business opportunities of IFB in Commercial bank of Ethiopia.
2. To assess the availability of demand for IFB products other than those currently provided by the bank.
3. To examine the challenges related with IFB in commercial bank of Ethiopia.

1.4. Research questions

1. What are the opportunities that can be harnessed on the areas of IFB in Commercial Bank of Ethiopia?
2. Is there a segmented potential demand for IFB in CBE other than the available products?
3. What are the challenges CBE has faced to significantly engage in IFB?

1.5.Significance of the study

This study tackled the challenges and opportunities of IFB system from the service providers' point of views. Hence the present study is expected to fill that gap by giving first-hand information on such as an important topic. It is expected to contribute both theoretically and practically. Theoretically, the findings of this study contributes by filling an important gap to serve as a reference material to the existing body of the literature and initiate other interested researchers. On the practical side, this study provides an opportunities to acquire knowledge and practical experience for the researcher, but also to bank managers (both governmental and private banks), bank policy and decision makers to identify and understand the challenges and opportunities of Interest free banking services. Moreover, the result of the study would contribute by providing case specific evidences on the probable situation faced by Ethiopian Banks that are offering interest free banking services

1.6. Scope of the study

This study conducted on the challenges and opportunities of IFB in banking industry in Ethiopia context. Moreover, the study area is limited to CBE. Further, the study included only staff and customer of interest free banking business in CBE at woliso branch.

1.7. Organization of the research

This paper is organized into five chapters. The first chapter deals with presenting the background and the statement of the problem under investigation, followed by the objectives and questions to be answered in the course of the study. The second chapter presents extensively the reviewed literature related with interest free bank banking system and also includes the conceptual framework followed throughout this study. Chapter three presents the description of studied banks and the methods used to meet the objectives of the study. The fourth chapter of the paper presents the findings as well as the quantitative and qualitative data analysis.Finally the fifth chapter deals with the conclusions of the study.

CHAPTER TWO

LITERATURE AND RELATED LITERATUR

This section reviews the literature written by different authors and researches conducted by different scholars in relation to the study and present a summary of challenges and opportunities of IFB such as definitions, principles and major concept regarding challenge and opportunity and review of empirical works. Finally the synthesis review of the study is included by summarizing the literature results.

2.1 Modes of Operation in Islamic Banking

In Islamic finance, the term "loan" refers only to a benevolent loan (*qard al Hassan*), a form of financial assistance to the needy to be repaid free of charge. Other instruments of Islamic finance are not referred to as "loans' but rather as financing modes falling under one of the three categories: Profit-and-loss sharing (PLS), non-PLS contracts, and fee-based products Hussein, Shahmoradi, and Turk, (2015).

2.1.2 QardHasan loans or Amanas (Benevolent loan)

It is a benevolent loan given to deserving customers by Islamic banks to alleviate poverty. The beneficiary is required by Shari 'a to pay back only the principal to the Islamic bank. However, the client may pay an addition to show appreciation to the Islamic bank but this intention should not be disclosed to the bank by the customer at the beginning of the transaction, Audio Bello et al. (2014). In the case that the debtor does not pay an extra amount to the creditor, this transaction is a true interest-free loan. Some Muslims consider this to be the only type of loan that does not violate the prohibition on „Riba, since it is the one type of loan that truly does not compensate the creditor for the time value of money, (Mohammed, 2012).

2.1.3 PLS Financing Products

As explained in its core principles it is equity and participation, as well as it have strong link to real economic activities, help promote a more equitable distribution of income, leading to a more efficient allocation of resources.

***1. Mudarabah* (Silent Partnership)**

A *mudarabah* contract is a financial transaction in which there are two partners in the contract. One of the partners will provide the needed capital (*Rabb-ul-Maal*) and the other partner will go into the business as entrepreneur (*Mud rib*).Abdu Bello et al. (2014) and Journal of Islamic Banking and Finance 2016 report show Mudharabah is one of the most well-known Islamic investments and its principles are widely adopted by Islamic banks. As Journal of Islamic Banking and Finance 2016 report Mudharabah, partnership which one partner (investor) gives money for investing, while the other partner is responsible in providing labor and skill to manage the money; the profits generated out of the investment are shared in a predetermined ratio. The profit sharing ratio could be 50:50, 40:60, or 30:70, depending on the contracting parties.

***2. Musharaqa* (Equity Partnership)**

Based on Abdu Bello et al.(2014) *Musharaqa* is a contract in which two or more persons contribute capital for the establishment of a particular business venture in such a way that each partner has right to either involve in the administration of the business or not. However, partners may decide to be active or sleeping partner at their own will. In this kind of transaction in Islamic banking, profits are shared based on agreed ratio which need not be equal to their individual capital contribution, but loss is shared strictly based on individual capital contribution. So, Islamic bank will act as a partner in this case in order to contribute in the capital formation as well as in sharing profits and loss.

Based on Ahmed (2000), Musharakah or partnership is a type of investment where by all partners (investors) share profits of a joint venture according to a mutually agreed ratio, while

losses are shared exactly in proportion to capital invested by each partner; at the same time, all partners have the right whether or not to participate in the management of the business.

2.1.4 Non-PLS Financing Products

Non-PLS contracts are most common in practice. They are generally used to finance consumer and corporate credit, as well as asset rental and manufacturing, Hussein et al. (2015).

1 .Ijarah (leasing)

Under this type of investment, the owner or lessor of an asset (a motor vehicle or house) will lease out his assets to a user or lessee for a certain amount of money or rentals; and at the same time, the ownership of the asset remains with the lessor. The aim of this kind of investment is for the investor or owner of the asset to recover the capital cost of purchasing the asset, plus a profit margin, which are obtained out of the rental payments, Ahmed (2000). As Hussein et al. (2015) a variety of *ijārah* takes a hire-purchase form, whereby there is a promise by the leaser to sell the asset to the lessee at the end of the lease agreement, with the price of the residual asset being predetermined.

2. Bai-salam or Salam

Mohammed, (2012) '*Bai-salam'* means a contract in which advance payment is made for goods to be delivered later. The seller undertakes to supply some specific goods to the buyer at a future date in exchange of an advance price fully paid at the time of contract.

3. Astana'

Astana'is a contract in which a commodity can be transacted before it comes into existence. The unique feature of *Astana'* (or manufacturing) is that nothing is exchanged on the spot or at the time of contracting. It is perhaps the only forward contract where the obligations of both parties are in the future. In theory, the Astana*'* contract could be directly between the end user and the manufacturer, but it is typically a three-party contract, with the bank acting as intermediary Hussein et al. (2015).

As Hussein et al (2015) explanations there are four main differences between Astana'and *Salam* contracts.

(i)Astana' involves the sale of unique manufactured goods as opposed to *Salam* that can be used in standardized goods;

(ii)Unlike*Salam* which requires the payment of full price up front, *istisna'* allows for spot, deferred, or even installment payments;
an *Astana'* contract can be cancelled unilaterally until the date that the manufacturer starts working on the goods, while the *Salam* contract can be cancelled only before the contract signature; and

(iii) The time of delivery is fixed in *salaam*, whereas Astana*'* can specify a maximum time for delivery after which the purchaser is no longer bound to accept the goods.

4 .Murabaḥah (Cost-Plus Sales Contract)

According to *Journal of Islamic Banking and Finance 2016* Just like Musharakah, Mudharabah is also a partnership, but the difference is that in Mudharabah, one partner (investor) gives money for investing, while the other partner is responsible in providing labor and skill to manage the money; the profits generated out of the investment are shared in a predetermined ratio. This type of contract is mostly used in the procurement of equipment. It is a sales contract between Islamic bank and its client at a fixed profit called mark-up. In this contract, the client will provide all the specifications of the commodity and the Islamic bank will take the risk of purchasing it for the client at a cost plus mark-up which the client can either pay in installment or sum at a spot or at a stated period.

2.2 Fee-Based Products

The fee-based services provided by Islamic banks include bank transfers, issuing letters of credit and guarantees, credit cards, and offering collection and safe-custody services, mostly used in trade financing Hussein et al. (2015).

2.2.1 Retail Islamic Banking Products

It is division of a bank that deals directly with retail customers. In Islamic banking retail product are the following:-

1. Current Account (Alwadiah): -The current account is basically safekeeping or Al-wadiah' account and used for day to day cash management. In 'Al-Wadiah', a bank is deemed as a keeper and trustee of the funds, Mohammed (2012). 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 Amanas (trust), creating an agency contract for the purpose of protecting and safekeeping the depositor's assets. (Iqbal and Mercator, 2011:154).

2. Savings Account: -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. (Ballad et. al (2009: 25)

3.***Investment Account:*** -According to Tabor, (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.

2.2.3 Conceptual literature

According to the study made by Ibrahim (2012), the concept of Islamic Banking and Interest- Free Banking is synonymously used in Islamic Economics literature as an alternative banking framework to the interest-based conventional banking practice. However, there is a difference between an interest-free bank and an Islamic bank but they are sometimes used interchangeably. Islamic banking not only avoids interest in all its ramifications but also it avoids all other Islamic ally prohibited activities. Interest-free

banking system on the other hand, does not engage in interest but there is no reason to suppose that all its other activities will be done strictly according to Islamic law "Shariah".

2.2.4 Principles of IFB

As Iqbal and Monteux (2005), Banks which participate in the Islamic banking system should follow the sharia (Islamic law) principle. This principle deals with the moral and ethical values which should be considered in dealing with business transaction. The main principles are ribald (usury), Gharry (risk and uncertainty), profit or loss sharing and prohibited transaction.

1. Rabat (USURY)

Based on the doctrine of Holy Quran which is pointed out in (2:275-280, 3: 130-132, 4:161-etc) and Hadith as ribald (interest) is prohibited. Ali and Sarkar (1995), Islam prohibits its followers to receive or provide usury even for the purpose of getting a loan or the charged interest rate is low. In Islam, only a number of loans are allowed, such as *Qard al-Hassan* (benevolent loan), where the borrower is not charged any interest or additional incrimination on the borrowed sum.

2. Risk and uncertainty (GHARAR)

"*Gharar*means risk, uncertainty, and legal ambiguity or uncertainty that any one of the parties to a contract can exploit at the expense of the others as Khalifa M. (2016). Activities or transactions like (sale of unborn-she-camel or sheep, conditional sale, sale with loan, selling of agricultural produce before mature, selling the fish in the water etc.) are not permissible/permissive Ajagbe T. S. et al (2013)**.** Though business transactions are generally plagued by a certain level of uncertainty, the excessive one is not welcome under Islamic finance. Hence, contracts forming the basis of business transactions and Islamic banking services should be known to a large extent about their consequence, Latifa and Mervyns (2007).

3. Profit and loss sharing (PLS)

Based on Dushkin and Abdullah (2007) study, since interest is prohibited in Islam, the providers of funds and the entrepreneur in an Islamic banking settings share the business

risk and profits based on mutual agreement. This act will equitably distribute income, enhance social justice, and alleviate poverty etc. Chong and Liu (2009) also identify that a unique feature of Islamic banking is its profit-and-loss sharing (PLS) paradigm, which is predominantly based on the *mudaraba*(profit-sharing) and *musharaka*(joint venture) concepts of Islamic contracting in which the assets and liabilities of Islamic banks are integrated in the sense that borrowers share profit and losses with the banks.

4. Prohibited transactions

Islamic banking system is known as a system free of business activities that violate Sharia regulations such as investment in business related to liquor and gambling. Therefore Islamic banks in Malaysia in particular have established their own Shariah Advisory Council, which comprises Sharia experts who act as auditors and advisors to the bank. They are wholly responsible in ensuring that operations and activities of the bank do not breach the values of Islamic ethics as MohammadTaqiuddin et al. (2013).

2.2.5 Forms/Types of Islamic banking

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

I. Islamic banks operating within a financial system where all banks are Islamized

II. Islamic banks operating alongside other conventional banks and

III. Shariah- complaint branches, windows and funds established by some conventional banks.

2.2.6 Islamic and conventional banking

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

Table 2.1 the major difference between Islamic and Conventional banking

Conventional banking system	Islamic banking system
Charge interest on loans.	Do not charge interest. Riba (interest) is an unjust return, interest or usury. The term applies to any financial gain by the lender as a condition of a loan and in a commodity trade. It also applies to any disparity in quantity or time of delivery; as such transactions are illegal under Islamic law (Martins, 1997; Chong & Liu, 2008). Zero-return loans. Prohibits the charging or receiving of interest. A unique feature of Islamic banking is its profit-and-loss sharing paradigm, which is based mainly on the mudarabah (profit-sharing) and Musyaraka (joint venture) concepts of Islamic contracting (Chong & Liu, 2008)

Principal stakeholders are Shareholders.	The principal stakeholder is God. The aim is to serve God, while the stakeholders are the clients and the general public. Clients are partners and the decisions are in the interest of society.
Support arms industries and industries that pollute the environment and exploit children	Shariah law places restrictions on business activities. The law further prohibits trading in alcohol, tobacco, products that contain pork, defense and weapon production and certain entertainment activities like gambling and pornography (Chong & Liu, 2008)
Gives loans to whoever has a guarantor	Gives loans to those who need loans. Do not need collateral to
Or collateral.	Get a loan.
Decisions are made in the interest of shareholders.	Islamic principles advocate for an economic system in which all forms of exploitation are eliminated. The other principle is Mudaraba (trust Financing), a profit-sharing agreement between two parties in which one Provides the finance and the other provides entrepreneurial and management skills.
Designed for those who have money and who do not care what it is used for. Consumers have no opportunity to choose where money is invested. Provides no information about what it does with depositors‟ money.	Islamic banks have an interest in how the money borrowed is used. The Islamic banks have a stake in the financial activities so that money is not used for economic activities that are injurious to society. Those who lend to the Islamic banks expect the banks not to invest their money in business activities that are not Shariah-compliant. Islamic banks invest only in business activities that are Shariah- compliant.
Its investment rewards companies even if they act irresponsibly.	Islamic banks share profits and losses. Murabaḥah (cost-plus financing) is a contract sale between the bank and its client for the sale of goods at a price that includes a profit margin for both parties.

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Its investment rewards companies even if they act irresponsibly.	Islamic banks share profits and losses. Murabaḥah (cost-plus financing) is a contract sale between the bank and its client for the sale of goods at a price that includes a profit margin for both parties.
Seeks to satisfy demand. Conventional banks open branches in those areas that	Seeks to satisfy need
Have sufficient demand but not needs.	

2.3 Empirical Literature Review

2.3.1 Empirical Literature Review-General

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2.3.2 Challenges IFB

2.3.3 Lack of Awareness and understanding

Based on Many studies which are done in different part of the world to implement IFB religious and cultural difference which existed with in one country has influence. Abdu Bello et al. (2014)

One of the major challenges of Islamic banking in Nigeria has to do with the country's multiple cultural and religious belief. This issue is a serious one that needs to be effectively and efficiently resolved if Islamic banking in Nigeria must prosper. This is because of the fact that others with different cultural and religious belief will have a misperception of the

institutions that may lead to not accepting the institution by the general public. Obaidullah (2005), Brown, Hassan and Skully (2007), Louis S. Nkwatoh et al .(*2014)*and also others studies show that Non-Muslims see IFB as an Islamization process, while Muslims see it as an ethical act predicated on religious belief.

2.3.4 Regulatory challenges

Islamic Banking is anchored on the principles of Shari'ah (operations of Islamic banks). Momoh et al (2011), the policy framework should provide the basis for competition of Islamic banks with conventional banks. However, this framework has been tailored in line with the conventional financial system which supports the existing conventional banking system and gives less credence to Islamic banking.

The relationship between Islamic banks and monetary authorities is a delicate one. Whatever the goals and functions are, Islamic banks came into existence in an environment where the laws, institutions training and attitude are set to serve an economy based on the principles of interest. For example, the operations of Islamic banks are on a profit and loss share basis (PLS), which actually does not come fully under the jurisdiction of the existing civil laws, (Mohammed, 2012).

2.3.5 Absence of Liquidity Instruments

Financial instrument will facilitate the business sector, the absence of this system on the Islamic banking taken as challenges for its development. According to Louis S**.** et al (2014), the financial market in Nigeria facilitates the banking relationship existing among commercial banks through the provision of short-term tradable financial instruments: inter-bank transactions, overnight funds and borrowings that satisfy the temporary liquidity needs of commercial banks. This places Islamic banking at a distinct disadvantage compared to conventional banking, because, it operates under the norms of Shari'ah (non-interest banking). More so, there are no institutions that provide long-term finances such as bond, equity etc. on the basis of Shari'ah. There is limited knowledge of accounting and auditing standards that mirrors the specificities of Islamic products.

2.3.6 Inadequate Human Resource

Louis S**.** et al (2014), the sustainability of Islamic banking depends adequately on qualified human personnel, training, and above all research on Islamic finance. This is due to the increasing challenges that continuously rock the banking industry especially with the advent of technology.

They also have to understand the moral and religious implications of their investments with the business ventures. There is also a need for banking professionals to be properly trained in Islamic banking and finance. Most banks‟ professionals have been trained in conventional economics. They lack the requisite vision and conviction about the efficiency of the Islamic banking, (Mohammed, 2012).

2.4 Lack of Supportive Institutional and Market links

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

For example, Islamic banks, without having an interest-free money and capital market, will not have adequate instruments to meet the pre-condition for liquidity management and effective maturity transformation. So, adequate financial mechanism still has to be developed, without which financial intermediation, especially the risk and maturity transformation, will not be performed (Hassan and Skull, 2007).

2.4.1 Sha'riah Related Issues

Abdu Bello et al. (2014), Due to the fact that Islamic banking has religious dimension, financial innovations in this institution needs to meet *Sha'riah* requirements. That is, any new financial products in Islamic banking cannot be adopted until it is approve by the

Sha'riah advisory board and also followed by post *Sha'riah* auditing. However, this act delays Islamic banking ability to take advantage of changing financial environment due to the fact that time has to be wasted before it is finally approved by the *Sha'riah* board

2.4.2 Lack of research and development

Many Islamic banks also lack the necessary expertise and institutional capacity for Research and Development (R & D) that is not only necessary for the realization of their full potential, but also for its very survival in this age of fierce competition, sophisticated markets and an informed public. Islamic banking cannot but stagnate and wither without dynamic and ongoing programmers. In addition, Islamic banks have so far not used the media appropriately. For example, even Muslims are not very much aware that the Islamic banking is being practiced in the world. Islamic banks have not ever used an effective media to the public their activities (Mohammed, 2012).

2.4.3. Empirical Literature Review-Ethiopian Context

2.4.3.1. IFB opportunities in Ethiopia

Based on the Economist Intelligence Unit report (2015), Africa is the world's largest untapped growth market for "Islamic" commerce, spanning Islamic finance (banking, insurance, bonds and capital markets) and halal (sharia-compliant goods and services). Islam is a dominant religion on the continent, along with Christianity, from those 67% of Muslims in Sub-Saharan Africa. A part of sub-Saharan country Ethiopia also has potential customer for IFB. Based on the 2007 national census report the Muslim population comprises 33.9% of the total population (www.csa.gov.et accessed on 12/02/2016) in Ethiopia. Therefore, the country has promise for the growth of Islamic banking.

Beyond satisfying the need of Ethiopian customers Islamic banking will also create for Ethiopian government to gain diplomatic advantages to make financial dealings with Muslim dominated nations (Usman, 2002). It is known that Ethiopia is garnering attention for forging investors

As Mohammed, (2012) introduction of Islamic banking for Ethiopian government will certainly create diplomatic advantages to make financial dealings with Muslim dominated nations especially to attract trillion dollars of equity finance from the gulf countries.

2.4.3.2.IFB challenges in Ethiopia

The development of Islamic banking start after 2008 when commercial bank of Ethiopia (CBE) start to implement Special Non-interest Savings Accounts (i.e. Special Demand Deposit), but there was no Sharia-compliant transactions up to 2013. Even though, National Bank of Ethiopia (NBE) issued a directive to banks allowing them to provide interest-free banking (Islamic banking) service using a separate window along with their other banking services, the system was started to implement only in 2013 by few commercial banks like Oromia international bank S.C, Commercial Bank of Ethiopia and united bank S.C.

This show in the context of Ethiopia, IFB is the recent phenomena. To the knowledge of the researcher, there appears to be very limited work on the challenges and opportunities of interest free banking in Ethiopia. These studies include the recent studies of (Kerima Ali, 2016) and (Abraham, 2017). Those studies examined the challenges on interest free banking services with particular reference to Commercial Bank of Ethiopia and determinate of customers' intention to use interest free banking products and factors affecting employee's product knowledge respectively.

A study done by Mohammed, 2012 on the "Islamic Banking: Opportunities and Challenges in Ethiopia" identified that the main challenges are lack of awareness, regulatory and supervisory challenges, institutional challenges, lack of support and institution, gap in research proposal and development in Islamic studies, lack of qualified human resource as well as wrongful association with specific religion and the global terrorism.

Akmel (2015) study examine the challenges and opportunities of Islamic banking service for resource mobilization of Ethiopian commercial banks through conducting questionnaire and Semi-structured interview for the selected three banks staff using stratified sampling. The result show that awareness, manpower, legal framework, societal belief, resource requirements as some of the challenges while economic growth, attraction

of investors, and fostering investment are the likely opportunities of the banks. The researcher 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.

Debebe (2015) study asses the willingness of the Ethiopian customers to use interest free banking and the factors that may influence their decision and 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.

Kerima (2016) conduct study in challenges on Interest free banking services in Ethiopia with particular reference to the commercial bank of Ethiopia and this research proposal has found out that the challenges to IFB services as: lack of commitment of the bank, lack of Shariah advisor, lack of supportive regulatory directives , Problem related to Ethiopian Commodity Exchange (ECX) law, lack of capacity to deliver IFB product at full rage, lack of awareness of customer about IFB products, lack of trust and confidence of customers, inadequate marketing and promotion, double taxation, nature of IFB products, unavailability of IFB products in all of its branches and the IFB being delivered in a Window model.

The recent study by Abraham (2017) on determinate of customers' intention to use interest free banking products and factors affecting employees' product knowledge in the context of commercial bank of Ethiopia and the result show that except knowledge, all the other variables: attitude, social influence, perceived financial cost and religious belief have significant effect on IFB use intention.

2.5.Synthesis of the review

From the population of Africa continent, Islam is a dominant religion along with Christianity, from those 67% of Muslims in Sub-Saharan Africa. As Ethiopia is part of in Sub-Saharan countries, there will be huge opportunity for the development of interest free banking. Due to interest free banking is the a contemporary phenomenon in the Ethiopian banking sector the main challenges and opportunities of interest free banking is not yet

studied. The main reasons for this study is to identify the main challenges that banks face in implementing interest free banking and will helps for the banking sector to move in the solution for this challenges.

Even though, different studies mainly focused on the challenges bank face on implementing interest free banking the prospect that interest free banking have is not well studied. Also, there is research paper on challenges and prospect of interest free banking which is conducted in 2012 by Mohammed the study did not show after the implementation of commercial banks, which is the study done before the implementation of *Sharia'* compliant Islamic banks by all commercial banks. This show there is time gap because the study research tries to examine the need for *Sharia'* compliant Islamic banks and also other studies are done only single bank.

In light of the above facts and research proposal gaps: the research proposal and working paper that will be conducted focused on the national but not at single organization level, as well as the researcher will use qualitative method of data collection and different literature conducted on specific organization.

The purpose of this study is identifying the challenges and opportunities of interest free banking in Ethiopia by selecting banks which provide interest free banking service after licensed by NBE. In terms of the methodology the researcher will use qualitative method approach using interview and questioners for data collection, descriptive research proposal design will be applied.

To address the gap the researcher assed empirical evidence to find out the challenges and opportunities of interest free banking in Ethiopia. Depending on the empirical evidence in Ethiopia the main challenges to IFB services are: lack of commitment of the bank, lack of Shariah advisor, lack of supportive regulatory directives , Problem related to Ethiopian Commodity Exchange (ECX) law, lack of capacity to deliver IFB product at full rage, lack of awareness of customer about IFB products, lack of trust and confidence of customers, inadequate marketing and promotion, double taxation, nature of IFB products, unavailability of IFB products in all of its branches and the IFB being delivered in a Window mode

CHAPTER THREE

THE RESERCH METHODOLOGY

3.1, Research Design

Kothari cited (2004) research design is what constitutes the blue print for collection, measurement and analysis of data. Descriptive research includes surveys and fact-finding enquiries of different kinds. The major purpose of descriptive research is description of the state of affairs as it exists at present. This study would be use descriptive research design in regarding to the researcher objective which is describing the views of the respondents with regard to the challenges and opportunity of interest free banking.

3. 2, Research Approach

According to Creswell, (2009) there are three type of research approach, these are – Qualitative, Quantitative and Mixed Approach. Kothari, (2004) also defined, quantitative approach involves the generation of data in quantitative form which can be subjected to rigorous quantitative analysis and it sub-classified into inferential, experimental and simulation approaches to research. The purpose of inferential approach to research is to form a data base from which to infer characteristics or relationships of population. This usually means survey research where a sample of population is studied (questioned or observed) to determine its characteristics, and it is then inferred that the population has the same characteristics. While, qualitative approach to research is concerned with subjective assessment of attitudes, opinions and behavior; and it generates results either in non-quantitative form or in the form which are not subjected to rigorous quantitative analysis through focus group interviews, projective techniques and depth interviews.

As Dawson (2003) defined qualitative research explores attitudes, behavior and experience through such methods as interview or focus groups but quantitative research generates statistics through the use of large scale survey research, using methods such as questioners or structured interviews. According to Creswell (2009, 4) definition "Mixed approach research is an approach to inquiry that combines or associates both qualitative and quantitative forms." Keeping in view of the purpose of this study the researcher was adopted mixed approach.

3.3, Target population

A population can be defined as all people or items (unit of analysis) with the characteristics that one wishes to study (Kothari, 2004). To make the research manageable, CBE at woliso branch will the bank considered in this research, the study will aim to identify the challenges and opportunities of interest free banking in CBE woliso branch, the target populations are the entire IFB employees of the CBE in woliso branch and IFB customers of the branch.

3.4, sampling techniques

The study population is customers and employees of CBE who use products of IFB and work at IFB windows respectively which are located in woliso branch Questionaries' distributed for

those employees who are declared to deliver interest free banking service for those sample branches and customers of the bank. Interview employed for those employees who are the head of interest free banking department with in the district and line manager of the branch. This study will use multistage sampling techniques-probability and non-probability to reach at the specific respondents.

3.5, sampling size determination

The target population of this study is the employees and customers of commercial banks in Ethiopia Woliso branch. Due to resource constraint, it is difficult to cover all branches and to keep the study manageable; however, the study will focus on branches which are located in Woliso town. All branches have two delegated employees who provide the service to their customers on separate window.

To determine the number of sample from the customer and employee of the bank- a sampling technique called Small Sample Techniques from National Education Association formula has be used (Krejcie& Morgan 1970). The formula has been used by Debebe (2015), Teferi (2015) and Kerima (2016).The formula is:

$$S= X2\ NP\ (1-P)/d2\ (N-1) + X2P\ (1-P)$$

WHERE S= required sample size, X2= Table value of X2 for 1 degree of freedom as the designed confidence level (i.e. 3.8416), N= population size, P= population assumes to be (0.50 since this provide the maximum sample size), d= the degree of accuracy expressed at the proportion (0.05)

3.6, Data Collection Techniques and Procedures

3.6.1. Data source

Basically there are two source of information used for research purpose – primary and secondary source. Primary source are those in which require to conduct a new survey for gathering information at different levels with regard to inquiry. Secondary source are those which are made available or have been collected for other research purpose (Adams, Khan, Reside, and white, 2007).

For this study, the primary data will collect by interviewing the assigned line managers and department head and questionnaire also distributed for customer service officer of interest free banking in branches and customers of the bank. A questionnaire is a list of carefully structured questions with a view to exploring a reliable response from a chosen sample (Hussey and Hussey 1997). A questionnaire consists of a number of questions printed or typed in a definite order on a form of close-ended questions were used to collect the primary data for the study from select samples in order to take the opinions of employees and customers on challenges and opportunities of interest free banking. Structured interview also will prepare to interviewee of interest free banking head department official and for line managers.

In order to achieve the objective of the research the researcher also use various secondary data in a bid to understand the challenges and opportunity including, journal articles, various post graduate studies, banks report and internal document, and web particularly Google scholar.

3.6.2 Data collection instruments

The researcher adopt and modifying questionnaires used by Mohammed (2012). The questionnaire contained structured questions using a method of with 3-point scale (Agree, neutral know and disagree). To improve the response rate, there was a cover letter explaining the reasons for the research, why the research is important, why the subjects was selected and a guarantee of the respondents' confidentiality provided.

The questionnaire has four parts, part one is about respondents' personal information. Moreover, part two is intended to measure opportunities of Islamic banking. Part, the researcher used close-ended questioner by considering demand of interest free banking service to customers or employees and part four assessed the challenges of IFB.To collect the data the researcher involved in the collection of the questionnaire in order to make the respondents feel comfortable about their response they gave and give support to rater while they are filling the questionnaire. Before distributing the questionnaire permission was obtain from branch manager and every respondent.

The other instrument used to collect primary data from the bank's IFB management team is interview. Interview method of data collection gives an opportunity to clarify any issues raised by the respondent or ask probing or follow-up questions. However, interviews are time consuming and resource-intensive. The researcher has conducted interview through a face to face

contact with the respective bank officials to obtain data. The secondary data have been collected by extracting relevant and supportive data from the bank's report obtained through its database as of December 31 of year 2013 through 2018.

3.6.3. Data Analysis Techniques

The researcher has performed quantitative and qualitative analysis from responses collected on the research questions. The data that is collected by using structured questionnaire (quantitative data) are coded and analyze using quantitative analysis with the help of Statistical Package for Social Sciences (SPSS) 20software. Descriptive statistics/analysis are use to analyze the data and the result that are present using tables, and graphs that show the frequencies, percentages and median values which facilitate the analysis and to make it easily understandable for readers.

The qualitative data which is interview have been collected by taking written notes during the interview and tape recordings of what is said provide the raw materials for the report. The analysis is summarized and presented by interpreting the information provided by the informant and relating it to the main objectives of the study using narrative approach. On the other hand, qualitative analysis also used to triangulate some of the response obtained through close ended questions

CHAPTER FOUR

Data analysis and interpretations

4.1 Introduction

This chapter presents the results and analysis of data that were gathered from primary and secondary sources through questionnaire and interview. The collected data have been analyzed, and interpreted accordingly. As per the sampling design 200 and 30 questionnaires were distributed to IFB customers and employees of the bank respectively. From the total distributed questionnaires which distribute to IFB customers 170, 85% questionnaire were found to be completed correctly and used for further analysis and the remaining 30 questionnaires were not

returned. And in addition to the questionnaire data was collected through interview and response obtained are summarized and presented accordingly.

Table 4.1: Questionnaire Response Rate

Sample	Distributed		Collection		uncollected	
	Number	Percentage	number	percentage	number	percentage
customer	200	100%	170	85%	30	15%
Staff	30	100%	30	30	0	0%

Source: Own Computation from responded questionnaire, Jan 2020

4.2 Background Characteristics of Respondents

In this section personal data of respondents which are collected through questionnaire have been summarized that include their qualification, Job position, religion, year of banking experience/relationship as the IFB product and/or IFB staff/customer as the case may be. Descriptive statistics has been used to analyze the demographic items as a means of describing the respondents.

The study has two types of sample which is bank's employee and customer. The employee sample constitutes two samples which are employee sub sample of customer service officer, branch manager and IFB department head.

4.2.1. Background Characteristics of Customers

1. Religion of customer

From the total valid customer response, 115 (67.64%) of the respondents were Muslim while 55(32.353%) are non-Muslim which shows the bank's majority IFB customers are Muslim.

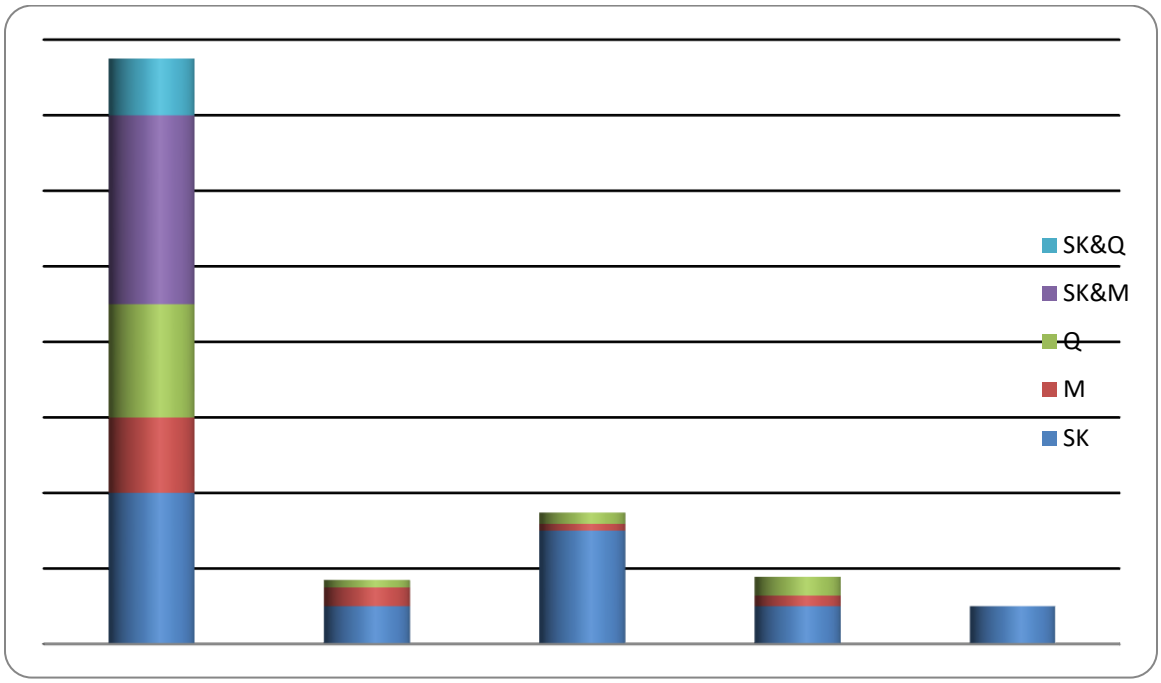
Table 4.2 Religion of respondents

	Frequency	percent	Valid percent	Cumulative %
Muslim	115	67.64	67.64	67.64
Non-Muslim	55	32.353	32.353	32.353
Total	170	100	100	100

Source: Own computation from primary data source, 2020

Figure 4.1, Respondent Relation with IFB the product

Respondent relation with IFB product



Source: Own Computation from Primary Data Source, 2020

The researcher sought to find out customer relation with the product of IFB service which provided by CBE among the target respondents involved in the study. The findings on Figure 4.1, illustrates that 40% of the respondents had used save keeping saving, another 30% of sample customer used Qurda, 20% used safe keeping and qured and 10% of sample respondent used safe keeping and mudaraba. These analyses show that majority of the customer use safe keeping. Therefore, in delivering or utilizing the other types of products there is a challenge that the bank or customer face.

4.2.2. Background characteristics of sample staffs

Demography of the sample staff respondents was assessed to see the factual data of respondents involved in the data collection including their educational qualification, year of banking experience and exposure to interest free banking.

4.2.2.1 Educational qualification

The study sought to determine the education level of the respondents from those involved in the study. From table 4.2 revealed that the majority of the respondents 70% of are university degree graduates, followed by those of degree holders with 20% and others 10% of the respondents are diploma.

	frequency	Percent	Valid %	Cumulative %
Valid diploma	3	10	10	10
BA/BSC	21	70	70	70
MA	6	20	20	20
Total	30	100	100	100

Source: Own Computation from Primary Data Source, 2020

4.2.2.2 Exposure to Interest-free Banking

Table 4.3 shows that 16.67% of IFB staff has less than one year IFB experience and 50% have work experience 1-2year experience, 13.33 % of respondent has 2-3 year experience on IFB has but 20% of the respondent have above 3 year experience. This shows that most of the staff has exposure to the system with respect to the bank launch the service. Thus, data obtained from them would be fair enough to draw reasonable conclusion.

Table 4.5 staff exposure to IFB

Exposure to Interest-free Banking	Frequency	Percent
up to 1	5	16.67%
1-2 year	15	50%

2-3	4	13.33%
3-above	6	20%
Total	30	100%

Source: Own Computation from Primary Data Source, 2020

4.3 Current financial services trends in Ethiopia

One of the research questions raised by the researcher is "Current Ethiopia trends in Financial Services have positive signs on the future of IFB service in CBE". The purpose of asking this question is to get answer for the current financial service trends in Ethiopian is one of the opportunities for the development of IFB in CBE or not.

The result obtained from IFB deposit customer and staff showed that currently the financial trend in Ethiopia is one of the opportunities of IFB. The detail of the results from both samples is tabulated as follows:

Table 4.7 Customers response about current financial services trends in Ethiopia

item	Statements	Sample	Response	Response Categories			Median value
				D	N	A	
1.	Current Ethiopia trends in Financial Services have positive signs on the future of IFB service in CBE	customer	F	50	75	45	3
			%	29.4	44.12	26.5	
		staff	F	10	5	15	3
			%	33.333	16.667	50	
2.	There is potential customer in IFB	customer	F	25	40	35	3
			%	27.78	44.44	38.889	
		staff	F	4	5	22	4
			%	12.9	16.3	70.96	
3.	Ethiopian	customer	F	70	40	60	

	investment policy create opportunity for Arabic country which use IFB products		%	41.2	23.53	35.3	3
		staff	F	5	6	19	3
			%	16.67	20	63.33	

Source: Own Computation from Primary Data Source, 2020

The above table show that, based on the sample deposit customer response about Current Financial Services trends in Ethiopia, 29.4% of respondents have disagree that the current global trends in financial service have positive signs on future development of IFB service in CBE. Moreover, 44.12% of sample staff is also neutral about Current Financial Services trends in Ethiopia. However, 26.5% of sample customer and 33.33% of the sample staff are disagree about the opportunity of the current global trends in financial service on IFB.Moreover, the descriptive statistics result shows that the median score of Current Financial Services trends in Ethiopia on the response obtained from customer and staff is 3 respectively. The result shows the value “agree”. This show the current Ethiopia trends in Financial Services pave the way for the future of IFB service development in CBE.

Table 4.7. Can clearly explain that the existence potential customer in IFB. Among the respondent, majority of the respondents of customer and staff 16.667% and 50% respectively disagree that there is potential customer in IFB and, 27.78% disagree and 44.44% of customer and staff respondents were neutral. 38.889%and 12.9% of the customer and staff respondent were agree anddisagree with the existence of IFB potential customer. Moreover, median value 3 show respondent are agreed with the existence of potential customer. The medianvalue 4 show of staff respondent are strongly agreed within question 3 “there is potential customer in IFB” For question three also 16.3% and 70.96% of customer and staff respondents respectively disagree with Ethiopian investment policy create opportunity for Arabic country which use IFB products, and 41.2% and 23.53% customer and staff respondent agreed respectively, the remaining 35.3% and 16.67% of customer and staff are neutral. In addition the median value is 3 and 4 for customer and staff respondent respectively. This show customer are agreed on the Ethiopian investment policy create opportunity for Arabic country which use IFB products and staff respondent are strongly agree with the existence of investment policy which create opportunity for Arabic country which use IFB products.

4.3.1 Interest effects on the IFB expansion

The other research questions that this study aimed to answer were effect of interest free banking service expansion on CBE. The effect of interest were assessed by using two question which focused on influence of interest in the service expansion or new investment and Muslim community reason for using conventional banking.

Table 4.8 Response from customer regarding to Interest Effects on the IFB Expansion

Statements	Response	Response Categories			Median
		D	N	A	
A plan for business expansion or new investment opportunity to be financed by bank loan cancelled due to interest based banking system	F	70	45	55	3
	%	41.2	26.5	32.4	
Muslims community who are not using conventional banking services is due to the fact that 'Savings and loan services involve interest	F	120	50	90	3
	%	46.2	19.23	34.62	

Source: Own Computation from Primary Data Source, 2020

CBE has access potential to reach the customers IFB service. As result illustrated on the above table, concerning of business expansion or new investment opportunity cancelation due to interest based banking system 41.2% of the respondents were disagree, while 26.5% were in the agreement level. The rest 32.4% were Agree. More over the median distribution of the response was found 3, which both value show the value of "agree". This implies IFB helps as a

means to reach those potential customers who were far from the banks due to interest application.

Regarding with the statement two which focused on Muslim community customers who are far from banking service conventional banking due to interest based system majority of the respondents 46.2% strongly agreed and agreed, while 19.23% were neutral and 34.62% were . Furthe Agree more, the median of the distribution of the response was found 3, which the shows “agree”. This implies that properly implementing IFB answer the requests of those deprived from the conventional banking service. It is also a potential for the banks to reach customers and answer the need of those customer who don’t want interest and avoided themselves using the conventional banking service.

Table 4.9. Response summary regarding with interest effects on the IFB expansion

Statements	**Response**	**Response Categories**			**Median**
		D	**N**	**A**	
Customers cancelled ***(or would cancel)*** a plan for business expansion or new investment opportunity to be financed by bank loan due to interest based banking system	F	11	8	10	**2**
	%	38	27.6	34.5	
Muslims community who are not using conventional	F	10	12	8	**3**

banking services is due to the fact that 'Savings and loan services involve interest	%	33.33	40	26.7	

Source: Own Computation from Primary Data Source, 2020

As illustrated in the above tables employees response rate regarding to the statement "Customers cancelled ***(or would cancel)*** a plan for business expansion or new investment opportunity to be financed by bank loan due to interest based banking system", most of the respondents 38% disagree that the respondent believe customer did not cancelled or wouldn't cancel plan of business expansion or new investment due to interest based banking system, 27.6% of the, and 34.5 % were agree respectively. Moreover, the descriptive statistics result shows that the median value 2 shows "neutral" this implies respondent are neutral on the effect of interest on customer utilization of banking products.

Many Muslim community not used conventional banking system due to its interest based system, as the result from the above table 33.33% of sample staff are disagree with Muslim community has not using conventional banking by its interest based banking system. 40% of sample respondent disagree. The rest of respondents which is 26.7% being agree. The median value 3 also indicates that Muslims community who are not using conventional banking services is due to the banking services involve interest.

4.3.2 Demand for IFB products

One of the research questions raised by the researcher is about the level of demand for IFB products other than the currently provided one. The purpose of asking this question is to get answer for the asses the demand of customer for the other type's products/services as opportunity for the development of IFB in the bank.

1. Customers and Staff Response

Accordingly, the data found from customer response the majority of the respondents are satisfied with the existed IFB products of the bank and the demand for more IFB products is low.

Table 4.10 Customer response for demand of IFB products

Statements	Response	Response Categories			Median values
		D	N	A	
Qurda, mudarabah or safe keeping is your only priority	F	57	73	40	3
	%	33.5	43	23.5	
CBE customers demanding more IFB products	F	73	42	55	2
	%	43	24.7	32.3	
commercial bank of Ethiopia IFB services address the Muslim community's need for IFB services	F	62	39	69	3
	%	36.4	23	40.5	

Source: Own Computation from Primary Data Source, 2020

As depicted from the above table 4.10, the majority of the respondents 23.5% of the customer are satisfied by the existing products and 43% and 23.5% of the respondent are neutral and disagree.

For question two, 43% of respondents have said they don't want more IFB products and the other 32.3% of the respondents agree and strongly agree, and 24.7% were neutral. As question 3 response shows majority of the respondents 63.5% agreed that CBE address the Muslim community's need for IFB services and 36.4% of them disagree.

As presented on table 4.10 the median value of the three items 3, 2 and 3 respectively show that customers are satisfied with the existed products and they are not demanding more IFB products. Moreover, the median value 3 for item (1 and 2) and median value 3 for item 2 also shows the service which is delivered by the bank address the Muslim community need for IFB services and customer did not demand more IFB products.

Table 4.11 Staffs response about demand

item	Statements	Response	Response Categories			Median value
			D	N	A	
1	Qurda, mudarabah or safe keeping is your only priority	F	13	3	14	3
		%	43.3	10	46.6	
2	CBE customers demanding more IFB products	F	17	4	9	1
		%	56.6	13.3	30	
3	commercial bank of Ethiopia IFB services address the Muslim community's need for IFB services	F	16	4	10	3
		%	53.33	13.3	33.3	

Source: Own Computation from Primary Data Source, 2018

Table 4.11 shows, from IFB deposit staffs sample, 46.6% of respondents have agreed that the existed products of IFB with in the bank existing are there only priority and 43.3% disagreed that there is no demand for the other types of IFB deposit products. From the sample staff respondent 30% of respondents agreed that CBE address the Muslim community need for IFB service. In addition the median value 3 for both item 1 and 3 CBE address the need of Muslim community the existed IFB products and also the median value 1 for question 2 show customers is not demanding more IFB products. These indicate CBE address the Muslim community need with in the existed product and customer also not demanding more IFB products. Moreover, response obtained through open ended question further confirms the

above situation, that is majority of respondents said that there is no demand/ request for additional IFB deposit products from customers.

4.4. Challenges of IFB products/Services

The other objective of this research was to identify the challenges that commercial bank of Ethiopia has faced while providing IFB products and also the challenges that customer has faced to utilize IFB products. Thus, this was set as one of the research questions to sought answer for. Both customers and staffs- line and management- of the bank have been requested about the challenges of IFB products/services that they have faced.

4.4.1 General awareness of IFB

The study tries to find out how respondents perceived Islamic banking (interest free banking.

Table 4.12 customer Response regarding awareness of the people towards IFB

Statements	Response	Response Categories			Median value
		D	N	A	
Muslim Community has awareness about IFB system	F	45	55	70	2
	%	26.4	32.3	41.1	
non-Muslims cannot use the product of IFB	F	61	72	37	3
	%	35.8	42.3	21.7	

Source: Own Computation from Primary Data Source, 2020

The output result the awareness of people towards IFB of the respondent showed that, 41.1of the respondent believed that Muslim community has awareness about IFB system by agree respectively. In addition to this 26.4% of the respondents disagree and 32.3% are neutral on the issue raised. More over the median distribution of the response was found 2 which show

the value of "disagree" for item (2) respectively. Accordingly it can be concluded that the Muslim community has not awareness on IFB system.

As shown in item (3) of the table 4.12, about 21.7% of the respondents agree that the nonMuslims cannot use the product of IFB but 35.8 disagree on it. On the other hand 42.3% has neutral idea on the issue Moreover, the median value 3 also show respondents are agreed with item 2. These show that customer believe that non-Muslim community cannot use IFB products the bank should make different awareness creation methods for the customer.

Table 4.13 Staff Response regarding awareness of the people towards IFB

Item	Statements	Response	Response Categories		Median	
			D	N	A	
1.	Muslim Community has awareness about IFB banking system	F	31		40	1
		%	77.5		22.5	
2.	People believe non-Muslims cannot use the product of IFB by wrong association with religion	F	14	2	24	3
		%	35	5	60	
3.	Customer have awareness about the major types of interest free banking products	F	35	2	3	2
		%	87.5	5	7.5	
4.	customers knows the Interest free banking products that currently provided by the bank	F	13	1	26	3
		%	32.5	2.5	65	

Source: Own Computation from Primary Data Source, 2020

Respondent of staff also show in the above table that, 22.5% of sample staff agree that Muslim community has awareness about IFB system. 77.5% of respondent disagree having awareness of Muslim community on IFB. The median value 1also shows the value "strongly disagree". People agree with non-Muslim community cannot use the product of IFB. Item two shows that, 60% of sample staff are agree with customer believe only Muslim can use IFB by wrong association with religion. In addition to this the median value also shows "agree" by the value 3.

In regarding to item 2 and 3, most of sample staff disagree with awareness of customer on the major types of interest free banking products by 60% respectively but 65% respondent agree with customers knows the Interest free banking products that currently provided by the bank. Behind this, 22% and 10% of the respondent are disagree and 7.5% being neutral within item (3). 32.5% and 2.5% are disagree and neutral within item (3). Moreover, the median value (2 and 3) for the last two questions respectively also confirmed that customers have not awareness about the major types of interest free banking products but they know that the products are provided by the bank. These show respondents are agreed with Muslim community awareness about IFB and people believe that the products are delivered only Muslim customer.

4.4.2 Supportive Financial Institution and Market Potential

In conventional commercial banking, medium term and long-term finance is provided through long-term bonds and equities. Without deposits collected from the general public, the important source of these long-term investments are investment banks, mutual funds, insurance companies and pension funds, but Islamic banks do not deal with interest bearing bonds. Therefore, there is a need for the same supportive financial markets are necessary (Akmel, 2015)

Table 4.16 Response regarding staff response on Supportive and financial institution

Item	Statements	Response	Response Categories			Median value
			D	N	A	

1.	Lack of institutions like Interest free Money Market and capital markets would create liquidity and other operational difficulties to Islamic Banking	F	8	16	6	3
		%	26.6	53.3	20	
2.	There is a lack of supportive and link institutions such as Shar'iah boards and consultancies for successful practice of Islamic Banking and Finance	F	11	5	14	3
		%	36.6	16.7	46.6	

Source: Own Computation from Primary Data Source, 2020

As a result found shown in item (1) of the table 4.16, about 26.4% of the respondents disagree about the liquidity and other operational difficulties due to the lack of financial institution. In addition to this 32.3% respondent has being neutral to the issue. 41.3% agree respectively on the issue raised. More over median distribution 3 for also implies that lack of institutions is a challenge for the banking sector development which creates liquidity and other operational difficulties to Islamic Banking.

On this issue there is also found response from open ended questions the staffs. According to the respondents the lack of financial institution which supports IFB is a challenge for the banking sector development because of not founding supporting financial institution for gaining additional financial resource when they require the fund beyond their existing liquidity problems. Accordingly it can be concluded that the Lack of institutions like Interest free Money Market and capital markets create liquidity and other operational difficulties to the banks.

4.5. Analysis of data from both qualitative and quantitative interview

The qualitative interview on the challenges and opportunity of IFB is analyzed by using narrative approach and presented below.

4.5.1. Opportunity of IFB

- One of the most important opportunities of Islamic Banking is the existence of potential customer of IFB financial service of the bank in Ethiopian, Muslims community. As Mohammed (2012) study show the non-availability of interest-free banking products results, many Ethiopians, including those in the economically disadvantaged strata of society, to be excluded from financial services due to reasons of their faith.
- Ethiopia is a developing country and needs huge investments. Investment framework is favorable in Ethiopia. Ethiopia's legal framework, which is the best and it protects foreign investors. Also, the economies of neighboring Islamic countries have limited opportunities to invest their country. Ethiopia has abundant human resource and labor force too. Introduction of Shariah-compliant banking will bring more Arab petrodollars into the country.

4.5.2. Challenges IFB Products

The main objective of this research was to identify the challenges and opportunities that commercial bank of Ethiopia has faced while providing IFB products and also the challenges that customer has faced to utilize IFB products. The challenges to utilized IFB by customers are identified by the customers by using distributing questioners to sampled customer. But the challenges which hindered IFB products from being delivered are identified by using structured interview to the line manager of the bank and IFB department manager. Both IFB department manager and branch manager of the bank have been requested about the challenges of IFB products/services that they have faced. The researcher has summarized the identified challenges as follows.

4.5.3 Challenges to deliver interest free banking Absence equity market

In a conventional system, this is provided through long-term bonds and equities. This function is performed by securities markets and specialized equity institutions. In addition to the general public, the most important sources of these investments are investment banks, mutual funds, insurance companies and pension funds. Islamic banks do not deal with interest-bearing bonds and therefore the need for equity markets is much higher in an Islamic framework. According to the respondents, non-interest bearing equity markets

Lack of Shariah

According to Pasha (2014) IFB shall comply with Shariah law, which means bank's products and services and even its transaction and business activity has to be in line with the principles and law stipulated in Shariah. But as the response of the bank officials there is no Shariah advisor board

Lack of supportive supervisory directive or Regulatory challenges

In delivery of IFB products supportive supervisory directive is taken as challenges. The directive does not consider the nature and requirements of IFB operation. The Islamic banks are regulated by the same framework as that of conventional banks except related to interest. According to Article 3 of limitation on investment of bank, directive SBB/12/1996, "A bank may hold shares in a non-banking business only up to 20% of the company's share capital and total holdings in such business shall not exceed 10%". This article creates a conflict for issuing Musharakah financing partnership agreement in which a bank could own majority of the share of a business/transaction at the time of the signing of the contract. Thus, this directive hinders the delivery of this product at all.

In addition to this the IFB directive does not give detail guide line and there is also weak support and follow up from NBE. Beyond this, government approves one window service and there no legal frame work issued for a full fledge interest free banking currently, IFB products in Ethiopia are being delivered through a window model which has created inconveniency and has affected the customers' trust negatively. Majority of the customer would like to obtain IFB service on a branch model or fully fledged model.

Lack of awareness and understanding

Availability of less number of customers is one of the obstacles and limits the bank to be the existed one. As the respondent of the officials show that some banks may not deliver the service even for one customer with in the whole day because of unavailability of customer. As the response of the bank officials, customers did not have trust if the product is delivered by non-Muslim staff and customer also believed that the service which it is delivered by the bank based Shariah compliant IFB product and services. As the response of bank officials, customers believed that there is mixing of IFB and conventional banking transaction and the bank is not even committed to give truly IFB services this has eroded the customers‟ trust.

4.6 Challenges to utilize interest free banking

Unavailability of IFB products/services in all of its branches

As the response show customers are CBE does not provide IFB to its all branches. And the response also show customer complained on not providing the service in all branches of the bank these can be taken as challenges to utilize the products by the customer.

Unequal Treatment of Debt and Equity and Double taxation

Under the existing rules in Ethiopia, interest is exempted from tax while dividends are taxed. In an Islamic financial institution, the capital is equity based as it is operating through profit and loss sharing. This therefore is a big disadvantage for Islamic financial companies as compared to other conventional financial firms. As a result of this buying and reselling of asset, double taxation occurs. The bank will pay tax when owning the asset and customer will also pay tax when buying the asset.

Lack of trust with in the bank

The result of the respondent of the bank officials indicated that customer believed that IFB the service which is provided by the bank are not fully separated from the conventional banking system. Customers are not satisfied with window based IFB service of the bank. The majority of the respondent of the staff show that in some branches there is only one IFB customer service officer these create gap to deliver the service when IFB

CSO staff is absent or in lunch time. Conventional window also deliver the service to the customer or customer will returned without getting the service. Mix of IFB and Conventional banking create complain with in the service that the customer to utilize and keep separate book account.

Generally the major challenges to deliver and utilize interest free banking are regulatory challenge, lack awareness and understanding, Lack of Shariah, Lack of supportive supervisory directive, undeveloped Islamic primary market and non-existence of secondary marker for Islamic product are some serious problems of to deliver IFB with in the bank.

CHAPTER FIVE

Conclusion and recommendation

5.1 Conclusion

The objective is the study was to assess the challenges and opportunities of interest free banking to utilize and delivers. Accordingly the study assessed the types of interest free banking products are used by CBE. Moreover, the demand levels for IFB products other than those currently provided by the bank are assessed.

The finding of the study particularly showed that the Current financial service trends in Ethiopian and large marketing opportunity of interest free banking have positive signs on the future of IFB service Islamic banking in Ethiopia. Even if there is potential customer Customers are satisfied with the existed Interest free banking products and there is no demand/ request for additional IFB deposit products from customers. In the utilization of IFB products, double taxation, non-provision of IFB products/services in all branches, the IFB being delivered in a Window model, lack of trust and confidence qualified human resource in Islamic banking are the major challenges.

According to the respondents even though long process approval of Shari'ah board for innovation of IFB products cannot be challenge for IFB development, there is lack of suitable banking policies and comprehensive legal framework, lack of awareness, lack of equity market, lack qualified human resource in Islamic banking, lack of trust by the customer, unavailability of IFB products in all branches and Unequal Treatment of Debt and Equity and Double taxation are some major obstacles that to deliver and utilize the service.

The current study examines the challenges and opportunities of IFB in commercial bank of Ethiopia. It gives hindsight for the staff and management of Commercial bank of Ethiopian towards Interest free banking challenges and opportunities. The contribution of this study is vital as it has identified the major opportunities for the development of IFB system and challenges deliver and customers to deliver and utilize IFB products. However, the study is bounded by both

Area coverage and problem addressed. Therefore, future studies can be conducted with wider scope and the effects of these challenges on the success of IFB.

5.2, Recommendation

Based on the research finding the following recommendation are provided in order to enhance opportunities, the delivery and use of IFB products in Ethiopian banking market .

- Currently the Islamic banks are regulated by the same framework as that of conventional banks. Since the two banking systems work differently, many issues of Islamic banking cannot be settled by the existing policy. A compatible regulatory framework will create a path for Islamic banks to compete freely with conventional institutions. NBE also should consider giving IFB products in separate facility, at least in dedicated branches of the conventional bank, in order to improve attitude and increase IFB adoption.
- Most of the training given to the staff of banks is in line with the conventional banking system. Compared to conventional banking concepts, Islamic banking is a very new discipline and has distinct rules and principles. This implies for, a need of training in the procedures and principles of Islamic banking which would further accelerate the growth of the sector. The bank needs to adopt comprehensive and regular training on the IFB products and service for those staff who are engaged in providing the service.
- The bank should have aggressive promotion and marketing campaign about IFB products to create awareness on IFB products by particularly towards the target market (the Muslim community) must be done consistently by using several promotional campaigns should be planned like poster, banner, media, and etc.
- Alongside awareness creation, bank has to build the trust and confidence of its customer by being transparent/disclose all its products, transaction and its IFB business activity to the public and confirm they are in line with Shariah. To support this action further the bank immediately has Shariah advisors. According to Pasha (2014) perception of Muslims that is the trust and confidence about the existing practice of IFB is truly of Shariah compliant and not a copy of the

conventional banking with a banner of Shariah compliant is very important issue for IFB existence and success.

- The Bank has to increase the accessibility of IFB products through increasing IFBW at customers‟ convenience and avail its products/services in all branches with the necessary facility that will increase the marketability of IFB products/services.
- The bank should work with sharia advisory board to come up with relevant regulations governing the operation of Islamic banking (interest free banking) that conforms to the principles.

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Appendix A, Customer Questioner in English

Wolkite University

Department of Accounting and finance

Dear Respondents, I am conducting research on "challenges and opportunity of interest free banking with particular reference to commercial bank of Ethiopia Woliso" as a partial fulfillment of BA study at Wolkite University. The main objective of this research is to investigate what are the challenges of interest free banking in relation to the delivery and use of its products and its opportunity. For the successful accomplishment of the study, your response will have a pivotal role by providing valuable input for the study. Thus, your genuine and honest response is very crucial for attaining the aim of the research and the researcher would like to thank you for your cooperation in advance.

Part one: Background Information Dear respondents, please label a characteristic that correspondent to your background data by using "√**"** mark.

1.1**religion of customer**:

Muslim Non-Muslim

1.3 **relations with the product**:

Safe keeping saving qured mudaraba

Safekeeping and qured

safe keppng and qured safe keeping and mudaraba

qured and mudaraba all

1. Opportunities of**IFB**

Items	**Agree** **1**	**Disagree** **2**	**I Do not Know** **3**
Current Ethiopia trends in Financial Services have positive signs on the future of IFB service in CBE			
Dou you believe there is potential customer in IFB			
Ethiopian investment policy create opportunity for Arabic country which use IFB products			
Your plan for business expansion or new investment opportunity to be financed by bank loan cancelled due to interest based banking system			
you are not using conventional banking services is due to the fact that 'Savings and loan services involve interest			

2. **Demand for IFB products**

Items	**Agree** **1**	**Disagree** **2**	**I Do not Know** **3**
Qurda, is your only priority choice			
mudarabah is your only priority choice			

safe keeping is your only priority choice			
commercial bank of Ethiopia IFB services address the your need for IFB services			
You demanding more IFB products			

3. **Challenges of IFB**

Items	**Agree** **1**	**Disagree** **2**	**I Do not Know** **3**
Muslim Community has awareness about IFB system			
non-Muslims cannot use the product of IFB			
There is Lack of suitable banking policies for Islamic banking			
There is a gap in research and development in Islamic studies in general and Islamic finance and economics in particular			
CBE have enough qualified human resource in Islamic banking to ensure that Islamic banking Services are up to date and fully comply with Sha'riah law			

Appendix B

Dear Respondents, I am conducting research on "challenges and Opportunity of interest free banking with particular reference to commercial bank of Ethiopia Woliso branch" as a partial fulfillment of BA study at Wolkite University. The main objective of this research is to investigate what are the challenges of interest free banking in relation to the delivery and use of its products and its opportunity. For the successful accomplishment of the study, your response will have a pivotal role by providing valuable input for the study. Thus, your genuine and honest response is very crucial for attaining the aim of the research and the researcher would like to thank you for your cooperation in advance. Attention

Instruction for each part of the questionnaire is given at the beginning of the questions

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 "√" mark.

1.2Educational qualification:

Diploma BA/BSC Master's Degree PHD 1.2

Current Job Position in the bank:_____

1.3 Banking Experience in number of years:

Up to 5 years 6-10years 11-15 years above

16 years

1.4 Exposure to Interest-free banking:

Up to 1 1-2 year 2-3 year 3-above

Opportunity of IFB

Items	Strongly disagree 1	Disagree 2	Neutral 3	Agree 4	Strongly Agree 5
Current Ethiopia trends in Financial Services have positive signs on the future of IFB service in CBE					
There is potential customer in IFB					
Ethiopian investment policy create opportunity for Arabic country which use IFB products					
A plan for business expansion or new investment opportunity to be financed by bank loan cancelled due to interest based banking system					
Muslims community who are not using conventional banking services is due to the fact that 'Savings and loan services involve interest					

Demand for IFB products

Items	Strongly disagree 1	Disagree 2	Neutral 3	Agree 4	Strongly Agree 5

Qurda, mudarabah or safe keeping is your only priority choice					
commercial bank of Ethiopia IFB services address the					
Muslim community's need for IFB services					
CBE customers demanding more IFB products					

Challenges of IFB

Items	Strongly disagree 1	Disagree 2	Neutral 3	Agree 4	Strongly Agree 5
Muslim Community has awareness about IFB system					
People believe non-Muslims cannot use the product of IFB by wrong association with religion					
Customer have awareness about the major types of interest free banking products					
customers knows the Interest free banking products that currently provided by the bank					
There is Lack of suitable banking policies for Islamic banking					

Lack of institutions like Interest free Money Market and capital markets would create liquidity and other operational difficulties to Islamic Banking					
There is a lack of supportive and link institutions such as Shar'iah boards and consultancies for successful practice of Islamic Banking and Finance					
There is lack of training in IFB system					
There is a gap in research and development in Islamic studies in general and Islamic finance and economics in particular					
CBE have enough qualified human resource in Islamic banking to ensure that Islamic banking Services are up to date and fully comply with Sha'riah law					

Open ended question

What do you think are the challenges that interest free banking products user face?

_____

. What do you think the challenges that the bank has faced to deliver Interest free products?

_____

. If you have any opinion, comment regarding the challenges on the delivery and use of

Appendix C: Interview Question

Interview Question for bank management by Yewubdar

What do you think about the current status of interest free banking in Commercial bank of Ethiopia?

What type of interest free banking products does the banking currently made available to its customers? Does customer request/demand for other IFB product that the bank currently not providing?

Does the bank face any challenges to deliver interest free banking products?

What do you think about support from government body on initiation, government regulation, policy and procedures needed on IFB provision and expansion?

As the IFB is in accordance of sharia law do you believe non-Muslim accept sharia law and adopt these services? Is there non-Muslim customers in your bank those used these services?

As your bank keep separate book account and windows in respect of IFB operation, do your bank trusted by customers as there is a proper maintenance of records for all transactions for segregation of funds or activities from conventional one? What do you think the challenges that interest free banking products user face on utilization IFB product